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MINORITY RIGHTS IN CORPORATE LAW: A REPLY TO CHANDER

James Thuo Gathii*

INTRODUCTION

In an insightful essay, entitled *Minorities, Shareholders and Others*, Anumpam Chander[1] argues that corporate law's protections of minority shareholders can be used as a model to inform protection of minority groups under the Constitution. Thus a central premise of his project is to contrast corporate law's predominant protection of minority rights against constitutional law's blindness to minority status so that the lessons of minority protection in corporate law can inform constitutional law.

In this reply, I argue that in many respects corporate law is not an ideal model for protecting minority rights, because corporate law's primary protections are procedural rather than substantive. Given the nature of corporate law's protection of minority shareholders, Chander overstates its purpose as the promotion of egalitarian goals.[2] Such egalitarianism is absent in much of corporate law. Consequently, there is not much that constitutional law can borrow from corporate law to protect minority rights.

Chander argues that the protections of minority rights in corporate law are premised on requirements of equality; much like affirmative action is or ought to be under the Constitution.[3] This confuses corporate law's fairness obligations with constitutional law's equality obligations. Further, he overestimates the protections of minority rights in corporate law. While Chander emphasizes the power of judicial review to protect to minority shareholders, this does little or nothing to upset the dominance of majority and controlling shareholders over minority shareholders. In short, much of corporate law jealously safeguards the substantive rights of majority shareholders while giving minority shareholders merely procedural rights.

While I share Chander's commitment to giving full faith and credit to the fourteenth amendment's equal protection requirements, I am uncertain that the procedural protections that corporate law gives minority shareholder can offer much guidance in the realm of protecting minority rights in constitutional law. This is not to say that we cannot draw some lessons from corporate law to inform constitutional law to adopt a more egalitarian equal protection approach. However, I do not believe we should begin our inquiry by looking at corporate law's protection of minority shareholders unless we would be satisfied with an equal rights jurisprudence that adopts a procedural rather than results oriented view of fourteenth amendment

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1. Anupam Chander, *Minorities, Shareholders and Otherwise*, 113 YALE L. J. 119 (2003).
2. *Id.* at 124. See Part II for my substantiation of this thesis.
3. *Id.* at 120.

equal protection. In my view, Chander takes too seriously the acknowledgment of injustices to minority shareholders in corporate law and concludes that its central mission is the protection of minority shareholders. The assumption that the protection of minority rights in corporate law is an equality requirement much like affirmative action is or ought to be under the Constitution confuses the fairness and procedural requirements of corporate law with the equality obligations of constitutional law.

I proceed as follows. In part one, I provide a quick overview of Chander's central claims particularly as they relate to my response. Part two is my response to Chander. It is divided into four short sections. In the first section, I examine how Chander reads *Pearlman v. Feldman* to support his thesis that minority protection is corporate law's central concern. I show that in doing so, Chander overlooks the manner in which *Perlman v. Feldman* is an exception to the rule that corporate law does not require equality of treatment of minority shareholders in the event of sale of control. Further, in *Perlman* the court did not completely depart from the rule that a controlling shareholder is entitled to keep a control premium to the exclusion of minority shareholders. The inequality of sharing in premia between minority and controlling shareholders undermines Chander's claim that a central mission of corporate law is the protection of minority rights.

The second section examines Chander's reading of *Joy v. North* and I argue that while the case demonstrates judicial concern for minority rights in the face of a dominant shareholder, the rights of minority shareholders are concerned more with procedural integrity than the structural and institutional inequalities reflected in corporate law. The unequal sharing of premia addressed in section one is just one example of such structural and institutional inequalities. Thus as long as powerful shareholders act with procedural fairness, their actions cannot be judicially reviewed. In fact, Chander overlooks the fact that in cases such as *Joy v. North*, the conduct in question arises from the unique power of boards of directors to appoint a committee to decide whether or not a suit against the board as a defendant should proceed. Thus, I show that while Chander celebrates corporate law's concern with power relations, he ignores the fact that corporate boards begin from a point of legalized dominance by virtue of their power to dismiss suits against them.

In the third section, I show by citing the opinions of the Delaware Chancery and Supreme Court that these courts overwhelmingly preserve the entire plenary of a board's decision making prerogatives where a board acts in a disinterested and independent manner. Thus cases like *Paramount v. QVC* that Chander cites to demonstrate judicial vigilance in the face of controlling shareholders ought to really be seen as establishing the baseline for enhanced review in favor of the board's authority rather than in favor of protecting minority shareholder rights.

Finally, in section four, I show that the deference to board conduct is enhanced by legislative immunity from due care violations and perhaps even duty of good faith violations. I end with a conclusion.

PART I: AN OVERVIEW OF CHANDER'S ARGUMENT

In order to respond to Anupam Chander's article,[4] I will provide a faithful, albeit brief, recitation of the author's substantive arguments and subsequent overstatements. Chander's article falls into three parts, each written with the goal of answering three distinct and overarching questions. First, *what* does corporate law do?[5] Second, *why* does corporate law do what it does? And, lastly, *what* can constitutional law learn from corporate law? These three questions, as answered by Chander, are summarized below.

In answering the first question (*what* does corporate law do?) Chander engages in a rereading of the "canon of corporate law."[6] Chander's rereading of corporate law and the values that inform it suggests that the protection of minority shareholders is the predominant concern of the body of corporate law.[7] As discussed below, this rereading fundamentally overstates the place of minority rights in corporate law and mistakenly declares that it predominantly promotes egalitarian goals.[8] To highlight what Chander calls corporate law's "simultaneous commitment to minority protection and egalitarianism,"[9] Chander focuses on both corporate common law and statutory and constitutional authorities.[10] In essence, argues Chander, "[c]ontemporary readings of the prominent corporate law cases have elided their central concern with minority protection."[11] Chander also views statutory and constitutional schemes as demonstrative of corporate law's overarching concern for minority shareholder protection.[12] Here, Chander refers to statutory and constitutional frameworks which are either "self-evidently directed at minority shareholders,"[13] including causes of minority shareholder actions sounding in oppression; the device of cumulative voting; and minority shareholder right of appraisal, or "less evidently" directed at minority status such as securities regulation.[14]

In answering the second question (*why* does corporate law do what it does), Chander argues that corporate law's concern with minority protection results from two fundamental goals sought uniquely under a corporate law framework.[15] "An examination of the motivations underlying law's solicitude towards minority shareholders reveals a concern for fairness and capital formation that has direct application to the issue of affirmative action."[16] Chander suggests the predominance of minority shareholder pro-

4. *See generally id.*
5. *Id.* at 124.
6. *Id.* at 124.
7. *Id.* at 119.
8. *See infra section II*
9. *Id.* at 124.
10. *See* Chander, *supra* note 1, at 129–51 (presenting such common law cases as *Joy v. North*, 692 F.2d 880 (2d Cir. 1982), *Perlman v. Feldmann*, 219 F.2d 173 (2d Cir. 1955), and *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, (1949).
11. *Id.* at 129.
12. *Id.* at 142-43.
13. *Id.*
14. *Id.* at 142–51. Notably, cumulative voting in corporate law has inspired arguments in favor of similar voting arrangements to protect minorities in electoral politics, see Lani Guinier, The Tyranny of the Majority: Fundamental Fairness in Representative Democracy, 1994
15. *Id.* at 150-51.
16. *Id.* at 151.

tection under corporate law is the direct result of corporate law's attempt to achieve the coexisting goals of fairness and capital formation.[17] Thus, argues Chander, corporate law necessarily focuses on the issue of power.[18] In fact, the concept of power informs a lot of Chander's discussion in the article.[19] In addressing the concept, the author distinguishes corporate from constitutional law.[20] Chander argues that corporate law "recognizes the inevitability of power imbalances" by seeking to manage these imbalances.[21] In this sense, protection of minority shareholders and the goals of fairness and formation of capital are furthered by establishing in such minority shareholders "other resources of power."[22] Conversely, when constitutional law examines the availability of educational and workplace opportunities, it necessarily "turns a blind eye to power."[23] The author summarizes the essence of constitutional law's failure to recognize power by quoting Kimberle Crenshaw's critical appraisal of constitutional law:

> '[a]fter all, equal opportunity is the rule, and the market is an impartial judge; if Blacks are on the bottom, it must reflect their relative inferiority.' This understanding is indifferent to power relations; any relations of domination or oppression are only products of marketplace judgments, which are themselves impartial.[24]

Where corporate law provides information as the resource of power for minority shareholders, Chander similarly views affirmative action as the promotion of power among the relatively powerless, at least in educational and workplace settings.[25]

Having provided the *why* of corporate law's canons, the author addresses the third and final overarching question: *what* constitutional law can learn from corporate law.[26] In short, he posits that "[c]orporate law teaches us how we might approach the project of minority protection generally."[27] Accordingly, Chander chooses three "contemporary civil rights debates. . .centering on affirmative action"[28] as illustrative of the ability to directly apply "corporate lessons about minority protection to the project of racial equality."[29] He discusses the U.S. Supreme Court decisions of *Grutter v. Bollinger*[30] and *Gratz v. Bollinger*[31]; California's Proposition 54, Classification by Race, Ethnicity, Color, or National Origin (which he refers to as *The Racial Blindness Initiative*); and the demographic shift whereby "minority races make up a majority of the population".[32] In all

17. *Id.* at 154.
18. *Id.* at 153–54.
19. *See e.g. Id.* at 122, 124, 128.
20. *Id.* at 152-53.
21. *Id.* at 155.
22. *Id.*
23. *Id.* at 154.
24. *Id.* (quoting Kimberle Williams Crenshaw, *Race, Reform, and Retrenchment: Transformation and Legitimation in Antidiscrimination Law*, 101 HARV. L. REV. 1331, 1380 (1988)).
25. *Id.* at 155–56.
26. *Id.* at 165.
27. *Id.* at 165.
28. *Id.* at 166.
29. *Id.*
30. 539 U.S. 306 (2003).
31. 539 U.S. 244 (2003).
32. *See* Chander, *supra* note 1, at 175.

three examples, Chander suggests that corporate law—with its acknowledgment of power imbalances, its goals of fairness and formation of capital, and its notable preoccupation with minority shareholder protections—provides valuable lessons for the issues of race currently examined through the body of constitutional law.

Part Two: Re-Reading Chander's Rereading of Corporate Law

Perlman v. Feldman: Formal Inequality in Corporate Law

Chander argues that the cause of action for "oppression" and the legal doctrines of derivative suits, freeze-out claims, fiduciary obligations and cumulative voting constitute substantive rights.[33] These and other features of corporate law demonstrate, in Chander's view, that corporate law is as sensitive to wealth maximization as it is to wealth distribution.[34] He only glancingly examines the view that minority protections are not central to corporate law or that there are numerous doctrines such as the business judgment rule that give solicitude to the rights of controlling shareholders.[35]

To test Chander's hypothesis that minority protection is corporate law's central concern,[36] it is necessary to analyze the cases and materials he identifies to make his case.

I will begin with his discussion of *Pearlman v. Feldman*.[37] Here, controlling shareholders appropriated for themselves an unusually large premium upon sale of their controlling interests to the exclusion of minority shareholders.[38] The minority shareholders challenged the transaction and argued that the sale of an unusually profitable corporate asset for selfish purposes by the controlling shareholders was inconsistent with their duty to act in the best interests of the corporation and that it violated their rights as minority shareholders.[39] Chander concludes that the Second Circuit's decision in favor of the minority shareholders is consistent with Rawlsian egalitarianism since its effect was to make inequality impermissible or because it benefited the "least well off."[40] Chander's analysis of this case is therefore largely centered on the Second Circuit's decision ordering a pro-rata sharing of the premium to benefit the minority shareholders, as opposed to the premium being re-directed back to the corporation.[41] While he acknowledges that *Perlman* is controversial and recent cases have tended to go the other way,[42] what he does not say is that *Perlman* is an exception to the rule that corporate law does not require equality of treatment for minority shareholders in the event of a sale of control by controlling shareholders. It is well settled that the duties of controlling shareholders in exercising their power to sell a controlling block of shares are not curtailed by a re-

33. *See id.* at 122.
34. *Id.* at 123.
35. The author devotes less than three pages in the essay for this purpose. *See id.* 125–28.
36. *Id.* at 129 (stating that corporate law's "central concern [is] with minority protection").
37. *Perlman v. Feldmann*, 219 F. 2d 173 (2d Cir. 1955).
38. *Id.* at 178.
39. *Id.*
40. *See* Chander, *supra* note 1at 132.
41. *Id.*
42. *Id.* at 131.

quirement of sharing the premium with minority shareholders.[43] The obligations owed to minority shareholders in this context are merely procedural.

These procedural obligations require controlling shareholders to ensure that a buyer of control is not a looter where the assets can be disposed off rather quickly and not to engage in fraudulent behavior in exercising this power or to sell a corporate asset or office upon sale of control. However, as the leading case of *Zetlin v. Hanson*[44] demonstrates, a controlling shareholder has no obligation to share the premium realized with minority shareholders.[45] The *Zetlin* court held in part:

> Recognizing that those who invest capital necessary to acquire a dominant position in the ownership of a corporation have the right of controlling that corporation, it has long been settled law that . . . a controlling shareholder is free to sell, and a purchaser is free to buy, that controlling interest at a premium price . . .[While] *minority shareholders* are entitled to protection against. . .abuse by controlling shareholders [t]hey *are not entitled, however, to inhibit the legitimate interests of other shareholders. It is for this reason that control shares usually command a premium price. The premium is the added amount an investor is willing to pay for the privilege of directly influencing the corporation's affairs.*[46](emphasis added)

In a debate on the inequality of sharing of premiums upon sale of control, four decades ago Professor Andrews advanced the view that corporate law should embrace an equal opportunity rule to ensure that minority shareholders shared in a premium realized upon the sale of control on equal terms with controlling shareholders.[47] This proposal would turn the rule in *Zetlin* on its head since it would reverse the automatic receipt of such a premium only to controlling shareholders. Prof. Andrews' argument was premised on the fact that the rule in *Zetlin* unfairly denied minority shareholders an equal right to share in such a premium since they also had an equity investment in the corporation and their stock was crucial to the controlling shareholders' ability to control the corporation. Further, he argued that a new controlling shareholder may loot or run down the corporation to the disadvantage of minority shareholders.[48] Prof. Andrews argued that the best way to guard against such an outcome was to allow minority shareholders to sell a pro-rata of their shares when a controlling shareholder decides to sell their shares to a new controlling shareholder. This formula would ensure that a controlling shareholder continues to be a shareholder upon sale of part of their shares. Such a shareholder would, in Prof. Andrew's view, be "loath to sell only part of his shares. . .if he expects the purchaser to destroy the value of what he keeps."[49] Under this formula,

43. *Zetlin v. Hanson Holdings, Inc.*, 48 N.Y.2d 685, 421 N.Y.S.2d 877, 878 (N.Y.1979).

44. *Id.*

45. *Id.* at 685.

46. *Zetlin v. Hanson Holdings, Inc.*, 48 N.Y.2d 685, 421 N.Y.S.2d 877, 878 (N.Y.1979).

47. *See generally* William D. Andrews, *The Stockholder's Right to Equal Opportunity in the Sale of Shares*, 78 HARV. L. REV 505 (1965).

48. *Id.* at 517.

49. *Id.* at 517.

controlling and minority shareholders would share in both the risks and benefits of the price received for the shares.[50]

To further fortify his equal opportunity proposal, Prof. Andrews analogized minority shareholders to a mortgagee who was subsidizing the controlling shareholders.[51] According to Prof. Andrews, "when a purchaser buys less than all the shares, he is acquiring a business worth more than what he pays in cash, and is financing the difference by leaving the minority shareholders outside."[52] Since minority shareholders were indispensable to controlling shareholders, Prof. Andrews argued that they were entitled to sharing in premiums realized upon sale of control.[53]

The equal opportunity rule that Prof. Andrews advanced was based on the explicit acknowledgment that corporate law favored, as it still does, the prerogatives of majority shareholders.[54] He argued that "beyond allowing judicial scrutiny of such [sale of control] transactions for fairness,"[55] corporate law offered "no way to enforce the equality of interest"[56] between minority and controlling shareholders in profits made by entering into dealings with the corporation.[57] In short, that corporate law offered no rule to make certain that transactions entered into by controlling shareholders ensured that all shareholders,[58] including non-controlling shareholders, would realize their entitlement to share "proportionately in the profits of the enterprise,"[59] especially given that the sale of stock is "one very important way of realizing a profit for shareholders."[60]

However, as Prof. Javaras in his response to Prof. Andrews argued, corporate law is predicated on the encouragement of beneficial transactions and a rule requiring an equal opportunity to partake in the premium upon sale of control would prevent such beneficial transactions by imposing untenable costs and constraints.[61] In essence, corporate law as illustrated by the non-sharing of premium on sale of control is predicated on preventing minority shareholders from sharing a premium in their own investment even though their investment is crucial to the realization of the premium.[62] Prof. Javarass' view, which represents current law, legitimates the unequal sharing of a profit realized as a result of the investments of both controlling and minority or non-controlling shareholders.

Prof. Andrews was not alone in making the point that a premium realized upon sale of control ought to be regarded as a corporate asset rather than a benefit exclusively accruing to controlling shareholders. Professor

50. *Id.* at 517-18.
51. *Id.* at 521.
52. *Id.* at 520.
53. *Id.*
54. *Id.* at 521. ; *but see* George B. Javaras, *Equal Opportunity in the Sale of Controlling Shares: A Reply to Professor Andrews*, 33 U CHI. L. REV. 420 (1965) (debating this issue with Andrews).
55. *Id.* at 521.
56. *Id.*
57. *Id.*
58. *Id.*
59. *Id.*
60. *Id.*
61. *See* George B. Javaras, *Equal Opportunity in the Sale of Controlling Shares: A Reply to Professor Andrews*, 33 U CHI. L. REV. 420 (1965).
62. *Id.*

Berle argued as long ago as in 1932 that such a premium is a corporate asset because it "arises out of the ability which the holder has to dominate property which in equity belongs to others."[63] Professor Berle correctly asserted that the premium was a windfall that a controlling shareholder commanded simply by virtue of dominating the corporation. Professor Hazen by contrast in disagreeing with Professor Berle argued that the premium was a "cognizable property right attaching to a controlling interest rather than representing a corporate asset."[64] Courts have overwhelmingly agreed with Professors Hazen and Javarass rather than with Professors Berle or Andrews.[65]

Even the court in *Perlman* did not completely depart from the rule that a controlling shareholder is entitled to keep a control premium to the exclusion of non-controlling shareholders. Rather than order the entire premium should be shared among the shareholders on a pro-rata basis, the court in *Perlman* limited recovery to the amount of the control premium it thought unreasonable.[66] In the court's words:

> "We do not mean to suggest that a majority stockholder cannot dispose of his controlling block of stock to outsiders without having to account to his corporation for profits or even never to do this with impunity when the buyer is an interested customer, actual or potential, for the corporation's product."[67]

The court therefore remanded and ordered the trial court below to determine the value of the "defendant's stock without the appurtenant control over the corporation's output of steel,"[68] suggesting that it could not determine the value of their equity in the corporation itself. However, because the defendants had violated their fiduciary duties they were not entitled to the profits realized for sale of a corporate asset.[69] In fact, on remand, the court estimated the enterprise value of the corporation's book value and earnings potential to establish the per-share and aggregate value.[70] This resulted in a premium of $5.33 per share and the pro-rata share awarded to the plaintiffs was $1,339,769 or 63% of the stock.[71] The defendants kept their share of the premium.[72]

Thus, Chander over-reads *Perlman* since that case does not stand for the proposition that all shareholders hold equal rights in sharing in a premium upon sale of control. The inequality in the sharing of a premium

63. Thomas L. Hazen, *Transfers of Corporate Control and Duties of Controlling Shareholders—Common Law, Tender Offers, Investment Companies—A Proposal for Reform*, 125 U. PA. L. REV. 1023-67 (1977) (citing A. BERLE & G. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 207-52 (rev. ed. 1968)). See also, David Cowan Bayne, S.J., "The Sale-of-Control Premium: The Intrinsic Illegitimacy," 47 Texas Law Review 215 (1968-9) (arguing the illegitimacy of the premium arises in part out of the sellers ability to determine the purchaser and therefore new controlling shareholder of the corporation)

64. Hazen, *supra* note 63, at 1023-67.

65. *See also* FRANK EASTERBROOK & DANIEL FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 119-27 (1991) (arguing that control premiums are an asset readily transferable with shares since voting control is tied to a controlling interest in the shares).

66. *Perlman v. Feldmann*, 219 F.2d 173, 178 (2d Cir. 1955)

67. *Id.* at 178. .

68. *Id.*

69. *Id.* at 177-78.

70. *Perlman v Feldmann*, 154 F. Supp. 436, 443-56 (D. Conn. 1957).

71. *Id.* at 446-47.

72. *Id.*

upon sale of control is as true today as it was when Prof. Andrews proposed an equality rule in 1965. To date, minority shareholders have no right to an equal share of the premium realized upon sale of control. In those very exceptional circumstances, such as in *Perlman*, where minority shareholders share in a premium, the justification is not premised on an equality theory but rather on justifications such as unjust enrichment arising from sale of a corporate asset,[73] corporate office[74] or sale to a looter.[75] In these three instances courts use fairness standards to test whether a controlling shareholder met their fiduciary duties in selling something other than their equity interest in the corporation.[76] The point of judicial review here is not to achieve equality but to ensure fairness in the exercise of a right that controlling shareholders have and non-controlling shareholders do not have.[77] As the court in *Zetlin* and in *Perlman* argued, non-controlling shareholders cannot prevent controlling shareholders from exercising their legitimate right to sell their shares at a premium or force them to share with them the premium.[78]

Thus, while Chander suggests that we should be surprised to find "values of fairness and equality"[79] in corporate law where we least expect to, he comes to this conclusion because his analysis does not focus on the overwhelming emphasis of corporate law in giving controlling shareholders, and in other circumstances top management, as much discretion in managing the corporation as long as they observe certain very minimum basic fairness or procedural safeguards. In addition, Chander uses these basic fairness or procedural safeguards as a proxy for the substantive equality vision of the "egalitarian"[80] vision of equal protection under the Constitution to claim that these procedural safeguards are predicated on Rawls difference principle.[81] This is misleading since Rawls difference principle would require that the least well off, the minority shareholders, be entitled to a share in a corporate asset ahead of controlling shareholders. However, as we have seen above, minority shareholders are not entitled to receive a share of the premium except in very exceptional circumstances.

I want to end this point by noting that the rule in *Zetlin* embeds within corporate law a formal inequality in the sharing of premia. The law sees controlling shareholders as having a legitimate right to share in a premium,

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73. *See generally id.* (providing a classic example).

74. *Essex v. Yates*, 305 F.2d 572 (2d Cir. 1962). *Caplan v. Lionel Corp.*, 20 A.D.2d 301 303 (1964) (holding that sale of corporate office is illegal because the "underlying principle is that the management of a corporation is not the subject of trade and cannot be brought apart from actual stock control." *Id.* at 303.).

75. The classic example here is *Gerdes v. Reynolds*, where the controlling shareholders sold their control shares at a premium but without properly investigating the motives of the buyers plans to immediately liquidate the securities held by the corporation. 28 N.Y.S. 2d 622 (Sup. Ct. New York County 1941). The controlling shareholders were held liable for failing to diligently investigate the bona fides of the buyer under circumstances where the controlling shareholders were rendering immediate control and getting an excessive premium. *Id.*

76. *See Esset*, 305 F.2d at 576-8, Caplan, 20 A.D. at 303-4, Gerdes, 28 N.Y.S. 2d at 656-57.

77. *Id.*

78. *See Perlman v. Feldmann*, 219 F.2d 173, 177-78 (2d Cir. 1955), *Zetlin v. Hanson Holdings, Inc.*, 48 N.Y.2d 685, 421 N.Y.S.2d 877, 878 (N.Y.1979).

79. Chander, *supra* note 1, at 122.

80. *Id.* at 120-21.

81. *Id.* at 132.

while non-controlling or minority shareholders do not. In this sense, corporate law places the inequalities in sharing the fruits of investment in stock beyond its scope of vision. Unlike Prof. Andrew's proposal of an equal opportunity rule, corporate law is therefore not concerned with equalizing the sharing of investments between controlling and non-controlling shareholders on a pro-rata basis. It is this point that Chander misses and mischaracterizes by invoking *Perlman* and Rawls. In fact as Prof. Javaras's response to Prof. Andrew's illustrates, corporate law presumes that beneficial transactions are only possible when the rules proceed from the justness of the premise of formal inequality in the sharing of premia between controlling and non-controlling shareholders.[82]

Formal inequality then lays the basis for would be purchasers to take the risk of buying control since minority shareholders ensure that these controlling shareholders do not put all their investment in one corporation based on the principle of diversification of risk of opportunity of a 'rational' investor. In effect, it is on the back of non-controlling shareholders that controlling shareholders accrue benefits such as control premia. If we are to take Chander seriously, then he cannot ignore or isolate his rereading of corporate law from its in-egalitarian constitutive values. Although he celebrates the fiduciary duties enforced in *Pearlman*, he does not tell us that these duties are little more than procedural safeguards in an otherwise in-egalitarian legal environment. While I do not want to minimize the significance of the fiduciary duties that Chander celebrates, my point is that they must be seen in the context of corporate law's constitutive values.

In short, my central disagreement with Chander is that his analysis or rereading of corporate law to unearth egalitarianism within it is predicated upon an unsustainable conceptual distinction between corporate law's concern for procedural integrity, on the one hand, and its institutional and structural inequalities that are placed well beyond the scope of judicial review, on the other. A search for egalitarianism in corporate law necessarily implicates both.[83]

The discussion in *Zetlin* illustrates that the protection of minority rights in corporate law can be better understood as an exception to the enormous safeguards of the prerogatives of controlling shareholders. Chander's discussion of *Joy v. North*, the second major case he discusses, bears this out. Here, the court overruled a special litigation committee decision to disallow minority shareholders to sue the corporation's controlling shareholders for involvement in self-interested transactions.[84] Chander concludes that in light of the court's reversal of the special litigation committee's decision to discontinue the shareholder suit, *Joy* "can only be un-

82. *See* George B. Javaras, *Equal Opportunity in the Sale of Controlling Shares: A Reply to Professor Andrews*, 33 U CHI. L. REV. 420 (1965)

83. In analogous context Horwitz argues that 'by promoting procedural justice' the rule of law "enables the shrewd, the calculating, and the wealthy to manipulate its form to their advantage." Morton Horwitz, *The Rule of Law: An Unqualified Human Good*, 86 YALE L.J. 561, 566 (1977) (book review). Thus I take up his call to use critical theory to "unmask the role of law in buttressing class domination, to unmask its pretensions to fairness, whenever, as if often or even usually the case, law serves to perpetuate injustice, and above all to combat the illusion that legal solutions alone can be found to the social and political problems of society." *Id.*

84. *Joy v. North*, 692 F. 2d 880, 897 (2d. Cir. 1982).

derstood as a case dissecting power relations, even if such dissection is in the service of shareholder wealth."[85] In Chander's view, the case demonstrates the court's concern "with power relations in the corporate sphere."[86] There is much truth in these conclusions since the Second Circuit majority in *Joy* is not blinded by the fact that the corporation in question, Citytrust, was "completely dominated"[87] by one of defendant directors, Mr. North. Mr. North exercised "strong control"[88] over the activities of the board and was a non-voting member of the special litigation committee.[89] *Joy* is indeed one of those extremely rare cases where a court declines to defer to a special litigation committee's recommendation by invoking the business judgment rule because in such cases directors cannot be expected to "render a fair judgment on allegations of their own misconduct."[90]

However, there is more than Chander tells us about the nature of the remedy involved in denying the motion to dismiss a suit pursuant to a special litigation committee's recommendation. While it is in fact true that the *Joy* court engages in examining the power behind the corporation and the special litigation committee, the court also finds that "[s]urviving a motion to dismiss and for summary judgment establishes only that a claim for relief has been stated and that there is a scintilla of evidence to support it. It does not establish that continued prosecution of the action is actually in the corporation's interest."[91] The court therefore rejected the contention that there is an absolute right to bring and maintain a derivative action since the Connecticut statute in question was "clearly of a *procedural* nature with 'no *substantive* effect."[92] (emphasis added) Thus the court's dismissal was predicated on its reading of a statutorily created right based upon "statutory fairness" requirements.[93] Under the Connecticut statute, the process or fairness requirements are contained in the rule that self-interested transactions are not voidable merely because a director is party to the transaction, or because of a family relationship or interest in the transaction, or if the relationship or interest is disclosed and approved by a disinterested majority of a corporation's board of directors.[94]

The standard of judicial review adopted in *Joy* is that excessive weight should not be placed on the recommendations of special litigation committees especially in cases "involving allegations of direct economic injury to the corporation diminishing the value of the shareholders' investment as a consequence of fraud and mismanagement or self-dealing."[95] I must concede to the extent that the court extrapolated its role in reviewing the board's conduct from the process or fairness requirements of the statute to

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85. Chander, *supra* note 1, at 132.
86. *Id.* at 133.
87. *Joy*, 694 F.2d at 894.
88. *Id.*
89. *Id.*
90. *Id.* at 889.
91. *Id.* at 890.
92. *Id.* The court says that the procedural requirements in the statute relate to "how and where such actions may be brought in a state court." *Id.*
93. *Id.*
94. *Id.* at 890 (reproducing CONN. GEN. STAT. ANN. § 33-323).
95. *Joy*, 692 F.2d at 891.

establish Mr. North's dominance of the board gives credence to Chander's thesis that in this case the court engaged in an inquiry of the power relations on the board. In fact, I do concede that procedural and fairness remedies are better than no remedies and further that procedural remedies may have the effect of attaining substantive ends. However, *Joy* has been superseded by statutory reform.[96]

Thus, while *Joy* is a case showing that corporate law "does not yield entirely to the operation of the market,"[97] it cannot also be said that it that reflects Chander's thesis that "corporate law is largely motivated by the fear of abuse of control by controlling shareholders controlling management."[98] Why is this so? It has to do with the fact that special litigation committees are a unique feature in the entirety of American law. Using this device, a board of directors has the unique and unprecedented power to decide whether or not it would be sued! As the Delaware Chancery Division noted in *Lewis v. Faqua*,[99] special litigation committees are the "only instance in American jurisprudence where a defendant can free itself from suit by merely appointing a committee to review the allegations of the complaint."[100] In my view, one cannot overstate a court's refusal to dismiss a derivative suit on the basis that there is a scintilla of evidence that impugns the "independence, good faith and a reasonable investigation"[101] of a special litigation committee.[102]

If we are to take Chander seriously that corporate law has as a central objective the control of power, then it is curious that it is only in corporate law in the entirety of American jurisprudence that a defendant has the legal power to anoint a committee to decide whether or not the suit against such a defendant should proceed. That Chander is not outraged by the legal power of a defendant to essentially determine if it ought to be legally accountable as such a defendant is by non-independent special litigation committees of the *Joy* variety is to see one evil and to ignore another one. By creating special litigation committees, corporate law creates an inbuilt tension by enabling those who have an interest in possible litigation against them to decide whether or not they could be sued. This tension violates a basic precept of the law that a person who has an interest in controversy cannot be a judge of their actions.

The judicial review that Chander celebrates as demonstrating corporate law's central commitment to power relations must be understood against the background that corporate boards begin from a point of legalized dominance by virtue of the power of dismissing suits against them. Further, judicial review of special litigation committee decisions hinges more on whether or not the committee followed appropriate investigation

96. *See Finley v. Superior Court*, 80 Cal. App. 4th 1152, 96 Cal. Rptr. 2d 128 (4th Dist. 2000) (at footnote 8 noting that Joy v North has been overruled by statute).

97. Chander, *supra* note 1, at 150.

98. *Id.*

99. *Lewis v. Fuqua*, 502 A.2d 962 (Del. Ch. 1985).

100. *Lewis v. Fuqua*, 502 A.2d 962, 967 (Del. Ch. 1985); *see also Einhorn v. Culea*, 235 Wis.2d 646, 654 (2000) (citing by the Wisconsin Supreme Court).

101. *Lewis*, 502 A. 2d. at 966.

102. This is the first part of the test for dismissal of a derivative suit upon the recommendation of a special litigation committee to the board of directors. *See Lewis*, 502 A.2d at 967.

procedures and whether it was independently constituted.[103] Absent a showing of a lack of these elements, special litigation committees have the power "to control derivative litigation to the exclusion of derivative plaintiffs."[104] In fact, where such a committee follows the procedural method for bringing a motion to dismiss in the absence of the foregoing elements, Delaware courts are more likely than not to dismiss derivative suits at the instance of a special litigation committee.[105]

My point here has simply been that the judicial review available to check the built-in tension created by special litigation committees is directed towards ensuring integrity in the decision making process rather than the underlying "structural bias" which makes it unlikely that the non-defendant disinterested directors will find their co-director defendants as having breached their fiduciary duties.[106] It is reasonable to think of special litigation committees as creating a fundamental conflict with the rule that a person ought not to be a judge in a case against them. This is especially so in light of the fact that professional and social relationships among board members, whether derivative defendants or not, may create a "common cultural bond" or "natural empathy and collegiality" that inherently corrupt the independence of a special litigation committee.[107]

Notwithstanding cases like *Joy*, courts in cases such as *Beam v. Stewart*, while expressing skepticism, have held that the fact a defendant like Martha Stewart had friendships with other directors with whom she "moved in the same social circles, attended the same weddings, developed business relationships before joining the board,"[108] in addition to her 94% voting power, is "insufficient without more to rebut the presumption of independence."[109] Thus, by adopting extremely high pleading standards to establish lack of independence or domination and control,[110] courts more often than not acquiesce to the authority of the board to dismiss suits against it. In addition, the possibility of appointing an independent committee rather than a special litigation committee to decide whether demand should be excused skirts around the more rigorous standard of judicial review applied in cases like *Joy v. North*.[111] In fact, special litigation committees are thought unnecessary where the board has a disinterested majority capable of making an objective decision.[112] All these factors undermine Chander's thesis that cases like *Joy* demonstrate that a central concern of corporate law is to prevent abuse of power on the part of powerful share-

103. *Einhorn*, 235 Wis.2d at 663–66.

104. *In re Oracle Corp. Derivative Litigation*, 808 A.2d 1206, 1211 (2002).

105. *Id.* at 1216.

106. *See* Dennis J. Block et al, The Business Judgment Rule 1765 (5th ed. 1998).

107. Michael P. Dooley & E. Norman Veasey, *The Role of the Board in Derivative Litigation: Delaware Law and the Current ALI Proposals Compared*, 44 Bus. Law. 503, 544 (1989).

108. *Beam v. Martha Stewart Living Omnimedia, Inc.*, 845 A.2d 1040, 1051 (Sup. Ct. Del. 2004).

109. *Id.*

110. *See Stein v. Orloff*, No. 7276, 1985 WL 11561 (Del. Chan. May 30, 1985). "In order to excuse demand there must be allegations of fact which raise a reasonable doubt as to the actual independence of the directors and these facts must demonstrate that the directors are beholden to the controlling person through personal or other relationships." *Id.* at *3.

111. Dooley, *supra* note 55, at 503 n.27 (noting that in Delaware such a committee would have to comply with the of Del. Gen. Corp. Law § 141 (e)).

112. *Id.* at 512–13.

holders, especially since the standards of judicial review are the procedural questions of whether or not the committee acted independently, in good faith and whether there was a reasonable basis for their decision. In all other cases, a board appointed committee is presumed to have acted independently, in good faith and with a reasonable basis for their decision.

Finally, *Joy* may also be regarded as an exception to the rule that courts will rarely substitute their judgments for those of the board of directors even if the board's decision resulted in a loss to the corporation. Thus, even in cases where a court finds that there are alleged facts that raise the possibility that a special litigation committee lacked independence, courts nevertheless emphasize that the standard of judicial review they adopted seeks to balance between "empowering corporations to dismiss derivative meritless litigation. . .while checking the power with appropriate judicial oversight over the composition and conduct of the special litigation committee."[113] The bottom line is that judicial review of special litigation committee is "limited to the issues of good faith, independence, and sufficiency of their investigation."[114] Even in *Zapata v. Maldanado*, a leading case often invoked to demonstrate minority rights protection, the court was careful to note that beyond the foregoing issues, the "ultimate conclusion of the committee. . .is not subject to judicial review."[115]

Another reason *Joy* is exceptional is that, as Chander acknowledges, the decisions of board of directors are protected by the extremely deferential business judgment rule.[116] Under this rule, boards are expected to observe certain formalities such as to act with ordinary care and skill in undertaking their directorial duties and in particular to inquire, to monitor, to maintain familiarity with the financial status of the corporation, to supervise, to act in good faith, to act in an informed manner and to take reasonable steps to put in place mechanisms to ferret out wrong-doing.[117] These

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113. *Culea v. Einhorn*, 235 Wis.2d 646, 671 (2000). In *Marx v. Akers*, the court in expressing that 'derivative actions by their very nature infringe upon the managerial discretion of corporate boards' noted:

> [a]chieving balance between preserving the discretion of directors to manage a corporation without undue interference, though the demand requirement, and permitting shareholders to bring claims on behalf of the corporation when it is evident that directors will wrongfully refuse to bring such claims, through the demand futility exception, has been accomplished by various jurisdictions in different ways.

Marx v. Akers, 88 N.Y.2d 189 194 (1996). In *Zapata v. Maldanado*, 430 A.2d 779, 786 (Sup. Ct. Del. 1981), justice Quillan of the Delaware Chancery Division noted,

> the problem is relatively simple. If on the one hand, corporation can consistently wrest bona fide derivative actions away from well meaning derivative plaintiffs through the use of the committee mechanism, the derivative suit will lose much, if not all, of its generally-recognized effectiveness as an intracorporate means of policing boards of directors . . . . If, on the other hand, corporations are unable to rid themselves of merit less or harmful litigation and strike suits, the derivative action, created to benefit the corporation, will produce, opposite, unintended result . . . It thus appears desirable for us to find a balancing point where bona fide stockholder power to bring corporation causes of action cannot be unfairly trampled on by the board of directors, but the corporation can rid itself of detrimental litigation.

114. *Alford v. Shaw*, 358 S.E.2d 323, 325 (N.C. 1987).

115. *Zapata*, 430 A.2d at 787. Further the court noted that "when a derivative plaintiff is allowed to bring a suit after a wrongful refusal, the board's authority to choose whether to pursue the litigation is not challenged . . . ." *Id.* at 786.

116. Chander, *supra* note 1, at 127.

117. *Id.*

are all process-oriented decision making requirements to ensure fairness but not necessarily substantively correct results.

Kamin v. American Express[118] illustrates rather well that corporate decision making is not intended to ensure substantively correct results – especially if by substantively correct results we mean maximizing the corporation's investment for the benefit of all its shareholders.[119] In *Kamin v. American Express*, a board had to choose between two investment options with regard to 1,954,418 shares of the common stock of a publicly traded corporation.[120] The plaintiffs, minority shareholders, alleged that the decision of the board of directors to declare a special dividend to distribute the shares to the shareholders was in violation of the fiduciary duties the directors.[121] In their view, the plaintiffs would rather the directors have sold the shares on the market resulting in a capital loss of $ 25 million that would in turn be offset against other investments resulting in a $ 8 million tax savings.[122] In dismissing the case, the court held that "the directors' room rather than the courtroom is the appropriate forum for thrashing out purely business questions which will have an impact on profits, market prices, competitive situations, or tax advantages."[123] Thus, even if the directors were mistaken about their decision and if it were to benefit some shareholders more at the expense of others, judicial review was unavailable on how to treat a "loss already incurred on an investment."[124] Absent a showing of "fraud, oppression, arbitrary action, or breach of trust,"[125] the complaining shareholders had no remedy.[126] As the court in *Pollitz v. Wabash Railroad*[127] noted, courts have no business interfering with "unwise or inexpedient" board room decisions as long as the board meets its obligations to act with due care.[128]

Kamin illustrates the marginality, irrelevance and weakness of the consent of non-controlling shareholders to imprudent or unwise decisions of controlling shareholders and management.[129] In addition, although in *Kamin* some shareholders would have benefited more than the plaintiffs following the distribution of the shares as dividends, the court nevertheless found that this was insufficient to taint the transaction with the kind of self-interest that would have triggered judicial review.[130] In fact, since non-controlling shareholders do not often control their corporation's agenda, even when they consent to management proposals, they may only do so because they deem it second best.[131] Thus, as Melvin Eisenberg has argued:

118. *Kamin v. American Express Co.*, 86 Misc. 2d 809 (1976)
119. *Id.* at 814.
120. *Id.* at 811.
121. *Id.*
122. *Id.*
123. *Id.* at 812-13.
124. *Id.* at 815.
125. *Id.*
126. *Id.*
127. *Pollitz v. Wabash Railroad*, 207 N.Y. 113 (1912).
128. *Id.* at 124.
129. *See generally id.*
130. *Kamin*, 86 Misc. 2d at 814-15.
131. Melvin A. Eisenberg, *The Conception that the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm*, 24 J. CORP. L. 819, 824 (1999).

> "a corporation . . . is not only a hierarchical organization; it is a bureaucratic hierarchical organization. That means, among other things, that much of the activity in a corporation is organized by established bureaucratic rules that are not open to continued re-examination, let along negotiation."[132]

My point here as I noted from the beginning is simply to highlight the extremely procedural nature of the protections minority shareholders enjoy, and the extremely powerful prerogatives of controlling shareholders within corporations. Thus, while Chander marshals an admirable line of cases in which there was dicta or a decision in favor of minority shareholders, his argument that "minority protection serves as a driving concern in the case law"[133] is hardly convincing. Again, to take another case he cites for the argument that corporate law imposes an obligations on boards of directors to act in a disinterested manner between classes of shareholders – *Zahn v. Transamerica*.[134] Here, Class A stockholders complained that a call of their shares prior to a lucrative dissolution by the controlling shareholders deprived them of sharing in the profits realized upon dissolution.[135] The Third Circuit emphatically held that the powers of a dominant shareholder are held in trust for the corporation and their "dealings with the corporation would be subjected to rigorous scrutiny"[136] when challenged and would not be sustained if such a dominant shareholder cannot "prove the good faith of the transaction but also . . . its inherent fairness from the viewpoint of the corporation and those interested therein."[137] Even with this powerful statement of the obligations of controlling shareholders, on remand, the court ratified the challenged transactions and awarded damages to Class A shareholders equivalent to what "they would have received if they had converted their shares into Class B stock prior to the liquidation."[138] The remedy was simply disgorgement of the profits.[139] While this may not be an insignificant victory for the Class A shareholders, the remedy was not to enjoy what Class B stock received *after* liquidation but *before* liquidation.[140] Thus Class A shareholders would not share in the profits realized upon liquidation.[141] At the end of the day, the complaining or minority shareholders got a remedy but not nearly what the controlling shareholders realized upon liquidation.[142]

Imbalance between Authority and Accountability in Corporate Reorganizations

Chander examines a number of cases that make his point about the corporate law's "long tradition of vigilance in the face of controlling share-

132. *Id.* at 829.
133. Chander, *supra* note 1, at 140
134. *Zahn v. Transamerica*, 162 F.2d 36 (3d Cir. 1947); *see also* Chander, *supra* note 1, at 139.
135. *Id.* at 38.
136. *Id.* at 42.
137. *Id.* (quoting *Pepper v. Lipton*, 308 U.S. 296, 306 (1939)).
138. *Speed v. Transamerica Corp.*, 235 F.2d 369, 374 (3d Cir. 1956).
139. *Id.* at 373-74.
140. *Id.* at 374.
141. *Id.*
142. *Id.*

holders,"[143] and its simultaneous concern for "minority protection and egalitarianism"[144] along with its concern for efficiency.[145] He cites the Delaware Supreme Court case in *QVC v. Paramount*[146] to show that in addition to receiving a share of control premia, minority shareholders were also held to be entitled to 'protective devices of significant value' such as supermajority voting provisions to ensure the "possibility of minority power."[147] He argues that *QVC* therefore demonstrates that maximizing market value is not the only obligation that controlling shareholders have in the context of a corporate reorganization.[148]

As I have already noted, Chander's analysis is centered around cases in which the authority of the board of directors is subjected to judicial review, especially where it lacked independence or its decision making process was inadequate. By contrast, Chander underestimates the overwhelming weight of judicial opinion that preserves the entire plenary of the board's decision-making prerogatives when its acts in a disinterested and independent manner. While *QVC* certainly protected the rights of Paramount's minority investors in the face of Redstone's controlling influence of the acquirer, QVC,[149] in the balance between the authority and accountability of the board, the decision weighs more heavily in preserving the prerogatives of board power in a case without the conflicted interests that plagued the Paramount/QVC scenario. In the court's words, the key features of its enhanced review of conflicted merger transactions were:

> "[first] a judicial determination regarding the adequacy of the decision-making process employed by the directors; including the information on which the directors based their decision; and [second] a judicial examination of the reasonableness of the directors' action in light of the circumstances then existing."[150]

Under these tests, the board need not make the right decision but only show that they employed a defensible decision-making process to prevail in showing that their decision was reasonable.[151] Again, it is important to cite from the court's own opinion:

> "Although an enhanced scrutiny test involves a review of the reasonableness of the substantive merits of a board's actions, a court should not ignore the complexity of the directors' task in a sale of control. There are many business and financial considerations implicated in investigating

143. *Chander, supra* note 1, at 138
144. *Chander, supra* note 1, at 124.
145. *Id.*at 124.
146. *QVC v. Paramount*, 637 A. 2d 34 (Del. 1994).
147. Chander, *supra* note 1, at 139-40 (quoting QVC 637 A. 2d at 43).
148. In his words: "If the Delaware Supreme Court did not believe in hidden value, the case law could be simplified dramatically: The corporate board would simply be obliged to maximize the current market value of the consideration received for the company's stock. But the court's willingness to countenance transactions that guaranteed minorities some degree of power against the controlling shareholder demonstrates that minority protection serves as a driving concern of the caselaw." *Id.* at 140
149. As Chander correctly notes the danger in such situations is that a controlling shareholder in the acquiring corporation can make payments to the directors of the target corporation to win their cooperation so that the controlling shareholder is able to keep the gains after the merger transaction without sharing it on a pro-rata basis with the pre-existing mass of dispersed shareholders.
150. QVC, 637 A. 2d at 45. .
151. *Id.* at 42.

> and selecting the best value reasonably available. The board of directors is the corporate decisionmaking body best equipped to make these judgments. Accordingly, a court applying enhanced judicial scrutiny should be deciding whether the directors made *a reasonable* decision, not *a perfect* decision. If a board selected one of several reasonable alternatives, a court should not second-guess that choice even though it might have decided otherwise or subsequent events may have cast doubt on the board's determination. Thus, courts will not substitute their business judgment for that of the directors, but will determine if the directors' decision was, on balance, within a range of reasonableness."[152] (emphasis in original)

It is crucial to note that the court was clear that it did not have a role to play in making decisions that would best be made in the board room.[153] This fact has not been lost on subsequent Delaware merger decisions. Thus, in *City Capital Assoc. v Interco*[154], the court noted the danger of enhanced scrutiny may lead courts to "assert the primacy of their own view on a question upon which reasonable, completely disinterested minds might differ."[155] Indeed, the Delaware Supreme Court sounded further caution in its *Unitrin*[156] decision observing that the "range of reasonableness" review standard gives the board of directors "latitude in discharging its fiduciary duties to the corporation and its shareholders when defending against perceived threats."[157] The court further called for judicial restraint under this standard suggesting that, notwithstanding concerns of conflicted interests and potential injury of minority rights, Delaware courts have since *Paramount* arguably moved in the direction of the authority of the board rather than towards minority protection at all costs.[158] To this extent, Chander's analysis overstates the centrality of the protection of minority rights in so far as the case law indicates the balance may actually tilt towards deference to board decisions even in the face of conflicts of interests that may injure minority rights.

Paramount and its progeny demonstrate that the baseline for enhanced judicial review is the formally unequal relationship between minority and controlling shareholders. As a result, the *Paramount* progeny demonstrate the delicateness with which courts invoke their discretion to question the authority of conflicted boards on the premise that too much judicial intrusion would cancel out, distort or nullify the balance in favor of the power of the board relative to its obligations vis à vis complaining shareholders. The equilibrium line between the authority of the board and its duties to account is clearly in favor of the board's authority. Thus, when courts remedy violation of fiduciary duties, they are no more than simply restoring this unequal status quo. It is therefore plausible to say that the expansive authority of boards simply overwhelm minority rights. After all, judicial enforcement of these rights must not only meet an especially high standard of judicial review, but other innumerable procedural obstacles as well as the extremely high cost of litigation. It is therefore a stretch to

152. *Id.* at 45.
153. *Id.* at 46.
154. *City Capital Assoc. v. Interco Inc.*, 551 A. 2d 787 (Del. Ch. 1988).
155. *Id.* at 796.
156. *Unitrin v American General Corporation*, 651 A. 2d 1361 (Del. 1995).
157. *Id.* at 1388.
158. *Id.*

conclude as Chander does that judicial review of controlling shareholder abuses in cases like *Perlman* is either central to corporate law or justifiable on the basis of Rawls' difference principle.

The overwhelming weight of judicial authority in favor of the unlimited discretion of boards of directors is also confirmed in another case that Chander relies on and discussed earlier in this article: *Joy v. North*. There, the court noted:

> "While it is often stated that corporate directors and officers will be liable for negligence in carrying out their corporate duties, all seem agreed that such a statement is misleading. . .Whatever the terminology, *the fact is that liability is rarely imposed upon corporate directors or officers simply for bad judgment* and this reluctance to impose liability for unsuccessful business decisions has been doctrinally labeled the business judgment rule."[159] (emphasis added)

At the risk of belaboring the point, the Delaware Supreme court in *Brehm v Eisner*[160] emphasized that "courts do not measure, weigh or quantify directors' judgments,"[161] since due care "in the decision making context is *process* due care only."[162] The *Brehm* court rejected the contention that the business judgment rule allows a court to engage in "substantive due care" analysis of board decisions.[163]

Before proceeding, I want to emphasize that the procedural nature of judicial review of directorial decisions is comparable to one dimension of Rawls's thesis of justice in his classic book, *A Theory of Justice*. In this book, Rawls argued that the "idea of the original position is to set up a fair procedure so that any principles agreed to will be just. The aim is to use the notion of pure procedural justice as a basis of theory."[164] My critique of the procedural nature of judicial review of directorial conduct revolves around the fact that it does not focus on substantively fair results. Instead, it is only concerned with fair processes. As Rawls argued, such a pure procedural justice gains acceptance "when there is no independent criterion for the right result.'[165] Thus, once a fair process is followed, the outcome is considered just. Corporate law adopts the same philosophy and, therefore, it is as limited as the original position espoused by Rawls to the extent t which it is at peace with or at least blind to unbalanced power.[166]

Immunity from Duty of Care and Perhaps Duty of Good Faith Violations

In addition to the judiciary adopting a deferential standard towards board conduct under the business judgment rule, the Delaware legislature has enacted a statutory exculpation clause effectively immunizing directors from personal liability for duty of care violations. Section 102(b)(7) of the Delaware General Corporation Law protects directors from personal liabil-

159. *Joy*, 692 F. 2d at 885.

160. *Brehm v Eisner*, 746 A.2d 244 (Del. 2000).

161. *Id.* at 264.

162. *Id.*

163. *Id.* at 262-64. In an earlier decision, the Delaware Supreme court had effectively decided that it had the business judgment rule incorporate substantive due care, *see Cede & Co. v. Technicolor Inc.*, 634 A.2d 345 (Del. 1993).

164. John Rawls, A Theory of Justice, 136 (1971).

165. *Id.* at 86

166. *See* Micheal J. Sandel, Liberalism and the Limits of Justice (1982).

ity arising from gross negligence.[167] This statutory exculpation clause was enacted after the Delaware Supreme Court found the directors in *Smith v. Van Gorkom*[168] personally liable for gross negligence, which amounted to breaching the duty of care.[169] The Delaware legislature justified the enactment of Section 102(b)(7) as necessary to encourage qualified people to serve as directors without fear of attracting personal liability.[170] The effect of Section 102(b)(7) is essentially to incapacitate one of the major procedural safeguards which required informed decision-making within the corporation. Thus, given that the safeguards established to ensure a reasonable standard of care towards shareholders are procedural rather than substantive, section 102(b)(7) virtually eliminates the risk of personal liability for negligent directorial conduct under a gross negligence standard and arguably a reckless standard as well.[171] As Theresa Gabaldon has argued "[l]iability limitations artificially distance individuals from the real life effects of the enterprise in which they invest thus decreasing their acknowledged personal responsibility."[172] This distancing of corporate action from its effects perhaps reflects corporate law's endorsement of economic liberty and its suspicion of the consequences of addressing equality, such as those contemplated under the Fourteenth Amendment.[173]

Furthermore, while the statutory exculpation clause does not protect directors for violations of their duty of good faith, Delaware courts have often preconditioned imposition of liability for good faith violations to a demonstration of illicit motive or a bad state of mind.[174] The requirement of establishing motive to prove a good faith violation by a director is analogous to the intent requirement to prove racial discrimination in cases such as *Washington v. Davis*.[175] Thus, just as the intent requirement of *Washington v. Davis*[176] and its progeny have made it harder to litigate equal protec-

167. This section applies if the Delaware General Corporation Code empowers a corporation to amend its certificate of incorporation to exculpate directors from all duty of care violations. DEL CODE ANN. TIT. 8, § 102(b)(7).

168. *Smith v. Van Gorkom*, 488 A.2d 858, 893 (Del. 1985).

169. *Malpiede v Townson*, 780 A. 2d 1075, 1093 (Del. 2001) (holding that Section 102(b)(7) protects directors from liability for gross negligence).

170. David Rosenberg, Making *Sense of Good Faith in Delaware Law: A Contractarian Approach*, 29 Delaware Journal of Corporate Law, 491, 499 (2004)

171. In *Tomczak v. Morton Thiokol, Inc.*, 1990 WL 42607, at 12(Del Ch. April 5, 1990) the Delaware Chancery court intimated that gross negligence means recklessness. Note that in *Smith*, 488 A.2d at 873, a pre Section 102(b)(7) case, the court held that the conduct of the directors in that case was reckless. However, the court did not conclude that this constituted a breach of the duty of good faith.

172. Theresa Gabaldon, *The Lemonade Stand: Feminist and Other Reflections on the Limited Liability of Corporate Shareholders*, 45 VAND. L. REV. 1387, 1429 (1992).

173. This theme is explored by LAWRENCE E. MITCHEL, CORPORATE IRRESPONSIBILITY: AMERICA'S NEWEST EXPORT(2001).

174. *Desert Equities Inc. v. Morgan Stanley Leveraged Equity Fund, II, L.P.*, 624 A. 2d 1199, 1208 (Del. 1993). In *Zirn v. VLI Corp.*, 681 A.2d 1050, 1061 (Del. 1996), the Delaware Supreme court held that in the absence of a showing of 'pecuniary motive' or such other 'plausible motive deceiving shareholders' it could not hold directors liable for breach of the duty of good faith. *Id.*

175. *Washington v. Davis*, 426 U.S. 229 (1976).

176. In California, a district court has recently questioned the necessity of the intent to discriminate requirement of *Washington v. Davis* as a precondition of establishing discrimination: see *Chin v. Runnels*, 343 F. Supp. 2d 891, 905-08 (N.D. Cal, 2004) (where court focuses on subconscious/unconscious biases/prejudices as requirement to prove discrimination to bolster statistical evidence of disparate impact).

tion under the Fourteenth Amendment, so does the illicit motive or bad state of mind requirement of proving good faith violations of corporate law. Both the illicit motive and the intent requirements set up almost insuperable barriers to hold those with decision making power accountable for actions which disproportionately harm vulnerable minority groups.

Conclusion

Chander proposes that constitutional law should place the protection of minority rights at the center of its mission. He looks to corporate law's treatment of minority rights as an analogy which he argues puts the protection of minority rights at the center of its mission. While I do not hold the view that corporations are inherently oppressive,[177] it would be inaccurate to characterize corporate law's central mission as the protection of minority shareholder rights. Thus by re-examining the examples Chander uses to illustrate his thesis, I have sought to demonstrate that the protection of minority rights in corporate law is exceptional and not as systemic as Chander argues. What is more, the protection of minority rights is not ensured by judicial review of the substantive results of corporate decision-making, but rather minority rights are guarded through fair processes in the exercise of the unquestioned power of boards of directors and controlling shareholders. To this extent, minority rights protection in corporate law is not as powerful an analogy for equal rights constitutional jurisprudence.[178]

This is all the more so because the process based safeguards for minority rights in corporate law have largely overshadowed the kind of egalitarian commitments that Chander sets out to uncover within corporate law. As I have shown in Part 2, the privileges and prerogatives that boards of directors and controlling shareholders enjoy to the exclusion and to the disadvantage of minority shareholders embody and define corporate law. As such, the rights that minority shareholders enjoy cannot be understood outside this context. My reply to Chander argues that the procedural protections of minority rights in corporate law are a reflection that corporate law has made peace with the concentrated power enjoyed by boards of directors and controlling shareholders. Thus, to celebrate corporate law's protection of minorities through rules requiring controlling shareholders and management to act with formal neutrality and fairness is to make peace with the in-egalitarian nature of power between minority and controlling shareholders. If this is so, corporate law's lessons for constitutional law's equal protection mission are especially limited.

177. Here I agree with Kellye Y. Testy, *Linking Corporate Law With Progressive Social Movements*, 76 Tul. L. Rev. 1227,1243 (2001-2002).

178. International human rights law and the experiences of other constitutional democracies might offer some comparative perspective. Such an approach has its strong and weak points as well.