THE "SIGNIFICANT SOCIAL POLICY ISSUE" EXCEPTION TO THE BUSINESS JUDGMENT RULE

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The business judgment rule is a fixture of corporate law. Under the business judgment rule, when a shareholder alleges that a corporation's board of directors violated its fiduciary duty of care by making an unwise business decision, the court will dismiss the action. The rule makes sense. It would be the height of hubris for a judge to, at the behest of a shareholder, second-guess the wisdom of a board of directors' decision (this is especially true when one considers that the vast majority of judges do not have expertise in business).

The two primary rationales for the business judgment rule are (1) that directors are business experts (and judges are not), and (2) that application of the business judgment rule encourages optimal risk taking by directors.

This Article will demonstrate that those rationales may justify deference to directors when they make ordinary business decisions; however, those rationales apply with significantly less force, if at all, to decisions that implicate a significant social policy issue, such as climate change, or human rights, among others.

Rather than deference to directors, these are decisions where the arguments in favor of shareholder input are stronger. After all, as Professor Bayne wrote in 1957, later quoted by the D.C. Circuit in Medical Committee for Human Rights, "[a]s much as one may surrender the immediate disposition of [his money in the form of an investment], he can never shirk a supervisory and secondary duty (not just a right) to make sure these goods are used justly, morally and beneficially."[i]

Accordingly, this Article argues that there should be a "significant social policy issue" exception to the business judgment rule. Where a

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[i] David C. Bayne, S.J., *The Basic Rationale of Proper Subject*, 34 U. DET. L.J. 575, 579 (1957) (quoted by Med. Comm. for Hum. Rts. v. SEC, 432 F.2d 659, 680 n.31 (D.C. Cir. 1970), *vacated as moot*, 404 U.S. 403 (1972)).

shareholder challenges a business decision that implicates a significant social policy issue, rather than applying the business judgment rule and showing deference to the decision of the board of directors, the court should apply the intermediate level of enhanced scrutiny. The board should be required to show (1) it used a reasonable decision-making process, and (2) it chose from one of several reasonable alternatives. If the board fails to make the required showing, the court should enjoin the challenged action.

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I. INTRODUCTION

The business judgment rule bars judicial review of a business decision made by a corporation's board of directors.[1] The classic example: in 1916 the Dodge brothers filed a lawsuit seeking to enjoin Ford Motor Company from using a large multi-year surplus ($111.9 million) to expand its manufacturing plant (despite the fact that Ford's board of directors already voted for it).[2] The Supreme Court of Michigan refused to enjoin expansion of the plant (and in doing so reversed an injunction granted by the court below), reasoning that "judges are not business experts."[3]

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[1] *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) ("It is a presumption that in making a business decision the directors . . . acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the corporation."); Brehm v. Eisner, 746 A.2d 244, 264 n.66 (Del. 2000) ("[D]irectors' decisions will be respected by courts unless the directors are interested or lack independence relative to the decision, do not act in good faith, act in a manner that cannot be attributed to a rational business purpose or reach their decision by a grossly negligent process that includes the failure to consider all material facts reasonably available.").

[2] Dodge v. Ford Motor Co., 170 N.W. 668, 673 (Mich. 1919).

[3] *Id.* at 684. The Supreme Court of Michigan refused to enjoin the construction of the manufacturing plant but did find that the portion of the additional surplus that was not used for construction of the plant should be distributed as a dividend. *Id.* at 685; *see* Lide E. Paterno, *Irresponsible Corporate-Responsibility Rules*, 77 U. PITT. L. REV. 499, 527 n.132 (2016) (quoting *Dodge*, 170 N.W. at 684) ("Even as the *Dodge* court ordered Ford to pay dividends, it reversed the trial court's injunction of the new factory construction."). For another classic example of application of the business judgment rule, see Shlensky v. Wrigley, 237 N.E.2d 776, 781 (Ill. App. Ct. 1968) (dismissing disgruntled shareholder's challenge to the decision of Chicago National League Ball Club not to install lights at Wrigley Field, causing a loss of revenue from night games).

Where the board of directors is making an ordinary business decision, such as the decision to expand the manufacturing plant in *Dodge v. Ford*, application of the business judgment rule is appropriate (because directors have superior expertise, and the court does not want to stifle risk-taking);[4] however, where a board of directors is making a decision that implicates a significant social policy issue (such as climate change or human rights), the opposite is true for two interrelated reasons:

- *The expertise rationale for the business judgment rule applies with significantly less force, if at all, to decisions that implicate a significant social policy issue*. When a decision implicates a significant social policy issue, the decision-making process necessarily moves beyond quantitative methods of analysis with which most directors are familiar (such as finance), to include qualitative methods of analysis (such as directors listening to impacted parties and incorporating what they hear into the decision-making process).[5] I am not saying that directors are incapable of listening to impacted parties, or incapable of incorporating what they hear into the decision-making process; but I am saying

[4] For a discussion of optimal risk taking, see *infra* Section II.D. While beyond the scope of this Article, some scholars argue that the business judgment rule helps protect "corporate sovereignty." *See* Kenneth B. Davis, *Once More, The Business Judgment Rule*, 2000 WIS. L. REV. 573, 587–89 (2000). Professor Davis traces the "sovereignty" rationale for the business judgment rule to section 141 of the General Corporation Law, that states, "[t]he business and affairs of a corporation . . . shall be managed by . . . a board of directors." *Id.* at 587 n.34 (quoting DEL. CODE ANN. tit. 8, § 141 (2020)). Further, Professor Stephen M. Bainbridge points out that treating the board of directors like a sovereign is desirable because there must be an ultimate decision-maker to resolve conflicts between the various constituents of the corporation ("employees, creditors, equity investors, and other necessary factors of production"), and the board of directors is best positioned to efficiently do so (consistent with legal obligations imposed on it by contract, regulation, or statute). *See* Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 555–57 (2003) (citing KENNETH J. ARROW, THE LIMITS OF ORGANIZATION 68–69 (1974)).

[5] Qualitative data collection tools explore impacts that are non-quantifiable, or difficult to quantify. Such tools may include interviews, focus groups, and document review. *See generally* FELICE D. BILLUPS, QUALITATIVE DATA COLLECTION TOOLS: DESIGN, DEVELOPMENT, AND APPLICATIONS (2020). While qualitative assessment may involve looking at impacts on health and the environment, it must be remembered that the board must do so to meet its fiduciary duty *to shareholders*. *See infra* Section IV.B. That is to say, while stakeholders benefit from such an understanding of the director's fiduciary duty, the duty still runs to the shareholders, and only shareholders would have standing to enforce it. *See id.*

that directors *do not have any superior expertise* in this area that would justify deferring to their judgment.[6]

- *The optimal risk-taking rationale for the business judgment rule applies with significantly less force, if at all, to decisions that implicate a significant social policy issue*. When a decision implicates a significant social policy issue, the risk moves beyond what can be diversified away (such as a financial loss), to risks that cannot be diversified away (such as climate risk, or human rights risk).[7]

Given the foregoing, I propose that when a shareholder challenges a decision that implicates a significant social policy issue, the court should apply the intermediate standard of enhanced scrutiny.[8] To meet the standard, the board of directors must demonstrate (1) the reasonableness of "the decisionmaking process employed[,] . . . including the information on which the directors based their decision;" and (2) "the reasonableness of the directors' action in light of the circumstances then existing."[9] Note that the burden of proof rests first with the shareholder to show that a significant social policy issue is implicated, and then shifts to the board of directors.[10] If the board fails to make the required showing, the court should enjoin the challenged action.[11]

Application of the intermediate standard of enhanced scrutiny is appropriate because it still affords some respect to the board of directors' decision (as long as the board chose "one of several reasonable alternatives," the court should not second-guess the decision);[12] on the other hand, it requires the board of directors to explain the reasoning for their decision, preventing the board of directors from hiding behind the business judgment rule when making a controversial decision that goes beyond ordinary business (such as decisions that implicate climate change or human rights).[13]

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[6] *See infra* Section IV.C.

[7] *See infra* Section IV.D.

[8] *See infra* Part V.

[9] *See* Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 45 (Del. 1994).

[10] *See infra* Section V.B.

[11] *See id.*

[12] *Paramount*, 637 A.2d at 45.

[13] *See* John H. Matheson & Brent A. Olson, *Shareholder Rights and Legislative Wrongs: Toward Balanced Takeover Legislation*, 59 GEO. WASH. L. REV. 1425, 1458–59 (1991) ("[T]he business judgment rule may be wielded to further broaden directors' discretion to bypass shareholder input.").

This proposal empowers shareholders to force their way back into the decision-making process, albeit through litigation.[14] This power is especially important when we consider that shareholders have been locked out of less "confrontational" means of influencing corporate behavior, such as the process for nominating directors. (Yes, it is true that shareholders can vote for directors, but the vote is for a preordained slate of directors.[15] Further, greater shareholder influence through use of the proxy access rules has been, at best, met with mixed success.[16])

Finally, and importantly, these are decisions (i.e., decisions that implicate climate change or human rights) where the arguments in favor of shareholder participation are stronger, and thus eclipse the situationally undermined arguments in favor of deference to directors. Where a significant social policy issue is implicated, shareholders have a right—indeed a duty—to participate in the decision-making process.[17] As Professor David Bayne wrote in 1957, and it still rings true today, "[a]s much as one may surrender the immediate disposition of [his money in the form of an investment], he can never shirk a supervisory and secondary duty (not just a right) to make sure these goods are used justly, morally, and beneficially."[18]

I proceed as follows: Part II explains the business judgment rule. It discusses three important Delaware cases with an emphasis on the

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[14] *See infra* Part V.

[15] One commentator writes of the problem:

> The historical practice in the United States has been for a public corporation's board of directors (directly or through a nominating committee) to nominate candidates for election at an upcoming annual meeting of shareholders. This exercise rarely augurs change in the corporation's business strategies or operations because the nominees are usually incumbent directors standing for re-election. . . . A mix of practice and law over the years has relegated a shareholder's voice in the election of directors to low decibels. Boards can and often do elicit input from major shareholders about potential candidates, but are under no duty to act upon shareholders' recommendations. Boards are free to nominate candidates exceeding the number of open seats, but the practice has been to nominate only the bare minimum, akin to a political election where only one party nominates candidates.

Eric D. Roiter, *Disentangling Mutual Fund Governance from Corporate Governance,* 6 HARV. BUS. L. REV. 1, 52–53 (2016).

[16] *See infra* Part III; *see also* John H. Matheson & Vilena Nicolet, *Shareholder Democracy and Special Interest Governance*, 103 MINN. L. REV. 1649, 1668–71 (discussing greater shareholder influence via the proxy access rule).

[17] Med. Comm. for Hum. Rts. v. SEC, 432 F.2d 659, 680 n.31 (D.C. Cir. 1970) (quoting David C. Bayne, S.J., *The Basic Rationale of Proper Subject*, 34 U. DET. L.J. 575, 579 (1957)).

[18] Bayne, *supra* note 17, at 579.

policy rationales the courts consider, such as deference to board of directors' expertise, and encouraging optimal risk-taking.[19] Part III lists several types of decisions that implicate significant social policy issues (these include, but are not limited to, decisions that implicate climate change and human rights). Part IV explains why the traditional policy rationales in favor of business judgment deference apply with significantly less force, if at all, to a board decision that implicates a significant social policy issue. To illustrate this point, I use a hypothetical decision. It is a decision that, on its face, implicates the significant social policy issue of climate change: a utility company is facing increased demand for electricity; the board of directors must choose between a new power generation plant that will contribute to climate change (coal-fired or gas-fired) or one that will not (solar, wind, or hydroelectric).

Part V sets out my proposal for a significant social policy issue exception to the business judgment rule: where a board decision implicates such an issue, the court should apply the intermediate standard of enhanced scrutiny.

II. THE BUSINESS JUDGMENT RULE

A. *Overview of the Business Judgment Rule*

There are many different formulations of the business judgment rule (and the sections that follow will discuss some of those variations).[20] The purpose of this section, however, is to give the reader a general understanding of the mechanics of the business judgment rule and the most salient policy rationales behind it.

[19] I chose Delaware because "[t]he Delaware Court of Chancery is a specialized court of equity with specific jurisdiction over corporate disputes" and is "known worldwide for its . . . expert and impartial judges that decide its corporate cases." *Why Businesses Choose Delaware*, DELAWARE.GOV, https://corplaw.delaware.gov/why-businesses-choose-delaware/ (last visited Oct. 5, 2021); *see* Robert B. Thompson & Randall S. Thomas, *The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions*, 57 VAND. L. REV. 133, 165 (2004) ("[Delaware] is the center of shareholder litigation in this country.").

[20] *See* Julian Velasco, *A Defense of the Corporate Law Duty of Care*, 40 J. CORP. L. 647, 653 (2015) ("[T]he business judgment rule can be understood alternatively as a presumption, as a differential standard of review, or as a policy of non-review."); *see also* E. Norman Veasey & Julie M.S. Seitz, *The Business Judgment Rule in the Revised Model Act, the* Trans Union *Case, and the ALI Project—A Strange Porridge*, 63 TEX. L. REV. 1483, 1484–87 (1985) (discussing different formulations of the business judgment rule); S. Samuel Arsht, *The Business Judgment Rule Revisited,* 8 HOFSTRA L. REV. 93, 102 (1979) (observing that confusion results when courts use different formulations of the business judgment rule in the same decision).

The most common understanding of the business judgment rule is that it operates as a presumption.[21] Thus, where a shareholder claims that a board of directors' decision violates the fiduciary duty of care, the court will presume that the board's decision was proper and dismiss the action, unless the shareholder overcomes the presumption.[22] The shareholder can overcome the presumption by showing one of the following: (1) the board of directors acted fraudulently;[23] (2) the board of directors was grossly negligent in the process it followed to reach the decision, including rushing to reach a decision,[24] or failing to inform itself[25] (which is not the same as arguing that the substance of the decision was grossly negligent); or (3) the duty of loyalty was implicated.[26]

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[21] Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

[22] *See id.* Note that a decision is required: "[T]he business judgment rule operates only in the context of director action. Technically speaking, it has no role where directors have either abdicated their functions or, absent a conscious decision, failed to act." *Id.* at 813.

[23] Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 64 (Del. 1989).

[24] *See* Smith v. Van Gorkom, 488 A.2d 858, 874 (Del. 1985), *overruled by* Gantler v. Stephens, 965 A.2d 695 (Del. 2009).

[25] *See Aronson*, 473 A.2d at 812 ("[T]o invoke the rule's protection directors have a duty to inform themselves, prior to making a business decision, of all material information reasonably available to them."); *see also* Hanson Trust PLC v. ML SCM Acquisition, Inc., 781 F.2d 264, 274–75 (2d Cir. 1986) (holding that, for protection of business judgment rule to apply, board must gather and review all relevant information).

[26] The business judgment rule never applies when the fiduciary duty of loyalty is implicated: self-dealing is a clear example. *See* Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 90 (2004) ("[T]he business judgment rule has never protected directors who commit fraud or self-dealing."). There are decisions, however, that do not rise to the level of self-dealing, but where business judgment deference is also not appropriate. The court stated in *In re Rural Metro Corp. Stockholders Litig.*:

> Delaware has three tiers of review for evaluating director decision-making: the business judgment rule, enhanced scrutiny, and entire fairness. Enhanced scrutiny is Delaware's intermediate standard of review. It applies to specific, recurring, and readily identifiable situations involving potential conflicts of interest where the realities of the decision-making context can subtly undermine the decisions of even independent and disinterested directors. Inherent in these situations are subtle structural and situational conflicts that do not rise to a level sufficient to trigger entire fairness review, but also do not comfortably permit expansive judicial deference.

In re Rural Metro Corp. Stockholders Litig., 88 A.3d 54, 81–82 (Del. Ch. 2014) (internal citations omitted).

Once the presumption is overcome, the court will generally apply entire fairness review,[27] or in some cases, the intermediate standard of enhanced scrutiny.[28]

Like many legal concepts, the business judgment rule is best understood by reviewing examples of its application. Reviewing those examples has the added benefit of illuminating the various policy rationales for the business judgment rule. We will focus on the business expertise rationale (emphasized by Justice McNeilly's well-reasoned dissent in *Smith v. Van Gorkom*),[29] and the optimal risk-taking rationale (emphasized in *Brehm v. Eisner*[30] and *Gagliardi v. Trifoods*).[31]

B. *Business Expertise and* Smith v. Van Gorkom

Smith v. Van Gorkom is perhaps a strange case to use to begin to explain the business judgment rule.[32] That is because *Van Gorkom* is the rare case where the business judgment rule failed to protect the board of directors.[33] But what makes this case significant for our purposes is the stinging dissent, written by Justice McNeilly, where he calls the majority to task for failing to defer to the expertise of Trans Union's Directors.[34]

The facts of *Smith v. Van Gorkom* are well-known. Van Gorkom, late in his tenure as Trans Union's Chairman and Chief Executive Officer, undertook to sell the company.[35] The reason for the sale was ostensibly[36] to solve what Van Gorkom referred to as a "nagging

[27] *See* Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983).

[28] *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954–55 (Del. 1985).

[29] *See* Smith v. Van Gorkom, 488 A.2d 858, 894–95 (Del. 1985) (McNeilly, J., dissenting), *overruled by* Gantler v. Stephens, 965 A.2d 695 (Del. 2009).

[30] *See Brehm*, 746 A.2d at 263.

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

[32] *See Van Gorkom*, 488 A.2d at 858.

[33] *See id.* at 881.

[34] *See id.* at 893–94 (McNeilly, J., dissenting). Justice Christie also dissented, but explained his dissent in only one paragraph, boiling down to his belief that the board's action was protected by the business judgment rule. *See id.* at 898 (Christie, J., dissenting).

[35] *Id.* at 866.

[36] I use the term "ostensibly" because it is also possible that Van Gorkom, who was close to retirement, was motivated by a desire to cash out his shares at a price higher than the publicly traded price. *See id.* at 865–66. Of course, that would raise the possibility that the court was actually treating this as a duty of loyalty case (as opposed to a duty of care case), despite the statement in the decision that "there were no allegations of . . . self-dealing, or proof thereof." *Van Gorkom*, 488 A.2d. at 873; Jonathan R. Macey, Smith v. Van Gorkom: *Insights About C.E.O.s, Corporate Law Rules, and the Jurisdictional Competition for Corporate Charters*, 96 Nw. U. L. Rev. 607, 608 ("The board's decision was not tainted by even a hint of self-dealing or conflict of interest. There has never been a serious argument that *Smith v. Van Gorkom* was a

problem" with tax credits.[37] Trans Union produced inadequate income to fully take advantage of investment tax credits to which it was entitled.[38]

Van Gorkom, without discussing the matter with the board of directors, approached corporate takeover specialist, Jay A. Pritzker, and proposed that one of Pritzker's companies acquire Trans Union.[39] He prepared a presentation, explaining how Pritzker could pay fifty-five dollars per share and pay off the associated debt within five years.[40] How Van Gorkom arrived at the fifty-five dollars figure is unclear; the Supreme Court of Delaware stated, "[a]part from the Company's historic stock market price, and Van Gorkom's long association with Trans Union, the record is devoid of any competent evidence that $55 represented the per share intrinsic value of the Company."[41]

Thereafter, things moved very quickly.[42] The initial meeting between Van Gorkom and Pritzker took place on September 13, 1980.[43] Over the next seven days, Van Gorkom and Pritzker worked out the details, but there was no further negotiation of the fifty-five dollars price.[44]

Van Gorkom called a special meeting of the Trans Union board of directors for September 20.[45] Copies of the proposed merger agreement were not available for the board to review, and instead, Van Gorkom gave a twenty-minute oral presentation.[46] The entire meeting lasted a mere two hours.[47] At the end of the meeting, the board approved the proposed merger agreement sight-unseen.[48]

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duty of loyalty case in disguise."). *But see* Alan R. Palmiter, *Reshaping the Corporate Fiduciary Model: A Director's Duty of Independence*, 67 Tex. L. Rev. 1351, 1354 (1989) ("*Van Gorkom* was not . . . a case about the director's duty of care. Instead, it was one of a growing number of cases implicating a director's duty of independence.").

[37] *See Van Gorkom*, 488 A.2d at 865.

[38] *See id.* at 864–65 (explaining that one solution was to make any unused credits refundable in cash; however, Congress was unwilling to make such a change to the Tax Code).

[39] *Id.* at 866.

[40] *Id.*

[41] *Id.*

[42] *See id.* at 866–67.

[43] *Van Gorkom*, 488 A.2d at 866.

[44] *See id.* at 866–67.

[45] *Id.* at 867.

[46] *Id.* at 868.

[47] *Id.* at 869.

[48] *Id.*

Plaintiff shareholders brought suit.[49] Their complaint alleged that the board of directors violated their fiduciary duty of care by agreeing to the merger and undertaking to consummate it.[50] Specifically, they alleged that the board of directors failed to "obtain the requisite information pertinent to the proposed transaction and failed to weigh and consider carefully the proposed transaction . . . ."[51]

The majority agreed.[52] While the business judgment rule is a formidable defense to a fiduciary duty of care claim, it will not protect a decision that is uninformed or that was reached using a grossly negligent process.[53] The court then found that the board "did not adequately inform themselves . . . as to the intrinsic value of the Company" and were "grossly negligent in approving the 'sale' of the Company upon two hours' consideration, without prior notice, and without the exigency of a crisis or emergency."[54]

The Supreme Court of Delaware remanded the case to the Court of Chancery to award damages in the amount that the intrinsic value of Trans Union exceeded fifty-five dollars per share.[55] That amounted to $1.87 per share.[56] The result was significant monetary liability for the individual directors ($23.5 million).[57] At the time, commentators found *Smith v. Van Gorkom*'s imposition of monetary liability on the directors for violating their fiduciary duty of care "shocking."[58] The Delaware legislature too was shocked and effectively overturned the case with Section 102(b)(7), which provides that, going forward, a

[49] *See generally* Amended Verified Complaint, Smith v. Pritzker, 488 A.2d 858 (Del. 1985) (No. 6342), https://www.law.upenn.edu/live/files/6509-a [hereinafter Van Gorkom Complaint].

[50] *Id.* at 10.

[51] *Id.* at 10–11.

[52] *Van Gorkom*, 488 A.2d at 881.

[53] *Id.*

[54] *Id.* at 874.

[55] *Id.* at 893.

[56] Stephen A. Radin, *The Director's Duty of Care Three Years After Smith v. Van Gorkom.*, 39 HASTINGS L.J. 707, 719 (1988).

[57] Bayless Manning, *Reflections and Practical Tips on Life in the Boardroom After Van Gorkom*, 41 BUS. LAW. 1, 1 n.* (1985). The original amount plaintiffs claimed was more than $100 million. *Van Gorkom*, 488 A.2d at 899.

[58] *See, e.g.*, Radin, *supra* note 56, at 707 ("Three years ago, the Delaware Supreme Court shocked the corporate world by holding in *Smith v. Van Gorkom* that a board of directors had been grossly negligent in approving a cash-out merger proposal . . . ."); Edward Rock & Michael Wachter, *Dangerous Liaisons: Corporate Law, Trust Law, and Interdoctrinal Legal Transplants*, 96 NW. U. L. REV. 651, 651 (2002) ("People were shocked by *Smith v. Van Gorkom*."); Jonathan Macey, Smith v. Van Gorkom: *Insights About C.E.O.s, Corporate Law Rules, and The Jurisdictional Competition for Corporate Charters*, 96 NW. U.L. REV. 607, 621 (2002) ("The Delaware Supreme Court's opinion in *Smith v. Van Gorkom* sent shock waves through the corporate world.").

certificate of incorporation may contain a provision eliminating the personal liability of a director for breach of the fiduciary duty of care.[59]

As mentioned above, Justice McNeilly wrote a stinging dissent describing the majority's opinion as a "comedy of errors."[60] It is that dissent I would like to focus on now. Justice McNeilly began his dissent by surgically dismantling the majority's proffered reason for not deferring to the Trans Union board's expertise, i.e., that the Trans Union board failed to inform itself prior to making the decision.[61] This, he explained, was not the case.[62]

But more importantly, Justice McNeilly's dissent acutely focuses on the business expertise rationale for the business judgment rule.[63] He recognizes two sources of expertise: expertise gained through education and expertise gained through experience.[64] As to the Trans Union directors' education, he points out that it is unimpeachable.[65] They were graduates (or in some cases, professors and deans) at prestigious business schools, including the College of Commerce and Business Administration of the University of Illinois Urbana-Champaign (now Gies), the Business School of the University of Chicago (now Booth), and Harvard Business School.[66] As graduates,

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[59] DEL. CODE ANN. tit. 8, § 102(b)(7) (2020); *see* Rock & Wachter, *supra* note 58, at 663 (discussing 102(b)(7) as a legislative reaction to *Smith v. Van Gorkom*).

[60] *Van Gorkom*, 488 A.2d at 894 (McNeilly, J., dissenting).

[61] *Id.* at 895.

[62] *Id.* Justice McNeilly further stated, as to the Trans Union board being informed, by virtue of their position on the board, they already knew most of the information they needed to judge the proposal:

> At the time of the September 20, 1980 meeting the Board was acutely aware of Trans Union and its prospects. The problems created by accumulated investment tax credits and accelerated depreciation were discussed repeatedly at Board meetings, and all of the directors understood the problem thoroughly. Moreover, at the July, 1980 Board meeting the directors had reviewed Trans Union's newly prepared five-year forecast, and at the August, 1980 meeting Van Gorkom presented the results of a comprehensive study of Trans Union made by The Boston Consulting Group. This study was prepared over an 18 month period and consisted of a detailed analysis of all Trans Union subsidiaries, including competitiveness, profitability, cash throw-off, cash consumption, technical competence and future prospects for contribution to Trans Union's combined net income.

Id.

[63] *See id.*

[64] *See id.* at 893–95.

[65] *See Van Gorkom*, 488 A.2d at 894 (McNeilly, J., dissenting).

[66] *Id.* (discussing that Robert Reneker attended Harvard Business School and University of Chicago Business School; W. Allen Wallis was a professor of economics at Yale University and former dean of the graduate school of business at the University of Chicago); *see also* Snap-On Inc., Definitive Proxy Statement (Form 14A), at 7 (Mar. 9,

professors, and deans at top-tier business schools, they would have received training in typical business disciplines, set out in the chart below.

Chart 1
Typical Director Areas of Education[67]

As to the directors' experience, it too was impressive.[68] The five "inside" directors had a collective sixty-eight years of experience as directors of Trans Union.[69] Van Gorkom is representative. He was educated as an accountant at the University of Illinois and began his career at Trans Union in the role of controller.[70] Thereafter, he served as Trans Union's CEO for eighteen years.[71] In addition to his service to

2011) ("Mr. Chelberg earned a Bachelor of Science degree in commerce from the University of Illinois at Urbana-Champaign.").

67 ASS'N TO ADVANCE COLLEGIATE SCHS. OF BUS. (AACSB) INT'L, 2020 GUIDING PRINCIPLES AND STANDARDS FOR BUS. ACCREDITATION 38 [hereinafter GUIDING PRINCIPLES].

68 *See Van Gorkom*, 488 A.2d at 894 (McNeilly, J., dissenting).

69 *Id.*

70 Terry Wilson, *Jerome W. Van Gorkom; Revived Schools' Finances*, CHI. TRIB., Mar. 19, 1998, at 12.

71 *Id.*

Trans Union, he also served on the board of directors of thirteen other corporations and organizations.[72]

The five "outside" directors had a collective fifty-three years of experience as directors of Trans Union.[73] Here, Graham Morgan is representative. He was Chairman and CEO of U.S. Gypsum and helped shepherd over thirty corporate takeovers in the two decades prior to the Trans Union transaction.[74] Certainly, he had the experience necessary to evaluate the merger. The other outside directors had similar experience, as CEOs of I.C. Industries, American Steel, and Swift and Company.[75]

Of course, the depth of their experience would not be limited to corporate takeovers (which is generally considered part of the broader category of strategic direction). A panoramic view of areas where these directions would have developed extensive experience[76] is set out in the chart below:

[72] *Id.*

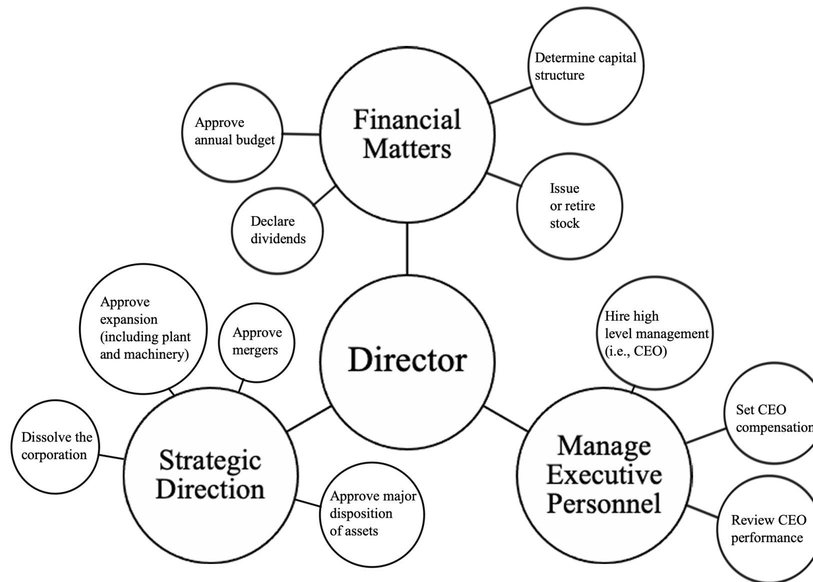
[73] *See Van Gorkom*, 488 A.2d at 894 (McNeilly, J., dissenting).

[74] *Id.*

[75] *Id.* The outside directors also had seventy-eight years of combined experience as chief executive officers. *Id.*

[76] I list responsibilities that may result in a single act that, in turn, may result in a lawsuit by a shareholder. I distinguish these responsibilities from the director's duty to engage in ongoing day-to-day monitoring. *See In re* Caremark Int'l Inc. Derivative Lit., 698 A.2d 959 (Del. Ch. 1996) (discussing directors' duty to actively monitor). I also do not include "softer" duties, such as setting the tone at the top. *See* Mary Jo White, Chair, Sec. & Exch. Comm'n, A Few Things Directors Should Know About the SEC, Speech Before the Twentieth Annual Stanford Directors' College (June 23, 2014) [hereinafter A Few Things] ("Ensuring the right "tone at the top" for a company is a critical responsibility for each director and the board collectively.").

Chart 2
Typical Director Experience[77]



These areas of expertise gained through experience—like expertise gained through education—are predominantly quantitative in nature. For that reason, the majority's refusal to defer to the board's expertise on a matter that was purely quantitative (i.e., the fair price for Trans Union shares) was, to Justice McNeilly, indefensible.[78]

He not-so-subtly reminded the other justices that Trans Union's ten directors—not the Supreme Court of Delaware sitting en banc as some form of "super board of directors"—were the best "qualified" to decide the proper value of the corporation.[79]

[77] *See* DEL. CODE ANN. tit. 8, §§ 151, 161 (2020) (power to issue stock); *Id.* § 243(a) (power to retire stock); *Id.* § 170 (power to declare dividends); *Id*. § 251(b) (power to approve mergers); *Id.* § 271 (approve major disposition of assets); *Id*. § 275 (power to dissolve corporation); *see generally* Jill Fisch, *Corporate Governance: Taking Boards Seriously*, 19 CARDOZO L. REV. 265, 272 (1997) (discussing the roll of the board of directors); PAUL MILGROM & JOHN ROBERTS, ECONOMICS, ORGANIZATION & MANAGEMENT 314 (1992) (same).

[78] *Van Gorkom*, 488 A.2d at 894–95 (McNeilly, J., dissenting).

[79] *Id.* at 895 ("These men . . . were more than well qualified to make on the spot informed business judgments concerning the affairs of Trans Union including a 100% sale of the corporation."). Indeed, the willingness of the majority to serve as a "super

The thrust of Justice McNeilly's argument is that board expertise is at its zenith—and should receive deference—when directors are called upon to make a decision requiring quantitative analysis. The natural corollary to that argument, of course, is that director expertise is not at its zenith—and should not be deferred to—when the decision requires exploring impacts that are non-quantifiable, or difficult to quantify.[80] That is to say, this Article takes the position that where the decision at hand requires qualitative assessments, the expertise rationale for deferring to the board of directors will apply with significantly less force.[81]

C. *Optimal Risk-Taking and* Brehm v. Eisner

The next major case in Delaware applying the business judgment rule was *Brehm v. Eisner*.[82] The background to the case was a tragedy: The Walt Disney Company lost its president, Frank Wells, in a helicopter crash in 1994.[83] In early 1995, Disney CEO, Michael Eisner, set out to find a replacement and settled on his longtime friend, Michael S. Ovitz.[84]

Ovitz was not an obvious choice.[85] He lacked experience managing a diversified public company like Disney.[86] (His primary qualifications seemed to be his connections developed as an important

board of directors" is somewhat surprising given its reluctance to do so in other circumstances. *See* Paul E. Burns, *Timing Is Paramount: The Impact of* Paramount v. Time *on the Law of Hostile Takeovers*, 19 FLA. ST. U. L. REV. 761, 793 (1992) (describing "Delaware judiciary's . . . struggle . . . to avoid becoming a 'super board of directors.'").

[80] *See generally* BILLUPS, *supra* note 5.

[81] A more complete discussion of why decisions that implicate significant social policy issues (such as climate change or human rights) require qualitative analysis is discussed in Part IV below.

[82] *See generally* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

[83] *See* Andrew S. Gold, *A Decision Theory Approach to The Business Judgment Rule: Reflections on Disney, Good Faith, and Judicial Uncertainty*, 66 MD. L. REV. 398, 410 (2007) ("Disney's need for a new president came about when the corporation suffered several misfortunes. First came the untimely death of its President, Frank Wells, in a fatal 1994 helicopter crash.")

[84] Despite Eisner's longtime friendship with Ovitz, the Court did not find that the fiduciary duty of loyalty was implicated. *See* Sean J. Griffith, *Good Faith Business Judgment: A Theory of Rhetoric in Corporate Law Jurisprudence*, 55 DUKE L.J. 1, 21 (2005) ("The Eisner-Ovitz relationship, however, falls short of establishing a breach of the duty of loyalty. Even if one accepts that a personal relationship can disqualify a director as disinterested, the only member of the Disney board to flunk the test was Eisner, and none of the usual indicia of 'domination or control' were present to suggest that Eisner's conflict had spread to the rest of the board.").

[85] *Brehm*, 746 A.2d at 249–50.

[86] *Id.*

talent broker in Hollywood and Chairman of Creative Artists Agency.[87]) Nevertheless, Eisner recommended him, and the Disney board acquiesced, approving his employment agreement.[88]

The employment agreement between Disney and Ovitz, in the words of the Supreme Court of Delaware, was "exceedingly lucrative, if not luxurious, compared to Ovitz' value to the Company."[89] The five-year contract gave Ovitz a base salary of $1 million, and two sets of stock options entitling Ovitz to five million Disney shares (worth in excess of $80 million at the time).[90] The stock options were divided into the "A" options (three million shares); and the "B" options (two million shares).[91]

What made the contract "exceedingly lucrative" is that the "A" options vested immediately in the event of a no-fault termination of Ovitz.[92] In addition to a no-fault termination resulting in the immediate vesting of the "A" options, it entitled Ovitz to his remaining salary payments under the five-year agreement, a $10 million severance payment, and "an additional $7.5 million for each fiscal year remaining under the agreement."[93]

In deciding whether to approve the proposed employment agreement (which it did on October 1, 1995), the Disney board enlisted the help of corporate compensation consultant, Graef Crystal.[94] He presumably informed the Disney board of much of the substance set forth above, however, by his own admission, Mr. Crystal failed to inform the board regarding "the costs that would be incurred by Disney in the event Ovitz was terminated from the Company for a reason other than cause prior to the natural expiration of the Ovitz Employment Agreement."[95] More specifically, it seems that Mr. Crystal did not inform the board that Ovitz was actually incentivized "to find a way to exit the Company via a non-fault termination as soon as possible because doing so would permit him to earn more than he could by fulfilling his contract."[96] And in fact, on December 27, 1996, a mere fifteen months after being hired, when it became apparent that

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[87] *Id.*
[88] *Id.* at 250.
[89] *Id.* at 249.
[90] *Id.* at 250. The $80 million figure assumes that Disney's shares were trading around $17.50 in 1995.
[91] *Brehm*, 746 A.2d at 250.
[92] *Id.* The "B" options were forfeited in the event of a no-fault termination. *Id.*
[93] *Id.*
[94] *Id.* at 251.
[95] *Id.*
[96] *Id.*

things were not working out between Disney and Ovitz,[97] Disney granted Ovitz a no-fault termination allowing him to walk away with $140 million.[98]

The plaintiff's primary allegation was that the Disney board of directors violated its fiduciary duty of care by following a grossly negligent decision-making process and otherwise failing to properly inform itself when deciding to approve the employment agreement.[99] (On its face, the argument that the business judgment rule is overcome by the board's failure to inform itself seems promising, especially in the wake of the earlier *Smith v. Van Gorkom* case where the Court's finding of liability was largely premised on the fact that the board's decision was uninformed.[100])

The Court began by stating that under the business judgment rule, where a shareholder claims that a board of directors' decision violates the fiduciary duty of care, the court will presume that the board's decision was proper and dismiss the action, unless the shareholder overcomes the presumption.[101] The Court further stated (agreeing with the plaintiffs) that the presumption can indeed be overcome where the plaintiff shows[102] that the board failed to follow a valid decision-making process, "measured by concepts of gross negligence, includ[ing] consideration of all material information reasonably available."[103]

Unfortunately for the plaintiffs, the Court found that the board's decision-making process was not grossly negligent.[104] The board took months to make the decision[105] (not two hours, as was the case in *Smith v. Van Gorkom*).[106] And during that time, it hired and relied in

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[97] The allegations contained in the complaint stated that Ovitz exercised an imperious management style anathema to Disney's corporate culture, refused to learn about Disney's financial affairs, and upon realizing he was failing, spent his time actively negotiating for an executive position with SONY, as opposed to doing his job at Disney. *See* Second Amended Consolidated Derivative Complaint at 27, Brehm v. Eisner, 746 A.2d 244 (Del. 2000) (No. 15452), https://www.law.upenn.edu/live/files/8294-a-hreflivefiles8294-second-amended-complaintpdf.

[98] *Brehm*, 746 A.2d at 252.

[99] *Id.* at 258–60.

[100] *Van Gorkom,* 488 A.2d at 881.

[101] *Brehm*, 746 A.2d at 259.

[102] Technically, because *Brehm* was a derivative lawsuit where no demand was made, the plaintiffs must raise a "reasonable doubt" that "the challenged transaction was otherwise the product of a valid exercise of business judgment." *Id.* at 253 (quoting Aronson v. Lewis, 473 A.2d 805, 814 (Del. 1984)).

[103] *Id.* at 259 (emphasis omitted).

[104] *Id.* at 260–62.

[105] *Id.* at 251.

[106] Smith v. Van Gorkom, 488 A.2d 858, 874 (Del. 1985).

good faith on the expert advice of Mr. Crystal (this would be akin to a board getting a fairness opinion in the mergers and acquisitions context).[107] With no lack of irony, it is Mr. Crystal's later public comments about the failures of that process that form the basis of many of the factual allegations in the complaint, that are recounted above.[108]

As a fallback argument, the plaintiffs alleged that the substance of the employment contract itself evidenced gross negligence, which it characterized as a violation of "substantive due care" (as opposed to process due care).[109] The Court quickly disposed of that claim:

> As for the plaintiffs' contention that the directors failed to exercise "substantive due care," we should note that such a concept is foreign to the business judgment rule. [Pursuant to the rule] [c]ourts do not measure, weigh or quantify directors' judgments. . . . Irrationality is the outer limit of the business judgment rule. Irrationality may be the functional equivalent of the waste test or it may tend to show that the decision is not made in good faith, which is a key ingredient of the business judgment rule.[110]

But what does the Supreme Court of Delaware say in *Brehm v. Eisner* about the rationale for the business judgment rule? The Court says that "[a]ny other rule would deter corporate boards from the optimal rational acceptance of risk."[111] Interestingly, while *Brehm v. Eisner* quotes *Lewis v. Vogelstein* for the proposition that the business judgment rule is necessary to encourage the optimal acceptance of risk, that proposition can also be traced back to *Gagliardi v. Trifoods*,

[107] *Brehm*, 746 A.2d at 259. In so holding, the Court emphasized the language of Section 141(e) of the Delaware General Corporation Law:

> A member of the board of directors, or a member of any committee designated by the board of directors, shall, in the performance of such member's duties, be fully protected in relying in good faith upon the records of the corporation and upon such information, opinions, reports or statements presented to the corporation by any of the corporation's officers or employees, or committees of the board of directors, or by any other person as to matters the member reasonably believes are within such other person's professional or expert competence and who has been selected with reasonable care by or on behalf of the corporation.

Id. at 261 n.51 (emphasis omitted) (quoting DEL. CODE ANN. tit. 8, § 141(e)). The Court further noted "[t]his protection, however, is not without limitation, as in a case of corporate waste." *Id.*

[108] *Id.* at 251.

[109] *Id.* at 262.

[110] *Id.* at 264.

[111] *Id.* at 263 (quoting Lewis v. Vogelstein, 699 A.2d 327, 336 (Del. 1997)).

the next case we will discuss.[112] For now, it suffices to say that the Disney board took a risk in offering a lucrative contract to Ovitz to entice him away from being Chairman of Creative Artists Agency.[113] The upside risk was that Ovitz could bring the same entrepreneurial drive to Disney that he used to build one of the most formidable talent agencies in the United States.[114] (Apparently that is what Eisner believed.) Of course, the downside risk was that Ovitz could fail. He had no experience as the president of a public company.[115] If Ovitz failed, not only would Disney be back at square one, searching for a president, but also Disney would forfeit much in the way of cash and stock.[116]

With the benefit of hindsight, the Disney board's decision may seem like it was foolishly risky; nevertheless, the Delaware Supreme Court found the decision to be protected by the business judgment rule. I believe the Court did so because a contrary ruling would discourage both bad (unprofitable) and good (profitable) risk-taking. And as the Court has stated elsewhere, "[t]he business judgment rule exists precisely to ensure that directors and managers acting in good faith may pursue risky strategies that seem to promise great profit."[117]

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[112] *Vogelstein*, 699 A.2d at 336 (citing Gagliardi v. TriFoods Int'l, Inc., 683 A.2d 1049, 1052 (1996) ("[T]he first protection against a threat of sub-optimal risk acceptance is the so-called business judgment rule.")).

[113] The Internal Disney Memo regarding the matter stated "[i]t is necessary and appropriate to provide [Ovitz] with downside protection and upside opportunity to compensate to the extent feasible for [the loss of] the very successful business he will abandon." Opening Brief of the Walt Disney Co. and the Director Defendants in Support of Their Motion to Dismiss at 9, Brehm v. Eisner, 746 A.2d 244 (Del. 2000) (No. 15452), https://www.law.upenn.edu/live/files/8289-a (quoting Internal Disney Memo dated July 7, 1995). Indeed, the Disney Board feared that absent a lucrative compensation package, they could not attract Ovitz. *Id.*

[114] *Id.* (discussing the need to attract a "highly successful and unique entrepreneur").

[115] *Brehm*, 746 A.2d at 249.

[116] *Id.* at 250. And of course, forfeiting much cash and stock is exactly what happened. Ovitz was paid $38,888,230.77 in cash, and stock options worth $101,000,000.00. *Id.* at 252–53.

[117] Trenwick Am. Litig. Tr. v. Ernst & Young, L.L.P., 906 A.2d 168, 193 (Del. Ch. 2006); *see* Bainbridge, *supra* note 26 at 110 (The business judgment rule is necessary to avoid "the risk of stifling innovation and venturesome business activity.") (quoting AM. L. INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS 141 (1994)).

D. *Optimal Risk-Taking and* Gagliardi v. TriFoods

In 1993, it became clear that TriFoods International, Inc. was in financial trouble and that action was necessary to return the company to profitability.[118] Eugene Gagliardi, the founder and Chairman of the Board of TriFoods, favored a conservative plan of action; TriFoods' President, Hart, and the remainder of the board of directors, favored a more risky plan of action.[119] The more risky plan of action involved taking on a large amount of debt to build and fit-out a new factory to manufacture the products itself—rather than sub-contracting with a third party—and the purchase of several new food lines: Steak-umms and Lloyd's Ribs.[120]

The debate regarding the direction of the company became contentious, and after a power struggle, Gagliardi was ousted from his position as Chairman of the Board and his employment by TriFoods was terminated.[121] Although he retained his thirteen percent ownership interest in the company, those shares were insufficient to influence company direction.[122]

Gagliardi brought a lawsuit against Hart and the board of directors for breach of their fiduciary duty of care.[123] He alleged that after his ouster, under their leadership, the business of TriFoods deteriorated.[124] He further alleged, "implementation of [Hart's and the board of directors'] grandiose scheme for TriFoods' future growth . . . in only eighteen months destroyed TriFoods."[125]

Unsurprisingly, Chancellor Allen dismissed the fiduciary duty action.[126] He stated that the board of directors of TriFoods was in a position where some bet-the-company risk-taking was necessary to turn around the fortunes of a struggling cash-pressed company.[127] He explained that:

> alleg[ing] that a corporation has suffered a loss as a result of a lawful transaction, within the corporation's powers, authorized by a corporate fiduciary acting in a good faith pursuit of corporate purposes, does not state a claim for

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[118] *See* Gagliardi v. Trifoods Int'l, Inc., 683 A.2d 1049, 1053 (Del. Ch. 1996) (describing the company's struggles and that it was "cash-pressed").

[119] *Id.* at 1051.

[120] *Id.*

[121] *Id.* at 1050.

[122] *Id.*

[123] *Id.* at 1051.

[124] *Gagliardi*, 683 A.2d at 1051.

[125] *Id.*

[126] *Id.* at 1050–51.

[127] *Id.* at 1053.

relief against that fiduciary no matter how foolish the investment may appear in retrospect.[128]

That is true even if the board's decision was "foolishly risky! stupidly risky! egregiously risky! — you supply the adverb."[129]

What is most instructive about Chancellor Allen's decision in *Gagliardi v. TriFoods* is how deeply he discusses the optimal risk-taking rationale for the business judgment rule.[130] Chancellor Allen's decision itself could double as a law review article on the important role the business judgment rule plays in encouraging optimal risk-taking.[131] This optimal risk-taking rationale for the business judgment rule would later be picked up in *Lewis v. Vogelstein* and then *Brehm v. Eisner*.[132]

Chancellor Allen's decision points out that a shareholder prefers risky projects because the potential gain is high, while the potential loss is capped.[133] Even if the risky project fails and results in the corporation's insolvency, the corporate liability shield limits the shareholder's loss to her initial investment, no more.[134] Second, because of diversification, the shareholder will make up for that loss with gains made at other companies.[135] This is similar to the viewpoint of a venture capital firm, which "assumes it will lose its bets on most of its startups" but make huge returns on the few others.[136]

Prominent scholarship supports Chancellor Allen's view.[137] Professor Bainbridge suggests that shareholders consent to risk-taking by directors—and agree to limitations on their ability to bring lawsuits when such risks turn out badly—precisely because they benefit fully from the upside risk while limiting their downside risk.[138] He states that if they were able, shareholders would contractually agree "to refrain from challenging the reasonableness of managerial business decisions."[139] Because the "practicalities of . . . fluid stock ownership"

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[128] *Id.* at 1052.

[129] *Id.*

[130] *Gagliardi*, 683 A.2d at 1052–53.

[131] *Id.*

[132] *See Brehm*, 746 A.2d at 263; *Vogelstein*, 699 A.2d at 336.

[133] *Gagliardi*, 683 A.2d at 1052; *see also* Bainbridge, *supra* note 26, at 111 ("[R]isk and return are directly proportional.").

[134] Bainbridge, *supra* note 26, at 111 ("[S]hareholders thus do not put their personal assets at jeopardy, other than the amount initially invested.").

[135] *Gagliardi*, 683 A.2d at 1052.

[136] Henry T. C. Hu & Jay Lawrence Westbrook, *Abolition of The Corporate Duty to Creditors*, 107 COLUM. L. REV. 1321, 1381 (2007).

[137] Bainbridge, *supra* note 26, at 115.

[138] *Id.*

[139] *Id.*

preclude this, the business judgment rule intercedes to impliedly create the contract the parties would otherwise expressly create.[140]

Broader society too benefits from the corporate risk-taking that the business judgment rule fosters.[141] Alan Palmiter writes, "[l]iability standards that risk introducing timidity in the boardroom could have enormous costs . . . to society in general."[142] Professors Hu and Westbrook list "bet the company" projects that benefited society, including "Boeing having bet the company on the 707, the first commercial jet airplane, [and] IBM having . . . spen[t] more than the cost of the Manhattan Project––to develop the IBM 360."[143]

The final point made by Chancellor Allen in *Gagliardi v. TriFoods* is that the business judgment rule aligns the risk tolerance of directors with the risk tolerance of shareholders.[144] (The business judgment rule's downside risk protection makes it more likely that directors will take the risk shareholders prefer.[145]) This is especially necessary when one considers that, unlike shareholders, directors do not share in the upside risk (financial benefit). That is because, as the Court of Chancery points out in *Gagliardi v. TriFoods*, directors have a relatively small claim in the residual profits.[146]

And so, absent the protection of the business judgment rule, the directors' share of any downside loss is large, while their share of any upside gain is small.[147] Chancellor Allen explains that "[i]f . . . corporate directors were to be found liable for a corporate loss from a risky project on the ground that the investment was too risky . . . their liability would be joint and several for the whole loss (with I suppose a right of contribution)."[148] In short, absent the protection of the business judgment rule, directors are heavily disincentivized to take risk.[149]

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[140] *Id.*
[141] Hu & Westbrook, *supra* note 136, at 1380–81.
[142] Palmiter, *supra* note 36, at 1463.
[143] Hu & Westbrook, *supra* note 136, at 1380–81.
[144] Gagliardi v. Trifoods Int'l, Inc., 683 A.2d 1049, 1052 (Del. Ch. 1996).
[145] *Id.*
[146] *Id.*; *see also* Bainbridge, *supra* note 26, at 116 (stating "[c]orporate directors of public companies typically have a very small proportionate ownership interest in their corporations and little or no incentive compensation. Thus, they enjoy (as residual owners) only a very small proportion of any 'upside' gains earned by the corporation on risky investment projects.") (quoting *Gagliardi*, 683 A.2d at 1052).
[147] *Gagliardi*, 683 A.2d at 1052.
[148] *Id.*
[149] *Id.* at 1052–53.

E. *Conclusions and More Questions*

Conclusion 1. As illustrated in *Van Gorkom*, the first argument in favor of the business judgment rule is deference to the board of directors' business expertise.[150] This argument is especially compelling when the directors are valuing a company for sale, as was the case in *Van Gorkom*.[151]

Related Question 1. Shareholders may be willing to defer to director decisions where they have special expertise—such as valuing a company for sale—but are they willing to defer in areas where directors do not have special expertise, such as climate change or human rights?

Conclusion 2. As illustrated in *Brehm* and *Gagliardi*, the second argument in favor of the business judgment rule is that it allows directors broad latitude to take risks.[152] The argument is especially compelling when the downside risk is purely financial, and the possible negative impact is limited and can be diversified away.[153]

Related Question 2. Shareholders may prefer risk-taking when it comes to decisions that present purely financial downside risk, and the possible negative impact is limited and can be diversified away. But do shareholders prefer risk-taking when it comes to decisions that implicate their own health and safety? What if the risk-taking implicates third-party health and safety?

III. SIGNIFICANT SOCIAL POLICY ISSUES

In a subsequent part, I will argue that, while the business judgment rule should shield from scrutiny ordinary business decisions, the business judgment rule should not shield from scrutiny decisions that implicate significant social policy issues. That begs a fundamental question: what is a "significant social policy issue?" Fortunately, here, we do not need to reinvent the wheel. In this part, I will explore the definition of "significant social policy issue" used by the Securities and Exchange Commission (SEC).

First, one point of clarification: I am not proposing that federal law should control state law on this matter. I am simply suggesting

[150] Smith v. Van Gorkom, 488 A.2d 858, 894–895 (Del. 1985) (McNeilly, J., dissenting).

[151] *Id.* at 895 ("These men knew Trans Union like the back of their hands and were more than well qualified to make on the spot informed business judgments concerning the affairs of Trans Union including a 100% sale of the corporation.").

[152] *See* Brehm v. Eisner, 746 A.2d 244, 263 (Del. 2000) (quoting Lewis v. Vogelstein, 699 A.2d 327, 336 (Del. 1997)); *Gagliardi*, 683 A.2d at 1052.

[153] *Gagliardi*, 683 A.2d at 1052.

that the former can inform the latter. This is not unlike how state law has informed interpretations of federal securities law (albeit in reverse).[154]

A. *"Significant Social Policy Issues" for Purposes of the Ordinary Business Operations Exclusion*

To unpack the SEC's definition of "significant social policy issue," one has to briefly examine the operation of the federal rule governing shareholder proposals, Exchange Act Rule 14a-8.[155] Promulgated by the SEC, the main thrust of 14a-8 is that, when a shareholder submits a proposal,[156] the corporation must include that proposal in their proxy materials and allow it to be voted on at their annual meeting, *unless* there is a valid reason to exclude it.[157] One valid reason to exclude a shareholder proposal is that it intrudes on the ordinary business operations of the corporation. This is referred to as the "ordinary business operations exclusion."[158]

The ordinary business operations exclusion is silent as to whether it has any exceptions.[159] The exclusion language is short and cryptic: exclusion is appropriate "[i]f the proposal deals with a matter relating to the company's ordinary business operations."[160] That is it. Nothing more.

The SEC, however, has made clear that the exclusion may not be applied to a proposal—even one that intrudes on ordinary business operations—if it *also* raises a significant social policy issue that transcends the protection afforded by the ordinary business operations exclusion (that is to say, the exclusion has an exception).[161] Courts have referred to such proposals as "transcend[ing] . . . ordinary

[154] For example, the federal interpretation of "investment contract" is borrowed from state "blue sky" laws. *See* SEC v. W.J. Howey, Co., 328 U.S. 293, 298 (1946).

[155] 17 C.F.R. § 240.14a-8 (2020).

[156] A "shareholder proposal" is a "proposed course of action that [the presenting shareholder] believe[s] the company should follow." *Id.* § 240.14a-8(a).

[157] *Id.* § 240.14a-8(g). The burden is on the company to demonstrate that exclusion is appropriate. *Id.*

[158] *Id.* § 240.14a-8(i)(7).

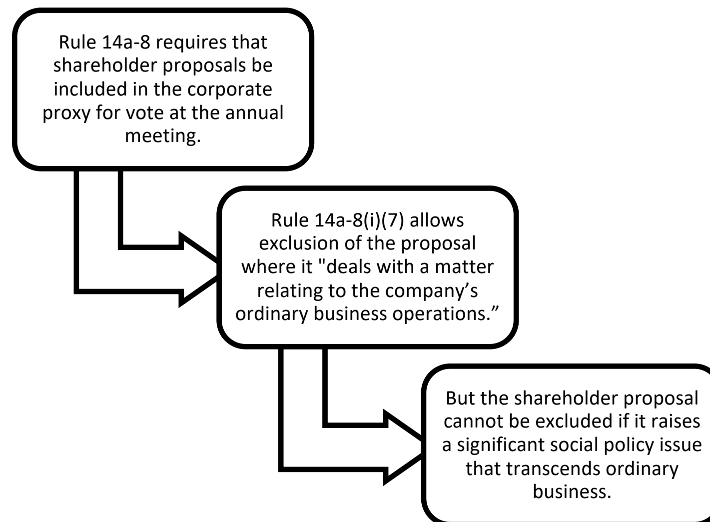
[159] *Id.*

[160] *Id.*

[161] *See* Adoption of Amendments Relating to Proposals by Security Holders, Exchange Act Release No. 12,999, 1976 SEC LEXIS 326, *31–32 (Nov. 22, 1976) [hereinafter 1976 Adopting Release] (stating that the exclusion should not be applied to matters that have "significant policy . . . implications inherent in them"); Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 39,093, 1997 SEC LEXIS 1962, *49–50 (Sept. 26, 1997) [hereinafter 1997 Proposing Release] (stating that the exclusion should not apply to "proposals . . . focusing on significant social policy issues").

business operations."[162] The rule, exclusion, and exception to the exclusion, can be visualized as follows:

Chart 3
The Significant Social Policy Issue Exception



The SEC issues formal interpretive guidance ("Releases") that we can use to further our understanding of the significant social policy exception to the ordinary business operations exclusion.[163] Consider the following releases (these releases are important because, absent regulatory text, they are the first place bench and bar look for guidance):

- 1976 Release. The SEC stated that going forward the ordinary business operations exclusion may not be used to exclude "matters which have significant policy . . . implications inherent in them." It provided the following example: "a proposal that a utility company not construct a proposed nuclear power plant."[164]
- 1997 Release. The SEC reaffirmed that going forward the ordinary business operations exclusion may not be used to exclude matters that "raise[] significant social policy

[162] Trinity Wall St. v. Wal-Mart Stores, Inc., 792 F.3d 323, 345 (3d Cir. 2015).
[163] *Id.* at 337.
[164] 1976 Adopting Release, *supra* note 161, at *31–32.

> issues."[165] This would allow, for instance, a proposal to "expressly prohibit discrimination on the basis of sexual orientation."[166]

In addition to Releases, the SEC issues no-action letters written by attorneys employed in its Division of Corporate Finance ("SEC Staff").[167] The SEC explains no-action letters as follows:

> [A person] who is not certain whether a particular . . . action would constitute a violation of the federal securities law may request a "no-action" letter from the SEC staff . . . . [I]f the staff grants the request for no action [the letter will state] that the SEC staff would not recommend that the Commission take enforcement action against the requester based on the facts and representations described in the [person's] request.[168]

The SEC also writes, "[m]ost no-action letters describe the request, analyze the particular facts and circumstances involved, [and] discuss applicable laws and rules . . . ."[169] Unfortunately, the last two features are regularly absent from no-action letters regarding exclusion of shareholder proposals.[170] Most no-action letters simply states whether they concur (or do not concur) with the company's grounds for

[165] 1997 Proposing Release, *supra* note 161, at *41–50. The SEC proposed reversing a controversial SEC no-action letter that stated: "[T]he fact that a shareholder proposal concerning a company's employment policies and practices for the general workforce is tied to a social issue will no longer be viewed as removing the proposal from the realm of ordinary business operations of the registrant." *Id.* at *43–44. After comment, it adopted the proposal six months later. *See* Amendments To Rules On Shareholder Proposals, Exchange Act Release No. 34-40018, 1998 SEC LEXIS 1001, *15 (May 21, 1998) ("We are adopting our proposal to reverse the Cracker Barrel position, which provided that all employment-related shareholder proposals raising social policy issues would be excludable under the 'ordinary business' exclusion."); *see also* Selected Labor and Employment Law Updates, 1 U. PA. J. LAB. & EMP. L. 789, 790–91 (1998) ("Proposals relating to 'ordinary business' subject matters such as employment, but focusing on sufficiently significant social policy issues (e.g., discrimination), would transcend the day-to-day business matters and raise policy issues appropriate for a shareholder vote.").

[166] *See* N.Y.C. Emps.' Ret. Sys. v. SEC, 45 F.3d 7, 9 (2d Cir. 1995) (containing language of proposal).

[167] *See Trinity*, 792 F.3d at 330–31 (discussing how the no-action letter process applies in the context of Rule 14a-8 shareholder proposals).

[168] *No Action Letters*, U.S. SEC. & EXCH. COMM'N, https://www.investor.gov/introduction-investing/investing-basics/glossary/no-action-letters (last visited Feb. 10, 2021).

[169] *Id.*

[170] *See* Reilly S. Steel, *The Underground Rulification of The Ordinary Business Operations Exclusion*, 116 COLUM. L. REV. 1547, 1549 (2016) (explaining that no-action letters are devoid of the staff's reasoning).

exclusion.[171] Nevertheless, even if detailed reasoning is absent, we can identify categories of proposals that the SEC believes implicate transcendent significant social issues—and thus, should not be excluded—including, but not limited to, climate change and human rights.[172]

B. *Climate Change*

The 1997 Release, discussed above, made clear that building a nuclear power plant is a decision that implicates significant social policy issues.[173] There, the significant social policy issue was the safety concern that a nuclear power plant poses.[174] The next logical question is: does building a power generation plant that uses other kinds of fuel, likewise, implicate significant social policy issues? In 2011, the SEC Staff implied that it did—at least where its construction could contribute to climate change (which is the case for coal-fired and gas-fired power generation plants).[175] At issue was a shareholder proposal

[171] *Id.* In fairness, there is some helpful language from the SEC itself indicating that a significant social policy issue is one that is a "consistent topic of widespread public debate." Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 40,018, 1998 SEC LEXIS 1001, *17 (May 21, 1998); *see* SEC Staff Legal Bulletin No. 14A, 2002 SEC No-Act LEXIS 638, *4 (July 12, 2002) ("[T]he presence of widespread public debate regarding an issue is among the factors to be considered in determining whether proposals concerning that issue 'transcend the day-to-day business matters.'") (internal citation omitted).

[172] *See Trinity*, 792 F.3d at 342–43 (using no-action letters to determine the boundaries of the exclusion); Steel, *supra* note 170, at 1549 (describing how no-action letters are imperfect tools for determining the contours of the ordinary business operations exclusion).

[173] 1976 Adopting Release, *supra* note 161, at *31–32; *see* Northern States Power Co., SEC Staff No-Action Letter, 1998 SEC No-Act. LEXIS 168, at *1 (Feb. 9, 1998) (denying no-action relief for proposal encouraging company to convert a nuclear power plant into a natural gas plant). Further, the SEC used similar reasoning to refuse to grant no-action relief where shareholders submitted a proposal asking for a report on the safety of a nuclear power plant, finding that the subject of the safety of nuclear power transcends ordinary business. *See* Florida Progress Corp., SEC Staff No-Action Letter, 1993 SEC No-Act. LEXIS 87, *2 (Jan. 26, 1993) (denying no-action relief for proposal requesting a special report on the operation and safety of a nuclear power plant); *see also* Burlington Northern, Inc., SEC Staff No-Action Letter, 1985 SEC No-Act. LEXIS 1759, at *1 (Feb. 19, 1985) (denying no-action relief where shareholders sought report regarding transportation of nuclear materials).

[174] 1976 Adopting Release, *supra* note 161, at *31–32.

[175] U.S. DEP'T OF ENERGY, ENV'T BASELINE, VOLUME 1: GREENHOUSE GAS EMISSIONS FROM THE U.S. POWER SECTOR 4 (2016) [hereinafter ENVIRONMENT BASELINE] (breaking down carbon dioxide emissions by power plant type).

that asked Dominion Resources to "invest in demand control and new renewable generation sources."[176]

The SEC took the position that the proposal should not be excluded, stating that "the determination whether to . . . develop[] renewable energy generating systems [is a] significant policy issue[]."[177] This is not surprising, as climate change, and the significant role played by the energy sector, has generated widespread public debate over the past three decades.[178] The debate has shifted back and forth, and then back again. The United States signed onto the Kyoto Protocol in 1997 and then withdrew in 2001;[179] the United States signed onto the Paris Agreement in 2015, then withdrew in 2020,[180] and then rejoined in 2021.[181]

In a separate matter, the SEC Staff took the position that a shareholder proposal requesting a report explaining how an energy company's business will be impacted by climate change is not excludable.[182] The SEC Staff reasoned that the proposal is not

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[176] Dominion Resources, Inc., SEC Staff No-Action Letter, 2011 SEC No-Act. LEXIS 131, *5, *7 (Feb. 9, 2011). The entire proposal was actually quite broad, and included discouraging nuclear power plant construction:

> RESOLVED, that the shareholders of Dominion Resources urge the Board of Directors to: be open and honest with us about the enormous costs and risks of new nuclear construction; invest in demand control and new renewable generation sources for the safest and quickest returns to shareholders, stakeholders, community and country; and therefore, stop wasting shareholder money by pursuing the increasingly costly and unnecessary risky venture of a new nuclear unit.

Id. at *7.

[177] *Id.* at *2 (emphasis added).

[178] Nathaniel Rich, *The Next Reckoning*, N.Y. TIMES MAG. (Apr. 14, 2019) https://www.nytimes.com/interactive/2019/04/09/magazine/climate-change-capitalism.html (describing the decades long debate over climate change).

[179] Jonathan B. Wiener, *Climate Change, U.S. Domestic Regulation and the Future of the Car: Radiative Forcing: Climate Policy to Break the Logjam in Environmental Law*, 17 N.Y.U. ENV'T L.J. 210, 249 (2008).

[180] Lisa Friedman & Somini Sengupta, *Despite U.S. Exit, World Moves Ahead on Climate Pact*, N.Y. TIMES, Nov. 5, 2020, at A10. While President Trump broadcasted his intent to withdraw from the Paris Agreement in 2016, the United States could not legally withdraw until 2020. Marc Zemel, *The Rise of Rights-Based Climate Litigation and Germany's Susceptibility to Suit*, 29 FORDHAM ENV'T L. REV. 484, 486 (2018).

[181] *Paris Climate Agreement*, WHITE HOUSE (Jan. 20, 2021), https://www.whitehouse.gov/briefing-room/statements-releases/2021/01/20/paris-climate-agreement/.

[182] Devon Corp., SEC Staff No-Action Letter, 2014 SEC No-Act. LEXIS 271, at *1–2 (Mar. 19, 2014). The text of the proposal was:

> Resolved: Shareholders request that Devon prepare a report by October 2014, omitting proprietary information and prepared at reasonable cost, on the company's goals and plans to address global concerns regarding

excludable because it "focuses on the significant policy issue of climate change."[183]

C. *Human Rights*

Generally, the position of the SEC Staff is that shareholder proposals involving human rights implicate a significant social policy issue.[184] But there are many categories here. I will focus on two: human rights problems in the supply chain (usually in the form of suppliers using forced- or child-labor), and actions that infringe on free speech and free association.

Nucor Corporation is a steel producer, a component of which is pig iron.[185] The company faced scrutiny in 2006 when the financial press revealed that Nucor was purchasing pig iron produced using forced labor.[186] Shareholders were rightly concerned. They brought a shareholder proposal asking the directors to formally adopt supply chain policies designed to prevent such occurrences from happening in the future.[187] Nucor sought to exclude the shareholders' human rights proposal on the basis that it dealt with management and retention of suppliers, and thus interfered with ordinary business operations.[188]

> the contribution of fossil fuel use to climate change, including analysis of long and short term financial and operational risks to the company.

Id. at *28.

183 *Id.* at *1–2; *see* Hess Corp., SEC Staff No-Action Letter, 2016 SEC No-Act. LEXIS 171, at *1 (Feb. 29, 2016) (denying no-action relief because "the proposal focuses on the significant policy issue of climate change"). But where the shareholder proposal goes beyond requesting that the directors develop a plan of action, the SEC has been less willing to require its inclusion in the proxy materials. *See* Exon Mobil Corp., SEC Staff No-Action Letter, 2019 SEC No-Act. LEXIS 215, at *1–2 (Apr. 2, 2019) (allowing proposal to be excluded because it required the company to set actual targets, and as such, micromanages the Company).

184 Brent J. Horton, *Malign Manipulations: Can Google's Shareholders Save Democracy?*, 54 WAKE FOREST L. REV. 707, 751–52 (2019).

185 Michael Smith & David Voreacos, *The Secret World of Modern Slavery*, BLOOMBERG MKTS., Dec. 2006, at 48.

186 *Id.* at 48. The forced labor produces the charcoal in the forests of Brazil, which is then used to produce the pig iron. *Id.*

187 Nucor Corp., SEC Staff No-Action Letter, 2008 SEC No-Act. LEXIS 372, at *4–5 (Mar. 6, 2008). The actual proposal read:

> Shareholders request the Board of Directors to review the company's policies and practices related to its global operations and supply chain to assess areas where the company needs to adopt and implement additional policies to ensure the protection of fundamental human rights and to report its findings to shareholders, omitting proprietary information and at reasonable expense, by October 2008.

Id.

188 *Id.* at *5.

The SEC Staff took the position that Nucor should include the proposal in its proxy materials and allow it to go to a shareholder vote.[189] While the SEC Staff provided no reasoning for its position, it is worth noting that the proponents emphasized that a proposal must be included in proxy materials if it implicates a significant social policy issue (and this is a position that the SEC Staff, by denying Nucor's request for no-action relief, apparently agreed with).[190] The outcome is not surprising. Forced labor in supply chains has been, and continues to be, a source of widespread public debate.[191]

Abercrombie & Fitch ("A&F") is a clothes retailer that sources much of its merchandise in Asia and South America.[192] It faced negative press when it settled a lawsuit brought by workers "who alleged they were mistreated while they worked for [one of A&F's] vendors."[193] The shareholder proposal in question required that A&F adopt and enforce a vendor code of conduct to protect the human rights of those workers.[194] The SEC Staff took the position that the proposal should be included in the company's proxy materials because human rights is a significant social policy issue.[195] Indeed, forced labor in the fashion industry is a matter of constant discussion in the press[196] and academia.[197]

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[189] *Id.* at *1.

[190] *Id.* at *5–6.

[191] *See* Ana Swanson & Chris Buckley, *Chinese Solar Companies Tied to Use of Forced Labor*, N.Y. TIMES (Jan. 8, 2021), https://www.nytimes.com/2021/01/08/business/economy/china-solar-companies-forced-labor-xinjiang.html.

[192] Abercrombie & Fitch Co., SEC Staff No-Action Letter, 2010 SEC No-Act. LEXIS 373, at *10 (Apr. 12, 2010).

[193] *Id.* at *11.

[194] *Id.* at *12.

[195] *Id.* at *1–2. The SEC seems willing to allow shareholder proposals that require corporations to prepare reports or implement policies to protect human rights in the supply chain; but where the proposal goes further, and threatens a specific product (that is to say, proposes altering the company's "product mix"), the SEC is more likely to allow it to be excluded. For example, the SEC allowed Amazon (the owner of Whole Foods) to exclude a shareholder proposal aimed at stopping Whole Foods from selling shrimp produced with child labor because SEC staff viewed the proposal as seeking to "micromanage" the company's choice of what products to sell. *See* Amazon.com, Inc., SEC Staff No-Action Letter, 2019 SEC No-Act. LEXIS 261, at *1 (Apr. 3, 2019).

[196] *See* Elizabeth Paton, *Close Look at a Fashion Supply Chain is Not Prett*y, N.Y. TIMES, Aug. 6, 2020, at D.4 (discussing forced-labor in the fashion supply chain); *see* Leslie P. Norton, *Investing in China Isn't Easy. Focusing on ESG Can Help.*, BARRON'S (Jan. 25, 2021), https://www.barrons.com/articles/investing-in-china-isnt-easy-focusing-on-esg-can-help-51611309600 (discussing that H&M stores cut ties with a supplier said to have been using forced labor).

[197] *See* Lisa Bollinger Gehman, *Achieving Transparency: Use of* Certification *Marks to Clean up the Fashion Industry's Supply Chains*, 9 DREXEL L. REV. 161, 168 (2016)

Shareholder proposals opposing corporate stifling of free speech are usually not excludable.[198] Apple came under increased scrutiny for being complicit in China's censorship of its own citizens.[199] Specifically, Apple removed anti-censorship tools from its App Store in China.[200] It had also (in)famously removed the New York Times app from its App Store in China after being pressured by Beijing.[201]

When an Apple shareholder, upset by these occurrences, submitted for vote at the annual meeting a proposal that required Apple to set up a human rights committee, the SEC held that the company could not exclude the proposal because it dealt with a matter of ethical and social significance.[202] In refusing to allow the proposal to be excluded, the SEC staff reasoned that Apple admitted that "the Board and management firmly believe that human rights are an integral component of the Company's business operations," and utterly failed to "explain why this particular proposal would not raise a significant issue for the Company."[203]

A similar shareholder proposal submitted at Yahoo! was also not excludable.[204] The proposal required that Yahoo! adopt the following human rights principles:

> No information technology products or technologies will be sold, and no assistance will be provided to authorities in

("Common problems in the fashion industry's supply chains include child labor, forced labor, sweatshops, and unsafe manufacturing facilities.").

[198] *See, e.g.*, Apple, Inc., SEC Staff No-Action Letter, 2017 SEC No-Act. LEXIS 382, *1–2 (Nov. 11, 2017) [hereinafter Apple No-Action Letter]; Yahoo! Inc., SEC Staff No-Action Letter, 2011 SEC No-Act. LEXIS 363, *2 (Apr. 5, 2011) [hereinafter Yahoo! No-Action Letter].

[199] Katie Benner & Wee Sui-Lee, *Apple Removes New York Times News Apps from its Chinese Store*, N.Y. TIMES, Jan. 4, 2017, at B.1.

[200] Paul Mozur, *Joining Apple, Amazon's China Cloud Service Bows to Censors*, N.Y. TIMES (Aug. 1, 2017), https://www.nytimes.com/2017/08/01/business/amazon-china-internet-censors-apple.html ("Days after Apple yanked anti-censorship tools off its app store in China, another major American technology company is moving to implement the country's tough restrictions on online content.").

[201] Benner & Sui-Lee, *supra* note 199, at B.1.

[202] Apple No-Action Letter, *supra* note 198, at *1–2.

[203] *Id.* (internal quotations omitted). As to the second comment, it is an understatement. As I have discussed elsewhere:

> In an oddly out-of-touch rebuttal to Mr. Zhao, Apple's attorneys spent many pages of its letter to the SEC Staff explaining that human rights is a day-to-day management concern at Apple, but focused on how Apple furthers human rights through environmental protection. Apple never discussed how fighting government censorship is a day-to-day management concern (perhaps because they could not).

Horton, *supra* note 184, at 751–52.

[204] Yahoo! No-Action Letter, *supra* note 198, at *1–2.

> China and other repressive countries that could contribute to human rights abuses. No user information will be provided, and no technological assistance will be made available, that would place individuals at risk of persecution based on their access or use of the Internet or electronic communications for free speech and free association purposes.[205]

The SEC Staff refused to concur that it could be excluded, because it "focuses on the significant policy issue of human rights."[206]

D. *Indiscriminate Weapons*

Weapons that may cause unnecessary suffering or have indiscriminate effects ("indiscriminate weapons") are not illegal per se, and thus they can be manufactured, although doing so obviously implicates significant social policy issues.[207] Indiscriminate weapons include napalm (which causes horrific burns) and cluster munitions (which kill indiscriminately, even after the end of the conflict).[208] The landmark case here is *Medical Committee for Human Rights v. SEC*.[209] That case involved the Medical Committee for Human Rights ("Medical Committee"), which had received several shares of Dow Chemical, submitting the following shareholder proposal:

> RESOLVED, that the shareholders of the Dow Chemical Company request the Board of Directors [amend the] Certificate of Incorporation of the Dow Chemical Company [to provide] that napalm shall not be sold to any buyer unless that buyer gives reasonable assurance that the substance will not be used on or against human beings.[210]

The Medical Committee gave the following reasons in support of the proposal:

> [W]e wish to note that our objections to the sale of this product [are] primarily based on the concerns for human life inherent in our organization's credo. However, we are further informed by our investment advisers that this product is also bad for our company's business as it is being used in the Vietnamese War. It is now clear from company statements and press reports that it is increasingly hard to

[205] *Id.* at *6.

[206] *Id.* at *2.

[207] W. Hays Parks, *Means and Methods of Warfare*, 38 GEO. WASH. INT'L L. REV. 511, 518–19 (2006).

[208] *Id.* at *523.

[209] *See* Med. Comm. for Hum. Rts. v. SEC, 432 F.2d 659 (D.C. Cir. 1970), *vacated as moot*, 404 U.S. 403 (1972).

[210] *Id.* at 662.

> recruit the highly intelligent, well-motivated, young college men so important for company growth. There is, as well, an adverse impact on our global business, which our advisers indicate, suffers as a result of the public reaction to this product.[211]

Dow sought to exclude the proposal as interfering with its ordinary business operations, and the SEC acquiesced, granting no-action relief.[212] Thereafter, the Medical Committee sought review of the SEC's decision.

The D.C. Circuit Court found serious problems with the SEC decision, finding that the SEC acquiesced in a "very dubious legal theory."[213] Specifically, the Court said it could find no detailed discussion in the record of why the proposal interfered with ordinary business operations (interestingly, the Court stated that such an argument would need to be premised on what ordinary business operations means for purposes of state law).[214]

Further, the Court emphasized that the proposal raised a significant social policy issue. The Court stated:

> management may [not] properly place obstacles in the path of shareholders who wish to present to their co-owners . . . the question of whether they wish to have their assets used in a manner which they believe to be more socially responsible but possibly less profitable than that which is dictated by present company policy.[215]

Following that language, which commentators have stated (and I agree) "strongly suggested the proposal was indeed eligible under rule 14a-8[,]"[216] the Court remanded the matter to the SEC to make a more "enlightened determination of whether enforcement action would be appropriate."[217]

At that point Dow saw the writing on the wall. In January 1971, the Medical Committee again submitted its napalm resolution for inclusion in Dow's 1971 proxy statement. This time, Dow acquiesced and included the proposal in its proxy materials.[218]

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[211] *Id.*

[212] *Id.* at 663.

[213] *Id.* at 674–75.

[214] *Id.* at 680.

[215] *Med. Comm.*, 432 F.2d at 681 (emphasis added).

[216] Patrick J. Ryan, *Rule 14a-8, Institutional Shareholder Proposals, and Corporate Democracy*, 23 GA. L. REV. 97, 111 n.53 (1988).

[217] *Med. Comm.*, 432 F.2d at 672.

[218] SEC v. Med. Comm. for Hum. Rts., 404 U.S. 403, 405–06 (1972).

Since that time, matters involving indiscriminate weapons have generally been includable in proxy statements because they raise a significant social policy issue.[219] In 1988, Honeywell came under scrutiny from its investors, who were troubled by claims “that cluster bombs made by Honeywell ‘lie unexploded in Lebanon and Southeast Asia, waiting to maim curious schoolchildren . . . .’”[220] The shareholders were concerned that, regardless of the truth of the accusations, “the Company is the target of at least two public vilification and pillory campaigns which could impact its public relations, its ability to recruit engineers and executives[,] and its ability to market its products.”[221] The Marianist Society and other religious groups owning shares in Honeywell submitted a shareholder proposal asking the company to submit a plan for diversifying its manufacturing away from, inter alia, cluster munitions (and toward the manufacture of civilian products).[222] Honeywell sought to exclude the proposal as relating to ordinary business operations.[223] The SEC Staff refused Honeywell’s request for no-action relief and took the position that the proposal could not be excluded.[224]

IV. THE BUSINESS JUDGMENT RULE SHOULD NOT APPLY TO DECISIONS THAT IMPLICATE A SIGNIFICANT SOCIAL POLICY ISSUE

Here, I will explain why the business judgment rule should not apply to decisions that implicate the significant social policy issues highlighted in Part III. To help illustrate my point, I will use the hypothetical of a board’s decision to build a power generation plant, which implicates the significant social policy issue of climate change (please note that the same arguments would apply, albeit with some

[219] *See* Honeywell, Inc., SEC Staff No-Action Letter, 1988 SEC No-Act. LEXIS 247, *1 (Feb. 24, 1988) [hereinafter Honeywell No-Action Letter] (denying no-action relief to Honeywell, Inc.); *see also* General Electric, SEC Staff No-Action Letter, 2001 SEC No-Act. LEXIS 62, *1–2 (Jan. 16, 2001) [hereinafter GE No-Action Letter]. This is an interesting matter where GE tried to exclude such a proposal as substantially implemented and did not even try to argue it interfered with ordinary business operations.

[220] Honeywell No-Action Letter, *supra* note 219, at *20–21.

[221] *Id.* at *21.

[222] *Id.* at *2, *20–21.

[223] *Id.* at *2–3.

[224] *Id.* at *1. An interesting note, in 2001, General Electric received the following proposal from shareholders: “RESOLVED that the shareholders request GE management to establish a firm policy to renounce future involvement in . . . cluster bomb production.” GE No-Action Letter, *supra* note 219, at *2. GE tried to argue that it should be excluded as substantially implemented (14a-8(i)(10)) because “GE does not make landmines or cluster bombs, nor does it make parts or components of landmines or cluster bombs.” *Id.* The SEC Staff disagreed and required that the proposal be included. *Id.* at *1.

modification, to decisions that implicate other significant social policy issues, such as human rights).

Imagine a situation where the board of directors of a utility company must decide what kind of power generation plant to build. The board is free to choose among the available alternatives: retaining the status quo (no new plant); coal-fired or natural gas-fired (which would contribute to climate change); or solar, wind, or hydroelectric (which would not contribute to climate change).[225] Now assume that after deliberation, the directors decide to construct a new coal-fired power generation plant.

Thereafter, a group of shareholders seek an injunction. They claim that the board of directors violated its fiduciary duty of care.[226]

Such an action would almost certainly be dismissed under the business judgment rule. The decision to expand or build a new power generation plant is a quintessential business judgment.[227] A close analogy would be the important case of *Dodge v. Ford*, where the Michigan Supreme Court held that the board's decision to use its extraordinary cash surplus to expand its manufacturing plant was an

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[225] *See* ENVIRONMENT BASELINE, *supra* note 175, at 4 (breaking down carbon dioxide emissions by power plant type).

[226] While I am unaware of any such cases in the United States, such a case was recently filed in Poland. *See* Alice Garton, Marcin Stoczkiewicz & Peter Barnett, *Briefing, Ostrołęka C: Energa's and Enea's Board Members' Fiduciary Duties to the Companies and Shareholders*, CLIENTEARTH (Sept. 20, 2018), http://blogs2.law.columbia.edu/climate-change-litigation/wp-content/uploads/sites/16/non-us-case-documents/2018/20180920_Not-Available_na-1.pdf.

[227] *See* Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919) (refusing to enjoin construction of plant); Troy A. Paredes, *The Firm and the Nature of Control: Toward a Theory of Takeover Law*, 29 J. CORP. L. 103, 162 (2003) ("[The decision to] build a new factory or enter into a new line of business . . . falls squarely within the board's control."); Thomas Joo, *Global Warming and the Management-Centered Corporation*, 44 WAKE FOREST L. REV. 671, 680 (2009) ("Regardless of whether it would be a poor business judgment to forego the 'green' market, it would nonetheless be a business judgment and as such it would not be actionable by shareholders under state corporation law."). Also, consider the analogous situation of a nuclear power plant. While there have been no shareholder lawsuits challenging the construction of nuclear power plants in the United States, there is little doubt that any such challenge would fail under the current articulation of the business judgment rule. Professor Ramseyer points out that when such lawsuits were commenced in Japan (where there is a long history of opposition to nuclear power), those lawsuits have been dismissed under the Japanese equivalent to the business judgment rule. *See* J. Mark Ramseyer, *Nuclear Power and the Mob: Extortion in Japan*, 13 J. EMPIRICAL LEGAL STUD. 487, 500 (2016); *see also* Shiro Kawashima & Susumu Sakurai, *Shareholder Derivative Litigation in Japan: Law, Practice, and Suggested Reforms*, 33 STAN. J INT'L L. 9, 43 (1997) ("In *Chubu Electric Power*, the shareholders initiated a derivative action to prevent the power company from constructing a nuclear power plant.").

exercise of business judgment that would not be disturbed.[228] (True, the Court also held that the board abused its business judgment when it did not declare a special dividend, but that was only because not all of the cash surplus was used to expand its manufacturing plant.[229])

We must remember, however, that "the 'business judgment' rule is a judicial creation,"[230] and each exception to the business judgment rule is likewise a judicial creation.[231] It would be entirely proper for a court to hold that the business judgment rule does not shield the decision of the board of directors where it implicates a significant social policy issue based on two interrelated arguments:

Argument 1. Shareholder expectations define the "ends" of the fiduciary duty of care. For regular decisions (those that do not implicate a significant social policy issue), shareholders expect directors to choose the course of action that maximizes financial return. For decisions that do implicate a significant social policy issue (such as (1) the environment and/or (2) human rights), the "ends" will be more nuanced. (For example, shareholders may expect that directors maximize financial return, but not at the expense of (1) the environmental and/or (2) human rights.[232])

Argument 2. If the "ends" of the fiduciary duty of care are more nuanced (i.e., shareholders expect that directors do more than look beyond maximization of returns), then it is not appropriate to apply the business judgment rule because (1) directors do not have special expertise regarding all of the "ends" implicated,[233] and (2)

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[228] *Dodge*, 170 N.W. at 684.

[229] *Id.* at 685 (finding the refusal to declare a dividend an abuse of discretion).

[230] Zapata Corp. v. Maldonado, 430 A.2d 779, 782 (Del. 1981).

[231] Shaunna L. Wollpert, MM Companies, Inc. v. Liquid Audio Inc.: *Determination of the Review Standard When Directors' Defensive Measure Impedes Shareholders' Right to Vote*, 29 DEL. J. CORP. L. 175, 182 (2004) ("Despite the business judgment rule's evidentiary burden on the moving party, the protections of the business judgment rule are not absolute, and there are some court-created exceptions to the general rule.").

[232] *See infra* Section IV.A. Interestingly, one could argue that there is no conflict between maximizing profits and avoiding harm to the environment (or, for that matter, avoiding human rights abuses). *See* David B. Spence, *Corporate Social Responsibility in the Oil and Gas Industry: The Importance of Reputational Risk*, 86 CHI.-KENT L. REV. 59, 68 (2011) ("Customers may be willing to pay a premium for 'green' electricity or oil that comes from a relatively green oil company . . . ."); Truzaar Dordi & Olaf Weber, *The Impact of Divestment Announcements on the Share Price of Fossil Fuel Stocks*, 11 SUSTAINABILITY 3122, 3123 (2019) (suggesting reputational harm would place downward pressure on their share price).

[233] *See infra* Section IV.C.

shareholders cannot diversify away the risk of environmental harm or human rights harm.[234]

A. *Shareholder Expectations Define The "Ends" Of The Fiduciary Duty Of Care*

The generally accepted version of the fiduciary duty of care requires that directors use appropriate means (e.g., fully informing themselves prior to making the decision) toward accepted ends (e.g., maximizing return to shareholders).[235] If the accepted end in this means-ends analysis is maximizing return to shareholders, then business judgment rule deference makes sense. After all, as discussed in Part II, directors are uniquely equipped to assess which course of action will maximize returns to shareholders.

However, the foregoing begs a fundamental question: why is maximizing return to shareholders the accepted end? The most likely explanation is that because shareholders invest to make money. As stated in *Dodge v. Ford*, maximizing returns to shareholders is consistent with those shareholders' "just expectations."[236] Specifically, in that case, the Dodge brothers "expect[ed] to obtain the profits of their investment in the form of regular dividends."[237] Ford's board of directors violated that expectation—and it follows, their fiduciary duty of care—when they decided not to declare a dividend, but instead use the profits to subsidize the price of automobiles (in the words of Henry Ford, "to spread the benefits of this industrial system to the greatest possible number . . . .").[238]

The same idea—that shareholder expectations set the proper ends for purposes of our means-ends analysis—is reflected in later work by Berle and Means.[239] In their landmark book, The Modern

[234] *See infra* Section IV.D.

[235] Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919) ("A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end . . . .").

[236] *See id.* at 682 (withholding a dividend from the shareholders "would defeat their just expectations" (quoting MORAWETZ ON CORPORATIONS (2d ed.), § 447)); David B. Guenther, *The Strange Case of the Missing Doctrine and the "Odd Exercise" of Ebay: Why Exactly Must Corporations Maximize Profits to Shareholders?*, 12 VA. L. & BUS. REV. 427, 485–86 (2018) (arguing that the *Dodge* decision was based on the court's understanding of shareholder expectations).

[237] *Dodge*, 170 N.W. at 682.

[238] *Id.* at 683.

[239] ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 243–44, 246–47 (1932); *see* William W. Bratton, *Berle and Means Reconsidered at the Century's Turn*, 26 J. CORP. L. 737, 763 (2001) (explaining that Berle

Corporation and Private Property, they explain that the corporation is characterized by owners' expectation of a financial return.[240] Owners entrust their money to management with the expectation that it will be used wisely, and dividends will be paid to them.[241]

From the foregoing, it follows that if shareholders expect wealth maximization, then wealth maximization is the proper end.[242] But it also follows that if shareholder expectations change or become more nuanced, so too should the ends that directors pursue.[243] I suggest that shareholder expectations of profits are in fact nuanced; they do not want profits derived from harming, by way of example, (1) health and the environment; or (2) human rights.[244]

Consider the first "nuance" to the general rule that shareholders want profits—i.e., that shareholders do not want profits derived from harming health or the environment—as an example. While one can safely assume that shareholders want a financial return, it is equally safe to assume that shareholders do not want a financial return at the expense of their own health. And such an expectation is not solely self-interested. Such an expectation is also based upon (or at least should be based upon) avoiding harm to the health of the broader public as well.

Likewise, human rights. Professor David Bayne, S.J., wrote in 1957, and it still rings true today, "[an investor] never can shirk a supervisory and secondary duty (not just a right) to make sure [their investment is] used justly, morally and beneficially."[245] More recently,

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and Means discussion of shareholder "expectations of fair dealing . . . went on to serve for decades as a primary justification for fiduciary duties in corporate legal theory.").

[240] BERLE & MEANS, *supra* note 239, at 242–44, 246–47.

[241] *Id.*

[242] Arthur Acevedo, *Responsible Profitability? Not On My Balance Sheet!*, 61 CATH. U. L. REV. 651, 696 (2012) ("[P]rofit maximization . . . is what the law requires and what shareholders expect.").

[243] I am not the first to suggest that the contours of the fiduciary duty should follow shareholder expectations. *See* John C. Carter, *The Fiduciary Rights of Shareholders*, 29 WM. & MARY L. REV. 823, 841 (1988) (When courts apply fiduciary duties, the "justifiable expectations of the shareholders in a publicly held corporation . . . should be protected."); Therese H. Maynard, *Spinning in a Hot IPO-Breach of Fiduciary Duty or Business as Usual?*, 43 WM. & MARY L. REV. 2023, 2083–84 (2002) (suggesting that default fiduciary duty rules should reflect what shareholders reasonably expect).

[244] One problem with such nuanced expectations is what those expectations actually are. Philip C. Sorensen, *Discretion and Its Limits—An Analytical Framework for Understanding and Applying the Duty of Care to Corporate Directors (and Others)*, 66 WASH. U. L. Q. 553, 584–85 (1988) (discussing that while the theoretical basis for the duty of care is shareholder expectations, courts seem unwilling to revisit what those expectations actually are, and are happy to stick with wealth maximization due to its ease of application).

[245] Bayne, *supra* note 17, at 579.

in 2020, Pope Francis observed that, "in the effort to amass wealth," investors should avoid doing so through "exploitation."[246]

Professor Santiago Mejia does important work on the theoretical foundations of moral obligations transferring from shareholder to director: at the same time that the director (agent) pursues profit on behalf of the shareholder (principal), the director is bound by many, but not all, of the shareholder's moral obligations.[247] That is to say, many, but not all, of the shareholder's moral obligations carry over to the director.[248] (This is a natural corollary to agency law that is often overlooked by legal scholars.)

Professor Mejia created a two-part test for determining which moral obligations "roll over" from shareholder to director: (1) it must be a moral obligation implicated by the business the corporation is engaged in; and (2) it must be a moral obligation that the shareholder would want the director to discharge on her behalf.[249] Professor Mejia's proposed framework is important because it requires directors—consistent with shareholder duties (and expectations)—to make decisions consistent with shareholders' moral expectations.

B. *A Different Decision-Making Process for The Board of Directors: Multiple Ends Analysis*

For the reasons listed above, a decision that implicates a significant social policy issue is exactly the kind of decision where shareholder expectations are likely to be more nuanced. Because shareholder expectations are more nuanced, the ends in our means-ends analysis must be more nuanced as well.

Returning to our hypothetical decision to build a power generation plant, the board of directors will be required to build a profitable plant while avoiding health and environmental harm. To those, I add a third "nuance" to shareholders' expectation of wealth maximization: avoiding reputational harm.[250]

[246] Pope Francis, Address of His Holiness Pope Francis to the Committee of Experts from the European Council (Oct. 8, 2020), https://www.vatican.va/content/francesco/en/speeches/2020/october/documents/papa-francesco_20201008_comitato-moneyval.html.

[247] Santiago Mejia, *Weeding Out Flawed Versions of Shareholder Primacy: A Reflection on the Moral Obligations that Carry Over from Principals to Agents*, 29 BUS. ETHICS Q. 519, 520 (2019).

[248] *Id.*

[249] *Id.* at 528.

[250] Causes of action claiming that directors breached their fiduciary duty of care by causing reputational harm to the corporation are not entirely unique. But previous causes of action claiming reputational harm have been based on financial loss, not violation of shareholder expectations. *See generally* Beam v. Stewart, 845 A.2d 1040

While the board of directors can examine profitability using traditional business analysis,[251] examining health, environmental harm, and reputational harm requires policy analysis. I call the combination of business analysis and policy analysis "Multiple Ends Analysis."[252] The Multiple Ends Analysis process is illustrated in the chart below.

Chart 4
Multiple Ends Analysis
(policy analysis components in ***bold italic***)[253]

1	**Identify problem**	Corporation needs to produce more power to meet demand
2	**Specify ends** (this is a list of desirable ends based on shareholder expectations)	• Provide power • Seek profitability • ***Avoid harm to health and the environment*** • ***Avoid reputational harm***
3	**Decide on criteria** (these criteria are used to measure whether the ends are met)	• Provide power: megawatts • Seek profitability: dollars • ***Avoid harm to health and the environment: use both quantitative and qualitative assessment techniques*** • ***Avoid reputational harm: use both quantitative and qualitative assessment techniques***

(2004); Cement-Lock v. Gas Tech. Inst., No. 05C0018, 2007 U.S. Dist. LEXIS 83748, at *27 (N.D. Ill. Nov. 8, 2007).

[251] For a discussion of how business decision-makers decide whether to pursue a project, see ASWATH DAMODARAN, APPLIED CORPORATE FINANCE 162–224 (2d ed. 2005) (analyzing profitability of building a factory to produce linerboard). For a broader explanation of business decision-making, see generally Earnest R. Archer, *How to Make a Business Decision: An Analysis of Theory and Practice*, 69 MGMT. REV. 54, 55–59 (1980).

[252] For an explanation of policy analysis, see Warren E. Walker, *Policy Analysis: A Systematic Approach to Supporting Policymaking in the Public Sector*, 9 J. MULTI-CRITERIA DECISION ANALYSIS 11, 14–18 (2000) (using an eight-step process).

[253] This chart combines considerations used in a traditional profit analysis, *see* DAMODARAN, *supra* note 251, with considerations used in public policy analysis. *See id.* at 14–16.

4	**Select alternatives**	• No new plant • Coal • Natural gas • Solar • Wind • Hydroelectric
5	**Analyze alternatives** (this involves doing the actual measurement)	• Provide power: measure the output of each alternative in megawatt • Seek profitably: compare the costs (building) to the future revenue (from sale of power); use discounted cash flow ("DCF") analysis to bring future revenue to present value • ***Avoid harm to health and the environment: can be measured quantitatively (using damage cost avoided, substitute cost),***[254] ***but also requires qualitative tools, including interviews and focus groups*** • ***Avoid reputational harm: measure reputational impact of each alternative using qualitative tools, including interviews and focus groups***
6	**Compare alternatives**	Compare how each of the alternatives meets each of the ends. Compare tradeoffs to determine the best choice.
7	**Implement chosen alternative**	Build the power-generation facility that best meets the ends (or if the decision was to stick with the status quo, no power-generation facility).
8	**Monitor and evaluate results**	Is the new power-generation facility meeting the ends? If not, the decision may have to be reexamined.

[254] *See* Brent J. Horton, *Terra Incognita: Applying the Entire Fairness Standard of Review to Benefit Corporations*, 22 U. PENN. J. BUS. L. 842, 886–89 (2020) (discussing possible methods for quantifying environmental harm).

C. *The Expertise Rationale for the Business Judgment Rule Applies with Significantly Less Force When the Board is Applying Multiple Ends Analysis*

As we think about how a board of directors would conduct Multiple Ends Analysis, it becomes clear that the board of directors will have some (but not all) of the required expertise.

1. Expertise Regarding the First End: Seek Profitability

First, the board of directors will need to make sure the power plant is profitable. On this issue the board does have superior expertise for the many reasons discussed in Section II.B.

2. Expertise Regarding the Second End: Avoid Health and Environmental Harm

The second end is avoiding harm to health and the environment. Here, an analogy can be drawn to the case of the Netherlands deciding whether it should build a new airport to meet increased demand and, if so, where.[255] Professor Warren E. Walker describes how he was approached by the Dutch government to conduct a policy study, part of which was estimating the relative safety of each option. Options included the base case (i.e., doing nothing), or building a new airport in a densely populated area, in a sparsely populated area, in the sea, in a lake, or at the border.[256]

Professor Warren evaluated impacts on safety and natural settings qualitatively.[257] Likewise, in our power generation plant hypothetical, we should estimate the effects on health and the environment qualitatively (although quantitative estimates may certainly play a role as well).

Qualitative analysis is important because some costs to health and the environment are difficult to quantify.[258] Not every impact can be reduced to a number. For example, by interviewing those directly affected by similar decisions (by this company or one of its competitors), we can gain an understanding of the impact of similar decisions.[259] For example, if a competitor recently built a coal-fired power plant, how did it impact community health? What was the impact on the environment?

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[255] *See* Walker, *supra* note 252, at 19.

[256] *See id.*

[257] *Id.* at 15.

[258] *See* Exec. Order No. 13,563, 76 Fed. Reg. 3821 (Jan. 18, 2011) (recognizing that some benefits and costs are difficult to quantify).

[259] Sara Sternberg Greene, *The Bootstrap Trap*, 67 DUKE L.J. 233, 242 (2017).

Further, even where an impact to health or the environment can be reduced to a number, "[b]y engaging intimately with individuals directly affected by laws, policies, and systems, qualitative work adds context and nuance to [those numbers]."[260] That is why the National Environmental Policy Act (NEPA),[261] which governs decision-making by federal agencies,[262] requires that government agencies evaluate the environmental impact of a project in both quantitative and qualitative terms.[263] Specifically, the implementing regulation requires that when the environmental impact statement includes a quantitative analysis, it also must "discuss the relationship between that [quantitative] analysis and any analyses of unquantified environmental impacts . . . ."[264]

And here, a quick clarification may be in order: it is not my intent to disparage directors as single-mindedly focused on money, or unable to engage in qualitative analysis. Every year, business schools are getting better at training them to do so.[265] What I am saying is that directors do not have any special expertise regarding qualitative analysis of health or environmental harm. Deference to directors regarding their assessment of health or environmental harm is not justified by special expertise.

[260] Kate Sablosky Elengold, *The Investment Imperative*, 57 HOUS. L. REV. 1, 26 (2019).

[261] National Environmental Policy Act of 1969, Pub. L. No. 91-190, 83 Stat. 852 (1969) (codified as amended at 42 U.S.C. §§ 4321-70f).

[262] I use the word "generally" because NEPA only applies to "major federal action." 42 U.S.C. § 4332(C); *see* Winnebago Tribe of Neb. v. Ray, 621 F.2d 269, 270 (8th Cir. 1980) (finding that private construction of power transmission line was not "major federal action"). Under some circumstances, however, a private action may qualify as a "major federal action" if "the project receives significant federal funding; [or where] the federal agency must undertake 'affirmative conduct' before the non-federal actor may act." Mineral Pol'y Ctr. v. Norton, 292 F. Supp. 2d 30, 54–55 (D.D.C. 2003); *see generally* David J. Hayes & James A. Hourihan, *NEPA Requirements for Private Projects*, 13 B.C. ENV'T. AFF. L. REV. 61 (1985) (discussing problems that arise when privately funded projects are found to involve "major federal action").

[263] 42 U.S.C. § 4332(A) (requiring an "interdisciplinary approach"); *see* 40 C.F.R. § 1502.23 (2002) (requiring qualitative analysis); Exec. Order No. 13,563, 76 Fed. Reg. 3821 (2011) (directing agencies to consider both quantitative and qualitative benefits and costs when making regulatory decisions).

[264] 40 C.F.R. § 1502.23 (stating further, "[f]or purposes of complying with the Act, the weighing of the merits and drawbacks of the various alternatives need not be displayed in a monetary cost-benefit analysis and should not be when there are important qualitative considerations").

[265] GUIDING PRINCIPLES, *supra* note 67, at 7 ("In achieving its mission and vision, AACSB emphasizes and models the values of quality, diversity and inclusion, a global mindset, ethics, social responsibility, and community.").

3. Expertise Regarding the Third End: Avoid Reputational Harm

The third end is protecting the corporation's reputation. History teaches us that directors are woefully inadequate at assessing harm to their company's reputation caused by controversial decisions. A fascinating case study about this appears in Why Napalm is a Cautionary Tale for Tech Giants.[266] In that article, Kevin Roose explains how Dow Chemical, which was widely known for household goods like Saran Wrap, suddenly became known for napalm.[267]

Dow's reputation was destroyed when it began to produce napalm for the Pentagon during the Vietnam War.[268] Dow became associated with nightly news images of children with horrific napalm burns.[269] That reputational harm haunted Dow for decades.[270] Roose writes that "[Dow's] marketing department was forced to embark on a long and expensive campaign to win back the public's trust."[271]

It was a reputational harm that the Dow directors—for all their training and experience—significantly underestimated.[272] To the extent that the directors did foresee reputational harm, they thought about it in purely quantitative terms.[273] They thought (wrongly) that the harm would be proportionate to the napalm contract's value, i.e., the reputational harm would be small because "napalm was a small part of the company's overall business."[274]

Qualitative analysis—i.e., listening to early signs of opposition through interviews and focus groups[275]—would have revealed to the directors the kind of backlash they could expect.[276] But qualitative analysis is not directors' expertise.[277]

As is the case with qualitative assessment of health and environmental harm, directors do not have any special expertise regarding qualitative analysis of reputational harm. Again, deference

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[266] *See generally* Kevin Roose, *Why Napalm Is a Cautionary Tale for Tech Giants*, N.Y. TIMES, Mar. 6, 2019, at B1.

[267] *Id.*

[268] *Id.*

[269] *Id.*

[270] *Id.*

[271] *Id.*

[272] Roose, *supra* note 266, at B1.

[273] *Id.*

[274] *Id.*

[275] Interviews and focus groups are classic qualitative methods. *See generally* BILLUPS, *supra* note 5.

[276] Roose, *supra* note 266, at B1.

[277] *See supra* Section II.B.

to directors regarding their assessment of reputational harm is not justified by special expertise.

4. Information Gathering

Even where a decision implicates a significant social policy issue, directors are more likely to ask for quantitative data to assist them in the decision-making process (after all, ther is what they are most comfortable with).[278] Unfortunately—yet interestingly—one study found that when subordinates report quantitative probability assessments (as opposed to qualitative probability assessments) to higher-ups, the probability assessments are more likely to turn out wrong.[279] That means that when a decision-maker asks for quantitative assessments of future events—such as impacts on health or the climate—they may be making the decision based on less accurate information.[280]

Finally, even if directors did want qualitative data, they may have difficulty accessing it. Pretend this was a problem that called only for examination of the first end (making a profit). The board of directors would have access to all the information necessary to conduct such an analysis.[281] For example, to determine the future net cash flows of a project, the board of directors, as sovereign of the corporation, can order management to provide them with the necessary information.[282] As Professor Bainbridge points out in describing the board of directors as a sovereign that has access to information by fiat, "[i]nformation flows up a branching hierarchy to a central office."[283] Thereafter "binding decisions flow back down."[284]

The board, however, has no superior access to the qualitative data necessary to evaluate health or environmental impacts. Directors

[278] Even those who make policy for a living tend to believe that correct decisions can be reached using "improved technical skills" and sometimes lose sight of the fact that "[other c]ompetencies usually considered 'softer'—imagination, judgment, interpretive skills—are just as important." *See* Walker, *supra* note 252, at 26.

[279] Jeffrey A. Friedman, Jennifer S. Lerner & Richard Zeckhauser, *Behavioral Consequences of Probabilistic Precision: Experimental Evidence from National Security Professionals*, 71 INT'L ORG. 803, 817 (2017).

[280] *Id.* at 817. Interestingly, the same study implied that decision-makers seem to recognize that they are getting inaccurate (or at least misleading) information, and compensate for it by seeking more information. *Id.* at 814–15.

[281] Bainbridge, *supra* note 26, at 124.

[282] The net income of current plants is already determined and aggregated for purposes of preparing SEC filings. *See* Duke Energy Ohio, Inc., Annual Report (on Form 10-K), at 22 (March 12, 2010) (disclosing net income).

[283] Bainbridge, *supra* note 26, at 124.

[284] *Id.*

(even if they are the sovereign of the corporation) cannot order members of the local community to provide them with information. They may have better luck with stakeholders with whom they have a preexisting relationship—such as shareholders, suppliers, and customers—but again, they do not have superior access that would justify the sort of deference required by the business judgment rule.

5. Some Conclusions Regarding Expertise

In short, the board of directors may have superior expertise in assessing the corporation's ability to meet the first end, profitability. But the board of directors does not have any superior expertise in assessing the corporation's ability to meet the second end, avoiding health and environmental harm, or the third end, avoiding reputational harm.

Further, assessing the second and third ends involves access to information not readily at the fingertips of directors or the corporation they lead. Under such circumstances, the superior expertise justification for the business judgment rule applies with less force, if at all.

D. *The Optimal Risk-Taking Rationale for the Business Judgment Rule Applies with Significantly Less Force When Applying Multiple Ends Analysis*

The second rationale for the business judgment rule (and the corresponding deference to director decisions) is that the rule encourages optimal risk-taking by directors.[285] Both shareholders and broader society are willing to defer to director risk-taking based on the assumption that the upside risk is greater than the downside risk.[286]

Shareholders consent to risk-taking by directors based on the assumption that the corporate liability shield will limit their downside risk (their loss is limited to their initial investment), as will portfolio diversification.[287] But neither a liability shield nor portfolio diversification will protect a shareholder from risk to their health or the environment.[288]

It is also doubtful that shareholders are willing to turn a blind eye while the directors of the corporation they (the shareholders) have

285 *See supra* Section II.D.

286 *See id.*

287 *See id.*

288 Namrita Kapur, *Investors Can't Diversify Away from Climate Risk*, FORBES (May 26, 2017, 10:29 AM), https://www.forbes.com/sites/edfenergyexchange/2017/05/26/investors-cant-diversify-away-from-climate-risk/?sh=105dc30e49de.

funded take risks with the health of others or the environment that others enjoy. They will want to take an active role in such decision-making, thus undercutting any argument in favor of deference.

Society more broadly consents to director risk-taking because most ordinary business decisions present very little downside risk. For example, when "IBM . . . bet the company—spending more than the cost of the Manhattan Project—to develop the IBM 360,"[289] the worst-case scenario for society was an IBM bankruptcy, and a slight uptick in the unemployment rate. But the downside risk for decisions that implicate significant social policy issues is potentially greater. In the case of our hypothetical, the downside risks include increased disease, droughts and heat waves, and rising sea levels.[290]

V. PROPOSAL: THE SIGNIFICANT SOCIAL POLICY ISSUE EXCEPTION TO THE BUSINESS JUDGMENT RULE

If it is not appropriate to apply the business judgment rule to a decision that implicates a significant social policy issue, then what standard of review should the court apply? In Delaware, at first look, there are two ends of the spectrum: the business judgment rule (which we have ruled out) and entire fairness.[291] But entire fairness also does not seem appropriate, for two reasons. First, it is often outcome determinative; it would be very difficult for a director decision to pass scrutiny (that is to say, it swings the pendulum too far in the other direction).[292] Second, while the entire fairness test does examine fair process, the emphasis is the fair price of a given transaction.[293] Yet in the significant social policy issue context, the shareholders' concern is not receiving a fair price for a transaction. Instead, their expectation is that the decision will lead to profit while also not unduly harming the environment or posing a threat to human rights.

Fortunately, Delaware courts have shown a willingness to adopt standards of review between the extremes of business judgment and

[289] Hu & Westbrook, *supra* note 136, at 1381.

[290] *The Effects of Climate Change*, NAT'L AERONAUTICS & SPACE ADMIN., http://climate.nasa.gov/effects/ (last visited Feb. 12, 2021); *see* Jody Freeman & Andrew Guzman, *Climate Change and U.S. Interests*, 109 COLUM. L. REV. 1531, 1581 (2009) (discussing links between climate change and increased disease).

[291] Julian Velasco, *Structural Bias and the Need for Substantive Review*, 82 WASH. U. L.Q. 821, 840 (2004).

[292] Stephen M. Bainbridge, *Unocal at 20: Director Primacy in Corporate Takeovers*, 31 DEL. J. CORP. L. 769, 795 (2006).

[293] Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983) ("[W]e recognize that price may be the preponderant consideration outweighing other features of the merger.").

entire fairness.[294] This is especially true, as is the case here, where the policy rationales for the business judgment rule apply with significantly less force.

A. *The Enhanced Scrutiny Test (And Why It Fits Here)*

In the 1980s, there was a wave of hostile takeovers.[295] The corporate raider—e.g., Carl Icahn or T. Boone Pickins—would purchase a company and then sell off its parts.[296] In response, boards of directors of target corporations began putting in place defensive measures designed to fend off the raider (such as poison pills, lockups, or stock repurchases).[297]

When corporate raiders challenged these defensive measures, courts reviewed them under the very deferential business judgment rule, which generally led to victory for the boards of directors implementing the defensive measures.[298] That changed (the standard, not the outcome) with *Unocal v. Mesa Petroleum Co*.[299] In that case, Pickins' company, Mesa, engaged in a coercive two-tier "front loaded" tender offer for Unocal's shares at fifty-four dollars per share.[300] In response, the Unocal board approved a self-tender offer for the shares at seventy-two dollars per share.[301] (The self-tender offer would require Unocal to take on a large amount of debt, making it less attractive to the corporate raider.[302])

Mesa challenged the defensive measures in court, arguing that the board violated its fiduciary duties by, inter alia, approving the self-tender offer.[303] Conceptually, the Supreme Court of Delaware situated the case somewhere between a duty of care case (requiring business

[294] *See In re* Dollar Thrifty S'holder Litig., 14 A.3d 573, 597 (Del. Ch. 2010) ("Avoiding a crude bifurcation of the world into two starkly divergent categories—business judgment rule review reflecting a policy of maximal deference to disinterested board decisionmaking and entire fairness review reflecting a policy of extreme skepticism toward self-dealing decisions—the Delaware Supreme Court's *Unocal* and *Revlon* decisions adopted a middle ground.").

[295] John C. Coffee, Jr., *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1, 3 (1986).

[296] *Id.* at 3 ("[They] intend[] not to assimilate the target, but to dismantle it.").

[297] *Id.* at 6, 64 n.175.

[298] Pogostin v. Rice, 480 A.2d 619, 627 (Del. 1984).

[299] *See* Unocal v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

[300] *Id.* at 949.

[301] *Id.* at 951.

[302] *Id.* at 950 ("The cost of such a proposal would cause the company to incur $6.1-6.5 billion of additional debt.").

[303] *Id.* at 953.

judgment deference) and a duty of loyalty case (requiring a showing of entire fairness).[304] The Court began by stating:

> [in the takeover context] a board's duty is no different from any other responsibility it shoulders, and its decisions should be no less entitled to the respect they otherwise would be accorded in the realm of business judgment.[305]

The Court, however, went on to state a very important caveat:

> We must bear in mind the inherent danger in the purchase of shares with corporate funds to remove a threat to corporate policy when a threat to control is involved. The directors are of necessity confronted with a conflict of interest, and an objective decision is difficult.[306]

So, the Court concluded:

> Because of the omnipresent specter that a board may be acting primarily in its own interests [to entrench itself], . . . there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred.[307]

The above referenced enhanced judicial examination has two parts.[308] It requires that the directors show (i) that they undertook a reasonable investigation, and (ii) that the chosen defensive mechanism was reasonable in relation to the threat posed.[309] The Court held that the Unocal board met its burden by reaching the well-supported conclusion that the Mesa offer was inadequate, and that the self-tender offer was a proportionate response.[310] (It must be emphasized that *Unocal*, in addition to rejecting business judgment deference, placed the initial burden of proof on the board of directors to "at minimum convince the court that they have not acted for an inequitable purpose."[311])

Why should the intermediate standard of enhanced scrutiny be used (or modified for use) in the context of decisions that implicate a significant social policy issue? In *Blasius Industries, Inc. v. Atlas Corp.*, the Court of Chancery decided that the business judgment rule should be replaced with the intermediate standard of enhanced scrutiny when

[304] *Id.* at 954–55.
[305] *Unocal*, 493 A.2d*.* at 954.
[306] *Id.* at 955.
[307] *Id.* at 954.
[308] *Id.* at 958–59.
[309] *Id.*
[310] *Id.*
[311] Mercier v. Inter-Tel (Del.), Inc., 929 A.2d 786, 807 (Del. Ch. 2007).

public policy requires it.[312] In *Blasius*, protecting the sanctity of the shareholder vote outweighed traditional public policies in favor of application of the business judgment rule.[313] (The corporation tried to argue that "packing" the board of directors was a valid exercise of business judgment.[314]) Likewise, where a decision implicates a significant social policy issue, rationales in favor of enhanced scrutiny (shareholder input regarding policy issues) are strong,[315] while rationales in favor of the business judgment rule (i.e., deference to expertise and encouraging risk-taking) apply with significantly less force.[316]

Second, plaintiffs challenging a decision that implicates a significant social policy issue will not be seeking monetary damages. They will be seeking a change in the decision itself, usually in the form of injunctive relief. As commentators have pointed out, "courts apply enhanced scrutiny liberally in actions for injunctive relief . . . ."[317]

Third, even if the action does not result in an injunction, the fact that the court applies enhanced scrutiny requires the board to communicate to the court (and thus, the shareholders) the information it relied on to make the decision and why that decision fits within a range of reasonable alternatives, enhancing the credibility of the decision.[318] As mentioned in the Introduction, this prevents the board of directors from bypassing shareholder input when making decisions regarding important policy matters (such as decisions that implicate climate change; human rights, including forced- or child-labor and free speech; or indiscriminate weapons).[319]

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[312] Blasius Indus, Inc. v. Atlas Corp., 564 A.2d 651, 659–60 (Del. Ch. 1988) (finding that the business judgment rule should not be applied where "ordinary considerations to which the business judgment rule originally responded are simply not present . . . ."); *see* Velasco, *supra* note 291, at 840 (suggesting the use of a middle-ground test where the decision is plagued by structural bias).

[313] *Blasius*, 564 A.2d. at 659–60.

[314] *Id.* at 657–58.

[315] *See supra* Section IV.A (discussing a shareholder's duty to make sure the board uses their (the shareholder's) investment morally).

[316] *See supra* Sections IV.C, IV.D.

[317] Clark W. Furlow, *Reflections on the Revlon Doctrine*, 11 U. PA. J. BUS. L. 519, 522 (2009); *see* Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 312 (Del. 2015) ("*Unocal* and *Revlon* are primarily designed to give stockholders and the Court of Chancery the tool of injunctive relief to address important M & A decisions in real time, before closing.").

[318] Paramount Commc'ns v. QVC Network, 637 A.2d 34, 45 (Del. 1993).

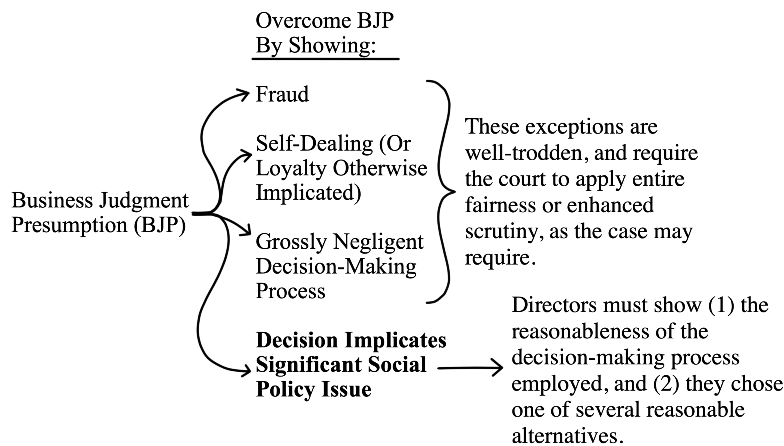
[319] *Id.*

B. *Modifying the Enhanced Scrutiny Test for Board Decisions that Implicate a Significant Social Policy Issue*

For our purposes, a slightly different formulation of the enhanced scrutiny test is appropriate (as compared to the version used in the defensive measures context). First, the shareholder challenging the decision must show that the decision implicates a significant social policy issue. Thereafter, the burden would shift to the board of directors to demonstrate (1) the reasonableness of "the decisionmaking process employed by the directors, including the information on which the directors based their decision;" and (2) "the reasonableness of the directors' action in light of the circumstances then existing."[320]

In judging the second prong, the court should show some deference (albeit not to the level of business judgment deference) to the reasonableness of the decision itself. As the Delaware Supreme Court in *Paramount Communications v. QVC Network* wrote: "[A] court applying enhanced judicial scrutiny should be deciding whether the directors made a reasonable decision, not a perfect decision."[321] If the board chose "one of several reasonable alternatives" the court should not grant the injunction.[322] A visualization of this modified enhanced scrutiny test is provided below.

Chart 5.
How Proposal Fits Within Current Legal Framework



[320] *Id.*
[321] *Id.*
[322] *Id.*

How would the modified enhanced scrutiny test apply to our hypothetical scenario? If the board decides to build a coal-fired power plant (or gas-fired power plant, or any other kind of power plant that the shareholder plaintiff believes contributes to climate change), the shareholder plaintiff would bring a lawsuit seeking to enjoin the construction. The shareholder plaintiff must show that building a coal-fired power generation plant implicates a significant social policy issue. If they are successful, the burden would then shift to the board of directors to show that it engaged in a reasonable decision-making process, and that the board acted reasonably considering the circumstances then existing.

1. Plaintiff Shareholders Have the Initial Burden

The reality is that "significant social policy issue" is hard to define. Fortunately, we can borrow from 14a-8 case law and SEC no-action letters.[323] If a matter falls into one of the specified categories—or is significantly like a matter that falls into one of the categories—it is a "significant social policy issue." (There is precedent for using a category approach; it is akin to the "family resemblance" used by securities lawyers to determine when notes are securities.[324]) In Part III above, I pointed out many categories that are considered significant social policy issues, including human rights, indiscriminate weapons, and decisions to build power generation plants (implicating climate change).

Returning to our hypothetical scenario, what would the plaintiff shareholders need to show to shift the burden to the board of directors?

a. The plaintiff shareholders must identify (i) the decision being made by the board of directors, and (ii) the implicated significant social policy issue. Here, the decision is what kind of power generation plant to build, and the significant social policy issue is climate change.

b. The plaintiff must show a connection between the two. A foreseeability analysis seems appropriate.[325] Can the decision-maker foresee the decision implicating the

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[323] *See supra* Part III.

[324] *See* Reves v. Ernst & Young, 494 U.S. 56, 64–65 (1990) (adopting the family resemblance test).

[325] Foreseeability is one of the most adaptable tools in legal analysis. *See* Shyamkrishna Balganesh, *Foreseeability and Copyright Incentives*, 122 HARV. L. REV. 1569, 1594–1600 (2009) (discussing the many applications of foreseeability).

significant social policy issue?[326] Here, one can foresee that the decision to build a power generation plant would implicate climate change.

c. The plaintiff shareholders must show that the social policy issue in question is indeed significant. Here, as discussed in Part III above, they could rely on what various federal courts and SEC staff have indicated is significant. Here, there is a plethora of no-action letters holding that climate change is a significant social policy issue.

2. The Burden Shifts to the Board of Directors

Once the burden of proof shifts to the board of directors, the first thing that the directors will need to establish is "the adequacy of the decision-making process employed . . . including the information on which [they] based their decision."[327] Because the matter implicates a significant social policy issue, the board should show that they considered ends *in addition to* profit maximization. For the reasons discussed in Section IV.B above, these ends would include avoiding harm to health and the environment and avoiding reputational harm. By way of example, as to the last end, the board of directors could review any number of studies regarding how each type of power generation plant impacts climate change.[328] They would learn that coal-fired plants release 210.20 pounds of carbon dioxide per million British thermal units ("Btu") produced, and natural gas-fired plants release 117 pounds of carbon dioxide per million Btu produced.[329] On the other hand, solar, wind, and hydroelectric are not significant sources of carbon dioxide.[330]

[326] The dictionary definition of "implicate" is "to entwine in or with." *Implicate, v.*, *OED Online* (Oxford University Press 2020), https://www.oed.com/view/Entry/92475?rskey=0EVSqI&result=2&isAdvanced=false#eid.

[327] *Paramount*, 637 A.2d at 45.

[328] ENVIRONMENT BASELINE, *supra* note 175, at 4 (breaking down carbon dioxide emissions by power plant type). In addition, the directors should review how the choice of power plant impacts human health. *See, e.g.*, Jonathan I. Levy, Lisa K. Baxter & Joel Schwartz, *Uncertainty and Variability in Health-Related Damages from Coal-Fired Power Plants in the United States*, 29 RISK ANALYSIS 1000 (2009); Muzhe Yang & Shin-Yi Chou, *The Impact of Environmental Regulation on Fetal Health: Evidence from the Shutdown of a Coal-Fired Power Plant Located Upwind of New Jersey*, 90 J. ENV'T ECON. & MGMT. 269 (2018); Julia Kravchenko & H. Kim Lyerly, *The Impact of Coal-Powered Electrical Plants and Coal Ash Impoundments on the Health of Residential Communities*, 79 N.C. MED. J. 289 (2018).

[329] ENVIRONMENT BASELINE, *supra* note 175, at 4.

[330] Carbon Dioxide Emissions Coefficients, U.S. ENERGY INFO. ADMIN. (Feb. 14, 2013), https://www.eia.gov/environment/emissions/co2_vol_mass.php.

As discussed in Section IV.C above, however, the board of directors should supplement any quantitative data with qualitative data to gain a deeper understanding of how their decision will impact the world. This can be accomplished with any number of qualitative tools, including interviews or case studies. The directors do not need to conduct such studies themselves (although they can); they may incorporate existing studies into the decision-making process. [331]

The final prong requires the directors to establish "the reasonableness of [their] action in light of the circumstances then existing."[332] Here, as stated in *Paramount*, the court should show some deference: it should simply ask if the board chose "one of several reasonable alternatives."[333]

In our example, while a coal-fired power generation plant may produce the most carbon dioxide, it may still be a reasonable alternative (even the most reasonable alternative). Let me illustrate: in 2013 the University of Alaska at Fairbanks ("UAF") faced a problem.[334] Its existing coal-fired power generation plant, built in 1964, was reaching the end of its fifty-year life span.[335] It was beginning to fail, and the University feared that the next breakdown could be catastrophic (Fairbanks winter temperatures can drop to minus-sixty degrees Fahrenheit).[336] Pipes would freeze, causing

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[331] The President's Council on Environmental Quality suggests that "qualitative . . . discussion of the impacts of GHG emissions [can be] based on authoritative reports such as the USGCRP's National Climate Assessments . . . ." Memorandum from Christina Goldfuss, Chair, Council on Env't Quality, to the Heads of Fed. Dep'ts & Agencies 10 (Aug. 1, 2016), https://obamawhitehouse.archives.gov/sites/whitehouse.gov/files/documents/nepa_final_ghg_guidance.pdf (citing U.S. GLOBAL CHANGE RESEARCH PROGRAM, CLIMATE SCIENCE SPECIAL REPORT, FOURTH NATIONAL CLIMATE ASSESSMENT, Volume I (2017)). Many utilities have already begun to conduct or participate in qualitative studies of how their own infrastructure may be impacted by climate change. *See* U.S. DEP'T ENERGY, A REVIEW OF CLIMATE CHANGE VULNERABILITY ASSESSMENTS: CURRENT PRACTICES AND LESSONS LEARNED FROM DOE'S PARTNERSHIP FOR ENERGY SECTOR CLIMATE RESILIENCE 15 (2016) ("For example, a qualitative risk assessment may examine generally how extreme weather events impacted transmission and distribution systems in the past or how future scenarios of climate change may impact different types of assets.").

[332] *Paramount*, 637 A.2d at 45.

[333] *Id.*

[334] *See* Tegan Hanlon, *UAF Coal-Fired Plant Briefly Knocked Offline*, ANCHORAGE DAILY NEWS, Oct. 30, 2013, at A4.

[335] *Id.*

[336] *See* Univ. of Alaska Fairbanks, *Combined Heat and Power Plant: Project Background*, https://www.uaf.edu/heatandpower/background.php [hereinafter *Project Background*] (discussing the impact of plant failure to university finances and infrastructure); Tim Bradner, *UAF Needs $200M Power Plant Replacement, Sooner Rather Than Later*, ALASKA J. COM. (Aug. 30, 2012), https://www.alaskajournal.com/business-and-finance/2012-08-31/uaf-needs-200m-power-plant-replacement-

hundreds of millions of dollars of damage.[337] The University (which ironically conducts a great deal of climate change research) could be required to close.[338]

The decision-makers at UAF looked at several possible alternative solutions, including coal, natural gas, solar, wind, and hydroelectric; they even looked at a small nuclear reactor.[339] But they chose a coal-fired power generation plant.[340] Natural gas would be cleaner, but natural gas is simply not available in Fairbanks.[341] Even if they could truck it in, it would cost three times more than coal.[342]

Of course, solar, wind, or hydroelectric would be cleaner, but they were all non-starters. As to solar, in the dead of winter, Fairbanks only gets three to four hours of sunlight a day.[343] As to wind, "[t]he wind doesn't blow much in Fairbanks."[344] They looked into hydroelectric, but that would depend on the construction of the Watana dam on the Susitna River.[345] The dam was facing opposition, and even if it was constructed, it wouldn't be in operation until 2022.[346] A small nuclear reactor would have been tied up in regulatory approvals for years.[347]

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sooner-rather-later (discussing extremely low temperatures in Fairbanks and how failure of power and heat plants would be catastrophic).

[337] *Project Background*, *supra* note 336.

[338] *Id.*

[339] Joe Ryan Bloomberg, *University of Alaska Opens First New US Coal-Fired Power Plant in Years*, CHARLESTON GAZETTE-MAIL, Feb. 12, 2019, at P6A; *see Project Background*, *supra* note 336 (click on "Did You Look At Other Options" under FAQs).

[340] Bloomberg, *supra* note 339, at P6A.

[341] *Id.* ("The oil and gas fields of the state's North slope are 500 miles north. The nearest major port is in Anchorage, 350 miles south.").

[342] *See* Matt Buxton, *UAF Chancellor Says Replacing* Power *Plant Worth the High Pricetag*, FAIRBANKS DAILY NEWS-MINER (Feb. 19, 2014), https://www.newsminer.com/news/local_news/uaf-chancellor-says-replacing-power-plant-worth-the-high-pricetag/article_52be2b84-9943-11e3-92dc-001a4bcf6878.html.

[343] *See* Bloomberg, *supra* note 339, at P6A; Explore Fairbanks, *What Winter Solstice Looks Like in Fairbanks, Alaska*, EXPLORE FAIRBANKS ALASKA (Dec. 20, 2017), https://www.explorefairbanks.com/blog/post/winter-solstice-fairbanks-alaska/ ("On the shortest day of the year – December 21st this year – Fairbanks will have about 3hrs 41mins when the sun is up.").

[344] Bradner, *supra* note 336.

[345] *Id.*

[346] *Id.*

[347] *See New Coal-Fired Plant to Replace Old Boilers at UAF*, THE N. LIGHT, UNIV. ALASKA – ANCHORAGE, Sept. 17, 2017 ("[W]e even looked at a nuclear option but that didn't work out so well."); Ravenna Koenig, *In Interior Alaska, Reinvestment in Coal Power Runs Counter to National Trend*, FAIRBANKS DAILY NEWS-MINER (Oct. 15, 2018), https://www.newsminer.com/news/alaska_news/in-interior-alaska-reinvestment-in-coal-power-runs-counter-to-national-trend/article_dcd3fbee-d0a4-11e8-aeea-e7683304c41c.html ("I didn't particularly want to go with nuclear.").

The decision, while difficult, was made somewhat easier by the fact that the new "cleaner" coal boilers would reduce particulates by 50 percent.[348] While carbon dioxide emissions would only be reduced by 3 percent, sulfur dioxide and nitrogen oxides (that together cause acid rain) are reduced by 60 and 64 percent, respectively.[349]

Of course, what is "one of several reasonable alternatives" may be very different in another geographic location. For example, in the southern United States, like southern California and Arizona, which receive more sunlight and less cloud cover. There, solar might be the most reasonable alternative.

VI. CONCLUSION

The business judgment rule is judge-made law.[350] It requires that judges defer to business decisions made by a board of directors.[351] The first justification for the rule is that judges are not business experts.[352] The second justification is that judges are hesitant to second-guess risk-taking on the part of the board of directors—because such risk-taking accrues to the benefit of shareholders (and even society more broadly).[353]

However, as judge-made law, the business judgment rule is subject to judge-made exceptions. For example, courts will get involved where (1) the directors have engaged in fraud; (2) it is shown that the directors have engaged in self-dealing, or their loyalty is otherwise called into question; or (3) the decision-making process was grossly negligent.[354] I propose to add the following to this list of exceptions: (4) the decision implicates a significant social policy issue.[355] Where the significant social policy issue exception is triggered, the directors must show (1) the reasonableness of the decision-making process employed, and (2) that they chose one of several reasonable alternatives.[356]

The reason for my proposed additional exception is straightforward: the traditional justifications for judicial deference to

[348] *Conditions Attached to University of Alaska Fairbanks Power Plant,* ALASKA J. COM. (May 8, 2014), https://www.alaskajournal.com/business-and-finance/2014-05-08/conditions-attached-ua-power-plant-railroad-funding.

[349] *Project Background*, *supra* note 336.

[350] Zapata Corp. v. Maldonado, 430 A.2d 779, 782 (Del. 1981).

[351] *See supra* Section II.A.

[352] *See supra* Section II.B.

[353] *See supra* Sections II.C, II.D.

[354] *See supra* Section II.A.

[355] *See supra* Part V.

[356] *See supra* Section V.B.

the board of directors (such as the board's expertise or encouraging optimal risk-taking) apply with significantly less force, if at all, to decisions that implicate significant social policy issues.[357] While such decisions still call for quantitative analysis of profitability, they also call for qualitative analysis of impacts on such matters as health and environment, or human rights.[358] While directors may have special expertise with regard to quantitative analysis, they do not have any special expertise with regard to qualitative analysis that justify judicial deference.[359]

Turning to optimal risk-taking, shareholders defer to directors' assessments of risk based upon the assumption that their downside risk is limited and financial in nature.[360] But risks raised by significant social policy issues (like climate change or human rights violations) cannot be diversified away,[361] nor are they purely financial.[362]

Further, an analogous area of law—exclusion of shareholder proposals as interfering with ordinary business operations of the corporation—has an exception to the exclusion for significant social policy issues.[363] Shareholders cannot be prevented from submitting proposals that implicate climate change, human rights (forced- or child-labor), or indiscriminate weapons.[364] It seems odd that a similar exception has not evolved in the area of business judgment rule jurisprudence, especially considering that, in reverse, the ordinary business operations exclusion evolved as an attempt to ensure that shareholder proposals were not used to end-run the business judgment rule.[365]

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[357] *See supra* Part IV.

[358] *See supra* Section IV.C.

[359] *See supra* Section IV.C.

[360] *See supra* Section II.D.

[361] *See supra* Section IV.D.

[362] *See supra* Section IV.D.

[363] *See supra* Section III.A.

[364] *See supra* Sections III.B, C, D.

[365] Rule 14a-8's ordinary business exclusion evolved from the business judgment rule itself. Here, the SEC response to a question posed by Senator Herbert H. Lehman in 1956 are instructive:

> Question: How does the Commission determine whether a proposal made by a stockholder under rule 14a-8 relates to the ordinary business operations of the issuer?
>
> Answer: The policy motivating the Commission in adopting the [ordinary business exclusion] is basically the same as the underlying policy of most State corporation laws to confine the solution of ordinary business problems to the board of directors . . . . The basic reason for this policy [i.e., the business judgment rule] is that it is manifestly

Finally, my proposal allows shareholders to force their way back into the corporate decision-making process, albeit through litigation. This is especially important when we consider that shareholders have been locked out of less "confrontational" means of influencing corporate behavior, such as the process for nominating directors (shareholders can vote for directors, but the vote is for a preordained slate of directors).[366] In closing, there is something especially disturbing about not allowing shareholders—who are the true owners of the corporation—to challenge board decisions regarding important policy matters,[367] such as decisions that implicate climate change, human rights, or indiscriminate weapons. This proposal remedies that problem.

> impracticable in most cases for stockholders to decide management problems at corporate meetings.

Hearings on SEC Enforcement Problems before a Subcommittee of the Senate Committee on Banking and Currency, 85th Cong., 1st Sess., pt. 1 at 118 (1957) (statement of SEC Chairman J. Sinclair Armstrong). In fact, the same SEC written responses explain that in deciding whether a matter is properly excludable, it must "examine[] the law of the state of incorporation to determine whether there is any statute or case law defining what is meant by the conduct of the ordinary business operations of the company." *Id.*; *see also* Adoption of Amendments to Proxy Rules, Exchange Act Release No. 4979, 1954 SEC LEXIS 38, *3 (Jan. 6, 1954) (declaring that state law governs ordinary business exclusion).

[366] Roiter, *supra* note 15, at 52–53.

[367] Matheson & Olson, *supra* note 13, at 1458–59.