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MAJORITY RULES

Andrew Verstein

ABSTRACT—The "disinterested and independent majority," is one of the most important concepts in corporate law. Corporate actions are almost immune to legal challenge if a suitable majority stands ready to approve it.

Scholars have extensively debated the proper meaning and effect of "disinterested and independent," but no such literature analyzes "majority." As a matter of arithmetic, how do we compute whether a given set of directors contains a suitable majority? While seemingly innocuous, the concept of a majority means different things to different courts. Indeed, there may be no majority rule for majority independence. The article charts and analyzes a puzzle somehow undiscovered, though in the heartland of a field. In so doing, it asks questions important to debates far afield of corporate law. Majority rules matter for flawed democracies everywhere.

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INTRODUCTION

One of the law's foundational questions is how to translate from the individual to the group. When are the acts, beliefs, and desires of an individual imputed to her group?

Sometimes, a single member stands in for the entire collective.[1] Other times, only unanimity implicates the whole.[2] But it is rare to conflate groups with their most extreme members. More typically, we derive collectives from some subset of the members, very often *a majority*. A majority of voters selects a political leader. A majority of Congress approves a law. A majority of a civil jury finds liability. In corporate litigation, courts assess board independence depending on whether enough of its member-directors are independent, usually a majority.

The "disinterested and independent board majority" is one of the most important concepts in corporate law because it is the fulcrum on which most corporate litigation turns.[3] Where such a majority is present, it is virtually impossible for plaintiff-shareholders to win a lawsuit. That is because courts confer numerous protections upon suitably independent boards. For example, assume a shareholder sues a board for approving a ruinously costly transaction, but that none of the directors had any conflict of interest. Here, there is little doubt that the court will dismiss the plaintiff's suit; the only question is the grounds for dismissal: the business judgment rule,[4] the

[1] For example, a single partner can bind her partnership to ordinary contracts despite the protest of other partners, National Biscuit Co. v. Stroud, 106 S.E. 2d 692 (N.C. 1959). A corporation can be convicted for a specific intent crime of an employee, even if thousands of other employees and shareholders opposed the crime.

[2] For example, a partnership only admits new partners if all partners concur, and a jury convicts a defendant only if all jurors so agree.

[3] See, e.g. Orman v. Cullman, 794 A.2d 5, 23 (Del. Ch. 2002) ("Whether a particular director is disinterested or independent is a recurring theme in Delaware's corporate jurisprudence."). *See e.g.*, Harald Baum & Max Planck, *The Rise of the Independent Director: A Historical and Comparative Perspective*, HARVARD L. SCHOOL F. ON CORP. GOV. AND FIN. REG. (Aug. 23, 2016) https://corpgov.law.harvard.edu/2016/08/23/the-rise-of-the-independent-director-a-historical-and-comparative-perspective/; Collins J. Setiz Jr. & Michael Sirkin, *The Demand Review Committee: How it Works, and How it Could Work Better*, BUSINESS LAW TODAY (July 17, 2018)https://businesslawtoday.org/2018/07/demand-review-committee-works-work-better/.

[4] *Infra* Part I.A.2.

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demand requirement,[5] statute of limitations,[6] or perhaps something else altogether?[7] When an independent majority of the board acts, the fate of a legal challenge is overdetermined. Accordingly, board independence is litigated in almost every corporate dispute, and it is outcome determinative in almost as many.

In keeping with its importance, independence receives ample judicial attention.[8] Courts scan for conflicting financial interests.[9] They probe the subjective state of mind of a challenged director.[10] Their gaze climbs up family trees and across directorates.[11]

Scholars have likewise asked hard questions about independence.[12] Can a director be truly impartial when evaluating a merger proposed by the shareholder who appointed her to the board?[13] Can a director disinterestedly decide whether to sue the CEO alongside whom he has worked for years and shares numerous social ties?[14]

Yet something is missing from both the cases and commentary: the majority independence test is the *majority* independence test.[15] In stark

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[5] *Infra* Part I.A.3.

[6] *Infra* Part I.A.4.

[7] *Infra* Part I.A.1.

[8] For example, in just 2017, Delaware alone had 44 cases addressing board independence. (search: adv: independent! or disinterest! w/ 200 (board or director!); filter applied for 01/01/2017-01/01/2018).

[9] Harbor Fin. Partners v. Huizenga, 751 A.2d 879, 887 (Del. Ch. 1999) (finding a conflict despite arguably immateriality director's financial interest).

[10] *See* Cinerama, Inc. v. Technicolor, 663 A.2d 1156 (Del. 1995).

[11] *E.g.* Chaffin v. GNI Grp., Inc., 1999 WL 721569, at *5 (Del. Ch. 1999) (remanding for determination of whether father lacked independence in light of son's financial interest).

[12] *Infra* Part I.B.

[13] See, e.g., Julian Velasco, Structural Bias and the Need for Substantive Review, 82 Wash. U. L.Q. 821, 823 (2004) (questioning the protective consequences of an independence determination). Aronson v. Lewis, 473 A.2d 805 (Del. 1984).

[14] Matter of DISH Network Derivative Litigation, 401 P.3d 1081 (Nev. 2017) (considering relevant the social ties between special litigation committee members and potential defendant). John C. Coffee, Jr. & Donald E. Schwartz, The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform, 81 Colum. L. Rev. 261, 283 (1981); James D. Cox, Searching for the Corporation's Voice in Derivative Suit Litigation: A Critique of Zapata and the ALI Project, 1982 Duke L.J. 959, 962; Marc I. Steinberg, The Use of Special Litigation Committees to Terminate Shareholder Derivative Suits, 35 U. Miami L. Rev. 1, 24 (1980). Matter of DISH Network Derivative Litigation, 401 P.3d 1081 (Nev. 2017) (considering relevant the social ties between special litigation committee members and potential defendant).

[15] Aronson v. Lewis, 473 A.2d 805, 815 (Del. 1984) ("We recognize that drawing the line at a majority of the board may be an arguably arbitrary dividing point.").

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contrast to the voluminous literature analyzing "independence," almost no attention has been paid to the question of "majority."[16]

So, what is a "majority?" Once we agree about who is independent and who is not, we still need to ask whether the resulting numerical composition *counts as* a disinterested majority. For example, once we determine that Directors X and Y are independent (but Z is not), the question still remains whether the XYZ board deserves the protection independence brings.

No doubt, the notion of majority has received scant attention because it strikes most people as utterly uncomplicated: a majority means more than half![17] Seemingly, once we agree on who is independent, all that is left to do is "count heads."[18] The forgoing XYZ board has a disinterested majority because two directors are disinterested and one is not. Can there be any grounds for disagreement?

Yet it turns out that "majority" means different things to different courts, even to different Delaware Chancellors. The seemingly innocuous notion of "majority" admits of numerous permutations. *Indeed, there may be no majority rule when it comes to the disinterested majority rule.*

For one thing, some courts reject the notion that a majority means more than half.[19]And more than half of what? Courts take fundamentally different approaches to the ratio at the heart of the question.

One common version of the test finds a disinterested majority when the independent directors mostly approved of a given transaction.[20] Another version of the test asks whether the approving directors were mostly

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[16] Many courts state the requirement of a disinterested majority *without using the word* majority. *See, e.g*. *Kandell*, 2017 WL 4334149, at *11 ("To establish demand futility under *Aronson*, the plaintiff must allege particularized facts creating a reasonable doubt that 'the directors are disinterested and independent' or the 'challenged transaction was otherwise the product of a valid exercise of business judgment.' " (quoting *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984))). There has been some discussion over the years of some issues related to protective majorities. *See* Kenneth B. Davis, Jr., *Approval by Disinterested Directors*, 20 J. CORP. L. 215, 244 (1995); Claire M. Dickerson, *Interested Directors of New York Corporations and the Burden of Proof*, 1988 COLUM. BUS. L. REV. 91, 112–13 (1988); Bulbulia and Pinto, Statutory Responses to Interested Directors' Transactions: A Watering Down of Fiduciary Standards?, 53 NOTRE DAME L. REV. 201, 206 n.37 (1977); Arsht & Stapleton, *Delaware General Corporation Law,* 25. BUS. LAW 287, 290 (1969).

[17] *Majority*, BLACK'S LAW DICTIONARY (10th ed. 2014) ("2. A number that is more than half of a total; a group of more than 50 percent <the candidate received 50.4 percent of the votes — barely a majority>;A majority always refers to more than half of some defined or assumed set."); OXFORD ENGLISH DICTIONARY (What edition and year?)("**3. a.** The greater number or part; a number which is more than half the total number, esp. of votes").

[18] Cumming v. The Devisees and Tertenants of Eden, 1 Cow. 70 (N.Y. Sup. Ct. 1823).

[19] Infra Part III.B.5.

[20] Cooke v. Oolie, 2000 WL 710199 (Del. Ch. 1999).

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independent.[21] Yet another version asks whether a majority of the board was independent, regardless of how anyone voted. [22]

The difference in rule often means a different result. To see the difference, consider the XYZ board from above, and imagine that the disinterested directors (X and Y) split evenly between affirming and dissenting, while the conflicted director (Z) votes in favor of the transaction. For illustration, imagine the board is voting to sell corporate property to Z. [23]

Figure 1: Hiring Z

	Affirm	No
Independent	1	1
Conflicted	1	

Was the transaction approved by a disinterested majority? For some courts, the answer is "yes." These courts would point out that two out of three directors were disinterested.[24] However, other courts would answer "no." They would explain that independent and approving directors did not constitute a majority (only one third of the board met both conditions).[25] Other courts would answer "no" for a completely different reason: less than a majority of the disinterested directors (1/2) affirmed.[26]

The three tests often give different answers to the question of disinterested majorities because they are measuring majorities of different things. Whether the board must endure months of litigation and risk personal liability, whether the plaintiff will have any hope of righting a perceived wrong, turns on which sort of majority the court is looking for.

In this Article, I explore the notion of a "disinterested majority" with my focus exclusively on the "majority." Such an inquiry is warranted for at least four reasons. First, it goes to the heart of one of the greatest muddles in contemporary corporate law: conflict of interest rules. Delaware law has

[21] Chaffin v. GNI Grp., Inc. 1999 WL 721569 (Del. Ch. 1999).

[22] Not all independence inquiries involve approval of a transaction, or even board action at all. See e.g. Rales v. Blasband, 634 A.2d 927 (Del. 1993)(inquiring into the independence of directors in a demand futility cases, where underlying action concerned *failure* of the board to act).

[23] These are the facts of Gerald L. Pollack & Assocs. v. Pollack, 2015 WL 339715 (Mich. Ct. App. 2015). When depicting board votes with figures, I contrast "affirm" to "no." The latter category includes dissenting votes and abstentions unless otherwise stated. That is because dissents and abstentions have the same legal effect, which is to deprive a measure of the majority that it requires. Recusals, absences, and exclusions from the committee affect quorum and so can sometimes make a measure easier to pass. We discuss those *infra*.

[24] *See infra* Part I.A.3.

[25] *See infra* Part II.A.1.

[26] *See infra* Part II.A.2.

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become hopelessly confused on the issue.[27] Subtly different disinterested majority rules are at the heart of the confusion and promise its escape.

Second, it makes a great practical difference to litigants what rule is applied to them. Different rules mean litigants encounter contingent and unequal results in real cases.[28] This might be palatable if we were confident that courts were making predictable, or even principled, choices about which rule to apply. Unfortunately, there is no indication that courts are even aware that they are making a choice in determining what sort of "majority" is present. Likewise, scholars[29] and litigants[30] do not seem to appreciate that there are significant differences between different rules. The central legal issue in most corporate disputes may well be an issue that no one has seen: the conception of "majority" that the court uses. Advocates should be clear about what they are asking for, and judges should be clear about what they are giving. Only conceptual clarity makes that possible.

A third reason for problematizing the seemingly innocuous concept of "majority" is precisely because of how unproblematic the term otherwise strikes us. Here we have a concept that is mentioned in literally thousands of judicial decisions, but which has not been noticed as crucially ambiguous, leading real courts to unknowingly split on essentially the same facts. This inquiry into independent majorities is a reminder that important mysteries may hide in plain sight – and it also serves as an antidote to our tendency to pass over such puzzles in other areas of law.

Fourth, scholars far afield of corporate law should care what corporate law makes of a disinterested majority. Other areas of law must contend with similar questions – judicial panels, democratic elections – in which collective bodies deliberate despite heterogenous membership. When does the partiality of a member tarnish the group? Corporate law has consciously or unconsciously grappled with this question for years and its path may prove informative to other domains.

The plan of this Article is as follows. The first half of the Article locates and specifies the current judicial treatment of board majorities in corporate law. In it, Part I summarizes the corporate law issues that turn on the presence or absence of a disinterested majority. Readers familiar with corporate

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[27] See generally, William Bratton, Reconsidering the Evolutionary Erosion Account of Corporate Fiduciary Law, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3753589.

[28] *See infra* Part I.B.

[29] As paradigmatic cases of the two rules, I discuss two different cases which have not been previously juxtaposed as embodying opposing rules. To the contrary, these both have been cited *together* in the same footnote as the two examples of bright line rules in action. Jens C. Dammann, *Indeterminacy in Corporate Law: A Theoretical and Comparative Analysis*, 49 STAN. J. INT'L L. 54, 79 & n.157 (2013). I will argue that they certainly don't demonstrate *the same* bright line rule.

[30] *See infra* note 73 and accompanying text.

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litigation can safely skip ahead to Part II, which explains the splits in the operational doctrine: the three axes on which courts differ and the main paths they take in resolving those issues. It identifies the three major rules embraced by courts.

The Article then takes an evaluative and critical turn, asking what our majority rules teach us about corporate law and what corporate law teaches us about these majority rules. Part III considers three lenses which are imperfect grounds for *picking among* the various candidate independent majority rules, but which are nevertheless important sources of insight about them. First, I compare these rules to the statutory law supporting them, showing no easy fit. Second, I consider whether one rule is more board-friendly than another. I show that the rules are incommensurable such that neither board critics nor apologists should have a strong or strict preference between them.

This is not to say that courts should choose lightly between the rules. Part IV provides more fruitful grounds for differentiating among the rules. First, it identifies important practical differences between the rules. The rules differ as to whether they encourage corporate governance best practices and expeditious litigation.

Second, it considers the teleology of these rules. The law puts directors in the crosshairs of litigation and then releases them when a majority rule is satisfied. Why? I suggest that three bases are imminent in the three rules: deference, evidence, and incentive. Once we surface these principles, we are free to ask whether we endorse them and the majority rule that best advances it.

I. THE LEGAL SIGNIFICANCE OF A "DISINTERESTED MAJORITY"

The disinterested board majority occupies a central role in corporate law and scholarship. The presence of a disinterested majority can protect a board and a transaction from legal challenge. But what is independence? Section A describes judicial standards of independence. Section B of this Part describes the protective power of a disinterested majority.

In this discussion, and in this Article generally, I generally conflate the notions of "independent," "disinterested," "qualified," and other desiderata. I also conflate the absence of these qualities; thus, I write "conflicted" in a context where the litigants would have instead said "interested," "not independent," or "not qualified."[31] My goal is not to assert that certain terms

[31] *See e.g.*, Orman v. Cullman, 794 A.2d 5 (Del. Ch. 2002) at n.50("Many plaintiffs allege facts which they assert establish that the defendant 'lacked the disinterest and/or independence' necessary to consider the challenged transaction objectively. . . . A plaintiff must make clear to the Court the bases upon which his claims rest.").

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are truly interchangeable. Rather, I intend to streamline the exposition: legal tests scan directors for the presence or absence of some property, and this Article discusses how courts compute the legal meaning of the finding. It makes sense to bundle the properties, even if arguably different, so long as the computation procedure under study is the same.[32]

Likewise, I tend to conflate the various legal inquiries into one prototypical question of whether a transaction is "protected." I deem this an acceptable placeholder because it is consistent with many of the legal inquiries in which majorities are scrutinized in a similar manner. However, I also try to unpack and analyze differences where they exist and prove relevant.

A. The Definition of Independence

There is no single, authoritative definition of independence; a director may be independent for one purpose but not for another.[33] Both of America's premier stock exchanges require their listed companies to have majority-independent boards[34] – but their definitions differ.[35] The federal corporate governance regime embodied in the Sarbanes-Oxley Act of 2002 uses a completely different independence standard for its requirement that boards of exchange-traded corporations have an all-independent audit committee.[36] However, Delaware's common law of director independence is of central importance and influence, and this Article engages it as the heartland of the subject. [37]

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[32] To be sure, there may be cases where they receive different treatment. Perhaps "disinterested majority" means something different when we are talking about qualified directors than when we are talking merely about independent directors. In those cases, it will make sense to be precise. Likewise, we must be very careful if a director's lack of independence leads to a different result than their lack of disinterest. *Cf.* Orman v. Cullman, 794 A.2d 5 (Del. Ch. 2002). But my research teaches that it is usually safe to consider these different concepts together.

[33] Fairfax, The Uneasy Case for the Inside Director, 96 IOWA L. REV. 127, 133 (Nov. 2010). *See also* Rodrigues, The Fetishization of Independence, 33 J. CORP. L. 447, 466–467 (Winter 2008)(distinguishing between federal and Delaware definitions); Clarke, Three Concepts of the Independent Director, 32 DEL. J. CORP. L. 73, 78–84 (2007) ("the proper definition of 'independent director' depends on the role envisaged for him").

[34] NYSE Listed Company Manual Section 303A.01; Nasdaq Listing Rule 5605(b)(1).

[35] NYSE Listed Company Manual Section 303A.02(a); Nasdaq IM-5605. }

[36] SOX Section 301. Both stock exchanges require some committees to be at least majority-independent during a transition window, after which they must be all-independent. See e.g. NYSE Listed Company Manual Section 303A.00. (allowing only majority independence for the first 90 days to one year after IPO for audit committees.); Nasdaq Listing Rule 5615(b). (same). But, again, the definition of independence is not identical to the SOX definition.

[37] The Model Business Corporation Act comes to similar conclusions in MBCA §§ 1.43(b)(2); 8.60, 8.62(a).

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Delaware's approach to independence is context-specific and has been refined through the common law process.[38] The canonical statement defining Delaware independence comes from *Orman v. Cullman*, which defines three fact patterns that undermine the objectivity otherwise presumed of Delaware directors:

The first is when (1) a director personally receives a benefit (or suffers a detriment), (2) as a result of, or from, the challenged transaction, (3) which is not generally shared with (or suffered by) the other shareholders of his corporation, and (4) that benefit (or detriment) is of such subjective material significance to that particular director that it is reasonable to question whether that director objectively considered the advisability of the challenged transaction to the corporation and its shareholders.

To paraphrase, the first grounds for conflict is that a director materially gains or loses as a result of the disputed corporate action. This inquiry is subjective because it asks what would tempt a specific director.[39] For example, a director might lack independence as to a transaction that would deprive him of a job he considers material, but not if he "is a billionaire and his officer's position pays $20,000 per year and is not even of prestige value to him."[40]

In contrast to the subjectivity of the first analysis, the second crack in independence is implicated by objective circumstances. "The second instance is when a director stands on both sides of the challenged transaction."[41] *Orman* then cites to a statute containing two per se conflicts: a transaction between the corporation and the director; and a transaction between the corporation and some entity at which the director has a financial interest or serves as an officer or director.[42] Thus, a director of two companies lacks independence when the two do business, regardless of how impartial the director strives to be.

Finally, *Orman* describes a third threat to independence:

> the director's decision resulted from that director being controlled by another. A director can be controlled by another if in fact he is dominated by that other party,

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[38] Usha Rodrigues, *The Fetishization of Independence*, 33 J. CORP. L. 447, 450 (2008) ("Under Delaware law, one cannot determine independent status ex ante, before a conflict arises.").

[39] *See* Cinerama, Inc. v. Technicolor, 663 A.2d 1156 (Del. 1995)(recognizing "actual director" standard).

[40] Orman v. Cullman, 794 A.2d 5, 25 (Del. Ch. 2002).

[41] *Id.*

[42] DGCL 144(a).

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> whether through close personal or familial relationship or through force of will.[43]

The key to independence is "whether the controlled director is able to consider the corporate merits of the challenged transaction objectively."[44]

What does independence mean in practice? Courts reject the notion that directors lack independence merely because they have in the past approved a challenged action,[45] or because a lawsuit poses the barest risk of liability for them.[46] Directors can be independent despite having been hand-picked for office by a controlling shareholder or CEO.[47] Importantly, courts have held that the notion that directors do not lack independence just because of their common backgrounds and shared experiences on the board,[48] or "that directors are friendly with, travel in the same social circles, or have past business relationships with the proponent of a transaction or the person they are investigating, are not enough to rebut the presumption of independence."[49]

However, frequently vacationing with a director so familiar that he is called "Uncle" in emails,[50] or co-owning a jet airplane with a co-director, [51] can imply ties so strong that one director is unlikely to be impartial in the fate of another. Similarly, a parent can lack independence because of the financial consequences for her children.[52] And, of course, directors lack independence when they set their own compensation,[53] or approve transactions that might enrich themselves at the expense or to the exclusion of the corporation and the investors.[54]

B. The Legal Effect of Disinterested Majority

Much is at stake in corporate litigation against directors, officers, and controlling shareholders. If a plaintiff proves that the board breached its duties, the consequences can be severe. Contemplated transactions may be

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43 *Orman*, 794 A.2d at 25.

44 *Id.*

45 Aronson v. Lewis, 473 A.2d 805 (Del. 1984).

46 *Id.*

47 *Id.*

48 Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart, 845 A.2d 1040, 1050–51 (Del. 2004);*Aronson*, 473 A.2d 805; Cinerama, Inc. v. Technicolor, 663 A.2d 1156 (Del. 1995).

49 *In re* MFW Shareholders Litigation, 67 A.3d 496, 509 (Del. Ch. 2013)

50 *In re* DISH Network Derivative Litigation, 401 P.3d 1081 (Nev. 2017)

51 Sandys v. Pincus, 152 A.3d 124 (Del. 2016),

52 Harbor Fin. Partners v. Huizenga, 751 A.2d 879 (Del. Ch. 1999); Chaffin v. GNI Grp., 1999 WL 721569 (Del. Ch. Sept. 3, 1999) .

53 Calma v. Templeton, 114 A.3d 563 (Del. Ch. 2015).

54 Strassberger v. Earley, 752 A.2d 557 (Del. Ch. 2000).

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enjoined and completed transactions may be rescinded if the board breaches its duties.[55] Especially where it is impossible to restore the corporation to the position it would have been apart from the breach, the directors may be personally liable for disgorgement or compensatory or rescissory damages.[56] Even small harms to large corporations can result in millions of dollars of liability to the defendant directors.[57]

To a board threatened with such consequences, the presence of a disinterested majority is a godsend, shielding a transaction and its proponents from scrutiny and challenge. This Section identifies four areas where independence can make all the difference.[58] First, an independent majority overcomes the common law's impulse to invalidate conflicted transactions. Second, an independent majority is entitled to a deferential standard of review in corporate litigation. Third, a disinterested majority may quash plaintiff-led lawsuits under the "demand futility" requirement. Fourth, a disinterested majority causes the statute of limitations to run on potentially threatening lawsuits against the board or transaction.

1. Per Se Invalidity

For a corporate action to be valid, it must be approved by a majority of the directors present at a valid meeting.[59] For a meeting to be valid, a quorum of the board must be present – usually a majority of the whole board.[60] For most of the twentieth century,[61] common law dictated that the votes of conflicted directors did not count toward approval of an action,[62] nor did the

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[55] Gimbel v. Signal Companies, Inc. 316 A.2d 599 (Del. Ch. 1974).

[56] *Strassberger*, 752, A.2d 557.

[57] Gagliardi v. TriFoods Int'l, Inc., 683 A.2d 1049 (Del. Ch. 1996) (describing the risk to directors and the resulting incentive problems). However, some commentators argue that the risk of outside director liability is quite small. *See* Bernard S. Black et. al., *Outside Director Liability*, 58 STANFORD L. REV. 1055 (2006).

[58] These are not the only issues for which a disinterested majority is crucial. An independent committee helps remove the cloud of a transaction between a corporation and its controlling shareholder See Kahn v. M&F Worldwide Corp., 88 A.3d 635 (Del. 2014). Also, some courts have held that the absence of a disinterested board majority allows a shareholder to sue directly rather than derivatively, at least where the case involves a controlling shareholder. *See* Sciabacucchi v. Liberty Broadband Corp., 2018 WL 3599997, at *8 (Del. Ch 2018).

[59] DGCL 141(b).

[60] DGCL 141(b).

[61] Prior to the rule introduced in this sentence, an even more demanding rule prevailed: the presence of a single conflicted director could in principle invalidate a transaction. Blake Rohrbacher et. al., *Finding Safe Harbor: Clarifying the Limited Application of Section 144*, 33 DEL. J. CORP. L. 719, 720–721 (2008).

[62] *See, e.g.* Keenan v. Eshleman, 2 A.2d 904, 908 (Del. 1938) ("The resolution of November 15, 1924, whereby Sanitary agreed to pay to Consolidated monthly management fees, adopted by a Board of Directors of which the appellants were a majority, was at the least a voidable transaction. In the first place, the votes of the appellants could not be counted in making up a majority of the Board."); Colorado

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conflicted directors themselves count toward establishing quorum.[63] Therefore, a board that was not majority independent simply did not have enough suitable directors to approve an action. Under this rule, any action purportedly taken by a majority conflicted board could be voided by any shareholder.[64]

To see how this approach works, imagine that a four-member board approved a purchase of stock from two of its members (Z and R). This vote lacks a quorum because it is not true that a majority of the whole board was present and qualified to vote – half of the board is disabled by their conflict. A shareholder could void that sale, requiring the corporation to recover the payment, because the meeting authorizing the transfer simply lacked a quorum.

Figure 2: Per Se Invalidity

	Affirm	No
Independent	X, Y	-
Conflicted	Z, R	-

Per se voidability does not require the plaintiff to show, for example, that the conflicted directors actually acted in bad faith or succumbed to temptation, nor that the redemption was unfair. The plaintiff wins almost automatically. However, a board that can produce sufficient approving disinterested directors is protected against this per se voidability. If the forgoing board added another independent director, three independent directors could authorize the purchase from the two conflicted ones. Majority independent approval fully protects the board and transaction from per se invalidity.[65]

Management Corp. v. American Founders Life Ins. Co. of Denver, 359 P.2d 665, 668 (Colo. 1961). Some statutes preserve this harsh common law rule by statute. N.D. Cent. Code § 10-19.1-51(c); Minn. Stat. § 302A.255, subd. (1)(c).

[63] See, e.g., Belle Isle Corp. v. MacBean, 49 A.2d 5, 9 (Del. Ch. 1946). The rationale was that conflicted directors do not count to establish a quorum; since it would have been prudent for them to recuse themselves in light of their conflicts, the law presumes that they did in fact recuse themselves. Cf. Robert Cooter & Bradley J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 N.Y.U. L. Rev. 045, 1054 & n.23 (1991) ("Traditionally, a fiduciary was barred strictly from self-dealing.")

[64] See Kerbs v. Cal. E. Airways, Inc., 90 A.2d 652, 655 (Del. 1952) ("The interested character of the directors who voted for the stock option plan makes their action voidable only and thus subject to stockholders' ratification.")

[65] Even majority approval may be a somewhat modern innovation. "In 1880 it could have been stated with confidence that in the United States the general rule was that any contract between a director and his corporation was voidable at the instance of the corporation or its shareholders, without regard to the fairness or unfairness of the transaction." Harold Marsh, Jr., *Are Directors Trustees?*, 22 BUS. LAW. 35, 36 (1966). Marsh's characterization is not universally accepted. See Andrew F.

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Since the late 1950s, most states have enacted statutes modifying and structuring the common law of per se invalidity, providing several alternative paths to protection.[66] Accordingly, the threat of per se invalidity has been substantially reduced.[67] But the curative power of a disinterested majority has not been diminished. Indeed, it has only been expanded, as the following sections show.

2. Standard of Review

Much of corporate litigation concerns alleged breaches of fiduciary duties. The board of a corporation is argued to have acted (or failed to act) without due care, in bad faith, or without the corporation's best interests at heart. Two standards of review are available in ordinary breach of duty cases, one deferential and one exacting.[68] The choice between these two can be outcome determinative, and the choice depends on the presence or absence of a disinterested board majority.

The deferential standard of review is known as the business judgment standard. This standard instructs courts to presume that directors "of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[69] If the business judgment rule applies, "the courts will not step in,"[70] and the defendant board will almost certainly prevail.[71] "[W]here business judgment presumptions are applicable, the board's decision will be upheld unless it cannot be attributed to any rational purpose."[72] A court will likely dismiss

Tuch, *Reassessing Self-Dealing: Between No Conflict and Fairness*, 88 Fordham L. Rev. 939 (2019) (arguing that loyalty rules have always allowed greater robustness against voidness than commonly thought). Note also that the proper terminology, whether "void" "voidable" or "avoidable" is not consistently used by jurists and scholars. This Article implicitly conflates the various terms.

66 *See, e.g.* DGCL § 144; Cal. Corp. Code. § 310(c); Kans Stat. Ann. § 17-6304(b). However, several states have kept the earlier common law rule. *See supra* note 62.

67 On the history and operation of per se voidability, *see generally* Rohrbacher, *supra* note 53.

68 *In re* Rural Metro Corp., 88 A.3d 54, 82 (Del. Ch. 2014) ("A third standard of review is applied in special cases, such as board efforts to resist hostile takeovers. 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.").

69 Aronson v. Lewis, 473 A.2d 805 (Del. 1984).

70 Shlensky v. Wrigley, 237 N.E.2d 776, 778 (Ill. App. Ct. 1968).

71 Claire Hill & Brett McDonnell, *Sanitizing Interested Transactions*, 36 DEL. J. CORP. L. 903, 913 (2011) ("This burden is extremely hard for plaintiffs to overcome; they rarely succeed in cases decided under the business judgment rule."). *Cf.* David Bazelon, *Clients against Lawyers*, HARPER'S MAG., Sept. 1967, at 104, 112 ("The business judgment rule, which began as a minor exception, is now so dominant a winning argument that the only fun left is trying to prove that it . . . does not cover absolutely all forms of corporate theft.")

72 *In re* Walt Disney Co. Derivative Litigation, 906 A.2d 27 (Del. 2006).

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the action at the pleading stage, long before the plaintiff enjoys the benefit, or the board suffers the inconvenience, of discovery.[73]

At the other extreme lies the "entire fairness" standard of review. "Entire fairness is Delaware's most onerous standard of review."[74] Under this more exacting standard, the board bears the burden of showing that the price of any challenged transaction was entirely fair and that the process in securing that price withstands "careful scrutiny by the courts."[75] Although boards may well meet this burden,[76] the test is inherently worrying for boards because "there is no bright-line rule on what is entirely fair."[77] In Delaware, it is no defense that the interested director did her utmost to treat the entity fairly and otherwise acted in good faith.[78] If the transaction appears to have been unfair in retrospect, the results can be calamitous.[79]

Board independence is the key issue for courts deciding between these two standards of review:

> To rebut successfully business judgment presumptions in this manner, thereby leading to the application of the entire fairness standard, a plaintiff must normally plead facts demonstrating that a majority of the director defendants have a financial interest in the transaction or were dominated or controlled by a materially interested director. . . . If a plaintiff alleging a duty of loyalty breach is unable to plead facts demonstrating that a majority of a board that approved the transaction in dispute was interested and/or lacked independence, the entire fairness standard of review is not applied and the Court respects the business judgment of the board.[80]

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[73] See Stephen M. Bainbridge, The Business Judgment Rule as Abstention Doctrine, 57 Vand. L. Rev. 83, 101 (2004).

[74] *In* re Orchard Enters., Inc., 88 A.3d 1, 84 (Del. Ch. 2014).

[75] Weinberger v. UOP, 457 A.2d 701 (Del. 1983).

[76] Nixon v. Blackwell, 626 A.2d 1366, 1376 (Del. 1993) ("It is sometimes thought that the decision whether to apply the business judgment rule or the entire fairness test can be outcome-determinative . . . . Application of the entire fairness rule does not, however, always implicate liability of the conflicted corporate decisionmaker, nor does it necessarily render the decision void."). *Accord* Julian Velasco, *A Defense of the Corporate Law Duty of Care*, 40 J. CORP. L. 647, 689 (2015).

[77] In re Nine Systems Corporation Shareholders Litigation, 2014 WL 4383127, *1 (Del. Ch. 2014).

[78] *In re* Primedia, Inc. Shareholders Litigation, 67 A.3d 455 (Del. Ch. 2013) (holding that "self-dealing fiduciaries are liable because they breached their duty of loyalty if the transaction was unfair, regardless of whether they acted in subjective good faith.").The MBCA protects directors from liability if they acted in good faith. MBCA § 8.61(b).

[79] *In re* S. Peru Copper Corp. S'holder Derivative Litig., 52 A.3d 761, 819 (Del. Ch. 2011) (Upholding 1.43 billion damage award against board and controlling shareholders unable to carry their burden of entire fairness.)

[80] Orman v. Cullman, 794 A.2d 5 (Del. Ch. 2002). *Accord In re* Ultimate Escapes Holdings, LLC, 551 B.R. 749, 761 (D. Del. 2016) (Under Delaware law, the standard of review depends initially on whether the corporate fiduciaries (i) were disinterested and independent (the business judgment rule) . . .

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Other arguments can in principle rebut the business judgment rule – for example, a waste claim – but the legal standard for these arguments is usually too high for plaintiffs to have any chance.[81] In practice, substantive fiduciary duty suits live and die on majority independence.[82]

3. Demand Futility

Directors owe fiduciary duties to the corporation, and so the corporation must be the nominal plaintiff in most cases of alleged directorial wrongdoing. Thus, corporate litigation is commonly styled as "derivative" litigation.[83] A shareholder-plaintiff sues on behalf of the corporation in order to vindicate the corporation's rights – often against one or more director.

Yet the decision to sue is a business decision, meaning that it is the board's prerogative. Boards are understandably reluctant to vote to sue themselves. Derivative litigation is fiercely resisted by boards, not just because they might end up being liable, but because it limits the board's otherwise substantial autonomy; a plaintiff who successfully initiates a derivative suit can spend the corporation's money and sue in the corporation's name. In recognition of this intrusion into the board's domain, corporate law imposes a "demand requirement" on would-be plaintiffs. They must present their suit to the board and give the board the chance to consider the suit. If the board decides the corporation should not bring the suit, their choice to dismiss it is almost certainly protected.

A plaintiff's only realistic hope is to argue that they are excused from the demand requirement because the board is sufficiently conflicted that it could not consider the suit fairly. "If the board of directors lacks a majority comprising independent and disinterested directors, then demand is futile."[84] If demand is futile, demand is excused, and the plaintiff can pursue its derivative lawsuit.

There are other permutations in demand futility jurisprudence, but they recapitulate the same basic point.[85] If a board is arguably not majority

(iii) confronted actual conflicts of interest such that the directors making the decision did not comprise a disinterested and independent board majority (entire fairness).").

[81] *See, e.g.*, Freedman v. Adams, 58 A.3d 414 (Del. 2013) (plaintiff failed to establish waste where board sacrificed $40 million in tax benefits just so it wouldn't have to write down its philosophy for distributing executive bonuses, because the decision "was not unconscionable or irrational.").

[82] Benihana of Tokyo, Inc. v. Benihana, Inc., 906 A.2d 114 (Del. 2006).

[83] Robert B. Thompson &Randall S. Thomas , *The Public and Private Facts of Derivative Lawsuits*, 57 VAND. L. REV. 1747, 1762 (finding that among fiduciary duty suits that are not class actions, 61% were derivative suits).

[84] *In re* Ezcorp, Inc. Consulting Agmt. Deriv. Litig., 2016 WL 301245, at *34 (Del. Ch. 2016)

[85] For example, *Aronson*'s second prong asks whether the board-to-be-sued would be protected by the business judgment rule, which usually amounts to asking whether a past board was majority

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independent, the board can form a special litigation committee to consider the plaintiff's proposed suit. If this committee is sufficiently independent, the committee can vote to dismiss the plaintiff's suit and thereby protect the board. Whether by committee or whole board, a disinterested majority suffices to dismiss derivative litigation long before discovery has occurred.[86]

4. Statute of Limitations

When wrongdoing occurs at a corporation, the perpetrators may attempt to run out the statute of limitations.[87] The clock should begin as soon as the corporate managers learn about the wrongdoing, which may be long before information leaks out to potential derivative plaintiffs.[88] The corporate managers decide whether and when the corporation should sue. If they drag their feet long enough, then even viable suits against those managers are extinguished.

An important equitable exception protects corporations and their shareholders from such delay tactics: the doctrine of adverse domination.[89] When a board is dominated by directors who are averse to suing by virtue of their own adverse interests, courts will toll the statute of limitations, giving future boards or shareholders a chance to eventually bring the otherwise-stale actions:

> The doctrine of adverse domination allows the tolling of the statute of limitations where the entity [to whom the cause of action belonged] is controlled

independent. *See* Aronson v. Lewis, 473 A.2d 805 (Del. 1984). The Delaware Supreme Court has since displaced the *Aronson* and *Rales* tests for a unified test "blending," both. United Food & Com. Workers Union & Participating Food Indus. Emps. Tri-State Pension Fund v. Zuckerberg, 262 A.3d 1034, 1058 (Del. 2021). However, the new *Zuckerberg* test retains the majority independence inquiries of *Aronson* and *Rales*.

[86] While it is clear that most committees must be only majority independent in order to obtain protection, there is some suggestion that in some circumstances (Special Litigation Committees and independent committees evaluating a controlling shareholder's preferred merger), the committee must be *all* independent.

[87] Although most civil actions have rather long statutes of limitations, e.g. 14 M.R.S. § 752 (six years), many claims arising out of corporate litigation have shorter limitations periods. E.g. 42 Pa.C.S. §§ 5524(7) (two-year limitation period for fraud); 10 DEL. CODE § 8106(a) (three years for fiduciary claims). Given Delaware's importance in corporate litigation it is fair to note that two federal district court judges and one bankruptcy judge have written opinions doubting the application of adverse domination under Delaware law. *In re* Marvel Entm't Grp., Inc., 273 B.R. 58, 76 (D.Del.2002), *In re* AMC Inv'rs, LLC, 524 B.R. 62, 81 (Bankr. D. Del. 2015), *In re* AMC Inv'rs, LLC, 551 B.R. 148, 152 (D. Del. 2016). However, no Delaware court has ever addressed the issue, even in dicta.

[88] Note that the doctrine of adverse domination applies not just to derivative suits vindicating the rights of the entity. It also defines the rights of individual investors, suing directly in their personal capacity. *E.g.* Alexander v. Sanford, 181 Wash. App. 135, 325 P.3d 341 (Div. 1 2014).

[89] The earliest leading case was Fed. Deposit Ins. Corp. v. Bird, 516 F. Supp. 647, 651 (D.P.R. 1981). Following *Bird*, adverse domination has been a mainstay of bank-failure cases: the government takes over a failed bank and causes it to sue its former managers. Resolution Trust Corp. v. Scaletty, 257 Kan. 348, 891 P.2d 1110, 1114 (1995).

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> by or dominated by wrongdoers. The statute of limitations begins to run again when the wrongdoers lose control of the entity. The rationale behind the adverse domination doctrine is premised upon the principle that officers and directors who have harmed the entity cannot be expected to take legal action against themselves.[90]

Although courts disagree on what counts as adverse domination,[91] the most widespread rule is the "majority independence" rule.[92] If a board is majority independent, most courts will allow the board to restrain the corporation from suing until the actions are stale.[93] If a board is not majority independent, then the potential action is preserved. Majority independence is often decisive in determining directors' ability to protect themselves through delay.

II. THE CALCULUS OF MAJORITY

This Part identifies the three rules that courts adopt to determine whether a given combination of conflicted and independent directors results in legal protection for a director or transaction. The first test asks whether the approving directors were mostly independent. The second test asks whether the independent directors mostly approved. The third asks whether the directors were mostly independent, regardless of how they voted.

There is no easy way to name these tests, but having some label will help in exposition. Thus, the first test is the Affirmation Ratio. It asks whether a majority of all the directors both voted in favor of an action and also were independent.

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[90] Freeland v. Enodis Corp., 540 F.3d 721, 741 (7th Cir. 2008). Accord 13 A.L.R.7th Art. 3 (Originally published in 2016) ("The doctrine of adverse domination, [is] a rebuttable presumption that a corporate plaintiff cannot have notice of wrongdoing by directors when those directors are in control of the corporation").

[91] Some courts have adopted versions of the doctrine that are more favorable to defendant boards. Under the "single disinterested director version. . . . plaintiff has the burden of showing that the culpable directors had full, complete, and exclusive control of the corporation and must negate the possibility that an informed director or shareholder could have induced the corporation to institute suit." Resolution Trust Corp. v. Scaletty, 891 P.2d 1110, 1113 (Kan. 1995). Under the "complete domination test. . . . the statute of limitations is not tolled by reason of adverse domination unless the plaintiff can show the absence of any corporate director or shareholder who had actual knowledge of the alleged wrongdoing and the ability (and motivation) to sue the wrongdoers on behalf of the corporation or induce such a suit." Aiello v. Aiello, N.E.2d 68, 72 (Mass. 2006). Both of these tests appear to be minority approaches. And courts frequently find that a board lacking a disinterested majority *is therefore* completely dominated, thus drawing the tests closer together. E.g. Resolution Trust Corp. v. Bernard, 1995 WL 17164886 (M.D. N.C. 1995) (finding it unnecessary to decide which test North Carolina uses for adverse domination, because plaintiff had met its burden regardless).

[92] § 15:14.Limitations, laches, and acquiescence as defenses, 3 Treatise on the Law of Corporations § 15:14 (3d).

[93] See, e.g., Wilson v. Paine, 288 S.W. 3d 284 (Ky. 2009).

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$$\text{Affirmation Ratio} = \frac{Affirming\ Independent\ Directors}{Directors}$$

The second test is the Independence Ratio, which asks whether a majority of the independent directors approve of an action.

$$\text{Independence Ratio} = \frac{Affirming\ Independent\ Directors}{Independent\ Directors}$$

The third test asks whether a majority of the directors were independent, regardless of whether or how they voted.

$$\text{Director Ratio} = \frac{Independent\ Directors}{Directors}$$

To better understand these three ratios, let us compare three cases with seemingly similar facts but different outcomes. In two cases, four directors voted to affirm some action or transaction. In both cases, two of those directors were independent and two were conflicted. But in one case, the court found a disinterested majority and in the other did not. With nearly identical facts, decided by the same court within a matter of months of each other, the different outcomes must reflect judges applying different majority rules. In *GNI,* the court asked what percentage of the board was both independent and affirming. It therefore exemplifies an Affirmation Ratio. In *Oolie*, the court asked what percentage of the independent directors affirmed. It therefore exemplifies an Independence Ratio.

In the third case, the court decides on majority independence without determining that the board approved anything; unlike the other two tests, this third test operates without regard for voting patterns. It is therefore compatible with many hypothetical voting patterns, including those of *GNI* and *Oolie*. The court simply asked what percentage of the board was independent. *Chen* exemplifies a Director Ratio.

A. Affirmation Ratio: Chaffin v. GNI Group, Inc.

Chaffin v. GNI Group, Inc., concerned the acquisition of a waste management business on arguably unfair terms.[94] When GNI asked its banker to find an acquirer, more than 40 suiters came to call. The best offer came from 399 Venture Partners. A two-director independent committee

[94] Chaffin v. GNI Grp., Inc., 1999 WL 721569 (Del. Ch. 1999). The *Chaffin* approach has been widely used. Carsanaro v. Bloodhound Techs., Inc., 65 A.3d 618, 642 (Del. Ch. 2013) (refusing protection for four-person committee, two directors of whom were independent).

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deadlocked over the offer,[95] and so the matter went to GNI's whole board. All five directors voted. One independent director voted against the transaction. Two independent directors voted for it.

As for the remaining two votes in favor, their independence was questionable. One of them, Carl V. Rush, had been promised a cushy job in the new company. He would receive substantial stock, stock options, a cash bonus, and the forgiveness of a loan previously made to him.[96] The other, Titus H. Harris Jr., also faced temptation. His son, Titus H. Harris, III, would enjoy the same perks as Rush.[97] The plaintiffs, a group of former shareholders who lost their interests as a result of the transaction, contended that this merger was a breach of the board's duty of loyalty. They argued that it was a conflicted transaction (given Rush and Harris Jr.'s interests), which was not entirely fair, and which had not been cleared by any safe harbor.[98]

Taking the facts most favorably to the plaintiffs, the vote was two conflicted directors in favor, two independent directors in favor, and one independent director against. Figure 3: Plaintiff's GNI Facts illustrates the plaintiff's contended board composition.

Figure 3: Plaintiff's GNI Facts

	Affirm	No
Independent	2	1
Conflicted	2	

The defendants for their part argued that only one director was plausibly conflicted, since Harris Jr.'s *son*, and not himself personally, had the conflict. If only one director was conflicted, the defendants contended, the conflicted transaction would have been cleansed by the vote of a disinterested majority. It would therefore warrant scrutiny under the deferential business judgment rule standard. Likewise, a disinterested majority would be on hand to consider the plaintiff's demand, and so demand would not be futile. Figure 4: Defendant's GNI Facts shows the defendant's contended board composition.

[95] *Id.* at *2.Actually, the committee began with a third member (Harris Jr.), but he removed himself once it became clear that his son stood to gain from the transaction.

[96] *Id.*

[97] *Id.* at *3.

[98] The plaintiffs argued, and the court agreed, that the suit was direct rather than derivative, and thus demand was not required. Chaffin v. GNI Grp., Inc., 1999 WL 721569, at *7 (Del. Ch. 1999).

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Figure 4: Defendant's GNI Facts

	Affirm	No
Independent	3	1
Conflicted	1	

Does it matter whether fatherhood compromised Titus, Jr.'s independence? It does not matter in two of our tests. The Independence Ratio test asks whether a majority of the independent directors affirmed the transaction. That test is satisfied on either the defendant's and the plaintiff's facts because the independent directors either voted 2/3 or 3/4 in favor of the transaction. If the court had used that test, it could have granted the board's motion to dismiss, since the plaintiffs lose no matter what.

Nor does Titus Jr. matter on a Director Ratio test, which asks whether a majority of the directors were independent. This group of directors was either 3/5 independent or 4/5 independent. Either way it was majority independent.[99] If the court had used this test, it could have dismissed the case with prejudice.

> The court did not use either of those tests, and it did not dismiss the case. In light of the differing contentions on who was independent, Chancellor Jacobs declared that the duty of loyalty claim turns on whether the complaint supports an inference that Harris Jr., as a director, must be deemed 'interested.' . . . In this case that issue is pivotal, because if Harris Jr. (the father) may be deemed interested on that basis, then two of the four directors who approved the Merger were conflicted, and as a result, the merger would not have been approved by a majority of disinterested directors, and the entire fairness standard would apply. If, on the other hand, this circumstance is not sufficient to cause Harris Jr. to be interested, then a majority of independent directors would have approved the Merger, which would be protected by the business judgment standard.[100]

Thus, the rule in *GNI* is that board protection requires more than half of the voters both affirm and be independent. In *GNI*, the pivotal question therefore became whether 60% or 40% of the board offered independent approval.

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[99] Chaffin is by no means alone. *E.g.* Gries Sports Enterprises, Inc. v. Cleveland Browns Football Co., 496 N.E.2d 959, 968 (Ohio 1986) (applying Delaware law to find no disinterested majority where three conflicted directors and one independent director voted for a transaction and three conflicted directors abstained or dissented).

[100] Chaffin v. GNI Grp., Inc., 1999 WL 721569, at *5 (Del. Ch. 1999).

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Chancellor Jacobs accepted the plaintiff's complaint as well-pleaded because Rush's conflicts were so apparent and papa Harris's filial status would make it difficult for him to be objective. "Thus, only two disinterested directors approved the merger, which was one short of the required disinterested majority."[101] As we shall see, GNI's board had a tougher time than a nearly identical board only a few months later in front of a different Delaware Chancellor applying a different test.

B. Independence Ratio: Cooke v. Oolie

The cash-strapped Nostalgia Network spent the later months of the 1980s borrowing money from its directors and seeking equity financing from third parties.[102] When several bids came in, the four-member board voted unanimously to accept one offer—and to reject four competing bids, including one offering 15% more money.

Why? Perhaps it was because two directors, Oolie and Salkind, were also creditors of Nostalgia Networks to the tune of almost $2 million. The higher bidder planned to impose losses on creditors in the recapitalization. Nostalgia shareholders argued that Oolie and Salkind let their competing interests as creditors influence their decision.[103] They turned down a bid that was better for the corporation and its shareholders because it was worse for them, as creditors.

Taking the facts most favorable to the plaintiffs, the board was therefore half independent and half conflicted.

Figure 5: Cooke v. Oolie

	Affirm	No
Independent	2	0
Conflicted	2	0

Does such a transaction warrant the protection owing to a disinterested majority?

[101] *Id.* , at *6.

[102] Cooke v. Oolie, 2000 WL 710199, at *13 (Del. Ch. 2000).

[103] Nor is that the end of it. Unfortunately, the winning (low) bidder backed out of the deal, leaving Nostalgia Network in the lurch. Fortunately for Oolie and Salkind, one of the other bidders was still willing to purchase shares – but apparently only from Oolie and Salkind, not Nostalgia Network or its other shareholders. The bidder, Gold, bought warrants worth about 1% of the Nostalgia Network, from Oolie and Salkind, which it then exercised. The plaintiff-shareholders argued that this transaction amounted to a breach of fiduciary duties too. *Id.*

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Yes, according to Chancellor Chandler. He granted the defendant's motion for summary judgment in part because the transaction had received the approval of a disinterested majority: "[T]he two disinterested directors voted to pursue [the lower bid], which removes the alleged taint of disloyalty."[104] The court explained its reasoning:

> Under § 144(a)(1), this Court will apply the business judgment rule to the actions of an interested director . . . [if] a majority of the disinterested directors ratify the interested transaction. The disinterested directors' ratification cleanses the taint of interest because the disinterested directors have no incentive to act disloyally and should be only concerned with advancing the interests of the corporation.[105]

In dismissing the plaintiff's duty of loyalty suit, Chancellor Chandler therefore found disinterested approval where two conflicted directors voted in favor of an action alongside two independent directors.[106] These facts are almost the same as those in *GNI*, but the result was the opposite.

Had Chancellor Chandler followed the Affirmation Ratio test from *GNI*, decided only a few months prior, he would have denied the defendant's motion for summary judgment rather than granting it. He would have noted that two out of four directors were independent affirmers – a mere half rather than a majority of three or more. A court following *Chen*'s Director Ratio (to be discussed next) would likewise have denied the board's motion. That test asks whether most of the group was independent, regardless of how they voted. Here, only half (less than most) were independent.

C. Director Ratio: Garnett v. Chen

China Automotive Systems, Inc. (CAAS) is a 100 million dollar, NASDAQ-listed, Delaware corporation.[107] It sells power steering

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[104] *Id.* at *13. *Accord* Rapoport v. Schneider, 29 N.Y.2d 396,402 (1972) (finding a disinterested majority where two conflicted and two independent directors approved an action and one conflicted and one independent director voted against it); MCG Capital Corp. v. Maginn, No. CIV.A. 4521-CC, 2010 WL 1782271, at *26 (Del. Ch. May 5, 2010)

[105] Cooke v. Oolie, 2000 WL 710199, at *13 (Del. Ch. 2000). Although the court cites to 144(a)(1), it notes that the literal terms of 144 are not met because Oolie and Suskind did not actually stand on both sides of a transaction, nor was there a transaction at all, since the deal fell through. n.39.

[106] Actually, the Chancellor elsewhere concludes that the plaintiffs failed to allege plausible conflicts, despite the loans and sale of warrants. But in this portion of the opinion, the Chancellor puts that aside to show independent grounds for summary judgment.

[107] It also has the dubious distinction of being among two dozen firms investigated by the FBI because it was brought to market through a "reverse IPO" with the aid of New York Global Group. Matthew Goldstein *F.B. I. Botched Evidence Collection in Fraud Case, Judge Rules*, THE NEW YORK TIMES (June 16, 2017) https://www.nytimes.com/2017/06/16/business/dealbook/benjamin-wey-warrant-fraud-case.html.

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components to Ford Motor Company, Fiat Chrysler, and other manufacturers.[108] From 2009 to 2012, it filed erroneous financial statements. When the company restated its financials, the stock price dropped 15%.[109] Prior to that drop, two directors (Wu and Chen) allegedly dumped their shares on the unsuspecting public.[110] The other three directors were alleged to have breached their duties by failing to maintain adequate controls, utilize proper accounting and audit practices, and otherwise police the misconduct by Wu and Chen.[111] Arthur Garnett, a shareholder, brought a derivative suit on behalf of CAAS against its board.

Taking the facts as the plaintiffs alleged them, the board composition was three independent directors and two conflicted directors. Wu and Chen were conflicted because they are the subject of particularized complaints that, if true, could put them in a world of trouble.[112] The other three directors were disinterested because their alleged sins could not lead to liability.[113] Figure 6: *Garnett v. Chen* depicts the board structure in *Chen*.

Figure 6: Garnett v. Chen

Independent	3
Conflicted	2

Is such a board protected by an independent majority rule? We have no answer on the Affirmation or Independence Ratios. That is because both of those tests turn in part on voting patterns, but this case involved no vote. The decisions were either individual (Chen and Wu opting to sell stock) or the board's absence of a decision to implement better oversight. Importantly, a board with two conflicted and three independent directors could vote in ways that satisfy or fail the affirmation and independence ratio tests.

However, on the basis of these allegations, the court readily dismissed the plaintiff's case. Demand was not futile with respect to this board because it was majority independent. "Because the Plaintiffs have not alleged facts

[108] THE CHINA AUTOMOTIVE SYSTEMS (CAAS), https://caas-usa.com/site/about/ (last visited Feb. 19, 2019).

[109] M. Todd Scott et. al., In Re China Automotive Systems Inc. Derivative Litigation: When Are Directors Liable for Failing to Exercise Proper Oversight?, ORRICK SECURITIES LITIGATION, INVESTIGATIONS AND ENFORCEMENT (Sept. 6, 2013) https://blogs.orrick.com/securities-litigation/tag/in-re-china-automotive-systems-inc-derivative-litigation/.

[110] *In re* China Automotive Systems, Inc. Derivative Litigation., 2012 WL 5337401, 119-23 (Del. Ch. 2012)

[111] *Id.* at 119-15

[112] *Id.* , at *10.

[113] *Id.* at *7-9. Even if they had breached their duty of care, the breach would have been exculpated.

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showing that any of Richardson, Tung, or Xu were interested, not independent, or facing substantial threat of personal liability at the time the derivative Complaint was filed, these three directors – representing a majority of the Board – were entitled to consider demand." The court applied a Director Ratio because it simply divided the number of independent directors (3) by the total board (5).

The court was able to determine the board's independence without reference to board votes. That marks *Chen* as using a different rule from *GNI* and *Oolie* which were operationalized by considering particular voting patterns. Instead, *Chen* simply adds up the number of independent directors and divides by the number of directors. Three out of five is a majority, so the board is protected.

Had the board taken a vote on a litigation strategy, we might have seen that the Director Ratio can lead to different results than the other two ratios. It can be satisfied even in cases where the other two ratios are flunked. To see why, imagine that the directors in *Chen* actually voted to dismiss the potential lawsuit, so that we now have a decision with votes to consider. The Director Ratio would have remained the same, so the board would still prevail under that test.[114] On the other hand, we have no way of knowing whether the court would have still applied the Director Ratio had a vote been taken, or whether it would have relied on a different test.

Had the court applied *GNI*'s Affirmation Ratio, it is possible that the board would have failed, even with widespread support for dismissing the lawsuit. Figure 7 demonstrates a voting pattern that would protect the board under *Chen* but not under *GNI*.

Figure 7: *Chen* failing *GNI's* affirmation ratio

	Affirm	No
Independent	2	1
Conflicted	2	0

These facts would fail *GNI's* Affirmation Ratio because less than a majority (2) of the board was both affirming and independent.

[114] *Id.*at *6. *Garnett* was decided under *Rales v. Blaseband*, which was applicable when the challenged action was not a decision of the current board. *See* Rales v. Blasband, 634 A.2d 927 (Del. 1993). Aronson v. Lewis, 473 A. 2d 805 (Del. 1984) governs when the plaintiff does challenge a board action. Although the tests differ in some respects, they are the same on this element. *See id.* at 815. Importantly, the two tests have now been "blended" into one. 262 A.3d 1034, 1058 (Del. 2021).

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Likewise, the *Chen* board could have failed *Oolie*'s Independence Ratio, depending on how the board actually voted. It would only have required some reluctance among the independent directors.

Figure 8: *Chen* failing *Oolie's* independence ratio

	Affirm	No
Independent	1	2
Conflicted	2	0

With only one out of three independent directors affirming, no suitable majority would be found.

We have seen that *Chen*'s Director Ratio can exonerate where the other two tests do not. But that does not mean that the Director Ratio is strictly more protective than the Affirmation and Independence Ratios. Consider what would happen if the CAAS board had had two (rather than three) independent directors among its five. Such a board would not satisfy the Director Ratio, but it could easily satisfy the Independence and Affirmation Ratio tests.

Figure 9: Modified *Chen* satisfying other tests

	Affirm	No
Independent	2	0
Conflicted	1	1

Here, all of the independent directors affirm, thus satisfying the *Oolie*'s Independence Ratio test. And two out of three affirmers are independent, thus satisfying *GNI*'s affirmation test.

* * *

GNI, Oolie, and *Chen* have almost identical board compositions, but their boards received wholly dissimilar treatments. *GNI*'s board faced serious liability and *Oolie*'s board was protected. *Chen*'s board was protected without regard to any actual vote – and would have been protected under the Director Ratio test even if votes were taken that would have been unprotected in *GNI* and *Oolie* – but might have faced serious risks if a single independent director left the board.

What explains these different results is that the courts operated with different conceptions of "majority." For *GNI* and *Oolie*, the numerator is the same: the number of affirming, independent directors. The tests differ in their denominator. *GNI* uses an Affirmation Ratio because it seeks out the number

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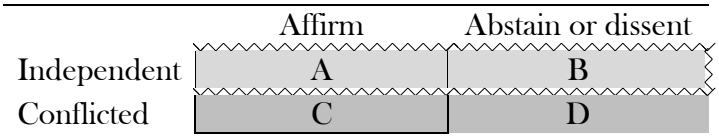
of independent directors who affirmed a disputed vote. *Oolie* uses an Independence Ratio because it asks whether most of the independent directors approved the action. *Chen* is altogether different because it asks whether the directors as a group were mostly independent or not, regardless of whether they voted or how they voted. It therefore exemplifies a Director Ratio.

To put these three tests formally, consider Figure 9.

Figure 9: Three tests



The Affirmation Ratio test is satisfied exactly when A>(B+C+D). The Independence Ratio test is satisfied exactly when A>B. The zig-zagging line shows which directors matter for its arithmetic. The Director Ratio is satisfied exactly when (A+B)>(C+D). It takes stock of all directors, lumping the independent directors together as separate from the conflicted directors.

III. MISUNDERSTANDING MAJORITIES

What shall we make of the fact that courts differ in how they compute a "majority?" For example, do these different rules reflect different commitments to following statutory law, such that one of them is grounded in the positive law and two are lawless departures? Is one of these rules good at addressing the relative risks of board malfeasance and plaintiff "strike" suits (while the other two get the balance wrong)? Or perhaps multiple rules persist because none of them even matter?

This search for understanding can be both explanatory and evaluative. As we check the fit between one means of understanding and a given rule, we can sometimes decide whether a tighter fit would be good or bad, and therefore whether we would change the rules in some way.

This Part presents three imperfect ways of looking at the different majority rules: conformity with the positive law, practical difficulty, and as epiphenomena. None of these outlooks is correct, but that does not make the exploration fruitless. To the contrary, in each instance, we profit from seeing *why* these are not useful lens for understanding majority rules: (A) "The law" is a poor guide because the law both underdetermines and confuses in ways we previously did not fully understand; (B) Practical difficulty fails as a tool because the rules cannot be ordered from most to least friendly to director-defendants; (C) An accusation of scholasticism – that there is no practical

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importance to the differing rules – highlights the many ways in which majority rules do matter.

A. The Law as We Find it

If the law affords benefits to disinterested majorities, it is natural to look to the law for guidance on which conception of "majority" fits best with governing statutes or controlling precedent. In this case, no firm guidance is to be found. To the contrary, statutes, court decisions, and party briefs all show substantial confusion about the state of the law.

That does not mean that examining the positive law is fruitless. In fact, examining the law in light of this Article's analysis helps explain and resolve one of the most persistent muddles in Delaware law: the interaction between DGCL 144 and the common law of conflicts. This muddle has occupied decades of case law, but its core is now clear: there are several distinct rules, *each of which* courts are attracted to. Courts' ambivalence about the function of Section 144 reflects their varying desires to invoke or reject the protection rule most naturally associated with Section 144. Because different rules are attractive at different times, courts cannot take a stable position on the status of Section 144.

1. Positive Law as Guide to Majorities

Statutory language exists that could guide an inquiry into the right disinterested majority rule. For example, DGCL 144(a) governs conflicted transactions for Delaware corporations. It provides that a transaction is not void just because of a director's conflict if "the board . . . authorizes the contract or transaction by *the affirmative votes of a majority of the disinterested directors* . . . ."[115] This language might seem supportive of *Oolie's* Independence Ratio test. That is because an Independence Ratio test asks what portion of the independent directors approved the transaction. So, it may seem that the most important corporate law jurisdiction has a clear statutory mandate on the correct protection rule.

However, such language provides only limited guidance.[116] There are four problems with deriving a proper protection rule from this statutory provision.

First, DGCL 144 applies by its terms to only *some*, statutorily enumerated, self-dealing transactions.[117] It does not address other, less direct

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[115] DGCL 144(a)(1).

[116] For an extended treatment of DGCL 144, see Bratton, supra note **Error! Bookmark not defined.**.

[117] Cooke v. Oolie, 2000 WL 710199, at *13 (Del. Ch. 2000) (recognizing that the defendants' allegedly self-serving actions "do not fall explicitly within § 144).

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conflicts, and so that statutory language could not provide guidance in many substantively similar contexts. For example, DGCL 144 does not appear to apply if a director has a material interest in a transaction that is not financial.[118] Nor does DGCL 144 address demand futility or statute of limitations tolling. These inquiries, and the relevant tests for them, are invented out of case law.[119]

Second, even for those enumerated transactions, statutes like DGCL 144(a) do not actually state that the independent majority confers protection.[120] Instead, compliance with the statute seems to address the rather esoteric matter of per se voidness alone.[121] Some courts have also elevated the statute to altogether cure conflicts of interest (and their standard of review) generally,[122] but other courts have balked, creating a rather messy state of the case law. One recent Chancery court opinion put the influence of Section 144 in this way:

> Our case law interpreting Section 144(a)(1) is murky at best. A search of one's favorite legal research site would yield cases that appear to support the view that Section 144(a)(1)'s safe harbor works as Defendants suggest [and provides a deferential standard of review]. That same search, however, would yield several cases, even post-*Benihana II*, where our courts have viewed Section 144(a)(1) much more narrowly.[123]

In that case, after an exhaustive review of the Section 144 jurisprudence, Chancellor Slights held that Section 144(a)(1) only bears on per se voidability and does not otherwise protect a board.[124] To determine what protection applies requires a court to consider case law rather than the plain text of Section 144.

Third, where courts have applied DGCL 144 to guide generalized breach of duty analyses on the same facts,[125] they have long modified it in

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[118] For example, a director who is being blackmailed with incriminating personal information might be biased toward the transaction demanded by the blackmailer, even though money has little to do with it.

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

[120] *Cf.* Cooke v. Oolie, 2000 WL 710199, at *13 (Del. Ch. 2000) ("Although Section 144 of the Delaware General Corporation Law does not explicitly apply, I recognize the policy rationale behind the provision's safe harbor.").

[121] Cumming v. Edens, 2018 WL 992877 (Del. Ch. Feb. 20, 2018).Etc. Rohrbacher *supra* 53 at 720 – 721.

[122] Many commentators read *Benihana* this way. Benihana of Toko, Inc. V. Benihana, Inc., 906 A.2d 114 (Del. 2006) ("Benihana II"). *See also Cumming*, 2018 WL 992877 reviewing the caselaw. See generally William Bratton, Reconsidering the Evolutionary Erosion Account of Corporate Fiduciary Law, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3753589.

[123] Cumming v. Edens, 2018 WL 992877, at *20 (Del. Ch. Feb. 20, 2018).

[124] Id at *22.

[125] Benihana of Tokyo, Inc. v. Benihana, Inc., 906 A.2d 114 (Del. 2006).

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the process.[126] Therefore, the statutory language is not a defining pillar of the duty analysis – the case law supplementing and modifying the statute controls its reception into a given area.

Fourth, DGLC 144 is ambiguous and allows at least two interpretations.[127] Recall that DGCL 144 provides that a transaction is not void just because of a director's conflict if authorized "by the affirmative votes of a majority of the disinterested directors."[128] One possible interpretation is that more than half the disinterested directors must vote in favor of the transaction. On this conception, "a majority" means more than half of the domain in question. This conception would favor a version of the Independence Ratio test, and it is the conception discussed so far in this Section.

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[126] *See* Lawrence v. Fliegler, 361 A.2d 218 (Del. 1975); Marciano v. Nakash, 535 A.2d 400, 404 (Del. 1987) ("This case illustrates the limitation inherent in viewing section 144 as the touchstone for testing interested director transactions.").

[127] The answer is little better under the statutes of other states. For example, New York's conflict of interest statute protects a transaction if "the board or committee approves such contract or transaction by a vote sufficient for such purpose without counting the vote of such interested director."

N.Y. Bus. Corp. Law § 713 (McKinney). This statute asks us to debit the conflicted directors, checking whether the vote would have succeeded without them. What does it mean for it to be sufficient without counting their votes? The question is stranger still when all directors have conflicts, but not pointing in the same direction. *See, e.g.*, Possis Corp. v. Continental Machines, Inc, 425 N.W.2d 286 (Minn. Ct. App. 1988) (two conflicted one way, the other two conflicted the other way). Shall we call this vote zero to zero? Then the status quo group of conflicted directors (the "no" votes) prevail. The answer depends on what manner of hypothetical non-voting the statute imagines them undertaking.

If the conflicted directors are deemed to have not voted by way of recusal or exclusion from a committee, then the New York test collapses into *Oolie's* Independent ratio test, with scoping down to the relevant electorate. Cooke v. Oolie, 2000 WL 710199, at *13 (Del. Ch. 2000).A majority of the independent directors voting or abstaining at the meeting is the only way to pass a measure when all the conflicted directors recuse themselves. That is because the independent directors are the only ones present at the meeting.

However, it might be that the conflicted directors are treated as having abstained. Then the New York rule is akin to a non-scaling Independence ratio test. That is because abstentions are as good as "no" votes. Dillon v. Berg, 326 F. Supp. 1214, 1227 (D. Del.1971). *But see* Equity Investors, Inc. v. Ammest Group, Inc., 563 P.2d 531, 535-36 (Kan. Ct. App. 1977). (counting abstention as affirmation). *Accord* Breaud v. Amato, 94-1054 (La. App. 5 Cir. 5/30/95); 657 So. 2d 1337, 1344. The transaction will then only succeed if the disinterested directors can muster enough "yes" votes on their own to pass the measure, which will surely require a majority of the disinterested directors to support it.

Still, the New York test is slightly clearer in preferring an Independent Ratio test of some sort rather than an Affirmer or Board ratio test. That is consistent with the trend of non-Delaware courts to absorb part or all of the MBCA, which is squarely an Independent Ratio regime.

Given the text of DGCL 144 and other statutes, only limited guidance can be found in positive, statutory law by which to pick an appropriate protective rule. But perhaps the search for a protective rule can shed light on a puzzle in statutory law.

[128] DGCL 144(a)(1).

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However, the term "majority" can also refer to the winning coalition. "The majority" is the group that voted and won.[129] For example, if five directors split their votes – three in favor, two against – then we might describe the three affirmers as "the majority." If "majority" here refers to a winning coalition, then DGCL 144 calls for an Affirmation Ratio. That is because it requires that the winning coalition must be independent.[130] On the example from this paragraph, it would require that there be three affirmers who are independent, regardless of who else is independent on a five-member board.

To some, this second interpretation will appear strained because of the word "the" in 144(a)(1). Recall that 144 applies where there are "affirmative votes of a majority of *the* disinterested directors . . . ." This word may seem to imply that the denominator must be the disinterested directors.

Yet, courts have ignored that article more often than they have cared about it. There are more court opinions addressing "a majority of disinterested directors" than "a majority of *the* disinterested directors," particularly in recent years.[131] Additionally, a substantial portion of the cases using "the" in the rule's formulation do so only when quoting the statute verbatim; when the court states the rule in its own words, it is less persnickety

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[129] *Majority*, OXFORD ENGLISH DICTIONARY 3.a. ("spec. (in a deliberative assembly or electoral body) the group or party shoe votes amount to more than half the total number, or which has the largest share of votes;")

[130] If "majority" refers to the group that prevails in a vote, it remains to ask what proportion of that "majority" must be independent for the majority to be independent. Perhaps it is a majority (of the majority). So two out of three approving directors on a five member board would suffice to qualify for disinterested approval. Perhaps the approving majority must be *all* disinterested for the majority to be disinterested. Then all three directors voting would need to be independent. Some scholars and jurists have even hinted that the presence of a single disinterested director among the winning majority would suffice to make the majority count as an independent majority. Professor Dent writes "Thus, plaintiffs face the daunting task of producing specific evidence that each of a majority of the responsible directors was actually influenced in the particular case. George W. Dent, *Jr., Independence of Directors in Delaware Corporate Law*, 54 U. LOUISVILLE L. REV. 73, 80 (2016). It is indeed a daunting task if the plaintiff must show that each of the affirming directors was conflicted. A single disinterested director would suffice to protect the action, despite legion conflicted directors. *Cf.* . Cooke v. Oolie, 2000 WL 710199 (Del. Ch. 2000)(implying approval of such a rule).

[131] For example, a Westlaw search for adv: "Majority of disinterested directors" yields 193 hits, which is 17 more than adv: "Majority of *the* disinterested directors." In recent years, the former formulation greatly exceeds the latter, with perhaps twice as many occurrences since 2000. Moreover, many of the remaining uses of "majority of *the* disinterested directors" amounts to quotations from the statute, rather than the court stating its understanding of the law. Nor are these the only two formulations adv: "majority of independent directors" gets 85 hits while adv: majority of *the* independent directors" gets 69. The point is that courts are not more likely to include the "the" than not, showing that courts have generally not found this word to be dispositive of meaning.

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and drops the "the."[132] Whatever answer the statute might suggest, courts have not embraced it.[133]

2. Majorities as Guide to Positive Law

Delaware jurisprudence on DGCL Section 144 is highly confused. The statute was passed to overcome the problem of per se voidability, allowing a sensible channel by which a transaction might be undertaken even in the face of director conflicts. The statute was never meant to address challenges to a transaction other than per se voidability, yet courts immediately seized upon the statute and thrust it into a complex interaction with a closely related body of law: the *common law* on voidability for breach of duty. Prior to the passage of DGCL 144, conflicted transactions could be challenged *either* because the presence of conflicted directors voided the transaction, *or* because unfair conflicted transactions breached the duty of the conflicted directors (and thus voided the transaction). DGCL 144 addressed the former, but some courts have taken it to address the latter as well.

The high point of conflation can be found in the Delaware Supreme Court's 2006 *Benihana* decision. There, the court cited DGCL 144 at every step of its analysis of a conflicted transaction. Having found that the board approved the transaction under DGCL 144(a)(1), the court concluded that the conflicted transaction was protected – unless the plaintiff could show an affirmative misuse of information by the conflicted director, which was not possible.[134] *Benihana* has been cited for the proposition that compliance with 144(a)(1) protects a transaction from both per se voidability and from the harsh "entire fairness" standard of review otherwise applicable to conflicted transactions.[135] In other words, *Benihana* conflates the test for per se and fiduciary voidability.

Other courts have resisted this conflation – insisting that compliance with 144's majority independence test does "not necessarily" provide a protective standard of review in fiduciary lawsuits.[136] Unfortunately, these courts have been somewhat unclear about what their alternative means. Does

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[132] Of the 70 cases that quote "majority of the disinterested directors," directly from the statute, almost half are only faithful while quoting the statute. 31 of those go on to paraphrase the rule with substantial modification elsewhere in the opinion, usually without the "the." *E.g.* Marciano v. Nakash, 535 A.2d 400, 404 (Del. 1987) ("approval of a noninterested majority of directors or shareholder").

[133] Nor does Westlaw seem to care about the article. Its headnotes blithely add or subtract "the." *Compare, e.g.* Bender v. Jordan, 525 F.Supp.2d 198, 205 (2007) (discussing a majority of "the" disinterested directors) *with id*. at 198 (Westlaw headnote summarizing the paragraph but omitting "the").

[134] Benihana at 121.

[135] *Sutherland v. Sutherland*, 2009 WL 857468, at *4 n.13 (Del. Ch. Mar. 23, 2009) (citing *Benihana II as* "stating that interested director transactions approved pursuant to the 144(a)(1) safe harbor are reviewed under the business judgment rule").

[136] Cumming v. Eden *22.

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it mean that board or shareholder approval provides no protection at all, and the court can still scrutinize the transaction for entire fairness?[137] Does it mean that the relevant degree of protection turns on an old common law test of disinterestedness (and, if so, what is that test)?[138]

The latter seems to be a plausible option but could lead some commentators to wonder what DGCL 144 does *at all*?[139] If a transaction obtains disinterested approval, it is protected under 144 and the common law. If the transaction lacks disinterested approval, it invalid under both 144 and the common law. So, what work does DGCL 144 do? One oft-cited law review article attempts to work out the difference between DGCL 144 and the common law, [140] but even it leaves one with the sense that DGCL 144 performs no function: the article provides no example of a transaction flunking DGCL but surviving the common law, suggesting that practitioners need only know the common law, since the case lives and dies with it.

The analysis in this Article makes clear that, while DGCL 144 and the common law may be different, neither one is strictly easier or harder to satisfy, and therefore helps explain why DGCL 144 cannot quite fade into the background. DGCL 144 plausibly uses an Independence Ratio in calling for a majority of the disinterested directors to approve. The common law plausibly uses an Affirmation Ratio, asking that a majority of the voting directors be independent affirmers. Both rules have some appeal, and so courts try to invoke both.

Sometimes courts cite to DGCL 144(a)(1) in "recogn[ition] of its policy rationale," even in cases where it clearly does not apply.[141] Courts do this because they want access to an Independence Ratio and 144(a)(1) seems to supply one. For example, in *Oolie*, the court addressed a unanimous board that was 50% conflicted and would thus fail an Affirmation Ratio test. That is, if Chancellor Chandler had followed Chancellor Jacobs's recent *GNI* decision, he would have sided with the plaintiffs.

However, Chancellor Chandler felt confident that the transaction was good and applied 144 by analogy in order to introduce the Independence Ratio it plausibly requires.

> Although Oolie's and Salkind's actions do not fall explicitly within § 144, the rationale behind the Legislature's creation of the safe harbor is on all fours with

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137 Cf. Remmillard v. Dandino.

138 Blake Rohrbacher, John Mark Zeberkiewicz & Thomas A. Uebler, *Finding Safe Harbor: Clarifying the Limited Application of Section, 144*, 33 Del. J. Corp. L. 719, 737–38 (2008).

139 See William Bratton, Reconsidering the Evolutionary Erosion Account of Corporate Fiduciary Law, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3753589 (arguing for the removal of 144).

140 Id.

141 *Oolie*.

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> [the] disinterested directors' ratification of the challenged action currently before the Court. The disinterested directors' vote to pursue the same proposal that Oolie and Salkind voted to pursue provides strong evidence to the Court that Oolie and Salkind acted in good faith and with the interests of TNN and its shareholders in mind.[40] If the USA deal favored Oolie and Salkind to the detriment of the other shareholders, then presumably the independent directors would not have voted to pursue the USA deal. As such, the disinterested directors' votes present the Court with another reason why the business judgment rule remains the appropriate standard with which to review Oolie's and Salkind's actions.[142]

In other words, DGCL 144 does not govern, but applying it would make it easier to switch tests to the one more favorable to the board.

We also have examples of the opposite: cases in which 144(a)(1) plainly *does* apply but the court stretches to impose an Independence Ratio (to the detriment of the board).[143] For example, in *Beneville v. York*, the court expressed ambivalence about whether to protect the decision of a two-director board, where one director was conflicted and the other was independent:

> Although the two-person board context at issue in this case makes the pure business judgment rule analysis somewhat murkier because the sole impartial director would always constitute "a majority of the disinterested directors" under 8 Del. C. § 144(a)(1), the key fact remains that the interested director possesses the blocking power to stop the impartial director from acting as he wishes.[144]

The court recognized that Section 144 applied and noted that it seemed to require an Independence Ratio test (which the transaction satisfied), but the court hesitated to bless a fishy-looking transaction that flunked the Affirmation Ratio.

Precision about what sorts of rules courts may apply allows us to see more clearly why the case law on DGCL 144 is so ambivalent. [145] Delaware

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[142] Cooke v. Oolie, 2000 WL 710199, at *13 (Del. Ch. 2000)

[143] Chaffin

[144] Beneville v. York, 769 A.2d 80, 85 n. 9 (Del. Ch. 2000)

[145] This explanation is compatible with interest group accounts, in which some knotty problems resist clarification and reform because they benefit Delaware lawyers. See, e.g. Stephen M. Bainbridge, Interest Group Analysis of Delaware Law: The Corporate Opportunity Doctrine as Case Study, in Can Delaware Be Dethroned? Evaluating

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law on conflicts requires courts to do what they may want to do anyway: apply *either* an Affirmation or an Independence Ratio. DGCL 144 arguably requires an Independence Ratio test, and the common law arguably requires an Affirmation Ratio test. Courts emphasize DGCL 144 when they wish to use an Independent Ratio and deemphasize it when they wish to use an Affirmation Ratio.

The Independence Ratio and Affirmation Ratio have different appeals in different cases. They give different results and so do justice under different circumstances. Which one a court wishes to invoke may depend on the problem the court observes. Part IV below discusses the policies best suited to one ratio or another.

B. Board-Friendliness

One natural way to evaluate rules is in their tendency to favor one side or the other. If the rules can be stacked in order from least board-friendly to most board-friendly, then we may surmise that courts selecting the former may have been seeking to discipline boards while the latter may have been seeking to protect boards from meddlesome shareholder lawsuits. Following such an explanation, we can move to normative evaluation. If *we* think it is *good* for courts to discipline (or defer to) boards, we can select the least (or most) deferential rule.

Unfortunately, board-friendliness is not an especially useful explanatory or normative principle in this case. The three prominent rules cannot be ranked from first to third most deferential. That is because they each protect boards under slightly different circumstances: a board that is protected by one rule may or may not be protected by the other two rules. Unless we have strong assumptions about how common various circumstances are, then it is impossible to say which one they would prefer. The rules are comparable, but ultimately incommensurable.

The comparison changes if boards act strategically, forming committees in order to improve their chances. In this situation, the three rules are commeasurable: all three are equally trivial. Again, one cannot pick among these three rules just based upon whether one likes boards or worries about them.

Delaware's Dominance of Corporate Law (2018); Jonathan R. Macey & Geoffrey P. Miller, Toward an Interest-Group Theory of Delaware Corporate Law, 65 Tex. L. Rev. 469, 475 (1987)

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1. Board-Friendliness as a Guide to Majority Ratios

We evaluate this section in two parts: first, naively, as though boards do not take strategic action to secure protection. Then we consider it a second time, to show how careful boards can structure votes to ensure better protections. An important lesson of this latter exercise is that committees are a powerful tool.

a. Naïve Board Protection

For a naïve board, none of the three widespread rules are strictly easier or harder to satisfy than its peers.[146] To see this, let us consider the three rules in action. Recall that the *GNI* demonstrated an Affirmation Ratio. *Oolie* demonstrated an Independence Ratio. *Chen* demonstrated a Director Ratio test.

The following table displays cases in which a board would be protected (check mark indicating protection) on a given voting pattern. For example, the fourth line down describes a board with four affirming directors (half independent, half conflicted) and one independent director abstaining or dissenting. The Figure indicates that the board would be protected on two of the three tests: *Oolie* and *Chen*, but not *GNI.*[147]

[146] That is not to say that any one rule is not strictly easier than another. Some are. The MBCA test is strictly harder than *Oolie* to satisfy. *Oolie* allows some sub-set directors to affirm a transaction. The MBCA sets a higher denominator, since it draws from a wider set of independent directors, but it cannot inflate the numerator: even the narrowest domain for a test covers all affirming directors. Adding some broader sample, such as recusing directors, will not bring in any more affirming votes. However, *both* the MBCA and *Oolie* (i.e. the affirmation ratio tests) are harder than the independence ratio tests in some cases and easier in others.

[147] Cf. In re Nine Sys. Corp. S'holders Litig., 2014 WL 4383127 (Del. Ch. 2014) (evaluating this constellation of votes and independence).

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Figure 10: Naïve Board Protection

		Affirm	No	Affirmer (*GNI*)	Independent (*Oolie*)	Board (*Chen*)
1	Independent	3	1	✓	✓	✓
	Conflicted	1	0			
2	Independent	2	0		✓	
	Conflicted	1	2			
3	Independent	2	2			✓
	Conflicted	1	0			
4	Independent	2	1		✓	✓
	Conflicted	2	0			
5	Independent	1	2			✓
	Conflicted	2	0			
6	Independent	1	1			
	Conflicted	2	1			
7	Independent	1	0		✓	
	Conflicted	4	0			

As can be seen, these three tests cannot be simply ranked by their toughness.[148] There are cases where the Independence Ratio provides more protection than the Affirmation Ratio[149] and vice versa.[150] There are cases where the Director Ratio protects but the other two tests do not.[151] It is true that the Affirmation ratio is strictly less protective than the director ratio, because success on the former test requires enough independent directors to satisfy the latter test. But it is impossible to rank the Affirmation or Director test relative to the Independence test. When boards do not act strategically,

[148] The only permutation not possible is one in which *GNI* protects but neither other rule protects. Every time *GNI* protects, some other rule would have reached the same result. *GNI*'s test is satisfied when more independent directors affirm than conflicted directors. Often, this will occur because there are more independent directors than conflicted directors, which will trigger *Chen*. Other times, this will occur because the independent directors overwhelmingly approved, yielding protection under *Oolie*. It is impossible for (independent approvers>conflicted approvers) & ((independent approvers + independent no's) ≤ (conflicted approvers + conflicted no's)) & (independent approver ≤ independent no's).

[149] Figure 10, Line 7.

[150] Figure 10, Line 3.

[151] Figure 10, Line 3.

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these rules lead to different outcomes, but none is systematically "best" for plaintiffs or defendants.

b. Strategic Board Protection

Strategic considerations alter the relative toughness of the various tests. Once strategic considerations are applied, all three tests prove to be easy for boards to satisfy. But they are equally easy.[152]

If a board majority exists sufficient to pass a measure, then a sufficient majority exists to force the use of a committee to consider an issue.[153] Even a conflicted board may vote to form a committee.[154] The use of a committee allows the board to push out whatever directors might undermine protection.[155] Sometimes that means willful independent directors, other times it is superfluous conflicted directors. A strategic board can always form a committee specified to survive whichever majority rule applies.

For example, consider a board with three directors (two independent and one conflicted) in favor of the transaction and two independent directors opposed to the action.[156] This board obtains protection under *Chen's* Director Ratio test but not *Oolie*'s Independence Ratio test or *GNI*'s Affirmation test. But it can obtain either protection if the three like-minded directors in favor of the action first vote to form a committee excluding the would-be dissenting directors. Now, only three directors (two independent, one conflicted) can vote, and they all vote in favor of the action. This action has now obtained 100% approval of the independent directors within the relevant domain, satisfying the *Oolie* test. The body is also 66% independent affirmers, thus satisfying *GNI*.

In Figure 11 below, I show the same sample boards as in Figure 10 above, but I adjust the result to reflect strategic use of committees. Where the committee would exclude a director, I strike through the number associated with how they would have voted. I place a new number, underlined, in the "exclusion" column to reflect the number of directors excluded from the committee. On the right-hand side of the figure, I introduce new check marks (highlighted) to indicate places where strategic use of committees has obtained new protection for the board. For example,

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[152] The following discussion assumes that courts accept the committees and do not penalize the board for designing a committee in order to secure protection.

[153] Note however, that some actions cannot be accomplished by a mere board committee. Committees cannot take board action for any transaction requiring a shareholder vote (such as a merger or charter amendment), nor a bylaw amendment. DGCL 141(c)(2).

[154] Zapata Corp. v. Maldonado, 430 A.2d 779, 786 (Del. 1981). MBCA § 7.44(b)(2).

[155] A committee is not just a group formed to research and recommendation action to the whole board; Delaware law permits ultimate decision making.

[156] Figure 10:

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on the fourth line (which tracks the example from the previous paragraph), a new check mark appears by *Oolie* to show that protection is now available. It is available because a dissenting independent director has been shunted from the committee.

Figure 11: Naïve Board Protection

		Affirm	No	Excluded	Affirmer (*GNI*)	Independent (*Oolie*)	Board (*Chen*)
1	Independent	3	1		✓	✓	✓
	Conflicted	1	0				
2	Independent	2	0		✓	✓	✓
	Conflicted	1	~~2~~ 0	2			
3	Independent	2	~~2~~ 0	2	✓	✓	✓
	Conflicted	1	0				
4	Independent	2	1		✓	✓	✓
	Conflicted	~~2~~ 0	0	2			
5	Independent	1	~~2~~ 0	2	✓	✓	✓
	Conflicted	~~2~~ 0	0	2			
6	Independent	1	~~1~~ 0	1	✓	✓	✓
	Conflicted	~~2~~ 0	~~1~~ 0	2			
7	Independent	1	0		✓	✓	✓
	Conflicted	~~4~~ 0	0	4			

As the table indicates, all three tests are completely eroded by strategic use of committees. So long as a single independent director favors the action, it is possible to compose a sole-director committee. Such a committee can protect the board on any of the three tests.

To summarize: if committees are not used strategically, all three tests are incommensurable. None is strictly easier than the others. If committees are used strategically, then all three tests become equally trivial. Either way, the toughness of the test cannot answer the question of which test to select. As a result, courts cannot decide among these rules based on some simplistic sense that it is appropriate to be tough on boards (or, conversely, on those litigating against the board).

Although this inquiry has revealed that board-friendliness cannot tell us which ratio is best, it has borne other fruit. First, it underscored just how powerful a strategy committee construction permits. So long as conflicted

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directors can persuade a single independent director to support a transaction, the approving coalition can form a committee to vote on the issue and thereby secure protection.

This point is not completely novel—it is well appreciated that special litigation committees can be formed to secure protection otherwise unavailable to a board. But the thrust of that discussion is that a thoroughly conflicted board can bring on new, like-minded (but independent) directors to obtain protection; the picture is of a unanimous board, being judged by its most innocent members. By contrast, this Section emphasized how a board could secure protection despite the vigorous dissent and opposition of nearly all of its independent directors, so long as a single independent director can be persuaded. Unless protection should be withdrawn *only* where *all* independent directors loath an action, it is probably undesirable how thoroughly committees can launder conflicts. Perhaps this is why corporate law forbids committees from taking certain kinds of actions: charter amendments, bylaw amendments, and mergers may only be approved by the whole board, where the various majority ratios actually matter.[157]

A second benefit of this discussion is that it allows for a reflection of the limitations and goals of corporate law. Strategic action – such as committee use - makes the precise ratio unimportant for the parties most likely to engage in advance planning, since they can engineer a transaction subject to protection regardless of which ratio is chosen. And a clear rule is most important for parties who engage in advance planning. Plenty of parties wander hapless into transactions that enjoy only ambiguous protection – depending on whether one rule is applied or another – but these are precisely the parties who weren't paying attention to the content of the rule anyway.

If this explanation is right, then the best rule might be the one that is friendly (or harsh) to the *least thoughtful* directors. Innocent or culpable, the directors who failed to think about the importance of committees are the only ones to whom variations on protective rules make a difference. And if this is right, it raises an interesting question about the structure of corporate law. While most scholars advocate majoritarian terms, it may be best to structure corporate law rules on sub-majoritarian grounds. The majority of sophisticated actors can pick the law they like, while the default rules catch those naïfs who neglected good corporate hygiene. Should corporate law be built with such boards in mind?

A third benefit of this discussion has been renewed focus on the effect that different majority ratios do and do not have on outcomes. Identifying conditions under which the ratio rules can make a difference naturally leads

[157] Supra note 154

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to an analytically prior question: do those conditions actually occur in the real world? That is, it matters little if ratios give us different results only on strange voting patterns – but if the real world rarely displays those voting patterns, then perhaps all of the tests collapse. It is that possibility of irrelevance to which we now turn.

C. Unimportance

There is a widespread consensus among academics that boards are collegial and proceed through consensus,[158] and thus board votes are basically always unanimous.[159] Does this reduce to mere scholasticism any study of different majority rules?[160] It does not, for four reasons.

First, the differing majority rules differ in their protection even of unanimous boards. We observed this in the previous Section. A board in which four directors (two conflicted, two independent) unanimously affirm a transaction is protected under an Independence Ratio, but not under an Affirmation Ratio or Director Ratio. This difference is outcome determinative in many cases, which is why courts struggled with it.[161]

Second, even if directors all voted in lock step, we would still want to have clear and rational rules for dealing with divided boards. That is because the current level of board consensus is partially an artifact of our current legal rules. Put simply, people vote and negotiate in the shadow of the law. We might observe a low level of board dissent precisely because would-be dissenters are unsure whether their vote makes any difference. We can surmise that we would see a few more dissents if the law reliably put great stock in them, as some (but not all) majority rules do.

Third, the high level of board consensus is consistent with board majority rules making a difference already. The majority protection rule may influence the items on which boards vote at all. If venal directors know that dissents or noisy abstentions by principled directors will draw judicial

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158 Stephen M. Bainbridge, Corporation Law and Economics (2002) at 264 (stating that the board "usually functions by consensus"); Lucian Arye Bebchuk et al., *Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. CHI. L. REV. 751, 767-79 (2002); James D. Cox & Harry L. Munsinger, *Bias in the Boardroom: Psychological Foundations of Corporate Cohesion*, 48 LAW & CONTEMP. PROBS. 83, 91 (1985) ("[T]he new board member is expected . . . to cooperate with other board members in reaching decisions by group consensus.");

159 *See, e.g.* Samuel N. Fraidin, *Duty of Care Jurisprudence: Comparing Judicial Intuition and Social Psychology Research*, 38 U.C. DAVIS L. REV. 1, 57–58 (2004) ("[B]oards' decisions are usually unanimous").

160 A related view might be that the broader investment and governance environment has rendered conflicts litigation irrelevant. See Bratton. While there is something to this view, it plainly does not apply to most private companies or controlled companies. Nor does it have anything to say about the continued importance of other majority rule settings, such as demand futility and statutes of limitations.

161 See, e.g. Beneville v. York, 769 A.2d 80, 85 n. 9 (Del. Ch. 2000).

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scrutiny, they may not bring the self-dealing transactions to the table. Thus, the high level of consensus may reflect bargaining in the shadow of the predicted, protective rule.

The bargaining position of directors to withhold their assent acts as a tax on certain types of transactions. The independent directors must be placated before the conflicted directors can obtain the protection they wish through an open vote. That placation may amount to an improvement in the quality of the transaction.[162] Directors who would have pillaged the corporation moderate their behavior knowing that the independent directors have some ability to retaliate. Getting the background rules right is essential if we want boards to calibrate their votes to match the law's goals.

Fourth, we do not actually know whether or not dissents are rare on American boards. Data from the United States is limited. The U.S. does not require public filing of board votes. The American Federation of State, County and Municipal Employees (AFSCME) has tried to get voting records made annually public, by way of non-binding shareholder resolutions, but the SEC has not supported the project.[163] Shareholders may demand the results of board votes pursuant to a DGCL 220 books and records request, or the equivalent. Such requests generally require a proper purpose. No widespread database exists yet of voting results discovered in this way.[164] Though there is some data on resignations, which may be a proxy for dissent.[165]

However, Italy, Israel, China, and Korea all have laws providing data on board votes and they reveal substantial non-conformity. In Italy, 10% of Italian listed companies experienced a resignation, dissent, or abstention in connection with open conflict over a controversial decision within a 13 year window.[166] In China, scholars found dissents at 3% of Chinese companies

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[162] Conflicted directors may also invest more resources in persuading or deceiving the independent directors. The welfare effect of this incentive is ambiguous. On the one hand, wasting resources in this way lowers the rents from conflicted transactions and lowers their overall incidence. On the other hand, it increases the already great confusion or obliviousness of independent directors, which makes it hard to do their other director tasks. And it increases the sense of distrust between directors. Independent directors with some power must now worry about whether conflicted directors are in the process of trying to trick the independent director out of the best use of that power.

[163] McKesson Corp., 2004 WL 725617 (SEC No Action Letter April 1, 2004) (denying AFSCME's request for disclosure of "the existence of any non-unanimous Board or Committee vote, identifying the director or directors whose votes were not in accord with the majority.").

[164] DGCL 220.

[165] See Cassandra Marshall, *Are Dissenting Directors Rewarded*, working paper (2010) (examining 287 resignations reported in 7k filings during 199-2006 period))

[166] Marchetti et al. *Dissenting Directors,* 18 EUR. BUS. ORG. L. REV. 659, 675 (2017). The total number of dissents nearly matched resignations and there was substantial overlap, suggesting that the number of dissents approached 10% as well. Id.

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per year.[167] In Israel, the rate was 3.3% *per decision*.[168] In Korea, the rate of dissension was 0.4% per decision.[169] These results vary, but they generally indicate a higher level of dissension at public companies than many commentators might have surmised.

Even if we speculate that American directors – former CEOs, appointees of activist hedge funds – are much less confrontational, or if other factors may be involved,[170] these studies at least provide a benchmark other than unanimity from which to speculate on the level of American dissent.

These studies of other jurisdictions also confirm a plausible intuition: lack of unanimity is especially common in the tense or problematic cases that are bound for litigation. People form committees, disappear, abstain, and dissent with reasonable frequency when the corporation engages in transactions with its executives or controlling shareholders.[171] These are central, rather than peripheral, cases for corporate law to address.

Thus, there is little grounds to dismiss an inquiry into majority ratios because of purported unanimity within American boards. To the contrary, understanding and improving our majority ratio jurisprudence proves vital to supporting the best board decisions, whether unanimous or not.

IV. IMMANENT PRINCIPLES IN MAJORITY RULES

The forgoing section shows that we cannot pick our majority rules in order to neutrally apply the law, nor to monotonically calibrate the outcome of corporate governance litigation, yet we cannot throw up our hands and say that none of this matters. We should admit the possibility that these three facts are not a coincidence. It may be that the law leaves judges the space

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167 Jiang, Wan & Zhoao, *Reputation Concerns of Independent Directors: Evidence from Individual Director Voting*, 29 REV. FIN. STUD. 655 (2016). They further found that 5.9% of directors dissented during the eight-year sample period.

168 Miriam Schwartz-Ziv & Michael S. Weisbach, What Do Boards Really Do? Evidence from the Minutes of Board Meetings, 108 J. Fin Econ. 349 (2013). This number likely understates the amount of dissension. 3.3% is the chance that a decision will not be unanimous, but the odds that a given director could dissent are higher, since a non-unanimous decision could have multiple dissenters.

169 Jaehoon Kim, Hwa Ryung Lee, *Friends in the Boardroom: Attendance, Voting, and Turnover*, This figure is the chance that a given independent director dissents on a given decision. The odds that some independent director will dissent on a given decision is slightly lower, closer to 3%.

170 Maarchetti et al. 673, noting that 2392 of the Italian Civil Code protects non-negligent dissenting directors from liability for approved actions. This provides an incentive to dissent. American courts provides a similar benefit, ___,so this does not predict strong differences. Italy does have a form of mandatory cumulative voting, allowing more minority directors even at controlled firms. Id. At 662.

171 Marchetti et al. 676 (finding that 43% of independent director dissents involved a related-party transaction); Jiang, Wan & Zhoao (finding 16.3% of dissents involved related party transactions, the second highest category).

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they need to pick the outcome they find most just and appropriate. Still, what makes a rule (and its application) seem most just and appropriate?

This Part offers a novel theory to account for some of the differences in majority independence rules: each ratio reflects a different stance about the rationale for protection. Thus, the different rules reflect immanent principles within the law for how courts interact with boards. Having surfaced those principles, we can decide which ones we like and in what context. This is not a complete and tidy account, but it does make suggestive progress in interpreting and guiding judges.

Section A articulates the three different rationales for affording protection based on an independent majority. Section B explains how each of these rationales fits most naturally with one of the majority rules. Section C offers advice about how to optimize the application of these rules to their respective purposes.

D. Why Independent Majorities Matter

There are three reasons a court may extend protective treatment to a board, upon a suitable showing of majority independence. First, the court may take the level of independence as a proxy for the quality of the board's decisions. If a suitable independent majority operates the board, that is some evidence that a contested matter ought to be resolved in the board's favor.

Second, a court may deploy a protective rule as an incentive, hoping to encourage boards to adopt good governance practices (including a place of high station for independent directors) in the future. Third, a court could be normatively inclined to defer to properly functioning boards (even where the court doubts the board's stance or thinks the quality of corporate governance could be higher). But even deferential courts need some place to draw the line, below which the board composition is so problematic that they do not deserve any judicial abstention, and majority independence serves that sorting function.

Of course, these rationales are mutually supporting. If a test seeks to encourage good governance practices, it is also likely that the presence of those governance practices predicts good decisions, and that a board so-governed commands legitimacy. Nevertheless, it is possible to distinguish between epistemological, exhortatory, and eminential inquiries. And doing so will bear fruit as we seek to fit the law to its purposes.

1. Evidence.

Using the *evidence* rationale, courts scrutinize a controversial decision and transaction for wisdom and fairness, but they take the directors' independence as important proxies for the quality of the underlying

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transaction. If independent directors liked the transaction, it was likely a good transaction that deserves judicial protection.

Cooke v. Oolie provides an example of the evidence rationale, in which Chancellor Chandler protected the board based on the information conveyed by the independent directors' unanimous approval:

> The disinterested directors' vote to pursue the same proposal that Oolie and Salkind voted to pursue provides strong evidence to the Court that Oolie and Salkind acted in good faith and with the interests of TNN and its shareholders in mind. If the USA deal favored Oolie and Salkind to the detriment of the other shareholders, then presumably the independent directors would not have voted to pursue the USA deal.[172]

Under this model, the court's reliance on an independent majority is instrumental and epistemic, valuable only insofar as it gives information about the instant controversy. It is instrumental because the protection is directly justified by the policies it serves, and it is epistemic because the policies served are evidentiary. If the alternative to protection is the court scrutinizing the transaction for fairness, the independent vote helps bolster the case that the transaction was fair.

2. Incentive

Sometimes courts structure legal rules not because those rules are the best *ex post* instruments for detecting wrongdoing, but because they provide useful *ex ante* incentives to establish desirable systems of practice. [173] For an explicit discussion of this rationale, consider the initial adoption of the *MFW* rule.

This rule protects from challenge some transactions undertaken with a controlling shareholder. When the board approves a transaction with such a shareholder, there is a risk that the board may bend to the controller's pressure and approve transactions that are bad for the entity. Accordingly, courts generally review challenges to such transactions under the entire fairness standard.[174] But in *MFW*, then-Chancellor Strine proposed, and the Delaware Supreme Court affirmed,[175] a different approach. Under this new rule, transactions can obtain business judgment protection if approved through a suitable deliberative structure, in which the transaction is contingent upon approval of both the independent shareholders and also a

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[172] *Oolie* at *13.

[174] Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del.1971)

[175] 88 A.3d 635 (Del. 2014).

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committee of independent directors. This is a majority independent standard, twice over.

One might have endorsed the *MFW* test on evidentiary grounds. As Chancellor Chandler reasoned in *Oolie*, it is a good sign if so many disinterested decision-makers approve of the transaction. Perhaps entire fairness review is unnecessary because of the high likelihood of fairness. But Strine does not hang his hat on such an epistemic argument. Instead, he offered a fundamentally different rationale focused on incentives.

Strine urged adoption of the new legal test "because it will provide a strong incentive for controlling stockholders to accord minority investors the transactional structure that respected scholars believe will provide them the best protection."[176] The transactional structure required for *MFW* protection is "the optimal one."[177] Strine's opinion used the word "incentive" 21 times to justify the new test.

Using the *incentive* model, courts are less focused on *ex post* evaluation of particular transactions and more focused on *ex ante* establishment of good rules for board conduct. Courts first determine what transaction structure is desirable. The right majority rule is the one that causes responsive boards to conform to the desirable decision-procedure.

3. Deference

Using the *deference* model, courts neither treat directors as barometers to be read nor subjects to be incentivized. Instead, courts think that the director role *entails* a high level of court protection rather than scrutiny in all ordinary cases. This designation of sovereignty blends an epistemic and normative dimension. First, boards are better at evaluating corporate decisions than courts, so even careful judicial scrutiny is likely to introduce error. Then-Chief Justice Strine gave a familiar recapitulation of this first part of the deference model in the recent landmark decision, *Corwin v. KKR Financial Holdings, LLC*:

> the core rationale of the business judgment rule . . . is that judges are poorly positioned to evaluate the wisdom of business decisions and there is little utility to having them second-guess the determination of impartial decision-makers with more information (in the case of directors) or an actual economic stake in the outcome (in the case of informed, disinterested stockholders).

The deference model is epistemic, in that it is concerned with relative business expertise, court versus board or shareholder.

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176 In re MFW S'holders Litig., 67 A.3d 496, 502 (Del. Ch. 2013).

177 Id. at 527.

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But it is not *only* epistemic. The deference is in part normative. The court regards the director as a pseudo-sovereign entitled to a sphere of legitimate autonomy. On this view, the court protects an independent board majority because such a board has a legitimate domain, such that a court would overstep if it intervened in the board's affairs. Then-Chief Justice Veasey gave one example of such a rationale in *McMillion v. Beran*:

> The business judgment rule, therefore, combines a judicial acknowledgment of the managerial prerogatives that are vested in the directors of a Delaware corporation by statute with a judicial recognition that the directors are acting as fiduciaries in discharging their statutory responsibilities to the corporation and its shareholders.[178]

The statutory and fiduciary relationship simply designate the board to be the decider, not the court. Courts must sometimes intervene to restrain boards, but it is always an intrusion into the board's legitimate prerogatives – and there is no suggestion that the reason is grounded in evaluations of the underlying transaction so much as the board having handled its responsibilities inappropriately.

The non-epistemic aspect of deference causes the court to defer to a properly constituted board, but not because the court is confident that the board makes better decisions than the court; perhaps the court could systematically spot board errors more often than it introduces new ones. Yet accurate assessments of particular transactions are not the only thing of value. Also of value is shareholder autonomy: they selected the board, not the court, to make these decisions.

Other practical concerns support some sphere of deference. Litigation is expensive: rational corporate patrons would only favor judicial scrutiny of board actions where the scrutiny yields gains large and frequent enough to justify the expense. Moreover, unprotected boards would anticipate frequent judicial scrutiny and act in a manner designed to protect them when the time comes. For example, they may spend more on financial and legal opinions than they otherwise would in order to bolster the impression that the transaction was fair. They may abstain from transactions that are only barely a fair price, out of fear that later litigants may convince a court to round down. At times, these changes in conduct may be excessive. On average, corporations benefit from transactions that are just barely fairly priced – if boards forsake such transactions out of fear that a court will condemn them for failing to get an even fairer price, then the court has excessively deterred borderline conduct.

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[178] McMullin v. Beran, 765 A.2d 910, 916 (Del. 2000)

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Deference is therefore not only about the tradeoff between board intelligence and court intelligence – it is instead about the tradeoff between expertise and accountability. Courts that liberally protect boards are leaving decisions in the hands of experts. Courts that liberally assist plaintiffs are increasing board accountability to shareholders. There is a tradeoff between expertise and accountability, as Stephen Bainbridge has argued for years, and the sovereignty model uses protection of independent majorities as the borderline of the tradeoff. [179]

The deference model is non-evidentiary, in that it does not look to board votes and composition as some kind of clue about transaction quality. Instead, it takes independence as the price of freedom from investor and judicial scrutiny. If boards are sufficiently independent as to earn some breathing room to take bold business risks, courts will abstain from the oversight otherwise natural.

E. Fitting Rationales to Tests

We have three tests: Independence, Affirmation, and Director. And we have three rationales: evidence, incentive, and deference. This is not a coincidence. There is some correspondence of fit among the three pairs. The evidence and incentive goals are both advanced by the Independence and Affirmation Ratios, but there is a slight difference in quality of fit. The deference rationale only fits well with the Director test.

Figure 12: Rationale-Test Pairings	
Evidence	Affirmation
Incentive	Independence
Deference	Director

1. Evidence - Independence

When courts consider majority independence a signal of transaction or governance quality, the most natural test is not a Director Ratio test. A five-member board with three independent directors would get deference under that test no matter how the directors voted – even if two thirds of the independent directors stomped their feet in protest at the transaction's foolishness or venality. That test gives too much credence to a weak signal

[179] See, e.g. Stephen M. Bainbridge, The Business Judgment Rule As Abstention Doctrine, 57 Vand. L. Rev. 83, 88 (2004).

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of quality. And, on the other hand, it makes it impossible for a court to trust a board that does not have enough independent directors, no matter how they vote.

This is no doubt why the *Oolie* court applied an Independence test to the contested transaction. The court reasoned that if all of the independent directors liked the transaction, that was a good proxy for quality and the decision probably deserved business judgment deference. Plainly, the independence test is adequately suited as a proxy.

It has the added benefit of not holding against a board the number of conflicted directors. In *Oolie,* there were simply too many conflicted directors (half the board) to ever satisfy an Affirmation Ratio test. And it is not clear that the extra conflicted directors are a problem. Are we to think that a unanimous decision involving one conflicted director is more trustworthy than one with two conflicted directors? And how can it be that a half-independent board is totally incapable of obtaining protection, no matter how the independent directors deliberate and vote? If superfluous conflicted directors are generally irrelevant, then it is a virtue of the Independence test that they never alter the level of protection. And if every company ought to have the chance to establish protection, only the Independence Ratio is always capable of satisfaction. As a rough and ready proxy, the Independence Ratio works quickly, efficiently, and broadly.

To be sure, *GNI*'s Affirmation Ratio test has a certain charm. For one thing, additional conflicted directors probably do matter in some cases. They alter the tone of the discussion, and they alter the relative power of the independent directors. An evidentiary test probably should count additional conflicted directors as a weakening of the positive signal, as the Affirmation Ratio test does.

After all, if the independent directors do not constitute a majority of the board, they do not control the board's agenda. They cannot order executives to research alternative deals, on pain of being fired. They cannot threaten to initiate litigation without the help of a conflicted director. They are a captive minority. The same is true if independent directors constitute a majority of the board but are somehow quite fractured in their opinions and votes – an independent director who wishes the corporation would explore altogether different options cannot do so.

A successful vote under the Independence Ratio test ensures that the independent directors basically liked the transaction better than the absence of the transaction, but it does not suggest that the transaction was as fair as it could have been, nor that there wasn't a better one just out of sight. Those possibilities are the sorts of things litigation might uncover. With no vote-based reason to assume those possibilities away, it is probably improper to

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select the Independence Ratio test on evidentiary grounds. By contrast, the Affirmation Ratio test is so exacting that it is only satisfied when the contested activity really satisfied and empowered an independent group – which is a strong proxy for quality.

If courts are looking for a high-quality shortcut, to use independence as a reason to protect boards in the absence of further proceedings, the test that best serves this function is the highly informative Affirmation Ratio. Given that the alternative is usually some subsequent adjudication (rather than outright liability) it makes sense to err on the side of protecting too rarely, rather than too often. However, the Independence Ratio will be more attractive when we are indifferent between false-positives and false-negatives. It is a simple test for benign transactions that is usable at any company.

2. Incentive – Affirmation

When the goal is to improve deliberation quality, there are three considerations: increasing dissents, having boards that are mostly independent, and committee construction. The first two goals may be impacted by the choice of protection rule, but the effect may be muted or uncertain. The third goal, adjusting committee composition, is also complex but gives a stronger endorsement of some rules over others.

Turning first to overall board independence, there has been a long history of scholars urging for more independent boards.[180] For those who like to see more independent boards, the selection of protection rule can have some impact on that outcome.[181] All three majority tests encourage appointment of independent directors.[182] However, the Affirmation and

[180] For an influential early article, see Victor Brudney, The Independent Director--Heavenly City or Potemkin Village?, 95 Harv. L. Rev. 597, 597-607 (1982).

[181] The actual benefits of independent boards have been questioned. It is not clear that independent boards outperform less independent boards. Romano, Quack Corporate Governance. When independent boards perform well, scholars also question whether the boards cause the good performance or whether changes in monitoring needs and capacities fully explain the benefits. Jeffrey N. Gordon, The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices, 59 Stan. L. Rev. 1465, 1469 (2007). Likewise, the benefits of independent committees have been questioned. Romano, discussing empirical research. Note that Sarbanes Oxley already requires substantial independence from most publicly traded companies, but it does not apply to private companies.

[182] This encouragement remains even if boards operate committees strategically, though for a surprising reason. The more independent directors are on the board, the more candidates for inclusion on a majority-independent committee. A board with ten independent directors can more easily be winnowed down to just a few who can constitute a majority-independent committee to bless a contested transaction. Of course, independence in the sense of this article is context specific. A director can be independent with respect to one transaction but not another. Given the dynamic quality of independence, it is hard to

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Independence Ratio tests encourage the appointment and involvement of independent directors, since protection ultimately hinges on their vote. The Director test permits them to be appointed and sidelined.

Second, the conception of majority in a rule can adjust the level of board dissension. It is widely believed that boards would benefit from more dissent than currently exists. Dissent can improve group decision-making.[183] Dissents send signals to the market.[184] Perhaps the signal is just that "this board is acrimonious enough that it won't be effective," but the market reacts more when nominees of institutional investors dissent, suggesting that other investors credit the apprehension of these relatively professional monitors as having spotted underlying trouble.[185]

Different rules are likely to affect the level of dissension differently. Most obviously, the Independence Ratio penalizes boards when independent directors dissent, because independent director approval is precisely what the protective rule demands. This will tend to increase independent dissent.[186] At the other extreme, the Director Ratio is completely indifferent to dissents, because it does nothing more than count heads.

The Affirmation Ratio test provides the same incentive as the Independence Ratio test, with one additional effect. Like the Independence Ratio, it yields consequences when independent directors withhold their consent. But it also discourages the appointment and retention of conflicted directors at all because their presence in the denominator makes it hard to obtain protection. While reasonable minds may differ, a rule that subtly discourages appointment and retention of conflicted directors probably improves the overall quality of corporate governance.

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encourage changes in overall board format through a protection rule except for the conflicts that are most predictably going to arise. Thus, a director might be discouraged from serving on the board of a company and its biggest supplier. For example, McDonald's corporation outsources most of its logistics to HAVI – it is perfectly predictable that the McDonald's board will often face decisions about its relationship with HAVI. An independence ratio would discourage McDonald's from drawing too many directors from the HAVI flock. Cf. https://www.havi.com/people/theodore-f-perlman (serving on the HAVI board and the board of Ronald McDonald's House Charities).

183 Samuel N. Fraidin, Duty of Care Jurisprudence: Comparing Judicial Intuition and Social Psychology Research, 38 U.C. Davis L. Rev. 1, 55-58 (2004

184 Marchetti et al. 684 (showing dissents lower stock prices in Italian firms, while noisy resignations raise them); Ma and Khanna, *Independent Directors' Dissent on Boards: Evidence from Listed Companies in China* (2013) (dissent lowers stock price at Chinese firms).

185 Id.

186 It is conceivable that would-be dissenters will dissent less once their vote has consequences, because they may have wished to merely express their dissatisfaction without tipping the apple cart. But such directors can already informally register their dissatisfaction with words. Directors who wish to do more than huff, who wish to create a record of their dissatisfaction presumably want that decision to have consequences.

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The nudge to exclude conflicted directors from the board applies also to committee membership. A difference between the Affirmation Ratio and the Independence Ratio is that the latter encourages mixed committees, while the former encourages delegation of decisions to all, or majority, independent committees.

Toleration of mixed committees was the approach endorsed in the 1988 revision of the Model Business Corporation Act (MBCA),[187] which remains the law in several states.[188] If directors are truly superfluous, or if their effect on protection could have been cancelled out by strategic scaling by the board, it may seem hyper technical and legalistic to punish boards and directors that do not merely go through the motions.

Years later, the MBCA would reverse course, requiring that superfluous conflicted directors be absent from the deliberation and voting of disinterested directors.[189] Implicit in this change is the notion that no deliberating and voting director is superfluous. Directors influence one another and independent directors may be persuaded or pressured by conflicted directors, and the net contribution of conflicted directors is negative.

Even if some directors truly are superfluous, perhaps because the independent directors have the grit to vote their conscience whomever is in the room, it is not self-evident exactly when a director is superfluous. The fact that a vote went through unanimously is not proof that the independent directors would have been unanimous if the vote occurred outside the sight of the conflicted directors. A detriment of the old MBCA approach is that it requires courts to use hindsight to guess who was superfluous at the time of the vote. A feature of the modern MBCA approach is that it pushes to boards the burden of avoiding circumstances under which it is at all unclear whose vote was superfluous. And this is a feature of the Affirmation Ratio.

3. Deference – Director

If courts use majority rules to determine which boards deserve deference, then the most natural choice is the Director Ratio test. It asks whether the board is suitably composed to warrant trust, without inviting

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[187] Model Bus. Corp. Act (1984) § 8.62(c) By the Committee on Corporate Laws, Changes in the Model Business Corporation Act-Amendments Pertaining to Director's Conflicting Interest Transactions by the Committee on Corporate Laws, 43 Bus. Law. 691, 712 (1988) ("Subsection (c) contains technical provisions dealing with quorum and superfluous votes by interested directors.")

[188] Ariz. Rev. Stat. Ann. § 10-862(c); MCA 35-1-463(3); Utah Code Ann. § 16-10a-852(3) (West); 18 Guam C.A. § 28862(c); Idaho Code Ann. § 30-29-862(3) (West); Conn. Gen. Stat. Ann. § 33-783 (West); Ala. Code § 10A-2-8.62(c). Wash. Rev. Code Ann. § 23B.08.720(3) (West)

[189] MBCA 8.62

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further inquiry. The other two tests privilege the actions and decisions of a subset of the board. This privilege is potentially problematic for two reasons.

First, there is an epistemic core to deference, recognizing that directors know things that the court does not. Additionally, it makes little sense to disregard conflicted directors altogether, since they also know things that the court does not. Indeed, they are often the most knowledgeable directors. Whatever the source of their conflicts, they are likely embedded in the specifics of the situation. By contrast, independent directors are often the ones who joined the board after the disputed incident (perhaps in order to serve on a Special Litigation Committee). Such arrivistas may not know more about the situation than the court does.

More importantly, the way you respect the sovereignty of a decisionmaker is to do as little as possible to inquire into details of the decision. Consider an example from an altogether different domain: deference to foreign sovereigns. Suppose that an individual claims to be the President of Mexico and asks the United States to accept their about Mexican foreign policy on that basis. Should the United States do so? After all, some individuals obtain political office through such election fraud that their decisions lack legitimacy. If America respects the sovereignty of Mexican democracy because the polity is acceptably democratic, it cannot be America's policy to recognize as Mexico's president only the candidate who prevailed in the least corrupt districts (the analogue to the Independence Ratio). The posture of America in determining foreign electoral results is not to determine independently who won the election (extrapolating from the best information available) – it is to first check whether official Mexican assessments are credible enough to be accepted and then accept them. The sovereignty conception of protection asks courts to leave the management of the corporation to acceptable boards, which places the focus squarely on whether the board was composed in a fashion to make it acceptable.

That is what the Director Ratio test does. If most of the board is independent, then the board can be basically trusted to make good decisions superior to the cost-adjusted decisions of an adjudicator, and the court may wisely defer.

F. Fitting Tests to Legal Inquiries

We have three rationales for plumbing independence. And we have three tests that relate to those rationales. We can now complete the motivating inquiry, by asking what test ultimately fits best with the legal inquiries to which they are deployed. The answer, not surprisingly, depends on which rationale the court seeks to vindicate in the instant dispute.

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One rationale concerns evidence. The wisdom of adopting an evidentiary majority rule depends on the context. It is more logical to rely on proxies (such as board composition) where information is scarce. For example, in demand futility inquiries, the plaintiff has not had the benefit of discovery. The plaintiff and the court are information starved. It may make sense in these settings to rely on proxies, such as board quality and board votes, to decide whether further inquiry is warranted.

By contrast, in a ruling on whether to rebut the business judgment rule, a court may have been presented with ample information gleaned from discovery. It may be possible for a court to peek ahead to see whether the transaction itself looks acceptable and defer less to the board. Likewise, when the question concerns the statute of limitations, there may be no need to rely on proxies. If the FDIC takes over a bank and seeks to sue its prior management, the FDIC now runs the bank. It may have ample evidence of wrongdoing (as well as exculpatory evidence). The FDIC's ability to bring the action probably ought to stand on the quality of that evidence rather than proxies for its quality. Where the signal quality of majority rules is low, or of low importance, some other principle should guide us.

A second rationale concerns deference. The appropriate degree of deference, and thus the appropriate test, turns in part upon the context in which the inquiry takes place. This Article discussed four inter-related contexts in which independent majority inquiries arise. First, a board may seek to protect a conflicted transaction from per se voidability. Second, many independent majorities are in the context of the demand requirement; is there a disinterested board capable of considering this claim, or should a shareholder-plaintiff be empowered to vindicate the corporation's rights? Third, independent majorities are often raised in order to obtain a safe harbor for a self-dealing transaction. Fourth, the presence or absence of an independent majority bears on whether the statute of limitations tolls.

On the deference model, we note that these four settings pose differing levels of intrusion into board prerogatives, and thus may implicate differing levels of appropriate deferential protection. One key difference between these four contexts concerns the intervention against which protection is sought. In each case, some proponent seeks to imperil a decision or director, placing their hands in the fate of another actor, but the nature of the peril differs greatly.

In a per se invalidity case, the question is whether the board can be trusted to decide at all, or whether the transaction should be void *ab initio*. In a demand futility inquiry, the question is whether the board can be trusted to vindicate the corporation's interests or whether the prosecution should be handled by shareholder-plaintiffs instead. In conflicts analysis, the question

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is whether the court should defer to the board's sense that a transaction was warranted or instead substitute its own sense of what is fair. In a statute of limitations case, the court is determining whether to honor the past decisions of the board not to sue certain actors, or whether it should instead recognize the power of new decisions-makers, such as a new board or bankruptcy trustee or its equivalent. These decision-making contexts arguably call for different levels of protection.

The demand futility context is arguably the most invasive of the three because it removes from boards their defining feature as the corporation's top decision-makers, and it assigns the power to actors who normally have no authority to lead the corporation. The decision to deny a motion to dismiss for failure to make a demand is a per se deprivation of board power. From that moment forward, depositions will be taken, and papers will be subpoenaed in the corporation's name. Whatever comes of the litigation, an essential operation of the board will have been outsourced to an insurgent camp.

Also highly invasive is a *per se* invalidity inquiry. Without protection from *per se* invalidity, a corporation's actions can be invalidated by the shareholders or a later board. A board with an unaddressed conflict among its ranks is therefore robbed of any power to act in the relevant area. It is a serious intrusion into board power if all the board's actions in a domain rest on quicksand – and it is important that boards are often able to obtain protection.

The conflicts setting is intermediate in its boldness of intervention. When a transaction is challenged as having been unfair to the corporation, the board remains the decisionmaker. What changes is that it must answer for itself to the court. This is no small thing, and boards prefer business judgment deference for good reason. But a court may well agree with the board that all was fair; if so, the board will have been inconvenienced and imperiled, but it will not have actually lost any of its authority at any point.

Least invasive is an independence inquiry arising out of a statute of limitations dispute. Although defendants are entitled to raise the statute of limitations at the pleading stage, and so it may chronologically proceed alongside a motion to dismiss for failure to make a demand (and precede a fairness inquiry arising out of a conflicted transaction), statute of limitations disputes are only crucially important where the plaintiff might otherwise have a leg to stand on. That is, the possibility that a statute of limitations might have tolled is most interesting in cases where the court would otherwise vindicate the plaintiff's claim. That makes the marginal invasiveness of tolling the statute of limitations on the basis of conflicted directors seem like a rather small complaint.

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To make things more concrete, the invasiveness of a demand futility and conflicts inquiry arises from the potential to take power from the board and give it to a non-board actor (the plaintiff-shareholder, the court). But statute of limitations disputes are often about the transfer of power from the past board to the present board. A past board declined to sue itself, a newly constituted board would like to sue. The past board cites the statute of limitations as a reason that the otherwise plausible suit cannot go forward. There may be good reasons internal to the statute of limitations for sympathizing to the past board.[190] But there do not seem to be *institutional* or *deferential* reasons favoring the past board over the current board.

Thus, a court that is deferential because of concern for board sovereignty should be *more* deferential in per se invalidity and demand futility cases and *less* deferential in statute of limitations cases.

1. Considering Committees

All three of these principles have an uneasy relationship to committees. On the one hand, the use of committees can help vindicate the principles. The vote of a largely independent committee can send a stronger signal of quality than the vote of a whole board when the latter is riddled with conflicts. Such a committee likewise may sufficiently embody the sovereignty befitting judicial deference, and it may be worthy of incentivization for these reasons.

Yet committees can also gut all three rules. If a single independent director favors the conflicted majority, the conflicted majority can jerrymander a committee capable of satisfying any of these rules. At the limit, a committee of one independent and affirming director will pass all three majority rules while frustrating all three motivating principles.

Courts cannot optimize their treatment of committees by fiddling with their majority rule, alone. Rather, it would be a different intervention to urge courts to disallow committees in certain instances, or to allow them only subject to a smell test.[191] Alternatively, the MBCA requires (for conflicted transactions) that the voting body must be all of the independent directors or else a group of independent directors selected by a majority vote of all the independent directors. The official comments make clear that both of these goals "are intended to preclude the appointment as committee members of a favorably inclined minority from among all the qualified directors." They are designed to encourage a good structure, in which independent directors control the process.

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[190] See generally Tyler T. Ochao & Andrew Wistrich, *The Puzzling Purposes of Statutes of Limitations*, 26 Pac. L. J. 453 (1997).

[191] Zapata.

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Likewise, the Director Ratio uses directors as the denominator (regardless of their independence or how they vote). But does it focus only on the committee charged with the relevant decision, or the whole board? If courts score based on the whole board, a majority conflicted board cannot strategically jerrymander an independent committee.

A thoughtful approach to majority rules would be most effective if this variable were not considered in isolation from others.

CONCLUSION

Courts use a variety of different rules to determine whether transaction or director is protected by a disinterested majority. At a high level, some courts look to whether independent directors have approved of the action, some look at whether the approvers of an action were independent, while other courts ask whether there are enough independent directors to outvote the conflicted directors as a block (regardless of whether there is a vote, or whether the groups vote as blocks). These differing conceptions of majority yield different results on the same facts, making a court's conception of majority as significant as it is undertheorized. This Article is a first effort to theorize these different conceptions: identifying and naming them, exploring the normative principles that animate them, evaluating their appropriate domain of use.

It may seem strange that courts have been able to operate for decades without developing consensus on the meaning of a central legal concept. Part of the reason may be that the inquiry is, at its core, known to be somewhat arbitrary. *Aronson,* until recently the north star for Delaware corporate litigation, admits as much: "We recognize that drawing the line at a majority of the board may be an arguably arbitrary dividing point."[192]

Once we resign ourselves to an arbitrary test, the particular variation can seem insignificant. Moreover, ignoring the particular rule allows courts and commentators more latitude than they would be entitled to enjoy. If courts don't clearly identify differences among rules, they can deploy whichever one yields the result they prefer. And if commentators remain steadfast in ignoring these differences, we can preserve an untested -- yet contestable – assumption: that boards are unanimous and strategic, such that all the tests tend to give the same answer.

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[192] Aronson v. Lewis, 473 A.2d 805, 815 (Del. 1984). Note that some courts have rejected the notion that a majority is the magic ratio. For example, a committee that is only 1/3 independent may count as an independent committee if the independent director is given a veto over the transaction. See Matter of DISH Network Derivative Litigation401 P.3d 1081 (Nev. 2017). Other courts have required unanimity. See, e.g. Cohen v. Ayers, 449 F. Supp. 298, 311 (N.D. Ill. 1978), aff'd, 596 F.2d 733 (7th Cir. 1979) (requiring unanimity among independent directors).

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Yet it is far from obvious that such an assumption is warranted empirically, much less normatively. The appeal of a multi-member board has always been that its members may see things differently.[193] If boards always ultimately agree (or if the winners are always effective in excluding dissenters from the voting committee) then the case for a board is weak.[194] Perhaps the paucity of attention to majority rules reflects growing hostility to boards from varying camps: some participants hoping to see the body's power shifted to shareholders, executives, and stakeholders (or believing the shift has already taken place).

Of course, that shift only moves the bump in the rug. Whatever body wields practical control will generate dissensus and face conflicts of interest.[195] Litigation will arise surrounding that body. Parties will ask courts to intervene. Courts will be inclined to condition their intervention in part on the independence of members of one faction or another. And they will do so in ways that reflect similar imminent principles, operationalized in similar ways. A focus on board "majorities" is somewhat arbitrary, but an interest in the composition and temptations of a ruling coalition is inevitable.

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[193] Andrew Verstein, Trustee or Delegate? Understanding Representation to Illuminate Shareholder Governance and Regulatory Change, 9 Eur. Comp. & Fin. L. Rev. 74 (2012).

[194] Stephen M. Bainbridge, Why a Board? Group Decisionmaking in Corporate Governance, 55 Vand. L. Rev. 1 (2002).

[195] See generally Henry Hansmann, The Ownership of Enterprise (2000) (arguing that the "ownership costs" of heterogenous preferences among controllers can be minimized but not eliminated).

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