A Director's Good Faith

Elizabeth A. Nowicki

Cornell Law School

Follow this and additional works at: https://digitalcommons.law.buffalo.edu/buffalolawreview

Part of the Business Organizations Law Commons, and the Legal Ethics and Professional Responsibility Commons

Recommended Citation

Available at: https://digitalcommons.law.buffalo.edu/buffalolawreview/vol55/iss2/3

This Article is brought to you for free and open access by the Law Journals at Digital Commons @ University at Buffalo School of Law. It has been accepted for inclusion in Buffalo Law Review by an authorized editor of Digital Commons @ University at Buffalo School of Law. For more information, please contact lawscholar@buffalo.edu.
A Director's Good Faith

ELIZABETH A. NOWICKI†

The last decade has witnessed the evolution of a surprising and disconcerting trend: corporations have imploded due to various acts of corporate mismanagement, and corporate directors have ably avoided liability for not having prevented these disasters. This trend is surprising because, as a technical matter, directors are responsible for running corporations, and directors are obligated to do so in good faith. Therefore, one would not intuit that directors should be free from liability for their failings. But they are. To the second year law student in a basic corporate law class, this disconnect between disaster and liability seems odd. To the corporate law scholar who has watched the evolution over the past two decades of "good faith" jurisprudence as it applies to director conduct, this gaping responsibility gorge is unsurprising. It raises the critical question: if directors are not going to be responsible for corporate disasters, then who?

Judicial attempts to enforce a director's obligation to act in good faith—what I refer to as the "bastardization of the phrase, 'not in good faith'"—fall away as merely restrictions on directors acting affirmatively in bad faith. And the attempts of other scholars to propound on good faith seem to only be focused on understanding what the courts are doing, as opposed to guiding what the judiciary should be doing. Moreover, the recent judicial emphasis on the phrase "good faith" appears not to have been preceded by any sort of thoughtful discussion on what that phrase can and should mean. The haphazard, unprincipled invocation and application of this phrase threatens the foundation of the corporate law realm—the implicit

† Visiting Associate Professor of Law, Cornell Law School and Washington & Lee University School of Law; J.D., Columbia Law School; B.A., Russell Sage College. Many thanks to Jeffrey Gleason, Anshu Pasricha, and the Buffalo Law Review for their superb editing. Outstanding research assistance was provided by Jennifer Jennings, Justin Curtis, and Kristin Watts.
historical agreement that directors will manage corporations in the best interests of the corporate entity and its owning shareholders.

This Article attempts to more thoughtfully review the phrase “good faith” as it is relevant in the director liability context. While not proferring to definitively end the “good faith” definitional discussion, this Article ultimately offers a considered, principled draft definition of good faith, from which further discussion among academics and jurists could evolve.

INTRODUCTION

Shareholders are the owners of corporations. Directors are the managers of corporations, and they are obligated by statute to manage their corporate charge on behalf of the shareholders, to the benefit of the corporation and shareholders. Yet common law and state statutes protect directors broadly from personal liability for their acts or omissions. Directors are afforded significant deference in what they specifically do (or do not do) to manage corporations, provided the directors act “in good faith.” Ultimately, directors are only personally liable to their shareholders if the directors do not act “in good faith.”

But what does “in good faith” mean, and what constitutes a failure to act in good faith? Interestingly, corporate law does not yet have a universally agreed-upon, usable definition for the phrase “in good faith,” despite its existence in corporate governance parlance for at least over a century. The lack of good faith parameters and, more importantly, lack of clear guidance on what good faith requires of a director is troubling. It is difficult to obligate directors to act in good faith or penalize directors for not acting in good faith without an affirmative definition of good faith to offer to the directors.

With every passing day in the corporate world, the need for some workable, logical, enforceable standard for defining good faith becomes more urgent. The corporate landscape of the recent past is littered with corporate

1. Discussions about loyalty and conflicts are deliberately omitted from this Article.
governance failures, sex scandals,\textsuperscript{2} executive gluttony,\textsuperscript{3} corporate lethargy,\textsuperscript{4} outright corporate looting,\textsuperscript{5} significant valuation depression, and disgruntled stockholders.\textsuperscript{6} Many of these situations could have been avoided or the carnage limited had directors detected wrongdoing sooner. Surely some of these situations, then, should have somehow been tied to a discussion of a director’s obligation to act “in good faith.” Without agreement on how to specifically define good faith in the director liability realm, however, it is difficult to convincingly argue that a director failed to act in good faith.

This absence of debate and dialogue regarding good faith would likely surprise any average American investor who is not a corporate law guru. The average investor, if asked whether directors who missed overt acts of financial fraud, who sanctioned, without question, outrageous pay packages, who remained uninvolved in important senior hiring, and who ignored significant shareholder dissent were acting in good faith, would likely answer “no,” relying only on her common sense understanding of “good faith” as the phrase is used in common parlance. Yet, the corporate

\begin{itemize}
  \item \textsuperscript{2} See Owen Moritz, \textit{Bada Boeing! CEO Out 37M}, \textit{DAILY NEWS} (N.Y.), Mar. 11, 2005, at 18 (discussing how former Boeing CEO, Harry Stonecipher, violated the company code of ethics when he had an affair with a company vice-president).
  \item \textsuperscript{3} See Mark Maremont, \textit{Amid Crackdown, The Jet Perk Suddenly Looks a Lot Pricier}, \textit{WALL ST. J.}, May 25, 2005, at A1 (discussing personal use by corporate executives of corporation-owned jets; values of the personal use were often well above $500,000 for 2004).
  \item \textsuperscript{4} "In 1986 Carl Icahn gave this account of a directors' meeting at a big company: 'Literally, half the board is dozing off. The other half is reading the Wall Street Journal. And then they put slides up a lot and nobody can understand the slides and when it gets dark they all doze off.'" \textit{Asleep in the Boardroom}, \textit{WASH. POST}, May 23, 2002, at A32.
  \item \textsuperscript{5} See Constance L. Hays, \textit{As Stewart Attends Hearing, Company Studies Options}, \textit{N.Y. TIMES}, Mar. 9, 2004, at C1 (discussing the board of directors of Martha Stewart Living Omnimedia grappling with Martha Stewart's position in the company after she was convicted of criminal obstruction of justice).
  \item \textsuperscript{6} See David Barboza, \textit{From Enron's Rubble, Life on a Luxury Tightrope}, \textit{N.Y. TIMES}, May 19, 2002, § 3, at 1 (describing how thousands of former Enron employees lost millions of dollars in retirement benefits); see also Ronald Brownstein, \textit{Enron Fallout Proves Personal Loss Can Have Big Political Consequences}, \textit{L.A. TIMES}, Feb. 20, 2002, at A10 (discussing how widespread increases in the diversity of stock ownership over the past twenty-five years has led to widespread interest in the Enron scandal, particularly with respect to how the stock of Enron was devastated by the scandals).
\end{itemize}
governance bar is unwilling to venture into the world of common sense and common language usage.

The failure to define the behavioral standards relevant to a director's obligation to act "in good faith" might explain, in part, why few corporate directors have been publicly pilloried for the failings of their corporate charges despite the fact that these failings have cost investors billions of dollars. The "good faith" definitional void might explain, at least in part, why there has been no self-revolution within the corporate directorate, and why Wall Street is not lined shoulder-to-shoulder with directors racing to the pulpit to atone. To be sure, the corporate landscape has been smattered with a few weak stabs at federal regulation, a fair amount of academic posturing, and a good amount of vacuous politicking. But there has yet to be a line drawn in the sand regarding a director's good faith obligation, across which line a director dare not find himself for fear of liability for his failure to act in good faith.

This Article attempts to draw such a line. Specifically in this Article, I call for a purposeful, affirmative definition of good faith that reflects the historical usage and the contextual import of the phrase in the director qua fiduciary realm. The phrase "in good faith" is a much more powerful phrase than the corporate bar, the American directorate, and the judiciary are willing to admit. The phrase should be defined in a sensible manner, to allow investors to demand more from their directors. With this Article, I hope to engage the academy in a more thorough discussion of the definition of good faith in the director liability context. In this Article, I assemble, analyze, and justify an affirmative definition of "good faith."

In Part I of this Article, I describe generally a director's fiduciary duty of care, as a foundation for the discussions in the rest of the Article. I explain the duty of care standard of conduct and I examine the standard of review that is

7. Many of the failures we have seen at the helm of many large corporations—much of the lax behavior and inattention in the boardroom—would be cause for termination in any other line of employment. Yet, such behavior is tolerated in the world of corporate governance. See generally Lyman P.Q. Johnson & David Millon, Recalling Why Corporate Officers Are Fiduciaries, 46 WM. & MARY L. REV. 1597 (2005) (discussing fiduciary duties in the context of the role that corporate officers and directors have played in recent corporate scandals).
applied by courts when faced with an alleged breach of a director's duty of care. In this Part, I explore the workings of the ephemeral business judgment rule, which is best described as a protective presumption that is automatically afforded to a director whose conduct is under judicial review based on an alleged duty-of-care breach. I explain how the business judgment rule presumption works to protect directors from being second-guessed by complaining shareholders and when the protections of the business judgment rule presumption will be stripped from a director. I then briefly explore legislative limitations on a director's liability exposure, such as Delaware General Corporation Law (DGCL) §102(b)(7). I end this Part with a summary of how the phrase “good faith” plays into this duty-of-care and director-liability calculus to emphasize the import of the definition of good faith in the director liability context. The protection of DGCL § 102(b)(7), which serves to completely insulate directors from personal liability to shareholders for monetary damages due to a director's breach of his duty of care, will not be afforded to a director who has acted “not in good faith.”

I explain that, if good faith continues to be misinterpreted in a very favorable way to directors, personal liability for a director's breach of almost all of his fiduciary duties, except for his duty of loyalty, will effectively cease to exist.

Part II of this Article contains the definitional analysis of the phrase “good faith.” In this Part, I consult the dictionary for a technical definition of good faith, I examine the interpretation of good faith in other areas of the law, I parse through the common law to assess which definitional components of good faith from other areas of the law to borrow and which to ignore, and I examine the context in which a director does his job and in which director liability becomes relevant. I conclude Part II with a summary of observations that can be made about good faith as it arises and is defined in other contexts.

In Part III, I use the above examination to construct and justify a definition of good faith to be considered for use in the director liability realm. In Part IV, I use this draft definition of good faith and parts of the analysis I constructed in order to define good faith to deal with a

compelling good faith issue that appears to be ignored by jurists and other scholars alike. Specifically, in Part IV of this Article, I address the legal question of what it means for a director to act "not in good faith," such that he is outside the protection of the business judgment rule presumption, he is outside the protection of a statutory liability-limiting provision, and he has violated his fiduciary obligation. Oddly, a director's legal obligation to act in good faith has almost always been treated as the legal obligation to *not act in bad faith*, notwithstanding the fact that the lack of good faith and an affirmative act of bad faith are two different things. This manipulation of the good faith parlance troubles me because requiring a plaintiff to prove that a director acted in true bad faith, as opposed to having to prove that a director exhibited a lack of good faith, imposes a significant burden on the plaintiff, making his case far more difficult than it otherwise would be. In addition, this bastardization of the phrases "good faith" and "not in good faith" erodes the essence of one of the pillars of corporate governance—the obligation of corporate agents to act in the best interests of the corporation. Using my "good faith" definition developed in Part III of this Article, I discuss in Part IV how a good faith analysis is supposed to proceed when it is alleged that a director failed to act in good faith.

I. DUTY OF CARE

One of the defining characteristics of the corporate form is the separation of ownership and control. Shareholders "own" the corporation, but the board of directors "controls" the corporation and is responsible for managing the

---


10. See id.; see also DEL. CODE ANN. tit. 8, § 141(a) (2001). As a practical matter, most boards of directors of large corporations delegate their authority for managing the daily minutiae of the corporation to officers, pursuant to the authority to delegate given to directors in DGCL § 141(a) (or the equivalent in the statutory code for the state in which the corporation is incorporated).

Throughout this Article, Delaware will be used as the primary state of reference for purposes of statutory analysis or close examination of case law, given that Delaware is home to 60 percent of the Fortune 500 and 50 percent of all publicly traded companies in the United States. See Delaware Division of Corporations, http://www.state.de.us/corp/default.shtml (last visited Mar. 16,
business and affairs of the corporation. While this separation is beneficial for the passive investor, this separation between the managers and the owners raises a vexing issue: How should one constituency manage the assets owned by a different constituency? To wit, how should the directors manage a business owned by shareholders? Because corporations do not have the unity of ownership and control exhibited in a sole proprietorship, where an owner herself manages the business that she owns, some minimum behavioral standards for directors are needed to ensure that corporate directors devote the same attention and effort to the corporation, owned by the

2007).

Much has been written about the ramifications of Delaware's pro-management statutory and judicial efforts to encourage corporations to incorporate in Delaware, and the debate continues among academics as to whether Delaware's efforts and the responsive efforts of other states have led to a "race to the bottom" in terms of corporate management deference and protection. See, e.g., ARTHUR R. PINTO & DOUGLAS M. BRONSON, UNDERSTANDING CORPORATE LAW 14 n.52 (1999) (citing William Cary, Federalism and Corporate Law: Reflections Upon [sic] Delaware, 83 YALE L.J. 663 (1974)); accord Liggett v. Lee, 288 U.S. 517, 557-58 (1933) (Brandeis, J., dissenting). See generally 2005 Annual Report: Delaware Department of State, Department of Corporations, http://www.state.de.us/corp/2005%20doc%20ar.pdf (last visited Mar. 16, 2007) (showing statistics and discussing the State's efforts to increase the number of corporations incorporated in Delaware).

While I find the "race to the bottom" discussion fascinating, it is beyond the scope of this Article. I will note, however, that I am sympathetic to Professor Lawrence Mitchell's position: "The laxity of Delaware law, or its significance, has long been a subject of dispute. With such shameful and disingenuous opinions as In re Caremark Int'l, 689 A.2d 959 (Del. Ch. 1996) and Lewis v. Vogelstein, 699 A.2d 327 (Del. Ch. 1997), I believe the matter can no longer be in dispute." Lawrence E. Mitchell, The Sarbanes-Oxley Act and the Reinvention of Corporate Governance?, 48 VILL. L. REV. 1189, 1189 n.2 (2003). Professor Mitchell reflects what was so poetically penned by other corporate law scholars almost a decade before regarding the state of Delaware corporate jurisprudence: "Predicting the course of Delaware law from prior case law is like watching clouds. They seem, at times, to take on recognizable shapes and forms, even to resemble something familiar. But you know that whatever shapes you think you see can vanish in a puff of wind." Lawrence A. Cunningham & Charles M. Yablon, Delaware Fiduciary Duty Law After QVC and Technicolor: A Unified Standard (and the End of Revlon Duties?), 49 BUS. LAW. 1593, 1626 (1994).


12. Useful discussions of the issues underpinning this question are contained in STEVEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS §§ 5.2-5.3, at 194-95 (2002).
shareholders, that the directors would devote to a business owned solely by themselves. It is in the shareholders’ best interests for directors to take well-considered risks, but directors need to be held to at least some behavioral standards. How should the directors manage, and how should the directors’ actions be judged? These questions are answered by evaluating a director’s “fiduciary duties.”

Directors hold a fiduciary position within the corporation (either characterized as an agent or trustee role), and directors are obligated to act with a primary

13. See Stephen M. Bainbridge, The Business Judgment Rule as Abstention Doctrine, 57 VAND. L. REV. 83, 85-86 (2004) (discussing the two competing views among academics as to which constituency’s interests should prevail). The discussion of whether directors actually prioritize shareholder interests as opposed to the directors’ own interests has been the fodder for much debate. Some academics embrace the “shareholder primacy model” of corporate governance, and others focus on the “director primacy model” of corporate discussion. For purposes of this discussion, neither perspective alters the fact that directors are inarguably fiduciaries for something (the corporation) or someone (the shareholders) else.

14. This discussion of the benefits to investors of their corporate management’s willingness to take calculated risks that the shareholder can arguably diversify away is summarized nicely by Judge Winter in Joy v. North, 692 F.2d 880, 885-86 (2d Cir. 1982):

Since shareholders can and do select among investments partly on the basis of management, the business judgment rule merely recognizes a certain voluntariness in undertaking the risk of bad business decisions. . . . The entrepreneur’s function is to encounter risks and to confront uncertainty . . . [and] because profit often corresponds to the potential risk, it is very much in the interest of shareholders that the law not create incentives for overly cautious corporate decisions. Some opportunities offer great profits at the risk of very substantial losses, while other alternatives offer less risk of loss but also less potential profit. Shareholders can reduce the volatility of risk by diversifying their holdings.

15. The question of what specific label is appropriate for directors as fiduciaries—whether agent, trustee, or bailiff—is a challenging question to answer. Traditionally, corporate officers and directors have been viewed as agents. See, e.g., FLOYD R. MECHEM, A TREATISE ON THE LAW OF AGENCY 34 (1889) ("[O]nly through the employment of agents [can] the executive functions of the corporation . . . be exercised."); FRANCIS B. TIFFANY, HANDBOOK OF THE LAW OF PRINCIPAL AND AGENT 104 (1903) ("[A] corporation . . . can act only through the intervention of agents."); John W. Pratt & Richard J. Zeckhauser, Principles and Agents: An Overview, in PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS 1, 2 (John W. Pratt & Richard J. Zeckhauser eds., 1985) ("The corporate executive . . . is an agent for the shareholders."). However, some scholars argue that officers and directors cannot be agents because the relationship between the director and the shareholder (the “agent” and the
See Robert C. Clark, Agency Costs Versus Fiduciary Duties, in PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS, supra, at 55, 56 ("[D]irectors are not agents of the corporation but are sui generis . . . neither [are] directors . . . agents of the stockholders.") (italicization added). Dean Clark seems to view the relationship between directors and the corporation or directors and the stockholders as one of both contract and statute as opposed to agency, but he seems unable to pin down a useful characterization of the relationship, if not an "agency" relationship. See id. at 56-59. I suppose the historical treatment of the manager/corporate relationship as one of agency can be partially reconciled with Dean Clark's position by viewing the manager and corporation/stockholder relationship as one of implied contract and, therefore, agency, as was done in Protection Life Ins. Co. v. Foote, 79 Ill. 361, 368-69 (1875):

[I]t must be presumed that each person, in becoming a member of the company, impliedly consents that it shall be represented by such officers and agents as are reasonably necessary for the transaction of its business, and that they shall possess the powers and perform the duties ordinarily possessed and performed by such officers and agents.

In any event, the characterization of the relationship between a corporation and its managers ("managers" meaning both directors and officers) as an agency relationship has a long history. See 2 VICTOR MORAWETZ, A TREATISE ON THE LAW OF PRIVATE CORPORATIONS § 575, at 547 (2d ed. 1886) ("Corporations almost invariably act through agents."). Indeed, while a corporation is a legal entity, able to contract and engage in other legal acts on its behalf, "[t]here are few acts which a corporation aggregate can possibly perform without the intervention of an agency of some kind." Id.

However, case law also indicates that the director-shareholder-corporation relationship involves both a trust relationship and an agency relationship: "[T]he ordinary rules of law relating to an agent are applicable in considering the acts of a board of directors in behalf of a corporation when dealing with third persons . . . [whereas] [t]he relation of the directors to the stockholders is essentially that of trustee and cestui que trust." People ex rel. Manice v. Powell, 94 N.E. 634, 637 (N.Y. 1911) (italicization added). Yet the Restatement of Trusts notes that:

There are many similarities and also differences in the roles and duties of trustees and those of corporate officers or directors, partners of various types of partnerships, and member-managers of limited-liability companies.

For example, trustees and corporate officers and directors, as fiduciaries, manage the affairs, respectively, of the trust or the corporation for the benefit of the beneficiaries or the shareholders. Corporate officers and directors, however, do not hold title to the property of the corporation and therefore are not trustees; accordingly their fiduciary duties are not within the scope of this Restatement.

RESTATEMENT (THIRD) OF TRUSTS § 5 cmt. g (2003).

Thus, there are at least three ways to characterize the fiduciary relationship between a director and stockholders: pure agency (director is an agent, stockholder is the principal); pure trust (the director is a trustee with respect to
fidelity to their beneficiary (the corporation or the shareholders). These fiduciary obligations are broken down into two specific fiduciary duties: the duty of loyalty and the duty of care. Judging the acts of corporate directors, then, requires a specific assessment of whether the directors complied with these fiduciary obligations.

the shareholder, who is the principal); and a combination of both (director is an agent with respect to the corporation as principal, and the director is a trustee with respect to his shareholders). Where does this ambiguity leave us? Nowhere of great import, as it is undisputed that directors hold some sort of fiduciary relationship with respect to their corporation and its shareholders. Moreover, the obligations of agents and trustees overlap to a large degree, such that the distinction in title is often of limited import. See Restatement (Third) of Trusts § 5 cmt. e (2003) ("Although an agent is not a trustee and is subject to rules of the law of agency, many of the same legal principles that are applied to trustees may be applied to agents . . ."). A more complete discussion of this interesting issue is beyond the scope of this Article.


17. The two fiduciary duties of directors have historically been the duty of care and the duty of loyalty. See In re Walt Disney Co. Derivative Litig., 825 A.2d 275, 286 (Del. Ch. 2003). Interestingly, however, over the past several years, the Delaware Supreme Court has, on occasion, referred to the fiduciary duties as a "triad," including the duties of care, loyalty, and good faith. See Emerald Partners v. Berlin, 787 A.2d 85, 90 (Del. 2001) ("The directors of Delaware corporations have a triad of primary fiduciary duties: due care, loyalty, and good faith."). This third duty—the duty of good faith—appears to have become a "duty" (which I take to mean something beyond merely an obligation, and something for which independent recourse exists) essentially overnight. Compare Emerald Partners, 787 A.2d at 90, and Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993) (referring to the triads of [a directors'] fiduciary duty—good faith, loyalty or due care), with Paramount Commc'n Inc. v. QVC Network Inc., 637 A.2d 34, 43 (Del. 1994) ("[T]he directors must act in accordance with their fundamental duties of care and loyalty." (quoting Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989))), and Citron v. Fairchild Camera & Instrument, 569 A.2d 53, 54 (Del. 1989) ("Eight of Fairchild's nine directors are charged with breach of their fiduciary duties of good faith and due care . . ."). The Delaware Supreme Court has never explained where they pulled this third duty from, and, indeed, more than one jurist on the Delaware Chancery Court has questioned the appearance of this new "duty." In addition, the Delaware Supreme Court has not been consistent in including this duty of good faith in its recitations of a director's fiduciary duties. While I certainly agree that directors have the obligation to act in good faith, the obligation to act in good faith has historically been subsumed both in the duty of care and the duty of loyalty as opposed to being a stand-alone duty. See Continuing Creditors' Comm. of Star Telecomm. Inc. v. Edgecomb, 385 F. Supp. 2d 449, 460 n.9 (D. Del. 2004) ("Although the Plaintiff also invokes the duty of good faith as separate from the duty of loyalty, Delaware case law states that the two duties are identical.").

18. For purposes of this Article, I am ignoring the duty of loyalty. Professor
Absent breaches of either fiduciary duty, our directors have fulfilled their fiduciary obligations. Absent a breach of either duty, our directors have managed the shareholders' assets as the law requires.

A. The Basics of the Duty of Care

A director's fiduciary duty of care obligates the director, when managing corporate affairs, "to use that amount of care which ordinarily careful and prudent men would use in similar circumstances." This standard of conduct—the care which ordinarily careful and prudent men would use in similar circumstances—is clearly very generous to directors, as it, by its terms, requires nothing more than the normal level of care a person would use in his business. The standard of review when a director is alleged to have failed to meet the standard of conduct is even more generous, however. As discussed below, when a duty of care breach

Lyman Johnson, however, makes a convincing argument that the duty of care issues that come up in cases such as Smith v. Van Gorkom, 488 A.2d 585 (Del. 1985), and In re Walt Disney Co. Derivative Litig., 825 A.2d at 286, could also be addressed as duty of loyalty issues. Are you being loyal, Professor Johnson would ask, and are you being faithful, when you (the director) pay little attention to the compensation of senior executives (for example)? In a more user-friendly hypothetical, would we call a friend, whom we have authorized to use our money, to pay our dog sitter while we are on vacation "loyal" if that friend gave the dog sitter a $200 tip just because the dog sitter showed up every day (like she was obligated to do anyway)? No. Our friend was not loyal; she was frittering away our money needlessly. If we view "loyal" conduct in the director context the way we view "loyal" conduct in real life—faithful conduct for the benefit of the one we are loyal to—then many "duty of care" fact patterns could just as well be viewed as "duty of care" cases. See Lyman Johnson, After Enron: Remembering Loyalty Discourse in Corporate Law, 28 Del. J. Corp. L. 27 (2003); see also Johnson & Millon, supra note 7 (discussing fiduciary duties in the context of the role that corporate officers and directors have played in recent corporate scandals).

19. Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 130 (Del. 1963); accord 1 Dennis J. Block et al., The Business Judgment Rule: Fiduciary Duties of Corporate Directors 109 (5th ed. 1998) ("[T]he duty of care requires that directors exercise the care that a person in a like position would exercise under similar circumstances."). Some states (such as New York and California) have codified the standard of conduct for directors, while other states (such as Delaware) have no such statutory provisions. See Cal. Corp. Code § 309 (West 2006); N.Y. Bus. Corp. Law § 717 (McKinney 2001). See generally 1 Am. Law Inst., Principles of Corporate Governance § 4.01(a) (1994).

20. See Melvin Aron Eisenberg, Corporations and Other Business Organizations 544-45 (8th ed. 2000) ("On their face, the duties of directors are
is alleged, the director's action at issue is initially presumed to be beyond judicial review and within the protections of the business judgment rule, subject to be set aside only if it is irrational. Only in the very rare case when this business judgment rule presumption is rebutted will a director's actions be subject to more stringent review.

B. The Standard of Review and the Business Judgment Rule

When reviewing an alleged breach of a director's duty of care, a court will first afford the directors the protections of the business judgment rule. The business judgment rule is a tool of judicial restraint, justified by the belief that courts are ill-equipped to second-guess the business decisions made by directors who are acting in good faith. The business judgment rule operates as a protective presumption, based on the assumption that the directors of a corporation "acted on an informed basis, in good faith and in the honest belief that the action [at issue] was in the best interests of the company." When a shareholder alleges that a director breached his duty of care, the director is initially assumed to be within the protections of this fairly demanding, insofar as they are measured by reasonability. In practice, however, the standards of review applied to the performance of these duties are less stringent than the standards of conduct on which the duties are based.

Judge Winter of the Second Circuit similarly went so far as to admit in an opinion:

While it is often stated that corporate directors and officers will be liable for negligence in carrying out their corporate duties, all seem agreed that such a statement is misleading. . . . [A] corporate officer who makes a mistake in judgment as to economic conditions, consumer tastes or production line efficiency will rarely, if ever, be found liable for damages suffered by the corporation.

Joy v. North, 692 F.2d 880, 885 (2d Cir. 1982) (citation omitted).

21. See Eisenberg, supra note 20, at 546.

22. See id.

23. See id. at 545.


business judgment rule presumption, and the reviewing court will only find that the director breached his duty of care if the actions of the director under attack are irrational, attributable to no reason of which a rational person would conceive. If the director's actions are not irrational, the director did not breach his duty of care.

26. See id. at 812; see also Eisenberg, supra note 20, at 545.

27. See Eisenberg, supra note 20, at 545. The business judgment rule presumption, with its very deferential "irrationality" standard of review, serves a sound policy goal: it encourages directors to exercise their discretion in making decisions based on then-existing facts without fear of being second-guessed. See id. at 547-48. See generally Bainbridge, supra note 13 (discussing the two competing views among academics as to which constituency's interests shall prevail). A lenient measure of post hoc review protects against hindsight bias:

As a result of a systematic defect in cognition known as the hindsight bias, however, under a reasonableness standard of review fact-finders might too often erroneously treat decisions that turned out badly as bad decisions, and unfairly hold directors liable for such decisions. Experimental psychology has shown that in hindsight people consistently exaggerate the ease with which outcomes could have been anticipated in foresight.

Eisenberg, supra note 20, at 547-48; see Joy v. North, 682 F.2d 880, 886 (2d Cir. 1982) ("[C]ourts recognize that after-the-fact litigation is a most imperfect device to evaluate corporate business decisions. The circumstances surrounding a corporate decision are not easily reconstructed in a courtroom years later . . . ."). A court will not, therefore, second-guess a decision made by a director that, in hindsight, was merely wrong, a mistake, or an unfortunate choice made when faced with multiple options. See Block et al., supra note 19, at 109. Although the relatively recent Delaware case of Aronson v. Lewis, 473 A.2d at 805, is usually cited to support this deference, this concept is actually not a modern one. See, e.g., Mechem, supra note 15, § 502, at 337-38 ("The law does not presume negligence on the part of the agent. On the other hand, it presumes that the agent has done his duty, until the contrary appears, and the burden of proof is upon him who alleges a misfeasance, to establish it.").

This deference to directors is sensible, because we want directors to make somewhat "risky" decisions, given that "potential profit often corresponds to the potential risk." See Joy, 692 F.2d at 886 (discussing the risk and reward calculus that weighs in favor of directors sometimes making riskier decisions to achieve greater benefits for the shareholders because shareholders can diversify away a corporation's risk); see also Eisenberg, supra note 20, at 540-44; Dennis J. Block & H. Adam Prussin, The Business Judgment Rule and Shareholder Derivative Actions: Viva Zapata?, 37 Bus. Law. 27, 32 (1981). Shareholders, knowing of this risk-reward calculus, can either elect not to buy stock, given that the market offers an array of other investment vehicles, or shareholders can mitigate the risk inherent in any given investment by diversifying their investment portfolio and holding many different stocks in disparate industries. See Joy, 692 F.2d at 885-86. This diversification or voluntary decision to invest
If the plaintiff can show that any of the four factual assumptions underpinning the business judgment rule are lacking, however, the protective presumption of the business judgment rule will be stripped from the director.\textsuperscript{28} The director's conduct will then be reviewed under a more demanding fairness and reasonableness standard of review,\textsuperscript{29} as opposed to an irrationality standard of review, and the director will have the burden of proving that she acted in a procedurally fair manner and reached a substantively fair result.\textsuperscript{30} If she cannot establish the

in stock with an understanding of the general volatility of the market frees the directors of each individual corporation to more broadly make appropriately risky decisions. See \textit{William A. Klein \& John C. Coffee, Jr., Business Organization and Finance: Legal and Economic Principles} 233-35 (8th ed. 2002); \textit{see also Eisenberg, supra note 20}, at 540-42 (quoting \textit{Klein \& Coffee, supra}). The Second Circuit in \textit{Joy v. North}, 692 F.2d at 886, went so far as to say that "[g]iven mutual funds and similar forms of diversified investment, courts need not bend over backwards to give special protection to shareholders who refuse to reduce the volatility of risk by not diversifying." A presumption of judicial abstention from substantive review of directors' decisions encourages directors to make these decisions as quickly as business imperatives require without the hamstring of liability fears. \textit{Eisenberg, supra note 20}, at 540-44.

28. As noted above, the four factual assumptions identified in \textit{Aronson v. Lewis} as justifying the business judgment rule presumption are (1) a decision having been made, (2) after the directors became reasonably informed about the matter at issue, and (3) the directors acted in good faith, (4) without any self-interest or conflict. \textit{Aronson}, 473 A.2d at 812; \textit{accord In re Caremark Int'l Inc. Derivative Litig.}, 698 A.2d 959, 967 (Del. Ch. 1996) (stating that the business judgment presumption is based on the assumption that "the decision made was the product of a process that was either deliberately considered in good faith or was otherwise rational"); \textit{see also Block et al., supra note 19}, at 110; \textit{Eisenberg, supra note 20}, at 545.

29. \textit{See Eisenberg, supra note 20}, at 545-46; \textit{see also Aronson}, 473 A.2d at 812.

30. \textit{See Block et al., supra note 19}, at 112 n.20; \textit{Eisenberg, supra note 20}, at 545-46 (discussing \textit{Cede \& Co. v. Technicolor, Inc.}, 634 A.2d 345 (Del. 1993)); \textit{see also McGowan v. Ferro}, 859 A.2d 1012, 1028 (Del. Ch. 2004) ("If the director defendants had disabling conflicts of interest or acted in bad faith . . . they would have to prove the fairness of the transaction.").

Given that Professor Eisenberg cites the \textit{Cede} case to support his position that the standard of review regarding a duty of care claim is based on irrationality when a director is outside the protections of the business judgment rule, let me use this opportunity to note that the \textit{Cede} case is the typical Delaware case I was thinking of in my introduction when I noted that the Delaware courts often seem befuddled. \textit{See supra note 10}. In the \textit{Cede} opinion, the court states that "the breach of the duty of care . . . is sufficient to rebut the business judgment rule." \textit{Cede}, 634 A.2d at 371. The court goes on to say that "[a] breach of either the duty of loyalty or the duty of care rebuts the
presumption” of the business judgment rule. *Id.* What does *that* mean?

It is my view (and I thought that of Professor Eisenberg, based on page 545 of his text) that the reverse of what the *Cede* court said is true. That is to say, if the business judgment rule is rebutted, the court will review an alleged duty of care claim on a “fairness and reasonableness” standard. If the claim is not fair and reasonable, the directors will be liable for breaching their duty of care. The *Cede* court cites the *Van Gorkom* opinion to support its backward position. See *Cede*, 634 A.2d at 368 (citing *Smith v. Van Gorkom*, 488 A.2d 858, 893 (Del. 1985)). The *Cede* court cites the final page of the majority opinion in *Van Gorkom*, wherein that court notes:

[T]he directors of Trans Union breached their fiduciary duty to their stockholders (1) by their failure to inform themselves of all information reasonably available to them and relevant to their decision to recommend the Pritzker merger; and (2) by their failure to disclose all material information such as a reasonable stockholder would consider important in deciding whether to approve the Pritzker offer.

*Van Gorkom*, 488 A.2d at 893. I do not read this language to say, as the *Cede* court suggests, that a breach of the duty of care rebuts the business judgment rule presumption. Rather, I read this language—the above language quoted from page 893 of the *Van Gorkom* opinion—to say, if anything, the opposite: the failure to satisfy the third of the business judgment rule prerequisites (becoming reasonably informed) leads to a breach of the duty of care.

Of course, the *Van Gorkom* opinion is no model of clarity itself. The above quoted language from *Van Gorkom* would have been made more clear (and thereby useful as precedent) and more representative of the law if it read as follows:

The Trans Union directors removed themselves from the generous protections of the business judgment rule by being grossly negligent in their efforts to become informed. By failing to become informed about all material reasonably available to them and relevant to their decision to recommend the Pritzker merger, thereby being grossly negligent and relinquishing the presumption’s protection, the director’s alleged breach of the duty of care will be reviewed against a reasonable and fairness standard. And we conclude that the directors of Trans Union did not meet this standard, and thereby breached their duty of care, when they (1) failed to inform themselves of all information reasonably available to them and relevant to their decision to recommend the Pritzker merger, thereby being grossly negligent and relinquishing the presumption’s protection, the director’s alleged breach of the duty of care will be reviewed against a reasonable and fairness standard. And we conclude that the directors of Trans Union did not meet this standard, and thereby breached their duty of care, when they (1) failed to inform themselves of all information reasonably available to them and relevant to their decision to recommend the Pritzker merger, thereby being grossly negligent and relinquishing the presumption’s protection, the director’s alleged breach of the duty of care will be reviewed against a reasonable and fairness standard. And we conclude that the directors of Trans Union did not meet this standard, and thereby breached their duty of care, when they (1) failed to inform themselves of all information reasonably available to them and relevant to their decision to recommend the Pritzker merger; and (2) failed to disclose all material information such as a reasonable stockholder would consider important in deciding whether to approve the Pritzker offer. Such failings are neither fair nor reasonable.

Mind you, the *Van Gorkom* opinion does not include the second half of my duty of care calculus: the opinion does not say “by being grossly negligent in their efforts to become informed” and thereby forfeiting the business judgment rule presumption, “the director’s alleged breach of the duty of care will be reviewed against a reasonable and fairness standard.” The opinion says nothing of that at all. Rather, by only its actual language, the court seems to say that once the business judgment rule presumption is rebutted, the directors are liable for breaching their duty of care. Yet, that cannot be. It seems to me that
reasonableness and fairness of her decision, her actions will be found to have violated her duty of care.

The "power" of the business judgment rule presumption then can only be undercut if a complaining shareholder can show one of three things:

(1) The director was conflicted;
(2) The director did not act in good faith; or
(3) The director was grossly negligent in becoming informed.\(^3\)

It is the good faith option that is of import in this Article.

C. Legislative Limits on a Director's Duty of Care Liability Exposure

As if the very generous standard of conduct and the

the value of a presumption is to shift the burden off of the director to allow him to be free of the fear of always being second-guessed with hindsight. Once the burden is shifted back to the defendant, however, this now-burdened party can still prove he is not liable (by establishing fairness and reasonableness), as opposed to immediately being held liable. That is the point of burdens and burden-shifting; they deal with proof.

Based on the lengthy discussion in the *Van Gorkom* opinion of the process followed by the Trans Union directors both in approving the merger price and reviewing and approving the merger agreement, I think we can safely conclude that the court was reviewing the fairness and reasonableness of the process. *See Van Gorkom*, 488 A.2d at 874-89. That is to say, on the unique facts of this case, the "informed" element of the business judgment rule substantially overlapped with the later "fair and reasonable" standard of review. The same Trans Union director conduct was relevant to both inquiries.

As well, footnote 13 of the *Van Gorkom* opinion cites and quotes cases that basically lay out the fair and reasonable test's criteria (whether the board passed an "unintelligent and unadvised judgment" and whether the board acted "without the bounds of reason and recklessly"). *Van Gorkom*, 488 A.2d at 873 n.13.

31. *See Aronson*, 473 A.2d at 812:

[T]o invoke the [business judgment] rule's protection directors have a duty to inform themselves, prior to making a business decision, of all material information reasonably available to them. Having become so informed, they must then act with requisite care in the discharge of their duties. While the Delaware cases use a variety of terms to describe the applicable standard of care, our analysis satisfies us that under the business judgment rule director liability is predicated upon concepts of gross negligence.
business judgment rule presumption described above were not protection enough for a director against a claim that she breached her duty of care, most states also offer a statutory limit on a director’s personal liability for breaching her duty of care. Specifically, most states have a section in their corporate code that permits a corporation to include in its charter a provision that prohibits (or dramatically limits) shareholder lawsuits against directors in which the shareholders seek money damages. For example, DGCL § 102(b)(7) provides that a corporation can include in its certificate of incorporation:

A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary

damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under § 174 of this title; or (iv) for any transaction from which the director derived an improper personal benefit.33

This provision of the Delaware code allows a business that is incorporated in Delaware to clearly insulate its directors against personal liability to their shareholders for money damages for duty of care breaches.34 A certificate of incorporation provision adopted pursuant to DGCL § 102(b)(7) operates as an affirmative defense.35 If a stockholder plaintiff brings a lawsuit seeking monetary damages against a defendant director based on an alleged duty of care breach,36 the director can point to the exculpatory charter provision as his affirmative defense.37 If

33. DEL. CODE ANN. tit. 8, § 102(b)(7) (2001). A few states offer statutory duty of care protection that differs slightly from Delaware's protection, but the differing statutes still serve to limit the personal liability exposure of the directors. For example, Virginia's statutory insulation offers directors protection via a monetary liability cap. The Virginia code limits the recoverable damages that can be garnered from any one director in any proceeding brought by, or in the right of, the corporation or its shareholders to the lesser of the monetary cap specified in the articles of incorporation or shareholder-approved by-laws, or the greater of $100,000 or the cash compensation received by the director from the corporation over the twelve months prior to the actions alleged to be fiduciary violations. VA. CODE ANN. § 13.1-692.1(A) (2006).

34. I say that DGCL § 102(b)(7) allows corporations "to clearly" insulate their directors against liability, because the reality is that the business judgment rule presumption as discussed in Aronson, 473 A.2d at 812, does, in effect, exactly the same thing as § 102(b)(7). See Emerald Partners v. Berlin, 787 A.2d at 91 (Del. 2001) ("The statutory enactment of Section 102(b)(7) was a logical corollary to the common law principles of the business judgment rule."). Apparently corporate directors wanted even more assurances than the business judgment rule presumption offered.


36. DGCL § 102(b)(7) does not prohibit a plaintiff stockholder from suing a director to seek injunctive relief.

37. See Malpiede, 780 A.2d at 1092-93. A defendant director can raise a DGCL § 102(b)(7) defense "on a Rule 12(b)(6) motion to dismiss (with or without the filing of an answer), a motion for judgment on the pleadings (after filing an answer), or a motion for summary judgment (or partial summary judgment)
the plaintiff has not pleaded that the conduct at issue falls within one of the exceptions specified in DGCL § 102(b)(7)—
(a) the duty of loyalty was breached in addition to the duty of care; (b) the director did not act in good faith or the director engaged in willful misconduct; or (c) the director was conflicted—the director defendant will be immune from shareholder suit for monetary damages for breaching his duty of care.38

D. The Unimportance of Being Earnest

The big picture, then, when we put together all the pieces of a duty of care analysis, looks bleak from a stockholder's perspective. If a stockholder tries to sue a director for doing something "wrong," and the director is not conflicted such that the duty of loyalty is implicated, the shareholder's only other option is to draft a complaint based on a duty of care breach.39 But if the stockholder does try to sue a director for breaching his duty of care, the stockholder immediately runs into the business judgment rule brick wall.40 The director is afforded the deference of the business rule presumption from the get-go. Under the business judgment rule presumption, the stockholder can only get past a defendant's motion to dismiss if she can plead facts indicating that the director's action was irrational—basically inexplicable.41

The only other way a stockholder can keep herself in the courtroom at that juncture is to identify facts that will justify removing the director from the protection of the business judgment rule.42 To do this, the shareholder must

under Rule 56 after an answer, with or without supporting affidavits.” Id. at 1092 (citations omitted); accord Emerald Partners, 787 A.2d at 91 n.35.


39. Again, recall that I do not support the position taken by some that directors have three fiduciary duties, this new "duty of good faith" being the third. See supra note 17.

40. See supra note 27 and accompanying text.

41. I have not come across a case where a defendant failed an irrationality analysis.

42. See supra note 28.
show that one of the four factual prerequisites to the business judgment rule presumption's protection is missing. The prerequisites that are usually implicated in this backward calculus are the obligation to act on an informed basis and the obligation to act in good faith. If the plaintiff can show that the director was grossly negligent in his attempt to become informed or did not act in good faith, the director is stripped of the business judgment rule presumption's protection (and its absurdly generous irrationality standard of review), and the standard of review becomes one of reasonableness and fairness.

However, even if a shareholder plaintiff overcomes the business judgment rule presumption, and even if a shareholder can show that the director did not act in a reasonable and fair way, such that the director breached his duty of care, the director is likely to still have further statutory protection under a charter provision based on DGCL §102(b)(7), such that the duty of care violation proved by the plaintiff is essentially irrelevant. The only way in that situation for a plaintiff stockholder to keep herself in the courtroom is to prove that the director did not act in good faith, such that he falls outside of the protections of the statutory liability limiting provision in addition to falling outside the protection of the business judgment rule presumption.

43. See, e.g., In re Walt Disney Co. Derivative Litig., 825 A.2d 275, 286 (Del. Ch. 2003).

44. Despite my statement in the text acceding to the basic majority view on what DGCL § 102(b)(7) means, I have long been of the view that DGCL § 102(b)(7) does not actually insulate against duty of care violations based on a director's obligation to act in good faith. Phrased differently, as I read Aronson together with DGCL § 102(b)(7), a stockholder in a corporation with a DGCL § 102(b)(7) provision in its charter cannot sue for a duty of care violation if the claim is based on the director's failure to become adequately informed prior to making a decision. However, I vary from the majority, it seems, in that I read the "good faith" language in DGCL § 102(b)(7) as leaving room for duty of care claims that are based on allegations of the absence of good faith, as opposed to allegations that the directors were grossly negligent in becoming informed.

I have yet to find an academic who mirrors my view. For that reason, for purposes of this discussion, it is easier, and makes no real difference, to accord with the majority view.

45. The terms of these statutes usually exclude duty of loyalty breaches, and intentional violations of the law, both of which are beyond the scope of this discussion.
Therefore, the entire duty of care analysis—essentially the entire discussion about whether a director did his job decently—often boils down to an assessment of good faith.\(^\text{46}\) If a director does a relatively poor job of running the corporation and is admittedly giving the task a mediocre effort, the only way that the owner of the corporation (the stockholder) can hold her director accountable is by circumventing the business judgment rule presumption’s protection and any statutory protection to prove that the director did not act in good faith. It is for this reason that, as discussed in the Introduction, it is important to have a clear definition of “good faith.” The judiciary’s and contemporary academics’ lack of consistency and clarity in the good faith area needs to be addressed before even a compelling case brought by a sympathetic plaintiff shareholder has a more than miniscule chance of success in the courthouse.

46. “Good faith” becomes an issue in at least two contexts when dealing with director liability for fiduciary failings. First, recall from above, that good faith is a factual prerequisite to the protections of the business judgment rule presumption. If a plaintiff can establish that a director did not act in good faith, the director defendant will not be afforded the protection of the business judgment rule presumption, and the director’s actions will be reviewed under a reasonableness and fairness analysis. Emerald Partners v. Berlin, 787 A.2d 85, 91 (Del. 2001) (“If the presumption of the business judgment rule is rebutted . . . the burden shifts to the director defendants to prove to the trier of fact that the challenged transaction was ‘entirely fair’ to the shareholder plaintiff.”).

Second, the text of most state exculpatory statutes such as DGCL § 102(b)(7) does not protect directors from personal liability for acts taken “not in good faith.” DEL. CODE ANN. tit. 8, § 102(b)(7) (2001). A corporation can include in its certificate of incorporation “[a] provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty,” but such provision cannot eliminate or limit a director’s liability “for acts or omissions not in good faith.” \(\text{Id.}\)

In addition, some would maintain that a director’s duty of loyalty is breached if the director fails to act in good faith, such that a good faith assessment is relevant for the review of an alleged duty of loyalty claim. See \textit{In re} Gaylord Container Corp. S’holders Litig., 753 A.2d 462, 476 (Del. Ch. 2000) (noting that the Delaware Supreme Court has “equate[d] good faith with loyalty”). Some would also argue that good faith is its own independent fiduciary duty, see supra note 17, and some take the position that good faith is an ephemeral concept binding directors in all that they do. See David Rosenberg, \textit{Making Sense of Good Faith in Delaware Corporate Fiduciary Law: A Contractarian Approach}, 29 \textit{Del. J. Corp. L.} 491, 513 (2004). For purposes of this Article, I will focus on only the first two situations in which good faith becomes relevant, as I am not convinced of the validity of the three other invocations of the “good faith” language.
II. THE MECHANICS OF DEFINING GOOD FAITH

There is no generally-accepted, well-reasoned definition of "good faith" in the director liability context. Neither common law nor recent scholarship offers a definition that is both generally transferable to the director liability context and agreeable, well-reasoned, and relatively precise. Part of the reason why the good faith landscape is barren of a good faith definition is attributable to the nature of the phrase—"good faith" has been described as

47. This "good faith" obligation imposed on directors is nothing new, as fiduciaries have always been obligated to act in good faith, and directors qua fiduciaries are no exception. For this reason, it is interesting that the Delaware Supreme Court has not yet defined "good faith" in the context of director liability, given the reputation of the Court to be the ultimate arbiter of corporate law. To be fair, I have found no evidence that the Delaware Supreme Court has been directly asked to define good faith. Indeed, in the recent Disney shareholder litigation where the issue of whether the directors acted in good faith was crucial, plaintiff-appellant's counsel did not propose an affirmative definition of good faith even one time. See Transcript of Oral Argument, In re Walt Disney Co. Derivative Litig., 906 A.2d 27 (Del. 2006) (No. 411) (on file with author). The fact, then, that no such firmly rooted definition of good faith exists in the director liability context affords me the luxury to work through a principled calculus below to generate a sensible, useful definition of good faith.

“loose and amorphous.”

In addition, part of the reason why the phrase “good faith” has no readily identifiable definition in the director liability realm is likely because, until late, good faith has not been outcome determinative in any director liability litigation. Nobody seems to have paid careful attention to what good faith means in the director liability context because nobody has needed to care until recently. There was no reason to go out and define good faith if the jurists were not using it to judge directors and if directors were not leaning on the phrase’s definition to guide their conduct.

Now, however, in the wake of recent scandals and litigation, good faith is being pulled from the disgruntled shareholder plaintiff’s arsenal as a tool to right the wrongs of corporate mismanagement. Therefore, it is time to begin thoughtfully defining the boundaries of a director’s obligation to act in good faith. Without a reasonably well-defined and agreed-upon definition of good faith, directors will continue to struggle to both meet and stay within the bounds of their good faith obligation, and it is likely that directors will become more conservative in situations where it might have made sense to assume more risk (for purposes of hopefully earning greater rewards). In addition, shareholders who are trying to plead that a director did not

49. Friedrich K. Juenger, Listening to Law Professors Talk About Good Faith: Some Afterthoughts, 69 TUL. L. REV. 1253, 1254 (1995). I am not sympathetic to the argument that “good faith” is too difficult to define. “[T]he words in question, ‘in good faith’ are clear and unambiguous, are words in common usage, and therefore need not be defined.” State v. A.G., 670 S.W.2d 516, 517 (Mo. Ct. App. 1984). “‘The phrase ‘good faith’ in common usage has a well-defined and generally understood meaning, being ordinarily used to describe that state of mind denoting honesty of purpose, freedom from intention to defraud, and, generally speaking, means being faithful to one’s duty or obligation.’” Id. (quoting People v. Nunn, 296 P.2d 813, 818 (Cal. 1956)).

50. See Sean J. Griffith, Good Faith Business Judgment: A Theory of Rhetoric in Corporate Law Jurisprudence, 55 DUKE L.J. 1, 15-16 (2005) (“The mystery of good faith has been a part of Delaware law for as long as the business judgment rule. It has been an express component of the rule at least since the oft-cited Aronson formulation appeared in 1984 and an explicit part of the statute [DGCL § 102(b)(7)] since it was amended in 1987. Yet the concept was unexplored for almost two decades, until the chancery court’s development of good faith jurisprudence in 2003.”).

51. See id.

act in good faith are left guessing about what they have to plead.

But defining good faith in the director liability context is, as alluded to before, not simple. In addition to the fact that good faith is "loose and amorphous" in and of itself, the stakes are high when defining good faith in the context of director liability. Too narrow a definition will mean that directors can satisfy their obligation to act in good faith with no more than minimal effort and attention. Certainly that is not acceptable for a fiduciary who is acting in the stead of hundreds or thousands of shareholders. Yet too broad a definition of good faith will mean that directors will be fearful of taking the risks needed to achieve great wealth, and the essence of the business judgment rule and common law deference to directors will be undermined. It is unlikely that qualified, experienced people will want to serve as directors if they are faced with the likelihood of being second-guessed on every decision.

Adopting wholesale a definition of good faith from an area of law where the definition of good faith has roughly been agreed upon is not the solution, because, as we will see below, most of the definitions are specific to the context, such that they cannot be easily adopted. Indeed, the unique fiduciary relationship of the director-shareholder-corporation constituencies confounds even the most well-established definition of "good faith" in the arms-length context (such as, for example, in the commercial law context, where the definition of "good faith" is generally agreed upon).

That said, it is certainly worthwhile to look at how "good faith" is defined in other areas of the law, to see if there is some common thread to be pulled. While definitions from some areas of the law, such as the criminal law realm, are not particularly helpful individually, the definition of good faith in the trust context (where the trustee is a fiduciary of the beneficiary), in the agency context (where there is an agent-principle fiduciary relationship), and in the insurance context (where we have both a contractual relationship and a sometimes fiduciary relationship) all prove useful because their factual contexts line up nicely, as do their underlying relational ties, with the director liability realm. In addition, good faith in commercial and contracts law realms merit a longer look as directors are under implicit, if not explicit, contractual obligations to the
corporation that they serve. Therefore, the definitions of 
good faith as the term is used in the context of a fiduciary 
relationship, when examined along with the dictionary\textsuperscript{53} 
and tempered with a good dose of common sense, ultimately 
prove most helpful as demonstrated below, in constructing 
a sensible, defensible, and useful definition of “good faith” 
in the director conduct context.

A. The Dictionary

Black's Law Dictionary defines good faith as: "A state of 
mind consisting in (1) honesty in belief or purpose, (2) 
faithfulness to one's duty or obligation, (3) observance of 
reasonable commercial standards of fair dealing in a given 
trade or business, or (4) absence of intent to defraud or to 
seek unconscionable advantage.—Also termed \textit{bona fides}.”\textsuperscript{54}

Analyzing whether a director acted with a lack of good 
faith in violation of the business judgment rule or a 
§ 102(b)(7) charter provision would be easy if we simply 
used Black's good faith definition. The jurist attempting to 
assess a director's alleged good faith violation would line up 
a director's conduct with whichever phrase (e.g., “(1),” “(2),” 
“(3),” or “(4)”) from the definition of good faith that was 
most appropriate with respect to the facts of the case (likely 
“faithfulness to one's duty or obligation”) and analyze 
whether the acts at issue fit within the definition of “good 
faith.”\textsuperscript{55} Was a director who did not inquire further into 
whether an executive's pay package was justifiably at the 
top of the pay range among his peers acting with

\textsuperscript{53} See generally Joseph Scott Miller & James A. Hilsenteger, \textit{The Proven 
Key: Roles and Rules for Dictionaries at the Patent Office and the Courts}, 54 AM. 

\textsuperscript{54} BLACK'S LAW DICTIONARY 701 (7th ed. 1999). However, beneath the 
definition is a paragraph of text that seems to imply that good faith is not so 
easily defined. The paragraph quotes the Second Restatement of Contracts in 
which it is noted that "'[t]he phrase 'good faith' is used in a variety of contexts, 
and its meaning varies somewhat with the context.'" \textit{Id.} (quoting RESTATEMENT 
(SECOND) OF CONTRACTS § 205 cmt. a (1981)).

\textsuperscript{55} Although the language in the definition refers to "[a] state of mind," see 
\textit{supra} text accompanying note 54, it seems that courts would have to view the 
acts at issue objectively, as opposed to using the subjective viewpoint of the 
director under fire, if good faith is going to have any value in guiding a 
director's fulfillment of his fiduciary duties.
"faithfulness to [his] duty or obligation" as a director?\textsuperscript{56}

Notwithstanding the fact that the reference to the dictionary is legitimate in defining terms for legal purposes,\textsuperscript{57} for those who oppose resort to the dictionary alone (or at least without considering in full other options), the survey below of the common law definitions of "good faith" in other contexts and a specific analysis of the interpretation of good faith in the agency, trustee, and insurance contexts all support and further shape the definition of good faith provided in Black's.

B. Existing Good Faith Definitions from Statutes and Common Law

The definition of good faith varies by context. While good faith has a well-defined meaning in some areas of the law, the definition is less clear in other areas of the law, where courts take more of a "we know it when we see it" approach.\textsuperscript{58} It is worthwhile to broadly review the definitions of "good faith" from other areas of the law for purposes of trying to assess what common ground, if any, exists within definitions. As we will see below, there is some overlap among definitions.

Our review will ultimately prove that the factual and legal aspects of a director's role preclude the mere copying of a good faith definition from a non-fiduciary context to the director liability context. Reviewing the definitions in other areas is not a wasted effort, however, because it gives us a

\textsuperscript{56} These facts represent a generalization of the facts implicated in the recent Disney director litigation related to the hiring and firing of Michael Ovitz as Disney President. See infra Part II.B.4.


\textsuperscript{58} "The term 'good faith' is not easily defined and the requirement is not capable of pragmatic and mechanical application. In the last analysis it is the same as pornography, one cannot define it but will readily recognize it when one sees it." In re Noll, 172 B.R. 122, 124 (Bankr. D. Fla. 1994) (citing Jacobellis v. Ohio, 378 U.S. 184, 197 (1964) (Stewart, J., concurring)).
sense of the commonality of purpose of the phrase "good faith" in other areas of the law.

1. Survey of Good Faith in Other Areas of the Law.

Certain themes recur when defining good faith in various areas of the law. In the criminal context, "honesty of purpose, freedom from the intention to defraud, and . . . being faithful to one's duty or obligation" appear often as "good faith" themes. When dealing with the unlawful prescription of narcotics, for example, one must have good intentions and make "an honest endeavor to carry on [one's] profession." In property disputes, good faith includes an "honest and reasonable belief" with no knowledge or intent otherwise. Other contexts demand of a good faith actor that he "[act] sincerely and with a belief he is doing right," form honest beliefs after conducting a reasonable inquiry; make decisions "well grounded in fact and . . . warranted . . . by reasonable grounds," and provide "fair and full disclosure." In the bargaining arena, good faith is defined by an "honest purpose" and "sincere


60. See Bradford, 368 So.2d at 325 (quoting Smith v. State, 13 N.E.2d 562, 565 (Ind. 1938)) (defining "good faith" in a statute criminalizing the unlawful sale of narcotics by physicians).

61. Id. (quoting State v. Weeks, 335 So.2d 274, 277 (Fla. 1976) (reversing prior decision holding doctor guilty of selling narcotic drugs) (internal citations omitted)).


65. Id.


desire" to cooperate and reach an agreement, and the actor's sincerity must be evidenced by his or her active participation in the bargaining process. To creditors and collections agents, good faith requires "that a party justify its action," "honesty in fact [and] in conduct," and "diligent and honest" discovery efforts. Treaty signatories must have the "intent of faithful performance" and must adhere to their commitments. Finally, good faith in various federal statutory schemes requires reasonable attempts at compliance. In summary, good faith requires honest, faithful, sincere, fair, and reasonable intent and conduct.

2. Good Faith in the Fiduciary Context. "Good faith" as defined in the fiduciary context—in the context of agents, trustees, and insurers in particular—merits its own discussion because good faith requires more of actors in these contexts than with respect to actors in most other contexts. In addition, good faith in the fiduciary context is more goal-specific than is good faith in other contexts. As we will see below, good faith in the fiduciary context has as its goal an act "in the best interests" of the person whom

---


71. IND. CODE ANN. § 26-1-1-201 (LexisNexis 2006) (defining "good faith" in Indiana transactions).


74. See id. at 1907.


a. Agents and Trustees. Agents, trustees, and fiduciaries generally are obligated to act in good faith:

It is a fundamental and wholesome provision of the law which requires a trustee must act in good faith in the administration of his trust, and that requirement means that he must act honestly and with finest and undivided loyalty to his trust, not merely with the standard of honor of the workaday world, but with a punctilio of honor the most sensitive.\(^{77}\)

---

\(^{77}\) Sauvage v. Gallaway, 66 N.E.2d 740, 743 (Ill. App. Ct. 1946); see Sokoloff v. Harriman Estates Dev. Corp., 754 N.E.2d 184, 188-89 (N.Y. 2001) (quoting W. Elec. Co. v. Brenner, 360 N.E.2d 1091, 1094 (N.Y. 1977)) (discussing an action by prospective homeowners, who had hired a contractor to provide pre-construction services for construction of a home on their property, seeking specific performance of contractor's contract with architect hired to design home, stating, “fundamental to the principal-agent relationship ‘is the proposition that an [agent] is to be loyal to his [principal] and is prohibited from acting in any manner inconsistent with his agency or trust and is at all times bound to exercise the utmost good faith and loyalty in the performance of his duties’”); see also In re Marriage of Petrie, 19 P.3d 443, 447 (Wash. Ct. App. 2001) (quoting Esmieu v. Schrag, 563 P.2d 203, 207 (Wash. 1977)) (discussing an action to remove children's father as custodian for his children's investment accounts and as trustee of their real estate trust for breach of his fiduciary duties, stating “[a] trustee owes the beneficiaries of the trust ‘the highest degree of good faith, care, loyalty and integrity’”); Hardy v. Hardy, 263 S.W.2d 690, 694-95 (Ark. 1954).

Using particularly compelling language in a disciplinary hearing against an attorney who mishandled his clients fund, the Supreme Court of Oklahoma said:

A trustee is a fiduciary of the highest order in whom the hope and confidence of the settlor are placed with the expectation that the trustee will exercise the obligations of the office for the exclusive benefit of the cestui que trust. A trustee always owes to the cestui que trust uberrima fides.

State ex rel. Okla. Bar Ass'n v. Wallace, 961 P.2d 818, 826 (Okla. 1998). As the court notes, uberrima fides means “the most abundant good faith, absolute and perfect candor or openness and honesty.” Id. at 826 n.23 (quoting BLACK'S LAW DICTIONARY 1690 (4th ed. 1968)).

This obligation has deep historical roots:

When a trustee, in the discharge of his legal duty, has received into his hands good funds, and seeks to discharge himself from liability therefor, on the ground that the same has been converted by him into Confederate money and lost, the burden of proof is upon the party who insists upon such loss, and he should be required to make clear and satisfactory proof that he has acted with entire good faith to entitle
The meaning of good faith in the trust and agency contexts is essentially the same. In both cases, good faith obligates the trustee or the agent to act in the best interests of his beneficiary or principle, even to the extent of favoring the same over himself. For example, in challenging the Illinois Supreme Court to officially define a trustee’s good faith, the lower court stated:

To even wet [sic] your appetite and entice the Appellate Court to go in and explore this thing, I would offer a definition. ... *Good faith means unswerving loyalty and fidelity to the wishes of the settlor.* A loyalty and fidelity which may mean the trustee [sic] may give the trustee leave to ignore outside influences and changes and circumstances. That’s what I believe good faith means when it’s encompassed with trust documents such as this.

When dealing with an Alaska state statute regarding litigation expenses incurred by an estate representative, the Supreme Court of Alaska said: “We hold that ‘good faith’ under AS 13.16.435 incorporates the statutory requirement that a personal representative act with the intent to benefit successors named in the instrument the

---


78. As one court noted:

The fiduciary owes a duty of the most perfect and scrupulous good faith (“uberrima fides”) to his principal. ... Not many rules of law are as entrenched or honored in our system of justice in the United States as are the fiduciary’s duty of full disclosure and the fiduciary’s duty of good faith and loyalty. ... The duty of good faith and loyalty specifies that a fiduciary must act in accordance with the highest standard of integrity, with utmost good faith, and with scrupulous openness, fairness, and honesty, and a court of equity can and will require such behavior. All the power, influence, and skill of a fiduciary is to be used for the advantage of the principal, and not for the personal gain of the fiduciary.


personal representative seeks to uphold . . . .”

b. Insurers. “Good faith” exists in insurance law as a fundamental matter because every insurance contract contains an implicit obligation that the parties thereto act in good faith and fair dealing." This good faith obligation applies to both parties to the contract, and it prohibits either party from acting to impair the right of the other to receive benefits under the insurance contract. Traditional contract remedies are available to either party injured by the other’s failure to act in good faith, but many jurisdictions also recognize an independent tort action for the same. In addition, some jurisdictions have enacted a statute that imposes the good faith obligation and defines penalties for the failure to comply with such. The statutes may expand, restrict, or mirror the common law duty, or

80. Enders v. Parker, 66 P.3d 11, 17 (Alaska 2003); see ALASKA STAT. § 13.16.435 (2006) (stating that a personal representative who defends or prosecutes any proceeding in good faith is entitled to receive necessary expenses and disbursements from the estate).

81. See LEE R. RUSS & THOMAS F. SEGALLA, COUCH ON INSURANCE § 198:6 (3d ed. 2005) [hereinafter COUCH]; see also Neal v. Farmers Ins. Exch., 582 P.2d 980 (Cal. 1978) (stating that the insurer’s duty of good faith to the insured imposes a number of obligations, including, but not limited to, the duty of an insurer to accept reasonable settlements of third party claims against its insured and the duty not to withhold payments due under a policy without good reason). An insurer’s duty to investigate claims filed by an insured may arise from an insurer’s duty of good faith and fair dealing. See Gilderman v. State Farm Ins. Co., 649 A.2d 941 (Pa. Super. Ct. 1994) (including duty to investigate as part of an insurer’s duty of good faith and fair dealing owed to the insured); Warren v. Am. Family Mut. Ins. Co., 361 N.W.2d 724 (Wis. Ct. App. 1984); see also COUCH, supra, § 198.27 n.37 (citing both of the above cases).


84. See COUCH, supra note 81, § 198:8.

85. See, e.g., Ace v. Aetna Life Ins. Co., 139 F.3d 1241 (9th Cir. 1998) (recognizing an actionable tort against insurers for breach of implied covenant of good faith and fair dealing).

86. See COUCH, supra note 81, § 198:11.

87. See id. (“[T]he precise nature of the duty imposed may vary considerably.”).
the statutes may create a right of action for insureds\textsuperscript{88} and third parties against insurers for a breach of the duty.\textsuperscript{89}

Good faith also often takes on an additional common law dimension with respect to an insurer because the insurer is sometimes viewed as a fiduciary. An insurer who is defending or negotiating a settlement for an insured with respect to a claim made against the insured is obligated to act in good faith.\textsuperscript{90} Though the insurer's obligations to the insured are based, in the first instance, on the insurance contract between the two parties, as discussed above, the definition of good faith used by the courts when the insurer is called upon to fulfill his end of the contractual bargain by acting on behalf of the insured is more stringent than the standard good faith and fair dealing definition gleaned from contract law. To wit, good faith in this insurance context obligates the insurer to affirmatively act to protect the interests of the insured.\textsuperscript{91} Good faith in this context "means more than an absence of intent to harm."\textsuperscript{92} This heightened standard of conduct has been justified by the courts on the basis of a myriad of different factors, including the fiduciary relationship (or degree thereof) between the parties (and all of the factors that address whether a fiduciary relationship exists), and the insured's ceding of control to the insurer.\textsuperscript{93}


\textsuperscript{89} See Theriot, 694 So. 2d at 187-88.


\textsuperscript{91} See Shell Oil Co., 52 Cal. Rptr. 2d at 588.

\textsuperscript{92} Id.

That said, insurers are not always automatically tied in a fiduciary relationship to their policyholders. Indeed, as noted above, the relationship between the insured and the insurer is primarily one of contract, founded on the terms of the insurance agreement. Courts that go further and find that there is also a fiduciary relationship between the insured and the insurer, such that the insurer can be held to heightened standards of conduct, look to the terms of the insurance contract to see if the terms create a fiduciary tie. Two factors impact whether a fiduciary relationship


Given the fiduciary nature of the insurer-insured relationship, it should come as no surprise that the “not in good faith” versus “bad faith” debate discussed later in this Article, rears its ugly head in the insurance context as well. See infra Part IV. Regarding the suggestion made that an insurer’s lack of good faith should be proven by a complaining insured by establishing bad faith, Professor Couch says:

Dissenters abound, however, frequently on the ground that it is both intellectually and practically indefensible to define one term by its opposite, or its absence. Nor is the attempt to define good faith by reference to bad faith likely to be entirely satisfactory, given that bad faith itself has been described as “an imprecise label for what is essentially some kind of unreasonable insurer conduct, and such words serve only to obscure and oversimplify the rationale of the decisions.” COUCH, supra note 81, § 198:6 (quoting Austero v. Nat’l Cas. Co., 148 Cal. Rptr. 653, 670 n.22 (Ct. App. 1978), overruled on other grounds by Egan v. Mut. of Omaha Ins. Co., 620 P.2d 141 (1979)).

94. See COUCH, supra note 81, §§ 198:7, 198:14; see also EMIC FISCHER, PETER NASH SWISHER & JEFFREY W. STEMPLE, PRINCIPLES OF INSURANCE LAW 93 (3d ed. 2004); STEMPLE, supra note 93, § 10.01 n.7 (providing extensive commentary and citations regarding fiduciary status). “Note that while the characteristics which mark a ‘good-faith relationship’ contract are not exactly, or not always exactly, the same as those which characterize a fiduciary relationship, they are similar.” COUCH, supra note 81, § 198:14. But

[s]ince the contract specifies the terms upon which the subservient party’s consideration becomes due, it can be strongly argued that once these terms are met in fact, the subservient party becomes the owner of the benefits called for by the contract, although the dominant party retains temporary possession of those funds—a true fiduciary relationship.

Id.; see also id. § 198:7.

95. See COUCH, supra note 81, § 198:7; see also supra notes 90-94.

will be found to exist: (1) whether the contract is a first or third party insurance contract; and (2) whether the insurer has a contractual duty to settle and to defend.\(^9\) Third party insurance benefits accrue to a third party who makes the claim, as opposed to the policyholder himself, and the policyholder in a third party insurance contract (that is to say, the actual party to the contract—the insured) generally contracts away to the insurer its right to settle and defend any third party claims.\(^9\) It is this three party set of interactions and the transfer of control from an insured to an insurer that leads some courts to find a fiduciary relationship. If the insurer is acting on behalf of the insured (policyholder) pursuant to the insurance contract, even though it is the insured who is being sued by the injured third party, some courts conclude this transfer of rights transforms the insurer into the policyholder’s agent when it settles and defends claims, and consequently, the insurer is a fiduciary or owes duties tantamount to those of a fiduciary to the policyholder.\(^9\) Other courts reach the same conclusion without the explicit intermediary step of agency.\(^100\)

---

97. See COUCH, supra note 81, § 198:3 (explaining first versus third-party claims and the duty to settle); STEMPLE, supra note 93, §§ 2.06(f), 9.03(a).


3. Good Faith in Contracts and Commercial Law. Because good faith is so regularly and consistently defined in the commercial and contracts law realms, good faith in these contexts merits a closer look in this Article. In addition, directors are contractually obligated to the corporations that they serve, such that, at the least, good faith in the commercial and contracts law realms should be a floor on a director's good faith obligation.

Good faith arises in two main ways in the contracts and commercial law realms: one way is more focused on mental state—"a good faith purchaser"—and one way is focused on objective performance. A good faith purchaser is one who purchases something with no knowledge of any underlying fraud or illegality impeding the free transfer of title. A party is a good faith purchaser "only if he acted with innocent ignorance or lack of suspicion" regarding notice that his purchase from a seller whose own title to the object at issue was voidable or was somehow legally questionable. A purchaser in good faith should not be punished but should be protected. With respect to good


Interestingly, a few courts, including some of those in Delaware, seem to have taken, or at least toyed with, the position that no heightened duties are owed to a policyholder in any instance because the policyholder-insurer relationship is purely contractual. See Corrado Bros. v. Twin City Fire Ins. Co., 562 A.2d 1188, 1192 (Del. 1989) (holding insurer owes no special duties to policyholder even when resulting settlement required policyholder to pay retroactive premiums, but noting that the insurer has the burden of demonstrating that it acted reasonably and in good faith when its interests diverged from those of the policyholder); Johnson v. Fed. Kemper Ins. Co., 536 A.2d 1211, 1213 (Md. Ct. Spec. App. 1988); Duncan v. Andrew County Mut. Ins. Co., 665 S.W.2d 13, 19 (Mo. Ct. App. 1983). But see Tackett v. State Farm Fire & Cas. Ins. Co., 653 A.2d 254, 265 n.6 (Del. 1995) ("The Tacketts argue that, like Cummings, their claim arose in a relationship of 'trust and confidence.' While there may be a fiduciary obligation in an insurer's handling of a third-party claim, '[t]he mere relationship of insurer and insured does not import an obligation of trust.'" (quoting Craig v. Iowa Kemper Mut. Ins. Co., 565 S.W.2d 716, 723 (Mo. Ct. App. 1978) (emphasis added)).


102. Id.

103. See id. Professor Farnsworth gives us two illustrations:

Whether the holder of a negotiable instrument is a holder in due course depends, under the Code, on whether he purchased in good faith.
faith performance, a party to a contract or a merchant is obligated to perform their contractual or commercial obligations "in good faith."104 This good faith assessment is arguably an objective analysis.105

Whether the purchaser of goods takes good title from a seller whose own title is voidable because of fraud depends, under the Code, on whether he purchased in good faith.

Id. (citing U.C.C. §§ 2-403(1), 3-205, 3-302 (1958)).

If the parties to a sales contract leave price or performance terms open, to be fixed by either buyer or seller, that party is to fix them, under the Code, in good faith. If they describe the quantity as seller's output or buyer's requirements, their obligations are defined under the Code in terms of such output or requirements as may occur in good faith. If a merchant buyer is left in possession of goods that he has rightfully rejected, his obligation to effect salvage under the Code is one of good faith. If the seller, before performance, has assigned his right to payment under his contract with the buyer, their power to modify their agreement, even after notice, is limited by the requirement that the modifications must be made in good faith. In each of these instances "good faith" would appear to be used in the sense of good faith performance. And each represents a specific application of the general obligation of good faith—resulting in an implied term of the contract requiring cooperation on the part of one party to the contract so that another party will not be deprived of his reasonable expectations.

Id. (citing U.C.C. §§ 2-305(2), 2-306(1), 2-311(1), 2-603(3), 9-318(2) (1958)).

105. The late Professor Allan Farnsworth, principal draftsman of the Uniform Commercial Code and the Second Restatement of Contracts, argued that good faith in the performance aspects of contracts jurisprudence hinged on an objective standard. He maintained that fixing good faith performance on a subjective standard would make no sense, as "[s]urely the test is not whether one party actually believed that he was acting decently, fairly or reasonably. Surely he must do more than form an honest judgment. Otherwise no more than knowing and deliberate unfairness, maliciousness, trickery and deceit would be forbidden." Id. at 672.

At one point, I was convinced that Vice Chancellor Strine indirectly addressed the point with the following language from Guttman v. Huang, 823 A.2d 492, 506 n.34 (Del. Ch. 2003):

A director cannot act loyally towards the corporation unless she acts in the good faith belief that her actions are in the corporation's best interest. For this reason, the same case that invented the so-called "triad[ ]" of fiduciary duty, also defined good faith as loyalty.

It does no service to our law's clarity to continue to separate the duty of loyalty from its own essence; nor does the recognition that good faith is essential to loyalty demean or subordinate that essential requirement. There might be situations when a director acts in subjective good faith and is yet not loyal (e.g., if the director is interested in a transaction subject to the entire fairness standard and
The Uniform Commercial Code ("U.C.C.") provides that "[e]very contract or duty within [the U.C.C.] imposes an obligation of good faith in its performance and enforcement," and the U.C.C. defines good faith as "honesty in fact in the conduct or transaction concerned." The latter articulation of good faith—good faith performance—is the more sticky of the good faith cannot prove financial fairness), but there is no case in which a director can act in subjective bad faith towards the corporation and act loyally. The reason for the disloyalty (the faithlessness) is irrelevant, the underlying motive (be it venal, familial, collegial, or nihilistic) for conscious action not in the corporation's best interest does not make it faithful, as opposed to faithless.

Upon reflection, Vice Chancellor Strine's last sentence perplexes me. With that sentence, he seems to be saying that faithfulness is judged objectively, with no reference to underlying motive. I would take that to mean that good faith (e.g., "faithfulness") is judged objectively. Yet Strine uses the phrase "faithful" to pertain to the duty of loyalty assessment. So he seems to be saying that good faith can be a subjective assessment, while loyalty will be an objective assessment, despite the fact that he uses "faithfulness," which I almost view as a synonym for "good faith," to refer only to loyalty.

The U.C.C. was proposed to create a uniform body of contract law and has been adopted by forty-nine states. See LON L. FULLER & MELVIN ABRAHAM EISENBERG, BASIC CONTRACT LAW 71-73 (West 2001) (1946). The preamble to the U.C.C. states that it applies to "[c]ertain Commercial Transactions in or regarding Property and Contracts and other Documents concerning them." E. ALLAN FARNsworth, FARNsworth ON CONTRACTS § 1.9(a) (2d ed. 1998). It is unclear whether provisions of Article I of the U.C.C. apply only to transactions within the scope of those in later articles or whether it applies to all "commercial" contracts. See id. However, provisions that are generally accepted, such as U.C.C. § 1-203 on good faith, are usually applied broadly in the commercial transactions and contracts realm. See id. Additionally, even where a provision is not directly applicable to a transaction, the principle within the provision may still serve as a source of law. See FULLER & EISENBERG, supra, at 72. Therefore, even where the contract at issue does not directly fall into a category covered by the U.C.C., the principles of the U.C.C. are often still viewed as persuasive authority and are followed.

Farnsworth criticizes such a characterization of good faith, noting that the U.C.C. definition leaves the duty of good faith "so enfeebled that it could scarcely qualify . . . as an 'overriding' or 'super- eminent' principle." Farnsworth, supra note 101, at 674. Apparently the good faith definition was enfeebled by the practicing bar's objections to the language in prior drafts, which practicing attorneys saw as affording to courts "opportunities . . . to create innovative commercial obligations." Clayton P. Gillette, Limitations on the Obligation of Good Faith, 1981 DUKE L.J. 619, 624 (1981).
invocations in the U.C.C. and otherwise in the commercial and contracts areas of the law.

Honesty in fact and fair dealing, as used to define good faith performance, superficially seem to be uncomplicated phrases, but the actual implication of these phrases and the essence of the meaning of good faith performance was the subject of quite some debate immediately before and after the U.C.C. was adopted. Professor Robert S. Summers's "excluder" method of defining good faith emerged from the debate as a favored method for more precisely defining good faith performance in the contract and commercial law realm. The "excluder" method of defining good faith came from a 1968 article penned by Professor Summers in which he argued that good faith should be treated as an "excluder," with no single useful definition of its own.109 Instead of struggling to define good faith in and of itself,


It is worth adding a bit more detail to my description of Professor Summers's excluder analysis. Professor Summers argues in his much extolled article that good faith in the context of general contract law and the U.C.C. should be treated as an excluder, defined in a context-specific way by reference to bad faith and things that do not exhibit good faith. Summers, supra, at 200. To wit, Professor Summers maintains that good faith should be defined by things that were intended to be excluded from occurring by being deemed acts of bad faith. Id. If we can identify acts that constitute bad faith, we can define good faith by pointing to the absence of any of the bad faith acts. Professor Summers argued both that the gossamer nature of the phrase lends itself to this sort of post hoc defining and that it is practical to define the phrase this way "because the typical judge who uses this phrase is primarily concerned with ruling out specific conduct." Id. at 202. Colorfully, Professor Summers summarized his justification for his dogma by saying "general definitions of good faith either spiral into the Charybdis of vacuous generality or collide with the Scylla of restrictive specificity." Id. at 206. For those less familiar with erudite words, Merriam-Webster Online dictionary defines Charybdis as "whirlpool off the coast of Sicily personified in Greek mythology as a female monster," Merriam-Webster OnLine, http://www.m-w.com/dictionary/charybdis (last visited Mar. 12, 2006); and Scylla is defined as "a nymph changed into a monster in Greek mythology who terrorizes mariners in the Strait of Messina." Merriam-Webster OnLine, http://www.m-w.com/dictionary/scylla (last visited Mar. 12, 2006).
Summers argued that good faith is best viewed as a term referring to the absence of bad faith—good faith includes acts that exclude bad faith. If no form of “bad faith” is present, the actor acted in “good faith.”

Good faith definitions in the commercial and contracts realms are not limited to the excluder analysis. Twelve years later, Steven Burton introduced the “foregone opportunity analysis” to the good faith discussion in contract law, and this analysis describes good faith as “limit[ing] the exercise of discretion in performance conferred on one party by the contract.” According to Professor Burton, “[g]ood faith performance . . . occurs when a party’s discretion is exercised for any purpose within the reasonable contemplation of the parties at the time of formation . . . .” A decade later still, Professor William Patterson concurred that good faith was contextual, accounting for the reasonable expectation of the contracting parties.

110. See Summers, supra note 109. Indeed, Professor Farnsworth concludes that the Second Restatement of Contracts adopts this excluder analysis, by providing that:

A complete catalogue of types of bad faith is impossible, but the following types are among those which have been recognized in judicial decisions: evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of a power to specify terms, and interference with or failure to cooperate in the other party’s performance.

Farnsworth, supra note 106, § 7.17b (quoting Restatement (Second) of Contracts § 205 cmt. d (1981)). However, for a discussion of the problems of defining one term by its opposite, see infra notes 177-85 and accompanying text.

111. Steven J. Burton, Breach of Contract and the Common Law Duty to Perform in Good Faith, 94 Harv. L. Rev. 369, 369, 373 (1980); see also Centronics Corp. v. Genicom Corp., 562 A.2d 187, 193 (N.H. 1989) (“[U]nder an agreement that . . . invest[s] one party with a degree of discretion in performance sufficient to deprive another party of a substantial proportion of the agreement’s value, the parties’ intent to be bound by an enforceable contract raises an implied obligation of good faith to observe reasonable limits in exercising that discretion . . . .”); Farnsworth, supra note 106, § 7.17b n.19 (citing both Professor Burton and Centronics Corp.).

112. Burton, supra note 111, at 373.

113. See Dennis M. Patterson, Good Faith and Lender Liability: Toward a Unified Theory 58-59 (1990). Notwithstanding the fact that Professor Summers’s excluder analysis picked up considerable momentum after the publication of his article in 1968, not everyone then agreed with or now agrees with his analysis. See id. at 59.
Beyond the U.C.C. pure contracts realm, the definition and role of good faith in the common law and more general contracts context applies in a way that basically parallels what we see in the commercial law context. \(^{114}\) "[I]n every contract there exists an implied covenant of good faith and fair dealing," \(^{115}\) although the definition and parameters of good faith vary according to the context. \(^{116}\) The good faith obligation in contract law, \(^{117}\) which is performance-directed, is based on fundamental notions of fairness, \(^{118}\) and it "is not

\(\begin{align*}
114. \text{The U.C.C. draft dealing with good faith in the context of commercial transaction was drafted by Karl N. Llewellyn and adopted by the National Conference of Commissioners on Uniform State Laws (NCCUSL) and the American Law Institute (ALI) in 1952 and later adopted by the individual states. See Fuller & Eisenberg, supra note 106, at 72. The Second Restatement of Contracts was primarily drafted by Farnsworth and Robert Braucher and was adopted in 1981. See Farnsworth, supra note 106, § 1.8.}

115. Kirke La Shelle Co. v. Paul Armstrong Co., 188 N.E. 163, 167 (N.Y. 1933) (citation omitted); see also Anthony's Pier Four, Inc. v. HBC Assocs., 583 N.E.2d 806, 821 (Mass. 1991) (covenant of good faith and fair dealing is implied even "in contracts between sophisticated businesspeople"); Farnsworth, supra note 106, § 7.17 n.3 (citing the above cases). Similarly, good faith is implicated in the performance and enforcement of every contract. See Kirke La Shelle Co., 188 N.E. at 167; see also U.C.C. § 1-304 (2004) ("Every contract or duty within [the Uniform Commercial Code] imposes an obligation of good faith in its performance and enforcement."); Restatement (Second) of Contracts § 205 (1981) ("Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."); Farnsworth, supra note 106, § 7.17; 2 Joseph M. Perillo & Helen Hadjiyannakis Bender, Corbin on Contracts: Formation of Contracts § 5.27 (1995) [hereinafter Corbin] ("[E]very contract contains an implied obligation of good faith and fair dealing in its performance and enforcement.").

116. See Farnsworth, supra note 106, § 7.17. For example, "the duty may not only proscribe undesirable conduct, but may require affirmative action as well." Id.

117. Unfortunately, many academics employ the terms duty, obligation, and covenant interchangeably when discussing good faith. See id. This Article employs the term obligation.

118. See id. Note that good faith is distinguishable from the concept of "best efforts" in the contract context:

Good faith is a standard that has honesty and fairness at its core and that is imposed on every party to a contract. Best efforts is a standard that has diligence as its essence and is imposed on those contracting parties that have undertaken such performance. The two standards are distinct and that of best efforts is the more exacting, though it presumably falls short of the standard required of a fiduciary, who is required "to act primarily for the benefit of another in matter connected with his undertaking."
a contractual term that the parties are free to bargain in or out as they see fit."\textsuperscript{119} However, there is no one authoritative definition of the phrase.\textsuperscript{120} Good faith in the contracts realm can be addressed by reference to the Second Restatement of Contracts, common law, and the opining of some of the bastions of modern contract law.

The Second Restatement of Contracts provides that "[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."\textsuperscript{121} Comment \textit{a} to Section 205 of the Restatement provides that "[g]ood faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving 'bad faith' because they violate community standards of decency, fairness or reasonableness."\textsuperscript{122} Note that Comment \textit{a} reflects both an affirmative aspect and an "excluder" component, while Comment \textit{d} ("Good faith performance")

\textit{Id.} (citing \textsc{Restatement (Second) of Agency} § 313 cmt. a (1958)).

119. Carmichael v. Adirondack Bottled Gas Corp. of Vt., 635 A.2d 1211, 1216 (Vt. 1993); \textit{see also} \textsc{Farnsworth, supra} note 106, § 7.17 n.6 (citing the same). The U.C.C. also recognizes that the duty of good faith may not be completely waived:

The obligations of good faith, diligence, reasonableness, and care prescribed by [the Uniform Commercial Code] may not be disclaimed by agreement. The parties, by agreement, may determine the standards by which the performance of those obligations is to be measured if those standards are not manifestly unreasonable. Whenever [the Uniform Commercial Code] requires an action to be taken within a reasonable time, a time that is not manifestly unreasonable may be fixed by agreement.

U.C.C. § 1-302(b) (2004).

120. \textit{See Farnsworth, supra} note 106, § 7.17b ("Many courts have endorsed abstract and sweeping definitions of good faith.").

121. \textsc{Restatement (Second) of Contracts} § 205 (1979). As noted, E. Allan Farnsworth and Robert Braucher were primarily responsible for the drafting of the Second Restatement of Contracts. \textit{See Farnsworth, supra} note 106, §1.8. The American Law Institute began revising the Restatement of Contracts in 1962, with Braucher serving as its Reporter until his appointment to the Supreme Judicial Court of Massachusetts in 1971. \textit{See id.; Robert Braucher, N.Y. Times, Aug. 27, 1981, at D19.} Farnsworth then replaced Braucher as the Reporter and worked on the draft until it was published in 1981. \textit{See Farnsworth, supra} note 106, §1.8.

122. \textsc{Restatement (Second) of Contracts} § 205 cmt. a (1981).
within the same section of the Restatement reflects only an excluder analysis when discussing the performance of a contract:

Subterfuges and evasions violate the obligation of good faith in performance even though the actor believes his conduct to be justified. But the obligation goes further: bad faith may be overt or may consist of inaction, and fair dealing may require more than honesty. A complete catalogue of types of bad faith is impossible, but the following types are among those which have been recognized in judicial decisions: evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of a power to specify terms, and interference with or failure to cooperate in the other party's performance.123

Beyond the Restatement, common law varies a bit in terms of the exact language used to define good faith in the contractual context.124 For example, the Supreme Court of Wyoming described good faith in the contractual context as requiring "an honest intention to abstain from taking any unconscientious advantage of another . . . ."125 The Eighth Circuit Federal Court of Appeals concluded that good faith obligates each party to a contract "to do nothing destructive of the other party's right to enjoy the fruits of the contract and to do everything that the contract presupposes they will do to accomplish its purpose."126 A state court in Kansas used a reaching application of "good faith" to find that even if a termination was technically made in compliance with the negotiated-for termination provisions of a contract, the terminating party had the obligation to act in good faith when employing the termination provision, to avoid taking advantage of changed circumstances that adversely affected the non-terminating party.127

123. Id. § 205 cmt. d; Farnsworth, supra note 106, § 7.17b (quoting part of the same).

124. See Farnsworth, supra note 106, § 7.17b ("Many courts have endorsed abstract and sweeping definitions of good faith.").


126. Conoco, Inc. v. Inman Oil Co., Inc., 774 F.2d 895, 908 (8th Cir. 1985) (citation omitted); Farnsworth, supra note 106, § 7.17b (citing the same).

Similar to common law, the late Professor Samuel Williston defined good faith in the contracts realm as a requirement that "neither party will do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract . . . ."128 The late Professor E. Allan Farnsworth viewed good faith as essentially a gap-filler, used to imply missing terms in a contract, and "[g]ood faith performance has always required the cooperation of one party where it was necessary in order that the other might secure the expected benefits of the contract."129

4. Corporate Governance. Although "good faith" in corporate law generally and as appearing in the director liability jurisprudence is not yet often accompanied with a consistent, affirmative "good faith" definition130—hence this


128. WILLISTON ON CONTRACTS, supra note 83, § 38:15; see also CORBIN, supra note 115, § 5.27.

129. Farnsworth, supra note 101, at 672.

130. See E. Norman Veasey, State-Federal Tension in Corporate Governance and the Professional Responsibilities of Advisors, 28 J. CORP. L. 441, 448 (2003) (noting that "the jurisprudence of good faith is unresolved").

To be clear, understand that the phrase "good faith" has long been appearing in the context of director liability. See infra note 193. Most frequently, however, the phrase is left undefined or it is accompanied by an additional phrase such as "in . . . the best interests of the corporation [and/or shareholder] . . . ." Baker v. Health Mgmt. Sys., 264 F.3d 144, 150 (2d Cir. 2001) ("A corporation may indemnify any person . . . if such director or officer acted, in good faith, for a purpose which he reasonably believed to be in . . . the best interests of the corporation . . . .") (quoting N.Y. BUS. CORP. LAW § 722(a) (McKinney 1986 & Supp. 2000)); FDIC v. Castetter, 184 F.3d 1040, 1044 (9th Cir. 1999) ("A director shall perform the duties of a director . . . in good faith, in a manner such director believes to be in the best interests of the corporation and its shareholders . . . .") (quoting CAL. CORP. CODE § 309(a) (West 1998)); Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) ("[The business judgment rule] is a presumption that in making a business decision the 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."). It is curious to me that the latter phrase often accompanies "good faith," because, as I discuss in Part III, infra, I am of the view that good faith means "in the best interests of the shareholder." The question then becomes whether the writers who include language directing that a director is obligated to act "in good faith and in the
Article—the occasional court or corporate law scholar will pen something remotely akin to a definition of good faith. For example, in the context of a statutory embodiment of the business judgment rule, it was found that “good faith” presents a question as to whether “a process was engaged that would produce a defensible business decision,” and the “procedural soundness of a business decision may be assessed by examining the qualifications of the persons with whom the director consulted, the general topics, not the substance, of the information sought or imparted and, in this court’s view even whether the advice was followed.”

In a derivative suit against directors for failing to prevent a damaging corporate financial restatement due to accounting irregularities, Delaware Court of Chancery Vice Chancellor Leo Strine equated good faith with loyalty, noting: “A director cannot act loyally towards the corporation unless she acts in the good faith belief that her actions are in the corporation’s best interest. For this reason, the same case that invented the so-called ‘triad’ of fiduciary duty . . . also defined good faith as loyalty.”

best interests of the corporation” realize that they are being redundant, are intending to emphasize the meaning of good faith by repeating it, or do not believe that they are being redundant.


132. Gutman v. Huang, 823 A.2d 492, 506 n.34 (Del. Ch. 2003) (citing Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993) (Cede II)) (emphasis added). Note that the Cede II opinion did not explicitly define “good faith” as loyalty on the page cited by Vice Chancellor Strine. Rather, on page 361 of the Cede II opinion, the Cede court says: “To rebut the [business judgment rule], a shareholder plaintiff assumes the burden of providing evidence that directors . . . breached any one of the triads of their fiduciary duty—good faith, loyalty or due care.” Cede & Co., 634 A.2d at 361. However, note 36 on page 368 of the Cede II opinion states that “a board's actions must be evaluated in light of relevant circumstances to determine if they were undertaken with due diligence [care] and good faith [loyalty].” Id. at 368 n.36 (quoting Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989)).

Vice Chancellor Strine is not alone with the argument that “good faith” really only refers to the director’s avoidance of conflicts (divided loyalty). Agency and trust cases often discuss good faith in a manner that suggests it is synonymous with loyalty. State ex rel. Okla. Bar Ass’n v. Wallace, 1998 OK 65, 961 P.2d 818, 826 (discussing a disciplinary hearing against an attorney who
The recent Disney derivative litigation has repeatedly brought good faith into the domain of the Delaware state courts, though only one of the several opinions in the case—an opinion from the Delaware Court of Chancery announcing its judgment after the bench trial—says anything of use in terms of affirmatively defining good faith.\textsuperscript{133} Though the Delaware Supreme Court issued a final opinion in the case affirming the trial court’s decision in favor of the Disney directors and made repeated reference to a director’s obligation to act in good faith, the Delaware Supreme Court said nothing about the definition of good faith itself. Instead, the court approved the Chancery Court’s definition of “not in good faith” by way of bad faith.\textsuperscript{134}

mishandled his client’s trust funds and stating that good faith recognizes that “the hope and confidence of the settlor are placed with the expectation that the trustee will exercise the obligations of the office for the exclusive benefit of the \textit{cesnui [sic] que trust}). Yet, in those cases, and many others, the phrases “good faith and loyalty” and “utmost good faith and loyalty” appear together, with the phrase “good faith” accompanying the word “loyalty.” Myer v. Preferred Credit, Inc., 117 Ohio Misc. 2d 8, 15–16 (Ct. Com. Pl. 2001) (affirming an award of punitive damages for mortgage broker’s improper, fraudulent, and dishonest dealings under the Mortgage Brokers Act). If good faith and loyalty really did mean the same thing, such that good faith was merely a synonym for loyalty, the phrase “good faith and loyalty” would be redundant. Note that the Delaware Supreme Court recently chimed in on this issue, saying “the fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest. It also encompasses cases where the fiduciary fails to act in good faith.” Stone \textit{ex rel. AmSouth Bancorporation v. Ritter}, 911 A.2d 362, 370 (Del. 2006).

\textsuperscript{133} The Disney cases include: \textit{In re Walt Disney Co. Derivative Litig.}, 906 A.2d 27 (Del. 2006); \textit{In re Walt Disney Co. Derivative Litig.}, 907 A.2d 693 (Del. Ch. 2005); \textit{In re Walt Disney Co. Derivative Litig.}, 825 A.2d 275 (Del. Ch. 2003); and Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

\textsuperscript{134} I would like to blame the Delaware Supreme Court for this substantive failing, but the reality is that neither the appellants nor the appellees raised the issue of defining good faith at oral argument before the court. One would have thought that the Delaware Supreme Court would have brought up the issue \textit{sua sponte}, as they are permitted. One would be wrong. It is for reasons like this that I chuckle when reading Delaware Supreme Court’s statement that “Delaware has a substantial interest in defining, regulating and enforcing the fiduciary obligations which directors of Delaware corporations owe to such corporations and the shareholders who elected them.” Armstrong \textit{v. Pomerance}, 423 A.2d 174, 179 n.8 (Del. 1980) (quoting 61 Del. Laws c. 119 (1977)). Delaware does have a substantial interest in defining, regulating, and enforcing the fiduciary obligations of directors, but this interest obviously does not always result in the Delaware Supreme Court’s robust definition, regulation, and enforcement of those obligations. It should be no surprise that I am sympathetic
The one statement from the lengthy Disney litigation that deals affirmatively with good faith is from the opinion and order of the Chancery Court: "Good faith has been said to require an 'honesty of purpose,' and a genuine care for the fiduciary's constituents, but, at least in the corporate fiduciary context, it is probably easier to define bad faith rather than good faith." 135 Thanks for the help.

to the "race-to-the-bottom" discussion regarding Delaware’s director-coddling statutes and permissive fiduciary common law.

135. In re Walt Disney Co. Derivative Litig., 907 A.2d 693, 753 (Del. Ch. 2005) (citations omitted). The Chancellor later added, "To act in good faith, a director must act at all times with an honesty of purpose and in the best interests and welfare of the corporation." Id. at 755. The Chancellor goes on to justify his decision to define good faith by way of bad faith in the way that the Chancellor recognizes most courts have done by saying "[t]his may be so because Delaware law presumes that directors act in good faith when making business judgments." Id. 753. I address this issue in Part I.B, supra. The upshot is that defining good faith affirmatively does not result in directors being stripped of the good faith business judgment rule presumption from Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

Note that Chancellor Chandler continues in his good faith opining to say:

Bad faith has been defined as authorizing a transaction "for some purpose other than a genuine attempt to advance corporate welfare or [when the transaction] is known to constitute a violation of applicable positive law." In other words, an action taken with the intent to harm the corporation is a disloyal act in bad faith. A similar definition was used seven years earlier, when Chancellor Allen wrote that bad faith (or lack of good faith) is when a director acts in a manner "unrelated to a pursuit of the corporation's best interests." It makes no difference the reason why the director intentionally fails to pursue the best interests of the corporation.

Id. at 753-54 (quoting Gagliardi v. TriFoods Int'l, Inc., 683 A.2d 1049, 1051 n.2 (Del. Ch. 1996); In re RJR Nabisco, Inc. S'holder Litig., No. 10389, 1989 WL 7036 (Del. Ch. Jan. 31, 1989)).

Yet, in a footnote five pages later, Chancellor Chandler appears to embrace a much broader interpretation of what good faith requires, going well beyond traditional "bad faith," by referencing Professor Lyman Johnson’s article, in which he advocates broadly interpreting a director’s duty of loyalty to compel directors to be loyal to—faithful to—shareholders in the broader sense, much the way one would act loyally to a friend. Id. at 760 n.487 (citing Lyman P.Q. Johnson, After Enron: Remembering Loyalty Discourse in Corporate Law, 28 Del. J. Corp. L. 27 (2003)). In this schizophrenic footnote, referring to situations where the directors are alleged to be under the thumb of the CEO, the Chancellor says:

It is precisely in this context—an imperial CEO or controlling shareholder with a supine or passive board—that the concept of good faith may prove highly meaningful. The fiduciary duties of care and
In the twenty years since the 1986 Smith v. Van Gorkom decision, which is roundly viewed as the definitive modern case marking a shift in director liability common law, the Delaware Supreme Court has only once addressed good faith in a way that even roughly equated with an affirmative definition:

Thus, while numerous factors—timing, publicity, tax advantages, and Amsted's declining performance—point to the directors' good faith belief that the shareholders were getting the best price, we decline to fashion an iron-clad rule for determining when a market test is not required. The evidence that will support a finding of good faith in the absence of some sort of market test is by nature circumstantial; therefore, its evaluation by a court must be open-textured. However, the crucial element for supporting a finding of good faith is knowledge. It must be clear that the board had sufficient knowledge of relevant markets to form the basis for its belief that it acted in the best interests of the shareholders.136

Every other time in the past twenty years that the Delaware Supreme Court has dealt with a director's obligation to act in good faith, the court has done so by way of defining and looking for the existence of bad faith.137

loyalty, as traditionally defined, may not be aggressive enough to protect shareholder interests when the board is well advised, is not legally beholden to the management or a controlling shareholder and when the board does not suffer from other disabling conflicts of interest, such as a patently self-dealing transaction. Good faith may serve to fill this gap and ensure that the persons entrusted by shareholders to govern Delaware corporations do so with an honesty of purpose and with an understanding of whose interests they are there to protect.

Id. at 760 n.487 (internal citations omitted).

136. Barkan, 567 A.2d at 1288.

137. See, e.g., White v. Panic, 783 A.2d 543, 553-54 n.36 (Del. 2001) (discussing a derivative action, alleging that the board failed to take action to stop or sanction sexual misconduct of a corporate officer and stating that “[t]o prevail on a waste claim or a bad faith claim, the plaintiff must overcome the general presumption of good faith by showing that the board's decision was so egregious or irrational that it could not have been based on a valid assessment of the corporation's best interests”); Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 64 (Del. 1989) (discussing an action where a shareholder of a purchased corporation sued former board of directors alleging breach of fiduciary duty and gross negligence and stating that “[t]he [business judgment rule] presumption initially attaches to a director-approved transaction within a board's conferred or apparent authority in the absence of any evidence of ‘fraud, bad faith, or self-dealing in the usual sense of personal profit or betterment’”)
Corporate law academics who have yet chimed in on the good faith dialogue with respect to director liability differ in their articulations and approaches to good faith. Professor David Rosenberg states that "good faith is a circle around which all duties, corporate or contractual, are surrounded. A director who agrees to adhere to the terms of a corporate charter must do so in good faith . . . ."138 Professor Rosenberg takes a very robust view of the reach of good faith in his contractarian article, and he bases his position on the foundation of good faith in both the corporate law and contracts law realms. Professor Hillary Sale concludes that good faith in the corporate context is similar to scienter in securities fraud jurisprudence, such that we should analyze good faith in an analogous way.139 While not defining good faith directly, Professor Sale appears to attempt to describe what good faith is not, saying "[a]lthough a breach of good faith need not be intentional or conscious, it does require some sort of obvious, deliberate,

139. Hillary A. Sale, Delaware's Good Faith, 89 CORNELL L. REV. 456, 493 (2004) ("Although a breach of good faith need not be intentional or conscious, it does require some sort of obvious, deliberate, or egregious failure. That standard is like the standard of review applied to pleadings of scienter in securities fraud claims: motive is relevant, but not required. Intentional misstatements or omissions are actionable and intentional breaches of fiduciary duties should be as well.").
or egregious failure,"140 and "[i]f the conduct at issue is sufficiently irresponsible . . . good faith is implicated."141 Professor Sale essentially defines good faith with a scienter-based excluder analysis, without explaining why it is justifiable to take that position.142

Professor Sean Griffith also does not directly define good faith in his corporate good faith article; rather, he attempts to explain its existence:

Good faith . . . has, at its core, the basic concern of all corporate law jurisprudence—the question whether directors are really doing their best in acting for the corporation—but in seeking an answer, it blends questions generally thought to arise under the duty of care with those arising under the duty of loyalty. In seeking to answer the basic corporate law question, courts applying the good faith standard do not confine themselves to the analytics of either traditional fiduciary duty. Instead, good faith is used as a loose rhetorical device that courts can wield to find liability or enjoin actions that do not quite fit within established doctrinal categories.143

Professor Melvin A. Eisenberg, founding father of modern corporate governance, also does not advance the definitional ball regarding good faith. Rather, he describes qua defines good faith by looking at its value and its function. While he loosely defines good faith by aligning it with the U.C.C. and contracts definitions of good faith, he stakes no definitional ground beyond that.144

In short, though the corporate law realm is ripe for the adoption of an affirmative definition of good faith, such has

140. Id. at 493. With due respect, note that it appears that Professor Sale cites no source for the very strong language in her statement.

141. Id. at 487. Professor Sale continues to say that good faith conduct does not include conduct that is "deliberately indifferent, egregious, subversive, or knowing," though she does not tell us what any of these terms mean. Id. at 488. In addition, at one point Professor Sale suggests that "egregious, subversive, or deliberately indifferent conduct" does not evince good faith. Id. at 490. It is unclear to me, however, how deliberately indifferent conduct differs substantively from normal indifference or inadvertent indifference. I suppose that that is a subtlety much like the difference between "intentionally subverted" conduct, which would violate a director's fiduciary duties according to Sale, and unintentionally subversive conduct. Id. at 485.

142. See id. at 490.

143. Griffith, supra note 50, at 34.

144. See generally Eisenberg, supra note 52.
not yet already occurred.

C. The Propriety of "Borrowing" a Definition of Good Faith

Given the richness and extent of the "good faith" discourse in other areas of the law, there is a temptation to "adopt" a definition of good faith from a different area of the law to import to the director liability context.¹⁴⁵ That inclination is initially appealing, given the wellspring of good faith definitions from which to draw some inspiration in the effort to define the phrase in the world of director liability. However, the director liability realm is very different than most other areas of the law, such that it is inappropriate to borrow wholesale a good faith definition from another area of the law. My position is that good faith should have some sort of generally agreed-upon, albeit broad, definition in the director liability and corporate governance realm, and that definition should not consist of a wholesale adoption of the good faith definition from a different area of the law. Though there is much to be gleaned from the above-surveyed good faith definitions from other areas of the law, due to the circumstantial nature of the meaning of the phrase, good faith’s definition should be tailored to the sphere of corporate governance. Further, I am of the view that the definition of good faith should be affirmative, as opposed to excluder-based.

Below I explain why I oppose adopting wholesale a definition of good faith from another area of the law, and why I maintain that an affirmative definition, as opposed to an ex post excluder analysis, is appropriate for addressing good faith in the corporate governance realm. The upshot of my argument is that the relationship with respect to which the phrase "good faith" applies in the corporate context is a "special relationship," justifying a more demanding definition of good faith than can be found in other areas of the law where the actor does not have a special

¹⁴⁵. Chancellor Chandler, in the recent Disney litigation, seems to almost suggest that importing a definition might have been worth considering, when he says, "[d]espite the existence of significant jurisprudence with respect to good faith in the contractual context of the covenant of good faith and fair dealing, Delaware decisions have shown a reluctance to importing these contractual standards into the corporate fiduciary realm." In re Walt Disney Co. Derivative Litig., 907 A.2d 693, 753 n.449 (Del. Ch. 2005) (citation omitted).
relationship. In addition, the director liability context is a fiduciary context, such that analogies to the world of arms-length transactions do not well fit.

As discussed above, directors of a corporation have historically been viewed as agents and/or trustees.\textsuperscript{146} Even if we cannot decide whether directors are trustees or agents or both, directors are unquestionably fiduciaries and, as such, they have fiduciary duties.\textsuperscript{147} Knowing that the director holds a fiduciary position helps define good faith in the director liability context in two ways: (1) it transfers us

\begin{quote}
\textsuperscript{146} Some would argue that directors are merely parties to a contract with the shareholders or the corporation itself, such that the directors are neither trustees nor agents. This contractual relationship argument strikes me as still-born, given the clear historical foundation supporting the proposition that corporations can only act through agents, such being directors and officers. See Merton Ferson, Principles of Agency § 295, at 413 (1954) ("[A]n agent is a fiduciary in relation to his principal . . . ."); Francis B. Tiffany, Handbook of the Law on Principal and Agent 187-88 (2d ed. 1924) ("[A] corporation, being impersonal, can act only through the intervention of agents.").
\end{quote}

\begin{quote}
\textsuperscript{147} See infra Part III; Malone v. Brincat, 722 A.2d 5, 10 (Del. 1998) ("The directors of Delaware corporations stand in a fiduciary relationship not only to the stockholders but also to the corporations upon whose boards they serve."); Walsh, supra note 137, at 334 ("[T]he fiduciary underpinnings of director responsibility have been clearly established . . . .").
\end{quote}

\begin{quote}
'Fiduciary' includes a trustee under any trust, expressed, implied, resulting or constructive, executor, administrator, guardian, conservator, curator, receiver, trustee in bankruptcy, assignee for the benefit of creditors, partner, agent, officer of a corporation, public or private, public officer, or any other persons acting in a fiduciary capacity for any person, trust, or estate.
\end{quote}

\textbf{Unif. Fiduciaries Act § 1(1), 7A U.L.A. 367 (1922).}

As aforementioned, scholars have consistently been inconsistent as to whether the fiduciary position of directors was one of trust or agency. Professor Evans spoke to this issue well over a century ago:

\begin{quote}
All trustees . . . are agents; but all agents are not trustees. A trustee is an agent and something more. An agent is simply one placed in the stead of another; he is a trustee only so far as there is vested in him for the benefit of another some estate, interest, or power in or affecting property of any description . . . . Directors are persons selected to manage the affairs of a company for the benefit not of themselves but of the shareholders. Their office is one of trust.
\end{quote}

\textbf{William Evans, The Law of Principal and Agent 319, 339 (2d. ed. 1888).} That said, the distinction might well be irrelevant for our purposes given that "[i]t is well settled that an agent is a fiduciary in relation to his principal just as a trustee is a fiduciary in relation to his cestui que trust." Ferson, supra note 146, § 295, at 413.
into a duty-based realm where rules are predictably different than in the realm of arm's-length transactions;\(^{148}\) and, therefore, (2) it helps us narrow the pool of possible "good faith" definitions to consider.\(^{149}\)

1. A Fiduciary Relationship. The fiduciary relationship contemplates a person acting in trust and confidence for the benefit of another with respect to the relationship undertaken by him\(^{150}\) and, as such, "good faith" as used in the fiduciary context has a degree of narrowness to it.\(^{151}\) A defining aspect of the fiduciary context is the existence of the fiduciary—a person who is acting on behalf of or for the benefit of someone else.\(^{152}\) A fiduciary has long been

---

148. As one scholar noted:

[The law makes it unnecessary for a principal who delegates power to manage his property to an agent to provide by contract an array of prohibitions against the agent diverting to himself the principal's assets. The law of fiduciary obligations does that. It thereby facilitates specialization in economic enterprise, which enhances productivity for society, by saving the cost of individually contracting for the agent's loyalty in a myriad of situations, not all of which can be anticipated.


149. See D. Gordon Smith, The Critical Resource Theory of Fiduciary Duty, 55 VAND. L. REV. 1399, 1402 (2002) ("[F]iduciary relationships form when one party (the 'fiduciary') acts on behalf of another party (the 'beneficiary') while exercising discretion with respect to a critical resource belonging to the beneficiary.").

150. See Taylor v. GWR Operating Co., 820 S.W.2d 908, 911 n.2 (Tex. App. 1991) (citing BLACK'S LAW DICTIONARY 563 (5th ed. 1979)). "The term 'fiduciary' is derived from the civil law. It is impossible to give a definition of the term that is comprehensive enough to cover all cases. Generally speaking, it applies to any person who occupies a position of peculiar confidence towards another. It refers to integrity and fidelity." Kinzbach Tool Co. v. Corbett-Wallace Corp., 160 S.W.2d 509, 512 (Tex. 1942).

151. Professors Adler and Mann actually chart out in tables the interplay between the fiduciary nature of the "good faith" relationship at issue and the contracting protection offered to the aggrieved party by the court. See Robert S. Adler & Richard A. Mann, Good Faith: A New Look at an Old Doctrine, 28 AKRON L. REV. 31, 45, 51-52 (1994).

152. As Ernest Huffcut noted long ago:

The relation existing between a principal and his agent is a fiduciary one, and consequently the most absolute good faith is essential. The principal relies upon the fidelity and integrity of the agent, and it is the duty of the agent, in return, to be loyal to the trust imposed in him, and to execute it with the single purpose of advancing his principal's
obligated “to do the best he can for his principal.”

This relationship is very different from an arms-length relationship where “the parties owe each other no special duties and each is acting in his or her own self-interest.”

Acting for someone else involves different motivators and considerations than acting for one’s self alone, such that common law has not wavered in the strength with which it has imposed upon fiduciaries the exacting obligation to act in good faith.

Courts are clearer about the fact that fiduciaries must act affirmatively for their charges.

---

ERNEST W. HUFFCUT, THE LAW OF AGENCY § 90, at 110 (1901) (citing Michoud v. Girod, 45 U.S. (4 How.) 503 (1846)). Black’s Law Dictionary defines the phrase “fiduciary duty” to mean:

A duty of utmost good faith, trust, confidence, and candor owed by a fiduciary (such as a lawyer or corporate officer) to the beneficiary (such as a lawyer’s client or a shareholder); a duty to act with the highest degree of honesty and loyalty toward another person and in the best interests of the other person (such as the duty that one partner owes to another).

BLACK’S LAW DICTIONARY 545 (8th ed. 2004).

153. EVANS, supra note 147, at 275; accord, UNIF. BUS. CORP. ACT § 33, 9 U.L.A. 186 (1942) (“Officers and directors shall be deemed to stand in a fiduciary relation to the corporation, and shall discharge the duties of their respective positions in good faith, and with that diligence, care and skill which ordinarily prudent men would exercise under similar circumstances in like positions.”).

154. Adler & Mann, supra note 151, at 35.

155. See HUFFCUT, supra note 152, and the text quoted therein.

The duty of the agent to exercise good faith results from the fiduciary character of the relation. Of necessity the principal must repose confidence in the agent, and must rely upon his good faith and loyalty to the interest which is committed to him. The agent must therefore act solely in the interest of his employer, and not in his own interest or in the interest of another.

TIFFANY, supra note 15, § 146, at 387.

156. See Burdett v. Miller, 957 F.2d 1375, 1381 (7th Cir. 1992) (“A fiduciary duty is the duty of an agent to treat his principal with the utmost candor, rectitude, care, loyalty, and good faith—in fact to treat the principal as well as the agent would treat himself.”); Swinney v. Keebler Co., 480 F.2d 573, 578 (4th Cir. 1973) (“[I]f the sellers of control [majority shareholders] are in a position to foresee the likelihood of fraud on the corporation . . . their fiduciary duty imposes a positive duty to investigate the motives and reputation of the would-be purchaser . . . ”); Mid-Northern Oil Co. v. Walker, 211 P. 353, 355 (Mont. 1922) (“[T]he fiduciary relationship existing between the United States and the particular Indian wards imposed upon the government a positive duty to lease
Moderate attention or care is unacceptable.\textsuperscript{157}

Professors Adler and Mann discuss at length the difference in good faith obligations in the context of an arms-length transaction versus a fiduciary transaction in their article \textit{Good Faith: A New Look at an Old Doctrine}.\textsuperscript{158} Professors Adler and Mann note that the law policing the area of good faith performance "has been starkly dichotomous: those contracting parties who are considered to deal at arm's length receive a substantially lower level of protection than those who, because of a special relationship (fiduciary or confidential) between them, are not deemed to deal at arm's length."\textsuperscript{159} As Professors Adler and Mann observe, parties to a "special" relationship, which would include fiduciary relationships and relationships of confidence, such as the trustee-beneficiary relationship, the agent-principal relationship, the lawyer-client relationship, and the officer/director-shareholder/corporation relationship, have the obligation to act in a more principled manner, with the utmost good faith.\textsuperscript{160}

2. \textit{All about Duties}. Set aside for a moment the "fiduciary" aspect of the phrase "fiduciary duty." Simply consider the word "duty." Knowing that directors have duties (fiduciary or otherwise) is helpful in defining good faith in the context of a director's fiduciary duties.

A duty is a "legal obligation that is owed or due to another and that needs to be satisfied; an obligation for which somebody else has a corresponding right."\textsuperscript{161}

\textsuperscript{157} See \textit{supra} note 156 and accompanying text.
\textsuperscript{158} Adler & Mann, \textit{supra} note 151.
\textsuperscript{159} \textit{Id.} at 31.
\textsuperscript{160} See \textit{id.} at 34.
\textsuperscript{161} \textit{BLACK'S LAW DICTIONARY} 543 (8th ed. 2004).

We can also compare our director-shareholder-corporation relationship to the "duty-based" relationship a first year law student learns about in his torts class. The first-year law student is given the following hypothetical in his torts class:

It is a beautiful spring morning, and a former Olympic swimmer, and her
husband are going for their morning walk. They walk past the community pool, where they witness an adorable lab-mix puppy fall into the pool. The puppy is bobbing and barking, clearly unable to swim despite his lab heritage and semi-webbed feet. Luckily, the Pope, who was formerly a champion swimmer in the masters division prior to ascending to the papacy, drives by in his Popemobile. The Holy Father sees the struggling puppy bobbing in the deep end of the pool, and the Pope selflessly jumps into the pool to rescue the puppy. Unfortunately, the Pope’s papal regalia weighs him down in the water, such that now both he and the puppy are in trouble.

By pure stroke of chance, the President of the United States, George W. Bush is jogging by on his morning run, and he jumps into the pool to save the puppy and the Pope. The President, however, is not strong enough to support both the Pope in his resplendent regalia and the puppy, and the President is soon struggling as well.

The former Olympic swimmer witnesses this three-party aqua drama as she ambles along on her morning walk and she pauses, clearly moved. She hears the desperate chorus of the trio—the puppy is howling, the Pope calling for help in Latin, and the President is yelling something unintelligible. The swimmer’s husband says to her “Spouse, you love animals, you are a devout Catholic, and you still believe the stuff about the weapons of mass destruction. You must save those three. You have been trained in advanced water rescue, you swim competitively in the Olympics, you now teach swimming and water safety, and you know that I cannot save the drowning three because I cannot swim. Please, please save them. It would be easy for you to save them.” In response, the Olympic swimmer says “I am not about to save them. I have a busy day planned. I have no time for such tomfoolery. Besides, it will mess up my hair.” The President and the Pope continue to beg for help (or so one assumes, since neither of them can be understood) as the puppy continues to howl. The Olympic swimmer looks at them, looks at her husband, and then says “Folks, sorry. I have a big day today, and I just cannot waste the time to deal with your problems.” She then walks briskly away.

The first-year law student is outraged. “How could that morning exerciser just leave everyone in the pool to drown? The morning marauder could have easily saved them. She can’t just leave them when she could just as easily have saved them. It was wrong for her to walk away. Just wrong.” In response, the law school professor explains to his outraged student, “It might have been morally offensive for the champion swimmer to walk away instead of saving the pathetic trio, but it was not a liability creating event. The champion swimmer had no duty to the Pope, the President, or the puppy. Without a duty, we cannot obligate our innocent bystander to act. Our bystander had no duty to any of the three.”

Such is the rule in tort law—without a duty to act (including having created a dangerous situation such that you obligate yourself to act), a person has no obligation to take affirmative action. However, if the bystander has a duty to the group—if, for example, she was the life guard on her shift—she will be obligated to take affirmative action to help or be liable. Similarly, a director has a duty to his corporation and shareholders. The director cannot be passive any more than the lifeguard can be passive. The same way that the lifeguard has the obligation to jump in, throw a life ring, call for help, find a life pole, or do something else affirmatively intended to help the drowning group, the corporate
Professor Prosser, a forefather of modern tort law, said:

There is a duty if the court says there is a duty; the law, like the Constitution, is what we make it. Duty is only a word with which we state our conclusion that there is or is not to be liability; it necessarily begs the essential question. When we find a duty, breach and damage, everything has been said. The word serves a useful purpose in directing attention to the obligation to be imposed upon the defendant, rather than the causal sequence of events; beyond that is serves none. In the decision whether or not there is a duty, many factors interplay: the hand of history, our ideas of morals and justice, the convenience of administration of the rule, and our social ideas as to where the loss should fall.\(^1\)

Professor Prosser’s language pertaining to the assessment of whether a duty exists raises compelling points in the context of a director’s obligation to act in good faith: in terms of the hands of history, directors have always been required to act affirmatively in the best interests of their charges. In terms of “morals and justice” it certainly is no moral disservice to a director nor an offense to justice to obligate directors to do that which they seemingly agreed to do when they assumed a corporate leadership position. Indeed, directors are being compensated for doing a job.

Moreover, the duty of a director \emph{qua} trustee or agent of his shareholder or corporation has always been an active, or “positive,” duty. A positive duty is a duty “that requires a person either to do some definite action or to engage in a continued course of action.”\(^2\) The duty of a trustee to affirmatively try to manage the trust assets for the benefit of the trust beneficiaries requires the trustee to do something \emph{beyond} simply refraining from spending the trust assets for his own personal gain. Such is the case with all fiduciaries, including directors. The fiduciary is required to act in the best interest of his principal as opposed to being required only to refrain from harming the persons director has the obligation to affirmatively act in the best interest of the corporation. In first-year torts parlance, the director has a duty.


163. \emph{Black’s Law Dictionary} 544 (8th ed. 2004). Note that \emph{Black’s Law Dictionary} also defines specifically the phrase “duty to act.” Black’s defines such as duty as a “duty to take some action to prevent harm to another, and for the failure of which one may be liable depending on the relationship of the parties and the circumstances.” \emph{Id.}
whom the fiduciary serves.¹⁶⁴

3. Allocation of Power and Control. The allocation of power and control in a director-corporation-shareholder relationship (and in any fiduciary relationship) is a defining characteristic of the relationship,¹⁶⁵ and it is important to consider this almost unfettered power (and corresponding shareholder powerlessness) in assessing a director's fiduciary duty to the corporation and shareholders.¹⁶⁶ Given the powerless position of the shareholder, and given the fact that the shareholder has entrusted to the director power over the corporation, the director is in a very different position than is the arms-length third party who owes no special duty to the party with whom he contracted.¹⁶⁷ Phrased differently, the plain vanilla party to a contract is basically allowed to look out for his own interests and benefit only himself.¹⁶⁸ He is in no special relationship with respect to the other party—he has no obligation to affirmatively endeavor to benefit the other party to the contract, other than doing that which the contract requires. This is not so when dealing with a fiduciary, who has given up his disinterested third party status and voluntarily aligned himself (by accepting a director position) with the beneficiary. The fact that the beneficiary granted to the fiduciary the power to act for the beneficiary and the director qua fiduciary accepted this position of power (and assumed the related responsibilities) changes the nature of the relationship from a pure third-party, arms-length or commercial relationship.¹⁶⁹ The scope of the definition of

¹⁶⁴. See Gillette, supra note 108, at 620. This relationship—the fiduciary relationship—requires something affirmative, and something other than what is generally required by good faith. The factual context and the power and control disparities in the fiduciary context mandate something more exacting.

¹⁶⁵. See supra note 164 and accompanying text.

¹⁶⁶. See generally Dickerson, supra note 76, at 978-85.

¹⁶⁷. See Adler & Mann, supra note 151, at 31 ("[T] hose contracting parties who are considered to deal at arm's length receive a substantially lower level of protection than those who, because of a special relationship (fiduciary or confidential) between them, are not deemed to deal at arm's length.").

¹⁶⁸. See supra note 154 and accompanying text.

¹⁶⁹. See 1 JAMES D. COX & THOMAS LEE HAZEN, COX & HAZEN ON CORPORATIONS § 10.01, at 476-77 (2d ed. 2003) ("In fiduciary relationships, such as exists between the principal and her agent, the party on whom the principal

the “duty” of the director, then, should reflect this power disparity by requiring of the director something focused on achieving the result a corporation or shareholder themselves would have sought.

Allan Farnsworth raised an analogous point about control and power in assessing good faith performance when he discussed an objective versus a subjective application of good faith. Professor Farnsworth, when discussing U.C.C. § 1-208, which deals with “acceleration of payment or performance ‘at will’” and provides that a party with the power to accelerate payment or performance “do so only ‘if he in good faith believes that the prospect of payment or performance is impaired,’” observed that § 1-208 was noteworthy in that it dealt with good faith performance from a subjective standard, as opposed to the other U.C.C. provisions pertaining to good faith performance, which employed an objective standard.170 While noting that this U.C.C. provision puts the burden of proving lack of good faith on the party against whom the power has been exercised, Professor Farnsworth concludes that “if the Code makes any change in this regard, it probably favors the person against whom the power has been exercised.”171 This indicates that Professor Farnsworth recognizes the compromised position of the party who lacks power in a commercial relationship.

To a related point, Professor Gillette discusses good faith in the commercial actor context, and he argues against an expansive definition of good faith in part because such would “extend[] the responsibilities of commercial actors beyond bargained-for risk allocations.”172 But there is no similar concern in the director liability context. Even our

relied for representation and protection is not permitted to bargain with the principal at arm’s length or to claim immunity for questionable practices under the bargaining privilege of caveat emptor. Directors . . . are fiduciaries in a position of great power.”)

170. Farnsworth, supra note 101, at 672 n.33 (quoting U.C.C. § 1-208 (1958)).

171. Id. (emphasis added).

172. Gillette, supra note 108, at 620 (emphasis added); see also id. ("This conclusion is predicated on arguments that an expansive obligation extends the responsibilities of commercial actors beyond bargained-for risk allocations, subjects bargains to inconsistent and uncertain enforcement, and does not produce offsetting benefits in commercial conduct.").
contractualists would not try to argue that a director's obligations are purely contractual such that directors can be treated as arms-length actors with duties defined accordingly.\textsuperscript{173}

Ending where we began, the fiduciary must act "solely in the interest of the beneficiary," and, as Professors Mann and Adler recall, the cautioning words of then-Judge Cardozo govern: "Many forms of conduct permissible in a workaday world for those acting at arm's length are forbidden to those bound by fiduciary ties. A trustee [fiduciary] is held to something stricter than the morals of the market place."\textsuperscript{174} It is the relationship that directs the nature and strength of the good faith obligation. The tie between the trust and reliance of the shareholder and the director's resulting obligation to act only for the benefit of the beneficiary is critical to the nature of the meaning of good faith in the director \textit{qua} fiduciary context.

It is for these reasons that I oppose adopting wholesale a definition of good faith from a different area of the law where good faith might have a well-defined meaning, such as, for example, in the areas of contract law and commercial law. I would counsel against any convoluted effort to fit the good faith definition from those areas or any other areas into the corporate director context due to the existence of the above-discussed special relationship in the director liability context and the resulting factual and legal dissimilarity to other areas of the law.\textsuperscript{175} Borrowing

---

\textsuperscript{173} Professors Adler and Mann offer an extensive dialogue on the substantive difference between good faith in the pure arms-length contracts realm and in the context of a "special relationship." See Adler & Mann, \textit{supra} note 151, at 31.

\textsuperscript{174} \textit{Id.} at 35 (quoting Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928)).

\textsuperscript{175} \textit{See supra} Part II.C. I am not alone in my reluctance to adopt in full a good faith definition from a different area of the law. For example, Professor Claire Moore Dickerson similarly regards good faith as variable depending on the legal context; she basically views good faith on a continuum. Dickerson, \textit{supra} note 76, at 979 (opining that the lowest level of good faith in contracts common law might mean only the obligation "to prevent the agreement from being meaningless, or, in contract terms, illusory"). Additionally, Professor Clayton Gillette recognizes this difference in good faith definitions, but he views the differences not as testament to a continuum, but rather as evidence of "the intractable difficulty of defining the scope of the obligation to perform and enforce one's contract in good faith." Gillette, \textit{supra} note 108, at 619. An interesting observation from Professor Gillette that is relevant later in this
conceptually to a limited degree from the agency, trust, insurance, or general fiduciary contexts makes a bit of sense, as discussed below, given the factual similarities between the roles of the actors in those contexts and the director-corporation-shareholder in the corporate context. Beyond that, any other robust borrowing from other areas of the law does an injustice to the "trust and confidence" aspect of the director's role.

D. Useful Observations from Other Areas of the Law

I do not mean to say that some discrete observations from other areas of the law are of no help. They are of some help. First, there are some overarching themes among good faith definitions in various areas of the law that give a sense of what meaning the phrase "good faith" is often intended to convey. Second, although the fiduciary context and the contracts and commercial law contexts are factually distinct, there can be analogies drawn between these two areas of the law that prove helpful to discussing what purpose director liability is arguably intended to serve in the director liability context. Lastly, the definition of good faith in the specific fiduciary qua agent, trustee, and insurer contexts has a global "best interests" flavor to it that translates well into the director liability context, as alluded to above. Together, observations about good faith related to these three points help further create parameters within which to construct a "good faith" definition for the director liability context.

With respect to good faith generally, as it comes up in the law, recall that there are some repeating definitional themes, as discussed in Part II, supra:

Article in Part II.C is that "[m]easurement of the proper scope of the good faith obligation requires understanding its intended function in ordering commercial behavior." Id. at 621. I take the position in Part II.B.3 of this Article that a director has contractually obligated himself, via a formal or unwritten employment agreement, to act in the best interests of the corporation. This is, to me, valuable to remember for the purposes Professor Gillette suggests.

176. See Kimberlee K. Kovach, Good Faith in Mediation—Requested, Recommended, or Required? A New Ethic, 38 S. Tex. L. Rev. 575, 600 (1997) ("An examination of good faith in the other contexts where it has been used provides a starting point for its definition.").
(1) "[H]onest[y];"177
(2) Fair and full disclosure;
(3) Justified action and absence of improper motives;178
(4) Action in accord with agreed-upon objectives;179
(5) Conduct evincing "an honest purpose to arrive at an agreement";180
(6) Exercise of reasonable judgment;181 and
(7) Absence of bad faith, *mala fides*, or fraud.

In addition, there is a repeating theme in the fiduciary realm—that of endeavoring to do the best one can for the party to whom the fiduciary owes his obligation of trust and confidence. This appears in the insurance realm, the agent-trustee realm, and in the general fiduciary context. In these contexts, the good faith obligation is no longer a negative constraint. Rather, good faith in these contexts is treated as an affirmative obligation. This affirmative component cannot simply mean the affirmative obligation to refrain from doing negative things. That would be duplicative of the already existing obligation that arises *any time* good faith in *any* context is invoked, including the mere arm's-length context. Good faith would mean nothing "special" in the "special" fiduciary context if not doing bad things, being honest, and acting in the absence of bad motives were the only things required of a fiduciary acting to satisfy his good faith obligation. So while it is certainly fair to assume that good faith in the director liability context includes the

177. *Ashford v. Thos. Cook & Son (Bankers) Ltd.*, 471 P.2d 530, 535 (Haw. 1970) (quoting with affirmance the jury charge of a trial court: "[a] thing is done in good faith when it is in fact done honestly whether it is done negligently or not"); *see also* *Davis v. Easley*, 13 Ill. 193 (1851).

178. Interestingly, this motive-based assessment of good faith is often referred to as "bona fides." An actor is required to have "bona fides" in order to exhibit good faith. This is a curious usage of the phrase *bona fides*, however, given that *bona fides*, literally translated from Latin, means "good faith."

179. *See* *Turner v. Orr*, 759 F.2d 817, 819 (11th Cir. 1985).


181. *See* ARIZ. REV. STAT. ANN. § 13-3925(f)(1) (2006) ("Good faith mistake' [by a peace officer obtaining evidence] means a reasonable judgmental error concerning the existence of facts that if true would be sufficient to constitute probable cause.").
standard things that good faith in all areas of the law require—honesty, full disclosure, and the lack of bad faith—there is something more in the director *qua* fiduciary context.\textsuperscript{182} To wit, the fiduciary has a positive duty with respect to which he is obligated to affirmatively *do* something for his beneficiary.

As discussed above, good faith has a well-defined meaning in the contracts and commercial law realms, and I have twice been urged by commercial law gurus to consider adopting the U.C.C. definition of good faith.\textsuperscript{183} Professor Mel Eisenberg's recently published article on good faith discusses various usage options regarding good faith as defined in the U.C.C. and contracts law.\textsuperscript{184} Yet given the special fiduciary nature of the director-corporation-shareholder relationship, the director's obligation to act "in good faith" cannot be treated exactly like the good faith obligation existing (or not) in the typical arm's length commercial or contractual relationship.\textsuperscript{185}


\textsuperscript{183} Many thanks to Professors David Frisch (University of Richmond) and Tim Zinnecker (South Texas College of Law) for sharing their thoughts.

\textsuperscript{184} Eisenberg, *supra* note 52.

\textsuperscript{185} Adler & Mann, *supra* note 151, at 33 ("The parties to a contract are deemed not at arm's length when they have a special relationship, either confidential or fiduciary. In such relationships the law imposes additional duties beyond those required in an arm's length transaction upon one of the parties resulting in 'heightened' protection for the other party. In these relationships the law establishes a duty of full disclosure, utmost good faith, and fair dealing.").

For lack of a better place to go further with dispensing specifically of Professor Summers's "excluder" analysis in terms of its potential to be applied in the director liability context, allow me to offer the following:

Recall that many commercial and contract law scholars have embraced the "excluder" method of defining good faith, based on Professor Summer's 1968 law review article. This excluder analysis, as discussed *supra* Part II.B.3, entails defining good faith by reference to the absence of bad faith acts that the phrase "good faith" is intended to exclude, as a standard of conduct. Summers, *supra* note 109. More articles than not on "good faith" in the corporate law realm define good faith by reference to "bad faith"—a director has acted in "good faith" if a complaining shareholder has not been able to show that the director acted in bad faith. See, e.g., Sale, *supra* note 139, at 482-89 (giving examples of "bad faith" or violations of the duty of good faith in Delaware case law); Filippo Rossi, *Making Sense of the Delaware Supreme Court's Triad of Fiduciary Duties* 40-43
(June 22, 2005) (unpublished essay), available at http://ssrn.com/abstract=755784 (examining the concept of bad faith in Delaware case law and proposing a test formulated by the House of Lords to assess bad faith). In addition, as discussed in Part IV, infra, some courts have sidestepped discussing what good faith is in the context of director behavior by instead defining what good faith is not. For example, in McCall v. Scott, 250 F.3d 997, 1001 (6th Cir. 2001), the Sixth Circuit gave some definition to what it concluded would constitute a breach of a director's duty of good faith under Delaware law. Citing a Court of Chancery opinion authored by Vice Chancellor Strine, the McCall panel stated that "the duty of good faith may be breached where a director consciously disregards his duties to the corporation, thereby causing its stockholders to suffer." Id. at 1001 (discussing Nagy v. Bistricer, 770 A.2d 43, 49 (Del. Ch. 2000)). I do not view Summers's "excluder" analysis and its related "bad faith" definitional implications for good faith compelling, both in the abstract and as one would argue could be applied in the director liability context.

First, the words of Professor Summers's own good faith work indicate that the "excluder analysis" was not developed with an eye to addressing good faith in all areas of law, including corporate governance. Admittedly, Professor Summers often makes general references to good faith in the absolute sense without limiting his discussion to the contracts or commercial area of law:

If good faith had a general meaning or meanings of its own—that is, if it were either univocal or ambiguous—there would seldom be occasion to derive a meaning for it from an opposite; its specific uses would almost always be readily and immediately understood. But good faith is not that kind of doctrine.

Summers, supra note 109, at 201.

Yet, this "performance-based" invocation of good faith appears in the bulk of the article mainly with reference to the commercial or contracts law realms. There is nothing to indicate that Professor Summers intended to speak specifically to every other area of the law. Moreover, Professor Summers generally qualifies his good faith opining after the fact by noting that his statements pertain specifically to the contracts and commercial areas of law or by using illustrative facts pertinent only to those areas of the law by saying things such as "[i]n contract law, taken as a whole, good faith is an 'excluder.'" Id. In addition, Professor Summers provides a list of conduct—pertaining to commercial or contract-related factual scenarios—that constitutes bad faith, after which he provides related meanings of good faith based on the specific examples of bad faith conduct in the commercial and contracts law realm. Id. at 203 (discussing situations such as "seller concealing a defect in what he is selling . . . arbitrarily and capriciously exercising a power to terminate a contract, . . . [and] adopting an overreaching interpretation of contract language"). Finally, Professor Summers discusses only the contracts area of the law when analyzing forms of relief and making proposals regarding the same. Id. at 252-62 ("IV. Theories and Forms of Relief for Contractual Bad Faith—Some Modest Proposals.").

Additionally, the philosophical underpinnings of Summers's "excluder" analysis do not line up well within the sphere of director liability. Specifically, Professor Summers says:
It is appropriate to explain in some detail why the imposition and refinement of legal standards of good faith are of potentially great significance in contractual contexts, commercial and noncommercial. First of all, in these contexts good faith has pervasive and distinctive relevance. It is natural for two parties to assume that each will act in good faith toward the other throughout the course of their contractual dealings. Moreover, morals obligate them to act this way. Yet, in one sense their interests will remain essentially antagonistic, for each will be expecting to get something from the other on advantageous terms. And, in a given case, misunderstandings may arise, unforeseen events occur, expected gains disappear or dislikes develop which may motivate one party to act in bad faith.

Id. at 197-98.

Two aspects of this recitation convince me it is imprudent to take the liberty of importing Professor Summers's good faith analysis from the contracts and commercial realm to the world of the corporate director qua fiduciary. First, Professor Summers observes that the two contracting parties at issue in his discussion have, to a degree, antagonistic interests, "for each will be expecting to get something from the other on advantageous terms." Id. at 198. This dynamic simply does not hold when dealing with a director's conduct vis-à-vis his corporation and its shareholders. See infra Part III. When a director is acting as a director on behalf of the corporation and its shareholders, the director is not "expecting to get something from the other on advantageous terms" in the way the parties in Professor Summers's discussion would be. Id. at 198. A director's duty of loyalty precludes directors from advancing interests that are antagonistic to those of the corporation. In addition, the director is a fiduciary, as discussed above. While the scope of fiduciary relationships vary, the basic tenet that a fiduciary must act for the benefit of another, as opposed to "for his own interests," is immutable. Although the common law and statutes cannot control a director's thoughts, they can, and do, tie a director's hands such that the director is essentially unable to pursue interests antagonistic to the corporation or shareholder.

The second aspect of Professor Summers's above-quoted recitation that bolsters my unwillingness to import his excluder analysis to the corporate governance realm is his observation that "[i]t is natural for two parties to assume that each will act in good faith toward the other through the course of their contractual dealings. Moreover, morals obligate them to act this way." Id. at 197-98. This language is much weaker than that applicable to the director-corporation-shareholder relationship. An actionable legal obligation, as opposed to merely "nature" or "morals" as mentioned by Professor Summers, compels directors to act in good faith toward the corporation. The parties to an arms-length contract with each other are in a significantly different position, with no such legal obligation. The contractual arms-length context then, in which Professor Summers explores his good faith excluder analysis, is very different from the director liability realm, in which the actors are bound by a legal obligation much stronger than merely the assumptions (hopes, as it were) of good faith and moral conduct.

In addition to my contextual concerns with importing the excluder analysis from Professor Summers's contracts and commercial law article, I also disagree with Professor Summers as a matter of analytical dogma: just because it is
difficult to define a legal concept with exacting precision in a way that can be translated into many contexts does not mean that it should not be defined. See, e.g., Henry A. Diamond, Note, Reasonable Doubt: To Define, or Not to Define, 90 COLUM. L. REV. 1716, 1724 (1990) (“Although reasonable doubt is not a precise concept, its meaning can be made more clear through definition. Mathematical precision is perhaps impossible, but qualitative definitions can clarify the task of the jury by providing jurors with ‘a concept which they can relate to their own decision-making processes in their daily personal and business lives.’”) (citing United States v. Witt, 648 F.2d 608, 612 (9th Cir. 1981) (Anderson, J., concurring)). The United States Supreme Court has said, “In the construction to be given to words, they are to be received according to their ordinary meaning and import, or such meaning as is given to them by the common sense and understanding of mankind.” United States v. Prescott, 44 U.S. 578, 581 (1845); accord Smith v. United States, 508 U.S. 223, 228 (1993) (“When a word is not defined by statute, we normally construe it in accord with its ordinary or natural meaning.”). “Good faith” is a phrase that does have a common usage and is employed in everyday conversation, despite its gossamer feel. “Good faith” even has a dictionary definition as discussed in Part II.A, supra.

While many in the contracts and commercial law realm have obviously acceded to Professor Summers’s view that good faith should be viewed as an excluder, without its own precise meaning, I believe it neither prudent nor necessary to move the director liability jurisprudence in that direction.

I hasten to add that even scholars in Professor Summers’s own field have opposed his excluder analysis of good faith. Dennis M. Patterson offered:

The reason the excluder analysis will not work for good faith is that both good faith and bad faith are “substantive hungry”: they are each parasitic notions that require host concepts. The excluder analysis cannot work without the existence of a substantive notion upon which the excluder term does its work. Summers never supplies the substantive host, and for that reason alone his claims for the “felicity” of the excluder analysis cannot be sustained. In making his case for the excluder analysis, Summers fails to separate the need for clarification of a fuzzy concept from concepts that are totally parasitic on other notions. . . . If “good faith” were an excluder, it would have meaning only in relation to other legal concepts, but in Summers'[s] analysis, it does not.


In addition, Professor Summers concedes that no less than the venerable contracts guru E. Allan Farnsworth has viewed good faith differently than simply as a tool to prevent certain bad faith conduct. Summers, supra note 109, at 233 n.158 (“One writer has even suggested that the sole significance of good faith is ‘in implying terms in the agreement.’” (quoting Farnsworth, supra note 101, at 670)). After Professor Summers wrote his initial good faith article, Professor Steven J. Burton responded with an article in the Iowa Law Review, wherein he argued that an excluder analysis is not necessarily the only way to deal with good faith performance. See Steven J. Burton, Good Faith Performance of a Contract Within Article 2 of the Uniform Commercial Code, 67 IOWA L. REV. 1 (1981). Professor Steven Burton also is not convinced that good
That said, a fair bit of the "good faith" language in the contracts context is worth considering, as it is apropos of concepts that are transferable from the contracts realm into the corporate law realm. Moreover, as employees, directors have contractual ties to the corporation in addition to the fiduciary ties, such that the definition of good faith in the contracts and commercial law realms at least provides a minimum standard against which to judge a director's conduct.\textsuperscript{186}

As noted previously, the Second Restatement of Contracts ties good faith to the reasonable expectations of the parties: "Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party . . . ."\textsuperscript{187} The phrases "faithfulness to an agreed common purpose" and "consistency with the justified expectations of the other party" both could be added to the

faith is too gossamer to be defined:

Though some scholars have suggested that good faith under the U.C.C. is a necessarily vague concept, perhaps intended to give the courts leeway to impose equitable requirements on contract parties, the courts generally have not so approached the good faith performance provisions. Rather, good faith performance, as used by the courts, generally serves to effectuate the intentions of the parties, or to protect their reasonable expectations.

\textit{Id.} at 3. Professor Summers then penned another good faith article, see Robert S. Summers, \textit{The General Duty of Good Faith—Its Recognition and Conceptualization}, 67 CORNELL L. REV. 810 (1982), to which Professor Burton replied, see Burton, supra note 109. This extended scholarly exchange provides an interesting academic read.

Moreover, we see that the alleged impracticability of finding a meaning of good faith independent of bad faith is disproved by the fact that the draftsmen of the U.C.C. were able to define and include a definition of good faith in the Code (the defining language has existed since the initial 1949 draft of the Code), as Summers himself concedes. Summers, supra note 109, at 207 ("It is evident that the Code draftsmen were not, in 1949, thinking of good faith as an 'excluder.' Rather, they viewed it as a positive concept, with a general, definable meaning of its own.").

186. \textit{See} Rosenberg, supra note 46, at 513 ("A director who agrees to adhere to the terms of a corporate charter must do so in good faith: he must honestly try to be loyal; he must do his best to use care; and he must honestly try to carry out any other promise he has made to those who have entrusted him with control of their corporation. Good faith is merely a way of interpreting whether the parties adhered to the duties imposed upon them by the corporate charter or by contractual agreement.").

assemblage of useful language for purposes of defining a director's good faith obligation, as they do make sense in the director liability context. Directors obviously have an agreed purpose with the shareholders, to wit, benefiting the corporation and its owners. The one thing that the shareholders have in common with the directors is the corporation. An agreed common purpose, then, must include something with respect to that corporation. Within the range of corporation-related agreements, it seems likely that the shareholders implicitly agree with the directors that the directors would act in the corporation's and the shareholders' best interests. 188

Moreover, the "justified expectations" language invoked often in the commercial and contracts areas of the law can be easily overlaid on both the director's fiduciary and employment contract-based good faith obligations. Given that good faith in the contractual context includes the notion that the parties to the contract accord with the reasonable expectations they had when executing the contract, 189 it seems that a shareholder's reasonable expectations with respect to the director she was electing or hiring would include the expectation that the director would at least try to act in the best interest of the corporation. While the justified expectations of the shareholder would certainly include some expectation of calculated risk and honest misjudgment, and justified expectations cannot reasonably include the expectation of perfect decision-making by the directors, "justified expectations" surely would not include lethargy, ambivalence, lack of urgency when such is appropriate, and sleeping while on the job.

At the very least, it seems that "justified expectations"

188. Other agreements would include the implicit agreement that the directors will do a decent job but will make no effort to do the best job that they can or the agreement that the directors will do a perfect job. Of the range of potential implicit agreements, it seems that an agreement on acting in the best interests of the corporation would be reasonable.

189. See, e.g., RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. a (1981) ("Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party . . . ."); Burton, supra note 185, at 3 ("[G]ood faith performance, as used by the courts, generally serves to effectuate the intentions of the parties, or to protect their reasonable expectations.").
must include something in addition to refraining from acting in bad faith. It is inconceivable that a shareholder’s and potential director’s expectations would hinge merely on the agreement that the director not do anything “bad,” deliberately against corporate interests. Who would hire an employee—or give one’s power to an employee—who only undertook to essentially refrain from doing bad things? What investor would ever vote affirmatively for a director who promised only to not try to hurt the corporation? What reasonable investor would have such non-ambitions for her directors?

III. THE DEFINITION

Above I provided the tools with which to construct at least a “rough draft” affirmative (not excluder-based, that is) definition of good faith in the director context: I have reviewed good faith definitions from other areas of law and, in deference to the contextual nature of such definitions, examined more closely the fiduciary context in which good faith in the director liability context appears. I went through good faith definitions in other areas of the law, and I made what I view as justifiable decisions on what to import to the director liability context and what to leave behind. Upon review of the above options for defining good faith, I can best justify consulting the dictionary, reflecting the common law regarding fiduciaries, and, in part, picking from the well-evolved contracts and commercial law good faith definitions.

From these sources, it is clear that most definitions of good faith, and certainly those discussed above, include some aspect of honesty. No venal conduct or trickery is allowed. Beyond that, “dedication to agreement” comes up regularly, and adherence or commitment to reasonable expectations is a frequent refrain. This language pertains to the good faith actor’s sincere attempts to “do what she has agreed to do.” In terms of performance, good faith means

190. See Elizabeth A. Nowicki, 10(b) or Not 10(b)?: Yanking the Security Blanket for Attorneys in Securities Litigation, 2004 COLUM. BUS. L. REV. 637, 676-80 (2004) (discussing textualism and defining words in accordance with their plain meaning); see also Amoco Prod. Co. v. S. Ute Indian Tribe, 526 U.S. 865, 874 (1999) (consulting a dictionary to determine the plain meaning of the word “coal”).
that the actor shall give his or her honest attempt to perform in the way the parties agreed upon. In addition, in the context of a fiduciary, good faith takes on a loyalty component which obligates the fiduciary to act in the best interests of the person he serves.

From here, I can construct a sensible definition of good faith for use in the director liability context as a starting point for further discussion. I make no claim of being able to definitively espouse good faith in full, in a manner ripe for adoption by the corporate bar, academy, and bench alike. Rather, I offer a "first draft," if you will, of the definition of good faith, as a good faith attempt to well-enough define the phrase to stimulate further discussion: "good faith" as used in the director liability context (obligating a director to act "in good faith") can be reasonably summarized to mean that a director must act in the corporation's best interest. Good faith in the director

191. I am not sure that I have done enough research to convince myself that I could say that good faith requires "best efforts," though I have no trouble maintaining that a director's fiduciary obligation to act in good faith requires some level of effort proportionate to the issue at stake. Note that Professor Farnsworth has said:

[g]ood faith is a standard that has honesty and fairness at its core and this is imposed on every party to a contract. Best efforts is a standard that has diligence as its essence and is imposed on those contracting parties that have undertaken such performance. The two standards are distinct and that of best efforts is the more exacting, though it presumably falls short of the standard required of a fiduciary . . . .

FARNSWORTH, supra note 106, § 7.17c.

192. When I initially conceived of this Article, I intended to present one, succinct, almost universally-applicable definition of good faith for use in the director liability context. Though I still propound that is possible, I have changed my goal for the Article to a more modest one. It strikes me that it is sensible to have more discussion about a draft good faith definition before committing to a terminal definition of good faith.

193. In terms of the objectivity or subjectivity of the phrase "good faith," that discussion might itself merit its own law review article. At least one scholar in the corporate realm has concluded that a director need only act in subjective good faith. See Sale, supra note 139, at 488 ("Good faith based liability, then, moves the bar . . . to deliberately indifferent, egregious, subversive, or knowing behavior, and thereby raises issues related to the motives of the actors."). Yet the late Professor Allan Farnsworth adamantly (and logically, I would submit) argued that good faith performance cannot be judged on a subjective standard. See Farnsworth, supra note 101, at 671-73. "Surely the test is not whether one party actually believed that he was acting decently, fairly or reasonably. Surely he must do more than form an honest
liability context includes honesty, and it includes action focused on the reasonable expectations of the shareholders and corporate investors. It, however, requires more than that. As in the agency, trust, and insurance fiduciary contexts, good faith in the director context requires actions

judgment. Otherwise no more than knowing and deliberate unfairness, maliciousness, trickery and deceit would be forbidden." Id. at 672. Indeed, if nothing more than an honest heart was required of our directors, it would be very difficult for shareholders to ever vindicate any sort of mismanagement. See Kevin S. Shmelzer, Comment, The Door Slammed Shut Needs to be Reopened: Examining the Pleading Requirements Under the Private Securities Litigation Reform Act, 78 TEMP. L. REV. 405, 426 (2005) (discussing the difficulty of pleading scienter and its effect on corporate governance and accountability).

By enacting the higher hurdle of needing to plead deliberate recklessness for a securities fraud claim . . . it appears as though investor confidence in corporate entities will continue to erode as investors will encounter an even more difficult burden before being allowed to enter a courthouse. Congress should take note of the current corporate atmosphere and realize that the heightened inference requirement has resulted in making it more difficult to bring all securities fraud suits, including meritorious cases.

Id.

Recognition of the historical evolution of the phrase "good faith" is useful in developing more a context within which to define good faith. Recognizing the original role of good faith in the context of the law gives at least a hint for determining what specifically good faith could mean. To that end, good faith has long been a way to legalize conscience. See J.F. O'CONNOR, GOOD FAITH IN ENGLISH LAW 8 (1990). To the extent that law and morality are tied together in a form most recognizable as equity, good faith was the common thread tying together law and equity. As moral law and cannon law merged and morphed, good faith remained as the vestige of a quasi-moral obligation. Id. Professor O'Connor discusses the evolution from a conscience based jurisdiction to one based on equity by saying that there was an "increasing awareness of the distinction between individual conscience and rules operating in foro conscientie and the general conscience of the realm and rules operating in foro externo." Id. This shift makes more understandable the fact that good faith might well oblige a director to act in his own subjective good faith, but review will be conducted on an objective good faith standard. Id. at 53. Professor O'Connor says:

Directors must act "bona fide in what they consider—not what a court may consider—is in the best interests of the company and not for any collateral purpose". [sic] What is required is that the directors must do what they honestly believe to be right—i.e. subjective good faith—and here, as in other areas of the law where subjective good faith is required, they will normally succeed in satisfying this test unless it can be shown (objectively) that they have not behaved in accordance with the standards expected of honest and reasonable men . . . .

Id. (footnotes omitted)(emphasis removed).
or decisions focused on furthering the best interests of the party giving up power and control to, and exhibiting trust in, the actor.\textsuperscript{194}

\textsuperscript{194} Conduct in the best interests of the shareholders certainly must have a reasonableness threshold or materiality, otherwise directors would be obligated to act as super-officers, essentially repeating the job done by the officers in managing the corporation and constructing disclosure documents. If the director knows how to read financial statements and has a sense of what red flags look like, it is likely that the director has acted in the best interest of the shareholders by doing nothing more than that which he has done. Good faith cannot possibly require obsessive behavior, perfection, or double verification by the directors of each numerical item of financial disclosure. Good faith should perhaps be defined as conduct that is in the best interests of shareholders, given the context and circumstances, and reflects the fact that directors are not (and are not required to be) forensic accounting experts.

In the case of \textit{In re Caremark Int'l. Inc. Derivative Litig.}, 698 A.2d 959 (Del. Ch. 1996), the court recognized that there is a contextual element to the meaning of an action in the best interest of shareholders:

The vocabulary of negligence while often employed, is not well-suited to judicial review of board attentiveness, especially if one attempts to look to the substance of the decision as any evidence of possible "negligence." Where review of board functioning is involved, courts leave behind as a relevant point of reference the decisions of the hypothetical "reasonable person", [sic] who typically supplies the test for negligence liability. It is doubtful that we want business men and women to be encouraged to make decisions as hypothetical persons of ordinary judgment and prudence might. The corporate form gets its utility in large part from its ability to allow diversified investors to accept greater investment risk. If those in charge of the corporation are to be adjudged personally liable for losses on the basis of a substantive judgment based upon what an [sic] persons of ordinary or average judgment and average risk assessment talent regard as "prudent" "sensible" or even "rational", such persons will have a strong incentive at the margin to authorize less risky investment projects.

\textit{Id.} at 967 n.16 (citations omitted).

Indeed, one wonders on what moral basis might shareholders attack a good faith business decision of a director as "unreasonable" or "irrational". [sic] Where a director in fact exercises a good faith effort to be informed and to exercise appropriate judgment, he or she should be deemed to satisfy fully the duty of attention. If the shareholders thought themselves entitled to some other quality of judgment than such a director produces in the good faith exercise of the powers of office, then the shareholders should have elected other directors. Judge Learned Hand made the point rather better than can I. In speaking of the passive director defendant Mr. Andrews in \textit{Barnes v. Andrews}, Judge Hand said:

True, he was not very suited by experience for the job he had undertaken, but I cannot hold him on that account. After all it is the same corporation that chose him that now seeks to
IV. THE REMAINING ISSUE: "NOT IN GOOD FAITH"

Defining good faith in the director liability context is important, in and of itself, to give directors behavioral standards. However, I see defining good faith as equally important for purposes of creating the foundation on which the phrases "the absence of good faith" or "acts or omissions not in good faith" can be constructed. Although a director is obligated to act in good faith, and, for that reason, I have endeavored in this paper to affirmatively define "good faith," a director's legal and monetary liability exposure rests on whether a plaintiff can show that the director committed acts "not in good faith." What is an act "not in good faith," and how does one assess whether a director is acting in the absence of good faith? A comprehensive discussion of this issue is beyond the scope of this Article, but a summary of the issue is worthwhile.

In the corporate law realm over the past several years, courts and, worse, academics have consistently defined charge him . . . . Directors are not specialists like lawyers or doctors . . . . They are the general advisors of the business and if they faithfully give such ability as they have to their charge, it would not be lawful to hold them liable. Must a director guarantee that his judgment is good? Can a shareholder call him to account for deficiencies that their votes assured him did not disqualify him for his office? While he may not have been the Cromwell for that Civil War, Andrews did not engage to play any such role.

Id. at 968.

195. Remember from Part I that a director will not receive the benefit of the statutory exculpation from personal liability for acts "not in good faith." Del. Code Ann. tit. 8, § 102(b)(7) (2001). Moreover, note from Part IV that, while good faith is presumed to exist under the business judgment rule presumption, if a plaintiff can show that the director did not act in good faith, the business judgment rule protection will be stripped from the director, subjecting the director's complained of actions to the more rigorous "reasonable and fair" standard of review.

196. In a forthcoming article, Not In Good Faith, I address this issue in full. Elizabeth A. Nowicki, Not In Good Faith, 60 SMU L. Rev. (forthcoming 2007).

197. Most recently, in the Disney derivative litigation, Chancellor Chandler of the Delaware Court of Chancery offered two definitions on two different occasions for acts not in good faith. First, in 2003, in denying the motion of the Disney directors to have the claims against them dismissed, the Chancellor said:

Instead, the facts alleged in the new complaint suggest that the
this phrase "not in good faith" (the absence of good faith, that is) to mean the same thing as "bad faith," notwithstanding the fact that an act "not in good faith" is not necessarily the same as an affirmative act "in bad faith." 198 I object to defining an act that is not in good faith (such that the director loses the protection of the business judgment rule presumption and does not fall within the protection of a DGCL § 102(b)(7)) to mean a "bad faith act."

Bad faith has been defined as "dishonesty of belief or purpose" 199 or "[dishonest] motive or . . . purpose," 200 requiring the "conscious doing of a wrong because of dishonest purpose or moral obliquity . . . [and] a state of mind affirmatively operating with furtive design or ill

---

defendant directors consciously and intentionally disregarded their responsibilities, adopting a "we don't care about the risks" attitude concerning a material corporate decision. Knowing or deliberate indifference by a director to his or her duty to act faithfully and with appropriate care is conduct, in my opinion, that may not have been taken honestly and in good faith to advance the best interests of the company. Put differently, all of the alleged facts, if true, imply that the defendant directors knew that they were making material decisions without adequate information and without adequate deliberation, and that they simply did not care if the decisions caused the corporation and its stockholders to suffer injury or loss.

In re Walt Disney Co. Derivative Litig., 825 A.2d 275, 289 (Del. Ch. 2003).

In 2005, in the post-trial memorandum, Chancellor Chandler said:

Upon long and careful consideration, I am of the opinion that the concept of intentional dereliction of duty, a conscious disregard for one's responsibilities, is an appropriate (although not the only) standard for determining whether fiduciaries have acted in good faith. Deliberate indifference and inaction in the face of a duty to act is, in my mind, conduct that is clearly disloyal to the corporation. It is the epitome of faithless conduct.

In re Walt Disney Co. Derivative Litig., 907 A.2d 693, 755 (Del. Ch. 2005).

Both of these definitions say nothing about bad faith, yet the Delaware Supreme Court, in affirming the lower court and specifically sanctioning this language, refers to the language and standard as definitions of "bad faith." In re Walt Disney Co. Derivative Litig., 906 A.2d 27, 63 (Del. 2006).

198. I say "and worse, the academics" because the courts might have somehow viewed themselves bound to certain definition. Academics have the luxury of not being bound to any misinterpretation of the law.

199. BLACK'S LAW DICTIONARY 149 (8th ed. 2004).

Bad faith is provable in the corporate law context by showing "that the board's decision was so egregious or irrational that it could not have been based on a valid assessment of the corporation's best interests" or that the decision "is so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith." Yet, as discussed above, an act "in good faith" is an act in the best interests of the shareholders and corporation, such that an "act[] or omission[] not in good faith" is an act that is not in the best interests of the shareholders or corporation. An act "not in good faith," then, is not necessarily the same as an affirmative act "in bad faith" any more than a fruit that is not an apple is necessarily an orange. The latter is

203. Id. (quoting In re J.P. Stevens & Co. S'holders Litig., 542 A.2d 770, 780-81 (Del. Ch. 1988)).
205. See, e.g., Idaho v. Prestwich, 783 P.2d 298, 302 (Id. 1989) (Bistline, J., concurring) ("The trial judge did not find good faith; he only found lack of bad faith. I submit that the two are not synonymous." (citation omitted)); Art Form Interiors, Inc. v. Columbia Homes, Inc., 609 A.2d 370, 375 (Md. Ct. App. 1992) ("We view with considerable consternation the disturbing lack of good faith . . . but we are not prepared to hold that the appellants' actions constituted bad faith . . .").
206. Zdravkovich v. Bell Atlantic-Trion Leasing, Corp., 592 A.2d 498, 403 (Md. Ct. App. 1991) ("The District Court's finding that Zdravkovich 'has not shown good faith' is not the equivalent of a finding of 'bad faith' and cannot be the basis for the imposition of sanctions."); Commonwealth v. Belcher, No. F88-140, 1988 WL 613939, at *1 (Va. Cir. Ct. 1988) ("Although the court finds no bad faith, the court does not find good faith here either.").

As well, there might be another opinion regarding "good faith," "not in good faith," "bad faith," and "not in bad faith." The "no faith" option was discussed in Thomas v. W. World Ins. Co., 343 So. 2d 1298, 1304 (Fla. Dist. Ct. App. 1977), when the court analyzed an insurance company's refusal to defend an insured against the insurer's fiduciary obligation to exercise good faith in defending or settling claims against an insured. "In the case before us, there is no threshold question of 'good faith' vs. 'bad faith.' For here, the company exercised no faith at all." Id.

Richard Rector describes the distinction found in some cases between the violation of the duty of good faith and fair dealing and an affirmative finding of bad faith as "noteworthy, if slightly metaphysical." Richard Rector, Infotech and the Law: Good Faith, Bad Faith in Government Contracts, WASH. TECHNOLOGY, (Apr. 17, 2000), available at http://www.washingtontechnology.com/print/15_20/16188-1.html. Mr. Rector further observes that this suggests that "good
GOOD FAITH

actually a sub-category of the former, and the former embraces much more than does the latter. Courts that substitute the phrase “bad faith”\(^{206}\) when common law or the statutes refer to merely the lack of good faith are actually making new common law and rewriting DGCL § 102(b)(7) (and analogous statutes). The “bad faith” bastardizing of the English language significantly changes both common law and the meaning of statutes such as DGCL § 102(b)(7) in a way that is prejudicial to shareholders. The impact of this mutilation is particularly noteworthy when dealing with abdication or inattention-based fiduciary duty cases.

While the linguistic distinction between an act that exhibits a lack of good faith on the part of the actor versus an act that exhibits bad faith might not be important in casual conversation, the distinction becomes very important in legal discourse when reviewing facts in which it is alleged that the director should be stripped of the protections of the business judgment rule presumption or should not be afforded the protections of a charter provision adopted under DGCL § 102(b)(7) or a similar statute. To require the plaintiff to plead and prove bad faith affirmatively would require the plaintiff to prove that the director acted with ill will, consciously committed a wrong, or engaged in acts so egregious that they are virtually inexplicable for any reason other than bad faith. Proving bad faith requires much more than is required to prove that an act taken was not taken in good faith.

Many courts and academics seem oblivious to the fact and bad faith are not mirror images of one another . . . the government can fail to act in good faith without necessarily acting in bad faith.” Id. (quoting an Armed Services Board of Contract Appeals case in which the board observed that “[t]he mere absence of bad faith . . . does not mean the government met its obligation . . . to negotiate in good faith”).

206. See, e.g., In re Lukens Inc. S’holders Litig., 757 A.2d 720, 728 (Del. Ch. 1999) (dismissing shareholder claim for breach of the duty of good faith because “[l]ittle or nothing in the Complaint speaks in terms of bad faith misconduct or disloyalty”); McGowan v. Ferro, 859 A.2d 1012, 1036 (Del. Ch. 2004) (discussing a plaintiff’s attempt to plead that directors acted “not in good faith” as the phrase is used in DGCL § 102(b)(7), the court said “[b]ad faith is ‘not simply bad judgment or negligence,’ but rather ‘implies the conscious doing of a wrong because of dishonest purpose of moral obliquity . . . it contemplates a state of mind affirmatively operating with furtive design or ill will’” (quoting Desert Equities, Inc., 624 A.2d at 1208 n. 16)).
that they are, with nary a bit of explanation, setting for shareholders a much higher burden of proof than the long existing common law and exculpatory state statutes actually require.\textsuperscript{207} Distinguishing conduct that is "not in good faith" from conduct that is taken "in bad faith" is certainly not an overly ambitious distinction when dealing with a fiduciary. It is not enough for a fiduciary to just do bad things. The fiduciary is supposed to affirmatively try to do the right things.\textsuperscript{208} The fiduciary has a duty, an obligation. More is required of a director \textit{qua} fiduciary than is required of parties to an arms-length transaction. Therefore, many of the same reasons why I was adverse to defining good faith by borrowing a good faith definition from other areas of the law are relevant when assessing whether "bad faith" can be used as a substitute phrase for "the failure to act in good faith" (or "the absence of good faith").

To condone the continued definition of the lack of good faith as synonymous with bad faith does away with part of the affirmative nature of a director's obligation to act in good faith. Inasmuch as "bad faith" acts basically include only very egregious acts—acts such as fraud or deliberately reckless behavior—courts are setting new policy and changing the obligations of directors by essentially freeing the directors of the obligation to exercise a level of attention and monitoring that rises to the level of "in the best interests of the shareholder." For a fiduciary—someone who has the obligation to act affirmatively for the shareholder—this loss of an inattention-based category of liability is preposterous.

The shareholders will now be left with a board that cannot be held accountable for conduct that evinces a total lack of thought (e.g., the typical "asleep at the wheel" case). A total abdication of duty, with no \textit{mal fides}, will be beyond

\textsuperscript{207} The Delaware Supreme Court itself recently defined "bad faith" when assessing whether the lack of good faith had been pled, completely ignoring the fact that the application of DGCL § 102(b)(7), which was at stake in the case, hinged on an assessment of whether the acts or omissions complained of were taken "not in good faith." \textit{In re Walt Disney Co. Derivative Litig.}, 906 A.2d 27, 65 (Del. 2006).

\textsuperscript{208} See Rosenberg, supra note 46, at 512 ("Fiduciary duties are substantive obligations which must be honored in good faith in the same way that contractual obligations must be honored in good faith.").
the reach of an indignant shareholder. That simply cannot be acceptable behavior under the definition of "good faith" as it pertains to a fiduciary. Good faith does not contemplate lack of attention regarding that which the fiduciary has agreed to support. Good faith does not contemplate a lack of attention paid to that which the fiduciary has been trusted to do.

Given an affirmative definition of what good faith requires, interpreting the "not in good faith" language of DGCL § 102(b)(7) and the business judgment rule presumption as a jurisprudential matter to allow a complaining shareholder to point to the absence of affirmative good faith (as opposed to the existence of affirmative bad faith) to substantiate her claim that the director failed to meet his obligation to act in good faith is straightforward. A complaining shareholder plaintiff who is trying to either rebut the business judgment rule's presumption of a director's good faith or show that the director is outside the protection of a charter provision adopted under DGCL § 102(b)(7) would articulate the definition of good faith and then identify facts that show that the acts of the directors do not fit within the definition of "good faith." The burden would still be on the plaintiffs to prove that the directors did not act in good faith, and, though "proving" a negative is perhaps a counter-intuitive concept, it certainly is not an ethereal task from a practical standpoint.209

209. Some might worry that this analysis means that the directors will no longer be automatically given the protection of the business rule presumption. That worry is not merited; the directors will still receive the benefit of the presumption. If the plaintiffs cannot rebut the presumption of good faith by showing that, actually, good faith acts—acts in the best interests of the shareholders—were lacking or the acts at issue do not fit within the phrase "in the best interests of the shareholders," a director will forever hold the protection in that case.

Director liability jurisprudence is on the cusp of taking a sharp turn away from mainstream fiduciary duty common law, due to the bar's and the academy's apparent unwillingness to affirmatively, usefully define and analyze good faith and the continued bastardizing of the meaning of the failure to act in good faith. While some might argue that these wordsmith failures achieve the best possible result by insulating directors from liability in all but the most vulgar circumstances, that result—which is contrary to decades worth of fiduciary common law—is a result that is more appropriately achieved by legislative action. Though state legislatures perhaps intended to insulate their directors from everything but bad faith actions, the language of statutes such as DGCL § 102(b)(7) should not be unjustifiably mutilated to achieve that result.\textsuperscript{210}

It is hard to conceive of a world where the obligation of a director, who is tied in a fiduciary relationship to the shareholder and/or the corporation, will move from the obligation "to be loyal to the trust imposed in him, and to execute it with the single purpose of advancing his principal's interests,"\textsuperscript{211} to the mere obligation to refrain from doing things that evince "some sort of obvious, deliberate, or egregious failure."\textsuperscript{212} Yet, as I attempted to show in this Article, the perversion of the phrases "good faith" and "not in good faith" threaten to achieve exactly this shift, which, I maintain, would render impotent the bedrock faithfulness principles of the director's fiduciary position. Before this linguistic lapse turns into a substantive departure from long-established fiduciary common law, it makes sense for the bench, the bar, and the academy to engage in a more thoughtful analysis of what good faith should demand from a director.

\begin{footnotes}
\item[211] HUFFCUT, supra note 152, at § 90 (emphasis added).
\item[212] Sale, supra note 139, at 493.
\end{footnotes}
I offer my above analysis of, and attempt at, defining “good faith” as mustard seeds, for the single purpose of furthering the discussion about good faith and encouraging a more academically demanding investigation into the definition of good faith. My definition of good faith might prove distasteful to the academy, and one of my brethren might counter with a better definition. I welcome such a response, as my goal is not to establish my definition as the *sine qua non*, but, rather, to stimulate more good faith debate about good faith.

I am not suggesting that today’s boards are sloppy, inadequate, or otherwise consistently reproachable. I am suggesting, however, that a more exacting definition of “good faith” will either discourage potentially half-hearted directors from serving or will give rise to a market in professional directors. Either result is, in my view, a good result.