ADVISING A BOARD OF DIRECTORS IN THE FACE OF LEGAL UNCERTAINTY

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The law appears relatively straightforward: "[a] for-profit benefit corporation shall be managed in a manner that *considers* the best interests of those materially affected by the corporation's conduct, including the pecuniary interests of shareholders, and the public benefit or public benefits identified in its charter."[2] In fulfilling this obligation, a Tennessee for-profit benefit corporation's board of directors "shall not give regular, presumptive, or permanent priority to the interests of any individual constituency or limited group of constituencies materially affected by the corporation's conduct, including the pecuniary interests of shareholders."[3]

Despite this perceived clarity, neither Tennessee, nor any other court for that matter, has yet to interpret the meaning of these statutory provisions.[4] Accordingly, this Comment seeks to provide corporate counsel with clarity in its role as an advisor to a Tennessee For-Profit Benefit Corporation's ("FPBC") Board of Directors in the face of legal uncertainty. Part I, explains the fiduciary duty obligations a board of directors owes to a for-profit corporation operating under Delaware law.[5] Part I describes the duty of care as applied in *Smith v. Van Gorkom* and the duty of loyalty as stated in *Guth v. Loft, Inc.*[6] Part II opens with a re-

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[2] TENN. CODE ANN. § 48-28-104(d) (2015) (emphasis added).

[3] TENN. CODE ANN. § 48-28-106(a) (2016).

[4] As of November 25, 2017, the Shepard's Comprehensive Report on Lexis Advance did not reveal any citing decisions for TENN. CODE. ANN. § 48-28-106.

[5] *Infra* Part I.

[6] Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985); Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. Ch. 1939).

view of the shareholder wealth maximization norm.[7] It then explains how this norm influenced FPBC law.[8] Finally, Part III highlights three provisions in Tennessee's FPBC Act and how each relates to our role as corporate counsel.[9]

I. FIDUCIARY DUTY OBLIGATIONS UNDER DELAWARE LAW

The General Corporation Law of the State of Delaware ("DGCL") appoints the board of directors as the statutorily ordained managers of the corporation.[10] Unlike Model Business Corporation Act Section 8.30,[11] the DGCL does not include express "standards of conduct for directors."[12] Instead, these standards must be ascertained from judicial opinions. As the following discussion indicates, Delaware law

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[7] *Infra* Part II.

[8] *Infra* Part II.

[9] *Infra* Part III.

[10] *See* DEL. CODE ANN. tit. 8, § 141(a) (2016) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation."). Similarly, the Model Business Corporation Act provides:

> All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed by or under the direction of its board of directors, subject to any limitation set forth in the articles of incorporation or in an agreement authorized under section 7.32.

MODEL BUS. CORP. ACT § 8.01(b) (AM. BAR ASS'N 2006).

[11] MODEL BUS. CORP. ACT § 8.30(a) (AM. BAR ASS'N 2006) ("Each member of the board of directors, when discharging the duties of a director, shall act: (1) in good faith, and (2) in a manner the director reasonably believes to be in the best interests of the corporation.").

[12] Joan MacLeod Heminway, *Shareholder Wealth Maximization as a Function of Statutes, Decisional Law, and Organic Documents*, 74 WASH & LEE L. REV. 939, 947 (2017).

subjects a board of directors to two fiduciary duties: (1) the duty of care and (2) the duty of loyalty.[13]

A. Duty of Care

In *Smith v. Van Gorkom*,[14] the Supreme Court of Delaware addressed whether the directors of Trans Union Corporation reached an "informed business judgment ... in voting to 'sell' the Company for $55 per share pursuant to the … cash-out merger proposal."[15] To reach an informed business judgment, the Board must inform themselves "of all material information reasonably available to them."[16] This is commonly known as the duty of care.[17]

In *Smith*, Trans Union Corporation's shareholders brought a class action lawsuit "seeking rescission of a cash-out merger of Trans Union [Corporation]" into another company, or in the alternative, damages from the Trans Union Board of Directors.[18] The Delaware Court of Chancery ruled for the defendants.[19] It based its ruling, in part, on the fact "that the Board of Directors' approval of the [cash-out] merger proposal fell within the protection of the business judgment rule."[20] In other words, it ruled that the Board 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."[21]

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[13] *See, e.g.*, In re Walt Disney Co. Derivative Litig., 907 A.2d 693, 745 (Del. Ch. 2005) ("The fiduciary duties owed by directors of a Delaware corporation are the duties of due care and loyalty.").

[14] 488 A.2d 858 (Del. 1985).

[15] *Id.* at 874.

[16] *Id.* at 872 (quoting Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)).

[17] *Id.* at 872–73.

[18] *Id.* at 863.

[19] *Id.* at 864.

[20] *Id.* at 870.

[21] *Id.* at 872 (quoting *Aronson*, 473 A.2d at 812).

On appeal, the Supreme Court of Delaware reversed.[22] Contrary to the Chancery Court's findings, it found "that the directors of Trans Union breached their fiduciary duty to their stockholders … by their failure to inform themselves of all information reasonably available to them and relevant to their decision to recommend the … merger…."[23] It is likely that the *Smith* court would have reached a different result had the Board:

- Consulted with its Chief Financial Officer, Donald Romans, in more detail on the adequacy of the $55 cash-out merger price;
- Utilized their own investment banker, Salomon Brothers, whose Chicago specialist in merger and acquisitions was known to the Board and familiar with Trans Union's affairs;
- Insisted upon a forum in which they could ask questions and explore alternatives with senior managers; and
- Received written documents outlining the terms of the merger and adequacy of the cash-out merger price during the Chairman's 20-minute oral presentation of the proposal.

B. Duty of Loyalty

In the leading case of *Guth v. Loft, Inc.*,[24] the Supreme Court of Delaware described the duty of loyalty as "a rule that demands of a corporate … director … the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation … but also to refrain from doing anything that would work injury to the corporation…."[25] In other words, the duty of loyalty "mandates that the best interest of the *corporation and its shareholders* takes precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the stockholders generally."[26]

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[22] *Id.* at 864.

[23] *Id.* at 893.

[24] 5 A.2d 503 (Del. 1939).

[25] *Id.* at 510.

[26] Cede & Co. v. Technicolor, 634 A.2d 345, 361 (Del. 1993) (citing Pogostin v. Rice, 480 A.2d 619, 624 (Del. 1984)) (emphasis added); *see also* Stone ex rel. Amsouth Ban-

II. SHAREHOLDER WEALTH MAXIMIZATION & FOR-PROFIT BENEFIT CORPORATIONS

There is considerable academic debate about whether directors owe these fiduciary duties to the corporation or the corporation *and* its shareholders.[27] As Professor Joan Heminway points out, "[s]ome decisional law describes fiduciary duties owed to the corporation and other court opinions refer to duties owed to the corporation and its shareholders."[28] In fact, in *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla*, the Delaware Supreme Court expressed conflicting views on this issue within the same opinion.[29]

Despite this lack of clarity, "corporate law is often credited with creating, hewing to, or reinforcing a shareholder wealth maximization norm."[30] Professor Haskell Murray reiterated this belief by stating:

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corporation v. Ritter, 911 A.2d 362, 370 (Del. 2006) ("[T]he fiduciary duty of loyalty is not limited to causes involving a financial or other cognizable fiduciary conflict of interest. It also encompasses cases where the fiduciary fails to act in good faith.").

[27] BRANSON, ET. AL., BUSINESS ENTERPRISES: CASES, MATERIALS, AND PROBLEMS: LEGAL STRUCTURES, GOVERNANCE, AND POLICY, 532, (3d ed. 2016) ("an ambiguity frequently encountered by corporate directors, lawyers, and even judges is whether or not directors owe their fiduciary duties to the corporation and its shareholders, or to the corporation alone.").

[28] Heminway, *supra* note 12, at 952.

[29] Compare N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 99–100 (Del. 2007) ("It is well established that … directors owe their fiduciary duty obligations to the corporation and its shareholders [and] … must continue to discharge their fiduciary duties to the corporation and its shareholders by exercising their business judgment in the best interests of the corporation for the benefit of its shareholder owners."), with *id.* at 101 (asserting that "it is well settled that directors owe fiduciary duties to the corporation.").

[30] Heminway, *supra* note 12, at 939; *see* Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919) ("A business corporation is organized and carried on primarily for the profit of its stockholders."); *see also* eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 34 (Del. Ch. 2010) ("Having chosen a for-profit corporate form, the craigslist directors are bound by the fiduciary duties and standards that accompany that form. Those standards include acting to promote the value of the corporation for the benefit of its stockholders.").

> [T]he *persistent common perception* seems to be that directorial duties require placing shareholder wealth at the forefront. The perception may stem from the pronouncements of courts in *Dodge* and *eBay*, from various academic articles, from education in business and law schools, and from the popular media. The perception – as the phrase "shareholder wealth maximization *norm*" suggests – has arguably risen to the level of a widely recognized and influential norm.[31]

This norm is credited by many as the primary driver behind the creation of benefit corporation statutes.[32] A benefit corporation "is a type of for-profit corporation organized under specially tailored provisions included in a state's corporate law."[33] As mentioned in Professor Murray's companion piece to this Comment, Tennessee adopted its For-Profit Benefit Corporation Act in mid-2015 and the Act became effective on January 1, 2016.[34] Therefore, corporate counsel for Tennessee For-Profit Benefit Corporations must consider how the shareholder wealth maximization norm effects their clients.

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[31] J. Haskell Murray, *Choose Your Own Master: Social Enterprise, Certifications, and Benefit Corporation Statutes*, 2 AM. U. BUS. L. REV. 1, 17–18 (footnote omitted).

[32] Joan MacLeod Heminway, *Corporate Purpose and Litigation Risk in Publicly Held U.S. Benefit Corporations*, 40 SEATTLE U. L. REV. 611, 617 n. 24 ("The heart of the concern is that a court will find that board members ... have breached an applicable fiduciary duty by taking an action that the board determines to be in the best interest of the corporation but fails to maximize the financial benefits to shareholders. Two court opinions—Dodge v. Ford, 170 N.W. 668 (Mich. 1919), an 'old chestnut' decided in the closely held corporate context under Michigan law, and the more recent Delaware law opinion in eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 35 (Del. Ch. 2010)—are typically used to support the argument that corporate management should fear this result.").

[33] *Id.* at 616

[34] J. Haskell Murray, *Examining Tennessee's For-Profit Benefit Corporation Act*, 19 TENN. J. BUS. L. 325, 330 (2017).

III. ADVISORY ROADMAP

The remaining portion of this Comment will highlight three provisions in Tennessee's FPBC Act and how each relates to our role as corporate counsel. Under Tennessee law, a Tennessee FPBC's charter must "include a statement regarding the purpose or purposes for which the corporation is organized including one (1) or more public benefits to be pursued by the corporation...."[35] Unlike traditional corporate statutes, this statutory provision calls for a corporate purpose that is more specific than "any lawful purpose."[36]

As mentioned above, "[a] for-profit benefit corporation shall be managed in a manner that considers the best interests of those materially affected by the corporation's conduct ... *and the public benefit ... identified in its charter*."[37] When read together with the charter provision, it becomes apparent that this "management provision directly connects the benefit corporation's expressed charter-based public benefit to the management function."[38] In addition to considering the public benefit identified in its charter, the board must consider the "interests of those materially affected by the corporation's conduct."[39] Note, however, that the board cannot "give regular, presumptive, or permanent priority to the interests of any individual constituency … materially affected by the corporation's conduct."[40]

At the moment, it is unclear how courts will interpret this statutory requirement. It would appear that the shareholder wealth maximization norm would not apply to any judicial review of board decision mak-

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[35] TENN. CODE ANN. § 48-28-104(e)(1) (2015).

[36] Heminway, *supra* note 32, at 618 ("Most modern statutory corporate law provisions outside the benefit corporation context typically allow a corporation to be organized for any lawful purpose. . . . Benefit corporation statutes are designed to change that norm.").

[37] TENN. CODE ANN. § 48-28-104(d) (2015) (emphasis added).

[38] Heminway, *supra* note 32, at 622.

[39] TENN. CODE ANN. § 48-28-106(a) (2016).

[40] *Id.*

ing in the benefit corporation setting. Yet, as Professor Heminway notes, this "expectation[] may not be valid." [41] Time will tell.[42] Until then, this Comment suggests that corporate counsel adhere to the following steps:

1. Confirm that the company is operating under the intended statutory framework;[43]
2. Identify those materially affected by the corporation's conduct and the public benefit(s) identified in its charter;
3. Inform the Board of its fiduciary duty obligations under title 48, chapter 28, section 106(a) of the Tennessee Code Annotated Tenn. Code Ann. § 48-28-106(a); and
4. Record the Board's decision-making process in the company minutes.[44]

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[41] Heminway, *supra* note 32, at 633.

[42] Heminway, *supra* note 12, at 971 ("litigation involving board decision making in benefit corporations may help us to develop a better understanding of optimal board processes that take into account a more inclusive consideration of constituents. Only time will tell.").

[43] Heminway, *supra* note 32, at 614 ("a review of . . . Tennessee [For-Profit Benefit Corporation] filings suggests that well more than half were erroneously organized as benefit corporations.").

[44] *Id.* at 624 n. 55 (TENN. CODE ANN. § 48-28-106(b) and (c) "provide that compliance with the statutory duty prevents a director from being held liable, and allow[s] the corporation's charter to provide that a 'disinterested failure' to satisfy the board's express standard of conduct does not 'constitute an act or omission not in good faith, or a breach of the duty of loyalty' for fiduciary duty and indemnification purposes.").