



**Presents  
Corporate  
Governance 101:  
Fiduciary Duties of Officers and Directors**

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# **Why is the Delaware General Corporation Law so Important?**

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- **Delaware is the state of incorporation for:**
  - **More than 740,000 business entities**
  - **61% of the Fortune 500**
  - **More than half of the companies traded on the NYSE, the Nasdaq and other exchanges**
  - **75% of new IPOs**
- **130,000 new corporations, LLCs and partnerships are formed annually in Delaware**

# What is the Magic About Delaware?

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## ➤ Sophisticated Legislation

- The Delaware General Corporation Law is updated annually in cooperation among the General Assembly and Bar Association

## ➤ Expert Judiciary

- Most developed body of corporate caselaw in the country, offering consistency, predictability, and speed (*Delaware brags that it “moves at the speed of business”*)

## ➤ Internal Corporate Affairs Doctrine

- Delaware corporation law applies to board decisions regardless of where the corporation is headquartered or operates, and regardless of where the corporation is sued

# Where is Delaware In the Legal Universe?

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- **“Best legal system in the United States”**
  - *Thomas Donohue, President, U.S. Chamber of Commerce*
- **Annual U.S. Chamber of Commerce Survey of 50 State Litigation Systems**
  - **Delaware ranked #1, noting:**
    - ✓ competence and impartiality of the judiciary
    - ✓ timeliness of decisions
    - ✓ handling of scientific and technical evidence
    - ✓ treatment of punitive damages

# Corporation Law and Securities Law: State and Federal Roles

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## ➤ State Governments

- Traditional regulation of business formation and internal relations
- Stockholder economic and voting rights
- Responsibilities of directors and officers

## ➤ Federal Government

- Federal securities regulation
- Company disclosures in securities markets

## ➤ Areas of overlap

- Voting process (*proxy forms; shareholder proposals*)
- Sarbanes-Oxley (*audit committee composition/role; loans to insiders*)
- State blue sky laws (*private sale of securities*)

# Board of Directors vs. Stockholders: Balance of Power

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## ➤ Board of Directors

- Board has absolute power to manage the corporation; stockholders may not interfere with management
- Board owes fiduciary duties to the company (*and the stockholders derivatively*) and may be removed by stockholders at any time and for any reason

## ➤ Stockholders

- Stockholder's role in management is the ability to elect directors annually
- Stockholder vote required only for:
  - ✓ mergers
  - ✓ sale of all or substantively all of the corporation's assets
  - ✓ charter amendments
  - ✓ dissolution

# Governance of a Delaware General Corporation

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- **The Delaware General Corporation Law**
- **Fiduciary Duties**
  - **Duty of Care**
    - ✓ Due diligence requirement; directors must be fully informed of all material information reasonably available
  - **Duty of Loyalty**
    - ✓ Disinterestedness and independence requirement; directors must not have a pecuniary interest in transaction and must not be dominated or controlled
  - **Board has obligation to at all times act in “Good Faith”**
    - ✓ Oversight requirement; directors cannot consciously disregard their fiduciary duties and their obligation to manage the company

# Rules Governing Board Actions

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## ➤ Principal Rules

- Business Judgment Rule
- Entire Fairness (*applies to interested and controlling-stockholder transactions*)
- Duty of good faith and oversight

## ➤ Special Rules

- Enhanced Scrutiny (*e.g., takeover defenses*)
- Revlon Mode (*applies to sale of the company or the sale of control*)
- Compelling Justification (*e.g., interference with stockholder rights*)

# Business Judgment Rule

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- **Presumption that the directors acted on an informed basis (*duty of care*) and in the honest belief that they acted in the best interest of the corporation (*duty of loyalty*)**
  - **Process Inquiry not a Substantive Inquiry:** If the directors demonstrate that they satisfied their duties of care and loyalty, a court will not second-guess the board's decision even if, in hindsight, it turns out to be a "poor" business decision
  - **Purposes of the rule are to encourage entrepreneurial risk-taking and to encourage qualified individuals to serve on corporate boards**
- **Additional Statutory Protection**
  - **Directors may be exempt from monetary liability by certificate of incorporation, with exceptions:**
    - ✓ fraud
    - ✓ waste
    - ✓ self-Dealing

## **Entire Fairness (Self-Dealing Transactions)**

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- Approval of a self-dealing transaction by interested directors is not void, but voidable (*no shareholder approval is required*); however:
  - A self-dealing transaction must be “entirely fair” to the corporation and the board has the burden of proving “entire fairness” (*both process and transaction terms*). A self-dealing transaction is never entitled to business judgment rule protection. Burden shifts back to the plaintiff-stockholder to prove the transaction was not fair if transaction is approved by:
    - ✓ Disinterested directors (*or committee*)
    - ✓ Disinterested shareholders

## Entire Fairness

### *(Controlling-Stockholder Transactions)*

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- Controlling-stockholder transactions are also subject to entire fairness review; however:
  - If there is no single controlling stockholder, business judgment rule protection is available if the transaction is approved by a stockholder vote of a “majority of the minority outstanding” (*as opposed to a “majority of the minority voting”*)

# Duty of Good Faith

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## ➤ Duty of Oversight

- Duty is breached if there is a sustained and systematic failure of the board to exercise oversight

## Special Rules

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- **Enhanced Scrutiny (e.g., takeover defenses)**
  - Responses and defenses must be reasonable in relation to the perceived threat to the company's business plan
- **Revlon Mode (sale of the company or sale of control)**
  - Obligation to obtain best (*as distinguished from the highest*) price available when selling the company
- **Compelling Justification (e.g., interference with stockholder rights)**

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