Fiduciary Principles And Delaware Corporation Law: Searching For The Optimal Balance By Understanding That The World Is Not

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Distilled to the core, the principles that animate Delaware's regulation of the fiduciaries who govern corporations are to:

- give fiduciaries the authority to be creative, take chances, and make mistakes so long as their interests are aligned with those who elect them; but,

- when there is a suspicion that there might be a conflict of interest, use a variety of accountability tools that draw on our traditions of republican democracy and equity to ensure that the stockholder electorate is protected from unfair exploitation.

These principles aim to preserve the benefits of profit-increasing activities in a complex business world where purity is by necessity impossible. And even when a stricter approach to fiduciary regulation is warranted because of the potential for abuse, these principles hew to our nation's republican origins and commitment to freedom in another way: when possible to do so, regulation of fiduciary behavior that might involve a conflict of interest should involve not after-the-fact governmental review, but before-the-fact oversight by the fiduciaries of the corporation who are impartial and, most importantly, by the disinterested stockholders themselves.

Before examining several high-salience contexts that reflect these animating principles, it is helpful to review the evolution and institutional setting of the pertinent Delaware case law.

The Surprising (Im)Maturity of Delaware Corporate Fiduciary Law

Early in our nation's and Delaware's history, corporations only existed by virtue of company-specific charters granted by the legislature.[1] These charters were bespoke and quite specific, and often limited the corporation's conduct of business to limited and sharply articulated purposes. The so-called "ultra vires" doctrine was vibrant and largely confined corporations and their managers to pursuing the specific objectives using the specific means set forth in the charter.[2]

It was with the advent of so-called "general corporation laws," not much more than a century ago, that many of the developments we now cover began. General chartering was important because it increasingly enabled corporations to pursue any lawful business by any lawful means.[3] When no conflict of interest existed and when corporations were not engaging in fundamental transactions such as mergers, these statutes gave corporate managers broad discretion to innovate, go into new product lines, abandon old ones, and to take risks to advance the corporation's interests.

With this new discretion emerged a key question: could stockholders call on the courts to hold the fiduciaries to account for negligence when their business

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[1] Leo E. Strine, Jr. & Nicholas Walter, *Originalist or Original: The Difficulties of Reconciling Citizens United with Corporate Law History*, 91 NOTRE DAME L. R. 877, 894 (2016).
[2] *Id.* at 880, 899.
[3] Delaware did not adopt a general incorporation statute until 1875. Joel Seligman, *A Brief History of Delaware's General Corporation Law of 1899*, 1 DEL. J. CORP. L. 249, 249-250 (1976).

decisions turned out badly? This question implicated several concerns, including the realities that: (1) even a carefully considered business decision can generate poor results, as risk and reward tend to travel together in commerce; and (2) law-trained judges might not have the ideal training or mindset to assess whether a business decision that turned out wrong had resulted from inadequate contemplation, especially when business fiduciaries have to make a business judgment about how much time they devote to particular decisions.

When these questions began to arise, it was not even yet common for Delaware courts to have labeled them questions of "fiduciary" responsibility. The first use of the word "fiduciary" in a reported Delaware case did not occur until 1841.[4] Not until 1888 did a Delaware court recite that directors and officers stand in a fiduciary relationship with the corporation and its stockholders.[5]

Just fifty years later, however, the Delaware Supreme Court spoke confidently of a rule of fiduciary law, applicable to corporate directors and officers, and based on "[a] public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives."[6]

[4] *State v. Platt*, 4 Del. 154, 162 (1844) (reciting counsel's argument that the prohibition against compensation not agreed to "applies not only to trustees, strictly, but to all who are invested with a fiduciary character.").

[5] *Diamond State Iron Co. v Todd*, 14 A. 27, 33 (Del. Ch. 1888) ("The defendant Todd, as secretary, officer, and agent of the company, stood toward the company, its stockholders . . . in a fiduciary relation. He was a trustee for the stockholders. . . . The principle applies to directors of corporations.").

[6] *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939).

In the course of evolving toward what is now known as the business judgment rule and other doctrines such as the entire fairness standard,[7] *Unocal*,[8] and *Revlon*,[9] another key pattern began to emerge that continues to be central to Delaware corporation law: the acknowledgement of the separation between the normative duty owed by a director and the enforceable standard that would be used to hold the director accountable if sued for a breach of that duty. By way of example, in coming to embrace the business judgment rule and a reluctance to employ an after-the-fact review standard to expose business fiduciaries to tort-like negligence liability, the Delaware courts did not wish to suggest to business fiduciaries that they did not owe an obligation, to the corporations and stockholders they served, to act with prudence. As a matter of normative duty, the courts continued to emphasize that directors had a responsibility—a duty of care—to devote serious attention to key corporate decisions and to act reasonably under the circumstances they confronted. But, that did not mean that officers and directors, although required to act with prudence, could be liable for damages if they did not.

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[7] *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983).
[8] *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).
[9] *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

Other contexts gave rise to this same way of speaking: the so-called "acoustic separation"[10] that existed long before scholars gave it that name. In a landmark opinion defining the fiduciary duty of loyalty, the Delaware Supreme Court made the following declarations of legal principle, each of which appear, at least with the benefit of hindsight, to have been overstated and more true in spirit than in letter:

- "The rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest."[11] Or put this way: "Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests."[12] To the contrary, with the informed consent of stockholders or even just disinterested directors, or upon proof that the transaction is fair, a transaction between a corporate director

[10] Melvin Aron Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 FORDHAM L. R. 437, 467 (1993) ("Nevertheless, in some areas the complexity of a standard of review may introduce a kind of partial acoustic separation, because a primary actor may be unable fully to internalize such a standard and understand its operation, and may therefore feel, and in fact be, safer if he operates only under the simpler standard of conduct. To the extent that the law wants primary actors to conform to the standard of conduct, rather than the standard of review, this partial acoustic separation will itself be desirable. . . . "[S]tandards of review, which govern liability and validity, are not themselves standards of conduct. A director or officer who engages in self-interested conduct without having dealt fairly has acted wrongly, even though he is protected against liability by the relevant standard of review."); William T. Allen et. al., *Realigning the Standard of Review of Director Due Care with Delaware Public Policy: A Critique of Van Gorkom and Its Progeny As A Standard of Review Problem*, 96 NW. U. L. REV. 449, 450 (2002) ("Courts therefore play a critical role in preserving the public policy values that are furthered by the divergence between (1) the standard of conduct expected of directors as a normative matter, and (2) the standard of conduct that is judicially enforceable and that is embodied in the gross negligence standard of review.").
[11] *Id.*
[12] *Id.*

or officer and the corporation may be upheld even if the director or officer personally benefits from that transaction.[13]

- Fiduciary duty "demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or to enable it to make in the reasonable and lawful exercise of its powers."[14] Again, hyperbolic: even without the protection of exculpatory provisions in the corporate charter, directors are largely immune from liability for even negligent actions that "work injury to the corporation,"[15] and directors and officers are not accountable if they fail to apply their last ounce of "skill and ability" to benefit the corporation. For example, directors are not liable for harm to the corporation that could have been avoided through greater monitoring effort, unless for an "utter" failure to implement an internal information reporting system or failure to monitor corporate operations in a "sustained or systematic" way.[16]

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[13] *E.g.*, 8 *Del. C.* § 144(a) ("No contract or transaction between a corporation and 1 or more of its directors or officers . . . shall be void solely for this reason . . . if: (1) The material facts as to the director's or officer's relationship or interest and as to the contract or transaction are disclosed or are known to the board of directors . . . and the board . . . authorizes the contract or transaction . . . ."); FOLK, THE DELAWARE GENERAL CORPORATION LAW § 144.01, n. 9 ("[In] Delaware cases decided before the enactment of section 144, interested director transactions were deemed voidable only after an examination of the fairness of a particular transaction vis-à-vis the nonparticipating stockholders and a determination of whether the disputed conduct received the approval of a noninterested majority of directors or stockholders."); *Gerlach v. Gillam*, 139 A.2d 591, 593 (Del. Ch. 1958) (addressing a stock swap) ("[W]here a majority of fully informed stockholders ratify action of even interested directors, an attack on the ratified transaction normally must fail."); *Beard v. Elster*, 160 A.2d 731, 738 (Del. 1960) (addressing employee stock option plan) ("We think the fact that a disinterested Board of Directors reached this decision by the exercise of its business judgment is entitled to the utmost consideration by the courts in passing upon the results of that decision.").

[14] *Id.*

[15] *See infra* notes 28-37.

[16] *In re Caremark Int'l Deriv. Litig.*, 698 A.2d 959, 971 (Del. Ch. 1996); *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 370 (Del. 2006) ("We hold that *Caremark* articulates

But even as it announced these overstated propositions of fiduciary law the Delaware Supreme Court cautioned that these doctrinal principles were not to be applied in a doctrinaire fashion; rather, "[t]he occasions for the determination of honesty, good faith and loyal conduct are many and varied, and no hard and fast rule can be formulated. The standard of loyalty is measured by no fixed scale."[17] Or stated bluntly, when corporate fiduciary responsibility meets the messy world of commerce, context matters. To that context, we now turn.

<u>The Institutional Setting and Philosophical Foundations of Delaware Corporate Fiduciary Law</u>

It is not coincidental that corporate law borrows tools that our nation used to create a republican democracy.[18] Both contexts require a balance between the

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the necessary conditions predicate for director oversight liability: (a) the directors utterly failed to implement any reporting or information system or controls; *or* (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention."); *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 125 (Del. Ch. 2009) ("The Delaware Supreme Court made clear in *Stone* that directors of Delaware corporations have certain responsibilities to implement and monitor a system of oversight; however, this obligation does not eviscerate the core protections of the business judgment rule—protections designed to allow corporate managers and directors to pursue risky transactions without the specter of being held personally liable if those decisions turn out poorly.").

[17] *Guth*, 5 A.2d at 510.

[18] It is also fitting that the foundational article setting forth the agency cost theory of corporate governance begins with a quote from Adam Smith's 1776 seminal book, *The Wealth of Nations*, and was written in 1976, at the nation's Bicentennial. Michael C. Jensen & William H. Meckling, *Theory of the firm: managerial behavior, agency costs and ownership structure*, 3 J. FIN. ECON. 305 (1976). That article basically took Lockean and Federalist thinking that had always infused American corporate law, and expressed that thinking in the form of economic insight without as much attribution as was perhaps warranted. The novelty attributed to the

utility of creating a centralized authority over the affairs of those (in colloquial terms, the citizens) who are the objects of governance actions, and the potential that those given this authority may use it for disloyal reasons. Tools to arrive at the optimal balance involve variations of both republican and direct democracy approaches, such as: requiring citizen approval for constitutional changes or certain types of legislation; periodic elections of office-holders; and the separation of powers.[19] In corporate law, some actions were deemed so important (such as a merger divesting a stockholder of his investment) that they could only be accomplished with unanimous approval.[20] For less momentous managerial actions by fiduciaries, corporate law has achieved accountability, however imprecisely, through the requirement for regular elections, and, in a more targeted way, through judicial review of fiduciary conduct.

That judicial accountability mechanism became increasingly important with the advent in the early 20th century of a highly-enabling statutory framework for corporate law. That framework conferred expansive managerial powers on the

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article by law and economics scholars is, to be candid, surprising to anyone schooled in political science, history, and philosophy.

[19] *Compare* U.S. CONST. art. I, § 2 (election of the House of Representatives every two years) and U.S. CONST. art. V (amendment of the Constitution), *with* 8 *Del. C.* § 211 (requiring annual meeting to elect directors) and 8 *Del. C.* § 242 (requiring majority stockholder approval to amend the certificate of incorporation).

[20] *See Katz v. Bregman*, 431 A.2d 1274, 1275 (Del. Ch. 1981) (unanimous stockholder approval for sales of substantially all assets required at common law); *Salomon Bros., Inc. v. Interstate Bakeries Corp.*, 576 A.2d 650, 652 (Del. Ch. 198) (at common law a single stockholder could veto a merger).

board of directors, powers that are, with discrete but important exceptions, unfettered by any statutory limitation.[21] Voting rights, for example, could not block a majority stockholder from predation, and writing into statutes rules to address this threat risked rigidity and error. Therefore, the equitable overlay—"twice-testing" action, as Berle put it[22]—became a key answer to this problem of checking the potential for abuse of power. Thus, as the Delaware Supreme Court famously held in 1971, judicial inquiry into compliance with fiduciary duty is not foreclosed by formal statutory authorization: "inequitable action does not become permissible simply because it is legally possible."[23]

Depending on fiduciary duty litigation as a gap-filler to protect the interests of stockholders, however, is not without its costs. Judicial review can itself harm stockholders and the public when, for example, it erroneously condemns and imposes sanctions on fiduciaries simply because a decision turned out not to be

[21] Those exceptional limitations include statutory requirements that certain transactions, such as mergers, must be approved by a vote of stockholders (8 *Del. C.* § 251(c)), and that directors must stand for election by the stockholders at least once every three years (8 *Del. C.* § 141(d), 211(b)). Another limitation, derived from the governing statutes' grant of corporate power to conduct "lawful" business, is the obligation to act within the bounds of law applicable to the corporation. 8 *Del. C.* § 101(b); Leo E. Strine, Jr., *et al.*, *Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 GEO. L. J. 629, 650 (2010) ("For a corporate director knowingly to cause the corporation to engage in unlawful acts or activities or enter an unlawful business is disloyal in the most fundamental of senses.").

[22] Adolf A. Berle, *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1049 (1931) ("in every case, corporate action must be twice tested: first, by the technical rules having to do with the existence and proper exercise of the power; second, by equitable rules somewhat analogous to those which apply in favor of a *cestui que trust* to the trustee's exercise of wide powers granted to him in the instrument making him a fiduciary.").

[23] *Schnell v. Chris-Craft Industries, Inc.*, 285 A. 2d 437, 439 (Del. 1971).

profitable, and thereby inhibits future risk taking and overall wealth creation. At each turn in the road of the evolution of Delaware fiduciary law, then, the Delaware courts have had to balance concerns about opportunism or carelessness, unchecked by statute, against the direct and indirect costs of relying on litigation against directors to limit such opportunism or carelessness.

Achieving that balance has generally involved taking a realist approach to understanding commerce and human behavior that aims at increasing stockholder welfare and societal wealth, keeping levels of corruption low, and avoiding the imposition of unnecessary costs. That approach recognizes that if courts were to intervene too readily in business decisions after-the-fact, more hazard than good would result for stockholders. The business judgment rule, in substance and later in name, emerged to reflect the approach Delaware would take. That rule balanced the benefits and risk of centralized management in the following way: where the court was satisfied that the decision was being made by fiduciaries who had no conflict of interest and who had an incentive to make the corporation more profitable, it should not intervene; by stark contrast, where the fiduciaries were conflicted and stood to gain at the expense of the company, the courts would be the most intrusive. By focusing judicial review on those situations when conflicts of interest are present, and even then by tempering it when impartial directors and the disinterested stockholders themselves are given control over the action, the

Delaware courts have attempted to strike the most effective benefit to cost ratio for investors and society.

As a corollary of this approach, however, Delaware courts have had to ensure that director elections are conducted in a fair and credible way. To the extent that Delaware has empowered legitimately-elected directors and is reluctant to interfere with their discretion, Delaware has also had to make sure that those directors were in fact accountable to the stockholders at the ballot box, and did not manipulate the election process.

The balance of this chapter reviews four contexts of judicial review of director activity in which the Delaware courts have developed the approach described above: (1) claims of careless, but disinterested, business decisions (and the articulation of the "business judgment rule"); (2) challenges to mergers (especially freeze-outs) involving a controlling stockholder; (3) claims that directors have improperly deterred an unsolicited takeover bid or sold control of the company for less than full value; and (4) claims that actions by directors adversely affect stockholder voting rights.

The Business Judgment Rule

One of the earliest refinements in Delaware corporate fiduciary law was the articulation of the business judgment rule. Actually, calling this an "early" development is a bit misleading: before 1960 not a single Delaware case invoked the "business judgment rule" by name.[24] But by 1980 the term had become familiar enough that a leading Delaware practitioner traced the business judgment rule doctrine to an 1829 opinion by the Louisiana Supreme Court.[25]

In any event, the concepts underlying the business judgment rule were central to Delaware fiduciary law long before that terminology came into use. Early cases recite that a transaction will be sustained unless it results from "bad faith" or "reckless indifference to the rights of others,"[26] or the price "is so far below what is found to be a fair one that it can be explained only on the theory of fraud, or a reckless indifference to the rights of others interested."[27] The Delaware law of fiduciary duty, whether using the term "business judgment rule" or not, has also precluded director monetary liability for disinterested decisions based on a good faith effort, even if they could be found in hindsight to have been negligent.[28]

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[24] The earliest reported Delaware case using that term is *Beard v. Elster*, 160 A.2d 731, 736 (Del. 1960), referring to "the familiar sound business judgment rule concerning the acts of Directors." But a rash of opinions using the term soon followed. *E.g.*, *Isaacs v. Forer,* 159 A.2d 295, 298 (Del. Ch. 1960); *Mayer v. Adams*, 167 A.2d 729, 731 (Del. Ch. 1961); *Dann v. Chrysler Corp.*, 174 A.2d 696, 701 (1961); *Propp v. Sadacca*, 175 A.2d 33, 38 (1961), *aff'd in part and rev'd in part sub nom. Bennett v. Propp*, 187 A.2d 405 (Del. 1962). The earliest use of the term outside of Delaware was a 1943 opinion of the New York Appellate Division. *Marony v. Applegate*, 266 A.D. 412, 422 (N.Y. App. 1943).

[25] S. Samuel Arsht, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. R. 93, 97 (1979), *citing Percy v. Millaudon*, 8 Mart. (n.s.) 68 (La. 1829).

[26] *Cole v. Nat'l Cash Credit Ass'n*, 156 A. 183, 188 (1931) ("inadequacy must be so gross as to lead the court to conclude that it was due not to an honest error of judgment but rather to bad faith, or to a reckless indifference to the rights of others interested.")

[27] *Allied Chem. & Dye Corp. v. Steel & Tube Co.*, 120 A. 486, 494 (1923).

[28] *E.g., Graham v. Allis-Chalmers Mfg. Co.,* 188 A.2d 125, 130 (Del. 1963) ("a corporate director [may] become liable for losses to the corporation through neglect of duty … [i]f he has recklessly reposed confidence in an obviously untrustworthy employee, has refused or neglected

It was not until relatively recently, however, that the Delaware courts began to expressly articulate the policy balance that the business judgment rule seeks to achieve. In 1996, as his illustrious stint as a jurist drew to a close, and in dismissing claims that directors had breached their duty of care in a series of allegedly negligent management decisions,[29] Chancellor William T. Allen emphasized the absence of any allegations of conflict of interest, and proceeded to recite the foundational common law of the business judgment rule:

> [I]n the absence of facts showing self-dealing or improper motive, a corporate officer or director is not legally responsible to the corporation for losses that may be suffered as a result of a decision that an officer made or that directors authorized in good faith.[30]

He could have ended the opinion there, but didn't. Instead, he carefully laid out the premises of the business judgment rule, using widely accepted economic analysis:[31]

- Because "[s]hareholders can diversify the risks of their corporate investments," they "don't want (or shouldn't rationally want) directors to be risk averse."[32]

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cavalierly to perform his duty as a director, or has ignored either willfully or through inattention obvious danger signs of employee wrongdoing … .").

[29] *Gagliardi v. Trifoods Int'l, Inc.*, 683 A.2d 1049 (Del. Ch. 1996) (dismissing claims challenging decisions to (i) buy a manufacturing plant, a research facility, and new lines of business, (ii) approve sales commissions, (iii) pay a consultant for a new name and logo, and (iv) supply inferior products).

[30] *Id.* at 1051.

[31] FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 98-100 (1991).

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

- "But directors will tend to deviate from this rational acceptance of corporate risk *if* in authorizing the corporation to undertake a risky investment, the directors must assume some degree of personal risk relating to *ex post facto* claims of derivative liability for any resulting corporate loss."[33]

- Because corporate directors typically "enjoy (as residual owners) only a very small proportion of any 'upside' gains," but would suffer joint and several liability if they "were to be found liable for a corporate loss from a risky project," "[the] stupefying disjunction between risk and reward for corporate directors threatens undesirable effects."[34]

- "Obviously, it is in the shareholders' economic interest to offer sufficient protection to directors from liability for negligence, etc."[35]

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[33] *Id.*

[34] *Id.*

[35] *Id.* That stockholder interest may explain the Delaware courts' long-standing insistence on proof of "gross" rather than "simple" negligence to establish a breach of the director's duty of care. *See, e.g.*, *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 967, 967 n.6 (Del. Ch. 1996) (using a negligence analysis with the "hypothetical reasonable person" as a reference point to review board decisions would be "injurious to investor interests" because it would encourage "less risky investment projects" and inhibit the corporate form's utility of allowing "diversified investors to accept greater investment risk"); *In re Lear Corp. S'holder Litig.*, 967 A.2d 640, 651–52 (Del. Ch. 2008) ("Precisely so as to ensure that directors are not unduly hampered in taking good faith risks, our law eschews the use of a simple negligence standard. Even where it is possible to hold directors responsible for a breach of the duty of care, Delaware law requires that directors have acted with gross negligence. Unless judges are mindful of the substantial difference between a simple negligence and gross negligence standard, the policy purpose served by Delaware's choice of a gross negligence standard risks being undermined."); *Aronson v. Lewis*, 473 A.2d 805, 812 at n.6 (Del. 1984) ("While the Delaware cases have not been precise in articulating the standard by which the exercise of business judgment is governed, a long line of Delaware cases holds that director liability is predicated on a standard which is less exacting than simple negligence. *Sinclair Oil Corp. v. Levien*, Del.Supr., 280 A.2d 717, 722 (1971), *rev'g,* Del.Ch., 261 A.2d 911 (1969) ('fraud or gross overreaching'); *Getty Oil Co. v. Skelly Oil Co.*, Del.Supr., 267 A.2d 883, 887 (1970), *rev'g,* Del.Ch., 255 A.2d 717 (1969) ('gross and palpable overreaching'); *Warshaw v. Calhoun,* Del.Supr., 221 A.2d 487, 492–93 (1966) ('bad faith . . . or a gross abuse of discretion'); *Moskowitz v. Bantrell,* Del.Supr., 190 A.2d 749, 750 (1963) ('fraud or gross abuse of discretion'); *Penn Mart Realty Co. v. Becker,* Del.Ch., 298 A.2d 349, 351 (1972) ('directors may breach their fiduciary duty . . . by being grossly negligent'); *Kors v. Carey,* Del.Ch., 158 A.2d 136, 140 (1960) ('fraud, misconduct or abuse of discretion'); *Allaun v.*

Other opinions have identified related elements of the rationale for the business judgment rule, including: (i) concern about the institutional capability of the courts to evaluate the merits of business decisions,[36] (ii) the resulting potential for "hindsight bias" in addressing claims for damages based on allegedly negligent conduct,[37] and (iii) the potential excessive precaution costs as a response to potential liability for disinterested but careless action.[38]

As thus explained, the fiduciary duty of care, as circumscribed by the business judgment rule, reflects a policy judgment that the costs to shareholders of using fiduciary duty litigation to police careless (but disinterested) managerial action outweigh any benefits to shareholders in the form of either compensation for harm or encouragement of useful managerial attention and effort.

Consolidated Oil Co., Del.Ch., 147 A. 257, 261 (1929) ('reckless indifference to or a deliberate disregard of the stockholders')."

[36] *E.g.*, *Lewis v. Vogelstein*, 699 A.2d 327, 336 (Del. Ch. 1997) ("Courts are ill-fitted to attempt to weigh the 'adequacy' of consideration . . . .").

[37] *E.g.*, *Prod. Res. Group, L.L.C. v. NCT Group, Inc*., 863 A.2d 772, 777 (Del. Ch. 2004).

[38] *E.g.*, *Solash v. Telex Corp.*, 1988 WL 3587, at *8 (Del. Ch. 1988) (noting that one reason to use a gross negligence standard is because directors sometimes must make difficult decisions about what advisors and how many advisors to use, decisions that have costs in terms of not just money, but time, which is often critical in the business world). *See also* Lawrence A. Hamermesh & A. Gilchrist Sparks III, *Corporate Officers and the Business Judgment Rule: A Reply to Professor Johnson*, 60 BUS. LAW. 865, 873 (2005) ("[T]o avoid liability for merely a negligent breach of the duty of care, officers will engage in unnecessary investigations and obtain unnecessary second and third opinions, thereby causing the corporation to incur excessive precaution costs.") (citing Donald C. Langevoort, *The Human Nature of Corporate Boards: Laws, Norms, and the Unintended Consequences of Independence and Accountability,* 89 GEO. L.J. 797, 818 (2001) ("Most of the costs of subjecting directors to increased liability risk are well recognized: overprecaution, refusals of good people to serve, demands for increased insurance, indemnification rights, and compensation for the residual risk.").

Freeze-Out Mergers

The polar opposite of disinterested managerial action is when a controlling stockholder—one whose voting power gives it effective control over the composition of the board of directors and over the outcome of any stockholder vote—uses its control to approve a merger in which, in essence, it forcibly acquires the shares held by minority stockholders. In that circumstance, the controller's self-interest is in acquiring the minority's shares at the lowest possible price—an interest directly adverse to the interests of the minority whose shares are being acquired—and nothing in the corporate statute provides any direct, formal constraint on such an exercise of the controller's corporate power. To be sure, Delaware affords minority stockholders the right to seek a judicial determination and award of the "fair value" of their shares, in lieu of the consideration unilaterally imposed by the controlling stockholder,[39] and at times the Delaware courts have flirted with the notion that this statutory appraisal remedy is exclusive, and precludes judicial review for breach of fiduciary duty.[40] But that flirtation never led to a committed relationship,[41] and the Delaware courts have generally

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[39] 8 *Del. C.* § 262.

[40] *Weinberger v. UOP, Inc.*, 457 A.2d 701, 715 (Del. 1983) ("we return to the well established principles of *Stauffer v. Standard Brands, Inc.* and *David J. Greene & Co. v. Schenley Industries, Inc.*, mandating a stockholder's recourse to the basic remedy of an appraisal.") (internal citations omitted).

[41] In *Weinberger* itself, the court acknowledged that "[t]he appraisal remedy we approve may not be adequate in certain cases, particularly where fraud, misrepresentation, self-dealing, deliberate waste of corporate assets, or gross and palpable overreaching are involved." *Id.* at 714.

subjected the unilaterally imposed freezeout of minority shares to the most demanding level of judicial scrutiny: the "entire fairness" standard, which requires the controlling stockholder to establish that the transaction is fair both from financial point of view ("fair price") and from the standpoint of "fair dealing," including how the transaction was timed, negotiated, structured and disclosed.[42] In articulating that standard of judicial review, the Delaware courts have reiterated that it is the proponent of the transaction—the controlling stockholder, in the case of freezeout mergers—who bears the evidentiary burden of demonstrating that the demanding standard has been satisfied.[43]

The Delaware courts have come to recognize, however, that controller freezeout mergers may in some cases benefit minority stockholders, and that the inflexible imposition of a standard ("entire fairness") that inevitably entails detailed and expensive litigation effort is therefore contrary to stockholder interests, because it may unduly deter controllers from engaging in transactions that benefit the minority as well as themselves. The courts have therefore identified and encouraged the use of mechanisms that involve the approval of persons who are independent of the controlling stockholder and can effectively represent the interests of the minority stockholders—either independent members

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[42] *Id.* at 711.

[43] *Id.* at 710, *citing Sterling v. Mayflower Hotel Corp.*, 93 A.2d 107, 110 (Del. 1952); *Bastian v. Bourns, Inc.*, 256 A.2d 680, 681 (Del. Ch. 1969), *aff'd*, 278 A.2d 467 (Del. 1970); *David J. Greene & Co. v. Dunhill International Inc.*, 249 A.2d 427, 431 (Del. Ch. 1968).

of a special committee of directors, or the minority stockholders themselves, or both. In the face of such approvals, the Delaware courts have relaxed the application of the "entire fairness" standard in a variety of ways:

- The Delaware Supreme Court has encouraged controlling stockholders and their transactional planners to engage a committee of independent directors to negotiate the terms of a freezeout merger with the controller.[44] Doing so, the courts stated, might restore judicial deference of the sort contemplated by the business judgment rule.[45]

- In a variety of similar contexts, the Delaware courts suggested that controlling persons might be relieved of the burden of judicial review for "entire fairness" if a majority of minority stockholders, upon disclosure of all material information, voted to approve the transaction.[46]

- In *Kahn v. Lynch* in 1994,[47] the Delaware Supreme Court, explicitly harboring the suspicion that the approval of disinterested persons might not be fully voluntary,[48]

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[44] *Weinberger*, 457 A.2d at 709 n. 7 ("the result here could have been entirely different if UOP had appointed an independent negotiating committee of its outside directors to deal with Signal at arm's length.").

[45] *In re TWA, Inc. Shareholders Litig.*, 1988 Del. Ch. LEXIS 139, *19 (Del. Ch. 1988) ("Both the device of the special negotiating committee of disinterested directors and the device of a merger provision requiring approval by a majority of disinterested shareholders, when properly employed, have the judicial effect of making the substantive law aspect of the business judgment rule applicable and, procedurally, of shifting back to plaintiffs the burden of demonstrating that such a transaction infringes upon rights of minority shareholders.").

[46] *Michelson v. Duncan*, 407 A.2d 211, 223 (Del. 1979); *see also Smith v. Van Gorkom,* 488 A.2d 858, 890 (Del. 1985) ("The settled rule in Delaware is that where a majority of fully informed stockholders ratify action of even interested directors, an attack on the ratified transaction normally must fail.").

[47] *Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1117 (Del. 1994).

[48] *Id*. at 1116-1117 (quoting *Citron v. E.I. DuPont de Nemours & Co*., 584 A. 2d 490, 502 (Del. Ch. 1990) ("Even where no coercion is intended, shareholders voting on a parent subsidiary merger might perceive that their disapproval could risk retaliation of some kind by the controlling stockholder. . . . At the very least, the potential for that perception, and its possible impact upon a shareholder vote, could never be fully eliminated.").

> established that, despite such approvals relaxing the burden of the controlling stockholder to prove fairness, courts would still be required to evaluate the fairness of the transaction. Such approvals would merely shift to the minority stockholders the burden of establishing that the transaction was not entirely fair to them.[49]

But the evolutionary process did not end there. Over time, the Delaware courts recognized there was no way to escape judicial review of entire fairness and the concomitant costs and uncertainties of litigation. This led to a period of Kabuki settlements, where plaintiffs' lawyers were paid fees by settling and not challenging a merger whose price had been negotiated by a special committee.[50] Most important, controlling stockholders had no incentive to submit to approval by a committee of disinterested directors *and* by a majority of the minority stockholders. Under a literal reading of dictum in *Kahn v. Lynch*, a controlling

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[49] *Id.* at 1117 ("even when an interested cash-out merger transaction receives the informed approval of a majority of minority stockholders or an independent committee of disinterested directors, an entire fairness analysis is the only proper standard of judicial review.").

[50] *See* Elliott J. Weiss & Lawrence J. White, *File Early, Then Free Ride: How Delaware Law (Mis)shapes Shareholder Class Actions*, 57 VAND. L. REV. 1797, 1829, 1881 (2004) (finding that, for the 31 merger challenges between 1999 and 2001 that resulted in settlements including monetary recovery, the average legal fees paid to plaintiff attorneys totaled $2,814,000, despite the fact that "plaintiffs' attorneys frequently were able to free ride on the improved terms negotiated by SNCs or on the price improvements that resulted from competing bids, that they rarely claimed a major share of the credit for the improvements, and that they never persisted in challenging the terms negotiated by an SNC or the terms proposed by a competing bidder."). *See also In re Cox Commc'ns, Inc. Shareholders Litig.*, 879 A.2d 604, 621 (Del. Ch. 2005) ("[T]he record contains a shocking omission—the inability of the plaintiffs, despite their production of expert affidavits, to point to one instance in the precise context of a case of this kind (i.e., cases started by attacks on negotiable going-private proposals) of the plaintiffs' lawyers refusing to settle once a special committee has agreed on price with a controller.").

stockholder got no added benefit from using more than one of these devices.[51] And all that was was a burden shift, and no option to obtain dismissal at the pleading stage.[52] Accordingly, the courts took up the challenge of defining a set of procedures that would engage independent decision makers in a manner sufficient to relieve concerns about abuse and intimidation by the controller and permit application of the business judgment rule. Most importantly, the courts recognized that the law was inhibiting the transactional structure most likely to serve the interests of minority stockholders, and to facilitate beneficial, fair transactions without reliance on unprofitable litigation that burdens the cost of capital: what stockholders get under the Delaware General Corporation Law ("DGCL") in an

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[51] *Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1117 (Del. 1994) ("an approval of the transaction by an independent committee of directors *or* an informed majority of minority shareholders shifts the burden of proof on the issue of fairness from the controlling or dominating shareholder to the challenging shareholder-plaintiff.") (emphasis added); *In re MFW Shareholders Litig.*, 67 A.3d 496, 501 (Del. Ch. 2013), *aff'd sub nom. Kahn v. M & F Worldwide Corp.*, 88 A.3d 635 (Del. 2014) ("For controlling stockholders who knew that they would get a burden shift if they did one of the procedural protections, but who did not know if they would get any additional benefit for taking the certain business risk of assenting to an additional and potent procedural protection for the minority stockholders, the incentive to use both procedural devices and thus replicate the key elements of the arm's-length merger process was therefore minimal to downright discouraging.").

[52] *In re MFW Shareholders Litig.*, 67 A.3d 496, 525 (Del. Ch. 2013), *aff'd sub nom. Kahn v. M & F Worldwide Corp.*, 88 A.3d 635 (Del. 2014) ("the absence of a legally recognized transaction structure that can invoke the business judgment rule standard of review has resulted not in litigation that generates tangible positive results for minority stockholders in the form of additional money in their pockets, but in litigation that is settled for fees because there is no practical way of getting the case dismissed at the pleading stage and the costs of discovery and entanglement in multiyear litigation exceed the costs of paying attorneys' fees.").

arms-length merger—negotiation of the merger terms by impartial fiduciaries *and* the ability of the electorate to accept or approve the work product.[53]

What emerged from this challenge—and represents the current (although surely not the final) state of evolution—is the Delaware Supreme Court's 2014 opinion in *Kahn v. M&F Worldwide Corp* ("*MFW*").[54] In that case, the court (adopting the reasoning of the Court of Chancery) explained, as follows, why the business judgment rule "should govern mergers between a controlling stockholder and its corporate subsidiary, where the merger is conditioned *ab initio* upon both the approval of an independent, adequately-empowered Special Committee that fulfills its duty of care; and the uncoerced, informed vote of a majority of the minority stockholders:"[55]

- "[W]hen these two protections are established up-front, a potent tool to extract good value for the minority is established. From inception, the controlling stockholder knows that it cannot bypass the special committee's ability to say no.

[53] *In re MFW Shareholders Litig.*, 67 A.3d 496, 503-504 (Del. Ch. 2013), *aff'd sub nom. Kahn v. M & F Worldwide Corp.*, 88 A.3d 635 (Del. 2014) ("A majority-of-the-minority vote provides stockholders a chance to vote on a merger proposed by a controller-dominated board, but with no chance to have an independent bargaining agent work on their behalf to negotiate the merger price, and determine whether it is a favorable one that the bargaining agent commends to the minority stockholders for acceptance at a vote. These protections are therefore incomplete and not substitutes, but are complementary and effective in tandem. . . . [B]y also providing transactional planners with a basis to structure transactions from the beginning in a manner that, if properly implemented, qualifies for the business judgment rule, the benefit-to-cost ratio of litigation challenging controlling stockholders for investors in Delaware corporations will improve, as suits will not have settlement value simply because there is no feasible way for defendants to get them dismissed on the pleadings.").
[54] 88 A.3d 635 (Del. 2014), *aff'g In re MFW S'holders Litig.*, 67 A.3d 496 (Del. Ch. 2013).
[55] *Id*. at 644.

And, the controlling stockholder knows it cannot dangle a majority-of-the-minority vote before the special committee late in the process as a deal-closer rather than having to make a price move."[56]

- The two-part approval structure "is consistent with the central tradition of Delaware law, which defers to the informed decisions of impartial directors, especially when those decisions have been approved by the disinterested stockholders on full information and without coercion."[57]

- "Not only that, the adoption of this rule will be of benefit to minority stockholders because it will provide a strong incentive for controlling stockholders to accord minority investors the transactional structure that respected scholars believe will provide them the best protection, a structure where stockholders get the benefits of independent, empowered negotiating agents to bargain for the best price and say no if the agents believe the deal is not advisable for any proper reason, plus the critical ability to determine for themselves whether to accept any deal that their negotiating agents recommend to them."[58]

As is the case generally with equitable concepts such as fiduciary duty, it became clear that courts would not tolerate a rote, hollow application of the rule announced in *MFW*: where it appeared that the two-part approval structure was abused through manipulative and incomplete disclosures by the controlling stockholder, the protection otherwise available through use of that structure

[56] *Id.*
[57] As the Court of Chancery pointed out, the structure also replicated the expected statutory protections for arms-length mergers: (i) a set of fiduciaries, the board, negotiate the merger; (ii) subject to the rights of the electorate to approve or reject the work product. *Id.* at 644.
[58] *Id.*

disappeared.[59] As thus refined, the reasoning in Delaware case law governing mergers initiated by controlling stockholders implements the core principle of Delaware fiduciary law by providing incentives to place corporate decisions in the hands of those most inclined to make those decisions in the interests of the corporation and its stockholders, free of motivations that conflict with those interests.

Mergers and Acquisitions

Takeover Defenses

Perhaps even more than other common law traditions, corporate fiduciary duty doctrine cannot be "static";[60] it must address new developments in commercial practice and other realms of human experience. This proposition was illustrated, particularly in the 1980s, when the Delaware courts were called upon to examine and apply fiduciary duty principles to actions taken by corporate directors in connection with the then novel tactic of inviting stockholders to tender their shares in response to a general, open offer (a "tender offer") to acquire their shares, and thereby acquire control of the company, without the approval of the board of

[59] *In re Dole Food Co. Stockholder Litig.*, 2015 Del. Ch. LEXIS 223, *3 (Del. Ch. Aug. 2015) ("Despite mimicking *MFW*'s form, Murdock did not adhere to its substance. He and his right-hand man, defendant C. Michael Carter, sought to undermine the Committee from the start, and they continued their efforts throughout the process.").

[60] "Our corporate law is not static. It must grow and develop in response to, indeed in anticipation of, evolving concepts and needs." *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 957 (Del. 1985).

directors (as would be required, under the governing statute, for an acquisition of control by means of a merger).

The tender offer tactic posed two questions previously unanswered by the Delaware law of fiduciary duty. The first question was jurisdictional, in a sense: put colloquially, was it any business of the directors to insinuate their authority into the question of whether stockholders chose to sell their shares—their own property—to a tender offeror? Second, and if so, by what standard of review should the courts evaluate the actions of directors that might, by design or not, impair the stockholders' ability to tender their own shares?

These two questions provoked intense debate. One side advanced two principal contentions: (i) corporate acquisitions by tender offer ought to be viewed as equivalent to acquisitions by merger, and therefore the directors' role in responding to a tender offer should be no less active than in the case of a statutory merger, in which the directors' prior approval is indispensable; and (ii) the courts should examine director action no less deferentially (*i.e.*, under the business judgment rule) than would be the case in such a merger.[61] The opposing side contended that (i) stockholders, protected by laws requiring disclosure of relevant material information, should decide for themselves whether to tender their shares, free from director action interfering with that decision; (ii) there was no statutory

[61] This school of thought was advocated most notably by Martin Lipton, in *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101 (1979).

basis for directors to intervene to block a tender offer addressed solely to stockholders and not requiring corporate approval; and (iii) even if there were such authority, because of the directors' self-interest in preserving their control, any such action should be subject to judicial review under the demanding standard of entire fairness.[62]

In 1985, in what in hindsight seems like an extraordinarily compressed time frame, the Delaware Supreme Court faced and decided these two fundamental questions, but in a way that did not adopt wholesale the views of either of the contending sides. In its famous opinion in *Unocal Corp. v. Mesa Petroleum Co.*, the Court readily resolved the threshold question of the board's authority in regard to tender offers: consistent with the notion that the board of directors has a "fundamental duty and obligation to protect the corporate enterprise, which includes stockholders, from harm reasonably perceived, irrespective of its source," the Court was "satisfied that in the broad context of corporate governance, including issues of fundamental corporate change, a board of directors is not a passive instrumentality."[63]

That ruling could be said to follow plausibly from the broad powers conferred on the board of directors by the enabling corporate statutes, although it

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[62] The most visible advocates for this view, sometimes known as the director passivity thesis, were Frank H. Easterbrook and Daniel R. Fischel, in *The Proper Role of a Target's Board in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981).

[63] *Unocal*, 493 A.2d at 954.

involved some audacity to define, as "managing" the corporation, the use of defensive action to respond to a tender offer addressed solely to stockholders and in which the corporation had no statutory role. For that reason, the Court's citation to supporting authority was unusual in that it seemed largely built of federal cases that were still quite recent.[64] Consistent with the lack of established doctrine that directors could in fact impede tender offers, there was even less guidance to draw on about what standard of review to employ if they did so. On this question, both sides had a legitimate point: on the side of the advocates for judicial deference, directors adopting antitakeover measures do not inherently have a financial interest that is directly adverse to the corporation and its stockholders, so the traditional justification for the strictest form of judicial scrutiny is lacking; and on the side of director passivity, it is undeniable that there is at least some degree of inappropriate motivation—whether called fee-driven entrenchment or "circle the wagons" mentality—at work when directors engage in antitakeover actions.[65]

Faced with this novel and seemingly irreconcilable clash of views, the Delaware Supreme Court adopted neither side's contention with regard to the

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[64] *Id.* at 954-55 (citing four federal cases less than eight years old to support the assertion that "the board's power to act derives from its fundamental duty and obligation to protect the corporate enterprise, which includes stockholders, from harm reasonably perceived, irrespective of its source").

[65] Ronald J. Gilson, *A Structural Approach To Corporations: The Case Against Defensive Tactics In Tender Offers*, 33 STAN. L. REV. 819, 821-831 & 845-48 & 875-81 (1981).

standard of review. In one breath, the Court gave a nod to judicial deference, writing that, in addressing a takeover bid, "a board's duty is no different from any other responsibility it shoulders, and its decisions should be no less entitled to the respect they otherwise would be accorded in the realm of business judgment."[66] But in the very next breath, the Court noted that there were "certain caveats" to this deference:

> Because of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders, there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred.[67]

The Court defined the scope of that threshold "judicial examination" by requiring that the directors "show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed."[68] To make that showing, directors were required to "show[] good faith and reasonable investigation."[69] But to encourage decision making by the directors least likely to be motivated by selfish considerations, the Court noted that "such proof [of good faith and reasonable investigation] is materially enhanced . . . by the approval of a board comprised of a majority of outside independent directors . . . ."[70]

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[66] *Unocal*, 493 A.2d at 954.
[67] *Id.*
[68] *Id.* at 955.
[69] *Id.*
[70] *Id.*

More provocatively, the Court imposed a further requirement for validating antitakeover action by directors: specifically, it called on the courts to engage in a substantive evaluation of the reasonableness of that action, requiring that "[i]f a defensive measure is to come within the ambit of the business judgment rule, it must be reasonable in relation to the threat posed."[71] And in an early application of the *Unocal* doctrine, the Delaware Supreme Court made it clear that the presence of a strong majority of outside, independent directors, coupled with investment banker advice, would "constitute a *prima facie* showing of good faith and reasonable investigation," and would impose upon a plaintiff stockholder "a heavy burden of overcoming the presumptions attaching to the board's decisions" in responding to a takeover bid.[72] In so ruling, the Court again manifested its traditional inclination to place important corporate decisions in the informed hands of persons most capable of evaluating them objectively.

Since *Unocal*, this heightened form of judicial scrutiny has been refined and used to address important issues such as the reasonableness of deal protection measures like termination fees and no-shop provisions in merger and acquisition transactions.[73] Through this flexible tool of heightened reasonable review and the

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[71] *Id.*
[72] *Polk v. Good*, 507 A.2d 531, 537 (Del. 1986).
[73] *See, e.g.*, Fernán Restrepo & Guhan Subramanian, *The New Look of Deal Protection*, 69 STAN. L. REV. 1013, 1016 (2017) ("Around the [early 2000's] . . . the courts began to signal that 4-5% was at the very high end of what would be tolerated. . . . [T]his guidance has had the desired

encouragement it gives to shifting power to the independent directors of boards, the Delaware courts have been able to cabin the tendency of practitioners to push the limits of the acceptable and, even more importantly, instill a sense of fiduciary responsibility in boards that has led to boards themselves avoiding preclusive and coercive action, obviating the need for judicial intervention.

The balance struck under *Unocal* took into account two important contextual considerations. First, the Delaware courts relied on the potent voting power that stockholders have under our law to elect a new board. In the calculus of how to approach director action, the Delaware courts thus fashioned an approach that considered the potential utility to stockholders of active negotiating and defensive power by faithful fiduciaries, within an accountability structure where the incumbents were strictly precluded from interfering with the ability of the stockholders to replace them if they disagreed with their reaction to a takeover bid. In other words, the authorization of boards to engage in defensive action was not only subject to heightened scrutiny under *Unocal* itself, it was subject to stockholder monitoring within a legal structure that strictly policed electoral manipulation, a subject we discuss again later.

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effect: termination fees for Delaware targets (including any additive expense reimbursement) have capped out at just below this level . . . .") (citing *In Re Topps Co. S'holders Litig.*, *In re Answers Corp. S'holders Litig.*, 2011 WL 1366780 (Del. Ch. 2011); *In re Comverge, Inc. S'holders Litig*., 2014 WL 6686570 (Del. Ch. 2014); *Phelps Dodge Corp. v. Cyprus Amax Minerals Co.*, 1999 WL 1054255 (Del. Ch. 1999)).

The second contextual consideration for *Unocal*'s balance is the fact that, like many key cases in its era, *Unocal* involved an inquiry into whether to grant injunctive relief, and did not necessarily articulate the standard of review used in a claim for money damages for breach of fiduciary duty. The Delaware courts' use of the heightened reasonableness standard—which is similar to the review used in other tort contexts—thus does not pose a concern to directors that they will face monetary liability if a court enjoins their actions as unreasonable. This use of a stricter standard of review to govern injunctions illustrates again the attempt of Delaware to consider the dynamic factors in play and strike a sensible balance.

Change of Control Mergers

Another lasting legacy of the takeover era was the robust role for judicial review when control of the company was being sold. The opening salvo was the proto-*Revlon* case of *Smith v. Van Gorkom*[74]—where the Delaware Supreme Court, presumably aware that recognizing board power in takeovers meant taking board responsibilities in company sales seriously—actually held directors personally liable in monetary damages for lack of care. The adoption of exculpatory charter provisions eliminating director monetary liability for lack of care[75] may have

[74] 488 A.2d 858 (Del. 1985).
[75] As authorized by 8 *Del. C.* § 102(b)(7).

largely eliminated litigation asserting only such claims of liability,[76] but the underlying legacy of intensive fiduciary review of director actions on change of control mergers did not go away.

The engine that propelled that review was the kind of sale case scholars and institutional investors had warned about: one where a board allegedly resisted an unsolicited takeover bid and undertook to sell the company, not for the highest price, but to someone else than the original, higher bidder the CEO disliked. In *Revlon, Inc. v. MacAndrews & Forbes*, the defensive response of the board (after it adopted a rights plan and completed a tender offer for its own stock) was entering into a negotiated, or "friendly," acquisition by a private equity firm.[77] The deal was protected by an arsenal of devices—asset options, no-shop clauses, a termination fee, etc.—all structured (intentionally or not) to deter the competing hostile bid. In that context was born the *Revlon* doctrine, which not only stood for the unexceptional proposition that directors who sell the company should obtain the highest price reasonably available (why settle for less?),[78] but also for the

[76] *Corwin v. KKR Financial Holdings LLC*, 125 A.3d 304, 312 (Del. 2015) ("with the prevalence of exculpatory charter provisions, due care liability is rarely even available.").
[77] 573 A.2d 106 (Del. 1986).
[78] *See Paramount Commc'ns Inc. v. Time Inc.*, 1989 WL 79880, at *25 (Del. Ch. 1989), *aff'd*, 571 A.2d 1140 (Del. 1989) ("I have earlier expressed the view that *Revlon* was not a radical departure from existing Delaware, or other, law (i.e., it has 'always' been the case that when a trustee or other fiduciary sells an asset for cash, his duty is to seek the single goal of getting the best available price . . . ."); *City Capital Associates Ltd. P'ship v. Interco Inc.*, 551 A.2d 787, 802 (Del. Ch. 1988) (citing *Robinson v. Pittsburgh Oil Refining Corp.*, 126 A. 46, 49 (Del. Ch. 1924) as support for the proposition that "[Revlon's] holding that the board could not prefer one bidder

proposition that courts must review the directors' conduct in the sale using a form of enhanced scrutiny parallel to what the Court created in *Unocal*.

In the years since *Revlon* was decided, the Delaware courts have articulated a variety of possible rationales for this degree of scrutiny of decisions to sell the corporation:

- Does the defensive character of the sale, as in *Revlon* itself, warrant such scrutiny? If so, such scrutiny would perhaps be limited to situations in which the sale responds to a hostile bid. But *Revlon* has never been so limited.[79]

- Does enhanced scrutiny stem from the fact that in a transfer and concentration of control in the buyer, the stockholders lose control rights (voting rights) and any future opportunity to realize a control premium in the sale of their shares?[80] If so, *Revlon*-enhanced scrutiny would be limited—as it in fact has been—largely to cash acquisitions, and would not apply broadly to mergers in which target stockholders receive stock in an acquirer with no controlling stockholder, although *Unocal* would still police the deal protections in the mergers because of their defensive utility.
- Does enhanced scrutiny stem from a concern about a last period problem in which the selling corporation's directors will no

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to another but was required to permit the auction to proceed to its highest price unimpeded, can be seen as an application of traditional Delaware law: a fiduciary cannot sell for less when more is available on similar terms.").

[79] A sale of the company in response to a takeover bid is only one of three distinct, disjunctive bases for applying enhanced judicial scrutiny; the other two do not necessarily involve a predicate hostile bid. *Arnold v. Soc'y for Savings Bancorp*, 650 A.2d 1270, 1289-1290 (Del. 1995).

[80] *Paramount Commc'ns, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 45 (Del. 1993) (enhanced scrutiny "is mandated by: (a) the threatened diminution of the current stockholders' voting power; (b) the fact that an asset belong to public stockholders (a control premium) is being sold and may never be available again; and (c) the traditional concern of Delaware courts for actions which impair or impede stockholder voting rights.") (internal citations omitted).

> longer be accountable to stockholders?[81] If so, such scrutiny would be applied to all mergers in which the target's directors cease to hold office after the deal, but that has never been the case for stock for stock mergers.[82]

As has been the case with its application of the related *Unocal* doctrine, *Revlon* has been applied with a sensitivity to the underlying value of active but faithful fiduciary conduct. Thus, when board behavior has been led by the independent elements of the board, the courts have been more reluctant to intrude.[83] Where, by contrast, for example, the board seemed to defer to a self-interested CEO and allow him to dictate events, *Revlon's* bite has been quite severe.[84] This emphasis on stand-up behavior by the independent elements of the board, which is reflected in *Van Gorkom*, *Unocal*, *Revlon*, and *QVC*, is also rooted in the recognition that the decision to consider defensive action against tender offers an aspect of managerial behavior would be seen as an unprincipled sop to insiders, unless there was a corresponding recognition of the dangers of self-interest in the M&A context and thus an expectation that the impartial elements of

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[81] J. Travis Laster, *Revlon Is a Standard of Review: Why It's True and What It Means*, 19 FORDHAM J. CORP. & FIN. L. 5 (2013).

[82] *Arnold*, 650 A.2d at 1290 (no enhanced scrutiny where control remains in a "large, fluid, changeable and changing market").

[83] *Time Warner* and *Unocal* are good examples of this. *Paramount Commc'ns, Inc. v. Time Inc.*, 571 A.2d 1140, 1154 (Del. 1989); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 949 (Del. 1985).

[84] *Van Gorkom*, *Revlon*, and *QVC* are famous instances of this kind. *Smith v. Van Gorkom*, 488 A.2d 858, 866 (Del. 1985); *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 177 (Del. 1986); *Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 51 (Del. 1994).

the board would be expected to be called upon to protect the interests of stockholders. As is also the case with *Unocal* scrutiny, *Revlon* review has been contextual and not rigid, reflecting an understanding of the dynamic nature of commerce. Out of the cases have thus emerged guideposts to good practices, but not strict, bright-line rules.

Like *Unocal*, *Revlon* is a doctrinal tool that is focused on considering injunctive relief if boards take action that would cause irreparable harm by impeding the ability of stockholders to get the best deal reasonably attainable. Thus, when an injunction is not at issue and stockholders are seeking to hold a board liable for damages for approving an arms-length sale, the *Revlon* standard of reasonableness is not the test. Typically, because of the prevalence of exculpatory charter provisions, the plaintiff must plead that the directors knowingly breached their fiduciary duty of loyalty.[85]

And, if the disinterested stockholders themselves grant informed approval of the transaction, the business judgment rule applies and bars a damages action. In its opinion in *Corwin v. KKR Financial Holdings LLC*, the Delaware Supreme Court merely reaffirmed the long-standing principle of Delaware law, that "the

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[85] *Leal v. Meeks (In re Cornerstone Therapeutics, Inc.)*, 115 A.3d 1173, 1175-76 (Del. 2015) ("A plaintiff seeking only monetary damages must plead non-exculpated claims against a director who is protected by an exculpatory charter provision to survive a motion to dismiss, regardless of the underlying standard of review for the board's conduct—be it *Revlon*, *Unocal*, the entire fairness standard, or the business judgment rule.").

approval of the disinterested stockholders in a fully informed, uncoerced vote that was required to consummate a transaction has the effect of invoking the business judgment rule."[86] As *MFW* did in the context of addressing transactions with controlling stockholders,[87] the Court in *Corwin* expressly took account of the balance between the benefits and costs of judicial review of fiduciary conduct. The Court first emphasized the decisional autonomy of the stockholders, and recognized that active judicial involvement in review of fiduciary conduct inevitably imposes systemic costs due to unpredictability as well as out of pocket litigation expense:

> [W]hen a transaction is not subject to the entire fairness standard, the long-standing policy of our law has been to avoid the uncertainties and costs of judicial second-guessing when the disinterested stockholders have had the free and informed chance to decide on the economic merits of a transaction for themselves.[88]

As the Court elaborated, "there are sound reasons for this policy. When the real parties in interest—the disinterested equity owners—can easily protect themselves at the ballot box by simply voting no, the utility of a litigation-intrusive standard of review promises more costs to stockholders in the form of litigation rents and inhibitions on risk-taking than it promises in terms of benefits to them."[89]

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[86] 125 A.3d 304, 309 n. 19 (Del. 2015) (citing Delaware precedents dating back to 1928).
[87] *MFW*, 88 A.3d 635.
[88] *Corwin*, 125 A.3d at 312-313.
[89] *Id.*

Under this approach, then, the court focuses on whether the stockholder vote has integrity—in other words—is "free and informed." As the Court explained in *Corwin*, the doctrine that the stockholder vote invokes the business judgment rule "applies only to fully informed, uncoerced stockholder votes, and if troubling facts regarding director behavior were not disclosed that would have been material to a voting stockholder, then the business judgment rule is not invoked."[90]

Voting Manipulation and Entrenchment

As can be seen in each of the contexts previously discussed, the availability and integrity of a stockholder vote—to elect directors, or to approve or disapprove a merger—is a critical determinant of the level of judicial review of fiduciary conduct, and a key justification for judicial deference to director action. It is therefore not surprising that the Delaware courts have been vigilant to prevent directors from undermining the integrity of the stockholder vote.

At one point in the development of the Delaware law on the subject, one might have concluded that judicial protection of the vote was limited to policing against director actions that were improperly motivated or affirmatively fraudulent. In early cases on the subject, it was thus common for the courts to caution against director actions having a "sole or primary purpose" of entrenching their positions

[90] *Id.* at 312.

as directors.[91] Taken literally, that test might have had little practical bite: judicial protection of the stockholder franchise might have been limited to cases where a stockholder could somehow demonstrate actual, subjective improper motive on the part of the board.

The Delaware courts have since made clear, however, that the protection of stockholder voting rights is not limited to such cases. Instead, the courts began to treat certain impairments of stockholder voting rights as improperly motivated *per se*, without the need for proof of subjective improper intent. Thus, in *Schnell v. Chris-Craft*, the Court ruled that it was the *objective* circumstances that themselves established the requisite improper purpose: amending bylaws to advance the date for a meeting to elect directors and thereby leave the dissidents "little chance" to succeed in the election contest "amount to a finding that management has attempted to utilize the corporate machinery and the Delaware Law for the purpose of perpetuating itself in office . . . ."[92]

That judicial approach foreshadowed the even clearer solicitude for the protection of the stockholder franchise in the landmark opinion in *Blasius Corp. v. Atlas Industries, Inc.*[93] Briefly, that case involved an action by directors that

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[91] *E.g.*, *Cheff v. Mathes*, 199 A.2d 548, 554 (Del. 1964) ("if the board has acted solely or primarily for the purpose of perpetuating themselves in office, the use of corporate funds for such purposes is improper.").
[92] 285 A.2d at 439.
[93] 564 A.2d 651 (Del. Ch. 1988).

effectively cut off a pending effort to change the control of the board through an election contest, yet the Court found that the directors' subjective motivation was entirely in good faith to protect the corporation from harm they reasonably perceived would flow from the election of the dissident slate. Nevertheless, and despite the directors' good faith, the *Blasius* Court invalidated the directors' action, not because of entrenchment motivation but because the decision of whom to elect to the board belongs to the stockholders, and—in a classic manifestation of the concept of separation of powers—cannot be usurped by the directors themselves.[94]

Since *Blasius*, the Delaware courts have continued to police inequitable inhibitions of the stockholder franchise, as they have emerged, striking down things like "dead hand proxy puts" and "board reduction plans" as unreasonable barriers to the election of new directors.[95] Likewise, precisely because incumbent boards have been given leeway to block takeover bids in good faith, defensive

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[94] *Id.* at 660 (actions designed to impair the franchise cannot be left to the business judgment of the directors).

[95] *Kallick v. Sandridge Energy, Inc.*, 68 A.3d 242, 264 (Del. Ch. 2013) ("there is immediate, irreparable harm when the directors of a corporation leverage a Proxy Put to enhance the incumbent's board chances of procuring stockholder votes in a closely contested election, which could be decided by a few percentage points.") (internal citations omitted); *Pell v. Kill*, 135 A.3d 764, 793 (Del. Ch. 2016) ("[a]bsent an injunction, the Company's stockholders will be prevented from exercising their voting rights by electing three directors at the Annual Meeting. By pre-ordaining the results of the Annual Meeting, the Board Reduction Plan [decreasing the number of Class I board seats up for reelection] deprives stockholders of their right to vote.").

actions that prevent stockholders from electing a new board with a different view have been enjoined as inequitable.[96]

Another now well-established strand of Delaware fiduciary doctrine exists to protect the integrity of the stockholder franchise: namely, the case law establishing and defining the directors' fiduciary duty of disclosure. It is one thing, of course, to condemn director action that deprives stockholders of the opportunity to vote, where they are entitled to do so; it is another thing to ensure that when the stockholders do vote, they are afforded the benefit of the relevant information that is available to the directors who convene the meeting of stockholders and solicit their votes. Thus, one of the critical (and under-appreciated) innovations in the Delaware Supreme Court's 1985 opinion in *Smith v. Van Gorkom* was its establishment of the broad and now familiar requirement that when directors seek stockholder action (as when submitting a merger agreement for stockholder approval), their fiduciary obligations require them to disclose all material information reasonably available to them.[97] Although this obligation exists in publicly held corporations independently under federal law,[98] it remains a bulwark

[96] *Quickturn Design Sys., Inc. v. Shapiro,* 721 A.2d 1281 (Del. 1998) (striking down slow-hand poison pill); *Carmody v. Toll Bros., Inc.*, 723 A.2d 1180 (Del. Ch. 1998) (finding dead hand poison pill coercive).
[97] *E.g., Zirn v. VLI Corp.*, 681 A.2d 1050, 1056 (Del. 1996). For a description of *Van Gorkom*'s innovation in this regard, *see* Lawrence A. Hamermesh, *Calling Off the Lynch Mob: The Corporate Director's Fiduciary Disclosure Duty*, 49 VAND. L. REV. 1087, 1123-1125 (1996).
[98] 17 C.F.R. Regulation 14A: Solicitation of Proxies.

of the Delaware corporate law system's effort to avoid the costs of stockholder litigation challenging the substance of decisions made by disinterested persons, while preserving the role of the courts in policing corporate decisions that are impaired by conflict of interest or inadequate information.

Consistent with these policy concerns, Delaware decisions have been critical in driving fuller disclosure of key information like financial projections relevant to transactional votes,[99] material conflicts of interest,[100] and the process used to reach decisions.[101]

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[99] *See, e.g., In re Pure Res., Inc., Shareholders Litig.*, 808 A.2d 421, 450 (Del. Ch. 2002) ("When controlling stockholders make tender offers, they have large informational advantages that can only be imperfectly overcome by the special committee process, which almost invariably involves directors who are not involved in the day-to-day management of the subsidiary. The retention of financial advisors by special committees is designed to offset some of this asymmetry, and it would seem to be in full keeping with that goal for the minority stockholders to be given a summary of the core analyses of these advisors in circumstances in which the stockholders must protect themselves in the voting or tender process. That this can be done without great burden is demonstrated by the many transactions in which meaningful summary disclosure of bankers' opinions are made, either by choice or by SEC rule.")

[100] *See, e.g., In re El Paso Corp. S'holder Litig.*, 41 A.3d 432, 434 (Del. Ch. 2012) ("The record is filled with debatable negotiating and tactical choices made by El Paso fiduciaries and advisors. Absent a conflict of interest, these debatable choices could be seen as the sort of reasonable . . . ones that must be made in a world of uncertainty. After discovery, however, these choices now must be viewed more skeptically, as the key negotiator on behalf of the Board and a powerfully influential financial advisor each had [undisclosed] financial motives adverse to the best interests of El Paso's stockholders.").

[101] *See, e.g., In re Netsmart Techs., Inc. Shareholders Litig.*, 924 A.2d 171, 177, 209 (Del. Ch. 2007), *judgment entered sub nom. In re NETSMART TECHNOLOGIES, INC. SHAREHOLDERS LITIGATION.* (Del. Ch. 2007) ("The record, as it currently stands, manifests no reasonable, factual basis for the board's conclusion that strategic buyers *in 2006* would not have been interested in Netsmart as it existed *at that time.* . . . [It seems] important for Netsmart to at least disclose this judicial decision or otherwise provide a fuller, more balanced description of the board's actions with regard to the possibility of finding a strategic buyer. As the Proxy now stands, its description of that issue leads one to the impression that a more reasoned and thorough decision-making process had been used, and that the process was heavily influenced by earlier

Conclusion

Like all common law doctrines, the Delaware law defining the fiduciary duties of corporate directors has evolved, often rapidly, in the face of commercial change and experience. It will continue to do so. This brief examination of the development of that body of law may guide that future growth, however, by focusing attention on the underlying goals of judicial review of fiduciary conduct. As in the past, that development should be framed by considerations of how to encourage business activity and sensible risk-taking by placing authority for that activity in the hands of those most capable of engaging in it objectively and in the collective interests of the corporation and its stockholders, while reserving a role for active judicial scrutiny in situations in which such objective decision makers are either absent or impaired, through lack of pertinent information or otherwise, from making a truly voluntary decision.

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searches for a strategic buyer that provided a reliable basis for concluding that no strategic buyer interest existed in 2006.").