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Saying Yes: Reviewing Board Decisions to Sell or Merge the Corporation

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SAYING YES: REVIEWING BOARD DECISIONS TO SELL OR MERGE THE CORPORATION

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ABSTRACT

This Article responds to the explosion in litigation challenging board decisions to sell or merge the corporation by undertaking a comprehensive examination of the standards courts use and should use for reviewing such decisions. This examination is unique both in its breath and in its return to first principals by framing the analysis around the three goals for judicial review of board decisions generally. It shows that current Delaware law on the topic often is a muddle—which results from the failure to match standards with these goals. It explores when, in light of these goals, review of decisions to sell or merge calls for different standards than are used to review other decisions of corporate boards. This, in turn, leads to a proposal narrowing and refining the circumstances in which courts should review decisions to sell or merge under different standards than applied to other board decisions, as well as guidelines as to what such standards should entail.

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I. INTRODUCTION

The archetype corporate litigation of the 1980s challenged takeover defenses used by a corporate board seeking to fend off a hostile tender offer (situations in which the board says "no" to a buyer).[1] Today, the archetype corporate litigation challenges the decision by a corporate board to sell or merge the company (situations in which the board says "yes" to a buyer). Presently, most sales or mergers of public companies for over $100 million spawn multiple lawsuits complaining that the directors breached their fiduciary duties.[2]

To some extent, the explosion in litigation over saying yes is an outgrowth of the explosion in litigation over saying no. Saying yes to one buyer says no to other prospective buyers. This sort of Janus-like quality not only has fomented increasing litigation over board decisions to sell or merge the company, but also has produced a complex and confusing doctrinal response by the courts.

Traditionally, courts had started from the premise that the board's decision to sell or merge the company was not essentially different from any other decision by the board. Thus, it is subject to the business judgment rule under which courts will defer to the directors, barring some

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1. *See, e.g.*, Ronald J. Gilson, *Unocal Fifteen Years Later (and What We Can Do about It)*, 26 DEL. J. CORP. L. 491 (2001) (discussing the causes and judicial responses to the wave of litigation over defenses against hostile tender offers).

2. *E.g.*, Matthew D. Cain, et al., *The Shifting Tides of Merger Litigation*, VAND. L. REV. (forthcoming 2018), https://ssrn.com/abstract=2922121 [https://perma.cc/NY5Z-Y8HN].

conflicting relationship of directors with the buyer or an egregious lack of care.[3] By contrast, courts have recognized that actions by boards to fend off hostile tender offers involve something of a conflict of interest insofar as directors may be motivated by the desire to preserve their positions. Hence, such actions are subject to greater judicial scrutiny—the *Unocal* doctrine in Delaware—under which courts evaluate the reasonableness of the board's action.[4] However, since selling to one buyer may have the purpose or effect of fending off hostile tender offers from other prospective buyers, the way is open to argue that greater scrutiny than the business judgment rule is the appropriate standard for reviewing a challenged decision to sell or merge the company.

Complicating the situation further, corporate statutes do not give the board sole authority when it comes to saying yes. Mergers or sales of substantially all assets normally require a vote of approval by the shareholders.[5] Yet, it is possible to structure some sales or mergers in a way to circumvent these statutory requirements for shareholder approval.[6] More commonly, agreements respond to the requirement of shareholder approval by putting in so-called deal protection devices—termination fees, asset and stock lock-ups, and limitations on the board's action in the interval between agreement and shareholder vote.[7] By penalizing negative votes of the shareholders, some deal protection devices can pressure shareholders into approving a board-favored sale or merger. Depriving shareholders of effective consent either by structuring the deal to avoid a vote or by pressuring a favorable vote through deal protection devices, in turn, raises a further basis for arguing against the application of the business judgment rule.

Beyond this, there are subtler forces at work. The business judgment rule might be understood as a doctrine aimed not at the conduct of directors but at the conduct of judges—restraining the normal human impulse to second-guess the decisions of others.[8] The temptation for courts to second-guess business decisions can grow, however, with the perceived importance of the decision and the degree to which judges feel confident in their ability to evaluate the matter. This means that the magnitude and nature of decisions to sell or merge the corporation and the frequency of litigation challenging such decisions can operate in often unacknowledged

3. *See infra* notes 63-64 and accompanying text.

4. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

5. *E.g.*, DEL. CODE ANN. tit. 8, §§ 251(c), 271(a) (2016); MODEL BUS. CORP. ACT §§ 11.04(b), 12.02 (AM. BAR ASS'N 2010).

6. *See infra* notes 227-29 and accompanying text.

7. *See infra* notes 174-75, 177, 182-83, 194 and accompanying text.

8. *See, e.g.*, Melvin Aron Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 FORDHAM L. REV. 437, 462 (1993).

ways to lead courts away from the self-restraint imposed under the business judgment rule.

As the state of incorporation for the majority of America's public companies,[9] Delaware has had the most opportunity to address the appropriate standards for reviewing board decisions to sell or merge the corporation. It is the nature of common law that repeated visits by courts to a topic might, in some instances, produce greater clarity through the opportunity to refine doctrine and fill in interstices, but, in other instances, it simply produces inconsistency and confusion. Unfortunately, Delaware's experience in reviewing board decisions to sell or merge the corporation has followed the latter trajectory with a proliferation of standards for review triggered at often ill-defined borders and imposing often ill-defined obligations or levels of scrutiny; all of which results in an erratic pattern of judicial second-guessing of some decisions more than others.

The litigation churning in the wake of this doctrinal uncertainty imposes an added transaction tax on the sale or merger of corporations, both for additional shows of process in deciding upon the sale or merger[10] and for defending and settling the lawsuits that follow a large percentage of major deals.[11] It is uncertain whether in aggregate for the totality of all sales and mergers, the better result obtained for the selling shareholders exceeds the cost from this added process and litigation.[12] It is worth keeping in mind, however, that better deals for sellers means worse deals for buyers—a group already subject to the winner's curse in auctions[13] and who, studies suggest, often do not do well as a result of acquisitions.[14] Yet,

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9. *E.g.*, Liz Hoffman, *Dole and Other Companies Sour on Delaware as Corporate Haven,* WALL ST. J. (Aug. 2, 2015, 10:38 PM) (reporting that fifty-four percent of public companies are incorporated in Delaware).

10. *E.g.*, STEPHEN M. BAINBRIDGE, MERGERS AND ACQUISITIONS 69 (3d ed. 2012) (concluding that fear of litigation probably has resulted in many board decisions being over-processed).

11. *E.g.*, Lyman Johnson, *The Reconfiguring of* Revlon, *in* RESEARCH HANDBOOK ON MERGERS AND ACQUISITIONS 263, 278 (Claire A. Hill & Steven Davidoff Solomon eds., 2016) (Attorney's fees in settlements of cases challenging mergers "essentially represent a kind of transactional 'excise' tax . . . .").

12. *Compare id.* at 14-17 (courts rarely impose liability for damages or enjoin arms-length mergers), *and* Jill E. Fisch, et al., *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 TEX. L. REV. 557 (2015) (study of settlements of suits challenging mergers shows little of value achieved for the selling corporations' shareholders), *with* C.N.V. Krishnan, et al., *Shareholder Litigation in Mergers and Acquisitions*, 18 J. CORP. FIN. 1248, 1248 (2012) ("[T]he expected rise in takeover premia [from litigation challenging mergers] more than offsets the fall in the probability of deal completion . . . .").

13. The winner's curse in auctions refers to the fact that the successful bidder has paid an amount greater than any other bidder thought the item was worth, and hence, unless the successful bidder has some unique utility from the item or has knowledge that no other bidder has, the successful bidder has probably overpaid.

14. *E.g.*, Julian Franks, et al., *The Postmerger Share-Price Performance of Acquiring Firms*, 29 J. FIN. ECON. 81 (1991).

ironically, it is decisions to sell and, as we shall see, erosion of the business judgment rule that have provoked litigation, while board decisions to buy have provoked fewer challenges and little evident departure from maximum deference under the rule.[15]

Confronting this uncertainty, scholarship addressing judicial review of board decisions to sell or merge the corporation has largely taken fragmented approaches. Some works look at the heightened scrutiny imposed by Delaware courts on decisions to sell or merge in the cases reached by the unfathomable *Revlon* doctrine;[16] other works examine lock-ups and other deal protection devices;[17] and yet other works look at various procedural issues involving class actions challenging board decisions to sell or merge.[18] The result is a description of parts of the elephant that does not make sense of the whole beast.

This Article moves toward filling the gap by undertaking a comprehensive examination of the standards courts use and should use for reviewing board decisions to sell or merge the corporation.[19] Part II of this Article establishes the framework by briefly outlining the goals for judicial review of board decisions generally. This allows Part III to both describe the often-befuddled state of the current law (focusing particularly on Delaware) and compare how the current standards match up against the goals for judicial review. Part IV then steps back to take a wide-angle view of standards compared with goals when it comes to judicial review of

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15. *E.g.*, Ash v. McCall, No. Civ.A. 17132, 2000 WL 1370341 (Del. Ch. 2000) (dismissing claims against directors who approved what turned out to be a disastrous acquisition).

16. For recent articles on *Revlon*, see Stephen M. Bainbridge, *The Geography of* Revlon-*Land*, 81 FORDHAM L. REV. 3277 (2013); Johnson, *supra* note 11; Hon. 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); Mohsen Manesh, *Nearing 30, Is* Revlon *Showing Its Age*, 71 WASH. & LEE L. REV. ONLINE 107 (2014). For my own piece focusing on *Revlon*, see Franklin A. Gevurtz, *Removing* Revlon, 70 WASH. & LEE L. REV. 1485 (2013).

17. For a recent collection of articles addressing deal protections see the Journal of Corporate Law's Symposium, *Ten Years After* Omnicare. *E.g.*, E. Norman Veasey, *Ten Years After* Omnicare*: The Evolving Market for Deal Protection Devices*, 38 J. CORP. L. 891 (2013).

18. For recent articles looking at procedural aspects of class actions challenging mergers, see Matthew D. Cain & Steven Davidoff Solomon, *A Great Game: The Dynamics of State Competition and Litigation*, 100 IOWA L. REV. 465, 469 (2015); Fisch, et al., *supra* note 12; Phillip R. Sumpter, *Adjusting Attorneys' Fee Awards: The Delaware Court of Chancery's Answer to Incentivizing Meritorious Disclosure-Only Settlements*, 15 U. PA. J. BUS. L. 669 (2013); David H. Webber, *Private Policing of Mergers and Acquisitions: An Empirical Assessment of Institutional Lead Plaintiffs in Transactional Class and Derivative Actions*, 38 DEL. J. CORP. L. 907 (2014).

19. In addition, or as an alternative, to charging that the directors breached their fiduciary duty in agreeing to the transaction, lawsuits challenging corporate sales and mergers also commonly allege incomplete or misleading disclosure to the shareholders, *e.g.*, Fisch, et al., *supra* note 12, at 564, or might pursue (or even be limited to pursuing) a statutory claim to be cashed out at fair value as set by a judicially supervised appraisal. *E.g.*, Glassman v. Unocal Exploration Corp., 777 A.2d 242 (Del. 2001). Discussion of disclosure claims and appraisal rights is beyond the scope of this Article.

decisions to sell or merge. To keep this Article to a manageable length, this view will not be so wide as to reconsider the approach of corporate law to judicial review of board decisions generally. I have said what I have to say about that topic elsewhere.[20] Instead, Part IV will operate from the premise that standards for reviewing board decisions should not vary from decision to decision unless there is some reason for such variance stemming from the goals for judicial review. Following this premise, Part IV will examine both the articulated and unarticulated reasons why courts might subject decisions to sell or merge the corporation to different standards of review from other board decisions and compare these reasons against the goals of judicial review. This will allow us to narrow and refine the circumstances in which courts should apply different standards to decisions to sell or merge. It will also provide more precise insight into what such standards should entail.

II. WHY

Discussing standards for reviewing board decisions to sell or merge the corporation should start at the beginning by asking what courts seek to achieve in reviewing any decision of a corporate board. Indeed, as we shall see, much of the problem with the approach of the Delaware courts when reviewing board decisions to sell or merge the corporation results from the failure to match standards to goals.

Unfortunately, some of the normative literature in this area also tends to lose track of the goals for judicial review. Specifically, many normative discussions speak in terms of bottom line goals—maximizing the amount shareholders profit by a merger or sale,[21] or, even grander, ensuring that sales and mergers move resources to their highest value user[22] or serve as a discipline on inefficient management.[23] This mindset, in turn, leads writers into debates over the merits of board decisions regarding sales and mergers, such as agreeing to lock-ups or other deal protections.[24] Like

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20. Franklin A. Gevurtz, *The Business Judgment Rule: Meaningless Verbiage or Misguided Notion?*, 67 S. CAL. L. REV. 287 (1994).

21. *E.g.*, Sean J. Griffith, *The Costs and Benefits of Precommitment: An Appraisal of* Omnicare v. NCS Healthcare, 29 J. CORP. L. 569, 622 (2004); Brian JM Quinn, *Bulletproof: Mandatory Rules for Deal Protection*, 32 J. CORP. L. 865, 884 (2007).

22. *E.g.*, John C. Coates IV & Guhan Subramanian, *A Buy-Side Model of M&A Lockups: Theory and Evidence*, 53 STAN. L. REV. 307, 377 (2000).

23. *E.g.*, Marcel Kahan & Michael Klausner, *Lockups and the Market for Corporate Control*, 48 STAN. L. REV. 1539, 1553-54 (1996).

24. *See, e.g.*, Ian Ayres, *Analyzing Stock Lock-Ups: Do Target Treasury Sales Foreclose or Facilitate Takeover Auctions?*, 90 COLUM. L. REV. 682 (1990) (arguing that most lock-ups are harmless and should be allowed, but extreme lock-ups under which a bidder profits more by losing than by winning the auction forecloses higher value bidders and therefore should not be allowed); Coates IV & Subramanian, *supra* note 22, at 389-90 (concluding that whether lock-ups are helpful rather than harmful, and therefore should be

it or not, however,[25] corporate law proceeds from a much greater sense of humility when it comes to judicial review for breach of fiduciary duty, with the business judgment rule serving as a sort of Hippocratic Oath cautioning judges to 'first, do no harm.'[26] Perhaps this is because judges (or even academics) who would tell boards what to do might worry about hearing the old challenge: 'If you are so smart, why aren't you rich?'[27]

Focusing our attention then on judicial review, we can identify three basic goals—protecting against disloyal decisions, reducing unintended harm, and policing the allocation of power between boards and shareholders.

A. *Protecting Against Disloyal Decisions*

The most elementary danger of delegating power to act for another's benefit is that persons with such power will use it to benefit themselves (or persons controlling them) at the expense of the parties for whom they are supposed to act.[28] Hence, the first and most fundamental goal of re-

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allowed, depends up a variety of factors); Steven M. Davidoff & Christina M. Sautter, *Lock-up Creep*, 38 J. CORP. L. 681 (2013) (arguing for careful review of lock-ups, since attorneys pursuing their own interests, rather than market forces, are the source of increasingly aggressive use of lock-ups); Stephen Fraidin & Jon D. Hanson, *Toward Unlocking Lockups*, 103 YALE. L.J. 1739 (1994) (arguing that lock-ups can be helpful and are not harmful and therefore should be always allowed); Griffith, *supra* note 21 (arguing that strong deal protections are helpful and should be allowed when directors have conducted a good faith market check); Kahan & Klausner, *supra* note 23 (arguing that lock-ups to second bidders that are granted in anticipation of a hostile bid interfere with the discipline on poor management imposed by the market for corporate control and therefore those that exceed a reasonable estimate of the bidder's costs should not be allowed); Quinn, *supra* note 21 (arguing that termination fees covering the bidder's costs are helpful and should be allowed, but bulletproof deal protections that block other bids will prevent getting the best deal for the selling shareholders and should not be allowed); Fernán Restrepo & Guhan Subramanian, *The New Look of Deal Protection,* 69 STAN. L. REV. 1013 (arguing that courts should use game theory to identify effects of deal protections); David A. Skeel, Jr., *A Reliance Damages Approach to Corporate Lockups*, 90 NW. U. L. REV. 564 (1996) (arguing that lock-ups should be allowed only to the extent that they provide the bidder with the equivalent of reliance damages in the event the merger does not occur).

25. My prior writing shows I am less of a fan than most.

26. *See supra* note 8 and accompanying text.

27. *See, e.g., In re* J.P. Stevens & Co. S'holders Litig., 542 A.2d 770, 780 (Del. Ch. 1988) ("[B]usinessmen and women are correctly perceived as possessing skills, information and judgment not possessed by reviewing courts . . . ."); Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919) ("The judges are not business experts."); William T. Allen et al., *Function over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, 1294 (2001) ("[J]udges also face the difficulty of bringing legal expertise to bear in reviewing the decisions of business professionals, an exercise inherently fraught with risks of error." (emphasis omitted)).

28. *See, e.g.*, Tamar Frankel, *Fiduciary Duties*, *in* 2 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 127, 129 (Peter Newman ed., 1998) ("The duty of loyalty addresses the risk of abuse of entrusted power to which entrustors are exposed."); Deborah A. DeMott, *Disloyal Agents*, 58 ALA. L. REV. 1049, 1053-55 (2007) (describing a typography of disloyalty by agents).

viewing challenged board decisions is to ensure that the directors have not sacrificed the interests of the corporation and its shareholders in order to benefit themselves[29] (or persons controlling the directors[30]).

B. Reducing Unintended Harm

The law often seeks to reduce the incidence of harm to persons hurt by the poor decisions of others, even when the others intended no harm. Laws directed toward this end might operate through ex ante regulation[31] or ex post judicial review, which might order payment of damages both to deter harmful decisions and to compensate those harmed.[32] While such harm commonly consists of physical injury, the law often also seeks to prevent financial harm.[33]

The degree to which reducing unintended harm should be a goal for judicial review of board decisions is a contentious question. Indeed, many argue it should not be a goal at all.[34] Others suggest that review of the process used by directors to make their decision, but not the substance of the decision, can improve outcomes without undue interference by courts.[35] Still, others assert that allowing some review of the rationality, if not the reasonableness, of the substance of a board's decision reduces unintended harm in the same manner that reviewing reasonableness presumably reduces unintended harms by everyone else in society.[36]

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29. *See, e.g.*, Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939) ("A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director . . . an undivided and unselfish loyalty to the corporation . . . .").

30. *See, e.g.*, Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV. 1641, 1651 (2006) (discussing danger of controlling shareholders taking more than their proportionate share of the wealth generated by the corporation).

31. *E.g.*, Stephen D. Sugarman, *Doing Away with Tort Law*, 73 CALIF. L. REV. 555, 563 (1985) ("There has been a proliferation in collective intervention through safety agencies like CPSC, EPA, FAA, FDA, NHTSA, OSHA, and so on, through the alphabet. Perhaps even more pervasive are state, local and professional control regimes as diverse as building codes, highway engineering departments, and medical quality review boards." (footnote omitted)).

32. *Id.* at 559.

33. *See, e.g.*, Franklin A. Gevurtz, *The Role of Corporate Law in Preventing a Financial Crisis: Reflections on* In re Citigroup Inc. Shareholder Derivative Litigation, 23 PAC. MCGEORGE GLOBAL BUS. & DEV. L.J. 113, 120-130 (2010) (discussing laws seeking to prevent excessive risk taking by banks).

34. *See, e.g.*, Kenneth E. Scott, *Corporation Law and the American Law Institute Corporate Governance Project*, 35 STAN. L. REV. 927, 937 (1983) (advocating abolition of duty of care liability).

35. *See, e.g.*, *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996) (review of board decisions should focus only on process and good faith).

36. *See, e.g.*, AMERICAN LAW INSTITUTE: PRINCIPLES OF CORPORATE GOVERNANCE § 4.01(c) (allowing liability despite the business judgment rule if the decision is not just unreasonable but is also irrational).

The business judgment rule encapsulates the outcome of this debate. To begin with, a divergence of interpretations of the business judgment rule[37] reflects the unresolved divergence of viewpoints as to the degree to which judicial review should seek to reduce unintended harms from board decisions. However, the essence of pretty much every current interpretation of the rule is to accord directors with greater protection against judicial second-guessing than virtually any other private actor in our society.[38] This reflects the preponderance of opinion in this debate downplaying the goal of reducing unintended harms from decisions of corporate directors. Nevertheless, the fact that the rule still allows judicial intervention in cases of extreme deviations reflects the corresponding weight of opinion that corporate law does not completely forsake reducing unintended harms as a goal for judicial review.

One other aspect encompassed within the goal of reducing unintended harm to others is what to do in situations in which a decision trades off harm or benefit to one, versus benefit or harm to another, neither of whom (or else we are back to disloyalty) is the decision-maker. In the corporate context, this involves board decisions trading off benefits or harms to the shareholders, versus harms or benefits to creditors, employees, and other so-called stakeholders in the corporate enterprise. While this topic has been of endless fascination to commentators,[39] like the rest of the goal

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37. *E.g.*, Gevurtz, *supra* note 20, at 289-303 (discussing the various interpretations of the business judgment rule, ranging from precluding liability for disinterested decisions so long as directors act in good faith, through precluding liability in the absence of gross negligence, and from placing more emphasis on process rather than merits in reviewing disinterested decisions, to occasional older cases stating that the rule simply means directors are not liable for their disinterested decisions absent negligence).

38. *E.g.*, *id.*; Joy v. North, 692 F.2d 880, 885 (2d Cir. 1982) ("While it is often stated that corporate directors and officers will be liable for negligence in carrying out their corporate duties, all seem agreed that such a statement is misleading . . . . Whereas an automobile driver who makes a mistake in judgment as to speed or distance injuring a pedestrian will likely be called upon to respond in damages, a corporate officer who makes a mistake in judgment as to economic conditions, consumer tastes or production line efficiency will rarely, if ever, be found liable for damages suffered by the corporation." (citation omitted)).

39. *E.g.*, A.A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365 (1932); Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999); E. Merrick Dodd, *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932); Martin Gelter, *Taming or Protecting the Modern Corporation? Shareholder-Stakeholder Debates in a Comparative Light*, 7 N.Y.U. J.L. & BUS. 641 (2011); Kent Greenfield, *Reclaiming Corporate Law in a New Gilded Age*, 2 HARV. L. & POL'Y REV. 1 (2008); Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 441-42 (2001); Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, 12 BUS. ETHICS Q. 235 (2002); Jonathan R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, 21 STETSON L. REV. 23 (1991); David Millon, *New Game Plan or Business as Usual? A Critique of the Team Production Model of Corporate Law*, 86 VA. L. REV. 1001 (2000); Cynthia A. Williams, *Corporate Social Responsibility in an Era of Economic Globalization*, 35 U.C. DAVIS L. REV. 705 (2002); Milton Fried-

of reducing unintended harms, the business judgment rule has limited the practical impact of judicial review in setting corporate law limits on such tradeoffs to extreme cases.[40]

C. Policing the Allocation of Power Between Board and Shareholders

The two goals above correspond to the oft-listed duties of loyalty and care imposed on corporate directors.[41] At a much earlier time, courts and writers would have paid equal attention to a third goal—that of ensuring directors stayed within limits imposed on their power.[42] With the decline of the ultra vires doctrine,[43] the power concern now occupies only a small role in reviewing general business decisions by directors. Nevertheless, in certain contexts in which corporate law divides power between board and shareholders, someone must referee power disputes between the two.[44] Accordingly, a third goal for judicial review of board decisions is to resolve such disputes with fidelity to the division of power sought by the governing statute or documents.[45]

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man, *The Social Responsibility of Business is to Increase its Profits*, N.Y. TIMES, Sept. 13, 1970, at 17.

40. *See, e.g.*, N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92 (Del. 2007) (directors have a duty to creditors only when the corporation is insolvent); Franklin A. Gevurtz, *Getting Real About Corporate Social Responsibility: A Reply to Professor Greenfield*, 35 U.C. DAVIS L. REV. 645, 648-50 (2002) (finding that courts generally have not scrutinized business decisions to see whether directors sacrificed profit maximization to advance the interests of employees, creditors, customers, and the community).

41. *E.g.*, FRANKLIN A. GEVURTZ, CORPORATION LAW 278 (2d ed. 2010).

42. *See, e.g.*, 1 WM. L. Clark & WM. L. MARSHALL, A TREATISE ON THE LAW OF PRIVATE CORPORATIONS § 204 (1901) (discussing *ultra vires* doctrine).

43. *E.g.*, Gevurtz, *supra* note 41, at 20, § 1.1.3b (describing the gradual decline of the ultra vires doctrine in the nineteenth century as a result of legislative and judicial actions, which expanded the permissible activities directors could have the corporation undertake).

44. *E.g.*, CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227 (Del. 2008) (addressing the ability of the shareholders to command actions by the board through placing such commands into the corporation's bylaws using the shareholders' statutory power to amend the bylaws); Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 930 (Del. 2003) ("[T]he Delaware corporation law expressly provides for a balance of power between boards and stockholders which makes merger transactions a shared enterprise and ownership decision."); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) (holding that the directors have the power under their general statutory power to manage the corporation and the more specific power to have the corporation repurchase its outstanding stock to have the corporation make a self-tender offer for the purpose of interfering with the shareholders' selling their stock to a party making a hostile tender offer); Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437 (Del. 1971) (addressing the ability of the board to amend the bylaws in order to change the annual meeting date in a manner that negatively impacted the ability of dissident shareholders to wage a proxy contest).

45. This is not to say what constitutes fidelity in the spectrum between strict adherence to text versus interpretation based upon the purposes behind the governing provisions when seeking to determine the division of power sought by statute or governing documents. Hence, the approach of the Delaware courts to refereeing power disputes between board and shareholders is often to adopt a broad reading of power granted to the board but then

III. THE PRESENT MUDDLE

Courts, particularly in Delaware, apply various standards of review to decisions by directors to sell or merge corporations. While several of these standards are not, at least on their face, any different than the standards courts apply when reviewing decisions by directors in general, a pair of other standards, which arose out of cases dealing with takeover contests, are quite different. Many times, the application of these standards seems to readily correspond with the goals for judicial review of board decisions; in many other instances, however, figuring out the correspondence is head scratching.

A. *Starting Normal: Protecting Against Disloyalty When Sales or Mergers Involve Conventional Conflicts of Interest*

The principal exception to the application of the business judgment rule traditionally occurs when the board's decision involves a conflict of interest for some or all board members or parties controlling board members.[46] Here, it is easy to see that the goal for judicial review is to protect against disloyal decisions.

The simplest conflict of interest in selling the corporation occurs if directors or officers are among those purchasing, or owning the entity purchasing, the corporation—what is commonly referred to as a management buyout or MBO.[47] A subtler conflict of interest problem exists when directors or officers make a contract with the buyer for themselves (for example, to continue to work for the business after the sale) at the same time that they are negotiating to sell or merge the corporation. Because of the concern that directors or officers will trade a lower price for the overall company in exchange for a better contract for themselves, the parallel negotiation of such side deals and the sale or merger subjects the sale or merger to the more intense judicial review reserved for conflict of interest transactions generally.[48]

Mergers in which the majority or controlling shareholder ends up with the entire ownership of the corporation (freeze-outs of minority shareholders), force the directors to deal with the person who elected them and has the power to remove them. Hence, courts treat such transactions as presenting a conflict of interest.[49] Even when all shareholders are selling, rather than the majority kicking out the minority, different motivations

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to refine that by examining the equity of the use of power in a particular case. *E.g.*, Schnell, 285 A.2d at 439.

46. *E.g.*, Sinclair Oil Corp. v. Levien, 280 A.2d 717, 721 (Del. 1971).

47. *E.g.*, Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261 (Del. 1989).

48. *E.g.*, Smith v. Good Music Station, Inc., 129 A.2d 242 (Del. Ch. 1957).

49. *E.g.*, Weinberger v. UOP, Inc., 457 A.2d 701, 714 (Del. 1983).

by controlling shareholders might create a conflict of interest.[50] A factual issue that can arise in cases involving shareholder conflicts is whether shareholders with a large, but not a majority, block of votes are nevertheless controlling shareholders.[51]

Conflicts of interest by persons other than directors, officers, or shareholders can also impact decisions to sell or merge the corporation. For instance, conflicts of interest arise when investment bankers provide advice and assistance to the board of the seller in seeking the best deal, while at the same time the investment banker is attempting to sell services (commonly, assistance in raising money to finance the purchase) to a prospective buyer. Under such circumstances, the investment banker may steer the deal toward a buyer who will use its services over a buyer who will not (but who might pay a higher price for the corporation). A particularly egregious case of this sort recently led to a significant dollar award against the investment banker in *RBC Capital Markets, LLC v. Jervis*[52] based upon the theory that the investment banker aided and abetted the board's breach of duty.[53]

Corporate law in the United States, as typified by Delaware, generally takes a tri-part approach to dealing with conflict of interest transactions. Essentially, courts will void a transaction presenting a conflict of interest for directors or officers unless disinterested directors or shareholders approved the transaction after full disclosure, or the court, after careful scrutiny, finds the transaction is fair.[54] Delaware courts talk of fairness (or intrinsic fairness) as entailing fair dealing—including disclosure of all facts material to the transaction, but also looking at factors such as the

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50. *E.g.*, *In re* Trados Inc. S'holder Litig., 73 A.3d 17 (Del. Ch. 2013) (venture capital firms owning preferred stock had their representatives on the board push to sell the company in order to bail their investment out of a "zombie company" in a deal in which common stockholders received nothing).

51. *Compare In re* Zhongpin, Inc. Stockholders Litig., No. 7393-VCN, 2014 WL 6735457 (Del. Ch. Nov. 26, 2014) (plaintiff pled sufficient facts to suggest founder and CEO was a controlling shareholder even though he only owned seventeen percent of the stock), *with In re* Crimson Exploration, Inc. Stockholder Litig., No. 8541-VCP, 2014 WL 5449419 (Del. Ch. Oct. 24, 2014) (a thirty-four percent shareholder was probably not a controlling shareholder even though three of seven directors were its employees).

52. 129 A.3d 816 (Del. 2015).

53. Lest one worry too much about the 'blame the victim' quality of finding that the poorly served directors breached their duty, the court found a breach of duty sufficient to attach the aiding and abetting claim based upon a less deferential standard of review than applicable to a claim against the directors themselves.

54. *E.g.*, GEVURTZ, *supra* note 41, at § 4.2.1. Application of this approach to dealings with majority or controlling shareholders is more complex because of concerns regarding how much trust courts should place in any directors or even minority shareholders when dealing with a majority or controlling shareholder. *See, e.g.*, Kahn v. M & F Worldwide Corp., 88 A.3d 635, 642 (Del. 2014) (returning scrutiny of freeze-out mergers to the business judgment rule if negotiated by a committee of independent directors and (not or) approved by a majority of the minority shareholder vote).

timing of the deal and the extent of negotiation—and fair price.[55] Fair price, in turn, equates to an arms-length deal and often encompasses a range of values.[56] While some jurisdictions treat fair dealing (particularly disclosure) and fair price as a conjunctive test,[57] Delaware courts lump them together into a holistic review,[58] in which better process provides more slack on the substance of the price[59] and clear proof of a fair price can offset failing in process,[60] or, viewed from the other side, weakness in process can lead to greater skepticism about the price[61] and weakness in price can lead to greater doubts about the process.[62]

B. Maybe Normal: Addressing Unintended Harm from Decisions to Sell or Merge in the Absence of Conflicts of Interest

In the absence of conflicts of interest, courts normally apply the business judgment rule when dealing with challenges by disgruntled shareholders to decisions by corporate boards.[63] Delaware courts have equated the standard under the business judgment rule with a finding of gross negligence.[64]

The leading case equating the business judgment rule with a gross negligence standard, *Smith v. Van Gorkom*,[65] also happens to be the leading case applying this standard to a board's decision to sell or merge the corporation. Van Gorkom, shortly before he was due to retire from being CEO of Trans Union Corporation, negotiated a deal to sell Trans Union for $55 per share in a cash-out merger. The Delaware Supreme Court found the directors of Trans Union Corporation grossly negligent for approving this transaction after only a two-hour meeting, at which the di-

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55. *E.g.*, Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983).

56. *E.g.*, Fliegler v. Lawrence, 361 A.2d 218, 225 (Del. 1976); *In re* Orchard Enter., Inc. Stockholder Litig., 88 A.3d 1, 30 (Del. Ch. 2014).

57. *See, e.g.*, State *ex rel.* Hayes Oyster Co. v. Keypoint Oyster Co., 391 P.2d 979 (Wash. 1964).

58. *E.g.*, *Weinberger*, 457 A.2d at 711.

59. *Id.* at 709 n.7 (suggested that a showing of fairness is strengthened if boards use an independent negotiating committee to deal with the majority shareholder).

60. *See, e.g.*, *In re* Trados Inc. S'holder Litig., 73 A.3d 17 (Del. Ch. 2013) (finding a deal in which the common stock received nothing to be fair, despite unfair process, because of proof that the common stock had no value).

61. *E.g.*, William Penn P'ship v. Saliba, 13 A.3d 749, 757-78 (Del. 2011) (non-disclosure negatively impacted the court's view of the fairness of the price).

62. *See, e.g.*, *In re* S. Peru Copper Corp. S'holder Deriv. Litig., 52 A.3d 761, 801-02 (Del. Ch. 2011), *aff'd sub nom.* Americas Mining Corp. v. Theriault, 51 A.3d 1213 (Del. 2012) (poor price led the court to believe that the independent committee was just rationalizing the deal rather than seriously considering options).

63. *E.g.*, Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000).

64. *E.g.*, Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

65. 488 A.2d 858, 873 (Del. 1985).

rectors (who were just learning of the proposed deal) relied upon a twenty-minute oral presentation by Van Gorkom and did not inquire into the basis for the price. Next time, order sandwiches and plan to spend the day in a meeting.

Following cries of angst after *Van Gorkom*, the Delaware legislature added Section 102(b)(7)[66] to Delaware's corporation statute. This section allows companies to place in their certificate of incorporation a provision waiving liability of directors for monetary damages for breach of fiduciary duty. The section, however, does not allow waivers for certain misconduct, notably including acts not in good faith. The Delaware Supreme Court characterized the good faith standard applicable when selling a corporation with a Section 102(b)(7) waiver as "whether th[e] directors utterly failed to attempt to obtain the best sale price."[67]

So far, this all seems consistent with the minimalist approach of corporate law to reducing unintended harm from board decisions. In a law review article,[68] however, three prominent Delaware jurists (Allen, Jacobs, and Strine) commented that the Delaware Supreme Court had, in their view, slipped the bounds of the business judgment rule in reviewing board decisions to sell the corporation, even when, in *Van Gorkom* and in the court's later decision in *Cede & Co. v. Technicolor, Inc. (Cede II)*,[69] the Supreme Court purported to be applying the rule. *Van Gorkom* is a notoriously controversial decision.[70] *Cede II* undercut the notion that *Van Gorkom* was a one-off, with *Cede II*'s holding that the directors had been grossly negligent in approving the sale of the corporation despite, unlike the board of Trans Union, having a favorable fairness opinion on the deal from an investment banker.

Of course, one should be wary of making too much out of the fact that many might disagree with the result in a given case or two, especially when applying inherently imprecise standards such as gross negligence. The significance exists if the decision is symptomatic of an overall tendency—in this instance, to more carefully scrutinize decisions to sell or merge a corporation. In fact, seen in the light of later doctrinal developments, *Van Gorkom* and *Cede II* might now be understood as forays in moving toward explicitly more rigorous judicial scrutiny of board decisions to sell or merge the corporation. We now turn to those developments.

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66. DEL. CODE ANN. tit. 8 § 102(b)(7) (2015).

67. Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 244 (Del. 2009). This assumes the plaintiff attempts to show a lack of good faith from a lack of effort as opposed to bad motives. Chen v. Howard-Anderson, 87 A.3d 648 (Del. Ch. 2014).

68. Allen et al., *supra* note 27.

69. 634 A.2d 345 (Del. 1993).

70. *E.g.*, Daniel R. Fischel, *The Business Judgment Rule and the* Trans Union *Case*, 40 BUS. LAW. 1437 (1985).

C. Becoming Unrecognizable: Detaching the Standard from the Goals of Judicial Review in the Revlon *Doctrine*

Thus far, we have examined cases in which courts treat decisions to sell or merge the corporation at least nominally the same as any other decision of the board. But, most litigation involving arms-length sales and mergers come within what is known as the *Revlon* doctrine.[71] This doctrine arose in the context of selling to a "white knight" in a takeover contest, when the relationship between selling to one buyer (saying yes) and rejecting another buyer (saying no) is most transparent. The doctrine, however, is not limited to that context, making it difficult to figure out the basis for the *Revlon* doctrine and specifically, which of the goals for judicial review it seeks to achieve.

1. Making Up a Rule in Revlon

Revlon[72] arose out of an effort by a company named Pantry Pride to acquire Revlon using borrowed money, the debt from which Pantry Pride intended to repay by selling off Revlon's divisions. Unable to deter Pantry Pride from making a hostile tender offer, Revlon's board authorized its management to seek other buyers. Management's efforts produced a bid from the private equity firm, Forstmann Little, which also involved paying cash for all outstanding Revlon stock, financed by debt to be repaid through the sale of Revlon's divisions. Revlon's board accepted Forstmann's offer and cut off further bidding by granting Forstmann a lock-up option to buy a pair of Revlon's divisions so cheaply that it became uneconomic for Pantry Pride to buy Revlon. This decision to block further bids came in the face of the stated intention by Pantry Pride to top, by at least a small margin, any competing bid.

In the lawsuit brought by Pantry Pride, the Delaware Supreme Court condemned the action of Revlon's board to cut off bidding. Given that everyone recognized Revlon's breakup was inevitable and the board had authorized efforts to sell the company, the court explained in a much-quoted passage: "The directors' role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company."[73] Finding that Revlon's directors had not acted to get the best price, the court enjoined the deal with Forstmann.[74]

The subsequent history of *Revlon* suggests that sometimes courts should quit while they are ahead. Even under the business judgment rule, directors would seem to have some explaining to do if, in choosing be-

71. *E.g.*, Davidoff & Sautter, *supra* note 24, at 702.

72. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

73. *Id.* at 182.

74. *Id.* at 185.

tween two bidders offering cash for all the shares, they did not pick the one that would pay the highest price. Beyond this, however, it has been difficult to sensibly decide in what other cases *Revlon* has something relevant to say and to figure out what this something is. Perhaps this is because no one has ever articulated any persuasive rationale for the *Revlon* doctrine measured against the goals for judicial review of board decisions.

2. *When Do Courts Apply* Revlon*?*

When a standard of scrutiny arises from the goals for judicial review, events triggering such scrutiny follow from the goals; so, conflicts of interest trigger the fairness test to protect against disloyalty. The flip side is that controversy over the boundaries for triggering a standard of scrutiny might be a symptom demonstrating that the standard lacks a basis in the goals for judicial review. This describes the *Revlon* doctrine.

(a) The Foundational Formulations and the Paradox of Paramount's Paramours

From *Revlon*, one cannot really tell whether its rule is limited to defensive sales and auctions that, in either event, lead to the breakup of the company, or encompasses any decision by the board to sell the company. The Delaware Supreme Court landed on a middle ground between these two extremes through a pair of cases involving efforts by the movie company, Paramount, to merge with companies operating cable television networks.

In the first case, *Paramount Communications, Inc. v. Time, Inc.*,[75] Paramount tried to supplant a planned merger between Time (who not only published magazines, but also operated the HBO network) and another movie company, Warner, by beaming in with a generous tender offer to the Time shareholders before they could vote on the merger with Warner.[76] This, in turn, caused Time's board to restructure the transaction with Warner to pay the Warner shareholders with cash and debt rather than Time stock, thereby removing the need for a vote by Time's shareholders and forcing through the Warner merger.[77]

In the resulting lawsuit by Paramount and disappointed Time shareholders, the plaintiffs argued that the decision of Time's board to merge with Warner—whose pre-merger shareholders under the original plan would end up with a larger stake in the combined Time-Warner entity

75. 571 A.2d 1140 (Del. 1989).

76. *See id.* at 1147.

77. *See id.*

than would the pre-merger Time shareholders[78]—put Time up for sale and thereby triggered *Revlon*. Both the Delaware Chancery and Supreme Court rejected this argument; the Delaware Supreme Court doing so in an opinion that seemed to adopt the narrow interpretation of *Revlon*'s scope as limited to sales leading to dissolutions or breakups and occurring either after an auction or in response to a hostile tender offer.[79]

This view of *Revlon*'s scope did not last a second case involving Paramount. In *Paramount Communications, Inc. v. QVC Network Inc.*,[80] it was Paramount's board that had entered into a merger agreement with a cable network company (Viacom Inc., who operated Showtime) and then received a higher bid from another cable network company (QVC, who operated the home shopping network).[81] Blocked by aggressive deal protection provisions in the Paramount-Viacom merger agreement—including a lock-up option for Viacom to buy almost twenty percent of Paramount's stock cheaply—QVC sued.[82]

Once again, Paramount lost when, much to Paramount's surprise, the Delaware Supreme Court decided to apply *Revlon.*[83] As its rationale, the Supreme Court focused on the fact that the deal Paramount's board made with Viacom would leave Viacom's controlling shareholder (Sumner Redstone) in control of the combined entity.[84] By contrast, the court explained, the transaction in *Time* had left control in whatever fluid aggregation of unaffiliated shareholders might come together to cast a majority vote in any given election.[85] The Delaware Supreme Court thereby took a middle ground regarding the situations triggering *Revlon*. This adds to auctions and defensive sales leading to the breakup of the company, so-called sales of control in which the transaction leaves one person with controlling ownership of the corporation.

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78. *Id.* at 1149. Under the original Time-Warner merger agreement, the former Warner shareholders would have ended up owning sixty-two percent of the combined company. *Id.*

79. *Id.* at 1150-51, 1151 n.14.

80. 637 A.2d 34 (Del. 1994).

81. *See id.*

82. *Id.* at 39-40.

83. *Id.* at 46-48.

84. Redstone owned an overwhelming majority of the voting stock in Viacom, and the shareholders of Paramount would only receive a limited amount of voting (as opposed to non-voting) stock in Viacom. *Id.* at 38.

85. *Id.* at 46-48. This was the rationale that the Chancery Court had used to reject the application of *Revlon* in *Time*. *See Paramount*, 571 A.2d at 1150. Notice that under this view it did not matter that the originally planned Time-Warner merger called for the former Warner shareholders to receive a majority of the voting stock in Time, since the court conceived of the former Warner shareholders as indistinguishable from the original Time shareholders—in both cases, the shareholders were simply numerous unaffiliated investors in a fluid market. *Id.* at 43, 46-47.

This middle ground approach, as illustrated by the outcomes in *Time* and *QVC*, creates something of a paradox. In *QVC*, the shift in control over Paramount to a stranger under the proposed Paramount-Viacom merger,[86] triggered what all assumed was the more intensive scrutiny under *Revlon*. By contrast, in *Time*, the court applied what all assumed to be less scrutiny under *Unocal* to the board's forcing through Time's marriage to Warner—even though this merger left Time's board and management in charge of the combined entity. As a result, the rule is that the greater the conflict of interest for the selling corporation's board (as far as retaining the current directors' and managers' power), the less the court's scrutiny of the board's action—which seems to show that *Revlon* is not about the goal of protecting against disloyalty.

(b) Continuing Controversies over Revlon*'s Coverage*

Revlon referred both to the inevitability of breaking up the corporation and to the board's decision to seek a sale as changing the role of the board into auctioneers.[87] Later cases establish that the key moment is the decision to seek a sale. So, in *Lyondell Chemical Company v. Ryan*,[88] the Delaware Supreme Court rejected the plaintiffs' claim that the directors should have investigated possible acquirers as soon as the interest of a determined buyer put the company "in play" and thereby rendered the sale inevitable, but the board had not yet decided to seek a sale.[89] Flipping the situation around, the Delaware Supreme Court recently held in *RBC* that once the board decides to seek a sale, it could not avoid application of *Revlon* to its conduct prior to agreeing to the actual transaction on the ground that the sale is not inevitable until the board actually agrees to a specific deal.[90] This, however, does not necessarily mean that the board cannot change its mind once it decides to seek a sale. In *Arnold v. Society for Savings Bancorp, Inc.*,[91] the Delaware Supreme Court held that a stock-for-stock merger, which left control dispersed among numerous unaffiliated shareholders, did not trigger *Revlon* even though the directors unsuccessfully sought a bust-up transaction prior to agreeing to the stock merger.[92] In other words, *Revlon* triggers at the moment the board de-

86. While Paramount's CEO apparently was to be the CEO of the combined Paramount-Viacom company, the existence of a controlling shareholder of the combined company presumably would place the CEO into a subordinate role. *See id.* at 38.

87. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

88. 970 A.2d 235 (Del. 2009).

89. *Id.* at 241-43.

90. RBC Capital Mkts., LLC v. Jervis, 129 A.3d 816, 853-54, 853 n.121 (Del. 2015).

91. 650 A.2d 1270, 1274, 1289-90 (Del. 1994).

92. *But see* Johnson, *supra* note 11, at 2 (arguing that *Revlon* can apply to botched efforts to make a sale that would otherwise fall within the doctrine).

cides to embark upon a transaction within the doctrine so long as the final transaction fits within the doctrine.

A more controversial question is whether cashing out the shareholders triggers *Revlon* regardless of whether the buyer has a controlling shareholder. To the simple-minded,[93] the most obvious fact about the situation in *Revlon* was that it involved a choice between two all-cash, all-shares bids, making the only rational choice for directors to pick the bidder who will pay the shareholders the most cash. Subsequent descriptions of *Revlon* by the Delaware Supreme Court,[94] however, focus not on the cash, but on the bidders' plans to breakup the company—evidently based upon the notion that the board's decision to sell to such a bidder rendered irrelevant *Unocal*'s holding that the board can take defensive actions in response to "a danger to corporate policy and effectiveness."[95]

At first glance, *QVC* reinforces the view that the nature of the consideration received by the selling shareholders is irrelevant, since the court applied *Revlon* to a situation in which the board was faced with two bids, each with an equal mix of cash and of stock in the purchasing corporation. Nevertheless, *QVC* introduced an important conceptual shift that suggests the nature of the consideration might matter. Specifically, in holding that a change in control triggers *Revlon*, the court in *QVC* focused not on the impact to the corporation, but rather on the impact to the stockholders, including their lost ability to obtain a premium from selling control in the future[96]—something that is obviously true in a cash sale.

Subsequent Delaware Supreme Court opinions are inconclusive. In *Lyondell*, the Delaware Supreme Court accepted that a cash-out merger with a privately held buyer constitutes a change in control triggering *Revlon*.[97] By contrast, in *In re Santa Fe Pacific Corp. Shareholder Litigation*,[98] the Delaware Supreme Court held that *Revlon* did not apply to a merger with a company lacking a controlling shareholder when only 33 percent of the shareholders of the merging company received cash in the transaction while the rest received stock. Falling in between these two cases are situations in which, like *Lyondell* but not *Santa Fe*, the consideration is predominately cash rather than predominately stock-for-stock, but, like *Santa Fe* but not *Lyondell*, the transaction is with a company lacking a controlling shareholder.

Absent decisive direction from the Delaware Supreme Court, the Delaware Chancery Court has issued several opinions stating that cash-out

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93. Me.

94. *See, e.g.*, Paramount Commc'ns Inc. v. Time, 571 A.2d 1140, 1150 (Del. 1989).

95. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).

96. Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 43 (Del. 1993).

97. Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 242-43 (Del. 2009).

98. 669 A.2d 59, 64-65, 71 (Del. 1995).

mergers trigger *Revlon* if cash constitutes a primary proportion of the consideration, even if the merger occurs with a company lacking a controlling shareholder and so unaffiliated shareholders in the market still ultimately control the combined firms.[99] The basic rationale is that "there is no long run" for the cashed-out shareholders to justify forgoing maximum immediate value in favor of the sort of considerations listed in *Unocal*[100]—which brings one back to the simple minded view of what *Revlon* was about, but does not explain why one needs much of a doctrine.

3. *What Does* Revlon *Alter?*

Given the frequent dispute about when *Revlon* applies, one would have assumed that it is clear what it actually does. This, however, is not the case. Instead, *Revlon* and later opinions applying the doctrine suggest three possible impacts: (1) limiting the goals directors can pursue in the situation; (2) supplanting general standards governing the directors' conduct and the courts' review of this conduct with more specific rules for the process directors are to follow; and (3) imposing a heightened standard of judicial scrutiny over directors' actions. Unfortunately, the Delaware Supreme Court has treated these three impacts like the three shells in the carnival game in which a pea always seems magically to appear under a different shell than the player guessed. This is another symptom of a standard unhinged from the goals for judicial review that would justify anything more than the minimal scrutiny of the business judgment rule.

(a) *Limitation of Permissible Goals*

One aspect of the *Revlon* doctrine seems to be a narrowing of permissible goals for directors to pursue once they enter into the tube governed by *Revlon*. This involves both a clear, but controversial identification of an impermissible goal and an uncontroversial, but ultimately obscure statement regarding the goal toward which directors must work.

The impermissible goal of the directors identified in *Revlon* is the protection of the interests of the company's creditors over the interests of the company's shareholders.[101] Here, the court entered into the long debate about shareholder primacy versus stakeholder models in one of the rare

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99. *See, e.g.*, *In re* Smurfit-Stone Container Corp. S'holder Litig., No. 6164-VCP, 2011 WL 2028076, *15 (Del. Ch. May, 2011); *In re* NYMEX S'holder Litig., Nos. 3621-VCN, 3835-VCN, 2009 WL 3206051, *5 (Del. Ch. Sept., 2009); *In re* Lukens Inc. S'holders Litig., 757 A.2d 720, 732 (Del. Ch. Dec., 1999).

100. *In re Lukens*, 757 A.2d at 732 n.25.

101. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986). The court tosses out a bit of a red herring in its suggestion that the directors were concerned about the noteholders because the noteholders threatened to sue the directors, only to point out that the noteholders would not have had a claim against the directors anyway. *Id.* at 182-83.

decisions in which it really mattered.[102] Confronted with the language in its earlier *Unocal* decision, which stated that directors may take into account the interests of other corporate constituencies in reacting to a hostile tender offer,[103] the court in *Revlon* explained that this is only true if there are rationally related benefits accruing to the shareholders. This, the court concluded, meant that concern for non-shareholder interests was no longer appropriate once the directors decided to auction rather than protect the company.

This analysis follows a highly traditional, although often highly artificial, reconciliation of stakeholder interests with shareholder primacy long found in corporate law decisions in the United States. Under this reconciliation, courts defer to directors' decisions to sacrifice immediate profits and instead take actions that promote the welfare of workers, creditors, consumers, or the community on the ground that directors might rationally believe such actions could profit the corporation and therefore its shareholders over the long run.[104] Such long run benefit for the shareholders cannot occur, however, either if the transaction involves the dissolution or breakup of the corporation, or if all the shareholders are going to sell their shares immediately for cash in any event. In this instance, the only way to uphold the board's decision to sacrifice maximum gain for the shareholders in order to look out for other constituencies is to reject the traditional reconciliation and take a broader view of the directors' duty. *Revlon* refused to do so. A number of states have come out differently as a result of their legislatures' adoption of so-called other constituencies statutes.[105] These statutes empower the board to look out for other stakeholders in the corporation without regard to whether this advances the interest of the shareholders.[106] In any event, this is the one portion of the *Revlon* doctrine at least tethered to the goals of judicial review in a manner consistent with the normal humility of corporate law—*Revlon* marked an extreme situation in which the court intervened to enforce the traditional boundaries for trading off the interests of the shareholders versus other corporate stakeholders as part of the goal of reducing unintended harm.

Juxtaposed against this statement of an impermissible goal, *Revlon* set out a command identifying the goal toward which the directors must

102. *See supra* note 39 and accompanying text.

103. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).

104. *See, e.g.*, Gevurtz, *supra* note 40.

105. *See, e.g.*, IND. CODE ANN. § 23-1-35-1(f) (2018) ("[D]irectors are not required to consider the effects of a proposed corporate action on any particular corporate constituent group or interest as a dominant or controlling factor.").

106. For a discussion of these statutes see Am. Bar Ass'n. Comm. on Corp. Laws, *Other Constituencies Statutes: Potential for Confusion*, 45 BUS. LAW. 2253 (1990).

work. Specifically, the court stated that once the situation changed from defending against a takeover to selling the company, the central theme guiding the directors should have been obtaining the highest price for the shareholders.[107] Like a shimmering mirage on the desert surface, this command promises much and delivers frustration.

This command made sense in its original context. After all, in a situation in which the directors are choosing between two competing, all-cash bids with essentially the same method of financing, what else is there to do, assuming the directors' duty runs to the shareholders and no one else, but get the shareholders the highest price? The problem with this limited rationale manifests in *QVC*, when options become more complicated. Both bids for Paramount involved a roughly equal mix of cash and of stock in the purchasing corporation. Here, the Delaware Supreme Court stated that the directors must pursue the "best value reasonably available to the stockholders."[108]

Yet, how does this "best value reasonably available to the stockholders" objective differ from the continuing obligation that directors owe to the shareholders in any decision directors make regarding a corporate merger or acquisition, or, indeed, in any context? Put in terms of a concrete example, how did the impermissible objective for Paramount's directors in agreeing to the Viacom merger rather than going with QVC, differ from the permissible objective for Time's directors in agreeing to the Warner merger rather than going with Paramount in the *Time* case, where the court did not apply *Revlon*? The court's answer is a Rorschach test.

For those predisposed to find that *Revlon* narrows the acceptable goals for directors, the court in *Time* explained that whereas *Revlon* triggers a duty to maximize "immediate shareholder value," review under *Unocal* was not intended to lead to a simple "mathematical exercise" of comparing the discounted value of Time-Warner shares at some point in the future versus the value of Paramount's offer.[109]

The problem with this sort of formulation shows up when one looks at the factors involved in the choices facing the directors in the two cases. In *QVC*, the value of the bids depended in substantial measure upon the future performance of the stock in each packet, which, in turn, depended both on the performance of the combined entity (Paramount and Viacom or Paramount and QVC) and the interest in the combined entity repre-

107. *Unocal Corp.,* 493 A.2d at 964.

108. Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 43 (Del. 1993).

109. Paramount Commc'ns Inc. v. Time Inc., 571 A.2d 1140, 1150, 1153 (Del. 1989).

sented by the stock received by Paramount's shareholders.[110] But, the same sort of variables concerning the growth of the pie and the number of slices were at the heart of the decision facing the directors in *Time.* Specifically, the impact of the Time-Warner merger on Time's pre-merger stockholders depended upon whether the increase in the future earnings of the combined entity outweighed the immediate impact on Time's pre-merger shareholders resulting from issuing Time stock (or, under the revised iteration, cash) to the Warner shareholders.[111] Once Paramount arrived on the scene with a competitive bid, there was the additional question as to whether the value Time's shareholders gained in the Warner merger exceeded what Paramount offered. How is the determination of immediate shareholder value called for in *QVC* pursuant to *Revlon* supposed to differ from the more open-ended goals analysis allowed under *Unocal* in *Time*? Is the court saying that because *Revlon* did not apply, Time's directors were free to ignore whether the increased earnings from the Time-Warner combination would at least eventually offset the cash or shares paid to Warner's pre-merger shareholders or whether Paramount's offer provided better value for Time's stockholders than the Warner combination no matter how and when measured?

Maybe the court is saying that without *Revlon*, directors are entitled to use their own informed judgment on whether a combination or other decision enhances shareholder value, but once *Revlon* applies, directors must look to the market valuations of the exchanged securities[112]—which are immediate in the sense that one can cash out at this price today.[113] Nevertheless, other language in *QVC* casts doubt on this market value interpretation. Specifically, the court in *QVC* explained that directors are entitled under *Revlon* to take into account the bidder's business plans for the corporation and their effects on stockholder interest, and directors are not required to ignore totally their view of the future value of a strategic alliance.[114]

110. *See, e.g.*, FRANKLIN A. GEVURTZ, BUSINESS PLANNING 853-69 (5th ed. 2015) (discussing valuation in the context of selling a corporation, including the impact when sellers receive shares in the purchasing corporation).

111. *See, e.g.*, *id.* at 869-70 (discussing impact on the purchasing corporation's shareholders of issuing shares to purchase another corporation).

112. *See* Bernard Black & Reinier Kraakman, *Delaware's Takeover Law: The Uncertain Search for Hidden Value*, 96 NW. U. L. REV. 521 (2002) (attempting to explain *Revlon* as a situation in which courts focus on "visible" (market) value as the measure of a transaction's merits, as opposed to allowing directors to act based upon the directors' potential knowledge of "hidden" value of the corporation that the market price does not reflect).

113. It is true that business strategies often involve tradeoffs between short-term and long-term profits and that different investors might discount future profits differently, but this still does not explain immediate shareholder value as anything other than market prices.

114. Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 44 (Del. 1993).

Perhaps the answer is not found in what the court says, but what it actually did. In finding that Paramount's directors breached their duty, the court pointed to the $1 billion dollar advantage of the QVC bid over the Viacom bid when measured by the current market value of the securities involved and stated that Paramount's directors could not justify giving up this much advantage based upon their vision of a future strategy over which they would no longer have control.[115] So, is the court saying that market valuation trumps under *Revlon* and that a change in control precludes consideration of the added value of a strategic combination beyond that recognized in market prices, or is the court saying that directors must justify disregarding huge disparities in market valuations of competing bids and that a new management's continued willingness to implement the outgoing board's strategic plan following a change in control is too uncertain a reed upon which to justify such a huge disparity? If the answer is the latter, then by what standard does the court decide how much disparity in market values is too much for directors to overcome by their own assessments? We shall return to this question when we consider whether *Revlon* imposes a higher level of judicial scrutiny over directors' decisions than imposed by *Unocal*.

In the meantime, *QVC* starts to shift our attention from goals to process. Specifically, another way of viewing a command to focus more on market values in comparing bids is that the overall goal for directors remains the same—get the best value for the shareholders—but now, the court will specify the process directors must use in working toward this goal. This brings us to the second possible impact of *Revlon*.

(b) Substitution of Process Rules for General Standards of Conduct and Review

A fundamental tension in the law lies in choosing between governing conduct through specific rules (e.g., a posted speed limit) or through general standards (act as a reasonable prudent person).[116] When setting forth the impact of *Revlon*, the Delaware Supreme Court has tried to have it both ways.[117]

This inconsistency manifested itself in a two-round tussle between the Delaware Chancery and Supreme Court—first in *Lyondell* and then, not long ago, in *C&J Energy Services, Inc. v. City of Miami General Employ-*

115. *Id.* at 50.

116. *E.g.*, Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557 (1992).

117. Delaware courts frequently have tried to gain the advantage of specific guidelines within general standards by providing directors "safe harbor" suggestions for processes that will clearly comply with fiduciary duties. *E.g.*, Malone v. Brincat, 722 A.2d 5 (Del. 1998); Broz v. Cellular Info. Sys., Inc., 673 A.2d 148 (Del. 1996). This is different, however, from mandating specific processes.

ees' and Sanitation Employees' Retirement Trust.[118] In both, the Chancery Court held that directors, in sales falling under *Revlon*, must conduct a market test or else establish their impeccable knowledge of the market. In both, the Delaware Supreme Court then reversed, explaining that *Revlon* does not require any particular procedure of directors.

Before filing this away under the heading trial courts make mistakes, it is edifying to ask how the Chancery Court managed to get this wrong. In fact, the Chancery Court was following guidance the Delaware Supreme Court had provided in *Barkan v. Amsted Industries, Inc*.[119] This guidance began with the assurance that *Revlon* does not command a heated bidding contest (an auction) before any sale of control.[120] The Supreme Court then broke down situations that might arise into two possibilities. The first was multiple bidders competing for control. Here, the court admonished that fairness to the shareholders precludes using defensive mechanisms to favor one bidder over another.[121] This follows similar language in *Revlon*,[122] but contradicts the court's explanation in *Mills Acquisition Co. v. MacMillan, Inc.*,[123] that favoritism is okay if justified by getting the best deal for the shareholders.[124]

The Delaware Supreme Court in *Barken* next discussed the situation in which there was only one bidder.[125] In this circumstance, the court stated that unless the directors have reliable grounds for determining if the one bid is adequate, they must canvass the market to determine if higher bids might be available. Moreover, in commenting on what might constitute reliable information sufficient to forgo canvassing the market, the court cautioned that the advice of an investment banker is often a poor substitute for a market test to determine the adequacy of a single bid.[126]

Given this discussion, it is not surprising that the Chancery Court thought that directors in a *Revlon* situation without competing bidders must test the market unless they can establish their impeccable knowledge of the market. Moreover, given the Delaware Supreme Court's shifting statements regarding process and *Revlon*, it is somewhat understandable that the Chancery Court was not totally convinced by the reversal in *Lyondell,* and so the Delaware Supreme

118. 107 A.3d 1049 (Del. 2014).

119. 567 A.2d 1279 (Del. 1989).

120. *Id.* at 1286-87.

121. *Id.*

122. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 184 (Del. 1986).

123. 559 A.2d 1261 (Del. 1988).

124. *Barkan*, 567 A.2d at 1286-87.

125. *Id.* at 1282-83.

126. *Id.* at 1287-88.

Court in *C&J Energy* again had to reverse a Chancery Court decision holding that *Revlon* requires market tests or impeccable board knowledge of the market.[127] Interestingly, however, the Delaware Supreme Court in *C&J Energy* could not quite itself completely dismiss the notion that *Revlon* might command some sort of market test. Instead, it pointed out that the case involved a "passive test" insofar as the board retained a "fiduciary out" provision allowing it to abandon the merger if a better deal happened to come along and the deal protection devices in the merger agreement were modest.[128] Indeed, the Delaware Supreme Court's recent decision in *RBC* contains a discussion quoting *C&J Energy* as standing for the necessity of market tests.[129]

(c) Heightened Scrutiny

The final impact of *Revlon* is a notion of heightened scrutiny. Indeed, the Delaware Supreme Court once scolded an attorney for referring "inappropriately" to "*Revlon* duties" in order to describe the "enhanced scrutiny courts accord to certain types of transactions."[130] What this enhanced scrutiny entails, however, is not entirely clear.

There are two possibilities for *Revlon* increasing scrutiny over *Unocal* and where it might fit into the overall standards for reviewing director decisions: (1) *Revlon* might establish a new intermediate standard which is more demanding than *Unocal*, albeit less demanding than the fairness test; and (2) *Revlon* might extend heightened scrutiny to situations previously covered by the business judgment rule standard.

The best source for answering whether scrutiny under *Revlon* is more demanding than scrutiny under *Unocal* should have been *QVC*, since the court distinguished *Time*, in which it applied *Unocal*, from the case before it, in which it applied *Revlon*. Unfortunately, in terms of clarity, the court in *QVC* spoke of *Revlon* as both narrowing the acceptable goals for directors and enhancing the scrutiny applied by the court[131]—thereby making

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127. In fact, the Delaware Chancery Court adhered to this market test or impeccable knowledge formulation in other decisions following *Lyondell* and before being reversed again in *C&J Energy*. *See, e.g.*, *In re* OPENLANE, Inc. S'holders Litig., No. 6849-VCN, 2011 WL 4599662 (Del. Ch. Sept. 30, 2011).

128. C&J Energy Servs., Inc. v. City of Miami Gen. Emps., 107 A.3d 1049, 1070 (Del. 2014).

129. RBC Capital Mkts., LLC v. Jervis, 129 A.3d 816, 854 (Del. 2015) ("*Revlon* permits a board to pursue the transaction it reasonably views as most valuable to the stockholders, provided 'the transaction is subject to an effective market check under circumstances in which any bidder interested in paying more has a reasonable opportunity to do so.' " (quoting *C&J Energy Servs., Inc.*, 107 A.3d at 1066)).

130. Arnold v. Soc'y for Sav. Bancorp, Inc., 650 A.2d 1270, 1289 n.40 (Del. 1994).

131. Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 48 (Del. 1993).

it unclear whether *Revlon* differs from *Unocal* by adding to scrutiny under *Unocal* a narrowing of the acceptable goal, or by both narrowing the goal and increasing the scrutiny relative to *Unocal*. Nor did the court's analysis of the situation in front of it clarify the matter. Specifically, the passage in which the court states that Paramount's directors could not justify, based upon their vision of future strategy, taking a bid with $1 billion less market value than the competing bid might mean that directors must focus their attention on getting the most value for the shareholders as measured by market prices or could reflect a greater level of scrutiny under which the court examines market prices and other factors to decide for itself whether the shareholders got the best value.

Beyond the question of whether *Revlon* creates a higher level of scrutiny than *Unocal*, there is also the question of whether *Revlon* extends an intermediate level of scrutiny to situations not covered by *Unocal* and, hence, otherwise subject to evaluation under the deferential approach of the business judgment rule (or even limited to assessment of whether the directors acted in good faith if a Section 102(b)(7) waiver applies). *Lyondell* illustrates this issue. *Lyondell* involved the sort of cash-out merger negotiated with a solitary bidder reminiscent of *Van Gorkom*, where the plaintiff at least nominally had to establish the directors were grossly negligent in order to prevail under the business judgment rule.[132] Moreover, Lyondell's certificate of incorporation contained a provision, as allowed by Section 102(b)(7), waiving liability of directors for monetary damages except for actions not in good faith.[133] Yet, the court in *Lyondell* treated the case as a sale of control coming within *Revlon*,[134] which suggests more rigorous scrutiny of the board's action than either the business judgment rule or good faith standards.

The Delaware Supreme Court in *Lyondell* found it necessary for the plaintiff to establish a lack of good faith.[135] Yet, all this may show is that certificates of incorporation can waive monetary damages from *Revlon* claims so long as the directors acted in good faith. Such waivers, however, do not apply to actions pursuing an injunction.[136] Indeed, in its recent *Corwin* decision,[137] the Delaware Supreme Court went even further in

132. Since *Van Gorkom* predates *Revlon*, however, it is possible that the Delaware Supreme Court would have applied *Revlon* to *Van Gorkom* had the order of the decisions been reversed.

133. Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 239 (Del. 2009).

134. *See id.* at 242-43.

135. *Id.* at 243.

136. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (can waive claims for monetary damages). Section 102(b)(7) also refers only to claims against directors, not officers, thereby still leaving the *Revlon* standard to govern claims that officers breached their duty in negotiating a sale or merger. *E.g.*, Chen v. Howard-Anderson, 87 A.3d 648 (Del. Ch. 2014).

137. Corwin v. Fin. Hldgs. LLC, 125 A.3d 304 (Del. 2015).

looking to the remedy sought as the way to reconcile scrutiny under *Revlon* versus scrutiny under either the business judgment rule or for good faith. In holding that the business judgment rule applied to the plaintiffs' damage action even if the challenged merger came within *Revlon*,[138] the court in *Corwin* observed that *Revlon* was designed for cases seeking an injunction, not damages.[139] The basis for this distinction seems to be that greater scrutiny is okay when courts kibitz in real time, rather than when after-the-fact liability for damages is at stake.

Corwin, however, further complicates the issue of heightened scrutiny by also ruling that a fully informed, non-coerced shareholder vote returns scrutiny to the business judgment rule even in a *Revlon* situation.[140] Yet, if the court issues an injunction against the deal before the shareholders vote, then there is no shareholder approval to bring the standard to the business judgment rule. On the other hand, it seems strange to employ heightened scrutiny as to whether directors acted appropriately to get the best price in order to prevent the shareholders from having the opportunity to vote in a manner that would cause the court to defer under the business judgment rule to the board's decision.

D. Mixing Things Up: Conflating Disloyalty and Power Goals When Reviewing Deal Protections and Shotgun Corporate Marriages

If *Revlon* provides a doctrine largely disconnected from the goals for judicial review as normally applied, Delaware's approach to deal protections and shotgun corporate marriages tries to connect to these goals but loses its way.

1. Omnicare *Prescribes* Unocal

Revlon and *QVC* struck down lock-ups and other deal protections because, as employed in these cases, they seemed to be interfering with, rather than facilitating, getting the best price—contrary to the objective required of the board under the *Revlon* doctrine. In *Omnicare, Inc. v. NCS Healthcare, Inc.*,[141] the Delaware Supreme Court addressed fiduciary duty limits on deal protection devices in cases not governed by *Revlon*.

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138. This case involved a merger between an LLC and a limited partnership to which the court only applied corporate law doctrines, such as *Revlon*, because the parties all took the position that corporate law doctrines governed. *Id.* at 306 n.3. Since the merger was an equity exchange (stock-for-stock in corporate speak) with a publicly traded buyer—albeit one subject to control of its general partners rather than an elected board—it was uncertain whether *Revlon* applied even if one treated this as a corporate law case. *Id.* at 308 n.12.

139. *Id.* at 312.

140. *Id.* at 308.

141. 818 A.2d 914 (Del. 2003).

NCS was in financial distress, having defaulted on its debts.[142] Its board sought a cure in potential buyers.[143] Two other healthcare firms were interested in acquiring NCS: Omnicare and Genesis.[144] After various competing proposals and negotiations, Genesis offered a merger that would fully pay all of NCS's debts and give some Genesis stock to NCS shareholders.[145] Genesis, however, demanded a pair of deal protections: (1) a promise by NCS's directors to submit the merger to a vote by NCS's shareholders even if a better deal came along that caused the board to withdraw its recommendation supporting the merger; (2) an agreement by the chair of NCS's board and its CEO, who between them owned shares possessing a majority of the votes,[146] to vote for the merger.[147] Taking the sure deal over the risk that Omnicare was simply toying with it while hoping to force a bankruptcy sale after Genesis departed, NCS's board and controlling shareholders agreed to the Genesis offer with its deal protections.[148] Omnicare responded with a cash tender offer and a lawsuit to invalidate the deal protections.[149]

The Delaware Supreme Court began its analysis with the question of what is the appropriate level of scrutiny to apply.[150] The Genesis merger did not fall within *Revlon*, because it was a stock-for-stock merger with a company lacking a controlling shareholder.[151] The Supreme Court assumed that the business judgment rule protected the decision to merge with Genesis.[152] When it came to agreeing to the deal protections, however, the court decided on a different level of review: it held that *Unocal* provided the appropriate standard.[153]

Having decided to import *Unocal*, the *Omnicare* court brought along all of the *Unocal* formula as refined in later decisions. This means requiring the directors to prove, first, that they had reasonable grounds for agreeing to the deal protection devices (here, the threat that NCS would otherwise lose the Genesis deal and find itself without any better offer), and second, that the devices were reasonable in relation to this threat.[154]

142. *Id.* at 920.

143. *Id.*

144. *Id.* at 921.

145. *Id.* at 922.

146. This was because they owned the bulk of a class of shares having ten votes per share. *Id.* at 919-20.

147. *Id.* at 925.

148. *Id.* at 924-25.

149. *Id.* at 926.

150. *Id.* at 927.

151. *Id.* at 928.

152. *Id.* at 929.

153. *Id.* at 930-31.

154. *Id.* at 935.

To establish this second element, the court in *Omnicare* also imported the two-part inquiry from the court's *Unitrin* decision.[155] This requires that the deal protections not be coercive or preclusive and that they be within a range of reasonable responses. Because the combined impact of the directors' and the controlling shareholders' promises guaranteed that the merger would take place, the court in *Omnicare* condemned the deal protections as coercive and preclusive.[156] In a second part of the opinion, the court also condemned the deal protections on the alternate ground that the directors must leave themselves an "effective fiduciary out" in order to meet a continuing fiduciary obligation to take a better deal if one comes along after entering the merger agreement.[157]

Courts in some other states have explicitly rejected *Unocal*, as opposed to the business judgment rule, as the standard against which to review directors' agreeing to deal protection devices.[158] Indeed, *Omnicare*'s reasons for scrutiny under *Unocal* conflate and confuse the goals potentially justifying this standard.

The court had essentially two reasons for applying *Unocal*. The simple reason is that the purpose and effect of deal protection devices is to fight off competing offers. In this sense, deal protection devices operate like poison pills or other defenses against tender offers, which are subject to review under *Unocal*.

Yet, this sort of simple reasoning fails to ask a fundamental question (that the court also failed to ask in *Revlon*): Which of the goals for judicial review justified heightened scrutiny in *Unocal*? *Unocal*'s express concern about the omnipresent specter that directors might be acting to preserve their positions[159] indicates that the basis for heightened scrutiny is to protect against disloyalty. This potential disloyalty is inherent when (as in *Unocal*) resistance to a takeover keeps the corporation independent, and thus the current directors in their positions. When, however, as in *Omnicare* (or in *Revlon*), the company will be sold, it is no longer automatically true that the current directors will keep their positions. If they do not, *Unocal*'s omnipresent specter disappears.

The court in *Omnicare* also invoked another potentially deeper rationale. This was to find "conflicts of interest"[160] in the tension between the directors' desire to have their way on a merger and the statutory power granted the shareholders to vote contrary to the board's wishes. While the court no doubt invoked the term conflicts of interest in order to fall

155. Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1386-88 (Del. 1995).

156. *Omnicare*, 818 A.2d at 935-36.

157. *Id.* at 936-39.

158. *E.g.*, Monty v. Leis, 123 Cal. Rptr. 3d 641 (Cal. Ct. App. 2011).

159. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985).

160. *Omnicare*, 818 A.2d at 930.

within the traditional rubric under which conflicts of interest remove transactions from the business judgment rule and justify higher scrutiny, the use of the expression in *Omnicare* is quite different from the traditional understanding.

Normally, one thinks of conflicts of interest as situations, such as directors entering contracts between themselves and their corporation, in which the directors can gain some financial advantage by making decisions that are not in the best financial interest of the corporation or its shareholders. *Unocal* fits within this normal understanding insofar as the directors' financial, as well as non-financial interest, in retaining their positions can lead them to oppose a tender offer that would remove them from the board, even though accepting the offer might be the most profitable decision for the shareholders.

This, however, is not the sort of conflicts of interest referred to in *Omnicare*. Instead, the court is treating the mere desire to have one's way on the transaction by preventing a shareholder veto as a conflict of interest. Perhaps the court is expanding the concept of "interest" that can be in conflict to include not just financial and other benefits that result from a decision, but the interest in possessing the raw power to decide—in which case board choices affecting the allocation of power create a conflict of interest because more power for the board is less for the shareholders (and vice versa). Perhaps the court is concerned that the motive to get one's way on a decision is often such a strong force that it can cloud one's judgment. Perhaps the court is using board efforts to force a decision on the shareholders as a signal that maybe there is a more conventional conflict of interest hidden in the deal. In any event, this is a very different conception of conflicts of interest.

Actually, it really was not necessary for the court to try to fit the square peg of protecting the shareholders' veto into the round hole of protecting against board disloyalty by invoking conflicts of interest. A direct approach is simply to recognize the third goal for judicial review of board actions—this being to referee power disputes between the board and shareholders.

Ironically, while the power concern thus could justify heightened scrutiny for some deal protections, it does not reach the defenses before the court in *Omnicare*. Indeed, *Omnicare*'s mistake is to assume that all deal protection devices potentially undermine shareholder power and then, to illustrate why this assumption is wrong, pick out two promises that did not undermine shareholder power. The shareholder voting agreement was an exercise by the shareholders in respect to their voting power, rather than a board imposed reduction of the shareholders' power.[161] The board's promise to bring the merger to a vote no matter what, decreased, not increased, the power of the board vis-à-vis the voting power of the shareholders.

5. *Applying* Unocal *Scrutiny to Specific Devices*

There are a variety of deal protection devices and their acceptability under *Unocal* (or *Revlon* for that matter[162]) in an individual case may depend upon the specific device, the combined impact of the various devices employed in the particular agreement, and the overall context of the deal. It is analytically useful to break the discussion down by the identity of the party who carries out the promise involved in the specific device and then turn to the impact of context. In some cases, the results correspond to the goals for judicial review of board decisions; in other cases, they do not; and, in either event, this is often rather random.

(a) *Shareholder Promises*

The deal protection devices in *Omnicare* differed from those in earlier cases, such as *Revlon* and *QVC*, in the inclusion of promises by shareholders holding a majority of the votes. This is something that is impractical in the more common cases involving companies with entirely dispersed ownership.

Omnicare found the voting promise coercive and preclusive because, when combined with the directors' promise to bring the merger to a vote, it preordained the Genesis merger despite the arrival of a better deal preferred by NCS's public shareholders.[163] The preclusive label is literally true, because the agreements rendered this a done deal, thereby precluding consideration of other offers. Of course, all merger agreements are preclusive in this sense after the shareholders vote to approve, and the court never explains what is magic about becoming preclusive before, versus after, the formal vote, so long as the holders of a majority of the votes voluntarily decided to support the merger. The characterization of the agreement as coercive is also strange. True, the public shareholders lacked the votes to block the merger despite owning most of the equity in NCS; but this is a function of super voting stock and a shareholder voting agreement—both accepted parts of Delaware and other states' corporate

161. True, one of the parties to the agreement was chairman of the board. However, a directors' voting of his or her shares is not transferring power from shareholders to the board.

162. Presumably, devices that do not pass muster under *Unocal* as applied by *Omnicare* will not pass muster under the more demanding *Revlon* standard. *E.g.*, Davidoff & Sautter, *supra* note 24, at 702-03. *But see* Restrepo & Subramanian, *supra* note 24, at 33-37 (explaining uncertainty in Delaware cases as to whether deal protections in situations falling under *Revlon* could be acceptable even if they do not meet *Omnicare*'s test but arguing against this interpretation).

163. *Omnicare*, 818 A.2d at 936.

law.[164] Otherwise, the agreement was only coercive in the sense that majority rule is always coercive on the outvoted minority, but such is the nature of democratic governance and longstanding corporate law allowing approval of mergers by majority rather than unanimous vote.[165]

Subsequent Delaware Chancery Court decisions indicate that shareholder actions can be part of deal protections, even when the result is to quickly preclude competing bids and the opportunity to get a potentially better deal. In a pair of cases, the Chancery Court rejected challenges to mergers in which shareholders having a majority of the votes provided written consents to approve the merger within a day of the board's entering the merger agreement.[166] As the Chancery Court explained, nothing in Delaware's corporation statute requires a minimum period before shareholders can approve a merger by written consent.[167] Hence, the upshot of *Omnicare* as far as locking up the sale of corporations when a small number of insiders have a majority of the votes might be that parties simply should use written consents rather than voting agreements.[168]

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164. *E.g.*, DEL. CODE ANN. tit. 8, §§ 151(a) (2015) (corporation may issue different classes of stock having different voting rights); 281(c) (allowing shareholder voting agreements); MODEL BUS. CORP. ACT §§ 6.01 (AM. BAR ASS'N 2010) (corporation may issue different classes of stock having different voting rights); 7.31(a) (allowing shareholder voting agreements).

165. *See supra* note 5.

166. *In re* OPENLANE, Inc. S'holders Litig., No. 6849-VCN, 2011 WL 4599662 (Del. Ch. Sept., 2011); Optima Int'l of Miami, Inc. v. WCI Steel, Inc., No. 3833-VCL (Del. Ch. June 27, 2008), (transcript of ruling available at, http://lawprofessors.typepad.com/mergers/files/_0702120713_001.pdf [https://perma.cc/E5CS-LSBJ]) (bench ruling denying preliminary injunction). Interestingly, in *OPENLANE*, the plaintiff did not challenge the use of written consents, although the plaintiff complained that board members held shares with enough votes to pass the merger. The court pointed to the impact of the consents in rendering this effectively a done deal as minimizing the practical relevance of a no-solicitation provision about which the plaintiff complained.

167. *Optima*, *No. 3833-VCL,* at transcript 127. Delaware's corporation statute requires a minimum 20-day notice before the shareholder meeting at which shareholders vote to approve a merger (DEL. CODE ANN. tit. 8, § 251(c)), but Section 228(a) of Delaware's corporation statute (DEL. CODE ANN. tit. 8, § 228) allows shareholders to act without a meeting and without advance notice if shareholders holding enough votes to approve the relevant action provide written consent. Federal proxy rules, where applicable, impose a minimum 20-day delay before actions approved by written shareholder consent can take effect—this for the purpose mandating that all shareholders who were entitled to vote receive information about the action. 17 C.F.R. § 240.14c–2. This, however, delays closing, not approval.

168. Provisions in the agreement allowing the buyer to walk away from the deal without negative consequence if the majority does not provide written consent to the merger create the incentive for quick action by the majority.

Another approach used in mergers post-*Omnicare* is to include a so-called "fall away" provision in the shareholder voting agreement. Under such a provision, the arrival of a superior bid allows enough shareholders to opt out of their promise to vote for the merger that the number of committed votes falls below a majority, thereby avoiding the merger technically being a fait accompli. Since the holders of the votes allowed opting out often have other reasons for favoring the original merger, the result of the fall away provision may be largely cosmetic. Brian JM Quinn, Omnicare*: Coercion and the New* Unocal *Standard*, 38 J. CORP. L. 835, 845-46 (2013).

(b) Board Promises

Discussion of what the board can and cannot promise to do in a merger agreement begins at a simple point: directors cannot promise to do things that would breach their fiduciary duty.[169] Of course, this leads to the question of what such things are. To answer this question, it is helpful to break the discussion into three categories: (1) dealings with the shareholders; (2) gatekeeping; and (3) dealings with potential competing bidders.[170]

Dealings with the shareholders leads to the easiest case: directors cannot promise to withhold material facts about the merger (such as information about a potentially better deal) from the shareholders.[171] Not only is disclosure part of directors'[172] (or, indeed, any agent's[173]) basic fiduciary duty, but assuring disclosure is also consistent with *Omnicare*'s underlying concern about protecting shareholder power and part of the goal of refereeing power disputes. After all, shareholders cannot effectively exercise their power if they do not possess the facts.

One complication, however, regarding disclosure to shareholders arises with promises by the board to recommend that the shareholders approve the merger. Suppose by the time of the vote the directors no longer think that the merger is such a good idea. In that case, recommending approval without disclosing that the directors no longer support the deal seems to be misleading. Merger agreements typically attempt to address this problem through provisions allowing directors to forgo recommending the merger if required by their fiduciary duty (fiduciary outs).[174] If the

169. *E.g.*, Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 936 n.74 (Del. 2003) (quoting RESTATEMENT (SECOND) OF CONTRACTS § 193 (AM. LAW INST. 1981)).

170. While these three categories encompass board promises that directly serve as deal protection devices, other promises of the board (such as a generic best efforts promise to seek to implement the agreement) might indirectly serve as a deal protection by setting up a claim for tortious interference with contract against any competing prospective buyers who manage to breakup the deal. *E.g.*, Jewel Cos., Inc. v. Pay Less Drug Stores Nw., Inc., 741 F.2d 1555 (9th Cir. 1984). Discussion of such interference claims is beyond the scope of this Article. Suffice it to say that courts, both in determining whether the defendant unjustifiably interfered with a contract, and, if so, in assessing damages, must keep in mind that even if some sort of contract exists before shareholders vote to approve the merger, the agreement to merge, itself, is not a binding contract before that point. This means, for example, that even if a merger partner demonstrates a later bidder enticed a board to break a best efforts promise by not bringing the merger to a shareholder vote, there would be no damages from interfering with the best efforts promise without proof that the shareholders would have approved the original merger in the face of a better offer.

171. *E.g.*, ConAgra, Inc. v. Cargill, Inc., 382 N.W.2d 576, 586 (Neb. 1986).

172. *E.g.*, Malone v. Brincat, 722 A.2d 5 (Del. 1998).

173. *E.g.*, RESTATEMENT (THIRD) OF AGENCY § 8.11 (AM. LAW INST. 2006).

174. *E.g.*, Clare O'Brien & Rory O'Halloran, *The Board's Prerogative and Mergers*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Sept. 28, 2015), http://corpgov.law.harvard.edu/2015/09/28/the-boards-prerogative-and-mergers/ [https://perma.cc/ZH2J-LDEX].

trigger for a fiduciary out is simply that the directors have changed their minds about the merits of the merger, then the promise to recommend that the shareholders approve the merger, combined with a fiduciary out allowing directors not to make this recommendation if the directors change their minds, turn into a null set in which the directors may as well not have made the promise to recommend the merger.

Merger agreements often attempt to give real effect to the promise to recommend the merger by limiting the fiduciary out to defined events, such as a superior offer (as defined in the agreement). Agreements also often require the board to engage in a process—such as getting an opinion from an attorney that the board was required to change its recommendation in order to comply with its fiduciary duty—prior to changing its recommendation.[175] The problem with such provisions is that the directors are then promising not to accurately state to the shareholders the directors' subjective views about the merger at the time the shareholders vote, since the directors may no longer support the merger based upon circumstances which do not match the defined fiduciary out.

Curiously, there have been no judicial rulings on whether directors' disclosure obligations preclude promises to recommend a merger unless a defined fiduciary out arises—perhaps because this is a moot point until someone tries to enforce the promise in a situation in which the directors change their recommendation. Statements from the Chancery Court suggest such provisions might be unenforceable.[176]

Delaware's corporation statute allows directors to bring a merger to a shareholder vote that will decide the fate of the transaction even if the board no longer recommends the merger.[177] This, in turn, allows merger agreements to avoid the disclosure problem just discussed by having the board promise to bring the deal to the shareholders regardless of the board's views at the time of the shareholder vote (a "force the vote" provision). *Omnicare*, however, indicates that the board may not so easily contract out of a gatekeeping responsibility to block mergers it no longer supports.

The fact that *Omnicare* boils down to the need for directors to preserve their own gatekeeping power (at least when the shareholder vote is precommitted) is ironic, because it stands *Omnicare*'s rationale for adopting *Unocal* scrutiny on its head. The court in *Omnicare* adopted *Unocal*, in substantial part, because of the conflict between the board's desire to get its way on a transaction and the shareholders' right to vote against the

175. *Id.*

176. *In re* NYSE Euronext S'holders Litig., No. 8136-CS, 13 (Del. Ch. May 10, 2013) (transcript of ruling available at, http://www.rlf.com/files/6884_NE051013Rulings.pdf [https://perma.cc/B8T5-QVR8]).

177. DEL. CODE ANN. tit. 8, § 146 (2015).

board's wishes. How the court can get from this concern to a holding essentially that a board must preserve the board's own power to change its mind and block the shareholders from a vote is amazing. Indeed, *Unocal* scrutiny serves to check the board's assumption of gatekeeping power,[178] not to demand the board maximize it.

In any event, *Omnicare* leaves the question of whether, in situations in which there is no shareholder agreement locking up the vote, a board can promise that it will bring a merger to a shareholder vote even if before the vote there is a better offer for the company. The final part of the court's opinion presented, as an alternate ground for its decision, the holding that directors must leave themselves an "effective fiduciary out."[179] Some have read this to prohibit the board from ever making an agreement that would prevent it from canceling the vote in the event of a superior offer.[180] On the other hand, *Omnicare* continued to invoke the impact of the shareholders' agreement even in this portion of the opinion. Perhaps this is because, without the shareholder voting agreement, full disclosure of a superior bid provides (if we assume shareholders are not stupid) an effective out even if the merger comes to a vote.[181]

Finally, and most complex, are board promises regarding dealings with potential competing bidders before the shareholder vote. These run a spectrum in terms of their restrictive impact from (at the least restrictive end) provisions in the merger agreement expressly allowing solicitation of competing bids ("go-shops"), to prohibitions against actively soliciting other bids ("no-shops" as narrowly defined), to requirements that the board give the existing merger partner an opportunity to put forward a new offer to meet any superior bid ("matching rights"), to (at the most restrictive end) prohibitions against cooperation or communication with another prospective bidder ("no-talks," albeit sometimes referred to as a no-shop

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178. *E.g.*, Gevurtz, *supra* note 16, at 1493-97 (discussing how *Unocal* responds to the directors' assumption of a gatekeeping power to block the sale of the corporation through tender offers, which corporation statutes do not explicitly provide to the board).

179. Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 918 (Del. 2003).

180. *Id.* at 943 (Del. 2003) (Veasey, C.J., dissenting); *In re* OPENLANE, Inc. S'holders Litig., No. 6849-VCN, 2011 WL 4599662, *10 n.53 (Del. Ch. Sept. 30, 2011). Nevertheless, force the vote provisions continue to be found in merger agreements, with the general decline in the use of such provisions after *Omnicare* being no greater in mergers involving Delaware corporations than in mergers involving corporations formed under the laws of states in which *Omnicare* does not govern. Megan W. Shaner, *Revisiting* Omnicare*: What Does Its Status 10 Years Later Tell Us?*, 38 J. CORP. L. 865, 880 (2013).

181. One caveat to this conclusion arises if there will be significant delay before the shareholder vote can take place, during which time the superior offer is effectively blocked. *See, e.g.*, Leo E. Strine, Jr., *Categorical Confusion: Deal Protection Measures in Stock-for-Stock Merger Agreements*, 56 BUS. LAW. 919, 937-38 (2001). This suggests that the acceptability of a force the vote provision (when shareholders remain free to vote down the deal) might depend upon the amount of dawdling allowed.

under a broader use of that term).[182] Also, instead of making a promise regarding its own conduct, the seller's board may curb later contacts with competing bidders by extracting "standstill" agreements with "don't ask, don't waive" terms from prospective bidders. In a standstill, a prospective bidder agrees (commonly in exchange for access to confidential company information) not to launch a tender offer. The don't ask, don't waive term adds a promise not to publicly ask (or even to ask the board privately) for a waiver of the standstill after the board has selected a different buyer.[183]

Determining what is acceptable with regard to board promises curbing dealings with prospective competing bidders is complicated, not only because of variations in such promises and their particular impacts, but, on a more fundamental level, because this involves two distinct concerns—both of which only partially correlate to the goals for judicial review. Specifically, there is the promise's impact of stifling the emergence of competing bids, and there is the promise's impact upon information reaching the board about the prospect for such bids.

This difference in the underlying concerns, in turn, creates a couple of doctrinal impacts. To begin with, the prospect of stifling competing bids might arguably have more salience to *Revlon* situations, with its heightened focus on obtaining the best deal, than to review under *Omnicare* outside of *Revlon*. By comparison, agreements that cut off information to the board seem to come squarely within *Omnicare*'s recognition of continuing fiduciary obligations for the board. Moreover, Delaware Chancery Court judges have recognized that directors might reasonably trade reducing prospects for later competing bids in exchange for getting an offer, or better terms in an offer, right now.[184] By comparison, it seems more problematic to assert that directors should be able to horse-trade when it comes to being sufficiently informed to carry out their obligation to fully inform the shareholders of all material facts up to the vote.

Turning to some of the specific promises, the court in *QVC* drew a distinction between agreements not to actively solicit competing bids and agreements not to consider unsolicited bids or negotiate with unsolicited bidders.[185] While this was in the context of *Revlon* with its imperative for the board to get the best deal, subsequent Delaware Chancery Court decisions have drawn a similar distinction without regard to whether the sit-

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182. *See, e.g.*, MERGERS & ACQUISITIONS COMM., ABA, MODEL MERGER AGREEMENT FOR THE ACQUISITION OF A PUBLIC COMPANY 150, 161, 164 (2011) (discussing provisions in merger contract for go-shops, no-shops, notice of competing offers, and no-talks).

183. Christina M. Sautter, *Promises Made to Be Broken? Standstill Agreements in Change of Control Transactions*, 37 DEL. J. CORP. L. 929, 931 (2013).

184. *E.g.*, *In re* Toys "R" Us, Inc. S'holder Litig., 877 A.2d 975, 1015-21 (Del. Ch. 2005).

185. Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 49 n.20 (Del. 1993).

uation falls within *Revlon*.[186] This distinction may be justified by both of the impacts just discussed. The failure to formally solicit other possible buyers might not have much impact on getting other bids given that public announcement of a pending merger shows the company is for sale.[187] It also does not cut a board off from information that prospective competing bidders are trying to put right in front of it. By contrast, refusal to provide information to or negotiate with other prospective bidders might not only significantly impede their ability to put forth a better offer, but also is patently blinding the board to information relevant both to its duty to fully inform shareholders and to the continuing gatekeeping obligation imposed by *Omnicare*.[188]

Since matching rights, while creating some disincentive for smaller topping bids,[189] are less likely to deter a prospective competing bidder planning a significant jump, and also do not cut off information to the board,[190] we might expect greater tolerance by the court toward matching rights than toward no-talks. This appears to be the case in Chancery Court decisions dealing with matching rights.[191]

Standstill agreements present a difficult problem. Standstills with 'don't ask, don't waive' terms cut off information to the board and the shareholders, which led some Chancery Court decisions to either invalidate or suggest the court might invalidate such agreements.[192] On the other hand, a bench ruling by then Chancellor Strine[193] recognized the

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186. *E.g.*, Ace Ltd. v. Capital Re Corp., 747 A.2d 95, 106-08 (Del. Ch. 1999) (drawing a distinction between no solicitation and no-talk provisions and questioning the legality of the latter whether or not the situation falls within *Revlon*). The result has been that merger agreements stopped using stronger no-talks. Davidoff & Sautter, *supra* note 24, at 683 n.13; *see also* ABA Model Agreement, *supra* note 182, at 4.4 (including a no-talk with a fiduciary out).

187. Albeit it is possible that prospective acquirers might not be on the lookout for such announcements by small cap. companies.

188. *E.g.*, Phelps Dodge Corp. v. Cyprus Amax Minerals Co., Nos. CIV.A. 17398, CIV.A. 17383, CIV.A. 17427, 1999 WL 1054255 (Del. Ch. Sept. 27, 1999).

189. Since prospective competing bidders might ask what is the point of investing time into preparing a competing bid if the first merger partner will just match the new slightly better offer?

190. Except insofar as competing bids simply do not materialize.

191. *E.g.*, Davidoff & Sautter, *supra* note 24, at 705 (Chancery Court has repeatedly upheld matching rights).

192. *In re* Celera Corp. S'holder Litig., No. 6304-VCP, 2012 WL 1020471, at *21-22 (Del. Ch. Mar. 23, 2012) (approving a settlement that removed the standstill); *In re* Complete Genomics, Inc. S'holder Litig., No. 7888-VCL, at *14-18 (Del. Ch. Nov. 9, 2012) (transcript of ruling available at, https://jenner.com/system/assets/assets/6921/original/Complete_20Genomics_20Transcript.pdf [https://perma.cc/7T2P-GQRA]) (holding provision invalid); *In re* Rehabcare Grp., Inc. S'holders Litig., C.A. No. 6197-VCL, at 46 (Del. Ch. 2011) (questioning the validity of a standstill with a don't ask, don't waive term).

193. *In re* Ancestry.com, Inc. S'holder Litig., No. 7988-CS (Del. Ch. Dec. 17, 2012) (transcript of ruling available at, http://www.wlrk.com/docs/121712%20Ancestry%20ruling.pdf) (motion for preliminary injunction).

utility of such agreements in forcing parties to present the board with their best offer during an auction, rather than holding back, figuring that they can always come back later with the lure of a better bid to breakup the deal prevailing in the auction. Strine's suggested solution to reconcile this utility with the board's disclosure obligation is to disclose to the shareholders the standstill.

(c) Corporate Promises

Deal protections often involve promises of corporate performance—specifically to pay termination fees or to sell some assets or stock cheaply (asset and stock lock-ups) if the merger or sale does not take place. These provide a consolation prize for the jilted buyer. They also can punish shareholders for voting contrary to the board's wishes, as well as deter other bidders by lowering the value of the corporation and its outstanding stock if the proposed merger or sale does not take place.[194]

Both *Revlon* and *QVC* involved this sort of deal protection—an asset lock-up in *Revlon* and a stock lock-up and termination fees in *QVC*. While the court in *Revlon* was only concerned about how the board used the lock-up, the court in *QVC* condemned aspects of the lock-up itself as draconian.[195] While this came in the context of applying scrutiny under *Revlon*, the bar on draconian actions is actually part of *Unocal*.[196]

The Delaware Supreme Court returned to corporate promise deal protections in *Brazen v. Bell Atlantic Corp.*[197] Interestingly, the court dealt with the termination fees challenged in that case under the rubric of acceptable liquidated damages rather than fiduciary duty. This categorization seems odd given that a shareholder vote against the merger would hardly constitute a breach of the merger contract. The contract, however, characterized the fees in this manner and the plaintiff, because the case predates *Omnicare* and did not involve a *Revlon* situation, used this as a tool to get out of the business judgment rule. In any event, while the question of whether termination fees are reasonable in the contract law liquidated damages context is not the same as whether they meet the multistage reasonableness inquiry under

194. *E.g.*, Coates IV & Subramanian, *supra* note 22, at 337-53 (discussing impacts of termination fees and asset and stock lock-ups). For many years prior to a change in accounting rules that made this irrelevant, granting a stock option of sufficient size also prevented any other possible acquirer from obtaining desirable pooling of interest accounting, thereby further deterring some later bids. *E.g.*, Strine, *supra* note 181, at 922 n.7.

195. Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 49, 51 (Del. 1993).

196. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985). Indeed, given that the other deal protection condemned in *QVC*, the no-talk, also probably would flunk even the *Unocal*/*Omnicare* standard, one is led to wonder whether the whole discussion of whether to apply *Revlon* can now be seen as just a big red herring in *QVC*.

197. 695 A.2d 43 (Del. 1997).

Unocal; the court stated that the tests were in some respects analogous.[198] The court pointed particularly to the part of *Unocal* requiring the board's response to be within a range of reasonableness.

The court held that the $550 million termination fee was a reasonable estimate of damages rather than an impermissible penalty.[199] In part, the court based this upon a comparison of the size of the fee measured as a percentage of the corporation's market capitalization, with the size of fees (similarly measured) held to be reasonable in prior Delaware Chancery Court opinions. In addition, the court pointed to the analysis the parties had undertaken in setting the fee of the costs they had incurred. Significantly, in terms of the dollars involved, this included not just out of pocket costs, but also the lost opportunity costs associated with only dealing with the other party to the merger contract.

The condemnation of an asset lock-up in *Revlon* and a stock lock-up in *QVC*, juxtaposed against the acceptance of a termination fee in *Brazen*, appears to have contributed to a decline in the use of asset and stock lock-ups and an increase in the size of termination fees, turning such fees into the primary corporate promise deal protections.[200] At first glance, one must wonder whether M&A attorneys are overreacting to what might be coincidental differences in bottom line results. On the other hand, the court's concern in *QVC* with the lack of a cap on how much money the stock lock-up will translate into does point to a difference between asset and stock lock-ups and termination fees. Termination fees commonly are fixed in an amount that one might attempt to justify as an estimate of costs incurred by the jilted bidder,[201] but the payoff from an asset or stock lock-up is not.[202]

While the court in *Omnicare* did not specifically address corporate promise deal protections, the opinion's prohibition on deal protections that are coercive or preclusive provides a potentially useful structure

198. *Id.* at 49.

199. *Id.*

200. *E.g.*, Lawrence A. Hamermesh & Jacob J. Fedechko, *The Role of Judicial Opinions in Shaping M&A Practice* 12-13, (Widener U. Del. Law Sch., Working Paper No. 15-17, 2015), http://ssrn.com/abstract=2648350 [http://perma.cc/CDC5-BBNS]. On the other hand, the end of pooling of interest accounting removed this reason for stock option lock-ups. More recently, perhaps to avoid Delaware court decisions limiting the size of acceptable termination fees, asset lock-ups (in the form of licensing arrangements) and stock lock-ups (as part of financing arrangements) have made something of a comeback. Restrepo & Subramanian, *supra* note 24, at 19-32.

201. So-called topping fees, however, are measured as a proportion of the amount by which the later superior bid exceeds the agreed merger price.

202. Condemning stock locks on this ground, however, might arguably be short sighted. Because the payoff for the jilted would-be buyer with the stock lock-up depends upon the price paid by the ultimately successful later buyer, there can be a desirable incentive for the party holding such a lock-up to encourage the sale of the corporation to a party willing to pay the highest price. Coates IV & Subramanian, *supra* note 22, at 381.

to consider the two impacts of asset and stock lock-ups and termination fees: they might coerce shareholders into voting for the deal by penalizing negative votes and they might preclude other bids. Subsequent Chancery Court decisions have tended to focus much more on fees and lock-ups deterring later bids than on their pressuring the shareholders for a favorable vote.[203]

One reason for less focus on the coercive aspect of termination fees and asset and stock lock-ups comes from the Chancery Court's analysis in *McMillan v. Intercargo Corp.*[204] The court stated that the termination fee there would not deter a negative shareholder vote because the fee was only payable in the event that the company was quickly sold for more than the merger price—as opposed to becoming payable with a shareholder rejection in the absence of a better deal (a "naked no" vote). The result has been to discourage use of fees triggered by naked no votes,[205] as well as to shrink their size,[206] thereby decreasing use of coercive fees.

A potentially greater obstacle to coercion claims comes from *Brazen*, where the court rejected the plaintiff's argument that the termination fee impermissibly coerced the shareholders into voting for the merger.[207] The court conceded that the fee might have influenced shareholders to vote for the deal in order to avoid damage to the company. Nevertheless, the court held that fee did not fall within the definition of coercion found in the court's earlier decision in *Williams v. Geier*.[208] In *Williams*, the Delaware Supreme Court (in addressing a shareholder vote to amend a company's certificate of incorporation) stated that actions leading shareholders to vote for some reason other than the merits of the transaction they are asked to approve could constitute coercion.[209] Applying this definition in *Brazen*, the court reasoned that because the termination fee was an integral part of the merger contract, the shareholders' consideration of the

203. *See, e.g.*, *In re* Atheros Commc'ns, Inc. S'holder Litig., No. 6124-VCN, 2011 WL 864928, at *7 n.61 (Del. Ch. Mar. 4, 2011); *In re* 3Com S'holders Litig., No. 5067–CC, 2009 WL 5173804, at *7 (Del. Ch. Dec. 18, 2009); *In re* Lear Corp. S'holder Litig., 926 A.2d 94, 119-20 (Del. Ch. 2007).

204. 768 A.2d 492, 505-06 (Del. Ch. 2000).

205. *E.g.*, Ely R. Levy, Note, *Corporate Courtship Gone Sour: Applying a Bankruptcy Approach to Termination Fee Provisions in Merger and Acquisition Agreements*, 30 HOFSTRA L. REV. 1361, 1389-90 (2002).

206. *E.g.*, Daniel Wolf & David Fox, *A Quick Survey of Recent Developments in Public M&A Deal Terms*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (May 22, 2011), http://corpgov.law.harvard.edu/2011/05/22/a-quick-survey-of-recent-developments-in-public-ma-deal-terms/ [https://perma.cc/DR73-BN5D].

207. Brazen v. Bell Atl. Corp., 695 A.2d 43, 50 (Del. 1997).

208. 671 A.2d 1368, 1382-83 (Del. 1996) (citing Lacos Land Co. v. Arden Grp., Inc., 517 A.2d 271 (Del. Ch. 1986)).

209. *Id.*

fee's impact was not a consideration of something other than the merits of the transaction, and, hence, not coercion.[210]

Of course, if this holding means that every provision in a merger contract is part of the merits of the deal simply because it is in the contract and so no provision in the merger contract can constitute coercion, then a provision in a merger contract allowing one company to dynamite all of the other company's property if the other company's shareholders vote down the merger would not be coercion. What the court presumably meant was that insofar as the fee was an attempt to compensate the other side, rather than to pressure the shareholders, it was part of the deal's merits and so not coercion. Given this, the question becomes whether the reasonable estimation of damages and coercion issues collapse entirely into one inquiry or whether to find coercion the court must find that the termination fee is so large that it both exceeds a reasonable estimate of damages and impacts how the shareholders vote (which might involve different levels).

In many cases, it might not matter whether one focuses on the lock-up's or termination fee's impact of pressuring the shareholders or the impact of deterring other bids (which could render the lock-up or fee preclusive, even if not coercive). Still, in some cases, there may be a difference in impact.[211] Moreover, as discussed earlier when dealing with board promises, the risk of deterring other possible bids in the future may be more salient in *Revlon* situations and might be traded for a bid (or a better bid) now; whereas coercion of the shareholders would go to the core of *Omnicare*'s concerns and might not be subject to trading for a deal now. Most fundamentally, coercing shareholders relates to the refereeing power disputes goal for judicial review, whereas preclusion of other offers, barring context raising loyalty concerns, is simply another business judgment.

In any event, Delaware Chancery Court decisions, while disavowing a rule of thumb making termination fees of around three percent of the corporation's value okay,[212] have repeatedly said that fees of around this percentage are okay.[213] In part, this follows the approach in *Brazen* of comparing the fee at hand as a percentage of company value against the

210. *Brazen*, 695 A.2d at 50.

211. *See, e.g.*, J. Travis Laster & Steven M. Haas, *Judicial Scrutiny of Deal Protection Measures*, 11 M&A LAW. 18 (2007) (arguing that courts should evaluate termination fees as a percentage of both enterprise value and equity value, as the former is relevant to preclusion of other bidders and the latter is relevant to coercion of shareholders).

212. *E.g.*, La. Mun. Police Emps. Ret. Sys. v. Crawford, 918 A.2d 1172, 1181 n.10 (Del. Ch. 2007).

213. *E.g.*, Davidoff & Sautter, *supra* note 24, at 705 (two percent to four percent repeatedly upheld); Hamermesh & Fedechko, *supra* note 200, at 13-14 (three percent to four percent generally upheld).

magnitude of fees upheld in prior cases,[214] which the Chancery Court has increasingly supplemented by referring to what is standard in merger contracts.[215] In part, it reflects a casual assumption that other prospective bidders either are not going to be too impacted in their decision by fees of this magnitude or else would not be willing to pay enough more to lose sleep over anyway.[216] By contrast, termination fees whose size relative to the size of the corporation makes them stand out like a sore thumb have attracted a negative reaction by the Chancery Court.[217] As in *Brazen*, the degree to which the fee represents expenses incurred by the bidder is a factor, particularly in justifying larger percentage fees in the case of smaller acquired companies.[218]

(d) Impact of Context

The court's reaction to deal protection devices not only depends upon the individual provision, but also upon the broader context. This context includes both the constellation of deal protections found in the merger agreement and also the background setting of the deal.

Omnicare, itself, illustrates how a pair of protections for the merger, which might have been acceptable individually, became unacceptable because of their combined impact. Along the same lines, the disincentive to competing bids, or the pressure on shareholders to vote for a merger, created by individual fees, lock-ups, no-talks, and the like, add up to create a greater impact as the merger agreement aggregates a number of such

214. *E.g.*, *In re* Smurfit-Stone Container Corp. S'holder Litig., No. 6164-VCP, 2011 WL 2028076 *21 (Del. Ch. May 24, 2011); *In re* Pennaco Energy, Inc., 787 A.2d 691, 707 (Del. Ch. 2001); McMillan v. Intercargo Corp., 768 A.2d 492, 505-06 (Del. Ch. 2000) (fee was at the high end of what courts had approved).

215. *In re Smurfit-Stone Container Corp. S'holder Litig.,* 2011 WL 2028076, at *21; *In re* Atheros Commc'ns, Inc. S'holder Litig., No. 6124-VCN, 2011 WL 864928, at *7 n.61 (Del. Ch. Mar. 4, 2011); *In re* 3Com S'holders Litig., No. 5067–CC, 2009 WL 5173804, at *7 (Del. Ch. Dec. 18, 2009).

216. *E.g.*, *McMillan*, 768 A.2d at 505-06 ("[I]t is difficult to see how a 3.5% [termination] fee would have deterred a rival bidder who wished to pay materially more for [the company]."). Perhaps this is because stock prices randomly go up and down by this sort of margin all the time. *See, e.g.*, Coates IV & Subramanian, *supra* note 22, at 333 (discussing the argument that losing two to three percent of the company's value "could hardly be deemed 'coercive' because no shareholder" in voting or manager in deciding whether to make a competing bid "could measure the value of the merged entity with such precision").

217. *In re* Comverge, Inc. S'holders Litig., No. 7368-VCP, 2014 WL 6686570, at *15 (Del. Ch. Nov. 25, 2014) (thirteen percent when taken together with favorable conversion rate on notes issued to buyer); Phelps Dodge Corp. v. Cyprus Amax Minerals Co., Nos. CIV.A. 17398, CIV.A. 17383, CIV.A. 17427, 1999 WL 1054255, at *2 (Del. Ch. Sept. 27, 1999) (6.3%).

218. *E.g.*, *In re* Topps Co. S'holders Litig.*,* 926 A.2d 58, 86 (Del. Ch. 2007) (a termination fee that was a bit high in percentage terms could be explained by the small size of the deal and that it included the buyer's expenses).

provisions.[219] In this instance, however, unlike *Omnicare*, the aggregating effect is a matter of degrees. This makes it difficult to say when such an effect will be too much. As one Chancery Court opinion put it, "[O]ne of these days some judge is going to say 'no more' and, when the drafting lawyer looks back, she will be challenged to figure out how or why the incremental enhancement mattered. It will be yet another instance of the straw and the poor camel's back."[220]

The context provided by the background setting of the deal potentially includes: Why were the directors looking for a buyer? How much did the directors shop for competing bids before agreeing to the merger with the deal protections? What motive did the directors have for agreeing to the deal protections? How good was the deal? Also, subsequent events (the presence of parties actually interested in making a later competing bid) add to the context.

Judicial reactions to such background context seem to vary. In *Revlon*, such context was everything. By contrast, the court in *Omnicare* seemed unmoved by the desperate straits in which NCS found itself, which made a bird in the hand desirable even at the expense of completely foreclosing other more attractive offers. This may suggest a greater focus on context in *Revlon* situations with its emphasis on getting the best deal—something that may depend, for example, as much on the extent directors shopped before agreeing to the merger as it does on the terms of the deal protection devices. By comparison, broader contextual issues regarding the deal have less to do with *Omnicare*'s expressed concern about protecting the shareholders' veto. Still, one wonders whether the decision in *Omnicare* would have been the same despite the fait accompli if there were no superior bid by Omnicare to create seller's remorse. Indeed, one Chancery Court opinion has mused about whether the court should issue an injunction even when faced with deal protections violating *Omnicare* if there is no other bidder on the horizon.[221]

6 Unocal *Scrutiny of Shotgun Corporate Marriages Beyond Just Deal Protections*

The court in *Omnicare*, citing *Time*, assumed that the business judgment rule governed the decision to accept the Genesis proposal and confined review under *Unocal* to agreeing to the deal protections.[222] In *Time*,

219. *See, e.g.*, La. Mun. Police Emps. Ret. Sys. v. Crawford, 918 A.2d 1172, 1180-81 (Del. Ch. 2007) (deal protections formed an "intricate barricade" to another bidder).

220. *In re* Orchid Cellmark Inc. S'holder Litig., No. 6373-VCN, 2011 WL 1938253, at *8 (Del. Ch. May 12, 2011).

221. *In re* OPENLANE, Inc. S'holders Litig., No. 6849-VCN, 2011 WL 4599662, at *10 n.53 (Del. Ch. Sept. 30, 2011).

222. Omnicare, Inc., v. NCS Healthcare, Inc., 818 A.2d 914, 928-29 (Del. 2003).

the court upheld under the business judgment rule the original decision by Time's board to merge with Warner and only applied *Unocal* (with one notable exception[223]) once the board, in response to Paramount's offer, restructured the Warner merger into a cash deal to remove the need for a vote by Time's shareholders.[224] This, however, forces us to ask what exactly it was about the restructuring by Time's board that triggered *Unocal*.

One possibility is that *Unocal* applied simply because the restructuring occurred in response to a hostile tender offer and *Unocal* applies to any board action taken for the purpose of interfering with a hostile tender offer. Following this line of reasoning, decisions to sell or merge (and not just the deal protection devices) for the purpose of interfering with hostile tender offers (a sort of corporate marriage of necessity so to speak) are subject to review under *Unocal* when not subject to *Revlon*.

An alternate possibility is that *Unocal* applied only because the restructuring removed the right of the shareholders to vote on the Time-Warner deal, thereby taking away from Time's shareholders the ultimate choice between marrying Warner or marrying Paramount. Under this analysis, decisions to sell or merge the corporation (rather than just agreeing to deal protection devices) do not trigger *Unocal* scrutiny, even if motivated as a response to a hostile tender offer, so long as the shareholders can vote down the deal.[225]

Yet, even if *Unocal* only applies to depriving shareholders of a vote, but not to the deal itself, this may still have considerable impact. In *Time*, the restructuring was reactive—hostile bid followed by restructuring to eliminate the vote requirement. *Unocal* scrutiny, however, is not limited to decisions following a hostile bid. Instead, preemptive actions, such as deal protection devices or takeover defenses, are subject to *Unocal* scrutiny despite being taken before any hostile bid.[226] This creates the prospect that whenever boards choose to structure a corporate combination in a manner that does not require a shareholder vote, review of this decision demands scrutiny under *Unocal*. Indeed, this conclusion seems to follow given that *Omnicare* justified applying *Unocal* to deal protection devices based in substantial part on protecting the shareholders' power to vote contrary to the board's wishes, and the seeming equivalence between co-

223. The court in *Time* applied *Unocal* to certain deal protection features in the original Time-Warner merger agreement. Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1151 (Del. 1989).

224. *Id.* at 1152.

225. The Delaware Supreme Court's decision in *Williams* provides support for this interpretation in its application of the business judgment rule, rather than *Unocal*, to takeover defenses enacted through shareholder approved certificate amendments and its explanation that *Unocal* only applies to unilateral (as opposed to shareholder approved) defensive actions by the board. Williams v. Geier, 671 A.2d 1368, 1377 (Del. 1996).

226. *E.g.*, Strine, *supra* note 181, at 934.

ercing shareholders with deal protection devices and depriving the shareholders of a vote altogether.

This, however, brings us back to the old debate over the *de facto* merger doctrine when it comes to shareholder rights. In *Time*, switching the consideration received by Warner's shareholders to cash avoided a NYSE listing requirement to put large stock issuances to a shareholder vote. Yet, something quite different avoided any requirement under Delaware's corporation statute for a vote by Time's shareholders. By structuring the Time-Warner combination as a merger of Warner with a subsidiary of Time, rather than with Time itself, the "shareholder" on the Time side who needed to approve the merger under Delaware law was Time—meaning that Time's board cast the shareholder vote to approve the Time-Warner merger.[227]

Courts in some jurisdictions have attempted to prevent use of deal structure to avoid triggering shareholder rights (such as voting or appraisal rights) that normally attach to a merger by labeling such a transaction a de facto merger.[228] The Delaware Supreme Court in *Hariton v. ARCO Electronics, Inc.*,[229] rejected, however, any recognition of the *de facto* merger doctrine when it comes to shareholder rights in Delaware.

Does *Hariton* preclude applying *Unocal* scrutiny to structuring corporate combinations in ways that avoid a shareholder vote (other than, as in *Time*, in reaction to a hostile tender offer)? Perhaps not, since such scrutiny would be consistent with a broader Delaware approach encapsulated within *Unocal* under which the Delaware Supreme Court interprets the corporation statute to grant broad authority to the board, but then applies more careful scrutiny to the use of such authority to reduce shareholder power in particular instances. This allows the court to take a flexible approach in using judicial review to carry out the goal of refereeing power disputes between the board and shareholders.

IV. WHAT'S SO DIFFERENT ABOUT SAYING YES?

The arcane standards in Delaware for reviewing board decisions to sell or merge the corporation suggest the utility of stepping back to take a wider view. Our objective is to identify precisely when and how, in light of the three goals for judicial review, board decisions to sell or merge the corporation raise greater or different concerns than exist for other board decisions, thereby calling for different standards.

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227. *Time*, 571 A.2d at 1146.

228. *E.g.*, *In re* Penn Cent. Sec. Litig., 367 F. Supp. 1158 (E.D. Pa. 1973) (involving a triangular merger); Pratt v. Ballman-Cummings Furniture Co., 495 S.W.2d 509 (Ark. 1973). *But see* Terry v. Penn Cent. Corp., 668 F.2d 188 (3d Cir. 1981).

229. 188 A.2d 123 (Del. 1963).

A. Dangers of Disloyalty

1. At the Buzzer

The principal argument that decisions to sell or merge the corporation inherently present a heightened danger of disloyalty invokes what economists refer to as a final period problem.[230] Specifically, the incentives for doing a good job created by directors' and senior executives' desire to maintain or advance their positions within the corporation disappear if the directors and senior executives know that the sale or merger will lead to their removal.

This final period rationale is different in a fundamental way from the conflict of interest concerns that traditionally lead to increased scrutiny of board decisions. Conflicts of interest produce incentives that affirmatively encourage directors to act contrary to the corporation's or the shareholders' interests. So, in making a contract between a director and the corporation in which he or she is a director, the director has an incentive to give him or herself a good deal. Less extreme, but still similar, the normal human desire to retain power, not to mention whatever compensation or perquisites go with the position, give directors an incentive to oppose tender offers that would remove them from their positions. By contrast, the final period argument, in itself, does not posit any incentive that affirmatively encourages directors and senior executives to sacrifice corporate or shareholder interests. Rather, the argument is that the directors and senior executives will not have as much incentive as they normally do to make the right decision for the corporation and its shareholders.

This distinction, in turn, forces one to ask whether decreased incentives for good decisions justifies heightened judicial scrutiny of board decisions to sell or merge the corporation based upon the goal of protecting against disloyal motives.[231] The problem is that once courts begin adjusting the level of scrutiny to offset decreased incentives directors may have in some situations, it is difficult to know where to stop. For example, the final period situation involving the sale or merger of a corporation is not the only final period situation, and, indeed, may not even be the most important final period situation. Businesses in trouble present a final period situation.[232] Should heightened scrutiny, rather than the business judgment rule, apply to every decision directors make for failing corporations?

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230. *E.g.*, Reis v. Hazelett Strip-Casting Corp., 28 A.3d 442, 458-59 (Del. Ch. 2011); Sean J. Griffith, *Deal Protection Provisions in the Last Period of Play*, 71 FORDHAM L. REV. 1899, 1942 (2003).

231. Thinking ahead, the reader might also ask whether the loss of incentives in a final period situation demands added scrutiny under the goal of reducing unintended harm, even if it does not under the goal of protecting against disloyal decisions. To avoid duplication, the present discussion will serve for both.

232. *E.g.*, Griffin, *supra* note 230, at 1943.

Moreover, the inevitability of aging presents each director with his or her own final period situation. The impact of Van Gorkom's impending retirement on the events in the *Van Gorkom* case provides an example of this.[233] On the other hand, directors, who are not in the final stages of their career, may have plenty of incentive to do a good job in order to preserve their reputation in the broader market for their services even if they will never face another election by a particular corporation's shareholders.[234] Should the level of scrutiny depend on the average age of the board members?

Beyond this, compensation schemes and stock ownership create different degrees of incentive toward good performance.[235] Does this mean courts should apply a higher degree of scrutiny to a board decision if the directors do not own much stock in their corporation or do not receive compensation dependent upon corporate performance and so may have limited financial incentives for making good decisions? How about directors of non-profit corporations, who may not receive any compensation;[236] should their decisions be subject to stricter scrutiny because of less financial incentive to do a good job?

Such questions suggest pause before imposing added scrutiny on board decisions to sell or merge the corporation because of the loss of incentives in a final period situation. This is especially so since the final period argument as applied to directors in a corporation with widely dispersed ownership sounds better the less one thinks about it. After all, it has long been recognized that the need to answer to widely dispersed shareholders in a public company provides very little discipline upon corporate boards even before a final period occasioned by sale or merger.[237]

Some writers[238] have attempted to tie the final period problem into more conventional disloyalty by raising the concern that directors and senior executives may respond to the final period involved in selling or merging the corporation by seeking to maintain their positions following the sale or merger and by making side deals with the buyer. However, it

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233. Van Gorkom's approaching retirement, combined with his substantial holding of Trans Union stock, may have motivated him to seek a sale, rather than worrying about getting the top dollar.

234. *E.g.*, Michael P. Dooley & E. Norman Veasey, *The Role of the Board in Derivative Litigation: Delaware Law and the Current ALI Proposals Compared,* 44 BUS. LAW. 503, 526 (1989).

235. *E.g.*, Daniel R. Fischel & Michael Bradley, *The Role of Liability Rules and the Derivative Suit in Corporate Law: A Theoretical and Empirical Analysis,* 71 CORNELL L. REV. 261, 276 (1986).

236. *E.g.*, Thomas Lee Hazen & Lisa Love Hazen, *Punctilios and Nonprofit Corporate Governance - A Comprehensive Look at Nonprofit Directors' Fiduciary Duties*, 14 U. PA. J. BUS. L. 347, 364 (2012).

237. *See infra* notes 244-45 and accompanying text.

238. *E.g.*, Bainbridge, *supra* note 16, at 3291-92.

is distracting and over-inclusive to assume that every sale or merger involves the danger of disloyal motives as a final period because some sales or mergers involve efforts to maintain positions or making side deals.

2. One Door Closes, Another Door Opens

As just seen, the real disloyalty problem from directors and senior executives potentially losing their positions as a result of selling or merging the corporation lies with efforts by directors and senior executives to assure their continued positions after the sale or merger and to negotiate with the buyer over the terms of such employment or other sorts of compensation. This disloyalty can manifest itself in two ways: Directors and senior executives may favor a transaction with a buyer who will continue them in their positions over a deal with a buyer who will not, or directors and senior executives in negotiating the transaction may trade a lower price for the company in exchange for a better package for themselves.[239]

It is important, however, to analyze when this danger is greater and when the danger is less when it comes to selling or merging a corporation. This starts by asking why, if directors and senior executives are worried about maintaining their positions, they decided to sell or merge the company.

Revlon involved one explanation: If the directors did not sell to the white knight, the shareholders were going to sell to a hostile bidder. Moreover, in times of industry consolidation, directors might not wait for a hostile bidder before seeking friendly partner. Still, sales or mergers of corporations take place all the time without the threat that if the directors do not sell or merge now, they will inevitably face a successful hostile offer later.[240] This suggests that before assuming a danger of disloyal motives in any sale or merger in which directors or senior executives maintain their positions, one must ascertain the extent to which their positions were at risk without the sale or merger.

One caveat to this conclusion is that announcements of agreements to sell or merge the corporation often encourage other parties to make a higher bid.[241] Directors, who have agreed to a transaction with a buyer

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239. *E.g.*, Jay C. Hartzell, et al., *What's in It for Me? CEOs Whose Firms Are Acquired*, 17 REV. FIN. STUD. 37, 51-56 (2004) (finding that management of selling corporations exchange lower premiums for generous compensation packages); Julie Wulf, *Do CEOs in Mergers Trade Power for Premium? Evidence from "Mergers of Equals,"* 20 J.L. ECO. & ORG. 60, 94 (2004) (finding that management of merging corporations exchange lower premiums for employment in the surviving entity).

240. *See, e.g.*, Mark Lebovitch & Peter B. Morrison, *Calling a Duck a Duck: Determining the Validity of Deal Protection Provisions in Merger of Equals Transactions*, 2001 COLUM. BUS. L. REV. 1, 27 (deal protections most often approved " 'on a clear day,' when a third-party unsolicited bidder has yet to come forward").

241. *See, e.g.*, *id* at 28-29 (acquirers would not ask for deal protections if they did not fear later bids); Heath Price Tarbert, *Merger Breakup Fees: A Critical Challenge to Anglo-*

that will keep them in their positions, might worry that such higher bids could come from buyers that will not. Hence, *Unocal* scrutiny of deal protection devices based upon entrenchment concerns seems reasonable when directors agree to a transaction with a buyer that will maintain current management, even in situations in which there was no threat to current management without a sale or merger. Still, much as Delaware courts have taken a fairly relaxed view under *Unocal* toward the mere adoption of a poison pill prior to a hostile offer,[242] courts might reasonably be less rigorous in reviewing deal protections in the absence of an actual earlier or later bidder who threatens to replace the board.

More significantly, the importance of retaining positions to the appropriate level of scrutiny is a double-edged sword. In sales or mergers in which directors or senior executives do not retain their positions, this motive for potential disloyalty does not exist. Indeed, insofar as the traditional justification for heightened scrutiny under *Unocal* lies in the omnipresent specter that directors might be acting to preserve their positions, it becomes hard to justify applying *Unocal* to deal protections for sales or mergers in which the directors will lose their positions.[243]

Moreover, it is worth noting that sales or mergers in which directors and senior executives retain their positions commonly still leave the directors and senior executives in a worse situation than they were before. This is most evident in a sale of control, such as the Paramount-Viacom merger condemned in *QVC*.

At least since Berle and Means,[244] it has been understood that shareholders of companies with widely dispersed ownership do not really select or control the directors.[245] A sale of control, such as the proposed Paramount-Viacom merger, changes this dynamic, since senior executives and directors are now answerable to a single shareholder with the real ability to exercise control.[246] Indeed, they may find themselves sharing the often-unhappy lot of managers of professional sports teams who must keep the teams' owners happy. By contrast, a merger that leaves control among widely dispersed shareholders, such as the Time-Warner combination,

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American Corporate Law, 34 LAW & POL'Y INT'L BUS. 627, 631 (2003) (deal jumping by making a higher bid between the time of the merger agreement and the time of shareholder approval sharply increased in the mid-1990s).

242. *See, e.g.*, Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985).

243. For a brief discussion of a case in which the defendant directors, in fact, argued that the court should apply a deferential standard of review to a sale in which none of the board would maintain their positions after the sale, see Strine, *supra* note 181, at 931 n.35.

244. ADOLPH A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

245. *E.g.*, Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 679 (2007).

246. *E.g.*, *Gilson*, *supra* note 30, at 1650-51.

keeps the Berle-Means dynamic for the directors and senior executives who retain their positions following the transaction. This is why the results in *Time* and *QVC* produce a paradox and the *Revlon* doctrine as transmitted through *QVC* is entirely upside-down. Indeed, to the extent that scrutiny of decisions to sell or of deal protections in *Revlon* situations should differ from scrutiny under *Unocal* as applied to so-called mergers of equals or efforts to remain independent, the standard applied to *Revlon* situations should be less demanding, not more.

Beyond the concern that directors and senior executives may favor a buyer who will retain them in their positions, there is the concern that, in negotiating with the buyer, directors and senior executives may trade a lower price for the company in exchange for a better employment package or other sorts of side payments for themselves. This means that courts have appropriately increased scrutiny of agreements to sell or merge the company negotiated along with employment or other contracts for the directors and senior executives.[247]

The court can also deter selling out the shareholders when negotiating side deals by applying the rule that an agent must fork over to the principal any benefits the agent receives from parties with whom the agent is negotiating on behalf of the principal absent approval of the agent's conduct by a fully informed principal.[248] Applied here, the senior executives or directors should give to their former shareholders any even arguably above-market compensation they receive from the buyer whenever there is simultaneous negotiation of the sale and any personal contracts, unless independent directors or shareholders have voted specifically to approve the simultaneous negotiation after full disclosure.[249]

Still, one might worry that the danger of side deals goes beyond simultaneous negotiation of the sale or merger and of the terms of employment or other arrangements. Specifically, directors and senior executives might try to curry favor with the prospective buyer in the hope that the buyer will remember kindly what they did when later setting the terms of their new employment package or in other ways. Such conduct is obviously much more difficult to detect and police. Nevertheless, there are other incentives to consider. For example, managers might think twice before beginning their relationship with

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247. *See supra* note 48 and accompanying text. Extensive securities law disclosure requirements should make it difficult to keep such deals a secret in the sale or merger of a publicly held corporation. *E.g.*, Fraidin & Hanson, *supra* note 24, at 1786.

248. *E.g.*, RESTATEMENT (THIRD) OF AGENCY § 8.02 (AM. LAW INST. 2016).

249. In this regard, it is important to recognize that approving the sale or merger is not the same as approving the simultaneous negotiation, and disinterested directors or shareholders should not be forced to approve of the practice of simultaneous negotiations as the price for getting a deal that they do not wish to turn down.

their new boss by taking actions that will give their new boss grounds to suspect their future trustworthiness.[250]

3. Being Human

Judges and commentators, who assert that the final period problem creates a risk of disloyalty extending beyond efforts to maintain positions or making side deals with the buyer, worry that directors and senior executives will give in to all sorts of motives when selling or merging the corporation.[251] As evidence, they often recite the amusing tale of personal pique motivating the key players in the *Revlon* drama[252] or similar stories.

No doubt such tales may paint a far more realistic picture of selling or merging the corporation than the sterile models of rational wealth maximizing, deal-making often used as the basis for normative discussions. Still, to suggest that such very human behavior only infects decisions to sell or merge the corporation and is restrained before a final period, is to show that one does not get out very much.[253] Just read the *Disney* case,[254] or better yet, read the more journalistic descriptions of the events surrounding Michael Ovitz' hiring and firing by Michael Eisner.[255] As suggested by this example—not to mention any experience on hiring or tenure committees—personnel decisions are particularly susceptible to emotional reactions.[256] Should courts start applying

250. *E.g.*, Fraidin & Hanson, *supra* note 24, at 1811.

251. *E.g.*, *In re* El Paso Corp. S'holder Litig., 41 A.3d 432, 439 (Del. Ch. 2012) ("[A] range of human motivations, including but by no means limited to greed, can inspire fiduciaries and their advisors to be less than faithful to their contextual duty to pursue the best value for the company's stockholders."); Griffith, *supra* note 230, at 1947 ("Directors and managers may favor one deal over another because it is more in line with their self image and view of the world or because it is more likely to cause them to be remembered fondly by employees or the business press.").

252. *E.g.*, *El Paso*, 41 A.3d at 439 n.24 ("Revlon's CEO, Michel Bergerac, rebuffed Pantry Pride's acquisition overtures in part because of the 'strong personal antipathy' felt by Bergerac towards Pantry Pride's CEO, Ron Perelman, who was an upstart from Philly and not someone . . . Bergerac wanted running his storied company.").

253. *See, e.g.*, Johnson v. Trueblood, 629 F.2d 287, 292-93 (3d Cir. 1980) (stating that the business judgment rule is based on the recognition that all director decisions involve some personal interest, but it would be impractical to take this into account).

254. *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693 (Del. Ch. 2005), *aff'd* 906 A.2d 27 (Del. 2006).

255. *E.g.*, Kurt Andersen, *Ovitz and Eisner: A Kids' Story*, N.Y. MAG., http://nymag.com/nymetro/news/columns/imperialcity/10900/ [https://perma.cc/T8GT-LJWZ] ("The Eisner-Ovitz debacle resulted from the sort of emotional, irrational mischief ordinarily made by children.").

256. This is not to say that only personnel decisions exhibit such tendencies. One can see an example of such very human decision-making in the long-time refusal by the majority owner of the corporation operating the Chicago Cubs to have the company install lights in Wrigley Field based upon his view that baseball is a daytime sport. Shlensky v. Wrigley, 237 N.E.2d 776 (Ill. App. Ct. 1968).

heightened scrutiny to selection of senior corporate executives? If not, it is difficult to see this as justification for heightened scrutiny of decisions to sell or merge the corporation.

4. The Other Guys

Discussions of the final period problem, of retaining positions and making side deals, and of acting on emotions, often point to examples involving senior executives. The directors, however, made the challenged decision to sell or merge the corporation. Suspect motives by persons who are not directors do not, without more, justify heightened scrutiny of the board's decision.

The easiest case for imposing heightened scrutiny over a board decision based upon conflicts of interest for persons other than the directors occurs with transactions with controlling shareholders (freeze-outs). By definition, controlling shareholders control the directors, thereby turning the controlling shareholders' conflicts into the directors' conflicts.

Conflicting motives of senior executives (for example, the CEO) are trickier. The senior executives might also be directors—albeit, it would be rare in a public corporation in this day and age for senior executives to occupy the entire or even most of the board.[257] A realistic assessment of board dynamics commonly shows, however, the influence possessed by executives, and especially the CEO, over outside directors.[258]

Still, belief in the ability of disinterested (or at least independent) directors to protect the corporation from executive conflicts reigns as a central tenet of corporate law. Statutory provisions allowing the vote of disinterested directors to cure conflicts of interest by directors or officers[259] reflect this belief. Indeed, the most dramatic conflict of interest transaction involving corporate executives, the setting of their compensation, generally falls within the business judgment rule by virtue of disinterested director approval.[260] Hence, if one wishes to challenge the notion that non-executive directors can protect the corporation and shareholders from the conflicts of senior executives, decisions to sell the corporation are hardly the only area demanding heightened scrutiny.

257. *See, e.g.*, *N.Y.S.E. Manual* 303A.01, http://nysemanual.nyse.com/lcm/sections/lcm-sections/chp_1_4/default.asp [https://perma.cc/XDH3-T7K8?type=image] (listed companies must have a majority of independent directors).

258. *E.g.*, LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION 26-34 (2004) (discussing various ways in which CEOs possess influence over directors).

259. DEL. CODE ANN. tit. 8, § 144(a)(1) (2016).

260. *E.g.*, Michelson v. Duncan, 407 A.2d 211 (Del. 1979).

B. Reducing Unintended Harm

Having seen that arguments for heightened scrutiny based upon concerns over disloyalty only justify special treatment of decisions to sell or merge in much narrower contexts than currently done, we now arrive at the goal of reducing unintended harm. In this instance, the factors that might lead courts to impose greater than normal scrutiny on decisions to sell or merge are often unarticulated, and, indeed, may operate on an almost subconscious level. Hence, we must bring these factors to the surface and then ask whether they, or other more articulated factors, justify departing from the minimalist approach to this goal normally followed in corporate law.

1. Making a Big Deal of Big Deals

Perhaps the most obvious fact about a decision to sell or merge the corporation is its significance—indeed, one might argue that it will often be the most important decision that a board will ever make. From this observation, courts might draw the common sense conclusion that boards should engage in more investigation and deliberation in deciding to sell or merge the company than boards do in more mundane matters (say, declaring a dividend or recommending a vote against a shareholder proposal appearing on the company's proxy form).

Yet, we must ask not just how directors respond to more important board decisions, but also how do judges. Here we confront the prospect that the greater significance of a board's decision may cause a court to pay more attention to challenges to that decision and thus (often unwittingly) produce a degree of scrutiny—either in nominally applying the business judgment rule or in deciding to depart from that rule—which is inconsistent with the approach of courts in more ordinary contexts.

To understand the phenomenon, consider the likely reaction of a judge to a complaint that directors breached their duty of care in making some fairly ordinary business decisions—such as refusing to install lights in a baseball stadium,[261] blowing some tax savings by declaring an in-kind dividend,[262] or operating a supermarket chain in a manner that the retired CEO thinks ill-advised.[263] Challenges to such matters highlight that the judge is being asked to get involved in the ongoing running of a business and create a concern that anything more than a back-of-the-hand dismissal could lead to an avalanche of similar litigation. Besides, the judge might view the plaintiff in such cases as a bit of a crank. By contrast, a challenge to a mega corporate transaction is likely to make a

261. *See Shlensky*, 237 N.E.2d 776.

262. *See* Kamin v. Am. Express Co., 383 N.Y.S.2d 807 (N.Y. App. Div. 1976).

263. *See* Gagliardi v. Trifoods Int'l, Inc., 683 A.2d 1049 (Del. Ch. 1996).

judge sit up and take notice and thus, get a more serious look—especially when a more substantial party (such as a disappointed bidder) with more capable attorneys brings the challenge. As the court takes a more serious look, the inevitable blemishes in the deal and the process leading up to it begin to show, which, in turn, provokes greater examination and ultimately a different degree of scrutiny than applied to challenges to an ordinary business decision.

Naturally, it might be a bit tacky, and raise questions about equal access to justice, for courts to come out and state that they will apply greater scrutiny to more significant corporate transactions. Still, one can get a hint of this in the explanation for heightened scrutiny in the *QVC* decision. Specifically, in holding that shifting control to a single person triggered *Revlon*—thereby dramatically expanding the circumstances under which Delaware courts explicitly give increased scrutiny to decisions to sell or merge—the court expressed concern about the loss of effective voting power for the unaffiliated shareholders once a single individual owns a majority of a corporation's outstanding voting stock, and explained that the transaction, in essence, involved the sale of a valuable asset belonging to the public shareholders (the ability to obtain a premium price for selling control over the corporation).[264] These concerns, however, simply demonstrate that the decision is an important one to the shareholders.[265] If the court had pointed to such concerns as mandating careful investigation and deliberation by the directors, this would have been unexceptional. But this is not what the court said. It said that such concerns—in other words, the importance of the deal—mandated enhanced scrutiny by the court.

Of course, one might argue that greater scrutiny of more consequential decisions makes a certain amount of sense as a matter of efficient use of judicial resources. Yet, among the lexicon of arguments asserted in support of deference to board decisions under the business judgment rule,[266] judicial economy has rarely, if ever, been one of them. Put differently, none of the rationales for deference under the business judgment rule—such as the concern about deterring necessary risk taking in business or the greater business expertise of directors versus judges—apply less to big decisions than to small ones.

Even, however, if one believes that more important board decisions warrant greater judicial scrutiny, the assumption that deciding to sell or merge the corporation is more important than other board decisions is at

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264. Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 42-43 (Del. 1993).

265. *Id.* at 43 ("Because of the intended sale of control, the Paramount–Viacom transaction has economic consequences of considerable significance to the Paramount stockholders.").

266. *See, e.g.*, Gevurtz, *supra* note 20, at 305-20 (discussing the rationales for the business judgment rule).

best a very crude and commonly inaccurate approximation. To see why, compare two cases: *Van Gorkom* and the shareholder derivative suit against the directors of the government-rescued bank in *In re Citigroup Inc. Shareholder Derivative Litigation*.[267] Perhaps if Trans Union's board had been more careful in *Van Gorkom* the shareholders would have gotten a better deal—maybe $60 as opposed to $55 per share.[268] During a corporation's history, directors will make many decisions that have far more impact over the long haul than ten percent of the value of the stock.[269] By comparison, the board's allowing Citigroup's operation in CDOs during the mid-2000s cost Citigroup billions of dollars in losses when the mortgage market went bust, which, in turn, necessitated a government bailout to save Citigroup and drove once pricy stock to peanuts.[270] Indeed, for courts to give more careful scrutiny to claims that directors failed to get every last cent in selling or merging the company than courts do in cases in which directors preside over corporate ruin seems upside down if judicial economy is the criteria.

2. A Locus for Focus

The comparison between the *Van Gorkom* and *Citigroup* cases suggests another factor that may prompt unconsciously greater judicial scrutiny of board decisions to sell or merge the company. Such decisions ultimately entail a binary choice by the corporation's board upon which to focus the review. While slightly complicated by a couple of later meetings in which the board reaffirmed its earlier decision, *Van Gorkom* is ultimately all about a two-hour meeting at which the board decided to sell the company for $55 per share. We know what process the board followed and what decision it made, and the responsibility lay entirely with the board. By contrast, the misadventures with CDOs at the heart of the *Citigroup* derivative litigation involved a series of decisions and non-decisions—e.g., getting involved with putting together CDOs to begin

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267. *In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106 (Del. Ch. 2009).

268. Sixty dollars per share was the high-end estimate of the price for an LBO that Trans Union's cash flow would support.

269. *See, e.g.*, Ryan Derousseau, *The Four Horseman of Bad Decision Making*, FORTUNE (Sept. 28, 2015, 1:04 PM), http://fortune.com/2015/09/28/bad-ceo-decisions/ [http://perma.cc/R58D-M7RM] (discussing causes and examples of bad decisions by CEOs picked by boards, including VW's CEO's actions in emissions scandal, which resulted in a forty percent drop in the price of VW stock); Diana Samuels, *Bad Boards Breed Bad Decisions*, SILICON VALLEY BUS. J. (May 18, 2012, 3:00 AM), http://www.bizjournals.com/sanjose/print-edition/2012/05/18/bad-boards-breed-bad-decisions.html (discussing causes and examples of poor board decisions particularly with respect to CEO turnover, with significant consequences for the corporations involved).

270. *E.g.*, Eric Dash & Julie Creswell, *The Reckoning: Citigroup Saw No Red Flags Even as It Made Bolder Bets*, N.Y. TIMES (Nov. 22, 2008), http://www.nytimes.com/2008/11/23/business/23citi.html [https://perma.cc/8PDH-2EJD].

with, expanding the CDO operation, not curtailing the CDO operation in the face of signs of weakness in the market for subprime mortgages, placing risky terms for the issuer (liquidity puts) in the CDOs, financing the CDO operation with short-term money through special investment vehicles—made by Citigroup executives at various levels and acquiesced in by the board or committees of the board over time.[271] In the former case, it is relatively easy for a court to second guess exactly what the board should have done differently; in the latter case, stating exactly which directors should have done what differently, and when, is less straightforward.[272] As a result, board decisions to sell or merge present a much more inviting target for scrutiny and second-guessing.

The irony, however, is that insofar as one purpose of the business judgment rule is to allow the board to make decisions free from the fear of judicial second-guessing,[273] the single binary board decision needs at least as much, if not more, protection from excessive after-the-fact scrutiny as does the board's more general exercise of its oversight role.

3. *Routinized and Scrutinized*

In explaining why directors are protected by the business judgment rule while doctors are not, Melvin Eisenberg once argued[274] that there are protocols for medical decisions against which to measure the doctor's conduct, which is not the case for decisions by the board. This suggests that if courts come to view certain board decisions to be subject to accepted protocols or routines, courts will be more willing to carefully scrutinize deviations from such routines. In fact, this might be going on in Delaware cases reviewing board decisions to sell or merge the company.

Earlier, this article discussed the continued efforts by the Delaware Chancery Court to impose certain processes—market checks in the absence of impeccable board knowledge—upon board decisions governed by *Revlon*.[275] Why is this occurring? In fact, this potentially illustrates a spiral, in which greater scrutinization of activities by courts leads to greater routinization by parties, which, in turn, leads to greater scrutinization by courts.

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271. *E.g.*, *id.*; Gevurtz, *supra* note 33, at 115-20.

272. Indeed, one is reminded of Judge Hand's discussion of the impossibility of proving that the defendant director's neglect caused the failure of the business in *Barnes v. Andrews,* 298 F. 614, 617-18 (S.D.N.Y. 1924).

273. *E.g.*, Joy v. North, 692 F.2d 880, 886 (2d Cir. 1982).

274. *See* Melvin A. Eisenberg, *The Duty of Care of Corporate Directors and Officers*, 51 U. PITT. L. REV. 945, 963-64 (1990).

275. *See supra* notes 118-28 and accompanying text.

The spiral begins[276] in court opinions that seek to explain what stands condemned and, particularly in Delaware, provide advice on what is acceptable.[277] Two groups of attorneys use such language to influence the conduct of directors. The first group consists of attorneys who advise boards. Their job is to urge directors to act in a manner blessed in prior court decisions and avoid any actions that a prior court decision even hints might have raised concern.[278] The second group consists of plaintiffs' attorneys who challenge board decisions to sell. Their job is to pounce on any deviation from actions clearly blessed in prior court decisions and any actions that vaguely resemble actions criticized in prior court decisions.

As the actions of these two groups of lawyers herd directors into defined channels of carrying out their duties, the resulting consistency of board conduct, in turn, can influence court opinions. The ability to compare the case at hand against normal protocols followed by corporate boards gives the court the confidence to overcome the lack of expertise rationale for deference under the business judgment rule.[279] Indeed, the much-ballyhooed business expertise of Delaware judges,[280] reinforced by frequent merger litigation, can actually work to decrease deference by giving the judges confidence in reviewing board decisions to sell or merge.

Perhaps moving away from deference when boards deviate from accepted protocols for investigation and deliberation is a good thing. Few airline passengers would vote to have pilots abandon pre-flight checklists, and adherence to protocols by health care professionals can reduce the incidence of harmful medical errors.[281] Yet, one must be aware of the potentially broad impact of accepting this view for decisions to sell or merge the company.

To begin with, while scrutinizing deviations from protocols for deliberation and investigation, as opposed to scrutinizing the substantive merits of the decision, might seem relatively harmless, it may be a shorter jump than one thinks to go from protocols dealing with process to protocols

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276. The reader might wonder whether this discussion has put the chicken before the egg.

277. *See, e.g.*, Mohsen Manesh, *Damning Dictum: The Default Duty Debate in Delaware*, 39 J. CORP. L. 35, 57 (2013) (discussing use of dictum in Delaware court opinions to provide guidance).

278. *E.g.*, Hamermesh & Fedechko, *supra* note 200, at 2 ("[B]y identifying certain conduct as desirable and tending to reduce the threat of liability, or vice versa, judicial opinions encourage transactional advisors to shape their clients' behavior in accordance with that identification.").

279. *See supra* note 27.

280. *E.g.*, Franklin A. Gevurtz, *Why Delaware LLCs?*, 91 OR. L. REV. 57, 108 (2012) (business sophistication of Delaware judges given as a rationale for selecting Delaware as the state in which to form LLCs).

281. *E.g.*, Clement J. McDonald, *Protocol-Based Computer Reminders, the Quality of Care and the Non-Perfectibility of Man*, 295 N. ENG. J. MED. 1351 (1976).

dealing with substance. For example, at the heart of any decision to sell or merge is valuation. Should courts carefully scrutinize deviations from the norm by boards when it comes to approaches used for valuation?[282]

Moreover, decisions to sell or merge the company might not be the only board decisions in which routinization could lead to greater scrutiny and greater scrutiny could lead to greater routinization. This, in fact, returns us to the issue in the classic *Wrigley* case:[283] If all major league baseball teams but one play night games under lights, should the court scrutinize the decision of the directors in charge of the corporation operating that team not to install lights in its stadium?

4. Mid-course Corrections

As discussed earlier,[284] the Delaware Supreme Court, in its recent *Corwin* decision, suggested that heightened scrutiny under *Revlon* and *Unocal* is designed for injunction actions providing real time relief, while greater deference under the business judgment rule[285] should govern damage actions. The underlying notion apparently is that courts can be more liberal in intervening in board decisions when there is the opportunity by quick action to get it right, without the chilling effect or other negative consequences that can follow from imposing liability for damages based upon twenty-twenty hindsight.[286]

Whatever the merits of this distinction—a topic that depends upon which of the rationales for the business judgment rule one finds persuasive[287]—there is no reason to confine the distinction to decisions to sell or merge the corporation. If injunction actions allow for more scrutiny of decisions to sell or merge than allowed by the business judgment rule for damage actions arising from such sales or mergers, then injunction actions to force a corporate board to install lights in the baseball stadium

282. In fact, as discussed earlier, among possible readings of the *Revlon* doctrine is an obligation to pay greater attention to market valuation; moreover, the *QVC* opinion states that directors in *Revlon* situations should normally determine the value of non-cash consideration paid for the company with the assistance of experts using generally accepted methods of valuation. Paramount Commc'ns v. QVC Network Inc., 637 A.2d 34, 44 n.14. (Del. 1993).

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

284. *See supra* note 139 and accompanying text.

285. Or no liability absent bad faith if a Section 102(b)(7) waiver is present.

286. Allen et al., *supra* note 27, at 1297 n.30.

287. Specifically, is the purpose of the business judgment rule to prevent the chilling of useful risk taking that fear of personal liability might otherwise create or is the purpose for the business judgment rule based upon comparative expertise of directors versus courts—in which case there is no reason for distinguishing cases seeking injunctions from cases seeking damages?

operated by the corporation,[288] or to prevent corporate expansion and declare a dividend,[289] similarly allow for greater scrutiny.

5. Win Some, Lose Some

The factors discussed so far might cause courts to exercise greater scrutiny of decisions to sell or merge the corporation than done for other board decisions. Some commentators,[290] however, have made an argument that might justify courts exercising less scrutiny of decisions to sell or merge than courts exercise over other decisions.

The argument stems from the observation that shareholders commonly own a portfolio of stocks and, hence, shareholders in the selling corporation might also own stock in the purchaser, at least in cases in which the purchaser is a public, rather than privately held, corporation. As a result, what the selling corporation's shareholders lose with a worse price, they might gain with a better price for the buyer. Of course, not all the selling company's shareholders will own stock in the buyer and the proportionate ownership of those who do may not be the same. Perhaps the seller's shareholders might purchase stock in a publicly held buyer with the cash they receive in a cash sale (and, of course, will get stock in the buyer in a stock-for-stock deal). Yet, this hardly removes the loss from less cash or a lower exchange ratio of stock in the deal—otherwise why bother to negotiate such things. In any event, this is not the only deal that may affect the shareholders. In some future deal, the shareholders who are now complaining about a low price might only own shares, or own more shares, in the buyer and so, over the long run, better deals for publicly held buyers might offset the worse deals for sellers in terms of impact on the selling corporation's shareholders' overall portfolios. Moreover, lower prices for buyers might lead to more purchases of corporations, giving the selling corporation's shareholders a greater chance of another premium price sale of shares they own in another corporation.[291]

Accepting a blasé view of board decisions to sell the corporation based upon this sort of portfolio approach to shareholder interest would radically rewrite directors' duties in ways reaching far beyond decisions to sell or merge the corporation. To begin with, as many advocates of a stakeholder approach to directors' duties like to point out,[292] acceptance of a view of shareholder interests that goes beyond

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288. *Shlensky*, 237 N.E.2d at 776 (seeking injunction).

289. Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919) (seeking injunction).

290. BAINBRIDGE, *supra* note 10, at 34-35, 59.

291. Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1176-80 (1981).

292. *E.g.*, JAMES E. POST, LEE E. PRESTON & SYBILLE SACHS, REDEFINING THE CORPORATION: STAKEHOLDER MANAGEMENT AND ORGANIZATIONAL WEALTH 51-56 (2002).

the interest as shareholders in the corporation at hand undercuts a shareholder primacy or shareholder wealth maximization norm as the goal against which to measure directors' conduct.

Revlon provides an illustration. The narrow holding of *Revlon* is that the directors breached their duty by accepting a bid in order to protect the holders of Revlon promissory notes instead of getting the most money for the shareholders. Revlon, however, had issued the promissory notes to its own shareholders in payment for a pro-rata purchase of just some of each of their shares in a hugely oversubscribed self-tender—meaning that protecting the noteholders was protecting another investment of potentially many Revlon shareholders. Moreover, even those Revlon shareholders who did not hold the notes might benefit if directors can accept lower price bids for a company when those bids better protect corporate creditors. After all, Revlon shareholders might hold corporate debt issued by other companies. Also, perhaps other corporations in which the Revlon shareholders own stock could obtain loans on better terms in the future if directors look out for creditors when selling the company.[293] Hence, a view of shareholder interests that goes beyond the interest as shareholders in the corporation at hand makes the *Revlon* decision wrong.

Beyond this, the sale of a corporation is not the only situation in which shareholders may have invested in companies in which what is bad for one is good for another.[294] The most dramatic example would be shareholders who have invested in companies that compete with each other. Indeed, such shareholders might assert that advertising and any other expenditures aimed at building market share at the expense of a company's publicly held competitors constitutes waste as actions serving no legitimate purpose, because such actions do not advance the shareholders' interest when considering the shareholders' total portfolios.

6. Cannot Pull the Dodge Dodge

Discussion of the role of the noteholders in *Revlon* points to one way in which decisions to sell the corporation for cash are different than other decisions by the board: It is no longer possible for courts to avoid the question of whether directors can sacrifice profit for the shareholders to look out for employees, creditors, consumers, the community, or so on in the manner in which courts have ever since

293. Indeed, Lynn Stout and Margaret Blair's team production theory would support an argument that shareholders with diversified portfolios of corporate stocks could prefer to take actions sacrificing maximum value in mergers and sales in order to protect the interests of workers, as this would promote firm-specific investments of human capital in other ventures in which the shareholders own, or might in the future own, stock. *See* Blair & Stout, *supra* note 39.

294. In fact, such diversification of risk is the idea behind investing in a portfolio of stocks.

the famous *Dodge* case.[295] There, the court, after lecturing Henry Ford on how the directors breach their duty if they act to change the end objective of the corporation from profiting the shareholders to seeking to benefit others, actually allowed Ford to forgo obedience to maximizing shareholder profits on the off chance that the shareholders might end up better off in the long run by Ford's plans anyway.[296] When the shareholders are cashed out, there is no such long run.[297]

Considerable debate exists over whether the law should require directors to focus on shareholder wealth maximization, or allow directors to balance the interests of competing stakeholders in the corporation.[298] Weighing into this debate is beyond the scope of this Article. For those who would allow directors to balance the interests of competing stakeholders, decisions to sell the company call for no different scrutiny in this regard than any other board decision. For those demanding adherence to the primacy of shareholder wealth maximization, the business judgment rule no longer affords the directors discretion to balance the interests of shareholders versus employees, creditors, consumers, and the community at large when, as in *Revlon*, the shareholders are cashing out and so it becomes impossible to rationalize how, in the long run, looking out for other stakeholders also looks out for the shareholders. In one sense, this is stricter scrutiny, since directors lose the discretion they possess in other contexts to balance interests between shareholders and other stakeholders. In another sense, however, it is not changing the level of scrutiny from the business judgment rule. After all, the reason that courts in cases like *Dodge* conjure up the prospect of possible long run benefit to the shareholders is that the business judgment rule does not protect decisions that self-evidently cannot possibly profit the shareholders regardless of motivations.[299]

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295. Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919).

296. *Id.* at 507-08. While it is true that the court ordered Ford to declare a dividend, this was only because the company had the money to both pay the dividend and pursue Ford's socially motivated expansion plans—which the court refused to enjoin.

297. Admittedly, the expression that there is no long run for cashed out shareholders is a bit of an exaggeration. If the buyer is publicly traded, the seller's shareholders could purchase shares in the buyer with the cash they received. Still, there is no way to rationalize paying less cash to the seller's shareholders as being in their long-range interest on the ground they can purchase stock in the buyer. The lower the price paid by the buyer, the greater the value of the buyer's outstanding shares and so the seller's shareholders will pay more to acquire equivalent stock in the buyer than the amount of cash they received in the sale.

298. *See supra* note 39 and accompanying text.

299. *See, e.g.*, Joy v. North, 692 F.2d 880, 886 (2d Cir. 1982) (business judgment rule does not protect a decision that lacks a business purpose or constitutes a no-win situation).

C. Guarding the Shareholders' Veto Power

Having found that the nature of board decisions to sell or merge can tempt courts toward applying greater scrutiny to reduce unintended harm, but fails to justify such treatment, we now arrive at the goal of refereeing between the board and shareholders when it comes to the exercise of decision-making power. In this instance, there is a clear difference between decisions to sell or merge and most other board decisions: Corporation statutes ordinarily require approval by the shareholders of decisions to merge or to sell substantially all of the company's assets, which is not the case for most other decisions by the board.[300] The problem lies in turning this difference into a standard for judicial review consistent with the goal one is trying to achieve.

1. Opening Skirmishes

Regardless of the standard of review employed, courts must begin by asking how, if at all, did the board's action reduce the shareholders' power to veto a merger or sale favored by the board. For example, as pointed out earlier,[301] the deal protections in *Omnicare* did not actually reduce the power of the shareholders; indeed, as we shall see, the situations in which board actions materially impact the shareholders' veto power is a rather confined set. If the board's action does not interfere with the shareholders' power, then there is no reason for additional scrutiny based upon the goal of policing the allocation of power between board and shareholders.

Finding that the board's action in some manner reduced the effectiveness of the shareholders' veto power is not enough, however, to condemn the action. Otherwise, a shareholder lawsuit might demand that the directors fly all the shareholders to Maui for a several day retreat during which the shareholders hear presentations in favor and opposed to the proposed merger—all the better to create a more engaged and better informed shareholder electorate. Hence, we must ask by what standard should courts determine whether a board decision is acceptable despite in some manner reducing the effectiveness of the shareholders' power.

Before running off the rails, the court in *Omnicare* displayed reasonable instincts in calling for higher scrutiny than just deference to the board under the business judgment rule when dealing with power clashes between the board and shareholders. After all, why should the court a priori favor one side over the other in a dispute over power—as opposed to a dispute over the merits where the board can invoke its greater expertise and the deference due from its unquestioned power?

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300. *E.g.*, GEVURTZ, *supra* note 41, § 3.1.3*a* (discussing distinction between decisions requiring shareholder approval and those left solely to the board).

301. *See supra* discussion accompanying note 161.

Stripped to its core, *Unocal* imposes a standard of reasonableness.[302] This provides a workable beginning of an alternate framework to the business judgment rule for evaluating board actions impinging in some manner on the shareholders' right to veto corporate mergers and sales; after all, what could be more reasonable than demanding that the board be reasonable.[303] More seriously, reasonableness embodies the idea of an even-handed test that does not (for reasons just discussed) defer to the board, but, at the same time, does not put a thumb on the scale in favor shareholder claims—as appropriate to the goal of mediating power disputes. Besides, more important than the general rubric is the specific content. Indeed, *Omnicare*, *Time*, and a number of other Delaware court opinions demonstrate the need to carefully develop an analytical framework for deciding what is reasonable in this context.

2. *Right Makes Might*

An inherent danger in using a contextual tool like fiduciary duty or a standard like reasonableness as the vehicle for policing board efforts to reduce the shareholders' power lies in the potential for the substantive merits of the decision to influence the question of who had the power to make it. Seller's remorse, as in *Omnicare*, might tempt the finding that the board impermissibly usurped the shareholders' veto power; while good deals with no better offers might tempt courts to turn a blind eye to a little arm twisting.

Perhaps one might argue that judicial review of the deal's merits is the appropriate standard to apply in response to claims of board impingement of the shareholders' right to veto mergers and sales. Beyond just extreme pragmatism, the basis for this argument is a notion of functional substitutes. Specifically, if the purpose of shareholder approval is to serve as a double check on the wisdom of the board's action, then careful review of the deal's merits by the court could achieve the same objective. The structure of statutory provisions dealing with director conflict of interest

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302. *See, e.g.*, Allen et al., *supra* note 27, at 1309-10, 1319-20 (discussing *Unocal*/*Unitrin* intermediate reasonableness review).

303. One might argue for an even higher level of scrutiny when dealing with challenges to shareholder voting power. The fairness standard, however, looking as it does to whether a business transaction is a good deal for the corporation or shareholders, is irrelevant to power disputes. Courts in Delaware require a "compelling justification" when reviewing actions by directors that interfere with proxy contests (*e.g.*, Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988)), which is more relevant. Yet, there is a danger in adopting a standard so demanding that once invoked, it determines the outcome regardless of the specific facts. This might lead courts to use the issue of whether the standard governs the situation at hand as an escape valve for applying a more flexible review. The result is to convert the nominal standard into simply a conclusion invoked after the court has reviewed the challenged action under a standard that the court never articulates. Some Delaware judges have observed that this seems to have happened to the *Blasius* compelling justification standard. Allen et al., *supra* note 27, at 1313.

transactions lends some support to this argument.[304] Such provisions allow either a vote by shareholders or a judicial finding of fairness to cure the conflict.

This assumes, however, that the purpose for shareholder approval of mergers and sales is just to get a second opinion. While this is the objective when dealing with transactions in which directors or officers have a conflict of interest,[305] it is ahistorical to assume this is the goal behind requiring shareholder approval of mergers and sales. Instead, the requirement for shareholder approval of mergers and sales stems from legitimacy concerns—specifically the need for consent, for its own sake, by owners to the alteration of their property rights.[306] Seen in this light, heightened judicial scrutiny of the merger or sale would no more provide a functional substitute for an un-coerced shareholder vote than it would if the current directors cancelled the annual election of the board and asked the court to review whether the incumbents have done a good job.

Still, one might argue that while legitimacy in the alteration of ownership rights was the historical basis for the shareholder vote, the vote serves a different function today. The problem is that most of the academic rationalizations for the shareholder vote focus more on trying to explain why decisions to merge or sell are different from decisions that do not require shareholder approval than they do on explaining why a shareholder veto produces smarter decisions. So, for example, Melvin Eisenberg argues that while directors have an advantage in expertise when it comes to business decisions (e.g., build a plant, discontinue a product line), shareholders have as much expertise as directors when it comes to broad investment decisions (buying and selling stock their company).[307] Frank Easterbrook and Daniel Fischel argue that while shareholders will not pay much attention to ordinary corporate decisions, they will give thoughtful consideration to critical decisions such as whether to merge.[308] Both of these arguments, even if accurate,[309] suggest that shareholders

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304. DEL. CODE ANN. tit. 8, § 144 (2010).

305. *See, e.g.*, Gevurtz, *supra* note 40 (explaining that the basic approach to conflict of interest transactions is to have someone trustworthy determine whether conflicted directors gave the corporation a fair deal).

306. *See, e.g.*, Lynne L. Dallas, *The Control and Conflict of Interest Voting Systems*, 71 N.C. L. REV. 1, 6-11 (1992) (tracing the history of shareholder voting rights from a partnership / contract concept in which the owners (shareholders) had the ultimate control over the company and fundamental changes in the owners' rights required the consent of all, to a shared control by managers and owners, with the owners' majority vote required for certain changes in the corporate entity).

307. MELVIN A. EISENBERG, THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS 14-16 (1976).

308. Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395, 416 (1983).

309. *See* BAINBRIDGE, *supra* note 10, at 58 (arguing that rational shareholders will not spend the effort to find grounds to oppose a merger buried in the proxy statement and will

are not going to make worse decisions than the board when it comes to selling or merging the corporation; but they do not really say that shareholders will make better decisions.[310] Ronald Gilson gets closer to such an argument when he asserts that final period incentives justify the shareholder vote;[311] but we have already addressed the problem with arguing that the final period situation uniquely calls for heightened scrutiny of mergers and sales.

Legitimacy as the basis for the shareholder vote also means that arguments based upon the shareholders being dumb, ignorant, or confused, or having a greedy short-term perspective, do not justify—notwithstanding the unfortunate holding in this regard in *Time*[312]—impinging upon the shareholders' power to veto mergers or sales. As the later history of the Time-Warner combination suggests,[313] sometimes the confused shareholders would have gotten it right, while the board got it wrong. More fundamentally, the very existence of the shareholder franchise resolves such arguments in favor of the shareholders.

3. A Horsehead in the Bed

As discussed earlier,[314] termination fees and asset and stock lock-ups can punish shareholders for a negative vote, thereby potentially coercing shareholders into voting for a merger or sale they would otherwise reject. This prospect depends upon the terms of the fees or lock-ups and upon their size.

Looking at terms, one must distinguish fees or lock-ups only triggered if the corporation is immediately sold at a better price, from fees or lock-ups triggered by a shareholder rejection in the absence of a better offer (naked no-votes). The former should have no direct impact upon the

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approve a merger even where approval is not what an informed shareholder would do). *But see* Kai Li, Tingting Liu & Juan Wu, *Vote Avoidance and Shareholder Voting in Mergers and Acquisitions* (European Corp. Governance Inst. Fin., Working Paper No. 481, 2016), http://ssrn.com/abstract_id=2801580 [https://perma.cc/R2RW-BG7R] (study finding correlation between requirement of approval by shareholders of acquiring company and better outcomes in mergers and acquisitions).

310. If the notion is that shareholders will make better decisions (when lack of expertise or rational apathy do not apply) because shareholders have the best incentive to judge what is in their own interest, then judicial assessment of a deal's merits does not provide a functional substitute.

311. RONALD J. GILSON & BERNARD S. BLACK, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS, 720-21 (2d ed. 1995).

312. Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1153-54 (Del. 1989) (Time's directors successfully argued that the shareholders might be ignorant, mistaken, or confused in preferring Paramount's offer).

313. *E.g.*, Thomas Lee Hazen, *The Corporate Persona, Contract (and Market) Failure, and Moral Values*, 69 N.C. L. REV. 273, 291 n.105 (1990) (describing later price of Time-Warner stock).

314. *See supra* note 194 and accompanying text.

shareholders' decision—since the fee or lock-up does not happen with a simple rejection, and there is no sense voting for an inferior deal over a superior one just to avoid the fee or lock-up that becomes the buyer's problem.[315] Fees or lock-ups falling between those triggered by naked no-votes and those limited to an immediate other sale—as, for example, those triggered upon by the mere appearance of another offer prior to a shareholder rejection, even if the company never takes the other offer, or where the fee or lock-up lingers to reach sales or mergers taking place well into the future[316]—create the need for individual analysis and evidence to determine their potential impact on the shareholders' vote.

Turning to size, the fee or lock-up's financial impact and, hence, the degree to which it influences the shareholders' decision is de minimis when the fee or lock-up is small enough. As the fees or lock-ups grow, it becomes an empirical question, upon which a court might wish to consider actual evidence,[317] as to when their negative impact upon the corporation and shareholders becomes material in motivating the shareholders to vote for a merger or sale that the shareholders might otherwise reject.

Brazen raises the question of whether a legitimate reason for a termination fee or asset or stock lock-up should matter once a fee or lock-up is of a nature and size to influence the shareholders' vote. As discussed earlier,[318] a rational interpretation of *Brazen*'s holding that termination fees in a merger contract are part of the merits of the deal and so are not coercive, would limit this to fees having a legitimate purpose independent of their impact on how the shareholders vote. What, if anything, is a legitimate purpose, however, calls for a more careful analysis than found in *Brazen* or in much of the literature on the topic.

The fact that the buyer demanded the fee or lock-up as the price of entering a favorable merger is not a legitimate purpose, in itself, for a material termination fee or asset or stock lock-up. Otherwise, a provision allowing the buyer to dynamite all of the selling company's properties if the selling company's shareholders vote down the merger would not be coercive if demanded by the buyer as a non-negotiable condition for entering a favorable agreement. Instead, we must engage in a two-sided analysis

315. McMillan v. Intercargo Corp., 768 A.2d 492, 505-06 (Del. Ch. 2000). Fees or lock-ups will have an indirect impact on the shareholders' decision if they deter other bids or impact the desirability of a competing stock-for-stock bid; but we will address this later.

316. In *Brazen* for example, $200 million was payable if the company received a proposal from another party before the shareholders voted to reject the merger regardless of whether the company merged with this other party or anyone else; another $350 million became payable if within a year and half the company accepted an offer from a party who made a proposal prior to the vote. Brazen v. Bell Atl. Corp., 695 A.2d 43, 45 (Del. 1997).

317. *See, e.g.*, Davidoff & Sautter, *supra* note 24, at 703 (discussing the use of expert witnesses on the impact of deal protections).

318. *See supra* text accompanying note 208.

examining both what legitimate reason a buyer has for demanding a termination fee or asset or stock lock-up and why this reason makes it legitimate for the selling corporation's board to agree to the fee or lock-up.

Brazen points us to a seemingly reasonable concern: The buyer is investing time and energy in seeking the deal, which will go uncompensated if the purchase does not occur. A termination fee or a lock-up option to buy assets or stock cheaply provides compensation for these costs in the event the shareholders vote down the deal. Hence, as a first approximation, the buyer is justified in asking for such compensation and the seller's board is justified in agreeing in exchange for getting a bid or getting a better bid, all of which are completely independent of trying to force the deal through. It turns out, however, that issue is far more complex than suggested by this first approximation.

To begin with, it is misleading to suggest, as is often done,[319] that the board must agree to termination fees or asset or stock lock-ups or else prospective buyers will not spend the money to put together a bid. As illustrated by the facts in *Revlon* and *Omnicare*, proposed deal protections come as part of a package with a bid; indeed, a board would be crazy to agree to significant fees or lock-ups without knowing what the bid is. Hence, the costs incurred by the prospective buyer in initially investigating the company and negotiating the bid are sunk before the board agrees to deal protections.[320]

Still, there can be further costs after the board accepts the offer, such as due diligence and regulatory compliance,[321] fees entailed in lining up external financing,[322] as well as various switching costs triggered by the anticipation of integrating the merging firms together,[323] which the buyer may be less willing to incur (or incur at the same deal price) without assurance of recovery in the event of a negative shareholder vote. Potentially larger, *Brazen* pointed to the opportunity costs incurred by the buyer while waiting on the shareholders' decision; albeit one should probably discount the value of the buyer's lost opportunity to engage in another acquisition to reflect the statistics showing buyers often have cause to regret acquisitions.

There can also be a case for covering initial investigation and negotiation costs when the selling corporation sought out prospective buyers with the assurance, even if not a binding contract, that the company will agree to termination fees or asset or stock lock-ups if the board likes their offer.

319. *E.g.*, Griffith, *supra* note 21, at 613.

320. *E.g.*, Richard M. Buxbaum, *The Internal Division of Powers in Corporate Governance*, 73 CALIF. L. REV. 1671, 1705 (1985).

321. *E.g.*, Tarbert, *supra* note 241, at 632.

322. *E.g.*, BAINBRIDGE, *supra* note 10, at 87.

323. Coates IV & Subramanian, *supra* note 22, at 358-60.

Indeed, one might argue that the customary practice of boards agreeing to fees and lock-ups creates an enticement for prospective buyers to incur search and negotiation costs on a more general scale.[324] The evidence for this phenomenon is inconclusive.[325] Moreover, a shrewd board, if thinking only of the interest of the shareholders as shareholders in the selling corporation, would decline to protect the buyer's sunk costs—at least if not negotiating with a repeat player that might stand its ground to preserve its reputation.[326] This, in turn, brings us back to the question of whether the law should command boards to focus solely on the interest of the shareholders as shareholders of the selling corporation.[327]

Beyond this, we must consider the fact that the buyer's risk addressed by termination fees or asset or stock lock-ups only exists because corporate law curbs the board's authority to merge or sell the company without shareholder approval; parties do not need such provisions for contracts binding upon the corporation the minute the board agrees.[328] This raises the question of whether the fees or lock-ups should themselves be beyond the board's authority. Put differently, if we assume that corporate law encapsulates the arrangements parties would have made for themselves if they wrote up a contract, does it make sense to assume that shareholders would have insisted on retaining a veto over whether to sell or merge

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324. *E.g.*, Skeel, *supra* note 24, at 568.

325. *Compare* Davidoff & Sautter, *supra* note 24, at 700-01 (effects of lockups on attracting initial offers are uncertain), *with* John C. Coates, IV, *M&A Break Fees: U.S. Litigation Versus UK Regulation*, *in* REGULATION VERSUS LITIGATION: PERSPECTIVES FROM ECONOMICS AND LAW 255, 262–63 (Daniel Kessler ed., 2011) (There are more bids in the United States, where boards commonly agree to termination fees and the like, than in England, where boards cannot agree to such terms). The problem is that a prospective buyer faces other risks beyond shareholder rejection when deciding whether to embark upon possibly acquiring another corporation—including the investigation showing that the prospective target is unsuitable, failure to reach a deal with the targeted corporation's board, and, worst of all, the acquisition turning out to be a business mistake—which makes it uncertain how much difference it will make to remove the risk of wasted costs just in case of shareholder rejection.

326. A rational buyer should neither agree to pay more than its reservation price (the point at which the purchase is no longer profitable) in exchange for a promise to cover sunk costs if the deal does not occur, nor, viewing the negotiation as a one-off, should the buyer stop bidding before reaching its reservation price, thereby leaving a profitable deal on the table with nothing to show for its sunk costs, simply because the seller refuses to pay the sunk costs if the deal does not go through.

327. *See, e.g.*, Easterbrook & Fischel, *supra* note 291, at 1176-80 (board actions that prevent bidders from recovering investigation costs by raising the price the buyer must pay in the one sale, while good for the one company's shareholders in the one deal, will decrease the number of acquisitions, resulting in less wealth creating transactions and less discipline on inefficient management, to the detriment of shareholders as a group overall).

328. This is not addressing termination fees triggered by events independent of shareholder disapproval, such as antitrust or regulatory barriers. Some commentators have attempted to defend termination fees as serving the same function as liquidated damages. *E.g.*, Stephen M. Bainbridge, *Exclusive Merger Agreements and Lock-ups in Negotiated Corporate Acquisitions*, 75 MINN. L. REV. 239, 245-46 (1990). It is not a breach of the contract, however, for the shareholders to vote down the merger.

the company, but still have authorized their board to promise a consolation prize to the prospective buyer if the shareholders decide that the board brought back a poor deal—particularly if the consolation prize is large enough to influence the shareholders to accept a deal that they would prefer to reject?

We can simplify things considerably by focusing our attention on fees and lock-ups triggered by rejections other than to take a better offer—keeping in mind that fees and lock-ups limited to rejections to take a better offer do not pressure shareholders in their votes. Once we narrow our focus to rejections in the absence of a better offer—which is quite rare[329]—the risk that the buyer will be out its deal costs without a deal to show for it, and, accordingly, the concern that bidders will not bid without fees and lock-ups, decreases dramatically. Moreover, it is one thing to offer, as sometimes done for government procurement contracts, to compensate bidders' costs for preparing a bid in order to entice bidders to enter into an expensive competitive bidding process in which only one bidder can prevail. It is something quite different to offer to compensate such costs in the event that shareholders conclude that their board negotiated a poor deal. Indeed, the buyer's request for such compensation signals that the buyer thinks the board negotiated a poor deal for the shareholders; otherwise why else be worried that the shareholders would reject the deal in the absence of a better offer from someone else?[330]

Hence, termination fees or asset or stock lock-ups triggered by naked no votes should be considered coercive if the fee or lock-up is large enough to be material. In other cases (such as *Brazen*), the court should carefully assess both the potential influence of the fee or lock-up on the shareholders' vote and the costs incurred or expected before the vote by the buyer—giving greater weight to out-of-pocket costs necessarily incurred between the board action and the shareholder vote—and seek to reach a reasonable balance covering the most justified expenses with the least influence on the shareholders.

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329. John Mark Zeberkiewicz & Blake Rohrbacher, *Paying for the Privilege of Independence: Termination Fees Triggered by "Naked No Votes,"* 21 INSIGHTS 1, 2 (2007) (shareholder rejection of the Lear-Icahn merger in 2007 was only the 8th time since 2003 that shareholders voted down a merger out of the over 1000 submitted for shareholder approval).

330. One might argue that such compensation is justified by the option effectively created as a result of the logistical delay entailed in obtaining a shareholder vote in a public corporation, during which time the shareholders can sit back and see whether subsequent events make the deal unattractive. *See, e.g.*, Smith v. Pritzker, No. 6342, 1982 WL 8774, at *3 (Del. Ch. July 6, 1982), *rev'd sub nom.* Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985). Beyond better offers, however, it is difficult to know what such events could consist of; but this might be a rationale for upholding an agreement providing for termination fees in the event of shareholder rejection upon either a superior offer or other material intervening event (the company striking gold).

4. A Choice not an Echo

While termination fees and asset and stock lock-ups triggered only when shareholders reject a deal to take a better offer do not directly influence how the shareholders vote, these and other deal protections can indirectly influence shareholder approval by deterring potentially better deals surfacing before the vote.[331] This raises the question of whether depriving shareholders of potential choices interferes with their right to veto mergers and sales. At first glance, the answer is obviously yes. Depriving the shareholders of possible better offers effectively pressures them to vote for the board-favored deal as the only game in town.

On the other hand, this conclusion once again embodies an ahistorical view of the purpose for the shareholder vote. Corporate statutes requiring shareholder approval of a merger or sale long pre-date the relatively recent phenomenon of prospective buyers taking advantage of the resulting logistical delay in order to make competing offers to the shareholders.[332] There is no sign that the goal behind the requirement for shareholder approval was to establish a mandatory forum in which every public company was effectively up for auction after the board had entered one deal. Instead, as discussed earlier,[333] the shareholder vote requirement stems from legitimacy concerns calling for the owner's consent. The model is consent to one deal, not picking off a menu.

Admittedly, even if the requirement of shareholder approval was originally based upon legitimacy, this does not mean that the requirement might not serve a different purpose today. Before concluding, however, that the requirement for shareholder approval has evolved to serve the important function of promoting auctions,[334] one must ask why demand auctions only for selling the corporation—why not require the board to submit all large corporate contracts to competitive bidding before the board can enter a binding agreement? Also, why demand a second auction in cases in which the board accepted the merger or sale agreement only after conducting an auction to begin with?

More broadly, this gets into the debate regarding the utility of selling the corporation through auctions and of allowing boards to influence the process through deal protections granted to one bidder (so-called pre-

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331. Or by rendering a competing stock-for-stock deal less attractive.

332. *See, e.g.*, Dallas, *supra* note 306 (tracing history of shareholder voting rights through nineteenth-and early twentieth-century developments); Tarbert, *supra* note 241, at 631 (deal jumping by making a higher bid between the time of the merger agreement and the time of shareholder approval sharply increased in the mid-1990s).

333. *See supra* note 306 and accompanying text.

334. *See, e.g.*, J. Travis Laster, Omnicare'*s Silver Lining*, 38 J. CORP. L. 795, 828-33 (2013) (arguing that allowing higher bids before shareholder vote will produce prices closer to the buyer's reservation price).

commitment). Attempting to run through this debate here would unduly lengthen an already long article. Suffice it to say that the bottom line is that there is no bottom line. Instead, the literature is full of conflicting predictions concerning the impact of allowing board intervention in the auction process,[335] compounded by an often-unacknowledged difference as to what the desired object of the law should be.[336] This reminds us why judicial review proceeds with humility in pursuing the goal of avoiding unintended harm from board decisions and suggests caution before turning the requirement for shareholder approval into a tool for demanding auctions that last until the shareholders vote.[337]

All told, this analysis suggests that board actions, which deter competing offers, but otherwise leave undiminished the shareholders' power to veto the deal agreed to by the board, do not call for heightened scrutiny based upon the goal of protecting the shareholders' power to vote against a board-favored deal. Of course, there can be other reasons for imposing heightened scrutiny upon such actions. Specifically, concerns over disloy-

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335. *See, e.g.*, Ayres, *supra* note 24 (purporting to show when stock lock-ups will prevent a higher valuing bidder from prevailing in a contest to acquire the corporation); Timothy R. Burch, *Locking out Rival Bidders: The Use of Lockup Options in Corporate Mergers*, 60 J. FIN. ECON. 103, 106 (2001) (study of acquisitions found that target shareholders are not systematically harmed by use of lockup options, but on average obtained higher returns in deals in which such options were used); Coates IV & Subramanian, *supra* note 22, at 311-13 (testing the theoretical models put forward by Ayres, Fraidin & Hanson, and Kahan & Klausner against the available empirical evidence and finding that their models are inadequate in explaining the impact of lockups on bidder behavior and more generally on the market for corporate control); Davidoff & Sautter, *supra* note 24, at 700 ("[L]ock-ups may have positive, negative, or no effects depending upon the circumstances of the transaction. Nor can we make definitive empirical conclusions at this time about the effect of lock-up-creep. It is difficult to isolate and identify individual lock-ups and their effect on bidding."); Fraidin & Hanson, *supra* note 24, at 1822-30 (presenting examples purporting to show that lock-ups can allow desirable deals to take place and will not produce undesirable deals); Kahan & Klausner, *supra* note 23, at 1545-51 (identifying a critical missing element in Ayres' analysis of the effects of lock-ups); Quinn, *supra* note 21, at 878-80 (arguing that leaving the threat of a higher offer open leads to higher prices for the shareholders); Skeel, *supra* note 24, at 567-84 (challenging Fraidin & Hanson's analysis).

336. Specifically, is the goal to obtain the highest price for the selling shareholders, see Griffith, *supra* note 21, to have the party who places the highest value on the corporation win the contest to acquire the company regardless of the price paid, see Coates IV & Subramanian, *supra* note 22, or to promote corporate acquisitions as a discipline on inefficient management, see Kahan & Klausner, *supra* note 23.

337. Since state legislatures never had auctions between competing buyers in mind when creating the requirement for shareholder approval of mergers, it is not only fortuitous that auctions now occur as the result of the logistical delay in obtaining shareholder approval, but it is also an accident that the sequence written into the statute—board approval first, shareholder approval later—does not lend itself to arrangements commonly found in contexts in which owners have agents sell their property pursuant to prior instruction, whether that involves masterpieces auctioned at Sotheby's or decorator art sold through a consignment store. Perhaps legislatures should amend corporation statutes to allow the shareholders to switch the order by authorizing the board to sell pursuant to an auction or negotiation following specified rules with perhaps a minimum price. But this is a topic for another article.

alty can justify heightened scrutiny of board actions to protect a deal in which the directors will retain their positions or otherwise have a conflict. This conclusion also makes it is important to distinguish between deal protections that present the shareholders with an immediate choice between saying yes or no to just one offer and deal protections that deter other bids sufficiently far into the future so as to effectively lower the value of the shareholders' stock and thereby punish negative votes. The test is to ask whether the long-term negative impact of the deal protection's deterrence of offers appearing after the shareholders vote would be material to shareholders in deciding how to vote even in absence of any other present bidders.

5. Voting in the Dark

Some deal protections or other board actions reduce information available to the shareholders prior to voting on a merger or sale, thereby undermining the effectiveness of the shareholders' veto power. Lest, however, shareholders start demanding retreats at nice resorts in order to hear presentations about the proposed merger, not every board decision that arguably reduces, in some manner, information to shareholders constitutes a breach of fiduciary duty. Once again, the question should be what is reasonable.

The easiest part is to say that shareholders should receive whatever material information the board knows. Hence, withholding material information or misleading the shareholders, and any agreement that would call for such, is a breach of fiduciary duty. Indeed, viewing the matter in terms of the goal of policing the allocation of power with respect to a vote undertaken as an exercise in legitimacy establishes that scrutiny of disclosure to the shareholders is worthwhile without regard to establishing that better deals result.[338] The issues of whether there can be a more cost-effective way of ensuring complete and accurate disclosure than class action litigation and when courts should approve disclosure only settlements are subjects beyond the scope of this article.

The more difficult problem arises with deal protections—such as no-talk provisions and standstill agreements with don't ask, don't waive terms—which indirectly cut off information to the shareholders by cutting off information to the board. Here, the issue becomes whether it is sufficient that the shareholders know what the board knows—so long as the board had adequate information to make its decision under the relevant standard—or does the fact that the board serves as a conduit for information to the shareholders change the standard under which the court

338. *But see* Fisch et al., *supra* note 12.

evaluates the board's obligations with respect to obtaining information. The answer should depend upon symmetry in the use of the information.

In a situation in which the directors needed to gather positive and negative information about a proposed deal (including prospects for better offers) for their own decision as much as do the shareholders, then the standard should not change because of the indirect impact on information going to the shareholders. Symmetry breaks down if the directors favor a deal in which they retain their positions or otherwise have an interest. In this instance, however, increased scrutiny based upon loyalty concerns can protect against actions by the board to remain blissfully ignorant of possible better deals. Symmetry breaks down more subtly for information arising after the board agrees to a deal, even when directors do not retain their positions or have any other interest. Unless the board is engaged in an active post-signing market check, and particularly if the board has agreed to a force the vote provision, at this point we are talking about information whose primary utility is for the shareholders to vote against the deal the board made. This raises a power issue and the normal human instinct not to be as concerned about keeping information flowing so that someone else can say you were wrong.

Hence, reasonableness scrutiny of actions potentially curbing information reaching the board and, in turn, the shareholders in the interval between the board's and the shareholders' approval is appropriate. This does not mean that any interference is unreasonable. For example, as pointed out earlier,[339] standstills with don't ask, don't waive provisions might serve the legitimate function of forcing prospective buyers to present their best offer during an auction, which can be especially useful if the board feels it can obtain the highest price by conducting a sealed bid, rather than an English style auction.[340]

6. Executive Action

Time illustrates how directors can eliminate the shareholders' power to veto a board-favored deal by structuring the transaction to avoid the requirement for a shareholder vote. It is difficult to see how courts can subject deal protections to heightened scrutiny in order to protect the shareholders' power to veto a board-favored merger or sale, but, at the same time, give a pass under the business judgment rule to structuring the deal in a manner that avoids putting the merger or sale to a vote alto-

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339. *See supra* text accompanying note 192.

340. Jay B. Kesten, *Adjudicating Corporate Auctions*, 32 YALE J. ON REG. 45 (2015) (explaining how the sealed bid auction can produce bids closer to the winning bidder's reservation price than is the case with the traditional English open bidding auction—in which the winning bid is just higher than the second place bidder's reservation price—and how the sealed bid auction cannot occur without the board being able to commit to the winning bidder prior to the shareholder vote).

gether. Indeed, if *Time* stands for the proposition that *Unocal* governs only when the action avoiding the vote occurs after the appearance of a hostile bid, then the result simply might be to encourage boards to structure mergers or sales from the outset in a manner that avoids the vote.

There are a variety of factors beyond shareholder voting rights—e.g., insulation from liabilities, acquisition of non-transferable property, tax treatment, general business concerns—that might influence parties to structure a merger or sale as a triangular transaction and to pay with cash rather than stock.[341] If these factors result in a deal structure in which shareholders do not get to vote, so be it. Reasonableness inquiry should establish the bona fides of these reasons in motivating the board's decision, but courts should otherwise respect the board's decision. Given the somewhat arbitrary lines dividing deal structures requiring a shareholder vote from those that do not, so long as the board is taking a "let the chips fall where they may" attitude toward the impact of their chosen deal structure on the requirement of a shareholder vote, so should the court.

The more difficult question is what can justify a board decision, as in *Time*, to deliberately avoid a shareholder vote. The rationale accepted in *Time* that Time's shareholders might have preferred Paramount's offer because they were ignorant, mistaken, or confused seems to fly in the face of requiring a shareholder vote in any instance. Indeed, perhaps the only legitimate reason for allowing the board to structure a transaction with the goal of avoiding the requirement for a shareholder vote would be where the board is entirely confident in prevailing but seeks to avoid the delay and expense entailed in going through the exercise.

V. CONCLUSION

There is considerable room for improvement in judicial review of board decisions saying yes. Courts should cut back on when they treat decisions to sell or merge differently from other board decisions and, whenever they treat such decisions differently, should more carefully match the standard with the goals for judicial review.

Cutting back on treating board decisions to sell or merge the corporation differently from other board decisions involves differences in what courts say and what they do. In terms of the latter, courts should be on the lookout for the unconscious tendency to apply more rigorous review to board decisions to sell or merge even when purporting to apply conventional standards of review.

In terms of explicitly distinct standards for reviewing board decisions to sell or merge, Delaware courts can start by abolishing the *Revlon* doctrine. The *Revlon* decision, itself, can be viewed as an application of the

341. *E.g.*, GEVURTZ, *supra* note 110, at 869-85, 950-77, 988-1030.

business judgment rule to an extreme situation in which, because the shareholders cashed out, it became impossible to rationalize how looking out for creditors was in the long-range interest of the shareholders as shareholders of the corporation.[342]

Courts should apply a reasonableness (*Unocal* without the bells and whistles) review based upon either of two triggers: (1) the directors maintain their positions following the sale or merger; or (2) the shareholders' veto power is diminished. Conventional approaches addressing conflicts for officers and individual directors are sufficient to handle the potential disloyalty resulting from continued employment or side deals for senior executives.

The rigor with which the court should review board actions favoring a buyer who will retain the directors should depend (when based upon protecting against disloyalty) upon the degree to which the directors' positions were threatened without the challenged action and the degree to which the sale or merger reduced the current directors' power and security in any event. Hence, deal protections adopted when, even without the protections, there is no present or likely future other bidder who would replace the board should get the same slack in reviewing reasonableness given to the mere adoption of a poison pill prior to the appearance of any hostile offer. Sales that transfer control from widely dispersed shareholders to a single person also require somewhat less (rather than greater as current law stands) rigorous scrutiny for reasonableness even when directors retain their positions following the sale.

Actions calling for reasonableness scrutiny because they undermine the effectiveness of the shareholders' power to veto mergers and sales include termination fees and asset and stock lock-ups of a nature and magnitude to be material to the shareholders' vote because of their negative effect on the value of the shareholders' stock, actions that reduce information to shareholders, and structuring transactions in a manner that avoids a shareholder vote. They do not, contrary to *Omnicare*, include shareholder voting agreements and force the vote provisions. Critically, they also do not include actions that deter other potential offers without otherwise impacting how the shareholders vote.

Reasonableness scrutiny triggered by loyalty concerns is ultimately about whether the directors favored a deal that would preserve their posi-

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342. Of course, this does not mean directors must (or even may) advance shareholder interests by violating statutes, judicial doctrines, or contracts existing for the protection of creditors or other corporate stakeholders. This includes, for example, fraudulent transfer acts, provisions for the protection of creditors found in corporation statutes, fiduciary duties imposed by courts in favor of creditors when the corporation is insolvent, employment laws, laws protecting tort victims, antitrust laws, and so on. Also, states choosing to follow a more liberal view of directors' duties in respect to balancing the interests of shareholders versus other stakeholders will not follow the *Revlon* decision even as limited to its extreme facts.

tions over a better deal for the shareholders. By contrast, assessing the reasonableness of actions challenged for their impact on the shareholders' veto power is not about the merits of the deal. Courts should view some actions impacting the shareholders' veto as per se unreasonable. This includes: material termination fees and asset and stock lock-ups either triggered by naked no votes or exceeding a reasonable estimate of the buyer's costs, failure to fully disclose material facts to the shareholders, and (contrary to *Time*) structuring transactions in a way that avoids a shareholder vote because the board fears the shareholders will vote down the deal. Other actions will require a more nuanced evaluation of the extent to which the action reduces in some manner the effectiveness of the shareholders' veto power versus legitimate reasons for the action.