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M&A FIDUCIARY DUTIES: DELAWARE'S MURKY JURISPRUDENCE

DANIEL J. MORRISSEY*

I. INTRODUCTION

MERGERS and Acquisitions have become the endgame in corporate practice,¹ with one textbook calling them the “sexiest topic”² in that area of law. They have also been heralded as “one of the most important corporate-level strategies in the new millennium.”³ Entire businesses become objects of commerce⁴ and, just like other pieces of property in a market economy,⁵ trade freely among those who place different values on

* Professor and former Dean, Gonzaga University Law School. The article is dedicated to two lovely ladies, the author's aunts Frances and Ramona Carroll. The author wishes to thank Professors Marc Steinberg, Lynn Daggett, Megan Ballard, friends from practice Mike Liles and Dean Little, and student assistants Lin Sun, Dan Rosenbaum, Lisa Whyatt, and Greg Morrissey, and faculty assistant Vicky Daniels for their helpful comments.

1. FRANKLIN A. GEVURTZ, CORPORATIONS LAW 661 (2d ed. 2010). As one author put it: “[t]here is no more complicated transaction than a merger or acquisition. The various issues raised are broad and complex, from valuation and deal structure to tax and securities laws.” ANDREW J. SHERMAN, MERGERS & ACQUISITIONS FROM A TO Z xiii (3d ed. 2010).

For more on the complicated nature of this process, both in its business and legal aspects, see WILLIAM W. BRATTON, CORPORATION FINANCE 965 (7th ed. 2012) and THOMAS LEE HAZEN & JERRY W. MARKHAM, CORPORATIONS AND OTHER BUSINESS ENTERPRISES (3d ed. 2009).

2. ALAN PALMITER & FRANK PARTNOY, CORPORATIONS: A CONTEMPORARY APPROACH 895 (2010).

3. MICHAEL A. HITT, JEFFREY HARRISON & R. DUANE IRELAND, MERGERS AND ACQUISITIONS: A GUIDE TO CREATING VALUE FOR STAKEHOLDERS ix (2001). Like the economy, M&A is a global phenomenon. A recent Wall Street Journal series, *The New M&A: National Icons, Foreign Owners*, highlighted a trend there. The accompanying stories described the purchase of a famous U.K. cereal maker Weetabix by the Chinese firm, Bright Food Group, and the acquisition of a controlling position in Avotz, the struggling Russian automaker, by Renault and Nissan. Laurie Burkitt, *The New M&A: National Icons, Foreign Owned: Chinese Food Company Eats English Breakfast*, WALL ST. J., May 3, 2012, at B1; Ira Iosebashvili, *The New M&A: National Icons, Foreign Owned: Renault-Nissan Buy Into Russia's Aged Auto Giant*, WALL ST. J., May 4, 2012, at B1.

4. ROBERT W. HAMILTON, JONATHAN R. MACEY & DOUGLAS K. MOLL, CASES AND MATERIALS ON CORPORATIONS INCLUDING PARTNERSHIPS AND LIMITED LIABILITY COMPANIES 997 (11th ed. 2010).

5. A key issue, as in all market transactions, is how much the buyer is willing to pay. Purchasers, therefore, often seek the advice of investment bankers on the financial value of the firms they want to acquire. HAZEN & MARKHAM, *supra* note 1, at 647. *But see infra* notes 310–55 and accompanying text on recent cases involving double-dealing by those financiers.

Money of course, is not the only consideration in much of our decision-making. See MICHAEL J. SANDEL, WHAT MONEY CAN'T BUY: THE MORAL LIMITS OF MARKETS (2012). That is a value to keep in mind, given the human costs of some of

their productive uses.⁶ These changes of corporate control are crucial events in the lives of companies and their employees, often carried out in dramatic fashion “with high-powered take-over ploys and ingenious defensive gambits.”⁷

Beginning in the 1960s, when mergers and acquisitions first became a major factor in the economy, commentators have engaged in lengthy debates about their overall value to society.⁸ One study by a leading accounting firm found that eighty-three percent of them fail to produce any benefit for their shareholders and over half actually destroy value.⁹ Work-

these deals in things like worker displacement and their negative impact on communities. See *infra* notes 144–147 and accompanying text.

6. See generally JESSE H. CHOPER, JOHN C. COFFEE, JR. & RONALD J. GILSON, *CASES AND MATERIALS ON CORPORATIONS* 957 (7th ed. 2008). As one author commented on the motives of acquisitions: “[s]easoned executives and entrepreneurs have always searched for efficient and profitable ways to increase revenues and gain market share.” SHERMAN, *supra* note 1, at 1. One distinguished author gives this description of the economic motivation of the buying firm: “[t]he decision to invest rests upon the expectation that the future returns to existing shareholders, discounted to present value at a rate which reflects the risks, will exceed the amount presently invested.” BRATTON, *supra* note 1, at 965. Correspondingly, he says this of the seller’s interests: “From the point of view of the acquired corporation, the initial inquiry also concerns . . . whether enough is being received for the value given up . . . and whether synergistic or other gains are being appropriately divided.” *Id.* at 966. A more jaundiced view of mergers and acquisitions holds that they are empire-building exercises benefiting only the managers of bidding companies. Dean Clark thus described the questionable desires that may drive those decisions: “As bosses of bigger companies, they will acquire greater power and prestige. Perhaps they expect to obtain greater executive compensation, another often alleged correlative of company size.” ROBERT CLARK, *CORPORATE LAW* 537 (1986).

7. PALMITER & PARTNOY, *supra* note 2, at 895. Delaware case law provides good descriptions of those anti-takeover moves as they have evolved. See *infra* notes 151–236 and accompanying text.

8. See *infra* notes 135–47 and accompanying text; see also Richard E. Caves, *Effects of Mergers and Acquisitions on the Economy*, in 31 FEDERAL RESERVE BANK OF BOSTON CONFERENCE SERIES 149–72 (Lynn E. Browne & Eric S. Rosengren eds., 1987), available at <http://www.bos.frb.org/economic/conf/conf31/conf31f.pdf>; Devra Golbe & Lawrence J. White, *Mergers and Acquisitions in the U.S. Economy: An Aggregate and Historical Overview*, in *MERGERS AND ACQUISITIONS* 25–48 (Alan J. Auerbach ed., 1987), available at <http://www.nber.org/chapters/c5820.pdf>.

For more recent comment on the questionable efficacy of certain mergers, see Andrew Sorkin, *AT&T to Buy T-Mobile USA for \$39 Billion*, N.Y. TIMES (Mar. 20, 2011), <http://dealbook.nytimes.com/2011/03/20/att-to-buy-t-mobile-usa-for-39-billion/> and Nicholas Jackson, *Maybe a Second AOL-Time Warner Marriage Would Work Better*, THE ATLANTIC (Aug. 11, 2011), <http://www.theatlantic.com/technology/archive/2011/08/maybe-a-second-aol-time-warner-marriage-would-work-better/243430/>.

9. KPMG, *UNLOCKING SHAREHOLDER VALUE: THE KEY TO SUCCESS 2* (1999), available at http://www.imaa-institute.org/docs/m&a/kpmg_01_Unlocking%20Shareholder%20Value%20-%20The%20Keys%20to%20Success.pdf. An earlier study from the 1980s also questioned whether wealth gains came from hostile takeovers. Andrei Shleifer & Lawrence H. Summers, *Breach of Trust in Hostile Takeovers* (Nat’l Bureau of Econ. Research, Working Paper No. 2342, 1987), available at <http://www.nber.org/papers/w2342.pdf>.

ers at target firms are impacted most immediately—often with lay-offs and force reductions.¹⁰ On the other hand, top management, board members, and bankers are substantially enriched by them.¹¹ This has led to periodic calls that mergers and acquisitions should only be allowed if they can be shown to benefit society as a whole.¹² But despite continuing controversy,¹³ these gigantic corporate deals

10. See Sheryl R. Tynes, *The Walking Wounded: Employees' Perspectives on Mergers and Acquisitions*, 67 SOC. INQUIRY 299 (1997). The recent Stanley-Black & Decker merger of two long-established companies is a good recent example. Lorraine Mirabella & Gus G. Sentementes, *A Md. Company Fades into Future*, BALT. SUN (Mar. 14, 2010), http://articles.baltimoresun.com/2010-03-14/business/bal-bz.black-decker14mar14_1_stanley-black-decker-decker-employees-towson-based-black. In that \$4.5 billion deal 4,000 workers were laid off worldwide, 250 from Black & Decker's corporate headquarters. *Id.* The transaction, however, paid off handsomely for Black & Decker's CEO who is scheduled to receive \$89 million in total compensation over three years. *Id.* For recent comment on a related subject, see Daniel Indiviglio, *Why Are Companies Acquiring Instead of Hiring?*, THE ATLANTIC (Aug. 23, 2010), <http://www.theatlantic.com/business/archive/2010/08/why-are-companies-acquiring-instead-of-hiring/61941/>.

11. The take-over phenomenon over the last several decades has contributed to the rising income inequality in our country. G. William Domhoff, *Who Rules America?* SOCIOLOGY (May 2, 2011), <http://www2.ucsc.edu/whorulesamerica/power/wealth.html>. As of 2007, the top 1% owned 34.6% of America's assets and the next 19% owned 50.5% of them. *Id.* Just 1/5 of our citizens controlled over 85% of its wealth. *Id.* Most of the income gains during the last several decades were by corporate executives and financiers. Peter Whoriskey, *With Executive Pay, Rich Pull Away from Rest of America*, WASH. POST (June 18, 2011), http://www.washingtonpost.com/business/economy/with-executive-pay-rich-pull-away-from-rest-of-america/2011/06/13/AGKG9jaH_story.html.

12. See Daniel J. Morrissey, *Safeguarding the Public Interest in Leveraged Buyouts*, 69 OR. L. REV. 47, 82–84 (1990).

13. The 2012 presidential candidacy of Mitt Romney made this an even more prominent issue. Romney claimed that he created over 100,000 jobs through companies he helped grow while a principal at the private equity firm, Bain Capital. At some companies that Bain Capital bought and sold, however, the workforces were reduced through downsizing or were totally eliminated when the firms went bankrupt. The jobs that were lost as a result of those deals were much better compensated than the ones that replaced them. Paul Krugman, Op-Ed., *Bain, Barack and Jobs*, N.Y. TIMES, Jan. 5, 2012, at A25. *But see* Kimberly A. Strassel, *Vampire Capitalism? Please*, WALL ST. J. (May 17, 2012) <http://online.wsj.com/article/SB10001424052702303360504577410573651845802.html> (discussing Kansas City steel company acquired by Bain that is featured in Obama television ad critical of Romney). The company eventually went bankrupt but the piece argues that Bain actually rescued the company by infusing new capital into it. *Id.* It was then profitable for several years until it became a victim of international competition. *Id.* For the author's recent views on how President Obama's reelection may impact this area of corporate law, see Daniel J. Morrissey, *A new Corporate Model*, NAT'L L.J. (Jan. 7, 2013), <http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202583322316>.

have come in waves¹⁴ and remain a dominant part of today's business world.¹⁵

Mergers and Acquisitions can be accomplished in several different ways—generally either by friendly¹⁶ or hostile purchases¹⁷ of the shares of a target company, or by buying its assets.¹⁸ The way they are accomplished

14. Before now, the most recent merger surges have been in the 1980s when many were hostile acquisitions in the oil and gas, banking, and pharmaceutical industries and in the mid to late 1990s when many were inspired by globalization, deregulation, and telecommunications. *History of Mergers and Acquisitions*, ECONOMY WATCH (July 17, 2010). The former were funded by debt, the notorious junk bonds, while the latter involved mostly equity financing, the so-called “private equity” deals. *Id.* Another author gave this vivid description of those waves:

The 1980s featured washbucklers and the use of aggressive tactics to gain control over targets. The 1990s were equally dynamic in terms of companies evolving through upsizing and growth, downsizing, rollups, divestitures, and consolidation, but focused on operations synergies, scale efficiencies, increases in customer bases, strategic alliances, market share, and access to new technologies. This period, however, came to a crashing end with the bursting of the tech bubble and the global recession that followed.

SHERMAN, *supra* note 1, at xii. See also BRATTON, *supra* note 1, at 971–73.

15. See BRATTON, *supra* note 1, at 972–73. The 1990s merger wave subsided when the high-tech market went bust in 2000. *Id.* It picked up in late 2003, only to crest in 2006 and then fall flat again with the 2008 financial meltdown. *Id.* Recovery began in 2010. *Id.*

A study found that \$2.25 trillion changed hands globally in merger and acquisition activity in 2010, the highest since 2007. Quentin Webb & Denny Thomas, *M&A Tops \$2.2 Trillion in First Yearly Rise Since 2007*, REUTERS (Dec. 17, 2010), <http://www.reuters.com/article/2010/12/17/us-deals-idUSTRE6BG00D201012>

17. In 2011, the value of mergers and acquisitions in the U.S. topped \$1 trillion—the highest since 2008 and a fifteen percent increase over 2010. With much cash on hand and favorable interest rates, experts expected even more activity in 2012. Tiffany Hsu, *Merger and Acquisition Deals Expected to Increase in 2012*, L.A. TIMES (Mar. 1, 2012), <http://articles.latimes.com/2012/mar/01/business/la-fi-mo-merger-acquisition-deals-20120301>.

16. There, the target's board and management are receptive to the takeover and recommend shareholder approval. Usually the acquiring company offers the target's shareholders a premium over the current price of their shares. DONALD DEPAMPHILIS, *MERGERS, ACQUISITIONS, AND OTHER RESTRUCTURING ACTIVITIES* 740 (5th ed. 2009). The corporate statutes of various states establish procedures for these combinations. See, e.g., DEL. CODE ANN. tit. 8, §§ 251–66 (2010); see also HAZEN & MARKHAM, *supra* note 1, at 651–55.

17. This occurs when a bidder's initial approach to purchase a company is unsolicited and unwelcome by the target's management. DEPAMPHILIS, *supra* note 16. It therefore contests the takeover. *Id.* The bidder then seeks to circumvent management and achieve control by acquiring more than half of the target's shares. *Id.* It may make a direct offer of cash or stock for them (a hostile tender offer) or it may buy shares in a public stock exchange (an open market purchase). *Id.*

18. This involves the purchase of the selling company's property—facilities, vehicles, equipment, stock, and inventory. 19 AM. JUR. 2D *Corporations* § 2170 (2012). One important difference between an asset acquisition and a stock purchase is that in the former the buyer can specify the liabilities it is willing to assume and leave others behind. *Id.* In the latter, however, the consolidated company will assume all the selling company's obligations. *Id.*

can present major issues of fairness and conflicts of interest. This is particularly true when public companies are put into play, either voluntarily or involuntarily.¹⁹ With such high dollar figures involved, the wealth of those firms is ripe for misappropriation through abusive tactics. This may be truer today than ever in an era of recurrent corporate scandals²⁰ and exorbitant executive compensation.²¹ A Goldman Sachs executive recently called the Wall Street culture “as toxic and destructive as I have ever seen it.”²²

Occasions for such wrongdoing exist most prominently in public companies because control of those enterprises is separated from their ownership.²³ There, a board of directors is empowered to manage the business for the numerous and widely scattered shareholders who have the ultimate claim on its worth.²⁴ This has given management (the officers and directors) and their allies (bankers, lawyers, analysts, accountants, etc.) a great opportunity to enrich themselves at the expense of the shareholders and

19. See *infra* notes 270–355 and accompanying text.

20. For a fine summary of that corruption over the last several decades, see M. Thomas Arnold, “It’s Déjà vu All Over Again,” *Using Bounty Hunters to Leverage Gatekeeper Duties*, 45 TULSA L. REV. 419, 420–24 (2010) (summarizing corporate corruption over last several decades). Right after the financial meltdown of 2008, one respected commentator called the last decade: “an era of rapacious capitalists and heedless self-indulgence.” Frank Rich, Op-Ed., *The Rabbit Ragu Democrats*, N.Y. TIMES, Oct. 4, 2009, at WK8.

Numerous accounting scandals, Madoff-like frauds, and ingenious corporate malfeasance like options backdating resulted from that attitude. For the author’s take on that rampant wrongdoing, see Daniel J. Morrissey, *Shareholder Litigation After the Meltdown*, 114 W. VA. L. REV. 531 (2012) and Daniel J. Morrissey, *The Path of Corporate Law: Of Options Backdating, Derivative Suits, and the Business Judgment Rule*, 86 OR. L. REV. 973 (2007).

21. While the average American worker earned \$46,742 in 2010, the mean compensation of S&P CEOs was \$12 million. Gary Strauss, *Stock Options Help CEOs Cash In*, USA TODAY (July 10, 2011), http://usatoday30.usatoday.com/NEWS/usa-edition/2011-07-08-ceopay_ST_U.htm. The perceived injustice of that disparity helped fuel the Occupy Wall Street movement in fall, 2011. George Packer, *All the Angry People*, NEW YORKER, Dec. 5, 2011, at 32.

22. Greg Smith, Op-Ed., *Why I Am Leaving Goldman Sachs*, N.Y. TIMES, Mar. 14, 2012, at A27.

23. See *infra* notes 44–57 and accompanying text. Even one of the earliest and most ardent proponents of capitalism noted the mischief that could arise from such an arrangement:

The directors of such companies, however, being the managers rather of other people’s money than their own, it cannot be expected that they should watch over it with the same anxious vigilance with which partners in a private copartnery frequently watch over their own.

ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 264–65 (Edwin Cannan ed., 1977).

24. Delaware’s statute is typical here. Section 141(a) of the Delaware Corporate Code provides: “[t]he business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation.” DEL. CODE ANN. tit. 8, § 141(a) (2010); accord MOD. BUS. CORP. ACT § 801(b).

other stakeholders in the company (employees, consumers, communities, and society at large). The latter group of course has a legitimate interest in the honest and effective operation of their corporations and can be hurt by wrongdoing there.²⁵

The law has attempted to constrain those corrupting tendencies by imposing special fiduciary duties on these insiders and their allies.²⁶ And because of their unique role in American corporate jurisprudence,²⁷ the obligation to determine whether controlling managers and their allies have acted fairly and in good faith has fallen on the courts of Delaware.²⁸

25. See *infra* notes 144–47 and accompanying text. One well-respected academic has recently argued, against the conventional outlook, that the interests of these corporate constituents are equally as important as those of stockholders, i.e. that a corporation should not be run primarily for the profit of shareholders and that the law in fact does not require that. See generally LYNN STOUT, *THE SHAREHOLDER VALUE MYTH* (2012) (arguing particular method for running corporation).

26. See *infra* notes 34–43 and accompanying text.

27. Even though large corporations operate in many states and a number of countries, basic American corporate law is created not by the federal government but by the states, specifically, the jurisdiction where a particular company has been incorporated. This is known as the Internal Affairs Doctrine. Some have ascribed this anomaly to federalism. See Mark J. Roe, *Takeover Politics*, in *THE DEAL DECADE 321* (Margaret M. Blair ed., 1993); see also Frederick Tung, *Before Competition: Origins of the Internal Affairs Doctrine*, 32 J. CORP. L. 33 (2006) (arguing doctrine's inception was not owing to competition among states). Instead, its origins depended on “a fortuitous sequence of events, driven by ideology, interest group influences, and institutional inertia.” *Id.* at 34. The Internal Affairs Doctrine therefore prescribes that the essential rights and duties of corporate actors are set by the states of their incorporation. As the United States Supreme Court put it:

The beneficial free market system depends at its core upon the fact that a corporation—except in the rarest situations—is organized under, and governed by, the law of a single jurisdiction, traditionally the corporate law of the State of its incorporation.

. . . .

It is thus an accepted part of the business landscape in this country for States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares.

CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 89–91 (1987). American statesmen from James Madison to 20th century presidents like Theodore Roosevelt, William Howard Taft, Woodrow Wilson, and Franklin D. Roosevelt have disdained this jurisprudence. Alex Marshall, *How to Get Business to Pay Its Share*, N.Y. TIMES, May 4, 2012, at A23. As early as 1787 Madison foresaw that someday companies would grow so large that they “would pass beyond the authority of a single state, and would do business in other states.” *Id.* He therefore urged that the federal government should “grant charters of incorporation in cases where the public good may require them, and the authority of a single state may be incompetent.” *Id.* Since the 1930s, however, the federal government has regulated public companies, although in an indirect way, by the federal securities laws. The focus of those statutes is by and large disclosure, not rules of substantive conduct for the governance of corporations. See *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977); see generally CHOPER, COFFEE & GILSON, *supra* note 6, at 299–304.

28. Delaware’s predominant position in corporate law came about in the first part of the 20th century. See William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663 (1974). As the corporation became the dominant legal form for large firms, the story goes, states began competing with one another

This Article will therefore begin in Part II by discussing the seminal Delaware cases that established those duties.²⁹ It will describe how they evolved, in common law form,³⁰ from the general rules governing the obligations of corporate managers. Parts III and IV will focus more particularly on opinions from the 1980s and 1990s that made new application of those principles. Courts developed many of the principles in cases that dealt with defensive tactics invented to discourage the hostile takeovers that were surging during those decades.

Part V will assess how those fiduciary standards have formed the basis for decisions in several recent and very significant opinions. Those cases have come from the increased acquisition activity as the economy re-

to gain the fees that would come with chartering them. *Id.* Many have said this created an unseemly “race to the bottom,” with states vying to be the most lax in regulation. Delaware allegedly won that inglorious contest. Delaware was apparently motivated to become the top state of incorporation because of the large payments that small state could garner from that process. Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition Over Corporate Charters*, 112 YALE L.J. 553 (2002). In the first part of the last decade, it was raking in over \$600 million in franchise fees for a jurisdiction with a population of only 796,000. *Id.* at 556 n.13. This revenue constitutes a large percentage of the state’s budget. *Id.* at 556.

Delaware was therefore “said to have a bad name, as a haven for incumbent management.” *Barbarians in the Valley*, ECONOMIST, June 26, 2003, at 61. Yet in recent years things may have turned around, with a belief that the courts there “have become more sensitive to the wishes of big shareholders.” *Id.*; see also Paul D. Brown & K. Tyler O’Connell, *Key 2011 Corporate Law Decisions Include Notable Stockholder Victories in the Delaware Courts*, BUS. LAW TODAY (Jan. 23, 2012), <http://apps.americanbar.org/buslaw/blt/content/2012/01/article-2-brown-oconnell.shtml>. For a discussion of cases evidencing that change, see *infra* notes 310-55 and accompanying text.

Others have argued that Delaware has justly earned its preeminence as the nation’s business tribunal. As one noted authority put it: “[c]orporations often prefer to litigate issues in Delaware rather than elsewhere because of the knowledge, expertise, sophistication and experience of the Chancellor and the four Vice Chancellors on corporate matters.” HAMILTON, MACEY & MOLL, *supra* note 4, at 147. For a discussion on the efficiency of Delaware in adjudicating corporate claims, see Mark J. Loewenstein, *Delaware as Demon: Twenty-Five Years After Professor Cary’s Polemic*, 71 U. COLO. L. REV. 497 (2000). In any event, Delaware is currently the state of incorporation for more than fifty percent of all U.S. publicly traded companies and sixty-three percent of companies on the Fortune 500 list. HAMILTON, MACEY & MOLL, *supra* note 4, at 148. With some understatement, therefore, the then Vice-Chancellor and now Chancellor of Delaware commented that his state has “some modest importance in the American scheme of corporate governance.” Leo E. Strine, Jr., *The Inescapably Empirical Foundation of the Common Law of Corporations*, 27 DEL. J. CORP. L. 499, 501 (2002).

29. See *infra* notes 44–57 and accompanying text.

30. Apropos of the fact-rooted nature of that jurisprudence one observer said, “Delaware judicial opinions are known for their story-like narrative approach” Andrew S. Gold, *The New Concept of Loyalty in Corporate Law*, 43 U.C. DAVIS L. REV. 457, 527 (2009). Another made much the same point calling them “a set of parables” about good and bad directors. Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1016 (1997).

bounds from the financial meltdown of the last decade.³¹ Delaware's Chancellor and Vice-Chancellors have been apt at finding instances of unfairness and self-dealing in those cases.³² Yet they have been less successful, I will argue, in fashioning effective remedies for that wrongdoing.

Part VI of this Article will conclude with an assessment of Delaware's fiduciary jurisprudence in this area. As the title of this Article states, it is murky because the jurists of that small state struggle with competing considerations. Yet, because of quirks in our jurisprudence, their tribunals have the ultimate supervisory power over corporate directors.

On the one hand, the courts must hold corporate directors to faithful execution of their responsibilities, policing against corrupt insider profits and inefficient entrenchment—making sure directors are ultimately accountable to their shareholders and the financial markets. To that end I will urge that courts should make more use of that great tool of Equity, the injunction, to stop mergers and acquisitions outright where corrupt activity is evident and to fashion ancillary relief to prohibit its recurrence.³³

On the other hand, the Delaware courts have also been keenly aware that the profitability and sustainability of each business is committed to the care of its directors. They therefore want to give directors sufficient latitude to manage their firms according to their best judgments. This has resulted in an unwillingness to second-guess corporate strategy—particularly when it can plausibly inure to the long-term benefit of the overall enterprise.

Delaware courts will thus continue to walk that line, often perhaps by condoning or reproofing board decisions on grounds that may not be obvious from their opinions. In doing that, I will argue, judges are expressing the ambivalence that most Americans feel about our economic system—respecting its potential for productivity, but distrustful of the damage it can cause when short-term profit-maximization is its guiding principle. It is an open question whether the approach administered by the courts of Delaware is best serving the interest of society. I will therefore conclude by proposing a more effective tribunal for those concerns.

II. FIDUCIARY DUTIES OF OFFICERS AND DIRECTORS

A. *Early Notions of Corporate Fiduciary Duties*

Prohibitions on conflicts of interest are as old as the Scriptures.³⁴ In English jurisprudence courts of equity developed the law of trusts to prescribe the responsibilities of those who held legal title to property on be-

31. See *infra* notes 270–355 and accompanying text.

32. See *infra* notes 270–355 and accompanying text.

33. See *infra* notes 356–75 and accompanying text.

34. “No man can serve two masters.” *Matthew* 6:24.

half of others.³⁵ Equity called those special obligations fiduciary duties,³⁶ and under its “No Further Inquiry”³⁷ rule any arrangement that violated those duties was voidable even if it was fair to the beneficiaries of the trust. Corporate law adopted those obligations to regulate the activity of boards of directors that managed companies for their shareholders who provided the entrepreneurial capital.³⁸

Yet the nature of fiduciary standards for corporate officers and directors developed over time. Early decisions showed a judicial distrust of almost any dealings that management had with their companies and made the dealings voidable by the shareholders.³⁹ That absolutist approach, however, eased over time as it became apparent that some of these related party transactions were beneficial to corporations.⁴⁰ The law thus shifted to allow such transactions if they were ratified in good faith by disinterested directors⁴¹ or shareholders,⁴² or if they could be shown to be fair to the corporation.⁴³

B. *The Changing Realities of Corporate Control*

As corporations evolved, the dynamics of their ownership also developed. In the early years, large shareholders typically served as the direc-

35. Tamar Frankel, *Fiduciary Law*, 71 CALIF. L. REV. 795 (1983). As Chancellor Strine and his co-authors put it almost poetically: “[t]racing this doctrine back into the womb of equity, whence it sprang, the foundation becomes plain.” Leo J. Strine, Jr., Lawrence A. Hamermesh, R. Franklin Balotti & Jeffrey M. Gorris, *Loyalty’s Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 GEO. L.J. 629, 643 (2010). “Wherever one man or a group of men entrusted another man or group with the management of property, the second group became fiduciaries.” *Id.*

36. From the Latin word “fides” meaning faith. Strine et al., *supra* note 35, at 645. Delaware Justice Randy Holland made the same point commenting on the Latin adjective “fidelis” meaning loyal or faithful. Randy J. Holland, *Delaware Directors’ Fiduciary Duties: The Focus on Loyalty*, 11 U. PA. J. BUS. L. 675, 700–01 (2009).

37. See UNIF. TRUST CODE § 802(b) (2000); see also Harold Marsh, Jr., *Are Directors Trustees? Conflicts of Interest and Corporate Morality*, 22 BUS. LAW. 35 (1966).

38. *Charitable Corp. v. Sutton*, 2 Atk. 400, 26 Eng. Rep. 642 (Ch. 1742). The Lord Chancellor of England first ruled on that in 1742 holding that corporate directors are both agents and trustees and must act with “fidelity and reasonable diligence.” *Id.* As the United States Supreme Court put it: “[d]irectors and managers, if not technically trustees, occupy positions of a fiduciary nature.” *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 549 (1949).

39. See Marsh, *supra* note 37, at 35. That may have reflected a skeptical viewpoint best expressed by Justice Louis Brandeis. That renowned jurist wrote most compellingly about the inherent potential for misuse that comes when financial stewards are entrusted with wealth owned by others. LOUIS BRANDEIS, *OTHER PEOPLE’S MONEY AND HOW THE BANKERS USE IT* (1914).

40. HAMILTON, MACEY & MOLL, *supra* note 4, at 745.

41. DEL. CODE ANN. tit. 8, § 144(a)(1) (2010); accord MODEL BUS. CORP. ACT § 8.61(b)(1).

42. DEL. CODE ANN. tit. 8, § 144(a)(2) (2010); accord MODEL BUS. CORP. ACT § 8.61(b)(2).

43. DEL. CODE ANN. tit. 8, § 144(a)(3) (2010); accord MODEL BUS. CORP. ACT § 8.61(b)(3).

tors of their corporations.⁴⁴ As stock was sold broadly in public offerings, however, share ownership became widely diffused.⁴⁵ In a 1932 study, Professors Berle and Means definitively documented the resulting separation of corporate ownership from control.⁴⁶

The professors found that in the largest corporations it was rare that one shareholder owned even one percent of the outstanding stock.⁴⁷ Stockholders of big publicly held firms, those legally entitled to their residual profits, had thus lost the power to run their companies. That power had gone to a managerial class that formally perpetuated its power by soliciting shareholder proxies to elect its nominees for the board.⁴⁸

Berle and Means went on to define the large issues arising from that new reality:

The surrender of control over their wealth by investors has effectively broken the old property relationships and has raised the problem of defining these relationships anew. The direction of industry by persons other than those who have ventured their wealth has raised the question of the motive force back of such

44. See generally Andrei Shleifer & Robert Vishny, *Large Shareholders and Corporate Control*, 94 J. POL. ECON. 461 (1986), available at http://www.economics.harvard.edu/faculty/shleifer/files/lg_shareholders.pdf. As two noted scholars have recently put it: “industrialists such as John D. Rockefeller, Cornelius Vanderbilt, Andrew Mellon, and Andrew Carnegie ruled empires that rivaled whole countries in their size and scope—and power. The companies had public shareholders, but the men who built them held huge stakes to back their stewardship.” ROBERT A.G. MONKS & NELL MINOW, *CORPORATE GOVERNANCE* 120 (5th ed. 2011).

45. Gardiner C. Means, *The Diffusion of Stock Ownership in the United States*, Q.J. ECON., Aug. 1930, at 561, 562.

46. ADOLF A. BERLE & GARDINER COIT MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932).

47. Means, *supra* note 45, at 571. Looking back, a leading contemporary corporate scholar summed up those landmark insights:

A little over fifty years ago, Berle and Means reported that the separation of ownership and control in the modern corporation had left shareholders effectively powerless, as managers could neither be ousted from office by shareholders who were widely dispersed, and therefore incapable of coordinated action, nor disciplined effectively by the capital market—at least so long as managers could rely on internal cash flow to finance corporate expansion.

John C. Coffee, Jr., *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1, 15 (1986). A reverse trend has arisen in recent years that would once again concentrate corporation ownership in large holders of stock such as mutual funds, pension funds and other institutional investors. See MONKS & MINOW, *supra* note 44, at 154–237.

48. See Exchange Act Rules 14a-14b, 17 C.F.R. §§ 240.14a-14b (2012); see also MONKS & MINOW, *supra* note 44, at 125 (attributing this “disenfranchisement” of shareholders to “management’s vastly superior access to the proxy, both procedurally (in terms of resources) and substantively (in terms of appropriate subject matter)”). But see Ben Protess & Katherine Reynolds Lewis, *Changing Face of Investor Activism*, N.Y. TIMES, June 8, 2012, at B1 (describing renewed recent efforts of mainstream shareholders to assert power in governance of their corporations).

direction and the effective distribution of the returns from business enterprise.⁴⁹

The year before, however, Berle set out his own theory of how corporate law should deal with the fear that corporate managers would channel the wealth of their businesses into their own pockets.⁵⁰ The title of Professor Berle's piece said it all: *Corporate Powers as Powers in Trust*.⁵¹ He analogized corporate directors to trustees who are given wide latitude in managing the property of their beneficiaries so long as they do so as fiduciaries.⁵² Every corporate act, therefore, had to not only be executed in technical compliance with the law but also had to be judged "with a view toward discovering whether under all the circumstances the result fairly protects the interests of the shareholders."⁵³

Berle went on to illustrate those principles as they would be applied to five "'absolute' corporate powers:"—issuing stock, declaring dividends, acquiring stock in another corporation, amending the corporate charter, and effecting mergers.⁵⁴ He defined the latter as broadly encompassing any transfer of the corporate enterprise.⁵⁵

Berle then cited recent cases that had moved the law from a concern that those maneuvers were only made in formal compliance with the law to one where fairness to minority shareholders was the ultimate standard.⁵⁶ He concluded that even though "business situation[s] demand greater flexibility than the trust situation," the rules of corporate governance should nevertheless become in substance a branch of that body of law.⁵⁷

C. Foundational Cases on the Duties of Corporate Management

Just a few years after Berle and Means's groundbreaking work, the Delaware Supreme Court followed Berle's theory of trusteeship in its seminal decision on corporate fiduciary duties, *Guth v. Loft, Inc.*⁵⁸ Guth was the president of a company named Loft that operated a chain of candy

49. BERLE & MEANS, *supra* note 46, at 2.

50. A. A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931).

51. *Id.*

52. *Id.*

53. *Id.* at 1074.

54. *Id.* at 1050 (introducing "'absolute' corporate powers" concept with emphasis on "absolute"); *id.* at 1050–74 (discussing individual absolute corporate powers).

55. *Id.* at 1070.

56. *Id.* at 1070–73.

57. *Id.* at 1074.

58. *Guth v. Loft, Inc.*, 5 A.2d 503 (Del. 1939). The Delaware Supreme Court had already expressed its view that directors owe fiduciary duties to their shareholders. *Bodell v. Gen. Gas & Elec. Corp.*, 132 A.2d 442 (Del. Ch. 1926), *aff'd*, 140 A.2d 246 (Del. 1927).

stores using Coca-Cola syrup. When Coke raised its prices, Guth asked a vice-president of Loft to investigate buying the company that produced Pepsi-Cola, which was then in bankruptcy and for sale.⁵⁹

Loft had ample funds to buy Pepsi, but without offering the opportunity to Loft, Guth bought the company secretly himself through another firm that he owned.⁶⁰ He even had the soft drink produced at Loft's facilities.⁶¹ In doing that, the court said, Guth furthered his personal interests in a way that was "incompatible with the superior interests of his corporation."⁶² Therefore, the court found that his breach of loyalty to Loft showed "gross violations of legal and moral duties" and ordered that he account to Loft's shareholders for his profits in Pepsi.⁶³

In a later, significant case, *Sinclair Oil Corp. v. Levien*,⁶⁴ where the controlling shareholder was another corporation, the Delaware Supreme Court elaborated on this duty of loyalty and distinguished it from situations where it would defer to a board's business judgment. The plaintiff there was a minority shareholder in Sinven, a corporation that operated solely in Venezuela.⁶⁵ Ninety-seven percent of Sinven was owned by Sinclair, which named all of its directors.⁶⁶

Because of this parent-subsidiary relationship, the court said, Sinclair owed Sinven a fiduciary duty.⁶⁷ It further noted that such a special obligation is particularly relevant when the parent is on both sides of a transaction and can therefore receive something from the subsidiary to the detriment of its minority shareholders.⁶⁸ The court then discussed two questioned transactions: one where the court found the parent had not acted improperly; and the other where the parent had breached its fiduciary duty to the subsidiary.⁶⁹

In the first transaction, Sinclair caused Sinven to pay out large dividends, distributing the lion's share of them to the parent.⁷⁰ Sinven's minority shareholders however received their pro rata portion of those payments.⁷¹ Even though the plaintiff claimed the large dividends left Sinven without resources to expand, the court deferred to the directors'

59. *Guth*, 5 A.2d at 512.

60. *Id.* at 513.

61. *Id.* at 512.

62. *Id.* at 515.

63. *Id.* at 510.

64. 280 A.2d 717 (Del. 1971).

65. *Id.* at 719.

66. *Id.*

67. *Id.*

68. *Id.* at 720.

69. *Id.* at 720-23.

70. *Id.* at 720.

71. *See id.* at 721-22.

business judgment as to how the company's resources should be used.⁷² The court found that there had been no improper self-dealing.⁷³

In the second transaction, however, Sinven's minority shareholders were able to convince the court that Sinclair had treated Sinven unfairly.⁷⁴ There, Sinclair made Sinven agree to sell Sinclair's crude and refined oil subsidiary at specific prices.⁷⁵ Sinclair, however, had the purchasing subsidiary breach that contract by failing to pay for the oil on time and in the minimum amounts stipulated.⁷⁶ The relationship was thus unfair to Sinven's minority shareholders.⁷⁷ Sinclair was able to enrich itself at the shareholders' expense, and in doing so it breached its duty of loyalty to them.⁷⁸

When Delaware's jurisprudence involving duties of loyalty does not control, however, directors have only to use due care and have a rational basis for their actions. Under the business judgment rule, courts will defer to their choices.⁷⁹ A leading case, *Aronson v. Lewis*,⁸⁰ explains that distinction, but the opinion itself is puzzling because the transaction in question had all the earmarks of self-dealing. It involved a lucrative consulting agreement and an interest-free loan that the board gave to a seventy-five year old retired director who owned forty-seven percent of the company's

72. *Id.* at 722.

73. *Id.*

74. *See id.* at 723.

75. *See id.* at 722–23.

76. *See id.* at 723.

77. *See id.*

78. *Id.* In another significant parent-subsidary case a decade later, *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983), the Delaware Supreme Court also found that a parent company had breached its fiduciary duties to the minority shareholders of its subsidiary. *Id.* There, a parent company that had acquired a majority interest in a subsidiary and controlled over half of its board planned to give the subsidiary's minority shareholders cash for their shares in a take-out merger, a practice allowed under Delaware law when the boards of both companies approve. *Id.* at 703.

The parent charged two of its officers, who were also directors of the subsidiary, to do a secret feasibility study about the price the parent could profitably pay for the subsidiary's shares. *Id.* at 705. The figure they came up with was much greater than what the parent ultimately paid the minority shareholders. *Id.* The figure was also supported by an investment banker's hastily prepared fairness opinion. *Id.* The court again found this self-dealing to be a breach of the duty of loyalty that the parent company owed to the minority shareholders of its subsidiary because it failed to give them fair value for their shares. *Id.* at 715.

79. One commentator has cleverly called that principle "a rule that is not a rule." Douglas M. Branson, *The Rule That Isn't a Rule—The Business Judgment Rule*, 36 VAL. U. L. REV. 631, 654 (2002). As that distinguished corporate scholar put it, "[m]ost generally, the business judgment rule acts as a presumption in favor of corporate managers' actions. *Id.* at 632. "Stronger still, the rule provides a safe harbor that makes both directors and their actions unassailable if certain prerequisites have been met." *Id.*

80. 473 A.2d 805 (Del. 1984), *overruled on other grounds by* *Brehm v. Eisner*, 746 A.2d 244 (2000).

stock.⁸¹ A shareholder brought a derivative suit⁸² charging that those payments had “no valid business purpose” because the aged director performed “no or little services.”⁸³ The situation presented an obvious conflict because a director and dominant shareholder were entering into financial dealings with his corporation where the company may not have been getting fair value.⁸⁴

Following accepted practice, however, the court held that whether a wronged corporation should bring an action for its alleged injury was a decision for the board.⁸⁵ A shareholder, thus, has to make a demand on the board under Chancery Rule 23.1⁸⁶ to initiate the suit unless the shareholder can show such action will be futile.⁸⁷ To do that, a stockholder will have to demonstrate that there existed a reasonable doubt that “the directors are disinterested and independent and the challenged transaction was otherwise the product of a valid business judgment.”⁸⁸

Surprisingly, in this situation the court found no such grounds to excuse the demand even though a forty-seven percent shareholder is usually able to control a board. In addition, it was questionable whether the director receiving those high payments could render services to the corporation justifying them. Nevertheless, the court found no conflict and deferred to the board’s business judgment, dismissing the suit.⁸⁹

But just when it seemed that Delaware would give directors a free pass on any corporate decision that did not involve their personal interests, its high court issued a startling opinion, *Smith v. Van Gorkom*.⁹⁰ In *Sinclair*, the court had seemingly reaffirmed its traditional deference to management with comments like this, “[a] board of directors enjoys a presumption of sound business judgment, and its decisions will not be disturbed if

81. *Id.* at 809.

82. Derivative suits are legal mechanisms whereby shareholders can bring an action on behalf of their corporation against officers and directors who have wronged it. The Supreme Court has called them: “the chief regulator of corporate management.” *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 548 (1949). The author has written several articles about those actions. Morrissey, *Shareholder Litigation After the Meltdown*, *supra* note 20, at 550–52; Morrissey, *The Path of Corporate Law: Of Options Backdating, Derivative Suits, and the Business Judgment Rule*, *supra* note 20, at 993–95; Daniel J. Morrissey, *New Rulings Threaten the Derivative Suit—Will the “Needed Policeman” Keep Walking the Beat?*, 36 S.C. L. REV. 631 (1985).

83. *Aronson*, 473 A.2d at 805.

84. *See id.* at 808–09.

85. *See id.* at 811–13.

86. *Accord* Del. Ch. Ct. R. 23.1 (2013), available at <http://courts.delaware.gov/forms/download.aspx?id=39138>.

87. *Aronson*, 473 A.2d at 814.

88. *Id.* In a later case, the Delaware Supreme Court explained that these prongs are disjunctive. *Brehm v. Eisner*, 746 A.2d 244, 256 (Del. 2000). If either is satisfied, demand is excused. *Id.*

89. *Aronson*, 473 A.2d at 817–18.

90. 488 A.2d 858 (Del. 1985), overruled on other grounds by *Gantler v. Stephens*, 965 A.2d 695 (Del. 2009).

they can be attributed to any rational business purpose.”⁹¹ However, *Van Gorkom* found directors liable for *gross negligence* in the approval of a merger.

Jerome Van Gorkom, the chairman and chief executive officer of a public company, negotiated a sale of the firm on his own and then called a special meeting of his board on one day’s notice—keeping it in the dark about the agenda.⁹² Only when the directors gathered did he finally tell them of his deal for the company, a cash-out merger that would give its shareholders a premium over the market price of their stock.⁹³ Even then, Van Gorkom furnished his directors no documents about the transaction.⁹⁴

In support of his assertion that the merger price was a good deal for the shareholders, Van Gorkom offered only an internal study finding that a leveraged buyout of the company would be feasible at a comparable cost.⁹⁵ He provided the board no opinion about the merger’s fairness from an outside expert.⁹⁶ Yet he urged that the directors immediately approve it, which they did.⁹⁷

Even though there were provisions in the merger agreement that allowed for the solicitation of competing offers, the court found they were too restrictive to establish any true market test for Van Gorkom’s deal.⁹⁸ Therefore, the court held that even though the directors had not personally profited from the questioned transaction, the business judgment rule would not protect their decision.⁹⁹ Instead, the directors breached their fiduciary duties to make an informed and deliberate decision about this matter of ultimate importance for their company.¹⁰⁰

Alarmed that this would open corporate management to widespread second-guessing of their activities, the Delaware legislature quickly added Section 102(b)(7) to its Corporate Code.¹⁰¹ It became known as the

91. *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971).

92. *Van Gorkom*, 488 A.2d at 858.

93. *Id.* at 868.

94. *Id.*

95. *Id.*

96. *Id.*

97. *Id.*

98. *See id.* at 879–80.

99. *See id.* at 890–92.

100. *See id.* at 893. For further commentary arguing that *Van Gorkom* is really about a board’s duty to search for the true worth of a company and thus a prelude to the *Revlon* rule, see *infra* notes 179–93 and accompanying text. *See also* Bernard Black & Reinier Kraakman, *Delaware’s Takeover Law: The Uncertain Search for Hidden Value*, 96 NW. U. L. REV. 521 (2002).

101. The provision was adopted by the Delaware legislature in 1986 in response to a purported liability insurance crisis for corporate officers and directors brought on by *Van Gorkom*. *Malpiede v. Townson*, 780 A.2d. 1075, 1095 (Del. 2001).

“raincoat”¹⁰² because the provision offered protection from monetary liability to the management of any company that adopted it. A firm need only place an exculpatory statement to that effect in its certificate of incorporation.

Certain improper activities, however, were exempt from that blanket absolution. Chief among them were breaches of duties of loyalty, actions undertaken in bad faith, and those that involved intentional misconduct or knowing violation of the law.¹⁰³ Also excluded were any transactions from which a director received an improper personal benefit.¹⁰⁴ Delaware cases then started talking about a “triad” of fiduciary duties owed by directors to their corporations and shareholders: due care, good faith, and loyalty.¹⁰⁵ Commentators followed with elaborate dissections of the differences between those three obligations and how their standards for fulfillment might vary.¹⁰⁶

As a general principal, directors could not be liable for mere breaches of the duty of care, even grossly negligently ones such as in *Van Gorkom*.¹⁰⁷ Yet directors could still be held to answer for conduct so wrongful that it was undertaken in “bad faith” and two cases decided in 2006 fleshed out what that term meant. One, *Stone v. Ritter*,¹⁰⁸ involved a derivative suit charging that directors had failed to exercise oversight of employees who did not file proper reports under bank secrecy and anti-money laundering laws.¹⁰⁹ The court held that for bad faith liability to be predicated on such inactivity it had to be almost deliberate—“that the directors knew that they were not discharging their fiduciary obligations.”¹¹⁰ The court then ruled that the board would not be liable in *Stone* because it had acted to assure the existence of “a reasonable information and reporting system” and no “red flags” indicating impropriety appeared to call the directors’ good faith into question.¹¹¹

102. See Jonathan Macey, *Delaware: Home to the World’s Most Expensive Raincoat*, 33 HOFSTRA L. REV. 1131 (2005).

103. DEL. CODE ANN. tit. 8, § 102(b)(7) (2010). The Model Act has followed suit. See MOD BUS. CORP. ACT § 8.31(a).

104. See *supra* note 103 and accompanying text.

105. See, e.g., *Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1998); *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993).

106. Christopher M. Bruner, *Good Faith, State of Mind, and the Outer Boundaries of Director Liability in Corporate Law*, 41 WAKE FOREST L. REV. 1131 (2006); Melvin A. Eisenberg, *The Duty of Good Faith in Corporate Law*, 31 DEL. J. CORP. L. 1 (2006); Hillary A. Sale, *Delaware’s Good Faith*, 89 CORNELL L. REV. 456 (2004).

107. *Malpiede v. Townson*, 780 A.2d 1075, 1094 (Del. 2001).

108. 911 A.2d 362 (Del. 2006).

109. Charges that directors have breached their fiduciary duties by failing to monitor employees are called *Caremark* claims. The term comes from a Chancery Court decision upholding the settlement of a derivative suit alleging such violations. *In re Caremark Int’l, Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996).

110. *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362 (Del. 2006).

111. *Id.* at 373.

The second case, *Brehm v. Eisner* (“*Disney*”),¹¹² involved a cause célèbre in the entertainment business. The Disney Company hired famed talent agent Michael Ovitz as its president but fired him only a year later.¹¹³ That cost Disney approximately \$130 million in severance payments.¹¹⁴ Shareholder plaintiffs charged that the actions of Disney’s board were so improvident that they constituted bad faith.¹¹⁵ In response, the court first defined “bad faith,” holding that it does not necessarily require a showing of spiteful or malevolent intent.¹¹⁶ It can also be satisfied by “an intentional dereliction of duty, a conscious disregard for one’s responsibilities.”¹¹⁷ Yet, even though the court found that the directors did not follow best practices in employing and terminating Ovitz,¹¹⁸ their conduct did not reach the level of wrongdoing that would constitute “bad faith.”¹¹⁹ Thus, the directors had not breached their fiduciary duties and their decision was entitled to the protection of the business judgment rule.¹²⁰

It seemed after *Disney* that Delaware courts would be willing to tolerate high levels of wrongful conduct when directors were charged with careless actions. A ruling from Chancellor Chandler, however, reaffirmed that the standard for misconduct there is not inordinately high. In a 2009 decision,¹²¹ he refused to dismiss a waste claim involving compensation paid to Citigroup’s CEO Charles Prince. Mr. Prince was given sixty-eight million dollars in severance upon leaving the company after the collapse of the housing market.¹²²

After stating the general authority of boards to set executive compensation, the Chancellor made this telling comment:

It is also well settled in our law, however, that the discretion of directors in setting executive compensation is not unlimited. Indeed, the Delaware Supreme Court was clear when it stated that “there is an outer limit” to the board’s discretion to set executive compensation, “at which point a decision of the directors on ex-

112. 906 A.2d 27 (Del. 2006).

113. *Id.* at 44.

114. *Id.* at 57.

115. *Id.* at 52.

116. *Id.* at 64.

117. *Id.* at 65–66.

118. The first part of the title of a fine article sums up Disney’s ill-considered action. Marc I Steinberg & Matthew D. Bivona, *Disney Goes Goofy: Agency, Delegation, and Corporate Governance*, 60 HASTINGS L. J. 201 (2008).

119. *Brehm*, 906 A.2d at 63.

120. Two circuit court opinions, however, appear to take a broader view of director liability than *Disney* for corporate wrongdoing that is not protected by Section 102(b)(7). See *In re Abbott Labs. Derivative S’holder Litig.*, 325 F.3d 795 (7th Cir. 2003); *McCall v. Scott*, 239 F.3d 808 (6th Cir. 2001).

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

122. *Id.* at 138.

ecutive compensation is so disproportionately large as to be unconscionable and constitute waste.”¹²³

The Chancellor went on to examine the allegations that Mr. Prince’s large payments were improper, particularly since he was allegedly responsible for huge losses suffered by the company in the financial meltdown.¹²⁴ The Chancellor found that they raised a reasonable doubt that Citi’s board was well informed, careful, and rational in approving that compensation plan.¹²⁵

The next year, Delaware’s current Chancellor, Leo J. Strine, co-authored an article on that point with several other scholars of that state’s corporate jurisprudence.¹²⁶ They argued that good faith is closely akin, if not rooted, in the ideal of loyalty. That, they said, “requires that the action have been undertaken in good faith to advance the interests of the shareholders” as defined by the law creating that entity.¹²⁷ Conscious disregard of one’s duties is thus really disloyal conduct, a point that has been made earlier by other scholars.¹²⁸

One commentator rephrased this as “[u]nder the current law, the duty of loyalty prohibits not only self-interested transactions but also knowing breaches of the duty of care, and, more importantly, actions that are illegal even where they are intended to benefit the corporation and maximize profits.”¹²⁹ That broad concept of loyalty might even buttress the ethic of corporate social responsibility, as that commentator argued. It would see “the moral corporation as a necessary ingredient of civil society”

123. *Id.*

124. *Id.* at 129–30.

125. *Id.* at 136.

126. Strine et al., *supra* note 35.

127. *Id.* at 643.

128. As two law and economics scholars put it:

It is conventional to draw a sharp distinction between the duty of care . . . and the duty of loyalty The usual explanation for this dichotomous treatment is that the decisions tainted by a conflict of interest are entitled to less judicial deference than those that are not. Some have argued that the differences between the duty of care and the duty of loyalty are so fundamental that the latter should be strengthened and the former abolished.

Ultimately, though, there is no sharp line between the duty of care and the duty of loyalty. What is the difference between working less hard than promised at a given level of compensation (a breach of the duty of care) and being compensated more than promised at a given level of work (a breach of the duty of loyalty)? Both are agency costs, conflicts of interest in an economic sense, that reduce shareholders’ wealth. The existence of a conflict of interest, therefore, cannot explain the distinction between the duties of care and loyalty.

FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 103 (1991) (footnote omitted).

129. David Rosenberg, *Delaware’s “Expanding Duty of Loyalty” and Illegal Conduct: A Step Towards Corporate Social Responsibility*, 52 SANTA CLARA L. REV. 81, 83 (2012).

and include the interests of all its stakeholders in that fiduciary obligation.¹³⁰ Indeed, Chancellor Strine and his co-authors implied as much. Even when directors act with an intent to maximize profits, their actions would not be in the best interests of shareholders if they are inimical to society as a whole.¹³¹

Chancellor Strine and his co-authors also had no problem turning aside charges that their all-encompassing duty of loyalty made other explicitly stated obligations of directors redundant. They called such re-emphasis a “pervasive presence in statutes and contracts” and a “belt and suspenders protection against unintended consequences.”¹³² Thus, the “new categories” of non-exculpatory conduct provided in Section 102(b)(7) hardly created any additional fiduciary duties.

For instance, one could take an extremely narrow reading of the duty of loyalty as only the negative obligation not to profit at the expense of the corporation. Yet, even then, the new prohibition to not receive “improper personal benefit” could only be distinguished from that at great difficulty.¹³³ It could very well be just a re-enforcement of the obvious principle that directors should not loot their corporations.¹³⁴

III. APPLYING MANAGEMENT’S DUTIES TO M&A

A. *The Time of Hostile Take-Overs*

The era of tender offers played out against this background of developing fiduciary principles. It began in the mid-1960s with aggressors trying to gain controlling interests in companies by making public proposals to purchase their shares. Those offers stated the buyers’ willingness to pay shareholders of target companies a premium in cash over the market price of their stock.¹³⁵ Up until then, those maneuvers had an unsavory reputation among the corporate establishment. They were something that was only done by “raiders” intent on looting viable companies.¹³⁶

When Congress began considering a legislative response to the new phenomenon, its primary intent was to protect established companies from such “corporate piracy.”¹³⁷ But a new justification for tender offers was emerging from law and economics jurisprudence. Hostile takeovers

130. *Id.* at 103.

131. Strine et al., *supra* note 35, at 653.

132. *Id.* at 660.

133. *Id.*

134. *Id.*

135. HAMILTON, MACEY & MOLL, *supra* note 4, at 1003.

136. James C. Wine, *Private Litigation Under the Williams Act: Standing to Sue, Elements of a Claim and Remedies*, 7 J. CORP. L. 545, 553 (1982). Just what constituted “looting,” however, could be a tricky question. See *Perlman v. Feldmann*, 219 F.2d 173 (2d Cir. 1955) (involving premium for control given for ability to sell steel produced by company).

137. In 1965 Senator Harrison Williams spoke of “proud old companies” that were beset by “white-collar pirates.” 111 CONG. REC. 28,257 (1965).

were really a form of shareholder empowerment—a response to Berle and Means’s classic criticism of unaccountable corporate management.¹³⁸

Stock prices, as that theory went, decline when management is inefficient in deploying its firm’s resources to their most profitable uses. Such underpriced companies attract bidders who want to gain controlling interests in the corporation’s shares. The bidders can then dismiss the underperforming incumbent officials and restructure the company to achieve its most gainful ends.¹³⁹

In such scenarios, everyone supposedly benefited except the managers who were replaced. Selling shareholders received a premium for their stock, remaining investors had their wealth enhanced, and the bidder profited by the difference it paid for the controlling shares and the new higher value of the restructured company. Most importantly, the economic well-being of society as a whole advanced because of a more productive use of its scarce resources.¹⁴⁰ Even the threat of a hostile takeover, it was said, disciplined management to be more attentive to maximizing their firm’s earnings for fear of being replaced if its stock was undervalued.¹⁴¹

Therefore, federal legislation, when it took final form in the Williams Act of 1968, adopted a neutral position vis-à-vis the regulation of tender offers. It didn’t aim to stop them, but just to ensure that tendering shareholders received fair treatment.¹⁴² The legal action then shifted to the

138. See 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, 1168–69 (1981); Ronald J. Gilson, *A Structural Approach to Corporations: The Case against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819 (1981).

139. Stewart Toy, Elizabeth Ehrlich, Aaron Bernstein & Stan Crook, *The Raiders*, “They Are Really Breaking the Vise of the Managing Class,” BUS. WK., Mar. 4, 1985, at 80, 83.

140. In an editorial from that era, the Wall Street Journal wrote:

Capitalist structures need to evolve, and we certainly are not willing to leave the evolution solely to incumbent managements that represent the old order. We find ourselves sympathizing when in defense of his controversial activities, a Carl Icahn [a hostile bidder] argues that we would not have the Rust Belt today if it had been possible to “pierce the establishment” in the steel industry 20 years ago.

Creative Destruction—III: The Delaware Tilt, WALL ST. J., June 12, 1985, at 30.

141. Judge Henry Friendly famously called takeovers “the sharpest blade for the improvement of corporate management” See Henry J. Friendly, Senior Judge, U.S. Court of Appeals for the Second Circuit, Speech at the ALI-ABA Regional Symposium on the Structure and Governance of Corporations (May 4-6, 1978), reprinted in 3 ALI-ABA Course Materials J., no. 3, 1979 at 93, 128.

142. The Williams Act thus requires that bidders make appropriate disclosures on such subjects as their goals and the sources of their funds. It also slows down the process so that the offeree shareholders can use that information to make knowledgeable decisions about whether to tender their shares. The Act contains other provisions as well to protect the tendering shareholders by giving them the ability to withdraw their shares during the offer, to have them purchased on a pro rata basis with all other tendering shareholders, and to receive the highest price in the offering. To that end the Act adds sections 13(d), 13(e), 14(d), 14(e),

legitimacy of responses that incumbent management could undertake either in anticipation of tender offers or in answer to them.

Other viewpoints, however, not at all as sanguine as those of the law and economics school, challenged those assumptions. As Chancellor Allen described that contrary outlook:

In the financial setting of the 1980s, dramatically higher stock prices could often be achieved by sharply increasing the debt of the corporation and reducing or eliminating certain operations. But increasing debt substantially made the enterprise riskier and thus reduced the value of the corporation's existing bonds and restricting operations injured workers and management, who were thrown out of work.¹⁴³

According to Chancellor Allen, the surge of hostile tender offers in the 1980s therefore forced courts to confront an issue they had "papered over" during the previous decades.¹⁴⁴ Was the corporation to be primarily run to maximize profits for shareholders? Yes said the "Property" view, best exemplified by holdings from some early 20th century cases.¹⁴⁵ No, responded the "Equity" theory, which maintained that the corporation should be seen as an institution with a range of loyalties to many members of society.¹⁴⁶

The author wrote a trilogy of law review articles during that time which covered the controversy and the significant legal decisions it produced.¹⁴⁷ Because of their continuing relevance to the topic of this article, this segment will summarize the salient issues of that era and the holdings of the major cases that followed in their wake.

B. *Questions About Defensive Tactics*

Observers quickly noted that board actions to forestall hostile takeovers were quite different from decisions directors made in routine commercial matters. The latter would be protected from judicial review by unproblematic applications of the business judgment rule. Unfriendly

and 14(f) to the Securities Exchange Act of 1934 and empowers the SEC to make regulations to implement them. See generally GEVURTZ, *supra* note 1, at 736–50. For an early article by two SEC lawyers highly critical of defensive tactics to impede shareholders' rights to tender, see Gary G. Lynch & Marc I. Steinberg, *The Legitimacy of Defensive Tactics in Tender Offers*, 64 CORNELL L. REV. 901 (1979).

143. William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 274 (1992).

144. *Id.* at 272.

145. See, e.g., *Dodge v. Ford Motor Co.*, 170 N.W. 668 (Mich. 1919).

146. For an expostulation of that view, as it emerged in the 1930s, see E. Merriek Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932).

147. Daniel J. Morrissey, *Law, Ethics, and the Leveraged Buyout*, 65 U. DET. L. REV. 403 (1988); Daniel J. Morrissey, *Defensive Tactics in Tender Offers—Does Anything Go?*, 53 TENN. L. REV. 103, 124 (1986); Morrissey, *supra* note 12, at 47.

tender offers, on the other hand, challenged not just the quality of the directors' management decisions but their very right to be in those positions.

Because of that inherent tension, unsolicited tender offers posed a direct conflict of interest for a board.¹⁴⁸ Some commentators, therefore, urged that legal tactics, which contested them, raised issues of loyalty, not care.¹⁴⁹ This structural bias might even infect outside directors who would not only empathize with their colleagues employed by the target company but would also lose their own privileged offices if a hostile takeover was successful.¹⁵⁰

C. Early Legal Responses Condoning Defensive Tactics

Nevertheless, cases from Delaware and the federal appellate courts during this first wave of hostile takeovers generally accepted various tactics undertaken by management to ward them off. Delaware courts turned aside claims that the takeovers constituted breaches of the directors' duty of loyalty. Many of those involved the sale of stock by the board to either placate a hostile bidder or to fend one off.

An early example of the former is *Cheff v. Mathes*,¹⁵¹ where the directors bought back shares from a potential hostile bidder at a premium over the market price, a tactic that would later be called "greenmail."¹⁵² Even though just the year before the Delaware court had placed the burden on directors to justify any strategy that might be undertaken to maintain their control,¹⁵³ it now held that such an action is not the same type of "self-dealing" as when a director sells property to the corporation.¹⁵⁴ It then upheld the repurchase as necessary to quell unrest among key employees and safeguard the firm from liquidation.¹⁵⁵

Several subsequent cases from the federal circuits illustrated the latter defensive tactic: selling shares to friendly groups to forestall a hostile bidder. In two cases from the Second Circuit decided in 1980, *Treadway Cos. v. Care Corp.*,¹⁵⁶ and *Crouse-Hinds Co. v. Internorth, Inc.*,¹⁵⁷ the target com-

148. See Jennifer J. Johnson & Mary Siegel, *Corporate Mergers: Redefining the Role of Target Directors*, 136 U. PA. L. REV. 315 (1987) (proposing that only independent directors be empowered to enter into mergers and only then with prior shareholder approval).

149. This perspective gave rise to a spate of articles urging that boards remain passive in the face of a hostile tender offer. See, e.g., Easterbrook & Fischel, *supra* note 138 and accompanying text; Gilson, *supra* note 138 and accompanying text.

150. For a more lengthy commentary written by the author during that time period, see Morrissey, *supra* note 147, at 124.

151. 199 A.2d 548 (Del. 1964).

152. GEVURTZ, *supra* note 1, at 708.

153. *Bennett v. Propp*, 187 A.2d 405, 409 (Del. 1962).

154. *Cheff*, 199 A.2d at 556–57.

155. *Id.*

156. 638 F.2d 357 (2d Cir. 1980).

157. 634 F. 2d 690 (2d Cir. 1980).

panies sold shares to such a “White Knight” to discourage hostile bidders. In both situations the courts disregarded the patent self-interest of boards and approved the tactic under the business judgment rule because a plausible argument was made that the take-over would be harmful to the corporation and its shareholders.¹⁵⁸

D. Unocal and the Poison Pill

Then in 1985, at the height of that decade’s tender offer fervor,¹⁵⁹ the Delaware Supreme Court decided two landmark cases that endorsed a target board’s power to resist them. Both bowed to the directors’ traditional authority to manage a corporation as sanctioned by the business judgment rule.

The first, *Unocal Corp. v. Mesa Petroleum Co.*,¹⁶⁰ involved a discriminatory stock repurchase. T. Boone Pickens, a notorious hostile bidder of

158. At about the same time, cases from both the Third and Seventh Circuits also ruled in favor of incumbent managers against charges that certain of their actions were designed only to retain control of the firm. In the former, *Johnson v. Trueblood*, the majority shareholder refused to raise funds that the company needed by selling shares to minority shareholders because the majority would then have lost control to the minority. 629 F.2d 287 (3d. Cir. 1980). The court applied the business judgment rule to dismiss the suit saying that it was appropriate to defer to management absent a showing that impermissible motives predominated.

In the latter case, *Panter v. Marshall Field & Co.*, the target company adopted a number of “shark-repellant” tactics to create anti-trust problems for a hostile bidder. 646 F.2d 271 (7th Cir. 1981). When the bidder withdrew its offer and the company’s stock dropped considerably, shareholders sued. The court however dismissed claims that the defensive tactics were unwarranted as “precisely this sort of Monday-morning-quarterbacking that the business judgment rule was intended to prevent.” *Id.* at 297. It found justification for the board’s actions in “[t]he desire to build value within the company, and the belief that such value might be diminished by a given offer.” *Id.* at 296. In a later case from the Second Circuit, however, *Norlin Corp. v. Rooney, Pace Inc.*, the court refused to allow a defensive tactic where a target’s board issued additional shares to two entities that it controlled. 744 F.2d 255 (2d Cir. 1984). The board would then have voting power of almost a majority of the company’s shares. *Id.* at 267. Not only was that action taken without the required approval by the NYSE and the firm’s other shareholders, but the company’s chairman admitted in a letter that he had taken it to fend off a hostile takeover. *Id.* at 268–69. With those facts, the court refused to condone the maneuver finding that the board’s self-interest overruled the normal presumptions of the business judgment rule. *Id.* at 269.

159. Financier Ivan Boesky made the signature statement from that epoch at a business school commencement speech shortly before he was indicted for insider trading: “Greed is all right by the way, . . . I think greed is healthy. You can be greedy and still feel good about yourself.” PATRICK DILLON & CARL M. CANNON, *CIRCLE OF GREED* 108 (2010). It was the template for Gordon Gecko’s famous declaration that “greed if good” in Oliver Stone’s 1987 movie. *Wall Street* (20th Century Fox Film Corp.). Michael Douglas won an academy award for his role as Gecko. As one author wrote of that era of massive corporate change: “[d]uring the 1980s, nearly half of all U.S. companies were restructured, more than 80,000 were acquired or merged, and over 700,000 sought bankruptcy protection in order to reorganize and continue operations.” SHERMAN, *supra* note 1, at xiii.

160. 493 A.2d 946 (Del. 1985).

that day, made a “two-tier,” “front-end-loaded” tender offer for Unocal proposing to buy part of that company’s stock for \$54 per share in cash and then exchange subordinated debt valued at that amount for the remainder.¹⁶¹ To counter, Unocal offered to exchange high quality debt securities valued at \$72 for each of its common shares. Pickens, however, who then owned thirteen percent of the company’s stock was specifically excluded from the deal. The court found that tactic was reasonable given the board’s view that Pickens’s offer was coercive and inadequate.¹⁶² It described the directors’ role in a tender offer as that of a gatekeeper—almost like their statutory duty to approve a merger or a sale of a firm’s assets before they are submitted to shareholders for ratification.¹⁶³

The *Unocal* court, however, circumscribed its holding by noting that it found reasonable justification for the company’s defensive maneuver.¹⁶⁴ It said, “[a] corporation does not have unbridled discretion to defeat any perceived threat by any Draconian means available.”¹⁶⁵ It spoke of an “enhanced duty”¹⁶⁶ in such a situation where directors must show that they have “reasonable grounds for believing that a danger to corporate policy and effectiveness existed because of another person’s stock ownership.”¹⁶⁷

The second major Delaware opinion of 1985 followed *Unocal* rapidly in time and faithfully in logic. It was *Moran v. Household Int’l Inc.*,¹⁶⁸ the poison pill case. *Moran* officially condoned that most effective defense against hostile takeovers—shifting the balance of power to management in the 1980s wave of M&A deals.

The pill approved in *Moran* involved rights issued to the company’s common shareholders to purchase \$100 worth of its preferred shares.¹⁶⁹ They were not valuable when issued but when someone made a tender offer for a substantial amount of the company’s stock, a “flip-over” provision came into play.¹⁷⁰ In the event of a merger, it gave the preferred stockholders the ability to purchase \$200 of the acquiring company’s stock for \$100, making Household prohibitively expensive for any hostile buyer.¹⁷¹ That burdensome obligation, however, would not encumber a friendly bidder because Household’s board retained the ability to redeem the rights for a small amount any time before they became exercisable.¹⁷²

161. *Id.* at 949.

162. Exchange Act Rule 13e-4(f)(8)(i) promulgated under authority given by the SEC in the Williams Act now requires that tender offers be open to all security holders of the class subject to the tender offer.

163. *Unocal*, 493 A.2d at 958.

164. *Id.*

165. *Id.* at 955.

166. *Id.* at 954.

167. *Id.* at 955.

168. 500 A.2d 1346 (Del. 1985).

169. *Id.* at 1349.

170. *Id.*

171. *Id.*

172. *Id.* at 1354.

Given its ruling in *Unocal* it was no surprise that the Delaware Supreme Court tolerated Household's use of the pill.¹⁷³ It appeared even more appealing to the court because it was "pre-planned," not enacted in response to a particular hostile attack.¹⁷⁴ The court also noted that the board had the authority under the Delaware statutes to issue the preferred shares with the flip-over rights.¹⁷⁵ Acceding to the directors' business judgment, the court held that Household's directors adopted the pill in good faith to protect against a coercive tender offer.¹⁷⁶

Even while approving the pill, however, the court added a caveat. Under the appropriate circumstances, a bidder might make a tender offer conditioned on the board's redemption of the rights.¹⁷⁷ The court indicated that in such a case it would not permit an arbitrary refusal of that demand.¹⁷⁸

E. *The Revlon Qualification and Its Aftermath*

In the later 1980s, the Delaware Supreme Court handed down two other major cases on board fiduciary duties that dealt with the limits on their discretion to oppose mergers and acquisitions. One came in 1986, a year after *Unocal* and *Moran*, and the other in 1989, as the takeover surge of that era drew to a close. The first, *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,¹⁷⁹ began with a \$45 per share tender offer for Revlon's shares by Pantry Pride.¹⁸⁰ Revlon's board responded by adopting a poison pill.¹⁸¹ Pantry Pride raised its offer and, after some other defensive moves by Revlon, Pantry Pride countered with an even higher bid.¹⁸²

Revlon's board then entered into a friendly merger with the Forstmann Group that would buy all the company's stock for \$56 per share and agreed to some other actions that would benefit the company's noteholders.¹⁸³ When the Forstmann merger was announced, Pantry Pride raised its offer to \$56.25.¹⁸⁴ Forstmann, however, outbid Pantry Pride's offer when given financial data that Pantry Pride did not receive.¹⁸⁵ Revlon also sweetened its deal with Forstmann.¹⁸⁶ It gave Forstmann an option to purchase one of its divisions at a substantial discount if another bidder got

173. *See id.* at 1351 (discussing recent decision in *Unocal*).

174. *Id.* at 1350.

175. *Id.* at 1353.

176. *Id.*

177. *Id.* at 1354–55.

178. *Id.* at 1354.

179. 506 A.2d 173 (Del. 1986).

180. *Id.* at 176.

181. *Id.* at 180–81.

182. *Id.* at 178–79.

183. *Id.* at 184.

184. *Id.*

185. *Id.* at 178.

186. *Id.*

40% of the company's shares.¹⁸⁷ It also put a *no shop* provision in its agreement with Forstmann by which Revlon agreed not to seek other offers.¹⁸⁸

When Pantry Pride sued, the Delaware Supreme Court upheld the original poison pill as a legitimate response by Revlon.¹⁸⁹ The court, however, ruled that things changed when the friendly suitor entered the picture.¹⁹⁰ Because it then became apparent that the company would not survive in its current form, "[t]he directors' role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders. . . ."¹⁹¹

Nor could the "auction ending" deal with Forstmann be defended as a way to safeguard the interests of the noteholders.¹⁹² Like all creditors, their rights were protected by contract law. By the lockup arrangement with Forstmann, Revlon's directors breached their duty of loyalty to obtain the highest price for their shareholders.¹⁹³

In the second case, however, *Paramount Communications, Inc. v. Time, Inc.*,¹⁹⁴ the Delaware Supreme Court qualified its *Revlon* rule. Time was set to consummate a merger by a share exchange with Warner when Paramount announced a \$175 cash tender offer for all of Time's stock.¹⁹⁵ Time's board responded that Paramount's price was inadequate even though it was substantially above what its shares were trading for in the open market.¹⁹⁶

187. *Id.*

188. *Id.* at 178.

189. *Id.* at 175–76.

190. *See id.* at 176 (discussing friendly acquisitions).

191. *Id.* at 182.

192. *Id.*

193. *Id.* But immediately after *Revlon*, the Delaware Supreme Court, per Justice Moore, affirmed a defensive strategy under *Unocal* principles. *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334 (Del. 1987). That case involved another takeover bid by T. Boone Pickens. *Id.* at 1336. He secretly purchased a stake in Newmont and then announced a cash tender offer for enough shares to gain control. *Id.* Newmont responded by selectively paying a dividend to a twenty-six percent shareholder who would respect the company's independence. *Id.* at 1333–34. The stockholder then increased its ownership in Newmont to 49.9%. *Id.* Thwarted in his bid, Pickens sued to enjoin the dividend, but the court deferred to Newmont's business judgment and dismissed the suit. *Id.* at 1345–46. Justice Moore pointed to Pickens's secret and coercive tactics and said they fit his "typical *modus operandi*." *Id.* at 1342. Yet, two years later the Delaware Supreme Court followed *Revlon* to find that a target board had mismanaged a bidding process that was "tilted" in favor of one of the potential purchasers. *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261 (Del. 1989). The board there was deceived by management about the auction but was also culpably negligent itself by failing in its duty of oversight, particularly since insiders were involved in the process. *Id.* at 1261.

194. 571 A.2d 1140 (Del. 1989).

195. *Id.* at 1147.

196. *Id.* at 1148.

Time also claimed that Warner was a more appealing business partner because it would respect its journalistic integrity.¹⁹⁷ Time then restructured its arrangement with Warner in a way that would not require shareholder approval.¹⁹⁸ In turn, Paramount raised its offer to \$200 per share and sought to enjoin the Time-Warner deal.¹⁹⁹

Chancellor Allen, however, refused to halt the merger rejecting Paramount's argument that *Revlon* required Time to accept its higher bid.²⁰⁰ The Time-Warner merger, said the Chancellor, was not an outright sale of control because ownership of the new firm remained in publicly traded shares.²⁰¹ In addition, the Time-Warner combination was a legitimate corporate strategy and the business judgment rule allowed management some discretion in long term planning even at the expense of short-term gain for shareholders.²⁰² On appeal, the Delaware Supreme Court affirmed the Chancellor's ruling.²⁰³

197. *Id.* at 1143.

198. *Id.* at 1146.

199. *Id.* at 1149.

200. *See In re Time Inc. S'holder Litig.*, No. 10670, slip op. at 56 (Del. Ch., July 14, 1989).

201. *Id.*

202. *Paramount*, 571 A.2d at 1151.

203. *See* David B. Hilder and Laura Landro, *Paramount Withdraws Its Hostile Offer as Time Begins Its Purchase of Warner—Battle Ends as High Court in Delaware Turns Down Paramount and Holders*, WALL ST. J., July 25, 1989, at A3. During oral argument, after listening to Time's counsel discuss other cases where the court had deferred to directors' long-term strategies, Justice Moore signaled his approval. From the bench the author of both *Unocal* and *Revlon* said with exasperation: "[h]ow many times does the court have to speak on this?" *Id.*

The Delaware Supreme Court's lengthy opinion affirmed its tradition of deference to a board's business judgment. *Paramount*, 571 A.2d at 1140. It there stated, "absent a limited set of circumstances as defined under *Revlon*, a board of directors, while always required to act in an informed manner, is not under any *per se* duty to maximize shareholder value in the short term." *Id.* at 1150. The court also ruled that, by entering into the merger deal with Warner, Time had not "put itself up for sale." *Id.* There was thus no *Revlon* event. *Id.* A noted commentator expressed dismay at the opinion stating: "[i]n Delaware today, shareholder protection is all too often largely rhetorical, lacking in substantive content." Marc I. Steinberg, *Nightmare on Main Street: The Paramount Picture Horror Show*, 16 DEL. J. CORP. L. 1, 2 (1991).

A few years after its disappointing bid for Time, Paramount found itself on the other side of a takeover. It entered into a friendly merger arrangement with Viacom that would give Viacom's CEO a controlling interest in the new company. *Paramount Commc'ns, Inc. v. QVC Network, Inc.*, 637 A.2d 34 (Del. 1994). The agreement also contained several provisions designed to make a competing bid more difficult. *Id.* at 39. Despite those barriers, QVC came in with a higher offer after the Viacom-Paramount merger was announced. *Id.* at 41. The Paramount board rebuffed it and a bidding war ensued. *Id.* When QVC requested "auction procedures," however, Paramount's board continued to resist, holding fast to its preferred deal with Viacom. *Id.* at 41.

QVC then sued asking the Delaware Court to apply the *Revlon* and *Unocal* principles to Paramount's anti-takeover actions. *Id.* at 42. That posed two significant questions: was the proposed merger of Viacom-Paramount a *Revlon* event demanding a process to secure the best price for the company's shareholders?; if so,

IV. FIDUCIARY DUTIES IN THE NEW WAVE OF MERGERS

A. *The Rise of New Takeover Techniques*

The merger surge of the 1980s died out for a short spell in the early 1990s²⁰⁴ but quickly resumed and strengthened as the high-tech boom of that decade accelerated.²⁰⁵ By then, sophisticated anti-takeover techniques, most prominently the poison pill,²⁰⁶ had taken hold and presented a formidable barrier to simple cash tender offers.²⁰⁷ As a result, a new generation of takeover strategies appeared to deal with that impregnable defense which seemed to allow target boards to “Just Say No.”

A prominent strategy was on display in the case of *Unitrin, Inc. v. American General Corp.*,²⁰⁸ where a bidder sought to have its own directors elected so they could neutralize a poison pill. The target, Unitrin, first adopted the pill in response to what it deemed was an inadequate tender offer.²⁰⁹ And then to head off a proxy fight it announced a plan to repurchase its shares for a premium over their market price.²¹⁰

Unitrin’s directors already owned twenty-three percent of its outstanding shares and the repurchases would increase their holdings.²¹¹ That, then were the defensive measures of the merger agreement justified under *Unocal*? *Id.* at 49.

The Delaware Supreme Court answered “yes” to the first question and correspondingly “no” to the second. *Id.* at 51. The controlling interest in Paramount was such a valuable asset, said the court, that its potential sale to Viacom’s CEO brought *Revlon* into play. *Id.* at 48. When that happened, the enhanced standard of *Unocal* kicked in, negating the business judgment presumption that would favor Paramount’s defensive actions. *Id.* at 45. Unlike *Revlon*, no break up of Paramount was likely to result from its merger to Viacom, the court distinguished the QVC matter from the earlier *Time* situation. *Id.* at 46. After the merger there, control of the new company would remain fluid in publicly held shares. *Id.* at 40. After the Paramount-Viacom merger, however, the CEO of Viacom would become the dominant shareholder of a new consolidated company. *Id.* at 38. The court found Paramount was effectively put up for sale when it made the preliminary merger agreement with Viacom. *Id.* at 50. That, the court said, triggered the board’s *Revlon* duties to realize optimum value for their shareholders. *Id.* at 47.

204. Several events gave rise to that pause. See generally *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69 (1987) (affirming stronger anti-takeover defenses and state anti-takeover statutes). The Gulf War and a recession played their part as well. See *History of Mergers and Acquisitions*, *supra* note 14. But perhaps the chief reason was the criminal conviction of junk bond financier Michael Milliken. See *Predator’s Fall: Drexel Burnham Lambert*, *TIME* (Feb. 26, 1990), <http://www.time.com/time/magazine/article/0,9171,969468,00.html>. Milliken’s firm Drexel Burnham, had raise huge amounts of capital to make large hostile take-overs possible and his imprisonment put an end to that stream of financing. *Id.*

205. See HAMILTON, MACEY & MOLL, *supra* note 4, at 997; see also BRATTON, *supra* note 1, at 972.

206. GEVURTZ, *supra* note 1, at 706.

207. Lucian Arye Bebchuk & Marcel Kahan, *A Framework for Analyzing Legal Policy Towards Proxy Contexts*, 78 CALIF. L. REV. 1071, 1134 (1990).

208. 651 A.2d 1361 (Del. 1995).

209. *Id.* at 1369.

210. *Id.* at 1370.

211. *Id.*

along with a supermajority provision in the company's certificate of incorporation, would enhance the ability of Unitrin's management to frustrate the bidder from electing its own directors in a proxy contest.²¹²

When shareholders sued to challenge the stock repurchase, the Delaware Court of Chancery ("Chancery Court") first found that no *Revlon* event had occurred.²¹³ The poison pill was therefore a proper reaction to a perceived inadequate hostile bid.²¹⁴ The lower court, however, enjoined the stock repurchase plan because it might deter the bidder from waging a proxy fight to elect its own directors to defuse the pill.²¹⁵ But the Delaware Supreme Court was not so sure of that. The share repurchases were not inherently coercive, it said.²¹⁶ In conjunction with the other defenses, they therefore might not be so draconian that they would preclude the bidder's efforts.²¹⁷ The Delaware Supreme Court thus remanded the matter to the Chancery Court to determine whether the defensive measures were reasonable under the *Unocal* standard.²¹⁸

B. "Dead Hands" and "No Hands"

One traditionally acceptable but weak measure to forestall hostile takeovers is to classify or stagger the terms of the target's directors.²¹⁹ Because only one-third of a board will then be up for election each year, it will take a bidder with a majority of the shares two years to gain control of the company. That tactic can thus delay but not ultimately prevent the acquirer's success.²²⁰

After *Unitrin*, directors of potential target companies devised a stronger way to entrench directors. These were the so-called "dead hand" and "no hand" provisions that would prohibit or greatly delay newly installed boards from neutralizing poison pills. With such measures in place, proxy contests to replace boards, even if successful, would be futile because pills would still be there to make any unfriendly acquisition pro-

212. *Id.*

213. *Id.* at 1372.

214. *Id.*

215. *Id.*

216. *Id.* at 1388.

217. *Id.*

218. Earlier, the Delaware Chancery Court allowed a target to sell shares to a management friendly ESOP when it would thwart a sale to a bidder for an unfairly low price. *Shamrock Holdings, Inc. v. Polaroid Corp.*, 559 A.2d 257 (Del. Ch. 1989).

219. DEL. CODE ANN. tit. 8, § 141(d) (2010); accord MOD BUS. CORP. ACT § 8.06.

220. The incumbent directors may also feel psychological pressure to resign rather than oppose the new majority shareholder, thus limiting that defense. GEVURTZ, *supra* note 1, at 705. Of late, the number of shareholder proposals to eliminate these classified boards and have all directors stand for election annually has shot up significantly. Protess & Lewis, *supra* note 48.

hibitively expensive. Two Delaware cases in 1998, however, struck down both versions of that strategy.

In *Carmody v. Toll Brothers, Inc.*,²²¹ shareholders challenged a “Continuing Director” provision in a pill-like rights plan that stipulated it could be removed only by the incumbent board. A bidder who won a proxy contest would thus find its own directors powerless to redeem the rights.²²² The Chancery Court therefore held that “dead hand” provision invalid as a preclusive measure that disenfranchised the firm’s shareholders.²²³

Quickturn Design Systems, Inc. v. Shapiro,²²⁴ featured a similar defensive strategy that was not quite so radical.²²⁵ There the target’s board adopted two features to deter a hostile takeover.²²⁶ It amended the firm’s by-laws to provide that any special shareholder meeting could only take place ninety days after it had been requested.²²⁷ Any unwelcome bidder who won a proxy contest would therefore have to wait three months before it could elect new directors.²²⁸

The board also originally had a “dead-hand” pill removal feature like *Carmody*’s.²²⁹ It replaced it, however, with a possibly more acceptable delayed redemption provision.²³⁰ That required newly elected directors to wait at least six months before they could bring about any transaction like a merger with an entity that had elected them.²³¹

The Chancery Court upheld the ninety-day waiting period. The Delaware Supreme Court however focused on the “no-hand” delayed redemption feature and found it invalid.²³² Section 141(a) of the Delaware Corporate Code provides that a board has the ultimate responsibility to manage a corporation unless there are limits to its authority set out in the firm’s certificate of incorporation.²³³

No such restrictions existed here and the “no-hand” feature made it impossible for the newly elected directors to remove the pill for six months.²³⁴ They therefore could not exercise their judgment to defuse

221. 723 A.2d 1180 (Del. Ch. 1998).

222. *Id.* at 1194.

223. *Id.* at 1180. Earlier Delaware cases had taken a hard line against strategies that disenfranchised shareholders. See *Stroud v. Grace*, 606 A.2d 75 (Del. 1992) (taking hard line stance against disenfranchising strategies); *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988) (same).

224. 721 A.2d 1281 (Del. 1998).

225. *Id.* at 1281.

226. *Id.* at 1283.

227. *Id.*

228. *Id.* at 1285.

229. *Id.* at 1287.

230. *Id.* at 1289.

231. *Id.* at 1287–88.

232. *Id.* at 1290–92.

233. *Id.* at 1291.

234. *Id.* at 1289–90.

that defensive measure and allow a tender offer to proceed.²³⁵ The “no-hand” provision was thus just as impermissible as a “dead-hand” one.²³⁶

C. *Disclosure and Due Care*

A significant case at the end of that era established that directors could also violate their fiduciary duties by misrepresenting material facts to shareholders to gain their approval for a merger.²³⁷ That can result in courts scrutinizing the “entire fairness” of the transaction, losing directors the presumptions of the business judgment rule and subjecting them to monetary damages.²³⁸ The case, *Emerald Partners v. Berlin*,²³⁹ involved a merger between May Petroleum Company (“May”) and thirteen corporations owned by one Hall. At that time, Hall owned over half the stock of May as well.²⁴⁰

The proxy statements sent to shareholders soliciting their approval contained misstatements about the thoroughness of the merger process and Hall’s holdings in some of the companies.²⁴¹ The transaction was also allegedly unfair to the minority shareholders of May because the price paid for Hall’s companies was too high.²⁴² The Chancery Court dismissed the case against all of May’s directors except Hall because it found at most

235. *Id.* at 1290–93.

236. *Id.* Three years later a North Carolina court stated its exasperation on these issues. *First Union Corp. v. Suntrust Banks, Inc.*, No. 01-10075, 2001 WL 1885686 (N.C. Sup. Ct. Aug. 10, 2001). It found Delaware’s various standards for defensive tactics confusing and called for a “refocus on the relationship between shareholder rights and directors duties to make informed decisions” *Id.* at *17–18. The court found support for that more straightforward position in an article by the then Delaware Vice-Chancellor (now Chancellor). *Id.* at *19–20; see also Leo E. Strine, Jr., *Categorical Confusion: Deal Protection Measures in Stock-for-Stock Merger Agreements*, 56 *BUS. LAW.* 919 (2001). The North Carolina case itself involved what the court called a “numb hand” provision in a merger contract that extended it five months beyond a shareholder vote disapproving the deal. *First Union*, 2001 WL 1885686, at *38. The court struck it down because it violated the duties of the target company’s directors and the rights of its shareholders. *Id.* at *38–39.

237. See generally *Emerald Partners v. Berlin*, 726 A.2d 1215 (Del. 1999).

238. See generally *id.*

239. 726 A.2d 1215 (Del. 1999). Partial disclosure can also be misleading. *Arnold v. Soc’y for Savings Bancorp, Inc.* 650 A.2d 1270, 1280 (Del. 1994). A recent study has shown that there is litigation in almost every acquisition of U.S. public companies valued over \$100 million. These typically allege disclosure violations and many claim that the target’s board did not conduct a sales process to maximize shareholder value. See *Developments in M&A Shareholder Litigation*, THE HARV. L. SCH. F. ON CORP. GOVERNANCE AND FIN. REG. (Mar. 4, 2012 8:58 AM), <http://blogs.law.harvard.edu/corpgov/2012/03/04/developments-in-ma-shareholder-litigation/>.

240. *Emerald Partners*, 726 A.2d at 1218.

241. *Id.* at 1222.

242. *Id.* at 1221.

they had only breached their duty of care and could not be liable under Section 102(b)(7).²⁴³

But dismissal was premature, said the Delaware Supreme Court; given the substantial disclosure violations, the entire fairness of the transaction had not been shown.²⁴⁴ Lacking that, the defendant directors had the burden to show that they had only violated their duties of care and not their duties of loyalty or good faith.²⁴⁵ When, on remand, the Chancery Court still failed to make that finding, the Supreme Court again sent the case back down holding that “exculpation must then be examined in the context of the completed judicial analysis that resulted in a finding of unfairness.”²⁴⁶

D. *Locks Up and Go Shops in the 2000s*

In several more merger cases during the last decade, the Delaware Supreme Court continued to define the duties of directors to seek the best value for their shareholders.²⁴⁷ One, *Omnicare, Inc. v. NCS Healthcare, Inc.*,²⁴⁸ began with an offer by Omnicare for NCS, a struggling company. NCS’s board turned it aside and found better merger terms from Genesis.²⁴⁹ NCS’s directors then agreed to submit that bid to their shareholders regardless of whether a higher one came along.²⁵⁰ Two large shareholder-directors of NCS who owned a majority of the stock in the company also committed to vote their shares for the deal.²⁵¹

Even when Omnicare came back with a better bid, NCS’s shareholders had no choice but to accept the Genesis merger.²⁵² Without a “fiduciary out”²⁵³ that would have allowed Omnicare’s directors to abrogate the deal if they found a better one for their shareholders, the merger was a *fait accompli*,²⁵⁴ both preclusive and coercive. The court said that Omnicare’s board had acted like the Paramount directors in QVC who breached their duty with the “no-shop” provision with Viacom.²⁵⁵ Both boards had im-

243. *Id.* at 1223. For additional discussion of Section 102(b)(7), see *supra* notes 101–04 and accompanying text.

244. *Emerald Partners*, 726 A.2d at 1223–24.

245. *Id.* at 1227.

246. *Emerald Partners v. Berlin*, 787 A.2d 85, 98 (Del. 2001).

247. For a fine article exploring the nuances of that issue, see Christina M. Sautter, *Shopping During Extended Store Hours: From No Shops to Go Shops*, 73 BROOK. L. REV. 525 (2008). For a good discussion of how boards can best satisfy that duty, see Guhan Subramanian, *Go-Shops vs. No-Shops in Private Equity Deals: Evidence and Implications*, 63 BUS. LAW. 729 (2008).

248. 818 A.2d 914 (Del. 2003).

249. *Id.* at 924.

250. *Id.* at 925.

251. *Id.* at 943–45.

252. *Id.* at 927.

253. *Id.* at 936.

254. *Id.*

255. *Id.* at 937.

properly prevented their shareholders from getting a superior bid.²⁵⁶ Two justices dissented.²⁵⁷

*In re Topps Company Shareholders Litigation*²⁵⁸ was also a situation where the Court found that a target's management engaged in a number of improper activities to favor one bidder over another. Among them, the directors solicited proxies for a merger with the favored suitor without making full disclosure of an arrangement that would have allowed them to remain in control of the company.²⁵⁹ They also appeared to be manipulating the financial analysis in those documents to make the deal they were recommending look more attractive.²⁶⁰

In addition, in exchange for furnishing a potential acquirer some confidential information, the target's management had secured a so-called standstill agreement from that bidder that it would hold off making its offer.²⁶¹ By refusing to waive that provision, however, the court found that the target's management had breached its fiduciary duty to permit its shareholders to entertain a better proposal and to receive useful information that was critical of the deal favored by the board.²⁶²

In the last year of the decade, in a case called *Lyondell Chemical Co. v. Ryan*,²⁶³ the Delaware Supreme Court once again came back to the *Revlon* and *Van Gorkom* issues. Upon careful analysis and with supportive outside opinions, the board accepted an attractive merger offer that was ratified by an overwhelming percentage of shareholders.²⁶⁴ A dissident claimed, however, that unless the board could show it had "impeccable knowledge of the market"²⁶⁵ it violated its *Revlon* duties and acted in bad faith by not seek competing bids.

The Delaware Supreme Court, however, held that *Revlon* only required that directors use reasonable judgment to secure the best price for the company.²⁶⁶ And the evidence in this case indicated that they did.²⁶⁷ They were aware of the value of their company, received an expert opinion that the bidder had offered a "blowout" price, and even placed a "fiduciary out" in the merger agreement in case a better offer came along.²⁶⁸ There was thus no "bad faith" or "breach of loyalty" in their action that

256. *Id.* at 931, 937.

257. *Id.* at 939.

258. 926 A.2d 58 (Del. Ch. 2007).

259. *Id.* at 88.

260. *Id.* at 76.

261. *Id.* at 83 n.20.

262. *Id.* at 92–93.

263. 970 A.2d 235 (Del. 2009).

264. *Id.* at 239.

265. *Id.* at 243.

266. *Id.* at 240–41.

267. *Id.*

268. *Id.* at 244.

would be unprotected from liability by the company's Section 102(b)(7) exculpatory clause.²⁶⁹

V. MERGERS AFTER THE MELTDOWN

A. *More on Boards' Duties to Maximize Value*

As confidence began returning to the M&A market a few years after the financial collapse of 2008, Delaware decisions appeared that added new twists to that state's law of fiduciary duty.²⁷⁰ In two significant cases, the Chancery Court reached different results based on the disparate relationship the targets' boards had with their shareholders.

In re OPENLANE, Inc. Shareholder Litigation,²⁷¹ involved a board that actively managed its company and knew it well. In addition, sixty-eight percent of the firm's stock was held by its officers and directors.²⁷² As a result of a lengthy search for potential acquirers, the company chose to merge with KAR because it offered shareholders the best value.²⁷³ The situation, however, almost seemed like a reprise of *Omnicare*, because the merger agreement contained no "fiduciary out" and did not allow OPENLANE to solicit other bids.²⁷⁴

Unlike that earlier case, however, the court did not find this arrangement preclusive or coercive.²⁷⁵ Since OPENLANE's board could terminate the agreement if shareholder approval was not received in twenty-four hours, the court held that the deal was not a *fait accompli*.²⁷⁶ The active pre-merger market test also led the court to find that the arrangement was well considered.²⁷⁷ That conclusion was additionally strengthened because the deal was approved by a knowledgeable board whose holdings gave it a personal interest in maximizing shareholder value.²⁷⁸ Therefore, the court refused to block the merger, which would have denied the shareholders the ability to profit by the transaction.²⁷⁹

*In re Southern Peru Copper Corp. Shareholder Derivative Litigation*²⁸⁰ concerned an acquisition where the controlling shareholder's interests were

269. *Id.* at 239.

270. Michael J. De La Merced & Jeffrey Cane, *Confident Deal Makers Pulled Out Checkbooks in 2010*, N.Y. TIMES (Jan. 3, 2011), <http://dealbook.nytimes.com/2011/01/03/confident-deal-makers-pull-out-checkbooks-in>.

271. No. 6849-VCN, 2011 WL 4599662 (Del. Ch. Sept. 30, 2011).

272. *Id.* at *7.

273. *Id.* at *11–13.

274. *Id.* at *9.

275. *Id.*

276. *Id.* at *12.

277. *Id.* at *5–6.

278. *Id.* at *16.

279. *Id.*

280. 30 A.3d 60 (Del. Ch. 2011), *superseded by In re Southern Peru Copper Corp. S'holder Derivative Litig.*, 532 A.2d 761 (Del. Ch. 2011), *vacated*, No. 961-CS, 2011 WL 6476919 (Del. Ch. Dec. 22, 2011).

not so well aligned with those of the other stockholders. The questioned transaction involved Southern Peru's agreement to purchase another mining company, Minerva, from Southern Peru's majority owner, Grupo Mexico.²⁸¹ The deal had been proposed by Grupo and the sale price was to be paid in Southern Peru shares.²⁸² Because of that obvious conflict, Southern Peru formed a special committee to consider the offer.²⁸³ It was comprised of four directors who were independent from Grupo and disinterested in the transaction.²⁸⁴ But a financial advisor retained by the special committee to evaluate the offer raised a significant concern.²⁸⁵ It found that under the terms proposed by Grupo it would get Southern Peru stock worth substantially more than Minerva.²⁸⁶ Before the deal closed Southern Peru's stock rose even higher, making that price imbalance even more lopsided in Grupo's favor.²⁸⁷

Despite those facts, the special committee and Southern Peru's shareholders approved the Minerva purchase.²⁸⁸ When dissident stockholders sued, Grupo's conflict was obvious and the parties agreed the acquisition had to be tested by the "entire fairness" standard.²⁸⁹ The court, however, placed the burden to prove that on the defendants since the special committee, despite its independence, was not "well functioning."²⁹⁰ It had no authority to negotiate with Grupo or to investigate alternatives to its proposal to sell Minerva to Southern Peru.²⁹¹

In addition, one of the special committee members was potentially compromised.²⁹² He was employed by a fourteen percent stockholder of Southern Peru that needed Grupo's consent to register its Southern Peru shares for public sale.²⁹³ The court also found that the shareholder vote was not informed because the proxy materials failed to disclose questions about Minerva's value.²⁹⁴ With all that in the mix, the court could not be convinced that the transaction was entirely fair to the shareholders of Southern Peru.²⁹⁵ It ordered Grupo to pay Southern Peru over \$1.3 bil-

281. *Id.* at 65–66.

282. *Id.* at 65.

283. *Id.*

284. *Id.*

285. *Id.* at 66.

286. *Id.*

287. *Id.* at 83.

288. *Id.* at 80.

289. *Id.* at 65.

290. *Id.* at 89.

291. *Id.* at 69.

292. *Id.* at 86.

293. *Id.*

294. *Id.* at 74–75.

295. *Id.* at 97.

lion in damages—the difference between the market value of the shares Southern Peru gave for Minerva and the true worth of that company.²⁹⁶

B. *Another Look at the Pill*

During the post-meltdown recovery, Delaware also had occasion to revisit the poison pill, more than a quarter century after it first condoned that most formidable and durable of defensive tactics.²⁹⁷ The opinion in *Air Products and Chemicals, Inc. v. Airgas, Inc.*,²⁹⁸ was written by a long-time veteran of Delaware corporate litigation, Chancellor William Chandler, shortly before he left the bench.

He saw the case as posing the ultimate issue of corporate governance—“the allocation of power between shareholders and directors.”²⁹⁹ “When, if ever, will a board’s duty to the corporation and shareholders require it to abandon concern for long-term values (and other constituencies) and enter a current share value maximizing mode?”³⁰⁰ The Chancellor’s answer was that directors might have to do that at some point, but not under the facts of the case before him, however compelling.³⁰¹ Air Products had made a public tender for all of Airgas’s stock, ultimately raising its bid to seventy dollars per share.³⁰² With the support of several outside opinions by financial experts, Airgas’s board held fast, maintaining that its stock was worth at least seventy-eight dollars.³⁰³ When it refused to remove its pill, Air Products waged a proxy fight and was able to secure three seats on Airgas’s staggered board.³⁰⁴ But then, surprisingly, even those directors agreed with the remaining board members that Air Products’ offer was inadequate.³⁰⁵

The tender offer battle had gone on for over a year, longer than any litigated poison pill in Delaware history, and Airgas’s shareholders were fully told about its directors’ opinion on the inadequacy of Air Products’ bid.³⁰⁶ That led Chancellor Chandler to express his personal view that the

296. *Id.* at 120. Legal fees awarded to plaintiffs’ attorneys amounted to \$285 million. Tom Hals, *Plaintiffs Attys in So Copper Case Get \$285 Mln Fee*, THOMSON REUTERS (Dec. 19, 2011), [http://newsandinsight.thomsonreuters.com/Legal/News/2011/12_-_December/Plaintiffs_attys_in_So_Copper_case_get_\\$285 mln_fee/](http://newsandinsight.thomsonreuters.com/Legal/News/2011/12_-_December/Plaintiffs_attys_in_So_Copper_case_get_$285 mln_fee/).

297. *See supra* notes 169–73 and accompanying text.

298. 16 A.3d 48 (Del. Ch. 2011).

299. *Id.* at 54.

300. *Air Products*, 16 A.3d at 54.

301. *Id.* at 55.

302. *Id.* at 55–56.

303. *Id.*

304. *Id.* at 127. The Chancellor used that as evidence that it was not impossible for Air Products to run a successful proxy contest, take over the company, and redeem the pill. The Delaware Supreme Court had recently found that an important factor in upholding a pill. *See Versata Enters., Inc. v. Selectica, Inc.*, 5 A.3d 586, 601–04 (Del. 2010).

305. *Id.* at 128.

306. *Id.* at 54.

rights plan had served its purpose.³⁰⁷ Airgas's directors, however, were well informed and acted in good faith to prevent their shareholders from tendering into an inadequate offer.³⁰⁸ Under prevailing precedent the Chancellor therefore felt constrained to hold that Airgas's directors were still entitled to maintain the pill.³⁰⁹

C. *Putting the Focus on Investment Banks*

Large financial institutions typically act as advisors to both purchasers and sellers in merger and acquisition transactions. Traditionally their duties are defined by contract. One earlier case,³¹⁰ however, where the bank also acted as a financier of the deal, held that they might have fiduciary duties in those situations as well.³¹¹ Two recent decisions involving major Wall Street firms present a window on some of their continuing, unseemly practices in these large corporate dealings.

The first, *In re Del Monte Foods Co. Shareholders Litigation*,³¹² involved the \$5.3 billion leveraged buyout of Del Monte by a group of private equity firms led by Kohlberg, Kravis, and Roberts ("KKR").³¹³ From this sale, the shareholders of Del Monte would receive nineteen dollars per share in cash, substantially more than the trading value of the company's stock.³¹⁴ Some stockholders, however, sought a preliminary injunction to stop the deal alleging that Del Monte's directors had failed to provide proper oversight of the company's financial advisor, Barclays.³¹⁵ The shareholders claimed that because of Barclay's double-dealing they had been prevented from getting the best price for their stock.³¹⁶

Barclays had been a long-time advisor to Del Monte.³¹⁷ When it was for sale, Barclay's met with KKR and another private equity firm to en-

307. *Id.* at 57.

308. *Id.*

309. *Id.* at 57–58.

310. *In re Daisy Sys. Corp.*, 97 F.3d 1171 (9th Cir. 1996).

311. See M. Breen Haire, Comment, *The Fiduciary Responsibilities of Investment Bankers in Change-of-Control Transactions*: *In re Daisy System Corp.*, 74 N.Y.U. L. REV. 277 (1999). Additionally, in *Weinberger v. UOP*, there were allegations that an investment banker rendering a fairness opinion in a take-out merger breached its fiduciary duties to the minority shareholders. See Carol B. Haight, Note, *The Standard of Care Required of an Investment Banker to Minority Shareholders in a Cash-Out Merger*: *Weinberger v. UOP, Inc.*, 8 DEL. J. CORP. L. 98 (1983).

In the wake of the financial meltdown, Goldman Sachs paid a record fine for engaging in conflicted transactions in the derivative market. See *Sec. & Exch. Comm'n v. Goldman, Sachs & Co.*, *Litigation Release No. 21592*, 2010 WL 2799362 (July 15, 2010) (announcing \$550 million fine for Goldman Sachs).

312. 25 A.3d 813 (Del. Ch. 2011).

313. *Id.* at 817.

314. *Id.*

315. *Id.*

316. *Id.* at 826.

317. *Id.* at 817.

courage them to make bids for the company.³¹⁸ When the other firm made the first bid, Del Monte hired Barclays to advise it.³¹⁹ Barclays, however, did not tell Del Monte that it would profit from that purchase by providing financing to the buyer.³²⁰

Barclays did represent to Del Monte that it was encouraging other bids for the company (one of which was by KKR) and that it would secure price competition in the process by not allowing buyers to team up in their offers.³²¹ At first, Del Monte's board rejected all the offers that came from those solicitations.³²² But then several months later, Barclays again worked with KKR and another firm that had originally outbid it for Del Monte to produce a team bid for the company.³²³

Barclays and KKR then approached Del Monte with the new offer, keeping their "team bid" a secret.³²⁴ When Del Monte then hired Barclays as its financial advisor with the goal of getting the highest bid from KKR, Barclays came back with what the court called "two unsavory requests."³²⁵ Barclays, for the first time, asked Del Monte to allow KKR's team bid with a firm that might offer more for Del Monte on its own.³²⁶ Then Barclays also asked if it could provide some of the financing for KKR even though Del Monte and KKR had not yet agreed on a price and Barclays was supposed to be getting the best price for Del Monte.³²⁷

Because of Barclays's dual role, Del Monte had to pay another advisor three million dollars for a fairness opinion on KKR's offer.³²⁸ Then when Del Monte provisionally accepted KKR's bid, it engaged Barclays in another conflicted role by having it solicit competing offers for forty-five days.³²⁹ Not surprisingly, because Barclays would benefit by the KKR deal, no other bids were forthcoming.³³⁰

The court found that Barclays, aided by KKR, "secretly and selfishly" manipulated this sales process.³³¹ It did not disclose its efforts to put Del Monte in play, thereby allowing the bank to profit twice—both as the company's advisor and as KKR's financier.³³² It compounded its disloyalty by engineering KKR's team offer that may have prevented Del Monte's share-

318. *Id.* at 820.

319. *Id.* at 817.

320. *Id.* at 821.

321. *Id.* at 834–35.

322. *Id.* at 820–22.

323. *Id.* at 823–24.

324. *Id.* at 824–25.

325. *Id.* at 826.

326. *Id.* at 824–25.

327. *Id.* at 825–26.

328. *Id.* at 826.

329. *Id.* at 827.

330. *Id.*

331. *Id.* at 817.

332. *Id.*

holders from getting more than they did by that collusive bidding.³³³ Because the company's directors had a duty to maximize the value of Del Monte for its shareholders, they should have better supervised this process so that Barclays could not engage in its double-dealing.³³⁴ Even though the court found that the directors were less culpable than Barclays because Barclays had misled them, they had still breached their fiduciary duties to the shareholders.³³⁵

Given Section 102(b)(7)'s provision allowing directors to be exonerated from liability for mere breaches of their duty of care, the Vice-Chancellor was unsure if the board could be held liable for monetary damages.³³⁶ He did however enjoin the sale of Del Monte for twenty days to see if any additional bidders would emerge who would top KKR's offer.³³⁷ None did and the merger took place.³³⁸ But despite the Vice-Chancellor's comments about the unlikelihood of monetary relief, Barclays and Del Monte settled with the shareholders by paying \$67 million in damages after legal fees of over \$20 million.³³⁹

The second case, *In re El Paso Corp. Shareholder Litigation*,³⁴⁰ also involved perfidious conduct by an investment bank, Goldman Sachs, which had been a long-time advisor of the target company.³⁴¹ When Kinder Morgan offered El Paso shareholders a package of stock and cash that was a substantial premium over the market price of their shares, El Paso sought advice from Goldman.³⁴² El Paso knew that Goldman owned nineteen percent of Kinder's stock and had two seats on its board.³⁴³ The leading Goldman banker advising El Paso, however, did not disclose to his client that he personally owned \$340,000 of Kinder stock.³⁴⁴

After a deal was negotiated and renegotiated between El Paso and Kinder, Goldman advised El Paso to take it.³⁴⁵ El Paso's board did, instead of pursuing an earlier strategy of selling off one of its two divisions that did exploration.³⁴⁶ Doug Foshee, El Paso's CEO, negotiated the deal with Kinder but he did not tell El Paso's board that he wanted to lead a

333. *Id.*

334. *Id.* at 841–42.

335. *Id.*

336. *Id.* at 838.

337. *Id.* at 842–43.

338. See *Del Monte Foods Stockholders Approve Merger Agreement* (Mar. 7, 2011), <http://investors.delmonte.com/releasedetail.cfm?ReleaseID=662563> (issuing statement on approval of merger).

339. Michael J. De La Merced, *Del Monte and Barclays Settle Investor Lawsuit for \$89.4 Million*, N.Y. TIMES, Oct. 7, 2011, at B7.

340. 41 A.3d 432 (Del. Ch. 2012).

341. *Id.* at 434.

342. *Id.*

343. *Id.*

344. *Id.*

345. *Id.* at 436.

346. *Id.* at 437–38.

group to buy the company's exploration business from Kinder after the merger closed.³⁴⁷ Of course, that raised all kinds of questions about whether Foshee was negotiating the best deal for El Paso's shareholders or was just taking a lesser amount from Kinder so that it would sell him the exploration business for a favorable price.³⁴⁸

Goldman was also compromised in its advice to El Paso by its own large stake in Kinder and the shares held by its lead partner.³⁴⁹ The bank may have thus been willing to recommend a deal where Kinder paid a suboptimum price for El Paso.³⁵⁰ That taint was hardly removed when Goldman brought in Morgan Stanley as a supposedly neutral advisor, because Morgan Stanley only got paid its thirty-five million dollar fee if the total Kinder deal got approved.³⁵¹

In his review of the case, Chancellor Strine forcefully expressed his disapproval of the conduct of both Goldman and Foshee saying "[t]he kind of troubling behavior exemplified here can result in substantial wealth shifts from stockholders to insiders that are hard for the litigation system to police if stockholders continue to display a reluctance to ever turn down a premium-generating deal when that is presented."³⁵²

Yet unlike *Del Monte*, the Chancellor in *El Paso* refused to enjoin a shareholder vote on the sale.³⁵³ He strangely did not even discuss the *Del Monte* decision, which had occurred just a year earlier. Instead he commented that equitable remedies, such as injunctions, might not offer much real protection to shareholders in situations like the El Paso merger.³⁵⁴ In fact he stated his belief that they might actually make it harder for them to sell their stock at a premium if they eventually frustrated a buyout.³⁵⁵

VI. DELAWARE'S M&A FIDUCIARY JURISPRUDENCE

A. *Accountability for Corrupt Activities*

"The rules in Equity vary with the length of the Chancellor's foot," goes the hoary legal maxim.³⁵⁶ From an historic perspective, Delaware's apparent inconsistency on fiduciary duties may bear that out. The small state along the Atlantic seaboard was once thought to be a haven for dere-

347. *Id.* at 434.

348. *Id.* at 442.

349. *Id.* at 434.

350. *Id.* at 442.

351. *Id.*

352. *Id.* at 450.

353. *Id.* at 448.

354. *Id.* at 449–52.

355. *Id.* at 451–52.

356. *Cf.* JOHN SELDEN, TABLE TALK 43 (Frederick Pollock ed., 1927) ("Equity is a Roguish thing . . . 'Tis all one as if they should make the Standard for the measure, we call a Foot, a Chancellor's Foot; what an uncertain measure would this be?").

licit corporate officials—letting them neglect their shareholders' interests with impunity.³⁵⁷

Then along came *Guth*³⁵⁸ and *Sinclair*³⁵⁹ establishing baseline obligations that insiders not steal business from their corporations and treat their minority shareholders with a modicum of fairness. *Van Gorkom*,³⁶⁰ although modified by statute,³⁶¹ issued a wake-up call to directors that they must make informed, deliberate decisions on important corporate matters. Yet Delaware's rulings on the fiduciary duties of directors do not exhibit much of a thematic unity. They might best be characterized as episodic, ad hoc responses to flagrant corporate misconduct.

When it comes to mergers and acquisitions, whether friendly or hostile, the Delaware courts have shown a propensity to step back and let boards make those decisions. This tolerance exists so long as management is not ultimately disenfranchising its shareholders³⁶² or blocking them from profiting when their firm is up for sale.³⁶³ Yet if insiders and their allies engage in self-dealing, enriching themselves unfairly at the expense of their shareholders and other corporate stakeholders, the Delaware courts have progressively shown a willingness to intervene. That trend appears to be gaining momentum. As two observers put it recently, “[t]he year 2011’s most important corporate law decisions . . . included significant victories in Delaware for investors asserting fiduciary duty claims.”³⁶⁴ Following on that, the tongue lashing that Chancellor Strine gave the *El Paso* insiders in early 2012 was a fitting rebuke for their deceitful conduct.

“I’m glad somebody is cracking down on this corruption,” may seem like an appropriate response. With Madoff-like scams going undetected for decades and the government’s weak prosecution of crimes from the financial meltdown,³⁶⁵ it seems like the Chancery Court is at least one place where corporate malefactors will have their day of reckoning. Such an effective tribunal is needed now more than ever. As shown by Greg Smith’s high profile protest against the greed and malfeasance in the financial community, it appears deceitful conduct on Wall Street is now worse than ever.³⁶⁶

357. See *supra* note 28 and accompanying text.

358. See *supra* notes 59–63 and accompanying text.

359. See *supra* notes 64–78 and accompanying text.

360. See *supra* notes 90–100 and accompanying text.

361. See *supra* notes 101–02 and accompanying text.

362. See *supra* notes 219–36 and accompanying text.

363. See *supra* notes 179–203 and accompanying text.

364. See Paul D. Brown, *supra* note 28.

365. For the author’s take on these substantial short-comings in white collar criminal prosecution, see Daniel J. Morrissey, *After the Meltdown*, 45 TULSA L. REV. 393, 398–405 (2010).

366. The recent \$2 billion loss by J.P. Morgan in its derivative trading raised new concerns about improvident and highly speculative practices on Wall Street. It also may have violated various regulations requiring banks to hold sufficient

So, of late, the Chancery Court in Delaware, spurred on by investor advocates, has been doing something to keep the conscience of corporate America. Yet one could certainly wish for more. They have made too sparing use of that “strong arm of Equity,”³⁶⁷ the injunction. As Chancellor Strine lamented in *El Paso*, much of the wrongful activity in mergers and acquisitions may never be stopped because shareholders are reluctant to turn down deals, no matter how flawed, that give them a premium over the market price of their stock.³⁶⁸ But the Chancellor and his colleagues are themselves too indulgent of such wrongdoing by not permanently enjoining those corrupt transactions for fear of depriving shareholders of some temporary gain. To extend President Theodore Roosevelt’s logic,³⁶⁹ shareholders are not innocent if by their greedy desire for short-term profits they are passive accomplices to corrupt activity.

Damage suits may provide shareholders some remedy, but that monetary relief rarely comes from the personal pockets of culpable corporate officials.³⁷⁰ Instead it is usually paid from insurance purchased with shareholder money to protect them from personal liability. Because “[e]quity delights to do justice and not by halves”³⁷¹ the Delaware courts must therefore give a fully effective remedy for this deceitful conduct.

To stop such corrupt activity dead in its tracks the courts should permanently enjoin any transactions brought about by secret double-dealing. They would then be true to the historic origins of fiduciary jurisprudence

reserve capital. Mark Scott, *Regulators Looking into JP Morgan Trading Activities Before \$2 Billion Loss*, DEALBOOK (May 11, 2012), <http://dealbook.nytimes.com/2012/05/11/regulators-looking-into-jpmorgan-trading-activities-before-2-billion-loss/>.

For a fine recent article about the continued lack of transparency in Wall Street investment banks, see Frank Partnoy & Jesse Eisinger, *What’s Inside America’s Banks?*, ATLANTIC, Jan.–Feb. 2013, at 60. J.P. Morgan’s chairman Jamie Dimon has admitted that his firm was “sloppy” and “stupid” in making those trades. Yet J.P. Morgan has spent \$20 million over the last three years on lobbying and campaign contributions urging less government regulation. Dana Milbank, *Banks Pay, Regulations Suffer*, SPOKESMAN-REVIEW, May 24, 2012, at 13A. Further news about Wall Street improprieties has surfaced involving Facebook’s recent public offering. Banks underwriting that IPO may have shared unfavorable information about the company with a select group of clients. Evelyn M. Rusli & Michael J. De La Merced, *Facebook Debut Raises Questions on I.P.O. Process*, N.Y. TIMES, May 23, 2012, at A1.

367. See *Bonaparte v. Camden & A.R. Co.*, 3 F. Cas. 821, 827 (C.C.D.N.J. 1830) (No. 1,617); see also JAMES L. HIGH, TREATISE ON THE LAW OF INJUNCTIONS 36 (4th ed. 1905).

368. *In re El Paso Corp. S’holder Litig.*, 41 A.3d 432 (Del. Ch. 2012).

369. Cf. Lawrence E. Mitchell, *The “Innocent Shareholder”: An Essay on Compensation and Deterrence in Securities Class-Action Lawsuits*, 2009 WIS. L. REV. 243, 244 (2009) (“Nothing is sillier than this outcry on behalf of the ‘innocent shareholders’ in the corporations.” (citing 6 THE LETTERS OF THEODORE ROOSEVELT 886 (Ething E. Morrison et al. eds., 1952))).

370. John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1549-51 (2006).

371. JOSEPH STORY, COMMENTARIES ON EQUITY PLEADINGS AND INCIDENTS THEREOF 76 (8th ed. 1870).

as it sprang from the law of trusts. There, the “No Further Inquiry” doctrine makes all transactions where trustees have breached those duties voidable regardless of whether the results are fair to their beneficiaries.³⁷² It also levies meaningful sanctions against trustee self-dealing that includes rescission, disgorgement of gain, and consequential damages.³⁷³ All those are available as ancillary remedies in injunctive actions.³⁷⁴

If the Delaware courts, through their piecemeal approach, cannot adequately police questionable M&A activity, sterner tribunals can be created. Two decades ago—at the end of the 1980s wave of mergers—this author, among others, called for such reforms.³⁷⁵ To combat some of the harmful financial excesses that surfaced during that era and continue to this day, a national authority such as the SEC could be empowered to pre-clear all M&A activity.

To that end, the Williams Act could be amended to add this additional provision: “It shall be unlawful for any person to purchase any shares in a tender offer unless the Securities and Exchange Commission finds that they are fair to the selling shareholders and in the public interest.” To make such adjudication fully-informed, all bidders for public companies would have to file a “public impact statement” in advance detailing the social and economic consequences of their acquisitions.

B. Revlon and the Business Judgment Rule

Air Products is the most recent evidence that Delaware will continue to afford target management substantial latitude in opposing hostile takeovers. *Unocal* does hold, however, that boards are not given carte blanche authority there.³⁷⁶ Their actions must be reasonable and proportionate to the threat.³⁷⁷ Yet the business judgment rule is available to give a board considerable support in resisting a bid that can be deemed inadequate.³⁷⁸

On the other hand, “dead hand” or “no hand” provisions that prohibit the removal of pill-like defenses will not be permitted.³⁷⁹ Target directors will also not be allowed to make sweetheart deals with certain suitors that will allow them to remain in power at the expense of their

372. UNIF. TRUST CODE § 802(b) (2000).

373. Melanie B. Leslie, *In Defense of the No Further Inquiry Rule: A Response to Professor John Langbein* 47 WM. & MARY L. REV. 541, 543 (2005).

374. As one commentator put it: “[t]raditionally courts of equity have had the power to shape full relief, taking into account the interests of the parties affected and the goals to be pursued, once their jurisdiction is properly invoked.” James R. Farrand, *Ancillary Remedies in SEC Civil Enforcement Suits*, 89 HARV. L. REV. 1779, 1781 (1976) (citing 1 JOHN NORTON POMEROY, EQUITY JURISPRUDENCE §§ 114–15, 181, 231, 236(a), 239(a) (5th ed. 1941)).

375. See Morrissey, *supra* note 12, at 82–84.

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

377. *Id.*

378. *Id.* at 955–56.

379. See *supra* notes 219–36 and accompanying text.

shareholders³⁸⁰ or to prematurely lock up transactions with favored bidders.³⁸¹

Most significantly *Revlon* comes into play when a company is effectively put up for sale. Management, in Justice Moore's intriguing phrase, cannot then keep defending "the corporate bastion."³⁸² Surrender is warranted, one that will maximize value for the firm's entrepreneurial risk-takers, the shareholders.

The *Revlon* decision is puzzling, however, in several ways. First, when do its duties kick in? In other words, what constitutes a *Revlon* event? Change of control is the touchstone there—according to *Paramount*. *Revlon* came into play there, the court said, because the new acquirer would have a dominant shareholder.³⁸³ In *Time* however, there was no *Revlon* event because after the merger control would remain fluid in publicly held shares.³⁸⁴ Was that a significant difference? Perhaps Warner's respect for *Time*'s journalistic integrity was the factor that influenced the court *sub rosa* to allow *Time*'s board to favor it over *Paramount*.

Second, *Revlon*'s duty is to secure the best price for shareholders once a company is on the auction block. If part of the compensation, however, is to be paid in securities whose value is dependent on the future success of the new entity, as it was in *QVC*, doesn't the board still have a role to play? Shouldn't it be able to block a deal that it honestly believes will not return the best value for its shareholders?³⁸⁵

Third, what is this heightened scrutiny that *Revlon* seems to demand that goes beyond routine deference to the board's business judgment? In *Lyondell*, the bidder came to the company with a very good offer that, with appropriate advice, it accepted.³⁸⁶ Yet a disgruntled shareholder claimed that the board should have sought competing bids unless it had perfect knowledge that it was receiving top dollar for the firm.³⁸⁷ The Delaware Supreme Court rejected that approach.³⁸⁸ With those facts, at least, the court found no bad faith and was fine acceding to the board's business judgment.³⁸⁹

380. See *supra* notes 259 and accompanying text.

381. See *supra* notes 261–62 and accompanying text.

382. *Revlon, Inc. v. MacAndrews & Forbes Holding, Inc.*, 506 A.2d 173, 182 (Del. 1986).

383. *Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 49 (Del. 1994).

384. *Paramount Commc'ns, Inc. v. Time Inc.*, 571 A.2d 1140, 1151 (Del. 1990).

385. For a good analysis here, see GEVURTZ, *supra* note 1, at 716.

386. *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 238–39 (Del. 2009).

387. *Id.* at 239.

388. *Id.* at 242–43.

389. *Id.* at 244.

C. *Fiduciaries for Whom?*

Two decades ago Chancellor Allen identified the issue of “purpose” as the fundamental question of corporate law.³⁹⁰ To answer it, he said, required much more than reference to a static set of legal rules.³⁹¹ Corporate law, rather, comes from the shared insights of our common legal culture that we continually recreate through interpretation.³⁹²

Conventional corporate wisdom once held that directors must run their corporations primarily to make profit for their shareholders. In the hostile takeover era, that outlook re-emerged as an attractive antidote to charges that management constituted an entrenched class, more concerned about protecting its own privileged positions than putting their firms’ resources to their most profitable uses.³⁹³ That still exercises a powerful, if not predominant, influence in our system of free enterprise where private capital funds businesses on the hope of getting the best possible returns.

However, broader views also have popular support. Communal and team approaches see board duties in a larger context. As two scholars put it, directors are:

[A] mediating hierarchy overseeing team production. . . . [T]he “firm” can be understood as a nexus of firm-specific assets that have been invested by a variety of groups, including most obviously shareholders, bondholders, managers, and employees. The board of directors acts as a fiduciary for the firm, meaning that it seeks to maximize the total value of these combined economic interests.³⁹⁴

For the last several decades, that outlook has been finding guarded support in important opinions and comments by leading Delaware jurists. First were the anti-takeover decisions of the 1980s, most famously *Unocal* and *Moran*, where the court under Justice Moore’s leadership upheld defenses against tender offer onslaughts by highly leveraged bidders such as T. Boone Pickens.³⁹⁵

Next came the important remark by Chancellor Allen in *Paramount*, embraced by the Delaware Supreme Court, that directors are not required to manage their firms to maximize short-term profit.³⁹⁶ Also of significance there may have been Time’s claim that Warner would be more respectful of its journalistic integrity—indicating that companies have

390. See William T. Allen, *supra* note 143, at 262.

391. *Id.*

392. *Id.*

393. See generally *supra* notes 204–07 and accompanying text.

394. Margaret M. Blair & Lynn A. Stout, *Director Accountability and the Mediating Role of the Corporate Board*, 79 WASH. U. L.Q. 403, 425 (2001).

395. *Moran v. Household Int’l Inc.*, 500 A.2d 1346 (Del. 1985); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

396. *Paramount Commc’ns v. Time Inc.*, 571 A.2d 1140, 1150 (Del. 1990).

responsibilities to society beyond making the most money in the quickest amount of time.³⁹⁷

Most recently we have the comments by two of Chancellor Allen's successors, William Chandler and Leo Strine,³⁹⁸ who have also acknowledged those broader corporate duties. Chancellor Strine, along with his co-authors in their Georgetown piece, indicated that the duty of loyalty has broad communal implications because the moral corporation is a necessary ingredient in civil society.³⁹⁹ In *Air Products*, we also have Chancellor Chandler's parenthetical nod to the duties of directors to "constituents" as well as shareholders.⁴⁰⁰ A further step to achieve that goal would be a governmental review as discussed above of all M&A activity in public companies.⁴⁰¹

VII. CONCLUSION

The Delaware courts reflect the mixed feelings most Americans have about our economic system.⁴⁰² They understand that the basic capitalist

397. *Id.*; see *supra* note 379–82 and accompanying text.

398. The Delaware Chancery Court has been called the "center of the corporate universe," and the Chancellor there has been compared to the Chief Justice of the United States. D. Gordon Smith, *Chancellor Allen and the Fundamental Question*, 21 SEATTLE U. L. REV. 577, 577 (1998) (citing *Firms Watch Change at Top of Del. Court*, BALTIMORE SUN, Mar. 3, 1997, at 10C).

399. See *supra* note 35 and accompanying text; see also JOEL BAKAN, *THE CORPORATION: THE PATHOLOGICAL PURSUIT OF PROFIT AND POWER* (2004).

400. *Air Products & Chems. Inc. v. Airgas, Inc.*, 16 A.3d 48, 54 (Del. Ch. 2011). But see *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 101 (Del. 2007) (ruling that directors owe their fiduciary duties to shareholders only, not creditors, when a corporation is in the "zone of insolvency"). Although neither one is part of its Corporate Code, two types of laws passed by other states may have influenced Delaware's judicial decisions: anti-takeover and constituent statutes. In the first, states regulate takeovers for their corporations by a number of means. A popular one, the *control share* statute, prohibits a bidder not approved by the target board from voting its newly acquired shares without a favorable vote of the remaining shareholders. The U.S. Supreme Court found that constitutional. *CTS Corp. v. Dynamics Corp.*, 481 U.S. 69 (1987). In the second, directors are empowered to consider the effects of their actions on a number of stakeholders in the firm such as employees, suppliers, customers, and communities where the businesses are located. Typical is Section 5/8.85 of the Illinois Business Corporation Act. See 805 ILL. COMP. STAT. 5/8.85 (1983). Just in the last couple of years some states have enacted legislation allowing the incorporation of so-called "Benefit" corporations. In addition to making profit, they explicitly acknowledge that they have other purposes as well such as making a positive impact on society and the environment. See generally Rakhi I. Patel, *Facilitating Stakeholder-Interest Maximization: Accommodating Beneficial Corporations in the Model Business Corporation Act*, 23 ST. THOMAS L. REV. 135 (2010); Dana Brakman Reiser, *Benefit Corporations—A Sustainable Form of Organization?*, 46 WAKE FOREST L. REV. 591 (2011).

401. See *supra* note 375 and accompanying text.

402. As one leading academic has put it: "[t]he modern American business corporation has been a subject of wonder and horror for much of the past century." LAWRENCE E. MITCHELL, *CORPORATE IRRESPONSIBILITY: AMERICA'S NEWEST EXPORT* 1 (2001).

rules of our society have generally served us well. When businesses are operated for profit they are the most productive and furnish the goods and services that assure our material well-being.⁴⁰³ Yet noted social philosophers like Michael Sandal point out what moral thinkers have long maintained: maximum material prosperity is not an absolute value—particularly if it is not evenly shared.⁴⁰⁴ Short-termism in business, as in the rest of human relationships, can have devastating costs.⁴⁰⁵ In a civilized society, the “creative destruction” of capitalism and its “animal spirits” must be tempered.

Delaware’s language about fiduciary duties displays the best in the equitable tradition—a balancing of concerns,⁴⁰⁶ a moral dimension,⁴⁰⁷ and a fact-sensitive decision-making process.⁴⁰⁸ Yet their decisions often come up short with murky distinctions, lacking the real bite of permanent injunctions or heavy monetary damages. If Delaware courts are going to hold the trust of the American community in regulating corporate conduct they still have work to do. If they cannot assume that responsibility, other measures as outlined in this Article will be necessary.

403. Even Professor Bakan calls the corporation “a remarkably efficient wealth-creating machine.” See BAKAN, *supra* note 399.

404. See *supra* note 356–75 and accompanying text.

405. STOUT, *supra* note 25 and accompanying text.

406. Because of Equity’s need for discretion in administering its particular brand of justice, the chancellor never considered himself bound by precedent like common law judges. F. W. MAITLAND, *EQUITY: A COURSE OF LECTURES* 8 (2d ed. 1949).

407. Because early chancellors had to be members of the medieval literary class, they were most often clergymen. Such persons might be deemed best able to advise the king about matters of conscience. OWEN M. FISS & DOUG RENDLEMAN, *INJUNCTIONS* 61 (2d ed. 1984).

408. Equity always offered flexible remedies particularized to the situation of the actual parties before them. See generally PETER CHARLES HOFFER, *THE LAW’S CONSCIENCE: EQUITABLE CONSTITUTIONALISM IN AMERICA* 8 (1990).

