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# NOTES

## Dissecting *Revlon*: Severing the Standard of Conduct from the Standard of Review in Post-Closing Litigation

*In* Corwin v. KKR Financial Holdings LLC *and its progeny, the Delaware courts made clear that a fully informed, uncoerced vote by disinterested stockholders triggers the waste standard. In* Corwin*, the Delaware Supreme Court also indicated that* Revlon *was only meant to provide stockholders with an expedited process for obtaining a preliminary injunction before the closing of a transaction. However, more recent cases indicate that* Revlon *in fact does apply after the closing of a transaction. Unfortunately, the Delaware courts have not been given an opportunity to determine which standard of review should apply at this stage—enhanced scrutiny, waste, or the traditional business judgment rule. This Note argues that both doctrinal evolution and modern corporate governance developments support the application of the traditional business judgment rule. In practice, this means that the plaintiff would need to prove a breach of the duty of loyalty by showing bad faith. This provides an appropriate balance between accountability and authority—courts should not reward corporate defendants with the waste standard in the post-closing context where* Corwin *obligations have not been met. Applying the bad faith standard to post-closing* Revlon *claims where* Corwin *does not apply also reflects the typical process by which corporate actions are reviewed by courts: by separating the standard of conduct from the standard of review. Recognizing* Revlon *as a standard of conduct—not as a conflation of a standard of conduct with a particular standard of review—highlights the doctrine's importance in serving as a guide for corporate actors in the M&A context.*

## INTRODUCTION

Any corporate board of directors seeking to sell the company should be prepared for litigation to arise out of the transaction. This is not surprising: substantial power rests in the hands of a few to make decisions that could impact millions of people and have billion-dollar implications. The high-stakes nature of mergers and acquisitions ("M&A") can exacerbate various issues including, but not limited to, agency costs, information asymmetry, and collective action problems. Even though the amount of deal litigation has decreased in recent years after a litigation epidemic in the early 2000s,[1] stockholders still challenge two-thirds of deals in court.[2]

Most companies incorporate in Delaware,[3] so Delaware courts often bear the responsibility of sorting through this deal litigation, pursuing avenues to protect both stockholder and corporate interests. Courts sometimes hesitate to second-guess the directors' business expertise,[4] but they frequently do so anyway, seeking an appropriate balance between authority (of the board) and accountability (to the stockholders).[5] In order to achieve this balance, Delaware courts apply different standards of review based on the risk that the board will not act in the best interests of the stockholders during the course of a particular transaction.[6] Until the mid-1980s, Delaware courts used only two levels of scrutiny when reviewing board decisions: the entire fairness test and the business judgment rule.[7] However, the assumption that directors fell into either an inherently interested category or a completely disinterested category failed to account for other situations where there was a reason to second-guess a board's action that was not inherently suspect.[8]

*Unocal Corp. v. Mesa Petroleum Co.* introduced "enhanced scrutiny" to account for these circumstances in the antitakeover context.[9] The Delaware Supreme Court then extended the application of enhanced scrutiny from the antitakeover context to the sale of a

1. *See infra* notes 86–95 and accompanying text.

2. Brandon Mordue, *The* Revlon *Divergence: Evolution of Judicial Review of Merger Litigation*, 12 VA. L. & BUS. REV. 531, 533 (2018).

3. *A Message from the Secretary of State – Jeffrey W. Bullock*, DEL. DIVISION CORPS., https://corp.delaware.gov/stats/ (last visited Jan. 1, 2020) [https://perma.cc/H7VT-9326] ("Delaware remains the home of the vast majority of top U.S. companies, including more than two thirds of the Fortune 500 and 80 percent of all firms that go public.").

4. Franklin A. Gevurtz, *Saying Yes: Reviewing Board Decisions to Sell or Merge the Corporation*, 44 FLA. ST. U. L. REV. 437, 438–40 (2017).

5. Stephen M. Bainbridge, *The Geography of* Revlon-*Land*, 81 FORDHAM L. REV. 3277, 3281, 3305 (2013).

6. Shrisha Juneja, Note, *Conflicted Merger Transactions: Consolidating the Standards of Review*, 22 FORDHAM J. CORP. & FIN. L. 133, 135 (2017) (explaining that a merger transaction's structure will affect the standard of review that the court applies).

7. J. Travis Laster, Revlon *Is a Standard of Review: Why It's True and What It Means*, 19 FORDHAM J. CORP. & FIN. L. 5, 8 (2013).

8. *Id.*

9. 493 A.2d 946, 955 (Del. 1985). This context is different from the *Revlon* context. The antitakeover context refers to situations where a corporation adopts strategies to protect itself from being acquired by another company. *See id.* at 949–51 (discussing a situation where the target company threatened to perform a discriminatory self-tender against a stockholder making a hostile tender offer). The *Revlon* context, on the other hand, refers to situations where the sale of a company is imminent. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) (discussing a situation where the "board's authorization permitting management to negotiate a merger or buyout with a third party was a recognition that the company was for sale").

company in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, where directors must seek the best offer reasonably available to the stockholders.[10] Although *Revlon* itself does not require directors to take specific actions when selling the company in order to satisfy their fiduciary duties,[11] subsequent cases more effectively defined the contours of the doctrine's scope and provided examples of actions that fulfill so-called *Revlon* duties under particular circumstances.[12] *Revlon* and its progeny established a standard of conduct that continues to guide corporate lawyers when advising boards of actions they should take when selling their companies.[13]

Since 2016, Delaware court decisions have cut back on the strength of *Unocal*, *Revlon*, and the other "Golden Age"[14] corporate law doctrines.[15] In one of the most noteworthy cases, *Corwin v. KKR Financial Holdings LLC*,[16] the Delaware Supreme Court held that a cleansing stockholder vote[17] invokes the business judgment rule instead

10. 506 A.2d at 180; *see* James D. Cox & Randall S. Thomas, *Delaware's Retreat: Exploring Developing Fissures and Tectonic Shifts in Delaware Corporate Law*, 42 DEL. J. CORP. L. 323, 331 (2018) ("*Revlon* embraces the standard that the objective of the board is to obtain the best offer reasonably available for the shareholders.").

11. *See* Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 242–43 (Del. 2009) (criticizing the lower court's "erroneous conclusion that directors must follow one of several courses of action to satisfy their *Revlon* duties"); Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 45 (Del. 1994) ("[A] court applying enhanced judicial scrutiny should be deciding whether the directors made a reasonable decision, not a perfect decision." (emphasis omitted)); Laster, *supra* note 7, at 19–20 ("Delaware courts have clarified that *Revlon* does not impose specific conduct requirements.").

12. *See, e.g.*, *Lyondell*, 970 A.2d at 243 (providing the board with three options to confirm that they obtained the best price available under *Revlon*); Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286, 1288 (Del. 1989) (holding that there is "no single blueprint that a board must follow" to adhere to *Revlon* duties, and in the absence of an active market test, it must be clear that the directors had "sufficient knowledge of relevant markets" to evaluate the transaction).

13. Delaware courts have provided lawyers with forty years of *Revlon* jurisprudence to use when advising their clients. *See, e.g.*, *Series of Avoidable Missteps by an Activist Stockholder and the Target Board Led the Court of Chancery to Find Fiduciary Breaches and Stockholder Aiding and Abetting in Connection with the Sale of a Company—PLX Technology*, FRIED FRANK (Nov. 9, 2018), https://www.friedfrank.com/siteFiles/Publications/FFMAPEPLXTech110918.pdf [https://perma.cc/J28W-4UXL]; J. Anthony Terrell, Revlon *in Review*, PILLSBURY (May 11, 2016), https://www.pillsburylaw.com/images/content/1/0/104200.pdf [https://perma.cc/5HFW-6T4J].

14. The "Golden Age" of corporate law refers to four decisions in the 1980s that put Delaware courts in the international spotlight by not only defining the owner-manager relationship, but also by establishing the obligations of owners and managers in recurring deal contexts. *See* Cox & Thomas, *supra* note 10, at 324–25 ("From inception each of the cases was rightly viewed as creating vigorous fiduciary responsibilities for directors and officers to act in the best interests of their company's shareholders."). These four decisions are *Revlon*, *Unocal*, *Weinberger*, and *Blasius*. *Id.*

15. *See id.* at 325–26 ("[C]entral to the judicial constrictions of [these cases] is the obeisance the Delaware Supreme Court repeatedly accorded to what it believes are the natural disciplining forces of informed shareholder consent and competitive markets for corporate control.").

16. 125 A.3d 304 (Del. 2015).

17. A cleansing stockholder vote is "a fully informed, uncoerced vote of the disinterested stockholders." *Id.* at 309; *see infra* notes 115–117 and accompanying text.

of enhanced scrutiny.[18] Subsequent cases clarified that the version of the business judgment rule that applies is the waste standard.[19] Therefore, the waste standard applies unless the plaintiff can prove that the stockholder vote was not (1) fully informed; (2) uncoerced; or (3) made by disinterested stockholders.[20] Over three years later, *Corwin* remains highly controversial and receives substantial criticism for restricting *Revlon*'s scope and playing a significant role in the decline of Delaware deal litigation.[21] On the other hand, some argue that *Corwin* incentivizes adherence to corporate formalities and accountability to the stockholders,[22] which expunges conflict-of-interest concerns. This Note does not discuss whether *Corwin* was correctly or incorrectly decided, however. Regardless of that inquiry, the result of the decision was a severe restriction on the scope of *Revlon*.[23]

In *Corwin* and a few subsequent cases, Delaware courts seemed to make clear that *Revlon* was only intended to provide stockholders with an expedited process for obtaining a preliminary injunction before the closing of a transaction.[24] In other words, courts did not intend for *Revlon* to apply post-closing. This understanding of *Revlon* persisted until recently, when a few decisions indicated that *Revlon* does in fact apply post-closing.[25] These recent cases, however, did not provide

18. *Corwin*, 125 A.3d at 308–09.

19. *See infra* notes 119–120 and accompanying text.

20. *See infra* notes 117–120 and accompanying text.

21. *See* Franklin A. Gevurtz, Cracking the *Corwin* Conundrum and Other Mysteries Regarding Shareholder Approval of Mergers and Acquisitions 32–38 (Sept. 19, 2018) (unpublished manuscript), https://ssrn.com/abstract=3252264 [https://perma.cc/9F4S-7KVU] (expressing skepticism that a fully informed shareholder vote expunges the conflict-of-interest concerns because the narrow, binary decision to sell or not sell ignores the possibility that the board could have pursued a better deal). For example, Gevurtz states that "[f]or defendant directors, *Corwin* has become a veritable wishing well, whose magic they invoke to shield them in litigation arising out of corporate mergers and sales." *Id.* at 2 (citing Robert S. Reder, *Delaware Court Refuses to Invoke* Corwin *to "Cleanse" Alleged Director Misconduct Despite Shareholder Vote Approving Merger*, 70 VAND. L. REV. EN BANC 199, 200 (2017)).

22. *See* Mordue, *supra* note 2, at 575–76 (explaining that the *Corwin* doctrine should incentivize directors to provide greater disclosure to the stockholders and hold clean votes).

23. *See* Cox & Thomas, *supra* note 10, at 326 (explaining that Delaware courts have "substantially muted" the "Golden Quartet": *Revlon*, *Weinberger*, *Unocal*, and *Blasius*); Joel Edan Friedlander, *Vindicating the Duty of Loyalty: Using Data Points of Successful Stockholder Litigation as a Tool for Reform*, 72 BUS. LAW. 623, 645 (2017) ("Before *Corwin*, recovering significant monetary relief in post-closing litigation was considered the highest object of plaintiffs' counsel in stockholder class action litigation. After *Corwin*, there is no clear path to do so.").

24. *See* Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 312 (Del. 2015) ("*Revlon* [is] primarily designed to give stockholders and the Court of Chancery the tool of injunctive relief to address important M & A decisions in real time, before closing."); *In re* Solera Holdings, Inc. Stockholder Litig., No. 11524-CB, 2017 WL 57839, at *6 (Del. Ch. Jan. 5, 2017).

25. *See* Kahn v. Stern, No. 393, 2018 WL 1341719, at *1 (Del. Mar. 15, 2018) ("To the extent . . . the Court of Chancery's decision suggests [that plaintiffs must] plead facts suggesting . . . a majority of the board committed a non-exculpated breach of its fiduciary duties

Delaware courts with an opportunity to formulate the appropriate analysis for claims where the board fails to satisfy its obligations under *Corwin*. In particular, none of the cases required the courts to decide whether enhanced scrutiny or the traditional business judgment rule[26] applies as the standard of review.[27]

The standard of review in corporate litigation, as in other areas of law, often determines the outcome of the case.[28] In corporate law, however, the standard of conduct and the standard of review uniquely diverge.[29] The standard of review refers to the degree to which the court will scrutinize the party's actions, whereas the standard of conduct defines the actions that individuals must take in a given situation.[30] This Note argues that since the standards typically diverge in corporate law to successfully balance authority with accountability, the traditional business judgment rule—not enhanced scrutiny or the waste standard—should apply in post-closing litigation brought against

in cases where *Revlon* duties are applicable, but the transaction has closed and the plaintiff seeks post-closing damages, we disagree . . . ."); van der Fluit v. Yates, No. 12553-VCMR, 2017 WL 5953514, at *11–12, *11 n.159 (Del. Ch. Nov. 30, 2017).

26. The courts could have determined that one of two versions of the business judgment rule applied: the traditional business judgment rule—which in the *Revlon* context allows the plaintiffs to prove the breach of the duty of loyalty under the bad faith standard—or the waste standard. *See infra* Section II.B.3.

27. *See Kahn*, 2018 WL 1341719, at *1 ("We affirm this decision on the grounds that the Court of Chancery properly found that the pled facts did not support a rational inference that any of the directors faced a non-exculpated claim for breach of fiduciary duty . . . . [A]nd the transaction at issue resulted from a thorough market check and was to a buyer without any prior ties to management."); *van der Fluit*, 2017 WL 5953514, at *11 n.159 ("I conclude that Plaintiff fails to state claims under either enhanced scrutiny or the business judgment rule."); *see also* Edward B. Micheletti & Bonnie W. David, *Key Developments in Delaware Corporation Law in 2017*, SKADDEN (Jan. 23, 2018), https://www.skadden.com/insights/publications/2018/01/2018-insights/key-developments-in-delaware-corporation-law [https://perma.cc/Q9Z8-GK9V] ("It remains to be seen whether in 2018, the Delaware courts will offer further clarity on whether enhanced scrutiny under *Revlon* or *Unocal* remains a viable post-closing theory in deal litigations seeking money damages.").

28. Mordue, *supra* note 2, at 534 (quoting Jack B. Jacobs, *Fifty Years of Corporate Law Evolution: A Delaware Judge's Retrospective*, 5 HARV. BUS. L. REV. 141, 155 (2015)); Amanda Peters, *The Meaning, Measure, and Misuse of Standards of Review*, 13 LEWIS & CLARK L. REV. 233, 234 (describing standards of review as "the essential language of appeals" and the "keystone to court of appeals decision-making" (quoting STEVEN ALAN CHILDRESS & MARTHA S. DAVIS, FEDERAL STANDARDS OF REVIEW ix (3d ed. 1999); then quoting MICHAEL D. MURRAY & CHRISTY H. DESANCTIS, LEGAL RESEARCH AND WRITING 493 (2005))); *see also* Payne v. Borg, 982 F.2d 335, 338 (9th Cir. 1992) ("The relevant standards of review are critical to the outcome of this case.").

29. William T. Allen et al., *Function over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 26 DEL. J. CORP. L. 859, 868 (2001).

30. *Id.* at 867–68.

a board of directors[31] that failed to satisfy its *Corwin* obligations.[32] In practice, this would require the plaintiffs to prove either waste or a breach of the duty of loyalty by showing bad faith.[33] Part I provides an introduction to enhanced scrutiny and describes the shift from understanding *Revlon* as a purely pre-closing action to both a pre- and post-closing action. Part II analyzes arguments for applying enhanced scrutiny or the business judgment rule to post-closing *Revlon* claims where the directors failed to satisfy their obligations under *Corwin*. Part III argues that traditional business judgment deference should apply in the absence of a cleansing stockholder vote in post-closing litigation because weak conflict-of-interest concerns call for greater deference to the board's expertise in order to balance accountability with authority. For purposes of clarity, I will refer to post-closing *Revlon* claims where *Corwin* does not apply as "non-*Corwin* post-closing claims."[34]

*Revlon* commentary often conflates the standard of review with the standard of conduct.[35] But this contradicts the norm in corporate law where the two standards uniquely diverge in order to adequately balance accountability with authority.[36] Acknowledging this distinction

31. This Note does not address litigation brought against third parties for aiding and abetting. The case law in this area is not clear. *See In re* PLX Tech. Inc. Stockholders Litig., No. 9880-VCL, 2018 WL 747180, at *2–3 (Del. Ch. Feb. 6, 2018) (refusing to grant a hedge fund summary judgment for breach of fiduciary duty claims because "[d]eciding whether *Corwin* calls for applying the business judgment rule, even without a fully informed stockholder vote, would force a lone trial judge to attempt to harmonize arguably conflicting language in Delaware Supreme Court precedents spanning decades"). Four years ago, a defendant before the Delaware Supreme Court argued that enhanced scrutiny should not apply post-closing, but the court avoided making this determination by holding that regardless of the standard of review, the actions by the defendants fell outside the range of reasonableness under *Revlon*. RBC Capital Mkts., LLC v. Jervis, 129 A.3d 816, 857 (Del. 2015) (rejecting the defendant's argument that the trial court erred in finding a due care violation without gross negligence because "the individual defendants breached their fiduciary duties by engaging in conduct that fell outside the range of reasonableness, and that this was a sufficient predicate for its finding of aiding and abetting liability").

32. *Corwin* does not apply in the absence of a fully informed, uncoerced vote by disinterested stockholders. *See* Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 308–09 (Del. 2015).

33. *See infra* notes 243–247 and accompanying text.

34. I include "post-closing" as part of the phrase to avoid confusion with pre-closing *Revlon* claims, which are technically non-*Corwin* claims as well because a cleansing vote likely has not occurred pre-closing. Additionally, the characterization of these claims as "post-closing *Revlon* claims" is inadequate because all post-closing claims in this context apply *Revlon* as the standard of conduct, regardless of whether *Corwin* applies. Thus, consistent use of the language "non-*Corwin* post-closing claims" seeks to avoid any confusion that would otherwise result from occasional variations in phrasing.

35. *See infra* Section I.B.

36. *See* Chen v. Howard-Anderson, 87 A.3d 648, 666–67 (Del. Ch. 2014) ("Delaware corporate law distinguishes between the standard of conduct and the standard of review . . . . The numerous policy justifications for this divergence largely parallel the well-understood rationales for the business judgment rule."); Bainbridge, *supra* note 5, at 3289 ("[J]udicial hesitation to second-guess

in post-closing claims not only conforms to typical judicial analysis in corporate litigation but also counters the extreme, yet very popular assertion that *Revlon* is dead.[37] Even if a lower standard of review than enhanced scrutiny applies, *Revlon* still serves an essential role by establishing a standard of conduct—making it very much alive.

## I. THE EVOLUTION OF *REVLON* AND ITS PROGENY

Before 1985, Delaware courts applied one of two levels of scrutiny when reviewing board decisions: the entire fairness test or the business judgment rule.[38] The entire fairness test applies to self-dealing transactions, where controlling shareholders or directors receive a benefit not shared equally with the remaining shareholders.[39] In these situations, the controlling shareholders or directors have the burden of proving that the deal was entirely fair by showing fair dealing and fair price.[40] This plaintiff-friendly standard protects the accountability of the directors in an interested transaction but does so at the expense of efficiency and risk-taking.[41]

The business judgment rule, on the other hand, essentially requires courts to defer to the board's decision unless "there is a

board merger decisions . . . reflect[s] an appropriate balance between the competing claims of authority and accountability.").

37. *See* Lawrence A. Cunningham & Charles M. Yablon, *Delaware Fiduciary Duty Law After* QVC *and* Technicolor*: A Unified Standard (and the End of* Revlon *Duties?)*, 49 BUS. LAW. 1593, 1595 (1994) (arguing that *Revlon* duties "no longer exist[ ] under Delaware law"); Lyman Johnson & Robert Ricca, *The Dwindling of* Revlon, 71 WASH. & LEE L. REV. 167, 219 (2014) ("The *Revlon* doctrine . . . seems to retain unusually robust rhetorical force; but it actually has been drained of genuine remedial clout."); Lynn A. Stout, *Why We Should Stop Teaching* Dodge v. Ford, 3 VA. L. & BUS. REV. 163, 172 (2008) (asserting that *Revlon* "has become nearly a dead letter").

38. Laster, *supra* note 7, at 8.

39. *See* Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983) (applying the entire fairness test to a majority shareholder squeeze out). Now, however, courts review controlling shareholder freezeout mergers under the business judgment rule "where the merger is conditioned *ab initio* upon both the approval of an independent, adequately-empowered Special Committee that fulfills its duty of care; and the uncoerced, informed vote of a majority of the minority stockholders." Kahn v. M & F Worldwide Corp., 88 A.3d 635, 644 (Del. 2014); *see also* Ann M. Lipton, *After* Corwin*: Down the Controlling Shareholder Rabbit Hole*, 72 VAND. L. REV. 101, 121–23 (2019) (explaining that the difficulties in determining whether a stockholder is "controlling" further creates uncertainty about whether the directors must satisfy *Corwin*'s cleansing obligations or *MFW*'s additional sanitizing requirements to invoke the business judgment rule).

40. *See Weinberger*, 457 A.2d at 711 (holding that the directors failed to satisfy their burden of entire fairness in a majority shareholder squeeze out when interlocking board members failed to disclose information to members of the other board). This is not a bifurcated test between fair dealing and fair price: "All aspects of the issue must be examined as a whole since the question is one of entire fairness." *Id.*

41. *See In re* Cornerstone Therapeutics Inc., Stockholder Litig., 115 A.3d 1173, 1181 (Del. 2015) ("The stringency of after-the-fact entire fairness review by the court intentionally puts strong pressure on the interested party and its affiliates to deal fairly before-the-fact when negotiating an interested transaction.").

showing of gross and palpable overreaching."[42] Unlike the entire fairness standard, this defendant-friendly review promotes efficient decisionmaking and often necessary risk-taking at the expense of the board's accountability to the stockholders.[43] These two levels of scrutiny adequately cover the two opposite ends of the standard of review spectrum, but over time, Delaware courts recognized that an intermediate level of scrutiny would more appropriately resolve issues that fall somewhere in the middle. This Part describes the evolution of this intermediate standard of review: enhanced scrutiny.

### *A. The Rise of Enhanced Scrutiny*

The Delaware Supreme Court created enhanced scrutiny as an intermediate standard of review in *Unocal*.[44] In *Unocal*, Mesa Petroleum, a minority shareholder owning 13% of Unocal's shares, began a two-tiered, front-loaded tender offer[45] to take over the company.[46] Mesa sought to purchase an additional 37% in a front-end cash offer[47] for $54 per share and the remaining shares in a back-end

42. Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971); *see also* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (explaining that the business judgment rule presumes "that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company"), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000); Davis v. Louisville Gas & Elec. Co., 142 A. 654, 659 (Del. Ch. 1928) (noting that it is not the judiciary's "function to resolve for corporations questions of policy and business management. The directors are chosen to pass upon such questions and their judgment unless shown to be tainted with fraud is accepted as final."); Shlensky v. Wrigley, 237 N.E.2d 776, 780–81 (Ill. App. Ct. 1968) (holding that the lower court properly dismissed the plaintiffs' complaint that alleged that the board of directors acted in bad faith by refusing to schedule night games at Wrigley Field).

43. *See, e.g.*, *In re* Walt Disney Co. Derivative Litig., 731 A.2d 342, 361–62 (Del. Ch. 1998) ("It is the essence of the business judgment rule that a court will not apply 20/20 hindsight to second guess a board's decision, except 'in rare cases where a transaction may be so egregious on its face that the board approval cannot meet the test of business judgment.' " (quoting *Aronson*, 473 A.2d at 815)).

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

45. This tactic involves one offer to take over one hundred percent of the target corporation through a two-step process. First, the offeror normally uses cash to secure some of the target's shares before completing the second step, where the offeror acquires the remaining shares for securities worth less than the cash paid in the first step. Comment, *Front-End Loaded Tender Offers: The Application of Federal and State Law to an Innovative Corporate Acquisition Technique*, 131 U. PA. L. REV. 389, 389 (1982). This is a very attractive option for acquirers because normally it is less expensive than a single-step partial tender offer and it incentivizes shareholders from the target company to tender their stock as soon as possible before the first-step deal expires. *Id.*

46. *Unocal*, 493 A.2d at 949.

47. The front-end offer of a two-tiered tender offer is normally the better of the two offers, because a hostile bidder wants to coerce shareholders to sell their shares. Even if the shareholders believe that their shares are worth more, the first offer will still coerce them to sell because it is better than the second offer. For example, "[i]n such offers, a shark announces in advance that he will buy 50% of a company's shares in a tender offer for say, $40/share *and* will follow that up with

offer[48] of $54 per share in junk bonds.[49] In order to prevent this,[50] Unocal threatened to perform a discriminatory self-tender where it would buy back all outstanding shares (except for those owned by Mesa) if Mesa were to pursue the front-loaded offer.[51] Despite the enormous cost that this scorched-earth tactic[52] would levy against the company and its stockholders,[53] the Delaware Supreme Court ultimately held that the board could employ the discriminatory self-tender because Mesa's offer posed a threat to the corporation and the defensive measure was reasonable in relation to the threat.[54]

In reaching this conclusion, the Delaware Supreme Court observed that takeover disputes should require a standard of review that falls in between the business judgment rule and the entire fairness test.[55] On the one hand, just like any other board responsibility that is ordinarily reviewed under the business judgment rule, takeover bids

a freezeout merger for say, $30/share." Robert A. Prentice & John H. Langmore, *Hostile Tender Offers and the "Nancy Reagan Defense": May Target Boards "Just Say No"? Should They Be Allowed To?*, 15 DEL. J. CORP. L. 377, 440–41 (1990). In this situation, the target shareholders will sell for $40 per share even if they believe they may be worth $50 or $55 per share in order to avoid the second deal, which would leave them worse off. *Id.* at 441.

48. The back-end offer, normally worse than the first, occurs after shareholders quickly take advantage of the first offer. *See supra* note 47.

49. *Unocal*, 493 A.2d at 949–50.

50. The board attended a nine-and-a-half-hour meeting where they were informed by investment banks that the offer was grossly inadequate. *Id.* at 950. According to the valuations, Unocal's stock was worth in excess of $60 per share. *Id.*

51. *Id.* at 950–51.

52. A scorched earth defense is "[t]he attempt of a takeover target to make itself look undesirable by threatening to liquidate or destroy assets in the event of a hostile takeover." *Scorched Earth Defenses*, BLACK'S LAW DICTIONARY (2d ed. 1910), https://thelawdictionary.org/scorched-earth-defenses/ (last visited Jan. 1, 2020) [https://perma.cc/LHA6-HUN6].

53. *Unocal*, 493 A.2d at 950 ("The cost of such a proposal would cause the company to incur $6.1–$6.5 billion of additional debt . . . ."). After this case, the SEC banned the discriminatory self-tender defensive measure. *See* Amendments to Tender Offer Rules All-Holders and Best-Price, Exchange Act Release No. 23421, 36 SEC Docket 96 (July 11, 1986) (amending regulations to require tender offers to be "open to all security holders of the class of securities subject to the tender offer"); Nathaniel C. Nash, *Exclusionary Tender Offers Banned*, N.Y. TIMES (July 9, 1986), https://www.nytimes.com/1986/07/09/business/exclusionary-tender-offers-banned.html [https://perma.cc/SU3J-YS9X] ("After more than three hours of debate, the five-member commission voted to outlaw so-called exclusionary tender offers and adopted a rule that requires anyone seeking to take over a company to make the same price available to all holders of the same class of stock.").

54. *Unocal*, 493 A.2d at 958–59. The court explained that the board made a reasonable investigation that the value of the company was more than $54 per share and that the junk bonds were worth significantly less than $54 per share. *Id.* at 955–56. The offer was deemed coercive because the two-tiered offer incentivized shareholders to sell in the first tier so they would not be left with junk bonds offered in the back-loaded offer. *Id.* at 956. Additionally, the court pointed out that "the threat was posed by a corporate raider with a national reputation as a 'greenmailer.' " *Id.*

55. *Id.* at 954–55.

require directors to decide whether the action would be in the best interests of the stockholders.[56] On the other hand, the court noted that a higher standard of review must apply when analyzing takeover measures because of the "omnipresent specter that a board may be acting primarily in its own interests."[57] Thus, the court established enhanced scrutiny: if the board can show that it reasonably believed that it faced a takeover threat and the defense was reasonable in relation to the threat posed, the business judgment rule applies.[58] If the board fails this two-part analysis, however, the entire fairness test applies.

The Delaware Supreme Court then extended the application of enhanced scrutiny to situations involving the board's decision to sell the company.[59] In *Revlon*, Pantry Pride planned a hostile takeover of Revlon after its friendly acquisition offer was rejected by Revlon's chairman of the board and CEO.[60] In response, the Revlon board adopted defensive measures, including a stock repurchase of ten million shares in exchange for high-interest notes and a primitive poison pill[61] that would trigger when anyone acquired beneficial ownership of at least 20% of the company's shares.[62] The board later decided to negotiate with other potential buyers and eventually found a white

56. *Id.* at 954.

57. *Id.* at 954–55. Ideally, the interests of the stockholders and the directors are the same, but in practice, a tender offer could "spell drastically altered career paths for many top executives." Leslie Wayne, *Self-Interest and Takeovers*, N.Y. TIMES (Apr. 3, 1981), https://www.nytimes.com/1981/04/03/business/self-interest-and-takeovers.html [https://perma.cc/S5Q9-8FUQ]. For example, a chief executive may be relegated to serving as the head of a single division post-takeover, and even without a pay cut, she would lose significant power in the overall corporate scheme in terms of giving orders. *Id.*; *see also* David T. Merrett & Keith A. Houghton, *Takeovers and Corporate Governance: Whose Interests Do Directors Serve?*, 35 ABACUS 223, 223–24 (1999) (examining internal records of board meetings to get a sense of the directors' motivations during takeover negotiations).

58. *Unocal*, 493 A.2d at 953, 955.

59. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180–81 (Del. 1986).

60. *Id.* at 176.

61. A poison pill is a "takeover prevention strategy that makes stock look bad to the interested buyer." *Poison Pill*, BLACK'S LAW DICTIONARY (2d ed. 1910), https://thelawdictionary.org/poison-pill/ (last visited Jan. 1, 2020) [https://perma.cc/294Y-DNE8]. The more primitive version of the poison pill is called a flip-over trigger in contrast to the more modern flip-in trigger. In this case, if Pantry Pride purchased at least 20% of Revlon's shares, then the shareholders had the right to be bought out by the corporation at a substantial premium. *Revlon*, 506 A.2d at 177. This would give the Revlon board the opportunity to buy back a majority of the shares, thus preventing Pantry Pride from taking over the company. *Id.* This defense is costly from both companies' perspectives, which is likely the reason why the poison pill has only been triggered once. *See* Mark D. Gerstein et al., *Lessons from the First Triggering of a Modern Poison Pill:* Selectica, Inc. v. Versata Enterprises, Inc., LATHAM & WATKINS 1–2 (Mar. 2009), https://www.lw.com/upload/pubContent/_pdf/pub2563_1.pdf [https://perma.cc/XTE4-FVEL] (analyzing the implications of "swallow[ing] a modern poison pill").

62. *Revlon*, 506 A.2d at 177.

knight,[63] Forstmann Little.[64] The two parties agreed to a leveraged buyout for $57.25 per share provided that Revlon agree to a lock-up provision,[65] a no-shop provision,[66] and a $25 million cancellation fee.[67] Pantry Pride responded by increasing its bid to $58 per share before filing a claim in the Court of Chancery for a preliminary injunction.[68]

As in *Unocal*, the Delaware Supreme Court applied enhanced scrutiny because the transaction raised "the omnipresent specter that a board may be acting primarily in its own interests."[69] The court upheld Revlon's initial takeover measures, the stock repurchase, and the poison pill under the *Unocal* test because the defensive measures were held to be reasonable in relation to Pantry Pride's takeover threat, which was deemed a "grossly inadequate" bid.[70] However, once the Revlon directors agreed to look for other bidders while Pantry Pride continued to increase its offer price, "it became apparent to all that the break-up of the company was inevitable."[71] According to the court, this meant that the "duty of the board had thus changed from the preservation of Revlon . . . to the maximization of the company's

63. A white knight is a "friendly company who takes over control." *White Knight*, BLACK'S LAW DICTIONARY (2d ed. 1910), https://thelawdictionary.org/white-knight/ (last visited Jan. 1, 2020) [https://perma.cc/YZ8G-F4Q7]. It is not terribly surprising that Revlon actively sought other investors. During the 1980s, Ronald O. Perelman, the chairman of the board and CEO of Pantry Pride, had a reputation as a fierce corporate raider and was deemed a "shareholder-unfriendly anti-Warren Buffet." Andrew Bary, *The Upside of Swimming with a Shark*, BARRON'S (June 22, 2013), https://www.barrons.com/articles/SB50001424052748704311204578557971330719586 [https://perma.cc/8GHS-ZUXF]. The Delaware Supreme Court noted that Revlon's chairman and CEO, Michel C. Bergerac, felt "strong personal antipathy to Mr. Perelman." *Revlon*, 506 A.2d at 176.

64. *Revlon*, 506 A.2d at 178.

65. A lock-up provision is "[w]hen a company allows a white knight to purchase its most valuable assets to prevent a hostile takeover." *Lock-Up Option*, BLACK'S LAW DICTIONARY (2d ed. 1910), https://thelawdictionary.org/lock-up-option/ (last visited Jan. 1, 2020) [https://perma.cc/ZB5J-YWU3].

66. A no-shop provision is an "agreement clause between an owner and a prospective buyer to suspend all other purchase negotiations for a stated time period. In other words, the seller agrees to stop seeking other acquisition proposals." *No-Shop Clause*, BLACK'S LAW DICTIONARY (2d ed. 1910), https://thelawdictionary.org/no-shop-clause/ (last visited Jan. 1, 2020) [https://perma.cc/3DRG-6RHN].

67. *Revlon*, 506 A.2d at 178–79. The cancellation fee required Revlon to pay Forstmann $25 million if it did not proceed with the transaction. *Id.* at 175.

68. *Id.* at 179.

69. *Id.* at 180 (quoting Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985)); *see* Juneja, *supra* note 6, at 140 (explaining that *Revlon* furthered enhanced scrutiny after *Unocal* by recognizing that conflicts of interest can exist "not only when the board is in complete control of the corporation but also during the period of the corporation's final sale").

70. *Revlon*, 506 A.2d at 176–77, 180–81 (explaining that the Revlon board was informed by their investment banker at a meeting that "$45 per share was a grossly inadequate price for the company").

71. *Id.* at 182.

value . . . for the stockholders' benefit."[72] Although lock-up provisions, no-shop provisions, and cancellation fees are not per se impermissible defensive measures, they were impermissible under these particular circumstances because they impeded the active auction process.[73] As a result, the Delaware Supreme Court held that the directors breached their fiduciary duties by "allow[ing] considerations other than the maximization of shareholder profit to affect their judgment . . . to the ultimate detriment of its shareholders."[74]

*Revlon* stands for the proposition that when a company is up for sale, its board must seek the best offer reasonably available for the stockholders.[75] Under *Revlon*, the board can trigger the business judgment rule by proving that its decisionmaking process was adequate and its decision was reasonable.[76] Interestingly, even though the court applied enhanced scrutiny in both *Revlon* and *Unocal* to protect stockholders from "the omnipresent specter" of director self-interest,[77] the focus of *Revlon* seems to diverge from that of *Unocal* to some extent. *Revlon*'s deeper investigation into the board's decisionmaking process suggests a greater concern with the board's execution of its duty of care than in *Unocal*, where the duty of loyalty was the principal focus.[78] *Revlon*'s goal—to protect against conflicts of interest and duty of care violations—is achieved by requiring directors to fulfill so-called *Revlon* duties,[79] which are simply specific applications of the board's

72. *Id.*

73. *Id.* at 183–84.

74. *Id.* at 185.

75. Cox & Thomas, *supra* note 10, at 331.

76. *Revlon*, 506 A.2d at 182–85.

77. *See id.* at 180; Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954–55 (Del. 1985).

78. *Revlon*, 506 A.2d at 185 ("No such defensive measure can be sustained when it represents a breach of the directors' fundamental duty of care." (citing Smith v. Van Gorkom, 488 A.2d 858, 874 (Del. 1985), *overruled on other grounds by* Grantler v. Stephens, 965 A.2d 695, 713 n.54 (Del. 2009))); *see Unocal*, 493 A.2d at 954–55 (expressing concern with the motivations of the board diverging from shareholders during a takeover); Mohsen Manesh, *Defined by Dictum: The Geography of* Revlon-*Land in Cash and Mixed Consideration Transactions*, 59 VILL. L. REV. 1, 26 (2014) ("'*Revlon* [duties] . . . do not admit of easy categorization as duties of care or loyalty.' Instead, *Revlon* implicates *both* of these fiduciary duties." (quoting *In re* Santa Fe Pac. Corp. S'holder Litig., 669 A.2d 59, 67 (Del. 1995))). This became even more evident when the Delaware Supreme Court weakened the second step of the *Unocal* test by prohibiting draconian defenses (those that are preclusive or coercive) but allowing all other actions to be reviewed under *QVC*'s "range of reasonableness" standard. Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1387–88 (Del. 1995) (quoting Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 45–46 (Del. 1994)) (remanding the case to allow the Court of Chancery to determine whether the target company's repurchase program was a draconian defensive measure, and if not, whether it fell within the "range of reasonableness").

79. *See* Laster, *supra* note 7, at 10 ("*Revlon*'s prominent language . . . seemed to contemplate affirmative duties for the selling board, including a potential duty to auction."); Manesh, *supra* note 78, at 26–27 ("[*Revlon*] is not just about potential conflicts of interests between boards and shareholders. It is also about ensuring that directors act in an 'informed and deliberate manner'

"traditional fiduciary duties of care and loyalty in the context of control transactions."[80] Even though Delaware courts find that "certain fact patterns demand certain responses,"[81] "there is no single blueprint that a board must follow to fulfill its duties."[82]

The Delaware Supreme Court's decision left *Revlon*'s scope and application largely undecided. However, subsequent cases established that *Revlon* applies in at least three different scenarios:

> (1) "[W]hen a corporation initiates an active bidding process seeking to sell itself or to effect a business reorganization involving a clear break-up of the company;" (2) "where, in response to a bidder's offer, a target abandons its long-term strategy and seeks an alternative transaction involving the break-up of the company"; or (3) when approval of a transaction results in a "sale or change of control."[83]

Although a few cases muddled the confines of the doctrine's scope,[84] *Revlon* and its progeny established a standard of conduct that goes into effect when a change of control becomes inevitable.[85]

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with respect to significant and irreversible end-of-the-line transactions." (quoting Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1345 (Del. 1987))).

80. *In re* Alloy, Inc. S'holder Litig., No. 5626-VCP, 2011 WL 4863716, at *7 (Del. Ch. Oct. 13, 2011); *see* McMillan v. Intercargo Corp., 768 A.2d 492, 502 (Del. Ch. 2000) ("The fact that a corporate board has decided to engage in a change of control transaction invoking so-called *Revlon* duties does not change the showing of culpability a plaintiff must make in order to hold the directors liable for monetary damages.").

81. Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989).

82. *Id.*; *see QVC Network*, 637 A.2d at 45 ("[A] court applying enhanced judicial scrutiny should be deciding whether the directors made a reasonable decision, not a perfect decision."); Laster, *supra* note 7, at 19–20 (explaining that *Revlon* does not impose specific conduct requirements but rather calls on courts to determine the reasonableness of the conduct).

83. Arnold v. Soc'y for Sav. Bancorp, Inc., 650 A.2d 1270, 1289–90 (Del. 1994); Bainbridge, *supra* note 5, at 3314 (quoting *id.*).

84. *See* Johnson & Ricca, *supra* note 37, at 175–76 (noting that this uncertainty stems from a failure to clearly identify the rationales for a heightened level of scrutiny and why certain transactions do or do not fall under the *Revlon* doctrine); Alicia E. Plerhoples, *Can an Old Dog Learn New Tricks? Applying Traditional Corporate Law Principles to New Social Enterprise Legislation*, 13 TRANSACTIONS: TENN. J. BUS. L. 221, 246 (2012) (explaining that uncertainty surrounding *Revlon*'s application "continues to feed into the risk-aversion of directors and corporate managers as they contemplate acquisitions"); *see also* Alexandros N. Rokas, *Reliance on Experts from a Corporate Law Perspective*, 2 AM. U. BUS. L. REV. 323, 344–45 (2013) (explaining that *Revlon*'s impact on the reliance doctrine is unclear).

85. *See* Wells M. Engledow, *Structuring Corporate Board Action to Meet the Ever-Decreasing Scope of* Revlon *Duties*, 63 ALB. L. REV. 505, 528–34 (1999) (explaining how corporate lawyers should counsel boards on fulfilling process-oriented *Revlon* duties); Megan Wischmeier Shaner, *How "Bad Law, Bad Economics and Bad Policy" Positively Shaped Corporate Behavior*, 47 AKRON L. REV. 753, 791–92 (2014) ("Prior decisions such as *Revlon* and *Unocal* led to significant changes in thinking with respect to the types of deal protection devices a target board could agree to as well as the flexibility of a target board in agreeing and responding to proposals containing strong deal protection devices."); *see also* E. Norman Veasey, *Counseling the Board of Directors of a Delaware Corporation in Distress*, 2008 AM. BANKR. INST. J. 1, 60–61 (discussing the importance of the standards of review established in Delaware case law, including *Revlon*, in determining how to best advise corporations in distress).

### *B.* Revlon *as an Exclusively Pre-Closing Claim*

An epidemic of deal litigation in the 2000s led Delaware courts to significantly restrict *Revlon*'s application just as they were beginning to clarify its scope.[86] In 2005, stockholders challenged approximately 39% of M&A transactions over $100 million, whereas in 2011, they challenged approximately 92% of these transactions.[87] Many class action lawyers abused the higher standard of review established in *Unocal* and *Revlon* by filing weak claims that were less likely to be dismissed in the early stages of litigation under enhanced scrutiny than under the business judgment rule.[88] All claims—meritorious and frivolous alike—incentivized defendants to settle because it protected the transaction and avoided high discovery and litigation costs.[89] Settling was also a cheaper alternative for corporations because it did not require them to indemnify directors,[90] who, in the absence of director and officer liability insurance,[91] would otherwise remain fully exposed to monetary liability for breaches of the duty of care[92] and the

86. *See* Cox & Thomas, *supra* note 10, at 375–80.

87. Matthew D. Cain & Steven Davidoff Solomon, *A Great Game: The Dynamics of State Competition and Litigation*, 100 IOWA L. REV. 465, 469 (2015); *see also* Cox & Thomas, *supra* note 10, at 375 (explaining that between 1999 and 2013, the percentage of deals that were litigated increased from 10% to 96%).

88. *See* Cox & Thomas, *supra* note 10, at 375–76 (noting that three-quarters of the deals that were litigated in 2013 resulted in settlements and "over three-quarters of those settlements were disclosure-only settlements"); Friedlander, *supra* note 23, at 629 ("Counsel for stockholder plaintiffs were able to file suits indiscriminately and settle them, knowing that . . . enhanced judicial scrutiny of certain forms of transactions made the cases hard to dismiss.").

89. *See* Ryan Lewis, Comment, *What Happens in Delaware Need Not Stay in Delaware: How* Trulia *Can Strengthen Private Enforcement of the Federal Securities Laws*, 2017 BYU L. REV. 715, 729 (explaining that when plaintiffs bring these types of claims, "corporate mechanics will incentivize defendants to settle quickly, even if the claim has no underlying merit . . ."). Settlement also allows the corporation to "facilitate a securities offering, merger, large transaction, [or] other deal timeline." *Id.*

90. They would still have to indemnify the directors for expenses, however. *See* Bennett L. Ross, Note, *Protecting Corporate Directors and Officers: Insurance and Other Alternatives*, 40 VAND. L. REV. 775, 785 (1987) ("When a suit is brought derivatively on behalf of the corporation, directors and officers cannot be indemnified for judgments or amounts paid in settlement, but can be indemnified only for expenses.").

91. Many corporations have director and officer ("D&O") liability insurance, which can protect directors even in situations where they cannot be indemnified. Jun Sun Park, *A Comparative Study of D&O Liability Insurance in the U.S. and South Korea: Protecting Directors and Officers from Securities Litigation*, 10 CHI.-KENT J. INT'L & COMP. L. 1, 10–11 (2010). However, some policies can contain exclusions for conduct related to takeover activities. Ross, *supra* note 90, at 77–78.

92. The duty of care is a "legal requirement . . . where the board of directors and executives must make informed decisions in discharging their fiduciary responsibilities." *Duty of Care*, BLACK'S LAW DICTIONARY (2d ed. 1910), https://thelawdictionary.org/duty-of-care/ (last visited Jan. 1, 2020) [https://perma.cc/Z67P-WV7K].

duty of loyalty[93] prior to the effective date of the director exculpation statute.[94] While class actions significantly benefitted plaintiffs' lawyers through attorneys' fees, they provided little benefit to the stockholders themselves and created concerns that deal litigation was not being driven by the merits.[95]

As a result, the Delaware Court of Chancery increased the standard for evaluating disclosure-only settlements[96] in *In re Trulia, Inc. Stockholder Litigation*.[97] In response to shareholder lawsuits,[98] defendant corporations and directors would obtain settlements that provided sweeping releases from liability in exchange for additional disclosures in the proxy statement and attorneys' fees for plaintiffs'

93. The duty of loyalty is a "legal requirement . . . where the board of directors and executives must ensure that any action taken is done in good faith and with the best interests of shareholders in mind." *Duty of Loyalty*, BLACK'S LAW DICTIONARY (2d ed. 1910), https://thelawdictionary.org/duty-of-loyalty/ (last visited Jan. 1, 2020) [https://perma.cc/65ZP-9HFE].

94. *See* Johnson & Ricca, *supra* note 37, at 205–06 (explaining that the value-maximization objective of *Revlon* included duty of care liability since the director exculpation statute, section 102(b)(7) of the Delaware General Corporations Law, did not become effective until July 1, 1986). The statute allows for corporations to include a provision in their corporate charters that eliminates directors' liability for breach of the duty of care. *See* Douglas M. Branson, *Assault on Another Citadel: Attempts to Curtail the Fiduciary Standard of Loyalty Applicable to Corporate Directors*, 57 FORDHAM L. REV. 375, 380–81 (1988) (referring to the Delaware director exculpation statute as the "opt out statute"); Carl Samuel Bjerre, Note, *Evaluating the New Director Exculpation Statutes*, 73 CORNELL L. REV. 786, 786 (1988) (explaining that other states have followed Delaware's lead in allowing such charter provisions, which has created a "race for the bottom" to create hospitable legal environments to entice corporate leadership to incorporate in their respective states (quoting William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 705 (1974))).

95. *See In re* Walgreen Co. Stockholder Litig., 832 F.3d 718, 721 (7th Cir. 2016) (characterizing deal litigation as an accumulation of strike suits that "are designed to end—and very quickly too—in a settlement in which class counsel receive fees and the shareholders receive additional disclosures concerning the proposed transaction"); Cox & Thomas, *supra* note 10, at 376 ("Fear that such litigation is not driven by merits, but rather by the quest for a quick settlement, is fed by a study finding no correlation between the premium shareholders receive as a consequence of the merger and the likelihood of there being a fiduciary class action claim." (citing Charles R. Korsmo & Minor Myers, *The Structure of Stockholder Litigation: When Do the Merits Matter?*, 75 OHIO ST. L.J. 829, 836, 876–77 (2014))); Friedlander, *supra* note 23, at 623 (describing the widely held recognition that stockholder class actions challenging mergers are often not productive).

96. Disclosure-only settlements were "the most common form of settlement" in shareholder class action suits before *Trulia*. Jason Klig, *Disclosure-Only Settlements and the Case for* In re Trulia, 31 GEO. J. LEGAL ETHICS 689, 689–90 (2018).

97. 129 A.3d 884, 898 (Del. Ch. 2016).

98. By the late 1990s and early 2000s, "class actions and, in particular, acquisition-related class actions appear[ed] to have become 'the dominant form of corporate litigation, outnumbering derivative suits by a wide margin.' " Elliott J. Weiss & Lawrence J. White, *File Early, Then Free Ride: How Delaware Law (Mis)Shapes Shareholder Class Actions*, 57 VAND. L. REV. 1797, 1800 (2004) (quoting Robert B. Thompson & Randall S. Thomas, *The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions*, 57 VAND. L. REV. 133, 135 (2004)).

lawyers.[99] Delaware courts, as well as other state courts,[100] worried that these releases were overly broad because they barred all stockholders from bringing future litigation related to the transaction unless they affirmatively opted out.[101] Since corporations often face litigation related to a transaction regardless of the precautions they take, the fact that they could obtain such broad releases through disclosure-only settlements actually incentivized them to withhold complete disclosure at the beginning of the transaction.[102] In response to these concerns, the *Trulia* court announced that it would exercise greater vigilance in analyzing the reasonableness of disclosure-only settlements by requiring the plaintiff to show plainly material disclosures or omissions.[103] In the opinion, the Court of Chancery heavily relied on studies demonstrating that greater disclosure to stockholders has very little impact on stockholder voting.[104] As a result, "[t]he flood of

99. Lewis, *supra* note 89, at 729–30; *see* Peter J. Walsh, Jr. & Aaron R. Sims, *Delaware Insider:* Trulia *and the Demise of "Disclosure Only" Settlements in Delaware*, BUS. L. TODAY, Feb. 2016, at 1–2, https://www.americanbar.org/content/dam/aba/publications/blt/2016/02/delaware-insider-201602.authcheckdam.pdf [https://perma.cc/QZ5J-JS6S] (describing the history of disclosure-only settlements in Delaware). Disclosure-only settlements were often seen as an opportunity for "attorneys to make a quick buck." Klig, *supra* note 96, at 695.

100. *Trulia*, 129 A.3d at 896; Klig, *supra* note 96, at 695.

101. Klig, *supra* note 96, at 694–95. Standard releases covered "all possible claims, known or unknown, asserted or un-asserted, arising out of or relating to the events that were the subject of the litigation." *Id.* at 694 (quoting Brinckerhoff v. Tex. E. Prods. Pipeline Co., 986 A.2d 370, 385 (Del. Ch. 2010)). In shareholder class actions, "[m]any shareholders are not incentivized to both determine whether it is in their best interest to opt out of a class and then take the *affirmative* step to opt out because they do not have large enough interests." *Id.* at 695.

102. *Id.* at 697. Attorneys advised corporate clients to withhold certain information because they would inevitably face litigation regardless of the amount of disclosure they provided, and then they could obtain a broad release from liability through a disclosure-only settlement later. *Id.* at 697–98.

103. *Id.* at 898–99. The Court of Chancery explained the implications of the new standard:

> [P]ractitioners should expect that disclosure settlements are likely to be met with continued disfavor in the future unless the supplemental disclosures address a plainly material misrepresentation or omission, and the subject matter of the proposed release is narrowly circumscribed to encompass nothing more than disclosure claims and fiduciary duty claims concerning the sale process, if the record shows that such claims have been investigated sufficiently.

*Id.* at 898.

104. *See id.* at 895 n.29–30 (citing Jill E. Fisch et al., *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 TEX. L. REV. 557 (2015)).

disclosure-only cases quickly dropped to more manageable levels"[105] and alleviated the pressure to settle meritless disclosure-only claims.[106]

Even before *Trulia*, Delaware courts limited stockholders' ability to obtain pre-closing relief under *Revlon* in *C & J Energy Services, Inc. v. City of Miami General Employees' & Sanitation Employees' Retirement Trust* ("*C & J Energy*").[107] The Court of Chancery and the Delaware Supreme Court had two starkly different interpretations of the facts,[108] but the Delaware Supreme Court ultimately held that *Revlon* is not an affirmative obligation on the board to seek the highest bidder.[109] In reaching the decision, the court also strongly discouraged granting injunctions in the absence of a competing bidder,[110] especially because the stockholders are "capable of addressing [the] harm themselves by the simple act of casting a 'no' vote."[111] An injunction would be appropriate in three scenarios:

> (1) [W]here plaintiffs have shown a reasonable likelihood of success on their claims for breach of fiduciary duty *and* there is a 'rival bidder' attempting to buy the company; (2) where there are disclosure violations and the stockholders are not adequately informed; and (3) where the stockholders "will be coerced into accepting the transaction if they do not find it favorable."[112]

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105. Cox & Thomas, *supra* note 10, at 325–26. Although disclosure-only litigation dropped in Delaware state court, there is significant evidence that this caused plaintiffs to flock to the federal courts. *Id.* at 378; *see also* Lewis, *supra* note 89 (arguing for a uniform application of *Trulia*'s "plainly material" standard to reduce abusive securities-based class actions).

106. Courts not only hated disclosure-only settlements because they often pressured defendants to settle meritless cases, but also because the settlements often included releases from future claims not addressed in the complaint. *See* James D. Cox, *How Understanding the Nature of Corporate Norms Can Prevent Their Destruction By Settlements*, 66 DUKE L.J. 501, 509–10 (2016).

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

108. *See* Mordue, *supra* note 2, at 545. The Court of Chancery took the view that the company set out to acquire another company and ended up selling itself instead. *Id.* Since the corporation had an exculpatory provision for the duty of care that barred post-closing damages, the Court of Chancery issued a preliminary injunction to stop the deal. *Id.* at 548. However, the Delaware Supreme Court viewed the situation as a strategic decision "with contractual protections for the seller and a price supported by a passive market check." *Id.* at 545–46.

109. *C & J Energy*, 107 A.3d at 1067–71. This is despite the fact that *Revlon*'s language seems to suggest that this is an affirmative obligation. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) ("The directors' role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company.").

110. *C & J Energy*, 107 A.3d at 1073:

> [W]here no rival bidder has emerged to complain that it was not given a fair opportunity to bid, and where there is no reason to believe that stockholders are not adequately informed or will be coerced into accepting the transaction . . . the Court of Chancery should be reluctant to take the decision out of their hands.

111. *Id.* at 1072.

112. Mordue, *supra* note 2, at 553–54 (footnotes omitted) (quoting *C & J Energy*, 107 A.3d at 1073).

Although the court acknowledged that "an after-the-fact monetary damages case is an imperfect tool," it decided that ordering an injunction under the circumstances was improper.[113] Therefore, *C & J Energy* clearly limited stockholders' ability to obtain pre-closing injunctive relief, but the court's reference to post-closing damages as an "imperfect tool" suggested that shareholders could still recover post-closing damages under *Revlon*.[114]

After *C & J Energy*, however, the Delaware Supreme Court not only severely restricted the application of enhanced scrutiny, but also seemed to prevent stockholders from recovering post-closing damages under *Revlon*. In *Corwin v. KKR Financial Holdings LLC*,[115] stockholders challenged a stock-for-stock merger after it was approved through a stockholder vote.[116] Affirming the Court of Chancery, the Delaware Supreme Court held that "when a transaction not subject to the entire fairness standard is approved by a fully informed, uncoerced vote of the disinterested stockholders, the business judgment rule applies."[117] The court further explained that "*Unocal* and *Revlon* are primarily designed to give stockholders and the Court of Chancery the tool of injunctive relief to address important M & A decisions in real time, before closing."[118] Delaware courts subsequently clarified that the version of the business judgment rule that applies after a cleansing vote is the waste standard,[119] which requires the plaintiff to show that the defendants authorized a transaction that was "so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration."[120] Although

113. *C & J Energy*, 107 A.3d at 1073.

114. *Id.*

115. 125 A.3d 304 (Del. 2015).

116. *Id.* at 306–08. Note that it is uncertain whether this transaction actually triggered *Revlon*. Gevurtz, *supra* note 21, at 8. First, it is not clear whether the same corporate law doctrines in this context apply to LLCs. *Id.* Second, "[t]he merger was an equity exchange involving two publicly traded entities—albeit, a general partner, rather than an elected board, controlled the limited partnership." *Id.*

117. *Id.* at 308–09.

118. *Id.* at 312 ("They were not tools designed with post-closing money damages claims in mind, the standards they articulate do not match the gross negligence standard for director due care liability under *Van Gorkom*, and with the prevalence of exculpatory charter provisions, due care liability is rarely even available.").

119. Singh v. Attenborough, 137 A.3d 151, 151–52 (Del. 2016) ("When the business judgment rule standard of review is invoked because of a vote, dismissal is typically the result . . . because it has been understood that stockholders would be unlikely to approve a transaction that is wasteful."); van der Fluit v. Yates, No. 12553-VCMR, 2017 WL 5953514, at *5 (Del. Ch. Nov. 30, 2017) ("Where the business judgment rule applies pursuant to *Corwin*, claims are dismissed absent a showing of waste.").

120. *E.g.*, Seinfeld v. Slager, No. 6462-VCG, 2012 WL 2501105, at *3 (Del. Ch. June 29, 2012) (quoting *In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 136 (Del. Ch. 2009)). The waste standard is nearly impossible to show. *See, e.g.*, *id.* at *6 ("A plaintiff, as here, alleging waste

directors' actions do not always satisfy *Corwin*,[121] traditional *Revlon* claims where *Corwin* does not apply arise rather infrequently.[122] As a result, *Corwin* insulates almost all of the board's decisions when selling the company, as long as the directors produce an untainted, cleansing vote.[123]

While seeming to entirely foreclose *Revlon*'s applicability post-closing, the court's language in *Corwin* appears to conflate *Revlon*'s standard of review (enhanced scrutiny) with the standard of conduct (the board's actions). The Delaware Supreme Court used both *Revlon* and *Unocal* to justify the elimination of *Revlon*'s applicability post-closing,[124] but *Unocal* does not even apply in this context—it applies only when the board uses antitakeover defenses. This suggests that the underlying reason for preventing *Revlon* from applying post-closing is the standard of review: enhanced scrutiny. The court's language therefore demonstrates an understanding of the *Revlon* doctrine that is contrary to that of most corporate law doctrines, where the standard of conduct and the standard of review diverge.[125] As a result, the court essentially eliminated the standard of conduct it must analyze under the applicable standard of review. And unfortunately, the conflation of *Revlon*'s standard of review and standard of conduct was not limited to *Corwin*. As recently as 2017, the Delaware Court of Chancery dismissed a non-*Corwin* post-closing claim, stating that *Revlon* "was not a tool 'designed with post-closing damages claims in mind.' "[126]

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arising from the decision of an independent board concerning employee compensation has set himself a Herculean, and perhaps Sisyphean, task.").

121. *See van der Fluit*, 2017 WL 5953514, at *7–8 (determining that *Corwin* did not apply when the board failed to disclose that key representatives involved in transaction negotiations would receive post-deal employment benefits because the stockholders were not fully informed); *In re* Saba Software, Inc. Stockholder Litig., No. 10697-VCS, 2017 WL 1201108 (Del. Ch. Mar. 31, 2017) (declining to apply *Corwin* when the proxy issued in connection with the transaction contained material omissions); *In re* Massey Energy Co. Derivative & Class Action Litig., No. 5430-VCS, 2011 WL 2176479 (Del. Ch. May 31, 2011) (holding that *Corwin* does not apply where the challenged conduct occurred well before the merger).

122. *See* Gevurtz, *supra* note 21, at 2 ("For defendant directors, *Corwin* has become a veritable wishing well, whose magic they invoke to shield them in litigation arising out of corporate mergers and sales."); Zachary A. Paiva, Note, *Quasi-Appraisal: Appraising Breach of Duty of Disclosure Claims Following "Cash-Out" Mergers in Delaware*, 23 FORDHAM J. CORP. & FIN. L. 339, 354 (2017) ("While not insurmountable, *Corwin*'s cleansing remains a serious hurdle for plaintiffs . . . .").

123. *See* Mordue, *supra* note 2, at 575.

124. *See Corwin*, 125 A.3d 304, 312 (Del. 2015).

125. *See infra* notes 143–146 and accompanying text.

126. *In re* Solera Holdings, Inc. Stockholder Litig., No. 11524-CB, 2017 WL 57839, at *6 (Del. Ch. Jan. 5, 2017) (quoting *Corwin*, 125 A.3d at 312); *see* Robert S. Reder & Tiffany M. Burba, *Delaware Courts Confront Question Whether "Cleansing Effect" of* Corwin *Applies to Duty of Loyalty Claims*, 70 VAND. L. REV. EN BANC 187, 189–93 (2017).

### *C.* Revlon *as a Post-Closing Claim*

Despite that these cases limited *Revlon*'s applicability to the pre-closing context, more recent Delaware court decisions have applied the doctrine post-closing. In *van der Fluit v. Yates*, the Delaware Court of Chancery analyzed a non-*Corwin* post-closing claim under *Revlon* even though prior Delaware jurisprudence rejected this practice.[127] In a two-step merger transaction between Opower and Oracle,[128] Opower's disclosure materials neglected to inform the stockholders that two of the company's negotiators received "post-transaction employment and the conversion of unvested Opower options into unvested Oracle options."[129] Although the stockholders approved the transaction, van der Fluit—a stockholder for Opower—filed a lawsuit four months later alleging that the stockholders were not fully informed because the Schedule 14D-9 failed to disclose material information[130] and the directors failed to fulfill their duties under *Revlon*.[131]

First, the Court of Chancery held that *Corwin* did not apply because Opower failed to fully inform the stockholders that certain fiduciaries had self-interests that were arguably in conflict with shareholder interests.[132] Even though the court recognized that *Corwin* "might be read to suggest that *Revlon* does not apply at this stage of litigation," it still analyzed the post-closing claim under *Revlon*.[133] The Vice Chancellor explained, "I need not decide the standard of review, because I conclude that Plaintiff fails to state claims under either enhanced scrutiny or the business judgment rule."[134] The court

127. van der Fluit v. Yates, No. 12553-VCMR, 2017 WL 5953514 (Del. Ch. Nov. 30, 2017).

128. Before *van der Fluit*, the Delaware courts extended the holding in *Corwin* to the first step of two-step mergers. *See In re* Volcano Corp. Stockholder Litig., 143 A.3d 727, 747 (Del. Ch. 2016), *aff'd*, 156 A.3d 697 (Del. 2017).

129. *van der Fluit*, 2017 WL 5953514, at *8.

130. "'An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding' whether to approve the challenged transaction." *Id.* at *7 (quoting Rosenblatt v. Getty Oil Co., 493 A.2d 929, 944 (Del. 1985)).

131. *Id.* at *1–4.

132. *Id.* at *8. In an attempt to invoke the entire fairness standard, the plaintiff also raised two arguments that Laskey and Yates were controlling stockholders, but the court rejected both. *Id.* at *5–7. To constitute a controlling stockholder, the individual or group of individuals must (1) own greater than 50% of the voting power or (2) exercise control over the business affairs of the corporation. *Id.* at *5. However, Laskey and Yates only owned 30% of the stock and the two agreements that they signed (a tender agreement and an investor rights agreement) did not render them a control group because neither included binding agreements related to voting or decisionmaking. *Id.* at *6–7; *see* Robert S. Reder & Elizabeth F. Shore, *Chancery Court Holds that Defendant Directors' Failure to Disclose Material Facts Defeated Application of* Corwin*, But Nevertheless Dismisses Claims Against Directors Due to Plaintiff's Failure to Adequately Plead Directorial Breach of Their Duty of Loyalty*, 72 VAND. L. REV. EN BANC 41, 45–47 (2018).

133. *van der Fluit*, 2017 WL 5953514, at *11–12, *11 n.159.

134. *Id.* at *11 n.159.

dismissed the case for failure to state nonexculpated claims against the board,[135] but the fact that the court analyzed the claim at all left open the possibility that stockholders could obtain post-closing relief under *Revlon*.

After *van der Fluit*, the Delaware Supreme Court indicated that *Revlon* applies post-closing. In *Kahn v. Stern*,[136] the Delaware Supreme Court affirmed the defendant's motion to dismiss the stockholders' claim for breach of the duty of loyalty against the directors.[137] It pointed out, however, that the Court of Chancery's reasoning in dismissing the suit was not entirely sound. According to the Supreme Court, plaintiffs are *not* limited to pleading that the directors breached only nonexculpated fiduciary duties "in cases where *Revlon* duties are applicable, but the transaction has closed and the plaintiff seeks post-closing damages."[138] The Supreme Court's disagreement with the Court of Chancery on this requirement conveys two important points. First, the court clarified that an exculpatory charter provision, which insulates directors from duty of care liability, does not provide a blanket exception from performing *Revlon* duties.[139] Second, the more general reference to *Revlon*'s applicability post-closing illustrates that damages relief against individual directors for breaches of traditional *Revlon* duties is an available avenue for stockholders to recover in deal litigation.[140]

In sum, *van der Fluit* and *Kahn* affirm that courts will review non-*Corwin* post-closing claims under *Revlon*. Neither case, however, presented the Delaware courts with an opportunity to decide which standard of review applies, because both claims were too weak to survive motions to dismiss even under the business judgment rule.

135. The court held that the target company sought the highest value reasonably available after describing the company's detailed process used to seek a high value and the target company's ability to negotiate a 30%–51% premium for the shareholders. *Id.* at *11–12.

136. No. 393, 2018 WL 1341719 (Del. Mar. 15, 2018).

137. *Id.*

138. *Id.* at *1 & nn.3–4; *see* Robert S. Reder & Victoria L. Romvary, *Delaware Supreme Court Clarifies Pleading Standard in Post-Closing Damages Action Alleging Breach of "*Revlon*" Duties*, 72 VAND. L. REV. EN BANC 29, 37 (2018). The two footnotes provided in this sentence of the court's short opinion provide more context. The first footnote states that an exculpatory charter provision does not mean that *Revlon* is inapplicable, but rather that *Revlon* "remains applicable as a context-specific articulation of the directors' duties but directors may only be held liable for a non-exculpated breach of their Revlon duties." *Kahn*, 2018 WL 1351719, at *1 n.3. The second footnote cites two prominent *Revlon* cases. *Id.* at *1 n.4 (citing Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1989); then citing *In re* Toys "R" Us, Inc. S'holder Litig., 877 A.2d 975 (Del. Ch. 2005)).

139. *See id.* at *1 & n.3.

140. *See* Reder & Romvary, *supra* note 138, at 37–38.

## II. Balancing Accountability and Authority Using Enhanced Scrutiny and the Business Judgment Rule

The standard of review often drives the outcome of litigation.[141] One element that distinguishes corporate law from other practice areas, however, is the relationship between the standard of review and the standard of conduct.[142] In many areas of the law, an individual's required conduct under a given set of circumstances often conflates with the court's test to review the conduct.[143] For example, in a tort case involving a car accident, the standard of conduct and the standard of review both evaluate whether the person drove carefully.[144] In corporate law, however, the two standards diverge because the courts must attempt to support efficient decisionmaking while also resolving agency costs.[145] Another way to characterize this balancing is one between authority and accountability.[146]

In accordance with the typical separation of the standard of conduct from the standard of review in corporate law, the standard of conduct for all post-closing *Revlon* claims—both where *Corwin* applies and where it does not—requires the board to adhere to its traditional *Revlon* duties by taking actions that satisfy the applicable standard of review. Where *Corwin* applies, the applicable standard of review is waste,[147] so the remaining question is which standard of review applies to non-*Corwin* post-closing claims: Enhanced scrutiny or a form of the business judgment rule? On one hand, enhanced scrutiny may produce more uniformity and predictability than applying another standard since it already applies to pre-closing *Revlon* claims. On the other hand, given the rise of independent directors, the business judgment rule may

141. *See supra* note 28.

142. Allen et al., *supra* note 29, at 868.

143. *See id.*; Melvin Aron Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporation Law*, 62 Fordham L. Rev. 437, 437–38 (1993).

144. Eisenberg, *supra* note 143, at 437. Another example is agency law: the standard of conduct governs the agent as he acts on behalf of the principal and the standard of review is based on whether the agent acted fairly in his dealings with others. *Id.*

145. *See* Chen v. Howard-Anderson, 87 A.3d 648, 666–67 (Del. Ch. 2014) ("The numerous policy justifications for this divergence largely parallel the well-understood rationales for the business judgment rule."); Bainbridge, *supra* note 5, at 3289. The two standards would be identical in corporate law only in a perfect world "in which information was perfect, the risk of liability for assuming a given corporate role was always commensurate with the incentives for assuming the role, and institutional considerations never required deference to a corporate organ." Eisenberg, *supra* note 143, at 437–38. Additionally, many corporate law scholars "believe that the fundamental concern of corporate law is 'agency costs.' " Bainbridge, *supra* note 5, at 3289 (quoting Kent Greenfield, *The Place of Workers in Corporate Law*, 39 B.C. L. Rev. 283, 295 (1998)).

146. Bainbridge, *supra* note 5, at 3281, 3290 (noting, however, that complete reconciliation of these two interests is impossible).

147. *See supra* notes 115–120 and accompanying text.

provide the proper deference to the board's authority in the absence of concerns with conflicts of interest. The appropriate standard of review for post-closing deal litigation should provide the best balance between authority and accountability.

### *A. Arguments for Enhanced Scrutiny*

Enhanced scrutiny requires the directors to show that they "act[ed] reasonably to seek the transaction offering the best value reasonably available to the stockholders."[148] When the board sells the company, the concern is that the directors may not act in the best interests of the stockholders, so applying a lower standard of review may fail to adequately protect stockholder interests and upset the equilibrium between accountability and authority. Enhanced scrutiny thus appropriately balances the two by providing a more rigorous analysis of the directors' accountability. This Section explains the arguments for the application of enhanced scrutiny in non-*Corwin* post-closing claims from a modern corporate governance perspective and from a doctrinal standpoint.

#### 1. Corporate Governance Perspective

The nature of modern corporate governance, which is shaped by recent developments in the corporate world and natural human responses, may justify the application of enhanced scrutiny.

One recent corporate development that may call for greater scrutiny is the rise of hedge fund activism. Hedge fund activism, which refers to hedge funds' actions to take "an aggressive investment interest in the stock . . . of a public company and seek[ ] to make returns by influencing the corporation to change its capital structure or business plan,"[149] began in the early 2000s and has led to a significant increase in M&A activity.[150] Although not all hedge fund targets can be neatly placed into one category,[151] often they are companies with lagging performance where hedge funds can make improvements to increase

148. Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 43 (Del. 1994).

149. Leo E. Strine, Jr., *Who Bleeds When the Wolves Bite?: A Flesh-And-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L.J. 1870, 1886 (2017). The fact that hedge funds can be "activists" is a bit of an oxymoron itself since hedge funds were originally meant to temper, or "hedge" risk. *Id.* at 1885–86.

150. James D. Cox & Randall S. Thomas, *Corporate Darwinism: Disciplining Managers in a World with Weak Shareholder Litigation*, 95 N.C. L. REV. 19, 39–40 (2016).

151. *See* Strine, *supra* note 149, at 1889.

value and short-term profits.[152] Since hedge funds face strong incentives to increase the company's value so they can sell the stock for a higher price,[153] they often pursue board positions to enhance the company's corporate governance.[154] Hedge funds' powerful influence also indirectly affects the actions of other corporations, which adopt strategies to make themselves less attractive targets for hedge funds.[155]

Hedge fund activism creates potential conflicts of interest in the M&A context that may justify enhanced scrutiny. One of these potential conflicts is the concept of "short-termism."[156] While hedge funds focus on making profits as quickly as possible before selling the stock,[157] most remaining stockholders, who lack the financial resources to compete with hedge funds for decisionmaking power, seek long-term gains.[158] The concern is that hedge funds will make important corporate decisions, including those in the M&A context, to serve their own short-term interests, even when doing so will detriment the long-term interests of the remaining stockholders.[159] Hedge funds may also hold board positions[160] or yield strong voting power in two corporations seeking to merge with each other,[161] which presents another opportunity for hedge funds to exert strong influence in merger decisions to serve their own interests without taking into account those of other stockholders. Although hedge funds initially invest in corporations to improve corporate governance, the perhaps unintended consequence of creating conflicts of interest may support the application of enhanced scrutiny.

152. *See* Lucian A. Bebchuk, *The Myth That Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637, 1664 (2013).

153. *See* Giovanni Strampelli, *How to Enhance Directors' Independence at Controlled Companies*, 44 J. CORP. L. 103, 128 (2018).

154. Cox & Thomas, *supra* note 150, at 23–24; Strine, *supra* note 149, at 1872.

155. *See* Strine, *supra* note 149, at 1934. Although this seems to serve as a negative effect at first glance, remember that hedge funds seek to develop struggling or undervalued companies to make profits. *See* Bebchuk, *supra* note 152, at 1664 ("[A]ctivists target companies whose operating performance lags behind peers, and that their interventions are followed by consistent and long-term improvements in operating performance."); Strine, *supra* note 149, at 1890–91 (noting that modern target companies are profitable, but are undervalued as they "pay out less profits than the industry average"). Thus, company efforts to deter hedge funds from influencing their own corporation likely have indirect positive effects.

156. *See* Mark J. Roe, *Corporate Short-Termism—In the Boardroom and in the Courtroom*, 68 BUS. LAW. 977, 985–87 (2013).

157. Strine, *supra* note 149, at 1892.

158. *Id.* at 1876–85.

159. *See* Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1083–84 (2007); Roe, *supra* note 156, at 985.

160. *See* Strine, *supra* note 149, at 1962 (discussing the debate about whether activist hedge funds should owe fiduciary duties to their targets).

161. *See* Kahan & Rock, *supra* note 159, at 1073–75 (discussing hedge fund conflicts in merger votes).

Natural human behavior also plays a role in shaping modern corporate governance. The high-stakes nature of mergers and acquisitions can cause deviations from common behavioral norms that may warrant stricter review of board decisions.[162] The decision to sell a corporation sparks "a range of human motivations, including but by no means limited to greed,"[163] and thus opens the door to potential abuse by the board. These transactions present opportunities for a variety of improper behaviors, including self-dealing, that may be rationalized by cognitive biases.[164] Given the significant financial implications and human consequences of these transactions, there is a high risk that the board will not act in the best interests of the stockholders. Delaware courts have long recognized the danger of favoritism, but enhanced scrutiny could effectively mitigate its consequences.

### 2. Doctrinal Perspective

From a doctrinal perspective, applying enhanced scrutiny post-closing would create greater consistency between pre- and post-closing analyses, especially given that the same concerns with conflicts of interest exist regardless of when the lawsuit is filed.

Concerns about conflicts of interest are not somehow expunged just because the stockholders brought the claim after, not before, closing. The court is less worried that the board acted contrary to the interests of the stockholders where *Corwin* applies because the stockholders approved the transaction through a fair, cleansing vote. In a non-*Corwin* post-closing claim, however, the board denied the stockholders a fair opportunity to approve the transaction because the vote was not fully informed, coerced, or made by interested stockholders. Without a fair vote, the risk that the board acted contrary to the interests of the stockholders has not been mitigated. Since conflicts of interest exist in both pre-closing *Revlon* claims and non-*Corwin* post-closing claims, there is a strong argument that enhanced scrutiny should apply in both situations.

In addition, applying the same standard of review for pre-closing *Revlon* claims and non-*Corwin* post-closing claims may provide consistency and uniformity.[165] Reviewing board actions under varying

162. *See* Laster, *supra* note 7, at 17.

163. *In re* El Paso Corp. S'holder Litig., 41 A.3d 432, 439 (Del. Ch. 2012).

164. *See* City Capital Assocs. Ltd. P'ship v. Interco Inc., 551 A.2d 787, 796 (Del. Ch. 1988); Laster, *supra* note 7, at 17 ("These include familiar cognitive biases such as overconfidence, excessive optimism, groupthink, reactive devaluation, and in-group/out-group thinking.").

165. *See* Laster, *supra* note 7, at 53–54 (stating that the existence of varying standards of review leads to an unnecessary waste of time and expense litigating about which standard of

standards of review merely based on the timing of the lawsuit may yield inconsistent outcomes related to whether the board acted in accordance with its *Revlon* duties.[166] In other words, applying a different standard of review to non-*Corwin* post-closing claims may produce a doctrinal split. Some board actions may satisfy *Revlon* duties under one standard of review but not the other—even though neither situation involves an untainted, cleansing vote. The timing of the lawsuit would serve as the only basis for creating this split, which is a weak justification because, as discussed, the timing of the lawsuit has no bearing on the level of risk of conflicts of interest. Adopting a uniform standard of review for both pre-closing *Revlon* claims and non-*Corwin* post-closing claims preserves predictability and avoids complicating the *Revlon* doctrine any further.

One might push back on this argument by suggesting that Delaware courts have already created a doctrinal split with the decision in *Corwin*.[167] For instance, the board's actions may be sufficient to satisfy the waste standard under *Corwin* but not enhanced scrutiny. However, this so-called split results from the presence or non-presence of an intervening action that mitigates the risk that would otherwise justify a higher standard of review.[168] In this way, *Corwin* does not really produce a doctrinal split because the cleansing vote adequately addresses the risk of conflicts of interest.[169] In non-*Corwin* post-closing claims, this risk is not reduced since the board failed to obtain a cleansing vote. Therefore, applying different standards of review where the risks of conflicts of interest are the same undermines the very justification for applying enhanced scrutiny in the first place.[170]

One disadvantage of applying a higher standard of review in many legal contexts is that it may invite excessive and frivolous litigation. Shifting the burden of proof to the defendant invites plaintiffs' attorneys to file weak claims and pressure defendants to settle.[171] This behavior generates fear that litigation is not being driven

review should apply); Juneja, *supra* note 6, at 134–35, 153 (arguing that the consolidation of the standards of review for all conflicted merger transactions would provide uniformity and efficiency).

166. *See* Laster, *supra* note 7, at 53–54.

167. *See supra* notes 115–120 and accompanying text.

168. *See* Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 308–09 (Del. 2015).

169. *See id. But see supra* note 21.

170. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) ("Because of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporations and its shareholders, there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred.").

171. *See* Meehan Rasch, *Not Taking Frivolity Lightly: Circuit Variance in Determining Frivolous Appeals Under Federal Rule of Appellate Procedure 38*, 62 ARK. L. REV. 249, 271 (2009) ("The applicable standard of review can play a role in a finding of frivolity by setting the threshold

by the merits, which plagued the Delaware courts during the deal litigation epidemic of the early 2000s.[172]

Applying enhanced scrutiny to non-*Corwin* post-closing claims, however, would not have this effect today. Delaware courts have already crafted barriers to prevent the filing of frivolous lawsuits that may otherwise result from applying a higher standard of review. *Trulia* and *Corwin* provided the two principal barriers against frivolous lawsuits. *Trulia* deincentivizes plaintiffs' attorneys from filing frivolous lawsuits because even if claims are strong enough to withstand pretrial challenges, the courts will approve disclosure-only settlements[173] only where the plaintiff can prove plainly material disclosures or omissions.[174] Facing a higher risk that a weak claim will fail to satisfy the "plainly material" standard, lawyers are unlikely to expend their own resources to bring questionable claims. *Corwin* plays a significant role in curbing frivolous litigation by allowing corporations to replace enhanced scrutiny with a fully informed, uncoerced vote of disinterested stockholders.[175] Invoking a lower standard of review and shifting the burden to the plaintiffs results in more dismissals of frivolous claims in the early stages of litigation.[176] Since the holdings in *Trulia* and *Corwin* curbed abuse by plaintiffs' attorneys during an earlier era of excessive deal litigation,[177] these barriers will prevent frivolous post-closing claims even if a higher standard of review applies.[178] Therefore,

over which a successful appellant must pass."); *see also* Brian W. LaCorte, *Supreme Court Rulings Expected to Curb Meritless Patent Litigation*, BALLARD SPAHR LLP (Apr. 30, 2014), https://www.ballardspahr.com/alertspublications/legalalerts/2014-04-30-supreme-court-rulings-expected-to-curb-meritless-patent-litigation.aspx [https://perma.cc/UJV4-6BE4] (discussing two Supreme Court patent cases that shifted standards of review in order to "curb meritless 'patent troll' litigation").

172. *See* Cox & Thomas, *supra* note 10, at 375–76.

173. Disclosure-only settlements became a common method for "quickly resolving stockholder lawsuits that [were] filed routinely in response to the announcement of virtually every transaction involving the acquisition of a public corporation." *In re* Trulia Stockholder Litig., 129 A.3d 884, 887 (Del. Ch. 2016). In these settlements, the plaintiff stockholders agree to drop the lawsuit provided that the defendant supplement the proxy materials that were already given to the stockholders before they voted on a particular transaction. *Id.* As a result of the settlement, the stockholders do not get any economic benefit and the only money that changes hands is the attorneys' fees for plaintiffs' counsel. *Id.*

174. *See id.* at 898 (explaining that "plainly material" means that "it should not be a close call that the supplemental information is material").

175. *See* Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 308–09 (Del. 2015).

176. *See* Lisa L. Casey, *Twenty-Eight Words: Enforcing Corporate Fiduciary Duties Through Criminal Prosecution of Honest Services Fraud*, 35 DEL. J. CORP. L. 1, 17 (2010) (explaining that when shareholders have the burden of proving breach of fiduciary duty, "the defendants usually win early dismissal of the litigation").

177. *See* Cox & Thomas, *supra* note 10, at 375–80.

178. However, this may not necessarily prevent plaintiffs from filing lawsuits in other jurisdictions. *See id.* at 326 (noting that after *Trulia*, there was evidence of flight to federal courts); Mordue, *supra* note 2, at 589 ("It is unclear how much of that outflow represents an attempt to

enhanced scrutiny could serve as a stronger check on the directors' accountability without causing a flood of litigation.

### *B. Arguments for the Business Judgment Rule*

The business judgment rule, the default standard of review in corporate law,[179] defers to the directors' business expertise unless the plaintiff can prove that the directors did not act "on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[180] From an institutional standpoint, this deference seems reasonable because directors possess more business expertise than judges do, which makes them better equipped to evaluate business decisions.[181] As a result, courts leave decisionmaking power in the hands of experts and support the board's authority in the absence of conflict-of-interest concerns. This Section explains the arguments for the application of business judgment deference in non-*Corwin* post-closing claims from a modern corporate governance perspective and from a doctrinal standpoint.

#### 1. Corporate Governance Perspective

Although some developments in corporate governance, such as hedge fund activism, create potential conflict-of-interest concerns, other developments in the M&A context mitigate such concerns. When Delaware courts introduced enhanced scrutiny in the 1980s, most corporate boards consisted of a majority of interested directors, including the firm's senior officers or outsiders with deep connections to the firm.[182] Such board compositions are no longer the norm, however.[183] Filling boards with independent directors was first deemed a mere voluntary "good governance" decision, but today, reducing

avoid *Corwin* versus an attempt to avoid *Trulia* and continue bringing meritless disclosure litigation in the hopes of a settlement."). For example, "[o]f the deals completed in 2016, only 34% were challenged in Delaware, while 61% were challenged in other states and 39% in federal court." Matthew D. Cain et al., *The Shifting Tides of Merger Litigation*, 71 VAND. L. REV. 603, 608 (2018).

179. *See, e.g.*, Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 87 (2004).

180. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

181. *See* Bainbridge, *supra* note 179, at 117–24.

182. Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1468 (2007) (explaining that before the 2000s, most believed that "as a normative and positive matter . . . boards should consist of the firm's senior officers, some outsiders with deep connections with the firm . . . and a few directors who were nominally independent but handpicked by the CEO").

183. *See id.*

agency costs with independent directors is practically mandatory.[184] For example, companies listed on major stock exchanges must have majority-independent boards to list their shares[185] and public companies must have an audit committee composed solely of independent directors to comply with post-Enron legislation.[186] Although many aspects of corporate governance have remained unchanged over the years, independent directors have become increasingly mandatory in the modern business world.

The rise of independent directors naturally decreases the risk of conflicts of interest. Although the *Revlon* court did not clearly explain why enhanced scrutiny applied,[187] most scholars agree that the court's concern with the omnipresent specter of director self-interest is at least a major contributing, if not the decisive, factor in both the *Unocal* and *Revlon* decisions.[188] An independent board mitigates accountability concerns because it "enhance[s] the fidelity of managers to stockholder objectives, as opposed to managerial interests or stakeholder interests."[189] The prominence of independent directors thus diminishes the very justification for enhanced scrutiny's original foundation. As a result, applying enhanced scrutiny may overprotect stockholder interests, which compromises efficient decisionmaking. For this reason, the business judgment rule may serve as a better alternative to preserve this balance.

184. *Id.*

185. Mordue, *supra* note 2, at 553; *see* NYSE Listed Company Manual § 303A.01 ("Listed companies must have a majority of independent directors."); Nasdaq Listing Rule 5605(b)(1) ("A majority of the board of directors must be comprised of Independent Directors."); *see also* Howard B. Dicker et al., *Requirements for Public Company Boards*, WEIL, GOTSHAL, & MANGES LLP 2–4 (Mar. 2015), https://www.weil.com/~/media/files/pdfs/150154_pcag_board_requirements_chart_2015_v21.pdf [https://perma.cc/XX3C-4N3W] (explaining the independent board requirement under the NYSE and Nasdaq as well as the definitions of "independent director" under requirements for both stock exchanges).

186. *See* Listing Standards Relating to Audit Committees, 17 C.F.R. § 240.10A-3(b)(1)(i) (2019) ("Each member of the audit committee must be a member of the board of directors of the listed issuer, and must otherwise be independent . . . ."); NYSE Listed Company Manual § 303A.06; Nasdaq Listing Rule 5605(c)(2); Gordon, *supra* note 182, at 1468.

187. *See* Manesh, *supra* note 78, at 25–27 ("[T]here seems to be no one single policy or principle that animates Revlon and its progeny.").

188. *See* Laster, *supra* note 7, at 54–55 (explaining that even though the court's rationale for applying enhanced scrutiny in *Revlon* was unclear from the opinion, Delaware decisions consistently recognize the omnipresent specter as the principal justification).

189. Gordon, *supra* note 182, at 1469. Independent directors resolve other issues in the United States as well that include "enhanc[ing] the reliability of the firm's public disclosure" and "provid[ing] a mechanism that binds the responsiveness of firms to stock market signals but in a bounded way." *Id.*

### 2. Doctrinal Perspective

From a doctrinal standpoint, reviewing claims for post-closing damages under business judgment deference would perhaps create the most practical outcome when considering the role of the courts in M&A litigation.

One of the justice system's roles in M&A litigation is to determine the proper relief. In pre-closing actions, courts can provide quick injunctive relief to ensure that directors act informatively with respect to irreversible transactions.[190] However, once a transaction closes, courts can no longer provide injunctive relief to block the transaction. In fact, a post-closing challenge to a merger may occur years after closing.[191] Since the court cannot "unscramble the eggs" once a transaction closes, the stockholders' only form of relief is damages.

Given that directors are generally only liable for damages after the transaction closes, the business judgment rule safeguards necessary risk-taking by the board.[192] Before closing, a stockholder vote likely has not occurred, so a cleansing vote under *Corwin* cannot substitute for enhanced scrutiny in a pre-closing action.[193] After closing, a stockholder vote has occurred, so a cleansing vote can substitute for enhanced scrutiny as long as it is untainted—meaning that it is made by fully informed, uncoerced, and disinterested stockholders.[194] Although non-*Corwin* post-closing claims exist only if the board taints the cleansing vote, holding directors to a higher level of scrutiny for post-closing damages deincentivizes risk-taking strategies that may otherwise maximize stockholder interests.[195] Granting deference to the board in this situation still holds directors accountable for damages but protects efficiency and encourages board participation by the most experienced and knowledgeable business experts.

The business judgment rule also promotes judicial restraint, which may be preferable in deal litigation from an institutional standpoint.[196] Courts are experts in the law, not in corporate transactions negotiated among those with substantial business

190. *See* Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 308–09, 312 (Del. 2015); Gevurtz, *supra* note 21, at 19; Manesh, *supra* note 78, at 25–27 (arguing that the *Revlon* doctrine is meant to ensure that directors act informatively with respect to irreversible transactions, not just to fix conflict-of-interest situations).

191. *See* Mordue, *supra* note 2, at 588.

192. *See* Gevurtz, *supra* note 21, at 19.

193. *Id.*

194. *See supra* notes 115–120 and accompanying text.

195. *See* Gevurtz, *supra* note 21, at 19.

196. *See* Gevurtz, *supra* note 4, at 439.

expertise.[197] Even though the argument for deference to expertise applies in many legal contexts,[198] it lacks vigor in the context of Delaware corporate law because Delaware judges possess a significant amount of business expertise.[199] Since the extraordinary corporate migration to Delaware, the Delaware courts have grappled with thousands of complex legal issues arising out of various corporate transactions.[200] Thus, deferring to the board solely based on their expertise is an unconvincing justification standing alone. But judicial interference in the post-closing context jeopardizes the board's risk-taking strategies (which are necessary to succeed in today's competitive corporate world) and remains harder to justify given the rise of independent directors.

### 3. Versions of the Business Judgment Rule

There are two versions of the business judgment rule that could apply to non-*Corwin* post-closing claims. First, the traditional business judgment rule, which normally applies to non-change-in-control decisions, requires stockholders to prove a breach of the duty of care or the duty of loyalty.[201] Since corporations can now essentially eliminate the ability of stockholders to bring duty of care claims against directors,[202] in practice, stockholders are limited to proving a breach of the duty of loyalty under the bad faith standard.[203] The waste standard, on the other hand, requires stockholders to show that the defendants authorized a transaction that was "so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration," which is typically an insurmountable burden.[204] The waste standard applies, for example, in the presence of

197. *See* Bainbridge, *supra* note 179, at 117–24.

198. *See, e.g.*, Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837, 842–44 (1984) (holding that the court should defer to the agency as long as the statute is ambiguous and the agency's interpretation is reasonable); *see also* James J. Brennan, Note, *The Supreme Court's Excessive Deference to Legislative Bodies Under Eighth Amendment Sentencing Review*, 94 J. CRIM. L. & CRIMINOLOGY 551, 574 (2004) (arguing that the Supreme Court exercises too much deference to legislative bodies in the Eighth Amendment context).

199. *See* Gevurtz, *supra* note 21, at 41 ("[T]he frequent merger litigation in Delaware courts both creates and demonstrates substantial sophistication by Delaware judges in dealing with mergers and acquisitions.").

200. *See id.* ("At any event, it is also no secret that a mini industry has developed in litigation challenging the majority of board decisions to merge, thereby imposing what many have referred to as a transaction tax on mergers and acquisitions.").

201. *See supra* note 180 and accompanying text.

202. *See infra* Section III.A.2.

203. *See infra* notes 242–246 and accompanying text.

204. *E.g.*, Seinfeld v. Slager, No. 6462-VCG, 2012 WL 2501105, at *3, *6 (Del. Ch. June 29, 2012) ("A plaintiff, as here, alleging waste arising from the decision of an independent board

an untainted cleansing vote under *Corwin* to insulate directors from liability arising out of transactions that the stockholders themselves approved through a fair vote.[205] Since both standards are versions of the business judgment rule, they both provide significant deference to the board of directors and place a heavy burden on the stockholders.

### *C. Determining the Order of Analysis*

Deciding the appropriate standard of review will also necessarily require determining whether the analysis of post-closing claims should begin with *Corwin* or the merits of the stockholders' claims. Delaware courts have not yet determined whether to begin with an analysis of *Corwin* or of the potential breach of fiduciary duties. The Delaware Court of Chancery took both approaches when analyzing post-closing claims in the same year.[206] In *In re Cyan, Inc. Stockholders Litigation*, Chancellor Bouchard first held that stockholders failed to plead breaches of the duty of care and loyalty before deciding that *Corwin* applied (thus invoking the waste standard).[207] However, less than a month later, in *Sciabacucchi v. Liberty Broadband Corp.*, Vice Chancellor Glasscock first decided that *Corwin* did not apply (because structural coercion tainted the stockholder vote) *before* analyzing the merits of the stockholders' claims.[208]

The order of review takes on crucial importance regardless of the applicable standard of review for post-closing claims. Courts should begin their analysis by determining whether the directors have met their *Corwin* cleansing obligations because this will determine how the court will review the board's conduct. If the stockholder vote satisfies *Corwin*'s requirements, then the waste standard applies.[209] If not, then the court would apply the appropriate standard of review for non-*Corwin* post-closing claims. The only circumstance that would potentially render a preliminary *Corwin* analysis irrelevant would be if the waste standard applied in non-*Corwin* post-closing claims because applying the same standard of review—regardless of whether the directors held an untainted, cleansing vote—would effectively render *Corwin* useless by failing to incentivize a cleansing vote. Assuming that

concerning employee compensation has set himself a Herculean, and perhaps Sisyphean, task."); *see also supra* notes 119–120 and accompanying text.

205. *See supra* notes 115–120 and accompanying text.

206. *See* Sciabacucchi v. Liberty Broadband Corp., No. 11418-VCG, 2017 WL 2352152, at *15–24 (Del. Ch. May 31, 2017); *In re* Cyan, Inc. Stockholders Litig., No. 11027-CB, 2017 WL 1956955, at *8–17 (Del. Ch. May 11, 2017).

207. 2017 WL 1956955, at *8–17.

208. *Sciabacucchi*, 2017 WL 2352152, at *15–24.

209. *See supra* notes 115–120 and accompanying text.

standards of review do in fact determine the outcome of the case, it seems proper to determine which standard of review applies by analyzing *Corwin* before examining the directors' conduct.[210]

## III. SOLUTION: EVALUATING BOARD ACTIONS IN NON-*CORWIN* POST-CLOSING CLAIMS UNDER THE TRADITIONAL BUSINESS JUDGMENT RULE AND *REVLON*'S STANDARD OF CONDUCT

The traditional business judgment rule—not enhanced scrutiny or the waste standard—should apply when reviewing non-*Corwin* post-closing claims because deference protects the board's authority in the absence of accountability concerns. In practice, applying the traditional business judgment rule would require the plaintiffs to prove a breach of the duty of loyalty by meeting the bad faith standard. While this is concededly a high burden, it is still lower than the waste standard. The waste standard would provide too much deference, particularly because there is still reason to question the transaction in the absence of a fair, cleansing vote. Understanding *Revlon* not as a conflation of enhanced scrutiny with the board's actions, but as a standard of conduct, re-establishes the divergence of the two standards that consistently recurs in corporate law doctrine and reinforces the importance of *Revlon*, even when enhanced scrutiny does not apply.

### *A. Deference in Response to Recent Corporate and Legal Developments*

The business judgment rule should apply to non-*Corwin* post-closing claims, as opposed to enhanced scrutiny, because recent business and legal developments largely extinguish the specific concerns that justified applying enhanced scrutiny to pre-closing *Revlon* claims. This Section argues not only that corporate governance developments have substantially decreased concerns that the board may be acting primarily in its own interest but also that applying the business judgment rule better reflects Delaware's recent deferential positions in duty of care claims.

#### 1. Corporate Governance Developments Support Business Judgment Deference

The rise of independent directors substantially minimizes the threat of the "omnipresent specter" of director self-interest that

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

concerned the Delaware Supreme Court in *Unocal* and *Revlon*.[211] The percentage of independent directors serving on boards has increased over the past ten years, and more than three-quarters of S&P 500 boards have put additional limits on their directors' ability to accept positions with other corporations.[212] Although one may argue that the high financial stakes of mergers and acquisitions still raise the concern that independent directors will not pursue the stockholders' best interests,[213] this argument underestimates the directors' expertise.[214] Most boards consist of individual directors with specialized knowledge in a variety of industries, and the percentage of directors with global professional experience increased to 32% in 2018.[215] Further, lead and presiding directors often served in critical decisionmaking roles for corporations before obtaining their current positions.[216] Directors' extensive business experience and education diminish concerns that their decision to sell a company will be based solely on their own greed—these are career professionals who have made similar decisions in high-stakes situations before and are aware of the legal implications of breaching their fiduciary duties.[217] Therefore, the prominence of director independence justifies the application of the business judgment rule.

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211. Gordon, *supra* note 182, at 1468; *see* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180 (Del. 1986); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985).

212. *2018 United States Spencer Stuart Board Index*, SPENCER STUART 16 https://www.spencerstuart.com/-/media/2018/october/ssbi_2018.pdf (last visited Jan. 1, 2020) [https://perma.cc/4MW5-2SWN] [hereinafter *Spencer Stuart 2018*] ("More than three-quarters of S&P 500 boards (77%) have established some limit on their directors' ability to accept other corporate directorships, an increase from 56% in 2008.").

213. *See supra* notes 162–164 and accompanying text.

214. *See* Alan S. Gutterman, BUSINESS COUNSELOR'S LAW AND COMPLIANCE PRACTICE MANUAL § 14:9 (2014) ("Realizing the practical and public relations advantages of recruiting board members who are well-versed in financial reporting and accounting issues, companies have adopted policies with respect to director qualifications that emphasize the need to find candidates with education and experience.").

215. *Spencer Stuart 2018*, *supra* note 212, at 12–14. This was an increase from 29% in 2017. *2017 United States Spencer Stuart Board Index*, SPENCER STUART 13 https://www.spencerstuart.com/~/media/ssbi2017/ssbi_2017_final.pdf (last visited Jan. 1, 2020) [https://perma.cc/33F3-TGFZ] [hereinafter *Spencer Stuart 2017*]. In addition, "13% of new independent directors were born outside the U.S., an increase from 8% in 2017." *Spencer Stuart 2018*, *supra* note 212, at 12.

216. *Id.* at 23 ("47% of lead/presiding directors are retired CEOs, chairs, vice chairs, presidents or COOs.").

217. *See* Gutterman, *supra* note 214, § 14:10 (explaining that corporate directors "have a number of opportunities to attend educational and training programs [that] include presentations by outside legal experts on topics of current interest including recent court decisions interpreting the duties of directors of public companies").

Some critics have questioned the independence of directors after the Enron and WorldCom scandals,[218] but the principal institutional failure in those situations was related to gatekeepers,[219] not independent directors.[220] Even so, post-Enron legislation has increased the requirements for director independence.[221] For example, the New York Stock Exchange not only requires that an independent director have "no material relationship with the listed company" but it also delves into the director's prior employment, familial and consulting relationships, and charitable ties.[222] The Securities and Exchange Commission also responded by increasing its independence standard for directors who serve on the audit committee under the Sarbanes-Oxley Act.[223] Even without considering these legal reforms, corporations have created innovative board structures to foster attitudes of mutual accountability, which promotes independence-in-fact.[224] For instance, corporations have established committees tasked with specific functions that have separate legal and transactional committees and have adopted various means to restrain the CEO's agenda-setting authority.[225] Even if weak independence standards had played a small role in the Enron and WorldCom scandals, both legal and corporate institutions responded with reforms that increased the quality of director independence.

The rise of hedge fund activism has also decreased concerns of conflicts of interest in M&A transactions overall. Even though hedge

218. Jeffrey N. Gordon, *What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections*, 69 U. CHI. L. REV. 1233, 1241 (2002) (explaining that the failure of the monitoring board was due to weaknesses of the independence of directors serving on specialized committees and those tasked with performing crucial monitoring functions); Jonathan H. Gabriel, Note, *Misdirected? Potential Issues with Reliance on Independent Directors for Prevention of Corporate Fraud*, 38 SUFFOLK U. L. REV. 641, 649–51 (2005) (explaining that Enron was largely caused by the independent directors' failure to monitor); *see also* Victor Brudney, *The Independent Director – Heavenly City or Potemkin Village?*, 95 HARV. L. REV. 597, 658–59 (1982) (viewing the independence of the board skeptically and doubting whether independent directors will effectively monitor corporations).

219. "Gatekeepers" here refers to "intermediaries who provide verification and certification services to investors." John C. Coffee, Jr., *Understanding Enron: "It's About the Gatekeepers, Stupid,"* 57 BUS. LAW 1403, 1405 (2002).

220. *Id.* at 1403–05; Gordon, *supra* note 182, at 1539.

221. *See* Gordon, *supra* note 182, at 1477 (breaking down mechanisms of director independence into four categories: (1) tightening legal rules; (2) increasing positive and negative sanctions; (3) development of intra-board structures; and (4) reducing CEO influence in director selection).

222. *See* NYSE, Inc., Listed Company Manual § 303A.02; Gordon, *supra* note 182, at 1483.

223. *See* 17 C.F.R. § 240.10A-3(b) (2019); Standards Related to Listed Company Audit Committees, Securities Act Release No. 8220, 79 SEC Docket 2876 (Apr. 9, 2003); Gordon, *supra* note 182, at 1483.

224. Gordon, *supra* note 182, at 1490.

225. *Id.* at 1490–1500.

fund activism does create these conflicts occasionally, hedge funds' efforts to increase board accountability as a wealth-increasing strategy largely outweighs these concerns. Many individual stockholders are long-term investors,[226] but all stockholders (both long-term and short-term investors alike) desire significant liquidity, regardless of whether that happens in the short term or the long term.[227] Even if there were a crucial distinction between the interests of short-term and long-term investors in this context, empirical studies reveal that hedge fund targets that experience short-term gains actually continue to enjoy positive effects in the long run.[228] Therefore, the perception that hedge funds "pump and dump"[229] at the expense of long-term stockholders is likely just a result of their business model, which requires short investment horizons.[230] Even when a hedge fund holds financial stakes in two corporations seeking to merge, its ultimate goal remains the same: to maximize the value of its portfolio.[231] This goal therefore mitigates the conflict-of-interest concerns because the hedge fund continues to serve other stockholder interests by seeking to maximize value.

Additionally, hedge funds provide substantial corporate governance benefits that significantly outweigh the infrequent and unintended consequence of creating conflicts of interest. For example, large blockholders, such as hedge funds and other institutional investors, increase corporate accountability by creating concentrated ownership, which gives them more power and incentives to actively improve corporate governance than individual stockholders with small stakes in the corporation.[232] The large financial stake that hedge funds have in these ventures not only reduces collective action costs in a way that promotes better corporate governance but also incentivizes managerial oversight.[233] Given that hedge fund activism already acts

226. Strine, *supra* note 149, at 1876–85.

227. *See* Paul Rose & Bernard S. Sharfman, *Shareholder Activism as a Corrective Mechanism in Corporate Governance*, 2014 BYU L. REV. 1015, 1044 (2014).

228. *See* Lucian A. Bebchuk et al., *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085, 1090–91 (2015) (finding no evidence that long-term shareholders of target companies experienced significant negative returns three years after the hedge fund reduced its stake below 5%); Alon Brav et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, 1735 (2008). Empirical studies on hedge fund activity outside of the United States are consistent with these results. *See* Rose & Sharfman, *supra* note 227, at 1041 n.132 (citing Dionysia Katelouzou, *Myths and Realities of Hedge Fund Activism: Some Empirical Evidence*, 7 VA. L. & BUS. REV. 459, 479 (2013)).

229. *See* Bebchuk et al., *supra* note 228, at 1130–35.

230. *See* Rose & Sharfman, *supra* note 227, at 1046.

231. *Id.* at 1044–47.

232. *See* Cox & Thomas, *supra* note 150, at 22–23.

233. *See id.* at 22–26.

as an effective market force to increase accountability to the stockholders ex ante, applying enhanced scrutiny ex post is unnecessary.[234]

2. Current Legal Doctrine Supports Business Judgment Deference

In addition to the various corporate governance developments that support application of the business judgment rule in this context, recent Delaware court decisions support use of the business judgment rule as well.

Providing the board of directors with greater deference is consistent with the current direction that Delaware corporate law is heading in terms of analyzing duty of care claims. Even though *Revlon*'s original application of enhanced scrutiny investigated the board's decisionmaking process to prevent "slothful indifference,"[235] Delaware case law has since shifted away from stringent review of duty of care issues.[236] The Delaware Supreme Court's decision in *Smith v. Van Gorkom*,[237] which held directors personally liable for failing to carefully scrutinize a cash-out merger favored by the company's CEO, propelled the Delaware legislature to enact section 102(b)(7) of the Delaware General Corporation Law.[238] The statute permits corporations to adopt charter provisions that eliminate or limit the "personal liability of a director to the corporation or its stockholders for monetary damages"

234. *See id.* at 23 (explaining that hedge fund activism has served as a market check on corporate governance at a time when legal doctrines have barred many opportunities to challenge the board's actions through class action litigation).

235. *See* Manesh, *supra* note 78, at 28.

236. *See* Reza Dibadj, *Disclosure as Delaware's New Frontier*, 70 HASTINGS L.J. 689, 690–91 (2019) (arguing that the duty of candor and the duty of disclosure should be the new frontier for corporate law because courts underprotect shareholders from breaches of the duty of care and duty of loyalty) ("The duty of care—watered down to a gross negligence standard by the business judgment rule, and further eroded by statutory exculpation clauses permitted under DGCL section 102(b)(7)—is notoriously weak."); Lyman Johnson, *After Enron: Remembering Loyalty Discourse in Corporate Law*, 28 DEL. J. CORP. L. 27, 28 (2003) ("Today, the duty of care serves as only a very weak substantive constraint on director conduct and is spoken of in unusually shrunken terms."); Thomas Rivers, Note, *How to Be Good: The Emphasis on Corporate Directors' Good Faith in the Post-Enron Era*, 58 VAND. L. REV. 631, 639 (2005) (explaining that "now-common exculpatory provisions have tempered the practical effect of the duty of care").

237. 488 A.2d 858 (Del. 1985) (holding that the directors breached their duty of care in approving a proposed cash-out merger because their process was inadequate after the company CEO neglected to provide written materials or hire an investment banker for the quick presentation at the board meeting before approval), *overruled on other grounds by* Grantler v. Stephens, 965 A.2d 695, 713 n.54 (Del. 2009).

238. Dennis R. Honabach, Smith v. Van Gorkom*: Managerial Liability and Exculpatory Clauses—A Proposal to Fill the Gap of the Missing Officer Protection*, 45 WASHBURN L.J. 307, 307, 310–11 (2006) (explaining that until *Van Gorkom*, the legal community believed that directors were essentially immune for breaches of the duty of care); Hillary A. Sale, *Delaware's Good Faith*, 89 CORNELL L. REV. 456, 464–67 (2004); *see* DEL. CODE ANN. tit. 8, § 102(b)(7) (2020).

for breaches of the duty of care.[239] Unsurprisingly, almost every publicly traded company immediately adopted one of these provisions.[240] Allowing corporations to contract out of the duty of care demonstrates its dwindling importance and corporate law's considerably stronger deference to the board's authority, at least in the post-closing context. In light of recent developments in corporate governance and Delaware law, the business judgment rule is the appropriate standard of review for analyzing non-*Corwin* post-closing claims.

### *B. Incentivizing Adherence to Corporate Formalities and Fiduciary Duties*

Applying the traditional business judgment rule, as opposed to the waste standard, provides proper deference to the board of directors while also recognizing that issues tainting the stockholder vote create a reason to question the transaction.

Since a tainted stockholder vote clearly does not mitigate concerns about the transaction (hence, the word "tainted"), the waste standard fails to provide stockholders with enough legal protection in the absence of a cleansing vote. The waste standard applies in the presence of a cleansing stockholder vote because otherwise, stockholders would be able to challenge deals that they approved through a fair vote.[241] If the vote is tainted, however, the stockholders may not have voted with full knowledge of the realities of a transaction. A stockholder vote is considered "tainted" and renders *Corwin* inapplicable when the stockholders can show that the vote was (1) not fully informed; (2) coerced; or (3) made by interested stockholders.[242] Since the stockholders may not have voluntarily approved the transaction with full knowledge of the realities, requiring them to satisfy the nearly impossible burden of waste is inconsistent with the incentives created under *Corwin*. Since concerns about the transaction are not mitigated, the traditional business judgment rule should apply.

Even though the waste standard does not apply, the traditional business judgment rule is still concededly a high burden on the stockholders in the *Revlon* context.[243] In practice, stockholders are generally limited to proving a breach of the duty of loyalty. Duty of care

239. DEL. CODE ANN. tit. 8, § 102(b)(7).

240. Honabach, *supra* note 238, at 312–13.

241. *See supra* notes 115–120 and accompanying text.

242. *See supra* notes 115–117 and accompanying text.

243. *See* Casey, *supra* note 176, at 17, 20–21; Julian Velasco, *The Diminishing Duty of Loyalty*, 75 WASH. & LEE L. REV. 1035, 1065 (2018) ("Today . . . it is extremely difficult to prevail on a duty of loyalty claim.").

claims are very difficult to prove. Most corporate charters include a director exculpation provision that insulates directors from personal liability for breaches of the duty of care.[244] If stockholders allege a breach of the duty of care in the presence of an exculpatory charter provision, they must satisfy the often insurmountable waste standard.[245] Even in the absence of such a provision, they must prove gross negligence, which is also a high bar.[246] As a result of the unsurprising popularity of director exculpation provisions, the stockholder is practically limited to proving a breach of the duty of loyalty, which requires a showing of bad faith.[247]

While this is a high burden, it is still lower than the waste standard.[248] Additionally, stockholders can recover damages based on director-by-director assessments. Delaware courts have "emphasized that each director has a right to be considered individually when the directors face claims for damages in a suit challenging board action."[249] As a result, plaintiffs can recover damages from any one of the directors—they need not prove bad faith and damages across the entire board.

Although the traditional business judgment rule requires the stockholders to prove bad faith, it provides a better balance between accountability and authority than enhanced scrutiny and the waste standard. For one, the diminished concern with the omnipresent specter of director self-interest fails to justify the application of enhanced scrutiny. However, courts should not reward directors with the waste standard if the stockholder vote was not entirely informed, uncoerced, or disinterested because this would eliminate the incentive to hold cleansing votes in the post-closing context.

Since the waste standard would not apply, review of any post-closing *Revlon* claim should begin with a *Corwin* analysis before

244. *See supra* notes 239–240 and accompanying text.

245. Laster, *supra* note 7, at 51 ("Complaints against *Revlon* transactions are subject to dismissal on the pleadings for failure to plead facts sufficient to overcome an exculpatory charter provision.").

246. *Id.*

247. *See* Stone *ex rel.* AmSouth Bancorporation v. Ritter, 911 A.2d 362, 370 (Del. 2006).

248. Joseph K. Leahy, *Corporate Political Contributions as Bad Faith*, 86 U. COLO. L. REV. 477, 507–08 ("[B]ad faith is a 'broader' and more 'flexible' theory than waste or self-dealing.").

249. *In re* Cornerstone Therapeutics Inc., Stockholder Litig., 115 A.3d 1173, 1182 (Del. 2015); *see also* Ellen J. Odoner et al., *Fiduciary Duties of Corporate Directors in Uncertain Times*, WEIL, GOTSHAL & MANGES & COLUM. L. SCH. 9 (Aug. 2017), https://www.weil.com/~/media/files/pdfs/2018/fiduciary-duties-of-corporate-directors-in-uncertain-times.pdf [https://perma.cc/7HQQ-4VL9] ("The liability of the directors must be determined on an individual basis because the nature of their breach of duty (if any), and whether they are exculpated from liability for that breach, can vary for each director." (quoting *In re* Emerging Commc'ns, Inc. S'holders Litig., No. Civ.A. 16415, 2004 WL 1305745, at *38 (Del. Ch. May 3, 2004))).

analyzing the directors' conduct. The presence or absence of a cleansing stockholder vote determines the standard of review that should apply when reviewing the particular transaction at issue. If the quality of the stockholder vote is sufficient to satisfy *Corwin*, then courts review the transaction under the waste standard.[250] If not, then the traditional business judgment rule applies. Courts need to know how closely to scrutinize the transaction before reviewing it because the standard of conduct (the board's *Revlon* duties) cannot act on its own to effectively balance between accountability and authority.[251] Thus, bypassing this preliminary determination again conflates the standard of review with the standard of conduct and jeopardizes the role that the standard of review plays in shaping litigation outcomes.

### *C. Preserving* Revlon*'s Standard of Conduct*

If the traditional business judgment rule applies to non-*Corwin* post-closing claims, the board's *Revlon* duties will remain the same because the standard of conduct does not change. Only the standard of review changes, so the fact that courts scrutinize the transaction differently does not alter the requirement that directors satisfy their fiduciary duties when selling a company. For example, the shift in the standard of review will not require directors, at the time of the transaction, to do more if stockholders bring the claim pre-closing rather than post-closing. The existence of various levels of scrutiny is not a response to different board actions but rather the risk created by the transaction that the board is not acting in the stockholders' interests.

The result of applying a different standard of review to non-*Corwin* post-closing claims from pre-closing *Revlon* claims is that the timing of the lawsuit will determine which party has the burden of proof. In pre-closing *Revlon* claims where enhanced scrutiny applies, the defendants must prove that they sought the best offer reasonably available under the circumstances.[252] In non-*Corwin* post-closing claims

250. *See supra* notes 115–120 and accompanying text.

251. *See* Peters, *supra* note 28, at 258 (explaining that the first thing that the court should consider is the review process and "[f]or a standard of review to work the way it was intended to work, however, it must be understood, applied, and used by the court to reach its decision").

252. *See supra* notes 72–76 and accompanying text.

where the traditional business judgment rule applies, the plaintiffs must prove breach of nonexculpated *Revlon* duties.[253]

Although corporate law consistently separates the standard of conduct from the standard of review,[254] scholars and courts conflate the two standards when discussing *Revlon*. In non-*Corwin* post-closing claims, requiring a showing of bad faith does not necessarily make the claim a non-*Revlon* one. Rather, the standard of conduct under traditional *Revlon* remains the same, but the application of a different standard of review merely shifts the burden from the defendants to the plaintiffs. In terms of the standard of conduct, it is still a *Revlon* claim; the standard of review just requires the plaintiffs to show more.

## CONCLUSION

Many critics continue to assert that *Revlon* is no longer of significant importance, and some even assert that the doctrine is "dead."[255] However, just because enhanced scrutiny applies less frequently than in the past does not mean that *Revlon* is now irrelevant. When viewing *Revlon* as a standard of conduct independent of the standard of review, the doctrine still defines what is required of directors every single time they put corporations up for sale.

Severing the standard of conduct from the standard of review allows courts to better adapt to changes in corporate governance over time. Instead of throwing *Revlon* out the window just because changed circumstances no longer justify the application of enhanced scrutiny, courts can preserve fundamental corporate law doctrines while reviewing them more or less rigorously, thus making them more adaptable over time. In the 1980s, boards consisted of mostly interested directors, so the omnipresent specter of director self-interest justified the application of enhanced scrutiny.[256] The prominence of independent directors today, however, largely extinguishes the justification for applying enhanced scrutiny.[257] These recent changes in modern corporate governance call for traditional business judgment deference in non-*Corwin* post-closing claims, but lowering the standard of review

253. *See* Kahn v. Stern, No. 393, 2018 WL 1341719, at *1 n.3 (Del. Mar. 15, 2018) ("The presence of an exculpatory charter provision does not mean that *Revlon* duties no longer apply. Rather, *Revlon* remains applicable as a context-specific articulation of the directors' duties but directors may only be held liable for a non-exculpated breach of their *Revlon* duties.").

254. *See supra* notes 142–146 and accompanying text.

255. *See supra* note 37.

256. *See* Gordon, *supra* note 182, at 1468.

257. *See supra* Section III.A.1.

still preserves *Revlon* as a standard of conduct. *Revlon* continues to govern in any case involving the sale of a company, and contrary to what many critics believe, the doctrine is very much alive.

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