Articles

THE ILLUSION OF ENHANCED REVIEW OF BOARD ACTIONS

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INTRODUCTION

It is axiomatic that corporate directors face a myriad of difficult and complex decisions that they must make consistently with the fiduciary duties they owe to the corporation. Delaware courts have developed a variety of tests to monitor whether directors have remained true to these duties: the business judgment rule, the enhanced business judgment rule, *Revlon*, entire fairness, *Blasius*, and *Schnell*. Courts and scholars will reflexively repeat that under the business judgment rule, judges defer to the directors' decision when it was made in compliance with their fiduciary duties. In contrast, the conventional wisdom is that the other five tests—the enhanced business judgment rule, *Revlon*, entire fairness, *Blasius*, and *Schnell* (hereinafter the "five tests")—require substantial judicial involvement and scrutiny. Such involvement makes sense, since the applicability of each test necessarily first required a court to conclude that the business judgment rule was inapplicable.

This Article contends that the conventional wisdom about the five tests is an overstatement: While courts state openly that they defer to the directors' judgment under the business judgment rule, similar deference, repackaged, occurs with three of the other five tests as well. In addition, Delaware courts often utilize three external monitors that offer a high probability of fairness—independent directors, disinterested shareholder approval, and the market—to avoid judicial review. Moreover, this Article contends that courts have created high hurdles for plaintiffs to qualify for the remaining two tests, so that few cases ever need be decided solely by judicial review. Thus far, scholars have paid significant attention to when courts will apply each of these tests[1] but have devoted scant attention to the premises underlying these tests. Transactional and litigation lawyers who understand what lurks beneath the five tests will thus be better able to plan for a successful litigation outcome.

Part I of this Article briefly explains the business judgment rule and

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1. *See, e.g.*, Bryan Ford, *In Whose Interest: An Examination of the Duties of Directors and Officers in Control Contests*, 26 ARIZ. ST. L.J. 91 (1994) (analyzing when the enhanced business judgment test will apply); Ronald J. Gilson & Reinier Kraakman, *What Triggers* Revlon?, 25 WAKE FOREST L. REV. 37 (1990) (discussing the role of the *Revlon* test and its triggers in the context of Delaware law); David C. McBride & Danielle Gibbs, *Interference with Voting Rights: The Metaphysics of* Blasius Industries v. Atlas Corp., 26 DEL. J. CORP. L. 927 (2001) (surveying when courts will apply the *Blasius* test).

the five tests. Part II discusses Delaware cases decided under each of the five tests, showing that while courts overtly state that they review directors' decisions in all five tests, courts instead typically employ a non-judicial monitor to avoid such a review in the *Unocal*, *Revlon*, and entire fairness tests. Although no monitor is available for either the *Schnell* or *Blasius* tests, courts have made it quite difficult to invoke either of these tests so that the instances of judicial review under these tests are almost nonexistent. Part III discusses the strengths and weaknesses of the external monitors; readers can therefore evaluate whether corporate case law has been improved by courts largely bypassing judicial review in favor of these monitors. Part IV discusses a few notable exceptions to this pattern of deference and explains how these decisions would have been otherwise decided using one or more non-judicial monitors.

I. A BRIEF OVERVIEW OF THE SIX TESTS

A. *The Business Judgment Rule*

Perhaps the most often quoted description of the business judgment rule is found in *Aronson v. Lewis*: The rule is "a presumption 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."[2] Plaintiffs must dislodge that presumption by producing sufficient evidence[3] that directors violated their duty of care or loyalty.[4] In Delaware, directors satisfy their duty of care if they are not grossly negligent,[5] and their duty of loyalty requires them to be both independent[6] and disinterested[7] (hereinafter collectively referred to as

2. 473 A.2d 805, 812 (Del. 1984) (citing Kaplan v. Centex Corp., 284 A.2d 119, 124 (Del. Ch. 1971)). Unlike the standards contained in the five tests, the business judgment rule is not a standard of review. Instead, "it is an expression of a policy of non-review of a board of directors' decision when a judge has already performed the crucial task of determining that certain conditions exist." William T. Allen et al., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, 1297 (2000).

3. *See* Grimes v. Donald, 673 A.2d 1207 (Del. 1996) (stating that it is the plaintiff's burden under the business judgment rule to rebut the presumption that directors complied with their fiduciary duties in making a decision); *In re* Santa Fe Pac. Corp. S'holder Litig., 669 A.2d 59, 71 (Del. 1995) ("[T]he presumption of the business judgment rule attaches *ab initio* and to survive a [motion to dismiss], a plaintiff must allege well-pleaded facts to overcome the presumption.").

4. Williams v. Geier, 671 A.2d 1368, 1378 (Del. 1996) ("Only by demonstrating that the Board breached its fiduciary duties may the presumption of the business judgment rule be rebutted."); State of Wisconsin Inv. Bd. v. Bartlett, C.A. No. 17727, 2000 Del. Ch. LEXIS 42, at *11-12 (Del. Ch. Feb. 24, 2000) (reasoning that unless the presumption of the business judgment rule is sufficiently rebutted by the plaintiff creating a "reasonable doubt about self-interest or independence, the Court must defer to the discretion of the board"); *see also* STEPHEN A. RADIN, 1 THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS 53-55 (6th ed. 2009) (quoting several Delaware decisions that explain the burden for a shareholder plaintiff).

5. Stone v. Ritter, 911 A.2d 362, 369 (Del. 2006) (identifying "gross negligence" as the level of conduct that would "giv[e] rise to a violation of the fiduciary duty of care"); Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985) (establishing gross negligence as the standard by which boards are liable for violating their duty of care).

6. *Aronson v. Lewis* defines independence: "Independence means that a director's decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influences." 473 A.2d 805, 816 (Del. 1984). Delaware courts have further clarified that in order for a director to be classified as not independent, any benefit the director gets from a transaction must be both different from the benefit received by similarly-situated shareholders and material to that director. Nemec v. Shrader, 991 A.2d 1120, 1127 (Del. 2010) (holding that if directors receive identical benefits to similarly-situated shareholders, those directors lack independence); Cinerama, Inc. v. Technicolor,

"independent") and to have acted in good faith.[8] By stating that they will afford heightened deference to decisions made by outside, independent directors,[9] Delaware courts have incentivized corporations to design their boards with a majority of independent directors or to have interested directors recuse themselves so that decisions are made by a majority of independent directors.[10]

Delaware courts have given several different rationales for the business judgment rule. One is that "discretion granted directors and managers allows them to maximize shareholder value in the long term by taking risks without the debilitating fear that they will be held personally

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Inc., 663 A.2d 1156, 1168 (Del. 1995) (holding that a benefit given to a director must be material); *In re* Gen. Motors (Hughes) S'holder Litig., No. 20269, slip op. at 22 (Del. Ch. May 4, 2005) (holding, also, that a benefit received by a director must be material); *see also* Rales v. Blasband, 634 A.2d 927, 936 (Del. 1993) (explaining that a plaintiff can show a lack of independence where directors are so "under [the influence of another] that their discretion would be sterilized"); Orman v. Cullman, 794 A.2d 5, 24 (Del. Ch. 2002) (noting that courts apply a subjective "actual person" standard when assessing interestedness and independence).

7. To be considered disinterested, directors "can neither appear on both sides of a transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally." *Aronson*, 473 A.2d at 812; *see also Orman*, 794 A.2d at 23 (noting that the material interest required for a director to be considered interested is judged in relation to the director's economic circumstances).

8. Stone v. Ritter, 911 A.2d 362, 369–70 (Del. 2006) (holding that good faith is a subset of the duty of loyalty); *see also In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 64, 67 (Del. 2006) (defining good faith by giving two, non-exclusive definitions of bad faith: (i) subjective bad faith, where the fiduciary actually intends to harm the corporation, and (ii) where a fiduciary acts in conscious disregard of his duties or acts intentionally to violate the law).

9. *See* Grobow v. Perot, 539 A.2d 180, 190 (Del. 1988) ("Approval of a transaction by a majority of independent, disinterested directors almost always bolsters a presumption that the business judgment rule attaches to transactions approved by a board of directors that are later attacked on grounds of lack of due care."); Polk v. Good, 507 A.2d 531, 537 (Del. 1986) (reasoning that since ten of the thirteen directors were outside directors, and they received outside financial and legal advice, their actions constituted a "*prima facie* showing of good faith and reasonable investigation"); *In re* J.P. Stevens & Co. S'holders Litig., 542 A.2d 770 (Del. Ch. 1988) (emphasizing the deference accorded to independent directors in applying the business judgment rule to an independent committee's merger negotiations).

10. *See* Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1343 (Del. 1987) (noting that because the two interested directors recused themselves from participating in the board meetings, thereby leaving the independent directors in the majority, "proof that the board acted in good faith and upon reasonable investigation is materially enhanced"). Sometimes, a board will create a committee consisting solely of independent directors to make decisions where a majority of the board is not independent. *See, e.g.*, *infra* note 273 and accompanying text (discussing board's creation of an independent committee in *Kahn v. Lynch*).

liable if the company experiences losses,"[11] or if a better deal emerges in the future.[12] Second, the rule encourages qualified individuals to become directors, as the rule minimizes the chance of personal liability.[13] The third rationale is that courts are ill-equipped to make business judgments.[14] Judges are appointed or elected to the bench for a variety of reasons, but business judgment and expertise need not be prominent criteria for someone's ascension to the bench. Instead, shareholders elect directors to make business judgments on behalf of the corporation, presumably because candidates for this position have business judgment and expertise.[15] Finally, the business judgment rule ensures that directors, not shareholders, manage the corporation; if directors could easily be held liable, shareholders might frequently ask for judicial review and thereby intrude on the board's decision-making.[16] Several of these rationales are embodied in the following explanation by the Delaware Court of Chancery:

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11. *In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 139 (Del. Ch. 2009); *see also id.* at 131 ("[I]t is tempting in a case with such staggering losses for one to think that they could have made the 'right' decision if they had been in the directors' position. This temptation, however, is one of the reasons for the presumption against an objective review of business decisions by judges, a presumption that is no less applicable when the losses to the Company are large."); Gagliardi v. TriFoods Int'l, Inc., 683 A.2d 1049, 1055 (Del. Ch. 1996) (explaining that the business judgment rule acknowledges that directors will not take appropriate risks and consequently maximize returns for shareholders if they are concerned about personal liability from derivative actions).

12. *In re* Del Monte Foods Co. S'holders Litig., 25 A.3d 813, 830 (Del. Ch. 2011) (discussing when directors can be liable for their decisions and noting that "[t]ime-bound mortals cannot foresee the future").

13. *See* Teachers' Ret. Sys. v. Aidinoff, 900 A.2d 654, 668 (Del. Ch. 2006) (expressing concern that the business judgment rule's "utility in encouraging risk-taking and board service [not] be undermined"); *see also* RADIN, *supra* note 4, at 30 (stating that the business judgment rule encourages more people to become directors).

14. *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 746 (Del. Ch. 2005), *aff'd*, 906 A.2d 27 (Del. 2006) ("Because courts are ill equipped to engage in *post hoc* substantive review of business decisions," the business judgment rule allows courts to avoid such review); *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996) (commenting on the need for the business judgment rule in order to avoid "substantive second guessing by ill-equipped judges or juries").

15. *In re* J.P. Stevens & Co. S'holders Litig., 542 A.2d 770, 780 (Del. Ch. 1988) ("Because businessmen and women are correctly perceived as possessing skills, information and judgment not possessed by reviewing courts . . . courts have long been reluctant to second-guess such decisions when they appear to have been made in good faith.").

16. Michael P. Dooley, *Two Models of Corporate Governance*, 47 BUS. L. 461, 470 (1992) (explaining that the business judgment rule is intended to protect the authority of the board); Michel P. Dooley & E. Norman Veasey, *The Role of the Board in Derivative Litigation: Delaware Law and the Current ALI Proposals Compared*, 44 BUS. L. 503, 522 (1989) ("The power to hold to account is the power to interfere and, ultimately, the power to decide. If stockholders are given too easy access to courts, the effect is to transfer decisionmaking power from the board to the stockholders . . . .").

> The business judgment rule serves to protect and promote the role of the board as the ultimate manager of the corporation. Because courts are ill equipped to engage in *post hoc* substantive review of business decisions, the business judgment rule "operates to preclude a court from imposing itself unreasonably on the business and affairs of a corporation."[17]

Therefore, unless the plaintiff can raise sufficient doubt that the rule's presumption is inaccurate because a board was disloyal or not sufficiently careful, the rule "prevents a judge or jury from second guessing director decisions."[18] As a result, the business judgment rule overwhelmingly restricts plaintiffs and courts to claims that the process by which the board made its decision was inconsistent with the board's fiduciary duties. With rare exceptions, the rule precludes both plaintiffs and courts from attacking the board's decision itself.[19]

The business judgment rule is powerful not only because it requires the court to defer to the board's decision, but also because of the breadth of the rule's applicability. It is standard for courts to apply the business judgment rule to operational issues. For example, in *In re Walt Disney Co.*

17. *Disney*, 907 A.2d at 746 (citing Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 360 (Del. 1993)); *see also Aronson v. Lewis*, 473 A.2d at 812 ("Absent an abuse of discretion, [the board's] judgment will be respected by the courts."); Reading Co. v. Trailer Train Co., C.A. No. 7422, slip op. at 10 (Del. Ch. Mar. 15, 1984) ("The business judgment rule allows for the possibility that other people might disagree with a board's decision . . . . In the context of our corporate business world, courts should be loathe to interfere with the internal management of corporations or to interfere with their business decisions unless statutory or case law indicates they have overstepped their bounds.").

18. *In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 124 (Del. Ch. 2009).

19. There are a few Delaware cases that state that there is a sliver of room to attack the board's decision under the business judgment rule. *See, e.g.*, Gantler v. Stephens, 965 A.2d 695, 705-06 (Del. 2009) (explaining that under the business judgment rule, a court will not second-guess a board's decision unless it cannot find any rational basis for the decision); Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971) (stating that the board's decision under the business judgment rule will stand unless it "can[not] be attributed to any rational business purpose."); *accord* Parnes v. Bally, 722 A.2d 1243, 1246 (Del. 1999); *see also* Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000) (explaining that "[i]rrationality is the outer limit of the business judgment rule" and "may tend to show that [a] decision is not made in good faith, which is a key ingredient of the business judgment rule") (citation omitted); Todd M. Aman, *Cost-Benefit Analysis of the Business Judgment Rule: A Critique in Light of the Financial Meltdown*, 74 ALB. L. REV. 1, 8 (2010/2011) (reasoning that although plaintiffs can theoretically challenge the substance of the decision, they are limited to proving that the directors committed waste, a test "so difficult to satisfy that many commentators describe it as a judicial refusal to evaluate the substantive merits of a board's decision at all"); Allen et al., *supra* note 2, at 1298 (noting that if the conditions of the business judgment rule are satisfied, "it is as a practical matter impossible that the resulting decision can be found irrational").

Derivative Litigation,[20] the Delaware Supreme Court held that the business judgment rule applied to a board's compensation decisions surrounding the hiring of the corporation's president.[21] Despite a suit by Disney shareholders claiming that the directors breached their fiduciary duties by agreeing to the president's compensation package and highly lucrative severance package, the court applied the business judgment rule to the directors' decisions. Similarly, in *Benihana of Tokyo, Inc. v. Benihana, Inc.*,[22] the Delaware Supreme Court upheld the Court of Chancery's finding that the board's decision to issue additional stock was covered by the business judgment rule despite claims that the issuance was designed to dilute the power of certain shareholders.[23]

Courts, however, have not limited the business judgment rule only to operational issues; courts have also applied the rule to organic changes. For example, in *Paramount Communications v. Time, Inc.*,[24] the Delaware Supreme Court applied the business judgment rule to the Time board's original decision to enter into a merger agreement with Warner Brothers. In reviewing the shareholders' challenge to the board's conduct,[25] the Delaware Supreme Court stated:

> We begin by noting, as did the Chancellor, that our decision does not require us to pass on the wisdom of the board's decision to enter into the original Time-Warner agreement. That is not a court's task. Our task is simply to review the record to determine whether there is sufficient evidence to support the Chancellor's conclusion that the initial Time-Warner agreement was the product of a proper exercise of business judgment . . . . [T]he Time board's decision . . . was entitled to the protection of the business judgment rule.[26]

In addition to applying the business judgment rule both to operational

20. 906 A.2d 27 (Del. 2006).

21. *Id.* at 58.

22. 906 A.2d 114 (Del. 2006).

23. *Id.* at 121–22.

24. 571 A.2d 1140 (Del. 1990); *accord* Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985) (applying the business judgment rule to board's decision to enter into a third-party merger agreement, but finding that the board violated the rule); Van de Walle v. Unimation, Inc., No. 7046, 1991 Del. Ch. LEXIS 27, at *31 (Del. Ch. Mar. 6, 1991) (holding that the merger should be reviewed under the business judgment rule because "in substance and in form the merger was a *bona fide* arm's-length transaction negotiated with a third party").

25. While the court made clear that the business judgment rule governed the Time board's initial merger decision, 571 A.2d at 1142, most of the case involved a challenge to the board's conduct subsequent to the board's initial decision, after Paramount Corporation offered Time shareholders a substantially better deal than they would receive in the proposed Time-Warner merger. *See id.* at 1149-55.

26. *Id.* at 1151-52 (citations omitted).

issues as well as to organic changes, Delaware courts have held that the rule can govern even particularly sensitive issues. One example involved board conduct that had the effect of overturning the results of the shareholders' vote on the election of directors. Although Delaware courts have made clear that they will zealously safeguard shareholder voting rights against board attempts to eviscerate those rights,[27] the Delaware Supreme Court in *City of Westland Police & Fire Retirement System v. Alexis Technologies, Inc.*[28] held, in an en banc decision, that the business judgment rule would apply to the board's decision to enact a policy that instituted majority voting for the election of directors, but gave the board the power to refuse the resignation of any candidate who failed to garner the requisite number of votes.[29] The board then exercised that self-empowered discretion to reject the resignation of the candidates who did not garner majority support from the shareholders.[30] Although the plaintiff charged that a standard higher than the business judgment rule should apply, either because the case involved shareholder voting rights or because the allegedly independent directors were merely protecting their colleagues,[31] the Delaware Supreme Court held that the business judgment rule was the proper governing standard of review.[32]

Thus, the Delaware Supreme Court has given the business judgment rule a wide reach. Delaware courts have applied the business judgment rule to monitor transactions spanning from routine to organic changes, as well as decisions that are both difficult and politically charged. The wide applicability of the business judgment rule thereby generates a plethora of decisions in which the court will defer to the directors' business judgment

27. *See* MM Cos. v. Liquid Audio, 813 A.2d 1118 (Del. 2003) (striking down defensive measure that increased the size of the target's board because the primary purpose of this action was to impede the shareholder vote); Blasius Indus. Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988) (invalidating defensive measure of expanding board size because of its effect of impeding shareholder vote despite finding that directors acted in good faith); *see infra* notes 70-79 and accompanying text (describing courts' heightened scrutiny under the *Blasius* test as a result of concern for shareholder voting rights).

28. 1 A.3d 281 (Del. 2010) (en banc).

29. Specifically, the board enacted a "plurality-plus policy" that (i) required incumbent board candidates up for re-election to submit a resignation conditioned upon failing to receive majority support, (ii) required candidates to be elected by majority, rather than a plurality, of votes, and (iii) gave the board discretionary power to reject or accept resignations tendered by incumbent directors who failed to receive the requisite support. *Id.* at 283.

30. *Id.* at 285–86.

31. *Id.* at 286.

32. *Id.* at 291. While acknowledging that the board's decision to reject the proffered resignations had the effect of overriding the shareholder vote, *id.*, the court held that future shareholders could demand to inspect the corporate books and records to investigate the suitability of directors to continue in office. *Id.* at 289.

as long as plaintiffs are unable to surmount the significant burden of a *prima facie* showing that the board breached its fiduciary duties in the process of making the decision under review. One of the following five tests will apply only if plaintiff has made such a showing[33] or if the court believes that the board has transcended its powers.[34]

B. The Enhanced Business Judgment Rule

As noted above, the business judgment rule does not apply if the board is not disinterested and independent.[35] Thus, once the Delaware Supreme Court accepted target shareholders' claims that hostile tender offers create inherent conflicts for target directors,[36] the court could not apply the business judgment rule to monitor directors' responses to such offers. The Delaware Supreme Court in *Unocal Corp v. Mesa Petroleum Co.*,[37] however, bypassed its traditional conflict monitor, the entire fairness test,[38]

33. *See, e.g.*, Grobow v. Perot, 539 A.2d 180, 187 (Del. 1988) (stating that entire fairness "becomes an issue only if the presumption of the business judgment rule is defeated"); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 185 (Del. 1986) ("No such defensive measure can be sustained when it represents a breach of the directors' fundamental duty of care . . . . In that context the board's action is not entitled to the deference accorded it by the business judgment rule."); 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 corporation and its shareholders, there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred.").

34. *Blasius Indus. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988), *Mentor Graphics Corp. v. Quickturn Design Sys., Inc.*, 728 A.2d 25 (Del. Ch. 1998), and *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914 (Del. 2003) are all cases where at least part of the holding was that the board exceeded its powers. *See infra* notes 78, 236 and accompanying text.

35. *See supra* notes 4–8.

36. *See Unocal*, 493 A.2d at 954 (conceding that that there was "the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders"); *see also* Jennifer J. Johnson & Mary Siegel, *Corporate Mergers: Redefining the Role of Target Directors*, 136 U. PA. L. REV. 315, 324–25 (1987) (arguing that target directors may be motivated to reject an offer because of fear of losing their job and the accompanying power, prestige, and financial rewards).

37. 493 A.2d 946 (Del. 1985).

38. *See* Cede & Co. v. Technicolor, Inc. 634 A.2d 345, 361 (Del. 1993), *modified*, 636 A.2d 956 (Del. 1994) (noting that if a plaintiff rebuts the business judgment rule presumption, the burden shifts to the directors to show entire fairness); Kahn v. Roberts, 1995 Del. Ch. LEXIS 151, at *13-14 (Del. Ch. Dec. 6, 1995) (explaining that, in an interested director transaction, "courts generally will bypass the business judgment rule and conduct an entire fairness analysis on the challenged transaction"); R. FRANKLIN BALOTTI & JESSIE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 4.19B at 4-172 (2011 supp.) ("If the business judgment rule's

and instead created a new standard, which it named the "enhanced business judgment rule," to monitor decisions by target directors to enact defensive tactics when faced with a hostile takeover.[39] Characterizing this new test as an intermediate standard of review,[40] the Delaware Supreme Court explained:

> [T]he omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders, there is an enhanced duty which calls for *judicial examination at the threshold* before the protections of the business judgment rule may be conferred.[41]

Unlike the business judgment rule, which places the initial burden of proof on plaintiffs, this newly-created test requires the target board to bear the burden of showing first, that it acted with "good faith and reasonable investigation" by demonstrating that it had reasonable grounds to believe that the takeover posed a danger to corporate policy and effectiveness,[42] and second, that the defensive measure it chose was "reasonable in relation to the threat posed."[43] This second step must be neither coercive nor preclusive,[44] and the shareholders' option to vote their directors out of office must remain viable.[45] The *Unocal* test purports to lack the deference to the directors' judgment embodied in the business judgment rule because *Unocal* places the burden of proof on the board to show that it both

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presumption is rebutted, the burden shifts to the defendant directors to show the 'entire fairness' of the transaction.").

39. *See* BALOTTI & FINKELSTEIN, *supra* note 38, § 4.20[A] at 4-186 ("*Unocal* applies in change-of-control contexts when a board takes some action that alters, manages, or deters the threatened change of control.").

40. Equity-Linked Investors, L.P. v. Adams, 705 A.2d 1040, 1055 (Del. Ch. 1997) (noting in the *Revlon* context that enhanced business judgment is an "intermediate level of judicial review").

41. *Unocal* at 954 (emphasis added).

42. *Id.* at 955.

43. *Id.* If the board meets the *Unocal* test, the burden switches to the plaintiff to show "by a preponderance of the evidence that the directors' decisions were primarily based on perpetuating themselves in office, or some other breach of fiduciary duty such as fraud, overreaching, lack of good faith, or being uninformed." *Id.* at 958.

44. *See* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1387 (Del. 1995) (describing measures that are either coercive or preclusive as draconian).

45. *See id.* at 1388-89 (requiring proxy contest to remain viable in order for defensive tactic to avoid being preclusive); *Unocal*, 493 A.2d at 959 ("If the stockholders are displeased with the action of their elected representatives, the powers of corporate democracy are at their disposal to turn the board out."); Yucaipa Am. Alliance Fund II, L.P. v. Riggio, C.A. No. 5465-VCS, slip op. at 45 n. 182 (Del. Ch. Aug. 12, 2010) (explaining that the defensive tactic must leave an insurgent with a "fair chance for victory," rather than a "slight possibility of victory" in order for the defensive tactic to avoid being classified as preclusive).

conducted a reasonable process and chose a defensive tactic that is not preclusive, coercive or unreasonable. Thus, there is "judicial examination at the threshold" of the board's process as well as its decision, thereby providing both a subjective and an objective review of the defensive tactic.[46]

C. Revlon

Similarly, Delaware courts have chosen to apply enhanced business judgment[47] when a corporation is in the "*Revlon* mode," a designation the court created in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc*.[48] In *Revlon,* the Delaware Supreme Court held that if the corporation is in the *Revlon* mode, the board's duty changes from the preservation of the corporation to the "maximization of the company's value at a sale for the stockholders' benefit."[49] Since the board must focus solely on maximizing value for its shareholders, it may no longer consider the interests of "other . . . constituencies."[50] Moreover, because "[m]arket forces must be allowed to operate freely to bring the target's shareholders the best price available for their equity,"[51] a board's use of covenants that interfere with the market will be suspect.[52]

Thus, the Delaware Supreme Court invalidated the Revlon board's

46. *Unocal,* 493 A.2d at 954; *In re* Del Monte Foods Co. S'holders Litig., 25 A.3d 813, 830 (Del. Ch. 2011) ("Enhanced scrutiny has both subjective and objective components."); Air Products & Chemicals, Inc. v. Airgas, Inc., 16 A.3d 48 (Del. Ch. Feb. 15, 2011) (stating that the *Unocal* test requires an examination of both the process used to identify the threat and the reasonableness of the resulting decision); eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 30 (Del. Ch. 2010) ("Because of the omnipresent specter that directors could use a rights plan improperly, even when acting *subjectively* in good faith, *Unocal* and its progeny require that this Court also review the use of a rights plan *objectively*."); *see also* Lewis H. Lazarus & Brett M. McCartney, *Standards of Review in Conflict Transactions on Motions to Dismiss: Lessons Learned in the Past Decade*, 36 DEL. J. CORP. L. 967, 973–74 (2011) (stating that enhanced scrutiny has subjective and objective components).

47. Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1288 (Del. 1988) (noting that courts will apply enhanced scrutiny when a corporation is in the *Revlon* mode).

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

49. *Id.* at 182; *see also* Paramount Commc'ns Inc. v. QVC Network Inc. (In re Paramount Commc'ns Inc. S'holders Litig.), 637 A.2d 34, 44 (Del. 1994) ("In the sale of control context, the directors must focus on one primary objective—to secure the transaction offering the best value reasonably available for the stockholders—and they must exercise their fiduciary duties to further that end.").

50. *Revlon*, 506 A.2d at 182.

51. *Id.* at 184.

52. *Id.* at 183-84.

decision to grant a lock-up, cancellation fee, and a no-shop provision to its white knight in the face of a competing bidder because these covenants hindered, rather than promoted, competitive bidding for the target.[53] The Delaware Supreme Court warned future boards that although covenants are not illegal when a corporation is in the *Revlon* mode,[54] covenants are highly disfavored because they normally deter, rather than spur, competitive bidding.[55] While reserving the option to add additional categories to its list of *Revlon* "triggers,"[56] only a few fact patterns currently trigger *Revlon* review.[57]

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53. *Id.* at 184. A lock-up is an option to buy shares or assets of the target company. Jennifer J. Johnson & Mary Siegel, *Corporate Mergers: Redefining the Role of Target Directors*, 136 U. PA. L. REV. 315, 341 n.87 (1987). A cancellation fee provides liquidated damages to the bidder in the event the acquisition fails to close. *Id.* at 341 n.88. A no-shop provision prevents the target from seeking or negotiating with another bidder. *Id.* at 341 n.89. A "white knight" is a friendly acquirer sought by the target company in response to a hostile bidder's tender offer. *Id.* at 341 n.90.

54. *Revlon*, 506 A.2d at 183.

55. *Id.*; *see also* Paramount Commc'ns Inc. v. QVC Network Inc. (*In re* Paramount Commc'ns Inc. S'holders Litig.), 637 A.2d at 49 (Del. 1994) (holding that a no-shop provision impermissibly interfered with the directors' ability to negotiate with another known bidder when the corporation was in the *Revlon* mode); Rand v. W. Airlines, Inc., C.A. No. 8632, 1989 Del. Ch. LEXIS 118, at *10 (Del. Ch. Sept. 11, 1989) (warning that the only auction-ending devices that are permissible when the corporation is in a *Revlon* mode are those that "confer a substantial benefit upon the stockholders").

56. *In re* Smurfit-Stone Container Corp. S'holder Litig., No. 6164-VCP 2011 Del. Ch. LEXIS 79, at *45 (Del. Ch. May 20, 2011) ("The Delaware Supreme Court has determined that a board might find itself faced with [a *Revlon*] duty in at least three scenarios . . . .").

57. *See In re* Santa Fe Pac. Corp. S'holder Litig., 669 A.2d 59, 71 (Del. 1995) (listing the following transactions that will put the corporation in a *Revlon* mode: "(1) when 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") (quoting Arnold v. Soc'y for Sav. Bancorp, Inc., 650 A.2d 1270, 1290 (Del. 1994)) (citations and internal quotation marks omitted). Since the Delaware Supreme Court has yet to draw a clear line for when *Revlon* review would apply to a mixed cash and stock transaction, Delaware courts are working their way through these fact patterns. *See id.* at 70-71 (holding that thirty-three percent cash did not trigger *Revlon* duties); *In re* Smurfit-Stone, 2011 Del Ch. LEXIS 79, at *60 (holding that a merger in which target shareholders would receive half cash, half stock, and ownership of forty-five percent of the combined company, is in in a *Revlon* mode); *In re* Lukens Inc. S'holders Litig., 757 A.2d 720, 732 n.25 (Del. Ch. 1999), *aff'd sub nom*. Walker v. Lukens, Inc., 757 A.2d 1278 (Del. 2000) (suggesting that a merger that provided sixty-two percent of the consideration to target shareholders in cash would be in a *Revlon* mode). *Cf. In re* Synthes, Inc. S'holder Litig., 50 A.3d 1022, 1047-48 (Del. Ch. 2012) (holding that no change of control occurred so as to trip *Revlon* duties where sixty-five percent of the purchase price was paid with the purchaser's publicly-traded stock, making it impossible for the purchaser to have a controlling shareholder); *In re* NYMEX S'holder Litig., C.A. No. 361-VCN,

Delaware courts occasionally bristle, however, at the inference that there are special *Revlon* duties, as they view the directors' obligations in *Revlon* simply as an extension of their fundamental fiduciary duties.[58] Thus, the Delaware Court of Chancery explained that, in a *Revlon* transaction, the court:

> adopts an *intermediate level of judicial review* which recognizes the broad power of the board to make decisions in the process of negotiating and recommending a "sale of control" transaction, so long as the board is informed, motivated by good faith desire to achieve the best available transaction, and proceeds "reasonably[.]"[59]

Since courts will review a board's compliance with its *Revlon* duties under the enhanced business judgment rule, directors bear the burden of proving their compliance with their required duties.[60] As such, courts purport not to defer to the board's judgment under *Revlon*.

D. Entire Fairness

As noted above,[61] since the business judgment rule requires directors to be disinterested, a finding of self-interest makes the business judgment rule inapplicable. In situations involving a conflict of interest, courts

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3835-VCN, 2009 WL 3206051, at *5-7 (Del. Ch. Sept. 30, 2009) (dismissing shareholder challenge to merger and finding transaction adequate that offered shareholders thirty-six percent cash at the time of the merger, and forty-four percent cash at the closing of the merger, but declining to rule squarely on whether the corporation was in a *Revlon* mode).

58. Arnold v. Soc'y for Sav. Bancorp, Inc., 650 A.2d 1270, 1289 n.40 (Del. 1994) (describing "*Revlon* duties" as "colloquial[]" and "inappropriate[]"); Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989) (stating that *Revlon* duties mean simply that "directors must act in accordance with their fundamental duties of care and loyalty").

59. Equity-Linked Investors, L.P. v. Adams, 705 A.2d 1040, 1055 (Del. Ch. 1997).

60. *See* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993), *modified*, 636 A.2d 956 (Del. 1994) ("[I]n the review of a transaction involving a sale of a company, the directors have the burden of establishing that the price offered was the highest value reasonably available under the circumstances."); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954-55 (Del. 1985) (noting that when a court applies enhanced business judgment, the board bears the burden of proof); *see also supra* text accompanying notes 42–43 (explaining that the burden of proof is on the board of directors).

61. *See supra* notes 4, 6–8 and accompanying text (defining independence and its relationship to the duty of loyalty); *see also* Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 64 (Del. 1989) ("The burden falls upon the proponent of a claim to rebut the presumption [of the business judgment rule] by introducing evidence either of director self-interest, if not self-dealing, or that the directors either lacked good faith or failed to exercise due care.").

typically utilize the entire fairness test.[62] *Weinberger v. UOP, Inc.*,[63] a case involving a controlling-shareholder cash-out merger, provides, perhaps, the most often cited description of the entire fairness test. In *Weinberger*, the Delaware Supreme Court held that since the controlling shareholder controlled both sides of the merger, the target corporation was required to prove the entire fairness of the transaction.[64] The court explained that its examination would be thorough, encompassing a review of every feature of the board's conduct to determine whether it had engaged in fair dealing and had offered a fair price,[65] but warned that "[a]ll aspects of the issue must be examined as a whole since the question is one of entire fairness."[66] Thus, *Weinberger* put defendants on notice that they bear the burden of proving any factor that the court considers probative of the transaction's fairness.[67]

Following *Weinberger*, Delaware courts have repeatedly warned that the entire fairness test requires a court to conduct a searching and pervasive inquiry.[68] In fact, given the difficulty of the test, some judges consider the decision to apply the entire fairness test to be almost outcome determinative.[69] As such, the entire fairness test is the epitome of judicial

62. *See supra* note 38 (establishing that the entire fairness test is the usual test applied when directors are not disinterested).

63. 457 A.2d 701 (Del. 1983).

64. *Id.* at 710.

65. The Delaware Supreme Court in *Weinberger* defined fair dealing as involving "questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained," and fair price "relates to the economic and financial considerations" of the transaction. *Id.* at 711.

66. *Id.*; Lonergan v. EPE Holdings LLC, 5 A.3d 1008, 1020 (Del. Ch. 2010) ("[A] Delaware Court 'determines entire fairness based on all aspects of the entire transaction.'") (quoting Valeant Pharms. Int'l v. Jerney, 921 A.2d 732, 746 (Del. Ch. 2007)).

67. *Weinberger*, 457 A.2d at 710 (Del. 1983) ("The requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts.").

68. *See, e.g.*, *In re* Digex, Inc. S'holders Litig., 789 A.2d 1176, 1207 (Del. Ch. 2000) (noting the "careful scrutiny" required under entire fairness review); Linton v. Everett, No. 15219, 1997 Del. Ch. LEXIS 117, at *17 (Del. Ch. July 31, 1997) (holding that issuance by directors of shares to themselves did not satisfy the "rigorous standard" of entire fairness); *see also* 1 R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS 4-172, § 4.19[B][A] (Supp. 2012) (describing the "heavy burden" of showing entire fairness); RADIN, *supra* note 4, at 65 (noting that the "fairness requirement entails 'exacting scrutiny to determine whether the transaction is entirely fair to the stockholders'") (quoting Paramount Commc'ns Inc. v. QVC Network Inc. (*In* re Paramount Commc'ns Inc. S'holders Litig.), 637 A.2d 34, 42 n.9 (Del. 1994)).

69. Reis v. Hazelett Strip-Casting Corp., 28 A.3d 442, 459 (Del. Ch. 2011) ("Entire fairness is Delaware's most onerous standard."); Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1371 (Del. 1995) (noting that the standard of review under which directors' actions

review.

E. Blasius

Unlike the previous three tests, the *Blasius* test—created in *Blasius Industries v. Atlas Corporation*[70] and affirmed by the Delaware Supreme Court in *MM Cos. v. Liquid Auto*[71]—is tripped by a board's improper purpose. This doctrine states that if the plaintiff establishes that the board acted for the primary purpose of thwarting the exercise of the shareholder vote for the election of directors, the board must demonstrate a compelling justification for its actions.[72] In *Blasius*, the board attempted to thwart the shareholder vote by expanding the number of directors, which had the effect of preventing insurgents from gaining control of the board.[73] Although finding that the board had acted with good faith and care, and that the directors had good cause to be concerned about the insurgent's plan to take over the corporation, the Court of Chancery nevertheless found that the board had acted primarily to thwart the exercise of the shareholder vote.[74] Since the board could offer no compelling purpose for its actions, the court held that the directors had committed an "unintended violation of the duty of loyalty" and had acted outside the scope of their authority.[75]

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are evaluated is generally outcome determinative given the strength of the business judgment rule presumption and the scrutiny employed under the entire fairness standard); AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 111 (Del. Ch. 1986) ("Because the effect of the proper invocation of the business judgment rule is so powerful and the standard of entire fairness so exacting, the determination of the appropriate standard of judicial review frequently is determinative of the outcome of derivative litigation."). There are, of course, some cases in which defendants have proven the entire fairness of their decision. *See, e.g.*, Nixon v. Blackwell, 626 A.2d 1366 (Del. 1993) (holding that the board met its burden of proving its decision to have corporation repurchase stock of employee-shareholders, but not of non-employee shareholders, to be entirely fair).

70. 564 A.2d 651 (Del. Ch. 1988).

71. 813 A.2d 1118, 1132 (Del. 2003).

72. *Blasius*, 564 A.2d at 661–62; *see also*, *In re* Gen. Motors (Hughes) S'holder Litig., C.A. No. 20269, slip op. at 32 (Del. Ch. May 4, 2005), *aff'd*, 897 A.2d 162 (Del. 2006) (holding that the plaintiff has two burdens under *Blasius*: showing the board's primary purpose and the thwarting of the franchise); Nevins v. Bryan, 885 A.2d 233, 352 (Del. Ch. 2005), *aff'd*, 884 A.2d 512 (Del. 2005) (holding that the plaintiff must show both elements under *Blasius*).

73. 564 A.2d at 657–58. Blasius sought to enjoin the Atlas board's decision to add two new directors to its seven-member board. *Id.* at 652. Blasius claimed that the Atlas board expanded its membership in order to thwart Blasius' efforts to gain control of the board. *Id.* at 657–58.

74. *Id.* at 663.

75. *Id.* ("A majority of the shareholders . . . could view the matter differently than did the board. If they do, or did, they are entitled to . . . advance that view. They are also

The Court of Chancery's analysis in *Blasius* exposes the uncompromising nature of the compelling purpose requirement. The court first considered whether such board conduct should be per se illegal.[76] Instead, the Delaware Chancery Court settled for a slightly lesser standard and held that the board must demonstrate a compelling reason for its actions. The mere fact that the court considered making such board conduct *per se* illegal, however, highlights the skepticism with which the court will consider a board's proffered reason for its actions. Moreover, the court held that the board's good faith and due care are irrelevant in the analysis of whether they had a compelling justification for their conduct.[77]

Similarly, the court's logic for creating the *Blasius* test provides further evidence that judicial review under this test will be demanding. The court held that the board should not be able to monitor whom the shareholders elect to the board as the power to elect directors is outside of the province of the board's power.[78] Moreover, the court reasoned that the integrity of the shareholder vote merited special consideration because that vote legitimizes director control over corporate power.[79] Both of these reasons provide justification for courts to scrutinize the board's behavior carefully in order to keep the board from encroaching on the shareholders' domain.

The trigger for applying the *Blasius* doctrine explains why courts will not defer to directors under this test: Any board that acts primarily to thwart the vote of its shareholders is itself acting outside the scope of its powers. Such claims of board overreaching would not permit courts, by definition, to defer to the board. Moreover, only courts can evaluate whether a board has offered a compelling justification for its conduct.

F. Schnell

The final test, the *Schnell* doctrine, is the antithesis of the business judgment rule because the doctrine permits courts to invalidate a board's decision without first faulting the board's decision-making. In *Schnell v. Chris-Craft Industries, Inc.*,[80] corporate directors moved the date and

entitled . . . to restrain . . . the board, from acting for the principal purpose of thwarting that action.").

76. *Id.* at 662.

77. *Id.* at 660–61; *see also In re* MONY Group, Inc. S'holder Litig., 853 A.2d 661, 674 (Del. Ch. 2004) (noting that under *Blasius*, a board's good faith is irrelevant).

78. *Blasius*, 564 A.2d at 659.

79. *Id.*

80. 285 A.2d 437 (Del. 1971).

location of the corporation's annual meeting in an effort to thwart insurgent shareholders' proxy fight.[81] Although the Delaware Chancery Court upheld the board's conduct as being in full compliance with the statute and the corporation's charter,[82] the Delaware Supreme Court reversed, articulating what became known as the "*Schnell* doctrine": "[I]nequitable action does not become permissible simply because it is legally possible."[83] The Delaware Supreme Court found the board's conduct was inequitable because the directors purposefully manipulated the electoral machinery so as to entrench themselves in power.[84] As such, the court held that the board's conduct was per se illegal. Most,[85] but not all,[86] cases where the court has applied this doctrine have involved board attempts to frustrate the shareholder vote.

Thus, applicability of the *Schnell* doctrine requires a court to conclude that although the board acted legally, its decision was inequitable. Both components of this test make it impossible for a judge to defer to the board: Only a judge can determine if a board has acted legally, and only a judge can exercise a court's equitable powers to invalidate inequitable conduct.

G. Summary

In sum, Delaware courts have stated that judicial deference is warranted only under the business judgment rule and have also created the impression that the other five tests require extensive judicial review. The courts have created this impression by placing the burden on the board to

81. Chris-Craft's directors moved the meeting date from January 11, 1972, to December 8, 1971, thereby giving the insurgents less time to prepare and solicit proxies, and moved the location of the meeting to Cortland, New York in hopes that this location would be inconvenient and thus would deter shareholders from attending the meeting. Schnell v. Chris-Craft Indus., Inc., 285 A.2d 430, 432–34 (Del. Ch. 1971), *rev'd*, 285 A.2d 437 (Del. 1971).

82. *Id.* at 437.

83. *Id*. at 439.

84. *Id.*

85. Since *Schnell* was decided, only thirteen other cases have been decided using this doctrine. Of these thirteen cases, eleven relate to a voting issue. *See infra* note 191 (listing all 13 cases).

86. The two cases that did not relate to shareholder voting were *Hollinger Int'l v. Black*, 844 A.2d 1022, 1080–81 (Del. Ch. 2004) (citing *Frantz Manufacturing Co. v. EAC Industries*, 501 A.2d 401 (Del. 1985) to show that *Schnell* is applicable to bylaw amendments and then striking down bylaw amendments as inequitable) and *Seagraves v. Urstadt Property Co.*, C.A. No. 10307, 1989 Del Ch. LEXIS 155 (Del. Ch. Nov. 13, 1989) (refusing to dismiss a complaint regarding delisting of shares and nonpayment of dividends because of the potential for equitable relief under *Schnell*).

prove to the court's satisfaction the respective requirements of the *Unocal*, *Revlon*, and entire fairness tests. Similarly, only courts can determine if boards trigger and ultimately pass the requirements of *Blasius* and *Schnell*. As a result, Delaware courts have implied that they often review board decisions. As Part II of this Article delineates, however, there is more lurking behind these five tests than is superficially apparent.

II. PEELING BACK THE TESTS

A. *Enhanced Business Judgment:* Unocal

Pursuant to the enhanced business judgment test, the board loses its presumption of propriety and instead bears the burden of convincing the court that the directors have fulfilled their fiduciary duties both in identifying and in their reaction to their perceived threat to corporate policy. As noted above,[87] the court professes to examine both the board's process and its decision under this enhanced test. Underneath this veneer of judicial review, however, is convincing evidence that Delaware courts, in reality, heavily defer to the decision of the target directors.

The most obvious evidence that Delaware courts normally defer to the board under the enhanced business judgment rule is that the Delaware Supreme Court explicitly said that it would be particularly inclined to defer to the directors' decision to employ defensive tactics if a majority of independent directors made the decision.[88] The Court of Chancery recently explained the logic of diluting the board's burden if the decision was made by a majority of independent directors:

Under *Unocal*, where the defensive actions were taken by "a

87. *See supra* notes 42-46 and accompanying text.

88. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) (citations omitted) ("In the face of this inherent conflict directors must show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed because of another person's stock ownership. However, they satisfy that burden 'by showing good faith and reasonable investigation . . . .' Furthermore, such proof is materially enhanced, as here, by the approval of a board comprised of a majority of outside independent directors who have acted in accordance with the foregoing standards."); *see also* Paramount Commc'ns, Inc. v. Time, Inc., 571 A.2d 1140, 1154 (Del. 1989) ("The evidence supporting this finding is materially enhanced by the fact that twelve of Time's sixteen board members were outside independent directors."); *cf. Revlon*, 506 A.2d at 177, n.3 (rejecting the idea of deferring to the board because a majority of directors lacked independence); Grand Metro., PLC v. Pillsbury Co., 558 A.2d 1049, 1056 (Del. Ch. 1988) ("If a majority of the board consisted of 'outside, independent directors,' their 'proof' as to the *Unocal* requirements . . . is 'materially enhanced.'"); *see infra* note 113.

> majority of outside independent directors," proof of the board's good faith and reasonable investigation is "materially enhanced." Furthermore, the presence of a majority of outside directors, coupled with a showing of reliance on advice by legal and financial advisors, "constitutes a prima facie showing of good faith and reasonable investigation." . . . The rationale behind materially enhancing the proof of good faith and reasonableness of those decisions made by a majority of outside independent directors is directly related to the primary concern that enhanced scrutiny under *Unocal* is designed to address: that a board might adopt defensive measures simply to retain control, whether or not those measures are in the best interest of shareholders. Where decisions are made by outside independent directors instead of members of management who have a presumptive desire to retain their employment, the concern that the board's decisions are tainted by self-serving motives is mitigated, and there naturally follows a greater presumption of good faith and reasonable investigation. This is the essence of the material enhancement rubric in *Unocal* and its progeny.[89]

More subtle evidence that Delaware courts applying the enhanced business judgment test are more deferential to a board than they admit exists as well.

The first bit of evidence is that the Delaware Supreme Court chose to create a new test rather than dip into its existing arsenal of tests to monitor this conflict of interest. In other words, having accepted shareholder contentions that the business judgment rule was inapplicable because directors faced a conflict of interest, the court could have resorted to its traditional monitor for conflict issues, namely, the entire fairness test.[90] In the context of defensive tactics, the entire fairness test would require the court to analyze whether it was fair for the board to engage in a defensive tactic regardless of whether the process surrounding the employment of the tactic was, itself, fair. As Professor Gilson persuasively argued:

> Applying a fairness standard to this decision, however, requires a court to determine whether it was "fair" for control to remain with management rather than shift to the offeror. And this inquiry must necessarily focus on whether the shareholders would be better off with existing management or by selling their shares.[91]

Thus, the Delaware Supreme Court in *Unocal* shied away from

89. Selectica, Inc. v. Versata Enters., Inc., C.A. No. 4241-VCN, 2010 Del. Ch. LEXIS 39, at *43-44, *50-51 (Del. Ch. Mar. 1, 2010), *aff'd*, 5 A.3d 586 (Del. 2010).

90. *See supra* note 38, 64 and accompanying text.

91. Ronald J. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 827 (1981).

requiring target directors to prove that their conduct was entirely fair, as that test would have required the court to evaluate the management of both the target and the offeror to determine whether the target board's decision to employ any defensive tactic was merited. Instead, the Delaware Supreme Court created a new test, the enhanced business judgment rule, with a completely different focus from the entire fairness test. Instead of bearing the enormous burden of proving that it was fair for them to engage in defensive tactics because they had a better plan than did the offeror, target directors under this newly-created test must prove merely that they complied with their fiduciary duties.[92]

Second, while conceding that directors have a conflict of interest, the court nevertheless crafted in *Unocal* a test that is exceedingly deferential to directors. Although forty-seven cases have been decided under *Unocal*,[93]

92. The first prong of *Unocal* requires the board to show good faith and reasonable investigation to identify the threat to corporate policy, which requires care and good faith. The second prong of *Unocal* requires the board to respond proportionately to the threat posed, and to do so with due care. *See* Johnson & Siegel, *supra* note 53, at 330–37 (1987) (describing the two prongs of the *Unocal* test).

93. These forty-seven cases are: Versata Enters., Inc. v. Selectica, Inc., 5 A.3d 586 (Del. 2010); Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914 (Del. 2003); *In re* Santa Fe Pac. Corp. S'holder Litig., 669 A.2d 59 (Del. 1995); Unitrin, Inc. v. Am. Gen. Corp. (*In re* Unitrin, Inc. S'holders Litig.), 651 A.2d 1361 (Del. 1995); Gilbert v. El Paso Co., 575 A.2d 1131 (Del. 1990); Paramount Commc'ns, Inc. v. Time, Inc., 571 A.2d 1140 (Del. 1990); Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53 (Del. 1989); Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261 (Del. 1988); Polk v. Good, 507 A.2d 531 (Del. 1986); Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985); Frantz Mfg. Co. v. EAC Indus., 501 A.2d 401 (Del. 1985); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985); *In re* Openlane, Inc. S'holders Litig., C.A. No. 6849-VCN, 2011 Del. Ch. LEXIS 156 (Del. Ch. Sept. 30, 2011); Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48 (Del. Ch. 2011); Reis v. Hazelett Strip-Casting Corp., 28 A.3d 442 (Del. Ch. 2011); eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1 (Del. Ch. 2010); *In re* Dollar Thrifty S'holder Litig., 14 A.3d 573 (Del. Ch. 2010); Yucaipa Am. Alliance Fund II, L.P. v. Riggio, 1 A.3d 310 (Del. Ch. 2010); Perlegos v. Atmel Corp., C.A. Nos. 2320-N, 2321-N, 2007 Del. Ch. LEXIS 25 (Del. Ch. Feb. 8, 2007); Black v. Hollinger Int'l Inc., 872 A.2d 559 (Del. Ch. 2005); Orman v. Cullman, C.A. No. 18039, 2004 Del. Ch. LEXIS 150 (Del. Ch. Oct. 20, 2004); Aquila, Inc. v. Quanta Servs., 805 A.2d 196 (Del. Ch. 2002); Hills Stores Co. v. Bozic, 769 A.2d 88 (Del. Ch. 2000); Chesapeake Corp. v. Shore, 771 A.2d 293 (Del. Ch. 2000); *In re* Gaylord Container Corp. S'holders Litig., 753 A.2d 462 (Del. Ch. 2000); *In re* Lukens Inc., S'holders Litig., 757 A.2d 720 (Del. Ch. 1999); NiSource Capital Mkts., Inc. v. Columbia Energy Grp., C.A. No. 17341, 1999 Del. Ch. LEXIS 198 (Del. Ch. Sept. 24, 1999); *In re* Dairy Mart Convenience Stores, Inc., C.A. No. 14713, 1999 Del. Ch. LEXIS 94 (Del. Ch. May 24, 1999); Carmody v. Toll Bros., 723 A.2d 1180 (Del. Ch. 1998); H.F. Ahmanson & Co. v. Great W. Fin. Corp., Civil Action No. 15650, 1997 Del. Ch. LEXIS 84 (Del. Ch. June 3, 1997); Wells Fargo & Co. v. First Interstate Bancorp., C.A. No. 14623, 1996 Del. Ch. LEXIS 3 (Del. Ch. Jan. 18, 1996); Kidsco Inc. v. Dinsmore, 674 A.2d 483 (Del. Ch. 1995); Grover v. Simmons (*In re* Sea-Land Corp. S'holders Litig.), 642 A.2d 792 (Del. Ch. 1993); Yanow v. Scientific Leasing, Inc., C. A. Nos. 9536, 9561, 1991 Del. Ch.

only one has failed *Unocal*'s first step,[94] and only nine have failed *Unocal*'s second step,[95] producing a total failure rate of only twenty-one percent,[96] or

LEXIS 134 (Del. Ch. July 31, 1991); Stahl v. Apple Bancorp, Inc., 579 A.2d 1115 (Del. Ch. 1990); Tomczk v. Morton Thiokol, Inc., C.A. No. 7861, 1990 Del. Ch. LEXIS 47 (Del. Ch. Apr. 5, 1990); *In re* DeSoto, Inc. S'holder Litig., C.A. Nos. 11221, 11222, 1990 Del. Ch. LEXIS 15 (Del. Ch. Feb 5, 1990); *In re* Holly Farms Corp. S'holders Litig., 564 A.2d 342 (Del. Ch. 1989); Shamrock Holdings, Inc. v. Polaroid Corp., 559 A.2d 278 (Del. Ch. 1989); *Grand Metro. Pub. Ltd.*, 558 A.2d 1049; City Capital Assocs. Ltd. P'ship v. Interco, Inc., 551 A.2d 787 (Del. Ch. 1988); Robert M. Bass Grp., Inc. v. Evans, 552 A.2d 1227 (Del. Ch. 1988); Henley Grp. Inc. v. Santa Fe S. Pac. Corp., C.A. No. 9569, 1988 Del. Ch. LEXIS 32 (Del. Ch. Mar. 11, 1988); Ivanhoe Partners v. Newmont Mining Corp., 533 A.2d 585 (Del. Ch. 1987); Phillips v. Insituform of N. Am., Inc., C.A. No. 9173, 1987 Del. Ch. LEXIS 474 (Del. Ch. Aug. 27, 1987); AC Acquisitions v. Anderson, Clayton, & Co., 519 A.2d 103 (Del. Ch. 1986); MacAndrews & Forbes Holdings, Inc. v. Revlon, Inc., 501 A.2d 1239 (Del. Ch. 1985). *Cf.* Mentor Graphics Corp. v. Quickturn Design Sys., Inc., 728 A.2d 25 (Del. Ch. 1998) (invalidating defensive tactic under *Unocal*), *aff'd on other grounds*, 721 A.2d 1281 (Del. 1998); Mercier v. Inter-Tel (Del.), Inc., 929 A.2d 786 (Del. Ch. 2007) (suggesting that *Unocal* would be a better structure than *Blasius* for reviewing case).

94. *eBay Domestic Holdings, Inc.,* 16 A.3d 1.

95. *Omnicare, Inc.*, 818 A.2d 914 (finding that the lack of a fiduciary out impermissibly locked up the deal, making the defensive measures preclusive and coercive, and therefore, a violation of *Unocal*); *In re Santa Fe Pac. Corp. S'holder Litig.*, 669 A.2d 59 (finding the use of a poison pill in a discriminatory manner and authorizing a repurchase program were unreasonable responses in relation to the threat posed, and therefore a violation of *Unocal*); *Frantz Mfg. Co.*, 501 A.2d 401 (holding that funding an ESOP in an unauthorized manner was done with the purpose of perpetuating the board's control over the company, and therefore was an unreasonable response that violated *Unocal*); *Chesapeake Corp.*, 771 A.2d 293 (finding a violation of *Unocal* through the use of a supermajority bylaw, which the court found was a preclusive and unjustified impairment of the stockholder franchise); *Carmody*, 723 A.2d 1180 (finding that the board's unilateral adoption of a dead hand provision was done for entrenchment purposes, and was a preclusive and disproportionate defensive response in violation of *Unocal*); *Grand Metro. Pub. Ltd.*, 558 A.2d 1049 (concluding the directors' decision to keep the poison pill in place was not reasonable in relationship to any threat posed, thereby constituting a violation of *Unocal*); *City Capital Assocs. Ltd. P'ship*, 551 A.2d 787 (finding that the board's determination to leave the stock rights in effect was a defensive step that, in the circumstances of the offer and at the stage of the contest for control, was not a reasonable response to the threat posed and thus violated *Unocal*); *Robert M. Bass Grp., Inc.*, 552 A.2d 1227 (finding defensive tactic failed *Unocal* because plaintiffs demonstrated that restructuring was an unreasonable and disproportionate antitakeover response); *AC Acquisitions Corp*, 519 A.2d 103 (stating that it was not reasonable in relation to the threat to structure an equity option for shareholders that precluded them from accepting the hostile offer). Three other cases deserve mention: *MM Cos. v. Liquid Audio, Inc.*, 813 A.2d 1118 (Del. 2003), which found that an independent board failed the *Blasius* test within the *Unocal* framework; *Quickturn Design Systems, Inc.*, 728 A.2d 25, *aff'd on other grounds,* 721 A.2d 1281, which found that an otherwise independent board violated *Unocal*, and while the Delaware Supreme Court faulted the board's conduct, the Supreme Court's holding was on grounds other than a *Unocal* violation; and *Robert M. Bass Grp., Inc*., 552 A.2d 1227, *rev'd*, 559 A.2d 1261 (Del. 1989), which found that a board's defensive tactic failed *Unoca*l, whereupon the board abandoned that failed defensive tactic and instituted a different plan,

a success rate of seventy-nine percent. This seventy-nine percent success rate is itself revealing of the courts' deference, given that *Unocal* requires the board to bear the burden of proof and whoever has that burden is supposed to be more likely to lose.[97] Moreover, of the thirty-seven cases that passed *Unocal*, thirty-one had boards with a majority of independent directors, two did not, and courts in four cases did not provide this information.[98] Directors' seventy-nine percent success rate under *Unocal* increased to a minimum of eighty-four percent when they had independent boards.[99] These numbers demonstrate that courts engaging in a *Unocal* review defer heavily to independent boards.

Further analysis of the ten cases that failed *Unocal* shows that one of these cases did not identify the composition of the board,[100] five involved

which the Delaware Supreme Court held warranted review under *Revlon*, not *Unocal*; ultimately the board failed the *Revlon* test.

96. This twenty-one percent failure rate is similar to the results obtained by analyzing the number of opinions, rather than the number of cases, decided under *Unocal*. There are fifty-nine opinions from the Delaware Court of Chancery and Supreme Court, and only eleven of these opinions held that the board violated its *Unocal* duties—a failure rate of eighteen percent.

97. *See, e.g.*, Stephen Ferrey, *The Toxic Time Bomb: Municipal Liability for the Cleanup of Hazardous Waste*, 57 GEO. WASH. L. REV. 197, 277 (1988) (contending that "[w]hichever side . . . ultimately inherits the final burden of proof is likely to lose in any legal confrontation"); Janene R. Finley & Allan Karnes, *An Empirical Study of the Change in the Burden of Proof in the United States Tax Court*, 6 PITT. TAX REV. 61, 66 (2008) ("If all things are equal in a case, the party who would win is the one who does not have the burden of proof."); David McGowan, *Copyright Nonconsequentialism*, 69 MO. L. REV. 1, 2 (2004) ("[T]he legal endgame is to place the burden of proof on the other side. Whoever has to prove the unprovable facts is likely to lose."); Lawrence B. Solum, *Presumptions and Transcendentalism: You Prove It! Why Should I?*, 17 HARV. J.L. & PUB. POL'Y 691, 700 (1994) ("If we presume the evidence was damaging to the [defendant], then the [defendant] . . . is likely to lose. If we place the burden on the other party . . . , then it is unlikely to be able to meet that burden.").

98. Of the thirty-seven cases that passed *Unocal*, *Reis* and *Phillips* were the only two that did not have independent boards. The courts in the following four cases did not identify whether or not the board was independent: *Orman*, 2004 Del. Ch. LEXIS 140; *NiSource Capital Mkts, Inc.*, 1999 Del. Ch. LEXIS 198; *Wells Fargo & Co.*, 1995 Del. Ch. LEXIS 3; and *In re Holly Farms Corp. S'holders Litig.*, 564 A.2d 342. The court noted in the remaining thirty-one cases that the majority of the board was independent. *But see Yucaipa Am. Alliance Fund II, L.P.*, 1 A.3d at 346 n.214, (refusing to defer to a board with a majority of independent directors because the board had only a "bare majority of independent directors" who "never engaged in any separate deliberations" without the other directors and where some of the advisors to the board were not independent).

99. The minimum success rate of eighty-four percent derives from the fact that while thirty-one of the thirty-seven cases that passed *Unocal* had independent boards, courts in four other cases where boards passed this test did not identify whether the board was independent. *See supra* text at note 98 (listing cases in which the board passed the Unocal test but the court did not identify whether the board was independent).

100. *In re Santa Fe Pac. Corp. S'holder Litig.*, 669 A.2d 59.

corporations where the majority of directors were not independent,[101] and four were independent.[102] Three of these four cases where an independent board failed its *Unocal* duties involved boards adopting defensive tactics that the court found to be draconian,[103] and one of these cases resulted from the Court of Chancery's conclusion that the board's decision to keep a poison pill in place in the face of a viable tender offer that posed no threat to the corporation was unreasonable.[104] In other words, these independent boards engaged in extreme or unreasonable conduct.

This analysis demonstrates that not only are boards highly successful (seventy-nine percent) under *Unocal*, but boards consisting of a majority of

101. Frantz Mfg. Co. v. EAC Indus., 501 A.2d 401 (Del. 1985); eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1 (Del. Ch. 2010); Chesapeake Corp. v. Shore, 771 A.2d 293 (Del. Ch. 2000); City Capital Assocs. Ltd. P'ship v. Interco Inc., 551 A.2d 787 (Del. Ch. 1988); and AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103 (Del. Ch. 1986).

102. *See* Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914 (Del. 2003); Carmody v. Toll Bros., 723 A.2d 1180 (Del. Ch. 1998); Grand Metro. Pub. Ltd. v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988); Robert M. Bass Grp., Inc. v. Evans, 552 A.2d 1227 (Del. Ch. 1988). *Cf. supra* note 93 (discussing Mentor Graphics Corp. v. Quickturn Design Sys. Inc., 728 A.2d 25 (Del. Ch. 1998); MM Cos. v. Liquid Audio, Inc., 813 A.2d 1118 (Del. 2003); *Robert M. Bass Grp. Inc.*, 552 A.2d 1227).

103. *Omnicare, Inc.*, 818 A.2d 914; *Carmody*, 723 A.2d 1180; *Robert M. Bass Grp., Inc.*, 552 A.2d 1227. Each of these three cases deserves some explanation. In *Bass*, the board abandoned the defensive tactic that failed *Unocal*, and instituted a different plan, which the Delaware Supreme Court held warranted review under *Revlon*, not *Unocal*; the board failed the *Revlon* test. *Robert M. Bass Grp., Inc.*, 552 A.2d 1227. In *Carmody*, the chancery court held that a "dead hand" provision is coercive, and therefore draconian, when it prohibits newly elected directors from implementing a pill. *Carmody*, 723 A.2d at 1195. The court reasoned that such a provision makes a proxy contest 'realistically unattainable.' *Id.* In *Quickturn*, the Delaware Supreme Court invalidated a diluted version of the *Carmody* pill, namely, a delayed-redemption pill, on grounds that even the diluted version of the poison pill exceeded the scope of the board's authority under section 141(a). *Quickturn Design Sys. Inc.*, 721 A.2d 1281. Finally, it is questionable whether *Omnicare* should have even been decided under *Unocal*, rather than under the business judgment rule. As the dissent points out, this case should have been decided under the business judgment rule, not under *Unocal*, because the merger covenants were not defensive; rather than running from a hostile tender offer, the target board openly solicited offers, and tied up the one and only firm offer it received. *Omnicare, Inc. v. NCS*, 818 A.2d at 940-946 (Veasy, J., dissenting); *see also infra* note 233 (questioning whether *Omnicare* should have been decided under *Unocal*). Second, the reason that the majority of the Delaware Supreme Court held it was a violation of the second prong of *Unocal* was that it is preclusive to lock up a deal without a fiduciary out. *Omnicare, Inc.*, 818 A.2d at 918. Although the majority did not label its holding as a "new rule of law," the dissent, written by Chief Justice Veasey, characterizes this requirement for a fiduciary out as a new rule. *Omnicare, Inc.*, 818 A.2d at 940–46 (Veasy, J., dissenting); *see also infra* notes 242–43 and accompanying text (expanding upon the *Unocal* majority's requirement of a fiduciary out).

104. *Grand Metro. Pub. Ltd. Co.*, 558 A.2d at 1060 (reasoning that the board's decision to keep the poison pill in place was preclusive and not proportional to the threat posed).

independent directors are almost guaranteed to win: Only four independent boards have failed *Unocal*. Faced with the choice of making a difficult decision itself or relying instead on the board—particularly one with a majority of independent directors—the Delaware Supreme Court has chosen, in reality, to rely on target directors. Despite professed concern about the board's conflict of interest when it faces a hostile tender offer, the Delaware Supreme Court created a monitor that tacitly lets boards enact all but the most extreme defensive tactics. Thus, the enhanced business judgment test leaves a concededly conflicted board in charge of deciding whether and how to fight the tender offer, limited only by those actions that a court would classify as preclusive, coercive, or unreasonable. Tellingly, the Delaware Supreme Court has chided the Court of Chancery for invalidating defensive tactics that were merely "unnecessary."[105]

Before leaving *Unocal* and the enhanced business judgment test, two points are worth noting. One is that the Delaware Supreme Court in *Unocal* chose to permit target boards to enact defensive tactics, allegedly under judicial supervision. The Delaware Supreme Court, however, had an entirely different option, which it rejected: The court could have held that boards may not enact defensive tactics at all. Such a holding would have let the market decide the target's fate by allowing bidders unfettered access to target shareholders.[106] Reliance on the market is, in fact, one monitor the court subsequently chose for the *Revlon* test.[107]

Second, while the court's main reliance in *Unocal* was on the independent directors, the court backstopped that reliance with a safety valve: The defensive tactic cannot preclude shareholder voting rights, so that shareholders unhappy with their directors' defensive tactics can vote those directors out of office.[108] Since all shares, rather than just

105. Unitrin, Inc. v. Am. Gen. Corp. (*In re* Unitrin, Inc. S'holders Litig.), 651 A.2d 1361, 1385–86 (Del. 1995) (quoting Unitrin, Inc. v. Am. Gen. Corp. (*In re* Unitrin, Inc. S'holders Litig.), C.A. Nos. 13656, 13699, 1994 Del. Ch. LEXIS 187, *32 (Del. Ch. 1994)).

106. In *Unocal*, had the court precluded boards from engaging in any defensive tactics, the market would have determined the success or failure of the tender offer. Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1164, 1182–83 (1981) (arguing that, when faced with a tender offer, shareholder welfare is maximized when management is passive so that shareholders can decide the sufficiency of the market's offer); Ronald J. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 846, 865–67 (1981) (arguing that defensive tactics to tender offers are inappropriate because they interrupt the target shareholders' ability to freely consider whether to hold or sell their stock on the market).

107. *See infra* notes 118–28 and accompanying text (discussing *Revlon*'s requirement that directors engage the market as a means of assuring a fair transaction price).

108. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) ("If the stockholders are displeased with the action of their elected representatives, the powers of

disinterested ones, can vote in an election of directors, and since such a vote will occur after the directors have enacted their defensive tactics, this vote provides only indirect control over a board's response to a hostile tender offer.[109]

In sum, the enhanced business judgment test, as developed and applied in *Unocal*, has been little more than a paper tiger. Delaware courts have permitted boards—especially independent ones—to enact all but the most egregious defensive tactics under the veneer of judicial review.

B. Revlon

The Delaware Supreme Court held that if the corporation is in a "*Revlon* mode,"[110] the court will apply enhanced business judgment[111] to evaluate the board's efforts to achieve "maximization of the company's value at a sale for the stockholders' benefit."[112] Moreover, as in *Unocal*, Delaware courts will afford some degree of deference to a board consisting of a majority of independent directors.[113] Furthermore, just as target

corporate democracy are at their disposal to turn the board out."); *see also Unitrin, Inc.*, 651 A.2d at 1388–89 (requiring proxy contest to remain viable in order for a defensive tactic to avoid being preclusive); Yucaipa Am. Alliance Fund II, L.P. v. Riggio, 1 A.3d 310, 337 n.182 (Del. Ch. 2010) (explaining that the defensive tactic must leave an insurgent with a "fair chance for victory," rather than a "slight possibility of victory," in order for a defensive tactic to avoid being preclusive); *cf. In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 698 (Del. Ch. 2005), *aff'd*, 906 A.2d 27 (Del. 2006) (reasoning under the business judgment rule that when directors make poor business decisions, redress must come from the shareholders, rather than from courts); *see also* David Rosenberg, *Galactic Stupidity and the Business Judgment Rule*, 32 J. CORP. L. 301, 303 (2007) (reasoning that wealth is maximized by directors who know that their decisions will ultimately be reviewed by investors but not by the courts).

109. In contrast, under the entire fairness test, the vote by the disinterested shares on the transaction serves to monitor that transaction. *See infra* notes 179-80 and accompanying text (discussing the Delaware courts' belief in the efficacy of disinterested share votes as an external monitor).

110. *See supra* note 57 and accompanying text (discussing the triggers that will put a corporation in *Revlon* mode).

111. Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1287 (Del. 1989) (requiring courts to use enhanced scrutiny when a corporation is in a *Revlon* mode); *see also* Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 44 (Del. 1994) (applying enhanced scrutiny after deciding that the corporation was in a *Revlon* mode and explaining the key features of enhanced scrutiny are that the directors have the burden to prove they were adequately informed and acted reasonably).

112. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1985).

113. *Id.* at 176 n.3 (describing the composition of the Revlon board and stating that the court "cannot conclude that this board is entitled to certain presumptions that generally

directors under *Unocal* can enact a wide variety of defensive tactics, the Delaware Supreme Court has similarly held that "there is no single blueprint that a board must follow to fulfill its duties" under *Revlon*.[114]

Although courts will review both *Unocal* and *Revlon* under the enhanced business judgment rule and give deference to independent boards, the goals of *Unocal* and *Revlon* within this common standard of review differ. *Unocal* is designed to evaluate whether a board, in its effort to keep its corporation independent, has reasonably identified a threat to that independence and has enacted defensive tactics within a wide range of reasonableness. *Revlon*, in contrast, imposes a specific task on directors: attempt to maximize shareholder value. Director discretion in *Revlon* is broad on how best to achieve that narrow mandate, but the goal is, itself, limiting and specific. Delaware courts have sought to situate these *Revlon* duties within the broader context of the directors' fiduciary duties, stressing that once the board convinces the court that it has sought to maximize shareholder value, the court will defer to the board's decision:

> "[A] court applying enhanced judicial scrutiny should be deciding whether the directors made a *reasonable* decision, not a *perfect* decision. If a board selected one of several reasonable alternatives, a court should not second-guess that choice even though it might have decided otherwise or subsequent events may have cast doubt on the board's determination." . . . Thus, where the board has sought the best value reasonably available for the shareholders, it will be found to have acted reasonably and as required by its fiduciary duties.[115]

attach to the decisions of a board whose majority consists of truly outside independent directors"); *see also* Lawrence E. Mitchell, *The Trouble with Boards* 58 (George Washington Univ. Law Sch. Pub. Law & Legal Theory, Working Paper No. 159, 2005), *available at* http://papers.ssrn.com/sol3/Papers.cfm?abstract_id=801308 (reasoning that Delaware courts "repeatedly made clear the almost sanitizing effect that a majority-independent board . . . would have on corporate behavior in transactions involving conflicts of interest").

114. Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989); *accord*, Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 242 (Del. 2009) (stating that no court can tell directors how to maximize price for shareholders because each corporation faces a "unique combination of circumstances"); *In re* Netsmart Techs., Inc. S'holders Litig., 924 A.2d 171, 192 (Del. Ch. 2007) ("Our case law recognizes that [there] are a variety of sales approaches that might be reasonable, given the circumstances facing particular corporations.").

115. Golden Cycle, LLC v. Allan, C.A. No. 16301, 1998 Del. Ch. LEXIS 237, at *42 (Del. Ch. 1998) (quoting *Paramount Commc'ns Inc.*, 637 A.2d at 45); *see also In re* Lear Corp. S'holder Litig., 926 A.2d 94, 115 (Del. Ch. 2007) (reasoning that when in the *Revlon* mode, "[b]ecause there can be several reasoned ways to try to maximize value, the court cannot find fault so long as the directors chose a *reasoned* course of action"); *In re* J.P. Stevens & Co. S'holders Litig., 542 A.2d 770, 783 (Del. Ch. 1988) (stating that since "reasonable directors, exercising honest, informed judgment, might differ as to what course

Thus, Delaware courts have stressed that directors must act to try to maximize shareholder value, but boards will not be liable either for differences of opinion of what is the best price[116] or for failing to foresee that a better bid would emerge in the future. After commenting that courts must review the board's compliance with its fiduciary duties and the board's efforts to promote shareholder interests, the Delaware Chancery Court in *In re Fort Howard Shareholders Litigation* stated that "the validity of the agreement itself cannot be made to turn upon how accurately the board did foresee the future."[117]

In addition to the different goals of *Unocal* and *Revlon*, *Revlon*'s admonition that boards may use covenants only in their effort to achieve maximum shareholder value[118] highlights another difference from *Unocal*: *Revlon* relies on the market to monitor directors' compliance with their *Revlon* duties. As the court in *Revlon* stated, "directors cannot fulfill their enhanced *Unocal* duties by playing favorites with the contending factions. Market forces must be allowed to operate freely to bring the target's shareholders the best price available for their equity."[119] The teachings from all of the Delaware *Revlon* decisions require boards to engage the

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of action would most likely maximize shareholder interests," the court will defer to the expertise of the directors).

116. *In re* Del Monte Foods Co. S'holders Litig., 25 A.3d 813, 830 (Del. Ch. 2011) ("Time-bound mortals cannot foresee the future. The test therefore cannot be whether, with hindsight, the directors actually achieved the best price."); *In re* J.P. Stevens S'holders Litig. at 781 n.6 (Del. Ch. 1988) (stating that obtaining the best possible transaction for the shareholders "does not mean that material factors other than 'price' ought not to be considered and, where appropriate, acted upon by the board. Such factors might include form of consideration, timing of the transaction or risk of non-consummation"); *Golden Cycle LLC*, 1998 Del. Ch. LEXIS 237, at *49-51 (applying the rationale from *In re J.P. Stevens* and determining that the decision to accept a merger bid that was $.50 less than a second bid was defensible under *Revlon* as the higher bid was conditional and would trip a termination fee and reimbursement provisions of the deal with the other corporation).

117. C.A. No. 9991, 1988 Del. Ch. LEXIS 110, at *41 (Del. Ch. Aug. 8, 1988); *see Golden Cycle*, 1988 Del. Ch. LEXIS 237, at *49 (approving deal at $19.50 over subsequent deal at $20 because deal at $19.50 was the highest-price deal at time of board's decision); *see also infra* notes 124–26 (noting that Delaware courts expect boards to comply with their fiduciary duties but do not expect boards to be clairvoyant).

118. Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1283 (Del. 1989) (reiterating *Revlon* lesson that covenants are not illegal per se but recognizing that since covenants foreclose further bidding, they are illegal unless they generate a substantial benefit to target shareholders); *In re* Holly Farms Corp. S'holders Litig, C.A. No. 10350, 1988 Del. Ch. LEXIS 164 (Del. Ch. 1988) (finding the target board failed its *Revlon* duties when it precluded an auction by granting a lock up, termination fee, and reimbursement provision to one bidder without notifying the second bidder that the board, contrary to its previous position, decided to sell the corporation); *see also Revlon* discussion *supra* notes 51–55.

119. *Revlon*, 506 A.2d at 184.

market in ways most relevant to their corporation; when boards so act, courts can comfortably defer to the resulting transaction price.[120] Thus, while corporations are not necessarily required to "shop" the company, Delaware courts have been skeptical of those cases where there is no market information on the best price for target stock.[121] For example, in *Barkan v. Amsted Industries, Inc.*, the Delaware Supreme Court warned:

> When the board is considering a single offer and has no reliable grounds upon which to judge its adequacy, this concern for fairness demands a canvas of the market to determine if higher bids may be elicited. When, however, the directors possess a body of reliable evidence with which to evaluate the fairness of a transaction, they may approve that transaction without conducting an active survey of the market . . . [but] the circumstances in which this passive approach is acceptable are limited. "A decent respect for reality forces one to admit that . . . advice [of an investment banker] is frequently a pale substitute for the dependable information that a canvas of the relevant market can provide."[122]

Therefore, when boards and their financial advisors actively canvas the market, they sustain their burden of proving that they were sufficiently

120. *See, e.g.*, *In re* Dollar Thrifty S'holder Litig., 14 A.3d 573 (Del. Ch. 2010) (reviewing steps the board took to assess the market and concluded that since the board's "approach was a reasonable one, that was the product of considerable deliberation," the court would defer to the board's judgment); *see also*, Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 242 (Del. 2009) (faulting for its good faith analysis, but not faulting the Court of Chancery for its view that when corporations are in a *Revlon* mode, boards "must confirm that they have obtained the best available price either by conducting an auction, by conducting a market check, or by demonstrating 'an impeccable knowledge of the market'") (citing Ryan v. Lyondell Chem. Co., C.A. No. 3176-VCN, 2008 Del. Ch. LEXIS 105, at *19 (Del Ch. July 29, 2008); *In re* Netsmart Techs., Inc. S'holders Litig., 924 A.2d 171, 198 (Del. Ch. 2007) (rejecting the board's "excuse for the lack of *any* attempt at canvassing the strategic market"); McGowan v. Ferro, 859 A.2d 1012, 1033-1034 (Del. Ch. 2004), *aff'd*, 873 A.2d 1099 (Del. 2005) (reasoning that because a merger agreement was preceded by an active canvassing of the market with the help of its financial advisors, the board sustained its burden that the directors were sufficiently informed about the adequacy of the transaction price).

121. McGowan v. Ferro, 859 A.2d at 1033 (Del. Ch. 2004), *aff'd*, 873 A.2d 1099 (Del. 2005) (explaining that when there is no market check, the court's analysis will include a review of the information on which the board based its decision and the reasonableness of the directors' conduct); *In re* Desoto, Inc. S'holder Litig., C.A. Nos. 11221, 11222, 1990 Del. Ch. LEXIS 15 (Del. Ch. 1990) (faulting management which "made no effort to canvas the market to learn if there were other possible suitors or even to preliminarily learn of a canvas of the market would be worthwhile").

122. 567 A.2d 1279, 1287 (Del. 1989) (second alteration in original) (internal citations omitted).

informed about the adequacy of the transaction price.[123] Thus, in *Barkan*, the Delaware Supreme Court held that a board that had put the company in play and had redeemed its poison pill five weeks before the MBO deal closed, satisfied its *Revlon* duties, reasoning that "when it is widely known that some change of control is in the offing and no rival bids are forthcoming over an extended period of time, that fact is supportive of the board's decision to proceed."[124] Implicit in these *Revlon* cases is an understanding that a good-faith search period will necessarily have a fixed closing date.[125] Delaware courts obviously do not expect boards to be omniscient about the future; one Delaware court emphatically stated: "Time-bound mortals cannot foresee the future. The test therefore cannot be whether, with hindsight, the directors actually achieved the best price."[126]

Similarly, because *Revlon* review requires a commitment to an effective market check, Delaware courts are leery of covenants that are "show stoppers."[127] The courts' reliance on the market in a *Revlon* review stands in sharp contrast to *Unocal*, where the Delaware Supreme Court rejected the option of letting the market monitor tender offers.[128]

Despite these differences between *Unocal* and *Revlon*, their common framework of enhanced business judgment review with deference to independent directors has produced results that strongly favor target directors under both tests. Like *Unocal*, corporations in a *Revlon* mode have won the vast majority of their cases. Of the thirty-nine cases that

123. *Id.* at 1288 (reasoning that as the "crucial element supporting a finding of good faith is knowledge," the board convinced the chancery court that the timing, publicity, tax advantages and the corporation's declining performance made a market test unnecessary, a finding with which the Delaware Supreme Court agreed); McGowan v. Ferro, 859 A.2d at 1033–34 (Del. Ch. 2004) (citing the use of independent financial advisors as a factor in directors' proof that the board was adequately informed about the market).

124. *Id.* at 1287.

125. *In re* Toys "R" Us S'holder Litig., 877 A.2d 975, 1008–12 (Del. Ch. 2005) (sustaining the board's decision to accept a deal after an open market check of one year produced no capable buyers).

126. *In re* Del Monte Foods Co. S'holders Litig., 25 A.3d 813, 830 (Del. Ch. 2011); *In re* Fort Howard S'holders Litig., 1988 Del. Ch. LEXIS 110 at 40–41 (Del. Ch. 1988) (stating that a disinterested, well-informed board acting in good faith could lock up a deal because it could not be responsible for knowing what other deals might emerge in the future).

127. *In re* Holly Farms Corp. S'holders Litig., C.A. No. 10350 (Del. Ch. 1988), slip op. at 16–17 (citations omitted) (reasoning that the "lock-up was nothing but a 'show stopper' that effectively precluded the opening act."); *see also* Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1286 (Del. 1989) (differentiating between valid lock-ups which "draw bidders into a battle" and invalid lock-ups "which end an active auction and foreclose further bidding").

128. *See supra* note 106 and accompanying text.

found a corporation to be in a *Revlon* mode,[129] courts in thirty-one cases (or seventy-nine percent) held that the boards had met their *Revlon* duties.[130]

129. While the corporation was found to be in *Revlon* mode in thirty-nine cases, forty-eight Delaware courts, consisting of eleven Delaware Supreme Court opinions and thirty-seven Court of Chancery opinions, decided these cases. *See* Malpiede v. Townson, 780 A.2d 1075 (Del. 2001); Paramount Commc'ns v. QVC Network Inc., 637 A.2d 34 (Del. 1994); Gilbert v. El Paso Co., 575 A.2d 1131 (Del. 1990); Barkan v. Amsted Indus., Inc., 567 A.2d 1279 (Del. 1989); Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53 (Del. 1989); Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261 (Del. 1989); Revlon, Inc. v. MacAndrews and Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); *In re* Smurfit-Stone Container Corp. S'holder Litig., C.A. No. 6164-VCP, 2011 Del. Ch. LEXIS 79 (Del. Ch. May 20, 2011); *In re* Openlane, Inc. S'holders Litig., C.A. No. 6849-VCN, 2011 Del. Ch. LEXIS 156 (Del. Ch. Sept. 30, 2011); *In re* Orchid Cellmark Inc. S'holder Litig., C.A. No. 6373-VCN, 2011 Del. Ch. LEXIS 75 (Del. Ch. May 12, 2011); Binks v. DSL.net,Inc., C.A. No. 2823-VCN, 2010 Del. Ch. LEXIS 98 (Del. Ch. Apr. 29, 2010); *In re* Dollar Thrifty S'holder Litig., 14 A.3d 573 (Del. Ch. 2010); Police & Fire Ret. Sys. v. Bernal, C.A. No. 4663-CC, 2009 Del. Ch. LEXIS 111 (Del. Ch. June 26, 2009); *In re* Lear Corp. S'holder Litig., 926 A.2d 94 (Del. Ch. 2007); Mercier v. Inter-Tel, Inc., 929 A.2d 786 (Del. Ch. 2007); *In re* Netsmart Techs., Inc. S'holders Litig., 924 A.2d 171 (Del. Ch. 2007); Upper Deck Co. v. Topps Co., 926 A.2d 58 (Del. Ch. 2007); *In re* Toys "R" Us, Inc., S'holder Litig., 877 A.2d 975 (Del. Ch. 2005); *In re* MONY Grp., Inc. S'holder Litig., 852 A.2d 9 (Del. Ch. 2004); Cirrus Holding Co. v. Cirrus Indus., 794 A.2d 1191 (Del. Ch. 2001); *In re* Pennaco Energy, Inc. S'holders Litig., 787 A.2d 691 (Del. Ch. 2001); McMillan v. Intercargo Corp., 768 A.2d 492 (Del. Ch. 2000); *In re* Lukens, Inc. S'holders Litig., 757 A.2d 720 (Del. Ch. 1999); Golden Cycle, LLC v. Allan, C.A. No. 16301, 1998 Del. Ch. LEXIS 237 (Del. Ch. Dec. 10, 1998); Emerson Radio Corp. v. Int'l Jensen, Inc., C.A. No. 14992, 1996 Del. Ch. LEXIS 100 (Del. Ch. Aug. 21, 1996); Kahn ex. rel. Burnup & Sims v. Caporella, C.A. No. 13248, 1994 Del. Ch. LEXIS 29 (Del. Ch. March 10, 1994); Rand v. W. Air Lines, C.A. No. 8632, 1994 Del. Ch. LEXIS 26 (Del. Ch. Feb. 25, 1994); Grover v. Simmons (*In re* Sea-Land Corp. S'holders Litig.), 642 A.2d 792 (Del. Ch. 1993); *In re* Wheelabrator Techs., Inc. S'holders Litig., C.A. No. 11495, 1992 Del. Ch. LEXIS 196 (Del. Ch. Sept. 1, 1992); Herd v. Major Realty Corp., C.A. No. 10707, 1990 Del. Ch. LEXIS 211 (Del. Ch. Dec. 21, 1990); Freedman v. Restaurant Assoc. Indus., Inc., C.A. No. 9212, 1990 Del. Ch. LEXIS 142 (Del. Ch. Sept. 19, 1990); Crown Books Corp. v. Bookstop, Inc., C.A. No. 11255, 1990 Del. Ch. LEXIS 25 (Del. Ch. Feb. 28, 1990); *In re* De Soto, Inc. S'holder Litig., C.A. Nos. 11221, 11222, 1990 Del. Ch. LEXIS 15 (Del. Ch. Feb. 5, 1990); Norberg v. Young's Mkt. Co., C.A. Nos. 11208, 11253, 1989 Del. Ch. LEXIS 174 (Del. Ch.Dec. 19, 1989); *In re* RJR Nabisco, Inc. S'holders Litig., C.A. No. 10389, 1989 Del. Ch. LEXIS 9 (Del. Ch. Feb. 14, 1989); *In re* Holly Farms S'holders Litig., C.A. No. 10350, 1988 Del. Ch. LEXIS 164 (Del. Ch. Dec. 30, 1988); Doskocil Cos. v. Griggy, C.A. No. 10,095, 1988 Del. Ch. LEXIS 132 (Del. Ch. Oct. 7, 1988); *In re* Fort. Howard Corp. S'holders Litig., C.A. No. 9991, 1988 Del. Ch. LEXIS 110 (Del. Ch. Aug. 8, 1988); *In re* J.P. Stevens & Co. S'holders Litig., 542 A.2d 770 (Del. Ch. 1988).

130. Of the thirty-nine cases that found the corporation to be in a *Revlon* mode, *see supra* note 129, judges held that thirty-one of the boards in these cases had met their *Revlon* duties. *See* Malpiede v. Townson, 780 A.2d 1075 (Del. 2001); Walker v. Lukens, 757 A.2d 1278 (Del. 2000); Rand v. W. Air Lines, Inc, 659 A.2d 228 (Del. 1994); Sea-Land Corp. S'holder Litig. v. Abely, No. 147, 1993, 1993 Del. LEXIS 362 (Del. Sept. 21, 1993); Gilbert v. El Paso Co., 575 A.2d 1131 (Del. 1990); Norberg v. Young's Mkt. Co., 571 A.2d 787 (Del. 1990); Barkan v. Amsted Indus., Inc., 567 A.2d 1279 (Del. 1989); Citron v. Fairchild

Of those cases with successful outcomes, seventy-seven percent had boards with a majority of independent directors.[131] Thus, just as the Delaware courts are quite deferential to independent boards under *Unocal*, Delaware courts most often deferred to independent boards under *Revlon* as well.[132]

Camera & Instrument Corp., 569 A.2d 53 (Del. 1989); *In re* Openlane, Inc. S'holders Litig., C.A. No. 6849-VCN, 2011 Del. Ch. LEXIS 156 (Del. Ch. Sept. 30, 2011); *In re* Orchid Cellmark, Inc. S'holder Litig., C.A. No. 6373-VCN, 2011 Del. Ch. LEXIS 75 (Del. Ch. May 12, 2011); *In re* Smurfit-Stone Container Corp. S'holder Litig., C.A. No. 6164-VCP, 2011 Del. Ch. LEXIS 79 (Del. Ch. May 20, 2011); Binks v. DSL.net, Inc., C.A. No. 2823-VCN, 2010 Del. Ch. LEXIS 98 (Del. Ch. Apr. 29, 2010); *In re* Dollar Thrifty S'holder Litig., 14 A.3d 573 (Del. Ch. 2010); *In re* Lear Corp. S'holder Litig., 926 A.2d 94 (Del. Ch. 2007); Mercier v. Inter-Tel, Inc., 929 A.2d 786 (Del. Ch. 2007); *In re* Toys "R" Us, Inc., S'holder Litig., 877 A.2d 975 (Del. Ch. 2005); *In re* MONY Grp., Inc. S'holder Litig., 852 A.2d 9 (Del. Ch. 2004); Cirrus Holding Co. v. Cirrus Indus., 794 A.2d 1191 (Del. Ch. 2001); *In re* Pennaco Energy, Inc. S'holders Litig., 787 A.2d 691 (Del. Ch. 2001); McMillan v. Intercargo Corp., 768 A.2d 492 (Del. Ch. 2000); Golden Cycle, LLC v. Allen, C.A. No. 16301, 1998 Del. Ch. LEXIS 237 (Del. Ch. Dec. 10, 1998); Emerson Radio Corp. v. Int'l Jensen, Inc., C.A. No. 14992, 1996 Del. Ch. LEXIS 100 (Del. Ch. Aug. 21, 1996); Kahn Ex. Rel Burnup & Sims v. Caporella, C.A. No. 13248, 1994 Del. Ch. LEXIS 29 (Del. Ch. Mar. 10, 1994); *In re* Wheelabrator Techs., Inc. S'holders Litig., C.A. No. 11495, 1992 Del. Ch. LEXIS 196 (Del. Ch. Sept. 1, 1992) (assuming without deciding that corporation had *Revlon* duties, but board did not breach those duties); Herd v. Major Realty Corp., C.A. No. 10707, 1990 Del. Ch. LEXIS 211 (Del. Ch. Dec. 21, 1990); Freedman v. Restaurant Assoc. Indus. Inc., C.A. No. 9212, 1990 Del. Ch. LEXIS 142 (Del. Ch. Sept. 19, 1990); Crown Books Corp. v. Bookstop, Inc., C.A. No. 11255, 1990 Del. Ch. LEXIS 25 (Del. Ch. Feb. 28, 1990); *In re* RJR Nabisco, Inc. S'holders Litig., C.A. No. 10389, 1989 Del. Ch. LEXIS 9 (Del. Ch. Jan. 31, 1989); Doskocil Cos. v. Griggy, C.A. No. 10,095, 1988 Del. Ch. LEXIS 132 (Del. Ch. Oct. 7, 1988); *In re* Fort. Howard Corp. S'holders Litig., C.A. No. 9991, 1988 Del. Ch. LEXIS 110 (Del. Ch. Aug. 8, 1988); and *In re* J.P. Stevens & Co. S'holders Litig., 542 A.2d 770 (Del. Ch. 1988); *cf. In re* Answers Corp. S'holder Litig., C.A. No. 6170-VCN, 2012 Del. Ch. LEXIS 162, at *13 (Del. Ch. July 19, 2012) (denying rehearing of previously-denied motion to dismiss as court held pleadings that board breached its *Revlon* duties were sufficient to proceed to trial); *In re* Celera Corp. S'holder Litig., C.A. No. 6304-VCP, 2012 Del. Ch. LEXIS 66, at *2–9, 34 (Del. Ch. Mar. 23, 2012) (agreeing that corporation was in a *Revlon* mode but rejecting a challenge by the largest shareholder to a settlement of a class action lawsuit arising from a *Revlon* merger); *In re* Delphi Fin. Group S'holder Litig., C.A. No. 7144-VCG, 2012 Del. Ch. LEXIS 45, at *49–52 (Del. Ch. Mar. 6, 2012) (denying preliminary injunction of a *Revlon* merger as claims that board violated its *Revlon* duties were insufficient to show a reasonable likelihood of success at trial); *In re* El Paso Corp. S'holder Litig., 41 A.3d 432, 434 (Del. Ch. 2012) (holding that plaintiffs had a reasonable likelihood of successfully showing that board violated its *Revlon* duties, but nevertheless refusing to grant a preliminary injunction of the merger because no other bid had been submitted and the stockholders could choose whether to accept or refuse the merger offer); *In re* Micromet, Inc. Shareholders Litig., C.A. No. 7197-VCP, 2012 Del. Ch. LEXIS 41, at *41 (Del. Ch. Feb. 29, 2012) (denying preliminary injunction of a *Revlon* merger because none of plaintiffs' claims had a reasonable likelihood of success).

131. Of the thirty-one cases with successful outcomes, *supra* note 130, twenty-four had independent boards, which yields a seventy-seven percent success rate.

132. *See, e.g.*, Wayne Cnty. Emps. Ret. Sys. v. Corti, C.A. No. 3534-CC, 2009 Del. Ch.

Interestingly, having an independent board was not outcome determinative, as five[133] of the eight[134] cases in which the board failed its *Revlon* duties had independent boards. The five cases which faulted independent directors, however, are easily explained: In one case, the court

LEXIS 126, at *56 (Del. Ch. July 24, 2009), *aff'd*, 996 A.2d 795 (Del. 2010) (refusing to make an "independent business judgment of whether the consideration obtained for the shareholders was adequate" and instead limiting its review in *Revlon* to the board's decision-making process).

133. The five cases where independent boards failed their *Revlon* duties were: *Paramount Commc'ns v. QVC Network Inc.*, 637 A.2d 34 (Del. 1994); *Mills Acquisition Corp. v. MacMillan Inc.*, 559 A.2d 1261 (Del. 1989) QVC (both courts); *In re Netsmart Techs., Inc. S'holders Litig.*, 924 A.2d 171 (Del. Ch. 2007); *Upper Deck Co. v. Topps Co.*, 926 A.2d 58 (Del. Ch. 2007); *In re De Soto Inc. S'holder Litig.*, C.A. No. 11221, 11222, 1990 Del. Ch. LEXIS 15 (Del. Ch. Feb. 5, 1990); *cf. Ryan v. Lyondell Chem. Co.*, C.A. No. 3176-VCN, 2008 Del. Ch. LEXIS 105 (Del. Ch. July, 29 2008); *Robert M. Bass Grp., Inc. v. Evans*, 552 A.2d 1227 (Del. Ch. 1988); *see infra* note 134.

134. These eight failures produced nine opinions, three by the Delaware Supreme Court and six by the Delaware Court of Chancery. *See* Paramount Commc'ns v. QVC Network, 637 A.2d 34 (Del. 1994); Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261 (Del. 1989); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); Police & Fire Ret. Sys. v. Bernal, C.A. No. 4663-CC, 2009 Del. Ch. LEXIS 111 (Del. Ch. June 26, 2009); *In re* Netsmart Techs., Inc. S'holders Litig., 924 A.2d 171 (Del. Ch. 2007); Upper Deck Co. v. Topps Co., 926 A.2d 58 (Del. Ch. 2007); QVC Network Inc. v. Paramount Commc'ns, 635 A.2d 1245 (Del. Ch. 1993); *In re* De Soto, Inc. S'holder Litig., C.A. Nos. 11221, 11222, 1990 Del. Ch. LEXIS 15 (Del. Ch. Feb. 5, 1990); *In re* Holly Farms S'holders Litig., C.A. No. 10350, 1988 Del. Ch. LEXIS 164 (Del. Ch. Dec. 30, 1988). It should be noted, however, that the Court of Chancery in *Topps* faulted the target board solely in failing to release the competing bidder from its standstill agreement. 925 A.2d 58, 92 (Del. Ch. 2010). *Cf.* Ryan v. Lyondell Chem. Co., C.A. No. 3176-VCN, 2008 Del. Ch. LEXIS 105 (Del. Ch. July, 29 2008) (refusing to grant directors' motion for summary judgment as court had concerns that board breached its fiduciary duty of good faith in fulfilling their *Revlon* duties). *Ryan v. Lyondell* was reversed on grounds that board had not violated its duty of good faith, but leaving intact the Court of Chancery's view that corporation was in a *Revlon* mode. Lyondell Chem. Co. v. Ryan, 970 A.2d 235 (Del. 2000); Robert M. Bass Grp., Inc. v. Evans, 552 A.2d 1227, n.30 (Del. Ch. 1988) (noting that although plaintiff contended the board's conduct violated both *Unocal* and *Revlon*, the court's decision to grant an injunction on *Unocal* grounds "makes it unnecessary to (and the Court therefore does not) address the plaintiffs' claim under *Revlon*."). After the Court of Chancery found that an independent board's defensive tactic failed *Unocal*, *id.* at 1238–39, the board abandoned that failed defensive tactic and instituted a different plan. Therefore, the case that ultimately went to the Delaware Supreme Court was about the viability of the board's restructuring plan (rather than the original defensive tactic), which the Delaware Supreme Court held warranted review under *Revlon*, not *Unocal*. Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261 (Del. 1989). Ultimately, the Delaware Supreme Court held that the board failed the *Revlon* test. *Id.* at 1284–88; *see also supra* note 93 (discussing *Bass v. Evans* in the *Unocal* context). In addition, one district court, applying Delaware law, held that the board breached its *Revlon* duties. Black & Decker Corp. v. Am. Standard, Inc., 682 F. Supp. 772 (D. Del. 1988).

excoriated the board for its failure to get any reliable market information,[135] and four of these cases directly tested the assumption that independent directors will act independently of corporate management.[136] In these latter four cases, managers engaged in transactions motivated in part by their own self-interest, and the independent directors did little or nothing to stop them: Management took action to further the deal that provided for management's continued participation, rather than the deal that was best for their shareholders.[137] These boards either allowed corporate management to tie up a lesser bid that favored themselves,[138] or else interfered with their shareholders' potential to maximize value by failing to explore the market fully.[139] Thus, the Delaware courts perceived the directors in these cases as being only nominally independent of management, which remained largely free to engineer the transaction toward their own benefit. For example, the

135. *In re Desoto*, 1990 Del. Ch. LEXIS 15, at *23 (faulting management who "made no effort to canvas the market to learn if there were other possible suitors or even to preliminarily learn if a canvas of the market would be worthwhile").

136. Paramount Commc'ns v. QVC Network Inc., 637 A.2d 34 (Del. 1994); Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261 (Del. 1989); *Netsmart*, 924 A.2d 171; and Upper Deck Co. v. Topps Co., 926 A.2d 58 (Del. Ch. 2007).

137. Paramount Commc'ns v. QVC Network Inc., 637 A.2d 34 (Del. 1994) (criticizing the Paramount board for tying up an inferior deal with Viacom, which included keeping the Paramount CEO as CEO of merged entity, in the face of a substantially better bid from QVC); Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, n. 32 (Del. 1989) (reversing court below and enjoining consummation of lockup agreement between target corporation and a rival bidder because target board breached its duties of care and loyalty in locking up inferior deal in violation of the board's *Revlon* duties, noting "th[e] board's virtual abandonment of its oversight functions in the face of . . . [management's] patent self-interest was a breach of its fundamental duties of loyalty and care in the conduct of this auction . . . and created the atmosphere in which [management] . . . could act so freely and improperly"); *In re* Netsmart Techs., Inc. S'holders Litig., 924 A.2d 171, 198 (Del. Ch. 2007) (finding that because management believed its goals of continuing as management and obtaining a greater percentage of the equity would more likely be achieved with a private equity buyer than with a strategic buyer, management wrongly steered board away from exploring the strategic route); Upper Deck Co. v. Topps Co., 926 A.2d 58 (Del. Ch. 2007) (granting preliminary injunction because the target board, in violation of its *Revlon* duties, refused to release the potentially higher bidder from its standstill agreement, thereby denying this bidder the chance to bid for the target, while target board simultaneously agreed to merge with the lower bidder who promised to retain existing target management). *Cf. In re* Holly Farms S'holders Litig., C.A. No. 10350, 1988 Del. Ch. LEXIS 164, *16–18 (Del. Ch. Dec. 30, 1988) (skipping over a determination of whether the board was independent, finding the board failed its *Revlon* duties by granting covenants to lock up a deal with a bidder who would keep the target and therefore, management, substantially intact without notifying the second bidder that the board, contrary to its previous position, had decided to sell the corporation).

138. *See supra* note 137.

139. *In re* Netsmart Techs., Inc. S'holders Litig., 924 A.2d 171 (Del. Ch. 2007); *see supra* note 137.

Delaware Supreme Court, in *Mills Acquisition Co. v. MacMillan, Inc.*, described the "allegedly 'independent' board"[140] as "torpid, if not supine, in its efforts to establish a truly independent auction."[141]

Not surprisingly, materially deficient disclosure in proxy materials sometimes accompanied *Revlon* breaches, as boards failed to disclose their conduct that the court subsequently faulted.[142] In *Netsmart*, for example, the court required the corporation to provide in the proxy materials not only some of the information plaintiff claimed was omitted regarding valuation,[143] but also a fuller discussion of the board's decision not to seek out any strategic buyers.[144] Similarly, in *In re The Topps Company Shareholders Litigation*,[145] the court required the target board to release the competing bidder from its standstill agreement so that it could present its argument to the target shareholders:

> [T]here is no reasonable basis for permitting the Topps board to deny its stockholders the chance to consider for themselves whether to prefer Upper Deck's higher-priced deal, taking into account its unique risks, over Eisner's lower-priced deal, which has its own risks. . . . But [Topps management] cannot at this point avoid an injunction on the unsubstantiated premise that the Topps stockholders will be unable, after the provision of full information, rationally to decide for themselves between two competing, non-coercive offers.[146]

By insisting on full disclosure, the Delaware courts have drawn in the shareholder vote to monitor further the board's conduct.

Two lessons emerge from these *Revlon* cases. One is that Delaware

140. 559 A.2d 1261, 1266 (Del. 1989).

141. *Id.* at 1280.

142. *See* Upper Deck Co. v. Topps Co., 926 A. 2d 58, 73 (Del. Ch. 2007) (holding that proxy materials were materially misleading in failing to disclose both a valuation that cast doubt on the fairness of the merger price, and a prospective merger partner's assurances to target management that bidder would retain target management).

143. *In re Netsmart*, 924 A.2d at 201. The court agreed with plaintiffs that the proxy materials should have disclosed the projections the financial advisor employed in performing its discounting cash flow valuation that the advisor used to conclude that the proposed merger price was fair. The court disagreed with plaintiffs that the proxy materials were otherwise materially incomplete. *Id.* at 199–204 (holding that (i) the omitted May 11 projections were not material, (ii) the description in the proxy materials of the financial advisor's work was sufficient, and (iii) the proxy materials did not omit material information on the independence of the special committee).

144. *Id.* at 209.

145. 926 A.2d 58 (Del. Ch. 2007).

146. *Id.* at 93 (citation omitted); *see also In re Netsmart Techs., Inc. S'holders Litig.*, 924 A.2d at 206 (Del. Ch. 2007) (granting an injunction to require full disclosure so shareholders can make their own investment decision).

courts will grant great deference to independent directors, but only when their conduct demonstrates true independence from management; in those cases that failed *Revlon*, the court determined that directors were only nominally independent.[147] The second lesson is that Delaware courts strongly favor an unfettered transaction market, followed by disclosure to target shareholders, so that those shareholders can make their own investment decisions.[148] Thus, in these *Revlon* cases, Delaware courts have curtailed their role to assuring that the directors are truly independent, the transaction market is unfettered, and disclosure to shareholders is complete; thereafter, the external monitors have supplanted judicial review.

C. Entire Fairness

As noted above,[149] the Delaware courts diluted their own review under the *Unocal* and *Revlon* tests by deferring to independent directors. Moreover, in *Revlon*, the Delaware Supreme Court deferred to two other non-judicial monitors: the market and the shareholder vote. All of these monitors functioned *within* the framework of the relevant test: In *Unocal*, the independence of the board minimized the directors' conflict of interest, and in *Revlon*, the market and shareholder vote helped the court decide whether the board had sought the best price. In contrast, the Delaware Supreme Court has not built any non-judicial monitor into the entire fairness test. As such, when a court applies the entire fairness test, it does, in fact, do a searching and thorough inquiry through a process that is the antithesis of deference.[150] As the court in *Reis v. Hazelett Strip-Casting Corp.* explained:

Entire fairness is Delaware's most onerous standard. When a

147. *See, e.g.*, Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1266 (Del. 1989) (observing that "apparent domination of the allegedly 'independent' board by the financially interested members of management, coupled with the directors' evident passivity in the face of their fiduciaries duties . . . continued unchanged"). The *Mills* court also stated that "[i]n its decisions, the MacMillan board completely relied on management's portrayal of Bass[,]" the rival bidder. *Id.* at 1267. "Here, not only was there such deception, but the board's own lack of oversight in structuring and directing the auction afforded management the opportunity to indulge in the misconduct which occurred." *Id.* at 1279. "The board was torpid, if not supine, in its efforts to establish a truly independent auction . . ." *Id.* at 1280.

148. *See In re Netsmart*, 924 A.2d at 207 ("By issuing an injunction requiring additional disclosure, the court gives stockholders the choice to think for themselves on full information, thereby vindicating their rights as stockholders to make important voting and remedial decisions based on their own economic self-interest.").

149. *See* discussion of *Unocal*, *supra* notes 93–99, and *Revlon*, *supra* notes 129–32.

150. *See supra* notes 68–69 and accompanying text (describing the board's heavy burden to prove entire fairness).

> party challenging a board's decision alleges and later proves facts sufficient to overcome the business judgment rule, "the burden then shifts to the director defendants to demonstrate that the challenged act or transaction was entirely fair to the corporation and its shareholders." Once entire fairness applies, the defendants must establish "to the *court's* satisfaction that the transaction was the product of both fair dealing *and* fair price." "Not even an honest belief that the transaction was entirely fair will be sufficient to establish entire fairness. Rather, the transaction itself must be objectively fair, independent of the board's beliefs."[151]

Nevertheless, while the entire fairness test mandates judicial scrutiny,[152] Delaware courts have supported alternative paths so that defendants can, in some circumstances, virtually or actually *opt out* of entire fairness review. These alternative paths gained prominence in *Weinberger v. UOP, Inc.*,[153] which required the controlling shareholder to prove the entire fairness of its freeze-out merger. The controlling shareholder claimed, however, that it did not control both sides of the transaction because it had ceded control when it agreed to vote its shares as the majority of the minority shares voted their shares.[154] The Delaware Court of Chancery believed that such approval by the disinterested shares, combined with other factors, "conclusively sways the decision in favor of the defendants."[155] While the

151. 28 A.3d 442, 459 (Del. Ch. 2011) (internal citations omitted).

152. In a typical transaction that is subject to entire fairness review, there are no monitors to which the court can defer: the conflict voids reliance on directors, and enterprise transactions typically have no shareholder vote or market. *See, e.g.*, Nixon v. Blackwell, 626 A.2d 1366 (Del. 1993) (reviewing under the entire fairness test without the support of any external monitors the board's decision to repurchase shares from only one class of stock, which was the class the directors owned); Summa Corp. v. Trans World Airlines, Inc., 540 A.2d 403, 407 (Del.), *cert. denied*, 488 U.S. 853 (1988) (finding that entire fairness applied because "the parent, by virtue of its domination of the subsidiary, causes the subsidiary to act in such a way that the parent receives something from the subsidiary to the exclusion of, and detriment to the minority stockholders of the subsidiary"); Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. 1971) (applying entire fairness to a contract between two of the parent's subsidiaries, as no external monitor existed for this transaction).

153. 457 A.2d 701 (Del. 1983).

154. The controlling shareholder ceded its control by allowing the majority of the minority of shares to veto or approve the transaction. However, since Delaware law requires a merger to be approved by a majority of outstanding shares, the majority had to cast its votes in order for the transaction to comply with Delaware law. *See* DEL. CODE ANN. tit. 8, § 251 (2011). Therefore, the controlling shareholder said it would vote its shares however the majority of the minority voted. Since 51.9% of the minority shares voted for the merger, the majority cast its vote in favor of the merger as well. *Weinberger*, 457 A.2d at 708.

155. Weinberger v. UOP, Inc., 426 A.2d 1333, 1362 (Del. Ch. 1981), *rev'd*, 457 A.2d

Delaware Supreme Court discounted the shareholder vote because the controlling shareholder had not made a full disclosure,[156] the court did not dispute the Court of Chancery's logic that approval by disinterested shares could effectively monitor the transaction. Subsequent cases have made clear that the vote must be a majority of those minority shares entitled to vote, rather than simply a majority of those voting.[157] One Delaware Court of Chancery opinion explained the reasoning for requiring the majority of the outstanding minority shares as follows:

> The cleansing effect of ratification depends on the intuition that when most of the affected minority affirmatively approves the transaction, their self-interested decision to approve is sufficient proof of fairness to obviate a judicial examination of that question. I do not believe that the same confidence flows then the transaction simply garners more votes in favor than votes against . . . from the minority who actually vote. That position requires an untenable assumption that those who did not return a proxy were members of a 'silent affirmative majority of the minority.' . . . [A] failure to cast a ballot is a de facto no vote.[158]

Reasoning that approval of the majority of minority shares is a powerful cleanser if there is full disclosure, the Supreme Court in *Weinberger* held that an informed approval by the minority shares would thereafter shift the burden to the plaintiff of proving unfairness.[159] In reality, giving plaintiffs another chance to prove the board breached its duties under these circumstances may be merely cosmetic. Plaintiffs would be quite unlikely to sustain their burden of proving unfairness after a majority of their peers have voluntarily and knowingly relinquished their

701 (Del. 1983).

156. *Weinberger*, 457 A.2d at 712 (finding violation in controlling shareholder's failure to disclose details of feasibility study prepared by controlling shareholder and some target directors).

157. *See In re* John Q. Hammons Hotels Inc., S'holder Litig., C.A. No. 758-CC, 2009 Del. Ch. LEXIS 174, slip op. at 30 (Del. Ch. Oct. 2, 2009) (requiring a majority of the outstanding minority shares, not a majority of those voting, to constitute one of the "robust procedural protections . . . to ensure that the minority stockholders have sufficient bargaining power and the ability to make an informed choice of whether to accept the . . . offer for their shares").

158. *In re* PNB Holding Co. S'holders Litig., C.A. No. 28-N, 2006 Del. Ch. LEXIS 158, at *55 (Del. Ch. Aug. 18, 2006); *cf.* Rabkin v. Olin Corp., C.A. No. 7547, 1990 Del. Ch. LEXIS 50 (Del. Ch. Apr. 17, 1990), *aff'd*, 586 A.2d 1202 (Del. 1990) (declining to shift the burden of proof where the majority of minority shares entitled to vote approved the transaction, but the vote was not expressly contingent on their approval).

159. *Weinberger*, 457 A.2d at 703 (affirming the proposition "that the plaintiff in a suit challenging a cash-out merger must allege specific acts of fraud, misrepresentation, or other items of misconduct to demonstrate the unfairness of the merger terms to the minority").

veto power and instead approved the transaction. Delaware courts are reluctant to substitute their version of what is fair after shareholders have exercised their power to make their own investment decision. As the Court of Chancery recently stated, "Delaware courts place great faith in the discernment and acumen of shareholders . . . [o]nly in extraordinary circumstances will this Court . . . usurp the rights of shareholders to make their own informed decisions."[160] Thus, such burden shifting seems largely superfluous and underscores the efficacy of the vote of the disinterested shares.

The corporation must satisfy two requirements in order for the shareholder monitor to shift the burden of proof to plaintiff. One, there must be full and fair disclosure of all material information to the shareholders.[161] The freezeout cases, however, have isolated a second requirement: The shareholder vote must be free from coercion. For example, the Delaware Chancery Court in *In re Pure Resources* stated that a controlling shareholder transaction is coercive for minority shareholders "because the controlling stockholder threatens to take action after the tender offer that is harmful to the remaining minority . . . or because the offer's back-end is so unattractive as to induce tendering at an inadequate price to avoid a worse fate[.]"[162] When both factors are satisfied, however, Delaware courts defer heavily to the shareholder monitor. As the Court of Chancery stated, "[w]hen, as here, plaintiffs seek to prevent shareholders from making a fundamental decision, they bear a heavy burden to persuade the Court that shareholders are somehow unable to provide for their own protection, or that effective use of the corporate franchise is barred by some critical lack of information."[163]

In addition to sanctioning disinterested share approval, *Weinberger* suggested a second alternative that the defendants could have pursued:

160. La. Mun. Police Emps.' Ret. Sys. v. Crawford, 918 A.2d 1172, 1176 (Del. Ch. 2007); *see also In re* Netsmart Techs., Inc., S'holders Litig., 924 A.2d 171, 208 (Del. Ch. 2007) (noting that because there was no competing offer, it would be unwise to "enjoin the only deal on the table, when the stockholders can make that decision for themselves").

161. *See Weinberger*, 457 A.2d at 702 (nullifying a shareholder vote under entire fairness because the board had not made full disclosure).

162. *In re* Pure Res., Inc., S'holder Litig., 808 A.2d 421, 438 n.26 (Del. Ch. 2002); *see also In re* Siliconix Inc. S'holders Litig., C.A. No. 18700, 2001 Del. Ch. LEXIS 83 (Del. Ch. June 19, 2001) (holding that stockholders were free to accept or reject offers on their own, but that courts would intervene to protect their right to make a voluntary choice; voluntariness depended on the absence of improper coercion and the absence of disclosure violations); *cf.* Solomon v. Pathe, 672 A.2d 35, 39-40 (Del. 1996) (noting that in the context of a controlling-shareholder tender offer, which does not require the controlling shareholder to offer a fair price, there must still be a lack of coercion and full disclosure to target shareholders).

163. *La. Mun. Police*, 918 A.2d at 1176.

create a committee of independent directors to negotiate on behalf of the minority shares.[164] The controlling shareholder in *Kahn v. Lynch Communications Systems, Inc.*[165] pursued that suggestion. The Delaware Supreme Court held that Lynch's committee of independent directors had failed to act independently,[166] noting that independence in this context requires the controlling shareholder not to dictate the terms of the merger, and instead to negotiate at arms-length with a committee that exercises real bargaining power.[167] The Delaware Supreme Court held that a truly independent committee in a controlling-shareholder merger would negate the need for the defendant to prove the transaction's fairness. The court, however, rejected prior holdings that an effective special committee would invoke the business judgment rule,[168] and instead held that, due to the pervasive power of the controlling shareholder, such a committee would merely shift the burden of proof to the plaintiff to prove unfairness.[169] Just as disinterested share approval appears to give plaintiffs no realistic argument as to why the court should hold the transaction is unfair,[170] it seems similarly unlikely that plaintiffs could contend successfully that an independent committee had nevertheless produced an unfair deal.[171]

164. *Weinberger*, 457 A.2d at 709 n.7 (remarking that this case "could have been entirely different" had there been an independent committee to deal with the controlling shareholder at arm's length, which would have provided "strong evidence" that the transaction is fair).

165. 638 A.2d 1110 (Del. 1994) [hereinafter *Kahn I*]; 669 A.2d 79 (Del. 1995) [hereinafter *Kahn II*]; *see also* discussion of *Kahn infra* notes 261–300.

166. *Kahn I*, 638 A.2d at 1112.

167. *Id.* at 1117. For other cases where the independent committee did not function sufficiently well to shift the burden to plaintiff, see Kahn v. Tremont Corp., 694 A.2d 422 (Del. 1997); *Kahn II*, 669 A.2d at 82; Rabkin v. Phillip A. Hunt Chem. Corp., 498 A.2d 1099 (Del. 1985); *In re* MAXXAM, Inc., Nos. 12,111 & 12,353, 1997 Del. Ch. LEXIS 51 (Del. Ch. Apr. 4, 1997), *reprinted in* 23 DEL. J. CORP. L. 277 (1998); Kahn v. Dairy Mart Convenience Stores, Inc., No. 12,489, 1996 Del. Ch. LEXIS 38 (Del. Ch. Mar. 29, 1996), *reprinted in* 21 DEL. J. CORP. L. 1143 (1996); *In re* Trans World Airlines, Inc. S'holders Litig., No. 9844, 1988 Del. Ch. LEXIS 139 (Del. Ch. Oct. 21, 1988), *reprinted in* 14 DEL. J. CORP. L. 870 (1989).

168. *Kahn I*, 638 A.2d at 1115; *see infra* note 295 and accompanying text.

169. *Id.* at 1117; *accord* Kahn v. Tremont Corp., 694 A.2d 422, 428 (Del. 1997) (holding that the entire fairness test, rather than the business judgment rule, continues to apply when the procedural monitors function effectively).

170. *See supra* notes 159–60 and accompanying text.

171. This argument would require a court to conclude that plaintiff proved that an independent committee had produced an unfair deal by acting in a grossly negligent manner in their negotiations. A judge who felt that that the committee had not been aggressive enough would be more likely to conclude that the committee had not really been sufficiently independent, as it did in *Kahn I*. *See infra* notes 282–83 (discussing the court's reasoning in *Kahn I* as to why the special committee was not independent,); *see, e.g.*, Citron v. E.I. Du Pont de Nemours & Co., 584 A.2d 490 (Del. Ch. 1990) (shifting the burden to plaintiff after

Thus, while defendants can shift the burden of proof, either by having an effective independent committee of directors or by securing the informed vote of the disinterested shares, *Kahn v. Lynch* held that entire fairness would always serve as the standard of review in controlling-shareholder mergers. More recent Delaware Court of Chancery cases have, however, sought to eliminate entire fairness review completely by making the business judgment rule applicable to controlling-shareholder freeze-out transactions effectuated by a tender offer followed by a short-form merger if boards provide for approval by both disinterested directors and disinterested shares.[172] For example, in *In re CNX Gas Corp. Shareholders Litigation*,[173] the Delaware Court of Chancery gave a ringing endorsement to the argument that under certain conditions, defendants could change the standard of review from entire fairness to business judgment, and refined these conditions stating:

> [I]f a first-step tender offer is both (i) negotiated and recommended by a special committee of independent directors and (ii) conditioned on the affirmative tender of a majority of the minority shares, then the business judgment standard of review presumptively applies to the freeze-out transaction.[174]

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finding that the independent committee functioned well, and holding that the plaintiff had been unable to prove the unfairness of the transaction). It is possible, however, for a committee that is not independent to negotiate a fair deal. *Kahn II*, 669 A.2d at 90 (upholding the Court of Chancery's determination on remand that the transaction was entirely fair, even though the court in *Kahn I* had determined that the independent committee had been coerced by the controlling shareholder).

172. *See In re* CNX Gas Corp. S'holders Litig., 4 A.3d 397 (Del. Ch. 2010); *In re* Cox Commc'ns, Inc., S'holders Litig., 879 A.2d 604, 624 (Del. Ch. 2005); *In re* Pure Res., Inc. S'holders Litig., 808 A.2d 421 (Del. Ch. 2002), *appeal denied*, C.A. No. 19876, 2002 Del. Ch. LEXIS 116 (Del. Ch. Oct. 9, 2002); *In re* Siliconix Inc. S'holders Litig., 2001 Del. Ch. LEXIS 83 (Del. Ch. 2001). The court in *CNX* noted that it was working off the opinion in *Cox Communications* and, to the extent that *Cox Communications* can be read as allowing the burden to change from entire fairness to the business judgment rule, even if the independent committee is neutral on the proposed deal, *CNX* would disagree. Instead, the court in *CNX* affirmatively required a recommendation from the committee. *CNX Gas Corp.*, 4 A.3d at 415.

173. 4 A.3d 397.

174. *Id.* at 413. The court in *CNX* contended that *Cox Communications* had effectively changed the prior law articulated in *In re Pure Resources*, which had delineated a three-part test for identifying when controlling shareholders two-step freeze-outs could be governed by the business judgment rule instead of by entire fairness: A controlling shareholder tender offer will be deemed non-coercive if it is (i) subject to a non-waivable majority of the minority tender condition, (ii) the controlling shareholder commits to consummate a short-form merger at the same price as the tender offer, and (iii) the controlling shareholder has not made any retributive threats. *In re Pure Res.*, 808 A.2d at 424; *see also infra* notes 292–99 and accompanying text (discussing cases that reject *Kahn*'s holding that entire fairness is the proper standard of review for controlling-shareholder mergers).

In a third-party merger negotiated by the majority, where the majority and minority shares received different consideration, the Delaware Court of Chancery also agreed that when both structural protections are in place, the entire fairness test should not apply because the controlling shareholder is effectively on only one side of the transaction.[175]

Thus, a substantial shift has occurred from *Kahn v. Lynch*, which contended that the pervasive strength of the controlling shareholder always required entire fairness review, to these newer Delaware cases, holding that controlling shareholders may escape the entire fairness review under certain conditions; in other words, a shift from judicial review to reliance on monitors. The Delaware Court of Chancery has provided an explanation for this shift. In *In re Pure Resources*, then Vice Chancellor Strine (now Chancellor Strine) noted that the Delaware Supreme Court in *Kahn* "saw the controlling stockholder as the 800-pound gorilla whose urgent hunger . . . is likely to frighten . . . putatively independent directors who might well have been hand-picked by the gorilla . . . ."[176] Current Court of Chancery decisions allowing the business judgment rule to govern under certain conditions do not repudiate *Kahn*'s argument about the capacity of a controlling shareholder to overreach, but instead incorporate those concerns into procedural requirements for controlling-shareholder transactions to qualify as non-coercive.[177] Thus, these courts have provided content and depth to the external monitors, thereby allowing courts to rely comfortably on decisions made by independent directors and disinterested shares. As the court in *In re Pure Resources* summarized:

> This does not mean that controlling stockholder tender offers do not pose risks to minority stockholders; it is only to acknowledge that the corporate law should not be designed on the assumption that diversified investors are infirm but instead should give great deference to transactions approved by them voluntarily and knowledgeably.[178]

Similarly, in order to demonstrate the efficacy of disinterested committees combined with disinterested shares, the court in *CNX* cited numerous examples of independent committees and disinterested shares rebuffing a

175. *In re* John Q. Hammons Hotels Inc., S'holder Litig., C.A. No. 758-CC, 2009 Del. Ch. LEXIS 174, at *42 (Del. Ch. Oct. 2, 2009).

176. *In re Pure Res.*, 808 A.2d at 436. The Court of Chancery further noted that *Kahn*'s view that independent directors could be so intimidated is "premised on a less trusting view of independent directors than is reflected in the important case of *Aronson v. Lewis* . . . which presumed that a majority of independent directors can impartially decide whether to sue a controlling stockholder." *Id.* at 436 n.17.

177. *See supra* notes 172–74 and accompanying text; *see also infra* notes 178–79.

178. *In re Pure Res.*, 808 A.2d at 444.

controlling-shareholder transaction:

> Post-*Lynch* experience shows that special committees can negotiate effectively with controllers and that both special committees and minority stockholders can reject squeeze-out proposals. . . . These examples augur in favor of a unified standard under which independent directors and unaffiliated stockholders are given the tools to negotiate with controllers, backstopped by meaningful judicial review for fairness when those tools are withheld.[179]

Thus, Delaware courts do a searching review under the entire fairness test. Nevertheless, in those situations, where corporations can create an independent committee of directors and can submit the transaction to a vote of their disinterested shares, corporations can, at a minimum, shift the burden of proving unfairness to the plaintiff, and increasingly can opt out of the entire fairness test completely. As a result, corporations can effectively substitute two external monitors—independent directors and the shareholder vote—for intrusive judicial review.

Before leaving the discussion of entire fairness, it is worth contrasting the role of the monitors: In *Unocal* and *Revlon*, the monitors functioned *within* those tests, while the monitors in the entire fairness test may *change* the standard of review. Moreover, it is important to differentiate the shareholder vote as a monitor, as it is in entire fairness, from *Unocal*, where the shareholder vote is only a safety valve. A vote by disinterested shares on a transaction whereby shareholders sell their stock provides a strong monitor because such a transaction will surely garner their attention. In contrast, a standard election of directors not only involves merely voting in general agreement or disagreement with the candidates for the board, but also will permit all shares, rather than just disinterested shares, to vote, thereby diluting any monitoring effect. Thus, in order to serve as an effective monitor, the shareholder vote must be only by disinterested shares and only on the specific transaction, rather than simply a vote for or against candidates for the board of directors.[180]

179. *CNX Gas Corp.*, 4 A.3d at 413–14.

180. *See supra* notes 108–09 and accompanying text (discussing shareholder voting as a safety valve in *Unocal); cf. In re* Emerging Commc'ns, Inc. S'holders Litig., C.A. No. 16415, 2004 Del. Ch. LEXIS 70, at *114 (Del. Ch. May 3, 2004) ("[N]o Delaware case has held that burden-shifting can be accomplished by a tender of shares rather than by an actual vote. Nor should a tender be treated as the equivalent of an informed vote. Shareholders cannot be deemed to have ratified board action unless they are afforded the opportunity to express their approval of the precise conduct being challenged.").

D. Blasius *and* Schnell

Like the entire fairness test, *Blasius* and *Schnell* demand judicial review. Although both *Blasius* and *Schnell* are largely applicable only in voting cases, they provide two different justifications for the proposition that only courts can monitor certain issues. One is that, as in the *Blasius* fact pattern, there are simply no monitors available. Given that the court in *Blasius* reasoned that the board had no power to decide who should serve as directors,[181] the court could not rely on board monitoring. Furthermore, since the board's conduct stymied the shareholder vote, there was no shareholder vote to which the court could look for guidance. Finally, there is no market for board seats. As a result, judicial review was the sole option. Thus, a court alone must determine if the directors' primary purpose is to disenfranchise their shareholders, and whether the directors demonstrated a compelling purpose for their actions. The second justification for judicial review, as in *Schnell*, is that the test requires the use of equitable powers, which obviously belong only to judges. Therefore, courts applying the *Schnell* doctrine cannot defer to the board, the disinterested shares, or the market.

While courts have no choice other than to go it alone when applying the *Blasius* and *Schnell* standards, Delaware courts have made it extremely difficult to trigger either of these tests. As noted above,[182] the court in *Blasius* retreated from holding that directors who trip *Blasius* have acted per se illegally only because the court did not want to exclude the possibility that some scenario might warrant such board conduct. The court's consideration of making such board conduct per se illegal, however, coupled with the resulting test whereby directors must demonstrate a compelling purpose for disenfranchising their shareholders, strongly suggest that it is likely impossible for the board to pass this test. As a result of this difficulty, courts are highly reluctant to trigger a test that produces

181. Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 663 (Del. Ch. 1988) (noting that in the allocation of authority between shareholders and directors, directors lack the authority to decide who serves on the board). In several other cases, Delaware courts have similarly held that the board lacked the power for its desired actions. *See, e.g.*, Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 936 (Del. 2003) (striking down defensive measures that lacked a fiduciary out for directors); Mentor Graphics Corp. v. Quickturn Design Sys., Inc., 728 A.2d 25, 86-87 (Del. Ch.), *aff'd on other grounds*, Quickturn Design Sys., Inc. v. Shapiro, 721 A.2d 1281 (Del. 1998) (deeming poison pill invalid because pill stripped board of its general management authority for a given period of time); *cf.* CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227 (Del. 2008) (holding that a shareholder bylaw that had no fiduciary out to requirement that board must reimburse proxy expenses under certain conditions exceeded permissible parameters for bylaws).

182. *See supra* notes 76–77 and accompanying text.

an inevitable outcome. As the Delaware Court of Chancery in *Mercier* reasoned:

> The great strength of *Blasius* . . . came along with some overbroad language that rendered the standard of review articulated in the case too crude a tool for regular employment. . . . [T]he trigger for the test's application . . . is so pejorative that it is more a label for a result than a useful guide to determining what standard of review should be used by a judge to reach an appropriate result.[183]

Thus, it is not surprising that the Court of Chancery explained that it would use the equitable power invoked in *Blasius* "sparingly, and only in circumstances in which self-interested or faithless fiduciaries act to deprive stockholders of a full and fair opportunity to participate in the matter [to be voted on] and to thwart what appears to be the will of a majority of the stockholders."[184]

Thus far, only five cases, four by the Delaware Court of Chancery and one by the Delaware Supreme Court, have triggered the *Blasius* test,[185] and, at best, only one passed.[186] The small number of cases under *Blasius*

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183. Mercier v. Inter-Tel (Del.), Inc., 929 A.2d 786, 805–06 (Del. Ch. 2007).

184. *In re* MONY Group, Inc. S'holder Litig., 853 A.2d 661, 674 (Del. Ch. 2004).

185. MM Cos., Inc. v. Liquid Audio, Inc., 813 A.2d 1118 (Del. 2003) (invalidating bylaw amendment that expanded the size of Liquid Audio's board because of lack of compelling justification under *Blasius*); *Mercier*, 929 A.2d 786 (finding that a special committee had a compelling justification under *Blasius* for postponing a shareholder vote on a merger that independent directors believed was in the best interests of shareholders); Chesapeake Corp. v. Shore, 771 A.2d 293 (Del. Ch. 2000) (striking down a supermajority bylaw amendment because it interfered with a shareholder vote and lacked a compelling justification under *Blasius*); State of Wis. Inv. Bd. v. Peerless Sys. Corp., C.A. No. 17637, 2000 Del. Ch. LEXIS 170 (Del. Ch. Dec. 4, 2000) (denying a motion for summary judgment because of the applicability of *Blasius* to the board's decision to adjourn a shareholder meeting); Carmody v. Toll Brothers, Inc., 723 A.2d 1180 (Del. Ch. 1998) (finding a cognizable *Blasius* claim regarding a "dead hand" provision because of the provision's effect on shareholders' ability to elect a board that would accept a takeover offer).

186. The one case that arguably passed the *Blasius* test was *Mercier*. In *Mercier*, the Delaware Court of Chancery criticized *Blasius*, contending that once the test was triggered, no board could ever successfully offer a compelling purpose for purposefully disenfranchising its shareholders. 929 A.2d at 806. The *Mercier* court thus concluded that *Blasius* was not a test at all, since it could never be passed. *Id.* The *Mercier* court contended that the board's conduct should be reviewed through a modified *Unocal* test. *Id.* at 810–11. After showing how such a modified *Unocal* review would work in this context, and after finding that the target board would pass *Unocal* because it acted in good faith to preserve a value-maximizing offer, the *Mercier* court returned to the *Blasius* test. The court concluded that since it had no authority to overrule the *Blasius* test, which the Delaware Supreme Court had affirmed in *MM Cos.*, the Inter-Tel board's conduct would have to be filtered through the *Blasius* test. *Id.* at 813. The *Mercier* court held that the board had a compelling justification for its conduct and therefore successfully met the *Blasius* test. *Id.* at

indicates the courts' reluctance to invoke a test that is impossible—or nearly so—for boards to pass.[187]

Similarly, when a court invokes the *Schnell* doctrine, the judge cannot rely on any monitor to decide that the board's conduct is both legal and inequitable. Moreover, the consequence of a board failing *Schnell* is that the judge will exercise its equitable powers. Like *Blasius*, courts will invoke the *Schnell* doctrine sparingly, but for reasons that differ from the infrequent use of *Blasius*. The *Schnell* doctrine allows courts, without boundaries or guideposts, to invalidate otherwise legal conduct.[188] Thus, the Delaware Supreme Court has warned courts that a capacious use of the *Schnell* doctrine could "imperil[]" the stability of Delaware law.[189] Delaware courts have responded to this warning. Despite its forty-plus year history,[190] and its facial applicability to *any* aspect of corporate law, Delaware courts have applied the *Schnell* doctrine only thirteen times[191]

819; *cf. Peerless*, 2000 Del. Ch. LEXIS 170, at *54 (finding that *Blasius* applied and expressing doubt that the defendants could provide a compelling justification for their conduct, but refusing to resolve that issue in a motion for summary judgment).

187. *See, e.g.*, *Mercier*, 929 A.2d at 805–06 ("The great strength of *Blasius* . . . came along with some overbroad language that rendered the standard of review articulated in the case too crude a tool for regular employment."); *In re* Gen. Motors (Hughes) S'holder Litig., C.A. No. 20269, 2005 Del. Ch. LEXIS 65, at *42 (Del. Ch. May 4, 2005) ("[I]t is unlikely, if not impossible, for a defendant to meet this burden on a motion to dismiss.").

188. *See* Mary Siegel, *The Dangers of Equitable Remedies*, 15 STAN J.L. BUS. & FIN. 86, 95–96 (2009) (suggesting that *Schnell* be limited to voting cases because it could potentially invalidate any type of conduct on equitable grounds).

189. Ala. By-Products Corp. v. Neal, 588 A.2d 255, 258 n.1 (Del. 1991); *see also* Accipiter Life Scis. Fund, L.P. v. Helfer, 905 A.2d 115, 127 (Del. Ch. 2006) (declining to apply *Schnell* because that doctrine should be used only "where compelling circumstances suggest that the company unfairly manipulated the voting process in such a serious way as to constitute an evident or grave incursion on the fabric of the corporate law"); Mary Siegel, *Going Private: Three Doctrines Gone Astray*, 4 N.Y.U. J. L. & BUS. 399, 419–22 (2008) (suggesting that *Schnell* be limited to "cases involving voting mechanics"); Siegel, *supra* note 188, at 93–96 (noting problems with the boundless nature of the *Schnell* doctrine as well as its enabling of judges becoming "super-legislators"); Leo E. Strine, Jr., *If Corporate Action Is Lawful, Presumably There Are Circumstances In Which It Is Equitable To Take That Action: The Implicit Corollary To The Rule of* Schnell v. Chris-Craft, 60 BUS. LAW. 877 (2005) (noting the danger that courts will forget to respect the law side of the law-equity divide in exercising their equitable powers).

190. *Schnell* was decided in 1971.

191. Only thirteen Delaware cases (plus *Schnell* itself) involved a true *Schnell* analysis. *See* Portnoy v. Cryo-Cell Int'l, Inc., 940 A.2d 43 (Del. Ch. 2008) (finding *Schnell* violation because of agreement between shareholder and incumbent board which involved retaining the board in exchange for adding a seat to be filled by the shareholder's designee); Accipiter Life Scis. Fund, L.P. v. Helfer, 905 A.2d 115 (Del. Ch. 2006) (declining to invalidate action taken at annual meeting under *Schnell* because the action at issue was not sufficiently extraordinary to meet the *Schnell* standard); Hollinger Int'l v. Black, 844 A.2d 1022, 1080–81 (Del. Ch. 2004), *aff'd*, 872 A.2d 559 (Del. 2005) (holding *Schnell* applicable to bylaw

after *Schnell* was decided, and all but two of these cases[192] involved some aspect of shareholder voting rights.

Thus, while *Blasius* and *Schnell* mandate judicial review, the justification for applying either of these doctrines is unique. Although there are no monitors to use in either of these tests, courts have made the

amendments and then striking down those bylaw amendments as inequitable); Linton v. Everett, C.A. No. 15219, 1997 Del. Ch. LEXIS 117 (Del. Ch. July 31, 1997) (finding a *Schnell* violation where shareholders were given insufficient notice of a stockholder meeting to be able to nominate opposing directors); Dolgoff v. Projectavision, Inc., C.A. No. 1168, 1996 Del. Ch. LEXIS 24, at *25 (Del. Ch. Feb. 29, 1996) (refusing to grant preliminary injunction to delay a board meeting that "may have caught Mr. Dolgoff by surprise, arguably handicapping his ability to mount a counter-proxy campaign" because this was not sufficient to satisfy the *Schnell* test); Hubbard v. Hollywood Park Realty Enters., Inc., C.A. No. 11779, 1991 Del. Ch. LEXIS 9 (Del. Ch. Jan. 14, 1991) (finding *Schnell* violation where enforcement of bylaw would have led to incumbent board running unopposed in election); Stahl v. Apple Bancorp, Inc., 579 A.2d 1115 (Del. Ch. 1990) (declining to find a *Schnell* violation where the board decided to hold an annual shareholder meeting later than it had originally intended to in order to explore alternatives to a hostile tender offer); Seagraves v. Urstadt Prop. Co., C.A. No. 10307, 1989 Del Ch. LEXIS 155 (Del. Ch. Nov. 13, 1989) (refusing to dismiss a complaint regarding delisting of shares and nonpayment of dividends despite a lack of impropriety because of the potential for equitable relief under *Schnell*); Aprahamian v. HBO & Co., 531 A.2d 1204 (Del. Ch. 1987) (finding a *Schnell* violation where directors postponed a meeting at which they would likely not have been re-elected); Packer v. Yampol, C.A. No. 8432, 1986 Del. Ch. LEXIS 413 (Del. Ch. Apr. 18, 1986) (finding a *Schnell* violation where issuance of new stock would have the effect of perpetuating directors in office); Frantz Mfg. Co. v. EAC Indus., 501 A.2d 401, 407–08 (Del. 1985) (finding under *Schnell* that the board's funding of an ESOP was inequitable as the dilutive issuance had the "primary purpose of perpetuating . . . control" and disenfranchising shareholders); Huffington v. Enstar Corp., C.A. No. 7543, 1984 Del. Ch. LEXIS 492 (Del. Ch. Apr. 25, 1984) (finding no *Schnell* violation where directors changed date of the annual stockholder meeting in order to facilitate the sale of the company); Lerman v. Diagnostic Data, Inc., 421 A.2d 906 (Del. Ch. 1980) (striking down a bylaw amendment enacted because of plaintiff's intent to wage a proxy contest as inequitable under *Schnell*). However, Delaware courts have cited to *Schnell* in a variety of contexts without going on to apply the doctrine, perhaps to remind corporations that the court has a trump card with which it could invalidate inequitable conduct. *See, e.g.*, Del. Ins. Guar. Ass'n v. Christiana Care Health Servs., 892 A.2d 1073, 1078 n.20 (Del. 2006) (citing, in an insurance dispute,*Schnell*'s general rule that legal action is not necessarily equitable); *In re* Holly Farms Corp. S'holders Litig., C.A. No. 10350, 1989 Del. Ch. LEXIS 28, at *28 (Del. Ch. Mar. 22, 1989) (citing *Schnell* where stockholders wished to enjoin a vote on a merger until after their challenges to the merger had been resolved); Smith v. SPNV Holdings, Inc., C.A. Nos. 8395, 8080, 1987 Del. Ch. LEXIS 505, at *8 (Del. Ch. Oct. 28, 1987) (citing *Schnell* to support that "[u]nfair dealing by a controlling shareholder is not permitted regardless of the action's legality").

192. The two cases that did not relate to shareholder voting were *Hollinger*, 844 A.2d at 1022 (striking down as inequitable bylaw amendments that dismantled a special committee which was created to evaluate a transaction), and *Seagraves*, 1989 Del Ch. LEXIS 155, at *11-12 (noting the potential for relief under *Schnell* regarding the delisting of shares and the nonpayment of dividends).

hurdle to triggering either of these tests so high that the two tests are rarely used.

E. Summary

Delaware courts have relied heavily on the independent directors in the *Unocal*, *Revlon*, and entire fairness tests. In *Revlon* and entire fairness, Delaware courts have also added the monitors of disinterested shares and the market monitor, which plays a focal role in *Revlon*. Equally significant is that Delaware courts are increasingly embracing these external monitors, preferring decisions by independent directors and disinterested shares over judicial review of the entire fairness of controlling-shareholder transactions. Finally, *Blasius* and *Schnell* remain tests that are subject solely to judicial review, but invocation of either test is a rarity.

III. AN EVALUATION OF THE EXTERNAL MONITORS

The previous section demonstrated that lurking beneath the veneer of judicial review are three prevalent monitors: independent directors, disinterested shares, and the market.[193] As noted above,[194] judicial review under *Unocal*, *Revlon*, and entire fairness relies heavily on independent directors. In addition, courts applying both the *Revlon* and entire fairness tests added a reliance on the shareholder monitor. Finally, *Revlon* also relies heavily on the market monitor. While judicial reliance on these external monitors has not always been explicit, there is little doubt that these external monitors have heavily impacted Delaware court decisions. Each external monitor, however, has its strengths and weaknesses, or at least, its supporters and detractors.

Those who support trusting independent directors have one main argument: While concerns may exist relating to entrenchment motives or

193. When appraisal rights are available, some courts consider this right as an added monitor. *See, e.g.*, La. Mun. Police Emps.' Ret. Sys. v. Crawford, 918 A.2d 1172, 1192 (Del. Ch. 2007) (noting that although "serious questions" about the Caremark board's merger negotiations existed, "the ability of shareholders to vote in a fully-informed fashion, and the availability of appraisal rights to any shareholders that may be dissatisfied with the merger consideration shape the appropriate limits of judicial intervention"). In Delaware, however, shareholders do not often have appraisal rights, as mergers are the only transaction that offers these rights, which will nevertheless be denied if the market-out exception applies. *See infra* note 216 (discussing market-out exception to appraisal rights).

194. *See supra* Part II.E.

structural bias for inside directors,[195] approval by independent directors "has the effect of placing the board's decision-making function into impartial hands."[196] In *Selectica, Inc. v. Versata Enterprises, Inc.*, the Delaware Court of Chancery explained:

> Where decisions are made by outside independent directors instead of members of management who have a presumptive desire to retain their employment, the concern that the board's decisions are tainted by self-serving motives is mitigated, and there naturally follows a greater presumption of good faith and reasonable investigation.[197]

Indeed, courts[198] and Congress[199] alike have assumed that an independent board is the best tool for monitoring corporate management. As one scholar wrote, "[t]he independent director has always held a special place in the hearts and minds of corporate lawmakers as an idealized monitor of executives' behavior."[200]

195. Sanjai Bhagat & Bernard Black, *The Non-Correlation Between Board Independence and Long-Term Firm Performance*, 27 J. CORP. L. 231, 232 (2002) (noting that "an insider-dominated board is seen as a device for management entrenchment"); William B. Chandler III, *On the Instructiveness of Insiders, Independents, and Institutional Investors*, 67 U. CIN. L. REV. 1083, 1084 (1999) (noting that conventional wisdom holds that inside directors are more likely to take self-interested actions than are independent directors); Lynn A. Stout, *On the Proper Motives of Corporate Directors (or, Why You Don't Want to Invite Homo Economicus to Join Your Board)*, 28 DEL. J. CORP. L. 1, 19 (2003) (noting that the traditional distinction between inside directors and outside directors is sensible because inside directors often have personal interests that are adverse to the firm).

196. Clark W. Furlow, *Back to Basics: Harmonizing Delaware's Law Governing Going Private Transactions*, 40 AKRON L. REV. 85, 98 (2007).

197. Selectica, Inc. v. Versata Enters., Inc., C.A. No. 4241-VCN, 2010 Del. Ch. LEXIS 39, at *51 (Del. Ch. Mar. 1, 2010).

198. *See supra* note 9 (explaining that courts will defer to independent and well-informed directors under the business judgment rule); *supra* notes 88–89 (stating that courts will give deference to independent boards under *Unocal*); *supra* note 113 and accompanying text (stating courts will defer to independent directors under *Revlon*)

199. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (directing the Securities and Exchange Commission to undertake rulemaking, including mandatory listing standards for self-regulatory organizations, and subsequent enactment of rules by the New York Stock Exchange and National Association of Securities Dealers Automated Quotations requiring all listed companies to have boards consisting of a majority of independent directors); Dodd-Frank Wall Street Reform and Consumer Protection Act, ,Pub. L. No. 111-203, § 952, 124 Stat. 1376, 1392–94 (2010) (requiring the Securities and Exchange Commission to issue further rules directing the exchanges to require independent compensation committees).

200. Frederick Tung, *The Puzzle of Independent Directors: New Learning*, 91 B.U. L. REV. 1175, 1175 (2011). For a discussion of whether independent boards are more effective managers, see Bhagat & Black, *supra* note 195 (finding little difference in performance among firms that have independent boards versus those that do not).

On the other hand, critics of trusting directors are suspicious that even those who legally qualify as independent[201] may not actually be free from bias: "Independent directors traditionally were nominated by insiders and, in any event, generally are selected from the business community to ensure that they will have adequate expertise. Because of structural bias, it may be difficult for them to criticize either their fellow directors or the officers of the corporation."[202] Along the same lines, another commentator reasoned, "[d]isinterested directors may not have a financial interest in the transaction in question, but they may nevertheless be conflicted with respect to the decision itself, if only because of its effect on a colleague."[203]

Thus, supporters and opponents offer different views on whether legally-qualified independent directors are truly free of structural bias. Delaware courts, by choosing to rely on independent directors, have taken a leap of faith that independent directors will make independent decisions. The discussion above analyzing *Unocal* and *Revlon* cases in which a few independent boards nevertheless failed to meet their respective duties[204] demonstrates, however, that the Delaware courts' faith in independent directors goes only so far; these *Unocal* and *Revlon* failures reveal that Delaware courts are attuned to the possibility of nominally independent boards acting passively and subserviently to management's desires. It is impossible to conjecture about the extent to which Delaware's "trust but verify" approach sufficiently satisfies ardent believers in structural bias.

In contrast to the singular point of dispute about the efficacy of the independent-director monitor, those who support disinterested share approval offer three main arguments. One contention is that any self-

201. *See supra* note 6 (defining independent director).

202. Usha Rodrigues, *The Fetishization of Independence*, 33 J. CORP. L. 447, 460 (2008); *see also* Nicola Faith Sharpe, *The Cosmetic Independence of Corporate Boards*, 34 SEATTLE U. L. REV. 1435, 1448–49 (2011) (arguing that because there are practical and psychological limitations on independence, it is questionable whether even outside directors can be independent from the CEO); Claire A. Hill & Brett H. McDonnell, *Disney, Good Faith, and Structural Bias*, 32 J. CORP. L. 833, 838 (2007) (explaining that even outside directors will want to protect against hostile takeovers in order to protect their board positions and may also be "motivated by the 'pernicious golden rule' to defer to those whose deference they would want as officers . . . . thus mak[ing] decisions that favor those officers and themselves even if doing so is not the best course for the corporation as a whole").

203. Julian Velasco, *Structural Bias and the Need for Substantive Review*, 82 WASH. U. L.Q. 821, 842 (2004); *see also* William T. Allen et al., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law,* 56 BUS. LAW. 1287, 1308 (2000) (recognizing concerns that an independent committee may not be truly independent as they are "not hermetically sealed off from the inside directors").

204. *See supra* notes 103–04 and accompanying text (discussing cases where independent boards failed the *Unocal* test); *supra* notes 135–41 and accompanying text (discussing cases where independent boards failed the *Revlon* test).

dealing is effectively eliminated when the minority shares have the power to refuse the transaction.[205] Second, the shareholder vote provides an objective monitor of the transaction, rather than a court's subjective view of whether the transaction is fair or whether the directors were properly motivated.[206] Finally, such approval lets shareholders make their own investment decisions instead of a court deciding whether the deal recommended by the board is fair. As the court in *Louisiana Municipal Police Employees' Retirement System v. Crawford* stated, "[o]nly in extraordinary circumstances will this Court . . . usurp the rights of shareholders to make their own informed decisions."[207]

On the other hand, some contest the efficacy of disinterested shareholder approval on the theory that shareholders may simply rubberstamp management's recommendations.[208] Others contend that shareholders are not able to evaluate the terms of the transaction and have no viable option if they reject the deal.[209] These issues are accentuated in a

205. *See In re* CNX Gas Corp. S'holders Litig., 4 A.3d 397, 413–14 (Del. Ch. 2010) (explaining that in *In re* Revlon, Inc. S'holders Litig., 990 A.2d 940, 957 (Del. Ch. 2010) [*Revlon II*], because the majority of the minority shares twice rejected the deal proposed by the controlling shareholder, shareholders had been able to thwart management's self-dealing); *id.* (noting that in *In re* Siliconix Inc. S'holders Litig., C.A. No. 18700, 2001 Del. Ch. LEXIS 83 (Del. Ch. June 19, 2001), minority shares rebuffed controlling-shareholder's exchange offer and thus effectively combated the controller's efforts to self-deal).

206. *See* Mary Siegel, *Tender Offer Defensive Tactics: A Proposal for Reform*, 36 HASTINGS L.J. 377, 407–08 (1985) ("[A] fair vote of shareholders is an objective criterion that replaces judicial evaluation of management's motives.").

207. 918 A.2d 1172, 1176 (Del. Ch. 2007); *see also* Crown EMAK Partners, LLC v. Kurz, 992 A.2d 377, 388 (Del. 2010) ("[S]tockholders with economic ownership are expressing their collective view as to whether a particular course of action serves the corporate goal of stockholder wealth maximization."); *In re* Netsmart Techs., Inc. S'holders Litig., 924 A.2d 171, 208 (Del. Ch. 2007) (refusing to "enjoin the only deal on the table, when the stockholders can make that decision themselves."); *In re* Pure Res., Inc., S'holders Litig., 808 A.2d 421, 444 (Del. Ch. 2002) ("[C]orporate law should not be designed on the assumption that diversified investors are infirm but instead should give great deference to transactions approved by them voluntarily and knowledgeably."); *see also* Allen et al., *supra* note 2, at 1308 (reasoning that if the shareholder vote is uncoerced and is fully informed, the shareholder vote should be dispositive, especially given the Delaware Supreme Court's "rightful emphasis on the importance of the shareholder franchise and its exercise").

208. *See, e.g.*, Elliott J. Weiss, *The Law of Take Out Mergers: A Historical Perspective,* 56 N.Y.U. L. REV. 624, 676-77 (1981) ("[S]hareholders often behave like sheep when asked to vote on a transaction, and support docilely any recommendation management makes.").

209. *See* Bevis Longstreth, *Fairness of Management Buyouts Needs Evaluation*, LEGAL TIMES, Oct. 10, 1983, at 14 (noting that shareholders may not be in a position to evaluate transaction and often do not have realistic alternatives to approval); *see, e.g.*, *Kahn I*, 638 A.2d at 1116–17 (noting the concern that minority shareholder rights could be lost due to intended or unintended coercion by the majority); *In re* Celera Corp. S'holder Litig., C.A. No. 6304-VCP, 2012 WL 1020471 (Del. Ch. Mar. 23, 2012) (holding that minority

controlling-shareholder transaction, where concerns about "the potential for process manipulation by the controlling stockholder, and the concern that the controlling stockholder's continued presence might influence even a fully informed shareholder vote"[210] may leave opponents uneasy. Those who share these concerns may derive comfort from the Delaware Supreme Court's insistence in *Kahn v. Lynch* on reviewing all controlling-shareholder mergers under the entire fairness standard[211] or on the ability of the court to discount the shareholder vote by finding that defendants did not make a full disclosure.[212]

Finally, Delaware courts have relied on a market monitor in a variety of contexts,[213] but the transaction market is the one relevant for our purposes. In order for directors to fulfill their *Revlon* duties, "[m]arket forces must be allowed to operate freely to bring the target's shareholders the best price available for their equity."[214] Proponents of the market

shareholders may improperly lose their legal status as shareholders where they are not realistically given a choice, and are forced to accept the terms of the offer); *In re* Pure Res., Inc., S'holders Litig., 808 A.2d 421, 445 (Del. Ch. 2002) (noting the threat that controlling stockholders may coerce minority stockholders who could, essentially, be forced to accept the offered terms); *In re* Best Lock Corp. S'holder Litig., 845 A.2d 1057, 1075–76 (Del. Ch. 2001) (holding that the plaintiffs, who tendered their shares after a merger was consummated, "did not do so voluntarily," so as to acquiesce to the merger and forfeit any claims, because they were not given a "meaningful choice" when they were faced with a choice between "accepting the possibly inadequate merger consideration and pursuing a possibly inadequate appraisal remedy").

210. *In re* Wheelabrator Techs., Inc. S'holders Litig., 663 A.2d 1194, 1205 (Del. Ch. 1995); *see also In re* JCC Holding Co., Inc. S'holders Litig., 843 A.2d 713, 723 (Del. Ch. 2003) ("[I]nherent coercion is thought to undermine the fairness-guaranteeing effect of a majority-of-the-minority vote condition because coerced fear or a hopeless acceptance of a dominant power's will, rather than rational self-interest, is deemed likely to be the animating force behind the minority's decision to approve the merger.").

211. *See infra* note 270 and accompanying text. For a contrary view, see *infra* notes 292–300 and accompanying text (identifying cases criticizing *Kahn*'s holding that entire fairness must remain the standard of review in all controlling-shareholder mergers, and therefore finding ways to distinguish cases from *Kahn*).

212. *See, e.g.*, Smith v. Van Gorkom, 488 A.2d 858, 890 (Del. 1985) (negating shareholder vote on grounds that "the Board's lack of valuation information should have been disclosed"); Weinberger v. UOP, Inc., 457 A.2d 701, 712 (Del. 1983) (negating the effect of a shareholder vote because the controlling shareholder failed to disclose to shareholders the details of a feasibility study it prepared with the help of some target directors).

213. *See, e.g.*, Applebaum v. Avaya, Inc., 812 A.2d 880 (Del. 2002) (finding market price relevant in a reverse-stock split); Van de Walle v. Unimation, Inc., Civ. A. No. 7046, 1991 WL 29303, at *17 (Del. Ch. Mar. 7, 1991) (finding market price relevant in sale of corporation); Union Ill. 1995 Inv. Ltd. P'ship v. Union Fin. Grp., Ltd., 847 A.2d 340 (Del. Ch. 2003) (finding market price as the sole determinative factor in appraisal proceeding).

214. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 184 (Del. 1986); *see also supra* notes 119–24 and accompanying text (discussing importance of

monitor offer one major argument: under the right conditions, the market will offer fair value. As then-Vice Chancellor, and now Justice Jacobs, explained:

> The most persuasive evidence of the fairness of the . . . merger price is that it was the result of arm's-length negotiations between two independent parties, where the seller . . . was motivated to seek the highest available price, and a diligent and extensive canvass of the market had confirmed that no better price was available . . . . The fact that a transaction price was forged in the crucible of objective market reality (as distinguished from the unavoidably subjective thought process of a valuation expert) is viewed as strong evidence that the price is fair.[215]

Rather than voicing a generic objection to the fairness of the transaction market, critics instead focus on conditions when that market might not offer fair value.[216] The main concern surfaces when the

market check in *Revlon* test).

215. *Unimation*, 1991 WL 29303, at *17; *see also* M.P.M. Enters., Inc., v. Gilbert, 731 A.2d 790, 797 (Del. 1999) ("A merger price resulting from arms-length negotiations where there are no claims of collusion is a very strong indication of fair value.").

216. In contrast to the transaction market, the inherent reliability of the stock market price is more contentious and has surfaced specifically in the context of whether there should be a market-out exception to appraisal rights. Thirty-six states have adopted a market-out exception on the theory that, since the market offers fair value, there is no need for the judicially-determined valuation that appraisal rights offer. *See* Mary Siegel, *An Appraisal of the Model Business Corporation Act's Appraisal Rights Provisions*, 74 LAW AND CONTEMP. PROBS. 231, 246 n.75, 248 n.88 (2011) (listing states with market-out exceptions); DEL. CODE ANN. tit. 8, § 262(b)(1) (2001) (denying appraisal rights if there is a publicly-traded market); *see also* tit. 8, §§ 262(b)(2), (b)(3) (restoring appraisal rights under certain conditions despite market-out exception). Concerns about the reliability of the market price if the market is illiquid or if the transaction is a conflict transaction caused the authors of the Model Act's statutory appraisal provisions to limit the Act's market-out exception to those situations where the market is sufficiently liquid and the transaction is not an interested transaction. MODEL BUS. CORP. ACT §§ 13.02(b)(1), (b)(4) (2010) (listing requirements for liquidity and conflict-of-interest, respectively). For a discussion of the MBCA's market-out exception, see Siegel, *supra*, at 245–56. Eleven states have thus far adopted the Model Act's limits on the market-out exception. *See id.* at 248 nn.91–92 (listing states that limit the market-out to a liquid market and a non-conflict transaction). Fourteen states have no market-out exception at all. *Id.* at 246 n.76, 248 n.88. When appraisal rights are available in Delaware, Delaware courts begin the evaluation with a strong belief that the stock market offers reliable evidence of fair value. *See, e.g.*, *Applebaum*, 812 A.2d at 889–90 (relying on the average of the market price over a ten-day period preceding the proposed transaction to determine the fair value that corporation owed to those shareholders who were to be cashed out in a reverse stock-split, noting, "our jurisprudence recognizes that in many circumstances a property interest is best valued by the amount a buyer will pay for it. The Vice Chancellor correctly concluded that a well-informed, liquid trading market will provide a measure of fair value superior to any estimate

controlling shareholder or insiders can taint the transaction market. For example, an offer by a third party that is inadequate will likely be met with competing bids, but a similar transaction by a controlling shareholder will not.[217] Finally, questions also may arise whether bids by insiders, even if not controlling shareholders, have enough of an "inside track" to similarly distort the market. As the Delaware Supreme Court in *Applebaum v. Avaya, Inc.* reasoned:

> When a controlling stockholder presents a transaction that will free it from future dealings with the minority stockholders, opportunism becomes a concern. Any shortfall imposed on the minority stockholders will result in a transfer of value to the controlling stockholder. The discount in value could be imposed deliberately or could be the result of an information asymmetry where the controlling stockholder possesses material facts that are not known in the market.[218]

Delaware courts have met these concerns about the market by strengthening procedural protections to thwart the otherwise unbridled power of controlling shareholders.[219]

Despite arguments for and against the three external monitors, Delaware courts have developed a broad trust in them, with some fine-tuning. Delaware courts have calibrated their reliance on independent directors by delving below the label of independence until courts are satisfied that these directors have effectively represented their shareholders and explored the relevant market; established procedures to assure that the shareholder vote is both informed and voluntary; and required boards to get reliable, objective, market information. This Article now examines a few

the court could impose"); *Union Ill. 1995 Inv. Ltd. P'ship*, 847 A.2d 340 (using market price as the only factor in appraisal proceeding). The Delaware Supreme Court will qualify its confidence in the market price if the stock is not actively traded or the transaction is an insider transaction. *Applebaum*, 812 A.2d at 891 n.38 (noting that market price might satisfy the fair value requirement but not where the market price was set by the issuer company, acting as the primary (if not the sole) buyer); *see also* Gesoff v. IIC Indus. Inc., 902 A.2d 1130, 1154 (Del. Ch. 2006) (stating that a thinly traded, illiquid market does not produce a fair price). One final issue is that, in Delaware, the stock value for appraisal purposes will not include any minority discount, Cavalier Oil Corp. v. Harnett, 564 A.2d 1137, 1141 (Del. 1989), while the market price will reflect the value of a minority position. *In re* Loral Space & Commc'ns Inc. Consol. Litig., C.A. Nos. 2808-VCS, 3022-VCS, 2008 Del. Ch. LEXIS 136, at *116 (Del. Ch. Sept. 19, 2008) (noting that the trading price "was a minority value . . . . a rational market price would not attribute anything but a trivial value to the voting rights attached to the [minority] shares").

217. *See supra* note 210 (explaining concern that shareholders feel pressured to take the deal offered by the controlling shareholder).

218. 812 A.2d at 891.

219. *See supra* notes 172–75 and accompanying text.

"outlier cases" in which Delaware courts trusted only themselves despite the availability of one or more external monitors.

IV. A FEW OUTLIERS

Thus far, this Article has both demonstrated that Delaware courts typically avoid judicial review when the external monitors are available and identified the relevant refinements to each monitor. This section will discuss some "outlier" cases, namely those where a Delaware court went out of its way to engage in judicial review despite the availability of one or more of the monitors in their purest and best form. This section offers as outlier examples two decisions of the Delaware Supreme Court: *Omnicare v. NCS* and *Kahn v. Lynch*.[220] This section both explains the court's reasoning for trusting only itself and illustrates that the cost accompanying such judicial intervention has been decisions that even Delaware courts find questionable.

A. Unocal *Test:* Omnicare

Omnicare, Inc. v. NCS Healthcare, Inc.[221] is an outlier case, because the Delaware Supreme Court had all external monitors in play and instead chose to disregard them. The facts are not in dispute. When NCS Corporation was near bankruptcy, it explored strategic alternatives. While two corporations, Omnicare, Inc. and Genesis Health Ventures, expressed interest in purchasing NCS, both suitors were problematic: Omnicare would not to commit to a deal during the pendency of NCS' search process, and Genesis refused to proceed unless it had an exclusivity agreement and a lock-up in any potential deal.[222] Ultimately, the NCS board decided that "balancing the potential loss of the Genesis deal against the uncertainty of Omnicare's letter, results in the conclusion that the only reasonable

220. *See also* Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985) (disregarding, under the business judgment rule, the decision of an independent board, the shareholder vote, and the market because once the court found the board to be grossly negligent, the court reasoned that this negligence negatively infected the disclosure to shareholders that provided the basis for their vote and did not allow the board to adequately assess market information); Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981) (giving the Court of Chancery the option to disregard the decision of an independent committee that fulfilled its fiduciary duties and instead substitute the Court of Chancery's own business judgment on whether a derivative suit should proceed).

221. 818 A.2d 914 (Del. 2003).

222. *Id.* at 921.

alternative for the Board of Directors is to approve the Genesis transaction."[223] The NCS board therefore approved a two-part plan that guaranteed the approval of the Genesis merger: The board would commit to recommend the Genesis transaction to the NCS shareholders without a fiduciary-out clause,[224] and the majority shareholders—who were also officers and directors of NCS[225]—agreed to sign voting agreements to vote their shares in favor of the Genesis merger.[226] Shortly after NCS executed these agreements, Omnicare presented NCS with a proposal that was more favorable to the NCS shareholders,[227] and the NCS board withdrew its recommendation to the NCS shareholders endorsing the Genesis merger.[228] The board's withdrawal of its recommendation, however, was purely cosmetic, as the Genesis deal had previously secured the requisite board recommendation and shareholder vote.[229]

Omnicare and some NCS minority shareholders sued to enjoin the merger, claiming that the deal-protection devices in the NCS-Genesis merger agreement violated the NCS board's fiduciary duties because the agreement did not allow for the board to back out of the deal if a superior transaction—such as Omnicare's—emerged in the future.[230] When the Court of Chancery denied the request for an injunction, the case went to the Delaware Supreme Court on interlocutory appeal.[231] In a divided opinion,[232] the majority of the Delaware Supreme Court reviewed the

223. *Id.* at 925. Omnicare's letter to NCS was uncertain because it "was expressly conditioned on negotiating a merger agreement, obtaining certain third party consents, and completing its due diligence." *Id.* at 924.

224. *Id.* at 925. A fiduciary-out clause is a "contractual provision . . . that would permit the board of the corporation being acquired to exit without breaching the merger agreement in the event of a superior offer." *Id.* at 945 (Veasey, C.J., dissenting).

225. One was the Chairman of the NCS board of directors, and the other was the President, CEO and a director of NCS. *Id.* at 919–20.

226. *Id.* at 925.

227. *Id.* at 926.

228. *Id.*

229. *See supra* notes 224, 226 and accompanying text. The NCS directors were aware that they had irrevocably bound themselves to the Genesis deal, as NCS' legal counsel had advised the board that this deal "*would prevent NCS from engaging in any alternative or superior transaction in the future.*" *Id.* at 924.

230. Plaintiffs filed the fiduciary duty claim in *In re* NCS Healthcare, Inc., S'holders Litig., 825 A.2d 240 (Del. Ch. 2002).

231. *Omnicare*, 818 A.2d at 934. The Delaware Court of Chancery denied the request for a preliminary injunction in an order dated November 22, 2002, which it revised on November 25, 2002. *See In re NCS Healthcare*, 825 A.2d at 263 (in which the preliminary injunction request was denied). The interlocutory review was in Appeal No. 649, 2002. *See Omnicare*, 818 A.2d at 920 (relating the procedural history of the case at hand).

232. The en banc Supreme Court was divided in a 3-2 decision. *Omnicare*, 818 A.2d 914.

defensive measures of the merger agreement under the *Unocal* standard[233] and held that the deal-protection measures violated *Unocal*'s second step since the measures were both preclusive and coercive because no other proposal could succeed.[234] The majority held "alternatively"[235] that the NCS board was required to negotiate a fiduciary-out clause: "Notwithstanding the corporation's insolvent condition, the NCS board had no authority to execute a merger agreement that subsequently prevented it from effectively discharging its ongoing fiduciary responsibilities."[236]

In reaching its decision, the majority of the Delaware Supreme Court chose to ignore all monitors. After the Court of Chancery[237] and all five justices of the Delaware Supreme Court conceded that the NCS board was independent and well informed,[238] one would expect the majority to defer to this board.[239] The majority, however, gave two reasons to proceed

233. It is questionable whether this case should have been governed by *Unocal*. Traditionally, a third-party merger is governed by the business judgment rule. *See supra* notes 24–25 (noting that the business judgment rule applies to a merger in which there is no conflict of interest). In *Omnicare*, however, the majority of the Delaware Supreme Court decided that since the lock-up defended NCS, *Unocal* was applicable. In reaching this conclusion, the majority of the Delaware Supreme Court ignored that the reason *Unocal* requires enhanced business judgment review is because target directors face an inherent conflict of interest if they *defend* the corporation from being taken over by a hostile offeror; the court failed to square that logic with its concession that the NCS directors had no conflict of any kind in their desire to *sell* the corporation. Moreover, the board's enactment of deal-protection devices was not defensive, but rather proactive, in order to lure Genesis into a deal. *See id.* at 943 (Veasey, C.J., dissenting) (noting it is "debatable whether *Unocal* applies—and we believe that the better rule in this situation is that the business judgment rule should apply"); *Id.* at 947 (Steele, J., dissenting) (stating, "[i]n my opinion, Delaware law mandates deference under the business judgment rule to a board of directors' decision that is free from self interest, made with due care and in good faith"). *Cf.* Gantler v. Stephens, 965 A.2d 695, 705 (Del. 2009) (refusing to apply *Unocal* to the board's decision not to pursue a merger opportunity because there was no hostile tender offer or other action by which court could infer that board acted defensively).

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

235. *Id.*

236. *Id.* at 938.

237. *Id.* at 925 (noting that "the Court of Chancery determined the minutes reflect that the directors were fully informed of all material facts relating to the proposed transaction"); *see also id.* at 943 ("The overall quality of testimony given by the NCS directors is among the strongest this court has ever seen. All four NCS directors were deposed, and each deposition makes manifest the care and attention given to this project by every member of the board."); *In re NCS Healthcare*, Inc., S'holders Litig., 825 A.2d 240, 260 & n.46 (Del. Ch. 2002).

238. *Omnicare*, 818 A.2d at 940–41 (Veasey, C.J., dissenting) (noting that the majority opinion adopted the Court of Chancery's findings that the NCS board fulfilled all of its fiduciary duties, with dissent noting that "this conclusion is indisputable on this record").

239. *Id.* at 949 (Steele, J., dissenting) ("I believe that the absence of a suggestion of self-interest or lack of care compels a court to defer to what is a business judgment that a court is

otherwise. First, the majority reasoned that the board's conduct was both preclusive and coercive.[240] This conclusion, however, did not comport with its prior holdings that board conduct is draconian only when the board coerces the shareholder vote;[241] no one coerced the NCS controlling shareholders to execute a voting agreement. Recall that the controlling shareholders were officers and directors of NCS and thus heavily involved in the sale of the company; it was their judgment that a sale to Genesis was the only viable transaction. Thus, the majority failed to defer to a concededly independent and diligent board for an erroneous reason. Second, the court held it could not defer to this board because their agreement lacked a fiduciary out.[242] This logic, in essence, did not fault this particular board's conduct, but instead announced a new rule of law: There must always be a fiduciary out. While one can debate the wisdom of this rule,[243] an opinion based solely on this new requirement would have at least continued the courts' tradition of deferring to the judgment of independent and informed directors while faulting this board only for not complying with a yet-to-be announced rule of law.

Only the most favorable view of the majority's opinion would agree with the latter reason for not deferring to the NCS board. The court's logic for not deferring to the other two monitors, however, has no support. There simply is not a better case for trusting the shareholder vote. That vote was effectively the decision of the majority shareholders to execute the voting agreement with Genesis. These shareholders, as officers and directors, were informed; they chose to commit to the merger agreement not because the board coerced them or tricked them with misleading disclosure, but solely because their judgment was that a sure deal with Genesis was

not qualified to second guess.").

240. *Id.* at 936.

241. *See id.* at 945 (Veasey, C.J., dissenting) (noting that majority incorrectly applied law regarding a board coercing its stockholders to case at hand, where board took no such action).

242. *Id.* at 925.

243. *See, e.g.*, *id.* at 945 (Veasey, C.J., dissenting) (commenting on the majority's holding that a *per se* rule requiring a fiduciary out is necessary, and noting "[w]e know of no authority in our jurisprudence supporting this new rule, and we believe it is unwise and unwarranted"); *id.* at 948 (Steele, J., dissenting) ("I would not shame the NCS board, which acted in accordance with every fine instinct that we wish to encourage, by invalidating their action approving the Genesis merger because they failed to insist upon a fiduciary out. I use 'shame' here because the majority finds no breach of loyalty or care but nonetheless sanctions these directors for their failure to insist upon a fiduciary out as if those directors had no regard for the effect of their otherwise disinterested, careful decision on others."); *see also infra* notes 255–60 and accompanying text (describing cases that have rejected a *per se* requirement for a fiduciary out in a merger agreement).

preferable to a better deal that might or might not eventuate in the future.[244] Thus, unlike cases where courts invalidated the shareholder vote due to the board's defective disclosure,[245] there cannot be any claim that these controlling shareholders did not have all the facts. Moreover, the controlling shareholders obviously had the most at stake financially since collectively, they owned the majority of shares, and the deal gave both the majority and the unaffiliated shares the same consideration. As such, they had no conflict of interest. Thus, the minority votes were meaningless, not because of improper board conduct or faulty disclosure, but because the minority shares lacked the power to stop the controlling shareholders from exercising their votes as they wished.[246] Nor was there any finding that the minority shares, which need information in order to exercise their appraisal rights, were not given full and fair information. As a result, the court should have deferred to the shareholder vote, and the minority's disagreement, if any, should have been remedied solely through their appraisal rights.

Similarly, *Omnicare* is as compelling a case for deference to the market monitor as is possible. There was no reason for the court to distrust this market. This was not a conflict transaction. The NCS directors and controlling shareholders had no agenda other than what was best for NCS. The board did a thorough and careful market search.[247] Search periods

244. *Id.* at 944 (Veasey, C.J., dissenting) (reasoning that the controlling shareholders "were fully informed stockholders. As the NCS controlling stockholders, they made an informed choice to commit their voting power to the merger").

245. *See, e.g.*, Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983); Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985) (invalidating the shareholder vote on grounds that the board's gross negligence negatively affected its disclosure to the shareholders); *supra* note 156 and accompanying text (noting that the court in *Weinberger* invalidated the shareholder vote because the board had not made a full disclosure to the minority shares who had veto power over the deal).

246. *See Omnicare*, 818 A.2d at 944–45 (Veasey, C.J., dissenting) ("The minority stockholders were deemed to know that when controlling stockholders have 65% of the vote they can approve a merger without the need for the minority votes. . . . to the extent a minority stockholder may have felt 'coerced' to vote for the merger, which was already a *fait accompli*, it was a meaningless coercion—or no coercion at all—because the controlling votes . . . were already 'cast.' . . . there was no meaningful minority stockholder voting decision to coerce."); *see also* Freedman v. Restaurant Assoc., Indus., Inc., C.A. No. 9212, 1990 Del. Ch. LEXIS 142, at *18 (Del. Ch. Sept. 19, 1990) (reasoning that "a shareholder, even a majority shareholder, has discretion as to when to sell his stock and to whom").

247. The undisputed facts reveal that NCS began to explore its options in February of 2000 by retaining a financial advisor that contacted over fifty entities. *Omnicare*, 818 A.2d at 920. NCS then hired a different advisor in December of 2000, as NCS' financial situation deteriorated. *Id.* at 921. In the summer of 2001, NCS invited Omnicare to begin discussions with NCS' financial advisor; Omnicare submitted a bid that was unsatisfactory to NCS. *Id.* In January, 2002, NCS contacted Genesis about a possible deal, while Omnicare pursued secret discussions with one of NCS' directors. *Id.* In June, 2002,

require end dates,[248] particularly given NCS' dire financial straits: It was on borrowed time and staring into the abyss of bankruptcy. Despite the NCS board's repeated efforts to get Omnicare to the table,[249] the market produced only one bid—Genesis'—in the timeframe set by the NCS board. As the court in *Barkan* reasoned, "when it is widely known that some change of control is in the offing and no rival bids are forthcoming . . . that fact is supportive of the board's decision to proceed."[250] Moreover, the majority paid little heed to Genesis' role and needs: It was the Genesis deal that spurred a higher, concrete offer from Omnicare, but the Genesis deal would not have eventuated without the lock-up.

Given that the facts of *Omnicare* trip all three monitors and none of their exceptions or refinements, it is curious that the majority of the Delaware Supreme Court eschewed these monitors in favor of judicial review. The court's disregard of all of the monitors is inexplicable, save for the following telling comment:

> The latitude a board will have in either maintaining or using the defensive devices it has adopted to protect the merger it approved will vary according to the degree of benefit or detriment to the stockholders' interests that is presented by the value or terms of the *subsequent competing transaction*.[251]

In other words, the majority's decision can be explained by its frustration that the board was unable to seize the better deal; by invalidating the deal-protection devices, the majority of the Delaware Supreme Court delivered that better option to the NCS shareholders. Little

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Genesis made a proposal but insisted on an exclusivity agreement. *Id.* at 922. NCS and Genesis continued to negotiate the deal through July of 2002, *id.* at 923, when Omnicare resurfaced with a conditional offer. *Id.* at 924. As Justice Steele in dissent reasoned, "the NCS board had thoroughly canvassed the market in an attempt to find an acquirer, save the company, repay creditors and provide some financial benefit to stockholders. They did so in the face of silence, tepid interest to outright hostility from Omnicare. The only *bona fide*, credible merger partner NCS could find during an exhaustive process was Genesis." *Id.* at 947.

248. *See In re* Toys "R" Us, Inc. S'holder Litig., 877 A.2d 975, 1008–12 (Del. Ch. 2005) (finding board's decision to accept a deal after an open market check of one year produced no capable buyers); *see also supra* notes 124–25 and accompanying text (regarding additional information about *Toys "R" Us*).

249. The undisputed facts show that NCS reached out to Omnicare in the summer of 2001, *Omnicare*, 818 A.2d at 921, sent its financial advisor to meet with Omnicare's financial advisor in October of 2001, *id*., and only in late July of 2002, after Omnicare was concerned that NCS was negotiating a deal with an Omnicare competitor, did Omnicare present a proposal to NCS that would have been acceptable to NCS had it not been qualified by so many conditions. *Id.* at 924.

250. Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1287 (Del. 1989).

251. *Omnicare*, 818 A.2d at 933 (emphasis added).

time, however, need be spent highlighting the obvious: Courts should not second-guess any board's conduct based on a better offer that subsequently emerges. This is one rationale for the business judgment rule,[252] and a concern quickly blunted after *Revlon*, where Delaware courts repeatedly assured boards that they need not have a crystal ball, nor guarantee that they have secured the best bid.[253] In *Omnicare*, the majority of the Delaware Supreme Court reneged on that promise. As the Court of Chancery in *Orman v. Cullman* commented on *Omnicare*, "the test would appear to result in judicial invalidation of negotiated contractual provisions based on the advantages of hindsight."[254]

In sum, all monitors, as well as appraisal rights, were in play in *Omnicare*. Had the court deferred to the monitors, the majority would have decided the case differently. It is important to underscore, however, that rather than a debate of opinions about whether this board breached its fiduciary duties, the monitors instead provided concrete facts that would have supported a contrary outcome.

Moreover, the "market" of judicial opinions has decreed that *Omnicare* was wrongly decided. One California court has squarely held that *Omnicare* is not the law in California,[255] and the Delaware Court of Chancery has openly criticized *Omnicare* as "an aberrational departure" from the traditional view that the critical fact is whether the board acted reasonably based on all of the facts and circumstances.[256] Equally telling is that the Delaware Court of Chancery has attempted to dilute *Omnicare*'s effect on Delaware law. In *Openlane, Inc. Shareholders Litigation*,[257] the Delaware Court of Chancery held that no fiduciary out was required where the board agreed to a merger and the controlling shareholders signed written consents approving the merger the day after the board signed the agreement, as opposed to before the merger vote, as was the case in *Omnicare*. The Delaware Court of Chancery distinguished *Omnicare* by

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252. *Supra* note 12 (identifying that one rationale for the business judgment rule is to shield directors from liability when a better deal emerges in the future).

253. *See supra* note 117 (explaining directors can only attempt to get the best bid, and will not be liable if a better bid emerges in the future); *supra* note 126 and accompanying text (same).

254. C.A. No. 18039, 2004 Del. Ch. LEXIS 150, at *35 n.98 (Del. Ch. Oct. 20, 2004); *see also Omnicare*, 818 A.2d at 940 (Veasey, C.J., dissenting) ("Our jurisprudence cannot . . . be seen as turning on such ex post felicitous results. Rather, the NCS board's good faith decision must be subject to a real-time review of the board action before the NCS-Genesis merger agreement was entered into.").

255. Monty v. Leis, 123 Cal. Rptr. 3d 641, 646 (Cal. Ct. App. 2011), *rev. denied*, June 15, 2011 ("*Omnicare* has been criticized even by Delaware courts . . . . We decline to follow *Omnicare*.").

256. *Toys "R" Us*, 877 A.2d at 1016 n.68 (Del. Ch. 2005).

257. No. 6849-VCN, 2011 Del. Ch. LEXIS 156 (Del. Ch. Sept. 30, 2011).

reasoning that since the shareholder vote was not part of the merger agreement, the transaction was not a certainty.[258] Similarly, the Court of Chancery in *Orman v. Cullman*[259] granted defendants' motion for summary judgment in a merger where plaintiff claimed the board breached its fiduciary duties. In reasoning that the board had not locked up a deal, the court distinguished its case from *Omnicare* on two grounds, neither of which accurately portrayed that the deal was, realistically, locked up.[260] Thus, some opinions from the Delaware Court of Chancery range from outright criticism of *Omnicare* to outright evasion of *Omnicare*'s tentacles.

B. Entire Fairness: Kahn v. Lynch

Kahn v. Lynch Communication System, Inc.[261] (*Kahn I*) is another outlier case in that the Delaware Supreme Court chose to disregard two monitors: independent directors and the votes of disinterested shares. As discussed above,[262] *Kahn I* involved a shareholder's suit against his corporation, Lynch, which was acquired by Lynch's controlling shareholder, Alcatel U.S.A. Corporation (Alcatel), pursuant to a tender offer followed by a cash-out merger.[263] Plaintiff claimed that Alcatel breached its fiduciary duties to Lynch and its shareholders by dictating the

258. The Court of Chancery in *Openlane* was aware that its efforts to distinguish this case from *Omnicare* were razor thin, commenting in a footnote that even though there was no shareholder agreement in the case at hand, since board members owned sixty percent of the stock, majority approval of the merger the day after the merger agreement was signed was a "virtual certainty." *Id.* at *31 n.48. Furthermore, the Court of Chancery in *Openlane* presented another novel way to cabin *Omnicare*. The court in *Openlane* contended that since *Omnicare* may be read to require a fiduciary out in merger agreements, the world of hostile bidders was aware that it could bid for a company that had locked up a merger without a fiduciary-out clause; therefore, the Court of Chancery contended that there was no reason for the court to grant an injunction unless a better offer emerges. As the Court of Chancery conceded that such a merger agreement, followed quickly by consents, no doubt discouraged other suitors, the court lacked a response to its own argument. *Id.* at *34 n.53.

259. C.A. No. 18039, 2004 Del. Ch. LEXIS 150 (Del. Ch. Oct. 20, 2004).

260. The two bases for distinguishing *Orman* from *Omnicare* were first, that the board in *Orman* retained a fiduciary out, *id.* at *13 n.42, and second, the unaffiliated shares had veto power over the deal. *Id.* at *33 n.92. These two facts, however, convey an incomplete picture because the shareholders who owned thirty-six percent of the stock agreed to vote for the deal and against any alternative transaction for eighteen months. As the Court of Chancery recognized, "It was this deal or nothing, at least for that [eighteen month] period of time." *Id.* at *36 & n.99.

261. 638 A.2d 1110 (Del. 1994) [*Kahn I]*, *aff'd on reh'g*, 669 A.2d 79 (Del. 1995) [*Kahn II*].

262. *See supra* text accompanying note 165.

263. *Kahn I*, 638 A.2d at 1111.

terms of the merger, making false disclosures, and paying an unfair price.[264] While the Court of Chancery held that Alcatel was a controlling shareholder,[265] and, as such, owed fiduciary duties to Lynch and its shareholders, the court concluded that Alcatel had not breached those duties.[266] The Delaware Supreme Court agreed that Alcatel was a controlling shareholder,[267] but held that the Court of Chancery had erred in ruling that plaintiff bore the burden to prove that the merger transaction was unfair; instead, the Delaware Supreme Court held that the burden of proving the entire fairness of the merger remained with Alcatel because the independent committee of directors had been unable to act independently in light of Alcatel's coercive behavior.[268] As such, the Delaware Supreme Court remanded to the Court of Chancery for proceedings in accordance with its opinion.[269] Moreover, the Delaware Supreme Court in *Kahn I* held that its concerns about the innate power of controlling shareholders would require the standard of review in any controlling-shareholder merger to remain entire fairness, with the burden shifting to the plaintiff to prove unfairness if a committee proves it acted independently and effectively represented the minority shares.[270] On remand, the Delaware Court of Chancery held that the merger was entirely fair.[271] On the second appeal, the Delaware Supreme Court affirmed the Court of Chancery's holding that Alcatel satisfied the requirements for entire fairness.[272]

264. *Id.*

265. Kahn v. Lynch Commc'n Sys., Inc., C.A. No. 8748, 1993 Del. Ch. LEXIS 151, at *6–9 (Del. Ch. July 9, 1993). Alcatel owned 43.3% of Lynch. *Kahn I*, 638 A.2d at 1114.

266. *Kahn v. Lynch Commc'n Sys.*, 1993 Del. Ch. LEXIS 151. The chancery court specifically rejected plaintiff's claim that Alcatel had made insufficient disclosure. *Id.* at *22. The Court of Chancery also held that the independent committee had been able to negotiate at arm's length with Alcatel. *Id.* at *13.

267. *Kahn I*, 638 A.2d at 1112, 1114.

268. *Id.* at 1112.

269. *Id.* at 1121–22.

270. *Id.* at 1117.

271. Kahn v. Lynch Commc'n Sys., C.A. No. 8748, 1995 Del. Ch. LEXIS 44, at *6 (Del. Ch. Apr. 17, 1995); *see also Kahn II*, 669 A.2d at 83 (recounting the Court of Chancery's finding that the merger was entirely fair).

272. *Id.* In *Kahn II*, the Delaware Supreme Court ticked off, *seriatim*, each of *Weinberger*'s elements to explain why this transaction, although the product of a coerced committee, nevertheless was entirely fair. In essence, the Delaware Supreme Court in *Kahn II* reasoned that, "[w]here other economic forces are at work and more likely produced the decision to sell, as the Court of Chancery determined here, the specter of coercion may not be deemed material with respect to the transaction as a whole, and will not prevent a finding of entire fairness." *Id.* at 86. Turning to the fair price issue, the Delaware Supreme Court deferred to the Court of Chancery's analysis as to why Alcatel had offered a fair price. *Id.* at 87–88. Finally, the Delaware Supreme Court rejected plaintiff's claim that Alcatel violated its duty of disclosure by omitting to state that it used coercion to get the Lynch board to agree to the merger price. *Id.* at 89. The Delaware Supreme Court reaffirmed prior

In *Kahn I*, the Delaware Supreme Court had two chances to defer to independent directors—once, in analyzing the conduct of Lynch's committee, and a second time, in selecting the standard of review—and rejected both opportunities. Focusing first on the composition of Lynch's committee, both the Delaware Supreme Court and the Court of Chancery agreed that the committee consisted of three independent directors[273] and was well-advised by a prominent law firm, a financial advisor, and an investment bank.[274] The point of dispute between the two courts was whether Lynch's special committee had real bargaining power. As the Delaware Supreme Court explained: "[T]he performance of the Independent Committee merits careful judicial scrutiny to determine whether Alcatel's demonstrated pattern of domination was effectively neutralized so that "each of the contending parties had *in fact* exerted its bargaining power against the other at arm's length."[275]

The Court of Chancery's conclusion that the committee had met this test and negotiated effectively was based on two facts. First, the committee rejected Alcatel's proposed deal between Lynch and Celwave Systems, Inc., a corporation owned by Alcatel.[276] Second, when Alcatel withdrew the Celwave proposal and offered to acquire the fifty-seven percent of

case law that held that defendants need not confess to wrongdoing to avoid a claim that they omitted material facts. *Id.* at 89 (citing to Weiss v. Rockwell Int'l Corp., C.A. No. 8811, 1989 Del. Ch. LEXIS 94 (Del. Ch. July 19, 1989), *aff'd*, 574 A.2d 264 (Del. 1990)). Instead, the court held there was no material omission in the proxy materials because "[a] reasonable minority shareholder of Lynch was under no illusions concerning the leverage available to Alcatel and its willingness to use it to acquire the minority interest." *Kahn II*, 669 A.2d at 89. The court's holding that there was no disclosure violation was significant, as it "precludes the award of damages *per se*, bears directly upon the manner in which stockholder approval was obtained, and places this case in the category of 'nonfraudulent transactions' in which price may be the preponderant consideration. . . . Although the merger was not conditioned on a majority of the minority vote, we note that more than 94 percent of the shares were tendered *In re*sponse to Alcatel's offer." *Id.* As such, the Delaware Supreme Court in *Kahn II* rejected plaintiff's contention that coercion of the independent committee was either a per se breach of fiduciary duty or required the conclusion that the merger was not entirely fair. *Id.*

273. *Kahn I*, 638 A.2d at 1113 (noting that Alcatel dealt with Lynch's independent committee); Kahn v. Lynch Commc'n Sys., C.A. No. 8748, 1989 Del. Ch. LEXIS 102, at *1 n.1 (Del. Ch. Aug. 24, 1989).

274. Lynch's special committee received legal advice from the New York law firm, Skadden, Arps, Slate, Meagher & Flom LLP, and retained Thomson McKinnon Securities, Inc., as its financial advisor as well as Kidder Peabody & Co., Inc., as its investment banker. *Kahn I*, 638 A.2d at 1113.

275. *Id.* at 1118 (citing Weinberger v. UOP, Inc., 457 A.2d 701, 709 n.7 (Del. 1983)).

276. *Kahn I*, 638 A.2d at 1112-13. Alcatel proposed a combination of Lynch and Celwave and made clear that Alcatel would not consider any other deal until Lynch first considered merging with Celwave.

Lynch's shares that Alcatel did not already own,[277] the committee then rejected three bids from Alcatel and ultimately accepted Alcatel's fourth offer.[278] While Alcatel accompanied its fourth offer with a threat to engage in a hostile tender offer if the merger agreement did not eventuate,[279] the Court of Chancery reasoned that the committee was informed and aggressive, and under no compulsion to reach an agreement.[280] The Court of Chancery contended that the committee reached its decision after it was advised that the price was fair and there were no other alternatives, given that Alcatel, as the controlling shareholder, could block any alternative transaction.[281]

In contrast, the Delaware Supreme Court in *Kahn I* drew the opposite inference from these facts. While the Delaware Court of Chancery thought Lynch's rejection of the proposed merger with Celwave indicative of the committee's independence, the Delaware Supreme Court reasoned that Lynch's concession to Alcatel's demand that Lynch consider a merger with Celwave before considering any other merger partner made "the Independent Committee's ability to bargain at arm's length with Alcatel suspect from the outset."[282] The committee's ultimate rejection of the proposed deal with Celwave—a company *owned* by Alcatel—did not change the Delaware Supreme Court's view that the committee's consideration of the deal demonstrated that the committee was compromised. Second, unlike the Court of Chancery, the Delaware Supreme Court also believed that Alcatel's threat of a tender offer, if Lynch did not agree to the merger terms, undermined the committee: The record reflects that the ability of the Committee effectively to negotiate at arm's length was compromised by Alcatel's threats to proceed with a hostile tender offer if the $15.50 price was not approved by the Committee and the Lynch board. The fact that the Independent Committee rejected three initial offers, which were well below the Independent Committee's estimated valuation for Lynch and were not combined with an explicit threat that Alcatel was "ready to proceed" with a hostile bid, cannot alter the conclusion that any semblance of arm's length bargaining ended when the Independent Committee surrendered to the ultimatum that accompanied

277. *Id.* at 1113-14.
278. *Id.* at 1113.
279. *Id.* at 1119.
280. *Id.*.
281. *Id.*
282. *Id.* at 1118. At the August 1, 1986 Lynch board meeting, Alcatel representatives on Lynch's board made clear that they opposed consideration of a proposed Lynch-Telco merger before consideration of a Lynch-Celwave combination. *Id.* at 1112. At the conclusion of this same meeting, the Lynch board established an independent committee to negotiate with Celwave. *Id.* at 1113.

Alcatel's final offer.[283] Thus, the Delaware Supreme Court refused to defer to this independent committee.

Although claiming that the committee's conduct did not meet the court's standards for effective negotiations, the Delaware Supreme Court actually never gave this committee a chance. From the court's own statement of facts, Lynch's full board agreed to consider the Celwave merger and then appointed a committee to consider this proposed deal.[284] Thus, like any board committee, this one had no choice but to follow the orders of its board,[285] and Lynch's board tasked its committee to consider a merger with Celwave. The Delaware Supreme Court's contention, therefore, that the committee's *consideration* of the Celwave merger—a decision that the board, rather than the committee, made—instead of the committee's *rejection* of the merger, was dispositive, was a fact outside of the committee's control. Similarly, the Delaware Supreme Court believed that Alcatel's *threat* of a hostile offer that accompanied its fourth offer, rather than the committee's *rejection* of three offers from Alcatel before agreeing to the final offer, evidenced that the committee was compromised. The committee, however, could not prevent Alcatel from threatening to make a hostile offer. Therefore, the only relevant issue was evaluating the committee's reaction to Alcatel's threat: Did the committee's decision to accept Alcatel's fourth offer evidence surrender to this threat, or instead reflect a business judgment that, although this threat was insubstantial, as a tender offer would likely face serious difficulties with the fifty-seven percent of shares not owned by Alcatel if Lynch's board recommended rejecting Alcatel's offer,[286] the committee thought it had reached the limits of its negotiations. Traditionally, Delaware courts would punt on this call,

283. *Id.* at 1121 (citation omitted). For a case with similar facts that reached a contrary view see *In re* Siliconix, Inc., S'holders Litig., C.A. No. 18700, 2001 Del. Ch. LEXIS 83, at *3-4 (Del. Ch. June 19, 2001) (reasoning that a controlling shareholder two-step freezeout is not inherently coercive, despite controlling shareholder resorting to a no-premium exchange offer, after failing to strike a deal with independent committee of directors).

284. *See supra* note 282 (explaining that the Lynch board established an independent committee to negotiate with Celwave).

285. The board can delegate most management functions to a board committee. *See* DEL. CODE ANN. tit. 8, § 141(c)(1)–(2) (2007) (detailing the formation and powers of a board committee under Delaware corporate law); *see also* 1 R. FRANKLIN BALOTTI & JESSE A FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS § 410[B] (3d ed. 2011). The Lynch board created an independent committee and delegated to it the power to negotiate with Celwave on behalf of Lynch. *See Kahn I*, 638 A.2d at 1113 (detailing the formation of the Lynch independent committee). As such, the committee was required to follow the instructions of the board.

286. Alcatel owned only 43.3% of Lynch's outstanding stock, although it had some additional clout by virtue of a provision in Lynch's charter that required 80% share approval for any business combination. *Kahn I*, 638 A.2d at 1113.

deferring to the decision of an independent and well-informed committee.

Since both facts on which the Delaware Supreme Court relied were completely out of the committee's control, this committee could not win. Once the committee received orders from its board of directors to consider the Celwave merger, and once Alcatel uttered the words that it would consider resorting to a hostile tender offer, this committee could no longer prove its independence to the Delaware Supreme Court. Thus, no deference was possible, as the court based its decision not on the committee's conduct, but on what others did and said.

Given that case law states that courts will defer to independent committees who have demonstrated real negotiating power, and given that the court did not give this committee any chance to earn that deference, one suspects that the court's real concern was the power of a controlling shareholder to undermine the process in a controlling-shareholder transaction. The Delaware Supreme Court in *Kahn I*, however, had the opportunity to incorporate these concerns into its standard of review, and did, in fact, seize that opportunity, by holding that entire fairness will remain the standard of review in any controlling-shareholder merger.[287] Therefore, by keeping the monitor as entire fairness, the court already anointed itself the ultimate arbiter of whether a controlling-shareholder merger is entirely fair. As such, the court could have deferred to this independent and well-informed committee and shifted the burden to plaintiff to prove that the transaction was unfair, while still retaining the power to scrutinize the conduct of this controlling shareholder.

Similarly, the court could have deferred to Lynch's shareholders. It is noteworthy that ninety-four percent of Lynch's disinterested shares tendered their stock to Alcatel in its two-step tender offer/merger offer.[288] While technically not voting, shareholders in a tender offer are choosing to express their "vote" by selling their shares.[289] Although the court in *Kahn I* did not mention this shareholder support for the Alcatel transaction, the

287. *Id.* at 1116 ("Entire fairness remains the proper focus of judicial analysis in examining an interested merger, irrespective of whether the burden of proof remains upon or is shifted away from the controlling or dominating shareholder, because the unchanging nature of the underlying 'interested' transaction requires careful scrutiny."). Prior to *Kahn I*, the issue was open about whether a successful independent committee would shift the standard of review from entire fairness to the business judgment rule. *Id.* at 1115 (noting that the lower court had identified different views on whether approval by an independent committee would change the standard of review from entire fairness to business judgment rule).

288. *Kahn II*, 669 A.2d at 89.

289. *See, e.g.*, *In re* Pure Res., Inc., S'holders Litig., 808 A.2d 421, 445 (Del. Ch. 2002) (viewing shareholders' selling of their stock akin to voting for purposes of establishing criteria for a controlling-shareholder tender offer to avoid being classified as coercive).

court in *Kahn II* used this support as one factor in ultimately holding that the merger was entirely fair.[290]

As with *Omnicare*,[291] the "market" of cases has deemed *Kahn*'s choice of the entire fairness standard wrong. As discussed above,[292] cases like *In re Pure Resources, Inc. Shareholders Litigation*[293] and *In re CNX Gas Corp. Shareholders Litigation*[294] have attempted to change the standard of review in controlling-shareholder freezeout transactions from entire fairness to the business judgment rule by identifying conditions under which courts can comfortably defer to the director and shareholder monitors.[295] It is particularly important to underscore that the Court of Chancery agrees with the Delaware Supreme Court about the capacity of a controlling shareholder to overreach;[296] their disagreement with the logic of *Kahn* is purely based on their faith in the external monitors. For example,

290. *Kahn II*, 669 A.2d at 89; *see also supra* note 272 (discussing other factors supporting the court's holding).

291. *See supra* notes 255–60 and accompanying text.

292. *See supra* notes 172–75 and accompanying text.

293. 808 A.2d 421 (Del. Ch. 2002) (finding that in the context of a voluntary tender or exchange offer, Delaware law does not recognize the ability of shareholders to receive a particular price, and therefore, entire fairness is not the standard of review; the touchstone is the presence of "voluntariness," to which that court looks at factors such as (1) whether coercion is present or (2) whether materially false or misleading disclosures were made to shareholders in connection with the offer; if the court finds the offer voluntary, then the controlling shareholder does not have a duty to prove the entire fairness of the transaction, and the court will defer to the board of directors as required under the business judgment rule).

294. 4 A.3d 397, 412 (Del. Ch. 2010) (stating that the business judgment rule should apply to freeze-out transactions that mirror the elements of an arm's length merger); *see In re* CNX Gas. Corp. S'holders Litig., C.A. No. 5377-VCL, 2010 Del. Ch. LEXIS 139 (Del. Ch. July 5, 2010) (finding that the Court of Chancery's application of the business judgment rule raised a sufficient conflict within Delaware case law that was appropriate for review by the Supreme Court), *certifying questions to* 30 A.3d 782 (Del. 2010).

295. Other Delaware cases have similarly sought to distance themselves from the holding in *Kahn* by differentiating the facts based on the role of the controlling shareholder. *See, e.g.*, *In re* John Q Hammons Hotels Inc., S'holder Litig., C.A. No. 758-CC, 2009 Del. Ch. LEXIS 174 (Del. Ch. Oct. 2, 2009) (distinguishing from *Kahn* because an unrelated third party, rather than controlling shareholder, made the offer to minority stockholders); *see also* Allen et al., *supra* note 2, at 1307–08 (recognizing that while there may be legitimate hesitancy in changing the standard of review based on the approval of an independent committee of directors, there is no basis for such hesitancy if there is a fully informed and uncoerced vote by disinterested shares).

296. *In re Pure Res.*, 808 A.2d at 444 (noting that the "preferable policy choice" is to provide flexibility while recognizing the "inherent coercion" in controlling-shareholder transactions); *In re CNX Gas Corp.*, 4 A.3d at 415 (agreeing that a controlling shareholder has the ability to overreach, and characterizing such power as "the ability to use its voting power to remove and replace incumbent directors and, if it wishes, force through its chosen transaction via [a] merger").

the Court of Chancery in *Pure Resources* directly highlighted the inconsistency of *Kahn*'s view that independent directors could be so intimidated, which is "premised on a less trusting view of independent directors than is reflected in the important case of *Aronson v. Lewis* . . . which presumed that a majority of independent directors can impartially decide whether to sue a controlling stockholder."[297] Similarly, in *CNX*, the Court of Chancery summarized other Delaware Court of Chancery cases that have greater faith in the monitors than does *Kahn*: "It bears noting that the Injunction Decision, *Cox Communications*, and the *Pure Resources* line of cases implicitly conflict with *Lynch* by holding that a combination of protective devices can compensate sufficiently for inherent coercion so as to alter the standard of review."[298] Furthermore, in order to demonstrate the efficacy of the external monitors, the Court of Chancery in *CNX* cited numerous examples of independent committees and disinterested shares that had the backbone to rebuff a controlling-shareholder transaction and concluded:

> Post-*Lynch* experience shows that special committees can negotiate effectively with controllers and that both special committees and minority stockholders can reject squeeze-out proposals . . . . *These examples augur in favor of a unified standard under which independent directors and unaffiliated stockholders are given the tools to negotiate with controllers, backstopped by meaningful judicial review for fairness when those tools are withheld.*[299]

Thus, these Court of Chancery opinions agree with the concerns articulated

297. *In re Pure Res.*, 808 A.2d at 436 n.17.

298. *In re CNX Gas Corp.*, 2010 Del. Ch. LEXIS 139, at *26–27.

299. *In re CNX Gas Corp. S'holders Litig.*, 4 A.3d at 413–14 (emphasis added). The court described the specific examples:

> I am currently presiding over a challenge to a controlling transaction in which the majority-of-the-minority tender condition failed twice. *See Revlon*, 990 A.2d at 957. Last fall the directors of iBasis adopted a rights plan in response to a tender offer by its controlling stockholder, Royal KPN. The iBasis directors filed two lawsuits against Royal KPN, took one of the lawsuits through trial, and ultimately extracted a price increase from $2.25 to $3 per share. In 2005, minority stockholders at Cablevision Systems Corporation rejected a going private transaction proposed by the Dolan family, which controlled 74% of the company's voting power, despite its 51% premium over market. In 2003, the outside directors of Next Level Communications, Inc. resisted a Siliconix tender offer and filed suit against the controlling stockholder to enjoin the transaction. *Next Level*, 834 A.2d at 846-47. In *Siliconix* itself, the exchange offer that was the subject of the decision ultimately failed to satisfy its majority-of-the-minority condition.

Id. at 413.

in *Kahn I* that the controlling shareholder can overreach, but do not agree with the view in *Kahn I* that judges, rather than fully-functioning external monitors, are the best arbiter. As the court in *In re CNX Gas Corporation* contended, *Kahn* "de-emphasized market forces . . . and relies heavily on judicial review."[300]

In sum, these outlier cases are interesting because the court in each case suspended its traditional reliance on the external monitors. As such, adding the external monitors to the analysis does more than present a different view of whether the *Omnicare* board breached its fiduciary duties, or who should have had the burden of proof in *Kahn*, and what should be the standard of review in a controlling-shareholder merger; the monitors also provide objective facts on which to ground a decision. As *Omnicare* and *Kahn* illustrate, when courts disregard the external monitors, judges delegitimize their opinions by pinning their decisions on inferences and suspect economics.

CONCLUSION

This Article has exposed that while judges say that they will defer to the board only under the business judgment rule, such deference is quite widespread in other tests as well. Delaware courts have worked hard to develop the contours of the external monitors so that courts can comfortably defer to an independent board or committee, disinterested share votes that are informed and not coerced, and a reliable market. Particularly when more than one fully-functioning monitor is active, these monitors present a formidable reason for courts not to intervene. Moreover, even though judges from the Delaware Court of Chancery agree that a controlling shareholder has the capacity to overreach, they have attempted to change the standard of review in controlling-shareholder cases to further rely on these monitors. The courts' strong support for fully-functioning monitors is invaluable information for transactional and litigation lawyers. This information is, however, also useful to judges, who can supplant otherwise intellectually-shaky decisions based solely on their own instincts, with strong grounding based on information derived from the external monitors.

300. *In re CNX Gas Corp.*, 2010 Del. Ch. LEXIS 139, at *42.