10-29-2021

Optimizing The World's Leading Corporate Law: A 20-Year Retrospective and Look Ahead

Lawrence Hamermesh
University of Pennsylvania

Jack B. Jacobs
Young Conaway Stargatt & Taylor LLP

Leo E. Strine Jr.
University of Pennsylvania

Optimizing The World's Leading Corporate Law: A 20-Year Retrospective and Look Ahead

(Working Paper – October 29, 2021)

Lawrence A. Hamermesh[1]
Jack B. Jacobs[2]
Leo E. Strine, Jr.[3]

---

[1] Executive Director, Institute for Law & Economics, University of Pennsylvania Carey Law School; Professor Emeritus, Widener University Delaware Law School. Firms with which the authors have been affiliated have been involved in some of the cases discussed, which have arisen over a long period in Delaware law, and two of the authors also were involved in several of the cases when they were members of the Delaware Judiciary. Nevertheless, the views of the authors are theirs alone, and not that of any firm or other organization with which they are or have been affiliated.
[2] Senior Counsel, Young, Conaway, Stargatt & Taylor; former Justice and Vice Chancellor, the State of Delaware.
[3] Michael L. Wachter Distinguished Fellow at the University of Pennsylvania Carey Law School; Senior Fellow, Harvard Program on Corporate Governance; Of Counsel, Wachtell, Lipton, Rosen & Katz; former Chief Justice and Chancellor, the State of Delaware.

The authors are grateful for the incisive comments of Mark Gentile, Bill Lafferty, Ryan McLeod, Ted Mirvis, Trevor Norwitz, Kevin Shannon, Greg Williams, and John Mark Zeberkiewicz, and the help of Corey Banks, Michael Klain, Stephen Mattes, Peggy Pfeiffer, Daria Rose, Jarett Rovner, and Lorenzo Villegas.

Abstract

*In a 2001 article (*Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*) two of us, with important input from the other, argued that in addressing issues like hostile takeovers, assertive institutional investors, leveraged buyouts, and contested ballot questions, the Delaware courts had done exemplary work but on occasion crafted standards of review that unduly encouraged litigation and did not appropriately credit intra-corporate procedures designed to ensure fairness. Function Over Form suggested ways to make those standards more predictable, encourage procedures that better protected stockholders, and discourage meritless litigation, by restoring business judgment rule protection for transactions approved by independent directors, the disinterested stockholders, or both.*

This article examines how Delaware law responded to the prior article's recommendations, concluding that the Delaware judiciary has addressed most of them constructively, thereby creating incentives to use procedures that promote the fair treatment of stockholders and discourage meritless litigation. The continued excellence and diligence of the Delaware judiciary is one of Delaware corporate law's core strengths.

But some recent cases have articulated standards of review that involve greater than optimal litigation intensity and less than ideal respect for decision-making in which independent directors and disinterested stockholders have potent say. Those standards also impair the integrity of Delaware's approach to demand excusal in derivative cases and the identification of controlling stockholders. We also propose eliminating concepts like substantive coercion that do not provide a legitimate basis for resolving cases. Finally, we urge action to correct new problems such as the unfair targeting of corporate officers for negligence claims in representative actions and the frustrating state of practice under Delaware's books and records statute.

I. Introduction

A generation ago, two of us, together with our late friend, Professor and former Chancellor William T. Allen as co-author, and the third of us as a primary sounding board, published *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*.[4] We were all deeply committed to the integrity, fairness, efficiency, and thus effectiveness of Delaware corporate law. And we understood the challenge of helping to assure that a corporation law dependent on judicial common law responded appropriately to new market developments. In the main, the Delaware judiciary, supported by those who drafted and enacted

[4] William T. Allen, Jack B. Jacobs and Leo E. Strine, Jr., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287 (2001) [hereinafter *Function Over Form*].

Delaware's statutory corporate law, had done an exemplary job of addressing new phenomena such as hostile takeovers, assertive institutional investors, management- and controller-led leveraged buyouts, and contested ballot questions of various kinds.

We also recognized, however, that when courts charged with doing equity, often under considerable time pressure, confront novel situations involving corporate action arguably tainted by a conflict of interest to the detriment of the corporation and its stockholders, they may be tempted to develop litigation-intensive standards of review specifically tailored to each emerging situation.[5] Such standards can cause systemic inefficiency. Incentivizing transactional planners to use mechanisms that are both costly and risky, such as special committees or stockholder votes, requires that those mechanisms meaningfully restrain judicial review.[6] Review standards that afford courts undue freedom to second-guess transactions, even after negotiation by a special committee of independent directors or a fully informed vote by the disinterested stockholders, discourage transactional planners from using those processes. Litigation costs rise unnecessarily, when newly articulated standards of review increase the ability of plaintiffs' lawyers to extract a fee-generating settlement solely because the anticipated costs of discovery and litigating a case that cannot be dismissed on the pleadings exceeds the cost of a settlement.

Function Over Form identified specific areas where these tendencies had crept into Delaware law and eroded its effectiveness. To address them, we argued first that standards of review must make functional sense, and we proposed criteria for defining such functionality. Second, we proposed that Delaware's equitable common law of corporations should function on the basis of three standards of review: i) the business judgment rule, to govern decisions approved by impartial decision makers and to address damages claims based on a lack of due

[5] *Id.* at 1292.
[6] *Id.* at 1297.

care; ii) intermediate scrutiny, to address takeover defenses, corporate sales processes, and potential ballot manipulation; and iii) the entire fairness standard, to address self-dealing transactions that were not approved by impartial decisionmakers.[7] We suggested ways to make the application of these standards more predictable, to encourage decision-making procedures that better protected stockholders from abuse, and to afford a less litigious path where the challenged corporate decision was made by independent directors or approved by the disinterested stockholders, or both.[8]

In particular, *Function Over Form* advocated rationalizing standards of review that developed in response to the takeover and M&A boom of the 1980s and 1990s. At the outset of that era, the courts had not yet developed a standard of review that adequately and flexibly balanced the utility of applying business judgment rule deference to impartial decision-making against the reality that takeover bids presented new forms of conflicts of interest. To achieve that balance, the Delaware Supreme Court, in its foundational *Unocal* and *Revlon* decisions, created an intermediate standard of review that was more stringent than business judgment rule non-review yet less demanding and more flexible than entire fairness review.[9]

Function Over Form concluded that the Delaware courts' responses to the rapidly evolving market for corporate control, "viewed collectively and from a policy perspective, were balanced and productive."[10] But even so, a period of such intense doctrinal innovation would predictably leave the law more complex, less clear, and less than optimally fair and efficient. "From a technical corporation law perspective … th[e] results were often rationalized in a

[7] *Function Over Form*, *supra* note 4, at 1293.
[8] *Id*. at 1297.
[9] *E.g.*, Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985); Revlon, Inc. v. MacAndrews & Forbes Co., 506 A.2d 173 (Del. 1986); Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985); *Unitrin*, 651 A.2d 1361 (Del. 1995).
[10] *Function Over Form*, *supra* note 4, at 1291.

manner that gave inadequate guidance to lawyers whose task was to plan, and render advice to clients about, transactions based upon these post-1985 judicial opinions."[11]

To address this concern, *Function Over Form* examined how standards of review should function consistently with fundamental principles of equity:[12]

> Our thesis is that certain key Delaware decisions articulated and applied standards of review without adequately taking into account the policy purposes those standards were intended to achieve. [N]ew standards of review proliferated when a smaller number of functionally-thought-out standards would have provided a more coherent analytical framework. [W]e suggest a closer alignment between the standards of judicial review used in Delaware corporate law and the underlying policies that that body of law seeks to achieve.[13]

A core theme was that the Delaware Supreme Court's efforts to link all the emerging standards of review to the business judgment rule had created a complex and ambiguous framework for standards of review that was clunky and unpredictable. The article therefore proposed "mid-course corrections" to simplify these standards of review and make them more functional.[14] Specifically:

> To be functional, a standard of review should:
>
> (i) provide judges with a practical and logical framework to determine whether corporate directors have fulfilled their duties in a particular context and the appropriate remedies if they have not;
>
> (ii) avoid needless complexity that creates opportunities for inefficient processing of cases that have little likelihood of ultimate success; and

---

[11] *Id.* at 1291-92 n. 11 (citing, for example, confusion caused by the Supreme Court's decision in Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140 (Del. 1990) articulating what triggered duties under *Revlon*).
[12] A. A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1049 (1931); Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971); Sample v. Morgan, 914 A.2d 647, 664 n.54 (Del. Ch. 2007).
[13] *Function Over Form*, *supra* note 4, at 1292.
[14] *Id.* at 1295, 1309.

> (iii) be aligned with the public policies that animate the corporate law by providing incentives for directors to act in a manner most likely to advance corporate and stockholder interests, and by deferring to outcomes reached through effective intra-corporate dispute resolution mechanisms.
>
> To us, a reliable test of whether a standard of review is truly functional is utilitarian: is the standard a useful tool that aids the court in deciding the fiduciary duty issue? … Put another way, the truly functional standard of review is the test actually used by the judge to reach a decision, not the ritualistic verbal standard that in truth functions only as a conclusory statement of the case's outcome.[15]

The bottom line recommendation was that Delaware courts should apply the three core standards of review in a manner functionally consistent with those principles. Where a specific standard applied, the court should apply it on a standalone basis, and not attempt to link it to other standards in an effort to fabricate a kind of unified field theory.[16]

In this article, we examine how Delaware corporate law has responded to the prior article's recommendations. We conclude that in general, the Delaware judiciary has addressed most of the original article's concerns consistent with those recommendations. More specifically, the Delaware courts successfully clarified (and in some instances reshaped) review standards so as to create incentives for transactional planners and corporate boards to use decision making processes that promote the fair treatment of stockholders, and discourage meritless litigation.

Nevertheless, there are several areas where the concerns expressed in *Function Over Form* have persisted or acquired renewed resonance. The case law of the new century has generated certain standards of review and other doctrinal approaches that create excessive

---

[15] *Id*. at 1297-98 (footnotes and citations omitted).
[16] *Id.* at 1298; *see also id.* at 1309-11, 1319.

litigation intensity and suboptimal respect for intra-corporate decision-making processes in which independent directors and disinterested stockholders have potent say. Those areas of renewed concern – all but the last two of which implicate articulation of standards of review – are addressed below. Those problematic areas are summarized below, along with the remedies we propose:

a. Extending the inherent coercion theory expressed in *Kahn v. Lynch*[17] beyond freezeout mergers to all controller transactions, thereby (i) making the procedural requirements specified in *MFW*[18] applicable to decisions for which they were not designed and do not rationally pertain, and (ii) inappropriately expanding the range of full discovery and judicial review for fairness. We advocate abandoning *Lynch*'s inherent coercion rationale and limiting the reach of *MFW* to transactions in which a controlling stockholder seeks to acquire the minority's shares, or a statute requires the approval of both the board and the stockholders.

b. Enlarging the definition of "controlling stockholders" to include persons having little or no share voting power, and to lump together unaffiliated stockholders into a "control bloc," so that a different standard of review applies, thereby expanding the range of full discovery and judicial review for fairness. To address this concern, we propose limiting the concept of "controlling stockholder" to the situation where a stockholder's voting power gives it at least negative power over the company's future, in the sense of acting as a practical impediment to any change of control.

c. Insufficiently distinguishing between transactions involving classic self-dealing and transactions in which a fiduciary (whether a director or controlling stockholder) receives an

[17] Kahn v. Lynch Commc'n Sys., 669 A.2d 79 (Del. 1995) ("*Kahn v. Lynch*," or "*Lynch*").
[18] Kahn v. M&F Worldwide Corp., 67 A.3d 496, 528 (Del. Ch. 2013) (outlining procedures that if used in a going private merger proposed by a controlling stockholder invoke the business judgment standard of review), *aff'd*, 88 A.3d 635 (Del. 2014).

additional benefit only because of being differently situated, thereby extending entire fairness review to a context where it does not fit. We advocate restoring that distinction, at the injunctive stage, by applying *Unocal* and *Revlon* intermediate judicial review to transactions where a fiduciary merely receives (but does not force) a benefit, such as a post-merger compensation package, not received by other stockholders. In a post-closing damages case, the review standard should require the plaintiff to prove a breach of the duty of loyalty and resulting damages.

d. Circumscribing the reach of the second prong of *Aronson*,[19] by prescribing dismissal of a well-pleaded loyalty claim unless a majority of the directors face likely liability on a non-exculpated claim. We advocate reinvigorating *Aronson*'s second prong "safety valve" to allow demand excusal if the particularized facts support an inference that a breach of fiduciary duty has harmed the company. Alternatively, if that is not the case, and Delaware law presumes that independent directors who approved a transaction alleged to involve unfair self-dealing can turn around and impartially sue their interested colleague on the board over that same transaction after the fact, then logically it should also presume they can perform the easier and less dramatic upfront function of effectively negotiating a fair transaction or saying no if fair terms are not reached. Otherwise, Delaware law will rest on incoherent premises about independent directors.

e. Maintaining doctrinal complications like "substantive coercion" and the "waste" vestige of business judgment review. that obscure proper application of standards of review and frustrate the principles that should drive case outcomes. We advocate (i) eradicating the concept of "substantive coercion" as a basis for board authority to block a non-coercive bid, and relying instead simply on the board's ordinary authority; ii) interring the vestigial "corporate waste"

---

[19] Aronson v. Lewis, 473 A.2d 805 (Del. 1984).

claim where the disinterested stockholders approve the challenged transaction; and (iii) overruling *Cede II*'s[20] and *Unitrin*'s[21] effort to link together all three core standards of review.

f. Enabling the plaintiffs' bar to exploit the omission of coverage of corporate officers under § 102(b)(7), and avoid dismissal by singling out officers as defendants, where the challenged decisions are made by a majority independent board. To remedy this exploitation, we propose that § 102(b)(7) be amended to permit exculpation of officers for duty of care claims in class or derivative actions, but not for claims brought by the company to enforce a contract or corporate common law.

g. Expanding the scope of what constitutes "books and records" under § 220,[22] thereby enabling stockholder plaintiffs to prospect for a claim challenging a merger that requires stockholder approval. That in turn encourages defendants to interpose delaying tactics and objections that frustrate the intended summary character of these statutory proceedings. To address these problems, we recommend amending § 220 to provide that where a public company stockholder vote is held on a merger, "books and records" should be limited to the equivalent of SEC Rule 13e-3[23] materials within the company's control.

II. A Roadmap of the Article

In what follows, Section III traces how Delaware corporate law responded to the major concerns identified *Function Over Form*. Section IV addresses areas where the original article's concerns have either persisted or re-emerged, largely because of the inescapably difficult judgments that Delaware's excellent corporate law judges must make, in real time and on imperfect records. Section IV also elaborates on the ameliorating policy changes previewed

[20] Cede & Co. v. Technicolor, Inc., 634 A.2d 345 (Del. 1993) ("*Cede II*").
[21] Unitrin, Inc. v. American Gen. Corp., 651 A.2d 1361 (Del. 1995).
[22] DEL. CODE ANN. tit. 8, § 220 (West 2010).
[23] 17 CFR § 240.13e-3(d) and 240.13e-100 (Schedule 13E-3).

above. We submit that these measured but important recalibrations will enhance the ability of Delaware corporate law to fairly balance efficiency and fairness, reduce rent-seeking in the litigation process, provide meaningful incentives for faithful fiduciary conduct, and remain true to the business judgment rule tradition without detracting from the ability of Delaware courts to remedy genuine inequities.

III. Twenty Years of Doctrinal Evolution

A. *The Duty of Care: Towards Doctrinal Clarity*

The opportunity to enforce a duty of care tempts law-trained judges to consider imposing monetary liability on directors and managers who make business judgments in real time, by superimposing judicial views of appropriate business tactics with the benefit of hindsight. The business judgment rule exists to keep that temptation at bay. Consistent with that concern, *Function Over Form* questioned the Supreme Court's attempt in *Cede II*[24] to turn a conventional inquiry into whether a due care violation had occurred into a tour through multiple unrelated standards of review. The article criticized that ruling on several grounds: first, the basic rationale for entire fairness review—the difficulty of ascertaining, in non-arm's length transactions, the price at which a deal would have been effected—is alien to due care analysis; second, in cases not involving a specific transaction, an entire fairness analysis is of little or no utility; third, *Cede II*'s unprecedented standard-changing and burden-shifting treatment of the duty of care was procedurally unfair to directors, and would diminish their incentive to engage in risky wealth-creating transactions that, as a policy matter, boards should be encouraged to undertake; and fourth, that treatment conflicted with the policy for § 102(b)(7) provisions exculpating directors for duty of care damages claims without any showing of entire fairness, by seeming to require

[24] Cede & Co. v. Technicolor, Inc. 634 A.2d 345 (Del. 1993).

directors affirmatively to establish entire fairness to earn their statutory entitlement to exculpation.[25] This attempt to unify disparate standards of review that address quite distinct circumstances and concerns was confusing. *Function Over Form* advocated a straightforward approach to due care damages cases: the plaintiff should have to prove a due care breach and resulting damages.[26]

The article also questioned decisions treating the existence of an exculpatory charter provision as a factual matter that could not be considered at the motion to dismiss stage. Thus, one case suggested that a director who would be exculpated from liability for a due care breach had to remain a defendant in a case challenging an interested transaction, even if the complaint pled no facts inferentially establishing a non-exculpated breach of fiduciary duty.[27] This procedural oddity conflicted with other decisions, undermined the intended purpose of § 102(b)(7), raised litigation costs, and added needless complexity.

The Supreme Court has eliminated this ambiguity and oddity, by taking the side of those cases that had ruled that an exculpatory charter provision must be considered on a motion to dismiss.[28] If the complaint does not plead facts that rationally support a loyalty claim, it should be dismissed. Thus, the intended function of § 102(b)(7) is now better served.

The concern about *Cede II*'s due care/entire fairness linkage persists, however: the Delaware Supreme Court has yet to disavow that linkage explicitly, even though no Delaware

---

[25] *Function Over Form*, *supra* note 4, at 1304-05.
[26] *Id.*
[27] *E.g.*, Emerald Partners v. Berlin*,* 726 A.2d. 1215 (Del. 1999).
[28] *See In re* Cornerstone Therapeutics Inc., S'holder Litig., 115 A.3d 1173, 1185-86 (Del. 2015). For cases before *Cornerstone* embracing a similar view of § 102(b)(7), see McPadden v. Sidhu, 964 A.2d 1262, 1274-75 (Del. Ch. 2008); DiRenzo v. Lichtenstein, C.A. No. 7094-VCP, 2013 WL 5503034, at *34-38 (Del. Ch. Sept. 30, 2013); *In re* S. Peru Copper Corp. S'holder Derivative Litig., 52 A.3d 761 (Del. Ch. 2011); Raul v. Astoria Fin. Corp., C.A. No. 9169-VCG, 2014 WL 2795312, at *10 (Del. Ch. June 20, 2014).

court has since cited that aspect of *Cede II* approvingly. We view this silence as an implicit recognition that the *Cede II* linkage was dysfunctional, but hope that it will be given an overdue formal interment.

B. *Dispatching the "Triad:" Restoring Good Faith as a Fundamental Requirement of a Loyal Fiduciary*

Function Over Form noted another problem arising out of *Cede II*, namely its pronouncement that in addition to the two core fiduciary duties — loyalty and care[29] — there was a third duty, that of "good faith." This additional duty, creating what was described as a "triad,"[30] made little sense.[31] As *Function Over Form* noted:

> Although corporate directors are unquestionably obligated to act in good faith, doctrinally that obligation does not exist separate and apart from the fiduciary duty of loyalty. Rather, it is a subset or "subsidiary requirement" … subsumed within the duty of loyalty….[32]

Later case law, culminating in *Stone v. Ritter,*[33] has put the "triad" to rest. This clarified our law and aligned basic fiduciary doctrine with *Caremark*, which premises director liability on a failure to make a good faith effort to monitor the company's compliance with law.[34]

C. *Unocal Review Should Stand on its Own*

[29] The duty of loyalty is paramount and the duty to try to exercise reasonable care is itself a requirement of the duty of loyalty. A good faith effort to act prudently in making business decisions is required by the obligation of loyalty. *See* Marchand v. Barnhill, 212 A.3d 805, 821 (Del. 2019) ("In short, to satisfy their duty of loyalty, directors must make a good faith effort to implement an oversight system and then monitor it.) *See also* Firefighters' Pension Sys. of City of Kansas City v. Presidio, Inc., 251 A.3d 212, 251, 253 (Del. Ch. 2021) (discussing the duty of loyalty and "its subsidiary element of good faith").

[30] *Cede II*, 634 A.2d at 361 (citations omitted).

[31] Leo E. Strine, Jr., Lawrence A. Hamermesh, R. Franklin Balotti, and Jeffrey M. Gorris, *Loyalty's Core Demand: The Defining Role of Good Faith in Corporate Law*, 98 GEO. L.J. 629 (2009).

[32] *Function Over Form*, *supra* note 4, at 1305 n.69.

[33] Stone v. Ritter, 911 A.2d 362 (Del. 2006); Guttman v. Huang, 823 A.2d 492, 506 n.34 (Del. Ch. 2003).

[34] *In re* Caremark Int'l Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996).

Consistent with its focus on functionality, *Function Over Form* urged that the three basic standards of review operate independently: where a standard applies, the court's employment of that standard should be case-dispositive, and not invite an unnecessary detour into a different, unrelated standard of review. *Function Over Form* therefore urged that the attempt to link *Unocal* review (of the reasonableness of a target company board's defensive measure) to the entire fairness and business judgment standards of review served no useful function.[35] According to both *Unocal* and *Unitrin,*[36] however, finding a defensive measure reasonable (or not) under the *Unocal* standard would not end the inquiry. Rather, (i) if the board satisfies *Unocal*, its defensive actions would be subjected to a second layer of review under the business judgment standard, and (ii) if the board's actions fail *Unocal,* the defensive measures could still survive judicial scrutiny if the board can demonstrate that its actions were entirely fair.[37] But, it made no analytical sense to suppose that a board that passed the more stringent reasonableness test would fail the less demanding business judgment standard. Nor did it make sense to suppose that a board found to have acted unreasonably could nonetheless satisfy the more exacting entire fairness standard.

Perhaps recognizing that illogic, courts have made little use of *Unitrin*'s attempt to link *Unocal* and the business judgment and entire fairness standards. Rather, the Delaware courts have applied *Unocal*, and its sister *Revlon*, as free-standing standards of review.[38]

[35] Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).
[36] Unitrin, Inc. v. American Gen. Corp., 651 A.2d 1361 (Del. 1995).
[37] *See id.* at 1377 n.18, 1390; *see also Unocal,* 493 A.2d at 958.
[38] Accordingly, the cases now recognize that neither *Unocal* nor *Revlon* provides a framework for analyzing claims for monetary damages. *E.g.*, *In re* Cornerstone Therapeutics, Inc., 115 A.3d 1173, 1176 (Del. 2015) (a plaintiff seeking damages must plead non-exculpated claims against a director protected by a exculpatory charter provision regardless of the underlying standard of review); Corwin v. KKR Fin. Holdings, LLC, 125 A.3d 304, 312 (Del. 2015) ("*Unocal* and *Revlon* are primarily designed to give stockholders and the Court of Chancery the tool of injunctive relief to address important M & A decisions in real time, before closing. They were not tools designed with post-closing money damages claims in

D. *Securing the Ballot Box's Integrity Under the Intermediate Standard of Review*

The goal of simplifying standards of review into a tri-partite functional framework requires making policy choices. One such choice made in *Function Over Form* concerned using *Blasius*'s "compelling justification" standard as a functional standard of review.[39] That article – co-authored by the judge who authored *Blasius* – acknowledged that because of the broad authority entrusted to boards of directors, the legitimacy of Delaware corporate law would be suspect if it did not police ballot manipulation strictly, and applauded *Blasius* as an iconic reaffirmation of the principle that stockholders have a right to elect directors without electoral manipulation by management.

Even so, *Blasius* functioned not as a standard of review but as a label for a result, because the trigger that invoked the test was whether there was an intentional effort to disenfranchise the stockholders. Few if any cases, however, involve action so patently ham-handed; in most electoral cases there are plausible reasons, unrelated to blocking a free exercise of stockholder will, for the challenged action. The court's task, then, is to determine whether that action was legitimate, or merely a pretext to thwart a fair exercise of voting rights. *Function Over Form* urged that *Blasius* be eliminated as a standalone standard of review, and that its concerns be addressed by applying *Unocal* and requiring the board to identify a threat that justified their action and demonstrate that it was reasonable in light of that threat. That position did not condone board action designed to disenfranchise stockholders or tilt an election unfairly; it merely asserted that the *Unocal* test would be more effective in identifying such behavior,

---

mind . . . ."); McMillan v. Intercargo Corp., 768 A.2d 492, 502 (Del. Ch. 2000) (" that a corporate board has decided to engage in a change of control transaction invoking so-called *Revlon* duties does not change the showing of culpability a plaintiff must make … to hold the directors liable for monetary damages").

[39] *Function Over Form*, *supra* note 4, at 1311 (discussing Blasius Industries, Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. 1988)).

because boards never confess to acting in bad faith.[40] That two-part test gave the Court of Chancery a sound basis to smoke out pretext and determine whether action was unfairly preclusive, while permitting flexibility in the timing and conduct of voting in corporate elections and on transactions in a manner that serves the interests of stockholders.

The post-2001 case law developed in this direction: in *Liquid Audio*,[41] the Supreme Court essentially incorporated *Blasius*'s and *Schnell*'s spirit into the *Unocal* test. Applying that approach in cases involving debt provisions that impeded proxy contests by operating like a poison pill if an insurgent slate were elected, the Court of Chancery has vindicated the right of stockholders to run a proxy contest free of such impediments.[42] And a more recent decision adopting that approach invalidated an aggressive poison pill triggered at a level intended to be so low as to eliminate any economic incentive to engage in ballot-box activism.[43] According to the court's reading of the testimony, the board's rationale was that allowing *any* stockholder vote during the pandemic would be adverse to the company's best interests and stockholders might

[40] *Function Over Form*, *supra* note 4, at 1311. *See also* Kallick v. Sandridge Energy, 68 A.3d 242, 258-59 (Del. Ch. 2013) ("By enabling the Court of Chancery to examine whether the directors taking actions have acted in a circumstantially reasonable way, the Supreme Court provided a responsible form of review that smokes out self-interest and pretext, by requiring boards that face the omnipresent specter of *Unocal* to justify their actions as reasonable in relationship to a threat faced by the corporation. This Court has followed the Delaware Supreme Court and applied *Unocal* in these situations with a special sensitivity towards the stockholder franchise.").

[41] MM Cos., Inc. v. Liquid Audio, Inc., 813 A.2d 1118, 1129 (Del.2003) ("Both standards [*Unocal* and *Blasius*] recognize the inherent conflicts of interest that arise when a board of directors acts to prevent shareholders from effectively exercising their right to vote either contrary to the will of the incumbent board members generally or to replace the incumbent board members in a contested election."); see also Stroud v. Grace, 606 A.2d 75, 92 n.3 (Del.1992) (incorporating *Blasius* within *Unocal*).

[42] San Antonio Fire & Police Pension Fund v. Amylin Pharms., Inc., 983 A.2d 304, 315 (Del. Ch. 2009); Sandridge Energy, 68 A.3d 242, 258-59 (Del. Ch. 2013). But, when the board legitimately acted to move a vote to allow stockholders to consider new material information, Chancery found no violation. *E.g.*, Mercier v. Inter-Tel (Delaware), Inc., 929 A.2d 786 (Del. Ch. 2007). (In the interest of brevity, but with no disrespect intended, we occasionally refer to the Court of Chancery as "Chancery," a moniker common among members of the court itself).

[43] *In re* Williams Cos. S'holder Litig., Consolidated C.A. No. 2020-0707-KSJM, 2021 WL 754593 (Del. Ch. Feb. 26, 2021).

hurt the company by electing new directors or changing corporate policy during this delicate time. Rejecting that rationale, Vice-Chancellor, now Chancellor, McCormick stated:

> Viewing all stockholder activism as a threat is an extreme manifestation of the proscribed we-know-better justification for interfering with the franchise. That is, categorically concluding that *all* stockholder efforts to change or influence corporate direction constitute a threat to the corporation runs directly contrary to the ideological underpinnings of Delaware law. The broad category of conduct referred to as stockholder activism, therefore, cannot constitute a cognizable threat under the first prong of *Unocal*.[44]

Citing *Blasius*'s rejection of the idea that a board may protect stockholders from themselves by cutting off their ability to act at the ballot box, the court enjoined the pill under *Unocal*.[45]

As advocated two decades ago in *Function Over Form,* we applaud this use of *Unocal.* It provides a functional way for courts to expose and invalidate pretextual behavior even where a subjective inequitable purpose cannot be clearly established. That said, and as stated in *Function Over Form*: "our recommendation that voting issues be reviewed under *Unocal* rests on the assumption that courts will apply that test with rigor and that the doctrine of *Schnell v. Chris-Craft Industries, Inc.,* retains vitality."[46]

E. *Restoring Foundational Principles by Cabining* Kahn v. Lynch*'s Inherent Coercion Doctrine*

[44] *Williams*, 2021 WL 754593, at *30.
[45] *Id.* at *22 n.251 (citing and quoting *Blasius*, 564 A.2d at 662) ("[W]hen viewed from a broad, institutional perspective, it can be seen that matters involving the integrity of the shareholder voting process involve consideration not present in any other context in which directors exercise delegated power."); *see also Mercier*, 929 A.2d at 811 ("The notion that directors know better than stockholders about who should be on the board is no justification at all."). *Cf.* Coster v. UIP Cos., Inc., 255 A.3d 952, 963-64 (holding that a dilutive stock issuance was a breach of fiduciary duty because it stripped the plaintiff of the ability to exert negative control via continued deadlock, but not applying the integrated *Unocal* approach because the plaintiff framed its challenge solely under *Schnell* and *Blasius*).
[46] *Function Over Form*, *supra* note 4, at 1316 n.111.

Function Over Form also questioned the intrusive standard of review articulated in *Kahn v. Lynch Communication Systems, Inc.*[47] That decision upheld the view that neither approval by a special committee of disinterested directors nor approval by an informed "majority of the minority" stockholder vote would change the standard of review, and that entire fairness would remain the standard of review, but the burden would shift to the plaintiff to prove that the transaction was unfair.[48] The rationale was that a controlling stockholder that wished to take a company private had such retributive powers that both independent directors and stockholders would be subject to a form of inherent coercion, and could not exercise the free will to say no.

In so ruling, the court, surely unintentionally, created a disincentive to seek an approving "majority of the minority" stockholder vote, because the acquired company's board could obtain the same protection by using a lower cost, less risky "special committee" process as a "cleansing" mechanism. Although *Lynch* did not explicitly say so, the decision implied that even if both a special committee and a majority of the minority stockholder vote were required, the most that a controller could gain was the same burden shift as if it used only one of those cleansing mechanisms.[49]

Function Over Form urged that *Lynch* be re-thought, for several reasons. The inherent coercion theory could not be squared with market realities, which demonstrated both the vigor

---

[47] Kahn v. Lynch Commc'ns Sys., Inc., 638 A.2d 1110 (Del. 1994).
[48] *Lynch*, 638 A.2d at 1117.
[49] *Id.* Curiously, the threat supposedly presented by the controller in *Lynch* was the prospect of bypassing the board and making a tender offer directly to the public stockholders. This threat would have been hollow, however, had the Supreme Court held going private tender offers to a standard of equitable fairness equivalent to that applicable to mergers. But the doctrine was different: the controller had no such duty of fairness. Solomon v. Pathe Commc'ns, Corp., 672 A.2d 35 (1996); Lynch v. Vickers*,* 383 A.2d 278 (Del. 1977). This doctrinal inconsistency informed *Lynch's* embrace of a rigid standard of review and the inherent coercion rationale.

and ability of stockholders to oppose transactions they considered inadequate, and the effectiveness of properly advised independent directors when acting as a bargaining agent to extract a robust price from a controller. And Delaware law itself was much more potent in policing retribution than *Lynch* gave it credit for.[50]

Function Over Form therefore advocated that the inherent coercion rationale of *Lynch* should be cabined:

> The better policy… is to afford business judgment review treatment to self-interested mergers that are approved by either an effective independent director committee or by a majority of the minority stockholder vote…
>
> . . In today's environment there is insufficient justification for giving less than full cleansing effect to a self-interested merger that is conditioned on approval of a majority of the minority stockholders. That is especially true now that disclosure regulation by the Securities and Exchange Commission and the efforts of the private plaintiffs' bar are being augmented by the increased activism of institutional investors, and being facilitated by the enormous information flow made possible by new technology . . . [W]e propose that the more sound approach would be for the courts to defer to the business decision reached in good faith by the elected independent directors of the corporation. At the very least, the burden-shifting rule of *Lynch Communication* should be altered in the case of self-interested mergers that are conditioned expressly on majority of the minority shareholder approval.[51]

This recommendation rested on another fundamental premise: that where a controlling stockholder or other interested party proposes a self-dealing transaction that does *not* involve a going private merger, the entire fairness standard presumptively

---

[50] *Function Over Form*, *supra* note 4, at 1308-09 ("Delaware case law is replete with cases where majority stockholders have been held legally accountable for abusing the minority. There is no empirical basis for courts to presume conclusively—as our current rule does—that the threat of liability [if a controller took retributive action] would not, in most cases, check majority stockholder misconduct . . . .").
[51] *Id.* at 1309 & 1306-07.

applies, but if any of the traditional cleansing protections are employed to approve the transaction – *i.e.,* i) approval by a board comprised of a majority of independent directors; ii) approval by a special committee of independent directors; or iii) approval by a majority of the disinterested stockholders – the business judgment rule standard should apply.[52] In particular, approval by disinterested stockholders was a well-understood basis for invocation of the business judgment rule,[53] a position thoroughly documented in the Delaware Supreme Court's 2015 decision in *Corwin*.[54]

---

[52] In an excellent article, Vice Chancellor Laster put it this way:

> If a board of directors lacks an independent and disinterested majority, then the standard of review will de-escalate from entire fairness if the board exercised its authority under § 141(c) to empower a committee of independent and disinterested directors to make the relevant decision.
> If the board delegates its full power to address an issue to a committee, then the judicial search for a qualified decision maker shifts from the board to the committee. The same principles that govern the inquiry at the board level apply at the committee level, and the court will determine whether there were sufficient directors who voted in favor of the decision to make up a disinterested, independent, and informed majority of the committee. So long as the board has not retained some residual approval right or otherwise limited the committee's authority, in which case the board's retention of a portion of its authority undermines the committee's ability to decide the issue and keeps the judicial focus on the board, then a decision made by a disinterested, independent, and informed majority of the committee receives business judgment deference.

J. Travis Laster, *The Effect of Stockholder Approval on Enhanced Scrutiny*, 40 WM. MITCHELL L. REV. 1443, 1444 (2014) (citations omitted).
The article refers to the traditional cleansing protections, but aptly calls them "qualified decision makers," as a shorthand for an "independent, disinterested, and sufficiently informed decision maker." *Id.*

[53] *See Function Over Form*, *supra* note 4, at 1317-18 ("Under present Delaware law, a fully informed majority vote *of the disinterested stockholders* that approves a transaction (other than a merger with a controlling stockholder) has the effect of insulating the directors from all claims except waste."). For cases taking this view, *see* Smith v. Van Gorkom, 488 A.2d 858, 889-90 (Del. 1985); *In re* Wheelabrator Techs, Inc. S'holders Litig., 663 A.2d 1194 (Del. Ch. 1995); *In re* Lukens Inc. S'holders Litig., 757 A.2d 720, 736–38 (Del. Ch. 1999).

[54] *Corwin*, 125 A.3d at 310 n.19 (gathering precedents dating back to 1928 supporting this position). For an excellent historical discussion of this issue including the nuances of ratification, see Laster, *supra* note 52 (discussing a long line of Delaware cases reflecting that an informed vote of disinterested stockholders invoked the business judgment standard of review).

Even in the context of even a going private merger, *Function Over Form* did not embrace inherent coercion, and it certainly did not embrace that concept in any other context.[55] Nor did it embrace having one set of equitable rules for controlling stockholders and another for other interested parties. *Function Over Form* did not advocate that *Lynch* be applied to all controller transactions, especially ones that did not involve statutorily required vote; to the contrary, the thrust of the article was to confine *Lynch*, not extend it.

Although the path was long (about twenty years) and not entirely straight, Delaware law did evolve in the direction advocated in *Function Over Form*, culminating (almost fully) in the Delaware Supreme Court's decision in *Kahn v. M&F Worldwide Corp.* in 2014.[56] The path was bumpy, however, in several respects. First, because *Lynch* gave no credit for using both a special committee followed by a majority of the minority vote,[57] that cleansing structure was not used, thereby depriving stockholders of the optimal set of protections. Second, because defendants were unable to dismiss cases seemingly inexorably subject to an entire fairness standard, plaintiffs' lawyers obtained fees by filing suit immediately upon announcement of a going private merger proposal, and thereafter settling as soon as the special committee negotiated for a higher price than the controller initially offered.[58] Evidence indicated that any benefit for

---

[55] *See generally*, *Function Over Form*, *supra* note 4.

[56] Kahn v. M&F Worldwide Corp, 88 A.3d 635 (Del. 2014). For a history of the treatment of freezeouts after *Lynch, see In re* Pure Res. S'holders Litig., 808 A.2d 421, 433-41 (Del. Ch. 2002); *In re* Cox Commc'ns, Inc. S'holder Litig., 879 A.2d 604, 614-24 (Del. Ch. 2005); *M&F Worldwide Corp.*, 88 A.3d at 642-44.

[57] *Lynch*, 638 A.2d at 1117.

[58] In a recorded video interview, Kevin Abrams, counsel for Cox Communications, provides a vivid, in-person account of this phenomenon. Interview of Kevin Abrams and Stephen Jenkins, available at https://www.law.upenn.edu/live/news/8633-in-re-cox-comms-inc-shareholder-litigation-879-a2d.

stockholders derived from the efforts of the special committees, not plaintiffs' lawyers, who were often willing to settle for less than what the committee was able to achieve.[59]

Third, Delaware law was incoherent. If a controller proposed to effect a going private tender offer, it could do so without any duty of fairness so long as it disclosed the material facts and did not coerce the stockholders.[60] In fact, it was this differential treatment in the law that enabled the controller in *Lynch* to credibly threaten that it could bypass rejection by the special committee and still avoid entire fairness review. This potential influenced the adoption of the inherent coercion approach in *Lynch*, because it seemed to leave the special committee with what the Court believed to be inadequate protective clout. But, instead of using the case to subject going private tender offers to fairness review and thereby prevent the controller from escaping fairness review by bypassing the committee, *Lynch* deepened this incoherent treatment by subjecting a controller to unavoidable discovery costs and fairness review when it took the more stockholder-protective route by seeking cleansing via a minority stockholder vote, and seemingly even where it used a combination of two traditional cleansing protections - special committee approval and a minority of the majority vote - in tandem.[61]

Post-*Lynch* cases and scholarly articles exposed and criticized this incoherent scheme of transactional review.[62] In *Pure*[63] and *Cox,*[64] the Court of Chancery suggested that all controlling

---

[59] In an important article, scholars proved the poor cost-to-benefit ratio of this kabuki litigation, and the Court of Chancery noted this unseemly reality. Elliott J. Weiss & Lawrence J. White, *File Early, Then Free Ride: How Delaware Law (Mis)Shapes Shareholder Class Actions*, 57 VAND. L. REV. 1797 (2004); *Cox*, 879 A.2d at 629-30.
[60] *Solomon*, 672 A.2d at 39-40; Lynch v. Vickers, 383 A.2d 278, 279-81 (Del. 1977).
[61] *Lynch*, 638 A.2d at 1117.
[62] For some of the scholarly articles, *see* Weiss & White, *supra* note 59, Guhan Subramanian, *Post-*Siliconix *Freeze-Outs: Theory, Evidence & Policy*, 36 J. LEG. STUD. 1 (2007); Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785, 800-03 (2003).
[63] *In re* Pure Res. S'holders Litig., 808 A.2d 421 (Del. Ch. 2002).
[64] *In re* Cox Commc'ns, Inc. S'holder Litig., 879 A.2d 604 (Del. Ch. 2005).

stockholder going private transactions be treated comparably, and that even in this starkly zero-sum context, the business judgment standard should be applied if either a going private merger or a tender offer were made subject to approval by both a special committee of independent directors and a majority of the minority from the inception of the bid and offer process.[65] That approach would be coherent regardless of transactional form, and would address *Lynch*'s bypass concern.

Not until 2011, however, did a controller take the chance of employing both cleansing protections in combination in an effort to invoke business judgment rule protection. That enabled the Delaware courts to have a chance to consider, for the first time, the continuing viability of *Kahn v. Lynch*'s inherent coercion doctrine.

In *MFW*, MacAndrews & Forbes, M&F Worldwide's 43% stockholder, acquired M&F Worldwide's remaining shares in a cash merger. Under the procedure adopted, "upfront, MacAndrews & Forbes said it would not proceed with any going private transaction that was not approved: (i) by an independent special committee; and (ii) by a vote of a majority of the stockholders unaffiliated with the controlling stockholder . . . ."[66] Granting summary judgment, the court held that "when a controlling stockholder merger has, from the time of the controller's first overture, been subject to (i) negotiation and approval by a special committee of independent directors fully empowered to say no, and (ii) approval by an uncoerced, fully informed vote of a majority of the minority investors, the business judgment standard of review applies."[67]

---

[65] *See Pure*, 808 A.2d at 434-35, 443-44; *Cox*, 879 A.2d at 606, 623-24; *In re MFW Worldwide*, 67 A.3d at 525 & n.144. *See also In re* Cysive, Inc. S'holder Litig., 836 A.2d 531, 549-51 (Del. Ch. 2003); *In re* JCC Holding Co., Inc., 843 A.2d 713, 723 (Del. Ch. 2003); *In re* PNB Co S'holders Litig., Consolidated C.A. No. 28-N, 2006 WL 2403999, at *14 n. 69.

[66] *In re* MFW S'holders Litig., 67 A.3d 496, 499 (Del. Ch. 2013), *aff'd sub nom.* M&F Worldwide Corp., 88 A.3d 635 (Del. 2014).

[67] *Id.* at 502.

The Court of Chancery decision also explained why the inherent coercion rationale of *Lynch* gave too little weight to current market realities, to experience with special committees and stockholder votes, and to the ability of the Delaware courts to police retribution.[68] Adopting the trial court's reasoning, the Delaware Supreme Court affirmed,[69] and the viability of a motion to dismiss a complaint challenging a controller freezeout merger is now established in Delaware law, as *Function Over Form* advocated, where an informed and uncoerced special committee and the minority stockholders approve it.

IV. 21st Century Doctrinal Developments that Warrant Doctrinal or Legislative Change

In this section we identify concerns that Delaware law may have again created unnecessary complexity and potential for systemic unfairness, and propose solutions to make Delaware law more functional and predictable.

A. *The Continued and Expanded Life of* Lynch*'s Inherent Coercion Theory, and Its Negative Consequences*

As described earlier,[70] *MFW* reined in *Lynch*'s "inherent coercion" rationale, and the mischief it caused in connection with going private mergers.[71] The Supreme Court's affirming decision in that case, and its later decision in *Flood v. Synutra International, Inc.*[72] essentially rejected the inherent coercion theory, and restored traditional principles for determining the

---

[68] *Id.* at 503.
[69] *M&F Worldwide Corp.*, 88 A.3d 635. In a controversial footnote, the Court mused in *dictum* that the complaint would have survived a motion to dismiss, on the theory that allegations challenging the fairness of the price also thereby "call into question the adequacy of the Special Committee's negotiations." *Id.* at 645 n. 14. That was a seriously discordant note: if use of the procedure sanctioned in *MFW* did not yield business judgment rule deference and concomitant dismissal on the pleadings, its newly adopted doctrine would do little or nothing to incentivize controlling stockholders to adopt the approach taken by the controller in that case. In 2018, the Supreme Court put the footnote to rest, stating that "to the extent that note 14 is inconsistent with this decision, *Swomley* [*v. Schlecht*, 128 A.3d 992 (Del. 2015)], or the Court of Chancery's opinion in *MFW*, it is hereby overruled." Flood v. Synutra Int'l, Inc., 195 A.3d 754, 766 n.81 (Del. 2018).
[70] *See* Part III(F) above.
[71] Kahn v. M&F Worldwide Corp., 88 A.3d 635 (Del. 2014).
[72] 195 A.3d 754 (Del. 2018).

standard of judicial review applicable to conflict transactions. It did so by recognizing that (i) independent directors and stockholders can exercise real leverage and make informed choices when faced with a conflict transaction involving a controller,[73] and (ii) Delaware law is vibrant enough to protect minority stockholders from retribution by a controller that did not get its way.[74]

At the same time, *MFW* and its progenitors viewed going private mergers as a context in which the dangers of overreaching are particularly grave, and therefore developed a bespoke solution that could invoke the business judgment rule.[75] We did not view those decisions as imposing that solution on all controlling stockholder conflict transactions, but as instead normalizing the approach Delaware law would take to controller transactions and to treat them equally with other conflict transactions, at the very least where what was at issue was not a transaction or decision that required both the approval of the board and the approval of stockholders under the DGCL.[76]

But the common law evolves on a case by case basis, and precedent is sometimes applied, in good faith, in a manner that the decisions did not intend or contemplate. That is what

---

[73] The Supreme Court subtly distanced itself from the inherent coercion theory, notably by block-quoting with approval two paragraphs from the Court of Chancery's decision expressing the view that independent directors and minority stockholders are capable of expressing and acting on a view different than the controlling stockholder's. *M&F Worldwide Corp.*, 88 A.3d at 643-44 (citing *In re* MFW S'holders Litig., 67 A.3d 496, 528 (Del. Ch. 2013)).
[74] *M&F Worldwide Corp.*, 88 A.3d at 643-44; Flood v. Synutra Int'l, Inc., 195 A.3d 754, 762-63 (Del. 2018).
[75] *MFW*, 67 A.3d at 500 ("The approval of a special committee in a going private transaction is akin to that of the approval of the board in a third-party transaction, and the approval of the noncontrolling stockholders replicates the approval of all the stockholders."); *Cox*, 879 A.2d at 606; *Pure Resources*, 808 A.2d at 444 n.43.
[76] The decisions that led to the ultimate Supreme Court decisions in *MFW* and *Flood* took that position. *See Pure Resources*, 808 A.2d at 434-35, 443-44; *Cox*, 879 A.2d at 606, 623-24; *In re MFW Worldwide*, 67 A.3d at 525 & n.144. So did *Cysive*, 836 A.2d at 549-51; *In re* JCC Holding Co., Inc., 843 A.2d 713, 723 (Del. Ch. 2003); and *In re* PNB Co. S'holders Litig., Consolidated C.A. No. 28-N, 2006 WL 2403999, at *14 n.69 (Del. Ch. Aug. 18, 2006).

seems to have happened in the wake of *MFW*, leading to a phenomenon we describe occasionally as "*MFW* creep." Rather than confining *MFW* to the going private merger context for which that case was specifically designed, plaintiffs have successfully urged Chancery in several cases to require the full *MFW* suite of protections for any conflict transaction with a controlling stockholder, in order to invoke business judgment review, even where no statutory vote is required. The decisions that take this view are grounded not in reasoning in the cases leading up to *MFW*, but in *Lynch*'s inherent coercion logic, which those cases cast doubt upon, and which *MFW* and *Flood* implicitly abandoned. Admittedly, the decisions culminating in *MFW* necessarily referred to the inherent coercion doctrine in a way that was respectful, but in our view, clearly indicating that the doctrine was not convincing. But, instead of reading *MFW* as a move away from the inherent coercion doctrine toward the traditional approach, the recent Chancery cases have instead taken the view that inherent coercion exists in any situation where a controller has a conflict.[77]

[77] Decisions of this kind include: Berteau v. Glazek, C.A. No. 2020-873-PAF, 2021 Del. Ch. LEXIS 141 (Del. Ch. June 30, 2021); *In re* Tilray, Inc. Reorganization. Litig.*,* C.A. No. 2020-0137-KSM, 2021 Del. Ch. LEXIS 111, at *31 (Del. Ch. June 1, 2021). Interestingly, these opinions cite a statement by Chancellor Allen to justify the extension of *MFW* to all controller transactions: in *Kahn v. Tremont*, he wrote that "[d]efendants seek to limit *Lynch* to cases in which mergers give rise to the claim of unfairness, but offer no plausible rationale for a distinction between mergers and other corporate transactions and in principle I can perceive none." Kahn v. Tremont Corp., C.A. No. 12339, 1996 WL 145452, at *7 (Del. Ch. Mar. 21, 1996), *rev'd*, 694 A.2d 422 (Del. 1997), *remanded to* C.A. No. 12339, 1997 WL 689488 (Del. Ch. 1997). That statement, to our minds, cannot reasonably be read as an endorsement of the inherent coercion doctrine, as Chancellor Allen's view in *TWA* and other cases about the ability of independent directors to perform their duties with impartiality was to the contrary. *In re* Trans World Airlines, Inc., S'holders Litig., C.A. No. 9844, 1988 WL 111271 (Del. Ch. Oct. 21, 1988); *see generally* Gagliardi v. Trifoods Int'l, Inc., 683 A.2d 1049, 1051-52 (Del. Ch. 1996); *In re* RJR Nabisco, Inc. S'holders Litig., 576 A.2d 654, 657-59 (Del. Ch. 1990); J.P. Stevens & Co. S'holders Litig., 542 A.2d 770, 780-81 (Del. Ch. 1988); *Caremark*, 698 A.2d at 967-68. We view the Chancellor's statement simply as rueful acceptance that if the Supreme Court intended to base Delaware law on the idea that a controller had overweening retributive power and influence that *per se* disabled independent directors and minority stockholders from exercising free will, then it was hard to limit that reasoning to a particular transactional context. We believe, however, that there are many sound reasons to confine the *Lynch* doctrine to going private mergers. Those transactions involve a zero-sum game, which is not true of many other related party transactions. The controller can achieve the same result by a tender offer, arguably avoiding board

By way of leading example, in a scholarly and encyclopedic decision, the Court of Chancery in *EZCORP* reviewed the post-*Lynch* case law and concluded that the weight of authority did not cabin *Lynch* to the going private context, but applied its inherent coercion doctrine to all conflict transactions involving controllers.[78] In so doing, the court cited decisions leading up to *MFW* that said otherwise, including *Friedman v. Dolan*,[79] *Canal Capital Corp. v. French*,[80] and *Tyson*,[81] an important Chancery decision holding that because a special committee of independent directors approved executive compensation to a member of a controlling stockholder's family, the business judgment standard applied.

EZCORP concluded, however, that cases like *Tyson*, which applied traditional Delaware corporate law to controller transactions not requiring a statutory vote, were not persuasive, because it viewed the inherent coercion theory of *Lynch* as a continuing principle of the corporate common law.[82] In adopting that view, *EZCORP* relied upon the power of a controlling stockholder to wield influence at both the board level and the stockholder level, to justify subjecting any controller conflict transaction to the entire fairness standard, even a transaction not requiring a stockholder vote.[83] Nevertheless, *EZCORP* was careful to indicate that the

---

control and entire fairness review, which is not possible in other contexts. And, mergers require a statutory vote, which is also not the case with many other transactions, including those involving compensation.

[78] *In re* EZCORP Inc. Consulting Agreement Derivative Litig. (*EZCORP*), No. 9962-VCL, 2016 WL 301245, at *11-15 (Del. Ch. Jan. 25, 2016).

[79] C.A. No. 9425-VCN, 2015 WL 4040806 (Del. Ch. June 30, 2015).

[80] Civ. A. No. 11,764, 1992 WL 159008 (Del. Ch. July 2, 1995).

[81] *In re* Tyson Foods, Inc., 919 A.2d 563 (Del. Ch. 2007).

[82] *EZCORP*, 2016 WL 301245, at *16, *18.

[83] *Id.* at *30. *EZCORP* also found that this approach was not unduly burdensome because cases had shown that controllers could prove fairness, and because there was no persuasive evidence that the plaintiffs' bar would sue on any case just because the standard of review precluded dismissal. *Id.* at *23. We are not as sanguine, in light of two prior waves of meritless litigation, one caused by *Kahn v. Lynch* and the perverse incentives it created. See, for example, the evidence as to meritless Lynch litigation cited in Elliott J. Weiss & Lawrence J. White, *File Early, Then Free Ride: How Delaware Law (Mis)Shapes Shareholder Class Actions*, 57 VAND. L. REV. 1797 (2004); *In re* Cox Commc'ns, Inc. S'holder Litig., 879 A.2d 604 (Del. Ch. 2005). The second wave of non-meritorious cases involved third

Delaware Supreme Court had not spoken to the question of whether the *MFW* dual process approach was required outside of the going private merger context, or whether use of any of the traditional cleansing devices would henceforth suffice, to invoke business judgment review.[84]

We would answer that question differently than *EZCORP,* and would not apply *MFW* to all transactions with controlling stockholders: the *MFW* solution was tailored specifically to the problem created by the *Lynch* line of cases, namely that those cases created poor incentives in the going private merger context for transactional planners and encouraged wasteful litigation yielding no benefit for investors or society. The solution *MFW* embraced credits procedures that, if implemented with fidelity, give minority stockholders in a squeeze-out merger the key protections they would receive in a merger with a third party merger: a) fiduciaries actively negotiating for their benefit; and b) the right to determine for themselves as stockholders whether the transaction is in their best interests.[85] This solution addressed concerns unique to the controller going private context: the requirement that the controller concede that the special committee of independent directors could say no responded directly to the concern that the controller could bypass that committee decision by presenting a tender offer directly to the minority stockholders.

The *MFW* solution was never designed to apply to all transactions between controlling stockholders and companies. MFW repeatedly emphasized that it was addressing only the context of going private mergers: it defined the question presented as "what should be the correct

---

party deals. See, for example, ROBERT M. DAINES & OLGA KOUMRIAN, RECENT DEVELOPMENTS IN SHAREHOLDER LITIGATION INVOLVING MERGERS AND ACQUISITIONS, CORNERSTONE RESEARCH, March 2012 Update (documenting high incidence of meritless claims attacking third-party mergers in which the only tangible benefit was the payment of attorneys' fees to plaintiffs' lawyers).

[84] *Id.*; *see* also *Cornerstone*, 115 A.3d at 1181 ("[T]he burden of providing entire fairness in an *interested merger*" falls on the controlling stockholder proposing the transaction in the first instance) (emphasis added).

[85] *See M&F Worldwide*, 88 A.3d at 644.

standard of review for mergers between a controlling stockholder and its subsidiary,"[86] and recited that "[o]utside the controlling stockholder merger context, it has long been the law that even when a transaction is an interested one but not requiring a stockholder vote, Delaware law has invoked the protections of the business judgment rule when the transaction was approved by disinterested directors acting with due care."[87] Thus, the idea that MFW meant, without saying so, to define the treatment of all transactions with controlling stockholders is at odds with MFW's own text.

It is also at odds with widespread practice. One of the historical functions of audit committees has been to review and approve such related party transactions,[88] and controlling stockholders — many of which are businesses themselves — often provide or acquire services or goods to or from the controlled company. Likewise, controlling stockholder representatives often serve and are compensated as executives, and compensation committees comprised of independent directors were developed in part to address the potential for such conflicts.[89] We

---

[86] *MFW*, 67 A.3d at 524. *See also id.* at 500 (defining the question presented as "what standard of review should apply to a going private merger conditioned upfront by the controlling stockholder on approval by *both* a properly empowered, independent committee and an informed, uncoerced majority-of-the-minority vote.").

[87] *Id.* at 526-27.

[88] See these examples from corporate charters. Audit Committee Charter, Golden Star Resource Corp., exh. 99.2 to Form 10KSB filed Sep.28, 2007, available at https://www.sec.gov/Archives/edgar/data/1375348/000100201407000830/exh992.htm ("The committee should review, assess, and approve: ... (3) Significant conflicts of interest and related-party transactions."); Amended and Restated Audit Committee Charter of WebMD Corp. adopted Feb. 27, 2004, available at https://www.sec.gov/Archives/edgar/data/0001009575/000095014404002444/g87450exv99w1.htm (audit committee shall "review with management proposed related party transactions … and approve any such transactions"); City Capital Corp. Audit Committee Charter, exh. 99 to Form 10KSB filed Apr. 25, 2005, available at https://www.sec.gov/Archives/edgar/data/0000793986/000109432805000090/cityex99042505.txt (audit committee must "[r]eview and approve all related-party transactions affecting management or any board member.").

[89] *See* Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1468, 1490 (2007) (describing the

never understood that entire fairness review would be universally required in these common situations, or that the potential for controller self-dealing makes it impossible for the company's directors to avoid a judicial fairness inquiry.[90]

Rather, if one of the traditional cleansing techniques is used, the presumption should be that the transaction or compensation was approved by impartial fiduciaries who could faithfully represent the company's interest in getting a fair deal for itself. In that case, the business judgment rule would apply unless the plaintiff could use the waste doctrine to create an inference that an "apparently well motivated board" might not have been. The plaintiff could use this equitable "safety hatch" by pleading that the "decision is so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith."[91]

Section 144 of the DGCL further supports this view. The techniques that statute requires to validate an interested transaction largely reflect those that the common law of corporations had deemed necessary for the transaction to receive the protection of the business judgment rule, rather than inflexibly remain subject to entire fairness review.[92] With important judicial

---

rise of compensation committees comprised of independent directors to address potential conflicts and meet requirements of the NYSE).

[90] That this is traditional Delaware law is supported by the excellent articles of three distinguished lawyers written in response to the American Law Institute's Corporate Governance project in the early 1990s. See John F. Johnston & Frederick H. Alexander, *The Effect of Disinterested Director Approval of Conflict Transactions Under the ALI Corporate Governance Project —- A Practitioner's Perspective*, 48 BUS. LAW. 1393 (Aug. 1993); Charles Hansen, John F. Johnston, & Frederick H. Alexander, *The Role of Disinterested Directors in 'Conflict' Transactions: The ALI Corporate Law Project and Existing Law,* 45 BUS. LAW. 2083 (Aug. 1990). In those articles, the authors embrace the view that Delaware law holds that the use of any of the traditional protective devices with fidelity invokes the business judgment rule. This reality is not in question outside the controlling stockholder area. For example, in an incisive article, Vice Chancellor Laster takes this position as to conflict transactions that do not involve a controller. Laster, *supra* note 52.

[91] *In re* J.P. Stevens & Co. Inc. S'holders Litig., 542 A.2d 770, 780-81 & n.5 (Del. Ch. 1988).

[92] Marciano v. Nakash, 535 A.2d 400, 404 (Del. 1987) ("whether the disputed conduct received the approval of a noninterested majority of directors or shareholders … is now crystallized in the ratification criteria of § 144(a)."); *Cox*, 879 A.2d at 614-15 (stating that the common law of corporations the business judgment rule and its operation is resembles § 144).

adaptations to maintain credibility — *e.g.*, the cleansing vote must be one of only the disinterested stockholders,[93] and special committee members must be independent as well as disinterested[94] — the techniques prescribed in § 144 were considered sufficiently robust to eliminate the need for a fairness inquiry. Just as § 144 was built on equity cases involving fiduciary duty, and not just technical legal validity, later equity cases were built on the foundation established by § 144's codification of the then-recognized techniques for addressing conflict transactions.

In stating that, we do not exaggerate the consistency or precision with which Delaware case law addressed the standard of review ultimately applicable to conflict transactions. In earlier eras, the costs of discovery and the volume of cases facing corporations were smaller, and the importance of determining whether a case should proceed past the pleading stage was not as salient.

We also acknowledge the many cases stating that any conflicted self-dealing transaction with a controlling stockholder is subject initially to the entire fairness standard. Vice Chancellor Laster's exhaustive review of cases in his scholarly *EZ-Corp* decision well documents that reality.[95] And as far as that goes, we agree with that proposition. But that proposition does not, in itself, answer the important question the Supreme Court of Delaware has yet to answer post-*MFW*: outside of the going private context, what cleansing techniques will change that initial standard from entire fairness to business judgment review?

---

[93] Fliegler v. Lawrence, 361 A.2d 218, 221-22 (Del. 1976) (failing to accept cleansing effect of a shareholder vote because less than a majority of the votes cast were from disinterested shareholders).
[94] Gesoff v. IIC Indus Inc., 902 A.2d 1130, 1145-46 (Del. Ch. 2006) ("As a threshold matter, the composition of the special committee is of central importance. . . . [I]ndependence is the *sine qua non* of the entire negotiation process."); *see generally Marchand v. Barnhill*, 212 A.3d at 818-820 (discussing requirements to be deemed independent).
[95] *EZCORP,* 2016 WL 301245, at *12-15 (collecting cases).

When *Function Over Form* was published, independent directors had already shown themselves capable of standing up to corporate managers, and CEO tenure had been declining as a result.[96] Independent directors increasingly owed their continued access to directorships not to ties to management, but to their willingness to support policies that powerful institutional investors liked. These same institutional investors had shown themselves willing to criticize companies – including those with controlling stockholders – and to dissent at the ballot box. Moreover, Delaware courts had proven vigilant in policing electoral manipulation and coercion of stockholders in the voting process, and would readily address any controller who reacted to a negative vote with retribution.[97] Likewise, even controllers had to be sensitive to the prospect that replacing independent directors who said no to a conflict transaction with ones who would do their bidding would impair their ability to raise debt and other capital.[98] Decisions of the Delaware courts and actions by the Securities and Exchange Commission had enhanced the information base available to stockholders about salient developments like M & A transactions.[99]

---

[96] See, for example, these studies documenting these realities, Sanjai Bhagat & Bernard Black, *Is There a Relationship Between Board Composition and Firm Performance?*, 54 BUS. LAW. 921, 924 (1999)); Steven N. Kaplan & Bernadette A. Minton, *How Has CEO Turnover Changed?*, 12 INT'L REV. FIN. 1, 20-21 (2012).

[97] If a special committee, for example, said no to a related party transaction, and the controller used its authority to implement it by votes of its affiliate directors, then the entire fairness standard would act as a watchdog at its toothiest. Facing a suit to justify a transaction that the independent directors had rejected as unfair is not a situation any rational controller would wish to find itself in.

[98] Could they find candidates to do this? Independent directors often serve on more than one board and will sit on other boards without a controller, where they are likely to face adverse electoral consequences (withhold votes) from institutional investors and proxy advisors. Other boards seeking new directors will also likely shy away from the negative attention they can draw to themselves by nominating a director now regarded by institutional investors and their proxy advisors as a stooge.

[99] After the article appeared, disclosures in the transactional context grew even more robust. *E.g, Pure Resources*, 808 A.2d at 449 (("[S]tockholders are entitled to a fair summary of the substantive work performed by the investment bankers upon whose advices the recommendations of their board as to how to vote on a merger or tender rely"); Gordon, *supra* note 89, at 1543, 1548 (discussing the trend that corporations have been disclosing increasingly more information into the early 2000s, in part motivated by new SEC disclosure regimes).

For those reasons, *Function Over Form* argued that *Lynch*'s inherent coercion theory was empirically baseless.

Market activity since then has only strengthened that argument. Institutional investors have a powerful voice, no fear of controlling stockholders or corporate management. Stockholders challenge them frequently, and they have hedge funds and the media to help them. Independent directors are under great scrutiny too, and are expected to act aggressively in M&A situations to make sure that the public investors get a good deal. Proxy advisors and analysts scrutinize deals and help institutional investors decide how to vote.[100] Annual say on pay votes exist at most companies, and independent directors who run afoul of investor and proxy advisor sentiment over pay policies at one company (even ones with a controlling stockholder) can face withhold votes at other companies on whose boards they serve.[101] In light of these market developments, all of the constraints discussed earlier -- judicial review under the entire fairness standard where a controller replaces directors who stand in its way, the prospect of adverse effects on financing, and reputational damage with institutional investors and the press -- would at least as forcefully deter a controller in settings involving conflict transactions other than going private mergers. Thus, even more now than when *Function Over Form* was published, there is no reason to base the law on the

[100] *E.g.*, Stephen Choi et al., *The Power of Proxy Advisors: Myth or Reality,* 50 EMORY L.J. 869, 870 (2010).

[101] Articles citing evidence of the network efforts on directors include Yonca Ertimur, et al., *Board of Directors' Responsiveness to Shareholders: Evidence from Shareholder Proposals*, 16 J. CORP. FIN. 53, 54 (2010).); Kobi Kastiel & Yaron Nili, *In Search of the "Absent" Shareholders: A New Solution to Retail Investors' Apathy*, 41 DEL. J. CORP. L. 55, 88 (2016). Independent directors often serve on more than one board, and most will sit on other boards without a controller. Most directors hope to be in the game for some time and to join other boards. Institutional investors and proxy advisors do not let a director knuckle under to the controller at Company A, without facing electoral consequences at Companies B and C, where a withhold vote can effectively unseat them. Nor will other boards seeking new directors ignore the negative attention they can draw to themselves by sitting a director now regarded as a stooge.

view that stockholders cannot protect themselves at the ballot box, or that independent directors do not take their duties seriously when considering conflict transactions.[102]

The retributive rationale underlying the inherent coercion doctrine has also been undercut in a decisive way by *MFW*, if it and its predecessors are taken seriously. As we have discussed,[103] *Lynch*'s inherent coercion doctrine rested on the premise that a controller could bypass a special committee, make a going private tender offer, and escape ultimate fairness review.[104] That premise, unique to the going private context, would disappear if the Delaware Supreme Court were to make clear that a going private tender offer by a controller would be subject to the same level of judicial review as a going private merger,[105] and the condition in *MFW* that the controller cannot bypass the special committee or the minority stockholders would be rendered superfluous. Put simply, if, as *MFW*, *Cox*, *Pure*, and leading scholars suggest,[106] the equitable review of a going private transaction should not be driven primarily by statutory form,

---

[102] Applying *MFW* to transactions where no statutory vote is required has had odd results. In Tornetta v. Musk, 250 A.3d 793, 809-10 (Del. Ch. 2019). a board felt that it could not constitute a sufficiently independent compensation committee, so it put the compensation package it negotiated with the CEO to a vote of the stockholders not affiliated with the CEO, who approved it based on materially complete disclosures. Because it applied *MFW*, however, per *EZCORP*, the court ruled that a trial would be necessary to determine the fairness of a compensation package that the stockholders of a major corporation on full information approved, thereby requiring the court to substitute its own law-trained business judgment for that of informed, disinterested persons with a financial stake. We see no basis for such judicial review. Appraising a company sold in a conflicted merger with no market test is difficult enough; judicial pricing of compensation packages plans is unmoored in standards that would make any exercise of discretion reviewable in any coherent and consistent way.

[103] *See supra* at note 61 and accompanying text.

[104] *Kahn v. Lynch*, 638 A.2d at 1117.

[105] In *MFW*, *Cox*, and *Pure Resources*, Chancery discussed the reality that Delaware law had taken a different view of going private tender offers by controllers and suggested doctrinal convergence. *See Pure Resources*, 808 A.2d at 440-45; *Cox*, 879 A.2d. at 623-24 (Del. Ch. 2005); *In re* MFW S'holders Litig., 67 A.3d 535-36 (Del. Ch. 2013). For a case applying this doctrine, see Eisenberg v. Chi. Milwaukee Corp., 537 A.2d 1051, 1056 (Del. Ch. 1987).

[106] *See M&F Worldwide*, 88 A.3d at 644-46; *Cox*, 879 A.2d at 614-17; *Pure Resources*, 808 A.2d at 434-35, 438-39; *see also* Guhan Subramanian, *Post-*Siliconix *Freeze-Outs: Theory, Evidence & Policy*, 36 J. LEG. STUD. 1 (2007); Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785, 800-03 (2003).

especially when the merger route is more protective of minority stockholders, a foundational premise of the entire *Lynch* doctrine goes away.

For these reasons, *MFW* should be viewed as articulating a targeted solution to a targeted problem created in large measure by the anomaly in the case law arguably allowing a controller to use a tender offer to escape both a special committee's veto and fairness review, and not as prescribing a rigid set of procedures applicable to any transaction between a controlling stockholder and a company. Given the importance of going private mergers and the concerns this anomaly creates, we embrace the principled approach *MFW* took to replicating the protections afforded to stockholders under the DGCL in a third-party, arms-length merger. Because this bypass anomaly does not exist in other settings and because the inherent coercion doctrine is flawed and should not form a further basis for making corporate common law, we would not extend *MFW* beyond the going private context. But if it is to be extended, at most *MFW*'s two key protections should apply when a self-dealing transaction is statutorily required to be approved by stockholders.[107] Applying *MFW* when a self-dealing transaction must be approved by the stockholders and the board would have some logic, because it would match the basic reasoning of the decision.[108] But where no stockholder vote is required, *MFW*'s procedures have no fit, and their extension to such contexts involves judicial action better described as statute writing.

---

[107] For example, an acquisition of a company owned by the controller, where stockholder approval is required by statute because the buying company has to issue stock in sufficient quantity that § 251(f) of the DGCL requires a stockholder vote.

[108] Moreover, if that were done, *MFW* should apply only to a transaction as such, and not to other contexts where a stockholder vote is required and a conflict of interest exists, such as a certificate amendment that would create a class of high vote stock to be owned by the controller to enable it to maintain control while the company issues more equity to workers or other investors. So long as the charter amendment is subject to approval by a fully informed majority of the minority vote, then there is, in our view, no basis for subjecting the amendment to some unworkable form of "fairness review."

Extending *Lynch*'s inherent coercion doctrine after *MFW* had effectively rejected it, thereby dooming to failure any motion to dismiss unless the controller employs the costly *MFW* procedures, will not generate systemic value for diversified stockholders. Instead, it is more likely to result in excessive transaction costs, increased D & O insurance costs, and contrived settlements designed only to avoid the costs of discovery and justify the attorneys' fee that motivates most corporate representative suits.[109]

Corporate law is not designed for perfection. Although fairness is important, and investors must have protections against abuse, investors and society risk much if courts act as if they can capably address all situational concerns, and impose a toll on innovation, flexibility, and the cost of capital by facilitating litigation rent-seeking in situations when sufficient, intra-corporate guarantees of fairness have been employed. Corporate jurisprudence cannot require a microscopic review of every situation that might involve unfairness. Rather, it must rely on rules that incentivize the use of high-integrity procedures in most cases, and reduce the costs to society and investors of litigation and judicial second-guessing.

Accordingly, Delaware law should embrace the direction of *MFW* and *Function Over Form*, by reaffirming that most conflict transactions, even with a controlling stockholder, receive the protection of the business judgment rule if one of the three traditional cleansing procedures is credibly employed. Given vibrant stockholder power, the increased information available to them and the plaintiffs who represent them, the reputational and electoral implications for independent directors who bend to controllers' wills, and the potent ability of Chancery to police retribution by a controller that does not get its way, the benefits of the traditional approach

---

[109] The wave of meritless suits under *Lynch* itself, and of meritless non-*Revlon, Revlon* claims when defendants were faced with forum shopping, demonstrates that our concerns are based in empirics, not irrational fears. *See supra* note 83 and accompanying text (citing evidence of these waves).

outweigh the risks, and plaintiffs' lawyers would be encouraged to win cases on the merits, not extract fees based on an overly litigation-intensive standard of review.

B. *Expanding MFW by Expanding the Definition of "Controlling Stockholder"*

The "*MFW* creep" described in the previous section has been exacerbated by expanding the definition of a "controlling stockholder." If pleading that a conflict transaction involves a "controlling stockholder" inexorably requires a trial on entire fairness, the occasion for such after the fact economic review expands if courts expand the definition of a controlling stockholder.

Under Delaware law, it was historically difficult to establish that a stockholder having less than majority ownership was a controlling stockholder. Even in *Aronson*, where the main defendant, the former CEO and Chairman, controlled 47% of the vote, had close affiliations with several directors, and had an ongoing consulting arrangement, the court declined to infer control at the pleading stage.[110]

Kahn v. Lynch[111] took a more expansive view of the term "controlling stockholder." Alcatel, a 43.3% stockholder that was contractually limited to electing a minority of the board, was nonetheless found to be a controlling stockholder, based on evidence that the non-management directors had previously accepted Alcatel's refusal to renew management contracts that those directors had supported. Following *Lynch*, the Court of Chancery in *Cysive* determined that the founder, CEO and Chairman of the company, who owned 35 percent of the shares (but effectively 40 percent, taking into account stock options and shares owned by family members and subordinates),[112] was a controlling stockholder. The court reasoned that he owned a large enough percentage of shares to be a dominant force in any contested election and exercise

[110] *Aronson*, 473 A.2d at 808.
[111] *Kahn v. Lynch*, 638 A.2d at 1114-15.
[112] *Cysive*, 836 A.2d at 535.

managerial supremacy over the company.[113] Still, the court's reasoning remained deeply tied to voting, not just managerial power: as the court explained, "the analysis of whether a controlling stockholder exists must take into account whether the stockholder, as a practical matter, possesses a combination of stock voting power and managerial authority that enables him to control the corporation, if he so wishes."[114] And some subsequent rulings have been cautious in determining that a minority holder with a significant role in the company was a controller.[115]

Our concern, however, is that the revival of *Lynch's* inherent coercion theory has created pressure to expand the definition of controlling stockholder to reach persons having far less than a voting majority, but are either critically important to the company or associated with other stockholders as a group. *Tesla Motors*[116] illustrates the first of these two categories. Tesla's CEO, Elon Musk, held only about 22 percent of the company's voting power, but taking into account apparent board level conflicts and Musk's acknowledgements that he had substantial

---

[113] *Id.* at 552-53 (applying *Kahn v. Lynch*). According to the court:

> The conclusion that Carbonell possesses the attributes that the *Lynch* doctrine is designed to address is reinforced when one takes into account the fact that Carbonell is Chairman and CEO of Cysive, and a hands-on one, to boot. He is, by admission, involved in all aspects of the company's business, was the company's creator, and has been its inspirational force.

[114] *Id.* at 553.

[115] In one such case, the court held that the defendant, who owned 46 percent of outstanding stock, was not a controlling shareholder because non-majority ownership without more is insufficient to demonstrate control, and it was contractually limited to electing just two of the eight directors. *In re* W. Nat'l Corp. S'holders Litig., No. 15927, 2000 WL 710192 at *6 (Del. Ch. May 22, 2000); *cf.* Orman v. Cullman, 794 A.2d 5, 16-17 (Del. Ch. 2002) (holding that an entity owning 67 percent voting power in a company, despite owning only 37 percent of the shares outstanding, was a controlling stockholder). In another case, the putative controller's 27 percent ownership and right to appoint two of ten directors were held insufficient to support a rational inference that there was effective control. *In re* Morton's Rest. Grp., Inc. S'holders Litig., 74 A.3d 656, 661 (Del. Ch. 2013). And in yet another case the court concluded that a defendant that held only one percent of the company's shares and was therefore unable to replace directors was not a controlling shareholder, even though it managed the company's operations. *In re* KKR Fin. Holdings LLC S'holder Litig., 101 A.3d 980, 983, 994 (Del. Ch. 2014), *aff'd sub nom* Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304 (Del. 2015).

[116] *In re* Tesla Motors, Inc. S'holder Litig., C.A. No. 12711–VCS, 2018 WL 1560293 at *12 (Del. Ch. Mar. 28, 2018).

influence over the company and the board, the court found a reasonable inference that Musk was a controlling stockholder.[117]

Although that finding may have been appropriate, we are concerned that the court's reasoning in applying controlling stockholder doctrine sweeps too broadly. Even if Musk were not a controller, the finding that a majority of the directors were beholden to Musk would in itself invoke fairness review and demand excusal under the first prong of *Aronson*. The other finding – that Musk was so talented and visionary that the company could not succeed without him – does not rationally imply that someone is a controlling stockholder.[118] Being valuable to the company does not make an executive a controlling stockholder, nor does it implicate the concerns underlying *Lynch* – namely, the potential to use affirmative voting power to unseat directors and implement transactions that the minority stockholders do not like, and use blocking voting power to impede other transactions.[119]

---

[117] *Id.* at *14-19. Specifically, the plaintiff contended that Musk had a history of helping to expel managers when he was displeased with their decisions; he brought the contested acquisition to the board on multiple occasions; a majority of the board members involved in the transaction were not disinterested or were beholden to Musk; and Musk was highly involved in Tesla's management embracing his role as an instrumental part of the business.

[118] *See Id.* at *19. *See* Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd, 177 A.3d 1, 25 (Del. 2017) (rejecting argument that controller status could be grounded on the defendant's importance as a founder and successful CEO when he did not have close to voting control and had pledged to vote his shares in favor of a higher-priced transaction).

[119] In an article explaining why controlling stockholders had been treated differently by *Lynch* and cases adopting its inherent coercion doctrine, Vice Chancellor Laster emphasized the importance of considerable voting control:

> The presence of a controller creates a special case because the controller's influence operates at both the board and stockholder levels. It is not uncommon for a controller to nominate a majority of the corporation's directors. Agents, employees, and other fiduciaries of the controller, who serve on the corporation's board, face a conflict of interest arising from their respective dual fiduciary statuses. The controller's influence also undercuts the independence of otherwise independent and disinterested directors, because the controller has the power to determine whether those individuals will remain directors. At the stock-holder level, the controller can simply dictate the outcome of a vote.

Laster, *supra* note 52 at 1460. When a stockholder has no ability to dictate the vote, this rationale disappears.

The second avenue for expanding the controlling stockholder definition is to aggregate the voting power of stockholders holding blocs of shares, even though they are not bound by a voting agreement or founding family ties. These stockholders are then treated as a "control group" with the same force and effect on the standard of review as if they were a majority stockholder. If the only rationale for this treatment of otherwise disaggregated stockholders is that they had a similar view about a specific transaction's favorability, despite having no obligation or prior record of being tied together as to all issues, this mode of "situational control group" analysis should be applied with great caution. Aggregating into a single unit stockholders united only by a common view of what will optimize the value of their shares would enable plaintiffs to survive a motion to dismiss with no further proof that these stockholders, even if they hold fiduciary positions, breached their duty of loyalty.

To cabin this danger, the Delaware Supreme Court has required plaintiffs seeking to establish that the defendants are part of a control group to demonstrate that they entered into a contract, common ownership, agreement, or other arrangement where they worked toward a common goal.[120] Although several opinions have faithfully applied that requirement,[121] other cases appear more adventuresome. In *Dubroff II,* [122] the court found that the alleged facts

[120] Sheldon v. Pinto Techs. Ventures, L.P., 220 A.3d 245, 251-2 (Del. 2019) (declining to treat venture capital investors as a group, despite their participation in a voting agreement concerning the election of directors, where they were free to vote independently on other transactions).
[121] Patel v. Duncan, No. 2020-0418-MTZ, 2021 Del. Ch. LEXIS 227 (Del. Ch. Sep. 30, 2021) (declining to treat two private equity firms as a control group, due to absence of allegations of significant historical ties or any transaction-specific agreement); van der Fluit v. Yates, 2017 WL 5953514 (Del. Ch. Nov. 30, 2017) (declining to find that venture capital investors who were parties to an investment agreement, but had no agreement concerning the challenged transaction, constituted a control group); *In re* PNB Hldg. Co. S'holders Litig., 2006 WL 2403999, at *10 (Del. Ch. Aug. 18, 2006)) ("[R]ejecting claim that 'some twenty people (directors, officers, spouses, children, and parents)' comprised a control group and noting that 'there are no voting agreements between directors or family member[s]. Rather, it appears that each had the right to, and every incentive to, act in his or her own self-interest as a stockholder.'").
[122] Dubroff v. Wren Holdings, LLC, C.A. Nos. 3940-VCN, 6017-VCN, 2011 WL 5137175, at *8 (Del. Ch. Oct. 28, 2011).

supported an inference that three otherwise unaffiliated investors had acted as a controlling shareholder by engaging in a series of transactions that had enriched them at the expense of the minority shareholders, and by "work[ing] together to establish the exact terms and timing" of the challenged recapitalization. In *Frank v. Elgamal*,[123] plaintiffs survived a motion to dismiss by alleging members of the allegedly controlling group were united in entering into three agreements, despite having no voting agreement or common ownership. Relying on *Frank*, *Hansen Medical* held that allegations indicating coordination between the otherwise independent members of the supposed control group in previous transactions precluded dismissal where the members concurrently received benefits unavailable to minority shareholders in the contested transaction.[124]

This phenomenon is troublesome, particularly if extended to putative groups of stockholder-directors. If several directors are "interested" in a transaction for purposes of § 144, then that has important implications for the standard of review. But assessment of those implications should not be oversimplified by lumping together those directors' shares if they have no obligation to vote those shares uniformly. Delaware law generally regards share ownership by directors as useful, as it helps align the economic interests of directors with those of other stockholders. But the law should not reflexively deem a group of interested directors a controlling stockholder merely because they vote identically in one transaction.

Another troublesome issue arises where a court accepts the claim (at least for purposes of a motion to dismiss) that a person is a controller, with concomitant fiduciary obligations, despite

---

[123] Frank v. Elgamal, C.A. No. 6120–VCN, 2012 WL 1096090 at *8 (Del. Ch. Mar. 30, 2012).
[124] *In re* Hansen Medical, Inc. S'holders Litig., C.A. No. 12316–VCMR, 2018 WL 3030808 at *6-9 (Del. Ch. June 18, 2018).

owning no shares of stock at all.[125] To be sure, if a non-stockholder that exercises control through ownership of or managerial authority over a parent entity uses that control to exercise voting or managerial control of a subsidiary entity takes on fiduciary duties to the controlled subsidiary.[126] Our concern, however, is that the amorphous concept of "soft power" not arising out of stock ownership could be applied to trigger the entire fairness standard and preclude dismissal, where the premise of control involves circumstances that reflect garden variety commercial dealings, such as "the exercise of contractual rights to channel the corporation into a particular outcome by blocking or restricting other paths, … the existence of commercial relationships that provide the defendant with leverage over the corporation, such as status as a key customer or supplier, [or] [l]ending relationships, [which] can be particularly potent sources of influence."[127] The courts should heed doctrinal guardrails against overuse of this "soft power" concept: "authority [that] takes the form of a contractual right … must give the nonstockholder power akin to 'operating the decision-making machinery of the corporation' (a 'classic fiduciary'), rather than 'an individual who owns a contractual right, and who exploits that right,' forcing a corporation to 'react' (which does not support a fiduciary status)."[128]

---

[125] *In re* Pattern Energy Grp. S'holder Litig., C.A. No. 2020-0357-MTZ, 2021 WL 1812674, at *115-16 (Del. Ch. May. 6, 2021) ("[C]onsidering evolving market realities and corporate structures affording effective control, Delaware law may countenance extending controller status and fiduciary duties to a nonstockholder that holds and exercises soft power that displaces the will of the board with respect to a particular decision or transaction."); *In re* EZCORP Inc., No. 9962-VCL, 2016 Del. Ch. LEXIS 14, at *26-27 (Del. Ch. Jan. 25, 2016) ("An ultimate human controller who engages directly or indirectly in an interested transaction with a corporation is potentially liable for breach of duty, even if other corporate actors made the formal decision on behalf of the corporation, and even if the controller participated in the transaction through intervening entities.").

[126] *E.g.,* Eshleman v. Keenan, 187 A. 25 (Del. Ch. 1936), *aff'd* 2 A.2d 904 (Del. 1938) (individuals who controlled parent company through a voting trust owed fiduciary duties to the subsidiary corporation of which the parent was the majority stockholder).

[127] Basho Techs. Holdco B, Ltd. Liab. Co. v. Georgetown Basho Inv'rs, Ltd. Liab. Co., No. 11802-VCL, 2018 Del. Ch. LEXIS 222, *61-62 (Del. Ch. July 6, 2018).

[128] *Pattern Energy*, 2021 WL 1812674, at *122.

Perhaps most importantly, pressures by plaintiffs to characterize defendants as controlling stockholders when they possess far less than majority ownership, and even unaffiliated defendants as a "situational control bloc," could be reduced by returning to a robust recognition of the cleansing effect of informed independent director or stockholder approval. Interested transactions would not consequently receive starkly different treatment solely because the interested party defendants are characterized as a control group.

C. *The Related Temptation to Expand the Definition of Self-Dealing Transactions.*

Renewed recognition of the cleansing effect of informed independent director or stockholder approval would solve a separate and increasingly difficult classification problem: determining when a non-ratable benefit to a corporate fiduciary triggers entire fairness review. Non-ratable benefits come in many varieties: severance benefits for management, officer or director positions in the surviving corporation, different liquidity desires even in a pro rata transaction, a higher price for a class of stock with admittedly far greater value because of its voting control, an opportunity to acquire an equity interest in the acquiring company, and elimination of potential derivative claims, to name just a few.

Like the pressure to characterize interested parties as controllers, *MFW* creep encourages plaintiffs to argue that non-ratable benefits to a fiduciary that accompany otherwise third-party transactions constitute a conflict of interest that triggers entire fairness review. There is precedent supporting this position,[129] and we agree that a non-ratable benefit can require application of the entire fairness standard where (i) neither of the traditional cleansing mechanisms (independent director or stockholder approval) has been used and (ii) the fiduciary

[129] *E.g.*, *In re* Viacom Inc. S'holders Litig., 2020 Del. Ch. LEXIS 373, *40-41 (Del. Ch. Dec. 29, 2020) (quoting *In re Crimson*, 2014 WL 5449419, at *12) (taking this position)..

who received the benefit negotiated the main terms of the transaction and determined the allocation of the proceeds in a direct self-dealing manner.[130]

But Delaware courts should be cautious about expanding the use of non-ratable benefits as a basis for expanding the scope of the definition of self-dealing transactions. Entire fairness review serves as a check on self-dealing, by requiring a party that essentially negotiated with itself prove that what it received or gave constituted fair value. That function, however, is not implicated where a third party negotiates a merger with a company that has two classes of shares, and bargains over the price paid for each, and each class has a voluntary, informed class vote. Likewise, managers are entitled to contract for their future services and to receive fair compensation if they lose their job in a deal. Admittedly, it is problematic when directors or stockholders approve a transaction without realizing the existence of a non-ratable benefit to a fiduciary; but where that benefit is fully disclosed and approved, its recipient should not be required to disprove that it came at the expense of the corporation or the stockholders generally. Likewise, the fact that a controlled company makes a decision benefiting its parent should not invoke the entire fairness standard absent harm to the corporation or the minority stockholders.[131] Controllers should not have to pay rents to the minority to, for example, conduct business in a tax efficient manner. So long as the controller does not extract value from the minority, there is no proper basis for fairness review to apply. In sum, we submit that invoking the business

---

[130] *E.g.,* Jedwab v. MGM Grand Hotels, Inc.*,* 509 A.2d 584 (Del. Ch. 1986). In that case, the controlling stockholder of MGM Grand negotiated a merger with a third-party acquirer. But, rather than have the independent directors control the negotiations, the controller conducted the negotiations himself and then determined how the total consideration that the acquirer was willing to pay would be split between himself and other stockholders. In other words, he dealt directly with himself with the pool of funds the acquirer was willing to pay to the company as a whole. In that context, the court determined to subject the transaction to the entire fairness standard. *Id.* at 596.

[131] *E.g.*, Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971)**;** Gabelli & Co. v. Liggett Grp., Inc., 479 A.2d 276, 281 (Del. 1984); Summa Corp. v. Trans World Airlines, Inc., 540 A.2d 403, 405 (Del. 1988).

judgment rule based on use of any of the traditional cleansing protections would normalize and rationalize the judicial treatment of transactions involving non-ratable benefits to a fiduciary.[132]

More generally, we believe, as with duty of care claims, any plaintiff arguing that a non-ratable benefit was a breach of the duty of loyalty should have to prove breach and resulting damages. The entire fairness standard should not be wheeled out to address these kinds of cases in an awkward and confusing way. So long as the plaintiff has the chance to prove a breach of this kind (*e.g.*, that none of the protective devices was used with credibility or that the recipient fiduciary engaged in bad faith overreaching) and damages (harm to company and other stockholders), a more than adequate deterrent exists.

D. *Undermining Aronson's Important Second Prong And Creating Inconsistent Assumptions About The Ability of Independent Directors To Make Impartial Decisions*

The Delaware Supreme Court recently affirmed a ruling in which the Court of Chancery concluded that the two-prong demand requirement test articulated in 1984 in *Aronson v. Lewis*[133] is "no longer a functional test,"[134] and that demand can be excused only by demonstrating that a majority of directors face a claim of liability not exculpated by a charter provision under § 102(b)(7).[135] Although we have no quarrel with the result reached in the case (dismissal),[136] that

[132] This was the approach of Orman v. Cullman, 794 A.2d 5 (Del. Ch. 2002) ("Here, however, although the Cullman Group was the controlling shareholder of the target company both before and after the merger, the Cullman Group did not stand on both sides of the challenged merger. Instead it was approached by, and began initial negotiations with, an unaffiliated third party, Swedish Match. A Special Committee of independent directors then completed those negotiations. Therefore, the burden remains on Orman to allege other facts sufficient to overcome the business judgment presumption.").
[133] Aronson v. Lewis, 473 A.2d 805 (Del. 1984).
[134] United Food & Com. Workers Union & Participating Food Indus. Empls. Tri-State Pension Fund v. Zuckerberg (*Zuckerberg*), 250 A.3d 862, 886 (Del. Ch. 2020), *aff'd*, [ ] A.3d. [] (2021); *see also id.* ("[T]he first prong of *Aronson* remains viable, but . . . [t]he second prong of *Aronson* remains viable only in the unlikely event that a corporation lacks a Section 102(b)(7) provision, or to the extent that the particularized factual allegations portray a transaction that is so extreme as to suggest bad faith.").
[135] *See id.* at 885-86.
[136] *Zuckerberg* involved unusual and troublesome claims, and we have no quarrel with the result (dismissal). A previous lawsuit challenged a reclassification intended to enable the founder to sell shares

approach precludes the use of the second prong of *Aronson*'s demand futility test to challenge self-interested transactions where the pled facts support an inference that a conflict transaction unfairly benefited an interested party and the independent directors acted with gross negligence (but not disloyalty) in approving it. That approach also thereby encourages courts to strain to infer bad faith on the part of such directors to avoid dismissing a loyalty claim against the interested party that would historically have satisfied *Aronson*'s second demand utility prong. Neither development is salutary, in our view. The treatment of *Aronson* in any event clashes with the inherent coercion rationale discussed above as the foundation for "*MFW* creep," and the two doctrinal approaches cannot logically co-exist.

1. <u>Why Post-*Aronson* Developments Did Not Warrant Abandonment of the Second Prong</u>

The Supreme Court's *Zuckerberg* opinion largely accepts the analysis of the Court of Chancery, and rests on the proposition that three developments in Delaware law post-dating *Aronson* made its second prong no longer a useful way to evaluate demand futility.[137] For starters, *Zuckerberg* suggests that under *Aronson* merely pleading that the challenged transaction is one that would, as an initial matter, not be subject to the business judgment standard of review

---

and give the proceeds to charity, yet still maintain voting control. *Id.* at 869-70. The reclassification was abandoned, and the corporation was required to pay a sizable attorneys' fee based on mootness. *Id.* at 875. Nevertheless, in the follow-on derivative suit, plaintiffs alleged that the directors "'violated their fiduciary duties of care and loyalty' by pursuing and approving the Reclassification." *Id.* In light of the prior determination that the challenge to the Reclassification was moot, we do not grasp how that follow-on claim did not constitute in essence a collateral attack on the dismissal of the prior case. The later lawsuit was thus better understood as a challenge to the decision made or countenanced by the board to have the company, rather than Mr. Zuckerberg and other directors, pay the fee. It was therefore this decision, and not the approval of the abandoned transaction, that should have been the subject of the demand excusal test. The court did not conclude otherwise, but chose simply to assume that the operative decision was approval of the reclassification. 250 A.3d at 892. No pled facts, however, supported an inference that the decision to have the company pay the attorneys' fee was a breach of fiduciary duty, especially given court oversight of the fee award and the directors' strong advancement and indemnification rights.

[137] ____ A.3d at ___[2021 WL 434436 at *10-12].

itself satisfies *Aronson*'s second prong, a suggestion that echoes the Chancery decision it affirmed.[138] Second, the opinion explains away several cases decided in the wake of *Aronson* on the ground that § 102(b)(7) had not been enacted when they were decided.[139] Finally, the court suggested that its decision in *Cornerstone*, holding that directors against whom no non-exculpated claim has been pled should be dismissed on a proper Rule 12(b)(6) motion even if non-exculpated claims exist against other directors (such as the interested party in a conflict transaction), was a further development undermining the rationale for *Aronson*'s second prong.[140]

Building on these premises, *Aronson*'s second prong was seen as somehow too easy to satisfy — because it was triggered solely by pleading an initial standard of review, not particularized facts supporting an inference of ultimate breach (premise one) — and not fitting a world where independent directors can be dismissed under Rule 12(b)(6) if they only face an exculpated due care claim (premise two). The solution to this perceived problem was to abandon the second prong and essentially have the rule of *Rales v. Blasband* govern all demand cases,[141] thereby requiring a showing that a majority of the demand board face a non-exculpated claim or are not independent from the interested party. The universal demand excusal test thus became the following:

---

[138] *Id.* at [*10]. The Supreme Court opinion recites that "*Aronson* used the standard of review as a proxy for whether the board could impartially consider a litigation demand." The Chancery opinion was more precise in expressing its view that *Aronson's* second prong could be satisfied by pleading that the initial standard of review determined demand futility: 250 A.3d at 880-81 ("After *Tremont* and *Lynch*, a natural reading of *Aronson*'s second prong would suggest that demand becomes futile when entire fairness applies *ab initio*.").

[139] *Id., citing Levine v. Smith*, 591 A.2d 194, 205-06 (Del. 1991) and *C.L. Grimes v. Donald*, 673 A.2d 1207, 1216 (Del. 1996). This explanation, however, rests on a factual error: the opinion recites (_ A.3d at []) that § 102(b)(7) was adopted in 1995, but in fact it was adopted, with great publicity, in 1986, barely two years after *Aronson*, and long before *Levine* and *Grimes* were decided. 65 Del. Laws, c. 289, §§ 1, 2; *see, e.g.*, Leo Herzel, *Relief for Directors*, FIN. TIMES (July 17, 1986), Section I at 11.

[140] *Id.*, _ A.3d at [*12].

[141] *Id.* at [*7, *16], *citing* Rales v. Blasband, 634 A.2d 927 (Del. 1993).

(i) whether the director received a material personal benefit from the alleged misconduct that is the subject of the litigation demand;

(ii) whether the director would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand; and

(iii) whether the director lacks independence from someone who received a material personal benefit from the alleged misconduct that is the subject of the litigation demand or who would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand.[142]

Under this test, if *Aronson*'s second prong was to be preserved at all, a plaintiff could only satisfy it by pleading particularized facts supporting a non-exculpated claim against the demand board majority. In our view, that approach eradicates the historical function of *Aronson*'s second prong as a safety valve. Although a rational policy choice, discussed below, can be made in favor of that approach, such an important new policy shift cannot be justified on the grounds that intervening developments have made *Aronson*'s second prong, as originally intended to be applied, of no continuing utility.

Beginning with the first of the three developments summarized above, we believe that the purpose of the second prong was never about pleading an initial standard of review; rather, it required pleading facts supporting an inference of an ultimate breach of duty.[143] *Aronson*'s

[142] *Id.* at [*16] (quoting and adopting the Court of Chancery's proposed new test, 250 A.3d at 890). With admirable candor, the Chancery decisions suggesting that *Aronson* be abandoned in favor of a universal test based on *Rales* acknowledged that their reconstruction of *Aronson's* second prong was a reformulation of its originally intended application. *E.g.*, *In re* Tilray, Inc. Reorganization. Litig., Cons. C.A. No. 2020-0137-KSM, 2021 WL 2199123, at *16 (Del. Ch. June 1, 2021); *Zuckerberg*, 250 A.3d at 886.

[143] *E.g.*, Parfi Hldg., AB v. Mirror Image Internet, Inc., 794 A.2d 1211, 1231 n.47 (Del. Ch. 2001) ("The complaint pleads *particularized facts* that suggest that the entire fairness standard of review —rather than the business judgment rule — would apply to the Transactions *and* that the Transactions *might not have been fair*.") (emphasis added). If pleading that a transaction was an interested one was enough to satisfy the second prong, then *Aronson* itself – a case involving the compensation of a stockholder, current director, and former CEO owning 47% of the vote – would have come out differently. As it was, the court found that the plaintiff had not pled particularized facts supporting an inference that a breach of fiduciary duty occurred.

second prong explicitly calls on the Court of Chancery to inquire into "the substantive nature of the challenged transaction and the board's approval thereof."[144] This means that a plaintiff cannot plead demand excusal under the second prong simply by noting that the transaction, as an initial matter, is subject to entire fairness review. To the contrary, the second prong has often been found not satisfied when that standard initially applied.[145] If, for example, a special committee of independent directors approves a conflict transaction, and the plaintiff cannot plead particularized facts suggesting that the special committee process was tainted by some wrongdoing (*e.g.*, fraud on the committee by the interested party or gross negligence by the special committee), then demand is not excused.[146] The second prong requires pleading

---

[144] 473 A.2d at 814.

[145] For example, then Vice Chancellor (later Justice) Berger understood *Aronson* this way. *See* Canal Cap. Corp. v. French, C.A. No. 11764, 1992 Del. Ch. LEXIS 133 (Del. Ch. July 2, 1992). *Canal* involved a challenge to advisory fees paid to companies controlled by a 52% stockholder, transactions to which the entire fairness standard would initially apply. The court nevertheless dismissed under Rule 23.1, finding no basis to infer that the directors (a majority of whom were found to be disinterested and independent) breached their duty of care in approving the fees, and therefore concluded that *Aronson'*s second prong was not satisfied. *Id.* at *16-17.

The following cases all involve interested transactions, where absent use of a traditional cleansing mechanism (informed approval by a majority of minority shareholders or an independent committee of disinterested directors), the burden would be to prove entire fairness. In each of these cases, demand was found not excused under *Aronson*'s second prong because the court, upon review, found that the plaintiffs had not met their burden to plead particularized facts supporting an inference of an ultimate breach of fiduciary duty. *See* Chester Cnty. Empls.' Ret. Fund v. New Residential Inv. Corp., C.A. No. 11058-VCMR, 2017 WL 4461131, at *9-10 (Del. Ch. Oct. 6, 2017); Kandell *ex rel.* FXCM, Inc. v. Niv, C.A. No. 11812-VCG, 2017 WL 4334149, at *12, *15 (Del. Ch. Sept. 29, 2017); Ryan v. Armstrong, C.A. No. 12717-VCG, 2017 WL 2062902, at *17-18 (Del. Ch. May 15, 2017); Teamsters Union 25 Health Servs. & Ins. Plan v. Baiera, 119 A.3d 44, 65-68, 65 n.121, 68 n.132 (Del. Ch. 2015) ("Given that the second prong of *Aronson* asks simply whether the challenged transaction was otherwise the product of a valid exercise of business judgment, . . . it is understandable how one might find that test to be satisfied whenever entire fairness review might be triggered, irrespective of the circumstances triggering such review or the nature of the claims to which such review might apply.").

[146] In discussing its view that the initial standard of review is determinative under *Aronson*'s second prong, the Chancery decision in *Zuckerberg* cites *Unocal* cases that supposedly involve derivative claims. 250 A.3d at 881-82. This line of case rests on the original confusion caused by the odd categorization in early cases of *Unocal* challenges — that is, stockholder challenges to the use of defensive measures — as derivative. Moran v. Household Int'l, Inc., 490 A.2d 1059 (Del. Ch. 1985), *aff'd*, 500 A.2d 1346 (Del. 1985) (holding that a challenge to a pill not directed at a specific bid was derivative). This has never made sense, because blocking a takeover does not cause balance sheet injury but direct harm to stockholders. *E.g.*, *Williams Cos.*, 2021 WL at *16-20 (Del. Ch. Feb. 26, 2021) (explaining why a

particularized facts that supports a pleading stage inference that an ultimate breach of fiduciary duty occurred. That goes well beyond pleading an initial standard of review. Thus, properly applied, there is not a danger that the second prong of *Aronson* easily allows a plaintiff to usurp a board's presumptive authority to control the company's claims. The rigorous requirement to plead particularized facts support a rational inference of ultimate breach assures that is not the case.

As for the second and third developments that supposedly undermined *Aronson*'s second prong, we do not believe that the Delaware courts applied *Aronson*'s second prong for over 30 years without considering the impact of the enactment of § 102(b)(7) in 1986, and the long-standing potential for due care exculpation should have no bearing upon the continued utility of *Aronson's* second prong.[147] Delaware's corporate bar readily understood that § 102(b)(7) created situations where approving an interested transaction could result in monetary liability of the interested directors, but not of independent directors acting in the good faith belief the transaction was fair to the corporation.[148] Likewise, *Cornerstone* was not a seismic change in

---

Unocal claim attacking the reasonableness of a pill involves a direct, not derivative claim, and citing *In re* Gaylord Container Corp., S'holders Litig., 747 A.2d 71, 81 (Del. Ch. 1999)). Moreover, *Unocal* was designed as a tool to determine whether to grant injunctive relief, not money damages, and its entire rationale rested on an "omnipresent specter" that even independent directors might use defensive measures unreasonably, and thus the independent directors must prove to the court the reasonableness of their defensive decisions. *Unocal*, 493 A.2d at 954. That is, the very premise of *Unocal* was that the court should review takeover defense challenges, and that the role of independent directors in determining the defensive response should be a relevant factor in whether the board met its burden to show that its defensive actions were reasonable. *Unocal* cases are thus not a good guide to how *Aronson* applies to true derivative cases — ones in which it is alleged that the company was harmed by a self-interested transaction.

[147] *Rales* was decided seven years after §102(b)(7) was enacted, and even longer after *Van Gorkom* made clear that each director had to be examined individually in terms of their culpability. *See Smith v. Van Gorkom*, 488 A.2d at 888-89. The *Rales* court nevertheless viewed *Aronson* as still being fully viable in the bulk of derivative cases where a majority of the board that made the challenged decision is still in office. *Rales,* 634 A.2d at 933-34.

[148] *E.g.*, *Gesoff*, 902 A.2d at 1167 (exonerating a disinterested director despite finding other directors liable in a freezeout merger); *In re* Emerging Communications, Inc. Shareholders Litigation, 2004 WL 1305745, 2004 Del.Ch. LEXIS 70 (Del. Ch. May 3, 2004) (same).

practice under § 102(b)(7), as it was hardly the first case to recognize that individual directors not subjected to a non-exculpated claim should be dismissed[149] and not have to remain as defendants just because other defendants face non-exculpated loyalty claims.[150] In sum, no case law or legislative developments after *Aronson* warranted abandoning its important second prong.

2. *Rales* Should Not Displace *Aronson*'s Second Prong Because the Contexts of the Two Cases Differ.

It is also significant that the *Zuckerberg* decisions, which stress the functional similarities between the *Rales* test and the *Aronson* test,[151] overlook what is different about the context in which *Rales* applies – namely, when at least a majority of the board that would receive a demand is different than the one that made the decision that is the subject of the complaint.[152] That is, *Rales* applies when a board either in whole or at least in majority is not asked to cause the company to sue someone over a decision that they had made.[153] Delaware law has often looked to whether an independent board majority exists in terms of the deference it affords a decision,

[149] *See Cornerstone,* 115 A.3d at 1182 n.36 (citing, *inter alia*, Chen v. Howard-Anderson, 87 A.3d 648, 677 (Del. Ch. 2014)) (quoting *Emerging Commc'ns*2004 WL 1305745, at *38 (Del. Ch. May 3, 2004) ("The liability of the directors must be determined on an individual basis because the nature of their breach of duty (if any), and whether they are exculpated from liability for that breach, can vary for each director.")); Steinman v. Levine, 2002 Del. Ch. LEXIS 132, 2002 WL 31761252, *15 n.81 (Del. Ch. Nov. 27, 2002) (a plaintiff "is required to identify specific acts of individual defendants . . . for his claim to survive"), *aff'd*, 822 A.2d 397 (Del. 2003).
[150] The idea that some directors could be exonerated while others remained liable was evident in a ruling in *Smith v. Van Gorkom*, decided very soon after *Aronson*. *Smith v. Van Gorkom*, 488 A.2d at 899 (denying motion for reargument brought by individual directors complaining that their individual responsibility was not considered, but only because those directors had made no effort earlier in the case to present a defense distinct from the rest of the board, even though "a special opportunity was afforded the individual defendants . . . to present any factual or legal reasons why each or any of them should be individually treated").
[151] *See* 250 A.3d at 877, 888-89; _ A.3d at [ ] [2021 WL 4344361, at *7, *16].
[152] *Rales v. Blasband*, 634 A.2d at 934 ("Consistent with the context and rationale of the *Aronson* decision, a court should not apply the *Aronson* test for demand futility where the board that would be considering the demand did not make a business decision which is being challenged in the derivative suit. This situation would arise in three principal scenarios: (1) where a business decision was made by a board of a company, but a majority of the directors making the decision have been replaced . . . .).
[153] *See id.*

an approach resting on the sound intuition that when the independent directors have voting control of the board room they have more freedom for impartial action.[154] The different test in *Rales* is explained by the demand board's different responsibility for the transaction under litigation challenge and its effect on the board's ability to consider a demand.

This difference has important implications in the history of and rationale for *Aronson*'s second prong. *Aronson* was decided at a time when the concept of an "independent director" was still nascent, and when there was debate about whether the concept had meaning. Some felt that the natural relationship of fellow directors created a structural bias, and that led to skepticism that even putatively independent directors could impartially decide whether to sue a fellow director. *Aronson* took note of this debate and the second prong helped to ameliorate this concern by giving a plaintiff two routes to demand excusal. The first was to plead that a majority of the demand board had ties to the interested party that compromised their ability to consider a demand to sue. But even if a plaintiff could not satisfy that first route, *Aronson*'s second prong gave the plaintiff a chance to get a merits adjudication by pleading particularized facts supporting an inference that the demand board had made a decision that involved a breach of fiduciary duty. When a plaintiff made this difficult showing, *Aronson*'s intuition was that demand should be excused because it was difficult to presume credibly that a board could sue the interested parties to a transaction the demand board had approved. *Aronson* thus took into account both the reality of how difficult it is to sue a fellow director (structural bias) and that suing someone else over a decision that you also approved is at the very least exceedingly

[154] *See, e.g.*, Benihana of Tokyo, Inc. v. Benihana, Inc., 891 A.2d 150, 192-93 (Del. Ch. 2005) (deciding not to "disturb [the] decision" of the "majority of the disinterested and independent directors"); Air Prods. & Chems., Inc. v. Airgas, Inc, 16 A.3d 48, 123 (Del. Ch. 2011) (finding the reasonableness of a board defense of a poison pill because a board majority of independent directors sought to defend it); *Unocal*, 493 A.2d at 955 (giving enhanced credit to defensive decisions of a board comprised of an independent majority).

awkward, and involves some degree of hypocrisy. Without addressing this rationale, and the difference between the contexts of *Aronson* and *Rales*, *Zuckerberg* eliminated the historical function of *Aronson*'s second prong as a safety valve.

3. The Conflicting Rationales of *Zuckerberg* and Cases Extending the Reach of *MFW*.

The *Zuckerberg* opinions also create a stark contradiction with the inherent coercion rationale underlying what we call *MFW* creep. The Chancery decision took the view set forth in *EZCORP* that a transaction with a controller cannot be subject to business judgment rule review unless the full suite of *MFW* protections is used.[155] For the abandoned transaction that Chancery focused on, that did not occur. As important, Chancery found that the pled facts supported an inference that a special committee member faced a disloyalty claim for engaging in friendly communications with Mr. Zuckerberg that helped him in his negotiations with the special committee.[156] Furthermore, Chancery found that the pled facts suggested that the special committee was not assertive in responding to Mr. Zuckerberg's proposal, and the resulting transaction they approved was not fair to Facebook.[157] Thus, the Court of Chancery clearly found that the particularized facts supported an inference that Mr. Zuckerberg and one special committee member had breached their fiduciary duty of loyalty, and that the special committee had failed to assure fair terms.[158] Thus, although *EZCORP* presumes that even a properly motivated and assertive special committee cannot effectively check a controller and invoke the business judgment rule, *Zuckerberg* takes the view that the same directors who approved the

[155] 250 A.3d at 894 ("the Reclassification did not follow the template set out in *Kahn v. M & F Worldwide, Corp.,* 88 A.3d 635 (Del. 2014), so entire fairness would remain the operative standard of review.").
[156] 250 A.3d at 893; *see also Zuckerberg,* - A.3d at [ ] [2021 WL 4344361 at *4].
[157] *See Zuckerberg*, 250 A.3d at 893-94; *see also Zuckerberg*, _ A.3d at [ ] [2021 WL 4344361, at *4].
[158] 250 A.2d at 893.

challenged transaction can make the more difficult decision to cause the company to sue the controller (and the special committee member alleged to have cast his lot with the controller).

We respectfully submit, however, that this approach to *Aronson* ignores the continuing utility of *Aronson*'s second prong as an integrity-enhancing safeguard. Properly applied, *Aronson*'s second prong allows a plaintiff to plead facts suggesting that, despite the presence of a majority of independent disinterested directors and the use of facially adequate procedures, there was a fiduciary breach resulting in harm to the company. This safety valve exists precisely because of the potential for structural bias where (contrary to the assumption underlying *Rales*[159]) a majority of the demand board approved the business decision under attack in the derivative action. At the same time, by precluding claims, never presented to the board for consideration, when the plaintiff cannot meet either of its two tests, *Aronson* avoids burdening stockholders with the systemic costs of litigation and judicial second-guessing of matters on which elected directors, not courts, have the ultimate say.

4. The Effect of Abandoning *Aronson*'s Second Prong.

In most conflict transaction cases, the independent directors fulfill the important role of acting as a proxy for third-party bargaining. If the well pled facts support an inference that they failed to fulfill that role, not because of conscious disloyalty but because they did not act with due care, then their actions should have no cleansing effect. and entire fairness review should apply. That situation is the one the second prong was designed to address, giving effect to the intuition that even where a board majority is independent of an interested party, structural bias might make it difficult for the directors to sue a colleague. That intuition also accords with

[159] *Tilray*, 2021 Del. Ch. LEXIS 111, at *40 (quoting *Rales*, 634 A.2d at 934).

Delaware cases recognizing that it is easier to say no to a colleague on a conflicted transaction than to sue him.[160]

The Supreme Court suggested in *Zuckerberg*[161] that the well-reasoned decision by Chancellor Chandler in *McPadden v. Sidhu* was an outlier. We respectfully disagree: *McPadden* gave traditional and literal effect to *Aronson*'s second prong.[162] In that case, the company had sold a subsidiary to an officer for $3 million. Two years later the officer sold the subsidiary for $25 million. The plaintiffs alleged that the independent directors had breached their fiduciary duties by failing to oversee a proper sale process, by allowing the officer himself to conduct the sale process despite knowing he was an interested bidder, and then approving the sale to him at the low end of the valuation range.[163] Finding that the particularized pled facts supported a non-exculpated claim against the officer that his loyalty breach was facilitated by the other directors' gross negligence, the court denied the motion to dismiss under *Aronson*'s second prong, but dismissed the independent directors against whom no non-exculpated claim was pled under Rule 12(b)(6), leaving the officer who faced a non-exculpated loyalty claim as the sole defendant.[164]

Although the Delaware Supreme Court acknowledged in *Zuckerberg* that *McPadden* was "understandable … given the plain language of *Aronson*," it did not follow that plain language. Instead, the court abandoned the *McPadden* approach, finding that the second prong of *Aronson* is not satisfied unless the plaintiff pleads facts showing that a majority of the directors face a non-exculpated claim. This implies that a special committee or independent board majority can impartially consider a demand to sue the controller over a transaction that the committee or

---

[160] *E.g.*, *In re* Oracle Corp. Derivative Litig., 824 A.2d 917, 940 (Del. Ch. 2003); *Marchand v. Barnhill*, 212 A.3d at 820 & n.95.
[161] [ ] A.3d at [] [2021 WL 4344361 at *15]
[162] McPadden v. Sidhu, 964 A.2d 1262 (Del. Ch. 2008).
[163] *Id*. at 1271-72.
[164] *Id*. at 1270-75.

board majority had approved in a grossly negligent manner.[165] At the same time, however, the law as articulated in *EZCorp* and other recent Chancery decisions presumes that independent directors are not capable of standing up to a controller and acting as an effective countervailing negotiating and approval authority in a conflict transaction. The resulting conflict of views about the capability of independent directors leaves Delaware law taking the Kafkaesque position of allowing allegedly careless directors to block a lawsuit over a transaction that would otherwise be unfailingly subject to judicial review for substantive fairness.[166]

5. Creating Incentives to Characterize Director Conduct as in Bad Faith.

Another drawback of *Zuckerberg*'s elimination of *Aronson*'s second prong is that it pressures well-meaning trial judges to excuse demand by inferring that independent directors with no apparent motive to be disloyal consciously abetted overreaching by an interested party. A recent case *In Re CBS Corp.*[167] adopted that approach, holding that demand was excused because the members of the special committee who negotiated and approved the transaction, despite being independent from the controller, were subject to a claim of disloyalty because their efforts were considered ineffective and their acceptance of some of the controller's demands that

[165] *Lenois,* at *5; *Zuckerberg*, 250 A.3d at 888-89.

[166] The inherent complexities of demand excusal doctrine can result in confusion. For example, cases under *Caremark* have been cited in favor of a reading of *Aronson*'s second prong that requires a showing that a majority of the demand board face non-exculpated claims. But in *Caremark* cases, the plaintiff must by definition plead a non-exculpated claim to survive dismissal under Rule 12(b)(6) by virtue of the *Caremark* standard itself. *E.g.*, Guttman v. Huang, 823 A.2d 492 (Del. Ch. 2003). In these situations, the plaintiff tends to either state a non-exculpated claim against the entire board or no defendant at all. This is different from the core type of issue traditionally the focus of most derivative suits, cases challenging an interested transaction that involves a self-dealing conflict by some directors but that was approved by others. To hold in such cases that the independent directors can impartially sue the interested party, but cannot be trusted to say no to him in the first instance strikes us an inconsistency Emerson would not defend.

[167] *In re* CBS Corp. S'holder Class Action & Derivative Litig., No. 2020-0111-JRS, 2021 Del. Ch. LEXIS 12, *75 (Del. Ch. Jan. 27, 2021).

they had earlier rebuffed suggested conscious wrongdoing.[168] Remarkably, this decision came soon after a decision refusing to dismiss a claim that the same transaction was unfair to the stockholders of the *other* party to the merger.[169] In both decisions, the special committee defendants failed to win dismissal despite having qualified advisors, a lengthy process, and no apparent disloyal motive, because the merger — a zero sum transaction — was, as a matter of pled facts, so unfair to both companies (simultaneously) as to permit an inference that the special committee members were not just grossly ineffective, but also conscious facilitators of unfairness.[170]

The incentives created under *Zuckerberg*'s new reading of *Aronson* to question the motives of independent directors in this fashion and subject them to claims of disloyalty are troublesome because that exposure to litigation and reputational damage would give any rational director reason to be cautious about serving on a special committee.[171] It is one thing for a court to infer that a special committee without ties to a controller, and with qualified advisors, fell short of the mark in securing a fair transaction. It is quite another thing for the law to put the onus on the court to infer knowing complicity by the independent directors, just to ensure the

[168] *Id.* at *105. ("The extreme set of facts before the Court—the CBS Committee members' behavior that stood in stark contrast to the conduct of similarly situated fiduciaries confronting nearly identical circumstances less than a year before, combined with the documented evidence of Ms. Redstone's dogged determination to make this deal happen 'one way or the other'—suffice to state with particularity that each of the CBS Committee members breached their fiduciary duty of loyalty by approving the patently unfair Merger in order to appease Ms. Redstone.")

[169] *In re* Viacom Inc. S'holders Litig., Consolidated C.A. 2019-0948-JRS, 2020 WL 7711128, at *18 (Del. Ch. Dec. 29, 2020).

[170] In *CBS* (the latter of the two opinions) the court acknowledged the oddity that stockholders of both merging companies could viably contend that the merger was unfair to both companies simultaneously. *CBS*, 2021 Del. Ch. LEXIS 12, at *6.

[171] *See Cornerstone*, 115 A.3d at 1184-85 ("We decline to adopt an approach that would create incentives for independent directors to avoid serving as special committee members, or to reject transactions solely because their role in negotiating on behalf of the stockholders would cause them to remain as defendants until the end of any litigation challenging the transaction."). (internal citations omitted).

interested party is held accountable. Under the traditional and literal reading of *Aronson*, this perverse incentive did not exist.

The better way to address the potential for meritless litigation and to restore coherence to doctrine is not to undermine the credibility-reinforcing role of *Aronson*'s second prong. Rather, the business judgment rule principles upon which *Aronson* rested should be reinvigorated to give appropriate effect to the traditional protective devices, and to then use the second prong to permit cases to proceed where a plaintiff can plead with particularity a non-exculpated claim against any defendant. That result would require acknowledging that *McPadden* was correctly decided, but would not require doctrinal contortion: the court could simply add a fourth element to the three-part demand futility test it adopted in *Zuckerberg*,[172] excusing demand where the well pled facts indicate that a majority of the directors acted with gross negligence in approving a transaction with a controlling stockholder.

6. <u>Accepting *Zuckerberg*'s Policy Choice Requires Rejecting the Resurgence of the Inherent Coercion Doctrine.</u>

Zuckerberg represents at bottom an important new policy choice of Delaware's corporate common law, and cannot be rationalized on the ground that the logic of *Aronson*'s second prong has somehow been undermined by developments since the case was decided. As we have shown, that is not so, and properly understood, *Aronson*'s second prong acts as a check on structural bias by recognizing the difficulty directors have in suing colleague over a decision the same directors approved in the first place and requiring a judicial adjudication of a breach of fiduciary duty claim when the plaintiffs can meet a higher particularized pleading standard demonstrating a rational inference of an ultimate breach of duty causing harm to the company. This balance, requiring plaintiffs to make a stronger showing than required to survive a 12(b)(6)

[172] [ ] A.3d at [ ] [2021 WL4344361 at *17].

motion, but then excusing demand so that a claim that meets that demanding pleading requirement can be decided by a court on its merits, rather than gated by the board that approved the very decision under challenge, is one that remains a rational way to ensure the integrity of Delaware corporate law, while not undermining the principle that in most situations the board determines whether a corporation brings a claim belonging to the corporation.

If *Zuckerberg* is to be justified as a stable doctrine, then it must rest on acceptance of the actual policy choice that underlies it, which is that if a majority of the directors who approved a transaction that particularized facts suggest was tainted by a breach of fiduciary duty do not themselves face a risk of monetary liability, they can impartially decide to cause the company to sue the interested parties who do face that risk. That is a policy decision that no change in intervening law requires to have been made, and represents instead a belief that even when making the most difficult decision a director could make — to sue a fellow fiduciary over a transaction that the independent director approved in the first instance — Delaware law presumes impartiality.

Although we favor the balance struck by *Aronson's* second prong, we recognize that *Zuckerberg*'s different policy choice is defensible given the multiple accountability forces that work to hold corporate boards faithful, and independent directors in particular vigilant. But, if *Zuckerberg*'s policy direction is to be embraced, it must be embraced in a coherent manner. We have no doubt that it is much easier for a parent or friend to discourage a young adult from smoking a joint when that is illegal, or from drinking and driving before they engage in that behavior, than it would be to turn that young adult in to the police if they failed to heed the warning. And if the parent or friend condoned the behavior in the first instance, we think it even more doubtful that they could decide impartially to report the violation to the police.

Delaware law has previously recognized that for directors, it is therefore easier for them to act as a check on wrongdoing or overreaching in the first instance, and thus to say no to a self-dealing transaction as a member of the special committee if the terms are not fair, than it would be to sue a fellow fiduciary over a transaction after the fact, especially given that they had approved that transaction in the first place.[173] For these reasons, if *Zuckerberg* is to form a durable part of a coherent body of corporate law, restricting *Lynch*'s inherent coercion concept, limiting the application of *MFW* to going private transactions, and permitting the use of any of the traditional protective provisions with fidelity to cleanse other interested transactions is necessary if the premises on which fiduciary duty law rests are to be consistent and rational. If independent directors who the particularized facts suggest approved an unfair transaction by ineffectively failing to check the interested party's self-interest are presumed capable of impartially suing, then certainly independent directors advised by qualified advisors should be presumed capable of effectively negotiating for fair terms and their conduct should invoke the business judgment rule. If *Zuckerberg* signals the beginning of an alignment toward greater respect for the traditional protective measures and toward a confinement of *MFW* to its originally intended narrow function, then we view that development with more optimism. If, by contrast, *Zuckerberg*'s policy choice co-exists with *MFW* creep, then Delaware law will rest on contradictory assumptions about director conduct, and will invite criticism for subjecting certain claims to tighter judicial review, while using a change in demand excusal law to render that review illusory in the important context of derivative claims.

[173] *See* Sandys v. Pincus, 152 A.3d 124, 134 (Del. 2016) ("Causing a lawsuit to be brought against another person is no small matter, and is the sort of thing that might plausibly endanger a relationship.").

E. *Eliminating the Vestigial Waste Claim After Disinterested Stockholder Vote.*

Function Over Form noted that even an arm's length transaction approved by a fully independent board, or a conflict transaction approved by one of the traditional cleansing protections, cannot be sustained if it constitutes waste. This potential claim serves an important function where a transaction has not been approved, on full information, by the disinterested stockholders. Where only directors approve a transaction, the waste inquiry serves as a forensic device to ferret out possible covert disloyalty. If, despite approval of the transaction by independent directors, a plaintiff pleads facts supporting an inference that the transaction is so unfair to the corporation that its terms could not be approved as fair by a rational person, the case will go forward.

This safety valve has no logical role, however, where fully informed, disinterested stockholders have voted to approve the transaction.[174] Where the parties with money at stake have made the assessment that the transaction is favorable to the corporation, how, our courts have long asked, can the transaction be considered waste? The logical answer supplied by *Function Over Form* was that it could not be, and several Chancery cases later concurred.[175] It is now time to limit the waste safety valve to transactions that were not the subject of a vote by the disinterested stockholders.

[174] *Function Over Form*, *supra* note 4, at 1318 (citing Criden v. Steinberg, C.A. No. 17082, 2000 Del. Ch. LEXIS 50, at *9-*15 (Del. Ch. March 23, 2000)); Harbor Fin. Partners v. Huizenga, 751 A.2d 879, 895-902 (Del. Ch. 1999).

[175] *Tornetta v. Musk*, 250 A.3d at 814-15 (dismissing waste claim where an informed stockholder vote approved the challenged decision); *In re* Volcano S'holder Litig., 143 A.3d 727, 749-50 (Del. Ch. 2016) (same); Singh v. Attenborough, 137 A.3d 151, 151-52 (Del. 2016) (the waste exception to informed, uncoerced votes has no "real-world relevance" because disinterested stockholders would not approve a wasteful transaction).

F. *Eliminating the Orwellian Doctrine of "Substantive Coercion"*

Function Over Form argued that the parentalistic doctrine of substantive coercion[176] should not be expanded into the electoral context by allowing directors to argue that the stockholders might hurt themselves if, on a fully informed basis, they disbelieved the incumbent boards' view that it would be harmful to unseat them.[177] Several years earlier, the Delaware Supreme Court had employed the doctrine of substantive coercion to justify the reasonableness of the Time board's decision to revise a merger agreement so as to avoid a stockholder vote and push through a deal it preferred to a lucrative non-coercive tender offer that the market valued much higher.[178] The Time board maintained that there was a danger that the stockholders would ignore the board's belief that its preferred transaction, a merger with Warner, would offer more value in the long run than the huge premium offered by Paramount.[179] Holding that that the Time board's fundamental reshaping of the transaction to avoid a stockholder vote was reasonable — despite it involving a much higher cost to Time and larger debt than the original form of the merger that required a stockholder vote – the court held that substantive coercion was a legitimate threat.[180] Moreover, the court characterized substantive coercion as qualitatively different from the threat that the Paramount offer was inadequate.[181]

That ruling was made in the context of dictum criticizing factually unrelated decisions of the Court of Chancery, in particular *Interco*,[182] which held that a board could not use a poison

---

[176] The substantive coercion concept was originally articulated in Ronald J. Gilson and Reinier Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is there Substance to Proportionality Review?*, 44 BUS. LAW. 247 (1989).
[177] *Function Over Form*, *supra* note 4, at 1316 n.111.
[178] *Paramount Commc'ns, Inc. v. Time Inc.*, 571 A.2d at 1153 n.17.
[179] *Id.* at 1144-45.
[180] *Id.* at 1154.
[181] *Id.* at 1153 n.17.
[182] *See* City Cap. Assocs. Ltd. P'ship v. Interco, Inc., 551 A.2d 787, 799-800 (Del. Ch. 1988) (using a poison pill to "deprive shareholders of the ability effectively to choose to accept a noncoercive offer, after

pill to block a non-coercive tender offer indefinitely, but only for a period of time necessary to generate alternatives, bargain for a higher bid, and give stockholders information about the merits of the board's position.[183] In essence, *Time-Warner* used a non-pill case to hold that under *Unocal* a board could use a pill preclude a non-coercive tender offer with a pill.[184] In reality, that was a power allocation decision, cloaked in the guise of a pejorative description of the non-coercive offer as being "substantively coercive."[185]

As has been explained elsewhere,[186] this use of substantive coercion was alien to the intentions of the academics who created it, and is confusing and unhelpful, for a host of reasons that need not be repeated here. In all stockholder votes, there is the potential that stockholders might make a mistake. Delaware law has historically, however, given weight to the decisions of those whose equity capital is at stake, so long as they were fully informed.[187]

---

the board has had a reasonable opportunity to explore or create alternatives, or attempt to negotiate on the shareholders' behalf, would … be so inconsistent with widely shared notions of appropriate corporate governance as to threaten to diminish the legitimacy and authority of our corporation law.").

[183] For a more complete discussion, see Leo E. Strine, Jr., The *Story of Blasius Industries v. Atlas Corp.: Keeping the Electoral Path to Takeovers Clear*, *in* CORPORATE LAW STORIES 286-87 (J. Mark Ramseyer ed., 2009) [hereinafter *The Story of Blasius*].

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

[185] *Time, Inc.*, 571 A.2d at 1153 n.17; *The Story of Blasius*, *supra* note 183, at 287. The Supreme Court later employed the substantive coercion doctrine to the same end in *Unitrin*, 651 A.2d at 1385.

[186] *See, e.g.*, Jack B. Jacobs, *Fifty Years of Corporate Law Evolution: A Delaware Judge's Retrospective*, 5 HARV. BUS. LAW. REV. 141, 164-166 (2015); *The Story of Blasius*, *supra* note 183, at 274, 287-90; Chesapeake Corp. v. Shore, 771 A.2d 293, 324-30 (Del. Ch. 2000); *Air Prods. and Chems., Inc. v. Airgas*, 16 A.3d at 57, 97-101.

[187] *Unitrin* held that a target board could use a pill and a repurchase plan that increased insider voting power and made a proxy fight more difficult because of the threat of substantive coercion, but then held a proxy fight for board control was viable because the company had so many institutional investors with a motivation to get the best value, stating no company was more susceptible to a proxy fight over a matter of money. *Unitrin*, 651 A.2d at 1383, 1389-91. The two parts do not cohere. *Chesapeake Corp.*, 771 A.2d at 326 (describing *Unitrin* as cognitively dissonant, because "[o]n the one hand, a corporate electorate highly dominated by institutional investors has the motivation and wherewithal to understand and act [on proxy and tender offer disclosures by a hostile bidder]. On the other, the same electorate must be protected from substantive coercion because it…is unable to digest management's position on the long-term value of the company….").

If Delaware law wishes to allow boards to take the decision about a non-coercive tender offer out of the hands of stockholders if a board reasonably believes the offer is too low, the Delaware Supreme Court should just say so, as the Court of Chancery suggested in this key footnote to its important *Airgas* decision:

> Our law would be more credible if the Supreme Court acknowledged that its later rulings have modified *Moran* and have allowed a board acting in good faith (and with a reasonable basis for believing that a tender offer is inadequate) to remit the bidder to the election process as its only recourse. The tender offer [in this case] is in fact precluded and the only bypass is electing a new board. If that is the law, it would be best to be honest and abandon the pretense that preclusive action is *per se* unreasonable.[188]

Allowing boards to block non-coercive bids may or not be wise, and we think *Interco* adopted the rule most respectful of *Moran*'s[189] original promise that pills would be reviewed carefully for reasonableness in the heat of battle.[190] But at the least, Delaware takeover law should candidly rely on the view that it is within the board's authority to block a non-coercive bid, and not rest on a twisted misuse of the Orwellian concept of substantive coercion.

G. Amending Section 102(b)(7) to Exculpate Officers for Breaches of Duty

1. Origins of Section 102(b)(7) and the Unavailability of Officer Exculpation

---

[188] *Air Prods. and Chems., Inc. v. Airgas*, 16 A.3d at122 n.480.

[189] *Moran*, 500 A.2d at 1356-57.

[190] We recognize that market dynamics (*e.g.*, the rising power of institutions and independent directors, and the corresponding decline in classified boards and pills) have generally made takeover bids more viable than ever. The incidence of classified/staggered boards and poison pills has sharply declined. *See* Robert Daines, Shelley Xin Li, and Charles C.Y. Wang, *Can Staggered Boards Improve Value? Causal Evidence from Massachusetts* 1 (Harv. Bus. Sch., Working Paper No. 16-105, 2021) ("[T]he number of Standard & Poor's 500 (S&P 500) companies with an SB has declined by 82% during 2000–2020….") https://corpgov.law.harvard.edu/2020/05/06/the-return-of-poison-pills-a-first-look-at-crisis-pills/ S, https://www.reuters.com/article/us-dealtalk-poisonpills/poison-pills-drop-to-lowest-level-in-20-years-idUSTRE62T5D320100330; *see also* Jack B. Jacobs, *"Patient Capital": Can Delaware Corporate Law Help Revive It?*, 68 WASH. & LEE L. REV. 1645, 1655 (2011) (describing successful attempts of activist shareholders to curtail the use of poison pills).

After *Van Gorkom*[191] and the controversy it caused, the Delaware General Corporation Law enacted § 102(b)(7), which authorized corporate certificate provisions eliminating director monetary liability for breach of the duty of care.[192] Motivated by an ongoing crisis in the market for directors' and officers' liability insurance that *Van Gorkom* exacerbated,[193] the Delaware General Assembly enacted § 102(b)(7) to counteract the prohibitive expense (and in some cases, unavailability) of traditional D&O insurance policies for corporate boards.[194] Notably, the new legislation did not include corporate officers among those eligible for the liability exclusion authorized by § 102(b)(7).

The drafters of § 102(b)(7) explicitly considered whether to permit elimination of monetary liability for officers.[195] Those favoring affording corporate officers the same protections as directors asserted that the drafters "might be perceived of doing too little" if they did not grant to officers the possibility of immunity, and that because officers and directors were treated similarly for purposes of liability there was no need "to draw a distinction between them."[196]

That position did not prevail, however. The majority of the drafting committee first contended that monetary liability for officers for breach of the duty of care would serve as a

---

[191] *Smith v. Van Gorkom*, 488 A.2d 858, 873 (Del. 1985).
[192] *See* DEL CODE ANN. Tit. 8 § 102(b)(7) (2020).
[193] Roberta Romano, *What Went Wrong with Directors' and Officers' Liability Insurance?*, 14 DEL. J. CORP. L. 1, 23 (1989) ("*Van Gorkom*, . . . was decided in 1985 after the insurance crisis was well under way.").
[194] Synopsis of §102(b)(7), 65 Del. Laws, c. 289, §§ 1-2 (1986) (accessible at https://www.law.upenn.edu/live/files/7665-1986sb333pdf.); *see also* Memorandum from David B. Brown, Secretary, Council of Corp. L. Section of the Delaware State Bar Ass'n 1-2 (May 6, 1986) (accessible at https://www.law.upenn.edu/live/files/6891-a.).
[195] *See* Meeting Minutes from David B. Brown, Secretary, Council of Corp. L. Section of the Delaware State Bar Ass'n, to A. Gilchrist Sparks III, Chairman, Council of Corp. L. Section of the Delaware State Bar Ass'n 2-4 (Apr. 28, 1986) ("Much of the discussion focused on whether [Section 102(b)(7)] should apply to officers as well as directors . . . .") (accessible at https://www.law.upenn.edu/live/files/6685-a-hreflivefiles6685-860423-council-minutespdf.).
[196] *Id.* at 2.

disciplining mechanism, encouraging them to bring difficult or troubling matters to the board for resolution.[197] That majority also noted that "there was no pressing need for protection" of officers because jurisdiction over them could not be obtained in Delaware.[198] At that time, Delaware's long-arm statute (§ 3114)[199] permitted jurisdiction over corporate directors, but not officers.[200] Even recognizing that § 3114 could later be extended to officers, the drafters decided to study the matter further,[201] but they never returned to address this concern.

This history suggests that if § 3114 had provided for jurisdiction over corporate officers in 1986, the question of whether to exculpate officers may have been resolved differently.[202] In any event, nothing in the statute's history suggests that the drafters excluded officers because they intended to expose them to vastly different liability to stockholder plaintiffs for transactions that the board approved.

2. Post-102(b)(7) Developments in Personal Jurisdiction of Officers

In 2004, eighteen years after § 102(b)(7) was enacted, the Delaware General Assembly amended § 3114 to provide personal jurisdiction over principal corporate officers, as some of the drafters had foreseen.[203] The decision to extend jurisdiction to officers—thereby enabling them

---

[197] *Id.*; *see also* University of Pennsylvania Carey Law School, *102(b)(7): A. Gilchrist Sparks Interview*, YOUTUBE, at 46:52 (Apr. 20, 2018) [hereinafter *A. Gilchrist Sparks III Interview*], https://www.youtube.com/watch?v=jsvFzYqPjHQ ("[B]y not extending [Section 102(b)(7)] to officers, you would cause officers to do what they ought to do on sticky problems and bring them to the attention of the board, so they could be dealt with it at that level.").
[198] David B. Brown, *supra* note 194, at 3.
[199] DEL CODE ANN. Tit. 10 § 3114 (2020).
[200] David B. Brown, *supra* note 194, at 3.
[201] *Id.* The Council's view was blinkered because plaintiffs could likely secure personal jurisdiction over officers in the corporation's headquarters state. That said, it was natural for the Council to focus on the ability of stockholders to sue officers in Delaware, which is often preferred by plaintiffs as a more neutral forum than the company's hometown.
[202] *See A. Gilchrist Sparks III Interview*, *supra* note 197 at 45:35 ("at that point in time [§ 3114] did not give you long-arm jurisdiction over officers, so it wasn't customary to see officers named in lawsuits, *and some found that to be a reason why not to extend [§ 102(b)(7)] to officers, because it wasn't necessary*.") (emphasis added).
[203] DEL CODE. ANN. Tit. 10 § 3114(b) (2020).

to be sued in derivative and class actions—was not inspired by concerns that the threat of monetary liability was necessary to motivate officers to exercise care. Rather, that decision was a response to high-salience developments in corporate governance that exposed a gap in addressing concerns about officer loyalty.[204]

In response to scandals involving fraud within companies like Enron and WorldCom, the federal government and institutions including the New York Stock Exchange and the NASDAQ initiated a panoply of reforms designed to increase public confidence in the integrity of American corporations.[205] These reforms, which included the Sarbanes-Oxley Act of 2002 and listing requirements for the major stock exchanges, caused many corporations to increase significantly the percentage of independent directors sitting on their boards,[206] thereby reducing the presence of management directors in the boardroom.[207]

Although these reforms and the heightened use of independent directors garnered widespread praise,[208] the reduced presence of officer-directors created a "practical problem" for Delaware's ability to hold top officers accountable for fiduciary disloyalty:[209] because § 3114 only applied to corporate directors, Delaware courts lacked personal jurisdiction over key non-

---

[204] *See generally*, William B. Chandler III & Leo E. Strine, Jr., *The New Federalism of the American Corporate Governance System: Preliminary Reflections of Two Residents of One Small State*, 152 U. PA. L. REV. 953 (2003).
[205] *See id.* at 953-54; *see also* E. Norman Veasey, Corporate Governance and Ethics in the Post-Enron WorldCom Environment (2003), *in* 38 WAKE FOREST L. REV. 839, 840 (2003).
[206] *See* Chandler & Strine, *supra* note 204, at 963-67 (2002 reforms would increase independent directors on corporate boards); Gordon, *supra* note 89, at 1482 (describing the 2002 stock exchange requirements of the New York Stock Exchange mandating that boards be comprised of independent directors).
[207] Chandler & Strine, *supra* note 204, at 1002 ("One likely consequence of the 2002 Reforms is a further diminution in the already shrinking ranks of management directors who serve on boards of public companies."); Gordon, *supra* note 89, at 1476 ("By 2004, under the influence of the Sarbanes-Oxley and the stock exchange listing rules, the shift was virtually complete: 91% [public companies] reported two or fewer insiders; 9% reported three insiders."); *see also* Bhagat & Black, *supra* note 96, at 921 (discussing the trend in the decline of management directors from the 1960s through the 1990s).
[208] Chandler & Strine, *supra* note 204, at 955-57.
[209] *Id.* at 1002-1003 ("For Delaware, the trend toward boards comprised entirely of independent directors (with the exception of the CEO) has a subtle consequence.").

director officers, like those responsible for fraud in infamous scandals at companies such as Enron.[210] The General Assembly reacted by amending § 3114 to grant jurisdiction over key officers even if they were not directors.[211] That reaction arose not out of a concern that officers would fail to exercise care and needed to be held accountable, but in response to a national corporate crisis resulting from flagrant violations of the duty of loyalty by officers who might not otherwise be subject to Delaware jurisdiction.

3. Current Derivative and Class Action Litigation Against Officers

Not long after the amendment to § 3114, the Delaware Supreme Court recognized what the drafters of § 102(b)(7) had kept in mind a generation earlier:[212] namely, that the fiduciary duties of corporate officers should generally be measured by the same principles as those applicable to corporate directors.[213] Because of their exclusion from § 102(b)(7), however, corporate officers inhabit a very different litigation landscape than directors.

Because of the amendment to § 3114, stockholder plaintiffs now have an unhealthy and unfair incentive for stockholder plaintiffs to single out officers for due care claims. Because

---

210 *See* Lawrence A. Hamermesh & A. Gilchrist Sparks III, *Corporate Officers and the Business Judgment Rule: A Reply to Professor Johnson*, 60 BUS. LAW. 865, 866 (2005) ("[N]on-director officers were prominent, if not notorious, actors in recent corporate scandals involving Enron and WorldCom . . . ."). That neither Enron nor WorldCom was a Delaware corporation did not lessen the resolve to shore up officer accountability under Delaware corporate law.

211 *See* Del. Dep't of State, Div. of Corps., *Amendment to Corporate Law 2003* (June 30, 2003), https://corp.delaware.gov/decodeamend/2003amend/. ("Because of enhanced requirements for independent director representation on public company boards of directors, … fewer senior officers will also serve as directors. Therefore, had § 3114 not been amended, the ability to obtain personal jurisdiction in Delaware over some of the most significant participants in corporate governance would have been impaired."); *see also* Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749, 1769, 1769-70 n.91 (2006).

212 *See* David B. Brown, *supra* note 194, at 2.

213 Gantler v. Stephens, 965 A.2d 695, 708-09 (Del. 2009) ("In the past, we have implied that officers of Delaware corporations, like directors, owe fiduciary duties of care and loyalty, that that the fiduciary duties of officers are the same as those of directors. We now explicitly so hold."). In so stating, the court drew upon prior cases equating the fiduciary duties of corporate officers and officers, including Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939)); *Cede II*, 634 A.2d at 361; and *In re* Walt Disney Co. Derivative Litig., No. Civ.A 15452, 2004 WL 2050138, at *3 (Del. Ch. Sept. 10, 2004).

most public companies have boards with super-majorities of independent directors, plaintiffs are often unable to plead that a majority of the board has any self-interest in approving a suboptimal third-party transaction. With the independent directors therefore insulated from damages for a due care breach, plaintiffs have resorted to naming one or more non-director officers as defendants in suits challenging what was essentially a collective board decision.[214] And because a care claim against an officer or two who lack protection under § 102(b)(7) will survive a motion to dismiss, and trigger discovery that will generate most of the same costs as if the other directors were being sued, the stratagem of suing officers provides significant settlement leverage.[215]

This situation is not justifiable. The concern about fiduciary responsibility of officers, whether board members or not, has never been about due care, because officers have little incentive to be neglectful, certainly not at the gross level that *Van Gorkom* recognized as necessary to support liability.[216] The realistic concern is about loyalty: fiduciaries whose livelihoods are tied to full time employment at the corporation might be more susceptible to conflicts of interest when an opportunity attractive to stockholders (*e.g.*, a strategic acquisition) could endanger their employment.

[214] *See, e.g.*, City of Warren Gen. Emps. Ret. Sys., v. Roche, No. 2019-0740-PAF, 2020 WL 7023896, at *1 (Del. Ch. Nov. 30, 2020) (alleging violations of the duty of care by the CEO and Executive Chairman after a unanimous board of directors, with ten of the twelve officers independent, approved a buyout); *In re* Baker Hughes Inc. Merger Litig., No. 2019-0638-AGB, 2020 WL 6281427, at *1, *6 (Del. Ch. Oct. 27, 2020) (alleging violations of the duty of care by the CEO and President—two officer-directors—with plaintiff conceding that at least twelve members of the thirteen-member board were independent directors); Morrison v. Berry, No. 12808-VCG, 2019 WL 7369431 (Del. Ch. Dec. 31, 2019) (denying motion to dismiss claim that chief legal officer violated his duty of care in connection with corporate disclosures); Chen v. Howard-Anderson 87 A.3d 648, 686-87 (Del. Ch. 2014) (alleging sales process claim against CFO and CEO-director).

[215] *See, e.g.*, Olenik v. Lodzinski, 208 A.3d 704, 719 n.74 (Del. 2019) (targeting CEO-director to plead a non-exculpated claim and avoid dismissal); Voigt v. Metcalf, No. 2018-0828-JTL, 2020 Del. Ch. LEXIS 55, at *69-70 (Del. Ch. Feb. 10, 2020) (same).

[216] *Van Gorkom,* 488 A.2d at 873.

Although loyalty, not care, is the fundamental fiduciary concern, officers are being targeted with due care claims because plaintiffs cannot plead a loyalty claim against either them or the board. The unfairness of this strategy is accentuated by the realities that: (a) senior managers are subject to frequent replacement;[217] (b) analyst and investor scrutiny has never been more intense;[218] and (c) independent directors dominate most public boards, and private company managers typically are under pressure to perform and have no reason to lack diligence.[219]

Nevertheless, due care claims targeting officers are the latest result of the shareholder plaintiffs' bar's efforts to develop litigation tactics that offer potentially lucrative fee awards in the M&A field, especially given the decline of multi-forum litigation[220] and appraisal proceedings[221] and rulings acknowledging that an informed, uncoerced stockholder vote implicates the business judgment rule and warrants dismissal at the pleading stage.[222] One would think that such claims would be rare because independent boards are fulfilling the goals of advocates of an unfettered market for corporate control, by selling the company at a premium after appropriate market checks. But, because these claims are considered "direct" rather than derivative, no procedural obstacle to the plaintiffs' ability to sue exists. If a plaintiff can state *any viable* claim against *any* defendant, the suit proceeds to expensive, time consuming

---

[217] *E.g,* Per-Ola Karlsson, Martha Turner, and Peter Gassman, *Succeeding the Long-Serving Legend in the Corner Office*, STRATEGY+BUSINESS, May 15, 2019, https://www.strategy-business.com/article/Succeeding-the-long-serving-legend-in-the-corner-office?gko=90171 ("Turnover among CEOs at the world's 2,500 largest companies soared to a record high of 17.5 percent in 2018").
[218] *See* Geeyoung Min, *Shareholder Voice in Corporate Charter Amendments*, 43 J. CORP. L. 289, 290-91 (2017) (discussing the rise in shareholder activity and management responsiveness to their desires); Gordon, *supra* note 89, at 1509 (addressing the increased role of analysts).
[219] Gordon, *supra* note 89, at 1476; Bhagat & Black, *supra* note 96, at 924.
[220] *E.g.*, ROBERT M. DAINES & OLGA KOUMRIAN, *supra* note 83.
[221] *See* William J. Carney & Keith Sharfman, *The Death of Appraisal Arbitrage: Ending Windfalls for Deal Dissenters*, 43 DEL. J. CORP. L. 61 (2018). Jonathan Macey & Joshua Mitts, *Asking the Right Question: The Statutory Right of Appraisal and Efficient Markets*, 74 BUS. LAW. 1015 (2019).
[222] Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304 (Del. 2015).

discovery, and gives the plaintiff's lawyers leverage to extract a settlement and its accompanying attorneys' fee.

The duty of care claims asserted in these cases are highly problematic: plaintiffs accuse officer(s) or officer-director(s) of gross negligence in executing their responsibilities as an officer, most commonly because of their role in preparing the disclosures about the transaction in connection with the stockholder vote.[223] In cases where the targeted officer is also a director but is charged with carrying out a transaction *qua* officer, different Chancery judges have arguably applied seemingly inconsistent standards to determine in which capacity the individual allegedly acted.[224] Targeting non-director officers avoids that uncertainty, and is the most attractive strategy for plaintiffs because these officers cannot argue that they acted as directors and are therefore subject to exculpation.[225] Either way, disclosure claims against officers (whether board members or not) have proven an effective way for plaintiffs to increase the settlement value of their lawsuits.[226]

---

[223] *See, e.g.*, *Pattern Energy*, 2021 WL 1812674, at *69-70 (alleging duty of care claims against officers in sale of company); *In re* Mindbody, Inc. S'holders Litig., No. 2019-0442-KSJM, 2020 WL 5870084, at *32 (Del. Ch. Oct. 2, 2020) (alleging duty of care claim against CEO/COO for acting in grossly negligent manner throughout sale process); *In re* Coty S'holder Litig., No. 2019-0336-AGB, 2020 Del. Ch. LEXIS 269 at *21-22 (Del. Ch. Aug. 17, 2020) (discussing plaintiff's duty of care claim against defendants officer-directors for their allegedly negligent preparation of sale documents); *Voigt v. Metcalf*, 2020 Del. Ch. LEXIS 55, at *65-66 (alleging duty of care claim against defendants officer-directors for their advocation of a challenged transaction to board); Morrison v. Berry, No. 12802-VCG, 2019 Del. Ch. LEXIS 1412, at *56, *71 (Del. Ch. Dec. 31, 2019) (discussing duty of care claims against the CEO and the general counsel for role in negotiating sale of company).

[224] *Compare Firefighters' Pension Sys. of City of Kansas City v. Presidio, Inc.*, 251 A.3d at 283 (looking to the "primary role" of the CEO-director in the transaction to determine whether he acted as officer or director) *with Coty S'holders Litig*., 2020 Del. Ch. LEXIS 269, at *21-22 (looking to whether the officer-director merely "could have" breached his duties in his capacity as an officer), *and Voigt*, 2020 Del. Ch. LEXIS 55, at *69 (applying same standard).

[225] *See, e.g.*, *In re* Baker Hughes Inc., Merger Litig., No. 2019-0638-AGB, 2020 WL 6281427 (Del. Ch. Oct. 27, 2020); *Chen v. Howard-Anderson*, 87 A.3d at 686-87**.**

[226] Plaintiffs are, of course, not always successful. *See, e.g.*, *In re* AmTrust Fin. Servs., No. 2018-0396-AGB, 2020 Del. Ch. LEXIS 74, *at 36-7 (Del. Ch. Feb. 26, 2020) (dismissing plaintiff's claims against CEO-director because the complaint lacked information about which actions were taken exclusively in his officer capacity) in capacity as officer); *In re* Essendant, Inc. S'holder Litig., No. 2018-0789-JRS, 2019

Several recent cases featuring due care claims against officers and officer-directors illustrate their perverse consequences:

- *Preserving vestigial care claims after loyalty claims are dismissed*:

  In *City of Warren General Employees' Retirement System v. Roche*, the target company's board and nearly all of its stockholders approved a merger with two private equity companies. The plaintiff sued *only* the CEO-President and Executive Chairman, two officer-directors, in their capacities as officers, but did not assert any claims against any of the other directors.[227] The plaintiff alleged that those officers breached their duty of loyalty by (1) manipulating the board of directors to favor the buyout from the private equity firms, rather than an activist stockholder, in order to secure their own employment, and (2) producing a materially misleading proxy statement.[228] The court concluded that the complaint failed to state a claim that the officer-directors violated their duty of loyalty.[229] Nevertheless, the court determined that the plaintiff adequately pled a non-exculpable claim that the CEO-President breached his duty of care in preparing the proxy statement.[230] As a result, only a single officer-director remained potentially liable, *solely for lack of due care in his capacity as an officer*. Even though the principal concern was that the officers had been disloyal during transactions—a concern that the court determined was not adequately

Del. Ch. LEXIS 1404, at *32-3 (Del. Ch. Dec. 30, 2019) (dismissing duty of care claim against CEO-director because it did not allege facts sufficient to support an inference that the officer-director breached his duty).

[227] *Roche*, 2020 WL 7023896, at *10 ("In this action, Plaintiff does not assert any claim against any member of the Board in their capacity as directors. Rather, the Complaint contains a single count alleging [CEO-President] and [Executive Chairman] breached their fiduciary duties.").

[228] *Id.* at *1, *10.

[229] *Id.* at *18.

[230] *Id.* at *20, *24. The claim against the other officer-director was dismissed because the plaintiff did not plead enough about his involvement in creating the proxy statement.

pled—the plaintiff was able to extract significant settlement leverage because a non-exculpable care claim against one officer survived dismissal.[231]

- *Inconsistent treatment of similar conduct.*

In another recent case,[232] officers remained in the suit due to their managerial positions, but defendants who played at least as important a role in the disputed merger were exculpated due to their status as directors. Plaintiff claimed that the directors and an officer of the target company violated their fiduciary duties by not seeking the highest price.[233] The court granted summary judgment in favor of the non-officer defendants on that claim,[234] determining that the company's 102(b)(7) charter provision exculpated nearly the entire board,[235] but declined to dismiss the CEO-director and the CFO because of their officer status,[236] even though some board members had similar or even greater levels of involvement as the officer defendants. One non-officer board member fielded, organized, and reported on the initial calls about the potential merger,[237] served as the point of contact with the acquiror's CEO,[238] spoke with competing bidders,[239] and even attended meetings alone with the CEO-director and the acquiror's CEO to discuss the final transaction.[240]

---

[231] A similar situation occurred in *Baker Hughes*, 2020 WL 6281427 at *2, *21 (Del. Ch. Oct. 27, 2020) (dismissing all the claims against defendant except for single claim of a breach of the duty of disclosure by CEO-director in his capacity as an officer).
[232] Chen v. Howard-Anderson, 87 A.3d 648 (Del. Ch. 2014).
[233] *Id.* at 666, 686.
[234] *Id.* at 693. The court denied summary judgment as to a separate proxy disclosure claim because it could not determine whether the issue was one of loyalty, which would not be exculpable, or care. *Id.* at 692.
[235] *Id.* ("[B]ecause of the Exculpation Provision, summary judgment is entered on the sale process claims against the plaintiffs and in favor of defendants [directors].").
[236] *Id.* at 686-87.
[237] *See id.* at 655 (describing the role of director Steven Kraus).
[238] *Id.*
[239] *Id.* 655-56.
[240] *Id.* at 658.

Because that director was not an officer, however, he was exculpated, while the CEO and CFO, who participated at a similar level, were not.

- *Adding claims against officers to prolong tenuous litigation*.

In *Cirillo Family Trust v. Moezinia*,[241] the court granted summary judgment dismissing a disclosure claim because the plaintiff could not establish that any director had breached their duty of loyalty, and a 102(b)(7) provision precluded liability for any breach of the duty of care.[242] To keep the suit alive, the plaintiff moved for leave to assert a care claim against two officer-directors.[243] Although the court perceived this new claim as dubious,[244] it allowed the amendment because §102(b)(7) did not apply to the officer-defendants in their capacities as officers, and the complaint therefore "identified a theoretical path to recovery through a due care claim."[245] Merely by tacking on an additional claim with a low likelihood of recovery, the plaintiff was able to prolong the litigation and gain leverage to extract a settlement.

4. The Remedy: Amend Section 102(b)(7)

These developments cry out for a solution. Permitting stockholder plaintiffs to claim that officers have lapsed in their use of care over a proxy statement drives up litigation and insurance costs for companies and their stockholders, with little or no compensating benefit.[246] The wave

[241] No. 10116-CB, 2018 WL 3388398 (Del. Ch. July 11, 2018).
[242] *Id.* at *10-13.
[243] *Id.* at *18.
[244] *Id.* ("I am highly skeptical that the [plaintiff] ultimately could prevail on this due care theory given the factual record developed during discovery . . . .").
[245] *Id.* at *18.
[246] The problem is not limited to the context of public companies, where most due care claims are made. In that context, diversion of profits or other forms of self-dealing are the problem. In such cases, most claims are derivative, not direct, and it is typically not difficult for a plaintiff to identify an actual conflict of interest that has driven the decision alleged to be unfair. Most family-owned companies have family members with real skin in the game and no incentive to harm the business itself by negligence. And, in

of officer-focused due care claims raises another fundamental concern. A core function of the board of directors is policing the care of its officers. The recent proliferation of due care claims against officers and officer-directors subverts this function by wresting this key managerial prerogative from the board. Particularly where such claims are direct and do not require the plaintiff to make a demand on the board or plead demand excusal, plaintiffs can bypass Rule 23.1's "stringent requirements of factual particularity"[247] to demonstrate demand excusal.

When an independent board majority protected against due care liability approves a transaction or decision and no loyalty claim stands against any defendant, any damages case should be dismissed. The disparity of § 102(b)(7)'s coverage, however, has forced the courts to treat directors and officers differently for conduct devoid of loyalty concerns. This anomaly should be remedied by amending § 102(b)(7) to provide an option for stockholders to adopt a charter provision exculpating officers for non-loyalty claims, except for claims brought by the company itself. That amendment would be consistent with the legislative intent of § 102(b)(7), and most notably, the drafters' desire to maintain *some* liability for officers as a disciplining and information-forcing mechanism for boards.

Amending § 102(b)(7) in this manner would not, in itself, exculpate anyone. It would merely authorize private action, leaving the stockholders to decide whether to adopt or buy into a charter amendment exculpating officers. Stockholders have demonstrated that they can and do resist governance rules that they consider inappropriate. The market-oriented solution we propose would enable stockholders to determine whether it is optimal to allow derivative and class action plaintiffs to bring due care claims against officers.

---

the large private companies controlled by private equity, the officers are under very tight control, and thus loyalty again is the main issue, not care.

[247] Brehm v. Eisner, 746 A.2d 244, 254 (Del. 2000).

H. *Addressing the Dysfunctional State of Practice Under Section 220*

Function Over Form advanced the core claim that the law's failure to adjust adroitly to new commercial circumstances can lead to inefficiency and unjustifiable costs to our corporate governance system. That is true for statutes as well as case law, and in the past two decades, one form of statutory action has become quite salient and problematic, both in terms of its costs for litigants and for the Court of Chancery itself: actions seeking books and records under § 220.

For stockholder-plaintiffs, § 220 actions have come to resemble trench warfare rather than the summary proceeding the statute contemplates. Extending the metaphor, plaintiffs have been conscripted into battle: the Delaware Supreme Court has admonished plaintiffs to use the "tools at hand" provided by § 220 before bringing a derivative action in which they must plead facts supporting an inference that a breach of fiduciary duty has been committed.[248]

But heeding this advice, plaintiffs have too often met "overly aggressive" responses from corporate defendants, including arguments having no plausible grounding in the statute or precedent under it.[249] In one high profile case, for example, the plaintiff got the books and records that the Delaware courts found it was entitled to receive,[250] but by that time a derivative suit brought in the company's hometown that relied solely on publicly available records had been dismissed for failure to plead demand excusal.[251] That judgment – in a forum that most plaintiffs would have never used and that was entered against a plaintiff who did not seek books and

---

[248] *E.g.*, *Brehm v. Eisner*, 746 A.2d at 266-67.

[249] Chancery found this to be the case in two recent decisions and noted that there was a trend of similar behavior in § 220 cases., Pettry v. Gilead Scis., Inc., 2020 WL 6870461 (Del. Ch. Nov. 24, 2020); Pettry v. Gilead Scis., Inc., C.A. No. 2020-0132-KSJM, 2021 WL 3087027 (Del. Ch. July 22, 2021).

[250] *In re* Wal-Mart Stores, Inc. Del. Derivative Litig., 167 A.3d 513, 530 (Del. Ch. 2017) (affirming Chancery judgment granting books and records to plaintiff in § 220 action, when the Chancery had stayed other pending derivative actions in favor of making lead counsel the firm that sought books and records before filing a plenary action).

[251] *Id.*

records – was then held to preclude the plaintiff who followed the Delaware courts' "tools at hand" admonition from having its better pleaded claim examined on the merits.[252] This anomalous result creates poor incentives, by advantaging plaintiffs who rush into court without adequate due diligence over those who heed the Delaware courts' admonition to use § 220 to develop a complaint resistant to dismissal.

Corporations and their investors have also suffered from a new wave of § 220 demands and actions against companies whose boards have entered into an agreement to sell the company at a premium. Stockholders file "placeholder" demands and suits in advance of the deal closing, for the ostensible purpose of policing the deal for fidelity with fiduciary duty.[253] To justify this stratagem in advance of pending public company merger votes, where documents like proxy statements and 13e-3 materials are available, plaintiffs have invoked the Supreme Court's admonition to use § 220 in the very different context of derivative suits, where typically few if any public documents are available for plaintiffs to use but particularized facts must be pled to support demand excusal.[254] At times, the Court of Chancery has cited the tools at hand doctrine

---

[252] Cal. State Teachers' Ret. Sys. v. Alvarez, 179 A.3d 824 (Del. 2018) (finding that the dismissal of a similar Arkansas action — an action in Walmart's hometown — precluded the Delaware plaintiff who sought books and records from moving forward with its case).

[253] See, e.g., Kosinski v. GGP Inc., 214 A.3d 944 (Del. Ch. 2019) (granting inspection for the purpose of investigating potential wrongdoing in connection with a merger); Edward B. Micheletti & Bonnie W. David, Recent Trends in Books and Records Litigation (Jan. 21, 2020), available at https://www.skadden.com/insights/publications/2020/01/recent-trends-in-books-and-records-litigation ("given the marked decrease in M&A injunction requests and the corresponding decrease in discovery records created for that purpose, stockholder plaintiffs have increasingly turned to Section 220 — particularly in the merger context — for access to documents in advance of filing post-closing class action complaints for money damages.").

[254] AmerisourceBergen Corp. v. Lebanon Cnty. Emps' Fund, 243 A.3d 417, 426 (Del. 2020) ("For over a quarter-century, this Court has repeatedly encouraged stockholders suspicious of a corporation's management or operations to exercise this right to obtain the information necessary to meet the particularization requirements that are applicable in derivative litigation.").

in the public company merger context, without examining how different it is from the derivative suit context in which the admonition originated.[255]

Seeking to avoid the effect of long-standing Delaware case law that an informed stockholder vote on a third-party transaction invokes business judgment review and enables pleading stage dismissal in cases involving third-party mergers, the plaintiffs' bar claims to need books and records to plead a claim that the merger proxy was materially misleading. To that end, a new practice emerged: instead of a plenary action being filed in every deal case,[256] companies doing third-party sales transactions now often face multiple demands for books and records.

This practice is problematic for several reasons. First, these cases seek to support pleading what we describe as a "non-*Revlon Revlon* claim," even where, unlike in *Revlon* itself, target boards have employed active market checks and did not erect defenses to any higher bid. Second, the publicly available information on which to base a direct claim is more robust than ever, due to the interaction between Delaware corporate case law and SEC proxy disclosure rules requiring[257] disclosure of management projections, banker's analyses, and deal protections. In conflict transactions, moreover, Rule 13e-3 requires disclosure of board books and minutes, giving potential plaintiffs even more pleading fodder. Also, other market players supply information useful to plaintiffs. Because sale transactions are salient to institutional investors,

---

[255] *See* Lavin v. West Corp., C.A. No. 2017–0547–JRS, 2017 WL 6728702 at *9 (Del. Ch. 2017) (stating that the invocation of § 220 to gather books and records before filing a complaint is applicable to a situation whereby stockholders intend to challenge that a stockholder vote was not informed).

[256] Such plenary suits in Delaware had been an unwholesome deal toll that had supposedly been eliminated or at least sharply curtailed. Regrettably, many of these meritless claims are now filed in the guise of federal securities claims under § 14(a) of the Exchange Act of 1934 and a combination of judicial action akin to those taken by Chancery and the use of forum selection clauses to eliminate forum proliferation is needed to redress this rent-seeking at the expense of investors and overall economic growth. *See* Alexander Aganin, Cornerstone Research, *Securities Class Action Filings – 2018 Year in Review*, at 5, https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2018-Year-in-Review (M&A federal securities class action filings jumped from 13 in each of 2012-2014 to 198 and 182 in 2017 and 2018, respectively).

[257] *See supra* note 23.

analysts and proxy advisors produce reports and recommendations on every deal, encouraging boards to fulfill their fiduciary responsibilities and better enabling stockholders to decide how to vote and whether to sue.

Third, the wave of merger-related § 220 cases creates the oddity that once the challenged merger occurs the plaintiff typically no longer owns shares in the company from which books and records are being sought. Plaintiff therefore must rely on its prior status as a stockholder of a corporation that may no longer exist.

Finally, reliance on § 220 has burgeoned at a time when informal intra-corporate communications and discussions that in prior generations would likely have been conducted in person or by phone without a record, are, like all communications now, more likely to involve emails and texts. This phenomenon exponentially increases the potential grist for the § 220 mill, including more informal and less guarded communications which are of natural interest to plaintiffs' lawyers and of course legitimately discoverable if a plenary complaint survives dismissal. Despite offering some benefits for plaintiffs, these changes in corporate communications impose staggering costs on both sides of the litigation.

Understandably, plaintiffs would want statutory "books and records" to include all documents that would be discoverable in a plenary action. But that inclusion is inconsistent with the important, yet discrete, function of § 220. The statutory term "books and records" has never been understood to encompass every piece of paper touching on corporate conduct. Rather, that term describes the formal documents that a corporation uses to document important action, such as the minutes of board meetings, resolutions, and contracts. Merely touching on a corporate decision does not make a document a "book" or "record" within the intended meaning of § 220. For some time, case law has admonished that the scope of inspection must be guided by a standard of precision and limited to core materials necessary to satisfy the stockholder's proper purpose. That scope is far narrower than would be available in discovery after a plaintiff pleads a viable claim.

Unfortunately, practical reality predominates over legal correctness. Companies facing the potential costs of searching for and producing documents, before a complaint has survived a motion to dismiss, find it economically more rational to pay attorneys' fees to cause a meritless issue to go away rather than expend millions of dollars responding to the § 220 demand or action. This creates countervailing incentives that are equally unproductive: respondent companies that choose not to settle or face a non-settling § 220 demander have sometimes put up a stone wall and made plaintiffs fight for every document.[258] This problem is particularly acute in the case of companies that have not conducted their affairs with typical formality, and therefore have no meeting minutes, management reports, or advisor presentations that are responsive to a legitimate § 220 demand.[259] Such companies have made "sky is falling" arguments when faced with a demand to produce the only records they have –emails and texts.[260] These "sky is falling" arguments are regrettably made credible by the propensity of many § 220 petitioners to seek these informal documents even where traditional formal records are available and have already

[258] For example, facing what looks identical to pre-filing discovery requests in the guise of a § 220 request, companies have jumped to interject defenses that would be available to them in a plenary action. For example, in Lavin v. W. Corp., No. 2017-0547-JRS, 2017 Del. Ch. LEXIS 866 (Del. Ch. Dec. 29, 2017), the defendant to a § 220 case argued that books and records should not be produced because an informed, uncoerced vote of disinterested stockholders had occurred. Chancery rejected this gun jumping by the defendant, but many corporate defendants feel that Chancery itself has enabled plaintiffs in § 220 cases to gun jump and obtain full-blown discovery not after pleading a viable plenary claim, but in aid of finding one. *Id.*; *see also AmerisourceBergen*, 243 A.3d at 437 (plenary merits defenses typically cannot be asserted in response to a § 220 complaint).

[259] *See* KT4 Partners LLC v. Palantir Technologies Inc., 203 A.3d 738 (2019) (plaintiff had to take appeal to the Supreme Court to receive texts and emails in a situation where more traditional formal materials that addressed the relevant board behavior and decisions did not exist).

[260] Arguments like this were made in Wal-Mart Stores, Inc. v. Ind. Elec. Workers Pension Trust Fund IBEW, 95 A.3d 1264, 1272-74 (Del. 2014).

been produced. This tug and pull of the most unreasonable has exposed companies that do keep adequate formal books and records to the increased risk that the Court of Chancery will require them to produce information akin to a full discovery response in a plenary action. In this way, the entire § 220 regime has become skewed, and disserves both plaintiffs and companies in ways one cannot imagine was ever intended.

The current reality thus has the virtue of pleasing no one. For the diversified investors of Delaware companies, it creates more costs than benefits. One possible solution might have been to apply the standing rules that govern derivative actions, by denying standing to § 220 plaintiffs who cease to be stockholders.[261] A relatively obscure line of cases, however, has held that former stockholders have standing to seek books and records from their former corporation so long as the reason for doing so related to the period when they were stockholders and they had a recognized proper purpose.

In the first such case,[262] stockholders of record made a § 220 demand but later lost that status as a result of a merger in which some of the Class A stockholders, including the plaintiffs, were cashed out, and the rest (those affiliated with the board) continued as stockholders. The merger was approved by written consent of the stockholders who would continue after the merger. Only after the merger was consummated were the plaintiffs in the § 220 action informed that they would lose their shares. The company argued that the plaintiffs had no standing to seek books and records after the merger closed. The court held, however, that whether or not the merger was valid, the plaintiffs had standing because they had sought books and records while

---

[261] Two decisions soon after the enactment of § 220 in 1967 side-stepped whether a former stockholder could seek books and records from the company of which they were previously stockholders to examine conduct happening before they lost that status, finding that they were not entitled to inspection for other reasons. *See* Willard v. Harrworth Corp., 258 A.2d 914, 914-915 (Del. Ch. 1969); Tafel v. IT&T, No. 3149, 1970 Del. Ch. LEXIS 120, at *1 (Del. Ch. Apr. 13, 1970).
[262] Cutlip v. CBA Intern., Inc. I, No. 14168 NC, 1995 WL 694422 (Del. Ch. Oct. 27, 1995).

still stockholders, and § 220 does not contain a continuous ownership requirement like that imposed by § 327 in derivative suits.

The court adopted this interpretation of standing ten years later,[263] in a case where the plaintiff lost its stockholder status in a merger occurring after the rights offering that the plaintiff that sought to investigate under § 220. The corporation argued that the merger deprived the plaintiff of standing, but the court disagreed, holding that the plaintiff "established that it was a stockholder at the time of its demand and therefore has standing to maintain this action."[264]

Another ten years later, after *Corwin* reaffirmed the traditional principle that an informed stockholder vote invokes the business judgment rule, plaintiffs' lawyers seized upon the two standing cases by routinely submitting § 220 demands before a deal closed – not to stop the deal, but in search of a basis to plead in a post-closing damages action that the vote was not informed. Despite the distinct context in *Cutlip*, which involved a non-public corporation not subject to SEC disclosure requirements, the Court of Chancery has continued to rule that if a stockholder made a pre-closing demand and filed its § 220 action before the merger, it had standing to maintain a post-merger § 220 suit.[265]

The upshot is that virtually every publicly held Delaware corporation announcing an M&A transaction now faces demands under § 220, in addition to its duty to present the materials required by the SEC and Delaware law in connection with the stockholder vote. Companies often receive multiple § 220 demands and placeholder § 220 suits by plaintiffs who do nothing to

---

[263] Deephaven Risk Arb Trading, LTD. v. UnitedGlobalCom, Inc., C.A. No. 379-N, 2005 Del. Ch. LEXIS 107 (Del. Ch. July 13, 2005).

[264] *Id.* at 27.

[265] The requirement to file the § 220 suit before the merger was recognized in Weingarten v. Monster Worldwide, Inc., No. 12931-VCG, 2017 Del. Ch. LEXIS 31, at *3 (Del. Ch. Feb. 27, 2017). Although a restriction on standing, this requirement has in operation simply exposed companies to the need to deal with placeholder § 220 actions while addressing the time-consuming issues necessary to present and close a merger.

seek injunctive relief to stop the deal or to rally other stockholders to vote against it. These suits proceed on the expectation that the deal will close, and the plaintiffs will be allowed to prospect for a post-closing claim. The unbroken line of case law and the absence in § 220 of a continuous ownership requirement akin to that contained in § 327 make it unlikely that this new wave of rent-seeking can be remedied by a judicial decision holding that a plaintiff that is no longer a stockholder of the corporation from which it seeks books and records loses its standing to invoke § 220.

For these reasons, then, any solution must come from the Delaware General Assembly, acting upon the recommendation of the Delaware State Bar Association's Corporation Law Section Council. To address the problems in the current operation of § 220, the General Assembly might take more measured action that addresses legitimate concerns of each side of the "*v*." To address "overly aggressive" defenses, § 220 could be amended to give a stockholder that is not a competitor of the corporation and is willing to enter into a confidentiality agreement the presumptive right to receive specified materials, such as board and committee minutes, resolutions, manager and advisor presentations, and corporate contracts, without having to identify a particular purpose. To assure a fair balance, § 220 could be amended to create a presumption that materials outside that scope are not essential and need not be produced.

This proposed balance would reduce unreasonable obstruction of § 220 demands, yet address companies' legitimate concern that § 220 is being used as a form of full-blown discovery by plaintiffs who never filed a viable plenary complaint. It would also encourage good corporate documentation practices, because a failure to act with traditional formality in documenting important corporate actions would overcome the presumption and allow plaintiffs to receive materials like texts and informal emails because the statutorily prescribed records are either inadequate or nonexistent. This balance would also more efficiently enable the Delaware courts to satisfy legitimate plaintiffs' needs without subjecting companies to undue expense and overreach.[266]

To deal with the situation where mergers result in termination of stockholder status, the General Assembly could adopt legislation modeled on the sound reasoning in *Polygon Global Opportunities Master Fund v. W. Corp.*[267] There, an arbitrage fund sought books and records under § 220 in aid of seeking appraisal, and bringing a derivative and direct suit,[268] but the court denied inspection under § 220.[269] Even though valuing shares to determine whether to seek appraisal has traditionally been considered a proper purpose for inspection, the court held that the fund could obtain all "necessary and essential" information for the purpose of valuing its stock from public filings:[270]

> Polygon seeks additional information beyond that in West Corp.'s public filings in order to value its stock to determine whether or not to seek appraisal, yet it has not shown that the information publicly available in the connection with the transaction omits information that is necessary, essential and sufficient for its purpose. There is a dichotomy in § 220 cases between publicly traded companies and closely held companies. With regard to the former, public SEC filings typically provide significant amounts of

[266] *See Palantir*, 203 A.3d at 757 ("Ultimately, if a company observes traditional formalities, such as documenting its actions through board minutes, resolutions, and official letters, it will likely be able to satisfy a § 220 petitioner's needs solely by producing those books and records. But if a company instead decides to conduct formal corporate business largely through informal electronic communications, it cannot use its own choice of medium to keep shareholders in the dark about the substantive information to which § 220 entitles them."); Woods Trustee of Avery L. Woods Trust v. Sahara Enters., 238 A.3d 879 (Del. 2020) ("The starting point (and often the ending point) for an adequate inspection will be board-level documents that formally evidence the directors' deliberations and decisions and comprise the materials that the directors formally received and considered (the 'Formal Board Materials.')").

[267] Polygon Glob. Opportunities Master Fund v. W. Corp., C.A. No. 2313-N, 2006 Del. Ch. LEXIS 179 (Del. Ch. Oct. 12, 2006).

[268] *Id.* at *1, *5.

[269] The court reasoned that the fund lacked standing to bring either kind of contemplated action, having bought its stock after the conduct giving rise to possible claims arose. The court also held that the fund had not made a credible showing of possible wrongdoing despite the different form of consideration received by the controlling stockholders. *Id.* at *5.

[270] *Polygon*, 2006 Del. Ch. LEXIS 179 at *11.

> information about a company, and decisions granting § 220 demands are narrowly tailored to address specific needs, often in response to allegations of wrongdoing. In contrast, stockholders in non-publicly traded companies do not have the wealth of information provided in SEC filings and are often accorded broader relief in § 220 actions.
>
> In the case of a going private transaction governed by Rule 13e-3, the amount of information made publicly available is even more comprehensive than that required in standard SEC periodic filings. Through its preliminary and final proxy materials, and its Schedule 13E-3, and amendments, West Corp. would appear to have disclosed all material information necessary for Polygon to determine whether or not to seek appraisal. This is not to say that there is a *per se* rule that the disclosure requirements under Rule 13e-3 are coextensive with the "necessary, essential and sufficient" information standard under § 220 demands for valuing stock in the case of a minority squeeze-out merger. Nevertheless, in the present case, the detail and scope of West Corp.'s disclosures makes this so.[271]

Rejecting the fund's argument that it should "be given access to the same information it would receive through discovery in an appraisal action,"[272] the court determined that § 220 relief is categorically different from discovery in a plenary action, including an appraisal case. Permitting the fund to obtain "additional information beyond the comprehensive disclosure already in the public domain simply because it *could* receive such information in a later appraisal action would be putting the cart before the horse."[273]

Amending § 220 in accordance with this reasoning would generally preclude inspection of a public company's books and records by a person no longer a stockholder. The SEC and Delaware common law have combined to require substantial disclosures if a company seeks stockholder approval of a merger. To entitle stockholders to demand books and records in aid of showing that those disclosures are somehow incomplete or misleading displaces a well-thought-

[271] *Id.* at *16.
[272] *Id*. at *5.
[273] *Id*. at *5 (emphasis added).

out disclosure regime with a plenary discovery cacophony. That said, the amendment could allow a former stockholder to maintain a § 220 action, if the stockholder seeks to challenge the merger in which she gave up her shares, voted all her shares no, did not sell into the merger, and owned shares before the merger was announced. In that event, however, the plaintiff would only be entitled to the information required by Rule 13e-3 in conflict transactions to the extent it is in the company's possession. If such information were already publicly available, the case would be dismissed. By this means, Delaware stockholders would have the chance in all mergers on which a vote is required, to seek the same books and records as Rule 13e-3 requires, even if the merger is not one involving a conflict transaction to which that rule applies.

Another potential legislative fix would address the issue of companies being whipsawed by multiple § 220 demands. Amending § 220 to allow a company to consolidate all demands and require coordination, so that it has to produce only one consistent data set in response to related demands, would reduce costs of responding to demands often rooted more in jockeying within the plaintiffs' bar for positioning in a future plenary action.

By these measured and balanced changes, § 220 would better serve its purpose of facilitating prompt production of core books and records to stockholders, while reducing the rent-seeking and cost pressures now imposed on companies by overuse of § 220 in cases where already public information should presumptively suffice.

V. Conclusion

In this article we have identified ways to make standards of review more functional, and to make Delaware's excellent corporate law in discrete and unrelated areas even more fair and efficient. We do this in a constructive spirit, and with profound respect and admiration for the skill, timeliness, and common sense Delaware's hard-working Judiciary brings to bear on the resolution of difficult corporate law cases. Our goal is simply to suggest in good faith some measured steps to make the world's best corporate law fulfill its important role even more effectively. To summarize, our major recommendations are:

1. Restrict the *Lynch* inherent coercion doctrine and the bespoke *MFW* solution to it to the domain of going private mergers and tender offers with controlling stockholders or mergers with another company that the controller also controls. This will reduce the unhelpful pressures by plaintiffs to characterize as "controlling stockholders" defendants who have far less than majority ownership, and unaffiliated defendants as a "situational control bloc." Interested transactions would be treated symmetrically and not receive starkly different treatment simply because of the characterization of the interested party defendants.
2. For other self-dealing transactions within the meaning of § 144, restore symmetry among interested transactions by reaffirming, per traditional Delaware equity law, that any of the traditional cleansing protections invokes business judgment review if used with integrity.
3. Require plaintiffs challenging so-called "non-ratable benefits" to fiduciaries to prove that the non-ratable benefit resulted from a breach of fiduciary duty of loyalty and caused specific damage to the company and other stockholders. If the non-ratable benefit was approved by one of the traditional cleansing protections, the business judgment rule should apply.

4. Apply the second prong of *Aronson* to provide for demand excusal when the particularized pled facts support an inference of a non-exculpated breach of duty by any director — thereby preserving *Aronson*'s important integrity-reinforcing role in Delaware law. In any event, harmonize the deference to decisions by independent directors by according them at least the same level of respect in the less difficult realm of policing transactions up front as in determining whether to sue after the fact.
5. Remove old encrustations on Delaware law that make it unclear and do not add value:
    a. Eliminate the waste vestige qualifying the effect of an informed, disinterested stockholder vote.
    b. Formally overrule *Cede II*'s effort to impose and link layers of standards of review applicable in disparate contexts.
    c. End Delaware takeover law's reliance on the concept of substantive coercion, and hold that *Unocal* permits a board acting in the reasonable, good faith belief that a tender offer is too low to use a pill to block the bid, based on power allocation grounds and not on the premise that stockholders might harm themselves by ignoring the board's contrary view of value.
6. Amend § 102(b)(7) to allow stockholders to adopt corporate charters exculpating officers for breaches of the duty of care claims brought by way of a class or representative action, but not for claims brought directly by the company itself under a contract or corporate common law.

7. Restore balance to the litigation process by amending § 220 to require prompt production of core books and records, but preclude burdening companies and investors with what amounts to free ranging and expensive pre-filing discovery, especially where federal and state law already provide stockholders with a required and detailed information base on which to base a vote on, or challenge to, a transaction.

We are mindful how difficult it is for courts to address high-stakes corporate cases under extreme time pressure, and with dueling arguments from some of the most persuasive advocates in the nation. Shaping the common law of corporations inevitably involves policy judgments about the comparative value of investing greater trust in impartial decision making by directors and stockholders, as opposed to allowing for more intensive judicial review. There is no cost-free approach, and trade-offs are unavoidable.

But, we continue to believe that the traditional Delaware approach of encouraging impartial decision-making, but providing companies with flexible means to effect transactions and conduct their business, remains the optimal one. Diverting from that philosophical commitment to facilitate judicial review of the substance of more and more transactions, especially given the vibrancy of stockholder voice, market information flows, press scrutiny, and tied voting policies that make independent directors highly responsive to stockholder sentiment, creates more costs than benefits. Under the standards we have proposed, stockholders have a fair and effective chance to litigate if they can faithfully allege that a fiduciary breach has caused real harm. And simplifying and clarifying Delaware doctrine will enhance the ability of Delaware's hard-working and expert courts to do equity that makes not just case-specific, but also systemic, sense.