COMMENT

DEFENDING ESG: A NEW STANDARD OF REVIEW FOR DEFENSIVE MEASURES THAT IMPACT ESG RATINGS

NICOLE R. HOVATTER†

The permissiveness of corporate defensive measures has been debated since their inception in the mid-1900s. Courts, scholars, and practitioners have grappled with the costs and benefits of these measures to both shareholders and society at large—and for good reason. On one hand, scholars and practitioners argue that defensive measures erode shareholder value by entrenching management, while on the other hand, supporters view defensive measures as valuable tools that allow target boards to appropriately defend against inadequate takeover bids.

Delaware courts have confronted this debate in an interesting manner, initially viewing defensive measures as permissible under the business judgment rule, and later assessing them with enhanced scrutiny. But the Delaware courts have never considered defensive measures from a value perspective—or considered that certain defensive measures that depress ESG ratings—thus firm value—may warrant additional judicial scrutiny.

This Comment begins from the premise that higher ESG ratings are indicative of greater long-term firm value. As supported by empirical studies conducted over the last decade, the combination of a poison pill and staggered board reduces ESG ratings, and thus reduces long-term firm value. Therefore, this Comment contends that the combination of these measures—the cornerstone of a “just say no” defense—should be

† Executive Editor, Volume 171, University of Pennsylvania Law Review; J.D. Candidate, University of Pennsylvania Carey Law School, Class of 2023. I am incredibly grateful to Professor Elizabeth Pollman for the guidance and feedback that helped make this Comment possible. Thanks also to Cody James, Jason Halper, and Guy Singer for their essential encouragement and advice at the early stages of this project. To the Editors of the University of Pennsylvania Law Review, thank you for your thoughtful contributions, and to Camila Bayly, thank you for the accountability and friendship that helped bring this Comment to publication. Finally, my deepest gratitude to my family for their unwavering support and encouragement. The living and lasting legacies of Edward J. Hovatter, Esq. and Michael Macaluso, Sr. inform everything I do.
assessed with enhanced scrutiny by Delaware courts. These defensive measures must survive heightened review at the "compelling justification" level. If the defensive measures do not survive this heightened standard of review, they must be viewed as an impermissible depression of shareholder value and dilution of shareholder rights.

INTRODUCTION

In June 1957, P.T. Cheff met with Arnold Maremont to discuss the feasibility of a merger. Cheff was the Chief Executive Officer of Holland Furnace Company, a home heating corporation that generated annual revenue of roughly thirty-two million and had monthly trading volume of approximately 10,300 shares. Maremont was the President of Maremont Automotive Products, a public corporation that manufactured exhaust systems for automobiles. Maremont had expressed an interest in acquiring

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1 Cheff v. Mathes, 199 A.2d 548, 551 (Del. 1964).
2 Id. at 550–51.
3 Id. at 551, see also CLAIRE A. HILL, BRIAN JM QUINN & STEVEN DAVIDOFF SOLOMON, MERGERS AND ACQUISITIONS: LAW, THEORY, AND PRACTICE 498 (2d ed. 2019) (providing an overview of Maremont Automotive's operations prior to Cheff).
Holland, but Cheff wasn’t interested. The Holland directors thought that differences in sales practices made the merger unfeasible.\(^4\) Maremont walked away.\(^5\)

Over the following month, Holland’s monthly trading volume tripled.\(^6\) The mysterious spike in activity was resolved when Maremont approached Cheff stating that he had purchased 55,000 shares of Holland.\(^7\) By August 1957, Maremont had purchased an additional 45,000 shares of Holland to accumulate a total position of approximately 100,000 shares.\(^8\) Cheff and the other Holland directors grew uneasy—Maremont had a reputation as a corporate raider and Holland employees grew fearful that Maremont would bust up the company.\(^9\) Before long, twenty-five “key” employees of Holland had quit out of fear of an acquisition.\(^10\) Based on this information, the Holland board authorized a stock buyback, ostensibly for use in a stock option plan.\(^11\) This tactic was known as greenmail, a popular defensive measure in the 1980s.\(^12\) When Holland shareholders brought suit stating that the defensive measure violated Delaware corporate law, the Delaware Supreme Court was

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\(^4\) Cheff, 199 A.2d at 551.

\(^5\) See id. ("Mr. Maremont stated that, in the light of Mr. Cheff’s decision, he had no further interest in Holland nor did he wish to buy any of the stock of Holland.").

\(^6\) Id.

\(^7\) Id. Although Maremont had purchased a significant number of shares by this juncture, “no requests for change in corporate policy were made,” as Maremont had “made no demand to be made a member of the board of Holland,” nor had he expressed any intention of further control. Id.

\(^8\) See id. ("Maremont then made a demand that he be named to the board of directors, but Cheff refused to consider it.").

\(^9\) See id. ("Because of the position now occupied by Maremont, the board elected to investigate the financial and business history of Maremont and corporations controlled by him. Apart from the documentary evidence produced by this investigation, . . . leading bank officials had indicated that Maremont had been a participant, or had attempted to be, in the liquidation of a number of companies." (citations omitted)). Although the 1960s is a period known for company consolidation, the threat of divestiture by “corporate raiders” was nevertheless palpable. For a discussion of both the takeover wave of the 1960s and the corporate raider phenomenon of the mid- to late-1990s, see infra Section I.A. For further discussion of the effectiveness of corporate raiders, see Andrei Shleifer & Robert W. Vishny, Takeovers in the ’60s and the ’80s: Evidence and Implications, 12 STRATEGIC MGMT. J. 51, 52-54 (1991).

\(^10\) Cheff, 199 A.2d at 551.

\(^11\) Id. at 552.

\(^12\) “Greenmail” is a defensive tactic whereby a corporation makes a selective buyback of stock—usually at a substantial premium over market price—from a party deemed undesirable or a party threatening a takeover. Typically, the stockholder or potential acquirer signs an agreement preventing them from owning any of the company’s shares for a specified number of years following the buyback. See Andrei Shleifer & Robert W. Vishny, Greenmail, White Knights, and Shareholders’ Interests, 17 RAND J. ECON. 293, 293-94 (1986). Although greenmail was popular in the early-1980s, it is quite rare today. In 1987, Congress passed an Act imposing a fifty percent excise tax on all profits from greenmail. See 26 C.F.R. § 156.5881-1 (2021) ("Section 5881 of the [Tax] Code imposes a tax equal to 50 percent of the gain or other income realized by any person on the receipt of greenmail, whether or not the gain or other income is recognized."). Many states also adopted laws prohibiting the practice. See, e.g., OHIO REV. CODE ANN. § 1707.043 (West 1990); 15 PA. CONS. STAT. § 2575 (2020).
faced with the issue of whether the Holland directors had “reasonable grounds to believe a danger to corporate policy and effectiveness existed by the presence of the Maremont stock ownership.”13 Said differently, the Court was faced with deciding whether the board was authorized to adopt this defensive measure in the face of a hostile tender offer, or whether the board had violated their fiduciary duties in doing so.

The Delaware Supreme Court held that the adoption of the defensive measure was permissible.14 The court’s reasoning rested on the fact that the board had notice of Maremont’s character and plan, and thus, the directors were using their business judgment to determine the best interests of Holland shareholders.15 The merger was never consummated.

Notwithstanding the Holland board’s concerns, years later, Maremont came to be known as an exemplary citizen: “a patron of the arts, a fighter against discrimination and for the poor, and an excellent businessman.”16 By contrast, Holland was being pursued by the Federal Trade Commission (FTC) for deceptive sales practices. Holland’s salespeople would enter potential customers’ homes, represent themselves as government agents, and dismantle furnaces as unsafe but fixable with Holland’s help.17 In 1965, Holland was found guilty of criminal contempt and was fined $100,000.18 Cheff went to jail.19 By then, Holland's sales plummeted to two million with losses exceeding three million, as compared to a company valuation of over forty million at the time of Maremont's offer.20

Courts have grappled with issues similar to the Cheff court since defensive measures proliferated in the mid- to late-1900s.21 Delaware courts, scholars, and practitioners have long debated whether boards should be permitted to adopt defensive measures in the face of a hostile tender offer, or whether such

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13 [Cheff, 199 A.2d at 555.]
14 [Id. at 552.]
15 [Id.]
16 [HILL ET AL., supra note 3, at 502.]
17 [Holland Furnace Co. v. Fed. Trade Comm’n, 295 F.2d 302, 303-04 (7th Cir. 1961).]
18 [See id. at 303, 306 (denying Holland’s petition for a review of the FTC decision, which directed Holland to cease and desist from unfair and deceptive practices and imposed a fine).]
19 [See In re Holland Furnace Co., 341 F.2d 548, 555 (7th Cir. 1965) (sentencing P.T. Cheff to imprisonment for a period of six months and imposing a fine of $100,000).]
21 [For further examples of Delaware courts’ analyses of then-novel defensive measures, see infra notes 40–41, 46–48 and accompanying text.]
defensive measures entrench management and deprive shareholders of long-term value.22

This Comment analyzes this issue from a particular perspective: from the intersection of defensive measures and environmental, social, and governance (ESG) ratings. Specifically, this Comment hypothesizes that certain defensive measures—staggered boards and poison pills—are correlated with lower ESG ratings on average, and thus, that these defensive measures must be viewed with greater scrutiny by Delaware courts. Given the empirical evidence that higher ESG ratings increase financial performance over the long term, the fact that staggered boards and poison pills lower ESG ratings suggests that these defensive measures are detrimental to firm performance and firm value over the long term.23 Because these defensive measures deprive shareholders of value, the combination of a poison pill and a staggered board—perhaps the most powerful defense against an unwanted takeover and the cornerstone of a “just say no” defense—should only be permissible where boards have a compelling justification to defend their use.

This Comment proceeds in three Parts. In Part I, I begin by briefly reviewing the takeover scene from 1960 to 1980 and providing an overview of the controversy surrounding poison pills and staggered boards. In discussing the controversy surrounding these defensive measures, I canvas a number of seminal cases including Moran, Paramount v. Time, eBay, and Williams, and discuss Delaware courts’ treatment of defensive measures in these cases. Finally, Part I summarizes the historical debate between scholars and practitioners regarding whether these defensive measures should be permissible in the first place. In Part II, I provide an overview of ESG ratings and their implications for corporations. Using empirical studies conducted over the last decade, Part II argues that increases in ESG ratings are correlated with increases in long-term financial performance, but poison pills and staggered boards decrease ESG ratings on average. Therefore, the adoption of these defensive measures depresses firm value in the long run. Finally, in Part III, I build upon the argument from Part II to analyze its implications for Delaware corporate law. Specifically, I argue that because these defensive measures lower ESG ratings (and thus, overall financial performance) on average, the adoption of staggered boards and poison pills should be analyzed with a heightened standard of review by Delaware courts.

In the absence of explicit shareholder authorization, these measures should

22 For a nuanced discussion of the debate among scholars and practitioners as to the value (or harm) of defensive measures, see infra notes 67-75 and accompanying text.

23 For a discussion of defensive measures’ impact on firm value, see Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy, 54 STAN. L. REV. 887, 936-39 (2002). For empirical studies arguing that defensive measures are correlated with lower ESG ratings, see infra Section II.C.
only be permissible where boards have a compelling justification to defend their application.

I. A HISTORY OF DEFENSIVE MEASURES AND THEIR CONTROVERSY

In this Part, I offer an overview of staggered boards and poison pills through three Sections. First, I discuss the historical rise and controversy of defensive measures. Second, I analyze Delaware courts’ treatment of these defensive measures throughout history. And third, I describe the debate among scholars and practitioners regarding whether incumbent management should be permitted to adopt these defensive measures in the face of a hostile tender offer.

A. The Rise of Defensive Measures

The 1960s were characterized by a frenzy of merger and acquisition activity, constituting one of the largest takeover waves that the United States had ever seen.24 Mergers during this period were typically friendly transactions by large corporations of smaller firms outside of acquirers’ primary business lines.25 These acquirers were driven by the desire to diversify operations and capitalize on market factors, such as inflated valuations of company stocks and aggressive antitrust enforcement that simply disallowed mergers of firms in the same industry.26 Importantly, tender offers were relatively rare during this period and were regarded as “bad form” by most acquirers.27

But the experiment with diversification and inflated valuations proved largely disappointing. An estimated one-third of all acquisitions made in the 1960s and 1970s were later divested.28 When merger activity again accelerated in the 1980s, it took the form of an entirely different animal: the hostile

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24 See Shleifer & Vishny, supra note 9, at 51 (noting that the takeover wave of the 1960s “was the largest since the turn of the century” and that single business companies dropped from approximately twenty-three percent in 1959 to roughly fifteen percent by 1969). In total, approximately 25,000 companies were acquired over the course of the 1960s. See Devra L. Golbe & Lawrence J. White, Mergers and Acquisitions in the U.S. Economy: An Aggregate and Historical Overview, in NAT’L BUREAU ECON. RSCH., Mergers and Acquisitions 25, 31 fig.2.2 (Alan J. Auerbach ed., 1987).

25 Shleifer & Vishny, supra note 9, at 51.

26 Id. at 52, 55.

27 See Stephen M. Bainbridge, Redirecting State Takeover Laws at Proxy Contests, 1992 WIS. L. REV. 1071, 1081 n.37 (noting that the tender offer had “comparative advantages” and was highly profitable, but that the “social mores” of the business and financial communities caused hostile offers to be regarded as “bad form”).

28 See Shleifer & Vishny, supra note 9, at 52. For a general discussion of the merger and acquisition landscape following the divestiture wave, see David J. Ravenscraft & F. M. Scherer, Life After Takeover, 36 J. INDUS. ECON. 147, 154-55 (1987).
takeover. This 1980s merger wave mimicked that of the 1960s in terms of volume, but differed in that it was characterized by "radical new forms of control changes." While the 1960s created many conglomerates, the 1980s destroyed them: corporate raiders sought to "bust up" underperforming companies by selling off large fractions of targets' assets. Much of this activity was driven by the hands-off antitrust policy of the new Reagan Administration, which largely stopped challenging intra-industry mergers and opened the door for acquisition activity.

In response to the hostile takeover activity of this period, incumbent managers hired lawyers to develop an array of defenses. Dealmakers began experimenting with new forms of deal protection devices. The staggered board, which had long been established by the Delaware legislature, now stood alongside innovative defensive measures such as greenmail, "white knights," leveraged recapitalization, and "Pac-Man" defenses. But the

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29 Shleifer & Vishny, supra note 9, at 53.
30 Id.
31 Id. at 53.
32 The Reagan Administration's antitrust program has been widely characterized as one of the loosest antitrust enforcement regimes of the 20th century. See, e.g., William E. Kovacic, The Modern Evolution of U.S. Competition Policy Enforcement Norms, 71 ANTITRUST L.J. 377, 384-87 (2003) (characterizing the Reagan administration's antitrust policies as the "most lenient antitrust enforcement program" since the early 1930s, bringing the United States to "the brink of an antitrust apocalypse"); Eleanor M. Fox & Robert Pitofsky, Papers Presented at the Airlie House Conference on the Antitrust Alternative: Introduction, 62 N.Y.U. L. REV. 931, 931 (1987) (arguing that under Reagan, antitrust laws were being "seriously underenforced" in the merger context, reaching a "crisis point" that "threaten[ed] the American competition system"); Edward D. Cavanaugh, Attorneys' Fees in Antitrust Litigation: Making the System Fairer, 57 FORDHAM L. REV. 51, 72 (1988) (noting that the Reagan administration showed only "minimal" interest in "token" merger enforcement).
33 As proscribed by section 141(d) of the Delaware General Corporate Law:

The directors of any corporation organized under this chapter may, by the certificate of incorporation or by an initial bylaw, or by a bylaw adopted by a vote of the stockholders, be divided into 1, 2 or 3 classes; the term of office of those of the first class to expire at the first annual meeting held after such classification becomes effective . . . .

DEl. CODE ANN. tit. 8, § 141(d) (2020).
34 See Johnathan R. Macey & Fred S. McChesney, A Theoretical Analysis of Corporate Greenmail, 97 YALE L.J. 13, 13, 57-60 (1985) (defining greenmail payments and arguing for the traditional business judgment rule to be applied to challenges of greenmail).
35 See Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173, 183-84 (Del. 1986) (describing the use of a "white knight" defender, or a preferred acquirer who the target facilitated to step in to thwart a hostile offer by a different acquirer).
most advantageous weapon in the target board’s new arsenal—the poison pill—attracted the majority of the buzz. The poison pill largely rendered the other defensive measures trivial.\textsuperscript{38} The defensive measure did not entail significant transaction costs, could be adopted by a target board at any time without shareholder approval, and made the target company essentially takeover proof unless the pill was redeemed by the board’s unilateral decision.\textsuperscript{39} These new defensive measures expanded an already growing portfolio of defensive weapons and had clear advantages to incumbent management, but the legality of these new tools remained unknown. Delaware courts had yet to confront whether these tools were permissible under Delaware General Corporate Law, or whether these tools represented an overreach by management that was violative of shareholder rights.

**B. The History of Defensive Measures Through Case Law**

The creation of new defensive measures quickly led to controversy surrounding the use of such measures. Before long, target shareholders began challenging boards’ uses of defensive measures to thwart hostile tender offers at premiums over market prices.\textsuperscript{40} Delaware courts were faced with a novel question: when, exactly, was board adoption of a defensive measure permissible?

In the absence of shareholder approval, Delaware courts analyzed the legality of these defensive measures by determining whether the adoption of the defensive measure was a violation of board fiduciary duty. In \textit{Unocal Corp. v. Mesa Petroleum Co.}, the Delaware Supreme Court articulated for the first time that a board’s decision to adopt defensive measures in the face of a takeover was not entitled to a presumption of care under the business

\textsuperscript{38} The poison pill—also known as a shareholder rights plan—is a tool used to protect against a hostile takeover or shareholder activism. The pill dilutes a shareholder’s stake in a company once that shareholder crosses a certain threshold of ownership—known as the “trigger threshold”—thereby preventing that shareholder from acquiring majority ownership or control of the company. Namely, the pill dilutes the potential acquirer’s stake by giving all other shareholders, aside from the potential acquirer, the right to buy additional stock in the target company once the trigger threshold is met. See Caley Petrucci & Guhan Subramanian, \textit{Pills in a World of Activism and ESG}, U. CHI. BUS. L. REV. (forthcoming 2022) (manuscript at 2-3), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4104799 [https://perma.cc/V6FF-U22Y].


judgment rule. Instead, because of the “omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders,” the court reasoned that a heightened or “enhanced” standard of review must be applied. Under this heightened standard of review, business decisions made in a merger context—including the choice to adopt defensive measures—do not violate the board’s fiduciary obligations to the corporation if they pass a two-prong test. First, courts apply a reasonableness test: a board must have acted with reasonable grounds for believing that a threat to corporate policy and effectiveness existed. If a threat is identified and the business decision satisfies the first prong of the test, courts then consider a second proportionality test: the defensive measure adopted must have been proportional to that threat such that the measure was not preclusive or coercive to shareholders.

Following Unocal and Unitrin, the Delaware Supreme Court applied this “enhanced” standard of review to board adoptions of defensive measures. Initially, application of this heightened standard caused Delaware courts to view most defensive measures with hostility: in many instances, target boards were forced to eliminate certain defensive measures in pursuit of greater shareholder value. The court’s hostility towards certain defensive measures arguably reached its peak in Omnicare, when the Delaware Supreme Court struck down the combination of a termination fee, a force-the-vote provision without a “fiduciary out,” and a no-shop clause as a breach of target directors’ fiduciary duties.

But poison pills were not treated with the same hostility during this period. In Moran, the first significant case where the Delaware Supreme Court analyzed a poison pill, the court found the poison pill to be a legitimate exercise of

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41 See Unocal Corp. v. Mesa Petrol. Co., 493 A.2d 946, 954 (Del. 1985) (noting that while in prior cases the court employed the business judgment rule in the context of a takeover, “certain caveats” call for judicial examination “at the threshold,” prior to application of the rule).

42 Id.

43 Id. at 956-58.

44 Unitrin, 651 A.2d at 1373.

45 Id.

46 See, e.g., Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173, 185 (Del. 1986) (finding that the attempt to thwart a takeover using a “white knight” defender and an asset lockup violated the board’s fiduciary duty); Paramount Commc’ns Inc. v. QVC Network Inc., 637 A.2d 34, 49 (Del. 1994) (finding that the use of stock lockups and termination fees violates fiduciary duty in specific contexts).

47 See Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 936 (Del. 2003) (“The defensive measures that protected the merger transaction are unenforceable not only because they are preclusive and coercive but, alternatively, they are unenforceable because they are invalid as they operate in this case.”).

48 Moran v. Household Int’l, Inc., 500 A.2d 1346, 1350 (Del. 1985). Poison pills are also known as shareholder rights plans. See supra note 38 and accompanying text.
business judgment by the target board of directors.\textsuperscript{49} Three years later, the Delaware Court of Chancery appeared to reject the “just say no” defense.\textsuperscript{50} But this ruling was quickly overturned by the Delaware Supreme Court in \textit{Paramount Communications Inc. v. Time Inc.}\textsuperscript{51} There, the Delaware Supreme Court permitted the Time board to retain its poison pill based on the board’s conclusion that Paramount’s offer of $200 per share—an offer approximately fifty-eight percent above market value—was inadequate because of differences between the companies’ corporate cultures.\textsuperscript{52} In doing so, the Delaware Supreme Court held that “[d]irectors are not obliged to abandon a deliberately conceived corporate plan for a short-term shareholder profit,”\textsuperscript{53} and criticized the Court of Chancery’s earlier decision as “narrow and rigid.”\textsuperscript{54}

The Delaware Supreme Court’s reluctance to second-guess directors who refused to eliminate their poison pills continued throughout the 1990s and early 2000s. Namely, the court proceeded to uphold poison pills in a variety of contexts until 2010, issuing a seminal holding in \textit{Yucaipa} that made clear the court’s permissiveness towards the poison pill.\textsuperscript{55} This permissiveness arguably culminated in \textit{Air Products and Chemicals, Inc. v. Airgas, Inc.}, where the court quoted \textit{Paramount v. Time} to explicitly authorize the use of a standing poison pill in a “just say no” defense.\textsuperscript{56} Although hostile tender offers remained technically possible, it seemed that hostile acquirers could not expect much judicial interference in target board decisionmaking.\textsuperscript{57}

\textsuperscript{49} See Moran, 500 A.2d at 1348 (“In a detailed opinion, the Court of Chancery upheld the [Shareholder] Rights Plan as a legitimate exercise of business judgment . . . . We agree, and therefore, affirm the judgment below.”).

\textsuperscript{50} See City Cap. Assocs. Ltd. v. Interco Inc., 551 A.2d 787, 798 (1988) (finding that once the threatened takeover period had “closed,” the “legitimate role of the poison pill in the context of a noncoercive offer [had] been fully satisfied” and thus, that management had violated their fiduciary duties in refusing to redeem the pill). When employing a “just say no” defensive strategy, a target board refuses to redeem a poison pill indefinitely, even when the board is not facing a specific takeover threat. See \textit{Julian Velasco, The Enduring Illegitimacy of the Poison Pill}, 27 J. CORP. L. 381, 414-15 (2002).

\textsuperscript{51} See \textit{Paramount Commc’ns, Inc. v. Time Inc.}, 571 A.2d 1140, 1149-50 (Del. 1990) (finding that the use of a poison pill was permissible).

\textsuperscript{52} Id. at 1149.

\textsuperscript{53} Id. at 1154.

\textsuperscript{54} Id. at 1153.

\textsuperscript{55} See, e.g., \textit{Yucaipa Am. All. Fund II, L.P. v. Riggio}, 1 A.3d 310, 360-61 (Del. Ch. 2010) (dismissing shareholder suit for breach of fiduciary duty, and finding that adoption of a “just say no” poison pill was a good faith, reasonable response to a legitimate threat); \textit{Versata Enters., Inc. v. Selectica, Inc.}, 5 A.3d 586, 605-06 (Del. 2010) (finding that a poison pill was neither preclusive nor coercive, but rather was a proportionate response to a legitimate threat).

\textsuperscript{56} See \textit{Air Prods. & Chems., Inc. v. Airgas, Inc.}, 16 A.3d 48, 103, 112-13 (Del. Ch. 2010) (“[A]s the Supreme Court has held, a board that in good faith believes that a hostile offer is inadequate may ‘properly employ[] a poison pill as a proportionate defensive response to protect its stockholders from a low ball bid.’” (quoting \textit{Paramount}, 571 A.2d at 1150)).

But the tide seemed to turn less than one month after these seminal holdings. In *eBay Domestic Holdings, Inc. v. Newmark*, the Delaware Court of Chancery considered for the first time the validity of a poison pill adopted by the board of a closely-held corporation.\(^{58}\) *eBay*, a twenty-eight percent minority shareholder in Craigslist, sought to acquire Craigslist as a for-profit venture.\(^{59}\) Craigslist’s owners, however, believed that the company provided a valuable public service and did not focus on profit maximization.\(^{60}\) Thus, Craigslist directors adopted a poison pill to prevent a takeover.\(^{61}\) The Delaware Court of Chancery struck down the poison pill as violative of the directors’ fiduciary duties, stating that eBay posed no immediate threat to take over Craigslist or even increase their stake in the company.\(^{62}\) Instead, the Craigslist board acted simply to cement their roles as directors and thwart a hypothetical, self-conceived takeover threat.

This holding marked a shift in the Delaware courts’ treatment of the pill. Rather than sustain all uses of the defensive measure, *eBay* indicated that Delaware courts may strike down the use of a poison pill to protect noneconomic values, where the poison pill is punitive to a minority shareholder rather than a legitimate measure to further corporate objectives.

Finally, the Delaware courts again indicated skepticism towards adoption of the pill in *In re Williams Companies Stockholder Litigation*.\(^{63}\) There, the Williams board adopted a poison pill with a one-year term at a time when Williams’ stock was trading at an all-time low.\(^{64}\) This was not a “war time” pill: the Williams board faced no hostile takeover proposal or tender offer, but rather was concerned about pressure from stockholders over the company’s intense stock price volatility.\(^{65}\) The Court struck down the pill and criticized the board for acting on “hypothetical future threats.”\(^{66}\) Instead of acting in the best interests of the company and shareholders, the board arguably adopted the pill to cement their roles as directors during a time when shareholder dissatisfaction was likely to be at an all-time high. Together, the *eBay* and *Williams* decisions indicate that the permissiveness the Delaware courts once afforded to poison pills—in holdings such as *Moran*, *Paramount*, and *Air Products*—was not unbridled, but rather that the courts could view poison pills with skepticism and hostility going forward.

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58 eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 31 (Del. Ch. 2010).
59 Id. at 6, 8.
60 Id. at 8.
61 Id. at 20.
62 Id. at 7.
64 Id.
65 Id. at *24-26.
66 Id. at *24.
C. The Modern Debate: Do Defensive Measures Diminish Value?

In recent years, skepticism and debate regarding defensive measures has been equally as robust among practitioners and scholars as it has among Delaware judges. Many scholars argue that a target board should not be permitted to defend itself against an unsolicited and unwanted tender offer. Instead, they contend that target boards should simply remain passive, letting the shareholders’ votes decide.67 Taking this argument one step further, scholars such as Lucian Bebchuk argue not only for passivity, but also for management resistance to solicited tender offers, as it is “at best a risky proposition” for shareholders and is “at worst economically disastrous.”68 This view, known as the shareholder primacy view, contends that shareholders should be in control of the material decisions of the companies they invest in.69 Proponents of the shareholder primacy view argue that defensive measures—including staggered boards and poison pills—are counterproductive to shareholder protection and urge that shareholders should have the power to initiate a shareholder referendum on material corporate business decisions.70

67 In their famous article, The Proper Role of a Target’s Management in Responding to a Tender Offer, Judge Frank Easterbrook and Professor Daniel Fischel argue that the role of tender offer is to replace inefficient management. See Frank H. Easterbrook & Daniel R. Fischel, The Proper Role of a Target’s Management in Responding to a Tender Offer, 94 HARR. L. REV. 1161, 1173 (1981). Bidders in tender offers typically, if not always, pay a premium over the market price because they believe that the target’s assets have not been optimally utilized and that under superior management, they would earn a higher return. Id. at 1165-68. Therefore, Easterbrook and Fischel argue that tender offers must be permitted to provide shareholders with the incremental value that the inefficient incumbent management denied them. Id. at 1164. Viewed in this light, Easterbrook and Fischel argue what has come to be known as the “passivity thesis”: in the face of a tender offer, defensive measures are impermissible and management should be prohibited from resisting the offer in any fashion. Id. at 1201-02. They should simply be passive. Id. For further discussion of the passivity thesis and the argument that hostile tender offers increase shareholder value and are therefore socially desirable, see John C. Coffee, Jr., Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer’s Role in Corporate Governance, 84 COLUM. L. REV. 1145, 1163-64 (1984).


69 See Lucian A. Bebchuk, Letting Shareholders Set the Rules, 119 HARV. L. REV. 1784, 1809-13 (2006) (expressing Bebchuk’s view that boards’ “control over changes in the rules of the game regulating their own power” is “highly problematic” and that moving to “a regime with shareholder power to make such decisions” would improve corporate governance arrangements).

70 In support of this view, Bebchuk established and directed the Shareholder Right’s Project—a clinical program dedicated to proposing precatory shareholder resolutions under Rule 14a-8 seeking to eliminate staggered boards of S&P 500 companies. See 121 Companies Agreed to Move Towards Annual Elections, S’HOLDER RTS PROJECT, http://www.srp.law.harvard.edu/companies-entering-into-agreements.shtml [https://perma.cc/RB2M-DSNM]. In 2012, the first full-year proxy season in which the Shareholder Rights Project was active, the program submitted proposals to more than eighty S&P 500 companies, urging that their boards be declassified. See Lucian Bebchuk, Scott
Management should not only pause, but actively take a backseat, and defensive measures adopted by management should not be sustained without shareholder approval.

On the other end of the spectrum, scholars such as Stephen Bainbridge and Martin Lipton argue that the target board must be afforded latitude to defend, in line with language of the Delaware General Corporation Law (DGCL). These scholars endorse a board-centric view of corporate governance that has come to be known as the “director primacy” view. In response to the passivity thesis and the shareholder primacy view endorsed by Bebchuk, these scholars note that there is ultimately no persuasive empirical evidence that defensive measures reduce stockholder value over the long-term. Rather, according to the director primacy view, the absence of defensive measures makes it significantly harder for a public company to fend off “an inadequate, opportunistic takeover bid, and is harmful to companies that focus on long-term value creation.” Thus, board adoption of defensive measures should be sustained, as adoption of these measures furthers both corporate and shareholder interests in the long term.

The debate regarding defensive measures centers around whether permitting takeover defenses entrenches management, thereby preventing the takeover market from functioning effectively and reducing shareholder value; or whether takeover defenses appropriately allow target boards to safeguard against inadequate takeover bids in pursuit of greater long-term value. This controversy remains unanswered by both Delaware courts—who
initially held that poison pills were permissible even in a “just say no” context, but now seem to view the defensive measure with greater scrutiny—and scholars, whose lively discussion is ultimately inconclusive.

II. ESG RATINGS AND WHAT THEY TELL US

As discussed in Part I, the significant controversy surrounding the adoption and use of defensive measures has been tackled by Delaware courts in interesting ways. Scholars have crafted adamant arguments that defensive measures are both good and bad; at the same time, Delaware courts’ treatment of defensive measures has evolved from deference under the business judgment rule to enhanced scrutiny. But Delaware courts have never examined defensive measures from a value perspective—or considered that certain defensive measures that depress ESG ratings, and thus, firm value, may warrant additional scrutiny.

In this Part, I argue that ESG ratings are meaningful indicators of ESG performance, and that higher ESG ratings are correlated with higher firm value over the long-term. Building upon this logic, I argue that because defensive measures depress ESG ratings, these measures also diminish firm value over the long-term. Thus, Delaware courts should review these measures with enhanced scrutiny.

Part II proceeds in three Sections. First, Section A offers an overview of ESG ratings, discusses how these ratings are calculated, and explains what ratings indicate about rated companies. Section A specifically argues that ESG ratings are meaningful indicators of ESG performance. Section B examines empirical studies conducted over the last decade to argue that higher ESG ratings are correlated with increases in long-term financial performance and value. Finally, Section C builds upon these arguments to conclude that “just say no” defensive measures lower governance and aggregate ESG ratings on average, and thus lower ESG performance and depress overall firm value.

A. What is an ESG Rating and How is it Calculated?

Over the past several years, ESG issues have expanded, evolved, and come to the forefront of investors and shareholders’ interests. In the latest proxy season in particular, ESG-related issues became increasingly integrated into corporate boards’ decisionmaking processes. In other words, boards have

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voluntarily embraced ESG-related issues in the boardroom to align their oversight with investor and shareholder interests. Through discussion of ESG topics in public announcements, formal disclosures, press releases, or proxy statements, stakeholders sought every opportunity to express their ESG interests to boards, and boards have in turn sought every opportunity to express their ESG positioning and progress to stakeholders.

ESG ratings and disclosures are a core part of this ESG narrative. The European Union (EU) has required detailed ESG disclosures since 2018, when the Sustainable Finance Disclosure Regulation (SDFR) made sustainability reporting mandatory in the financial services sector, and the Corporate Sustainability Reporting Directive (CSRD) made ESG and taxonomy-related disclosure mandatory for non-financial services corporations. Following in the EU’s footsteps, investors called on U.S.-based companies to construct disclosure frameworks that logically and transparently summarized the impact of ESG items on companies and stakeholders. This call led to the voluntary disclosure of ESG-related information by many U.S. corporations, as well as the rating of companies’

[https://perma.cc/ TCN6-RZJL] (“Investments in ESG strategies grew 42% from 2018 to 2020 . . . ESG funds are on track for a record year of inflows in 2021 as well, raking in more than $21 billion in the first quarter alone.”).


81 See Commission Regulation 2019/2088 of Nov. 27, 2019, Sustainability-Related Disclosures in the Financial Services Sector, 2019 O.J. (L 317) 2 (“Disclosures [are required] to end investors on the integration of sustainability risks, on the consideration of adverse sustainability impacts, on sustainable investment objectives, or on the promotion of environmental or social characteristics . . . .”); see also Michal Barzuza, Quinn Curtis & David H. Webber, Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance, 93 S. CAL. L. REV. 1243, 1302-04 (2020) (discussing the importance of climate change to millennials in making investment decisions, and stating that nearly twenty-five percent of modern-day investors are committed to ESG investing). For further discussion of the importance of ESG disclosure to investors in U.S.-based companies, see infra notes 154–156 and accompanying text.
ESG performances by various third-party providers of reports and ratings. These ratings serve “to inform decision makers of how well a firm is managing ESG risks and opportunities” over time and as compared to peers. Today, ratings are increasingly relied upon by institutional investors, asset managers, and individual stakeholders in assessing a company’s ESG performance, and ratings often form the basis of shareholder engagement with companies on ESG matters.

1. How are ESG Ratings Calculated?

Third-party raters use proprietary methodologies, including hundreds of different metrics and key performance indicators, to evaluate a company’s ESG performance. Those metrics are then weighed to produce an aggregate “environmental” rating, “social” rating, “governance” rating, and ultimately, an aggregate ESG score. Each rating agency uses its own algorithm to process information and produce ESG ratings, considering factors ranging from carbon emissions to board diversity to management policies.

Although methodology, scope, and coverage vary greatly among providers, most providers gather information from companies’ own disclosures to formulate...
ESG scores. Among all data providers, four ratings agencies—MSCI, RepRisk, Sustainalytics, and Institutional Shareholder Services (ISS)—currently dominate the market.\(^88\) These four agencies collect public ESG information disclosed by companies through corporate social responsibility or sustainability reports, annual reports, and websites and other public sources (including government databases and NGO databases).\(^89\) These agencies also rely on direct company verification to formulate ratings and scores. In fact, most third-party providers invite companies to participate in a formal data verification process prior to publication of their ESG reports.\(^90\)

Once agencies synthesize a company’s metrics, they weigh the metrics to produce a global ESG rating.\(^91\) Importantly, the ultimate rating does not measure a company’s impact on the environment and society; rather it measures “the potential impact of the world on the company and its shareholders.”\(^92\) In other words, companies that are highly rated do not necessarily contribute positively to the world, but rather are highly rated simply because they are less financially exposed to ESG-related risks than lower-rated peers.\(^93\) For example, consider a hypothetical rating upgrade of a chemical manufacturer’s “water stress” score. This upgrade would not consider measurements of the company’s impact on the water supplies in the communities where it manufactures.\(^94\) Rather, the rating would consider whether the communities themselves have sufficient water to sustain the company’s factories and operations.\(^95\) Therefore, according to MSCI—the single largest ratings provider in the United States—ESG ratings are arguably “the most financially relevant” indication of ESG performance,\(^96\) providing a direct indication of the relationship between ESG and corporate financial risk.\(^97\)

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\(^88\) Id.

\(^89\) Id.

\(^90\) See Huber & Comstock, supra note 82 (providing an overview of the ten primary rating agencies, seven of which allow companies to engage in a formal data verification process prior to ratings publication).

\(^91\) See Senz, supra note 86 (“Each agency relies on its own analysts and algorithms to synthesize disclosures of ESG metrics . . . which are then consolidated to one ESG score.”).


\(^93\) Id.

\(^94\) Id.

\(^95\) Id.


\(^97\) See Serafeim & Yoon, supra note 83 (arguing that the role of ESG ratings is to provide an indication of financial exposure to ESG risks). But see Simon MacMahon, The Challenge of Rating ESG Performance,
2. Limitations and Shortcomings of ESG Ratings

Despite the recent rise of ESG and the growing importance of ESG to investors, there remains skepticism about the efficacy of ESG ratings. Namely, there are two criticisms of ESG ratings that have gained traction among scholars as of late. First, recent evidence suggests that ratings diverge significantly among ratings agencies.98 This evidence has led to severe criticism about the usefulness of ratings and the clarity of ratings for investors, with critics arguing that ratings have no meaningful relation to investment decisions or firm value.99 Indeed, a recent study by Dane Christensen, Anywhere Sikochi, and George Serafeim indicates that a ten percent increase in ESG disclosure is associated with approximately one to two percent increase in ESG score variation among major ratings providers.100

Second, environmentalists argue that ESG reporting promotes “greenwashing”—or the manipulation of ESG reporting to overstate a company’s “climate-friendliness” and other positive impacts of operations, products, and emissions on the environment.101 In support of this argument, Cam Simpson, Akshat Rathi, and Saijel Kishan argue that there is “a kind of doublespeak within the pages of a rating report”102: ratings allegedly trick

98 For a discussion of divergence among rating agencies, and an argument that divergence is based on non-overlapping aspects of social and governance responsibility, see Aaron K. Chatterji, Rodolphe Durand, David I. Levine & Samuel Touboul, Do Ratings of Firms Converge? Implications for Managers, Investors and Strategy Researchers, 37 STRATEGIC MGMT. J. 1597, 1607-09 (2016).
99 See Dane M. Christensen, George Serafeim & Anywhere Sikochi, Why is Corporate Virtue in the Eye of the Beholder? The Case of ESG Ratings, 97 ACCT. REV. 147, 150-53 (2022) (finding that raters disagree more about ESG outcome metrics than input metrics, and that ESG disclosure exacerbates disagreement about ESG ratings, making both ESG disclosure and ratings non-meaningful).
100 See Senz, supra note 86 (“According to [Sikochi, Serafeim, and Christensen’s] research, a 10 percent increase in corporate disclosure is associated with a 1.3 to 2 percent increase in ESG score variation among major ratings providers, which all interpret and process disclosures differently.”).
102 See Simpson et al., supra note 92.
investors into thinking that they measure a company’s impact on society, when in actuality they measure a company’s financial exposure to ESG-related risks. Investors who seek to positively impact the world are tricked into investments that do no such thing.

But these arguments do not lessen the effectiveness of ESG ratings as indicators of long-term ESG performance and, in turn, long-term firm value. Critics who argue that ESG ratings contain “doublespeak,” or promote greenwashing, may be correct that ESG ratings provide confusing information to investors about a company’s ability to positively impact the world or the environment. Whether the marketing or use of ESG ratings should more clearly convey their meaning to investors is an important topic for inquiry that is outside of the scope of this Comment. Nevertheless, the argument that ratings promote greenwashing does not diminish the usefulness of ratings in a financial context: ratings remain of use and importance to investors in their ability to convey financial exposure to ESG-related risks. In other words, ESG ratings’ potential mischaracterization as reflecting a societal good does not lessen ESG ratings’ true place as an indicator of financial risk exposure.

Similarly, critics who focus on the divergence in ratings among ratings providers fail to recognize the importance of the SEC’s proposed rules on ESG disclosures, which aim to partially standardize the ESG-related information that companies must publicly provide. Specifically, the SEC recently proposed amendments to Regulation S-K to require domestic issuers to disclose certain ESG-related information in registration statements, annual reports, and audited financial statements filed with the

103 Id. Simpson, Rathi, and Kishan argue that this “doublespeak” makes ESG ratings a “mirage”: companies have allegedly tricked investors into thinking that ratings measure environmental impact to gain profit. Id. For example, the authors note that McDonald’s received an ESG ratings upgrade from MSCI this past year, even though the company had a high level of greenhouse gas emissions. Id. But this upgrade was not due to an improvement in McDonald’s environmental performance or impact; rather, it was because MSCI removed “gas emissions” as an ESG ratings metric because emissions did not pose a financial “risk” nor an opportunity to McDonald’s bottom line. Id.

104 See supra note 96 and accompanying text.

SEC. Further, Institutional Shareholder Services (ISS) and Glass Lewis have proposed new proxy voting guidelines on climate change, board and workforce diversity, and ESG “responsiveness,” urging companies to provide ESG-related disclosure to shareholders via proxy materials. Because public filings serve as the starting point for ESG rating calculations, the SEC’s standardization of these filings would systematize the information that ratings agencies use to determine ratings. In short, the SEC’s new proposal is a much-needed step in creating uniformity at the disclosure stage, and thus promotes uniformity in the information used by ratings agencies. This consistency would mitigate the divergence in ratings among ratings providers.

Take, for example, agencies which provide ratings for creditworthiness. Different credit rating agencies almost always give the same ratings because their assessments are based on identical financial data. The SEC oversees credit raters. Thus, the SEC stepping in to oversee ESG disclosure has potential for a similar effect: the new ESG-reporting regime, where

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companies’ scores are based on ESG ratings, would be much like rating them for creditworthiness, where different agencies give similar ratings because their assessments are based on identical financial data that is overseen by the SEC.112 Put simply, improved data standards that underpin reporting and disclosure approaches would help to equalize the scores provided by ratings agencies.

ESG ratings have been established as an important investment metric for investors—one that measures exposure to financial ESG-related risks and thus is directly linked to the financial benefits of ESG performance. Current criticism—related to “greenwashing” or current divergence in ratings among ratings providers—does not lessen the financial efficacy of ratings. On the contrary, the nature of ESG ratings, the methods of ratings calculation, and the information that ratings provide indicate that ESG ratings are meaningful indicators of exposure to financial risk and opportunity.

B. *Increases in ESG Ratings are Correlated with Increases in Financial Performance*

In Section A, I provided an overview of ESG ratings and argued that notwithstanding certain shortcomings and criticisms, ESG ratings remain useful metrics in measuring financial exposure to ESG-related risks. In this Section, I argue that ESG ratings are correlated with increases in financial performance, and thus that depressions of ESG ratings depress financial performance and financial value.

112 The SEC’s proposal has occasioned significant debate on whether the agency has the statutory authority to mandate disclosure of climate-related information and other ESG metrics. While this Comment presents no opinion as to the SEC’s statutory authority over these disclosures, I note that the SEC has received over eight thousand letters in response to the Proposed Rule, the vast majority of which have supported the SEC’s efforts and have taken the position that the SEC has clear statutory authority to mandate disclosure. See, e.g., Jill E. Fisch, George S. Georgiev, Donna M. Nagy & Cynthia A. Williams, Comment Letter to the SEC on the Enhancement and Standardization of Climate-Related Disclosures for Investors, at 1 (June 6, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20130354-297375.pdf (stating, on behalf of thirty law professors, the view that the SEC has “ample, longstanding, and clear authority” to promulgate disclosures in this context); Alan Beller, Daryl Brewster, Robert G. Eccles, Carmen X.W. Lu, David A. Katz & Leo E. Strine, Jr., Comment Letter to the SEC on the Enhancement and Standardization of Climate-Related Disclosures for Investors, at 2 (June 16, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20131712-302129.pdf (“In our view, the proposed rule is a core exercise of the SEC’s well-established authority to require disclosure necessary and appropriate to protect the integrity of our nation’s securities markets and the investors in those markets.”); George S. Georgiev, Comment Letter to the SEC on Climate Change and Other ESG Disclosure (June 22, 2021), https://www.sec.gov/comments/climate-disclosure/cll2-8945393-245744.pdf (arguing that the SEC has established statutory authority to regulate climate disclosures).
The Global Sustainable Investment Alliance ("GSIA") estimates that approximately $35.3 trillion in assets are managed using a sustainable investment strategy, a number that has increased fifteen percent over the past two years and fifty-five percent over the past four years.\textsuperscript{113} The GSIA defines a sustainable investment strategy as an approach that considers ESG factors in portfolio selection and management.\textsuperscript{114} While some of this interest may stem from investors’ desire to align their portfolios with their personal and moral values—such as the desire to invest in a company that seemingly contributes positively to environmental conditions—empirical evidence suggests that growth in sustainable investments is primarily driven by the positive correlation between ESG performance and firm value.\textsuperscript{115}

Hundreds of empirical studies have found a positive correlation between ESG performance and long-term marketplace outperformance.\textsuperscript{116} For example, using a sample of one hundred and eighty corporations that voluntarily adopted sustainability practices, Robert Eccles, Ioannis Ioannou, and George Serafeim found that boards of high-sustainability companies outperform their counterparts over the long-term in both stock price and accounting performance.\textsuperscript{117} Likewise, Mozaffar Khan, George Serafeim, and Aaron Yoon found a similar positive correlation.\textsuperscript{118} Using calendar-time stock return regressions, the authors found that firms with good performance on material sustainability issues significantly outperformed their peers with poor performance on those same issues, suggesting that ESG efforts are value-enhancing.\textsuperscript{119} Gunnar Friede, Timo Busch, and Alexander Bassen conducted a meta-analysis of over two thousand empirical studies on ESG and financial performance, and found that the large majority of studies reported a non-

\textsuperscript{113} GLOB. SUSTAINABLE INV. ALL., GLOBAL SUSTAINABLE INVESTMENT REVIEW 2020, at 9 (2020).
\textsuperscript{114} Id. at 7.
\textsuperscript{115} See infra notes 116–122 and accompanying text (discussing a variety of empirical studies that have reported statistically-relevant correlations between sustainable management practices, disclosures, and aspects of financial success such as stock price and return on assets).
\textsuperscript{116} See TENSIE WHelan, Ulrich Atz, Tracy Van Holt & Casey Clark, N.Y.U. STERN CTR. FOR SUSTAINABLE BUS., ESG AND FINANCIAL PERFORMANCE: UNCOVERING THE RELATIONSHIP BY AGGREGATING EVIDENCE FROM 1,000 PLUS STUDIES PUBLISHED BETWEEN 2015–2020, at 4, 10 (2021), https://www.stern.nyu.edu/sites/default/files/assets/documents/ NYU-RAM_ESG-Paper_2021%20Rev_0.pdf [https://perma.cc/PLT9-4S3R] (finding that thousands of studies found a positive correlation between ESG and financial performance, while "very few studies found a negative correlation").
\textsuperscript{117} See Robert G. Eccles, Ioannis Ioannou & George Serafeim, The Impact of Corporate Sustainability on Organizational Processes and Performance, 60 MGMT. SCI. 2835, 2853–54 (2014).
\textsuperscript{119} See id. at 12 ("The estimated alpha for the top portfolio is significant . . . ranging from about 3% to about 8% annualized.").
negative correlation between ESG and long-term corporate financial performance, while only about ten percent reported a negative correlation.\textsuperscript{120} A team of researchers at Oxford University and Arabesque Partners also concluded that it was in the best economic interest of managers and investors to incorporate ESG considerations into decisionmaking processes.\textsuperscript{121} Finally, a recent study by Ali Alshehhi, Haitham Nobanee, and Nilesh Khare analyzed one hundred and thirty-two academic studies and found that seventy-eight percent of publications report a positive relationship between corporate sustainability and long-term financial performance.\textsuperscript{122}

Based on these studies, ESG performance can be best understood as a driver of corporate value. As summarized, all six studies—which collectively utilized metadata from over 2,000 separate empirical analyses to draw independent conclusions—find that companies that invest in ESG and sustainability efforts outperform industry peers in the long run. This outperformance can be measured using a variety of financial metrics, from stock price performance to operational success to cost of capital. Said differently, strong ESG performance drives financial success. And as discussed in Section A, ESG ratings—which are comprehensive scores that cover hundreds of metrics and vary by company and industry—are particularly “financially relevant” in measuring a company’s total ESG performance.\textsuperscript{123} By this logic, high ESG ratings are indicative of strong ESG

\textsuperscript{120} See Gunnar Friede, Timo Busch & Alexander Bassen, \textit{ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies}, 5 J. SUSTAINABLE FIN. & INV. 210, 210 (2015). This study was corroborated by an additional meta-analysis conducted by Marc Orlitzky, Sara Rynes, and Frank Schmidt which concluded that corporate social responsibility and environmental responsibility are likely to pay off in the form of financial returns. See Marc Orlitzky, Frank L. Schmidt & Sara L. Rynes, \textit{Corporate Social and Financial Performance: A Meta-Analysis}, 24 ORG. STUD. 403, 423 (2003) (“The results of this meta-analysis show that there is a positive association between [corporate social responsibility] and [corporate financial performance] across industries and across study contexts.”).

\textsuperscript{121} See GORDON L. CLARK, ANDREAS FEINER & MICHAEL VIEHS, OXFORD UNIV. & ARABESQUE PARTNERS, \textit{FROM THE STOCKHOLDER TO THE STAKEHOLDER: HOW SUSTAINABILITY CAN DRIVE FINANCIAL OUTPERFORMANCE} 10 (2015), https://arabesque.com/research/From_the_stockholder_to_the_stakeholder_web.pdf [https://perma.cc/H4GZ-YTXY] (conducting a meta-study from more than 200 different sources and finding significant quantitative evidence that top-tier ESG performance results in better financial performance). Specifically, the team of researchers found that eighty percent of studies linked sustainability practices to increased stock price performance, ninety percent of studies linked ESG efforts to lower costs of capital, and eighty-eight percent of studies linked solid ESG practices to better operational performance of firms. \textit{Id.} at 9.


\textsuperscript{123} See Simpson et al., supra note 92. As discussed in the prior Section, ESG ratings do not provide an indication of a company’s environmental, social, or governance impact on the world and society, but rather provide an indication of a company’s financial ESG-related risk and opportunity exposure. See discussion supra Section II.A.
performance, which drives higher firm value. Factors that lower ESG ratings also lower ESG performance, depressing firm value.

C. Defensive Measures are Correlated with Lower Ratings and Lower Value

The combination of a staggered board and poison pill—the cornerstone of a “just say no” defense—is understood to have a depressive effect on governance ratings and thus ESG ratings overall. Because these defensive measures depress ESG ratings, the measures depress ESG performance and ultimately depress firm value.124

Sections A and B provided an overview of ESG ratings and how ratings are calculated. As discussed in those Sections, ESG ratings use hundreds—and even thousands—of metrics that vary by company and industry to measure financial exposure to ESG-related risks. As further argued, ratings are meaningful measures of exposure to ESG-related risks notwithstanding certain limitations and shortcomings. Thus, the higher a company’s ESG risk exposure, the lower their ESG rating and ESG performance. And because ESG performance is correlated with higher long-term value, the lower a company’s ESG rating, the lower their long-term firm value.

Governance scores, which measure the impact of governance risks such as board and workforce diversity, human capital, stakeholder opposition, and responsiveness to shareholder concern, are decreased by company initiatives that lower responsiveness to shareholder interests and shareholder activism.125 By their very nature, defensive measures (which defend against activist shareholders or potential acquirers) mitigate shareholder activism in favor of a board of director’s determination that a takeover bid is opportunistic or otherwise inadequate.126 Stated differently, higher ESG ratings are correlated with higher long-term firm value; the adoption of defensive measures that lower governance scores and aggregate ESG ratings are therefore correlated with lower long-term firm value.127

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124 See supra text accompanying notes 116–122.
126 Although scholars differ in opinion as to whether defensive measures enhance or erode shareholder value, they ultimately agree that the adoption of defensive measures mitigates the interests of activist shareholders or shareholders who prefer the tender offer at a premium to market price, in favor of long-term interests that management deems valuable. For a nuanced discussion of this debate, see supra text accompanying notes 67–75.
127 See discussion supra Section II.B.
Because of this depressive effect, I argue that Delaware courts should view the combination of a staggered board and poison pill with heightened scrutiny. Namely, in the absence of explicit shareholder authorization, the joint adoption of a staggered board and poison pill should only be permissible where a board has a compelling justification.

III. A SUGGESTED STANDARD OF REVIEW FOR “JUST SAY NO” DEFENSIVE MEASURES

Thus far, this Comment has examined staggered boards and poison pills and canvassed the debate surrounding whether these defensive measures diminish or preserve long-term corporate value. This Comment has also described the debate regarding ESG ratings and what those ratings suggest about rated companies. Empirical studies conducted over the last decade have suggested that a correlation exists between ESG efforts and firm value. Finally, because a “just say no” defense lowers ESG ratings by its very nature, this Comment suggested that these defensive measures diminish value for both investors and shareholders.

In this final Part, I argue that due to the depressive effect of a “just say no” defense, in the absence of explicit shareholder authorization, the combination of a staggered board and poison pill should be permissible only where a board has a compelling justification to defend its usage.

A. Application of a “Compelling Justification” Standard of Review

As discussed in Part I, defensive measures such as staggered boards and poison pills have been analyzed with some scrutiny—and some controversy—by Delaware courts over the last decade. Delaware courts were initially reluctant to strike down adoption of these measures, yet later viewed them with greater skepticism. Nonetheless, in all recent assessments of staggered boards and poison pills, the standard of review applied by Delaware courts has remained the same: courts apply the Unocal standard. Under this test, courts deem defensive measures to be permissible if they are adopted in response to a threat to corporate policy and effectiveness, and if they are proportional to that threat such that they are not “draconian” to shareholders.128

Nonetheless, I contend that the adoption of both staggered board and a poison pill—the cornerstone of a “just say no” defense—warrants a stricter standard of review, above that applied to the adoption of defensive measures in other contexts. Co-application of these defensive measures has potential

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to erode ESG value and thus shareholder value in a unique way.\textsuperscript{129} Admittedly, these defensive measures can serve the best interests of both the corporation and shareholders in certain contexts, and thus should not be condemned in every circumstance.\textsuperscript{130} Namely, in certain contexts where a board must fend off an inadequate or opportunistiastic takeover bid that is harmful to shareholders, a “just say no” defense may serve the best interests of the corporation and may drive value for shareholders.\textsuperscript{131} Yet because these defensive measures generally erode ESG value and firm value,\textsuperscript{132} these measures deserve board deference and court approval only where adopted with compelling justification to defend.

Delaware courts have applied this heightened “compelling justification” standard of review in other contexts. In \textit{Schnell v. Chris-Craft Industries}, the Delaware Supreme Court held that a board breached its duty when it manipulated “the corporate machinery” to “perpetuat[e] itself in office.”\textsuperscript{133} In other words, a heightened standard of review was warranted where a board entrenched itself for selfish reasons or to the deprivation of shareholder benefit.

The court reiterated this heightened standard seventeen years later in \textit{Blasius Industries v. Atlas Corporation}. There, plaintiff Blasius owned close to nine percent of Atlas stock.\textsuperscript{134} Blasius proposed that Atlas sell certain assets and holdings, but the Atlas board resisted, finding that a sale was not in the best interests of shareholders or the corporation.\textsuperscript{135} In an effort to take control, Blasius requested to elect eight new directors to the Atlas board, the maximum allowed under Atlas’s corporate charter.\textsuperscript{136} In response, Atlas’s board held an emergency meeting and amended their bylaws to add two additional board members, effectively preventing Blasius from seizing majority control of the board.\textsuperscript{137} The Delaware Court of Chancery struck down Atlas’s defensive measure.\textsuperscript{138} In doing so, the court made clear that there is no clear-cut standard of review applied by Delaware courts in the face of...

\textsuperscript{129} For an argument that adoption of these defensive measures depresses ESG ratings and thus, has a depressive effect on firm value, see discussion supra Sections II.B–C.

\textsuperscript{130} Contra Bebchuk et al., supra note 23, at 931-40 (arguing that the combination of a staggered board and poison pill, dubbed an “effective staggered board,” should be condemned in all contexts unless explicitly authorized by shareholders).

\textsuperscript{131} See Lipton & Neff, supra note 75 (arguing that the defensive measures adopted in a just say no defense drive “long-term value creation” when companies must defend against inadequate takeover bids).

\textsuperscript{132} See discussion supra Section II.B.

\textsuperscript{133} Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971).

\textsuperscript{134} Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 653 (Del. Ch. 1988).

\textsuperscript{135} Id. at 654-55.

\textsuperscript{136} Id. at 655.

\textsuperscript{137} Id. at 655-57.

\textsuperscript{138} Id. at 662.
shareholder activism. In situations where activists campaign for change and directors adopt defensive measures with the “primary purpose” of interfering with the shareholder franchise, directors must have a “compelling justification” for their conduct.\textsuperscript{139} That is, \textit{Blasius} comes into play when a board claims to have acted in good faith, but has interfered with the shareholder franchise.\textsuperscript{140}

Following the holding in \textit{Blasius}, Delaware courts reiterated that where a board acts with the primary purpose of interfering with shareholders’ franchise rights, even in good faith, only a compelling justification will sustain the board’s action.\textsuperscript{141} In \textit{Coster}, the Delaware Supreme Court made clear that the \textit{Blasius} standard does not rise to the “most onerous” level of “entire fairness” review that is used in circumstances of stark self-dealing or direct conflicts of interest. Rather, the “compelling justification” standard is a “different and necessary judicial inquiry” that acts as a heightened subset of the \textit{Unocal} standard.\textsuperscript{142} Put simply, the \textit{Blasius} compelling justification standard “slots in” as a heightened form of \textit{Unocal}, but a lesser form of entire fairness.

Characterizing \textit{Blasius} as a subset of \textit{Unocal} put an end to nearly three decades of debate among Delaware jurists over whether \textit{Blasius} should be folded into the reasonableness-and-proportionality inquiry. \textit{Coster} also seemed to remind corporations of the equitable principles that underlie Delaware corporate law in the first place. Namely, “inequitable action does not become permissible simply because it is legally possible,”\textsuperscript{143} and even directors acting in good faith may violate their fiduciary duties if they are acting inequitably toward stockholders or are depriving shareholders of statutorily guaranteed franchise rights.

\textbf{B. Extension of “Compelling Justification” Review to “Just Say No” Defenses}

Under \textit{Blasius}, the burden of proof falls on the board to present a compelling justification for their actions. Although critics have argued that this standard echoes “the almost impossible to satisfy” standard of the United

\textsuperscript{139} Id. at 660-61.
\textsuperscript{140} See id. at 659 (stating that this standard of review subjects even good-faith interference with the shareholder franchise to “closer scrutiny,” because the shareholder franchise is the “underpinning upon which the legitimacy of directorial power rests”).
\textsuperscript{142} Coster v. UIP Cos., Inc., 225 A.3d 952, 958-60 (Del. 2021).
\textsuperscript{143} See id. at 959-60 (“As early as \textit{Schnell v. Chris-Craft Industries, Inc.}, we recognized that a board of directors could not escape judicial review of its actions by pointing to the legal authorization to undertake a given act.”).
States Supreme Court’s strict scrutiny analysis,\textsuperscript{144} the holding in \textit{Coster} says otherwise. \textit{Coster} proves that the \textit{Blasius} test is not so strict that no board can satisfy it. Instead, a board satisfies this standard by presenting sufficient evidence to support a finding that the board was acting with the “primary purpose” of benefitting the corporation rather than with the “primary purpose” of depriving shareholders’ rights or precluding shareholder action.\textsuperscript{145}

In \textit{Coster}, the board’s action did not merely interfere with a shareholder’s ability to elect directors or vote, but also interfered with a shareholder’s attempt to invoke her right, under Delaware law, to seek a custodian to break a deadlocked vote.\textsuperscript{146} Therefore, while \textit{Blasius} is usually synonymous with interference of shareholders’ voting rights, \textit{Coster} suggests that similar principles may apply when boards interfere with broader shareholders’ rights and entitlements.\textsuperscript{147} This expansive application of \textit{Blasius} seems to suggest that, as of late, Delaware courts view interference of shareholders’ rights and entitlements more broadly, and may apply heightened scrutiny to a wider array of board actions.\textsuperscript{148}

Following the logic of this recent precedent, this Comment argues that the heightened “compelling justification” standard of review should be applied to defensive measures that erode shareholder value and erode corporate ESG efforts. Specifically, the combination of a staggered board and poison pill depresses ESG ratings and therefore diminishes shareholder value. This, in turn, deprives shareholders of their priority under Delaware corporate law and undermines their right to have their investment controlled by directors with their best interests in mind. Summing up the instructions passed to the Court of Chancery on remand, the Delaware Supreme Court said that board action would survive judicial scrutiny only if the board can demonstrate a compelling justification for “interfering with \textit{Coster’s} statutory or voting rights."\textsuperscript{149} Therefore, according to the holding of \textit{Coster}, the

\ \footnotesize{\textsuperscript{144} Mercier v. Inter-Tel (Del.), Inc., 929 A.2d 786, 806 (Del. Ch. 2007).}
\ \footnotesize{\textsuperscript{145} \textit{Coster}, 225 A.3d at 962.}
\ \footnotesize{\textsuperscript{146} See \textit{id.} at 957 (“Coster alleged that the dilutive Stock Sale interfered with her voting rights and impeded her statutory right to seek court appointment of a custodian.”).}
\ \footnotesize{\textsuperscript{147} See \textit{id.} at 962 (arguing that Delaware courts not only apply heightened "compelling justification" scrutiny to an interference of shareholder voting rights, but also "closely scrutinize transactions that impede" a stockholder’s exercise of broader statutory rights).}
\ \footnotesize{\textsuperscript{148} This seems to mimic the heightened scrutiny applied to poison pills in recent years. See, e.g., eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 31 (Del. Ch. 2010) (finding a poison pill to be impermissible); \textit{In re Williams Cos. S’holder Litig.}, No. 2020-0707-KSJM, 2021 WL 754593, at *16 (Del. Ch. Feb. 26, 2021) (striking down the adoption of a poison pill that was deemed a punitive measure to a minority shareholder).}
\ \footnotesize{\textsuperscript{149} \textit{Coster}, 255 A.3d at 963 (emphasis added).}
interference of broader statutory rights must be placed on par with the interference of the stockholder franchise or stockholder voting rights.

Furthermore, board action that is directly proven to lower shareholder value—not only in the short-term, but also in the long-term\textsuperscript{150}—deprives shareholders of their rights under the Delaware General Corporate Law. Under Delaware Corporate Law, directors must act in the best faith of the corporation and must not act in a manner that causes injury to the corporation or its stockholders. The co-adoption of a staggered board and poison pill, however, erodes long-term firm value and ESG performance, depressing not only long-term value to shareholders but also reducing exposure to ESG-related opportunities and risks.\textsuperscript{151} Considering the ability of this “just say no” defense to erode shareholder value and thus shareholder priority under Delaware Corporate Law, the “compelling justification” standard of review should be expanded to apply to adoption of “just say no” defenses. Importantly, applying this standard of review to “just say no” defenses will not preclude the application of these measures in situations where they are warranted, or create a standard that is impossible for management to overcome. Instead, this heightened standard will simply place a greater burden on management to present evidence sufficient to support a finding that they were acting with business rationale rather than to suppress the rights of the shareholder franchise.

C. Limitations of the Compelling Justification Standard

Critics of \textit{Blasius} may argue that employing the compelling justification standard of review to analyze “just say no” defenses would expand \textit{Blasius} to unlimited and unknown bounds and would require the \textit{Blasius} standard to be employed in all merger contexts. Critics may similarly argue that the standard of review applied in \textit{Blasius} should be limited to cases of management interference with only the shareholder vote.

Such potential criticism should not deter application of a heightened standard of review in the context of a “just say no” defense. Applying the \textit{Blasius} standard of review to scrutinize “just say no” defenses does not expand \textit{Blasius} to all transactions under the DGCL, nor does it remove all limitations from the \textit{Blasius} standard of review. First, the combination of a staggered board and poison pill has been recognized as the most fundamental and effective defense mechanism to prevent shareholders from approving an

\textsuperscript{150} For a discussion of empirical studies linking depressed ESG ratings to depressed long-term value, see \textit{supra} Section II.C.

\textsuperscript{151} See discussion \textit{supra} Section II.C.
unwanted takeover.\textsuperscript{152} By using the combination of these measures, the board is effectively preventing shareholders from voting to approve a hostile takeover, while simultaneously depriving shareholders of long-term value.\textsuperscript{153} In this unique and rare circumstance—one in which both the shareholder franchise and the shareholder value is threatened—the compelling justification standard of review should be employed. Employment of this standard in this unique context does not extend Blasius to all defense mechanisms, nor to defense mechanisms that have no proven depressive effect on shareholder value, such as the application of a staggered board absent a poison pill, the usage of a poison pill absent a staggered board, or another standalone defensive measure approved by Delaware courts.

Second, investors and shareholders have expressed particular support for ESG efforts that exceeds investor support for other corporate governance topics or shareholder franchise rights. Every single class of investor has expressed support for climate and ESG efforts and disclosure, from individual investors,\textsuperscript{154} to public and private pension funds,\textsuperscript{155} to mutual funds and even charitable funds.\textsuperscript{156} Put simply, ESG efforts have garnered such a significant amount of investor interest that defense mechanisms which specifically depress ESG efforts and thus, shareholder value should be viewed

\textsuperscript{152} See Petrucci & Subramanian, supra note 38 (conducting a study of active poison pills and arguing that poison pills deserve special deference and review in the modern-day landscape of activism and ESG efforts).

\textsuperscript{153} See discussion supra Sections II.A–B.

\textsuperscript{154} See MORGAN STANLEY INST. FOR SUSTAINABLE INVESTING, SUSTAINABLE SIGNALS: INDIVIDUAL INVESTORS AND THE COVID-19 PANDEMIC 3 (2021) (presenting a survey of eight hundred U.S. individual investors age eighteen or older in which seventy-four percent of investors expressed interest in climate-themed investments); see also Michal Barzuza, Quinn Curtis & David H. Webber, Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance, 93 S. CAL. L. REV. 1243, 1302–04 (2020) (discussing the “importance” of climate change to millennials in making investment decisions, and stating that nearly twenty-five percent of modern-day investors are committed to ESG investing).


\textsuperscript{156} See News Release, T. Rowe Price, T. Rowe Price Releases 2020 Sustainability Report (July 8, 2021), https://troweprice.gcs-web.com/static-files/qfd35555-f387-45ab-b213-4b207ce57d3d [https://perma.cc/PU3J-TLTE] (stating that the T. Rowe Price funds utilize ESG climate disclosure regimes to make investment decisions); see also HABITAT FOR HUMANITY, ENSURING THAT CLIMATE CHANGE MITIGATION AND ADAPTATION EFFORTS HELP CLOSE THE HOUSING GAP FOR THE MOST VULNERABLE 1 (2021) (“Habitat for Humanity International is calling on stakeholders to incorporate . . . responses to climate change in two ways, to ensure that the people most impacted by climate change are put at the center . . .”).
with particular scrutiny by Delaware courts. Assessing ESG-depressive defenses with scrutiny does not, however, extend a heightened or enhanced standard of review to every defensive measure assessed by Delaware courts. But where a “just say no” defense mechanism is proven to lower ESG ratings and shareholder value, and is effective in stifling a shareholder vote, enhanced scrutiny must be employed at the compelling justification level.

**CONCLUSION**

The permissiveness of defensive measures has been debated by Delaware courts and practitioners since their inception in the 1980s. Certain courts and practitioners argue that takeover defenses entrench management, thereby reducing shareholder value, while others argue that defensive measures appropriately allow target boards to defend against inadequate takeover bids in pursuit of greater long-term value. Delaware courts initially viewed the combination of the poison pill and staggered board—the cornerstone of the “just say no” defense—as permissible in all contexts, but have lately viewed the defense with greater scrutiny. Other defensive measures have been assessed with enhanced scrutiny as well. In an influential opinion, for instance, the Delaware Supreme Court determined that defensive measures that impede the shareholder franchise and fundamental shareholder rights must survive enhanced scrutiny at the “compelling justification” level.\(^\text{157}\)

This Comment examined this issue from a unique lens: the standard of review that should be applied to defensive measures that depress ESG ratings and thus depress firm value and shareholder benefit. Namely, in Part I, I began by discussing the history and controversy of defensive measures among scholars and practitioners and within Delaware courts. Subsequently, in Part II, I provided an overview of ESG ratings, how ratings are calculated, and what ratings indicate about rated companies—and used those discussions to contend that ESG ratings are meaningful indicators of ESG performance, notwithstanding certain recognized shortcomings. Finally, as proven by empirical studies conducted over the last decade, Part II contended that higher ESG ratings and ESG performance are indicative of greater long-term firm value. Because empirical evidence and academic scholarship has further illustrated that the combination of a poison pill and staggered board reduces ESG ratings, defensive measures reduce ESG performance and long-term value.

Finally, building on the arguments from Parts I and II, Part III argued that the combination of a staggered board and poison pill should be assessed with enhanced scrutiny and must survive heightened review at the

“compelling justification” level. If the defensive measure does not meet this heightened standard of review, the defensive measures must be viewed as an impermissible depression of shareholder value and shareholder rights. In making this argument, Part III canvassed seminal holdings including Blasius and Coster to conclude that Delaware courts have applied the “compelling justification” standard of review in other contexts, and that Delaware courts have arguably expanded the application of this heightened standard not just to interference of the shareholder vote, but to a wider array of board actions. In Coster, for example, the board’s action did not merely impede a shareholder’s ability to vote, but also interfered with a shareholder’s attempt to invoke other statutory rights guaranteed by Delaware law. Therefore, Coster suggests that the “compelling justification” standard of review may apply when boards interfere with broader shareholders’ rights and entitlements.

Following this logic, this Comment contends that the heightened “compelling justification” standard of review should be applied to defensive measures that depress ESG ratings and in turn, deprive shareholders of long-term profit and their priority under Delaware corporate law. Importantly, the “compelling justification” standard of review is not impossible to satisfy and allows for “just say no” defenses to be permissible in certain contexts. But where a board cannot justify the co-adoption of a staggered board and poison pill—a measure that collectively depresses ESG ratings, reduces ESG performance, and thus deprives shareholders of long-term value—at a compelling level, the board of directors has deprived shareholders of their rights under Delaware General Corporate Law. Such defensive measures must be struck down as impermissible.