FIFTY YEARS OF CORPORATE LAW EVOLUTION: A DELAWARE JUDGE'S RETROSPECTIVE

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I. INTRODUCTION

I am greatly honored to be invited to my alma mater to meet with you this evening. Apart from the honor, the invitation is daunting because former Dean Clark and Chief Justice Strine have asked me to compact, into about one hour or so, how corporate law generally, and mergers and acquisitions (M&A) law specifically, have evolved during my professional lifetime. Five decades is a lot to synthesize and compress into that short a space. But, I will do my best and hope that, after you have heard what I have to say, it will dispel any myth you may have been taught in law school that judge-made corporate law is revealed truth that emanates from some all-knowing cosmic force. I suggest that the evolution in corporate law is better described as a series of practical resolutions of institutional conflicts that, over time, were influenced and developed by converging economic forces and events. What I hope to convey to you is a bigger picture of how those forces and events fit together.

It may surprise you to learn that fifty years ago, many of the topics you have covered in this and your business organizations course did not even exist. Moreover, and critically important, what has been presented as the current state of corporation and M&A law was not preordained and, but for some historical accidents, could easily have come out very differently from how it actually did.

To tell this story properly, I will set the stage with a baseline starting point by discussing two events that had to occur for state courts—and specifically, the courts of Delaware—to become today's leading expositors of corporate law. I will then break down and discuss that evolution into two oversimplified but workable categories—first, the evolution of the fiduciary duties of directors, and second, the evolution of the standards by which courts review whether those fiduciary duties have been observed. I will then conclude with some thoughts on where we may be heading in the future, given that institutional investors now constitute the stockholder base of U.S. public corporations. That development (I will argue) has led to an increase in shareholder power relative to that of boards of directors, and a challenge to

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the vitality of the board-centric model on which corporate law has traditionally rested.

Two preliminary points: First, although these two categories may appear to transcend M&A, in fact the developments I discuss all arose out of M&A transactions. Second, these categories are workable, but not airtight, because they cannot capture all the important changes that have occurred over the past half-century.[1] So, along the way I will backfill and, in the process, identify some doctrinal errors created by the Delaware courts themselves and how judges, Chief Justice Strine and others including myself, have gone about trying to rectify them.[2]

II. Setting the Stage

I came here as a first-year law student in 1964. At that time, corporate law was a dry and boring subject—at least to me—because all the fun activity was taking place at the federal securities law level. It has always been black letter law that in our federal system, the power to create and define corporate law belongs only to the states, and the power to create and define laws regulating the national securities markets resides solely in the federal government. That remains true today, although this division is less black-and-white due to the passage of federal legislation such as the Sarbanes-Oxley Act in 2002[3] and the Dodd-Frank Act in 2010.[4] In any event, that is the theory.

But, the theory did not fit the reality: during the 1960s, far more corporate law was being developed by the federal courts, under the rubric of section 10(b) of the Securities Exchange Act of 1934[5] (1934 Act) and Securities and Exchange Commission (SEC) Rule 10b-5,[6] rather than the state courts. Indeed, the iconic Louis Loss, who was my Corporations professor back then, devoted more time to federal securities law than to state corporation law—ostensibly the subject of the course. One reason (apart from his having fathered the field of securities law) was the reality that most of the action in the corporate and M&A field was in the federal courts in securities law cases under Rule 10b-5. That rule, you may recall, proscribes any purchase or sale

[1] Falling into a third category is the phenomenon of effecting governance changes through the bylaw adoption or amendment process, the most recent examples being exclusive forum selection and fee-shifting bylaws.

[2] Falling into both the second and third categories are what I contend are errors that were later fixed or that still need fixing. Examples are the doctrines of "ratification" and of "substantive coercion," the so-called "duty of good faith," and the pronouncement in *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993), that a transaction found to be the product of a breach of the directors' duty of care must be reviewed under the entire fairness standard.

[3] Sarbanes-Oxley Act of 2002, Pub. L. No 107-204, 116 Stat. 745 (codified in scattered sections of U.S.C.).

[4] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 112-203, 124 Stat. 1376 (2010) (codified in scattered sections of U.S.C.).

[5] 15 U.S.C. § 78j (2012).

[6] 17 C.F.R. § 240.10b-5 (2014).

of securities that involves actual fraud or conduct that "operates or would operate as a fraud."[7] The claim advocated by the plaintiffs' securities bar was that if a merger, even though it did not involve actual fraud, was economically unfair to the minority public shareholders, it "operated" as a fraud and therefore violated Rule 10b-5.

The plaintiffs' bar chose the federal forum because they were more likely to win there. At that time, state courts, including Delaware, were not shareholder-friendly. The mindset of state courts was that if the challenged transaction was not prohibited by the corporate statute or the corporation's certificate or bylaws, and was not fraudulent, it was valid—even if the transaction price was arguably not fair to shareholders. Most corporate statutes, like Delaware's, were enabling; that is, they imposed very few restrictions on board conduct. That statutory structure led state courts to conclude that any conduct not statutorily prohibited was therefore permitted, with outcomes usually favorable to management.[8] As a result, Delaware, the state of incorporation of a majority of New York Stock Exchange and Fortune 500 companies, came under harsh academic criticism for its anti-shareholder bias. It also led to proposals for outright federalization of all state corporation law, the famous article by Professor William Cary being a leading example of that kind of criticism.[9]

In contrast to state courts, the federal courts were more shareholder-friendly because they interpreted Rule 10b-5 to authorize judicial review of transactions such as mergers for their substantive unfairness, rather than limiting review to the adequacy of the transaction-related disclosures. That led federal courts to reach outcomes that were often more investor-protective,[10] and that in turn led to increased resort by the plaintiffs' bar to the federal courts. That trend became so pronounced that, by 1965, leading members of the American corporate defense bar were predicting that state corporate fiduciary enforcement would become de facto federalized under the rubric of Rule 10b-5.[11]

We now know, aided by hindsight, that that never occurred. Indeed, quite the opposite: state courts became restored as the expositors of corporate (as distinguished from securities) law and regulation, with the leading expositors being the previously maligned courts of Delaware. You may ask: how could this have happened? The answer, I submit, is historical accident, taking the form of two landmark decisions handed down during the 1970s: the Delaware Supreme Court decision in *Schnell v. Chris Craft Industries,*

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[7] *Id.*

[8] For further discussion, see generally Jack B. Jacobs, *The Uneasy Truce Between Law and Equity in Modern Business Enterprise Jurisprudence*, 8 DEL. L. REV. 1, 3 (2005).

[9] William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663 (1974).

[10] *See* Jacobs, *supra* note 8, at 3.

[11] *See, e.g.*, Arthur Fleischer, Jr., *"Federal Corporation Law": An Assessment*, 78 HARV. L. REV. 1146 (1965).

Inc.[12] and the U.S. Supreme Court decision in *Santa Fe Industries, Inc. v. Green*.[13]

In *Chris Craft*, a dissident stockholder group decided to conduct a proxy contest to replace the incumbent board. When the incumbent directors learned of that, they responded by amending the bylaws to empower the board to set the annual meeting date five weeks earlier than the original fixed meeting date. The intended effect was to reduce by five weeks the dissidents' time to wage a meaningful proxy contest, which materially disadvantaged the dissidents, who sued in the Delaware Court of Chancery to undo the board's action. The dissidents argued that the sole purpose of the board action was to perpetuate the incumbents in control and diminish the shareholders' ability to exercise their statutory right to elect a new board. The Chancellor dismissed the case, holding that relief could not be granted since neither the Delaware General Corporation Law (DGCL) nor the corporate certificate or bylaws had been violated.

The Delaware Supreme Court reversed, holding that "inequitable action [by corporate fiduciaries] does not become permissible simply because it is legally possible."[14] *Chris Craft* spawned a new galaxy of corporate fiduciary doctrine. From that point onward, judicial review of corporate fiduciary conduct would not be limited to what the company's foundational documents prescribed, but that conduct would also be subject to the overriding application of judge-made equitable principles. *Chris Craft* was a watershed in the evolution of American corporate law because it began an irreversible doctrinal development whereby equitable notions of fairness came to overlay judicial review of board decisions in settings far beyond contests for control.[15] As a consequence, the Delaware courts shed their previous institutional management-oriented bias and became more sensitive to legitimate claims and expectations of shareholders. That, in turn, mooted the criticisms of Delaware corporate jurisprudence and, over time, established the reputation of the Delaware courts as a fair, neutral forum in which to litigate internal affairs and corporate disputes.

The second iconic case was *Santa Fe*. That case was a landmark because it: (1) reversed outright the creeping federalization of state corporate law in lawsuits brought under Rule 10b-5; and (2) reallocated to the state courts, and particularly the courts of Delaware, all litigation challenging the substantive fairness of transactions involving securities—including mergers, tender offers, and other transactions touching on corporate control. *Santa Fe* involved a short form, cash-out merger between a parent company and its 95%-owned subsidiary. Minority shareholders of the subsidiary sued in federal court, claiming that by effecting the merger without any justifiable busi-

[12] 285 A.2d 437 (Del. 1971).
[13] 430 U.S. 462 (1977).
[14] *Chris Craft*, 285 A.2d at 439.
[15] Jacobs, *supra* note 8, at 7.

ness purpose, the Santa Fe board had breached its fiduciary duty of fair dealing and, as a result, violated Rule 10b-5.

The U.S. Supreme Court upheld the dismissal of the complaint for failure to state a federal claim for relief. The Court held that when adopting section 10(b) of the 1934 Act, Congress "did not seek to regulate transactions which constitute no more than internal corporate mismanagement."[16] Because the complaint did not allege any omission, misstatement, or fraud by the parent company in connection with the merger, the case was dismissible. From that point on, it would be for the state courts—and most relevantly the courts of Delaware—to decide the substantive legal propriety of board decisions, and of the board decision-making process.[17]

These two happenstance events set the stage for the Delaware courts, over the next forty years, to transform and evolve corporate law into what it has become today. That brings me to the first major evolution I will discuss—the evolution of fiduciary duties.

III. Two Corporate Law Evolutions

A. *Of the Fiduciary Duties of Corporate Directors*[18]

In the beginning (that is, from the beginning of corporate law time until the late 1970s), there existed only two bedrock fiduciary duties: the duties of care and loyalty. The duty of care, as we know, requires directors, in making a decision on behalf of and binding upon the corporation, (1) to act on an informed basis based on material information available to them, and (2) having become so informed, to act with appropriate care in arriving at their decision.[19] And the duty of loyalty, broadly defined, requires directors to avoid positioning themselves so that their self-interest conflicts with the best interests of the corporation and its shareholders, and should any such conflict arise, to place the interests of the corporation and its shareholders ahead of any conflicting personal interest.[20]

The fiduciary duties of directors have evolved in essentially four different areas: (1) director liability for breach of the duty of care, (2) the so-called independent duty of good faith, (3) the duty of oversight, and (4) the duty of disclosure. I next discuss each of these areas.

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[16] *Santa Fe*, 430 U.S. at 479.

[17] Jacobs, *supra* note 8, at 3–4.

[18] Although the discussion of the evolution of fiduciary duties focuses on directors, it is equally applicable to officers, since in 2009 the Delaware Supreme Court held that corporate officers, as well as directors, owe fiduciary duties to the corporation and its shareholders. *See* Gantler v. Stephens, 965 A.2d 695, 708 (Del. 2009).

[19] *See, e.g.*, Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 367 (Del. 1993); Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985); Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

[20] *See, e.g.*, Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939); Italo-Petro Corp. of Am. v. Hannigan, 14 A.2d 401, 408 (Del. Ch. 1940).

1. *The Duty of Care and the Duty of Good Faith*

You may be surprised to know that before 1985, no public company board of directors had been held liable for money damages solely for breaching their duty of care. Until 1985, liability was imposed only for duty of loyalty violations. *Smith v. Van Gorkom*[21] changed that,[22] which was surprising since, only one year before, the Delaware Supreme Court held that the standard for due care liability was "gross negligence"[23]—a far more onerous standard to satisfy than the simple negligence standard under common tort law. In *Van Gorkom*, an unconflicted and independent board was found grossly negligent for approving an arm's length merger without having informed themselves of the fair value of their company.[24] The Delaware Supreme Court held that the board would be monetarily liable for the difference between the adjudicated fair value of the company and the merger price the board had actually approved.[25]

Two important responses to that decision are worth noting. The first affected the practicing M&A bar. The *Van Gorkom* court criticized the board for not obtaining an independent valuation of the company before approving the merger. Although the court disclaimed any intent to require that target company boards must always retain an investment bank or other financial advisor,[26] nonetheless, target companies did—and still do—precisely that, on advice of M&A counsel.

The second response—in reaction to a national lobbying effort by the director and officer (D&O) insurance industry—was the adoption of DGCL § 102(b)(7) by the Delaware General Assembly. After *Van Gorkom*, the D&O carriers complained to the Delaware legislature that their risk underwriters, in calculating their premium structures, had never factored any risk for duty of care liability, since no court had previously imposed such liability. The carriers threatened that unless the legislature eliminated that liability risk, they would no longer sell D&O coverage or, alternatively, would increase the insurance premiums significantly. The legislature responded by adopting § 102(b)(7), essentially overruling the result in *Van Gorkom*. That legislation authorized Delaware corporations to place in their certificate of incorporation a provision exculpating directors in advance from liability for money damages resulting solely from a breach of the duty of care.

Although § 102(b)(7) eliminated the D&O insurance problem, it created a host of other issues for Delaware corporate law that no one had anticipated. To better explain what I mean, and to lay the groundwork for my discussion of fiduciary duty evolutionary changes, I must pause briefly to

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[21] 488 A.2d 858 (Del. 1985).
[22] *See id.*
[23] *Aronson*, 473 A.2d at 812.
[24] 488 A.2d at 876–78, 893.
[25] *Id.* at 893.
[26] *Id.* at 876.

describe § 102(b)(7) itself—one of the more baroquely constructed statutes ever crafted.

In a perfect world, § 102(b)(7) would have been drafted to provide, very clearly and simply, that Delaware corporations could adopt a charter provision exculpating directors from monetary liability solely for a breach of the duty of care. Instead, however, the drafters worded the statute to exculpate directors from monetary liability for "breach of fiduciary duty as a director,"[27] and then proceeded to carve out several exceptions. Two of those exceptions—for which exculpation would not be available—were for a breach of the duty of loyalty and also "for acts and omissions not in good faith."[28] That choice of structure and language would later prove to be pernicious, as evidenced by fifteen years of doctrinal confusion caused by the Delaware Supreme Court's flirtation with the elusive, so-called independent "duty of good faith."

To better understand why that became a problem, some additional background is helpful. Until 1993, the black letter law was that there are only two bedrock fiduciary duties in corporate law: the duty of care and the duty of loyalty. To be sure, it was understood that in discharging those duties, the directors must always act in good faith. But, good faith was viewed only as a subsidiary requirement of both the duties of care and loyalty, not as a third, standalone, liability-creating fiduciary duty of equal dignity with those two duties—that is, until the Delaware Supreme Court decided *Cede & Co. v. Technicolor, Inc.*[29] in 1993.

Technicolor was an attack on the acquisition of the motion picture company, Technicolor, by MacAndrews & Forbes, owned by Ron Perelman. Without articulating any legal basis, the Delaware Supreme Court identified, for the first time, what it called the "triads of director fiduciary duty—good faith, loyalty, and due care."[30] Because the *Technicolor* court held that the duties of care and loyalty deserve "equal weight,"[31] its reference to good faith (the third part of the triad) was interpreted to mean that good faith was a third, standalone duty. The *Technicolor* court cited no source of law for that proposition, but it was believed that the source was the "acts not in good faith" carve-out created by the Delaware legislature when enacting § 102(b)(7) in 1986. However, if the Delaware Supreme Court thought a separate duty of good faith existed because it had been legislatively created, that court never so stated.

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[27] Del. Code Ann. tit. 8, § 102(b)(7) (2015).

[28] *Id.*

[29] 634 A.2d 345 (Del. 1993).

[30] *Id.* at 361 ("To rebut the [business judgment] rule, a shareholder plaintiff assumes the burden of providing evidence that directors, in reaching their challenged decision, breached any one of the *triads* of their fiduciary duty—good faith, loyalty or due care.").

[31] *Id.* at 367.

The *Technicolor* decision gave rise to a new wave of corporate law jurisprudence[32] and scholarship devoted to this new fiduciary duty of good faith. It also led to some disquieting questions: what was the substantive content of the duty, what were its outer boundaries, and what differentiated the duty of good faith from the preexisting fiduciary duties of loyalty and care?[33] Some academics tried to solve the problem by cutting the duty of loyalty in half. That is, some speculated that the duty of loyalty would encompass cases where the fiduciaries had an economic conflict of interest, whereas the duty of good faith would govern cases where the fiduciaries had no conflicting economic interest but nonetheless acted in bad faith. But all that theory did was raise front and center the issue of definition: what cases would involve actionable bad faith, as distinguished from gross negligence—that is, a breach of the duty of care?

The academics had a lot of fun with these metaphysical gymnastics and, for a time, the plaintiffs' bar also had a field day. But, for the corporate bar and their board clients (and the Delaware courts), it became a nightmare. The plaintiffs' bar saw filing a bad faith case as an easy way to get around § 102(b)(7). The defense bar's response was to argue that the bad faith claim was a duty of care claim dressed up as a bad faith case—a veritable sheep in wolf's clothing—that was precluded by § 102(b)(7). And, the judges' response was to try to make sense of this, sometimes with the help of an extra bottle of Tylenol. At minimum the Chancery judges—including then-Vice Chancellor Strine and yours truly—believed there was no such thing as an independent, liability-imposing duty of good faith. But, if there was, it was unclear whether proving a violation required subjective malevolent intent or some yet-to-be-defined mental state short of malevolence but more egregious than gross negligence.

Inevitably, a time would come when these questions would have to be confronted. That time arrived when I was on the Delaware Supreme Court in 2006, a year during which two cases came up almost back-to-back—*In re Walt Disney Co. Derivative Litigation*[34] and *Stone v. Ritter*.[35] *Disney* enabled the court to give content and meaning to "bad faith," by holding that bad faith required conduct more egregious than gross negligence—namely, either an actual, subjective intent to do harm or an intentional dereliction of a known duty.[36] *Disney* also put an end to plaintiffs' attorney efforts to do an end run around § 102(b)(7) through arguments that conflated the duties of care and good faith. *Stone v. Ritter* enabled the court to put to rest the notion,

[32] *See, e.g.*, *In re* Walt Disney Co. Derivative Litig., 825 A.2d 275 (Del. Ch. 2003); Guttman v. Huang, 823 A.2d 492 (Del. Ch. 2003); Strassburger v. Earley, 752 A.2d 557 (Del. Ch. 2000).

[33] See, for example, the law review articles cited in *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 63 nn.99–100 (Del. 2006).

[34] 906 A.2d 27 (Del. 2006).

[35] 911 A.2d 362 (Del. 2006).

[36] 906 A.2d at 67.

erroneously articulated in *Technicolor* and later cases, that the duty to act in good faith was a third, standalone fiduciary duty separate and apart from the duties of care and loyalty. More specifically, *Stone v. Ritter* put good faith back in the original doctrinal box where it had always properly belonged—as a subsidiary element or "condition" of the duty of loyalty.[37] But, fixing this doctrinal confusion spawned by *Technicolor* required thirteen years.

2. *The Duty of Oversight*

The last five decades also saw the development of another variant of fiduciary duty, which had existed on the books since 1963 but had no vitality—or even a name—until 1996. I refer to the so-called director duty of oversight—that is, the duty to oversee that the conduct of management complies with applicable law.

The Delaware duty of oversight cases arose in the context of federal law violations committed by senior management without the knowledge of the board. As a result, those corporations were held liable for large civil and criminal fines and penalties that, in turn, resulted in their boards being sued derivatively in order to recover those losses.

To understand why I speak of the duty of oversight as an evolution, you must appreciate that most Delaware cases reviewing board conduct involved an affirmative decision by the board, typically to approve a corporate transaction of some kind. Until *Graham v. Allis-Chalmers Manufacturing Co.*[38] was decided in 1963, there had been no cases challenging a board for a failure to act—specifically, a failure to monitor whether senior management was complying with applicable law. The absence of case law in this area was hardly a surprise, since the role of the board is not and has never been to manage the day-to-day business of the company. But that case was the first to test the boundaries of that principle.

In *Allis-Chalmers*, senior management became involved in a price-fixing conspiracy in violation of federal antitrust law, resulting in the company becoming liable for large civil and criminal fines and penalties. A shareholder sued, claiming that the board should have known of the illegal conduct by the senior employees. The Delaware Supreme Court held that, absent cause for suspicion, the directors had "no duty . . . to install and operate a corporate system of espionage to ferret out wrongdoing which they have no reason to suspect exists."[39]

It took another thirty-three years for the issue to surface again, this time in the 1996 *Caremark* decision.[40] That case involved the court-approved settlement of a claim against a corporate board for failure to monitor the conduct of senior management, who had violated the Medicare Anti-Referral

[37] 911 A.2d at 370.
[38] 188 A.2d 125 (Del. 1963).
[39] *Id.* at 130.
[40] *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996).

Payments law and caused the company to incur significant civil and criminal penalties. As in *Allis-Chalmers*, the claim was that the *Caremark* board should have known of the illegal management conduct and should therefore be liable for failure to be active monitors of corporate management's performance.[41]

In a landmark decision, Chancellor William T. Allen pronounced that corporate boards have a duty to be "reasonably informed concerning the corporation" by, among other things, "assuring themselves that information and reporting systems exist in the organization that are reasonably designed to provide to senior management and to the board itself timely, accurate information sufficient to allow management and the board . . . to reach informed judgments concerning both the corporation's compliance with law and its business performance."[42] The Chancellor held that *Allis-Chalmers* did not hold otherwise, and that to the extent it did, that view had been superseded by developments over the past three decades.[43] Accordingly, Chancellor Allen held (in language foreshadowing *Disney* and *Stone v. Ritter*) that in cases where the board is unaware of employee misconduct that results in the corporation being held liable, "only a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists—will establish the lack of good faith that is a necessary condition to liability."[44]

Caremark recognized, and set in motion at warp speed, what we now call the director "duty of oversight." *Caremark* had two fallouts—one practical and the other doctrinal. In the practical business world, there sprang up almost overnight a new cottage industry—experts consulting with corporate boards (for a fee) on how to design and install an information and compliance system. This movement was so influential that certain aspects later became codified in the Sarbanes-Oxley Act,[45] and oversight became a key element in a specialized field that came to be called "corporate governance." That specialty also became a practice area in many law firms. What is remarkable about this development is that it all flowed from one Chancery decision, which the Delaware Supreme Court had no opportunity to review or approve until ten years later in *Stone v. Ritter*.

On the doctrinal level, the oversight duty was problematic because *Caremark* did not clearly decide what conduct would constitute an actionable violation of the duty of oversight or what category of fiduciary duty the oversight duty belonged to—care, loyalty, or "good faith." Although language in *Caremark* suggests that good faith was the appropriate cubbyhole, in fact, *Caremark* was ambiguous. Other language in the opinion suggested

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[41] *Id.* at 967.
[42] *Id.* at 970.
[43] *Id.* at 969–70.
[44] *Id.* at 971.
[45] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of U.S.C.).

that the oversight duty flowed from the duty of care—a non-starter, because due care liability would be precluded in any company having a § 102(b)(7) exculpatory charter provision. Ultimately, the same case in which the Delaware Supreme Court straightened out the independent-duty-of-good-faith doctrinal morass—*Stone v. Ritter*—also enabled that court to confirm *Caremark* as settled Delaware law and bad faith as the standard of liability for an oversight violation.

That brings me to a fourth evolution of board fiduciary duties that occurred during this period—the fiduciary duty of disclosure.

3. *The Duty of Disclosure*

When I began law practice in the late 1960s, there was no such thing as a fiduciary duty of disclosure, let alone a duty that Delaware courts would enforce against corporate directors for improper disclosures in proxy statements, tender offers, or other filings that public companies were obligated to make with the SEC. Regulating that kind of disclosure had always been regarded as within the purview of the Securities Act of 1933 and the 1934 Act, the latter being enforceable only in the federal courts. To be sure, Delaware, like all states, had rules prohibiting fraud, but that was the limit of the reach of its corporate disclosure regulation. That all changed in 1977 when the Delaware Supreme Court decided *Lynch v. Vickers Energy Corp.*[46]—beginning a string of developments no one would ever have predicted.

In *Lynch*, a controlling stockholder parent company (Vickers) made a going-private tender offer for its subsidiary's (TransOcean) outstanding minority shares. After the tender offer closed, a shareholder class action was brought against the parent corporation. The claim was that the parent's tender offer filings failed to disclose material information revealing that TransOcean's stock was worth more than the parent had offered.[47] The Delaware Supreme Court agreed, holding that, as a matter of Delaware law, corporate fiduciaries (there, the parent as controlling stockholder) had a duty to disclose all "germane" facts with "complete candor" to the minority stockholders when seeking to buy the minority's stock.[48] Because those material[49] facts were not disclosed, the parent was held liable for the resulting damages, measured by the difference between the adjudicated fair value of the shares and the tender offer price.

[46] 383 A.2d 278 (Del. 1977). *See generally* Jack B. Jacobs, *The Fiduciary Duty of Disclosure After* Dabit, 2 J. Bus. & Tech. L. 391 (2007).

[47] *Lynch*, 383 A.2d at 279.

[48] *Id.* at 281.

[49] In a later Delaware Supreme Court decision, the court clarified that "germane" meant "material" and that the Delaware materiality standard was the same as that adopted by the federal courts. *See* Rosenblatt v. Getty Oil Co., 493 A.2d 929, 944 (Del. 1985). In *Malone v. Brincat*, 722 A.2d 5 (Del. 1998), the Delaware Supreme Court took pains to explain why the Delaware fiduciary duty of disclosure was not preempted by the 1934 Act, *see id.* at 12–14.

That marked the first time a Delaware court had recognized a disclosure duty under state fiduciary law, paralleling the duty mandated by the federal securities laws governing tender offers and proxy statements under the 1934 Act. Many of us wondered if that new doctrine would survive a federal preemption challenge. No such challenge ever occurred, and, contrary to expectations, the fiduciary duty of disclosure experienced rapid expansion, and then later, some contraction.

After *Lynch*, the duty of disclosure was expanded to cover other fiduciaries and different contexts. In *Weinberger v. UOP, Inc.*,[50] a going-private merger case, the duty of disclosure was enforced against both the parent company-acquirer and the parent's "insider" appointees to the subsidiary's board. There, two "inside" directors of the subsidiary being merged into the parent obtained—only because of their "insider" fiduciary position—material information that the subsidiary was worth at least $3 per share above the merger price. Those two inside directors—who were also senior executives of the parent company—disclosed that information to the parent and its CEO, but not to their fellow directors on the subsidiary board. As a consequence, that important information was never disclosed to the subsidiary's minority stockholders whose approval by proxy of the merger had been solicited.[51] Both the parent company and the subsidiary's inside directors were held liable for violating (among other duties) their fiduciary duty of disclosure.[52]

Lynch, *Weinberger*, and other disclosure cases decided during the 1980s arose in the context of "conflict of interest" transactions that implicated the fiduciary duty of loyalty. In that context, the disclosure violation was viewed as merely another instance of fiduciary disloyalty. But, by the 1990s, the duty of disclosure had become unmoored from its loyalty roots and had developed a life of its own. *Van Gorkom*, for example, was an M&A case where a board consisting mostly of independent, unconflicted directors was found liable for breaching its duty of disclosure and its duty of care in approving a merger.[53] By 1993, the duty of disclosure reached a high point as an independent liability-creating doctrine, in the *Tri-Star* case,[54] which was a class action for damages.

In *Tri-Star*, a controlling stockholder sold assets to the corporation and received in exchange an alleged overpayment of the corporation's shares. In dictum, the Delaware Supreme Court stated that to establish liability for breach of the duty of disclosure, no reliance on the inadequate disclosure was required,[55] nor proof of actual damages, because "existing law and policy [had] evolved into a virtual *per se* rule of damages for breach of the

[50] 457 A.2d 701 (Del. 1983).
[51] *Id.* at 705–07.
[52] *Id.* at 712, 715.
[53] *See supra* text accompanying notes 20–21.
[54] *In re* Tri-Star Pictures, Inc., 634 A.2d 319 (Del. 1993).
[55] *Id.* at 327 n.10.

fiduciary duty of disclosure."[56] That language suggested that liability would be far easier to establish under the Delaware fiduciary duty of disclosure than under the counterpart federal securities law regime.

Eventually, the Delaware Supreme Court decided that those expansions of the duty of disclosure as a liability-creating doctrine had gone too far. The court cut back on the scope of *Tri-Star* four years later in *Loudon v. Archer-Daniels-Midland Co.*,[57] where the court retracted its earlier suggestion that nominal damages are always recoverable where a disclosure violation is established, and limited the reach of *Tri-Star* to cases involving similar facts.[58] In 2006, the court cut back *Tri-Star* even further by holding that a duty of disclosure violation will not entitle shareholders to recover compensatory damages absent a specific showing of resulting harm.[59]

One final footnote to the duty of disclosure: for over twenty years, duty of disclosure cases had arisen only in circumstances where the shareholders were being asked to take a specific action in response to the disclosure—normally, voting by proxy or tendering their shares. As a consequence, the Delaware case law uniformly supported the view that fiduciary duty of disclosure liability would be triggered only where the shareholders were being asked to take action. But suppose that the directors are not asking the shareholders to do anything, yet deceive the shareholders by intentionally overstating the company's financial condition in their annual report to shareholders. After the company's true financial condition is disclosed, the company loses most or all of its value. Although no shareholder is being asked to vote or to tender his shares, does that mean that the directors have no legal responsibility for the disclosure violation? In *Malone v. Brincat*,[60] the Delaware Supreme Court answered no: directors who knowingly and deliberately disseminate false information that causes injury to the corporation or to an individual stockholder violate their fiduciary duties and may be held accountable.[61]

Although the reach of the fiduciary duty has been somewhat curtailed, its vitality remains unimpaired. The role of the disclosure duty as a liability-creating vehicle is now limited to cases where resulting damages-in-fact are established. But where the relief being sought is injunctive, the doctrine remains in full force, particularly in the M&A transactional context.[62]

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[56] *Id.* at 333.

[57] 700 A.2d 135 (Del. 1997).

[58] *Id.* at 146–47.

[59] *In re* J.P. Morgan Chase & Co. S'holder Litig., 906 A.2d 766, 774–75 (Del. 2006).

[60] 722 A.2d 5 (Del. 1998).

[61] *Id.* at 9.

[62] *See, e.g.*, Wayne Cnty. Emps.' Ret. Sys. v. Corti, 954 A.2d 319, 329 (Del. Ch. 2008) ("A preliminary injunction motion is . . . the appropriate mechanism by which to challenge alleged disclosure violations."); *In re* Netsmart Techs., Inc. S'holders Litig., 924 A.2d 171, 207–08 & n.115 (Del. Ch. 2007) (reasoning that enjoining a transaction when improper disclosure is alleged is appropriate to prevent a messy damage suit later); ODS Techs., L.P. v. Marshall, 832 A.2d 1254, 1262–63 (Del. Ch. 2003) (citing precedent that "[i]t is appropriate for

To summarize, over my professional career, Delaware has recognized and enforced a duty of disclosure that operationally does not differ much from the federal disclosure doctrine. The main difference is that, in Delaware, the duty runs only to the corporation's shareholders rather than to the market generally.

B. Of the Standards for Reviewing Board Action

The second evolution that has occurred over the last half-century concerns the corporate law standards of review. This terminology is somewhat misleading, because in corporate law the standard of review is not the familiar civil procedure standard that governs how a higher court or other tribunal should review the decision of a lower tribunal. Rather, in corporation law, the term refers to the substantive standard that courts apply in deciding whether challenged board action constitutes an actionable breach of fiduciary duty.

To complicate matters further, the standard of review is not necessarily the same as the standard of conduct to which boards are expected to adhere. For example, in *Aronson v. Lewis*, the Delaware Supreme Court held that although corporate boards are expected to act with reasonable care, only gross (as opposed to simple) negligence will trigger director liability.[63] In ordinary tort law, there is no distinction between the standard of conduct and the standard of review. In corporate law, however, there is a distinction, for policy reasons. The primary policy reason is that the fear of personal liability should not deter corporate directors from taking reasonable risks in the pursuit of corporate wealth since inevitably, given the law of averages, some decisions, even though perfectly reasonable at the time they were made, will turn out badly through no fault of the board.[64]

For the evolution of corporation law to make sense, the story of how the standards of review evolved needs to be told. To summarize that story in a paragraph: in the beginning, there were only two standards. Then, two major developments occurred. First, the Delaware courts added clarity and content to those two preexisting standards, to afford guidance for their proper application. Second, those courts created an entirely new, "intermediate" set of standards in the landmark cases of *Unocal*,[65] *Revlon*,[66] and *Blasius*.[67] These new intermediate standards were needed to address new realities and issues arising out of novel legal and financial technologies, in order to solve the

the court to address material disclosure problems through the issuance of a preliminary injunction that persists until the problems are corrected").

[63] Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

[64] *See generally* William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Function over Form: A Reassessment of Standards of Review in Delaware Corporate Law*, 56 Bus. Law. 1287 (2001).

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

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

[67] Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988).

problem of whether and how boards should respond to hostile corporate takeovers. That evolution was game-changing. It reshaped the governance of boards and the conduct of all players, including legal and financial advisors, in the area of mergers and acquisitions.

The two bedrock standards of review in corporation law have always been—and still are—business judgment and entire fairness. The business judgment rule or standard (BJR) is a rebuttable presumption that "in making a business decision the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company."[68] Where that standard applies, the directors' decision will be upheld, meaning that if the case falls into "business judgment land," the board always wins. The only exception arises if and where the same business decision that receives business judgment review is found to be "irrational" (because, for example, it constitutes corporate waste)—an event never proved in any case that I am aware of. The BJR presumption is rebuttable if the plaintiff can show that the directors breached either their fiduciary duty of care or of loyalty (including acting in bad faith). If the BJR presumption is rebutted, then "the burden shifts to the director defendants to demonstrate that the challenged act or transaction was entirely fair to the corporation and its shareholders."[69]

The second bedrock standard is entire fairness—the most onerous standard our law imposes on corporate fiduciaries. The entire fairness standard applies whenever the fiduciaries propose or effect a transaction where the fiduciaries have a self-interest which conflicts with that of the shareholders. The paradigmatic case is an "interested" cash-out merger between a parent corporation and its subsidiary. Under this standard, the majority stockholder and the interested board members have the burden of proving that their actions and approvals were entirely fair to the corporation and its shareholders, both in terms of process and price.[70] Although the entire fairness standard has been with us since the beginning of corporate law time, it was amorphous and open-ended—that is, it lacked specific content that facilitated predicting the outcome of litigation—until 1983. Not until *Weinberger v. UOP, Inc.*[71] did the Delaware Supreme Court gave the practicing bar and the courts more detailed procedural guidance and a clearer analytical framework for determining whether a conflicted transaction is entirely fair.

Because the outcome of a transactional case most often will depend on what review standard is applied, it is not surprising that, over the last five decades, the issues of what standard applies and the nuances of its application have been heavily litigated. These issues arose in both the business judgment and the entire fairness spaces. I begin by highlighting two

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[68] Aronson, 473 A.2d at 812.
[69] *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 52 (Del. 2006).
[70] Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983).
[71] 457 A.2d 701 (Del. 1983).

problems—created by the Delaware Supreme Court itself—that arose in connection with business judgment review. One of these problems, shareholder ratification, has been fixed; the other, director duty of care claims, unfortunately has not.

The first problem concerns the doctrine of shareholder ratification. When I was a law student here, shareholder ratification had a very limited and straightforward role—to confer authority on directors retroactively in cases where the board took action that was not authorized. Over time, and particularly during the 1980s and 1990s when the hostile takeover movement was in full swing, the corporate defense bar attempted to stretch the doctrine of ratification far beyond its original meaning and purpose. Specifically, in cases where the board was sued for improperly effecting a merger that the shareholders had approved, the defense bar argued that the approving shareholder vote constituted a "ratification" of the pre-merger conduct that was claimed to be a breach of fiduciary duty.

That argument was a distortion of shareholder ratification as traditionally understood. The distortion originated, unfortunately, in *Smith v. Van Gorkom*.[72] There, the Delaware Supreme Court stated that where a board fails to reach an informed business judgment when approving a merger, the merger can still be upheld "if its approval by majority vote of the shareholders is found to have been based on an informed electorate."[73] In other words, a due care claim against the board for making an uninformed merger decision could be extinguished by reason of the same approving shareholder vote that was required for the merger to be statutorily valid. That pronouncement, to which no analysis was devoted in the *Van Gorkom* opinion, made no sense for two reasons. First, in the merger context, shareholders are typically asked to approve only the transaction itself, not the antecedent board conduct, and particularly not the board adoption of antitakeover defensive measures. Second, a shareholder vote was traditionally understood to have ratification effect only if the shareholder vote was not legally required. Under Delaware law, however, a merger requires shareholder approval to be valid.[74]

In any event, once the original *Van Gorkom* misconstruction of shareholder ratification took hold, the defense bar pushed the envelope even further, arguing that shareholder approval of a merger extinguished challenged board conduct that preceded the merger—in particular, the pre-transaction adoption of takeover defenses. I regret to admit that, in my early Chancery career, the defense bar convinced me of that position, leading me to write two misguided opinions.[75] After later reflection, I had to publicly repudiate

[72] 488 A.2d 858 (Del. 1985).
[73] *Id.* at 889.
[74] Del. Code Ann. tit. 8, §§ 251, 252 (2015).
[75] *In re* Wheelabrator Techs. S'holders Litig., C.A. No. 11495, 1990 WL 131351 (Del. Ch. Sept. 6, 1990); Weiss v. Rockwell Int'l Corp., C.A. No. 8811, 1989 WL 80345 (Del. Ch. July 19, 1989).

those earlier opinions in *Wheelabrator*.[76] In later cases, the Delaware Supreme Court, to its credit, undid the ratification mischief spawned by *Van Gorkom*,[77] but by the time that happened, twenty-five years had passed.

The second standard of review problem involves director duty of care claims. It had always been understood, in the area of common tort law, that if a defendant is found to have been negligent, and the negligent conduct was the proximate cause of the plaintiffs' injury, then the result would be a judgment for money damages against the tortfeasor defendant. *Van Gorkom* itself supported the view that this tort law concept was equally applicable to corporate law claims. That understanding was completely upended in 1993, however, when the Delaware Supreme Court decided another arm's-length merger case, *Cede & Co. v. Technicolor, Inc.*[78] There, the court held that if the acquired company's directors are found to have breached their duty of care in approving a merger transaction, the plaintiff is not required to show that the care violation proximately caused any injury, and no money judgment flows automatically from that adjudicated violation.[79] Instead, the directors have the burden of proving that the due care violation caused no injury, as well as the burden of proving (if they can) that the transaction was entirely fair.[80] That is, in the corporate law context, the tort requirement of proximate cause was dispensed with and, in its place, the directors' conduct became subject to a second level of review wherein they must prove the transaction's entire fairness.

To many of us, that pronouncement was startling because the entire fairness standard, by its nature, has always been rooted in duty of loyalty concerns. The specific concern is that corporate directors, as fiduciaries, cannot be trusted to protect the interest of the shareholders in a transaction where the directors have a conflicting personal self-interest. Therefore, it is presumed that the directors did not discharge their duty of loyalty unless they can show otherwise.

The concept announced in *Technicolor*—that entire fairness review applies where only a duty of care breach, but no disloyalty, is involved—was not only novel, but also alien to due care analysis. The new doctrine also violated the precept, emphasized by the Delaware Supreme Court in the *Dis-*

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[76] *In re* Wheelabrator Techs. S'holders Litig., 663 A.2d 1194, 1202–03 (Del. Ch. 1995).

[77] This undoing can be seen in cases such as *In re Santa Fe Pacific Corp. Shareholder Litigation*, 669 A.2d 59, 68 (Del. 1995) (declining to give ratification effect to a shareholder vote approving a merger, but not the defensive measures adopted by the defendant board that preceded the merger); *Williams v. Geier*, 671 A.2d 1368, 1379 n.24 (Del. 1996) (suggesting that ratification applies only to corporate action where stockholder approval is not statutorily required for its effectuation); and *Gantler v. Stephens*, 965 A.2d 695, 713–14 nn.53–54 (Del. 2009) (holding, with one exception, that the effect of ratification is to subject the challenged director action to business judgment review, as opposed to extinguishing the claim (that is, obviating all judicial review), and explicitly overruling *Van Gorkom* to the extent it holds otherwise).

[78] 634 A.2d 345 (Del. 1993).

[79] *Id.* at 367, 370.

[80] *Id.* at 371.

ney litigation, that due care review "in the decision making context is *process* due care only," with irrationality being "the outer limit of the business judgment rule."[81] The *Technicolor* court cited no precedent, and offered no policy explanation, for why duty of care claims should receive the same searching substantive review that is reserved for duty of loyalty claims. It is telling that, to my knowledge, no case has ever, after finding a duty of care violation, proceeded to a second, entire fairness, review analysis. This attempt to link a breach of the fiduciary duty of care with the entire fairness standard is, in my view, a fundamental conceptual error that the Delaware Supreme Court should overturn.[82] Unfortunately, the doctrine still remains on the books as good law.

Equally troublesome was the experience with litigating entire fairness cases in an area that, it was thought, had become settled. The forces that drive the intensity of entire fairness litigation—specifically, over whether, when, and how that standard should apply—are largely economic: the considerable time (often years) and expense required to defend entire fairness claims. Given the large stakes involved, litigated entire fairness cases took years to conclude, required expensive expert testimony on disputed valuation issues, and could not be resolved without a full trial on the merits. Although our courts have tried to fix the problem in various ways, this area of the law remains heavily litigated and the solutions still appear to be out of reach.

The storyline goes like this: when *Weinberger v. UOP*[83] was decided in 1983, it was believed that that case would settle the law in this area. *Weinberger* provided explicit guidance on how an entire fairness case should be presented and analyzed. Equally important, the case also created the expectation that if certain protective structures were utilized, entire fairness review might be avoided altogether. In a footnote, the *Weinberger* court stated that the adverse result "could have been entirely different, if [the subsidiary] had appointed an independent negotiating committee of its outside directors to deal with [the parent] at arm's length" because (the court said) "a showing that the action taken was as though each of the contending parties had in fact exerted its bargaining power against the other at arm's length is strong evidence that that the transaction meets the test of fairness."[84]

The corporate bar took this language to mean that if an independent negotiating committee process were utilized, a negotiated merger with a controlling party, if attacked in litigation, would receive business judgment review. Accordingly, in post-*Weinberger* mergers, board counsel structured transactions such that a special committee of independent directors negotiated and approved, separately from the entire board, the deal on behalf of the

[81] Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000).
[82] *See* Allen et al., *supra* note 64, at 1302–03.
[83] 457 A.2d 701 (Del. 1983).
[84] *Id.* at 709–10 n.7.

minority stockholders. The hope and expectation—stoked by *Weinberger*—that such a structure would merit business judgment review was disappointed. Instead, the result was a decade or more of litigation over the disputed issue of what effect the utilization of a special negotiating committee should have.

During this period in which the courts were struggling to reach a satisfactory answer, then-Chancellor Allen and I authored conflicting opinions on this issue. Chancellor Allen held that the effect of a special committee process was to shift the standard of review to business judgment; I held that the standard of review remained entire fairness with the burden of proving unfairness shifting to the plaintiff.[85] Not until 1994 did the Delaware Supreme Court, in *Kahn v. Lynch Communications, Inc.*, resolve that case conflict by holding that entire fairness with a burden shift was the consequence that flowed from utilizing a special committee negotiating process.[86] Even that resolution served only to generate more litigation, this time over whether, in specific cases, the committee was sufficiently independent, and its process sufficiently effective, to warrant a burden shift. The dissatisfaction with this solution prompted the corporate bar and the courts to continue looking for other ways to achieve business judgment review in controlled merger cases.

Three Chancery judges who were dissatisfied with the burden-shifting approach tried, within the confines of their judicial role, to advance the law in the direction of permitting business judgment view assuming the right structural protections were employed. In 2001, I coauthored an article with former Chancellor Allen and then-Vice Chancellor Strine, in which we criticized *Kahn v. Lynch*'s refusal to allow business judgment review of conflicted transactions negotiated by a genuinely effective independent negotiating committee. We proposed that if a controlled merger were expressly conditioned on approval by a majority of the minority shareholders, it should merit business judgment review. But it was not until 2013 that then-Chancellor Strine was able to achieve that goal, in *In re MFW Shareholders Litigation*.[87] *MFW* held that the combination of a fully effective negotiating committee *and* a fully informed majority-of-the-minority approval condition would subject a merger with a controlling party to business judgment review. As a Justice on the Delaware Supreme Court at that time, I was personally gratified to participate in the decision affirming that ruling.[88] On

[85] *Compare In re* Trans World Airlines, Inc. S'holders Litig., C.A. No. 9844, 1988 Del. Ch. LEXIS 139 (Del. Ch. Oct. 21, 1988) (holding that the standard of review shifts to business judgment), *with* Citron v. E.I. DuPont de Nemours & Co., 584 A.2d 490 (Del. Ch. 1990) (holding that the standard of review remains entire fairness, but with the burden shifting to plaintiff to show unfairness).

[86] Kahn v. Lynch Commc'ns., Inc., 638 A.2d 1110 (Del. 1994).

[87] 67 A.3d 496 (Del. Ch. 2013).

[88] Kahn v. M&F Worldwide Corp., 88 A.3d 635 (Del. 2014).

this entire-fairness-related issue, it took thirty years to close the circle that the Supreme Court began in 1983.[89]

C. The Intermediate Standards of Review

1. Why an Intermediate Standard Was Needed

This brings me to the intermediate standards of review, which bear directly on the subject of mergers and acquisitions. Since this is an M&A course, I assume you have already covered this subject in detail. That permits my discussion to be more abridged and focused at the conceptual level, while allowing me occasional digressions to identify problems that the Delaware courts created and have yet to resolve.

The intermediate standards, as we know, were announced in the 1985 *Unocal* and *Revlon* cases and also in *Blasius*,[90] which was decided in 1988. The intermediate standards were developed because the two preexisting standards—business judgment and entire fairness—were neither well suited nor responsive to the concern presented by hostile takeovers. The concern was that even independent target company directors not financially threatened by a hostile takeover might have a genuine but hard-to-prove aversion to being forcibly ousted from their board positions. That bias, in turn, could render the independent directors unable to evaluate, objectively and dispassionately, whether the hostile bid is in the best interest of the shareholders. That elusive potential bias was not only impossible to prove, but also did not fit either the entire fairness or the business judgment review

[89] This rendition of issues does not exhaust the entire-fairness-related subjects litigated during the past four decades. Another issue, not covered in detail here, concerns the interplay between entire fairness analysis and § 102(b)(7) exculpation clauses. Specifically, if directors who approved a controlled merger or other conflicted transaction subject to entire fairness review are charged with violating their duties of loyalty in a setting where the corporate charter contains an exculpation clause, may the trial court avoid entire fairness review altogether, either in whole or in part, by adjudicating first the threshold issue of whether the conduct of some or all directors amounted solely to a breach of the duty of care? If that is the case, those directors are exculpated from money damage liability, whether the transaction is entirely fair or not. That was my view of the matter, and the decision I reached after trial in the *Emerald Partners* case, a litigation protracted over more than fifteen years. The Delaware Supreme Court concluded otherwise, holding in their reversing decision that where a challenged transaction is subject to entire fairness review *ab initio*, the Court of Chancery must first determine the fairness issue, and only if and after the transaction is found to be unfair may the court decide whether some or all of the directors are exculpated under the § 102(b)(7) charter provision. Emerald Partners v. Berlin, 787 A.2d 85 (Del. 2001).

[90] Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988) (holding that where a target company board takes action intended to impede the shareholder franchise (in that case, their right to elect a new board), that action will be invalidated unless the board can demonstrate a "compelling justification" for its action). The standard advocated by *Blasius* was not formally approved by the Delaware Supreme Court until 2003 in *MM Cos. v. Liquid Audio, Inc.*, 813 A.2d 1118 (Del. 2003). Because *Blasius* is not, strictly speaking, an "intermediate" standard—indeed, it more closely resembles entire fairness review—it is not central to this narrative, and will not receive extensive treatment in this Article.

analytic paradigm.[91] The entire fairness standard governs transactions that either involve self-dealing by a majority stockholder or that were approved by a board having a financial conflict of interest. Yet, most corporate boards that adopted defenses against hostile tender offers had a majority of independent directors whose livelihoods would not be threatened by the outcome of the contest for control. In those cases, no concrete, identifiable self-dealing of the kind that triggers classic entire fairness review was presented. Nor did board-adopted defenses against hostile tender offers comfortably fit the business judgment paradigm either. That standard presupposes a board decision that involves the business or assets of the company. A hostile tender offer, in form at least, is a transaction that involves only the shares owned by the shareholders, not the assets or business of the company. And, as a formal matter, a tender offer involves only the offeror and the stockholders—but not the board, which had no statutory authority to approve or disapprove a tender offer by a third party.[92]

Equally important, applying the traditional review standards to hostile tender offer defenses created the risk of an either over- or under-inclusive regulation. Reviewing a takeover defense under the entire fairness standard created a significant risk of over-inclusion, that is, that the board-adopted defense would be found unfair merely because the defense would deprive the shareholders of an opportunity to receive a premium over the pre-tender market price of their shares. If employed, that approach would leave well-intended target boards unable to protect their shareholders against coercive and underpriced takeover bids of the kind struck down in *Unocal*. Conversely, applying business judgment review would virtually guarantee that every defensive measure would be upheld. Review under that standard created the risk that courts would unduly defer to defensive actions by compliant boards that had no conflicting financial interest and even acted in subjective good faith, yet were servile to the views of senior managers with a concrete, career-based self-interest in opposing a bid that, viewed objectively, would best serve shareholder interests.[93]

2. *The Quest for an Intermediate Standard*

This Catch-22 prompted the Delaware courts to embark on a quest to develop a review standard that would better address the complexities of hostile takeovers and the subtle motives that drove target board defensive responses. That twenty-five-year quest (1960–1985) involved experimenting with two alternative standards and ultimately jettisoning both in favor of the "reasonableness" standard articulated in *Unocal* and *Revlon*.

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[91] For further discussion, see Jack B. Jacobs, *Implementing Japan's New Anti-Takeover Defense Guidelines Part I: Some Lessons from Delaware's Experience in Crafting "Fair" Takeover Rules*, 2 N.Y.U. J.L. & Bus. 323 (2006).

[92] *Id.* at 329.

[93] *Id.* at 329–30.

The first experimental effort, reflected in cases such as *Bennett v. Propp*[94] and *Schnell v. Chris Craft Industries, Inc.*,[95] employed the "sole or primary purpose" test—whether the board was using the corporate machinery for the "sole or primary purpose" of maintaining itself in control. This test had the virtue of squarely addressing the concern that a nonfinancial conflicting interest may be driving the target board's defensive response to a hostile bid. To that extent, the "sole or primary purpose" test avoided the almost reflexive deference afforded by business judgment review. The drawback of that test was that to apply it—to prove that a board acted for the sole or primary purpose of entrenchment—required divining the directors' subjective motives, an inquiry laden with difficult problems of proof.

The second experimental approach—more objective yet still unsatisfactory—was exemplified by cases such as *Kors v. Carey*[96] and *Cheff v. Mathes*.[97] Under the doctrine endorsed in those cases, a board would be entitled to defend against a dissident's threat to capture control if the board shows it had "reasonable grounds to believe a danger to corporate policy and effectiveness existed."[98] This test—clearly a forerunner of *Unocal*—had the virtue of being easier to prove and more objective for courts to apply than the "sole or primary purpose" standard. Its drawback, however, was that all contested takeovers could plausibly be argued to involve a "policy dispute" over how the target company should be managed in the future. In the real world, every hostile acquirer will necessarily have a business strategy that differs from the one being pursued by incumbent management. Therefore, under this approach almost every takeover defense would be upheld.

These two experimental standards were ultimately jettisoned because they did not accomplish three objectives required of an effective review standard: (1) thwart defensive tactics motivated by management self-interest, (2) protect defensive tactics genuinely motivated to secure the best value for the shareholders, and (3) uncover defensive tactics being justified, pretextually, as in the shareholders' best interests, but in fact cloaking self-interested behavior.[99] An important reason why it was so difficult to locate a review standard that would accomplish all these objectives was that two underlying predicate issues also had to be resolved. The first issue was who should have the power to decide whether or not to accept an unsolicited takeover bid—the stockholders or the board? The second issue was which branch and institution of government—the executive, legislative, or judicial—should decide the first question.

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[94] 187 A.2d 405, 408 (Del. 1962).
[95] 285 A.2d 437 (Del. 1971).
[96] 158 A.2d 136 (Del. Ch. 1960).
[97] 199 A.2d 548 (Del. 1964).
[98] *Id.* at 555.
[99] Ronald J. Gilson, *The Poison Pill in Japan: The Missing Infrastructure*, 2004 Colum. Bus. L. Rev. 21, 31.

The second issue was ultimately resolved, largely by default, by the state courts—and predominately those of Delaware—because no federal or other governmental institution was asserting an interest in regulating this field. The first question was ultimately answered by the Delaware Supreme Court in *Unocal* and *Revlon*.

3. The New Intermediate Standards: Their Virtues and Drawbacks

Adopting a completely new analytical framework tailored specifically to contests for control, *Unocal* and *Revlon* established that the target company board, constrained by principles of fiduciary duty and policed by the courts, should decide whether a hostile bid would be permitted to go forward. To get there analytically, the Supreme Court was required to surmount the nettlesome problem that, as a state law statutory matter, the board has no power to approve, disapprove, or otherwise intervene in tender offers that, in form, do not implicate the corporation's assets or business. The court did that by innovating, as a matter of principle, the proposition that certain hostile bids may adversely affect the corporation's business and policy. In such cases, the board, under its general statutory power to manage the corporation's business and affairs,[100] may lawfully intervene between the hostile bidder and the shareholders.

Unocal accomplished two other conceptual breakthroughs. First, it addressed the unique concern posed by board defensive conduct that neither the business judgment nor the entire fairness standards could do successfully. Second, *Unocal* created a new analytical framework that objectified the inquiry for determining the validity of board-adopted defensive measures. Under that framework, a board-adopted defense could become entitled to business judgment review, but the target board must first earn the right to that deferential review by carrying its burden to show that the board reasonably perceived that the hostile offer constituted a threat to corporate business or policy, and next, that the defense the board adopted was a reasonable, and not disproportionate, response.[101] Only if the board satisfied both of these criteria would its defensive action receive business judgment review.[102] Similarly, *Revlon*, which applies in the distinct setting where the target board's defensive response is to sell the company, also imposed on target boards the burden of showing that the process they used to sell the company was reasonable and resulted in the shareholders receiving the best value reasonably available.[103]

Although these new standards represented a conceptual breakthrough, they were hardly trouble-free. As we now know, it took ten years for the courts to work out fundamental problems of application. *Unocal* generated

[100] DEL. CODE ANN. tit. 8, § 141(a) (2015).
[101] Unocal v. Mesa Petroleum Corp., 493 A.2d 946, 955 (Del. 1985).
[102] *Id.*
[103] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1985).

questions such as: what kinds of threat will trigger the board's right to defend; what analysis should the courts employ in determining whether the board-adopted defense is disproportionate; and how should this standard be applied to strike the proper balance between respecting the target board's judgment and upholding the court's determination that, on occasion, will require overturning that board decision? Many, though not all, of those doctrinal issues were resolved in the 1995 *Unitrin* case,[104] where the Supreme Court reframed and refined the proportionality prong of *Unocal* to tilt the balance in favor of respecting the judgment of the target board. *Revlon*, for its part, also generated fundamental questions, such as what precisely should trigger *Revlon* review, and how should the courts determine whether the target board's decision making process was reasonable and whether the transaction price constituted the best value reasonably available? Those questions were not answered until *Paramount v. QVC*[105] was decided in 1994.

I assume you are familiar with these nuances of *Unocal* and *QVC* jurisprudence and, therefore, will not dwell on them further. Instead, I will focus on two conceptual problems the Delaware courts created in the course of evolving the intermediate standard jurisprudence. The first was the so-called doctrine of "substantive coercion," and the second was the effort to link and unify the standards of review in a way that is (in my opinion) misconceived and unworkable.

a. Substantive Coercion

The "substantive coercion" narrative begins with the landmark law review article written by Professors Ronald Gilson and Reinier Kraakman.[106] That article was a well-intended effort to (among other things) identify the circumstances that courts should recognize as a "threat" entitling the board to interpose a defense under *Unocal*. That problem is minimal in cases where (as in *Unocal* itself) the hostile offer is structurally coercive—that is, where the offer is underpriced and its terms give shareholders no realistic choice except to tender. But, the problem does arise in cases where the hostile offer is underpriced but not coercive—that is, where the shareholders are free to take the offer or leave it, either way without being worse off. In that context, the issue is whether the board must step aside and let the shareholders fend for themselves, even if the board reasonably believes the offer merits rejection.

The Gilson-Kraakman theory was that if the shareholders were being misled into accepting an inadequate offer voluntarily, that could constitute a threat under *Unocal*. But, they explained, before the board can intervene on that basis, two conditions must exist: (1) the board must be able to generate

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[104] Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361 (Del. 1995).

[105] Paramount Commc'ns, Inc. v. QVC Network, Inc., 634 A.2d 34 (Del. 1994).

[106] Ronald J. Gilson & Reinier Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 Bus. Law. 247 (1989).

an expected market price for the company that exceeds the current bid price, and (2) a majority of shareholders must not believe what management claims to be the company's (higher) fair value that is not reflected in the current stock market price. Where those conditions exist, Professors Gilson and Kraakman proposed, the offer constitutes "substantive coercion" that triggers the board's right to intervene with defensive measures.[107]

Intending no disrespect for these two preeminent academics, both of whom I know and admire, this theory had three flaws. First, it was unnecessary, because the existing law already afforded a remedy. If an offer was unfairly underpriced, that circumstance, alone and without more, would constitute a "threat" without the court having to address whether or not the shareholders believe the board's claim that it can do better. After *Moran v. Household International, Inc.*,[108] decided four years before the Gilson & Kraakman article, the Delaware courts were already upholding target boards' refusal to redeem the poison pill where the board could show that it needed time to develop a transaction of higher value than the hostile offer.[109]

Second, the doctrine overlooks the real world. It presupposes a shareholder base that consists of mostly unsophisticated, powerless retail investors who require board protection. In fact, for some time our national securities markets have been "deretailized." Since the 1980s, the shareholder base has consisted predominantly of institutional shareholders with the resources to determine, without the need for board intervention, the value of their portfolio companies.[110]

The doctrine is also internally inconsistent. As Chief Justice Strine noted in 2000, in an opinion authored while a Vice Chancellor, the substantive coercion concept requires some cognitive dissonance, 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 or 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 . . . ."[111]

Finally, the doctrine is unworkable. It is easy to assert, but impossible to prove, that a fully informed shareholder electorate will disbelieve the

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[107] *Id.* at 260.

[108] 500 A.2d 1346, 1357 (Del. 1985).

[109] *See In re* Holly Farms Corp. S'holders Litig., C.A. No. 10,350, 1988 WL 143010, (Del. Ch. Dec. 30, 1988); Doskocil Cos. v. Griggy, C.A. No. 10,095, 1988 WL 105751 (Del. Ch. Oct. 7, 1988); Facet Enters. v. Prospect Grp., Inc., C.A. No. 9746, 1988 WL 36140 (Del. Ch. Apr. 15, 1988). *But see* Grand Metro. Pub. Ltd. v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988).

[110] *See* Jack B. Jacobs, *"Patient Capital": Can Delaware Corporate Law Help Revive It?*, 68 WASH. & LEE L. REV. 1645, 1650–51 (2011); *see also* John Armour, Jack B. Jacobs & Curtis J. Milhaupt, *The Evolution of Hostile Takeover Regimes in Developed and Emerging Markets: An Analytical Framework*, 52 HARV. INT'L L.J. 219, 240 (2011).

[111] Chesapeake Corp. v. Shore, 771 A.2d 293, 326 (Del. Ch. 2000).

board's claim that the company is more valuable under the current business plan than the tender offer price. In addressing that problem, Professors Gilson and Kraakman argued, as a factual matter, that disbelief can be presumed. But on that basis, a claim of substantive coercion could justify any board opposing any unsolicited offer and, for that reason, is readily subject to abuse. If the doctrine is to be credited by a court, then, at the very least, it should be only where the board can prove that the shareholders were actually misled into accepting an inadequate offer. I am aware of no Delaware case where this has actually ever happened.

Despite the doctrine's flaws, the Delaware Supreme Court proceeded to validate it as a legally valid category of *Unocal* "threat." The court did that in its *Paramount Communications, Inc. v. Time, Inc.*[112] decision in 1990, and reaffirmed the doctrine in its *Unitrin* decision in 1995.[113] After *Unitrin*, the doctrine has received public criticism in the 2001 law review article coauthored by Chief Justice Strine, former Chancellor Allen, and myself, has been publicly questioned by the Chief Justice in an opinion he authored in 2000, and most recently was questioned in a decision by former Chancellor Chandler in 2011.[114] I respectfully submit that the time has come for the doctrine to be revisited and repudiated, but only the Delaware Supreme Court can make that happen.

b. Efforts to Link or Unify the Standards of Review

The second set of conceptual problems with the intermediate review standards arose from the effort of the Delaware Supreme Court to unify all of the corporate law standards of review. As a conceptual matter, I have no quarrel with any effort to unify and rationalize principles of law, any more than with the efforts of theoretical physicists to discover a unifying principle that would explain observable phenomena at both the cosmic and the quantum levels of existence. To me the question is a practical one: is the end product workable? In the physical sphere where the phenomena are mathematically quantifiable, these efforts have met with partial (but not total) success. But, in the legal sphere, where the subject matter of review standards is qualitative, not quantitative, the effort to craft a theoretical structure that can link and unify all review standards has proved largely unworkable.

I have already discussed the example of *Cede & Co. v. Technicolor, Inc.*, which ruled that an adjudicated director's violation of fiduciary duty in approving a transaction will not directly result in a judgment for money damages but instead triggers a second level of review for entire fairness.[115]

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[112] 571 A.2d 1140 (Del. 1990).

[113] Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361 (Del. 1995).

[114] *See* Air Prods. & Chems., Inc. v. Airgas Inc., 16 A.3d 48 (Del. Ch. 2011).

[115] That attempted linkage has been criticized by others as well. *See* Lyman Johnson, *The Modest Business Judgment Rule*, 55 Bus. Law. 625, 631 (2000); Bud Roth, *Entire Fairness Review for a "Pure" Breach of Duty of Care: Sensible Approach or Technicolor Flop?*, 3 Del.

An example even more telling is *Unocal* itself. The problem *Unocal* was intended to address was that courts were limited to a Hobson's choice: apply either business judgment or entire fairness, with neither choice being a good fit for a board-adopted takeover defense. The doctrinal innovation contributed by *Unocal* was to conceptualize a new standard—reasonableness—under which target company boards would first have the burden to satisfy in order to become entitled to business judgment review. By its very nature, *Unocal*'s conceptual structure posited a direct linkage between review for reasonableness and review under the business judgment standard.

That structure did have a kind of surface elegance, but under any in-depth scrutiny the concept breaks down, for a simple reason. If a defensive measure passes *Unocal* scrutiny, then, by definition, it is because a court has found that the measure was reasonable. Once found reasonable, then if the measure is again reviewed under the business judgment standard, it must always—without exception—be upheld, unless the court finds the measure "irrational."[116] The problem is that it is both logically and legally impossible for a reasonable measure to be irrational.[117] It is impossible logically, because reasonableness is a stricter standard—higher up on the cognition scale—than rationality. A defense that passes a stricter standard perforce passes one that is less strict. And legally, if reasonableness did not require a higher level of scrutiny than business judgment review, the reasonableness rationale underlying *Unocal*—to craft a standard more exacting than business judgment—makes no sense.

In my view, once a defensive measure is found to pass *Unocal*, there should be no need for further judicial scrutiny—the defense should be "home free." If any further supporting evidence were needed, I would point to the fact that in no decision has any Delaware court ever found that a defense satisfied *Unocal* and then proceeded to employ a second, business judgment, level of review. To the contrary, over the two decades, the Delaware Supreme Court has recognized, albeit tacitly, that *Unocal* review is free-standing, and that once a takeover defense passes *Unocal*, it is valid. I suggest that the Supreme Court should formally say that de jure, and not just de facto.

Equally misconceived is the "flip side" of *Unocal*—announced in *Unitrin*—that if a takeover defense flunks *Unocal* it can still be upheld if the board can demonstrate that the defense is entirely fair.[118] But, for the reasons just outlined, if a board fails to demonstrate that its defensive measures were

L. Rev. 145 (2000). To my knowledge, no post-*Technicolor* case has followed or applied that doctrinal approach.

[116] *See* Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000). ("Irrationality is the outer limit of the business judgment rule. Irrationality may be the functional equivalent of the waste test or it may tend to show that the decision is not made in good faith, which is a key ingredient of the business judgment rule.").

[117] *See* Allen et al., *supra* note 64, at 1298.

[118] *See Unitrin*, 651 A.2d at 1377 n.18 ("We note that the directors' failure to carry their initial burden under *Unocal* does not, *ipso facto*, invalidate the board's actions. Instead, once

reasonable and not draconian (as *Unitrin* requires), how likely is it in the real world that the court would then find those same measures were, nonetheless, "fair"?[119] Again, I propose that the Court should formally recognize that no functional purpose is served by adding a second, entire fairness, or business judgment, layer of review, once the predicate *Unocal* inquiry is resolved.

IV. Potential Future Directions of Corporate Law

I conclude by sharing briefly some thoughts about the directions in which corporation law may evolve in the future. As Yogi Berra said, predictions are difficult, particularly about the future. Even so, there is one indisputable reality—the radical alteration of the shareholder profile of U.S. public companies (incorporated disproportionately in Delaware)—from which some modest predictions may plausibly be extrapolated.

As mentioned earlier, our American capital markets are now "deretailized." That is, unlike in the 1950s, when individual retail investors owned over 75% of all outstanding U.S. corporate equities, today institutional investors—including public and private pension and retirement funds, mutual funds, and hedge funds—comprise nearly 70% of that shareholder base.[120] Today's retail investors—people like us—are only indirect investors in those public companies, our direct investment being in the institutional funds and retirement plans that own directly the shares of those portfolio companies.

This transformation of the shareholder profile of U.S. public corporations has profound implications for the evolution of corporate law because the institutional shareholder base adds to the calculus two new and important elements.[121] First, unlike the retail shareholder paradigm, the institutional shareholder base is economically and legally empowered. It is economically empowered because the institutions have substantial financial resources, and because voting control of the shares they own is concentrated in a relatively small group.[122] And, it is legally empowered because of structural changes in the legal environment that have taken place during the past fifteen years.

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the Court of Chancery finds the business judgment rule does not apply, the burden remains on the directors to prove 'entire fairness' . . . .").

119 Allen et al., *supra* note 64, at 1310–11. To give the Delaware Supreme Court proper credit, not all of its efforts at review standard unification were flawed. Commendably, in *MM Cos. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1129–32 (Del. 2003), the court rationalized (and thereby unified) the *Blasius* and the *Unocal* standards. And properly so, because those quite different standards overlapped the same subject matter—a takeover defensive measure intended to impede the exercise of the shareholder franchise.

120 Jacobs, *supra* note 110, at 1650.

121 *See* Jack B. Jacobs, *Does the New Corporate Shareholder Profile Call for a New Corporate Law Paradigm?*, 18 Fordham J. Corp. & Fin. L. 19, 22.

122 As a former SEC General Counsel observed in 2007, the representatives of the institutions holding a majority of the shares of U.S. public corporations could fit into a mid-sized room. *See* Brian G. Cartwright, General Counsel, SEC, The Future of Securities Regulation, Address at the University of Pennsylvania Law School Institute for Law and Economics (Oct. 24, 2007), *available at* http://www.sec.gov/news/speech/2007/spch102407bgc.htm.

Second, those institutional shareholders have a short-term investment horizon and perspective. They are managed by persons or firms whose compensation depends on generating short-term returns from the portfolio company stocks under institutional management. Because of this combination of elements, institutional investors have both the wherewithal and the incentive to exert pressure on portfolio company managements and boards to deploy corporate assets and develop business strategies designed to yield short-term profits—in many cases, at the expense of alternative strategies that would yield higher profits over the longer term.[123]

Converging with this combination of institutional investor wealth and short-term outlook have been changes in the legal environment, that have given this new shareholder base the tools to lawfully influence corporate boards and managements to be more responsive to their economic agendas. In this regard, two developments are especially relevant: (1) the increased resort to the shareholder bylaw adoption process to limit the power of boards to adopt governance rules, including takeover defenses; and (2) the enactment of new rules providing for shareholder proxy access and proxy expense reimbursement.

For over a decade, institutional shareholders have invoked the shareholders' statutory authority to adopt and amend bylaws in order to restrict or eliminate the board's power to adopt poison pills. As a result, a significant percentage of public companies have dismantled their pills. Institutional shareholders have also invoked the bylaw amendment process to reform the proxy election system in a manner favorable to their interests. These bylaws typically require the corporation to reimburse the expenses of any dissident shareholder group that nominates a "short slate" of board candidates that is successfully elected. That development was validated initially by a 2008 Delaware Supreme Court decision holding that proxy reimbursement was a proper subject for shareholder action and would not infringe the board's statutory power to manage the corporation.[124] It later was reinforced legislatively by the adoption of §§ 112 and 113 of the DGCL.[125] Those provisions authorize the adoption of bylaws that allow a dissident shareholder group's proxy materials to be included in the board's proxy materials at company expense. Alternatively, should the dissident group choose to conduct its proxy contest independently, those statutes provide for the reimbursement of the dissident group's proxy solicitation expenses in specified circumstances.

The result has been to reduce the cost to dissident shareholders (including activist investors) of conducting a proxy contest for board representation or control. Not only have these developments empowered activist shareholders to alter the composition of the board, but they have also made even their threat to do so more credible, thereby increasing activists' leverage to influ-

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[123] *See* Jacobs, *supra* note 121, at 22–23.
[124] *See* CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 238 (Del. 2008).
[125] Del. Code Ann. tit. 8, §§ 112, 113 (2015).

ence board decision-making. In this vein, activist institutional shareholders have used their enhanced power to influence the approval of charter amendments dismantling staggered or classified boards, thereby making directors more vulnerable to removal and more motivated to respond to activist investor agendas.

Just how far-reaching the consequences of these developments have been can be grasped by contrasting the diminished power of corporate boards in relation to shareholders today, with the relative power boards possessed only fifteen years ago. In order to achieve higher returns, traditional institutional investors, including some university endowment funds, have increasingly invested significant resources with activist investors, thereby creating and making a new "asset class," now exceeding $200 billion, available to activist investors to finance their short-term agendas. Accordingly, over the past two years, the number and the success of activist investor initiatives have increased, such that today no corporation is too large to escape being an activist target. Two recent examples are Trian's campaign to change DuPont's business model, and Third Point's attempt to add to Dow Chemical's board two nominees who would be compensated separately by Third Point based on Dow Chemical's stock market performance.

One consequence of the altered character of the public company shareholder profile is that public company boards now operate under the shadow (that is, the implied threat) of a proxy contest to oust them at the next annual meeting should they resist or deviate from the agendas of their large institutional stockholders. Even without any threatened proxy contest, companies that have a majority vote requirement remain subject to the threat of a campaign to deny board incumbents the majority vote needed for their re-election. Those threats become accentuated if the activist investor initiative focused on a specific corporation is endorsed by proxy advisors such as ISS and Glass Lewis.[126]

This change in the identity and the nature of the public company shareholder base poses, I suggest, a challenge to the ongoing vitality of the board-centered model of corporation law. Personally, I believe that is not a good development, because it diminishes one of the few significant advantages the United States has in an increasingly competitive global economy—the ability to innovate new products. As I have argued elsewhere, the ability to innovate new products that the world will demand and be willing to pay for

[126] Jacobs, *supra* note 110, at 1651–52. Reinforcing this trend are external factors that exert pressure on boards to manage for the short term. To the extent that "senior executives are compensated with a package of cash and stock, weighted (for tax reasons) heavily in favor of stock options," that creates a pocketbook "incentive for corporate executives to manage their companies in a way designed to increase the stock price, or at least do nothing that will cause the stock price to go down. That incentive is amplified by stock analysts who microscopically scrutinize reported quarterly statements to see whether the quarterly results meet management projections. If they do not, the result is an adverse analyst report (the moral equivalent of a bad grade) that is usually followed by a sell recommendation that sends the stock price downward." *Id.*

requires the U.S. corporate community to nurture what has been described as "patient capital." To do that requires a legal and economic environment that permits boards to govern for the longer term, free from capital market-created pressures to generate quarterly returns or to liquidate assets for distribution to shareholders.[127] But, whether or not a more shareholder-centric world is thought to be good or bad, one can plausibly make some modest predictions.

First, it is predictable that many boards will resist activist investor interventions, which in turn will generate litigation over whether, and on what doctrinal basis, the courts will uphold board anti-activist defenses. In developing the law, I believe that Delaware courts will play a significant role by default, since no other governmental agency is likely to step up to the plate. In this highly politicized environment, Congress is unlikely to act, and any effort by the SEC to regulate this area will also likely meet with paralyzing political opposition. So, what we may witness is a replay of the 1980s, where the courts were forced to fashion new principles to redefine the power of the board to oppose hostile takeover bids by third-party bidders. This time, however, the "outsiders" will literally be "insiders"—the corporation's own institutional stockholders.

We have glimpsed an inkling of that future in the recent *Sotheby's* case[128]—the effort by Third Point to force a change in the business model and management of Sotheby's. In *Sotheby's*, the legal analysis was conventional because the case involved only a new variation of a now traditional poison pill defense. In future cases, however, boards may be forced to innovate entirely new defense strategies that may require courts to fashion new doctrine to demarcate more precisely the limits of a board's power to protect the corporation against its own shareholders. To express it a different way, this litigation may force the Delaware courts to reconsider to what extent the board-centric model can be preserved.

Second, the new institutional shareholder base may itself be good cause for the courts to reassess the need for judicial protection of shareholders in factual patterns of the kind involved in cases such as *Unocal*, *Revlon*, and *Blasius*. As I have suggested elsewhere,[129] those cases rest on a premise that is now outdated—namely, a shareholder base consisting of unsophisticated, powerless retail shareholders that need the courts to protect them from overreaching boards, majority shareholders, or hostile bidders. In today's world, the new shareholder base consists of wealthy, powerful, and highly motivated institutional investors fully capable, in many cases, of protecting themselves. It is, therefore, predictable that in future cases, the courts may be called upon to recalibrate, and perhaps in certain respects dial back, their perceived role as guardians of minority shareholder interests.

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[127] *See* Jacobs, *supra* note 110.
[128] *See* Complaint, Third Point LLC v. Ruprecht, C.A. No. 9469 (Del Ch. Mar. 25, 2014).
[129] *See* Jacobs, *supra* note 121.

But, whether and how these developments will occur is not for me to say. My privilege has been to witness, and play a small role in, the evolution of American corporate law over the past fifty years. It will now be the privilege of your generation to shape and witness how that law develops during the next half-century.