DELAWARE'S DUTY OF CARE

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ABSTRACT

The concerns that animated the Delaware Supreme Court's decision in Smith v. Van Gorkom—inattentive directors failing the shareholders at a critical juncture in a firm's life—could have led, even after the Delaware legislature enacted section 102(b)(7), to the development of a duty of care jurisprudence based on nonmonetary remedies. Instead, the Delaware Supreme Court developed a new law of transactions, built around banner cases such as Unocal and Revlon.

Now, two decades later, two key questions are asked: First, is there any duty of care left in Delaware? And, if the answer to the first question is no, is that a bad thing?

The first question is answered by tracing the waning of the duty of care: a rule that now requires little more of a director than a ritualistic consideration of relevant data. Today, after the director engages in this ritual, her decision will not violate the duty. In short, the classic duty of care no longer exists in Delaware.

But the Delaware courts clearly are not about to countenance every business decision, no matter how incoherent or ill-advised. So, they struggle to fit cases into either the loyalty or transactional model, even when these tools are ill suited to the task. No better example of this trend exists than the Delaware Supreme Court's decision in Omnicare, Inc. v. NCS Healthcare, Inc., where the court struggled to apply Unocal's entrenchment-based structure to deal protection devices in a friendly stock-for-stock merger.

Because we argue that Omnicare could have been better addressed under a classic duty of care analysis—no reasonable director would have agreed to totally lock up the deal—the second question is answered in the affirmative. There is a role, albeit a limited, narrow role, for the courts to review and question some decisions, even in the absence of loyalty or transactional concerns.

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Thus, this article highlights a subtle, and even unintended consequence of Delaware's increasing reliance on the loyalty and transactional duties. While the result may be the same regardless of which tool the courts use, attempts to fit classic duty of care cases under other headings—perhaps in a misguided attempt to avoid section 102(b)(7)—only muddle the development of a coherent analytical framework. This article argues for a reinvigoration of the classic duty of care analysis to preserve the distinct roles played by the director's fiduciary duties.

I. INTRODUCTION

Before 1985, the duty of care led a normal, humble existence in Delaware law. As a result of the business judgment rule, the duty of care protected shareholders only against extreme cases of managerial incompetence.1 This standard was changed in the decision in Smith v. Van Gorkom.2

In Van Gorkom, the Delaware Supreme Court held that the directors breached their duty of care by failing "to inform themselves of all information reasonably available to them" and which may have led to further shareholder gains in connection with a sale that admittedly netted shareholders a substantial premium over market prices.3 This full-throated version of the duty of care alarmed many and consequently was short-lived.

One year later, the Delaware legislature enacted section 102(b)(7) of the Delaware General Corporation Law (DGCL).4 The statute set forth that most directors would no longer face monetary damages for breach of the duty of care. Nonmonetary remedies, such as injunctions and rescissions, however, do not fall within the reach of DGCL section 102(b)(7). The concerns that animated Van Gorkom—inattentive directors failing the shareholders at a critical juncture in a firm's life—could have led to the development of a duty of care jurisprudence based on nonmonetary remedies. Instead, the Delaware Supreme Court developed a new law of transactions, built around banner cases such as Unocal Corp. v. Mesa

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2 488 A.2d 858 (Del. 1985) (finding the defendants liable for a lack of due care, despite an express finding of the directors' good faith). See infra Part II.B.

3 Van Gorkom, 488 A.2d at 893.

4 Del. Code Ann. tit. 8, § 102(b)(7) (2005) (allowing the certificate of incorporation to include a provision "eliminating or limiting the personal liability of a director" except for: (1) a breach of the duty of loyalty; (2) "acts or omissions not in good faith"; (3) an unlawful payment of dividends; or (4) any transaction where the director received "an improper personal benefit").
Petroleum Co. and Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc. But even this new law of transactions was later tempered or even undercut.

Now, two decades latter, we ask two key questions: First, is there any duty of care left in Delaware? Second, if the answer to the first question is "no," is that a bad thing?

We answer the first question by tracing the waning of the duty of care—a rule that now requires little more of a director than a ritualistic consideration of relevant data. Today, after the director engages in this ritual, her decision will not violate the duty. In short, the classic duty of care no longer exists in Delaware.

The Delaware courts are not about to countenance every business decision, no matter how incoherent or ill-advised. So, they struggle to fit cases into either the loyalty or transactional model, even when these tools are ill suited to the task. No better example of this trend exists than the Delaware Supreme Court's decision in Omnicare, Inc. v. NCS Healthcare, Inc., where the court struggled to apply Unocal's entrenchment-based structure to deal protection devices in a friendly stock-for-stock merger.

Because we argue that Omnicare could have been better addressed under a classic duty of care analysis—no reasonable director would have agreed to totally "lock up" the deal—we answer our second question in the affirmative. There is a limited role for the courts to review and question some business decisions, even in the absence of loyalty or transactional concerns.

Thus, we use this article to highlight a subtle and even unintended consequence of Delaware's increasing reliance on the loyalty and transactional duties. While the result may be the same regardless of which tool the courts use, attempts to fit classic duty of care cases under other headings only muddle the development of a coherent analytical framework. In this article, we argue for a reinvigoration of the classic duty

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5493 A.2d 946 (Del. 1985) (finding that defensive measures may be taken to prevent a merger where there is a threat to stockholder interests, and the defensive measure is reasonable in relation to this threat).

6506 A.2d 173 (Del. 1986) (finding directors must try to get the best price for stockholders' equity).

7E.g., Paramount Commc'ns, Inc. v. Time, Inc., 571 A.2d 1140, 1150 (Del. 1989) (finding absent a "limited set of circumstances" defined in Revlon, directors are "not under any per se duty to maximize shareholder value in the short term, even in the context of a takeover").

8818 A.2d 914, 933-36 (Del. 2003).

9We do not suggest, as some have before, that the duty of care should be reinvigorated or otherwise enhanced beyond its traditional role. E.g. Note, The Propriety of Judicial Deference to Corporate Boards of Directors, 96 HARV. L. REV. 1894 (1983) (criticizing the role of the board of directors in evaluating and approving management actions).

10Perhaps this is done in a misguided attempt to avoid DGCL § 102(b)(7).
of care analysis to preserve the distinct roles played by directors' fiduciary duties.

We do not urge the reanimation of the duty of care out of some academic sense of tidiness or simply to make some doctrinal, structural point. *Ex ante*, clearly-defined standards promote efficient results by allowing directors and their advisors to properly appreciate and price the present expected value of their choices. Forcing cases into categories based on confusing, *post hoc* rationalizations—as we argue the supreme court has recently done—hinders *ex ante* transparency and leads to unneeded costs and errors. In the case of Delaware, the leading corporate law jurisdiction in the world's largest economy, 11 this confusion is inefficient and costly. 12

The remainder of this article proceeds in three broad parts. Part II is divided into three sections: Section A traces the history of the duty of care in Delaware through 1985; Section B reviews the Van Gorkom case; and Section C reports on the duty of care post-Van Gorkom, leading to its present state as nothing more than a duty to look at information. Part III then explains how this stunted form of the duty of care led the Delaware Supreme Court astray in Omnicare. This part analyzes the rationale underlying Omnicare's application of Unocal and identifies weaknesses in this approach by demonstrating that Omnicare is not the typical Unocal case. Specifically, Omnicare involved a friendly merger, without a change of control and without the fear of director entrenchment or self-interest, the very basis of the Unocal standard. We argue that analyzing Omnicare under a duty of care analysis is more logical than viewing the transaction within Unocal's framework.

Part IV then situates our conception of the duty of care within the broader corporate fiduciary analysis. We begin by rejecting the notion, often expressed in recent Delaware decisions, that the duty of care should only be a purely procedural device. 13 We believe that an abjectly stupid or plainly absurd business decision will never stand, no matter how many investment bankers purport to bless the transaction and no matter how long the board meets. 14 More importantly, we reject the idea that directors who


13 See Brehm v. Eisner, 746 A.2d 244, 262-64 (Del. 2000).

14 *Contra In re* Caremark Int'l, Inc. Derivative Litig. 698 A.2d 959, 967 (Del. Ch. 1996). [W]hether a judge or jury considering the matter after the fact, believes a decision substantively wrong, or degrees of wrong extending through "stupid" to "egregious" or "irrational", provides no ground for director liability, so long as the court determines that the process employed was either rational or
hold themselves out as capable business people need or deserve the added protection of Delaware's "non-substantive" duty of care. Directors are already amply protected by a "gross negligence" standard of care\(^\text{15}\) and a robust business judgment rule that sometimes operates as a "substantive rule of law," rather than a standard of care or rule of deference, as more commonly conceived.\(^\text{16}\) As a rule of law, the Delaware business judgment rule acts as a complete defense to claims of breach of fiduciary duties of any kind when the plaintiff fails to meet their initial burden of proof.\(^\text{17}\)

We would reaffirm the existence of an agency relationship between the corporation and the directors, based on the professionalism of the directors as the chosen representatives of the shareholders' interests. Just as other professionals are not permitted to shield themselves from their own reckless or grossly negligent conduct,\(^\text{18}\) corporate directors should not have such protection simply because they deploy some preordained procedural ritual.

Much of the confusion regarding the duty of care results from Delaware's awkward attempt to address all director fiduciary duties under a unified standard of review,\(^\text{19}\) which is largely incoherent when applied to the duty of care.\(^\text{20}\) And case-by-case adjudication is often ill suited to a

\(^{15}\)In re Nat'l Auto Credit, Inc. S'holders Litig., No. 19,028, 2003 Del. Ch. LEXIS 5, at *46 (Del. Ch. Jan. 10, 2003) ("The duty of care requires that 'in making business decisions, directors must consider all material information reasonably available, and the directors' process is actionably only if grossly negligent.'") (quoting Brehm, 746 A.2d at 259).


\(^{18}\)See, e.g., In re United Artists Theatre Co., 315 F.3d 217 (3d Cir. 2003) (analogizing Delaware corporate law to find that a financial planner's agreement with a bankrupt company indemnifying the planner for the planner's ordinary negligence (but not gross negligence) was reasonable with the meaning of the bankruptcy statute). In dicta, the court stated that a provision indemnifying the planners if their gross negligence was a partial contribution to damages would be "out of bounds for acceptable public policy." Id. at 234.

\(^{19}\)Emerald Partners v. Berlin, 726 A.2d 1215, 1221 (Del. 1999) (explaining that "a breach of any one of the board of directors' triad of fiduciary duties, loyalty, good faith, or due care, sufficiently rebuts the business judgment presumption and permits a challenge to the board's action under the entire fairness standard").

\(^{20}\)Specifically, what a director could show to prove "entire fairness" after the plaintiff has carried its burden of rebutting the business judgment rule is unclear. And the very nature of the inquiry—how can a lack of care, at the level of gross negligence, ever be fair?—is perplexing.
broader consideration of the interaction of distinct elements like the business judgment rule, the standard of care, and the relationship of directors to the corporate entity.\textsuperscript{21} Finally, the injection of section 102(b)(7) into a common law doctrine that had matured over a century was bound to have unintended consequences. Nevertheless, while the confusion may be understandable, the time to correct the problem is at hand, before any semblance of the duty of care, and the important role it plays in a limited subset of cases, is lost.

II. THE DEVELOPMENT OF THE DUTY OF CARE

A. The Early Years

Courts have long recognized the inherent tension in corporate law between discretion and accountability, and this tension is especially acute in the duty of care context.\textsuperscript{22} As summarized by one court in the early twentieth century:

Perhaps no other manner of doing business has grown as much in the last century as that through corporations. No more useful expedient has been devised. At the same time, they have developed many opportunities for fraud and imposition, which, owing to the rules of the common law governing the liabilities of their officers, often went unpunished and unrequited. One of the problems of this situation has been to fix a just liability, a legal responsibility, either upon the corporation, or its officers, without unnecessarily impairing the utility or discouraging the existence of this great commercial agency.\textsuperscript{23}

As early as 1847, the Alabama Supreme Court explained that while directors exercise "a trust of the greatest delicacy," that does not mean "they possess such a perfect knowledge of the matters and subjects which may come under their cognizance, that they can not [sic] err, or be

\textsuperscript{21}See Kenneth B. Davis, Jr., Once More, the Business Judgment Rule, 2000 Wis. L. Rev. 573, 573 (reviewing court's application of the duty of care in light of five policy justifications for the business judgment rule).
\textsuperscript{22}See ROBERT CHARLES CLARK, CORPORATE LAW 123 (1986).
\textsuperscript{23}Randolph v. Ballard County Bank, 134 S.W. 165, 166 (Ky. 1911).
mistaken, either in the wisdom or legality of the means employed by them."  

Initially, American courts dealt with this tension by adopting the English rule that "gratuitous mandatories" (i.e., unpaid agents) could only be liable for "want of care" in cases involving near fraud. While not all jurisdictions followed this approach, it provided a fairly clear rule of deference. In most cases, this approach also fit well with the operative facts of early corporate enterprises; directors, especially of local banks, often served solely for the prestige associated with the position.

By the final decades of the nineteenth century, however, this reality had changed. In the early twentieth century, scholars were abandoning the notion of directors as "gratuitous mandatories" and replacing it with the notion of directors as corporate fiduciaries. By this time, many courts, including the United States Supreme Court, had already held that the standard of care for directors was gross negligence. Other courts disagreed.

These courts argued that officers and directors owed the corporation a duty of care which required "the same degree of care and prudence that

26See Hovenkamp, supra note 25, at 1667 (describing New York Court of Appeals decision applying an ordinary negligence standard). See also F.G. Stapleton, Degree of Diligence Required of an Agent, 27 S. Afr. L.J. 250, 256 (1910) (describing other common law jurisdictions held that an agent who undertook a task must exercise the requisite skill, whether paid or not).
27E.g., Neall v. Hill, 16 Cal. 145, 151, 76 Am. Dec. 508 (Cal. 1860) (reversing the lower court decision holding officers liable because there was no evidence of "gross negligence or willful misconduct," despite the failure to keep financial records and violations of the company's bylaws); Percy v. Millaudon, 8 Mart. (n.s.) 68 (La. 1829) (allowing a factual review of director and officer care where there were allegations of fraud and self-dealing).
31Spering's Appeal, 71 Pa. 11, 24 (1872).
[I]t would be a monstrous proposition to hold that trustees, intrusted with the management of the property, interests and business of other people, who divest themselves of the management and confide in them, are bound to give only slight care to the duties of their trust, and are liable only in case of gross inattention and negligence . . . .
men prompted by self-interest generally exercise in their own affairs." 33 The courts thus began a shift from an agency analogy to a trust analogy, and a corresponding shift to a higher expectation of care on the part of directors. 34 By the Great Depression, most jurisdictions agreed that directors could be found liable for failure to exercise the level of care expected by a hypothetical, reasonable director—that is, the standard became negligence. 35

These early formulations of the duty of care were embraced by New Jersey, and later Delaware, as they crafted modern corporate law. 36 One of the first duty of care cases arose in New Jersey in 1889. 37 This case was brought against the former directors of a bank to recover the proceeds from several loans made on improperly secured property. 38 The New Jersey court found that if the board "had performed its duty in this particular with ordinary care" the faults in the books would have been easily discovered. 39 The court held that the directors had an obligation to "bring to the discharge of the duties that they undertake ordinary competency, together with reasonable vigilance and care." 40 The New Jersey court embraced the New York Court of Appeals' opinion in Hun v. Cary, 41 stating that the directors of a bank "cannot excuse imprudence or indifference by showing honesty of intention coupled with gross ignorance and inexperience." 42

Early Delaware cases were often less than clear about whether the state followed the earlier agency theory of director care, or the newer New York/New Jersey trust-law theory. Delaware first addressed the duty of care in 1922 in Lofland v. Cahall. 43 The court found, like its recent predecessors, that the directors of a corporation were trustees of the

33 Id. at 71.
34 See Rhoades, supra note 29; M.C. Lynch, Diligence of Directors in the Management of Corporations, 3 CAL. L. REV. 21 (1914).
37 Williams v. McKay, 18 A. 824 (N.J. Ch. 1889).
38 Id. at 825.
39 Id. at 829.
40 Id. at 835.
41 82 N.Y. 69, 74 (1880).
42 Williams, 18 A. at 835.
43 Lofland v. Cahall, 118 A. 1 (Del. 1922).
interests of the shareholders of that corporation. Applying the principles of trusteeship, the court held that the behavior of the directors must reflect "the utmost good faith and fair dealing." 45

The next year, the duty of care was addressed again, this time in Allied Chemical & Dye Corp. v. Steel & Tube Co. 46 This case was brought by minority stockholders of a company to enjoin the sale of all the assets of the company, alleging that the transaction orchestrated by the directors unfairly favored the majority stockholders. 47 The court found that when majority stockholders "join hands in imposing its policy upon all," the majority assume a fiduciary relationship with the minority stockholders. 48 Further, the court determined that when the majority stockholders injure the minority stockholders in the exercise of their power "by letting . . . equitable assets go for an unfair and inadequate price, the act of the trustee in making the sale will in equity be condemned as wrongful." 49

The court, however, went on to state that "inadequacy of price will not suffice to condemn the transaction as fraudulent." 50 To prove a dereliction of the duty of care the accepted price must be "so far below what is found to be a fair one that it can be explained only on the theory of fraud." 51 This standard plainly emerged out of the courts' reluctance to second guess business decisions—today expressed as the business judgment rule.

The growth of this reluctance can be seen in a 1929 Delaware case where a company was sold, overly compensating the majority stockholders who coincidentally were the directors of the corporation. 52 The evidence was insufficient to overcome the presumption that the price achieved by the directors was fair and honest and reached in good faith. 53 The court found that to overcome the presumption in favor of the decision of the directors: "[t]he disparity must be sufficiently great to indicate that it arises . . . from either improper motives underlying the judgment of those in whom the right to judge is vested or a reckless indifference to or deliberate disregard of the interests of the whole body of stockholders." 54 Although this

44Id. at 3.
45Id.
46120 A. 486 (Del. Ch. 1923).
47Id. at 489.
48Id. at 491.
49Id. at 494.
50Allied Chem. & Dye Corp., 120 A. at 494.
51Id.
52Allaun v. Consolidated Oil Co., 147 A.2d 257, 259 (Del. Ch. 1929).
53Id. at 262-63.
54Id. at 261.
decision upholds the protections of the business judgment rule, it indicates that a director who exhibits "reckless indifference" to the interests of the shareholders could be held liable.55

Ten years later, in 1939, a Delaware court was more explicit in laying out the duties and obligations owed to the shareholders by the directors of a corporation.56 In *Guth v. Loft, Inc.*, the court found that while the directors were not trustees, they stood "in a fiduciary relation to the corporation and its stockholders."57 The court held that this fiduciary relationship required directors of a corporation to "scrupulous[ly] observ[e] [their] duty, not only affirmatively to protect the interests of the corporation . . . but also to refrain from doing anything that [will injure] the corporation."58

A well-known case in New York in 1940 went further in outlining the contours of the duty of care.59 In *Litwin v. Allen*, a New York court found that because directors of a corporation stood in a fiduciary relationship to the shareholders, they were "bound by all those rules of conscientious fairness, morality, and honesty in purpose [and were] under the fiduciary obligations and responsibilities. They [were] held, in official action, to the extreme measure of candor, unselfishness, and good faith."60 The court held that not only must the director act honestly, but also must "exercise some degree of skill, prudence and diligence" as well.61

In the decades leading up to *Smith v. Van Gorkom*, several cases in Delaware clouded the issue. Most notably, in 1963 the supreme court explained that directors must "use that amount of care which ordinarily careful and prudent men would use in similar circumstances."62 This seemingly placed Delaware in line with the majority of jurisdictions that treated the duty of care as a standard negligence-based tort, albeit one that was limited by the business judgment rule.63 But some prior Delaware decisions64 had apparently embraced a gross negligence standard, and the

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55 Id.
57 Id. at 510.
58 Id.
60 Id.
61 Id. at 678.
64 See *supra* text accompanying notes 46-49, 52-55 (discussing Allied Chemical & Dye Corp.).
court's own opinion appeared internally inconsistent. Nevertheless, examples of the "mere negligence" standard of care existed into the middle of the 1980s, even after the Delaware Supreme Court seemingly came down on the "gross negligence" side of the debate.

Accordingly, Delaware's duty of care was somewhat confused by 1980, although probably no more confused than in many other states. In large part this confusion resulted from the competing theories of the duty—trust and agency—and the tendency of courts to draw from both concepts in a single opinion. Thus, both before and after Van Gorkom, it is common to find decisions where directors are termed fiduciaries, consistent with the trust standard, whose actions will result in liability when they demonstrate "reckless indifference to or a deliberate disregard of the whole body of stockholders" or their actions are "without the bounds of reason," a standard consistent with the Gilded Age view of directors as gratuitous mandatories.

B. Van Gorkom and section 102(b)(7)

In Smith v. Van Gorkom, the board engaged in a rather sloppy and cursory review of a proposed cash-out merger of Trans Union into a subsidiary of another corporation. While the board's actions might have violated a simple negligence standard, scholars have argued that the conduct could not have violated a gross negligence standard, if that standard was to have its normal, tort law meaning. While the Van Gorkom opinion was decried as a threat to free-market, corporate capitalism, the opinion strongly suggested that a board could avoid most

65E.g., Rabkin v. Philip A. Hunt Chem. Corp., 547 A.2d 963, 972 (Del. Ch. 1986) (holding that director inaction was implicitly excluded from the adoption of the "gross negligence" standard).
69See William T. Allen et al., Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law, 56 BUS. LAW. 1287, 1299-301 (2001), reprinted in 26 DEL. J. CORP. L. 859, 872-73 (2001). The Delaware courts have criticized this decision as well, e.g., Arby Partners V, L.P. v. F&W Acquisition LLC, No. 1756-N, 2006 Del. Ch. LEXIS 28, at *53 (Del. Ch. Feb. 14, 2006) ([Van Gorkom] might have produced useful changes in practice but it is hardly a model for the principled application of the concept of gross negligence and arguably involved facts that, when considered in their totality, did not even amount to simple negligence.

liability by simply considering a fairness opinion,\textsuperscript{70} provided that the opinion was not obviously a sham.\textsuperscript{71}

Nevertheless, the Delaware legislature quickly responded by enacting DGCL section 102(b)(7), which allows shareholders to relieve directors of any personal liability for duty of care violations.\textsuperscript{72} The practical effect of this provision has been to limit the usefulness of most due care claims.\textsuperscript{73} Furthermore, Delaware Supreme Court jurisprudence has undoubtedly been influenced by the ubiquitous nature of DGCL section 102(b)(7) charter provisions,\textsuperscript{74} a point that will be explored in subsequent sections of this article.

\textsuperscript{70}Van Gorkom, 488 A.2d at 881.

\textsuperscript{71}As one columnist recently summarized:

Most shareholders probably don't realize that fairness opinions were never meant to be fair. They're really just insurance policies for boards of directors to protect themselves against shareholders who sue. The genesis of fairness opinions is a 1985 Delaware Supreme Court ruling that said ordering up an opinion from a bank was a valid way to defend against accusations that a board did not provide its "duty of care." Ever since, boards have routinely asked for fairness opinions on most deals.


\textsuperscript{72}DGCL section 102(b)(7) states that a certificate of incorporation may include:

A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under § 174 of this title; or (iv) for any transaction from which the director derived an improper personal benefit. No such provision shall eliminate or limit the liability of a director for any act or omission occurring prior to the date when such provision becomes effective. All references in this paragraph to a director shall also be deemed to refer (x) to a member of the governing body of a corporation which is not authorized to issue capital stock, and (y) to such other person or persons, if any, who, pursuant to a provision of the certificate of incorporation in accordance with § 141(a) of this title, exercise or perform any of the powers or duties otherwise conferred or imposed upon the board of directors by this title.

\textsuperscript{73}See, e.g., Mal piede v. Townson, 780 A.2d 1075 (Del. 2001) (holding that plaintiffs have the burden to plead director bad faith or a breach of the duty of loyalty in order to survive a motion to dismiss where the certificate of incorporation contains a section 102(b)(7) provision).

\textsuperscript{74}According to one treatise, in the year after enactment of the section, 4,206 charter amendments or restated certificates of incorporation containing director liability provisions were filed in Delaware. The 13,697 new certificates of incorporation were filed with these provisions. 1-6 DELAWARE CORPORATION LAW AND PRACTICE § 6.02 n.58 (2004).
C. Due Care After Van Gorkom

Despite the legislature's attempt to grant directors substantial deference in making business decisions, Delaware courts significantly expanded the obligations of directors to protect the best interests of their shareholders.\textsuperscript{75} Many of the enhanced duties imposed by the Delaware courts were in response to the flurry of hostile takeovers in the early and mid-1980s,\textsuperscript{76} leading to a new set of transactional duties which largely replaced the duty of care.

In \textit{Unocal Corp. v. Mesa Petroleum Co.},\textsuperscript{77} the Delaware Supreme Court formulated a new enhanced standard of review designed to evaluate board decisions in response to, or in anticipation of, a threat to corporate control.\textsuperscript{78} Applying the new standard, the court adopted a middle standard said to reside somewhere between the business judgment rule and entire fairness review used in cases where the board operated under a conflict of interest.\textsuperscript{79} The court was concerned that in situations where shareholders could lose control of the corporation, a board may act "primarily in its own interests, rather than those of the corporation and its shareholders."\textsuperscript{80} As a result, the court created "an enhanced duty which calls for judicial

\textsuperscript{75}See Paramount Commc'ns, Inc. v. QVC Network, Inc., 637 A.2d 34, 44 (Del. 1994) (holding that the directors' "primary objective [is] to secure the transaction offering the best value reasonably available for the stockholders"); Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1287 (Del. 1989) (holding that the board's "essential purpose" in the context of a sale of corporate control, is "the enhancement of the bidding process for the benefit of the stockholders"); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) (holding that the board's duty is to "maxim[ize] the company's value at a sale for the stockholders' benefit"); Unocal Corp v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) (holding directors addressing a takeover bid to an "enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred"); In re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996) (holding that the directors' duty includes implementing an adequate corporate information and reporting system).

\textsuperscript{76}The courts seemed particularly concerned when the board of the target corporation consciously decided to sell, break up, or transfer control of the corporation. \textit{Revlon}, 506 A.2d at 182 ("The directors' role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company."). Further, the courts condemned favoring one bidder over another, when both offer structurally similar bid. \textit{Id.} ("Selective dealing to fend off a hostile but determined bidder [is] no longer a proper objective."); \textit{but see QVC Networks, Inc.}, 637 A.2d at 44 (allowing directors to consider more than just the consideration granted in the deal).

\textsuperscript{77}493 A.2d 946 (Del. 1985).


\textsuperscript{79}Id. at 793 (citing \textit{QVC Network, Inc.}, 637 A.2d at 42 n.9).

\textsuperscript{80}\textit{Unocal}, 493 A.2d at 954.
examination at the threshold before the protections of the business judgment rule may be conferred."\(^8^1\)

The court set forth a new two-pronged inquiry as a prerequisite to business judgment rule protection. First, directors must have "had reasonable grounds for believing that a danger to corporate policy and effectiveness existed,"\(^8^2\) a burden which may be satisfied "by [a] showing of good faith and reasonable investigation."\(^8^3\) Second, the specific defensive measures adopted must have been "reasonable in relation to the threat posed."\(^8^4\) This requires the board to have undertaken an in-depth analysis of the threat and its effect on the corporation.\(^8^5\) If the directors satisfy both prongs, the business judgment presumption will attach, and the plaintiff will carry the heavy burden of proof. If the directors fail to meet either of the prongs, the court will evaluate the board's decision under the entire fairness standard of review, thereby placing the burden of proof on the directors.

In \textit{Unocal}, the board of directors approved defensive measures when one of its stockholders, Mesa,\(^8^6\) made a hostile tender offer for the company's stock.\(^8^7\) The board's outside directors—representing a majority of the board—unanimously rejected Mesa's tender offer and authorized a self-tender for the corporation's own stock, excluding Mesa.\(^8^8\) The court of chancery granted a preliminary injunction to Mesa, enjoining Unocal's tender offer.\(^8^9\) On appeal, the Delaware Supreme Court reversed, stating that the Unocal board "acted in good faith, and . . . that Mesa's tender offer was both inadequate and coercive."\(^9^0\) Thus, the court focused on whether the board violated its fiduciary duty by adopting a "selective exchange offer" that excluded Mesa from the bidding process.\(^9^1\)

\(^{81}\)Id.

\(^{82}\)Id. at 955.

\(^{83}\)Id. (quoting Cheff v. Mathes, 199 A.2d 548, 555 (Del. 1964)).

\(^{84}\)Unocal, 493 A.2d at 955.

\(^{85}\)Id.

\(^{86}\)Mesa Petroleum Co., Mesa Asset Co., Mesa Partners II, and Mesa Eastern, Inc. owned approximately thirteen percent of Unocal's stock. \textit{Id.} at 949.

\(^{87}\)Mesa planned on securing sixty-four million shares (approximately thirty-seven percent) of Unocal's outstanding stock through a cash tender offer of $54 per share and eliminating the remaining publicly held shares through an issuance of what the court described as "junk bonds." \textit{Id.} at 949-50.

\(^{88}\)Unocal, 493 A.2d at 950-51.

\(^{89}\)Id. at 949.

\(^{90}\)Id.

\(^{91}\)Id.
The court explained that although it had previously invoked the business judgment rule in the context of corporate takeovers, that standard insufficiently addressed all situations. Consequently, the court created an increased level of scrutiny to apply to board decisions that adopted defensive measures in the face of hostile takeovers. The court held that where there is a threat of a hostile bid, the target board could not implement defensive measures unless the board reasonably believed that the hostile bid posed "a danger to corporate policy and effectiveness," and the defensive actions were "reasonable in relation to the threat posed." The board had to meet both prongs of the new standard before its decision to employ the defensive measures could enjoy the protections afforded by the business judgment rule. Thus, Unocal established that directors would continue to maintain broad discretion in their decision-making ability, but the courts would require those directors to meet certain minimum standards in takeover situations to fulfill their duties to the corporation and its shareholders.

In Revlon v. MacAndrews & Forbes Holding, Inc., the supreme court expanded directors' transactional duties to include situations involving a sale of corporate control. The court held that upon certainty of the sale of the company, the duty of the board changed from "preservation of . . . [the] corporate entity to the maximization of the company's value at a sale for the stockholders' benefit." In Revlon, the target board confronted both a hostile takeover attempt by an unsolicited bidder, Pantry Pride, and a friendly buyout by a solicited bidder, Forstmann. After the Revlon board rejected Pantry Pride's initial offer as inadequate, Pantry Pride's board authorized the acquisition of Revlon through a hostile takeover should negotiations prove

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92Unocal, 493 A.2d at 954. The SEC subsequently prohibited discrimination among shareholders by enacting the "all holders" rule, which requires that the tender offer be made to all security holders and that the highest consideration paid to any security holder be paid to all security holders. [1934 Act Rule 14d-10,] 17 C.F.R. § 240.14d-10 (2005).
93Unocal, 493 A.2d at 954-55.
94Id. at 955.
95Id.
96Id.
97Ironically, the board's response to Mesa's coercive offer was at least as coercive, if not more so. Unocal, 493 A.2d at 950-51.
98506 A.2d 173 (Del. 1986).
99Id. at 182.
100Id.
101Revlon, 506 A.2d at 176.
102Id. at 178.
fruitless.\textsuperscript{103} In response to the impending threat of a hostile bid, the Revlon board held numerous meetings and adopted a number of defensive measures.\textsuperscript{104} One such measure included a self-tender for up to ten million shares, offering one Senior Subordinated Note (the Notes) in exchange for each share tendered.\textsuperscript{105} Revlon shareholders tendered eighty-seven percent of the outstanding shares (approximately thirty-three million).\textsuperscript{106} Revlon accepted the full ten million on a pro rata basis.\textsuperscript{107}

Although the Revlon board continued to negotiate with both Pantry Pride and Forstmann, it became readily apparent that the board favored Forstmann.\textsuperscript{108} The board gave Forstmann numerous negotiating advantages, including access to nonpublic financial data.\textsuperscript{109} Exclusive knowledge of this confidential information put Forstmann in a better position than Pantry Pride to acquire Revlon. Irritated by Revlon's refusal to deal fairly with, Pantry Pride sought an injunction to prevent the merger between Forstmann and Revlon.\textsuperscript{110} Pantry Pride claimed that the Revlon board breached its duties and acted contrary to its shareholders' best interests by entering into an exclusive agreement with Forstmann and effectively ending the bidding auction without considering Pantry Pride's offers in good faith.\textsuperscript{111} The trial court agreed with Pantry Pride and granted the injunction, finding that the board focused more on protecting the noteholders than on securing the best possible price for the company for the benefit of all shareholders.\textsuperscript{112} The Delaware Supreme Court affirmed the Delaware Court of Chancery decision and extended the transactional duties first developed in \textit{Unocal} to takeover situations involving one or more competing bidders.\textsuperscript{113}

\textsuperscript{103}\textit{Id.} at 176.
\textsuperscript{104}\textit{Id.} at 177.
\textsuperscript{105}Revlon, 506 A.2d at 177. In exchange for each share tendered, Revlon offered one Senior Subordinated Note (the Notes) of $47.50 principal at 11.75\% interest, due 1995, and one-tenth of a share of $9.00 Cumulative Convertible Exchangeable Preferred Stock valued at $100 per share. \textit{Id.}
\textsuperscript{106}\textit{Id.}
\textsuperscript{107}\textit{Id.} Not only did this permit Revlon to take stray shares off the market but it also permitted Revlon to subject itself to debt covenants which acted as anti-takeover devices.
\textsuperscript{108}\textit{Id.} at 184 ("It is ironic that the parties even considered a no-shop agreement when Revlon had dealt preferentially, and almost exclusively, with Forstmann throughout the contest.").
\textsuperscript{109}Revlon, 506 A.2d at 184.
\textsuperscript{107}\textit{Id.} at 175.
\textsuperscript{111}\textit{Id.} at 175-76.
\textsuperscript{112}\textit{Id.}
\textsuperscript{113}Revlon, 506 A.2d at 175-76.
Favortism for a white knight to the total exclusion of a hostile bidder might be justifiable when the latter's offer adversely affects shareholder interests, but when bidders make relatively similar offers, or dissolution of the company becomes inevitable, the directors cannot fulfill their enhanced Unocal duties by playing favorites with the contending factions.\footnote{Id. at 184.}

Thus, when a company's sale, dissolution, or change of control becomes inevitable, the "[target] board's primary duty becomes that of an auctioneer responsible for selling the company to the highest bidder."\footnote{Id.} In such situations, Revlon prohibits the use of defensive measures that effectively curtail or prevent the bidding process.\footnote{Id.} Tactics such as lock-up options, no-shop provisions, or golden parachutes, which favor one bidder over another, violate a target board's Revlon duties.\footnote{Revlon, 506 A.2d at 184 ("The no-shop provision, like the lock-up option, while not per se illegal, is impermissible under the Unocal standards . . . ").} Revlon also requires that "[m]arket forces must be allowed to operate freely to bring the target's shareholders the best price available for their equity."\footnote{Revlon, 506 A.2d at 184 ("The no-shop provision, like the lock-up option, while not per se illegal, is impermissible under the Unocal standards . . . ").}

In Mills Acquisition Co. v. Macmillan, Inc.,\footnote{Mills Acquisition, 559 A.2d at 1285.} the Delaware Supreme Court reiterated that a target board faces enhanced duties when engaged in a bidding contest.\footnote{Id.} The court explained that "[w]hen Revlon duties devolve upon directors, [the court] will continue to exact an enhanced judicial scrutiny at the threshold, as in Unocal, before the normal presumptions of the business judgment rule will apply."\footnote{Id. at 1288 (finding that the target board violated its Revlon duties by approving a lock-up provision and a no-shop clause while negotiating the sale of the company).} The court held that at a minimum, those duties require a board conducting an auction for the sale of corporate control to take measures to enhance, and avoid measures that diminish, stockholder interests.\footnote{Id.} Moreover, the court refused to limit those duties to only active auctions, but rather, extended Revlon to other types of sales, such as management buyouts and restructurings.\footnote{Id. at 1261 (Del. 1989).} The court reversed the court of chancery's refusal to enjoin the consummation of a lock-up agreement between a target

\begin{itemize}
\item \footnote{114}{Id. at 184.}
\item \footnote{115}{Id.}
\item \footnote{116}{Id.}
\item \footnote{117}{Revlon, 506 A.2d at 184 ("The no-shop provision, like the lock-up option, while not per se illegal, is impermissible under the Unocal standards . . . ").}
\item \footnote{118}{Id.}
\item \footnote{119}{559 A.2d 1261 (Del. 1989).}
\item \footnote{120}{Id. at 1288 (finding that the target board violated its Revlon duties by approving a lock-up provision and a no-shop clause while negotiating the sale of the company).}
\item \footnote{121}{Id.}
\item \footnote{122}{Id.}
\item \footnote{123}{Mills Acquisition, 559 A.2d at 1285.}
\end{itemize}
corporation and a favored rival bidder. The lock-up agreement was not fair to all stockholders because it "had the effect of prematurely ending the auction before the board had achieved the highest price reasonably available for the company."125

While the Delaware Supreme Court continued to assert its support of the increased scrutiny demanded by Unocal and Revlon,126 in Barkan v. Amsted Industries, Inc.,127 the court refused to find that a target board involved in a management-sponsored leveraged buyout breached its duties to its shareholders even though it had approved a number of defensive measures which effectively "shielded" the company from additional bids.128 Although the court distinguished Barkan from Revlon because only one bidder existed in Barkan,129 the court insisted the board was still obligated to search the market for potentially competitive bids.130 Despite the Barkan board's failure to do so and its imposition of a no-shop restriction, the court found the board did not breach its duties to the company and its shareholders.131

This potentially significant reinterpretation of Revlon, however, was short-lived. In Paramount Communications, Inc. v. QVC Network, Inc.,132 the Delaware Supreme Court extensively evaluated the Revlon standard and its application to takeover situations.133 The court declared that "[i]n the sale of control context, the directors must focus on one primary objective—to secure the transaction offering the best value reasonably available for the stockholders—and they must exercise their fiduciary duties to further that end."134 Moreover, the court held that defensive measures that curtail a bidding process, "whether or not they are

124Id. at 1264-65.
125Id. at 1264.
126Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989) ("[T]he general principles announced in Revlon, in Unocal and in Moran govern this case and every case in which a fundamental change of corporate control occurs or is contemplated.") (citations omitted).
127567 A.2d 1279 (Del. 1989).
128Id. at 1287.
129Id. at 1268-87.
130Id. at 1287.
131Barkan, 567 A.2d at 1286-88 (holding that when the investment community knew that the company was "in play," and the directors had reason to believe no other bidder would pay more for the company, "the directors could conclude in good faith" that they had the best bid for the company).
132637 A.2d 34 (Del. 1994).
133Id. at 42-48.
134Id. at 44.
presumptively valid in the abstract, may not validly define or limit the directors' fiduciary duties under Delaware law."  

In QVC, Paramount and Viacom had begun negotiations regarding the possible merger of the two companies. The negotiations, however, broke down when Viacom offered Paramount approximately $61 per share, which was substantially less than Paramount was sought. At that time, QVC expressed an interest in entering the bidding process, but Paramount immediately informed QVC that Paramount was not for sale. Shortly thereafter, Paramount resumed its merger negotiations with Viacom. The Paramount board unanimously approved a merger agreement with Viacom. In addition, the board approved a number of defensive measures to "make it more difficult for a potential competing bid to succeed."

Despite Paramount's attempts to dissuade competitive bids, QVC offered approximately $80 per share for Paramount's outstanding shares and requested a meeting with Paramount's board to discuss the terms of an agreement. Martin Davis, the CEO of Paramount, advised the Paramount board that to engage in such negotiations would breach the no-shop provision in its agreement with Viacom unless conditions imposed under that agreement were met. Eventually, the board agreed to consider QVC's bid, but was extremely slow in actually sitting down to discussions. Confronted with Paramount's hesitancy, QVC filed suit seeking to enjoin the merger agreement with Viacom and publicly announced its two-step offer to acquire all of Paramount's outstanding

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135 Id. at 48.
136 QVC Network, Inc., 637 A.2d at 38.
137 Id. (they were $70 per share).
138 Id.
139 Id.
141 Id.
142 Id. While the Paramount board adopted several tactics to thwart alternative bids, the court focused on the no-shop provision, the termination fee provision, and the stock option provision. Id.
143 Id. Paramount and Viacom stated, in numerous public statements, that their merger was a virtual certainty, a "marriage" that would "never be torn asunder," with only a "nuclear attack" able to break the deal. Id. Additionally, the Chairman and CEO of Viacom called major QVC stockholders to discourage them from making a competing bid on Paramount. Id.
145 Id. at 39-40 (stating that the conditions included that the competing bid must not be "subject to financing contingencies").
146 Id.
shares. \textsuperscript{147} In the face of this hostile bid, Viacom engaged in aggressive negotiations with Paramount in an attempt to remain competitive. \textsuperscript{148} Although these negotiations secured Paramount a higher price per share than the original agreement with Viacom, the new agreement continued to contain significant defensive measures aimed at thwarting competitive bids. \textsuperscript{149}

After a thorough evaluation of the board's duties under \textit{Revlon}, 150 the Delaware Supreme Court affirmed the court of chancery's order enjoining the defensive measures adopted by the Paramount board to facilitate the merger with Viacom and deter other competitive bids. \textsuperscript{151} The court found that the Paramount board breached its fiduciary duties to shareholders by refusing to negotiate with QVC. \textsuperscript{152} A number of actions taken by the Paramount board contributed to the court's finding. For instance, the board approved prohibitive defensive measures in the face of competitive bids. \textsuperscript{153} Applying \textit{Revlon}, the court noted that once the board had decided to sell the company, its primary obligation became achieving the best price reasonably available for the company for the benefit of all its shareholders. \textsuperscript{154} The board failed to meet this obligation when it adopted defensive measures that prohibited the board from negotiating with a competitive bidder offering to pay nearly $1 billion more than the favored bidder, Viacom. \textsuperscript{155} Further, the Paramount directors acted improperly by refusing to educate themselves about QVC's offer. \textsuperscript{156} The court declared, in the context of the sale of a company, that the directors incur both the special obligation to secure the best price reasonably available as well as the obligation to act reasonably in fulfilling that primary duty, which includes taking necessary steps to reasonably inform themselves of competing bids. \textsuperscript{157} The court explained that "[t]here are few events that have a more significant impact

\textsuperscript{147}Id.
\textsuperscript{148}QVC Network, Inc., 637 A.2d at 40.
\textsuperscript{149}Id.
\textsuperscript{150}Id. at 48-50.
\textsuperscript{151}Id. at 36-37.
\textsuperscript{152}QVC Network, Inc., 637 A.2d at 50. The court stated that the Paramount board "squandered" its "opportunity to negotiate on the stockholders' behalf and fulfill their obligation to seek the best value reasonably available." Id.
\textsuperscript{153}Id. at 49.
\textsuperscript{154}Id. at 48-49.
\textsuperscript{155}Id. at 50-51.
\textsuperscript{156}QVC Network, Inc., 637 A.2d at 50 ("[The directors] remained prisoners of their own misconceptions and missed opportunities . . . .").
\textsuperscript{157}Id. at 48-49.
on the stockholders than a sale of control or a corporate break-up." Thus, the court reasoned that directors involved in such situations may not hide behind the protection of the business judgment rule, but instead will be subjected to increased judicial scrutiny.

In Cede & Co. v. Technicolor, Inc., the Delaware Supreme Court continued to depart from its pre-Van Gorkom stance of judicial abstention in the face of director decisions and subjected the board to an enhanced level of scrutiny. In Cede, the court affirmed the business judgment rule as a rule of deference, granting director decisions significant protection from judicial analysis, but nonetheless reversed the court of chancery's ruling in favor of the defendant directors. The court did not find the directors liable, but instead remanded the case to the trial court to apply the entire fairness standard of review to the challenged transaction. Importantly, the court focused on the procedural aspects of the business judgment rule and rebuked the Delaware Court of Chancery for making it too difficult for the plaintiff to rebut the presumption in favor of the board. The court found that the plaintiff had in fact rebutted the presumption, and thus, the court of chancery should have viewed the board's actions with increased scrutiny. It is in this opinion that we first see the supreme court's attempts to both "proceduralize" the duty of care and integrate it into the complex burden-shifting framework that Delaware has used in fiduciary duty cases ever since.

The facts of Cede are voluminous; but, it suffices to say that the litigation involved a takeover situation in which MacAndrews & Forbes Group acquired Technicolor. The large majority of discussions regarding the merger occurred privately, between Morton Kamerman, Technicolor's chairman and chief executive officer, and Ronald Perelman, the controlling shareholder of MacAndrews & Forbes, to the exclusion of most of the Technicolor board. The plaintiff, Cinerama, dissented from the deal and

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158Id. at 47.
159Id. at 45.
160634 A.2d 345 (Del. 1993).
161Id. at 351.
162Id. at 371.
163Id. at 350-51.
164See Bud Roth, Entire Fairness Review for a "Pure" Breach of the Duty of Care: Sensible Approach or Technicolor Flop?, 3 Del. L. Rev. 145, 161-69 (2000) (describing why it was an innovation to use the entire fairness review to evaluate claims based on the duty of care).
165Cede & Co., 634 A.2d at 349.
166Id. at 353.
filed first an appraisal proceeding and later an individual suit alleging fraud and unfair dealing.\textsuperscript{168}

Significantly, the Delaware Court of Chancery entered judgment for the defendant directors, finding that the plaintiff had failed to meet the initial showing necessary to shift the burden of proof to the directors.\textsuperscript{169} Chancellor Allen stated that although he had "grave doubts" as to whether the board acted with due care in approving the merger,\textsuperscript{170} the plaintiff failed to show that it had suffered any injury resulting from "a proven claim of board lack of due care."\textsuperscript{171} Therefore, the court of chancery held that the board enjoyed immunity from further judicial review. On appeal, the Delaware Supreme Court rejected the trial court's decision as a "reformulation of the rule's requirements"\textsuperscript{172} and found that the plaintiff had fulfilled its burden of proof by providing some evidence of the board's lack of due care.\textsuperscript{173} Thereby, the court required the court of chancery to shift the burden back to the directors and impose an entire fairness standard of review on the challenged transaction.\textsuperscript{174}

\textit{Cede} offers an early illustration of the ongoing disagreement between the court of chancery and the Delaware Supreme Court as to the appropriate level of deference that should be afforded directors when they exercise their business judgment. To increase judicial scrutiny of director decisions, the Delaware Supreme Court has greatly expanded the range of situations to which it applies \textit{Unocal}'s enhanced standard of review.

For example, in \textit{Unitrin, Inc. v. American General Corp.},\textsuperscript{175} the Delaware Supreme Court significantly extended \textit{Unocal}'s scope and applied the enhanced standard to a board's decision to repurchase its own stock.\textsuperscript{176}

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{168} \textit{Id.} at 349.
\item \textsuperscript{169} \textit{Id.} at 350.
\item \textsuperscript{170} \textit{Cede & Co.}, 634 A.2d at 358.
\item \textsuperscript{171} \textit{Id.} at 359.
\item \textsuperscript{172} \textit{Id.} at 370.
\item \textsuperscript{173} \textit{Id.} at 367.
\item \textsuperscript{174} \textit{Cede & Co.}, 634 A.2d at 370. As one author notes: Entire fairness review is a doctrine historically used to scrutinize a transaction in which a member of the board (or other fiduciary) has a conflict of interest. Such claims normally involve accusations that a director engaged in self-dealing or personally profited from a transaction in a manner not shared with shareholders generally. Never before \textit{Technicolor} had the Supreme Court employed the entire fairness standard of review to examine a transaction that the trial court had expressly found was approved in good faith and untainted by self-dealing.
\textit{Roth, supra} note 165, at 161 (footnotes omitted).
\item \textsuperscript{175} 651 A.2d 1361 (Del. 1995).
\item \textsuperscript{176} \textit{Id.} at 1367.
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In doing so, however, the court departed from its increased tendency of holding directors liable. It reversed the Delaware Court of Chancery's order preliminarily enjoining the defendant directors from making any further repurchases.\textsuperscript{177} In response to an announced merger proposal, the defendant board approved a repurchase program.\textsuperscript{178} Applying \textit{Unocal}, the trial court subjected the repurchase program to enhanced scrutiny and found it disproportionate to the threat posed.\textsuperscript{179} The Delaware Supreme Court also recognized the substantial inadequacy of the proposed offer, but nevertheless agreed with the court of chancery's application of \textit{Unocal}'s enhanced scrutiny.\textsuperscript{180} The court significantly extended \textit{Unocal}'s reach and asserted that "[t]he \textit{Unocal} standard is a flexible paradigm that jurists can apply to the myriad of 'fact scenarios' that confront corporate boards."\textsuperscript{181} Thus, the court held that directors' actions should be subjected to enhanced judicial scrutiny whenever the record reflects that those actions constitute defensive measures taken in response to a "perceived 'threat to corporate policy and effectiveness which touches upon issues of control.'"\textsuperscript{182} Despite this expansive interpretation of \textit{Unocal}'s scope, the court held that the court of chancery improperly concluded that the repurchase program failed \textit{Unocal}'s enhanced test of proportionality because it was unnecessary.\textsuperscript{183} The court explained that determining the necessity of a business decision did not fall within the realm of the judiciary, but rather resided within the board of directors:

[Even] a court applying enhanced judicial scrutiny should be deciding whether the directors made \textit{a reasonable} decision, not \textit{a perfect} decision. If a board selected one of several reasonable alternatives, a court should not second guess that choice even though it might have decided otherwise or subsequent events may have cast doubt on the board's determination. Thus, courts will not substitute their business judgment for that of the directors, but will determine if the

\textsuperscript{177}Id.
\textsuperscript{178}Id. at 1370.
\textsuperscript{179}\textit{Unitrin}, 651 A.2d at 1367. The court of chancery found that "the threat to the \textit{Unitrin} stockholders from American General's inadequate opening bid was 'mild,' because the Offer was negotiable both in price and structure." \textit{Id.} at 1375.
\textsuperscript{180}Id. at 1372 n.9.
\textsuperscript{181}Id. at 1374 (internal citations omitted).
\textsuperscript{182}\textit{Unitrin}, 651 A.2d at 1372 (quoting \textit{Stroud v. Grace}, 606 A.2d 75, 82 (Del. 1992)).
\textsuperscript{183}Id. at 1385.
directors' decision was, on balance, within a range of reasonableness.\textsuperscript{184}

Thus, in \textit{Unitrin}, the Delaware Supreme Court managed to expand \textit{Unocal}'s reach while at the same time failing to find the directors liable.

The Delaware Supreme Court has continued to apply an increased level of scrutiny to board decisions while the court of chancery has not. In a departure from the usual trend in the court of chancery of affording substantial deference to corporate directors, however, Chancellor Allen, in \textit{In re Caremark International, Inc. Derivative Litigation},\textsuperscript{185} stretched directors' obligations under the duty of care to include a duty to "assure that a corporate information and reporting system [which] is adequate, exists."\textsuperscript{186} This imposition represented a significant expansion of directors' duties since a court following \textit{In re Caremark} could hold directors liable for failure to implement such a system even if there was no actual business decision to be challenged.

Despite Chancellor Allen's decision in \textit{In re Caremark}, the court of chancery has typically assumed a deferential stance toward director decisions even though the supreme court has not. In \textit{Emerald Partners v. Berlin},\textsuperscript{187} the Delaware Supreme Court reversed the court of chancery's judgment. \textit{Emerald Partners} concerned a merger agreement between May Petroleum (May) and thirteen corporations owned by the chairman and CEO of May.\textsuperscript{188} \textit{Emerald Partners}, a shareholder of May, dissented from the merger.\textsuperscript{189} \textit{Emerald Partners} sued to enjoin the merger on the grounds that, \textit{inter alia}, the merger triggered a supermajority voting provision located in May's certificate of incorporation.\textsuperscript{190} The court of chancery granted the injunction but was subsequently reversed by the supreme court.\textsuperscript{191} Later, events associated with Hall's bankruptcy lead to the dismissal of all claims against the defendants, save a disclosure claim.\textsuperscript{192} The "[p]laintiff[s] attempt[ed] to expand the allegations . . . to encompass . . . new theories in support of a Revlon claim and an entire fairness

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184Id. at 1385-86 (quoting \textit{QVC Networks, Inc.}, 637 A.2d at 45-46). \\
185698 A.2d 959 (Del. Ch. 1996). \\
186Id. at 970. \\
187726 A.2d 1215 (Del. 1999). \\
188Id. \\
189Id. \\
190Id. at 1218. \\
191\textit{Emerald Partners}, 726 A.2d at 1218-19. \\
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Finding that the remaining court did not "provide a basis" for the new theories, the court of chancery entered summary judgment in favor of the defendant directors. The Delaware Supreme Court reversed and remanded the case to the court of chancery to evaluate the entire fairness and duty of disclosure claims together, thereby affording Emerald Partners a better chance of proving that the merger was not entirely fair. Although the Delaware Court of Chancery found that Emerald Partners had satisfied its burden of pleading that the directors had breached their duty of care (as opposed to a finding that the directors had breached their duty of care), the supreme court held that "such a showing shifts to the director defendants the burden to establish" entire fairness.

On remand, the court of chancery again found in favor of the defendant directors, holding that the directors were exculpated under the company's certificate of incorporation, which contained a section 102(b)(7) provision. The Delaware Supreme Court held that the court of chancery had "once again" prematurely addressed the directors' exculpation claims and vacated the court of chancery's judgment and remanded with instructions for the court of chancery to conduct an analysis under the entire fairness standard of review. The supreme court explained that the directors could avoid personal liability only if they met the significant burden of proving that "their failure to withstand an entire fairness analysis was exclusively attributable to the violation of the duty of care." Significantly, the court rebuked the court of chancery for failing to subject the directors to the proper scrutiny and for simply granting them immunity under the respective exculpation provisions. On remand, the court of

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193 Id. at *9 n.2, reprinted in 21 Del. J. Corp. L. at 234 n.2.
194 Id.
195 Id. at *8-9, reprinted in 21 Del. J. Corp. L. at 234.
197 Emerald Partners, 726 A.2d at 1221-22.
198 Id. at 1218.
201 Id. at 98.
202 Id. at 97-98. The court stated:
When the case was remanded after the last appeal to this Court, the initial focus of the Court of Chancery's posttrial opinion should have been an entire fairness analysis. The Court of Chancery erred, as a matter of law, when it failed to engage in an entire fairness analysis and, instead, simply examined the plaintiffs' claims in the context of the Section 102(b)(7) charter provision.
chancery found that the merger was entirely fair to the corporation and its minority shareholders and entered judgment in favor of the defendant directors, immunizing them from any personal liability. The Delaware Supreme Court affirmed.

The ongoing debate between the court of chancery and the Delaware Supreme Court in Emerald illustrates the divergent views of the courts in their treatment of director liability for breach of the duty of care. The initial disposition of Brehm v. Eisner represents a further illustration of this dichotomy. The egregious facts of the case may ultimately cause Delaware courts to refuse to grant such protection to directors.

The Delaware Court of Chancery in Brehm dismissed with prejudice the plaintiff shareholders' complaint, which alleged inter alia that the board of the Walt Disney Company breached its fiduciary duties in agreeing to a nonfault termination agreement with then-president, Michael Ovitz. Despite finding that "the compensation and termination payout for Ovitz were exceedingly lucrative, if not luxurious, compared to Ovitz' value to the Company" and that the processes of the board "were hardly paradigms of good corporate governance practices," the court of chancery held that the plaintiffs failed to provide sufficient evidence to rebut the business judgment rule. Indeed, the court acknowledged that "the sheer size of the payout to Ovitz, as alleged, pushes the envelope of judicial respect for the business judgment of directors in making compensation decisions." The court, however, recognized that the protections afforded to the directors by the business judgment rule proved too substantial for the plaintiffs to overcome.

The Delaware Supreme Court, however, refused to take such a deferential position and reversed the court of chancery's dismissal to the extent that it was prejudicial and afforded the plaintiffs "a reasonable opportunity to file a further amended complaint" properly alleging the

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Id.


204 Id. at *149, reprinted in 28 DEL. J. CORP. L. at 1093.


206 746 A.2d 244 (Del. 2000).

207 Id. at 248.

208 Id. at 249. The plaintiffs alleged that the "severance package agreed to by the [Disney] Board [was valued] at over $140 million, consisting of cash payments of about $39 million" and over $101 million in value of the immediately vesting stock options. Id. at 253.

209 Id. at 249.

210 Brehm, 746 A.2d at 249.
directors' breach. The supreme court also took this opportunity to make its clearest statement yet that the duty of care in Delaware involves no substantive review of the merits of the contested decision, thus arguably increasing the importance of the procedural devices urged in early cases like Van Gorkom.

On remand, despite the court of chancery's assertion that "[i]t is rare when a court imposes liability on directors of a corporation for breach of the duty of care, and this Court is hesitant to second-guess the business judgment of a disinterested and independent board," the court found that the plaintiffs' complaint pled facts sufficient to rebut the business judgment presumption. Thus, the court denied the defendant directors' motion to dismiss. After trial, however, the court held that the directors did not breach their fiduciary duties.

Once again, in McMullin v. Beran and MM Cos. v. Liquid Audio, Inc., the court of chancery and the Delaware Supreme Court disagreed on the level of deference that courts should grant directors exercising their business judgment. In McMullin, the Delaware Supreme Court reversed the Delaware Court of Chancery's dismissal of a minority shareholder's claim challenging the parent company's sale of its subsidiary to a third party at the behest of a majority shareholder. The court held that although the board "could not effectively seek an alternative to the proposed . . . sale, [and thus] had no fiduciary responsibility [to do so,] its ultimate statutory duties . . . and attendant fiduciary obligations remained inviolable." The court asserted that the directors maintained their obligations "to act on an informed basis [and] independently ascertain how the merger consideration . . . compared to [the company's] value as a going concern."

In Liquid Audio, the Delaware Supreme Court liberally applied Unocal to a board's adoption of certain measures that changed the size and

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211Id. at 248.
212Id. at 264 ("Due care in the decisionmaking [sic] context is process due care only."). See also supra note 71 (stating that directors could avoid liability by considering a fairness opinion).
213In re Walt Disney Co. Derivative Litig., 825 A.2d 275, 278 (Del. Ch. 2003).
214Id.
215Id. at 291.
217765 A.2d 910 (Del. 2000).
21811 A.2d 1118 (Del. 2003).
219McMullin, 765 A.2d at 914-15.
220Id. at 920.
221Id. at 919.
composition of the board's membership. The company had a staggered board with three classes of directors, only one of which could be elected each year. Id. at 1122.

224 The company had a staggered board with three classes of directors, only one of which could be elected each year. Id. at 1122.

225 Id. at 1123.

226 Id. at 1121.

227 Liquid Audio, 813 A.2d at 1131.

228 Id. at 1120-21.

229 844 A.2d 1022 (Del. Ch. 2004).

230 Id. at 1059.

231 Id. at 1082-89.

232 Id. at 1084-88.

233 Hollinger Int'l, 844 A.2d at 1092.
The foregoing illustrates the key problem—when the Delaware courts want to find a due care violation, they increasingly turn to the Unocal standard, even though that standard makes little sense outside of a transactional setting. No better illustration of this confusion can be found than the recent Omnicare decision, which the next section addresses in full.

III. OMNICARE AND THE NEED FOR A DUTY OF CARE

The Delaware Supreme Court’s recent holding in Omnicare, Inc. v. NCS Healthcare, Inc. (Omnicare)\(^{234}\) has triggered much discussion and confusion in the world of corporate governance, specifically concerning a board’s adoption of deal protection devices.\(^{235}\) In part this is because the supreme court issued a split opinion (three to two)—a result seldom seen in Delaware.\(^{236}\) The opinion also illustrates the problems that result from the court's difficult and often awkward attempt to protect due care values with other tools.

Omnicare involved a suit by Omnicare Inc. and shareholders of NCS Healthcare Inc. to block a merger between NCS and Genesis Health Ventures Inc., claiming that the NCS board breached its fiduciary duties.\(^{237}\) NCS was on the brink of bankruptcy when it entered into a merger agreement with Genesis.\(^{238}\) Omnicare, Inc. was another potential acquiror that originally would consider only a chapter 11 acquisition of NCS.\(^{239}\)

Genesis had lost a potential acquisition because Omnicare placed a higher bid at the last minute.\(^{240}\) Consequently, Genesis demanded certain safeguards in its merger agreement with NCS to avoid acting as a "stalking horse" again.\(^{241}\) The merger agreement included a "force the vote" provision, which prohibited the NCS board from terminating the agreement

\(^{234}\)818 A.2d 914 (Del. 2003).


\(^{236}\)Justice Holland wrote the opinion for the majority, which also included Justice Berger and Justice Walsh. Then-Chief Justice Veasey and then-Justice Steele dissented. Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d at 914 (Del. 2003).

\(^{237}\)Id. at 919.

\(^{238}\)Id. at 920.

\(^{239}\)Id. at 921; 11 U.S.C. § 363 (2003).

\(^{240}\)Omnicare, 818 A.2d at 921.

before a stockholder vote approving the merger.\textsuperscript{242} Additionally, two majority shareholders (who were also directors) pledged their votes to Genesis.\textsuperscript{243} The merger agreement also contained a no-shop provision\textsuperscript{244} and lacked an effective "fiduciary out provision."\textsuperscript{245}

After the merger agreement was signed, Omnicare made a cash tender offer to acquire NCS at a price greater than the shareholders would have received under the proposed stock-for-stock merger with Genesis.\textsuperscript{246} When Omnicare offered a higher price for NCS, the NCS directors withdrew their support of the merger with Genesis; however, NCS was still bound by the merger agreement, including the requirement of calling a shareholder vote.\textsuperscript{247}

Based on existing Delaware precedents,\textsuperscript{248} the Delaware Supreme Court in \textit{Omnicare} could have fashioned its analysis in several ways.\textsuperscript{249} In \textit{Omnicare}, there was no change of control because it was a stock deal wherein the NCS shareholders could later receive a premium for their shares. Accordingly, the court did not utilize \textit{Reynolds}. The majority did subject the merger agreement, with its deal protection devices, to the enhanced scrutiny standard set forth in \textit{Unocal}.\textsuperscript{250}

The majority in \textit{Omnicare} applied the \textit{Unocal} test to the board's adoption of deal protection devices contained in the merger agreement between NCS and Genesis. The court applied \textit{Paramount Communications, Inc. v. Time, Inc.}\textsuperscript{251} finding that deal protection devices are held to \textit{Unocal} enhanced scrutiny.\textsuperscript{252} The majority found the reasonableness prong of \textit{Unocal} was satisfied but held that deal protection

\textsuperscript{242}\textit{Omnicare}, 818 A.2d at 925. At the time, "force the vote" provisions were addressed under section 251(c) of Delaware's corporation law. The language in question was subsequently deleted by the legislature and replaced by new section 146, which achieves the same end. See S. Bill No. 127, 142d Gen. Assem., Reg. Sess. (Del. 2003). We refer to old section 251(c) throughout to maintain consistency with the court's decision in \textit{Omnicare}.

\textsuperscript{243}\textit{Omnicare}, 818 A.2d at 926. Shareholder voting agreements allow the acquiror to lock up the deal by securing shareholder votes. Gregory V. Varallo & Srinivas M. Raju, A Process Based Model for Analyzing Deal Protection Measures, 55 BUS. LAW. 1609, 1617 (2000).

\textsuperscript{244}\textit{Omnicare}, 818 A.2d at 934.

\textsuperscript{245}Fiduciary out provisions enable a board to terminate a merger agreement if necessitated by its fiduciary duties. Varallo & Raju, supra note 243, at 1618-19.

\textsuperscript{246}\textit{Omnicare}, 818 A.2d at 926.

\textsuperscript{247}Id. at 927-28.

\textsuperscript{248}\textit{See supra} Part II for a discussion of Delaware jurisprudence.

\textsuperscript{249}\textit{See} Varallo & Raju, \textit{supra} note 243, at 1627-35 (discussing different standards of review associated with deal protection devices).

\textsuperscript{250}\textit{Omnicare}, 818 A.2d at 945; \textit{Unocal}, 493 A.2d at 954-55.

\textsuperscript{251}\textit{Time}, 571 A.2d at 1151. For more on this case, see \textit{infra} note 276 and text.

\textsuperscript{252}\textit{Omnicare}, 818 A.2d at 934.
devices were not proportional to the threat posed.\textsuperscript{253} The majority declared that the inclusion of the "force the vote" provision combined with the shareholder voting agreements resulted in an "absolute lock up."\textsuperscript{254} This complete lock up of the Genesis agreement made it impossible for the Omnicare transaction "to proceed, no matter how superior" it was to the Genesis offer.\textsuperscript{255} Thus, the court found that the board breached its fiduciary duties to nonmajority shareholders by excluding an effective fiduciary out provision.\textsuperscript{256} The court found the merger agreement unenforceable because the deal protection devices were preclusive and coercive, violating the enhanced scrutiny standard under \textit{Unocal}.\textsuperscript{257} Furthermore, the majority stated a per se rule barring merger agreements that lack effective fiduciary out provisions, which consequently bar other proposed mergers.\textsuperscript{258}

Nevertheless, the strong dissent in \textit{Omnicare} rejected the application of \textit{Unocal} to deal protection devices in friendly stock-for-stock mergers, suggesting that \textit{Omnicare} is unlikely to be the final word on the debate concerning deal protection devices.\textsuperscript{259}

Although the \textit{Unocal} enhanced scrutiny standard seems logical when the board undertakes defensive actions in response to threats from hostile bidders, enhanced scrutiny makes no sense when there is no threat of director entrenchment.\textsuperscript{260} The application of \textit{Unocal} to deal protection devices, when there is no risk of director self-interest, is inconsistent with the policy underlying \textit{Unocal}. The enhanced scrutiny standard set forth in \textit{Unocal} was largely based on fear of director self-interest.\textsuperscript{261}

The rationale for applying enhanced scrutiny to a target company's reaction to hostile takeover offers rested on an intuition regarding the self-interest of incumbent target directors: when a target is taken over, its board of directors is

\textsuperscript{253}Id. at 935.
\textsuperscript{254}Id. at 939.
\textsuperscript{255}Id. at 936.
\textsuperscript{256}\textit{Omnicare}, 818 A.2d at 936.
\textsuperscript{257}Id. at 939.
\textsuperscript{258}Id. at 936, 939.
\textsuperscript{259}Id. at 943, 946.
\textsuperscript{260}It should be noted that deal protection devices would be subject to \textit{Unocal} scrutiny if the target intended to merge with another "white knight" to ward off hostile bidders. Wayne O. Hanewicz, \textit{When Silence is Golden: Why the Business Judgment Rule Should Apply to No-Shops in Stock-for-Stock Merger Agreements}, 28 J. CORP. L. 205, 233 (2003).
\textsuperscript{261}\textit{Unocal}, 493 A.2d at 954; see Frank H. Easterbrook & Daniel R. Fischel, \textit{The Proper Role of a Target's Management in Responding to a Tender Offer}, 94 HARV. L. REV. 1161, 1198 (1981) (calling for enhanced scrutiny of the target board's adoption of defensive measures).
generally replaced, so incumbent directors have strong incentives, based in their own self-interest, to resist unsolicited takeover bids notwithstanding the best interests of the corporation and its shareholders.\textsuperscript{262}

This self-interest may hamper the shareholder's ability to receive premium offers and it also may impede "the efficient allocation of resources and mut[e] the disciplinary effects of the market for corporate control."\textsuperscript{263}

Without this risk of director self-interest, the enhanced scrutiny standard set forth in Unocal lacks a rationale. "[S]elfishly entrenched management is the [']omnipresent specter['] haunting the world of hostile takeovers, and the standard of enhanced scrutiny announced in Unocal was designed to protect shareholder welfare by controlling this threat. Friendly acquisitions, on the other hand, do not have such ghosts."\textsuperscript{264} Friendly deals involve negotiations between the target and acquiror, indicating that the target board is aware of its possible replacement or corporate restructuring.

The target directors, of course, may receive some benefit from the negotiations, but this is minimal when compared to the conflicts implicated in blocking an entire hostile takeover, perhaps to ensure job security. Most stock-for-stock mergers result in the target board losing its job, suggesting that the board approves these mergers for the benefit of shareholders.\textsuperscript{265} Entrenchment was not an issue in Omnicare because NCS was on the brink of bankruptcy, which could have pushed the directors out of office.\textsuperscript{266} In addition, the merger with Genesis also called for the displacement of the incumbent directors of NCS. Thus, in Omnicare, there was no risk of the "omnipresent specter" of self-interest so feared in Unocal.\textsuperscript{267}

Moreover, Unocal focused on defensive actions adopted in response to hostile threats.\textsuperscript{268} Deal protection devices, however, are not inherently defensive because the target board includes these devices in merger

\textsuperscript{262}Griffith, supra note 241, at 22.
\textsuperscript{263}Id.
\textsuperscript{264}Id. at 23; see also Unocal, 943 A.2d at 954.
\textsuperscript{265}Hanewicz, supra note 260, at 241.
\textsuperscript{266}For empirical studies demonstrating the risk of job loss to senior management during financial distress, see Stuart C. Gilson, Management Turnover and Financial Distress, 25 J. Fin. Econ. 241, 247 (1989); Lynn M. LoPucki & William C. Whitford, Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies, 141 U. Pa. L. Rev. 669, 723 (1993).
\textsuperscript{267}Unocal, 493 A.2d at 954.
\textsuperscript{268}Id. at 953.
agreements before the threat from potential acquirors. Obviously, it would be a defensive measure if the purpose of a merger was to fend off a hostile threat by the use of a "white knight." In Omnicare, the NCS board enacted deal protection devices in a friendly stock-for-stock merger agreement without a hostile threat.

Another difference between deal protection devices and the defensive actions taken in Unocal is that a target adopts defense mechanisms to protect itself, while deal protection devices protect the acquiror. Moreover, a target adopts defense mechanisms on its own initiative, which is not usually the case with deal protection devices. Specifically, in Omnicare, there was no unilateral board action taken by NCS since the shareholder voting agreements demonstrate shareholder approval. Defense mechanisms prevent the target from being acquired, while deal protection devices are used to tempt the acquiror. Many times, deal protection devices are necessary to negotiate merger agreements because they act as inducements to contract. Assuming deal protection devices result from arm's-length transactions, the substance of the deal protection provisions is not wholly within the control of the target board of directors. The board, however, still has some control over the substance of the merger agreement.

Because the decision of the board to enter into a merger agreement is not subject to the Unocal standard, it seems paradoxical to single out deal protection devices, which merely comprise one portion of the merger

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269 See McMillan v. Intercargo Corp., 768 A.2d 492, 506 n.62 (Del. Ch. 2000) (reviewing deal protection devices under a Unocal standard because "[u]nder a 'duck' approach to the law, 'deal protection' terms self-evidently designed to deter and make more expensive alternative transactions would be considered defensive and reviewed under the Unocal . . . standard . . . of course, the mere fact that the court calls a 'duck' a 'duck' does not mean that such defensive provisions will not be upheld so long as they are not draconian"); see also Mark Lebovitch & Peter B. Morrison, Calling a Duck a Duck: Determining the Validity of Deal Protection Provisions in Merger of Equals Transactions, 2001 COLUM. BUS. L. REV. 1, 10 (2001) (arguing that deal protection devices are defensive).

270 A "white knight" is "[a] person or corporation that rescues the target of an unfriendly corporate takeover, esp. by acquiring a controlling interest in the target corporation or by making a competing tender offer." BLACK'S LAW DICTIONARY 1591 (7th ed. 1999).

271 See Williams v. Geier, 671 A.2d 1368, 1377 (Del. 1996) (noting that the Unocal standard is only appropriate "when a board unilaterally adopts defensive measures").

272 As will be discussed infra, completely locking up a merger agreement may be a breach of the board's duty of care.

agreement, for enhanced scrutiny under Unocal. Super Deal protection measures are not adopted in isolation. Rather, they are merely one of many significant issues that are negotiated during the whole bargaining process of the merger itself. Super Deal

Lastly, while the majority in Omnicare relies on Paramount Communications, Inc. v. Time, Inc. when applying Unocal enhanced scrutiny to deal protection devices, this reliance is unfounded. Time involved a merger agreement between Warner Brothers and Time. Paramount made a separate offer for Time. Although there is powerful language in Time suggesting application of Unocal to deal protection devices, the holding in Time is more ambiguous than the language suggests. The court in Time never expressly applied Unocal to deal protection devices. Rather, Time applied the business judgment rule to the board's original merger plan, and this original merger contained the challenged deal protection devices. The court noted in a footnote that the legality of deal protection measures was "not a central issue," and the court upheld the no-shop provision because it was adopted at Warner's insistence and for Warner's protection. Furthermore, the court's analysis in Time was in the context of rejecting plaintiff's argument that Revlon should apply. Commentators remark that case law after Time generally applied the business judgment rule to no-shop provisions in stock-for-stock mergers. After Time, most of the subsequent court of chancery opinions


275Varallo & Raju, supra note 243, at 1631.

276571 A.2d 1140 (Del. 1989).

277Id. at 1142.

278Plaintiffs argue that the use of a lock-up agreement, and "dry-up" agreements "prevented shareholders from obtaining a control premium in the immediate future and thus violated Revlon." Id. at 1151. The court agreed that such evidence was "entirely insufficient to invoke Revlon." Id. The court noted that "[t]he adoption of structural safety devices alone does not trigger Revlon. Rather, as the Chancellor stated, such devices are properly subject to a Unocal analysis." Id.

279Hanewicz, supra note 260, at 228.

280Id. at 226, 229.

281Time, 571 A.2d at 1142; see Hanewicz, supra note 260, at 228.

282Time, 571 A.2d at 1151 n.15.

283Hanewicz, supra note 260, at 229.

284Id. at 226.
are devoid of any real Unocal analysis with regards to deal protection devices.\(^{285}\)

Certainly, if directors enact deal protection devices to ensure their longevity on the board, Unocal would still apply as the fear of director entrenchment persists; but, Unocal should not apply to deal protection devices used in friendly mergers where there is no danger of director entrenchment.

After reviewing the policy underlying Unocal, no justification exists to subject deal protection devices to enhanced scrutiny when there is no threat of director entrenchment. Simply put, in situations where entrenchment and coercion are not a risk, the rationale underlying the application of Unocal collapses. It is still essential, however, to ensure the appropriate balance of power between directors and shareholders. By applying a standard duty of care analysis to a board's decision to adopt deal protection devices, courts can ensure that directors properly serve as gatekeepers of corporate transactions while also maintaining consistency in Delaware jurisprudence, leading to doctrinal clarity.\(^{286}\)

In friendly stock-for-stock mergers, where there is no clear change of control and there is no risk of director entrenchment, instead of courts applying Unocal enhanced scrutiny, courts should apply a standard duty of care analysis. For instance, analyzing Omnicare as a duty of care case is more logical than viewing the merger in question as within Unocal's reach. Based on current Delaware jurisprudence, a duty of care analysis may result in the enforcement of most deal protection devices; however, it could properly combat devices that completely lock up transactions.

The majority in Omnicare assumed that the business judgment rule applied to the board's decision to merge with Genesis.\(^{287}\) The court also presumed that the board exercised due care when it abandoned the Independent Committee's recommendation to pursue a stalking horse strategy, without even trying to implement it; executed an exclusivity agreement with Genesis; acceded to Genesis' twenty-four hour ultimatum for making a final merger decision; and executed a merger


\(^{286}\)In situations, of course, where directors are self-interested, the duty of loyalty, with its entire fairness test, will apply.

\(^{287}\)Omnicare, 818 A.2d at 929.
agreement that was summarized but never completely read by the NCS board of directors.\textsuperscript{288}

Although the court presupposed that the board exercised due care when it approved the merger with Genesis, the court never considered whether the board exercised due care when it adopted the terms of the merger agreement.\textsuperscript{289} The court could have crafted the same result in \textit{Omnicare} utilizing a duty of care analysis, rather than a \textit{Unocal} analysis.

Before the Delaware Supreme Court issued the \textit{Omnicare} decision in April 2003, several Delaware court of chancery opinions suggested that a duty of care analysis should apply to deal protection devices, rather than the \textit{Unocal} standard. For example, in \textit{Phelps Dodge Corp. v. Cyprus Amex Minerals Co.},\textsuperscript{290} a stock-for-stock merger agreement between Cyprus Amex Minerals Company and Asarco contained a no-talk provision.\textsuperscript{291} Phelps Dodge launched a hostile bid for both companies and sued, challenging the validity of the no-talk provision. The court held, in the context of deciding whether to grant a preliminary injunction, that a straight "no-talk" provision with no fiduciary out prevented the target from considering information about alternative deals and thus showed a reasonable probability of being unenforceable, even in a non-\textit{Revlon} setting.\textsuperscript{292} The court declared that "the decision not to negotiate . . . must be an informed one" and an agreement foreclosing all opportunity to discuss alternatives is "the legal equivalent of willful blindness" and this blindness may be a breach of the duty of care.\textsuperscript{293}

The Delaware Court of Chancery also suggested a duty of care analysis in \textit{Ace Limited v. Capital Re Corp.}\textsuperscript{294} Ace sued to restrain Capital Re from terminating its stock-for-stock merger agreement that contained both a no-talk and termination provision.\textsuperscript{295} The court noted that "no-talk provisions . . . are troubling precisely because they prevent a Board from meeting its duty to make an informed judgment with respect to even considering whether to negotiate with a third party."\textsuperscript{296} The court maintained that since the stockholder vote was already locked up, the lack

\begin{itemize}
\item \textsuperscript{288}Id.
\item \textsuperscript{289}Id. at 930-31.
\item \textsuperscript{290}No. 17,398, 1999 Del. Ch. LEXIS 202 (Del. Ch. Sept. 27, 1999).
\item \textsuperscript{291}Id. at *4.
\item \textsuperscript{292}Id. The court, however, refused to grant the injunction because of a lack of irreparable injury. \textit{Id.} at *5.
\item \textsuperscript{293}Id. at *3-5.
\item \textsuperscript{294}747 A.2d 95 (Del. Ch. 1999).
\item \textsuperscript{295}Id. at 96-97.
\item \textsuperscript{296}Id. at 109 (quoting \textit{Phelps}, 1999 Del. Ch. LEXIS 202, at *4).
\end{itemize}
of an effective carve-out permitting the board to talk with unsolicited bidders was likely a violation of the duty of care. The court stated that there was a colorable claim on the merits that the board may have breached its duty of care, regardless of whether Unocal was implicated. Hence, Phelps and Ace imply that, if directors cannot even entertain or consider a proposal, a board may not fulfill its duty to manage the corporation or exercise its duty of care. It seems as if Ace and Phelps did not just examine the process undertaken by the board, but also scrutinized the substantive reasonableness of the deal protection measures.

Another court of chancery opinion indicating a willingness to employ a duty of care analysis in evaluating deal protection devices is In re IXC Communications, Inc. Shareholder Litigation. Plaintiffs sought the preliminary injunction of a shareholder's vote on a proposed merger, which contained a termination fee, stock option, and mutual no-talk provision, yet also included a fiduciary out. The court stated that "[p]rovisions such as [‘no-talk’ provisions] are common in merger agreements and do not imply some automatic breach of fiduciary duty." The court declared that when termination clauses are not defensive mechanisms instituted to respond to perceived threats from potential acquirors, or the result of disloyalty or lack of care, courts would review break-up fees under the deferential business judgment rule. This implies that, in order to receive deferential treatment, the board must act with due care when it adopts deal protection devices.

Notwithstanding these court of chancery opinions, the Omnicare court applied a Unocal analysis to the board's adoption of deal protection devices even though there was no risk of director entrenchment. The court set forth a bright-line rule requiring the preservation of effective termination rights by the target's board. In reaching this result, the court pointed to the preclusive and coercive nature of the merger agreement. The court could have found the board breached its duty of care, however,

297Id. at 108-09.
298Ace, 747 A.2d at 108-09.
301Id. at *2.
302Id. at *17.
303Id. at *20-21.
304Omnicare, 818 A.2d at 934.
305Id. at 936.
when it agreed to a complete lock up, without an effective fiduciary out.\textsuperscript{306} In \textit{Omnicare}, the merger agreement between NCS and Genesis required that "NCS would submit the merger agreement to NCS stockholders regardless of whether the NCS board continued to recommend the merger."\textsuperscript{307} This "force the vote" provision was coupled with a separate shareholder voting agreement, which irrevocably committed the majority shareholders to vote in favor of the Genesis merger.\textsuperscript{308} In effect, the merger between NCS and Genesis was guaranteed at the signing of the merger agreement.

Although Delaware's corporate law permits a shareholder vote regardless of board approval, this does not necessarily mean that the adoption of such a provision comports with the duty of care.\textsuperscript{309} In \textit{Omnicare}, the section 251(c) vote, coupled with a shareholder pledge of votes, enabled an exclusive lock up and disabled any escape route. Perhaps it was the board's duty to reject a section 251(c) provision in its entirety when the merger was simultaneously subject to a shareholder voting agreement. Alternatively, perhaps it was the board's duty to include a robust fiduciary out in the merger agreement when a section 251(c) vote was included. Either would have enabled the board to change its mind and reject the original merger, without the obligation of a shareholder vote. In addition, although there was a no-shop provision, rather than a no-talk provision, the lack of an effective fiduciary out made any negotiations with an alternative bidder meaningless because the NCS board had already locked up the Genesis deal. No reasonable director would have approved a merger agreement that lacked an effective fiduciary out because its absence prevents a board from considering future potential deals, thereby inhibiting its ability to be fully informed. Thus, the NCS board's failure to either oppose a section 251(c) shareholder vote or demand an effective fiduciary out was a breach of its duty of care.

Extending beyond the facts of \textit{Omnicare}, a board may breach its duty of care by failing to include an effective fiduciary out in any merger agreement because the board must make informed decisions. This could

\textsuperscript{306} \textit{Id.}
\textsuperscript{307} \textit{Id.} at 925.
\textsuperscript{308} \textit{Omnicare}, 818 A.2d at 933.
\textsuperscript{309} The majority in \textit{Omnicare} specifically stated that "[t]aking action that is otherwise legally possible, however, does not \textit{ipso facto} comport with the fiduciary responsibilities of directors in all circumstances." \textit{Id.} at 937 (citing \textit{Liquid Audio}, 813 A.2d at 1132). The majority continued, "The synopsis to the amendments that resulted in the enactment of Section 251(c) in the Delaware corporation law statute specifically provides: 'the amendments are not intended to address the question of whether such a submission requirement is appropriate in any particular set of factual circumstances.'" \textit{Id.} (citing \textit{DEL. CODE ANN.} tit. 8, § 251(c) (2003)).
effectively eliminate a board's ability to adopt a section 251(c) vote when a shareholder voting agreement concurrently locks up the deal. Essentially, agreeing to exclusive lock ups prematurely prevents target boards from negotiating with other bidders.

Even if a complete lock up is a breach of the duty of care, there are ways to protect the initial bidder. For example, a large break-up fee would have similar deterrent effects; yet, a break-up fee lacks the preclusive effect of a section 251(c) vote combined with a shareholder agreement.\(^{310}\) Although the absence of a shareholder vote would prevent a statutory merger, the acquiror could still attempt to merge through the use of tender offers and proxy fights. Also, a weak no-talk or no-shop provision would discourage other bidders, but leave open the possibility of future super deals.\(^{311}\)

Admittedly, the Delaware Supreme Court may have been influenced by section 102(b)(7) of the Delaware Code,\(^{312}\) which allows articles of incorporation to eliminate or limit the personal liability of a director to the corporation or shareholders for monetary damages for the breach of the duty of care.\(^{313}\) While the Delaware Supreme Court may have desired to steer clear of the duty of care because of section 102(b)(7), this fails to explain the court's entire analysis. Section 102(b)(7) allows articles of incorporation to limit monetary damages for directors, but it does not stop a court from issuing equitable relief, such as an injunction.\(^{314}\) Thus, even if section 102(b)(7) influenced the court in *Omnicare*, the court still could have ordered equitable relief and enjoined the locked-up merger.

Thus, unless the merger itself is a defensive measure, courts should apply a duty of care analysis, rather than *Unocal* enhanced scrutiny, to deal protection devices. When there is no fear of director entrenchment, the duty of care can effectively maintain the balance of power between the board of directors and shareholders. Further, when viewing the board's adoption of deal protection devices in merger agreements, where there is no risk of director entrenchment, utilizing a duty of care analysis promotes consistency in Delaware jurisprudence. In order to act with due care, a board must include an effective fiduciary out in all merger agreements. Although in *Omnicare* this duty limited the utility of a section 251(c) vote when it is combined with a shareholder voting agreement, the duty of care is fact intensive and may require further limitations.

\(^{310}\)See Varallo & Raju, *supra* note 243, at 1612 (discussing break-up fees).

\(^{311}\)See *id.* at 1617 (discussing no-shop provisions).


\(^{313}\)Id.; *see also supra* note 71 and text.

The well-established duty of care requirement provides sufficient protection for stockholders when deal protection devices are adopted. There is no cogent reason for courts to enter uncharted waters by applying the *Unocal* standard so long as there is no risk of director entrenchment. By doing so, the court creates uncertainty that will unnecessarily complicate future corporate litigation and director decision making. This argument is explored more generally in the next section.

IV. REANIMATING THE DUTY OF CARE

Two decades have passed since the Delaware Supreme Court announced its controversial decision in *Van Gorkom*. Since that time, the supreme court, in response to efforts by the Delaware legislature and the court of chancery to afford directors greater deference, has articulated a number of different tests to apply in a variety of contexts to increase judicial scrutiny over director decisions. In this way, the court has largely succeeded in holding directors liable for decisions that would otherwise have been included within the traditional notion of duty of care. But at what cost?

Judicial review of director competence now sits in the center of three doctrines—*Unocal*, *Revoln*, and due care—that join only imperfectly, leaving considerable space between each doctrine. Consider, for example, the board of an agricultural concern that reviews the available evidence and decides that hedging against dramatic swings in crop prices is unwise,\(^{315}\) because it agrees that derivatives are "financial weapons of mass destruction."\(^{316}\) This board has essentially made an informed but arguably foolish decision to subject the firm to the full variance of the spot markets in agricultural products.\(^{317}\) Stated differently, the board has dramatically increased the firm's risk profile in order to advance a larger, policy-based argument about derivatives.

Plainly there is no transaction here that would implicate either *Unocal* or *Revoln*, so even a strained application of these due care


\(^{317}\)One can imagine a firm making such a decision, but that choice would only be a thoughtful one if we assume additional facts not present in the text. For example, if the firm thought that the costs of hedging were excessive, and decided against hedging on this basis, the decision to face the full market risks might be defensible.
substitutes, such as in *Omnicare*, is probably out of the question. And recall that the Delaware Supreme Court has explained that "[d]ue care in the decision-making context is process due care only."318 Thus, unless we can say that the board's decision to shun derivatives is "irrational," which seems improbable, the board's actions are unreviewable in Delaware.319 The problem is not only that the Delaware duty of care has become a "process only" duty, but section 102(b)(7) has given a potential plaintiff a strong incentive to bring a suit before the firm has suffered actual damages from the board's decision.

In a non-transactional setting, a shareholder who believes the board has made an informed but foolish decision is encouraged to overstate the claim, to meet the requirement of showing irrationality, and bring the claim prematurely, to avoid the section 102(b)(7) bar on monetary damages. It is hard to believe that these types of incentives are socially optimal or otherwise desirable.

We agree with those who argue that "[a]sking whether a decision was made with reasonable care implicates not only the process by which the decision was reached but also whether the decision itself was the one the hypothetical reasonable person would have made."320 Due care is often a procedural issue, but it can never be a "procedure only" duty, and the Delaware courts surely must understand this. Thus, there is no reason to believe that the perverse incentives created by the contorted Delaware duty of care are simply the unhappy side effects of an intentional gap in corporate fiduciary duties.

Although the duty of care was obscure from inception, with its odd mix of tort and trust law concepts, post-*Van Gorkom* Delaware finds itself with three doctrines that cover what one doctrine once covered. A gap in coverage has developed as a result of the twin effects of section 102(b)(7) and the courts' incoherent explication of the traditional duty of care—both in terms of the "proceduralization" of the duty and the misguided, and oftentimes somewhat eccentric, attempt to detach due care from its roots in

318 Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000).
319 As explained by the *Brehm* court, "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." *Id.* Notably, this approach does have the merit of avoiding the effects of section 102(b)(7), which expressly excludes duty of care violations that result from bad faith. *See* Official Comm. of Unsecured Creditors of Integrated Health Servs. v. Elkins, No. 20,228-NC, 2004 Del. Ch. LEXIS 122, at *34 n.37 (Del. Ch. Aug. 24, 2004), *reprinted in* 30 Del. J. CORP. L. 535, 550 n.37 (2005).
While the court can only hope that the legislature might reconsider section 102(b)(7), there is much that can be done to repair the common law elements of the duty.

The changes needed to achieve this goal are small, yet profound. First, the court could abandon Technicolor's failed attempt to construct a unified fiduciary duty standard. Entire fairness makes little sense in the due care context, and the business judgment rule does similarly slight work in the duty of loyalty context—providing little more than a requirement that the plaintiff demonstrate that the board had a conflict of interest, an already obvious part of any duty of loyalty claim. Entire fairness should be left for the duty of loyalty, and due care should return to its classical status as a kind of malpractice action for corporate directors. This separation, combined with a move toward acknowledging the reality that due care involves some degree of substantive review whether openly conceded or not, would bring Delaware's law of fiduciary duties back to the relatively tranquil position it enjoyed before Van Gorkom.

V. CONCLUSION

In this article, we have urged a return to coherence for Delaware's duty of care. Omnicare is but the latest example of the court stretching and distorting once coherent doctrines to make up for past mistakes like Technicolor. It is time to start over.

On the other hand, we do not join with those who would expand the duty of care to provide for a more robust review of directorial decision making. Director error is a natural part of director discretion, and only in the extreme cases, when real issues of director carelessness arise, should courts interject themselves into what should otherwise be a contractual relationship between shareholders and their chosen agents.

321 Id. at 92 n.58.
322 See Johnson, supra note 78, at 802-03.