ASKING THE RIGHT QUESTION:  
THE MIXED CONSIDERATION DENOMINATOR PROBLEM

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ABSTRACT

Delaware law has been unsettled for the last two decades as to what level of scrutiny to apply when a stockholder challenges a transaction in which an acquirer purchases the target's stock for a mix of cash and stock. When stockholders are paid for their stock with shares in a diversely held and uncontrolled entity, Delaware law treats the transaction as a strategic combination and affords the directors business judgment deference. When stockholders receive cash, Delaware courts scrutinize the transaction more closely under Revlon as an end-stage transaction. The uncertainty in the law stems from the inherent difficulty in determining whether a mixed cash-stock transaction more closely resembles a strategic combination or a cash-out merger. Delaware courts have used a ratio in which the per-share merger consideration is the denominator and the market value of the acquirer's stock is the numerator. When this ratio is about half or less, Delaware courts have applied heightened scrutiny to the transaction as though it is an end-stage transaction. This Article illustrates that this test over-values the investment being surrendered by including the premium paid by the acquirer, and creates adverse incentives for directors in negotiations. Instead, the question of whether there is a long-run for stockholders is better answered using a ratio of the market value of the amount of stock in the combined entity to be received over the pre-announcement market value of the stock to be surrendered.

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I. INTRODUCTION

Because the Delaware Court of Chancery has three levels of scrutiny that it must apply to a broad spectrum of stockholder challenges to transactions,¹ the court has grappled with which standard of review should apply to various transactions.² When target stockholders are paid entirely, or mostly, in cash in exchange for their shares in a merger, those stockholders who choose to challenge the merger in the Court of Chancery enjoy a more favorable burden of proof, instead of the almost-insurmountable business judgment rule.³ The court has reasoned that when more than half of the consideration is in cash, the stockholders' investment is mostly extinguished by the transaction.⁴ An end-stage transaction needs a closer look than an ordinary director decision.⁵ If, on the other hand, the stockholders receive consideration mostly, or entirely, in the form of shares of the combined entity, the director-friendly business judgment rule applies.⁶ Reasoning that the stockholders' investment is, on average, continuing, the court treats the board's recommendation in favor of a mostly-stock merger as a director decision made in the course of business, unlike a board endorsement of an end-stage transaction.⁷

¹ See Reis v. Hazelett Strip-Casting Corp., 28 A.3d 442, 457 (Del. Ch. 2011) (“Delaware has three tiers of review for evaluating director decision-making: the business judgment rule, enhanced scrutiny, and entire fairness.”).
³ See, e.g., In re Dollar Thrifty S'holder Litig., 14 A.3d 573, 595-96 (Del. Ch. 2010).
⁴ See Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 42-43 (Del. 1994) (“[M]inority stockholders can be deprived of a continuing equity interest in their corporation by means of a cash-out merger.”).
⁵ See, e.g., Reis, 28 A.3d at 459 (“A reverse split in which stockholders receive cash in lieu of fractional interests is an end stage transaction for those stockholders being cashed out of the enterprise. A disinterested and independent board's decision to pay cash in lieu of fractional shares therefore should be subject to enhanced scrutiny.”).
⁷ See id.
This Article focuses on those transactions in which the consideration for stockholders is partially cash and partially stock and the challenge for directors created by the ratio currently used to determine whether a stockholder's investment is surviving. Delaware law has not settled on a standard of review because the court has not confronted a case where the standard of review would be dispositive.\textsuperscript{8} For this reason, Delaware courts have used a ratio of the stock received in the merger over total per share consideration as a short cut to answer the question: Does more than half of the stockholders' investment survive the transaction? As this Article will show, however, to answer that question in a close case, the court needs to look at a ratio of the stock received over the stock surrendered and ignore the cash.

The majority of transactions valued in excess of half a billion dollars—i.e., the deals that routinely attract stockholder challenges—pay stockholders a premium over the market price.\textsuperscript{9} Acquirers pay premiums because the merger price represents what an acquirer thinks a company may be worth under its leadership, taking into account possible synergies and what a target board is willing to accept.\textsuperscript{10} This value may be, and often is, different from the value of the target stockholders' investment if the target were to remain a stand-alone entity.\textsuperscript{11} To compare a per share merger price, which represents a premium over how the market presently values the target's shares, to the market value of the acquirer's stock which represents no such premium, is to compare apples to oranges.

Further, as the illustrations in this Article demonstrate, if a deal is subject to heightened scrutiny when 50% of the deal price or more is in cash, diligent target directors who press an acquirer for more cash in a mixed consideration deal are inadvertently penalized if the added cash causes the percentage of stock to fall below 50% of the overall deal consideration.\textsuperscript{12} This penalty—which may create a selfish director incentive to avoid litigation—is inconsistent with the goal of

\textsuperscript{8}See In re Lukens Inc. S'holders Litig., 757 A.2d 720, 732 n.25 (Del. Ch. 1999).
\textsuperscript{9}See ROBERT M. DAINES & OLGA KOUMRIAN, CORNERSTONE RESEARCH, SHAREHOLDER LITIGATION INVOLVING MERGERS AND ACQUISITIONS 1 (2013).
\textsuperscript{10}See Paramount Commc'n's Inc. v. QVC Network Inc., 637 A.2d 34, 43 (Del. 1994): The acquisition of majority status and the consequent privilege of exerting the powers of majority ownership come at a price. That price is usually a control premium which recognizes not only the value of a control block of shares, but also compensates the minority stockholders for their resulting loss of voting power.
\textsuperscript{12}See infra Part V.
incentivizing directors to negotiate aggressively and seek the best price available.  

This Article is not meant to defend or dispute the application of the business judgment rule to stock-for-stock transactions, but to suggest that the proposed test is more consistent with that regime than the current test. If Delaware courts intend to continue deferring to directors embarking on strategic stock-for-stock combinations, it is logical to offer the same deference to largely stock-for-stock combinations that also offer cash benefits to the stockholders trading in their stock for new stock. The way to determine if the transaction at bar continues the stockholders’ investment is to compare stock-to-stock, rather than stock-to-price. This proposed metric will align the directors' incentive to avoid litigation with their incentive to maximize the price for stockholders by asking for as much cash and stock as possible from the acquirer.

Part II begins with a description of the business judgment rule that the Delaware Court of Chancery applies to most director actions and the factors that it will weigh in considering whether to apply the heightened Revlon standard. Part III will summarize the difficulty the court faces when it evaluates a mixed consideration transaction. Part IV illustrates the potential self-interested motives that arise for directors because of the court's use of merger consideration as a stand-in for investment value. Finally, Part V proposes a modified test that is mathematically and logically consistent with Delaware law: Compare the value of the surrendered stock to the value of the new stock to determine whether most of the stockholders' investment survives.

II. STANDARDS OF REVIEW IN DELAWARE

The mixed consideration denominator problem arises from tension between two key Delaware levels of scrutiny that apply to decisions that the board of directors of a corporation may make: The business judgment rule and Revlon.

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13 See Leo E. Strine, Jr., Documenting the Deal: How Quality Control and Candor Can Improve Boardroom Decision-making and Reduce the Litigation Target Zone, 70 BUS. LAW 679, 684 n.8 (2015).
14 See infra Part II.
15 See infra Part III.
16 See infra Part IV.
17 See infra Part V.
18 See DAINES & KOUMRIAN, supra note 9, at 3-4. This Article focuses on Delaware as the most popular jurisdiction for these suits. Even in cases not proceeding in Delaware, Delaware law often applies.
"[T]he central idea of Delaware's approach to corporation law is the empowerment of centralized management, in the form of boards of directors and the subordinate officers they choose, to make disinterested business decisions. The business judgment rule exemplifies and animates this idea."\(^{19}\) "Under the business judgment rule, the judgment of a properly functioning board will not be second-guessed and absent an abuse of discretion, that judgment will be respected by the courts."\(^{20}\)

The business judgment rule can be viewed both as "a rule of judicial self-restraint"\(^{21}\) and as substantive law aimed at encouraging directors to take beneficial risks.\(^{22}\) The Court of Chancery's role is not to resolve for corporations questions of policy and business management. The directors are chosen to pass upon such questions and their judgment unless shown to be tainted with fraud is accepted as final.\(^{23}\) Under ordinary circumstances, it is a "fundamental principle that the management of the business and affairs of a Delaware corporation is entrusted to its directors . . . [and] neither the courts nor

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\(^{19}\)In re Cox Commc'ns, Inc. S'holders Litig., 879 A.2d 604, 614 (Del. Ch. 2005).


\(^{22}\)Hollinger Int'l, Inc., 844 A.2d at 1078 ("The DGCL is intentionally designed to provide directors and stockholders with flexible authority, permitting great discretion for private ordering and adaptation."). In combination with the exculpatory effect of § 102(b)(7), which protects directors from personal liability for negligent breaches of the duty of care, the low probability of liability provided by the business judgment rule encourages directors to take beneficial risks. In re Rural Metro Corp. S'holders Litig., 88 A.3d 54, 87 (Del. Ch. 2014) ("Like the business judgment rule, Section 102(b)(7) promotes stockholder interests by ensuring that directors do not become overly risk-averse . . . .), aff'd sub nom. RBC Capital Mkts., LLC v. Jervis, 129 A.3d 816 (Del. 2015); Emerald Partners v. Berlin, 787 A.2d 85, 91 (Del. 2001) ("The statutory enactment of Section 102(b)(7) was a logical corollary to the common law principles of the business judgment rule."); see also William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., Realigning the Standard of Review of Director Due Care with Delaware Public Policy: A Critique of Van Gorkom and Its Progeny as a Standard of Review Problem, 96 Nw. U. L. Rev. 449, 449 (2002) ("The gross negligence standard is consistent with Delaware's long-standing policy of deferring to business decisions made by well-motivated fiduciaries.").

the stockholders should interfere . . . .”

Delaware law recognizes that nearly every corporate decision is better made by directors—often industry experts well versed in the daily operations of their companies—than by judges acting as Monday morning quarterbacks.

Under the framework of the Delaware General Corporation Law (the "DGCL"), a director accepts the power to govern a company at a cost: The director must adhere to the fiduciary duties of care and loyalty. When the business judgment rule applies, directors enjoy the rebuttable presumption that they complied with these duties. Delaware courts will invalidate directors' decisions under the business judgment standard only if the stockholder plaintiff can show that the directors' decision was either self-interested or that the business judgment rule presumptions are rebutted because the decision can be shown to have not been made rationally in the pursuit of legitimate corporate interests. When evaluating claims against a merger, "[i]f the business judgment rule standard of review applies, the claims against the defendants must be dismissed unless no rational person could have believed that the merger was favorable" to the stockholders.

The business judgment rule presumptively applies to all decisions made by a board of directors of a Delaware corporation, including a decision to sell the entire company. If the directors of a target determine that an offer price from a would-be acquirer creates value for the stockholders, they may choose to accept the offer.

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24Paramount Commc'n Inc. v. QVC Network Inc., 637 A.2d 34, 41-42 (Del. 1994).
25Delaware Court of Chancery Imposes Revlon Duties on Board of Directors in Mixed Cash-Stock Strategic Merger, 125 HARV. L. REV. 1256, 1257 (2012).
26For a description of an ideal fiduciary, see René Reich-Graefe, Deconstructing Corporate Governance: The Mechanics of Trusting, 38 DEL. J. CORP. L. 103, 111-12 (2013) (emphasis in original) (internal citations omitted):

The fiduciary is a genuine model citizen: She is "cooperative" and "other-regarding" to a fault; always beneficent; she is loyal, honest, and faithful to her entrustor(s); she is diligent, confident, responsible, fair, empathic, self-sacrificing and altruistic in the pursuit of her charges; and, as a result, she will perform to perfection without any need (and additionally, often without any possibility—hence, the central agency cost problem) of supervision, monitoring or other forms of control by her entrustor(s).

For an in-depth exploration of the duty of loyalty, see Leo E. Strine, Jr. et al., Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law, 98 GEO. L.J. 629 (2010).
28Id. at *12.
31See, e.g., M & F Worldwide, 88 A.3d at 651 (“The undisputed record shows that the Special Committee, with the help of its financial advisor, did consider whether there were
is a company incorporated under the laws of Delaware, the board of directors, per the Revlon standard discussed below, may be compelled to seek the "best price" available for the target shares. Sometimes the acquirer makes a more complex offer: An exchange of stock-for-stock, plus cash to sweeten the deal.

Some stockholders may be glad to sell their shares to realize liquidity on their investment, but others may be disappointed by the price obtained or view the termination of their long-term investment in the company as premature. When a deal is announced, in addition to voting against the transaction, any dissatisfied stockholders can file a suit seeking to enjoin the deal in an effort to get a better price or more information regarding the board's decision to recommend the sale. The stockholder plaintiff will ask the court to scrutinize the board's process in reaching its decision.

Before granting or denying an injunction, Delaware courts determine whether the usual business judgment rule applies, or whether the transaction warrants subjecting the board's decision to greater scrutiny.

As mentioned earlier, the board-friendly business judgment rule applies if the board concludes that the transaction is in the best interest of the corporation as a whole, taking into account the shareholders' interests. The board is presumed to act in the best interests of the corporation unless shown otherwise. If the transaction is purely in cash, there is a presumption that the price is fair, and the stockholders who vote against the transaction must show that the deal is not fair enough to justify voting against it.

In a cash transaction, stockholders may also elect to seek appraisal of their shares after the deal has closed in lieu of embracing the difficulty that can arise from trying to hold up a transaction. Plaintiffs can sue for appraisal under the DGCL, but it is very popular to sue to enjoin the transaction. Nearly all announced acquisitions of public companies valued at over a half billion dollars are challenged by lawsuits. Given generous fee-shifting rules in favor of stockholders, some plaintiffs see little downside in pursuing a fiduciary duty action instead of an appraisal.

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33 Compare Reis, 28 A.3d at 457 (cash-out end stage transaction), with Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 39 (Del. 1994) (stock-for-stock exchange).
35 See Cam Merritt, How Does a Shareholder Make Money?, CHRON, archived at https://perma.cc/7LDM-THSJ (explaining that stockholders may want to sell their shares in a buy-out if they are not gaining capital appreciation).
36 In a cash transaction, stockholders may also elect to seek appraisal of their shares after the deal has closed in lieu of embracing the difficulty that can arise from trying to hold up a transaction. See Del. Code Ann. tit. 8, § 262 (2011) (stating appraisal rights of a stockholder).
37 Plaintiffs can sue for appraisal under the DGCL, but it is very popular to sue to enjoin the transaction. Nearly all announced acquisitions of public companies valued at over a half billion dollars are challenged by lawsuits. See Daines & Kourian, supra note 9, at 1 (providing an illustration of the percentage of merger and acquisition deals valued over $500 million that are subject to litigation). Given generous fee-shifting rules in favor of stockholders, some plaintiffs see little downside in pursuing a fiduciary duty action instead of an appraisal. See 1 R. Franklin Balotti & Jesse A. Finkelstein, THE DELAWARE LAW OF CORPORATE & BUSINESS ORGANIZATIONS § 9.37 (3d ed. 2015) (explaining that due to the unavailability of class action and fee shifting, plaintiff stockholders may find an unfair dealing action more attractive).
rule applies presumptively to director actions.\textsuperscript{39} However, as the sale of an entire company is not an everyday decision, circumstances often dictate that the court apply closer scrutiny than it would to a more routine director decision.\textsuperscript{40}

There are two additional forms of scrutiny that the Court of Chancery may apply to a sale of a company instead of applying the business judgment rule. At the extreme end of the spectrum, a judge will closely scrutinize a transaction between a company and its own controlling stockholder to verify that the self-dealing transaction is entirely fair to the minority.\textsuperscript{41} This entire fairness standard is the most favorable to plaintiffs, and it is often easy to tell when it applies.\textsuperscript{42} The court wrestles more often with the closer question, the subject of this Article, of whether to apply the deferential business judgment standard or the somewhat more rigorous Revlon scrutiny.\textsuperscript{43}

B. Revlon

"Avoiding a crude bifurcation of the world into two starkly divergent categories—business judgment rule review reflecting a policy of maximal deference to disinterested board decisionmaking and entire fairness review reflecting a policy of extreme skepticism toward self-dealing decisions"\textsuperscript{44}—the Revlon standard is a judge-made intermediate level of heightened scrutiny in between these two extremes.\textsuperscript{45}

The landmark Revlon decision addressed a stockholder challenge to the Revlon board's adoption of defensive measures in response to a

\textsuperscript{39}See id. at 1179 ("The vast majority of board decisions are insulated from judicial review by the business judgment rule, which is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company.").

\textsuperscript{40}See id. at 1183 ("Enhanced scrutiny also applies in situations when a company is for sale.").

\textsuperscript{41}See id. at 1181-82.

\textsuperscript{42}See S. Muoio & Co. LLC v. Hallmark Entm't Invs. Co., 2011 WL 863007, at *9 (Del. Ch. Mar. 9, 2011). Because the entire fairness standard places the burden on the defendants to show that the transaction was entirely fair, it is the most favorable standard to plaintiffs. For the curious, there are "cleansing" procedures that bring a hand-to-hand transaction out of entire fairness and back into the realm of business judgment, but those are not the subject of this Article. See In re MFW S'holders Litig., 67 A.3d 496, 501 (Del. Ch. 2013) (discussing "cleansing" procedures), aff'd sub. nom. Kahn v. M & F Worldwide Corp., 88 A.3d 635 (Del. 2014).

\textsuperscript{43}See Reis v. Hazelett Strip-Casting Corp., 28 A.3d 442, 457-58 (Del. Ch. 2011) (providing examples of when the business judgment rule applies and when other types of scrutiny apply).

\textsuperscript{44}In re Dollar Thrifty S'holder Litig., 14 A.3d 573, 597 (Del. Ch. 2010).

\textsuperscript{45}See id.
hostile takeover attempt. Pantry Pride Inc. approached Revlon's board to discuss a potential purchase of Revlon at $42-43 per share, which the Revlon board rejected as grossly inadequate. The board implemented defensive measures to prevent a hostile takeover by Pantry Pride at too low of a price. Pantry Pride came back with a much better offer—$53 per share and then later $56 per share. The Revlon board refused to engage Pantry Pride but authorized management to negotiate a merger or buyout with a third party. The Supreme Court of Delaware ruled that the Revlon board erred. Once the board recognized "that the company was for sale," it could not favor one bidder at the expense of another even if it thought some bidders would better preserve corporate value than others. After "it became apparent to all that the break-up of the company was inevitable," the board's usual duty to preserve "Revlon as a corporate entity" disappeared. Instead, 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." In subsequent decisions, Delaware courts have clarified what it means to say that a break-up of a company has become apparent in a way that would trigger Revlon scrutiny. Revlon scrutiny applies in three circumstances: (1) a corporation initiates an active bidding process seeking sale or break-up, (2) a target abandons its long-term strategy in response to an offer and seeks a transaction involving break-up, or (3) the approval of a transaction results in sale or change of control. As a result of any of these Revlon transactions, the stockholders' ability to hold their directors accountable for corporate decisions disappears.

The directors no longer face re-election by the stockholders and thus, the
court reasons, may see the opportunity to act on self-interested motives. When circumstances show the board that a "break-up of the company" is inevitable, directors may see the opportunity to exit their obligations as well as their investments. Sometimes directors who have been on the board for a few years experience investment fatigue and grow eager to cash out their shares and move on to a new project. In the alternative, the directors may secure for themselves a "continuing interest . . . in the surviving entity" without creating one for the stockholders.

The Revlon standard increases "the intensity of judicial review that is applied to the directors' conduct." The court must take a nuanced and realistic look at the possibility that personal interests short of pure self-dealing have influenced the board to block a bid or to steer a deal to one bidder rather than another. When Revlon scrutiny is triggered, the court requires stronger justification for directors' actions than the bare

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58 See id.; see also White-Smith, supra note 38, at 1177 (observing that it is not the best practice to "send out the salesman who just put in his two weeks' notice"). White-Smith discusses what he dubs the "Control Premium Theory," but that theory is unrelated to the control premium discussion in this Article. See id. at 1179 ("Part II analyzes the stated rationale—the control premium theory—for varying judicial scrutiny based on the method of payment in corporate takeovers."). Instead, White-Smith argues that cash and stock are "almost always completely fungible." Id. at 1205.

59 See Reis, 28 A.3d at 458 & n.6 (explaining that in a final stage transaction, managers may be "more likely to favor their own interests"); see also Revlon, 506 A.2d at 182. It is important to note, however, that a claim that factors are present that may challenge the loyalty of directors does not transform a claim for a breach of the duty of care into a breach of the duty of loyalty. In other words, not all claims under this level of scrutiny actually implicate loyalty, and the duties of care and loyalty do not become intertwined in a sale. See Stephen M. Bainbridge, The Geography of Revlon-Land, 81 FORDHAM L. REV. 3277, 3293-94 (2013) (explaining there is a difference between a claim under duty of loyalty and a claim under duty of care; thus, implying that the two do not become intertwined). The scrutiny is applied because "a court evaluating the propriety of a change of control must be mindful of 'the omnipresent specter that a board may be acting primarily in its own interest . . . ." Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989) (quoting Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 1279, 1286 (Del. 1985)).

60 See Jay Hartzell et al., What's In It For Me? Personal Benefits Obtained by CEO's Whose Firms Are Acquired, 17 REV. FIN. STUD. 37, 37 (2004) (implying that executives often know who will occupy the CEO position of the merged company and who will be on the board; thus, if executives do not like what they see, and do not think the merged company will do well, the executives may sell their investment).


62 In re Smurfit-Stone Container Corp. S'holder Litig., 2011 WL 2028076, at *13 (Del. Ch. May 24, 2011), reprinted in 37 DEL. J. CORP. L. 261 (2012) (stating that for present shareholders in a company that will be sold, there is no long run for them, implying that they will not have a continuing interest in the company).

63 Chen v. Howard-Anderson, 87 A.3d 648, 673 (Del. Ch. 2014) (quoting In re Netsmart Techs., Inc. S'holder Litig., 924 A.2d 171, 192 (Del. Ch. 2007)).

64 In re Dollar Thrifty S'holder Litig., 14 A.3d 573, 598 (Del. Ch. 2010).
"rationality" of the business judgment rule applicable to "garden-variety decisions." Instead, the court assesses the directors' actions for "reasonableness." Yet, the Revlon standard is still generally deferential. Even under this heightened standard, "courts will not substitute their business judgment for that of the directors, but will determine if the directors' decision was, on balance, within a range of reasonableness."

In addition to heightened scrutiny, the Revlon decision imposed stricter obligations on the board than those imposed by the business judgment rule. Once the directors see that a future Revlon transaction is implicated by company and market forces, they must focus their efforts on value for the soon-to-be-cashed-out stockholders, even at the expense of officers, employees, or, as was the case in Revlon, noteholders. Directors are forbidden to "play[] favorites" among bidders for any reason other than maximizing stockholder value. As noted above, although there is "no single blueprint" directors must follow to maximize value, in a Revlon situation directors encouraged act as "auctioneers."
C. Business Combinations versus End-Stage Transactions

Heightened scrutiny does not apply to all transactions that extinguish the fiduciary relationship between a board of directors and its stockholders.\footnote{J. Travis Laster, Revlon Is a Standard of Review: Why It's True and What It Means, 19 FORDHAM J. CORP. & FIN. L. 5, 33-35 (2013). The article describes and laments "Delaware law's nominally disparate treatment of third-party mergers." \textit{Id.} at 6. It should be noted that while Vice Chancellor Laster's well-known article advocates a unified standard to apply to both cash and stock transactions, this Article seeks only to resolve the use of the standards in their present forms as applied to a mixed consideration transaction.} When the acquiring company uses its shares that trade in a "large, fluid, changeable and changing market" to buy the target shares—so long as there is no controlling stockholder in the acquiring corporation—the deferential business judgment rule applies.\footnote{Arnold v. Soc'y for Sav. Bancorp., Inc., 650 A.2d 1270, 1289-90 (Del. 1994).} The court reasons that stock-for-stock exchanges are often synergistic business combinations that do not signal abandonment of the target's long-term strategy.\footnote{See, e.g., Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1150-51 (Del. 1990).} Therefore, the court allows the business judgment rule to apply because the business of the target corporation is not over and the stockholders' investment continues.\footnote{See Equity-Linked Investors, L.P. v. Adams, 705 A.2d 1040, 1055 (Del. Ch. 1997): The holding of \textit{Paramount}, however, was that where the stock to be received in the merger was the stock of a corporation under the control of a single individual or a control group, then the transaction should be treated for "\textit{Revlon} duty" purposes as a cash merger would be treated: there is no "tomorrow" for the stockholders (no assured long-term), the board's obligation is to make a good faith, informed judgment to maximize current share value, and the court reviews such determinations on a 'reasonableness' basis, which otherwise they would not do.}

The most important time to apply \textit{Revlon} scrutiny to a transaction, rather than the business judgment rule, is in an end-stage transaction in which the investors have "no tomorrow" for their chosen investment.\footnote{See McGowan v. Ferro, 859 A.2d 1012, 1032 (Del. Ch. 2004); see also Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 47 (Del. 1993) (quoting \textit{Time}, 571 A.2d at 1150) (enhanced scrutiny applies when "a target abandons its long-term strategy and seeks an alternative transaction involving the breakup of the company.").} When stockholders "will forever be shut out from future profits generated by the resulting entity as well as the possibility of obtaining a control premium in a subsequent transaction," they need recourse if the transaction is the product of an inadequate process.\footnote{\textit{In re Smurfit-Stone Container Corp. S'holder Litig.}, 2011 WL 2028076, at *13 (Del. Ch. May 24, 2011), \textit{reprinted in} 37 DEL. J. CORP. L. 261 (2012).} On the other hand, it would be peculiar and inaccurate to dub someone an "auctioneer" of an
extinguished company when, according to Delaware law, the company and its stockholders live on.\(^{80}\)

But it is not always clear whether the stockholders have a "tomorrow." As Chancellor Allen foresaw, "[h]ow this 'change in control' trigger works in instances of mixed cash and stock or other paper awaits future cases."\(^{81}\)

III. THE DILEMMA OF MIXED CONSIDERATION

As explained above, if an acquirer pays for all of the target shares using stock, the business judgment rule will generally apply.\(^{82}\) If, on the other hand, the acquirer pays in all cash, then Delaware courts apply heightened Revlon scrutiny.\(^{83}\) Not all transactions are so tidy, and sometimes acquirers will pay with a mix of cash and stock.\(^{84}\) Delaware courts thus must apply a binary choice of standards of review to a spectrum of transactions.\(^{85}\) When plaintiffs challenge the adequacy of mixed consideration, Delaware courts must evaluate the transaction on a case-by-case basis.\(^{86}\) Does the challenged mixed consideration transaction look more like a strategic combination with a cash bonus, or does it look more like the break-up of the company, perhaps with a token amount of stock in the new company? Is there a long run for stockholders?

Delaware courts have found that a mixed consideration transaction with a significant stock component is eligible for business judgment deference as though it were a pure stock-for-stock deal.\(^{87}\) Delaware first considered whether to apply Revlon to a mixed consideration transaction in the 1995 Santa Fe Pacific litigation.\(^{88}\) After a bidding war, Burlington


\(^{82}\) See Equity-Linked Investors, 705 A.2d at 1055.

\(^{83}\) See id. § 15.02, at 21.

\(^{84}\) See, e.g., In re Smurfit-Stone, 2011 WL 2028076, at *11.

\(^{85}\) See id. at *11-16.


\(^{87}\) See, e.g., In re Santa Fe Pac. Corp. S'holder Litig., 669 A.2d 59, 71 (Del. 1995).

\(^{88}\) Id. In considering the merits of a settlement, prior to the Santa Fe decision, Chancellor Allen assumed Revlon would have applied to a challenge to a mixed consideration transaction had the litigation gone forward, but the Chancellor did not weigh whether the business judgment rule would apply. See In re Amsted Indus. Inc. Litig., 1988 WL 92736 (Del. Ch. Aug. 24, 1988), reprinted in 14 DEL. J. CORP. L. 611 (1989).
Northern Inc. contracted to purchase Santa Fe in a two-step merger. First, Burlington and Santa Fe together executed a tender offer for 33% of Santa Fe shares for $20 in cash. Second, the remaining 67% of shares were converted into shares of Burlington valued at $20.60 per share. The Supreme Court of Delaware observed that the Santa Fe board remained "firmly committed to a stock-for-stock merger," rather than a cash merger, throughout its strategic alternatives process. Recognizing that exchanging publicly traded stock for similar stock that also traded in "a large, fluid, changeable and changing market" signified that the transaction was a business combination with a cash component, the Court applied the business judgment rule instead of heightened scrutiny.

In 2012, the Court of Chancery in *In re Synthes, Inc., Shareholder Litigation* similarly held that heightened scrutiny was not triggered when 65% of the consideration was stock in the acquiring entity. The plaintiff argued that after the deal closed, the stockholders would not have any further opportunity to get a control premium for their shares. The court rejected this theory, ruling that enhanced scrutiny did not apply because by receiving 65% of the merger consideration in stock, the stockholders had a substantial continuing interest in the surviving company. There was a "tomorrow" for their investment.

Otherwise, because challenges to mixed consideration transactions typically fail to state an adequate claim under either *Revlon* or business judgment scrutiny, in cases that were less clear than *Synthes* and *Santa Fe*, courts have assumed without deciding that heightened scrutiny applies to transactions in gray areas. In 1999, the Court of Chancery distinguished the Santa Fe transaction, in which only 33% of stockholders tendered their shares for cash, from the transaction in which Bethlehem Steel purchased Lukens Inc. Instead of giving all

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89 *In re Santa Fe*, 669 A.2d at 63-64.
90 *Id.* at 64.
91 *Id.*
92 *Id.* at 71.
95 *Id.* at 1031.
96 *Id.* at 1048.
97 See id.
98 See Manesh, *supra* note 2, at 13 ("Although the lower court has stated this principle on multiple occasions, each time it has been nonbinding dictum, unnecessary to the court's ultimate decision."). Manesh provides a thorough and useful review of the mixed consideration cases for the interested reader.
stockholders a mix of cash and stock, Bethlehem Steel paid approximately 62% of the stockholders in cash for their investment, and the remaining 38% were paid in stock in the new entity.\textsuperscript{100} As a result, "some—perhaps most—shareholders in Lukens liquidated their entire investment in the target corporation."\textsuperscript{101}

In dismissing the stockholder challenge, the Court of Chancery declined to rule whether Revlon scrutiny was applicable because the complaint deserved dismissal regardless of the standard of review.\textsuperscript{102} The court included a footnote, however, observing that it could not "understand how the Director Defendants were not obliged, in the circumstances, to seek out the best price reasonably available . . . . Whether 62% or 100% of the consideration was to be in cash . . . for a substantial majority of the then-current shareholders, 'there is no long run.'\textsuperscript{103}

This observation about a majority of stockholders has been interpreted in subsequent decisions to mean majority of consideration.\textsuperscript{104} In 2011, this question came to a head when several companies came forward to bid on Smurfit-Stone as it emerged from bankruptcy.\textsuperscript{105} Ultimately, Rock-Tenn emerged the victor after an auction, bidding $35 per share at a 50/50 mix of cash and stock.\textsuperscript{106} This offer represented a 27% premium to the then-trading price and a greater than 50% premium over the share price of the company when it first began trading after emerging from bankruptcy.\textsuperscript{107} The Court of Chancery finally had the opportunity to rule whether "merger consideration . . . split roughly evenly between cash and stock" warranted heightened scrutiny.\textsuperscript{108}

The court chose to "assume without deciding that the Revlon standard applies" to a "50/50 mix of cash and stock consideration," although this conclusion was "not free from doubt."\textsuperscript{109} It reasoned that half of Smurfit-Stone's stock would have "no tomorrow."\textsuperscript{110} That is to say, the stockholders would have neither a share in future profits nor the
opportunity to obtain a control premium in a subsequent transaction. The Court of Chancery held that by receiving 50% of the consideration in cash, the stockholders were sufficiently cashed-out to warrant Revlon scrutiny. "[T]he concern here is that there is no 'tomorrow' for approximately 50% of each shareholder's investment in Smurfit-Stone." The court held this without noting that the transaction premium meant that, using market value, more than half of the target stockholders' stock would be replaced with new stock. The court then denied the motion for preliminary injunction applying heightened Revlon scrutiny.

Subsequently, in In re Plains Exploration & Production Co. Stockholder Litigation, the Court of Chancery applied Revlon scrutiny to a 50/50 split transaction with a high premium. The price paid "represented a 39 percent premium to Plains' closing price on December 4, 2012, the day before the merger agreement was executed, and a 42 percent premium to the prior one-month average closing price." Since the transaction had been announced, "no competing bidder ha[d] emerged 'despite relatively mildly deal protection devices,'" and the Plains court was persuaded that this was likely due to the strength of the premium that the acquirer was paying for the Plains shares. Ultimately, the standard of review chosen did not end up being critical because the court ruled that the deal survived Revlon scrutiny.

One opinion, Chen v. Howard-Anderson, deviated from this trend towards a 50% threshold. In a challenge to a proposed 2010 transaction in which Calix contracted to acquire Occam for consideration valued at $7.75 per share representing a 60% premium to the going market price, the Court of Chancery issued a transcript ruling applying Revlon scrutiny. Although it was difficult to calculate, approximately half of the overall estimated price was to be paid in cash, and the

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111 Id. at *13.
112 In re Smurfit-Stone, 2011 WL 2028076, at *16.
113 Id. at *14.
114 Id. at *11.
115 Id. at *1, *26.
116 2013 WL 1909124, at *11 n.32 (Del. Ch. May 9, 2013).
117 Id. at *6.
118 Id. at *4, *6.
119 Id. at *11.
120 87 A.3d 648 (Del. Ch. 2014).
121 Id. at 664, 667; see also Laster, supra note 74, at 53 (criticizing the application of the business judgment rule to stock-for-stock transactions, and instead advocating applying Revlon more broadly).
remainder would be paid in Calix shares. The stockholder plaintiff sought a preliminary injunction enjoining the transaction.

At the preliminary injunction hearing, the Court of Chancery refused to "dance on the head of a pin as to whether it's 49 percent cash or 51 percent cash" in deciding the level of scrutiny to apply to the expedited case. Regardless of the break-down of cash and stock in the transaction, the court held that the sale presented "the only chance that Occam stockholders have to extract a premium, both in the sense of maximizing cash now, and in the sense of maximizing their relative share of the future entity's control premium." The court noted that the standard of review did not, at any rate, matter in the case at bar. Just as it did in Lukens, Smurfit-Stone, and Plains, the court ruled that even under the stricter standard, Occam's process passed muster, and the stockholders were not entitled to a preliminary injunction for their Revlon claim.

In his opinion in Synthes, then-Chancellor Strine expressly rejected the Chen reasoning that the amount of stock did not matter in determining the standard of review: "[U]nder binding authority of our Supreme Court as set forth in QVC and its progeny, Revlon duties only apply when a corporation undertakes a transaction that results in the sale or change of control." The court held that, under Santa Fe, consideration of approximately 65% stock "did not trigger Revlon review when there was no basis to infer that the stock portion of that consideration was stock in a controlled company. That decision is binding precedent."

Thus, Delaware courts have yet to consider a case in which the level of scrutiny selected would be dispositive—i.e., where the plaintiffs would prevail under Revlon but lose under the business judgment rule. In every case in which the courts have grappled with the question of

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123 Chen, 87 A.3d at 664.
125 Id. at 7.
126 Id. at 6, 7.
127 Id. at 3, 7-8. The court did grant a limited injunction based on the disclosure claim. Id. at 3.
129 Id. at 1048.
130 See In re Lukens Inc. S'holders Litig., 757 A.2d 720, 732 n.25 (Del. Ch. 1999) (noting that the Supreme Court of Delaware had not established a bright-line test for applying enhanced scrutiny for a cash and stock transaction).
whether Revlon might apply to a mixed consideration transaction, they have held that it was unnecessary to reach the question, because the plaintiff's challenge would fail regardless of the standard of review.\footnote{131} However, because the courts have not yet needed to rule definitively when Revlon must apply, we find ourselves with a regime, based on dicta from a handful of cases, giving plaintiffs potential access to Revlon scrutiny for transactions in which the stockholders are receiving stock worth a substantial percentage of the stock they are surrendering.\footnote{132} The courts risk mistakenly looking at strategic business combinations through the lens of an end-stage transaction and deeming directors of a continuing enterprise to be auctioneers.\footnote{133} Plaintiffs who believe they will get Revlon scrutiny may be more willing to drive up litigation costs.\footnote{134}

IV. THE PROBLEM WITH THE DENOMINATOR: ILLUSTRATIONS

As explained above, the courts currently use the below ratio as a shorthand for determining whether the target stockholders' investments mostly (more than 50%) survive or mostly end.\footnote{135}

\[
\frac{\text{Total Market Value of Acquirer's Stock Paid in the Transaction}}{\text{Total Per Share Merger Consideration (sum of above and cash)}}
\]

At present, corporations can expect that Revlon scrutiny will apply to any sale in which more than half of the consideration is paid in cash, in other words, if the above ratio is less than 50%.\footnote{136} If more than half of that value is replaced with cash, it is reasonable to conclude that more than half of the stockholder's investment is therefore disappearing.\footnote{137} As

\footnotetext[132]{See Bainbridge, supra note 59, at 3326.}
\footnotetext[133]{See, e.g., Transcript of Oral Argument at 4, 5, Chen v. Howard-Anderson, 87 A.3d 648 (Del. Ch. 2014) (No. 5878-VCL) (noting that the termination of an interest in Occam is the last chance an owner will have to exercise rights under Occam prior to its final sale).}
\footnotetext[134]{See, e.g., In re Smurfit-Stone, 2011 WL 2028076, at *11.}
\footnotetext[136]{See In re Lukens, 757 A.2d at 732 n.25; In re Smurfit-Stone, 2011 WL 2028076, at *16; In re Plains, 2013 WL 1909124, at *1, *4.}
\footnotetext[137]{In re Smurfit-Stone, 2011 WL 2028076, at *14 ("[T]he concern here is that there is no 'tomorrow' for approximately 50% of each stockholder's investment in Smurfit-Stone."). Note that here the comparison to Lukens is somewhat imperfect. In Lukens, 62% of the
illustrated below, however, using the deal price as a stand-in for investment value is imperfect and may inadvertently penalize boards that obtain a higher price.\footnote{See infra Part IV.A; see also Hamermesh, supra note 11, at 886-89.}

One reason that overall deal price is frequently not an ideal stand-in for investment value is that acquirers are not valuing their targets as stand-alone investments and then paying that value.\footnote{JENS KENGBACH ET AL., BOSTON CONSULTING GRP., DIVIDE & CONQUER: HOW SUCCESSFUL M&A DEALS SPLIT THE SYNERGIES 3, 5 (2013), archived at https://perma.cc/UX7L-JKT7.} An acquirer values a target in view of how much value that acquirer could obtain by incorporating the target into its business and under its own management.\footnote{Id.} For this reason, among others, acquirers usually pay a premium to the target stockholders over and above the market price of the shares.\footnote{See Hamermesh, supra note 11, at 881.}

In today's market, acquirers have proven willing to pay generous premiums to achieve control over a previously public company.\footnote{A study of major M&A deals during 2013 and 2014 reflected average deal premiums in excess of 30% for every quarter. U.S. M&A News and Trends, FACTSET FLASHWIRE US MONTHLY, (Nov. 2014), archived at https://perma.cc/9TJK-DM3R.} In at least one noteworthy deal, the target shareholders received a premium in excess of 100% of the stock price.\footnote{One acquirer offered a startling 163% above the share price the day before the announcement. Bristol-Myers (BMY) Acquires Inhibitex (INHX) at 163% Premium, STREETINSIDER (Jan. 7, 2012, 11:16 PM), archived at https://perma.cc/3TQ3-EDQR, see also Hamermesh, supra note 11, at 883-86. Even in a stock-for-stock merger where stockholders do share in merger gains, the acquirer often pays a premium to the target. Id. at 886. The acquirer may believe that the economic significance of issuing shares is relatively insignificant in comparison to the opportunity to corner a greater market share in an industry. Id. at 888. Whatever the reason, acquirers—even acquirers who are not controllers—are often willing to pay more than the market rate for shares in exchange for the benefits of joining forces (a benefit that can be difficult to quantify).}

Second, the current fraction uses the end-stage price to value the target stock but the market price to value the acquirer's stock.\footnote{See In re Smurfit-Stone Container Corp. S'holder Litig., 2011 WL 2028076, at *8, *9, *26 (Del. Ch. May 24, 2011), reprinted in 37 DEL. J. CORP. L. 261 (2012); In re Plains Exploration & Prod. Co. S'holder Litig., 2013 WL 1909124, at *6 (Del. Ch. May 9, 2013).} The market price for the acquirer's stock does not include an eventual premium even though the acquirer could expect to receive a premium in

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\footnote{See infra Part IV.A; see also Hamermesh, supra note 11, at 886-89.}

\footnote{JENS KENGBACH ET AL., BOSTON CONSULTING GRP., DIVIDE & CONQUER: HOW SUCCESSFUL M&A DEALS SPLIT THE SYNERGIES 3, 5 (2013), archived at https://perma.cc/UX7L-JKT7.}

\footnote{Id.}

\footnote{See Hamermesh, supra note 11, at 881.}


\footnote{One acquirer offered a startling 163% above the share price the day before the announcement. Bristol-Myers (BMY) Acquires Inhibitex (INHX) at 163% Premium, STREETINSIDER (Jan. 7, 2012, 11:16 PM), archived at https://perma.cc/3TQ3-EDQR, see also Hamermesh, supra note 11, at 883-86. Even in a stock-for-stock merger where stockholders do share in merger gains, the acquirer often pays a premium to the target. Id. at 886. The acquirer may believe that the economic significance of issuing shares is relatively insignificant in comparison to the opportunity to corner a greater market share in an industry. Id. at 888. Whatever the reason, acquirers—even acquirers who are not controllers—are often willing to pay more than the market rate for shares in exchange for the benefits of joining forces (a benefit that can be difficult to quantify).}

a future sale, just like the target. Thus, the decided cases have been using two different kinds of prices as a stand-in for the same concept: The value of the investment. Using this metric, either the target price is overvalued by including a premium, or the acquirer's value is undervalued by failing to include one. Since the court presumably cannot undertake a full appraisal of the premium value of the acquirer's stock to answer a threshold question regarding the burden of proof, it makes the most sense to use the more readily-available market price of both the target and acquirer's shares.

A. Illustrations: How Negotiating a Premium Could Hurt the Directors' Litigation Position

The Plains case, discussed above in which the Court of Chancery applied Revlon scrutiny to a 50/50 split of cash and stock, illustrates why the presence of a premium makes merger consideration a poor proxy for investment value. The total price paid to the Plains stockholders was valued at approximately $50 per share. Half of that consideration was cash; the other half was McMoRan stock valued at approximately $25. However, the total consideration gave stockholders a sizeable premium over the recent one-month average share price of approximately $35.

1. Hypothetical: Stock-for-Stock Trade

Comparing the pre-announcement market trading value of the McMoRan stock to the cash and stock deal price that included a premium is like comparing apples to oranges. If we were to compare the values apples-to-apples, the market trading value of the surrendered Plains stock, $25 per share is much more than half of the market trading value of the McMoran stock at $35 per share. In fact, had the transaction been structured as a pure stock-for-stock transaction in which Plains stock valued at approximately $35 was traded for McMoRan stock

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146 See In re Santa Fe Pac. Corp. S'holder Litig., 669 A.2d 59, 64 (Del. 1995); In re Synthes S'holder Litig., 50 A.3d 1022, 1029, 1030 (Del. Ch. 2012); In re Lukens Inc. S'holders Litig., 757 A.2d 720, 725 (Del. Ch. 1999); In re Smurfit-Stone, 2011 WL 2028076, at *9; In re Plains, 2013 WL 1909124, at *1, 6.
147 In re Plains, 2013 WL 1909124, at *4.
148 Id.
149 Id. at *1.
150 Id. at *6.
valued at approximately $35, the business judgment rule would have applied even with no premium for the Plains stockholders.\footnote{\textit{See Arnold v. Soc'y for Sav. Bancorp, Inc.}, 650 A.2d 1270, 1290 (Del. 1994).}

Ironically, the real deal—in which Plains stockholders received much more economic value than they would have received in the hypothetical stock-for-stock deal—was subjected to a higher level of scrutiny.\footnote{\textit{In re Plains}, 2013 WL 1909124, at *11.} Under the business judgment rule, this hypothetical stock-for-stock deal would not be ideal from an economic perspective, but absent some other indication that the directors breached their fiduciary duties, it is hard to argue that such a business combination would have been beyond the realm of rationality.\footnote{See \textit{id.} at *1.} The directors who secured a better deal had more to prove and a greater chance of losing the lawsuit than the hypothetical directors who accepted the stock-for-stock offer.\footnote{\textit{Id.} at *4.}

Thus, the modified \textit{Plains} hypothetical demonstrates why viewing mixed cash and stock deals through a stock-for-stock lens would be more in keeping with the DGCL principle of judicial restraint.\footnote{\textit{Weinberger v. United Fin. Corp. of Cal.}, 1983 WL 20290, at *6 (Del. Ch. Oct. 13, 1983); \textit{In re Rural Metro Corp.}, 88 A.3d 54, 87 (Del. Ch. 2014), \textit{aff'd sub nom. RBC Capital Mkts., LLC v. Jervis}, 129 A.3d 816 (Del. 2015).} It does not make sense for a court to scrutinize closely a transaction offering more economic value to stockholders when it would have afforded business judgment review to a stock-only transaction at lower economic value.\footnote{\textit{See Arnold}, 650 A.2d at 1290.} But the \textit{Plains} hypothetical, expanded below, reveals a second and more urgent problem: The test interferes with the business judgment rule as a substantive law designed to protect directors who take beneficial risks from undue court interference.\footnote{\textit{See In re Rural Metro}, 88 A.3d at 87.} As illustrated below, the current method for assessing investment value using the deal price inadvertently creates a potential litigation penalty for directors who negotiate well.

2. Hypothetical: Directors Bid Against Themselves

Imagine a hypothetical back and forth negotiation between Plains and McMoRan. McMoRan approaches Plains and offers a pure stock-for-stock trade: $35 of McMoRan stock for $35 of Plains stock. If Plains were to accept this transaction, as already discussed, the court would
analyze the transaction under the deferential business judgment standard.\textsuperscript{159}

But suppose the Plains directors, doing their best to act as good fiduciaries, demanded a higher price from McMoRan. McMoRan's second offer is the actual deal price paid in that transaction: $25 in McMoRan stock and $25 in cash. Ironically, this undoubtedly superior offer was scrutinized under the stricter \textit{Revlon} standard.\textsuperscript{160} If Plains' directors are keen to avoid litigation in which they could become defendants, those directors are incentivized to have Plains bid against itself.\textsuperscript{161} If McMoRan had only kicked in $24 in cash in addition to its $25 in stock, directors could enjoy the protections of the business judgment rule in a suit.\textsuperscript{162} This runs counter to one of the fundamental purposes of \textit{Revlon}: To reduce the likelihood that directors will act out of self-interest when considering a potential transaction.\textsuperscript{163}

Consider a third imaginary bid, this time illustrating not only how the current test creates perverse incentives, but also how employing the test could represent an overreach of judicial authority. Imagine the Plains directors are very tough negotiators, and McMoRan needs to acquire Plains in order to compete with its rivals. Desperate, McMoRan offers Plains stockholders a staggering $80 in consideration consisting of $40 of stock and $40 of cash yielding a premium in excess of 100\% of the current trading value of the Plains stock.\textsuperscript{164} In the absurd example, the stockholders are getting stock valued higher than their current stockholdings, plus the same amount of cash. Arguably, the Plains stockholders' investment in the continuing company is growing, not ending. But if a stockholder sued, under the current test, the court would scrutinize this transaction under the \textit{Revlon} standard as though these lucky stockholders had "no tomorrow" for their investment.\textsuperscript{165}

\begin{footnotes}
\item[159] See Arnold, 650 A.2d at 1290.
\item[161] See id.
\item[164] The reader may wonder what kind of stockholder would try to halt a transaction offering a 200\% premium. The example is intentionally absurd to illustrate the problem with using merger consideration as the basis for determining the level of scrutiny to apply. But in reality, even a transaction with a very high premium can attract a lawsuit. Lawsuits challenged 96\% of large deals announced in 2012, even as deal premiums rose. \textit{Daines & Koumbrian, supra} note 9, at 1. While hyperbolic, the example is not beyond the realm of possibility.
\item[165] See \textit{In re} Smurfit-Stone, 2011 WL 2028076, at *16; \textit{In re Plains}, 2013 WL 1909124, at *1, 4.
\end{footnotes}
Although the challenge would not likely succeed (absent a ludicrous gap of information in the market making the trade price wildly inaccurate), the transaction would be analyzed under *Revlon* scrutiny.\(^\text{166}\) The directors' personal incentive to avoid a lawsuit in this scenario runs counter to the stockholders' interest in gaining the best price readily available.\(^\text{167}\) Plains directors are peculiarly incentivized to bid against themselves.

V. POTENTIAL SOLUTION: COMPARE STOCK-TO-STOCK

*Market Value of Acquirer’s Stock Paid in the Transaction*

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*Market Value of the Target’s Stock Surrendered in the Transaction*

As suggested by the above examples, in order to determine whether more than half of the stockholders' investments survive a transaction, the courts should compare the pre-announcement market price of the target stock to the value of the stock portion of the transaction.\(^\text{168}\)

\(^{166}\)See *In re Smurfit-Stone*, 2011 WL 2028076, at *16.

\(^{167}\)Strine, *supra* note 13, at 684 n.8 ("Restructuring a transaction to make it take a form, for example, that does not invoke *Revlon* duties, does not mean that the transaction is a good one for investors"). Selfishly avoiding litigation by devaluing Plains stock may be a serious breach of duty. On the other hand, directors have a duty to enter into a transaction that is likely to close, if that transaction offers the best value available. Directors may be acting properly in crafting a transaction designed to avoid attracting a lawsuit.
transaction. If the stock offered by the acquirer is worth more than half of the value of the stock given up by the target stockholders, it is reasonable to conclude that the investment is, by-and-large, continuing. The stockholders in high-premium, mixed-consideration transactions receive a control premium now and retain the chance to gain another control premium in the future. The cash portion of the transaction can fairly be viewed as a one-time dividend payment in anticipation of merger-related synergies.

This is an apples-to-apples comparison because both stocks are being compared as the market values them without taking into account a potential control premium. The market's valuation of the stand-alone entity, as discussed above, more closely resembles the value of the target investment than the merger price, which reflects potential synergies or gains as a result of the merger.

In addition, this formulation avoids imposing unintended selfish motives on directors who want to avoid a lawsuit. In our hypothetical bid scenario illustrated in Figure 1 above, once Bid 1 crossed the threshold of providing stock worth more than half of the value of the target stock, the directors would be protected by business judgment so long as the negotiations caused overall consideration to increase without a decrease in the amount of stock offered per share. There would be no litigation downside to asking the bidder to throw in additional cash, additional stock, or the kitchen sink. In this way, the level of scrutiny becomes aligned with the directors' duties by encouraging them to act in the best interests of stockholders.

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168 See White-Smith, supra note 38, at 1194-96. The proposed test will avoid the end-stage transaction, described supra in Part I, because it will provide the target shareholder the opportunity to receive a control premium. The end-stage transaction was first introduced to Delaware courts in TW Services, Inc. v. SWT Acquisition Corp., where the Court of Chancery explained that in a wholly cash acquisition, the target shareholders are estopped from "sacrificing achievable share value today in the hope of greater long term value," and "is not present when all of the current shareholders will be removed from the field by the contemplated transaction." 1989 WL 20290, at *7 (Del. Ch. Mar. 2, 1989).

169 In re Smurfit-Stone, 2011 WL 2028076, at *12.

170 Merger-related synergy occurs when the value and performance of the acquirer and the target combined has a greater value than the sum of each individual companies. If the target shareholders receive the cash portion of the acquisition as a dividend, the shareholders enjoy the benefit of receiving cash now and the opportunity to increase their investment in the future.

171 As suggested supra Part III, an apples-to-apples comparison in which the court attempted to prognosticate the value of the future control premium for the acquirer and compared that value to the merger price would be highly impractical.

172 See KENGBACH ET AL., supra note 139, at 3.

173 See Strine, supra note 13, at 684 n.8.

174 See Hollinger Int'l, Inc. v. Black, 844 A.2d 1022, 1078 (Del. Ch. 2004) ("The DGCL is intentionally designed to provide directors and stockholders with flexible authority,
One might object that such a test would be too lenient and would give directors of the target too much leeway to behave self-interestedly without being scrutinized in a transaction that is very nearly an end-stage transaction. The response is three-fold. First, as illustrated above, this test alleviates one possible motive for behaving self-interestedly by removing a counter-incentive against negotiating for more cash.

Second, an objection to the proposed stock-to-stock test, on those grounds, is akin to reasoning behind the transcript ruling in *Chen*.

In other words, the objection is more addressed to the current standard for deciding to apply *Revlon* scrutiny, which allows directors to avoid closer scrutiny in a strategic stock-for-stock combination, than it is to the proposed test. Some deals that do not look like good deals, like the hypothetical $35 of stock for $35 of stock exchange, may get business judgment scrutiny under the current regime. But this is not a fault in the proposed test; rather, it is a criticism of the broader system, and it is a criticism that has been made aptly elsewhere.

Although the *Chen* transcript has not been overruled, its reasoning was criticized by then-Chancellor Strine in *Synthes*.

Third, at present, *Revlon* scrutiny applies automatically if a controlling stockholder of the buyer obtains majority control over the surviving entity regardless of the form of consideration. Thus, if there is no controller of the combined entity, and instead the acquirer's shareholders and the target's shareholders jointly hold the resulting company, there is no loss of a chance at a control premium. Even if the transaction is not perfect, the stockholders nevertheless retain a significant opportunity to seek a future control premium under this test.

One valid objection to this stock-to-stock comparison test is that administering it may not be completely straightforward. The Article's...
suggestion calls upon the courts to examine the value of two stocks instead of one, and it is likely that Delaware law will not be able to settle a single metric—for example the price of both stocks the day before the merger announcement—and apply it to every case.\textsuperscript{181} Instead, the parties are likely to argue in preliminary injunction briefing over what time period the court should use to value each stock.\textsuperscript{182} For example, should the court use the day before the merger announcement, a 30-day average, or a 90-day average?\textsuperscript{183} The Delaware Court of Chancery is, of course, not known for shying away from difficult math at the expense of intellectual honesty.\textsuperscript{184} But if it is true that this proposed test is less simple than the current test, or at least just as difficult, that undermines the idea that application of it could reduce overall litigation costs and effort. Just as with the current test, the parties may spend time arguing over which standard of review would apply.\textsuperscript{185}

In one way, the proposed test has the potential to be more straightforward than the current test. The current test requires the court to calculate a cash-equivalent value for the acquirer's stock and a cash-equivalent value for the overall consideration.\textsuperscript{186} Such a calculation can be tricky since stock prices are often somewhat volatile.\textsuperscript{187} The proposed test instead depends on calculating the ratio of target stock value to the acquirer's stock value. Under this apples-to-apples test, it is not necessary to discern an exact cash value for either stock. Instead, the court could choose to look at a set of ratios comparing target price to the value of the amount of the acquirer's stock to be paid per target share.\textsuperscript{188} The court could choose to look at, for example, all three of the one-day, 30-day, and 90-day average stock values for both stocks to look for patterns. Using a ratio instead of attempting to pinpoint a cash value will give the court a clearer glimpse into the fuzziness of long-term investment value that is subject to the daily whims of the market. As this

\begin{itemize}
  \item \textsuperscript{181}See \textit{In re Dollar Thrifty S'holder Litig.}, 14 A.3d 573, 585 (Del. Ch. 2010).
  \item \textsuperscript{182}See \textit{id}.
  \item \textsuperscript{183}See \textit{id}. (discussing the premium paid over the stock price for each metric).
  \item \textsuperscript{185}See \textit{ supra} Part II.
  \item \textsuperscript{186}See \textit{ supra} Part IV; \textit{In re Smurfit-Stone Container Corp. S'holder Litig.}, 2011 WL 2028076, at *11 (Del. Ch. May 24, 2011), \textit{reprinted in 37 DEL. J. CORP. L.} 261 (2012).
  \item \textsuperscript{188}See White-Smith, \textit{ supra} note 38, at 1194-96.
\end{itemize}
Article has demonstrated, it makes sense to use a ratio or proportion when the court is trying to discern whether an investment is—on average—surviving. Thus, a ratio is a better tool for determining what proportion of a stockholder's investment survives than a pinpoint cash value.

VI. CONCLUSION

Assuming that the Court of Chancery intends to continue to scrutinize business combinations paid for in stock differently from cash-out mergers, the proposed test will assist the court as it seeks to determine what standard of review to apply. The market reality, under Delaware law, is that a stockholder's investment mostly survives so long as most of her stock is replaced with new stock, regardless of what else happens in the transaction. Using this metric, the court can preserve its commitment to exercise maximum judicial restraint in evaluating director decisions that do not terminate their stockholders' investments, incentivize economically beneficial deal-making, avoid inadvertently creating a conflict between a director's fiduciary duties and a selfish desire to avoid litigation, and align its test with the values of the DGCL.

189 See supra Part V.