THE TWILIGHT OF ENHANCED SCRUTINY IN DELAWARE M&A JURISPRUDENCE

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ABSTRACT

Merger and Acquisition (M&A) transactions create the potential for self-interested behavior by the boards of directors of acquired, or target, corporations because target boards may have self-interested reasons for preferring one acquirer over another. The preferred acquirer may, for example, be more likely to retain the services of certain board members or to employ them in some other capacity after the completion of the transaction. In recognition of these potential conflicts of interest, the courts have recognized that target boards of directors may not always be incentivized to exercise their business judgment in M&A transactions in the best interests of shareholders and have therefore held them to the heightened standard of review of enhanced scrutiny.

Enhanced scrutiny contemplates substantive judicial review of the reasonableness of the target board's conduct in the sale of the company. Until recently, enhanced scrutiny review was not susceptible to being adjusted downward to business judgment-level review through procedural safeguards, such as the constitution of a special committee of the board or shareholder ratification. A special committee was not considered to be an effective means of cleansing an inherent conflict, and shareholder approval of the transaction was deemed to approve only the board's decision to sell, as opposed to the board's conduct of the sale process.

The Delaware Supreme Court revisited the issue, holding that the shareholder ratification doctrine applies to a shareholder approval of an M&A transaction on the rationale that shareholders, particularly institutions, are at least as well-positioned as judges to evaluate the merits of a sale. As a result, approval of an M&A deal by target shareholders displaces enhanced scrutiny of the board of directors' conduct in managing the sale in favor of the business judgment rule, effectively making the target board's decision unreviewable.

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This Article argues that recent Delaware jurisprudence on shareholder ratification constitutes a fundamental shift in M&A jurisprudence, it predicts that, while it will reduce deal litigation, it will have unnecessary detrimental effects on deal process, and it proposes a procedural mechanism for mitigating those effects in the form of a bifurcated shareholder vote on each of the deal process and the sale transaction.

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INTRODUCTION

Boards of directors contemplating a merger and acquisition (M&A) transaction with a third-party bidder; i.e., a non-controlling shareholder, must confront the possibility that they will leave the shelter of the protective business judgment rule and instead be held to the substantive judicial standard of review of enhanced scrutiny. Outside counsel routinely briefs boards of directors contemplating an M&A deal on their fiduciary duties in the transactional context. Until recently, such presentations would have emphasized the heightened levels of scrutiny that can come into play when a company pursues an acquisition and how the directors must conduct the sale process in order to fulfill them. Today, however, counsel to the board of a company entertaining a sale would be remiss not to also emphasize the possibility that the board can avoid enhanced scrutiny entirely through the implementation of specified procedural safeguards.

The possibility of using procedural mechanisms to reduce judicial standards of review in third-party M&A transactions arises because the Delaware courts have created end-runs around the traditional fiduciary duty standards that apply to target corporate boards. Importantly, the standards themselves have not been overruled. On the contrary, the formal architecture of judicial scrutiny of M&A transactions has been largely preserved. However, its application has been dramatically weakened in recent years, limiting the relevance of the so-called enhanced, or intermediate, level of scrutiny in corporate law by allowing it to give way to the deferential business judgment rule through procedural means.

In *Corwin v. KKR Financial Holdings LLC*, the Delaware Supreme Court held that a disinterested, fully informed, uncoerced vote of the stockholders of the target—approving a third-party transaction that would otherwise subject the target board to enhanced scrutiny in a post-closing suit for money damages—reinstates the business judgment rule standard of review.[1] It does not matter whether the stockholder vote was required by statute or was sought voluntarily by the board.[2] Under *Corwin*, the

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[1] Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 305, 308 (Del. 2015).
[2] *See id.* at 311 n.24.

directors' actions will give rise to liability only if they constitute corporate waste.[3]

While scholars have thoroughly analyzed the decades-long erosion of the substantive standards underlying enhanced judicial scrutiny of M&A transactions, they have paid scant attention to the prospective impact of the more recent judicially created procedural substitutes for such scrutiny, other than to note its dampening effect on merger litigation.[4] It is widely noted, for example, that Delaware's M&A standards have undergone a systematic dilution since their introduction. Professors Steven Davidoff Solomon and Randall Thomas chronicle this historical evolution in *The Rise and Fall of Delaware's Takeover Standards*.[5] According to Solomon and Thomas, takeover standards were developed by Delaware courts "in the mid-1980s to rectify a perceived failure in the corporate governance system, principally the apparent failure of directors to act responsibly in the corporate governance eco-system."[6] The authors posit that as the eco-system developed in the 1990s into a more robust environment in which alternative monitors emerged—namely, independent directors and institutional investors—Delaware courts could retreat from vigorous judicial oversight of M&A transactions.[7]

In *The Shifting Tides of Merger Litigation,* Professors Matthew Cain et al., identify *Corwin* as being one among a group of cases that have reduced the availability of a post-closing suit against target boards for damages, and thus, frivolous litigation.[8] They point out that reducing nuisance suits comes at the expense of eliminating meritorious cases and

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[3] William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *A Reassessment of Standards of Review in Delaware Corporation Law,* 56 BUS. LAW. 1287, 1317–18 (2001).

[4] *See, e.g.,* Zohar Goshen & Sharon Hannes, *The Death of Corporate Law* (European Corp. Governance Inst., Working Paper No. 402, 2018), https://ssrn.com/abstract=3171023 (advancing an economic efficiency rationale for the Delaware courts' diminished role in deciding corporate law issues generally). *But see* Matthew Schoenfeld, *From Corwin to Dell: The Cost of Turning a Blind Eye* (Feb. 12, 2018), *available at* https://ssrn.com/abstract=3122511 (critiquing the use of procedural safeguards as substitutes for the judicial application of heightened fiduciary duties).

[5] Steven Davidoff Solomon & Randall S. Thomas, *The Rise and Fall of Delaware's Takeover Standards* 7–8 (European Corp. Governance Inst., Research Paper No. 329, 2016), *available at* https://ssrn.com/abstract=2830257.

[6] *Id.* at 1.

[7] *Id.* at 7–8.

[8] Matthew D. Cain et al., *The Shifting Tides of Merger Litigation*, 71 VAND. L. REV. 603, 606 (2018).

state that "because transactions are negotiated in the shadow of potential litigation, the availability of a litigation remedy is likely to affect both the price and procedures of future mergers."[9] They nevertheless conclude that "the recent changes [to M&A jurisprudence] are quite modest and that the volume of litigation, at least to date, remains sufficient to discipline the merger process."[10]

Most recently, James Cox and Randall Thomas raised concerns in *Delaware's Retreat: Exploring Developing Fissures and Tectonic Shifts in Delaware Corporate Law* about the difficulty of interpreting whether a stockholder vote to approve a transaction, that is a statutory requirement to consummating the deal, is concurrently serving to approve the conduct of the target board in handling the transaction.[11] They are nevertheless sanguine about the prospects of shareholder monitoring in a post-*Corwin* world. As they view the current corporate governance landscape, "[s]hareholder monitoring can occur in a variety of ways, and the current vitality of hedge fund activism . . . may provide a good justification for weakening the mechanisms for investor monitoring via litigation."[12]

This Article goes beyond previous accounts of Delaware's evolving M&A jurisprudence to argue that the Delaware judiciary has recently altered the basic framework governing the application of enhanced scrutiny to M&A transactions and that the resulting regime will harm corporate governance in the deal arena. In *Corwin*, the Delaware Supreme Court purported to be hewing to well-established corporate governance principles. Yet, it went well beyond recalibrating its settled M&A jurisprudence. Formerly, enhanced scrutiny was the presumptive standard of review for post-closing money damages claims based on allegations of breach of fiduciary duty by target boards of directors in M&A transactions.[13] After *Corwin*, boards of directors of target companies can effectively insulate themselves from post-closing judicial scrutiny of their conduct in a takeover through the procedural mechanism of a stockholder vote—a vote that is statutorily required in all M&A transactions to which

[9] *Id.* at 635–36.
[10] *Id.* at 639.
[11] James D. Cox & Randall S. Thomas, *Delaware's Retreat: Exploring Developing Fissures and Tectonic Shifts in Delaware Corporate Law*, 42 DEL. J. CORP. L. 323 (2018).
[12] *Id.* at 327.
[13] *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

the target company is a party. As a result, the Delaware courts have, to a substantial degree, removed themselves from overseeing the deal process.

Practically, a reduction in the standard of review from enhanced scrutiny to business judgement level scrutiny is outcome-determinative for a fiduciary duty lawsuit against the target board of directors in an M&A transaction.[14] Once the business judgment rule applies, courts will review the board's decisions only for waste—an exceedingly difficult threshold for a plaintiff to overcome.[15] Dismissal at the pleading stage of the litigation is therefore virtually assured.

The implications of Delaware's reduced intervention in M&A transactions are already evident in declining deal litigation, as others have noted.[16] Importantly, however, judicial passivity is also likely to have substantive consequences. As dealmakers adjust their behavior to take advantage of a more flexible framework for the application of enhanced scrutiny, corporate governance practices at target boards is likely to weaken.

In order to situate the existing structure of judicial review of M&A transactions, Part I briefly presents the substantive standards of scrutiny that apply to the business decisions of boards of directors and traces the emergence and eventual dilution of the enhanced scrutiny standard. Part II analyzes the effect of shareholder ratification on the level of scrutiny applicable to board decisions. It then describes the evolution of *Corwin*, demonstrating that its holding elides key Delaware Supreme Court pronouncements on the legal effect on judicial scrutiny of a statutorily required stockholder vote on the applicable judicial standard of review. Contrary to the Court's assertion that *Corwin* did not upset existing jurisprudence, the case, Part II argues, represents an important shift in M&A jurisprudence that provides dealmakers with a procedural mechanism for insulating their decisions from substantive judicial review. Parts III and IV develop the implications of current doctrine for future deal litigation and deal process, contending that, while a procedural route to the business judgment rule reduces non-meritorious litigation, it also weakens

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[14] *E.g.* Morrison v. Berry, 191 A.3d 268, 273–74 (Del. 2018) (discussing breach of fiduciary duties relating to the case).

[15] *Id.* at 274.

[16] *See* Cain et al., *supra* note 8, at 607–09 (discussing possible changes in Delaware law becoming more restrictive).

the monitoring of target boards. The resulting degradation in corporate governance is likely to undermine the policy goals of takeover law, leading to the reallocation of merger premia from target shareholders to target managers and acquirers. Part IV also contends that such deleterious effects can be mitigated while simultaneously respecting Delaware law's shareholder ratification principles by decoupling the statutorily required stockholder vote in M&A transactions into discrete votes on the deal process and on the transaction. Part V offer concluding remarks.

I. THE EMERGENCE AND SUBSEQUENT DILUTION OF ENHANCED SCRUTINY

Shareholders in publicly held corporations have limited means for exerting influence over boards of directors. Under state corporations codes, a corporation's board is vested with the authority to direct the corporation.[17] Shareholders are thus highly vulnerable to misconduct by boards, which are subject to only limited monitoring. Such monitoring includes the statutory right of shareholders to elect directors, as well as the potential threat of a hostile takeover by an acquirer attracted by the opportunity to replace wayward management. In order to further constrain boards from neglecting or acting contrary to the shareholders' interests, shareholders are the beneficiaries of director fiduciary obligations consisting of the duties of care and loyalty in running the firm.[18]

Target shareholders in M&A transactions are especially vulnerable to director misconduct. In an M&A transaction, they face the so-called "final period" problem, in which individuals have incentives to behave without regard to the effect of their behavior on others.[19] Game theory provides a useful tool for analyzing the final period problem in the M&A context.[20] Consider a game with two players. A repeated game will potentially be played any number of times. As a result, the players do not know when the final game will take place. Assuming the players are aware

[17] STEPHEN M. BAINBRIDGE, THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE 34–35 (Oxford Univ. Press 2008).

[18] *Id.* at 32.

[19] *See* Stephen M. Bainbridge, *The Geography of Revlon-Land*, 81 FORDHAM L. REV. 3291–92 (2013) (discussing shareholder discipline and self-dealing).

[20] *See generally* JEFFREY M. PERLOFF, MICROECONOMICS 468–504 (7th ed. 2014) (introducing basic game theoretic principles and permutations).

of each other's moves, a rational player in a repeated game will always take its action with reference to the other player's anticipated action.

In the corporate governance context, board behavior can be expected to be influenced by the anticipation of future shareholder elections of directors. When the players are knowingly in the last period of a game, however, they know that they can behave in any way they wish without fear of retribution. By analogy, when target boards anticipate an acquisition, they are incentivized to behave opportunistically vis-à-vis shareholders. Faced with the choice between enriching themselves and maximizing shareholder value, they are more likely to favor their self-interest. They cannot be disciplined through traditional corporate governance constraints, which function most effectively when the company is independent.[21]

Delaware corporate fiduciary duty law that has been developed for the M&A context is designed to produce outcomes for target stockholders in a sale transaction that reflect arm's-length, or non-conflicted, bargaining by boards of directors who are aware that they are in their last period of play. Consistent with this purpose, courts accord target boards' decisions varying degrees of deference depending on the conditions surrounding their decision making.[22]

The most deferential standard of review, the business judgment rule, is the one to which Delaware law defaults.[23] It assumes that boards of directors acted on an informed basis, in good faith, and in the honest belief that their actions were in the best interests of the company and its stockholders. If these assumptions are met, then the price and terms of the deal are regarded by the courts as being consistent with those that would result from arm's-length negotiations.

In contrast, the courts are far less inclined to defer to the judgment of a board of directors that has violated the assumptions of trust and

[21] *See* Sean J. Griffith, *Deal Protection Provisions in the Last Period of Play*, 71 FORDHAM L. REV. 1899, 1947 (2003); *id.* at 1946 ("The last period problem thus exists as an *ex ante* structural concern each time the management team of a target firm faces restructuring following a prospective acquisition.").

[22] *See generally* William T. Allen et al., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287 (2001) (describing the relationship between standards of review and their policy functions).

[23] Griffith, *supra* note 21, at 1946.

confidence that the business judgment rule initially makes. Thus, if a majority of the board has an interest in a decision that could reasonably be expected to induce it to place its self-interest above the interest of the stockholders of the corporation as a whole, the courts will review the board's decision under the entire fairness standard.[24] The entire fairness standard entails judicial scrutiny of the substance of business transactions for objective fairness of both price and process.[25]

The Delaware courts have reasoned that in between the deferential business judgment rule and the entire fairness standard, there is reason to interpose an intermediate standard of review—enhanced scrutiny.[26] Enhanced scrutiny focuses on whether the board's business decision was objectively reasonable under the circumstances, a standard more exacting than the business judgment rule but less intrusive than entire fairness review.[27] The enhanced scrutiny standard applies in contexts that make it plausible to infer that a board is making a decision in the face of dueling loyalties to both its own interests and those of the company's stockholders.[28] Thus, deference to the board is unwarranted. Without actual conflict, however, the entire fairness review would be too stringent. Enhanced scrutiny applies because it is an intermediate standard of review, reflecting the Delaware courts' approach of imposing "varying [levels of scrutiny] according to the likelihood that the actions of the board or managers were tainted by conflicted interests in a particular transactional setting."[29]

In an M&A transaction negotiated by a company's board of directors, the specific contexts that give rise to enhanced scrutiny are the sale of control[30] of the company or entering into deal protection devices.[31]

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[24] Allen et al., *supra* note 22, at 1290.

[25] Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983) (referring to fairness as being comprised of both "fair dealing and fair price.").

[26] *See* J. Travis Laster, *The Effect of Stockholder Approval on Enhanced Scrutiny*, 40 WM. MITCHELL L. REV. 1443, 1491 (2014).

[27] *Id.* at 1447–50.

[28] *Id.* at 1475–77.

[29] Bainbridge, *supra* note 19, at 3303.

[30] *See* Paramount Commc'n Inc., v. QVC Network Inc., 637 A.2d 34, 42–43 (Del. 1994).

[31] Griffith, *supra* note 21, at 1901 (explaining that deal protection devices are designed to privilege a transaction with the board's preferred merger partner); s*ee also* Laster, *supra* note 26, at 1465.

In both instances, courts are reluctant to give business judgment rule protection to boards because potential conflicts of interest are inherent in the transactions. As the Delaware Court of Chancery has stated, enhanced scrutiny applies when "the realities of the decision-making context can subtly undermine the decisions of even independent and disinterested directors."[32]

A sale of control, in which a new owner will dictate the company's future decisions, may induce a board to favor a prospective buyer for self-interested reasons, such as the opportunity to remain employed or the opportunity to remain on the board of the merged company, even though pursuing a transaction with an alternative buyer may better serve the interests of the company's existing stockholders. In *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, the Delaware Supreme Court held that in such a setting, directors are charged solely with obtaining the highest value available for stockholders.[33] The directors simply have no other proper objective.

Similarly, the Delaware courts regard deal-protection measures, such as no-shop provisions,[34] matching rights,[35] and termination fees,[36] as inherently suspect. Such devices operate to deter competing bids by impeding subsequent bidders from topping a favored bidder with a more attractive offer. While the target board may enter into deal protections for proper purposes, such as to induce the favored bidder to enter into a transaction, the target's board may also have less virtuous reasons for agreeing to the protective provisions, such as the prospect of continued board or other service with the favored bidder. A board's decision to employ deal protections will thus be reviewed with enhanced scrutiny.[37] Under *Unocal v. Mesa Petroleum Co.,* to avoid enhanced scrutiny in the

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[32] Reis v. Hazelett Strip-Casting Corp., 28 A.3d 442, 457 (Del. Ch. 2011).

[33] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 185 (Del. 1986).

[34] *See* Karl F. Balz, *No-Shop Clauses*, 28 DEL. J. CORP. L. 513, 515 (2003).

[35] *See* Brian J.M. Quinn, *Re-Evaluating the Emerging Standard of Review for Matching Rights in Control Transactions*, 36 DEL. J. CORP. L. 1011, 1015 (2011) (explaining how an explicit matching right allows a prospective acquirer in a pending transaction to match subsequent superior proposals made by a competing bidder).

[36] *See* Griffith, *supra* note 21, at 1902 n.11 (explaining that termination fees are payments owed to a prospective acquirer in a pending transaction upon termination of the merger agreement).

[37] Ryan v. Lyondell Chem. Co., No. 3176–VCN, 2008 WL 2923427, at *16 (Del. Ch. July 29, 2008), *rev'd*, 970 A.2d 235 (Del. 2009)*, reprinted in* 34 DEL. J. CORP. L. 333.

context of deal protection measures, (1) the directors must have reasonable grounds to believe that a competing bid would be a threat to corporate policy and (2) the protective devices used must be a reasonable response to the perceived threat.[38]

The standards of review articulated in both *Revlon* and *Unocal* have been diluted judicially over time.[39] In its initial incarnation, *Revlon* scrutiny appeared to entail substantive review of the target board's sale process to determine whether the board acted reasonably with respect to its fiduciary duty in the change-of-control context to maximize shareholder value.[40] More recently, however, *Revlon* duties have been subsumed into the traditional fiduciary duties of care and loyalty.[41] The question now asked by the Delaware courts when they conduct a *Revlon* review is more deferential: Did the board act in bad faith in pursuing a sale by willfully disregarding its duty to obtain maximum value for the target shareholders?[42]

The Delaware courts have also eroded the *Unocal* standard of review, which the courts use to police over-reaching deal protection measures. With respect to the first prong of the *Unocal* test—whether the board reasonably believed it was defending against a threat to corporate policy[43]—the courts have shown extreme deference to the board's assessment of the danger posed by a competing bid. Specifically, in *Paramount Communications, Inc. v. Time Inc.*, the Delaware Supreme Court made clear that its determination of what constituted a legally cognizable threat under the first prong of *Unocal* would be "open-ended" and not impinge on the good faith perceptions of the board.[44] Five years later, in *Unitrin, Inc. v. American General Corp.*, the Delaware Supreme Court dealt a blow to the second prong of *Unocal*, which requires that the defensive measures installed be reasonable in relation to the threat posed,

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[38] Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985); *see also* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1372 (Del. 1995) (quoting Stroud v. Grace, 606 A.2d 75, 92 n.3 (Del. 1992)).

[39] Solomon & Thomas, *supra* note 5, at 5 ("[T]he courts gradually backed away from the interventionist approach and new standards of the 1980s.").

[40] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 184 (Del. 1986).

[41] *See In re* Cornerstone Therapeutics Inc., Stockholder Litig., 115 A.3d 1173, 1175 (Del. 2015).

[42] *See* Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 243 (Del. 2009).

[43] *Unocal Corp.*, 493 A.2d at 955.

[44] Paramount Commc'n, Inc. v. Time, Inc., 571 A.2d 1140, 1153 (Del. 1990).

by giving boards discretion to act within a "range of reasonableness" and emphasizing the "need of the board of directors for latitude in discharging its fiduciary duties to the corporation and its shareholders."[45] As a result of judicial interpretation, many commentators now believe that *Unocal* no longer provides the same level of enhanced review that it once promised.[46]

To summarize, the deferential business judgment rule is the default standard of review for directors who make corporate decisions, but it does not apply in actual conflict-of-interest transactions because such transactions offer managers discretion to take advantage of their positions to further their own interests at the expense of those of the corporation and its stockholders.[47] There, entire fairness scrutiny applies. In the context of M&A transactions in which conflicts are inherent, there is a danger that boards will manipulate the sale process or implement deal protection devices to privilege a favored bidder for self-interested reasons.[48] Fiduciary duty standards applied to board decisions in such instances are subjected to enhanced scrutiny relative to the default business judgment level of review.[49]

Despite the historical dilution of enhanced scrutiny in the M&A arena, it continues to serve a meaningful role. It induces boards to exercise a higher degree of care in representing shareholders' interests in a sale transaction than they otherwise might by posing the risk of litigation should a fiduciary duty lawsuit be brought against them.[50] Even this limited check on board misconduct, however, has been undermined by the Delaware Supreme Court's recent expansion of the shareholder ratification doctrine in the enhanced scrutiny arena.[51]

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[45] Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1388 (Del. 1995).

[46] *See, e.g.*, Cox & Thomas, *supra* note 11, at 323, 328 (describing the weakening of *Unocal* review); Paul L. Regan, *What's Left of Unocal*, 26 DEL. J. CORP. L. 947, 950 (2001) (same); Robert B. Thompson & Gordon D. Smith, *Toward a New Theory of the Shareholder Role: "Sacred Space" in Corporate Takeovers*, 80 TEX. L. REV. 261, 285 (2001). (same).

[47] Thompson & Smith, *supra* note 46, at 279.

[48] Griffith, *supra* note 21, at 1913.

[49] *See* Regan, *supra* note 46, at 951–52.

[50] Thompson & Smith, *supra* note 46, at 279.

[51] Cox & Thomas, *supra* note 11, at 326.

II. THE SHAREHOLDER RATIFICATION EFFECT ON ENHANCED SCRUTINY

When enhanced scrutiny displaces the business judgment rule as the standard of review for a board decision, the business judgment rule can be reinstated if certain procedural safeguards are implemented.[52] The key to reinstating the business judgment rule after it has been displaced is the approval of a neutral decision-making body, the judgment of which can serve as a substitute for the board's decision.[53] Delaware courts have held, for example, that approval by a special committee of disinterested, independent directors of a transaction with a party other than a controlling stockholder[54] qualifies to neutralize a transaction in which a majority of the board has an actual conflict of interest.[55] In addition, the business judgment rule will be reinstated as the standard of review in interested director transactions with non-controlling stockholders if shareholders, representing a majority of disinterested shares, outstanding ratify the transaction.[56] Such mechanisms are deemed to cleanse the board's disabling circumstances and restore the application of the business judgment rule to the judicial review of the board's decision.[57]

Inherent conflicts, where directors are nominally disinterested and independent but nevertheless face situational incentives to place their

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[52] Thompson & Smith, *supra* note 46, at 279.

[53] CHARLES HANSEN, A GUIDE TO THE AMERICAN LAW INSTITUTE CORPORATE GOVERNANCE PROJECT 48 (Roger Clegg ed., 1995).

[54] *See* Itai Fiegenbaum, *The Geography of MFW-Land*, 41 DEL J. CORP. L. 763, 786 (providing an in-depth analysis of Delaware's controlling stockholder jurisprudence). *See also* Kahn v. M&F Worldwide Corp., 88 A.3d 635, 645–46 (Del. 2014) (analyzing the use of procedural protections such as conditioning the prior approval of both an independent special committee and a vote of a majority of the stockholders unaffiliated with the controlling stockholder, and concluding that, used *in combination*, they produced arm's-length bargaining conditions between the parties). The Court thus applied business judgment level review to the directors' decision to approve the transaction. *Id.* at 644. Absent the implementation of both protections, however, the entire fairness standard would have applied. *Id.*

[55] *See* HANSEN, *supra* note 53, at 48; *see also* Iman Anabtawi, *Predatory Management Buyouts*, 49 U.C. DAVIS L. REV. 1285, 1309 (2016) (describing the use of procedural safeguards to reduce heightened standards of review otherwise applicable to conflict of interest transactions).

[56] Anabtawi, *supra* note 55, at 1398–409.

[57] *See generally* Claire Hill & Brett McDonnell, *Sanitizing Interested Transactions*, 36 DEL. J. CORP. L. 903, 905 (2011) (discussing the effect on the standard of review of disinterested director approval); D. GORDON SMITH, *The Modern Business Judgment Rule*, *in* RESEARCH HANDBOOK ON MERGERS AND ACQUISITIONS 83, 87 (Claire A. Hill & Steven D. Soloman eds., 2016) (same).

interests ahead of those of the shareholders in their decision-making, are less susceptible than actual conflicts to cleansing through procedural safeguards implemented at the board level—namely, through the use of a special committee.[58] As discussed in Part I, inherent conflicts in M&A transactions may induce a board to favor one bidder over others in order to secure future private benefits from that bidder. Such concerns formed the basis for the Delaware courts' construction of their enhanced scrutiny jurisprudence.[59] Thus, the *Unocal* court expressed concern that the board in that case was subject to the "omnipresent specter" of "acting primarily in its own interests, rather than those of the corporation and its shareholders."[60] Similarly, the *Revlon* court was animated by judicial anxiety over the inherent conflicts of interest in the context of a potential sale transaction when a sale of the company had become inevitable.[61] Where inherent conflicts of interest are at work, a special committee may support a target board's litigating position that its actions were reasonable.[62] However, it is not a complete mechanism for cleansing the decision-making process because objective disinterestedness and independence of directors does not address the natural tendency for directors to favor a prospective bidder that might benefit the directors at the expense of target stockholders.

The inability of special committees to serve as a single method to cure inherent conflicts that arise in M&A transactions leaves only one other procedural safeguard available for reinstating the business judgment rule in instances where enhanced scrutiny would otherwise apply—shareholder ratification. The shareholder ratification basis for curing an

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[58] *See generally* Julian Velasco, *Structural Bias and the Need for Substantive Review,* 82 WASH. U. L. Q. 821 (2004) (describing inherent conflicts of interest as a phenomenon whereby even disinterested directors can exhibit bias).

[59] *See* SMITH, *supra* note 57, at 91–92.

[60] Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985).

[61] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 181 (Del. 1986) ("However, when exercising that power in an effort to forestall a hostile takeover, the board's actions are strictly held to the fiduciary standards outlined in *Unocal.* These standards require the directors to determine the best interests of the corporation and its stockholders, and impose an enhanced duty to abjure any action that is motivated by considerations other than a good faith concern for such interests.").

[62] *See, e.g.,* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1375 (Del. 1995) ("The first aspect of the *Unocal* burden, the reasonableness test, required the Unitrin Board to demonstrate that, after a reasonable investigation, it determined in good faith, that American General's Offer presented a threat to Unitrin that warranted a defensive response. This Court has held that the presence of a majority of outside independent directors will materially enhance such evidence.").

inherent conflict at the board level to which *Unocal* or *Revlon* review applies is not, however, straightforward.[63] Specifically, it is complicated by uncertainty over whether a single stockholder vote for or against the transaction, which is a statutory prerequisite to the effectiveness of a negotiated M&A deal, is tantamount to a neutral decision-making authority having exercised discretion over the transaction. The Delaware Supreme Court addressed the role of the statutorily required stockholder vote in de-escalating enhanced scrutiny of M&A transactions in *Corwin v. KKR Financial Holdings LLC*.[64]

A. Corwin v. KKR Financial Holdings LLC

In *Corwin*, Chief Justice Strine put to rest any doubt over the legal effect of a statutorily-required stockholder vote approving an M&A transaction on the standard of review that applies when a plaintiff brings a post-closing claim for monetary damages against the target board. If the stockholder vote was disinterested, informed, and uncoerced, the business judgment rule applies irrespective of whether it would otherwise have been displaced by a higher standard of review.[65] Furthermore, the court will not review the merits of the board's decisions other than for waste.[66] In other words, the stockholder vote both reinstates and makes irrebuttable the business judgment rule.

Corwin involved the acquisition by private equity firm KKR & Co. L.P. (KKR) of KKR Financial Holdings LLC (Financial Holdings), a finance company that was externally managed by an affiliate of KKR.[67] Under Delaware's General Corporation Law, the merger was subject to the approval of the board and the stockholders of both constituent corporations.[68] In addition, the merger agreement required that the Financial Holdings stockholder approval be by a majority of shares held

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[63] *See* Laster, *supra* note 26, at 1448–50 (2014) (discussing potential doctrinal impediments to the case in favor of a stockholder vote lowering the standard of review from enhanced scrutiny to the business judgment rule).

[64] Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 305–06 (Del. 2015). *See also* J. TRAVIS LASTER, *Changing Attitudes: The Stark Results of Thirty Years of Evolution in Delaware M&A Litigation*, RESEARCH HANDBOOK ON REPRESENTATIVE SHAREHOLDER LITIGATION (Jessica Erickson et al. eds., forthcoming 2018) (cited with permission of author) (discussing the evolution of how enhanced scrutiny is applied in recurring M&A scenarios).

[65] *Corwin*, 125 A.3d at 305–06.

[66] *Id.* at 309 n.19.

[67] *Id.*at 306.

[68] *Id.* at 311.

by persons other than KKR or its affiliates.[69] Financial Holdings formed a special committee to consider a potential transaction.[70] The special committee conducted a process for the sale of Financial Holdings, ultimately recommending a transaction with KKR that resulted in KKR and Financial Holdings executing a merger agreement.[71] Financial Holdings solicited stockholder approval of the transaction through a proxy statement, and a majority of the non-KKR-affiliated stockholders of Financial Holdings approved the transaction.[72]

In the Delaware Court of Chancery, plaintiff-stockholders challenged the merger on several grounds, the one relevant here being that the members of Financial Holdings' board of directors breached their fiduciary duties in the sale of Financial Holdings.[73] A threshold issue in the case was the applicable standard of review.[74] On appeal, the Delaware Supreme Court affirmed the Court of Chancery's dismissal of the plaintiffs' claim that KKR was a controlling stockholder of Financial Holdings.[75] The Court next addressed the plaintiffs' contention that, even if KKR did not control Financial Holdings and the entire fairness standard of review therefore did not apply, the Court of Chancery erred in concluding that the Financial Holdings directors' conduct was not subject to enhanced scrutiny review under *Revlon.*[76] The Court opted not to reach the *Revlon* question.[77] Doing so was unnecessary, it reasoned, because even if *Revlon* applied to the directors' actions, the stockholder vote conferred business judgment rule protection on the directors.[78] Accordingly, the Delaware Supreme Court therefore affirmed the Court of Chancery's dismissal of plaintiffs' post-closing fiduciary duty claims against Financial Holdings' directors.[79]

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[69] *Id.* at 306–07.
[70] *Id.* at 307.
[71] *Corwin*, 125 A.3d at 307.
[72] *Id.* at 309.
[73] *In re* KKR Fin. Holdings LLC S'holder Litig., 101 A.3d 980, 989 (Del. Ch. 2014), *aff'd sub nom*. *Corwin*, 125 A.3d 304.
[74] *Id.* at 983.
[75] *Corwin*, 125 A.3d at 306–08.
[76] *Id.* at 308.
[77] *Id.*
[78] *Id.*
[79] *Id.*

According to the Delaware Supreme Court in *Corwin*, the effect of an affirmative stockholder vote in favor of a merger transaction—to which the enhanced scrutiny standard of review would in the first instance apply to the actions of the target's board—is to reduce that standard to the business judgment level unless the transaction involves a self-dealing controlling stockholder.[80] The Court relied on Delaware precedent to support its holding.[81] In affirming the Court of Chancery's invocation of the business judgment standard of review on the basis of the target stockholders' approval of the transaction, the Delaware Supreme Court emphasized that the Chancellor had "adhered to precedent"[82] and "doubted that the [Delaware] Supreme Court would have 'overrule[d] extensive Delaware precedent'"[83] on the matter.[84] It similarly described its own affirmance as "consistent with well-reasoned Delaware precedent,"[85] referring to the Court of Chancery's citation of such precedent[86] and citing additional precedent.[87]

The cases cited, both in its opinion and by reference to the Court of Chancery's opinion, are direct support for the *Corwin* Court's holding that spanned nearly a century.[88] Of these cases, however, only a few Court of Chancery decisions post-date the Delaware Supreme Court's decision in *In re Santa Fe Pacific Corporation Shareholder Litigation*,[89] and none post-date the Delaware Supreme Court's decision in *Gantler v. Stephens.*[90] At the time the *Gantler* case was decided, despite the wealth of case law on the subject, "the scope and effect of the common law doctrine of shareholder ratification [was] unclear, making it difficult to apply that

[80] *Id.* at 311.
[81] *Corwin*, 125 A.3d at 311.
[82] *Id.*at 308–09.
[83] *Id.* at 309..
[84] *See* Lawrence A. Hamermesh & Leo E. Strine, Jr., *Fiduciary Principles and Delaware Corporation Law: Searching for the Optimal Balance by Understanding that the World is Not* 34–35 (Harv. Law Sch. Ctr. for Law, Econ., and Bus., Discussion Paper No. 937, 2017), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3044477 ("In its opinion in *Corwin v. KKR Financial Holdings LLC*, the Delaware Supreme Court merely reaffirmed the long-standing principle of Delaware law, that 'the approval of the disinterested stockholders in a fully informed, uncoerced vote that was required to consummate a transaction has the effect of invoking the business judgment rule.'") (citation omitted).
[85] *Corwin*, 125 A.3d at 311.
[86] *Id.* at 309–11 n.19.
[87] *Id.*
[88] *Id.*
[89] *See In re* Santa Fe Pac. Corp. S'holder Litig., 669 A.2d 59 (Del. 1995).
[90] Gantler v. Stephens, 965 A.2d 695 (Del. 2009).

doctrine in a coherent manner."[91] The Delaware Supreme Court sought to clarify and build upon *Santa Fe* in *Gantler*.

B. *In re Santa Fe Pacific Corporation Shareholder Litigation*

Santa Fe addressed the effect of stockholder approval of a merger on the standard of review applicable to a target board's actions in connection with the sale process.[92] The board of Santa Fe Pacific Corporation, a publicly-held Delaware corporation, had entered into merger discussions with Burlington Northern, Inc., another publicly-held Delaware corporation.[93] After the two companies signed a merger agreement, Union Pacific Corporation contacted Santa Fe to express its interest in making a higher bid for Santa Fe.[94] The Santa Fe Board rejected Union Pacific's offer, and Union Pacific subsequently commenced a tender offer for a majority of Santa Fe's shares and filed a motion for expedited proceedings and preliminary injunctive relief.[95] On January 30, 1995, the motion was denied.[96] The following day, Union Pacific withdrew its competing tender offer and the Santa Fe-Burlington merger was approved by over 70% of Santa Fe's stockholders at a special stockholders meeting on February 7, 1995.[97]

In response to Union Pacific's tender offer, the Santa Fe Board adopted a shareholder rights plan, which would become effective if any person other than Burlington acquired at least 10% of Santa Fe's outstanding shares.[98] In addition, the merger agreement between Santa Fe and Burlington was amended to incorporate a termination fee.[99] Santa Fe and Burlington subsequently commenced a joint tender offer for up to 33% of Santa Fe's outstanding common stock; Santa Fe announced a stock repurchase program, following the joint tender offer, but prior to the merger, whereby Santa Fe could repurchase up to ten million shares of Santa Fe's common stock; and Santa Fe exempted from the shareholder rights plan the purchase by Allegheny Corporation of up to 14.9% conditional on Allegheny's support for the pending merger.[100] The

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[91] *Id.* at 712.
[92] *In re* Santa Fe, 669 A.2d at 63.
[93] *Id.*
[94] *Id.*
[95] *Id.* at 65.
[96] *Id.*
[97] *Id.*
[98] *In re* Santa Fe, 669 A.2d at 65.
[99] *Id.* at 64.
[100] *Id.* at 65.

cumulative effect of the foregoing purchases would be to place a substantial percentage of Santa Fe's shares in the hands of parties committed to the Santa Fe-Burlington merger.

Plaintiff-stockholders commenced a post-closing action against the board of directors of Santa Fe, claiming that the proxy materials disseminated to Santa Fe's stockholders in connection with the merger failed to disclose all material facts and that Santa Fe's board had breached its *Revlon* and *Unocal* duties.[101] Defendants moved under Court of Chancery Rule 12(b)(6) to dismiss the complaint.[102]

Vice Chancellor Jacobs authored the Delaware Court of Chancery's opinion in the case. One of the defendants' contentions was that the stockholder vote approving the merger operated to extinguish the claims for breach of loyalty alleged in the complaint.[103] The Court of Chancery first dismissed the disclosure claims, however, the Court proceeded to hold that an informed stockholder vote does not operate to extinguish a claim for breach of the duty of loyalty.[104] For this proposition, it cited Vice Chancellor Jacobs' own Delaware Court of Chancery opinion in *In re Wheelabrator Technologies, Inc., Shareholders Litigation*, in which he stated:

> To repeat: in only two circumstances has the Delaware Supreme Court held that a fully-informed shareholder vote operates to extinguish a claim: (1) where the board of directors takes action that, although not alleged to constitute *ultra vires,* fraud, or waste, is claimed to exceed the board's authority; and (2) where it is claimed that the directors failed to exercise due care to adequately inform themselves before committing the corporation to a transaction. In no case has the Supreme Court held that stockholder ratification automatically extinguishes a claim for breach of the directors' duty of loyalty.[105]

[101] *In re* Santa Fe Pac. Corp. S'holder Litig., No. 13587, 1995 WL 334258 at *1 (Del. Ch. May 31, 1995), *aff'd in part, rev'd in part*, 669 A.2d 59 (Del. 1995).

[102] *Id.*

[103] *Id.* at *5.

[104] *Id.* at *8.

[105] *In re* Wheelabrator Techs., Inc. S'holders Litig., 663 A.2d 1194, 1203 (Del. Ch. 1995).

Characterizing plaintiffs' *Revlon* and *Unocal* claims as implicating the duty of loyalty, with the consequence that they were not extinguished by stockholder approval, Vice Chancellor Jacobs went on to consider plaintiffs' *Revlon* and *Unocal* claims, and, ultimately, dismissed them for failure to state a claim for relief.[106]

On appeal, the Delaware Supreme Court considered *de novo* the question whether a fully informed stockholder vote extinguishes *Revlon* and *Unocal* claims.[107] It reached the same result on the question as the Court of Chancery—that stockholder approval does not operate to extinguish *Revlon* and *Unocal* claims—but on different grounds, according to the opinion's author Chief Justice Veasey, the effect of stockholder approval on the standard of review was not so much a function of whether the claim against the target board sounded in the duty of care or the duty of loyalty as it was about the underlying purposes of the *Revlon* and *Unocal* doctrines.[108] In elaborating those purposes, the Court focused on the risk that boards will use their positions to unduly influence the decisions of stockholders who are presented with a choice whether or not to approve the deal negotiated by the board.[109] It concluded that allowing a stockholder vote on a merger to remove board action from judicial scrutiny in a contest for corporate control would undermine the purposes underlying *Revlon* and *Unocal.*[110]

The *Santa Fe* Court thus declined to give ratification effect to the stockholders' vote to approve the merger.[111] Its reluctance to do so arose from the board's failure to decouple into separate voting matters, (1) approval of the Santa Fe–Burlington merger and (2) the board's decision to erect defensive measures against the Union Pacific offer.[112] It viewed the decision offered to the stockholders as "merely . . . a choice between the Burlington Merger and doing nothing."[113] The board's defensive measures were not specifically approved: "[T]he Santa Fe Stockholders did not specifically vote in favor of the Rights Plan, the Joint Tender or

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[106] *In re* Santa Fe, 1995 WL 334258, at *11–12.
[107] *In re* Santa Fe, 669 A.2d at 67-68.
[108] *Id.* at 67.
[109] *Id.* at 68.
[110] *Id.*
[111] *Id.*
[112] *Id.*
[113] *In re* Santa Fe, 669 A.2d at 68.

the Termination Fee."[114] Yet, those defensive measures operated to "work[] their effect before the stockholders had a chance to vote."[115] As a result, at the time of the stockholder vote, the Court viewed the Santa Fe stockholders as being faced with a decision-making option that had been shaped by a sale process designed and executed unilaterally by the board. By voting in favor of the merger, the stockholders were registering their preference for the merger over "doing nothing" rather than in favor of the board's defensive measures.[116] Characterizing as "coerc[ive],"[117] the Santa Fe board's presentation to the company's stockholders of a stockholder vote on the transaction as a whole as opposed to separate votes on the transaction and the sale process, the Court determined that it was appropriate to consider the merits of plaintiffs' *Unocal* and *Revlo*n claims post-closing.[118]

C. Gantler v. Stephens

Nearly 15 years later, Justice Jacobs, having been elevated in 2003 to the Delaware Supreme Court from the Delaware Court of Chancery, took occasion to parse the legal meaning and effect of shareholder ratification under Delaware law in *Gantler v. Stephens*.[119] *Gantler* involved the sale of First Niles Financial, Inc., a publicly traded Delaware corporation, against the backdrop of an overture by First Niles' management to take the company private.[120] After first considering, and rejecting, third-party offers to purchase First Niles, First Niles' board decided to pursue a going-private transaction.[121] The going-private transaction required the Company to amend its certificate of incorporation to reclassify certain shares of common stock into shares of Series A Preferred Stock.[122] Under Section 242 of the Delaware General Corporation Law, such an amendment requires both board and stockholder approval.[123] Each body approved the proposed reclassification amendment.[124]

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[114] *Id.*
[115] *Id.*
[116] *Id.*
[117] *Id.*
[118] *Id.* at 67.
[119] Gantler v. Stephens, 965 A.2d 695, 712 (Del. 2009).
[120] *Id.* at 699.
[121] *Id.* at 700.
[122] *Id.* at 702.
[123] DEL. CODE ANN. tit. 8, § 242 (2014).
[124] *Gantler*, 965 A.2d at 702–03.

Plaintiff-stockholders challenged the board's actions on fiduciary duty grounds. Count III of their complaint alleged that the board breached its duty of loyalty by proposing the reclassification to the stockholders out of self-interest.[125] The Court of Chancery held that that the plaintiffs pled sufficient facts to support an inference that a majority of the First Niles board may have been interested or not independent with regard to reclassification.[126] It then turned to the defendants' contention that an informed majority of the unaffiliated stockholders had approved the reclassification amendment, thereby "ratifying" the reclassification and "bringing the Board's decision to effect the reclassification back within the business judgment presumption."[127] Applying the business judgment rule to the board's decision, the Court of Chancery dismissed Count III.[128]

The Delaware Supreme Court reversed the Court of Chancery's dismissal of Count III of the plaintiffs' complaint on two alternative, independent grounds.[129] Writing for the Court, Justice Jacobs rejected defendants' shareholder ratification theory, under which fully informed stockholder approval of board action that is not otherwise entitled to business judgment rule protection is given that protection by virtue of stockholder approval of the transaction.[130] Second, the Court held that defendants could not avail themselves of their shareholder ratification argument because the proxy disclosures made in connection with First Niles' solicitation of stockholder approval were materially misleading.[131] Importantly, both grounds constituted holdings of the case.[132]

The Court went on to address the use and misuse of the term "shareholder ratification" under Delaware law and to determine its legal

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[125] *Id.* at 712.

[126] Gantler v. Stephens, No. 2392–VCN, 2008 WL 401124, at *15 (Del. Ch. Feb. 14, 2008), *rev'd*, 965 A.2d 695 (Del. 2009).

[127] Id. at *23.

[128] *Id.*

[129] *Gantler*, 965 A.2d at 712.

[130] *Id.* at 712–14.

[131] *Id.* at 714.

[132] Woods v. Interstate Realty Co., 337 U.S. 535, 537 (1940) ("[W]here a decision rests on two or more grounds, none can be relegated to the category of obiter dictum."). *But see* Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 310-11 (Del. 2015) (regarding *Gantler's* discussion of the ratification effect of a statutorily required stockholder vote as dictum).

impact on the standard of review applicable to board action.[133] Justice Jacobs first acknowledged that "[u]nder current Delaware case law, the scope and effect of the common law doctrine of stockholder ratification is unclear, making it difficult to apply that doctrine in a coherent manner."[134] Citing to the Delaware Court of Chancery opinion in *Wheelabrator*, which he had authored in 1995, he summarized the then-existing ambiguity surrounding the term's usage:

> [The doctrine of ratification] might be thought to lack coherence because the decisions addressing the effect of shareholder "ratification" have fragmented that subject into three distinct compartments . . . In its "classic" . . . form, shareholder ratification describes the situation where shareholders approve board action that, legally speaking, could be accomplished without any shareholder approval. . . . "[C]lassic" ratification involves the voluntary addition of an independent layer of shareholder approval in circumstances where shareholder approval is not legally required. But "shareholder ratification" has also been used to describe the effect of an informed shareholder vote that was statutorily required for the transaction to have legal existence. . . . That [the Delaware courts] have used the same term i[n] such highly diverse sets of factual circumstances, without regard to their possible functional differences, suggests that "shareholder ratification" has now acquired an expanded meaning intended to describe any approval of challenged board action by a fully informed vote of shareholders, irrespective of whether that shareholder vote is legally required for the transaction to attain legal existence.[135]

Justice Jacobs thus went out of his way to distinguish between two scenarios in which stockholders are asked to approve board action. "Classic ratification," also sometimes referred to as a "voluntary" or "non-statutory" stockholder vote, is approval of board action by the stockholders where stockholder approval is not statutorily required for the board action

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[133] *Gantler*, 965 A.2d at 714.
[134] *Id.* at 712.
[135] *Id.* at 713 (quoting *In re* Wheelabrator Techs. S'holders Litig., 663 A.2d 1194, 1201–02 n.4 (Del. Ch. 1995)).

to be legally effective.[136] In contrast, "statutory ratification," also sometimes referred to as an "organic" stockholder vote, is a vote that is statutorily required as a condition to the effectiveness of the action in question. For the latter proposition, the *Gantler* Court cited the Delaware Supreme Court's decision in *In re Santa Fe Pac. Corp. S'holder Litig.*[137] Examples under Delaware law, of decisions in the latter category, include amendments to a company's certificate of incorporation,[138] mergers or consolidations of domestic corporations,[139] and sales of all or substantially all of a corporation's assets.[140] Although often called "ratification," statutorily required votes, it has been suggested, would be better referred to as "votes in favor" or "stockholder approval" so as to avoid conceptual confusion.[141]

Having parsed the various uses of the term "shareholder ratification," Justice Jacobs went on to address squarely the legal effect of each species of ratification that he had just identified:

> To restore coherence and clarity to this area of our law, we hold that the scope of the shareholder ratification doctrine must be limited to its so-called "classic" form; that is, to circumstances where a fully informed shareholder vote approves director action that does *not* legally require shareholder approval in order to become legally effective. Moreover, the only director action or conduct that can be ratified is that which the shareholders are specifically asked to approve.[142]

Thus, *Gantler* held that only voluntary ratification—stockholder approval that is not a statutory condition of the effectiveness of corporate action—would henceforth have any standard-of-review-shifting effect on the fiduciary duties to which a board's decisions are held.[143]

> We previously so held in [*Santa Fe*], which involved a claim that by adopting defensive measures to block an

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[136] *Id.* at 713.
[137] *In re* Santa Fe Pac. Corp. S'holder Litig., 669 A.2d 59 (Del.1995).
[138] DEL. CODE ANN. tit. 8, § 242 (2014).
[139] *See id.* § 251.
[140] *See id.* § 271.
[141] Williams v. Geier, 671 A.2d 1368, 1379 (Del. 1996) (cited approvingly in *Gantler*, 965 A.2d at 714 n.55).
[142] *Gantler*, 965 A.2d at 713.
[143] *Gantler*, 965 A.2d at 713 n.53 (second alteration in original).

> unsolicited takeover bid, the directors of the target corporation breached their fiduciary duties. . . . [T]his Court held that "[s]ince the stockholders of Santa Fe merely voted in favor of the merger and not the defensive measures, we decline to find ratification in this instance."[144]

In addition, not every instance of even voluntary ratification could alter the standard of review to which a board would be held.[145] Only those votes that addressed specifically the individual matter, as to which the board was seeking to be protected against heightened scrutiny, would qualify as "shareholder ratification."[146]

In *Gantler*, Justice Jacobs held that (1) only "classic," non-statutorily required, ratification has cleansing power, and (2) reiterated the Delaware Supreme Court's holding in *Santa Fe* that for shareholder ratification to have any impact on the standard of review for board action, a unitary vote on whether or not to approve the transaction is insufficient; i.e., the stockholders must also vote separately to approve the decision-making process of the board.[147] As Chief Justice Strine noted in *Corwin*,[148] the former pronouncement was a departure from Justice Jacobs' own decision as Vice Chancellor in *Wheelabrator*. In *Wheelabrator*, then-Vice Chancellor Jacobs gave ratification effect to a statutorily required vote approving a merger, holding that stockholder approval, while it did not fully extinguish a claim of breach of fiduciary duty, nevertheless reduced the standard of review of an interested director transaction from entire fairness to business judgment-level scrutiny.[149] Two weeks after *Wheelabrator*, in his Delaware Court of Chancery opinion in *Santa Fe*, then-Vice Chancellor Jacobs cited *Wheelabrator* for the proposition that a statutorily required stockholder vote does not extinguish duty of loyalty claims.[150] Rather than apply the business judgment rule to the target board's decision to proceed with a merger with Burlington, as in

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[144] *Id.* (citing *In re* Santa Fe Pac. Corp. S'holder Litig., 669 A.2d 59, 68 (Del. 1995)).

[145] *Id.*

[146] *In re* Wheelabrator Techs., Inc. S'holders Litig., 663 A.2d 1194, 1200 (Del. Ch. 1995).

[147] *Gantler*, 965 A.2d at 713.

[148] Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 309, 309 n.14 (Del. 2015).

[149] *In re* Wheelabrator, 663 A.2d at 1200, 1204.

[150] *In re* Santa Fe Pac. Corp. S'holder Litig., No. 13587, 1995 WL 334258, at *8 (Del. Ch. May 31, 1995), *aff'd in part*, *rev'd in part*, 669 A.2d 59 (Del. 1995).

Wheelabrator, Vice Chancellor Jacobs considered the board's actions under *Revlon* and *Unocal* for *Santa Fe.*[151]

Given the chronology of *Wheelabrator*, *Santa Fe*, and *Gantler*, one should not make too much of the tension between *Gantler* and *Wheelabrator*. First, the Delaware Supreme Court decided *Santa Fe* between *Wheelabrator* and *Gantler*. In *Gantler*, Justice Jacobs would naturally be expected to have adjusted his position on the legal effect of shareholder ratification to take into account the Delaware Supreme Court's decision in *Santa Fe.* Recall that the *Santa Fe* Court declined to give ratification effect to the statutorily required stockholder vote approving Santa Fe's merger with Burlington.[152] In *Gantler*, Justice Jacobs did no more than reiterate the distinction that he had previously made in *Wheelabrator* between classic and statutory ratification and couple that distinction with the Delaware Supreme Court's subsequent holding in *Santa Fe* that the only category of stockholder approval that could serve to reduce the standard of review applicable to a target board's decision to approve a merger transaction is a stand-alone stockholder vote specifically approving the challenged conduct.[153] A statutorily required vote to approve the merger would not suffice.

In addition, *Gantler* is hardly unclear on the issue of the decision's impact on shareholder ratification jurisprudence. Justice Jacobs refers multiple times to his desire to bring clarity to the meaning and legal effect of shareholder ratification.[154] He states that the only type of stockholder approval that can alter the standard of review is the "so-called 'classic' form; that is, . . . where a fully informed stockholder vote approves director action that does *not* legally require stockholder approval in order to become legally effective."[155] In other words, although the term "ratification" is used loosely to refer to both classic and statutorily required stockholder approval, only the former has standard-of-review-shifting power. Shortly thereafter, he states that "the ratification doctrine does not apply to transactions where stockholder approval is statutorily required."[156] Finally, to remove any lingering doubt as to the scope of the

[151] *In re Santa Fe*, 1995 WL 334258, at *8–11.
[152] *In re* Santa Fe, 669 A.2d at 68.
[153] *In re* Wheelabrator, 663 A.2d at 1201–02 at n.4.
[154] Gantler v. Stephens, 965 A.2d 695, 713 (Del. 2009).
[155] *Id.*
[156] *Id.* at 714.

ratification doctrine, he reiterates, "[t]his Opinion clarifies that 'ratification' legally describes only corporate action where stockholder approval is not statutorily required for its effectuation."[157] After *Gantler*, the most coherent reading of Delaware law on the doctrine of shareholder ratification stood as follows: If (1) a stockholder vote is not required by law to make effective an act of the board; and (2) the stockholder vote approves the specific board conduct being challenged; then (3) the stockholder vote functions to reduce the standard of review applicable to a board decision otherwise subject to heightened scrutiny to that of business judgment.[158]

D. *Corwin v. KKR Financial Holdings LLC* Revisited

Six years later, in *Corwin*, the Delaware Supreme Court eliminated *Gantler's* two preconditions, holding that a statutorily required stockholder vote in favor of a merger transaction reduces enhanced-scrutiny-level review of a target board's decisions to business judgment-level review.[159] Although the *Corwin* Court described its holding as being consistent with long-standing precedent, it also acknowledged an incongruity between its decision and the Delaware Supreme Court's *Gantler* decision, stating that there was "[n]o doubt that *Gantler* can be read in more than one way" and that it wished "[t]o erase any doubt on the part of practitioners" as to *Gantler's* meaning.[160] The reading of *Gantler* that the *Corwin* Court embraced was that *Gantler's* discussion of the shareholder ratification doctrine was no more than a meticulous examination of the commonly used term "ratification" and that *Gantler* did not intend to opine as to the legal effect of ratification on the applicable standard of review; under such a view, the Court's position in *Corwin* did not disturb settled Delaware law.[161]

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[157] *Id.* at 714 n.55.

[158] *Id.* at 698–714.

[159] Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 306–07 (Del. 2015).

[160] *Id.* at 311.

[161] *Cf.* Joseph R. Slights III, Hon. Vice Chancellor, Del. Court of Chancery, Panel Remarks at the International Bar Association's 15th Annual International Mergers and Acquisitions Conference (June 8, 2016), *in* 16 M&A J., no. 9, 2016, at 2, 3 (viewing *Corwin* not as a "dramatic shift" but as "the Supreme Court, wanting to be very clear in offering guidance and some comfort to practitioners, that there is this kind of convergence, as Justice Jacobs described it in some of our discussions, a narrowing of the more exacting standards of review toward business judgment review").

Corporate law practitioners and commentators viewed *Corwin* in a different light. As they interpreted the decision and prior case law, *Corwin* made a substantial change in the application of enhanced scrutiny to board decisions under Delaware law. Whereas under *Gantler*, practitioners generally understood that board action subject to *Revlon* and *Unocal* review would not be protected by the business judgment rule as a result of a statutorily required stockholder vote approving the transaction, *Corwin* held that such a vote constitutes an affirmative defense that brings the challenged board action within the business judgment rule's protections.[162]

One leading practitioner stated, "The most important development in Delaware law during 2016 was arguably the courts' growing deference to stockholder approval," using the *Corwin* decision as a case in point.[163] Another described *Corwin* as a "major impact" decision."[164] Yet others saw *Corwin* as an element of a broader trend in Delaware law, contributing to "a radical change in M&A law in recent years":

> While the foundational principle of Delaware corporate law has always been deference to the business judgment of independent boards of directors (reflected in the "business judgment rule"), the courts had applied a "heightened scrutiny," and even an "entire fairness," standard in the more difficult settings of M&A transactions. Those standards had, since the advent of "modern" M&A in the 1980s, set the stage for directors' conduct when faced with a takeover bid or the negotiation and execution of a sale of the company. Now there has been a dramatic change of course—in the words of Vice Chancellor Slights, as reported in *The M&A Lawyer*, "a narrowing of the more exacting standards of review

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[162] *Corwin*, 125 A.2d at 313–14.

[163] Steven Haas, *The* Corwin *Effect: Stockholder Approval of M&A Transactions*, HARV. L. SCH. FORUM ON CORP. GOVERNANCE & FIN. REG. (Feb. 21, 2017), https://corpgov.law.harvard.edu/2017/02/21/the-corwin-effect-stockholder-approval-of-ma-transactions/.

[164] *Structuring, Negotiating & Litigating Public Deals: Has the Pendulum Moved?*, DEAL LAWYERS (Aug. 16, 2017), https://www.deallawyers.com/member/Programs/Webcast/2017/08_16/transcript.htm (interview with Cliff Neimeth, Shareholder, Greenberg Traurig LLP).

> toward business judgment deference" in M&A matters in almost every scenario.[165]

Rather than reading *Corwin* as a continuation of long-standing Delaware precedent, practitioners viewed it as a shift in the Delaware Supreme Court's application of its heightened scrutiny standard of review to board action.[166] To be sure, some regarded it as part of an ongoing reconstruction of the framework of Delaware's fiduciary duty law jurisprudence. Yet, however they contextualized it, all understood it to be a notable transformation.

Corporate law scholars similarly viewed *Corwin* as more than a mere continuation of Delaware precedent.[167] A leading treatise described the case as "an important ruling," in which the Court "explained that the enhanced scrutiny of *Revlon* was not designed with post-closing money damages claims in mind."[168] Another referred to its "great[] significance," explaining,

> *Corwin's* significance occurs on two important fronts. First, and most obviously, it allows stockholder approval to supplant *Revlon*, provided the transaction is not one that otherwise triggers an entire fairness inquiry because it is with a related party. Second, and of great significance to corporate law, *Corwin* holds that the shareholder vote compelled by statute for the transaction to be duly undertaken can also serve as a vote ratifying any lapse under *Revlon* or for that matter any other fiduciary principle.[169]

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[165] Gail Weinstein et al., *How Delaware Has Radically Changed M&A Law in Recent Years*, 21 No. 10 M&A LAW. NL 4 (Nov./Dec. 2017).

[166] *See* Joel E. Friedlander, *Vindicating the Duty of Loyalty: Using Data Points of Successful Stockholder Litigation as a Tool for Reform*, 72 BUS. LAW. 623, 643-645 (2017) (taking the view that *Corwin* represents a change in judicial policy).

[167] Franklin A. Gevurtz, Cracking the *Corwin* Conundrum and Other Mysteries Regarding Shareholder Approval of Mergers and Acquisitions 7-8 (September 19, 2018), available at https://ssrn.com/abstract=3252264 (noting the inconsistency between *Gantler* and *Corwin*); Brandon Mordue, *The* Revlon *Divergence: Evolution of Judicial Review of Merger Litigation*, 12 Va. L .& Bus. Rev. 531, 535 (2018) (referring to *Corwin* as one of three separate lines of cases that have altered the judicial review of merger litigation by Delaware courts).

[168] MARTIN LIPTON & ERICA H. STEINBERGER, TAKEOVERS & FREEZEOUTS § 11.02 (2018).

[169] JAMES D. COX & THOMAS LEE HAZEN, TREATISE ON THE LAW OF CORPORATIONS § 23:8 (2017).

If *Corwin* had not meaningfully altered the landscape of fiduciary duty law in Delaware, it would not have received such specific and sustained attention in corporate law circles. That it has been so discussed suggests it is an important development in the evolution of both the practice and jurisprudence of M&A.

The so-called "*Corwin* Doctrine," as it has come to be known, has already been extended multiple times and is operating in high gear. *Corwin* was decided in the context of a friendly one-step merger. Since *Corwin* was handed down, the Delaware courts have furthered its reach beyond *Corwin's* immediate context of a single-step merger. In *Volcano Corporation Stockholder Litigation*,[170] the Delaware Court of Chancery applied the *Corwin* doctrine to acquisitions structured as two-step transactions under Section 251(h) of the Delaware General Corporation Law.[171] Under Section 251(h), an acquirer is permitted to consummate a second-step merger without reaching the 90% threshold needed to consummate a short-form merger if, among other conditions, it acquired the same number of shares in the tender offer that would be required to approve a long-form merger.[172] The *Volcano* Court's rationale was that the tender of shares to the acquirer in a Section 251(h) transaction "essentially replicates [the] statutorily required stockholder vote in favor of a merger . . . ."[173]

The Delaware Court of Chancery has also applied *Corwin* in the context of aiding and abetting claims against third parties, such as financial advisors, with whom a board consulted in a transaction.[174] In *City of Miami General Employees' and Sanitation Employees' Retirement Fund v. Comstock*, the Court of Chancery dismissed aiding and abetting claims on the ground that the plaintiff failed to state a predicate breach of fiduciary duty claim against the board of directors under *Corwin*.[175] *Corwin* also applies even if a majority of the board of directors is not

[170] *In re* Volcano Corp. S'holder Litig., 143 A.3d 727 (Del. Ch. 2016).
[171] DEL. CODE ANN. tit. 8, § 251(h) (2016).
[172] *See id.* § 251.
[173] *In re Volcano Corp.*, 143 A.3d at 744.
[174] City of Miami Gen. Emps. v. Comstock, No. 9980-CB, 2016 WL 4464156, at *23 (Del. Ch. Aug. 24, 2016), *aff'd on other grounds,* 158 A.3d 885 (Del. 2017).
[175] *Id.*

independent.[176] Indeed, the only exception to the application of *Corwin* appears to be in a merger between a company and its controlling stockholder—a transaction which is not subject to enhanced scrutiny in any event.[177]

III. IMPLICATIONS OF SHAREHOLDER RATIFICATION FOR DEAL LITIGATION

Corwin has drastically limited the ability of plaintiffs to pursue post-closing fiduciary duty claims against boards of directors in M&A transactions under the enhanced scrutiny standard. According to *Corwin* and its progeny, the effect of asserting the affirmative defense of a stockholder vote under *Corwin* is to make the business judgment rule irrebuttable.[178] In other words, directors are deemed, not merely presumed, to have acted in an informed manner, in good faith, and in the honest belief that they were pursuing the best interests of the company.[179] The standard of judicial review of director conduct thus reduces to an inquiry whether the directors committed waste.

"A showing of waste requires proof that the consideration received is so clearly inadequate that the transaction effectively amounts to a gift of corporate assets serving no corporate purpose."[180] The Delaware courts have long regarded waste claims as being exceedingly challenging for plaintiffs. The exchange of corporate assets must be for consideration "so disproportionately small as to lie beyond the range at which any reasonable

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[176] *See In re* Columbia Pipeline Grp., Inc. S'holder Litig., No. 12152-VCL (Del. Ch. Mar. 7, 2017) (granting motion to dismiss); *In re* Solera Holdings, Inc. Stockholder Litig., No. 11524-CB, 2017 WL 57839, at *6 n.28 (Del. Ch. Jan. 5, 2017).

[177] *Cf.* Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 309 (Del. 2015) (holding that the business judgment rule applies to M&A transactions that are not subject to "the entire fairness standard [that is approved] by the fully informed, uncoerced vote of [a majority] of disinterested stockholders of the LLC").

[178] Espinoza v. Zuckerberg, 124 A.3d 47, 67 (Del. Ch. 2015) (citing Cambridge Ret. Sys. v. Bosnjak, No. 9178-CB, 2014 WL 2930869, at *9 (Del. Ch. June 26, 2014)).

[179] *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 52 (Del. 2006) (quoting Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000)).

[180] STEPHEN M. BAINBRIDGE, CORPORATE LAW 126-27 (Robert C. Clark et al. eds., 3d ed. 2015).

person might be willing to trade."[181] The test for waste is, indeed, so stringent that it is rarely satisfied.[182]

In cases implicating *Corwin*, a waste claim is even more precarious than in corporate transactions generally. In *Corwin* cases, a majority of the target's uncoerced, informed, disinterested stockholders have voted in favor of the transaction.[183] A waste claim in such circumstances is thus tantamount to a claim that over half of the disinterested stockholders are irrational. The Delaware courts have been reluctant to draw such a conclusion. In *Harbor Finance Partners v. Huizenga*, then-Vice Chancellor Strine explained, "If fully informed, uncoerced, independent stockholders have approved the transaction, they have, it seems to me, made the decision that the transaction is 'a fair exchange.'"[184] Indeed, he found it "logically difficult to conceptualize how a plaintiff can ultimately prove a waste or gift claim in the face of a decision by fully informed, uncoerced, independent stockholders to ratify the transaction."[185]

Delaware courts are now routinely dismissing post-closing damages lawsuits for alleged breaches of fiduciary duties in *Revlon* and *Unocal* transactions where the defendants raise the *Corwin* doctrine as an affirmative defense.[186] In order to avoid dismissal under *Corwin*, plaintiffs must either successfully rebut one of *Corwin's* preconditions in a post-closing suit for monetary damages or make their claims pre-closing as requests for preliminary injunctive relief.[187] Neither avenue for undermining the *Corwin* defense is trivial.[188]

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[181] *Espinoza*, 124 A.3d at 67 (citing Lewis v. Vogelstein, 699 A.2d 327, 336 (Del. Ch. 1997)).

[182] Official Comm. of Unsecured Creditors of Integrated Health Servs. v. Elkins, No. Civ.A. 20228-NC, 2004 WL 1949290, at *17 (Del. Ch. Aug. 24, 2004), *reprinted in* 30 DEL. J. CORP. L. 535.

[183] *See, e.g.,id* at *10.

[184] Harbor Fin. Partners v. Huizenga, 751 A.2d 879, 901 (Del. Ch. 1999) *reprinted in* 26 DEL. J. CORP. L. 931.

[185] *Id.*

[186] *See* Singh v. Attenborough, 137 A.3d 151, 151–52 (Del. 2016) (mem) (finding dismissal is typically the result when the business judgment rule standard of review is invoked).

[187] *See* Lavin v. W. Corp., No. 2017-0547-JRS, 2017 WL 6728702, at *8 (Del. Ch. Dec. 29, 2017).

[188] *Id.* (Del. Ch. Dec. 29, 2017) (calling defendants' litigating position "no easy task.").

Assuming that a majority of the disinterested stockholders of the target company have approved the transaction, the business judgment rule applies to the board's actions unless the stockholder vote was either uninformed or coerced.[189] With respect to whether the vote was informed, the Court of Chancery in *In re Solera Holdings, Inc. Stockholder Litigation*[190] held that a plaintiff challenging the decision to approve a transaction must first identify a deficiency in the applicable disclosure document.[191] The defendant then has the burden to demonstrate that the deficiency did not undermine the legitimacy of the stockholder vote.[192] Under Delaware law, directors who solicit a stockholder vote are required to disclose "fully and fairly all material information within the board's control."[193]

In the context of evaluating whether a stockholder vote was fully informed for purposes of applying the *Corwin* doctrine, the Delaware Court of Chancery has noted that "[f]ully informed does not mean infinitely informed."[194] Moreover, even troubling facts relating to directors' conduct are not sufficient to undermine the cleansing effect of a stockholder vote so long as they were not material.[195] The board must

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[189] *In re* Solera Holdings, Inc. Stockholder Litig., No. 11524-CB, 2017 WL 57839, at *1 (Del. Ch. Jan. 5, 2017).

[190] *Id.* at *7–9 ("It makes little sense in my view that defendants must bear this pleading burden for it would create an unworkable standard, putting a litigant in the proverbially impossible position of proving a negative.").

[191] *Id.* at *8; *cf. Lavin*, 2017 WL 6728702, at *10 (declining to invoke *Corwin* as a basis to bar a stockholder's demand to inspect books and records under Section 220 of the Delaware Corporations Code.

[192] *In re Solera*, 2017 WL 57839, at *8.

[193] *Id.* at *9 (quoting Stroud v. Grace, 606 A.2d 75, 84 (Del. 1992)). In determining whether an alleged omission or misrepresentation is material, Delaware courts use the standard of materiality of federal securities law. *Id.* Information is material under that standard not if it is merely helpful to a stockholder in making her decision. *Id.* (quoting Skeen v. Jo-Ann Stores, Inc., 750 A.2d 1170, 1174 (Del. 2000)). Rather, there must be "a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." *Id.* (quoting Rosenblatt v. Getty Oil Co., 493 A.2d 929, 944 (Del. 1985)). Put differently, the information must be of sufficient importance to the decision so as to create a substantial likelihood that it would alter the overall assessment of the matter being presented to a reasonable stockholder. *See id.* (quoting Arnold v. Soc'y for Sav. Bancorp, 650 A.2d 1270, 1277 (Del. 1994)).

[194] *In re* Merge Healthcare S'holder Litig., No. 11388–VCG, 2017 WL 395981, at *9 (Del. Ch. Jan. 30, 2017) (emphasis omitted).

[195] *See In re Solera*, 2017 WL 57839, at *9 (discussing the precondition of a fully informed vote under *Corwin*) (emphasis omitted).

disclose only those troubling facts that would have been material to a voting stockholder.[196]

The second circumstance in which an affirmative stockholder vote will not trigger *Corwin* is if the vote is coerced. The coercion precondition recognizes that any vote on a transaction is contextual and thus may not convey the collective support of the stockholders in the abstract. Rather, the vote registers the stockholders' preference for the deal under the then-existing circumstances and relative to readily available alternatives. If those circumstances or alternatives have been manipulated to induce the stockholders to approve the transaction, then stockholder approval does not serve its supposed purpose under *Corwin* and therefore does not give rise to business judgment rule protection. The courts have rejected the *Corwin* defense, however, on the basis of coercion under only extreme fact patterns.[197]

A plaintiff's alternative to a post-closing fiduciary duty suit for money damages is to seek a preliminary injunction of a transaction on breach of fiduciary duty grounds.[198] Indeed, *Corwin* counsels that doing so is the preferred course of action.[199] Yet, the very existence of a stockholder vote impairs a plaintiff's ability to meet its preliminary injunction burden.

Specifically, the Delaware Supreme Court found it relevant in *C&J Energy Services, Inc. v. City of Miami General Employees' & Sanitation Employees' Retirement Trust* that the target company's stockholders had

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[196] *See In re* Saba Software, Inc. Stockholder Litig., No. 10697–VCS, 2017 WL 1201108, at *7 (Del. Ch. Mar. 31, 2017), as revised (Apr. 11, 2017) (citing Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304 (Del. 2015)).

[197] Sciabacucchi v. Liberty Broadband Corp., No. 11418-VCG, 2017 WL 2352152, at *2 (Del. Ch. May 31, 2017); *In re Saba*, 2017 WL 1201108, at *1.

[198] Del. Ch. Ct. R. 65. (The preliminary injunction is an equitable remedy whereby a court prohibits or mandates certain action pending decision on the legality of that action. The remedy has been characterized as "extraordinary" because it restricts or impinges upon the parties' freedom to act without a full and fair hearing on the legal propriety of those acts.); s*ee*, *e.g.*, Petty v. Penntech Papers, Inc., 347 A.2d 140, 140–41 (Del. Ch. 1975) ("[T]he power to enjoin challenged conduct prior to a full evidentiary hearing constitutes the strong arm of equity jurisdiction.").

[199] Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 312 (Del. 2015) (stating that "*Unocal* and *Revlon* are primarily designed to give stockholders and the Court of Chancery the tool of injunctive relief to address important M&A decisions in real time, before closing.").

yet to vote on the transaction.[200] There, the Court reviewed the Court of Chancery's issuance of a preliminary injunction.[201] The question before the Court was whether the Court of Chancery erred in determining that plaintiffs had demonstrated a plausible violation by the target board of its duties under *Revlon* to seek in good faith the highest immediate value for the company.[202]

In its analysis, the *C&J Energy* Court considered it relevant that the target's stockholder vote had not yet occurred, stating that, in carrying out its *Revlon* duties, "the board could also take into account that its stockholders would have a fair chance to evaluate the board's decision for themselves."[203] A court applying *Revlon* must determine whether a board's actions were reasonably designed to produce the highest value available to the stockholders in a sale transaction.[204] *C&J Energy* suggests that a board has additional leeway under a reasonableness standard to approve a transaction that is subject to stockholder approval.[205] Later in the opinion, the Court again voiced its reluctance to issue an injunction "when the stockholders subject to irreparable harm are . . . capable of addressing that harm themselves by the simple act of casting a 'no' vote."[206] Thus, the stockholder vote also goes to the question whether irreparable harm is likely to occur if the injunction sought is not granted. It acts as a safety valve whereby the stockholders can reject a transaction that the board allowed to progress.[207]

Consider the position of a litigant who wishes to challenge board action with respect to a merger that is subject to enhanced scrutiny. In the early stages of litigation, the litigant confronts a higher bar to obtaining injunctive relief after *C&J Energy* because the deal is subject to a stockholder vote. Post-closing, an affirmative stockholder vote confers business judgment rule protection on the board under *Corwin*, diminishing

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[200] C&J Energy Servs., Inc. v. City of Miami Gen. Emps., 107 A.3d 1049, 1072–73 (Del. 2014).

[201] *Id.* at 1052.

[202] *Id.* at 1053.

[203] *Id.* at 1070.

[204] *See id.* at 1067.

[205] *Id.* at 1067–68.

[206] *C&J Energy,* 107 A.3d at 1072.

[207] *Id.* at 1072–73.

the litigant's ability to withstand a motion to dismiss. Merger litigation incentives have consequently declined.

Falling economic returns to plaintiffs and their lawyers from bringing deal litigation in Delaware have coincided with a sharp decrease in the volume of that litigation. In 2015, 60% of merger litigation filings were brought in Delaware.[208] In 2016, only 34% of such merger litigation was brought in Delaware, falling to a 9% rate in the first ten months of 2017.[209] Researchers attribute the decline primarily to the Delaware courts' decisions in *Corwin* and *In re Trulia*.[210] *C&J Energy*, decided by the Delaware Supreme Court on December 19, 2014, might also have played a role. The Delaware Court of Chancery's decision in *Corwin* was handed down on October 14, 2014,[211] and was affirmed by the Delaware Supreme Court on October 2, 2015.[212] As discussed above, *Corwin* reduced plaintiffs' likelihood of recovering money damages by providing boards with a roadmap for shifting the standard of review in a post-closing fiduciary duty lawsuit from the heightened scrutiny standards of *Unocal* or *Revlon* to the business judgment rule. *Trulia*, decided by the Delaware Court of Chancery on January 22, 2016, also had a chilling effect on merger litigation. There, the Court held that it would not approve non-monetary settlements that called for supplemental disclosure in advance of closing unless the supplemental disclosure corrects "plainly material" misrepresentations or omissions, and the release of defendants in connection with the settlement is narrowly tailored to the disclosure claims.[213] In combination, *Corwin*, *C&J Energy*, and *Trulia* drastically chilled merger litigation by making it more difficult to recover either post-closing money damages or pre-closing attorneys' fees in deal litigation brought in Delaware courts.

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[208] Cain et al., *supra* note 8, at 621.
[209] *Id.*
[210] *Id.* at 622.
[211] *In re* KKR Fin. Holdings LLC S'Holder Litig., 101 A.3d 980 (Del. Ch. Oct. 14, 2014).
[212] Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 304 (Del. 2015).
[213] *In re* Trulia Inc. Stockholder Litig., 129 A.3d 844, 898 (Del. Ch. 2016).

IV. IMPLICATIONS OF SHAREHOLDER RATIFICATION FOR DEAL PROCESS

The prevailing view on the likely effect of the *Corwin* doctrine on the M&A landscape is that its impact will be primarily to deter non-meritorious M&A litigation.[214] Such litigation was widely viewed to have spiraled out of control in the years preceding *Trulia*, with M&A litigation becoming so prevalent that it was begrudgingly accepted as "the transaction tax."[215] While *Corwin*'s impact on deal litigation rates was clear and predictable, the case is likely to have a less straightforward and foreseeable impact on how deals are structured, documented, and negotiated. It is thus important to consider the policy tradeoffs implicit in the *Corwin* case in order to provide guidance for future judicial application of the *Corwin* doctrine.

A. Potential Detrimental Effects of the Corwin Doctrine

Underlying the *Corwin* doctrine is the view that modern-day target stockholders will protect their own interests by registering their preferences for or against a sale in a statutorily required stockholder vote. Indeed, Chief Justice Strine identifies this premise as a policy basis for the holding in *Corwin*, expressly analogizing the *Corwin* doctrine to the business judgment rule:

> The reason for [judicial abstention] is tied to the core rationale of the business judgment rule, which is that judges are poorly positioned to evaluate the wisdom of business decisions and there is little utility to having them second-guess the determination of impartial decision-makers with more information (in the case of directors) or an actual economic stake in the outcome (in the case of informed, disinterested stockholders).[216]

As discussed in the remainder of this Article, however, the analogy between a statutorily required stockholder vote and either a decision of the

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[214] *See, e.g.,* Haas, *supra* note 163 (predicting that "*Corwin* will likely result in outright dismissal of most stockholder litigation challenging transactions that have been approved by stockholders" and downplaying concerns that "the post-*Corwin* regime is too lax and that it an [sic] over-correction to the problems stemming from widespread M&A litigation.").

[215] Browning Jeffries, *The Plaintiffs' Lawyer's Transaction Tax: The New Cost of Doing Business in Public Company Deals*, 11 BERKELEY BUS. L. J. 55, 108 (2014) (concluding that "plaintiffs' attorneys have successfully attached what amounts to a transaction tax to an overwhelming majority of large public company deals.").

[216] *Corwin*, 125 A.3d at 313–14.

board of directors of a company or the substantive review of a court applying enhanced scrutiny is a strained one. As a result, the first should not be expected to perform as a close substitute of the latter two mechanisms. If left unchecked, the *Corwin* doctrine is likely to produce the following adverse consequences:

Reduced Monitoring of Directors' Adherence to Fiduciary Duties in the M&A Context. In assessing whether directors have breached their fiduciary duties, Delaware corporate law distinguishes between the standard of conduct and the standard of review.[217] The standard of conduct is aspirational in the sense that it describes how directors should manage the corporation. It consists of the fiduciary duties of care and loyalty. The standard of review refers to the test that a court uses to determine whether directors have met the applicable standard of conduct.

As discussed in Part I, the standard of review is dynamic, and the level of scrutiny applicable to the directors' conduct can shift from its initial position to either a more or less stringent one. Directors are initially cloaked with the deferential business judgment rule, but a plaintiff can obtain a higher level of scrutiny by rebutting its presumptions. The business judgment rule can then be reinstated through procedural safeguards, such as approval by a special committee, approval by disinterested stockholders, or both.

In general, the standard of review is more lenient on directors than the standard of conduct.[218] Standards of conduct specify *how* directors are to act in the best interests of the corporation and its shareholders they serve.[219] For example, the duty of care contemplates that directors will perform their duties in good faith, in a manner that the director reasonably believes is in the best interests of the corporation, "and with the care that

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[217] *In re* Rural Metro Corp. Stockholders Litig., 88 A.3d 54, 81 (Del. Ch. 2014). *See* William T. Allen et al., *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, 451–52 (2002) (discussing the distinction between the two standards). *See* Melvin Aron Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law,* 62 FORDHAM L. REV. 437, 461–67 (1993); Julian Velasco, *The Role of Aspiration in Corporate Fiduciary Duties*, 54 WM. & MARY L. REV. 519, 553–58 (2012) (discussing academic treatments).

[218] *See In re* Trados Inc. S'holder Litig., 73 A.3d 17, 36 (Del. Ch. 2013).

[219] *Id.* at 35–56.

an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances."[220] In contrast, the standard of review by which directors' adherence to their duty of care is evaluated eschews consideration of whether the substance of the directors' conduct was reasonable and adopts the much less intrusive rationality review of the business judgment standard.[221]

A variable standard of review can expand the wedge between the standard of conduct and the standard of review by allowing judicially recognized procedural safeguards to substitute for more stringent examination of the substance of a board's decision where a heightened level of scrutiny applies in the first instance.[222] Implementation of the procedural safeguards, where applicable, replaces the presumptive standard of review with a weaker one. After *Corwin*, the procedural safeguard of an informed and uncoerced approval of the disinterested stockholders in a statutorily required vote on the transaction serves to displace enhanced scrutiny and reinstate the business judgment rule.

Less Robust Sale Process. Facing weaker judicial oversight of their M&A decisions, target directors can also be expected to reduce their level of conduct when engaging in sale transactions in at least two respects. First, directors whose conduct would otherwise be subject to *Revlon* review will have greater maneuverability on sale price and thus be more likely to trade off stockholder value for private benefits, even if they are required to disclose such benefits to stockholders to obtain the protection of the *Corwin* doctrine. Second, directors whose conduct would otherwise be subject to *Unocal* review will have greater maneuverability on deal protection devices and thus be more likely to incorporate them into their M&A contracts. Both developments are likely to erode target stockholder premia to the benefit of acquirers. Recent data on merger premia are consistent with the foregoing hypotheses. In 2017, just over a year after

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[220] *See generally* 1 AM. L. INST., PRINCIPLES OF CORPORATE GOVERNANCE, § 4.01 (1994).

[221] *In re* Trados Inc., 73 A.3d at 42–43.

[222] *But cf.* Matteo Gatti, *Reconsidering the Merger Process: Approval Patterns, Timeline, and Shareholders' Role*, 69 HASTINGS L. J. 835, 853 (2018) (finding that shareholders "approved an astonishing 98.68% of … mergers submitted to a vote in the 2006–2015 period" and hypothesizing that the high approval rate is attributable to the reluctance of boards of directors to submit questionable deals to a stockholder vote).

Corwin was decided, the average premium paid by bidders for targets was 22.5%, the lowest target premium observed since at least 2005.[223]

Corwin's requirement of an informed, uncoerced stockholder vote creates a theoretical lower bound for director misconduct, which may exceed the judicial constraint on boards of the business judgment rule. However, a stockholder vote does not serve as a perfect substitute for enhanced judicial scrutiny. To be sure, institutional shareholders are exercising more rigorous oversight of corporate managers than they have in the past.[224] They nevertheless remain imperfect monitors of boards of directors for structural reasons—namely, information asymmetries vis-à-vis management[225] and divergent interests among shareholders.[226]

However sophisticated and savvy a shareholder may be, its ability to value the firm is constrained by its limited incentives to undertake a thorough valuation. A valuation is time and resource intensive. Diversified shareholders will therefore be unlikely to ascertain whether the deal being proposed by management is fair. Moreover, institutional investors rely on a firm's management for information about the company. Management controls the "narrative" of the deal disclosed in the merger proxy.[227] Thus, even fully informed shareholders may undervalue a

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[223] Schoenfeld, *supra* note 4, at 5.

[224] *See* Jack B. Jacobs, *Fifty Years of Corporate Law Evolution: A Delaware Judge's Retrospective*, 5 HARV. BUS. L. REV. 141 (2015) (discussing the implications of the transformation of the shareholder profile of U.S. public corporations for corporate law); Jack B. Jacobs, *Does the New Corporate Shareholder Profile Call for a New Corporate Law Paradigm?*; 18 FORDHAM J. CORP. & FIN. L. 19 (2012) (discussing the effect that the new shareholder reality may have for corporate law theory and judicial decision-making); Solomon & Thomas, *supra* note 5, at 11 (noting the rise of institutional shareholders as active monitors in corporate governance).

[225] Charles R. Korsmo, *Delaware's Retreat From Judicial Scrutiny of Mergers*, __ UCI L. REV. ___ (forthcoming 2018) (manuscript at 47) (on file with authors) (noting that "even sophisticated stockholders operate at a severe informational disadvantage vis-à-vis management.").

[226] *See* Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561 (2006) (questioning the potential role of shareholders as corporate monitors based on shareholder conflicts of interest). *See also* Stephen Bainbridge, *The Implications of Investor Ideology for Delaware's Shareholder Ratification Doctrine,* ProfessorBainbridge.com (July 11, 2018), http://www.professorbainbridge.com/professorbainbridgecom/2018/07/the-implications-of-investor-ideology-for-delawares-shareholder-ratification-doctrine.html (questioning the information conveyed by a stockholder vote in the presence of heterogeneous investor preferences).

[227] Schoenfeld, *supra* note 4, at 1.

company whose managers wish to temper expectations. Divergent interests among shareholders also make it possible for shareholders to approve a transaction even when that transaction is not in the best interests of all shareholders. A transaction that sacrifices long-term value for an immediate merger premium will be attractive to certain shareholders, such as hedge funds, that produce out-size returns through M&A events.[228] For all these reasons, management has a built-in advantage in obtaining a favorable stockholder vote for its preferred transaction.

While there are sound reasons to question the limits of the shareholder ratification doctrine, particularly in the M&A context, the Delaware courts have made it abundantly clear in *Corwin* and its progeny that they believe that a stockholder vote in favor of a transaction obviates the need for enhanced scrutiny of the target board's conduct. Even so, the *Corwin* doctrine is suspect because the *Corwin* Court's reading of *Gantler* gives ratification effect to a stockholder vote that bundles the question whether to consummate a sale transaction with the question of how the sale process was conducted. Thus, shareholders are induced to vote for suboptimal takeovers irrespective of their sophistication.

In a bundled vote, shareholders do not vote specifically on the procedures adopted by the board to achieve the highest value transaction for the shareholders.[229] The shareholders are not permitted to express separately their preferences on the desirability of the sale procedures, on the one hand, and the sale transaction, on the other.[230] One can easily imagine that shareholders might vote in favor of the deal presented to them yet have reservations about the way in which the board managed the transaction. In a bundled vote in which the shareholders are voting only for or against the proposed transaction, however, the shareholders' choice is limited to either approving the transaction and collecting the merger premium or rejecting the transaction and suffering the resulting price decline. Because the shareholders cannot be certain on what terms or

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[228] *See* Robin Greenwood, *The Hedge Fund as Activist*, HBS Working Knowledge, (Aug. 22, 2007), https://hbswk.hbs.edu/item/the-hedge-fund-as-activist.

[229] *Cf. In re* Inv'rs Bancorp, Inc. Stockholder Litig., 177 A.3d 1208, 1222–23 (Del. 2017) (refusing to give ratification effect to a stockholder approval of "the general parameters of an equity compensation plan" because it did not approve sufficiently specific acts).

[230] *Cf.* James D. Cox et al., *Quieting the Shareholders' Voice: Empirical Evidence of Pervasive Bundling in Proxy Solicitations*, 89 S. CAL. L. REV. 1175, 1178 (2016) (evaluating the effectiveness of the anti-bundling rules adopted by the Securities and Exchange Commission in 1992).

whether the company can subsequently be sold, they are incentivized to approve even suboptimal transactions—ones that might not meet the standards of heightened scrutiny applied by courts. *Corwin* can thus be expected to lead to a less robust sale process, which reallocates gains produced by mergers from target shareholders to target managers and to acquirers.

Reduced Influence of Delaware Courts on the Development of Fiduciary Duty Law and the Practice of M&A. The regularity and rigor with which Delaware courts have opined on the fiduciary duties of directors in the sale context are among the bases for their national influence on M&A jurisprudence and the practices that target boards follow when conducting a sale. Delaware is the preeminent state of incorporation for Fortune 500 companies,[231] and, as a consequence of the internal affairs doctrine, fiduciary duty disputes involving those companies are decided under Delaware law.[232]

Although a non-Delaware court may have jurisdiction to hear a case to which Delaware law applies, several factors have historically encouraged parties to a fiduciary duty lawsuit to litigate in Delaware. The expertise of the Delaware Court of Chancery and the Delaware Supreme Court on Delaware corporate law makes Delaware an attractive jurisdiction for fiduciary duty litigants. In Delaware, the parties can reasonably expect their disputes to be resolved according to longstanding Delaware precedent and principles. Moreover, the Delaware judiciary brings both a scholarly sophistication and deep appreciation for corporate law practice to its role.[233] Finally, Delaware courts have a reputation for resolving disputes quickly and efficiently.[234]

As a result, Delaware courts have heard a substantial number of cases involving fiduciary duty issues in M&A transactions.[235] The canonical cases addressing the corporate law of fiduciary duties have all

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[231] STEPHEN M BAINBRIDGE, *Can Delaware Be Dethroned? Evaluating Delaware's Dominance of Corporate Law*, *in* CAN DELAWARE BE DETHRONED: EVALUATING DELAWARE'S DOMINANCE OF CORPORATE LAW 1, 1 (Stephen M. Bainbridge, et al. eds., 2018).

[232] *Id.*

[233] *Id.* at 4.

[234] *Id.*

[235] *See* Solomon & Thomas, *supra* note 5, at 3–9 (reviewing the foundational cases in Delaware takeover jurisprudence).

been decided by Delaware courts.[236] Over time, the Delaware judiciary has both developed and refined the fiduciary duties of corporate directors.[237] Indeed, it is inconceivable that one could articulate a board's fiduciary duties without referring to Delaware case law or, at a minimum, Delaware corporate law principles.

Delaware's dominance over corporate law has allowed it to shape corporate behavior to a substantial degree. The Delaware courts' influence occurs both directly, through deciding cases that set precedents to be followed, and indirectly, through signaling in dicta or otherwise how they are likely to view future cases that do not fall squarely within existing precedent. Corporate lawyers, reviewing Delaware corporate law decisions, adjust their recommendations to clients accordingly. Clients, in turn, internalize the advice they receive from their lawyers and implement so-called "best practices" in response to their lawyers' advice.[238]

After *Corwin*, however, cases initially implicating enhanced scrutiny, but ultimately reviewable under the business judgment rule as a consequence of shareholder ratification, will cease to provide the basis for providing judicial guidance on fiduciary duty best practices. Rather than being decided on their merits, they will be routinely dismissed at the pleading stage. Stockholders will, in effect, be stepping into the shoes of the court in M&A transactions. The corporate ballot box, however, is no substitute for carefully reasoned judicial opinions.

In combination, the foregoing effects undermine the policy goals that originally animated the development of enhanced scrutiny by the Delaware courts for the M&A context. In both *Unocal* and *Revlon*, the courts were troubled by the dual positions that the board occupies in a sale. On the one hand, the board is acting as a fiduciary of the shareholders charged with seeking for them the best deal available. On the other hand, the board has its own future professional opportunities to consider, which might be better served by conducting a less than full process favoring a bidder and compromising the shareholders' interests. Enhanced scrutiny,

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[236] *See id.*

[237] *See id.*

[238] Mireille Bahri, *The Magic of* Disney*: Turning Best Practices into Standards of Performance*, 37 SETON HALL L. REV. 1075, 1099 (2007) ("[T]he best practices articulated by the Delaware Court of Chancery have the potential to become the new standards against which director conduct is measured when evaluating a breach of fiduciary duty claim.").

which entails substantive review of the board's actions for reasonableness, was designed to counteract any inducement that the board might have to disregard its fiduciary duties when choosing among potential acquirers. The *Corwin* doctrine substantially reduces the vitality of enhanced scrutiny by focusing its application to the period before a stockholder vote when a plaintiff is seeking injunctive relief.

B. Mitigating the Detrimental Effects of the Corwin Doctrine

The Delaware Corporations Code provides that the corporation's "business and affairs . . . shall be managed by or under the direction of a board of directors."[239] The board exercises the decision-making function on behalf of the corporation and its shareholders, other than in certain limited circumstances in which the stockholders are the primary decision-makers.[240] An M&A transaction is one area in which the stockholders have statutory rights. The directors' authority to manage the corporation confers substantial discretion on them to initiate a sale process, to manage that process, and to negotiate the terms of any transaction to which the corporation is a party. In general, the stockholders are statutorily empowered to participate in the transaction, but only to a limited extent. For the transaction to become effective, the stockholders must approve the sale by a majority vote.[241] Up to that point, however, they have no formal role in the decision whether or how to pursue the deal.

Views of the function of the stockholder vote in connection with an M&A transaction have migrated over time. Traditional understandings of the purpose of the statutorily required stockholder vote in an M&A transaction emphasized the fundamental character of such a transaction, which alters the very nature of the target shareholders' investment.[242] The stockholder initially acquires an interest in a going concern, with the understanding that the company will continue operating for a period of time sufficient for it to carry out its business purpose. The transformation of that investment, for example into cash consideration, alters the shareholders' initial expectation that the corporation would fulfill the requirement under its charter documents "to conduct or promote any

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[239] DEL. CODE ANN. tit. 8, § 141(a) (2016).
[240] *See Gantler*, 965 A.2d at 712–14.
[241] *See* DEL. CODE ANN. tit. 8, § 251(c) (2016) (in the case of a merger); § 271(a) (in the case of an asset sale).
[242] Gatti, *supra* note 222, at 843.

lawful business or purposes"[243] and therefore requires their consent under contract law principles.[244]

The imposition of heightened levels of scrutiny, which displace the default business judgment rule, is justified when actual or presumed conflicts of interest undermine the basis for the broad discretion generally accorded to directors. Under the business judgment rule, boards enjoy the legal presumption that they have made business decisions both with due care and in the good faith belief that their actions are in the best interests of the corporation and its shareholders.[245] When there are legally cognizable reasons to question that presumption, however, corporate law authorizes inquiry into the motives of directors through substantive judicial review.[246]

Corwin expands the import of a statutorily required vote on an M&A transaction to encompass a judgment on the part of the shareholders that the transaction being presented to them for approval is the equivalent of a transaction that would have emerged from an arm's-length sale process conducted by the board.[247] In providing for the reinstatement of the business judgment rule through a statutorily required stockholder vote, *Corwin* conceptualizes that vote as an opinion on whether the transaction presented to the stockholders represents the good faith efforts of the board to obtain the best value available for the shareholders.[248] The procedural path that *Corwin* provides from enhanced scrutiny back to the business judgment rule thus invests the shareholders with the supervisory role of monitoring presumed conflicts of interest that the courts would otherwise

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[243] DEL. CODE ANN. tit. 8, § 101(b) (2016).

[244] *See, e.g.,* Blue Chip Capital Fund II Ltd. P'ship v. Tubergen, 906 A.2d 827, 833–34 (Del. Ch. 2006) (holding that the contract, not fiduciary principles, governed because the plaintiffs' claim arose from "contractual rights and obligations under the certificate of incorporation, a binding contract between the company and its preferred stockholders.").

[245] Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985). *See, e.g.*, FDIC v. Perry, No. 11–5561–ODW, 2011 U.S. Dist. LEXIS 143222, at *8, *10 (C.D. Cal. Dec. 13, 2011) (stating that under California law, both the common law and California's statutory business judgment rule apply only to directors, not officers).

[246] Bayer v. Beran, 49 N.Y.S.2d 2, 6 (N.Y. Sup. Ct. 1944) (In other words, the deferential business judgment rule "yields to the rule of undivided loyalty. This great rule of law is designed 'to avoid the possibility of fraud and to avoid the temptation of self-interest.' . . . It is 'designed to obliterate all divided loyalties which may creep into a fiduciary relation . . . .'") (citations omitted).

[247] Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 311–12 (Del. 2015).

[248] *Id.* at 312–313.

perform under enhanced scrutiny, effectively discharging the board of its fiduciary duty of loyalty.[249]

To illustrate the foregoing point, assume that *Gantler* prevailed, so that a statutorily required stockholder vote had no standard-reducing effect. In such a scenario, the stockholders would be entitled to approve an M&A transaction on the understanding that the deal presented to them was one in which the board had in good faith attempted to obtain the greatest shareholder value. Moreover, the stockholders would be entitled to bring a fiduciary duty lawsuit for monetary relief if they had reason to believe that the board had not done so, even if they had approved the transaction. Under *Corwin*, approval of the transaction constitutes a waiver of the stockholders' right to sue the board for breach of fiduciary duty other than for waste. In other words, the stockholders cannot choose to close and sue.

The ratification effect that *Corwin* confers, however, asks a unitary stockholder vote to do too much work. Its bundling of consent to (1) the decision to sell the business and (2) to the process and terms of the sale conflates two distinct decisions of stockholders. The first decision is whether it is an opportune time for the business to be transformed, either into cash or a different business. The second decision is whether the board has delivered to the stockholders a deal that warrants relief from the enhanced fiduciary duties that apply in the M&A setting. The two decisions are not coextensive. The stockholders might, for example, believe that the board breached its enhanced duties, yet still approve the deal because of the risk that the board will either not go back to market or will be unable to secure a better deal based on changed circumstances, or the perception that stockholder approval would not be forthcoming. Alternatively, they might believe that the board has adhered to its enhanced duties but prefer to remain invested in the company as an independent entity either because they believe in the long-run prospects of the business or that it is not a propitious time for a sale. The meaning of a stockholder vote under circumstances in which the stockholders are not entitled to rely on the board to have safeguarded their best interests, is thus unclear.

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[249] *Id.*

Put simply, stockholders who are asked to make two independent decisions should be entitled to do so in two separate votes in order to register their unambiguous preferences. One vote should consist of a discretionary vote on the sale process and terms. The other should consist of the statutorily required stockholder vote to which the stockholders are entitled under state corporate law. Only in the event of an affirmative vote on both issues should the *Corwin* effect result.

While such a regime espouses the core principles of *Santa Fe* and *Gantler,* that only those board decisions that the stockholders specifically approve can be ratified and that the ratification doctrine does not extend to a stockholder vote that is statutorily required for an M&A transaction to be effective, it differs from those decisions in an important respect. Implicit in *Santa Fe* and *Gantler* is the assumption that the doctrine of shareholder ratification is never available in instances in which board action is subject to a required stockholder vote. Thus, in *Gantler*, the court states that "the ratification doctrine does not apply to transactions where shareholder approval is statutorily required."[250] In that case, the court held that the necessity of stockholder approval of an amendment to the relevant company's certificate of incorporation eliminated the possibility that the shareholders could ratify the substance of a proposed amendment to the certificate.[251]

The court in *Corwin* likely viewed the issue of shareholder ratification in the M&A context according to a different assumption—that the only alternative to interpreting *Gantler* to mean that a statutorily required stockholder vote could not have ratification effect was to give it such effect. If stockholders are given a decoupled vote in which they are asked to make separate determinations on each--the closing of the transaction and the deal process and terms--they would never vote to approve the latter because it would be against their self-interest to do so. They could instead approve the deal but disapprove the board's conduct related to it, making it possible for them to allow the deal to proceed without forfeiting their right to claim monetary damages for a breach of fiduciary duty. A rational shareholder would thus never ratify a transaction in which it had the right to decouple its vote, into a vote on whether the transaction should become effective and another on the

[250] Gantler v. Stephens, 965 A.2d 695, 714 (Del. 2009).
[251] *Id.*

board's conduct in managing and negotiating it. Faced with the two obvious alternatives before it, the *Corwin* Court chose the less "litigation-intrusive standard"[252] on the ground that a contrary holding "promises more costs to stockholders in the form of litigation rents and inhibitions on risk-taking than it promises in terms of benefits to them."[253]

The foregoing conundrum relies, however, on the false premise that the decoupled votes would take place concurrently. In fact, it is possible to structure the timing of the votes so that the stockholders could register an advisory vote on the deal process before the company signs an acquisition agreement with an acquirer. A clean affirmative vote on the sale process would have the ratification effect sought in *Corwin*. Despite the non-binding character of the vote, it would be a meaningful one for both the stockholders and the board. An affirmative vote would serve as an inducement to the board to proceed with the transaction on the basis of its intended process. On the other hand, a negative vote might chill the board's enthusiasm for a sale, although it would not require the board to abandon the sale process or take any specific action to alter it. In addition, the board would gain meaningful information from a negative vote and could adjust its process accordingly. Full disclosure in connection with a stockholder vote would remain a precondition of deploying approval of the deal process as an affirmative defense to a fiduciary duty lawsuit against the board, as would a showing that the vote was not coerced.

In addition to providing target shareholders with a discrete vote on the sale process, a decoupled vote has several additional benefits. First, it is consistent with both *Santa Fe* and *Gantler*, while at the same time, it establishes a procedural route to the business judgment rule in M&A cases to which enhanced scrutiny applies. Second, it places less pressure on plaintiffs and courts to address indirectly, through *Corwin's* preconditions of full disclosure and the absence of coercion, sale processes that are genuinely troubling but that are cleansed under *Corwin*. Finally, it is plausible that judicial endorsement of a decoupled vote, as the only procedural safeguard that reduces the standard of review in M&A cases that are initially subject to enhanced scrutiny, will encourage deal-making by reducing ex ante for the board and potential acquirers, the risk that stockholders will later reject the transaction.

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[252] *Corwin,* 125 A.3d at 313.
[253] *Id.* (footnote omitted).

CONCLUSION

Enhanced scrutiny is in its twilight. Within the framework of heightened fiduciary duty standards for M&A transactions that the Delaware courts introduced in the 1990s, target boards of directors and their counsel have, subject to continuing judicial oversight, established robust mechanisms for maximizing shareholder value in sale transactions. These standards have, however, deteriorated over time. Until recently, the erosion was largely confined to a relaxation in the application of existing standards of review to target boards' decision-making. Thus, *Revlon* review of sales of control of a target corporation and *Unocal* review of deal protection devices erected to protect a favored bidder have undergone systematic dilution. In *Corwin v. KKR Financial Holdings LLC*, the Delaware Supreme Court went further by altering the very framework of M&A fiduciary duty law. After *Corwin*, target boards of directors can obtain the protection of the deferential business judgment rule against post-closing claims for monetary damages through a statutorily required stockholder vote approving the transaction.

On the one hand, the new limits on the ability of the Delaware courts to apply enhanced judicial scrutiny to M&A transactions have contributed to reduced deal litigation. On the other hand, such limits have generated costs for target shareholders. Reduced standards of review will weaken direct judicial monitoring of target boards. Moreover, with fewer M&A fiduciary duty cases to decide, the Delaware judiciary—historically a potent force in disciplining and guiding the conduct of M&A transactions—will enjoy less indirect influence over the sale process. With more leeway in conducting a sale, target boards will be incentivized to compromise deal process in exchange for obtaining personal benefits from acquirers. Completed transactions are therefore likely to occur at lower merger premia.

Already, there are indications that target shareholders are sustaining losses as a result of weakening judicial oversight of M&A transactions. Deal premia appear to be falling as dismissals of post-closing shareholder lawsuits rise. As a result, much of the fiduciary duty jurisprudence developed over the last three decades to police M&A transactions is at risk of becoming defunct. This article has suggested a mechanism for allowing target shareholders to ratify M&A transactions without requiring them to bless the sale process a precondition to approving the deal presented to them—a bifurcated vote on each of the deal process and the sale of the company. Such an approach would preserve the integrity of the enhanced scrutiny standard of review while simultaneously acknowledging the Delaware courts' increasing willingness to embrace shareholder ratification as a substitute for substantive judicial review of the fairness of M&A transactions.

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