TAKING *CORWIN* SERIOUSLY

by
*Itai Fiegenbaum**

Corporate law's most important development is founded on a misunderstanding of the channels and consequences of shareholder empowerment. This Article's title references the seminal Delaware Supreme Court decision that ruled that a positive shareholder vote effectively insulates a friendly sale from judicial oversight. Central to Corwin*'s reasoning is the notion that the shareholder vote provides an effective restraint against insider overreaching. Yet every deal that includes a premium over the market price is assured of shareholder approval. The doctrinal lynchpin's real-life insignificance exposes a baffling inconsistency in contemporary takeover jurisprudence.*

This Article makes two novel contributions to the burgeoning scholarship that Corwin *elicits. Descriptively, it uncovers the methods through which shareholders safeguard their interests without resorting to litigation. Shareholders' newfound voting clout does not manifest as an ability to vote down a concrete transaction they are asked to approve. Rather, it originates from the combined efforts of financial intermediaries and activist hedge funds. A hedge fund's modest ownership position does not pose a direct threat to insiders' continued incumbency. In combination with the voting power wielded by financial intermediaries, however, a hedge fund's demand is made loud and clear. The threat of displacement scares the corporate hierarchy into righting the ship. Normatively, this Article provides a framework for the continued evolution of the* Corwin *doctrine. Specifically, this Article proposes that the judicial inquiry into the effectiveness of the final vote focus on whether or not the company being sold was previously the target of hedge fund activism. While shareholder support is assured regardless, an activist presence prior to the sale is indicative of improved operating performance and increased shareholder value. This proposal strikes a proper balance between multiple competing*

* Visiting Assistant Professor, Willamette University College of Law. Earlier drafts of this Article were presented at the Rocky Mountain Junior Scholars Conference, the Canadian Law & Economics Conference, and the Corporation and Securities Litigation Workshop. I wish to thank commentators and participants at the Rocky Mountain Junior Scholars Conference, the Canadian Law & Economics Conference, and the Corporation and Securities Litigation Workshop for for helpful comments and suggestions on earlier drafts of this Article. I claim sole ownership of any remaining errors and inaccuracies.

considerations while remaining true to Corwin*'s ideological roots.*

Introduction 792
I. The Rise and Fall of Enhanced Scrutiny Review 796
   A. Court Oversight Over Friendly Sales of Control 797
   B. The Gradual Diminishment of Enhanced Scrutiny Review 804
   C. Corwin*'s Coup de Grace* 809
II. Explaining the Shift 812
   A. Capital Aggregation and Increased Voting Competence 812
   B. Unbridled Litigation Costs 814
III. The Inherent Limitations of the Shareholder Vote 816
IV. Taking *Corwin* Seriously 822
   A. Rehabilitating the Shareholder Vote 822
   B. The Future of Corwin *Compliance* 826
Conclusion 829

INTRODUCTION

Friendly sales of control are a well-known breeding ground for corporate agency costs.[1] Managers, for instance, might be tempted to push through a transaction with a favored bidder instead of exploring an overture organized by a party against whom they hold a grudge. Or they might offer the buyer a sweetheart deal with the anticipation (if not expectation) of lavish compensation from the newly sold entity. Both situations leave shareholders shortchanged.

Delaware law is aware of incumbents' predilection to stray from shareholders' interests and accordingly subjects friendly sales to a heightened standard of review.[2] The *Revlon* standard, so named for the iconic case in which it was unveiled,[3] stands

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[1] The term "friendly" connotes that the transaction was approved by the seller's board of directors. A sale of control that is carried out without board approval is referred to as a hostile takeover.

[2] Reis v. Hazelett Strip-Casting Corp., 28 A.3d 442, 457 (Del. Ch. 2011) ("Enhanced scrutiny is Delaware's intermediate standard of review. Framed generally, it requires that the defendant fiduciaries 'bear the burden of persuasion to show that their motivations were proper and not selfish' and that 'their actions were reasonable in relation to their legitimate objective.'" (quoting Mercier v. Inter-Tel (Del.), Inc., 929 A.2d 786, 810 (Del. Ch. 2007))).

[3] Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173 (Del. 1986); *see* Matthew D. Cain, Sean J. Griffith, Robert J. Jackson, Jr. & Steven Davidoff Solomon, *Does* Revlon *Matter? An Empirical and Theoretical Study*, 108 CALIF. L. REV. 1683, 1684–85 (2020) ("The *Revlon* doctrine has reached almost mythical status. . . . *Revlon* is one of the few cases every corporate lawyer knows. The case has been cited thousands of times in Westlaw. It is covered in every corporations casebook and has been the subject of hundreds of law review articles." (footnotes omitted)).

for the proposition that usual business judgment rule deference is no longer warranted in a sale scenario. The courts are instead instructed to evaluate the board's decision-making process in an attempt to uncover deviations from the proper goal of shareholder value maximization.[4] The standard used to have actual bite, as evinced by high-profile transactions that were invalidated by the courts. While the doctrinal directive has remained essentially constant for three decades, its application today is quite different.[5] Judges are loath to nix a firm offer to purchase a company. Egregious misdeeds will, at most, be remedied by additional disclosure and a slight delay before the deal is sent to the shareholders for their approval. And under the powerful *Corwin* doctrine,[6] a positive shareholder vote restores business judgment rule review, thereby insulating the transaction from judicial oversight.[7]

An accepted narrative for this tectonic shift in Delaware's takeover jurisprudence has recently emerged.[8] The large grant of authority given to corporate insiders introduces the risk of self-serving behavior. Shareholders' voting and litigation rights are designed to keep such behavior in check. Each measure comes with unique costs and benefits. Unfortunate trends diminished whatever goodwill was associated with representative shareholder litigation.[9] At the same time, the growth of financial intermediation invigorated the potency of the previously dormant shareholder vote.

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[4] 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, 328 (2018) ("*Revlon* is a corporate law icon standing for the broad proposition that, in Delaware, and about half the jurisdictions presented with similar issues, the board of directors has the burden of proving their independent and good faith pursuit of the *best offer* whenever control of the company is being sold. As so stated, the board does not enjoy the same deference courts regularly accord to director decisions regarding the company's affairs for which there is a high presumption of board propriety embodied in the business judgment rule." (footnotes omitted)).

[5] *See generally* Lyman Johnson & Robert Ricca, *The Dwindling of* Revlon, 71 WASH. & LEE L. REV. 167, 205–15 (2014) (detailing the gradual deterioration in the intensity of the judicial examination and decreased likelihood that a court will intervene in a friendly sale).

[6] Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304 (Del. 2015); *see also* James D. Cox, Tomas J. Mondino & Randall S. Thomas, *Understanding the (Ir)relevance of Shareholder Votes on M&A Deals*, 69 DUKE L. J. 503, 505 (2019) (referring to *Corwin* as the "most important development in corporate law in this still very new century").

[7] Singh v. Attenborough, 137 A.3d 151, 151–52 (Del. 2016) ("When the business judgment rule standard of review is invoked because of a vote, dismissal is typically the result. That is because the vestigial waste exception has long had little real-world relevance, because it has been understood that stockholders would be unlikely to approve a transaction that is wasteful." (footnotes omitted)).

[8] Part II, *infra*.

[9] James D. Cox & Randall S. Thomas, *Corporate Darwinism: Disciplining Managers in a World with Weak Shareholder Litigation*, 95 N.C. L. REV. 19, 26 (2016) ("[T]he business community shares the common view that shareholder litigation is vexatious, robust, and expanding."). *See generally* Randall S. Thomas & Robert B. Thompson, *A Theory of Representative*

Moving away from a meticulous examination of every sale eliminates the costs of frivolous litigation at no harm to shareholder value. Framed this way, everyone appears to be better off.

Or so it seems. Central to the *Corwin* line of reasoning is the notion that the shareholder vote provides an effective restraint against insider overreaching.[10] Yet every deal that includes a premium over the market price is assured of shareholder approval.[11] Even the revelation of evidence that casts the sales process in a negative light barely leaves a dent in their enthusiasm for the deal. The doctrinal lynchpin's real-life insignificance exposes a baffling inconsistency in the most important trend in contemporary takeover jurisprudence.

This Article contends that the *Corwin* doctrine is founded on a misunderstanding of the channels and consequences of shareholder empowerment. To be sure, shareholders today are able to utilize their voting clout as never before.[12] Yet this newfound power does not manifest as an ability to vote down a concrete transaction they are asked to approve. Rather, it originates from the combined efforts of financial intermediaries and activist hedge funds.[13] The latter seek out underperforming companies that exhibit traits of managerial indolence. A hedge fund's modest ownership position does not pose a direct threat to insiders' continued incumbency. In combination with the voting power wielded by financial intermediaries, however, a hedge fund's demand is made loud and clear. Full-blown proxy fights for corporate

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Shareholder Suits and Its Application to Multijurisdictional Litigation, 106 NW. U. L. REV. 1753 (2012) (depicting the causes for near-universal litigation rates against certain transactions).

[10] *Corwin*, 125 A.3d at 313–14 ("When the real parties in interest—the disinterested equity owners—can easily protect themselves at the ballot box by simply voting no, the utility of a litigation-intrusive standard of review 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. The reason for that 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).").

[11] Part III, *infra*.

[12] Paul Rose & Bernard S. Sharfman, *Shareholder Activism as a Corrective Mechanism in Corporate Governance*, BYU L. REV. 1015, 1018–19 (2014) ("Even though shareholder activism has been a feature of corporate governance for over one hundred years, only recently have all the pieces come together for shareholder activism to become a powerful force in corporate governance." (footnote omitted)).

[13] State corporate law statutes and federal securities acts and regulations lack a distinctive definition for the term "hedge funds." In practice, the term refers to a sect of unregulated investment vehicles maintained by wealthy individuals and entities. *See* William W. Bratton, *Hedge Funds and Governance Targets*, 95 GEO. L. J. 1375, 1382 (2007) ("Although hedge funds resist one-line definition, their regulatory status at the moment is clear enough: They lie outside the bounds of federal regulation of mutual funds, other investment companies, and their advisors.").

control remain rare; it is the threat of displacement that scares the corporate hierarchy into righting the ship.[14]

Uncovering the method through which shareholders safeguard their interests paves the way for this Article's proposal for reform.[15] The shortcomings of the final shareholder vote necessitate some measure of court oversight to deter insider overreaching. Considerable stakes ride on the courts' ability to identify the transactions that warrant a steeper review. An overly broad approach runs the risk of putting a damper on value-enhancing transactions and rekindling the harmful litigation dynamics that Delaware has endeavored to eradicate.[16] Too little oversight, by contrast, will inevitably lead to cursory adherence to transactional best practices.[17] This Article proposes that a target company's recent history with hedge fund activism factors prominently in the court's decision on whether to grant the standard-reducing effect of the *Corwin* vote.[18] In any case, the transaction is assured of shareholder

[14] William W. Bratton, *Hedge Fund Activism, Poison Pills, and the Jurisprudence of Threat*, *in* THE CORPORATE CONTRACT IN CHANGING TIMES 156, 156–57 (Steven Davidoff Solomon & Randall Stuart Thomas eds., 2019) ("[Hedge fund] activism threatens incumbent managers and disrupts their business plans by successfully appealing to the shareholders' interest in immediate returns. . . . Hedge fund activism has operated as a catalyst that enables dispersed shareholders to surmount collective action problems so as to register preferences regarding corporate business plans in connection with voting on competing candidates for board seats.").

[15] Scholarly proposals focus on suggestions to make the final *Corwin* vote a better predictor of shareholder value. *See* Iman Anabtawi, *The Twilight of Enhanced Scrutiny in Delaware M&A Jurisprudence*, 43 DEL. J. CORP. L. 161 (2019) (proposing to bifurcate *Corwin*'s single vote into a two-step procedure that features an advisory vote on the deal process prior to the statutorily required vote to approve the transaction); Cox et al., *supra* note 6 (conditioning the standard-reducing effect of a positive *Corwin* vote on a higher evidentiary burden); Sean J. Griffith & Dorothy S. Lund, *Conflicted Mutual Fund Voting in Corporate Law*, 99 B.U. L. REV. 1151 (2019) (proposing to exclude conflicted mutual funds from the voting constituency that is taken into account for the final vote); *cf.* Ann M. Lipton, *Shareholder Divorce Court*, 44 J. CORP. L. 297 (2018) (advocating for a reform of the appraisal remedy to permit dissenting shareholders to continue with a damages claim even after a positive *Corwin* vote).

[16] *See* Matthew D. Cain, Jill Fisch, Steven Davidoff Solomon & Randall S. Thomas, *The Shifting Tides of Merger Litigation*, 71 VAND. L. REV. 603, 610–19 (2018) (surveying the changes to Delaware law in response to a perception that merger litigation rates were too high).

[17] Charles R. Korsmo, *Delaware's Retreat from Judicial Scrutiny of Mergers*, 10 U.C. IRVINE L. REV. 55, 61 (2019) ("It is certainly possible that the deal-making norms built up since the 1980s will persist even after the legal landscape has shifted to eliminate the possibility of post-closing damages. It seems less likely, however, that managers and directors were moved to obey these norms by their respect for the wisdom of Delaware's judges than that they were motivated by fear of their sanctions. As that fear subsides, it would be naïve to expect these norms to persist unaltered.").

[18] Evaluating a company's history as a hedge fund target comports with the weeding out role played by the Delaware courts in the early stages of shareholder litigation. *See* Lawrence A. Hamermesh & Michael L. Wachter, *The Importance of Being Dismissive: The Efficiency Role of Pleading Stage Evaluation of Shareholder Litigation*, 42 J. CORP. L. 597, 602–03 (2017) ("[O]ne

support. An activist presence, however, is indicative of improved operating performance prior to the sale and, ultimately, increased shareholder value.[19] The proposal thus strikes a proper balance between multiple competing interests while staying true to *Corwin*'s ideological roots.[20]

The rest of this Article is structured as follows. Following this Introduction, Part I expounds on the factors that animate enhanced scrutiny review and tracks the standard's gradual decline. Part II depicts the accepted narrative for the current judicial attitude. Part III explains the considerations that undermine the vote's reliability when shareholders are asked to approve a sale of the company. Part IV clarifies the channels through which managerial accountability is preserved without resort to litigation and explains how to recalibrate *Corwin* in light of these findings. The last Part concludes.

I. THE RISE AND FALL OF ENHANCED SCRUTINY REVIEW

This Part documents the Delaware courts' shifting attitude toward alleged board misdeeds in the lead-up to a friendly sale. It begins by explaining the context-specific agency costs that necessitate heightened court supervision and, in extraordinary cases, even intervention. Next, it tracks the rise of ancillary doctrines that make the threat of judicial intrusion ring hollow. Lastly, it expands on the most recent doctrinal innovation, which provides a pathway to insulate the transaction from substantive court oversight.

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cannot count on symmetry of litigation costs to generate an efficient equilibrium in which unmeritorious cases are either dismissed or not brought at all: the one-sided threat of unchecked discovery costs becomes a source of leverage for extracting settlement payments without regard to the merits of the litigation. In that setting, efficiency depends upon a system of judicial supervision and triage at an early stage of the litigation, so that cases lacking merit are dismissed and thereby deprived of their extortive effect, and meritorious cases are identified as such early on and settled so that the enormous costs of discovery and trial can be avoided." (footnotes omitted)); *see also* Roy Shapira, *Corporate Law, Retooled: How Books and Records Revamped Judicial Oversight*, 42 CARDOZO L. REV. 1949 (2021) (explaining the current dynamics of the various preliminary stages of shareholder litigation).

[19] Part IV, *infra*.

[20] *See* Lipton, *supra* note 15, at 327 ("It is likely impossible to put the *Corwin* genie back in the bottle. Even if courts were to discover a new appetite for vigorous second-guessing of managerial decision-making, *Corwin*'s fundamental rationale—that the majority of shareholders should be permitted to accept transactions that they find beneficial, without being chained to a small number of holdouts—has a normative appeal. Nor is there a feasible mechanism for conducting a more nuanced analysis of shareholder conflicts, if only because *Corwin* itself is predicated on the sophistication of diversified—and thus conflicted—shareholders.").

A. Court Oversight Over Friendly Sales of Control

Standards of review are a defining feature of Delaware corporate law.[21] A standard of review signifies the intensity of judicial scrutiny over the challenged act.[22] Absent discernable conflicts of interest, a court will apply the default business judgment rule standard of review.[23] The business judgment rule's presumption of board propriety leaves no room for judicial intervention.[24] A plaintiff's failure to rebut the presumption results in a swift dismissal of the complaint.[25]

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[21] Robert B. Thompson, *Mapping Judicial Review:* Sinclair v. Levin, *in* THE ICONIC CASES IN CORPORATE LAW 79, 79 (Jonathan R. Macey ed., 2008) ("The intensity of judicial review of corporate decisions is the central issue of corporate law."); *In re* Molycorp, Inc. S'holder Derivative Litig., C.A. No. 7282, 2015 WL 3454925, at *7 (Del. Ch. May 27, 2015) ("Distinguishing among standards of review is an important (and frequently dispositive) exercise."); Emerald Partners v. Berlin, 787 A.2d 85, 89 (Del. 2001) (This is because "[t]he applicable standard of judicial review often controls the outcome of the litigation on the merits.").

[22] Melvin Aron Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 FORDHAM L. REV. 437, 437 (1993) (defining a standard of review as a "test a court should apply when it reviews an actor's conduct to determine whether to impose liability or grant injunctive relief"); *see also* William T. Allen, Jack B. Jacobs & Leo E. Strine Jr., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 26 DEL. J. CORP. L. 859, 867 (2001) ("A judicial standard of review is a value-laden analytical instrument that reflects fundamental policy judgments. In corporate law, a judicial standard of review is a verbal expression that describes the task a court performs in determining whether action by corporate directors violated their fiduciary duty. Thus, in essential respects, the standard of review defines the freedom of action (or, if you will, the deference in the form of freedom from intrusion) that will be accorded to the persons who are subject to its reach.").

[23] Carsanaro v. Bloodhound Techs., Inc., 65 A.3d 618, 637 (Del. Ch. 2013) ("The business judgment rule serves as Delaware's default standard of review and applies to the overwhelming majority of decisions that boards make.").

[24] Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 64 (Del. 1989) ("The business judgment rule is an extension of the fundamental principle 'that the business and affairs of a corporation are managed by and under the direction of its board.' The rule operates as both a procedural guide for litigants and a substantive rule of law. As a rule of evidence, it creates 'a presumption that in making a business decision, the directors of a corporation acted on an informed basis [i.e., with due care], in good faith and in the honest belief that the action taken was in the best interest of the company.' The presumption initially attaches to a director-approved transaction within a board's conferred or apparent authority in the absence of any evidence of 'fraud, bad faith, or self-dealing in the usual sense of personal profit or betterment.' The burden falls upon the proponent of a claim to rebut the presumption by introducing evidence either of director self-interest, if not self-dealing, or that the directors either lacked good faith or failed to exercise due care. If the proponent fails to meet her burden of establishing facts rebutting the presumption, the business judgment rule, as a substantive rule of law, will attach to protect the directors and the decisions they make." (citations omitted) (first quoting Pogostin v. Rice, 480 A.2d 619, 624 (Del. 1984); then quoting Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (alteration in original); and then quoting Grobow v. Perot, 539 A.2d 180, 187 (Del. 1988))).

[25] Nixon v. Blackwell, 626 A.2d 1366, 1376 (Del. 1993) ("It is sometimes thought that the decision whether to apply the business judgment rule or the entire fairness test can be outcome-

A hands-off judicial approach does not mean that corporate actors are free to act in any way they see fit. Accountability is preserved by way of continuous monitoring of the various markets in which a corporation competes.[26] Directors' preference for a steady stream of benefits over a one-time reward explains this method's effectiveness.[27] The corporate hierarchy treads lightly for fear that their transgressions will offend the markets and cut off this stream.[28]

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determinative."); Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993) ("The [business judgment] rule posits a powerful presumption in favor of actions taken by the directors in that a decision made by a loyal and informed board will not be overturned by the courts unless it cannot be 'attributed to any rational business purpose.' . . . To rebut the rule, a shareholder plaintiff assumes the burden of providing evidence that directors, in reaching their challenged decision, breached any one of the *triads* of their fiduciary duty—good faith, loyalty or due care. If a shareholder plaintiff fails to meet this evidentiary burden, the business judgment rule attaches to protect corporate officers and directors and the decisions they make, and our courts will not second-guess these business judgments." (citations omitted) (quoting Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971))).

[26] Stephen M. Bainbridge, Unocal *at 20: Director Primacy in Corporate Takeovers*, 31 DEL. J. CORP. L. 769, 785 (2006) ("Corporate directors operate within a pervasive web of accountability mechanisms that substitute for monitoring by residual claimants. A variety of market forces provide important constraints. The capital and product markets, the internal and external employment markets, and the market for corporate control all constrain shirking by firm agents."). These measures are strengthened by the non-legal norms embedded in the firm. *See* Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619 (2001) (explaining the role of non-legally enforceable rules and standards in structuring behavior within the business organization).

[27] FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 95 (1991) ("Poor performance is rational, as managers see things, when current gains exceed the present value of future costs. The relation between gains and future costs depends in large part on the likelihood of repeat transactions. The higher the probability of repeat transactions, the greater the incentive to perform well.").

[28] The negative repercussions of an offense manifest in several ways. Poor operating performance and a depressed share price increase a corporation's cost of raising capital, thereby exacerbating an already difficult financial situation. *See id.* At their extreme, underperforming corporations will find themselves either in bankruptcy or in the midst of a shareholder revolt. Both scenarios are detrimental to managements' continued livelihood. Well before the occurrence of these disastrous events, poor stock performance will directly impact the equity-based portion of director and management compensation.

A sale of the corporation, however, represents a final period of interaction with the firm's shareholders.[29] The distinction is significant, as the allure of future rewards and threat of retaliation no longer combine to keep directors honest.[30] Increased judicial vigilance counteracts the diminished effectiveness of a market-based accountability scheme.

An additional justification supports the need for court scrutiny over a friendly sale. Transactions that culminate with the establishment of a controller at a previously uncontrolled firm impact shareholders' legitimate rights and expectations.[31] Once a control block is formed, the new controller is free to pocket all proceeds from a sale of her shares.[32] The creation of a control block therefore forecloses any possibility minority shareholders had to participate in a future receipt of a control

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[29] Sean J. Griffith, *Deal Protection Provisions in the Last Period of Play*, 71 FORDHAM L. REV. 1899, 1942 (2003) ("The last period problem is a recognized phenomenon in game theory and rational choice economics. Cooperative undertakings predictably deteriorate in the last period because participants are more likely to pursue selfish objectives once they recognize that the system of rewards and punishments favoring cooperation during the life of the enterprise soon will no longer apply. In game theory, this phenomenon is most visible in the final period of 'social dilemma' games, such as the prisoner's dilemma." (footnotes omitted)).

[30] Bainbridge, *supra* note 26, at 789 ("Target management is no longer subject to market discipline because the target, by definition, will no longer operate in the market as an independent agency. As a result, management is less vulnerable to both shareholder and market penalties for self-dealing."); Sean J. Griffith, *The Costs and Benefits of Precommitment: An Appraisal of* Omnicare v. NCS Healthcare, 29 J. CORP. L. 569, 616 (2004) ("Acquisitions create a last period scenario for target managers and directors because the reorganization of the corporate structure following the transaction is likely either to end their tenure or, at the very least, significantly change their role in the company. With the alteration or elimination of their corporate responsibilities come increased incentives to defect from the best interests of the corporation and its shareholders in favor of their own interests.").

[31] *See* Lucian A. Bebchuk & Assaf Hamdani, *The Elusive Quest for Global Governance Standards*, 157 U. PA. L. REV. 1263, 1282 (2009) ("In [controlled] companies, control is not contestable. The controlling shareholder has a lock on control by virtue of its ownership of a majority of the voting rights—or at least a sufficient percentage of voting rights to secure an effective lock on control. . . . When an active market for corporate control exists, insiders are subject to the threat of removal if they fail to maximize shareholder value. . . . In [controlled] companies . . . the threat of a control contest does not exist and cannot constrain insider opportunism.").

[32] Abraham v. Emerson Radio Corp., 901 A.2d 751, 762 (Del. Ch. 2006) ("[T]he general rule [is] that controllers are free, as is any other stockholder, to alienate their shares, provided they comply with any transfer provisions in the relevant corporate instruments and in statutory law."). The general rule's narrow exception is known as the "known looter theory." As the name implies, this theory assigns liability to a controlling shareholder that sells her controlling shares to a buyer who she has reason to believe intends to loot the corporation. *See* Ford v. VMware, Inc., C.A. No. 11714, 2017 WL 1684089, at *9–10 (Del. Ch. May 2, 2017) (explaining the known looter theory).

premium.[33] Since the directors overseeing the sale might not internalize this result,[34] judicial oversight is necessary to ensure that shareholders are not left holding the short end of the stick.[35]

The seminal *Paramount Communications v. QVC* decision cements the notion that heightened court involvement is warranted in a final period transaction or in a merger that transforms shareholders in a widely-held firm into minority shareholders at controlled firms.[36] The announcement of a merger between Paramount and Viacom caused QVC to swoop in with an apparently superior cash offer for Paramount's shares.[37] Prior to the proposed transaction, Paramount's shares were widely distributed among the public float. The clear majority of Viacom's voting power, by contrast, was concentrated in the hands of a controlling shareholder. The merger called for Paramount's shareholders to relinquish their shares in exchange for a combination of cash and Viacom shares, transforming them from minority shareholders in a widely dispersed firm to minority shareholders in an entity with an entrenched controller. This transformation catalyzed Delaware's takeover jurisprudence.

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[33] Alexander Dyck & Luigi Zingales, *Private Benefits of Control: An International Comparison*, 59 J. FIN. 537 (2004) (documenting the premium paid for control block shares in 39 countries).

[34] Paul Davies, Klaus Hopt & Wolf-Georg Ringe, *Control Transactions*, *in* THE ANATOMY OF CORPORATE LAW 205, 207 (3d ed. 2017) ("Prior to the offer *de facto* control of the company was probably in the hands of the target board, so that, following a takeover, control shifts from the board of the target to the acquirer. Therefore, there is a disjunction between the parties to the dealings which bring about the transfer of control (acquirer and target shareholders) and the parties to the control shift itself (acquirer and target board). It is precisely this disjunction which generates the agency issues which need to be addressed.").

[35] *See In re* Dollar Thrifty S'holder Litig., 14 A.3d 573, 597 (Del. Ch. 2010) ("The heightened scrutiny that applies in the [intermediate standard of review] contexts are, in large measure, rooted in a concern that the board might harbor personal motivations in the sale context that differ from what is best for the corporation and its stockholders. Most traditionally, there is the danger that top corporate managers will resist a sale that might cost them their managerial posts, or prefer a sale to one industry rival rather than another for reasons having more to do with personal ego than with what is best for stockholders." (footnotes omitted)).

[36] Paramount Commc'ns, Inc. v. QVC Network, Inc., 637 A.2d 34 (Del. 1994).

[37] Subsequent renegotiations between Paramount and Viacom resulted in a slight price increase but otherwise had no effect on the original deal's protective measures. These measures included a no-shop provision, a considerable termination fee, and an uncapped option to purchase almost 20% of Paramount's stock should the merger somehow fail. Remarkably, Paramount agreed for the purchase price to be paid in subordinated notes of questionable marketability instead of cash. When Paramount's share price rocketed during the bidding war, this extremely generous option was worth nearly $500 million. *Id.* at 39–40.

Prior to *QVC*, the permissible contours of board actions leading up to a sale of control were both underdeveloped and unclear. Some of the confusion is attributable to the language used in the Delaware Supreme Court's *Revlon* decision,[38] which could be read as requiring a board-led auction as a precursor to every friendly sale of control.[39]

The Delaware Supreme Court quickly backtracked from *Revlon*'s "auctioneer" metaphor.[40] At the time *QVC* was handed down, however, a clear and workable framework through which to evaluate sales of control had yet to be developed. Contemporary Delaware jurisprudence offered two main standards of review: the business judgment rule and its antithesis, entire fairness.[41] The entire fairness standard of review applies to self-dealing or similarly conflicted transactions.[42] Judicial reluctance to intrude upon decisions taken by the board understandably disappears when

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[38] Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173 (Del. 1986). Although the specific directives were quickly abandoned by later Delaware Supreme Court precedent, the term "Revlon" carries on as a shorthand for a voluntary sale of control.

[39] *Id.* at 182 ("The duty of the board had thus changed from the preservation of Revlon as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit. . . . The directors' role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company.").

[40] Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1286 (Del. 1989) ("Directors are not required by Delaware law to conduct an auction according to some standard formula, only that they observe the significant requirement of fairness for the purpose of enhancing general shareholder interests."); Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989) ("[T]here is no single blueprint that a board must follow to fulfill its duties. A stereotypical approach to the sale and acquisition of corporate control is not to be expected in the face of the evolving techniques and financing devices employed in today's corporate environment. . . . When it becomes clear that the auction will result in a change of corporate control, the board must act in a neutral manner to encourage the highest possible price for shareholders. However, *Revlon* does not demand that every change in the control of a Delaware corporation be preceded by a heated bidding contest." (citations omitted)).

[41] J. Travis Laster, Revlon *Is a Standard of Review: Why It's True and What It Means*, 19 FORDHAM J. CORP. & FIN. L. 5, 8 (2013) ("Until the watershed year of 1985, Delaware recognized only two standards of review for evaluating board decisions: the business judgment rule and the entire fairness test. The two doctrines reflected a binary world view in which directors fell into one of the two categories: independent and disinterested directors who made decisions that court would have no cause to second-guess and interested directors who made decisions that were inherently suspect." (footnotes omitted)).

[42] *In re* Invs. Bancorp Inc. S'holder Litig., 177 A.3d 1208, 1217 (Del. 2017) ("Although authorized to do so by statute, when the board fixes its compensation, it is self-interested in the decision because the directors are deciding how much they should reward themselves for board service. If no other factors are involved, the board's decision will 'lie outside the business judgment rule's presumptive protection, so that, where properly challenged, the receipt of self-determined benefits is subject to an affirmative showing that the compensation arrangements are fair to the corporation.' In other words, the entire fairness standard of review will apply." (footnotes omitted) (quoting Telxon Corp. v. Meyerson, 802 A.2d 257, 265 (Del. 2002))); *In re* Martha Stewart

the corporation's decision makers have a contrary financial interest in the transaction.[43] Entire fairness review appropriately ends all judicial presumptions in the board's favor. When the standard applies, it is up to the corporate defendants to prove that the transaction was entirely fair to the shareholders.[44]

Neither of the two available standards of review—business judgment rule and entire fairness—are ideally suited for combating the subtle manipulations that might potentially contaminate a sale process.[45] The accompanying factors that help ensure board fidelity are severely undermined in a sale of control. In their absence, the lax judicial oversight embodied by the business judgment rule would fail to detect and

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Living Omnimedia, Inc. S'holder Litig., C.A. No. 11202, 2017 WL 3568089, at *11 (Del. Ch. Aug. 18, 2017) ("As this court has often reiterated, 'entire fairness is not triggered solely because a company has a controlling stockholder.' Rather, 'the controller also must engage in a conflicted transaction.' . . . In the controlling stockholder context, a conflicted transaction typically will fit one of two scenarios. In one scenario, the controller stands on both sides of the transaction, such as when a parent acquires its subsidiary. . . . In the other scenario, the controlling stockholder does not stand on both sides of the transaction but exploits its position of leverage on the sell-side to extract 'different consideration or derives some unique benefit from the transaction not shared with the common stockholders.'" (footnotes omitted) (quoting *In re* Crimson Expl. Inc. S'holder Litig., C.A. No. 8541, 2014 WL 5449419, at *12 (Del. Ch. Oct. 24, 2014))).

[43] Gottlieb v. Heyden Chem. Corp., 90 A.2d 660, 663 (Del. 1952) ("Human nature being what it is, the law, in its wisdom, does not presume that directors will be competent judges of the fair treatment of their company where fairness must be at their own personal expense.").

[44] Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983) ("The concept of fairness has two basic aspects: fair dealing and fair price. The former embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. The latter aspect of fairness relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock. However, the test for fairness is not a bifurcated one as between fair dealing and price. All aspects of the issue must be examined as a whole since the question is one of entire fairness." (citations omitted)). While the entire fairness standard puts a heavy burden on the defendants, it is by no means insurmountable. *See* Frederick Hsu Living Tr. v. Oak Hill Cap. Partners III, C.A. No.12108, 2020 WL 2111476 (Del. May 4, 2020) (post-trial judgment finding that the corporate defendants proved the entire fairness of their actions). Additionally, recent Delaware precedent provides guidelines for corporations wishing to downgrade the standard of review from entire fairness to the business judgment rule in the context of controlling shareholder self-dealing. *See* Kahn v. M & F Worldwide Corp., 88 A.3d 635, 645 (Del. 2014).

[45] *See In re* Dollar Thrifty S'holder Litig., 14 A.3d 573, 597–98 (Del. Ch. 2010) ("Avoiding a crude bifurcation of the world into two starkly divergent categories—business judgment rule review reflecting a policy of maximal deference to disinterested board decisionmaking and entire fairness review reflecting a policy of extreme skepticism toward self-dealing decisions—the Delaware Supreme Court's *Unocal* and *Revlon* decisions adopted a middle ground. In that middle ground, the reviewing court has leeway to examine the reasonableness of the board's actions that is more stringent than business judgment review and yet less severe than the entire fairness standard." (footnotes omitted)).

deter self-serving transaction planners. Subjecting non-conflicted sales of control to entire fairness review produces a different form of harm: A requirement that all sales of control be subject to entire fairness review would discourage efficient deals that enhance shareholder value.

The *QVC* court's Goldilocks solution forges a middle ground between the extreme permissiveness of the business judgment rule and the excess vigilance of entire fairness review. Central to the newly pronounced intermediate standard of review is the concept of reasonableness. Application of the enhanced scrutiny standard requires the courts to evaluate both the board's decision-making process prior to the sale and the subsequent substantive decision.[46] Similar to the entire fairness standard, the onus is upon the board of directors to demonstrate the reasonableness of their actions in both prongs of the judicial inquiry. At the same time, the range of reasonableness produced by the inquiry leaves sufficient leeway for a scrupulous board to exercise its business judgment for the benefit of all shareholders. Judicial deference to board autonomy and authority is preserved, for instance, in the directors' right to prefer a lower monetary offer. While shareholder value maximization remains the guiding light in a sale of control scenario,[47] its application goes beyond a straight mathematical comparison. An enhanced scrutiny review will uphold a board's decision to accept a facially inferior monetary offer so long as it is supported by a reasonable decision-making process and deliberation.[48]

The *QVC* court further demonstrated that enhanced scrutiny review has actual bite. The emergence of QVC as a viable alternative put Paramount in an advantageous negotiating position. Yet, instead of using its leverage to reduce the severity of the deal protection measures or otherwise unlock additional value for its share-

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[46] Paramount Commc'ns, Inc. v. QVC Network, Inc., 637 A.2d 34, 45 (Del. 1994) ("The key features of an enhanced scrutiny test are: (a) a judicial determination regarding the adequacy of the decisionmaking process employed by the directors, including the information on which the directors based their decision; and (b) a judicial examination of the reasonableness of the directors' action in light of the circumstances then existing. The directors have the burden of proving that they were adequately informed and acted reasonably.").

[47] *Id.* at 43 ("The consequences of a sale of control impose special obligations on the directors of a corporation. In particular, they have the obligation of acting reasonably to seek the transaction offering the best value reasonably available to the stockholders. The courts will apply enhanced scrutiny to ensure that the directors have acted reasonably." (footnote omitted)).

[48] *Id.* at 44–45 ("In determining which alternative provides the best value for stockholders, a board of directors is not limited to considering only the amount of cash involved, and is not required to ignore totally its view of the future value of a strategic alliance. Instead, the directors should analyze the entire situation and evaluate in a disciplined manner the consideration being offered. . . . While the assessment of these factors may be complex, the board's goal is straightforward: Having informed themselves of all material information reasonably available, the directors must decide which alternative is most likely to offer the best value reasonably available to the stockholders." (footnotes omitted) (citations omitted)).

holders, Paramount's board was unwavering in its support of the original transaction.[49] Paramount's refusal to properly comprehend the far-reaching effects of the deal protection devices was unreasonable and the Paramount-Viacom transaction was accordingly enjoined.

B. *The Gradual Diminishment of Enhanced Scrutiny Review*

The previous sub-Part explained the judicial framework used to evaluate friendly sales of corporate control. Entrance into "*Revlon*-Land" warrants a higher level of court oversight in response to the reduced effectiveness of market-based accountability measures and the diminished voting power of the remaining minority shareholders. Forcing the selling board to prove the reasonableness of its decision was designed to enable a reviewing court to uncover subtle biases that undermine the sale process. In the *QVC* case, Paramount's inability to prove its reasonableness led to an invalidation of the deal protection measures. *QVC*'s dramatic result, however, turned out to be an outlier.[50] The judiciary's reluctance to intrude upon decisions to sell quickly became a feature of the new intermediate standard of review.

The Delaware Supreme Court's analysis of the sale of Lyondell Chemical exemplifies the ancillary doctrines that operate in concert to minimize court intervention in a board's decision-making process in the lead-up to a friendly sale.[51] A potential buyer's announcement of the right to purchase a non-trivial cluster of Lyondell shares and plans for subsequent transactions spurred the Lyondell board to convene a special meeting. The momentous occurrence, however, failed to get the board to commit to any particular course of action. Two months of complete passivity passed by before Lyondell's CEO finally met with the would-be acquirer. The board's debriefing on this development lasted less than an hour; its lone output was a request for greater detail regarding the buyer's financing. Receipt of this information prompted the retention of a financial advisor to shepherd the deal. A merger agreement was finalized within a week. In all, fewer than ten hours of board deliberations preceded a multi-billion-dollar sale of the corporation.[52] Since the

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[49] *Id.* at 49 ("When entering into the Original Merger Agreement, and thereafter, the Paramount Board clearly gave insufficient attention to the potential consequences of the defensive measures demanded by Viacom. The Stock Option Agreement had a number of unusual and potentially 'draconian' provisions, including the Note Feature and the Put Feature. Furthermore, the Termination Fee, whether or not unreasonable by itself, clearly made Paramount less attractive to other bidders, when coupled with the Stock Option Agreement. Finally, the No-Shop Provision inhibited the Paramount Board's ability to negotiate with other potential bidders, particularly QVC which had already expressed an interest in Paramount." (footnotes omitted)).

[50] Johnson & Ricca, *supra* note 5, at 212 (documenting that between 2008 and 2013, only one of the fifteen requests to enjoin a friendly sale of control was granted by the Court of Chancery).

[51] Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 243–44 (2009).

[52] *Id.* at 237–39.

buyer would not budge from the price that was set in the first meeting with Lyondell's CEO, the only tangible benefit arguably attributable to board involvement was a slight reduction in the termination fee and a fiduciary out in the event that a better offer came along.[53]

The Delaware Supreme Court found even this low-level of board activity sufficient to satisfy enhanced scrutiny's reasonableness requirement. The first theme that emerges from the court's analysis relates to the temporal dimension of the intermediate standard of review. Commencement of a sale process redraws the boundaries of acceptable board action. The business judgment rule's zone of rationality is by definition more tolerant of board decisions than enhanced scrutiny's range of reasonableness.[54] The different approaches used by the Court of Chancery and Delaware Supreme Court to evaluate the first two months of board idleness illustrate the consequences of being on the wrong side of the cut-off line. The Court of Chancery's denial of summary judgment stemmed from its application of enhanced scrutiny to that time period. The Delaware Supreme Court singled out this error: Even when a sale of a corporation eventually takes place, a positive board decision to enter negotiations marks the point where enhanced scrutiny review sets in. All actions undertaken by the board prior to that threshold are shielded by the business judgment rule's presumption of propriety.[55] Limiting the time period that will subsequently be analyzed under enhanced scrutiny review enlarges the spectrum of board responses that are immune from judicial second-guessing.[56]

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[53] A "fiduciary out" is a contractual provision in the merger agreement that authorizes the selling party to terminate the merger in the event that a later more attractive offer emerges. *See* STEPHEN M. BAINBRIDGE & IMAN ANABTAWI, MERGERS AND ACQUISITIONS: A TRANSACTIONAL PERSPECTIVE 252 (2017).

[54] *In re* Netsmart Techs., Inc. S'holders Litig., 924 A.2d 171, 192 (Del. Ch. 2007) ("What is important and different about the *Revlon* standard is the intensity of judicial review that is applied to the directors' conduct. Unlike the bare rationality standard applicable to garden-variety decisions subject to the business judgment rule, the *Revlon* standard contemplates a judicial examination of the reasonableness of the board's decision-making process. Although linguistically not obvious, the reasonableness review is more searching than rationality review, and there is less tolerance for slack by the directors. Although the directors have a choice of means, they do not comply with their *Revlon* duties unless they undertake reasonable steps to get the best deal." (footnote omitted)).

[55] *Lyondell Chem. Co.*, 970 A.2d at 242 ("The directors decided that they would neither put the company up for sale nor institute defensive measures to fend off a possible hostile offer. Instead, they decided to take a 'wait and see' approach. That decision was an entirely appropriate exercise of the directors' business judgment. The time for action under *Revlon* did not begin until July 10, 2007, when the directors began negotiating the sale of Lyondell.").

[56] This limitation is compounded by the requirement that the negotiations produce a done deal. Failure to reach an agreement results in the retention of business judgment review over the whole aborted sale process, effectively shielding the sale-side directors from any meaningful judicial oversight. *See* Johnson & Ricca, *supra* note 5, at 195–205.

An additional theme that stands out from the *Lyondell* decision relates to the interplay between standards of review and directors' fiduciary duties. While some colloquial terminology may engender confusion, they are not synonymous:[57] A standard of review represents the degree of judicial scrutiny to be applied to the challenged board action; a fiduciary duty is a behavioral obligation for corporate directors to comport with.[58] Regardless of the applicable standard, directors must abide by the twin duties of care and loyalty. The duty of care is a context-specific application of the tort of negligence.[59] The duty of loyalty imposes on a director a continuous obligation to elevate the corporation's interests above all else and has traditionally been evoked to regulate self-dealing and similar situations in which a fiduciary has divergent financial incentives.[60]

Distinguishing the two has practical import. A corporate charter may eliminate all liability arising from a breach of the duty of care.[61] A similar option is unavailable for most aspects of the duty of loyalty.[62] An inability to plead a non-exculpated duty

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[57] Malpiede v. Towson, 780 A.2d 1075, 1083–84 (Del. 2001) ("*Revlon* neither creates a new type of fiduciary duty in the sale-of-control context nor alters the nature of the fiduciary duties that generally apply. Rather, *Revlon* emphasizes that the board must perform its fiduciary duties in the service of a specific objective: maximizing the sale price of the enterprise. Although the *Revlon* doctrine imposes enhanced judicial scrutiny of certain transactions involving a sale of control, it does not eliminate the requirement that plaintiffs plead sufficient facts to support the underlying claims for a breach of fiduciary duties in conducting the sale." (footnotes omitted)).

[58] ARTHUR R. PINTO & DOUGLAS M. BRANSON, UNDERSTANDING CORPORATE LAW § 8.01, at 221 (4th ed. 2013) ("[D]irectors and officers are in a fiduciary relationship to their corporation and to the shareholders. Controlling shareholders may also be characterized as fiduciaries. The primary problems faced by shareholders are mismanagement of the business or unfair self-dealing by those who are fiduciaries. The requirements and enforcement of fiduciary duty serves as a monitoring device to limit those harms." (footnotes omitted)).

[59] *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 749 (Del. Ch. 2005) ("The fiduciary duty of due care requires that directors of a Delaware corporation 'use that amount of care which ordinarily careful and prudent men would use in similar circumstances,' and 'consider all material information reasonably available' in making business decisions." (first quoting Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 130 (Del. 1963); and then quoting Brehm v. Eisner, 746 A.2d 244, 259 (Del. 2000))).

[60] Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939) ("Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests."); Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993) ("Essentially, the duty of loyalty mandates that the best interest of the corporation and its shareholders take precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the stockholders generally." (citation omitted)).

[61] DEL. CODE ANN. tit. 8, § 102(b)(7) (2022).

[62] To be precise, the Delaware General Corporation Law currently allows a corporation to renounce any interest or expectancy to participate in a specific business opportunity or a class of opportunities. *See* DEL. CODE ANN. tit. 8, § 122(17) (2022). In essence, this renouncement amounts to an ex-ante concession of a limited fiduciary breach. For an empirical study on the prevalence of such corporate opportunity waivers, see generally Gabriel Rauterberg & Eric Talley,

of loyalty claim is a litigation-ending deficiency.[63] Universal adoption of exculpatory provisions made claims against suspect behavior that lacks a clear non-pecuniary interest, such as a friendly sale of control, effectively litigation-proof.[64]

Clarifying the duty of good faith as a component of the duty of loyalty is a response to this untenable situation.[65] A successful challenge requires a showing that the members of the board consciously disregarded a required task that they were entrusted to perform.[66]

Enhanced scrutiny's intentional lack of specific directives in the lead-up to a sale makes it nearly impossible for a plaintiff to prove that the board knowingly ignored an obligatory undertaking. The *Lyondell* decision illustrates this paradox. All members of the Lyondell board were protected by an exculpatory bylaw provision. For the purpose of a motion to dismiss, the Court of Chancery was willing to equate the board's failure to comply with previously established judicial guidelines with the requisite showing of bad faith. The Delaware Supreme Court admonished this part of the lower court's decision. To be sure, the actions undertaken by the Lyondell board did not accord with the body of case law analyzing proper board

Contracting out of the Fiduciary Duty of Loyalty: An Empirical Analysis of Corporate Opportunity Waivers, 117 COLUM. L. REV. 1075 (2017).

[63] *In re* Cornerstone Therapeutics Inc. S'holders Litig., 115 A.3d 1173, 1175–76 (Del. 2015) ("A plaintiff seeking only monetary damages must plead non-exculpated claims against a director who is protected by an exculpatory charter provision to survive a motion to dismiss, regardless of the underlying standard of review for the board's conduct—be it *Revlon*, *Unocal*, the entire fairness standard, or the business judgment rule." (footnotes omitted)). Interestingly, although a § 102(b)(7) exculpatory provision shields directors from monetary liability for damages arising from a breach of the duty of care, it does not shield third parties from liability for aiding and abetting an exculpated fiduciary breach. *See* RBC Cap. Mkts., LLC v. Jervis, 129 A.3d 816, 873–75 (Del. 2015).

[64] Roberta Romano, *Corporate Governance in the Aftermath of the Insurance Crisis*, 39 EMORY L.J. 1155, 1160 (1990) (detailing how 41 states amended their corporation statutes to reduce directors' liability exposure).

[65] Stone *ex rel.* AmSouth Bancorporation v. Ritter, 911 A.2d 362, 369–70 (Del. 2006) (clarifying and situating the duty of good faith as a subset of the duty of loyalty, rather than an independent fiduciary duty).

[66] *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 67 (Del. 2006) ("A failure to act in good faith may be shown, for instance, where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties. There may be other examples of bad faith yet to be proven or alleged, but these three are the most salient." (quoting *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 755 (Del. Ch. 2005))).

actions in the lead-up to a friendly sale.[67] As the Delaware Supreme Court emphasized, however, that body of case law does not amount to a specific judicial decree.[68] Characterizing the output from judicial decisions as a spectrum of best practices has the benefit of preserving board flexibility in the face of unique circumstances. And yet, the refusal to set a mandatory baseline for a board response creates an impregnable barrier for a claim rooted in the board's alleged lack of good faith.

The inability to prove a breach of the duty of good faith impacts an additional aspect of the litigation dynamic. Challenges against friendly sales are frequently accompanied by requests to enjoin the transaction.[69] In deciding the issue, reviewing courts are instructed to consider the plaintiff's probability of success on the merits.[70] Plaintiffs find themselves in a Catch-22 scenario, as the lack of court-imposed sale mandates sounds the death knell for the injunction request as well.[71]

But the difficulties in enjoining a friendly sale do not stem solely from the lack of a court-mandated transactional blueprint. Two additional elements need to be met for a court to grant injunctive relief: that the claimant will suffer an irreparable harm absent the injunction, and that this harm outweighs whatever harms befall the defendants as a result of the injunction.[72] The prevailing judicial attitude makes these objectives impossible to achieve: Transfers of control are carried out via a merger or one of its transactional derivatives. By statutory design, shareholder approval is a condition precedent to a successful merger.[73] That shareholders are afforded an opportunity to fend for themselves undermines claimants' requests for injunctive relief, as it strains credulity to assume that a majority of shareholders willingly support a harmful course of action.[74] The next sub-Part will track this line of reasoning's doctrinal extension.

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[67] Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 243 (Del. 2009) ("The Lyondell directors did not conduct an auction or a market check, and they did not satisfy the trail court that they had 'impeccable' market knowledge that the court believed was necessary to excuse their failure to pursue one of the first two alternatives.").

[68] *Id.* at 242–43.

[69] Robert T. Miller, Smith v. Van Gorkom *and the* Kobayashi Maru*: The Place of the Trans Union Case in the Development of Delaware Corporate Law*, 9 WM. & MARY BUS. L. REV. 65, 214–15 (2017).

[70] Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173, 179 (Del. 1986).

[71] C&J Energy Servs., Inc. v. City of Miami Gen. Emps.' & Sanitation Emps.' Ret. Tr., 107 A.3d 1049, 1071 (Del. 2014) ("Because the Court of Chancery could not find that the plaintiffs had met their burden while misapplying *Revlon* and reading it to require an active market check in all circumstances, it certainly could not have found a reasonable probability of success when applying *Revlon* faithfully.").

[72] *Id.* at 1066.

[73] DEL. CODE ANN. tit. 8, § 251(c) (2022).

[74] *In re* Toys "R" Us, Inc. S'holder Litig., 877 A.2d 975, 1023 (Del. Ch. 2005) ("[T]he bottom line is that the public stockholders will have an opportunity tomorrow to reject the merger if they do not think the price is high enough in light of the Company's stand-alone value . . . . To

C. Corwin*'s Coup de Grace*

The previous sub-Part described the ancillary doctrines and prevailing judicial attitude that decrease the likelihood of court intervention in a sale of control. The availability of a later shareholder vote weighs heavily against the grant of injunctive relief. This same principle is responsible for the latest diminishment of enhanced scrutiny review.

A brief aside on the shareholder vote and its historical impact on friendly sales of control illuminates the significance of this development. When properly executed, shareholder ratification decreases the standard of review used by the courts to review a challenged corporate act.[75] While mergers are conditioned upon positive shareholder approval, earlier Delaware Supreme Court precedent appeared to suggest that friendly sales fall outside the scope of the ratification doctrine.[76] Such a reading prolongs the litigation and represents an immense tactical benefit to the shareholder-plaintiff.

The doctrinal confusion regarding the effect of a statutorily-mandated shareholder vote was emphatically resolved in *Corwin v. KKR Financial Holdings*.[77] As the name implies, KKR Financial Holdings was used as a publicly-traded finance vehicle for transactions sponsored by private equity giant KKR & Co. (KKR). A proposed merger between KKR Financial Holdings and several KKR-related affiliates would culminate in the elimination of the former's public float. A slew of lawsuits followed.[78] Importantly, none of the plaintiffs attempted to enjoin the shareholder vote. Instead, the crux of their complaint focused on demonstrating KKR's

issue an injunction preventing stockholders from choosing for themselves in the present circumstances poses more potential to do them harm—through, among other things, delay of their receipt of the merger consideration—than good.").

[75] J. Travis Laster, *The Effect of Stockholder Approval on Enhanced Scrutiny*, 40 WM. MITCHELL L. REV. 1443, 1459 (2014) ("If the board makes a business decision on an issue within its authority and submits the matter to the stockholders for a voluntary vote, and if the stockholder vote is fully informed and noncoerced, then the resulting stockholder approval not only causes the business judgment rule to protect the board's decision, but also has the additional effect of barring a stockholder plaintiff from seeking to rebut the presumptions of the business judgment rule. Under those circumstances, a court only will look to whether the decision served some rational business purpose, and because the stockholders already have approved it, a plaintiff will find it difficult to convince a court that no rational person could agree with the board's judgment." (footnotes omitted)).

[76] *See, e.g.*, Gantler v. Stephens, 965 A.2d 695, 713 (Del. 2009) ("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.").

[77] 125 A.3d 304 (Del. 2015).

[78] *In re* KKR Fin. Holdings LLC S'holder Litig., 101 A.3d 980, 984–89 (Del. Ch. 2014).

position as a controlling shareholder.[79] Chancellor Bouchard's rejection of this argument was followed by an additional discussion on the consequence of a positive shareholder vote. The apparent limitations imposed by *Gantler* were understood to be a simple clarification of the term ratification, rather than a denouncement of the general effect of a statutorily-required shareholder vote.[80] Absent a controlling shareholder, positive approval by KKR Financial Holdings' shareholders by itself was enough to restore the presumptions of the business judgment rule and consequent dismissal of the complaint.

The Delaware Supreme Court affirmed Chancellor Bouchard's findings and analyses.[81] Three additional reasons were given in support of the chancellor's conclusion regarding the litigation-ending effect of the shareholder vote. First, the intermediate standard of review was designed primarily to help the courts' assessment on whether to grant injunctive relief. A shareholder vote is last in a sequence of statutorily-defined events necessary to effectuate a merger. Afterwards, a plaintiffs' remedy is limited to post-closing damages.[82] The judicial framework used to evalu-

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[79] When a controlling shareholder is present, defendants need to voluntarily comply with the more rigorous *MFW* framework in order to downgrade the standard of review. *See* Kahn v. M & F Worldwide Corp., 88 A.3d 635, 646 (Del. 2014) (ruling that dual approval of a properly functioning independent director committee and a majority of the unaffiliated shareholders reduces the standard of review from entire fairness to the business judgment rule for a freeze-out transaction with a controlling shareholder); *see also* Flood v. Synutra Int'l, Inc., 195 A.3d 754 (Del. 2018) (clarifying the temporal requirements in initiation of the *MFW* framework).

[80] *In re KKR Fin. Holdings LLC*, 101 A.3d at 1102–03 ("Although the language from the Supreme Court's decision quoted above could be interpreted to imply that the legal effect of a fully informed stockholder vote would be different when the vote was voluntary as opposed to statutorily required, I do not read it that way. . . . Instead, I read the Supreme Court's discussion of the doctrine of ratification in *Gantler* to have been intended simply to clarify that the term 'ratification' applies only to a voluntary stockholder vote."). In essence, Chancellor Bouchard reasoned that had *Gantler* intended to overrule extensive precedent on shareholder voting, it would have done so directly. *Id.* at 1002.

[81] *Corwin*, 125 A.3d at 311 ("To erase any doubt on the part of practitioners, we embrace the Chancellor's well-reasoned decision and the precedent it cites to support an interpretation of *Gantler* as a narrow decision focused on defining a specific legal term, 'ratification,' and not on the question of what standard of review applies if a transaction not subject to the entire fairness standard is approved by an informed, voluntary vote of disinterested stockholders.").

[82] *In re* Lukens Inc. S'holders Litig., 757 A.2d 720, 728 (Del. Ch. 1999) ("Even disregarding plaintiffs' failure to pursue injunctive relief prior to the shareholder vote, *although that option was readily available*, it goes without saying that at this juncture it is 'impossible to unscramble the eggs.' Money damages being the only possible form of relief available, the question necessarily arises whether that form of relief is barred by Lukens's exculpatory provision." (quoting Gimbel v. Signal Cos., Inc., 316 A.2d 599, 603 (Del. Ch. 1974))); McMillan v. Intercargo Corp., 768 A.2d 492, 500 (Del. Ch. 2000) ("Under our case law, it is generally accepted that a completed merger cannot, as a practical matter, be unwound.").

ate director liability in such a setting is incompatible with enhanced scrutiny review.[83] Second, the result applies only to an uncoerced and fully informed shareholder vote. A vote that is marred by misleading disclosures or structural coercion will fail to produce the desired result. Finally, the analysis rests on the notion that business decisions are best left to impartial decision makers. Because of the litigation rents and chilling effect that follow judicial intervention, unavoidable enhanced scrutiny review would be value-diminishing to the affected shareholders.[84]

The Delaware Supreme Court subsequently clarified the shareholder vote's impact on a post-closing damages claim.[85] Director liability for the breach of the duty of care is predicated on a finding of gross negligence.[86] Shareholder approval elevates this already-high pleading burden by requiring plaintiffs to prove that the transaction was a result of irrational director conduct.[87] Therein lies the rub: That a transaction was approved by a majority of shareholders is proof positive of its rationality.[88] This chain of reasoning leads to an immediate dismissal of the case.[89]

This Part described the fluctuations in Delaware's approach to friendly sales of control. Situational conflicts of interest necessitate increased court oversight. While

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[83] *Corwin*, 125 A.3d at 312 ("*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. They were not tools designed with post-closing money damages claims in mind, the standards they articulate do not match the gross negligence standard for director due care liability under *Van Gorkom*, and with the prevalence of exculpatory charter provisions, due care liability is rarely even available." (footnote omitted)).

[84] *Id.* at 312–14.

[85] Singh v. Attenborough, 137 A.3d 151 (Del. 2016).

[86] Brehm v. Eisner, 746 A.2d 244, 259 (Del. 2000) ("The 'reasonably informed' language used by the Court of Chancery here may have been a short-hand attempt to paraphrase the Delaware jurisprudence that, in making business decisions, directors must consider all material information reasonably available, and that the directors' process is actionable only if grossly negligent.").

[87] Gagliardi v. TriFoods Int'l, Inc., 683 A.2d 1049, 1052–53 (Del. Ch. 1996) ("That [business judgment] 'rule' . . . provides that where a director is independent and disinterested, there can be no liability for corporate loss, unless the facts are such that no person could possibly authorize such a transaction if he or she were attempting in good faith to meet their duty.").

[88] Harbor Fin. Partners v. Huizenga, 751 A.2d 879, 881–82 (Del. Ch. 1999) ("As a matter of logic and sound policy, one might think that a fair vote of disinterested stockholders in support of the transaction would dispose of the case altogether because a waste claim must be supported by facts demonstrating that 'no person of ordinary sound business judgment' could consider the merger fair to Republic and because many disinterested and presumably rational Republic stockholders voted for the Merger." (quoting Saxe v. Brady, 184 A.2d 602, 610 (Del. Ch. 1962))).

[89] *Singh*, 137 A.3d at 151–52 ("When the business judgment rule standard of review is invoked because of a vote, dismissal is typically the result. That is because the vestigial waste exception has long had little real-world significance, because it has been understood that stockholders would be unlikely to approve a transaction that is wasteful." (footnotes omitted)).

the core doctrinal text has remained unaltered for nearly three decades, the likelihood of court intervention has never been lower. The shareholder vote plays a significant role in this development: The availability of the shareholder vote counsels against the grant of injunctive relief; post-closing, positive shareholder approval renders a claim for damages essentially dead on arrival. These developments foreclose the prospect of meaningful judiciary inquiry. The next Part expands on the reasons behind this shift.

II. EXPLAINING THE SHIFT

Once a bureaucratic necessity, shareholder approval has replaced judicial oversight as the primary policing mechanism for friendly sales of control. This Part elaborates on the policy considerations that undergird this development.

A. Capital Aggregation and Increased Voting Competence

Noted voting pathologies colored the courts' initial disdain toward the shareholder vote. Dispersed and uncoordinated shareholders are uniquely susceptible to the maladies of collective action and rational apathy.[90] An informed vote requires the accumulation and processing of a wealth of information. Assuming that a shareholder is willing to exert the necessary time and effort, a minuscule stake renders her inconsequential to the final vote. Additional effort and costs will therefore be needed to galvanize support from the far-flung ownership base. Yet the fruits of these labors would accrue regardless of an individual shareholder's expenditure. The rational course of action is to stay put and wait for somebody else to spearhead a campaign against an underperforming business. The shared wait-and-see approach of the shareholder base is responsible for the vote's historical weakness as an accountability mechanism.[91]

Corwin's analytical pull stems first and foremost from the documented ownership shift in the U.S. equity market.[92] Post-World War II legislative initiatives set

[90] Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601, 607 (2006) (describing rational apathy and shareholders' lack of incentives to become informed).

[91] Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 676–77 (2007) (expanding on the reasons that prevented shareholders from pressuring incumbent directors and documenting that, between 1996 and 2005, companies with a market capitalization in excess of $200 million saw an average of less than one contested director election per year).

[92] Cox & Thomas, *supra* note 4, at 380 ("*Corwin* likely also reflects the Delaware courts' increasing comfort with both the sophistication of public shareholders and the efficient operation of the securities markets."); J. Travis Laster, *Changing Attitudes: The Stark Results of Thirty Years of Evolution in Delaware M&A Litigation*, *in* RESEARCH HANDBOOK ON REPRESENTATIVE SHAREHOLDER LITIGATION 202, 222 (Sean Griffith, Jessica Erickson, David H. Webber & Verity Winship eds., 2018) ("It is impossible to identify with any degree of precession the reasons why

in motion a series of events that transformed the share-ownership paradigm.[93] In a process that spanned over half of a century, financial intermediaries eclipsed traditional retail traders as the dominant equity owners.[94] An aggregated ownership base reinvigorates shareholders' voting competency. A financial intermediary's ownership position is substantially larger than that held by the typical retail investor. Their degree of financial sophistication and access to resources are additional considerations that enable them to overcome rational apathy.[95] The current judicial attitude reflects a confidence in shareholders' newfound ability to safeguard their interests with minimal court intervention.[96]

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judicial attitudes have evolved so significantly, but there are several likely candidates. In my view, the predominant contributor has been the rise of sophisticated stockholders with the ability to influence the direction of corporate governance and the outcome of M&A events."); Jack B. Jacobs, Lecture, *Does the New Corporate Shareholder Profile Call for a New Corporate Law Paradigm?*, 18 FORDHAM J. CORP. & FIN. L. 19, 31 (2012) (noting that "the new shareholder profile is an irrefutable reality that justifies inquiring into whether courts should take that into account in formulating and applying fiduciary duty principals").

[93] Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 878–84 (2013) (detailing the tax policies that channeled retirement savings to the capital markets and the rise of portfolio investing theory). The pension system's connection with the capital market was reinforced by additional legislation in the 1970s. *See* Martin Gelter, *The Pension System and the Rise of Shareholder Primacy*, 43 SETON HALL L. REV. 909, 911–14 (2013).

[94] Marshall E. Blume & Donald B. Keim, *The Changing Nature of Institutional Stock Investing*, 6 CRITICAL FIN. REV. 1, 4–6 (2017). Between 1900 and 1945, financial intermediaries owned about 5% of the equity on the U.S. stock market. The comparable number for 1980 was 34%; by 2010, institutional ownership rose to almost 70%. *Id.*

[95] *In re* Cox Commc'ns, Inc. S'holders Litig., 879 A.2d 604, 619 (Del. Ch. 2005) ("[W]ith increasingly active institutional investors and easier information flows, stockholders have never been better positioned to make a judgment as to whether a special committee has done its job."); *In re* Pure Res., Inc. S'holders Litig., 808 A.2d 421, 444 (Del. Ch. 2002) ("Adherence to the *Solomon* rubric as a general matter, moreover, is advisable in view of the increased activism of institutional investors and the greater information flows available to them."); *In re* Staples, Inc. S'holders Litig., 792 A.2d 934, 952 (Del. Ch. 2001) ("[T]he Staples RD electorate is dominated by sophisticated institutional investors well-positioned to vote in an informed manner that reflects a full appreciation of the strategic and financial posture of Staples, assuming adequate disclosures. In circumstances like these, this court has been rightly reluctant to interpose its own view of the business merits, thereby precluding an opportunity for the genuine stakeholders to make their own decision.").

[96] *See, e.g.*, Lawrence A. Hamermesh & Leo E. Strine Jr., *Delaware Corporate Fiduciary Law: Searching for the Optimal Balance*, *in* THE OXFORD HANDBOOK OF FIDUCIARY LAW 871, 871 (Evan J. Criddle, Paul B. Miller & Robert H. Sitkoff eds., 2019) ("[W]hen possible, regulation of fiduciary behavior that might involve a conflict of interest should involve not after-the-fact governmental review, but before-the-fact oversight by the fiduciaries of the corporation who are impartial and, most importantly, by the disinterested stockholders themselves.").

B. *Unbridled Litigation Costs*

Increased shareholder voting competency coincided with another noticeable development. The initial disregard to the shareholder vote meant that judicial oversight was the primary policing mechanism against insider overreaching.[97] Unavoidable enhanced scrutiny review, however, creates its own set of litigation agency costs.[98] Over time, Delaware's hospitality toward shareholder complaints unfortunately became abused by some of the more unscrupulous elements of the plaintiffs' bar.

Drawn out litigation aimed at uncovering fiduciary breaches does not sit well with the "entrepreneurial" attorney business model.[99] Such a course of action against a publicly traded corporation requires a substantial investment of time and resources. A positive result on the merits is by no means a given. A quick settlement with a tidy reward frees up counsel's time and resources for the next opportunity.[100] A cost-benefit analysis leads a sizeable cohort of plaintiffs' lawyers to eschew a high-risk-high-reward strategy in favor of a steady stream of lower payouts.

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[97] Steven Davidoff Solomon & Randall S. Thomas, *The Rise and Fall of Delaware's Takeover Standards*, *in* THE CORPORATE CONTRACT IN CHANGING TIMES: IS THE LAW KEEPING UP? 29, 31–32 (Steven Davidoff Solomon & Randall Stuart Thomas eds., 2019) ("The early 1980s saw a sharp rise in the number and frequency of hostile takeovers, and of takeovers generally. . . . In this cauldron, the Delaware courts transformed the state's jurisprudence through a series of decisions that adopted heightened judicial review standards to takeover-related actions. . . . The consequence of the proliferation of standards was to insert the Delaware judiciary directly as arbiters of takeover contests." (footnote omitted)); Zohar Goshen & Sharon Hannes, *The Death of Corporate Law*, 94 N.Y.U. L. REV. 263, 273 (2019) ("The unprecedented wave of mergers and acquisitions during the 1980s intensified the role of the Delaware courts as arbiters between boards and shareholders over control rights conflicts. Control fights between corporate boards and would-be acquirers required courts to determine the extent to which boards may decide, notwithstanding the desires of shareholders, whether, and to whom, to sell the company. Much of modernity's relevant takeover jurisprudence crystallized during this 1980s heyday." (footnote omitted)).

[98] Similar to shareholder voting, collective action problems dissuade dispersed shareholders from volunteering to bear the costs necessary to bring litigation against a publicly traded entity. Agency costs emerge when the interests of the representatives diverge from the interests of the represented class. Frank H. Easterbrook, *Two Agency-Cost Explanations of Dividends*, 74 AM. ECON. REV. 650, 653 (1984).

[99] The representative attorneys' utility scale was famously illustrated in John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669 (1986). *See also* Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1 (1991).

[100] Note that the settlement does not need to provide a monetary recovery to the class in order to justify the grant of a special reward for counsel's effort. *See* Tandycrafts, Inc. v. Initio Partners, 562 A.2d 1162, 1164–66 (Del. 1989) (explaining the corporate benefit doctrine); Bird v. Lida, Inc., 681 A.2d 399, 402–03 (Del. Ch. 1996) (same).

The desire for a quick settlement is shared by the corporate defendants. The named defendants in a typical lawsuit are the board members who approved the sale of control. While personal liability remains a rarity in corporate litigation, an adverse financial judgment spells financial ruin.[101] Settlements, on the other hand, are paid out by the insurance provider.[102] The removal of a distraction for the incumbent directors reinforces their inclination to settle.[103]

Thus began an era of kabuki settlements that undercut the monitoring function of shareholder litigation. A relative trickle of complaints against merger deals at the turn of the century swelled into a torrent just 15 years later.[104] The lion's share of these lawsuits were settled for certain "corrective" disclosures of questionable value.[105] The direct parties to the litigation benefit from this turn of events. Corporate defendants receive a universal release from liability, at no personal cost. Plaintiffs' attorneys are entitled to a tidy fee relative to the paucity of actual adversarial effort. Left behind is the rest of the shareholder base, which no doubt would have been better served by more faithful representation.

Conditioning the standard of review on a shareholder vote highlights the interchangeability of the accountability mechanisms: As long as agency costs are held in check, neither measure enjoys an *a priori* preference over the other.[106] Sharehold-

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[101] *See, e.g.*, *In re* Dole Food Co. S'holder Litig., C.A. No. 8703, 2015 WL 5052214, at *47 (Del. Ch. Aug. 27, 2015). A breach of duty by the controlling shareholder and his chief lieutenant in connection with a going-private transaction resulted in personal liability of $148 million. This sum was subsequently reduced to $110 million following a settlement. *In re* Dole Food Co., Inc., S'holder Litig., C.A. No. 8703 (Del. Ch. Feb. 15, 2017).

[102] James D. Cox, *Making Securities Fraud Class Actions Virtuous*, 39 ARIZ. L. REV. 497, 512 (1997) ("[A]pproximately 96% of securities class action settlements are within the typical insurance coverage, with the insurance proceeds often being the sole source of settlement funds."). For a detailed study and critique of the D&O insurance dynamic, see Tom Baker & Sean J. Griffith, *The Missing Monitor in Corporate Governance: The Directors' and Officers' Liability Insurer*, 95 GEO. L.J. 1795 (2007).

[103] *See* Browning Jeffries, *The Plaintiffs' Lawyer's Transaction Tax: The New Cost of Doing Business in Public Company Deals*, 11 BERKELEY BUS. L.J. 55, 59 (2014).

[104] *Compare* Elliott J. Weiss & Lawrence J. White, *File Early, Then Free Ride: How Delaware Law (Mis)Shapes Shareholder Class Actions*, 57 VAND. L. REV. 1797, 1825 (2004) (finding that 18% of qualifying mergers between 1999 and 2001 were followed by at least one shareholder lawsuit), *with* Matthew D. Cain & Steven Davidoff Solomon, *A Great Game: The Dynamics of State Competition and Litigation*, 100 IOWA L. REV. 465, 476 n.55 (2015) (finding that 97.5% of qualifying transactions in 2013 were followed by at least one shareholder lawsuit).

[105] Cain & Solomon, *supra* note 104, at 478 tbl.III (finding that merger objection litigation led to a monetary reward for the shareholder class in less than 5% of the total complaints).

[106] Laster, *supra* note 92, at 222–23 ("Recognizing that stockholders are empowered and capable of making their own decisions changes the role of the judiciary. . . . [W]hen stockholders can protect themselves, they do not need judges. Only when the voting process itself is

ers' inability to threaten incumbents via the corporate ballot influenced early incarnations of enhanced scrutiny review. The costs of unbridled litigation did not escape the attention of the Delaware courts. While far from perfect, it was the absence of an alternative that made litigation attractive by comparison.[107] The process of capital aggregation reinvigorated previously dormant voters. Now that empowered shareholders are able to pressure incumbents via the corporate ballot, prohibitive litigation costs no longer have to be tolerated.[108] In short, everyone appears better off. The next Part exposes the flies in this particular doctrinal ointment.

III. THE INHERENT LIMITATIONS OF THE SHAREHOLDER VOTE

The previous Part depicted the principal drivers of Delaware's takeover jurisprudence. Friendly sales of control provide the corporation's bargaining agents an opportunity to divert value to themselves at the shareholders' expense. Accountability is preserved through a mix of shareholder voting and litigation rights. *Corwin* elevates the role of the shareholder vote at the expense of traditional litigation. Shareholders' ability to correctly distinguish between value-maximizing and value-reducing transactions and, having done so, only vote in favor of the value-maximizing ones, is the cornerstone upon which the doctrine rests. While we are undoubtedly experiencing a golden age of shareholder empowerment, a wide gap separates the ideal of an enlightened and value-discerning voter from the realities of the shareholder ballot.

A brief aside on the underlying function of the shareholder vote helps to frame the argument. A corporation's shareholder constituency is comprised of investors with wildly divergent assessments and idiosyncratic preferences.[109] Aggregating

undermined does a role for the judge remain. Otherwise, property owners can best make their own decisions about the fate of their property.").

[107] *Id.* at 214 ("The Delaware Supreme Court's unwillingness to view the stockholder vote as a meaningful check on director action had an important consequence. It meant that litigation provided the only effective means of enforcing the directors' fiduciary duties. The absence of an alternative decisionmaker to whom the court could defer likely reinforced the Delaware Supreme Court's strong attitudes toward other aspects of third party M&A scenarios.").

[108] Cox & Thomas, *supra* note 4, at 379–80 ("Delaware's retreat from *Revlon* can be understood as righting a legal doctrine that had listed dangerously against the public interest in view of the contemporary concern that shareholder litigation attending acquisitions had reached a near epidemic scale. . . . Corwin likely also reflects the Delaware courts' increasing comfort with both the sophistication of public shareholders and the efficient operation of securities markets. As quoted earlier, *Corwin* eagerly elevated the non-judicial scrutiny of a fully-informed non-coercive shareholder vote to supplant an ad hoc heightened judicial scrutiny.").

[109] Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 577–93 (2006) (depicting shareholders' divergent interests); *see also* Grant M. Hayden & Matthew T. Bodie, *One Share, One Vote and the False Promise of Shareholder Homogeneity*, 30

shareholders' preferences is theorized to produce the best result for the group.[110] Implicit in this view is that the parties at interest are endeavoring to maximize the value of their voting shares.[111] Unfortunately, a combination of factors undermine the veracity of that foundational principal.

Unlike dispersed and rationally apathetic retail investors, financial intermediaries are able to make their voting power felt. Financial intermediaries' pervasiveness, however, raises the likelihood that they find themselves on both sides of a contemplated merger.[112] Such a scenario separates a financial intermediary's utility function from that of the non-hedged shareholder base: Whatever losses it might realize from a bad deal on one side of the transaction will be offset by the gains from the other side.[113] The rest of the shareholders do not enjoy the same opportunity to compensate their losses. Intermediaries' conflicting incentives casts a dark pall over the purported utility of the voting outcome.[114]

An additional voting pathology manifests at the corporate ballot. Directors are authorized to propose a merger; shareholders, at most, are asked to approve it. An

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CARDOZO L. REV. 445, 500 (2008) (pointing out that shareholders do not share uniform preferences for wealth maximization).

[110] Zohar Goshen, *The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality*, 91 CAL. L. REV. 393, 399 (2003) ("Voting is commonly accepted as the best method for extracting group consensus from the disparate subjective assessments of the group's members. The voting mechanism is based on the assumption that the majority opinion expresses the 'group preference,' that is, the optimal choice for the group as a whole.").

[111] Crown Emak Partners v. Kurz, 992 A.2d 377, 388 (Del. 2010) ("[W]hat legitimizes the stockholder vote as a decision-making mechanism is the premise that stockholders with economic ownership are expressing their collective view as to whether a particular course of action serves the corporate goal of stockholder wealth maximization." (quoting Kurz v. Holbrook, 989 A.2d 140, 178 (Del. Ch. 2010))).

[112] Chris Brooks, Zhong Chen & Yeqin Zeng, *Institutional Cross-Ownership and Corporate Strategy: The Case of Mergers and Acquisitions*, 48 J. CORP. FIN. 187, 189, 191 (2018) (sampling over 2,000 mergers between 1984 and 2014, on average, 18% of the acquirer's stock was held by target institutional owners and 21% of the target stock was held by acquirer institutional owners); *see also* Gregor Matvos & Michael Ostrovsky, *Cross-Ownership, Returns, and Voting in Mergers*, 89 J. FIN. ECON. 391 (2008) (finding that institutional investors with cross-holdings were more likely to vote for mergers with negative announcement returns, while institutional investors without cross-holdings tended to vote against them).

[113] This is an example of a pathology referred to in the literature as "empty voting." An empty vote occurs whenever the party exercising a share's voting power will not bear the brunt of the economic impact of its vote. *See* Henry T. C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811 (2006) (providing an analytical framework and taxonomy for empty voting); Shaun Martin & Frank Partnoy, *Encumbered Shares*, 2005 U. ILL. L. REV. 775 (same).

[114] *See* Robert B. Thompson & Paul H. Edelman, *Corporate Voting*, 62 VAND. L. REV. 129, 154 (2009) ("Allowing empty voting completely undercuts our justifications of shareholder voting. Retaining the vote without a financial interest eliminates the error-correcting rationale of voting.").

intricate cognitive process is thought to precede a shareholder's ultimate voting decision. At its heart is a comparison between the price offered per share and its projected future value.[115] Voting in favor of the merger only makes sense if the former is higher than the latter.

The value-enhancing function of the vote thus hinges on shareholders' ability to discount a wide array of unknown variables into a single yes-or-no output.[116] A process so context-specific should be expected to produce some evidence substantiating shareholders' ability to collectively vote down bad deals. Actual shareholder voting records, however, reveal merger approval rates comparable to those enjoyed by totalitarian regimes.[117] These results erode the confidence in the increased responsibility afforded to the shareholder vote; after all, if a 90% litigation rate against certain transactions justifies the epithet of "systemic failure,"[118] what are we to make of even higher approval rates for friendly sales of control?

At the very least, near-universal sale approval by the voting constituency should cause us to question the value shareholders assign to the probability of future payouts. Shareholders' rejection of a sale proposal does not obligate the board to provide for a new offer. A failed vote therefore subjects shareholders to the innumerable

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[115] An added degree of complexity is seen when the sale consideration consists of other securities (or a mix of cash and other securities). In this scenario, selling shareholders are asked not only to evaluate the prospects of the company that they currently hold shares in, but also to discount the prospects of the entity whose shares they will receive.

[116] These factors include the corporation's prospects under current management, industry trends, and possibility of disruptive competition, as well as the probability of the arrival of another suitor down the line.

[117] Matteo Gatti, *Reconsidering the Merger Process: Approval Patterns, Timelines, and Shareholders' Role*, 69 HASTINGS L.J. 835, 854 (2018) (finding that shareholders rejected only a little over 1% of arm's-length mergers involving a Russell 3000 company between 2006 and 2015); John Mark Zeberkiewicz & Blake Rohrbacher, *Paying for the Privilege of Independence: Termination Fees Triggered by "Naked No Votes,"* 21 INSIGHTS: CORP. & SEC. L. ADVISOR, Sept. 2007, at 1, 2 (observing that shareholders rejected only eight out of more than one thousand M&A transactions from 2003 to 2007); Jill E. Fisch, Sean J. Griffith & Steven Davidoff Solomon, *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 TEX. L. REV. 557, 580–81 (2015) ("[T]he median percentage of yes votes as a percentage of votes cast is 99.00%, meaning that half of all transactions get an even higher number of yes votes. The statistics show that shareholder voting in takeover transactions is largely a yes game among shareholders who do cast votes. . . . When shares are voted, it is almost overwhelmingly in support of the transaction."). For evidence showing that minority shareholders' ability to reject a controlling shareholder freezeout is similarly rare, see Edward B. Rock, *Majority of the Minority Approval in a World of Active Shareholders*, in THE LAW AND FINANCE OF RELATED PARTY TRANSACTIONS 105, 115–17 (Luca Enriques & Tobias H. Tröger eds., 2019) (finding that all 17 going-private mergers conditioned on the approval of a majority of the minority shareholders between 2010 and 2017 received the requisite support).

[118] Laster, *supra* note 92, at 224 ("The ubiquity of stockholder litigation coupled with the routine generation of disclosure-only settlements amounted to a systemic failure.").

business variables that might go wrong. Habitual merger approval represents the fairly straightforward notion that a proverbial bird in the hand is preferable to the pheasant in the bush.[119] This pheasant's constant rejection, however, speaks volumes about shareholders' internal calculation. When asked to put their money where their votes are, the discounted prospects of future scenarios always come out less than whatever premium is offered for their shares.

An influential study by Fisch and coauthors illustrates this phenomenon.[120] Central to the *Corwin* line of cases is the assumption of a causative link between available information and the efficiency of a shareholder vote.[121] Since a shareholder's decision to approve the sale is ostensibly informed by all available pertinent data, the release of additional details that management had initially intended to obscure should negatively impact merger approval rates. This intuition, however, was refuted by the data: Supplemental disclosure barely left a dent on shareholder voting patterns.[122]

Corwin's conflation of a vote in favor of the transaction with a ratification of an alleged fiduciary breach further challenges the litigation-foreclosing effect of the shareholder vote. The bundled vote seemingly represents an independent assessment of both the merits of the merger proposal and the likelihood of a positive return following the litigation against the approving directors. A vote in favor is treated as both wholehearted support of the sale price and an unequivocal absolution of the suspect board behavior.

This foundational aspect of the doctrine unfortunately discounts shareholders' penchant to vote in favor of sub-optimal initiatives so long as a tangible benefit is

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[119] Franklin A. Gevurtz, *The Shareholder Approval Conundrum*, 60 B.C. L. REV. 1831, 1880 (2019) ("[W]e must remember the narrow nature of the shareholders' choice. Facts suggesting that, for instance, because of conflicts or sloppiness, the directors did not get the best deal do not mean that the deal at hand still is not better than the status quo. Moreover, these facts can make the shareholders doubt that the same conflicted or sloppy directors will manage to get a better deal if forced to go back and try again or whether they will even try again.").

[120] *See generally* Fisch et al., *supra* note 117. This study was influential in shaping Delaware's attitude toward disclosure-only settlements. The ripple effect from Delaware's change of heart impacted settlement dynamics and favored litigation venues. *See* Cain et al., *supra* note 16, at 610.

[121] Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 312 (Del. 2015) ("[M]ost important, the doctrine applies only to fully informed, uncoerced stockholder votes, and if troubling facts regarding director behavior were not disclosed that would have been material to a voting stockholder, then the business judgment rule is not invoked.").

[122] Fisch et al., *supra* note 117, at 585 ("In terms of our primary hypothesis—that disclosure-only settlements would have a negative effect on shareholder voting because they reflect the introduction of additional negative information about the merger—our regression results do not support this hypothesis. Rather we find a non-effect. . . . The lack of a significant relationship between disclosure-only settlements and shareholder voting suggests that shareholders may not value the additional information from these disclosures at least in a way that affects their vote." (footnote omitted)).

also on the ballot. Bebchuk and Kamar tested the bundling hypothesis via an examination of so-called mergers of equals.[123] A size disparity among merger participants typically means that the larger corporation will absorb the smaller one. A similarly obvious candidate to serve as the surviving entity does not readily present itself when the merging entities are of equal size. Without a clear acquirer, both participants should have similar odds of emerging from the transaction with their legal personality intact. And yet, the presence of a staggered board substantially increased the likelihood that a merger participant would be designated the surviving company.[124] Importantly, the results were generated at a time when companies were confronting intense shareholder pressure to de-stagger their boards.[125] The general sentiment at the time made it highly unlikely that either company would receive shareholder support for a stand-alone resolution to stagger its board.[126] Nevertheless, shareholders readily swallowed the bitter pill that was washed down with the tangible merger reward.

Shareholders' distinct tendency to support a merger is compounded by the increased sophistication of the capital markets. Near-universal merger approval rates do not eliminate the risk of non-consummation. A host of regulatory hurdles, both foreseen and unforeseen, need to be cleared before the approving shareholders receive their payout. Risk-averse or otherwise impatient shareholders would prefer an immediate guaranteed payment over a prolonged wait for the full merger consideration. Enter the merger arbitrageur. This specialized trader agrees to bear the risk of non-consummation and extended delay in return for a payment that is less than the complete merger price.[127]

[123] Lucian A. Bebchuk & Ehud Kamar, *Bundling and Entrenchment*, 123 HARV. L. REV. 1549 (2010).

[124] *Id.*, at 1571–80. The result holds when the merging entities combine to form a new entity. *Id.* at 1580–82.

[125] Lucian Bebchuk, Scott Hirst & June Rhee, *Towards the Declassification of S&P 500 Boards*, 3 HARV. BUS. L. REV. 157 (2013) (providing an overview of the Shareholder Rights Project and its efforts to de-stagger corporate boards.).

[126] *See* Lisa M. Fairfax, *Making the Corporation Safe for Shareholder Democracy*, 69 OHIO ST. L.J. 53, 70–71 (2008).

[127] Cox et al., *supra* note 6, at 557 ("When a merger or takeover deal is announced, large amounts of the target's shares change hands as the original shareholders of the target, now facing deal-completion risk, seek to realize the gains in price of the target shares and avoid future market and deal risks incident to that security. Other investors, called merger arbitrageurs, play a pivotal role in fulfilling this risk-avoidance strategy. The hedge funds and other short-term investors that pursue merger arbitrage strategies, also known as risk arbitrage, buy target companies' stock after proposed mergers are announced and hold it until deal completion in order to earn the spread between the deal price and price after the transaction is announced. This spread reflects the uncertainty that the deal will be successful or that it will close under the original terms." (footnotes omitted)).

This useful feature of a healthy market, however, further destabilizes the weight assigned to the shareholder vote. Cox and coauthors provide evidence detailing a significant change in institutional share ownership following a merger announcement. The attributes of both the selling and buying parties follow the pattern associated with merger arbitrage.[128] The buyer's profits will be wiped out if the transaction somehow fails to go through. The result is that a sizeable portion of the ownership base has a distinct economic interest to vote in favor of the transaction. Allegations of board misdeeds or failure to comport with best practices in brokering the deal have no bearing on their overarching incentive to vote in favor of the merger.[129]

To be sure, it appears that Delaware judges have taken heed of the criticism and are endeavoring to address it. Recent decisions have attempted to clarify the legal standard for both materiality and coercion.[130] While helpful, these steps fall short of correcting the underlying issues that plague shareholder voting. Even after these clarifications, every sale that is presented to the shareholders is assured of their approval. Disclosing that the company founder had misgivings about selling the company, as was the case in *Appel*, [131] or reached an understanding with a preferred bidder prior to the negotiations, as in *Morrison*,[132] will likely not change this predicament.[133]

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[128] *Id.* at 564 ("The key takeaway from Panel A is that short-term ownership increases on average by a noticeable 11.22 percentage points (of total institutional ownership) in the immediate quarter. Moreover, this change in ownership does not anticipate but rather takes place only after the announcement reflecting risk arbitrageurs in action. This evidence points to a large participation of short-term, merger arbitrageur investors that buy shares after mergers are announced but not before, as they do not try to anticipate mergers." (footnote omitted)).

[129] *Id.* at 581 ("Our data . . . show that substantial ownership changes among institutional investors occurs in the quarter the deal is announced, so that these new owners are committed to approving the deal by the investment they have already made. Thus, when the proxy statement later discloses details indicating possible unfairness—or worse, management laxity or conflicts—the vote by the arriving owners is hardly free of financial duress.").

[130] *See, e.g.*, Morrison v. Berry, 191 A.3d 268, 283 (Del. 2018) (explaining materiality); Appel v. Berkman, 180 A.3d 1055, 1060 (Del. 2018) (same); *In re* Dell Techs. Inc. Class V S'holders Litig., 2020 WL 3096748, at *20 (Del. Ch. June 11, 2020) (explaining coercion).

[131] *Appel*, 180 A.3d at 1057.

[132] *Morrison*, 191 A.3d at 273–74.

[133] *See* Joseph R. Slights III, Lecture, Corwin v. KKR Financial Holdings LLC—*An "After-Action Report,"* 24 FORDHAM J. CORP. & FIN. L. 6, 26 (2018) ("Given that a *Corwin*-compliant stockholder approval of a transaction results in pleading-stage business judgment deference, there is a concern certainly that has been expressed that *Corwin* may incentivize directors to overwhelm stockholders with proxy disclosures concerning the transaction, and the process that led to the transaction, before the stockholders vote on it. In that case, stockholder 'yes' votes may not in fact reflect that stockholders have 'decided that the transaction is a fair exchange.'" (quoting Harbor Fin. Partners v. Huizenga, 751 A.2d 879, 901 (Del. Ch. 1999))).

IV. TAKING *CORWIN* SERIOUSLY

A. Rehabilitating the Shareholder Vote

The previous Part depicted the various factors that undermine the veracity of the shareholder vote as an effective check on the agency costs that accrue in the lead-up to a friendly sale. These findings severely erode *Corwin*'s theoretical foundations. Accordingly, this sub-Part's first order of business is to rehabilitate the reputation of the shareholder vote. While shareholders have proven themselves undiscernible voters when asked to approve a sale of control, this attitude does not extend to all other situations. Understanding the circumstances that engender successful shareholder voting and the channels through which successful voting is achieved is a crucial first step toward this Article's proposal for reform.

Corporate law's myriad rules and regulations are designed to bridge the misalignment gap between equity investors and those entrusted with managing their property.[134] Even well-meaning fiduciaries are vulnerable to the natural tendency to shirk one's duties or push forward a strategy that is tenuously aligned with share–value maximization. Shareholder voting rights are designed to keep them in check.[135] Manne's seminal observation that a company's share price reflects the market's assessment of managerial competence illuminates the relationship between voting power and agency costs:[136] Conditioning a director's appointment and continued incumbency on shareholder approval is theorized to ensure devotion to shareholder interests.[137] Fear of retribution at the corporate ballot, or a lack thereof,

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[134] John Armour, Henry Hansmann, Reinier Kraakman & Mariana Pargendler, *What Is Corporate Law?*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 1, 2 (3d ed. 2017) ("Most of corporate law can be understood as responding to three principal sources of opportunism that are endemic to such organization: conflicts between managers and shareholders, conflicts between controlling and non-controlling shareholders, and conflicts between shareholders and the corporation's other contractual counterparties, including particularly creditors and employees. All three of these generic conflicts may usefully be characterized as what economists call 'agency problems.'").

[135] Paul H. Edelman, Randall S. Thomas & Robert B. Thompson, *Shareholder Voting in an Age of Intermediary Capitalism*, 87 S. CAL. L. REV. 1359, 1366 (2014) ("In contrast to the plenary role of the directors and the managers, shareholders can do only a few things . . . . These shareholder roles often reflect a monitoring function. Managers of a corporation, as the holders of day-to-day power over the sometimes vast aggregations of other people's money, require some form of monitoring. Without any monitoring, managers would be tempted to shirk their duties or divert assets to their own private benefit.").

[136] *See* Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 112–14 (1965).

[137] Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465 (2007) (explaining the connection between the increased informativeness of stock market prices and the greater proportion of independent directors amongst a company's board).

should be observable by a host of financial parameters and, ultimately, the share price.

Substantial data corroborates the effect that insulation from the shareholder vote has on accepted proxies for managerial agency costs. For instance, Masulis and coauthors have shown that entrenched incumbents are more likely to approve value-destroying acquisitions.[138] A similarly persuasive article by Faleye reported how higher director insulation correlates with less pay sensitivity and a reduced likelihood of replacing the CEO of an under-performing firm.[139] Bebchuk and coauthors constructed an influential "entrenchment index" to measure the procedural obstacles that hinder shareholders' ability to replace reigning incumbents.[140] The study found a correlation between a higher score on the entrenchment index and weaker financial performance.[141] Finally, Cohen and Wang detailed how stock prices reacted favorably to a court ruling that appeared to make it easier to oust unwilling incumbents, and then reversed course when that decision was overruled on appeal.[142]

This unflattering background illuminates the newfound effectiveness of the shareholder vote as an accountability measure and the means by which it is achieved. *Corwin*'s accepted narrative skips over an essential component of shareholder empowerment: Financial intermediation, by itself, did not pose a significant threat in the boardroom of underperforming companies. While certainly more knowledgeable and less apathetic than the retail investors of years past, financial intermediaries are still disincentivized from actively monitoring their portfolio companies and

[138] Ronald W. Masulis, Cong Wang & Fei Xie, *Corporate Governance and Acquirer Returns*, 62 J. FIN. 1851 (2007) (documenting that companies with governance provisions insulating directors are more likely to make acquisition decisions that are value-decreasing, as judged by the stock market's reaction to acquisition announcements).

[139] Olubunmi Faleye, *Classified Boards, Firm Value, and Managerial Entrenchment*, 83 J. FIN. ECON. 501 (2007).

[140] Lucian Bebchuk, Alma Cohen & Allen Ferrell, *What Matters in Corporate Governance?*, 22 REV. FIN. STUD. 783, 784–85 (2009) (The six parameters in the "Entrenchment Index" (E-Index) are staggered board, shareholder limitations on amending bylaws, shareholder limitations on amending charters, supermajority requirement to approve a merger, golden parachutes, and poison pill).

[141] *Id.* at 823 ("We have identified six entrenching provisions that are negatively correlated with firm valuation, as measured by Tobin's *Q*, as well as with stock returns during the 1990–2003 period."). The E-Index has subsequently been applied by more than 1,000 empirical papers since its initial circulation. *See* Tami Groswald Ozery, *More Than 1,000 Studies Apply the Entrenchment Index of Bebchuk, Cohen and Ferrell (2009)*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Mar. 16, 2020), https://corpgov.law.harvard.edu/2020/03/16/more-than-1000-empirical-studies-apply-the-entrenchment-index-of-bebchuk-cohen-and-ferrell-2009/.

[142] Alma Cohen & Charles C.Y. Wang, *How Do Staggered Boards Affect Shareholder Value? Evidence from a Natural Experiment*, 110 J. FIN. ECON. 627 (2013) (the results of this study not only confirm prior findings that staggered boards are associated with lower firm value, but they also support a causal inference).

spearheading revolts.[143] They can, however, identify and support value-maximizing proposals put forward by others. The shareholder-empowerment revolution began in earnest with the emergence of activist hedge funds.[144]

In contrast to financial intermediaries, hedge funds' largely unregulated nature and compensation structures incentivize them to seek out targets that would stand to benefit from shareholder intervention.[145] Without more, a hedge fund's relatively modest ownership position would not suffice to credibly threaten incumbents. In combination with the voting power wielded by financial intermediaries, however, hedge fund demands are made loud and clear.[146]

The division of labor between financial intermediaries and hedge funds soon settled into a familiar pattern. Hedge funds were entrusted with identifying companies that exhibit traits of underperformance and managerial slack.[147] Once identi-

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[143] Gilson and Gordon coined the term "rational reticence" to explain a financial intermediary's preferred course of action. Although their financial sophistication allows them to recognize value-enhancing voting options, the nature of the industry deters active efforts to initiate change. Financial intermediaries compete amongst themselves for a greater share of the investment market. Offering a comparable product at a cost-effective price is conducive to that goal. Agitating for corporate governance changes at a portfolio-held company is both costly and beneficial to competitors. When confronted with an underperforming company, the financially prudent decision is to sell the stock. *See* Gilson & Gordon, *supra* note 93.

[144] Brian R. Cheffins & John Armour, *The Past, Present, and Future of Shareholder Activism by Hedge Funds*, 37 J. CORP. L. 51, 87 (2011) ("The new wave of hedge fund activists, eager to increase their leverage with management, regularly sought to rally major institutional shareholders to back their dissident campaigns. . . . [T]o a greater extent than had been the case previously, key institutional investors were prepared to offer backing to activists prepared to do the dirty work, thus lending valuable credibility to campaigns to challenge managers of target companies.").

[145] Evading the purview of the Investment Company Act affords hedge funds significant leeway in structuring and managing their investments. Without an Investment Company Act-imposed obligation to redeem beneficiaries' investment when called upon, hedge fund managers contractually lock in the risk capital for an agreed-upon length of time. Absent a mandate to diversify their portfolio, hedge funds are free to concentrate a significant portion of their assets in a handful of investments. Instead of a fixed salary with bonus incentives tied to industry benchmarks, hedge fund managers are incentivized for absolute performance, which typically includes a 20% share of the fund's profits. The combination of these features results in an active approach to their investment. *See* Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1062–64 (2007).

[146] Marcel Kahan & Edward Rock, *Embattled CEOs*, 88 TEX. L. REV. 987, 1001–05 (2010) (depicting symbiotic investment pressure by hedge funds and various types of financial intermediaries).

[147] Ronald J. Gilson & Jeffrey N. Gordon, *Agency Capitalism: Further Implications of Equity Intermediation*, *in* RESEARCH HANDBOOK ON SHAREHOLDER POWER 32, 42 (Jennifer G. Hill & Randall S. Thomas eds., 2015) ("[Activist investors] arbitrage the value of governance rights. Their business model, symbiotic with that of the intermediary institutions, involves identifying companies whose business strategies could be significantly improved, buying a toe-hold stake, and

fied, a hedge fund's public campaigns for corporate change are met with a sympathetic ear by financial intermediaries.[148] Reluctant incumbents can either reverse course in the face of concentrated shareholder pressure or face the suddenly tangible prospect of being voted out.

Hedge funds' symbiotic relationship with financial intermediaries ushered in a new appreciation of the shareholder vote as an accountability measure. It is now clear that embattled incumbents have been spurred to reduce agency costs by the threat of losing their office. Mining a dataset of almost 900 firms, Brav and coauthors depict the improved financial performance enjoyed by activism targets.[149] The findings attribute shareholders' gains to a decline in noted agency cost proxies, such as excessive executive pay. Since Brav's findings focused on the operational results of the target companies in the two years following a hedge fund engagement, it elicited criticism that these interventions left companies worse off over a longer time horizon.[150] An expanded study therefore documented the result of activist interventions over a five-year time frame.[151] Once again, the study found that hedge fund engagement led to improved financial performance.[152] That underperforming firms were more likely to be targeted for intervention underscores the increased disciplinary force of the combined might of activist hedge funds and financial intermediation.[153]

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then going public with a plan to convince the company in the first instance, or the institutional shareholders if the board disagrees and a proxy constant proves necessary, of the wisdom of the activist's strategic proposal.").

[148] Marcel Kahan & Edward B. Rock, *Index Funds and Corporate Governance: Let Shareholders Be Shareholders*, 100 B.U. L. REV. 1771, 1808 (2020) ("[A] division of labor that reflects the differing incentives of the different players seems to be emerging. Company-specific performance problems are raised in the first instance by the investors with the best incentives and capacity to do so: actively managed mutual funds and activist hedge funds. If a firm rejects their proposed suggestions for improvement, activists, if sufficiently determined, can force the issue by means of a proxy contest.").

[149] Alon Brav, Wei Jiang, Frank Partnoy & Randall Thomas, *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729 (2008) (tracking hedge fund interventions and the subsequent two years of operating performance following the announcement of a Schedule 13D at 882 target companies between 2001 and 2006).

[150] To be sure, the criticism is unsupported by empirical evidence. *See* Lucian A. Bebchuk, *The Myth that Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637, 1667 (2013) ("Insulation advocates have thus far failed to provide empirical evidence showing that activist interventions are followed in the long term by losses to target companies or their shareholders. Indeed, these advocates have largely even failed to acknowledge the need for such evidence.").

[151] Lucian Bebchuk, Alon Brav & Wei Jiang, *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085 (2015).

[152] *Id.* at 1106 ("Table 3 displays clear patterns of improved operating performance relative to industry peers during the five years following activist interventions.").

[153] *Id.* at 1117 ("[A]ctivists do not generally target well-performing companies. Targets of activism tended to be companies whose operating performance was below industry peers and also

B. *The Future of* Corwin *Compliance*

The ebb and flow of Delaware's takeover jurisprudence stands on the verge of its next significant junction. Even in its diminished state, enhanced scrutiny review provided shareholders with tangible benefits.[154] Since personal liability for a fiduciary breach remains a rare occurrence, these benefits are attributable to the threat of court intervention.[155] Once *Corwin*'s dust settles, the core precept of deterrence theory should prevail: Decreasing the likelihood of court intervention, and thus the prospect of getting caught, will embolden self-serving fiduciaries to stray from shareholders' best interests.[156] Universal shareholder support for every friendly sale renders the final vote an ill-equipped tool for restoring deterrence.[157] Clearly, some

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their own historical levels at the time of intervention. Moreover, at the time of the intervention, the targets seemed to be in a negative trend with operating performance declining during the three years preceding the intervention."); Brav et al., *supra* note 149, at 1754 ("[A]ctivist hedge funds resemble value investors. A one-standard deviation decrease in [Tobin's] q is associated with a 0.49 percentage point increase in the probability of being targeted, other things equal. Relative to the unconditional probability of being targeted of 1.8%, the marginal probabilities are substantial. This suggests that activist hedge funds are seeking to identify undervalued companies where the potential for improvement is high.").

[154] *See* Cain et al., *supra* note 3, at 1708 (showing that the deals governed by the *Revlon* standard underwent more rigorous negotiations and enjoyed a higher likelihood of additional bidders. These factors produced higher deal premiums relative to non-*Revlon* sales). This finding comports with previous studies that show a connection between heightened court involvement over problematic transactions and higher shareholder gains. *See* Guhan Subramanian, *Fixing Freezeouts*, 115 YALE L.J. 2 (2005) (showing that controlling shareholder freezeouts that were subject to a transactional structure that elicited greater court scrutiny produced increased value to shareholders relative to a structure that was able to evade heightened court scrutiny).

[155] *See* Cain et al., *supra* note 3, at 1720 ("*Revlon* matters in Delaware because Court of Chancery judges take seriously the opportunity to review transactions for reasonableness. And because the judges of the Court of Chancery take reasonableness review seriously, well-advised parties do so as well. As a result, we find *Revlon* is reflected in the planning and execution of transactions involving Delaware companies.").

[156] Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169 (1968) (explaining that rational actors will weigh the probability of getting caught multiplied by the potential penalty against the anticipated gains that arise out of breaking the law or committing a civil wrong. Deterrence is achieved when the probability-adjusted penalty is greater than the anticipated gains). Since personal liability remains a rarity in corporate litigation, the concrete threat of a public rebuke by the Delaware courts is tacked on to the penalty side of the ledger. *See* Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009 (1997) (explaining this phenomenon).

[157] Slights, *supra* note 133, at 21 ("Not a single member of the Court of Chancery, and I think only one member of our Supreme Court, was actually in practice when the effects of Corwin were felt in the boardrooms. But I gather the effects are palpable. It is, perhaps, harder to sell 'do the right thing' advice when the prospect of injunctive relief or post-close damages is more remote." (footnote omitted)). Joseph R. Slights III is a Vice Chancellor in the Delaware Court of Chancery.

measure of court oversight is required to keep transactional planners honest. Its precise dosage remains an elusive target.[158]

This Article contends that the full standard-reducing effect of a positive shareholder vote should be granted to companies that have previously been the target of hedge fund activism. Enhanced scrutiny, by contrast, should be reinstated as the immutable standard for a friendly sale that transpired without the impetus of a hedge fund intervention.

This proposed bifurcated approach to friendly sales aligns with the interconnected policy choices that animate the *Corwin* doctrine.

First, court involvement should take a back seat in circumstances where shareholders are able to safeguard their own interests.[159] The shareholder vote to approve a sale has proven itself incapable of that task. Yet the vote's failure in this scenario does not negate its documented successes in other situations. To be sure, these achievements do not comport with *Corwin*'s portrayal of the channels and consequences of an empowered shareholder base. Even with hedge fund involvement, shareholders have a dismal track record of voting down concrete transactions.[160] The renaissance of shareholder empowerment instead takes a more indirect route. The arrival of an activist hedge fund portends a suddenly tangible threat to their continued incumbency.[161] Previously impervious insiders are keen to negotiate when the

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[158] Ann Lipton contends that Delaware will respond to the apparent relaxation in deterrence by being more willing to designate instigators of friendly sales as controlling shareholders, thereby subjecting the transaction to the onerous entire fairness standard of review. *See* Ann M. Lipton, *After* Corwin*: Down the Controlling Shareholder Rabbit Hole*, 72 VAND. L. REV. 1977 (2019). However, even in the absence of a bright-line rule for determining controlling shareholder status, this approach might be difficult to implement in situations where corporate insiders lack significant equity holdings. Additionally, Delaware is aware that funneling, or even threatening to funnel, an outsize share of suspect transactions to an entire fairness review might put a damper on deals that enhance aggregate societal welfare.

[159] Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 312–14 (Del. 2015) ("[W]hen a transaction is not subject to the entire fairness standard, the long-standing policy of our law has been to avoid the uncertainties and costs of judicial second-guessing when the disinterested stockholders have had the free and informed chance to decide on the economic merits of a transaction for themselves. . . . The reason for that 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).").

[160] Lucian A. Bebchuk, Alon Brav, Wei Jiang & Thomas Keusch, *Dancing with Activists*, 137 J. FIN. ECON. 1, 5 tbl.1 (2020).

[161] To be sure, even after the announcement of a hedge fund intervention, the likelihood of a contested proxy campaign is remarkably low. Mining data from activist interventions over a 14-year period, Bebchuk and coauthors document that only 5% of activism campaigns resulted in a contested vote. *See id.*

corporate ballot box looms near.[162] Hedge funds' centrality in this scenario highlights the impotence of the shareholder vote in their absence.

Second, shareholder value is best served with a framework that minimizes agency costs across multiple dimensions.[163] Agency costs are an inevitable result of the separation of control from the ownership of a large-scale business enterprise.[164] Their complete elimination is an unobtainable goal. The various accountability measures merely aim to reduce them. These measures, however, produce their own set of agency costs. While enhanced scrutiny originally focused exclusively on the agency costs that accrue in the lead-up to a sale, *Corwin* embodies a holistic approach. An innate comparison of both the benefits and drawbacks of shareholder voting and litigation brought about the end of unavoidable enhanced scrutiny review.[165] For this equation to hold true, the shareholder vote must provide an effective restraint against agency costs. There is scant evidence that the final *Corwin* vote fulfills this function. An activist presence, by contrast, incentivizes corporate insiders to run a tighter ship.[166] All shareholders benefit from a reduction in agency costs and the subsequent spike in the share price. Admittedly, these reductions stem from operational agency costs rather than the sales-related agency costs that enhanced scrutiny was originally designed to police. This distinction, however, does not undermine this Article's proposal. Contemporary judicial philosophy focuses on the aggregate reduction in agency costs, regardless of its source.[167]

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[162] *Id.* (finding that 13% of activist interventions during this period resulted in a settlement with the company).

[163] *Corwin*, 125 A.3d at 313 ("When the real parties in interest—the disinterested equity owners—can easily protect themselves at the ballot box by simply voting no, the utility of a litigation-intrusive standard of review 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.").

[164] John Armour, Henry Hansmann & Reinier Kraakman, *Agency Problems and Legal Strategies*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 29, 29 (3rd ed. 2017) ("[A]n 'agency problem'—in the most general sense of the term—arises whenever one party, termed the 'principal,' relies upon actions taken by another party, termed the 'agent,' which will affect the principal's welfare. The problem lies in motivating the agent to act in the principal's interest rather than simply in the agent's own interest."). For the canonical account and economic modeling of this insight, see Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308–09 (1976).

[165] *See supra* notes 106–08 and accompanying text; Laster, *supra* note 92, at 222–23; Cox & Thomas, *supra* note 4, at 379–80.

[166] *See generally* Alon Brav, Wei Jiang & Hyunseob Kim, *Hedge Fund Activism: A Review*, 4 FOUNDS. & TRENDS FIN. 185 (2010) (surveying the studies).

[167] *See* Hamermesh & Strine, *supra* note 96, at 876 ("At each turn in the road of the evolution of Delaware fiduciary law, then, the Delaware courts have had to balance concerns about opportunism or carelessness, unchecked by statute, against the direct and indirect costs of relying on litigation against directors to limit such opportunism or carelessness. Achieving that balance has generally involved taking a realist approach to understanding commerce and human behavior

CONCLUSION

From early on, the Delaware courts were wary of the situational conflicts that cast a cloud of suspicion over friendly sales of control. Shareholders' inability to police these conflicts themselves required the judiciary to assume an active role, and early incarnations of enhanced scrutiny review therefore contained a searching judicial analysis of the process and motivation that led to a sale. But the need for unavoidable judicial oversight diminishes when alternative accountability measures achieve similar results. Repeated abuse of the previous litigation-intensive framework coincided with changes in the corporate governance ecosystem. As a result of these changes, previously impervious insiders suddenly felt pressure from the corporate vote. *Corwin* builds upon this overarching narrative, and its grant of business judgment review following shareholder approval is theorized to ensure a meaningful check on the deal's merits with the additional benefit of a steep reduction in litigation agency costs.

Unfortunately, the *Corwin* doctrine ignores the precise mechanisms that spurred corporate managers to run a tighter ship. Shareholders have always been incapable of safeguarding their interests in the final merger vote. It is the combination of financial intermediaries with hedge fund activists that enables them to combat corporate agency costs. Unless the doctrine evolves to incorporate this reality, shareholders will be left holding the short end of the stick.

This Article's proposal comports with *Corwin*'s underlying principles. The shareholder vote has never been a cure-all for all corporate governance ailments. Instead, the shift towards *Corwin* represents an innate aggregation and comparison of the agency costs generated and prevented by the various accountability measures. Somewhere along the way, the assumed competency of the shareholder vote skyrocketed without careful appreciation of the channels and methods that enabled its success. As a result, *Corwin*'s current focus leads to a serious miscalculation in the foundational equation. Acceptance of this Article's proposal restores its accuracy.

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that aims at increasing stockholder welfare and societal wealth, keeping levels of corruption low, and avoiding the imposition of unnecessary costs. . . . By focusing judicial review on those situations when conflicts of interest are present, and even then by tempering it when impartial directors and the disinterested stockholders themselves are given control over the action, the Delaware courts have attempted to strike the most effective benefit-to-cost ratio for investors and society.").