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Unintentional Irony in Landmark Decisions of the Delaware Supreme Court Regarding Corporate Law

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UNINTENTIONAL IRONY IN LANDMARK DECISIONS OF THE DELAWARE SUPREME COURT REGARDING CORPORATE LAW

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"[S]tandards . . . should be clearly articulated, and then candidly and consistently applied. . . . Whatever it is to be, the standard . . . , once announced, should be adhered to in fact as well as in rhetoric."[1]

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1. William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Realigning the Standard of Review of Director Due Care with Delaware Public Policy: A Critique of* Van Gorkom *and its Progeny as a Standard of Review Problem*, 96 NW. U. L. REV. 449, 460 (2002).

Three landmark decisions of the Delaware Supreme Court exhibit unintentional irony: *Beam v. Stewart*, *Smith v. Van Gorkom*, and *Paramount Communications Inc. v. Time Inc*. In *Beam*, the court concluded that, regarding the decision of whether to seek remedy against Martha Stewart, her fellow directors would not have jeopardized their reputations for the minimal gain of continuing their business and personal relationships with her.[2] Ironically, the court failed to acknowledge that Martha Stewart—in trading on material nonpublic information, which gave rise to the corporate claim against her—jeopardized her reputation (ultimately losing hundreds of millions of dollars and her freedom) for minimal gain (less than $50,000). Having failed to acknowledge that internal inconsistency and unintentional irony, the court offered no explanation why some directors would jeopardize their reputations for minimal gain, but others would not do so. Part I attempts to fill the void and suggests that Stewart suffered from cognitive biases, which would not have affected her fellow directors.

In *Van Gorkom*, the court famously concluded that the plaintiff carried his burden of proving that the board was grossly negligent in informing itself when selling the corporation, although, during a multi-month period, no bidder stepped forward with a superior proposal.[3] The irony of the court's conclusion is virtually self-evident. Part II further discusses subsequent precedent, which suggests that, viewed in retrospect, the board could have carried its burden that it reasonably informed itself, turning the conclusion of *Van Gorkom* on its head, and furthering the irony.

In *Time*, the court held that Time's board did not preclude Paramount from hostilely acquiring Time when it affected an acquisition of Warner.[4] According to the consensus, Time's board in fact precluded Paramount, so the *Time* court could not have meant what it wrote. As described in Part III, examining for the presence of preclusive action sometimes may enlighten the ultimate inquiry of reasonableness, but other times, an examination into preclusion proves misleading. In dicta, the Delaware Supreme Court has acknowledged that preclusive conduct may be reasonable.[5] As the inquiry into preclusion has yielded misleading, if not ironic, results, and as the Delaware Supreme Court has indicated that preclusive action may be reasonable, the court should re-examine the utility of the preclusion inquiry as an outcome-determinative filtering device regarding the ultimate inquiry of reasonableness.

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2. Beam v. Stewart, 845 A.2d 140, 1052 (Del. 2004) (en banc).

3. Smith v. Van Gorkom, 488 A.2d 858, 881, 888 (Del. 1985) (en banc).

4. Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1155 (Del. 1990).

5. *See, e.g.*, Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1284 (Del. 1989) ("If the grant of an auction-ending provision is appropriate, it must confer a substantial benefit upon the stockholders in order to withstand exacting scrutiny by the courts."); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 184 (Del. 1986) ("Favoritism for a white knight to the total exclusion of a hostile bidder might be justifiable when the latter's offer adversely affects shareholder interests . . . .").

In these foundational decisions of corporate law, the Delaware Supreme Court could not have meant what it wrote. Each section incorporates clarifying concepts for consideration, and Part IV briefly concludes.

I.

The law acknowledges several key characteristics of corporations. First, as a corporation is a legal fiction,[6] a natural person or persons must make decisions on its behalf. For a corporation, the decision-maker generally is the board of directors, not the investor-shareholders.[7] Second, decisions of the board of directors generally are shielded from challenge by the shareholders by the business judgment rule.[8] The protections of the business judgment rule extend to the decision of whether to pursue a cause of action on behalf of the corporation.[9] However, if the board members breached a duty that they owe to the corporation, giving rise to a cause of action by the corporation against those board members, then we would expect that neither the corporation—which is a legal fiction incapable of acting for itself—nor the board members—who would be unlikely to sue themselves—to seek to remedy the wrong.[10] In such situations, the law empowers shareholders to step into the shoes of the corporation to initiate a cause of action on behalf of the corporation against the board members.[11] Such suits are termed derivative, as the shareholders' claim derives from the claim belonging to the corporation.

However, if a shareholder pursues a derivative suit, it is legally insufficient for the shareholder to simply name board members as defendants; otherwise, shareholders would too easily supplant the board's authority to manage the corporation. In *Aronson*, the Delaware Supreme Court articulated an inquiry to balance (1) the shareholder's right to remedy wrongs committed by board members against the corporation, and (2) the overarching principle that the board of directors, not shareholders, makes decisions on behalf of the corporation.[12] According to *Aronson*, to survive a motion to dismiss a derivative claim, the shareholder must plead facts with particularity giving reason to doubt that (1) a majority of the board was disinterested or independent or (2) the challenged decision was a valid exercise of business judgment.[13]

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6. Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518, 636 (1819) ("A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law.").

7. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a) (2019); MODEL BUS. CORP. ACT § 8.01 (2016). The board of directors may delegate day-to-day operations to officers and employees. *See, e.g.*, DEL. CODE ANN. tit. 8, § 142 (2019); MODEL BUS. CORP. ACT §§ 8.40, 8.41 (2016).

8. Brehm v. Eisner (*In re* Walt Disney Co. Deriv. Litig.), 906 A.2d 27, 52 (Del. 2006).

9. *See* Levine v. Smith, 591 A.2d 194, 200 (Del. 1991).

10. *See* Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541, 547–48 (1949).

11. *Id.*; *see also* FED. R. CIV. P. 23.1.

12. Aronson v. Lewis, 473 A.2d 805, 811–15 (Del. 1984).

13. *Id.* at 814. The law encourages shareholders to exhaust internal remedies by demanding that the board seek the shareholder's preferred remedy before initiating a derivative suit. FED. R.

In *Beam v. Stewart*,[14] the Delaware Supreme Court applied the *Aronson* inquiry, and the results were unintentionally ironic. In concluding that the plaintiff-shareholder did not plead particularized facts giving reason to doubt that a majority of the board members was disinterested or independent, the court emphasized the lifelong investment that the board members had made in their reputations—concluding that those individuals would be unwilling to trade on their reputations for minimal gain by appeasing another board member, Martha Stewart, who was also the majority shareholder and the genuine target of the underlying claim.[15] All the while the court failed to acknowledge that multi-millionaire Martha Stewart herself had jeopardized her reputation, as well as her vast wealth and her freedom, for minimal gain—less than $50,000.[16] So, if Martha Stewart jeopardized her reputation for minimal gain, was the court wrong to credit the board members' value of their own reputations? No, but having failed to acknowledge the unintentional irony of its own analysis, the court failed to explain why Stewart did so, but the other board members would not have done so. Part I. attempts to fill that void. Part A. sets forth the facts of the case and the court's holding. Part B.1. presents a rational cost-benefit analysis (CBA) theoretically undertaken by Stewart and concludes that the costs exceeded the benefits of her actions. Part B.2. then presents cognitive biases that may have infected Stewart's CBA and contributed to her irrational actions. Part C. extends the analysis to the other members of the board of directors and posits that those individuals would not have succumbed to those cognitive biases.

A.

On behalf of Martha Stewart Living Omnimedia Inc. (MSLO), a shareholder initiated a suit to recover damages suffered by the corporation attributable to Martha Stewart's alleged illegal trades in the stock of ImClone—a pharmaceutical company—as well as her attempts to cover up the illegality.[17]

The key players were friends and associates. Sam Waksal was the Chief Executive Officer (CEO) of ImClone as well as a former suitor of Stewart's daughter.[18] Importantly, Waksal and Stewart provided one another with recip-

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CIV. P. 23.1; DEL. CH. CT. R. 23.1. If the board refuses the shareholder's demand, and the shareholder nonetheless pursues a derivative suit, then the shareholder concedes that the board is disinterested and independent. *Levine*, 591 A.2d at 212. *But cf.* Grimes v. Donald, 673 A.2d 1207, 1219 (Del. 1996) (footnote omitted) (limiting *Levine* by recognizing that, "[i]f there is reason to doubt that the board acted independently or with due care in responding to the demand, the stockholder may have the basis *ex post* to claim wrongful refusal").

14. Beam v. Stewart, 845 A.2d 1040 (Del. 2004) (en banc).

15. *Id.* at 1047, 1052.

16. Superseding Indictment ¶ 21, United States v. Stewart, 305 F. Supp. 2d 368 (S.D.N.Y. 2004) [hereinafter DOJ Indictment]; Complaint ¶ 19, SEC v. Stewart, No. 03-CV-4070 (S.D.N.Y. June 4, 2003) [hereinafter SEC Complaint].

17. *Beam*, 845 A.2d at 1044.

18. Beam v. Stewart, 833 A.2d 961, 968 (Del. Ch. 2003), *aff'd*, 845 A.2d 1040 (Del. 2004).

rocal investment advice and assistance, and they shared a stockbroker at Merrill Lynch, Peter E. Bacanovic, who previously worked at ImClone.[19] When MSLO made its initial public offering of common stock in 1999, Bacanovic sold $10 million of the shares to Stewart's friends, including Waksal.[20] Waksal encouraged and assisted Stewart's investment in ImClone and other companies.[21]

For years, ImClone devoted significant resources to developing a promising cancer drug, Erbitux.[22] ImClone described Erbitux as its "lead product candidate," emphasizing its significance to the company's future.[23] On October 31, 2001, ImClone submitted to the FDA the final materials associated with its application for a license regarding Erbitux.[24] The FDA had until December 31, 2001 to decide whether to accept the application for filing.[25] If the FDA issued a Refusal to File (RTF) letter, then ImClone would have to commence new and costly trials.[26]

Not yet known publicly, "FDA reviewers found ImClone's application to be inconclusive and questioned Erbitux's efficacy. . . . Waksal knew that investors would be stunned by [the prospect of an RTF letter. So he] . . . personally call[ed] officials at the FDA."[27] On December 26, 2001, before any formal action by the FDA, Waksal privately learned that the FDA had decided to issue an RTF letter regarding Erbitux.[28] Waksal alerted his daughter of the development: "I thought that until I get the letter from the FDA and I know what's really happening, I'm not doing anything wrong."[29]

On the morning on December 27, 2001, the day before ImClone publicly disclosed that it received an RTF letter from the FDA, Waksal's daughter called Douglas Faneuil, Bacanovic's assistant at Merrill Lynch, to place an order to sell all of her ImClone shares.[30] Waksal's accountant also called Faneuil to order the sale of all of Waksal's ImClone shares.[31] Faneuil spent the morning

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19. *Id.*

20. *Id.*

21. *Id.* at 968–69.

22. DOJ Indictment, *supra* note 16, ¶ 9; SEC Complaint, *supra* note 16, ¶ 13.

23. ImClone Sys. Inc., Annual Report (Form 10-K) (Apr. 1, 2002).

24. DOJ Indictment, *supra* note 16, ¶ 12; SEC Complaint, *supra* note 16, ¶ 13.

25. DOJ Indictment, *supra* note 16, ¶ 12; SEC Complaint, *supra* note 16, ¶ 13.

26. DOJ Indictment, *supra* note 16, ¶ 12; SEC Complaint, *supra* note 16, ¶ 13.

27. EUGENE SOLTES, WHY THEY DO IT: INSIDE THE MIND OF THE WHITE-COLLAR CRIMINAL 202–03 (2016).

28. SEC Complaint, *supra* note 16, ¶ 14. In 2004, however, the FDA approved Erbitux. SOLTES, *supra* note 27, at 204. Bolstered by the drug's success, Eli Lilly acquired ImClone in 2008 for $6.5 billion, a significant amount above its $5 billion value at the time of Waksal's and Stewart's disputed trades in late December 2001. *Id.*

29. SOLTES, *supra* note 27, at 203.

30. SEC Complaint, *supra* note 16, ¶¶ 8, 15; *see also* DOJ Indictment, *supra* note 16, ¶ 13, 15.

31. SEC Complaint, *supra* note 16, ¶ 15; *see also* DOJ Indictment, *supra* note 16, ¶ 13.

talking to Bacanovic and others at Merrill Lynch about whether Waksal or his daughter could sell their ImClone stock.[32] The same morning, pursuant to Bacanovic's instructions, Faneuil informed Stewart that Waksal and his daughter were selling, or attempting to sell, all of their ImClone shares and that Bacanovic believed that Stewart might wish to act on that information.[33] Stewart then instructed Faneuil to sell all of her ImClone shares.[34] Faneuil immediately placed an order to sell all 3,928 of Stewart's ImClone shares and that order was executed at an average price of $58.43.[35]

On December 28, the FDA sent ImClone an RTF letter.[36] After the market closed on December 28, ImClone issued a press release, which disclosed that the FDA had issued an RTF letter.[37] At the close of the next trading day, Monday, December 31, the price of ImClone stock dropped 16% to $46 a share.[38] By selling one day before ImClone announced that the FDA had issued an RTF letter, Stewart avoided losses of $45,673.[39]

In June 2003, Stewart was charged criminally by the Department of Justice and civilly by the Securities and Exchange Commission (SEC).[40] Although Stewart was never convicted of securities fraud,[41] she was convicted of conspiracy, obstruction of justice and false statement charges and sentenced to five months in prison and five months of home confinement.[42] Stewart settled the SEC's enforcement action by consenting to a final judgment that imposed: (1) disgorgement of $45,673, representing losses avoided from her insider trading, plus prejudgment interest of $12,389; (2) a maximum civil penalty of $137,019, representing three times the amount of losses avoided; (3) a five-year bar from serving as a director of a public company; and (4) a five-year limitation on her service as an officer or employee of a public company.[43]

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32. SEC Complaint, *supra* note 16, ¶ 15.
33. DOJ Indictment, *supra* note 16, ¶¶ 15-16; SEC Complaint, *supra* note 16, ¶ 18.
34. DOJ Indictment, *supra* note 16, ¶ 17; SEC Complaint, *supra* note 16, ¶ 19.
35. DOJ Indictment, *supra* note 16, ¶ 17; SEC Complaint, *supra* note 16, ¶ 19.
36. SEC Complaint, *supra* note 16, ¶ 14.
37. DOJ Indictment, *supra* note 16, ¶ 19; SEC Complaint, *supra* note 16, ¶ 14.
38. SEC Complaint, *supra* note 16, ¶ 14; *see also* DOJ Indictment, *supra* note 16, ¶ 20.
39. DOJ Indictment, *supra* note 16, ¶ 21; SEC Complaint, *supra* note 16, ¶ 19.
40. *See* DOJ Indictment, *supra* note 16; SEC Complaint, *supra* note 16.
41. Stewart was not indicted for insider trading. She was indicted for securities fraud—making false statements to the public, in the wake of the federal charges, regarding the reasons for her trades in ImClone stock. According to the government's theory, by falsely asserting her innocence regarding her sales of ImClone, Stewart intended to deceive MSLO investors to maintain an artificially high share price in MSLO. DOJ Indictment, *supra* note 16, ¶ 60. Stewart was acquitted of securities fraud. United States v. Stewart, 305 F. Supp. 2d 368 (S.D.N.Y. 2004).
42. Constance L. Hays, *Marth Stewart's Sentence: The Overview*, N.Y. TIMES (July 17, 2004), https://www.nytimes.com/2004/07/17/business/martha-stewart-s-sentence-overview-5-months-jail-stewart-vows-ll-be-back.html?register=facebook.
43. Sec. & Exch. Comm'n v. Martha Stewart and Peter Bacanovi, 03 Civ. 4070 (RJH) (S.D.N.Y.), lit. rel. no. 19794, 2006 WL 2252393 (Aug. 7, 2006).

When news broke regarding the governmental investigations into Stewart's ImClone trades, the stock of MSLO plummeted.[44] Monica A. Beam, a shareholder of MSLO, filed a derivative action against Martha Stewart and five other members of MSLO's board of directors in August 2002.[45] Beam filed the derivative suit without making a demand on MSLO's board to remedy the alleged wrong.[46] When MSLO's board moved to dismiss the derivative suit for failure to make a demand upon it, the plaintiff responded that any such demand should be excused as futile because there was reason to doubt that a majority of the board was disinterested or independent.[47]

The MSLO board of directors consisted of six members: Stewart, Sharon L. Patrick, Arthur C. Martinez, Darla D. Moore, Naomi O. Seligman, and Jeffrey W. Ubben.[48] The complaint alleged sufficient facts to doubt the disinterestedness and independence of two directors, Stewart and Patrick, for purposes of considering a pre-suit demand. Stewart's potential civil and criminal liability for the acts underlying Beam's claim rendered Stewart an interested party and therefore unable to consider demand objectively.[49] Patrick's full-time position as an MSLO officer, together with the substantial compensation she received from MSLO, raised a reasonable doubt as to her ability objectively to consider pre-suit demand, given Stewart's controlling interest in MSLO.[50] Ubben's disinterestedness and independence went unchallenged.[51] Consequently, the Chancery Court was left to address allegations of the complaint, and the reasonable inferences that flow therefrom, to determine where Beam raised a reasonable doubt regarding the disinterestedness or independence of Martinez, Moore, or Seligman. The Chancery Court emphasized that those outside directors had invested in their reputations and would not have jeopardized their reputations by rejecting a demand by a shareholder to pursue a meritorious action to appease Stewart, if a demand had been made.[52] The Chancery Court dismissed the suit.[53] In affirming, the Delaware Supreme Court agreed with the Chancery Court's emphasis on reputation—examining whether "the non-interested director would be more willing to risk his or her reputation than risk the relationship with the interested director."[54]

Having focused on the value that the directors placed on their reputation, and their unwillingness to trade on their reputation to appease Stewart for some

44. Beam v. Stewart, 833 A.2d 961, 968 (Del. Ch. 2003), *aff'd*, 845 A.2d 1040 (Del. 2004).

45. *Id.* at 977.

46. *Id.* at 976.

47. *Id.* at 976–77.

48. *Id.* at 977.

49. *Id.*

50. *Id.* at 977–78.

51. *Id.* at 969 n.9, 978–84.

52. *Id.* at 978–84.

53. *Id.* at 984.

54. Beam v. Stewart, 845 A.2d 1040, 1052 (Del. 2004).

nominal gain, the court failed to appreciate the irony of its conclusion: By trading on material nonpublic information, Martha Stewart risked her reputation, along with millions of dollars and her freedom, to avoid the loss of less than $50,000. The Delaware Supreme Court implicitly contemplated corporate actors undertaking clear-headed cost-benefit analysis (CBA). If the Delaware Supreme Court mistakenly assumed that one corporate actor (Martha Stewart) would undertake clear-headed CBA, was the court mistaken in assuming that other corporate actors (MSLO's outside directors) would undertake clear-headed CBA? Part B. concludes that Stewart did not undertake CBA and that she succumbed to cognitive biases. Part C. concludes that cognitive biases would not have affected the outside directors' consideration of a pre-suit demand, if such a demand had been made.

B.

1.

"[I]nside traders are[] . . . rational decision-makers [and] 'highly-skilled'" at CBA.[55] If Martha Stewart had undertaken clear-headed CBA prior to her contemplated sale of ImClone stock, then she probably would not have authorized the trade. CBA would have required Stewart to compare the gains from trading on material nonpublic information, in light of their likelihood of occurrence, against the losses from trading on material nonpublic information, in light of their likelihood of occurrence. Future gains and losses would be discounted accordingly. Plus, she would have undertaken an analogous inquiry before her actions to cover-up the disputed trades. This part focuses only on the disputed trades.

The gains acquired—more accurately, the losses avoided[56]—by selling her ImClone shares prior to public disclosure of the negative development regarding Erbitux would have enabled her to sell at a higher, rather than at a lower, price. We know *ex post* that she enjoyed a gain of less than $50,000. The inquiry should be *ex ante*. An RTF letter may prompt significant depreciation in stock price,[57] with the magnitude of the drop hinging on the overall importance

55. James B. Stewart, *Risk vs. Reward*, N.Y. TIMES, Dec. 8, 2012, at A1 (quoting Preet Bhara, U.S. Attorney for the Southern District of New York); *see* Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. ECON. PERSP. 169 (1968) (discussing Becker evaluating the likely costs and benefits of parking illegally, before doing so).

56. *See* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 612 (8th ed. 2011) (explaining how losses avoided can be construed as "gains").

57. *See* Jennifer King, *Unforced Errors: FDA Refusal to File or Receive Letters*, CAMARGO (Jan. 18, 2017), https://camargopharma.com/2017/01/unforced-errors-fda-refusal-file-receive-letters/ ("For Catalyst, their stock price plummeted by 37% in a single day and the company was required to commit to an expensive and time consuming additional Phase 3 clinical study. In the case of PTC Therapeutics, the company's stock fell by 80% . . . . It is too soon to see the full impact of the action on Innocoll, but in the short term, the company stock fell by 65% on the first day of trading after the regulatory action.").

of the drug to the company. ImClone described Erbitux as its "lead product candidate,"[58] so Stewart should have expected a significant drop, which *ex post* amounted to sixteen percent.[59] In the best-case scenario, Stewart would have gained approximately $228,000, based on her ownership stake of 3,928 shares and on ImClone's stock price of approximately $58 per share, which assumes that price fell to $0 on the Erbitux news. Now, $50,000 (and certainly $228,000) is a lot of money to me, and may be a lot of money to you, but Martha Stewart is the person of interest. At the time of the trade, Stewart was worth hundreds of millions of dollars.[60] A gain of $50,000 (or even $228,000) is not significant to one worth hundreds of millions of dollars. As a rule of thumb in the regulation of securities, some consider as immaterial any amount less than five percent.[61] $228,000 comprises only 0.23 percent of $100,000,000, and $50,000 only 0.05 percent. For Stewart, the focus is on financial gains, but she may have experienced non-financial gains by engaging in the disputed trades. Perhaps, she enjoyed psychic gain, as some enjoy the rush from risky behavior; think bungee jumping.

In undertaking CBA, Stewart would have considered the likelihood that she would realize those gains. Because the RTF letter was nonpublic at the time of Stewart's trade, its public disclosure would cause ImClone's stock price to fall with virtual certainty.[62] So, whatever one's *ex ante* view of the magnitude of the fall, the *ex ante* likelihood of a fall approached one hundred percent.

Against the likely gains, Stewart would have compared the costs of her trades in ImClone stock in light of their likelihood of occurrence. Viewed *ex ante*, trading on material nonpublic information could have caused—and *ex post*

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58. ImClone Sys. Inc., Annual Report (Form 10-K) (Apr. 1, 2002).

59. *See* DOJ Indictment, *supra* note 16, ¶ 20; SEC Complaint, *supra* note 16, ¶ 14.

60. Clare O'Connor, *Martha Stewart Preps Sale of Empire Once Worth $2 Billion*, FORBES, (June 19, 2015, 3:31 PM), https://www.forbes.com/sites/clareoconnor/2015/06/19/martha-stewart-preps-sale-of-empire-once-worth-2-billion/#393d2fea7d46 (reporting that Stewart became a billionaire in 2000, and was ranked in Fortune's list of 400 richest people in America, but fell off that list in 2001). Stewart owned almost thirty-four million shares of MSLO, Martha Stewart Living Omnimedia, Inc., Proxy Statement (Schedule 14A) (Mar. 30, 2002), which had a closing price of $16.97 per share on December 28, 2001. MSO, HISTORICAL STOCK PRICE. So, based only upon her ownership stake in MSLO, Stewart was worth more than $500 million at the time of her disputed trade.

61. JAMES D. COX, ROBERT W. HILLMAN & DONALD C. LANGEVOORT, SECURITIES REGULATION: CASES AND MATERIALS 621 (8th ed. 2017). *But see* SEC Staff Accounting Bull. No. 99 (Aug. 12, 1999) (rejecting bright-line approach to materiality).

62. *See* Basic Inc. v. Levinson, 485 U.S. 224 (1988). Some argue that, given the time that it took the brokers at Merrill Lynch to reach Stewart, the information may no longer have been nonpublic. *See* Donald C. Langevoort, *Reflections on Scienter (and the Securities Fraud Case Against Martha Stewart that Never Happened)*, 10 LEWIS & CLARK L. REV. 1, 14 (2006). The brokers, however, acted as if there was urgency to the trade, which suggests that the market price did not fully reflect the information. *See* DOJ Indictment, *supra* note 16, ¶ 14. Of course, if Stewart thought that she had not engaged in illegal trading, then she would not have needed to engage in any cover up the sale. Moreover, CBA focuses upon one's beliefs, which may not reflect the true state of affairs. Consequently, arguments that Stewart did not actually engage in illegal insider trading generally miss the mark.

did cause—Stewart to suffer massive financial losses. First, news of Stewart's suspicious trades in ImClone stock would have prompted a fall in the stock price of MSLO because Stewart was the face of that company.[63] As an imperfect analogue, Michael Milken, who was the face of Drexel Burnham Lambert, pled guilty to insider trading and was sentenced to prison, which was the beginning of the end of that firm.[64] Milken/Drexel is unlike Stewart/MSLO in that Milken's business involved the trading of securities, whereas Stewart's business was not related to securities and, instead, involved cooking and decorating. Nonetheless, as Stewart was the face of MSLO, her suspicious trades would harm the share price of her company.[65] News of the allegations against Stewart prompted a steep decline in MSLO's stock price.[66] As the majority shareholder of MSLO, Stewart lost hundreds of millions in value.[67] Of course, shareholder losses prompted the derivative suit against Stewart.

Stewart also risked her positions as director and CEO of MSLO. The SEC could, and ultimately did,[68] secure her removal from those managerial positions.[69] As an employee of MSLO, Stewart did not receive compensation for her service as a director.[70] As CEO, Stewart was compensated, in the years leading up to the suspicious trades, as set forth in the following chart.[71]

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63. Martha Stewart Living Omnimedia, Inc., Registration Statement (Form S-1) (July 29, 1999) ("Our business would be adversely affected if Martha Stewart's public image or reputation were to be tarnished. . . . Our continued success and the value of our brand name therefore depends, to a large degree, on the reputation of Martha Stewart.").

64. *See* Kurt Eichenwald, *The Collapse of Drexel Burnham Lambert*, N.Y. TIMES, Feb. 14, 1990, at A1; Brett Duval Fromson, *The Last Days of Drexel Burham*, FORTUNE, May 21, 1990, at 90.

65. *See generally* Brooks Barnes, *Weinstein Company Files for Bankruptcy Protection*, N.Y. TIMES, Mar. 19, 2018, at B2 (reporting that production company filed for bankruptcy after Harvey Weinstein, the face of the company, was publicly accused of sexual misconduct).

66. Beam v. Stewart, 833 A.2d 961, 969 (Del. Ch. 2003), *aff'd*, 845 A.2d 1040 (Del. 2004) ("After barely two months of . . . adverse publicity, MSO's stock price had declined by slightly more than 65%."); *see also* Charles Gasparino et al., *Martha Stewart Shares Drop 21% Amid Controversy over Stock Sale*, WALL ST. J. (June 25, 2002), https://www.wsj.com/articles/SB1024957422696586960 (reporting that prices fell $3.42, or 21%, to $12.55). *Cf.* Constance L. Hays & Tracie Rozhonsept, *Is There Life for Martha Stewart Living Omnimedia Without Martha?*, N.Y. TIMES (Sept. 5, 2002), https://www.nytimes.com/2002/09/05/business/is-there-life-for-martha-stewart-living-omnimedia-without-martha.html (noting that a weak economy contributed to those losses, but attributing most losses to Stewart's trades).

67. Recall that Stewart owned almost thirty-four million shares of MSLO. When the Associated Press broke the news of Stewart's trades on the evening of June 6, 2002, MSLO's closing price was $19.01, which steadily fell to $11.47 on June 29, 2002. DOJ Indictment, *supra*, note 16, ¶ 58. During that period, the value of Stewart's stake in MSLO fell more than $250 million.

68. Sec. & Exch. Comm'n, *supra* note 43.

69. 15 U.S.C. § 77h-1(f) (2012).

70. MARTHA STEWART LIVING OMNIMEDIA INC., SCHEDULE 14A INFORMATION (2003).

71. *Id.*; MARTHA STEWART LIVING OMNIMEDIA INC., SCHEDULE 14A INFORMATION (2001).

Year	Salary	Bonus	Stock Option Awards	Potential Value of Option Awards at Assumed Annual Rates of Stock Price Appreciation		Other Compensation
				5%	10%	
2001	$900,000	$1,156,666	0	0	0	$647,737
2000	$900,000	$1,770,000	150,000	$2,505,750	$6,350,655	$2,322
1999	$1,055,044	$300,000	0	0	0	$2,270
1998	$2,975,000	$1,695,717	0	0	0	$4,050

Those amounts seem significant, but arguably would not be material to one worth hundreds of millions of dollars. Even if the amounts were not material to Stewart, the positions as CEO and director would have been significant to her, as she would have wanted to continue those managerial roles in the company that bore her name.[72] During the sentencing hearing, Stewart told the judge, "I have lost my job. I have lost my position in my company. I am no longer the CEO of Martha Stewart Omnimedia . . . . That makes me angry and sad."[73]

If she traded illegally in ImClone stock, Stewart would face significant civil and criminal liability, including jail time.[74] Ultimately, Stewart settled the administrative allegations against her,[75] paying relatively inconsequential amounts, but, as mentioned above, the settlement included bars that prevented her from serving as a director or officer of MSLO.[76] In the criminal proceeding, a jury convicted Stewart, not of insider trading and not of securities fraud,[77] but of obstructing the investigation into her trades of ImClone stock and of making false statements to investigators.[78] The court sentenced her to five months in prison plus five months of home confinement, placed her on probation for nineteen months, and imposed a relatively small fine.[79]

72. *See* Jeff Bercovici, *Don't Blame Greedy Martha Stewart for MSLO's Crummy Stock*, FORBES (Aug. 1, 2011, 6:12PM) (describing Stewart as a "control freak").

73. Krysten Crawford, *Martha: I Cheated No One*, CNN (July 20, 2006, 6:21 AM).

74. *See* Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677 (1988) (codified in scattered sections of 15 U.S.C.); Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264 (1984) (codified in scattered sections of 15 U.S.C.).

75. Sec. & Exch. Comm'n, *supra* note 43.

76. *Id.*

77. *See supra* note 41 and accompanying text.

78. Kara Cannell & Matthew Rose, *Martha Stewart is Found Guilty of All Charges*, WALL ST. J. (Mar. 7, 2004, 4:36 PM), https://www.wsj.com/articles/SB107833235519345426; Crawford, *supra* note 73.

79. Constance L. Hays, *Martha Stewart's Sentence: The Overview; 5 Months in Jail, and Steward Vows, 'I'll Be Back,'*, N.Y. TIMES (July 17, 2004), https://www.nytimes.com/2004/07/17/business/martha-stewart-s-sentence-overview-5-months-jail-stewart-vows-ll-be-back.html.

Of course, Stewart risked and ultimately damaged her reputation. One's reputation suffers after being publicly reprimanded for deviating from accepted standards or by suffering an adverse court judgment.[80] Speaking to reporters outside of the courthouse following her sentencing hearing, Stewart said, it was a "shameful day,"[81] as her "public image had been one of trustworthiness."[82]

Losses must be discounted by their likelihood of occurrence, and that likelihood largely equaled the likelihood that the disputed trades would be detected by regulators or the public. None of those losses would be realized unless Stewart's suspicious trading was detected. As an initial matter, insider trading is believed to be detected at a low rate.[83] Nonetheless, Stewart probably could not have objectively believed that her trades in ImClone stock would go undetected.[84]

The government has a broken-windows, zero-tolerance approach to insider trading.[85] A layperson may be ignorant of the fundamentals of insider trading or the government's zealous pursuit of those who engage in insider trading, but Martha Stewart could not claim such ignorance. Stewart once worked for a brokerage and was intimately familiar with the stock market.[86] Her broker prompted Stewart to trade by alerting her that Waksal was unloading shares. Section 16 of the Securities Exchange Act of 1934 required Waksal to publicly disclose his sales of ImClone stock,[87] and those sales on the eve of the FDA's RTF letter would have prompted investigation by the government and the pub-

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80. *See* Ted J. Fiflis, *Responsibility of Investment Bankers to Shareholders,* 70 WASH. U. L. Q. 497, 515 (1992) (discussing ethical codes and professional norms).

81. Crawford, *supra* note 73; *see* Constance L. Hays & Tracie Rozhonsept, *Is There Life for Martha Stewart Living Omnimedia Without Martha?*, N.Y. TIMES (Sept. 5, 2002), https://www.nytimes.com/2002/09/05/business/is-there-life-for-martha-stewart-living-omnimedia-without-martha.html (discussing rebranding of MSLO).

82. Jeffrey Toobin, *Lunch at Martha's*, NEW YORKER (Feb. 3, 2003) (quoting Stewart from an interview conducted post-ImClone-trade, pre-trial); *see also* Jeffrey Toobin, *A Bad Thing*, NEW YORKER (Mar. 22, 2004)), https://www.newyorker.com/magazine/2004/03/ 22/a-bad-thing ("humiliation and conviction").

83. Stephen M. Bainbridge, *Incorporating State Law Fiduciary Duties into the Federal Insider Trading Prohibition*, 52 WASH. & LEE L. REV. 1189, 1262 (1995).

84. *See* SOLTES, *supra* note 27, at 226 (noting that Waksal could not have expected to escape detection).

85. *See* Mary Jo White, Chairman of the Sec. & Exch. Comm., Remarks at the Securities Enforcement Forum (Oct. 9, 2013), https://www.sec.gov/news/speech/spch100913mjw. *See generally* SOLTES, *supra* note 27, at 205–06 ("An astounding number of intelligent and well-paid executives are caught engaging in illicit trading each year. Between 2010 and 2014, regulators in the United States brought more than four hundred successful civil and criminal cases."). To increase the perception of the likelihood that one will be caught, the government subjects defendants to "perp walks." *Id.* at 38.

86. *See, e.g.*, SEC Complaint, *supra* note 16, ¶ 6 ("[I]n the late 1960's and early 1970's, Stewart was a registered representative for [a] broker-dealer. . . . From June 2002 to October 2002, Stewart was a member of the Board of Directors of the New York Stock Exchange, Inc."); DOJ Indictment, *supra* note 16, ¶ 2.

87. 15 U.S.C. § 78p(a) (2012); *see* ImClone Sys., Inc., Proxy Statement (Schedule 14A) (Apr. 23, 2001) (discussing compliance with Section 16).

lic.[88] Being subject to Section 16 for purposes of her trades in MSLO,[89] Stewart would have been aware that Waksal was subject to Section 16 regarding ImClone.

Any governmental investigation into insider trading begins, but does not end, with the target. According to the former head of enforcement for the SEC:

> We've created databases to see who is trading in tandem, even if [we] know nothing about an event . . . . It's a trader-based approach, not an issuer-based approach. These trading patterns are the first clue to what might be insider trading rings. [We] then have to do the real detective work, pulling phone records and e-mails and using other techniques to uncover the links.[90]

Stewart would have known that any investigation into Waksal's trades would extend to any trades by his friends and associates, including her.[91] Moreover, they shared a broker,[92] which provided an avenue for suspicion and ultimately culpability. As noted above, the government searches for suspicious trading in tandem, notwithstanding the occurrence of a material event. However, ImClone *did* experience a material event. The temporal proximity of Stewart's trade to ImClone's public disclosure of the negative development regarding Erbitux would have heightened governmental scrutiny. Finally, the nature of her trade—complete liquidation—also would have heightened governmental scrutiny.

The expected losses from Stewart's suspicious trades dwarfed the expected gains of those trades.

2.

If CBA counseled against effectuating the trade in ImClone stock, why did Stewart affect the trade? "[F]ictitious . . . are the deliberation and struggle that are envisioned to emerge during decision making."[93] The typical white-collar

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88. The *Wall Street Journal* routinely spotlights the largest trades by insiders. *See Insider-Trading Spotlight*, WALL ST. J. (Jan. 25, 2018), http://www.wsj.com/mdc/public/page/2_3023-insider.html.

89. *See, e.g.*, Martha Stewart, Martha Stewart Living Omnimedia Inc., Statement of Changes in Beneficial Ownership (Form 4/A) (Dec. 4, 2015); Martha Stewart Family LP, Martha Stewart Living Omnimedia Inc., Statement of Changes in Beneficial Ownership (Form 4) (Dec. 4, 2015); *see also* Martha Stewart Living Omnimedia, Inc., Proxy Statement (Schedule 14A) (Mar. 31, 2000) (discussing compliance with Section 16).

90. James B. Stewart, *In a New Era of Insider Trading, It's Risk vs. Reward Squared*, N.Y. TIMES (Dec. 7, 2012), https://www.nytimes.com/2012/12/08/business/insider-trading-persists-and-gets-stealthier.html (quoting Robert S. Khuzami, Director of Enforcement, SEC).

91. DOJ Indictment, *supra* note 16, ¶ 11. ("At all times relevant to this Indictment, Martha Stewart and Samuel Waksal were personal friends"); SEC Complaint, *supra* note 16, ¶ 10 ("Stewart became friendly with Waksal in the early 1990s.").

92. SEC Complaint, *supra* note 16, ¶ 7 ("[[Bacanovic's] clients included Stewart, Waksal, and Waksal's daughter, Aliza."); *id.* ¶ 10 ("Stewart knew that Waksal had an account with Bacanovic.").

93. SOLTES, *supra* note 27, at 318.

criminal does not, on a yellow legal pad, write pro-and-con columns regarding the contemplated action.[94] According to an accountant who facilitated insider trading, "I just never really thought about the consequences . . . . The money was nominal . . . . I never once thought about the costs versus rewards."[95] Even Waksal conceded this point about his illegal trades, "I don't know what I was thinking . . . . I wasn't, sadly."[96] One's decision-making process may be corrupted by cognitive biases.[97] This section does not exhaustively survey cognitive biases; instead, it, along with Part I.C.2, introduces certain biases and offers a theory differentiating the court's treatment of Stewart (who traded on her reputation to gain little at great expense) and the other board members of MSLO (who would not have traded on their reputations to gain little at great expense). According to one scholar, Martha Stewart succumbed to cognitive biases regarding her non-suspicious trades contemporaneous to her suspicious trades in ImClone,[98] which suggests that her decision to trade her ImClone stock also may have been the product of cognitive biases.

Time does not allow for deliberative CBA regarding every decision. Instead of deliberative CBA, we commonly employ short-cuts based upon intuition. One's intuition regarding insider trading may be faulty because of selective views regarding the trade, the salience of the victims and the harm that they suffer, nonfeasance as opposed to malfeasance, the distant consequences of the trade, and inadequate scrutiny.

Business executives, including Martha Stewart, know that insider trading is illegal, but the contours that delineate legal and illegal are far from clear. Those fuzzy borders certainly impact rational CBA, but also contribute to faulty intuition.[99] I may surpass the 55MPH speed limit, but, even though I know that speeding is illegal, I do not view myself as a criminal. My faulty intuition is that I know better about the appropriate speed of travel, notwithstanding the judgment of elected officials and administrators who possess expertise and data.[100] I misperceive the risks that attend speeding because the crime seems victimless and because, until I get into an accident, the victims are unknown and unknowable. Many commentators believe that insider trading should not be illegal, for similar reasons, which will be explored in the following paragraphs.[101]

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94. *Id.* at 91.

95. *Id.* at 99 (quoting Scott London); *id*. at 13–16 (discussing Scott London who facilitated insider trading for objects worth less than $70,000—concert tickets, Rolex watch, a few envelopes of cash—ending his thirty-year career as a successful accountant and his $900,000 annual salary).

96. *Id.* at 226 (quoting Sam Waksal).

97. *Id.* at 314.

98. Meir Statman, *Martha Stewart's Investment Lessons*, 7 J. INV. CONSULTING 52 (2005).

99. *See* Fiflis, *supra* note 82, at 515 (discussing ethical and industry norms that may provide discipline).

100. Given low detection rates, rational CBA may lead one to exceed the speed limit, but that's beside the point.

101. For a deeper treatment of insider trading, see HENRY G. MANNE, INSIDER TRADING AND THE STOCK MARKET (1966), STEPHEN M. BAINBRIDGE, INSIDER TRADING LAW AND POLICY

The salience of the victim and the salience of the harm suffered by the victim impact one's intuition regarding illegal conduct.[102] One's intuition about the conduct is negatively impacted if the victim is unknown and unknowable.[103] Waksal, who pled guilty to insider trading, objected to the sentencing judge referencing his securities fraud in the same breath as Enron and WorldCom.[104] From Waksal's perspective, Enron and WorldCom "cook[ed the] books," and those affirmative misrepresentations cost thousands of people their jobs.[105] Waksal seemingly distinguished between the malfeasance of Enron and WorldCom and the nonfeasance of his silence in the face of a duty to disclose.[106] Faulty intuition is more closely related to nonfeasance than malfeasance.[107] Like Waksal, Stewart remained silent when trading her shares of ImClone. In an interview with Barbara Walters, Martha Stewart said, "I didn't cheat anybody out of anything."[108]

Some, seemingly including Waksal and Stewart, view insider trading as a victimless crime. If Martha Stewart had not traded, the counterparty to her trade would have traded at the same price with a different party,[109] as millions of shares of ImClone were traded daily on NASDAQ.[110] If the counterparty would have traded at the same price anyway, Martha Stewart arguably did not victimize that individual and did not cause harm to that individual. Moreover, Stewart did not know the counterparty to the trade, which occurred on the market, not face-to-face. Empathy for others—and one's intuition regarding the

(2014), FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW, 253-275 (1991); DONALD C. LANGEVOORT, INSIDER TRADING: REGULATION, ENFORCEMENT AND PREVENTION (1991).

102. *See* SOLTES, *supra* note 27, at 323 ("For deterrence to directly impact behavior, the aversion to engaging in particular conduct needs to become so salient that individuals are overtly concerned.").

103. Charities understand this concept, personalizing victims and beneficiaries. In its television ads, the ASCPA depicts individual victimized animals and, when requesting donations, states that contributors will receive a photo of an animal that has been given a second chance.

104. SOLTES, *supra* note 27, at 201.

105. *Id.*; *see id.* at 329.

106. *See* 17 C.F.R. § 240.10b5-1 (2018); *see also* United States v. O'Hagan, 521 U.S. 642, 669 (1997) (referencing the obligation of an insider to "abstain or disclose"); Chiarella v. United States, 445 U.S. 222, 249 (1980) (Blackmun, J., dissenting) (same).

107. *See* Evan Tsen Lee & Ashutosh Bhagwat, *The McCleskey Puzzle: Remedying Prosecutorial Discrimination Against Black Victims in Capital Sentencing*, 1998 SUP. CT. REV. 145, 189–90 (1998).

108. Crawford, *supra* note 73 ("Stewart, who has been steadfast in proclaiming her innocence, told Walters, 'I didn't cheat the little people. . . . We're all little people. I didn't cheat anybody out of anything.'").

109. *See* BAINBRIDGE, *supra* note 101, at 193.

110. *See Profile—ImClone Sys. Inc.*, YAHOO! FINANCE (Aug. 31, 2001) (reporting daily average volume for prior three months of 1.38 million shares), https://perma.cc/UZ58-SADL. Eli Lilly acquired ImClone, so its shares are no longer traded. *See* Shirley S. Wang, *Lilly Agrees to Acquire ImClone for $6.5 Billion*, WALL ST. J. (Oct. 7, 2008, 12:01 AM), https://www.wsj.com/articles/SB122329145082307287.

wrongfulness of conduct—is impacted by physical proximity to and causation of the harm.[111] "Economic harms fundamentally differ from other acts in that they do not trigger gut feelings of actually doing harm, as [is] the case with intimate, physical harm."[112]

Whether or not an insider's trade harms the counterparty, according to the Supreme Court, insider trading damages the integrity of the market and thus harms all investors.[113] Others reject that position. For insider trading to be profitable, the market price must not reflect the inside information; by trading on that information, the insider informs the market.[114] Market participants benefit from more accurate pricing.[115] Moreover, insider trading may be treated as a form of compensation, which could lower the entity's costs, benefitting investors.[116] Even if one accepts the Supreme Court's position, the abstract nature of the market as victim does not aid one's intuition regarding the inappropriateness of insider trading.

Just as physical distance impedes one's intuition regarding the inappropriateness of conduct, so too does temporal distance.[117] Though Waksal would have promptly reported his trades in ImClone stock,[118] Section 16 would not have required Stewart to report her trades in ImClone.[119] Her trades did not come to light until months later.[120] As the consequences, whether for the victim or the perpetrator, become temporally distant, one's intuition regarding inappropriate conduct becomes worse.[121]

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111. SOLTES, *supra* note 27, at 116–18, 126.

112. *Id.* at 120; *see id.* at 326 ("When regulators in the United Kingdom questioned Douglas Flint, chairman of HSBC, about the aiding of tax avoidance in his firm's private banking operations, he argued that: 'I don't feel that proximate to what was happening in the private bank.' But when the chairman who oversees a firm doesn't deeply relate to his firm's problems, who will seek to instill different norms?").

113. United States v. O'Hagan, 521 U.S. 653 (1997). *Cf.* SOLTES, *supra* note 27, at 329 ("According to the executive who committed insider trading, it's the ones who committed financial fraud who really damaged the integrity of the financial markets.").

114. *See* BAINBRIDGE, *supra* note 101, at 176–77; EASTERBROOK & FISCHEL, *supra* note 101, at 257.

115. *See* BAINBRIDGE, *supra* note 101, at 176–77; EASTERBROOK & FISCHEL, *supra* note 101, at 257.

116. BAINBRIDGE, *supra* note 101, at 176-177; EASTERBROOK & FISCHEL, *supra* note 101, at 257-59. On the other side of the ledger, deregulating insider trading would increase volatility, risk, and the perception of unfairness. *Id.* at 260–61.

117. SOLTES, *supra* note 27, at 324 ("China once doled out the death penalty for white-collar convicts, but even with this ultimate punishment looming, executives continued to engage in corporate mischief. . . . Sanctions, even when incredibly severe, are often just too far removed and remote to become relevant to executives in their everyday decision making.").

118. *See* 15 U.S.C. § 78p(a) (2012).

119. Nonetheless, an obligation to abstain or disclose may have arisen. *See* 17 C.F.R. §§ 240.10b5-1, -2 (2000); Dirks v. S.E.C., 463 U.S. 646 (1983).

120. DOJ Indictment, *supra* note 16, ¶¶ 17, 58 (noting that, on June 6, 2002, the Associated Press broke the news of Stewart's trade, which occurred on December 27, 2001).

121. *See* SOLTES, *supra* note 27, at 126–29.

One's real-world action may deviate from the course that would have been chosen in a sterile setting because of inadequate scrutiny of that action.[122]

> Sam Waksal remembers one of the first conversations he had with his lawyer, Lewis Liman, after being indicted for committing securities fraud in conjunction with his insider trading. "I kept saying to him that I didn't really do anything wrong," Waksal recalls. "Lewis said to me, 'Sam, would you have done the same thing if you were being filmed?' " Waksal remembers pausing to think about the question and soon responded: "probably not." With the powerful tools at the disposal of regulators to monitor trades, it's difficult to imagine that people like Waksal couldn't appreciate that trades by family members were being carefully watched. Yet, Waksal never . . . had that gut feeling telling him to stop. "I don't know what I was thinking. . . . I wasn't, sadly."[123]

One's decision may be anchored by the actions of others, and inadequate scrutiny of that anchored position may result from time pressure and a lack of differing viewpoints. The initial recommendation of an advisor may serve as an anchor which the ultimate decision-maker cannot overcome.[124] On the date of her trade, Merrill Lynch relayed information to Stewart to persuade her to sell—not buy and not hold—her ImClone stock. Merrill Lynch set the anchor: Sell ImClone.[125]

When pressed for time, one may side-step what one knows to be the correct behavior. For example, John M. Darley and C. Daniel Batson conducted an experiment on students at Princeton Theological Seminary.[126] Those students were asked to hurry to an adjacent building to deliver comments on the Good Samaritan,[127] but who one-after-another bypassed (and, in some instances, stepped over) a groaning victim positioned by the researchers in the path of the students.[128] "[E]xecutives are constantly engaged in a whirlwind of meetings, travel, and e-mails. With incessant demands on their time, they take few oppor-

122. SOLTES, *supra* note 27, at 314; *see also* Stephanos Bibas, *Plea Bargaining Outside the Shadow of Trial*, 117 HARV. L. REV. 2464, 2498 (2004) (noting that those who are overburdened may not spot nor account for cognitive biases).

123. SOLTES, *supra* note 27, at 226.

124. *See* Cass R. Sunstein, *Behavioral Analysis of Law*, 64 U. CHI. L. REV. 1175, 1188 (1997) ("Often people make probability judgments on the basis of an initial value, or 'anchor,' from which they make insufficient adjustments. The initial value may have an arbitrary or irrational source.") (footnote omitted).

125. Stewart was slow to affect any trade. Statman, *supra* note 98, at 53-59. She was slow to trade losers, despite the tax benefit of doing so. *Id*. at 55–56. And she was slow to trade winners for fear of missing out on additional future gains. *Id*. at 56. In December 2001, Bacanovic convinced her to realize some tax losses to offset some tax gains. *Id*. at 54. Those trades—in which she suffered losses—may have made her more willing to sell ImClone for a gain, when contacted by Merrill Lynch to do so.

126. John M. Darley & C. Daniel Batson, *From Jerusalem to Jericho: A Study of Situational and Dispositional Variables in Helping Behavior*, 27 J. PERSONALITY & SOC. PSYCH. 100 (1973).

127. *Id.* at 102.

128. *Id.* at 104, 107.

tunities to slow down, ruminate on their judgments, and engage in . . . more reflective thinking."[129]

Stewart was travelling and pressed for time on the date of her ImClone trade.[130] "Within minutes" of learning that Waksal "urgently" sought the sale of his shares of ImClone and that it was "imperative" that the sale take place on the morning of December 27, 2001, Merrill Lynch left a message for Stewart that ImClone was "going to start trading downward."[131] At the time of Merrill Lynch's call, Stewart was on an airplane. When the plane landed to refuel, Stewart checked her messages, contacted Merrill Lynch, and learned that Waksal was trying to sell his ImClone stock. Aware that the stock price was falling, aware that the company's CEO was selling his stake, and aware that her plane soon would be airborne, Stewart directed Merrill Lynch to liquidate her holdings of ImClone.[132] Discussions with those who present an alternative view may counter erroneous initial intuitions,[133] but no one presented Stewart with an alternative view of the anchored decision to sell ImClone.[134] Contrary to deliberative CBA, Stewart, seemingly affected by cognitive biases, decided to sell her ImClone stock.

C.

Beam, the plaintiff-shareholder, failed to make a demand on MSLO's board of directors to remedy the harm that Stewart allegedly inflicted upon MSLO. Thus, the board was not required to affirmatively respond to such a demand nor justify any decision. Part C.1. employs CBA and concludes that the directors' business and personal relationships with MSLO and Stewart would not have meaningfully impacted their consideration of Beam's claims. Part C.2. exam-

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129. SOLTES, *supra* note 27, at 152.

130. SEC Complaint, *supra* note 16, ¶ 19.

131. DOJ Indictment, *supra* note 16, ¶¶ 16-17. When discussing the Waksal's trades with his assistant, Faneuil, "Bacanovic exclaimed: 'Oh, my god! Get Martha on the phone!'" Thomas S. Mulligan, *Broker's Former Aide Says Martha Stewart Was Tipped*, L.A. TIMES (Feb. 4, 2017), https://www.latimes.com/archives/la-xpm-2004-feb-04-fi-martha4-story.html (quoting Faneuil's testimony regarding Bacanovic's statement). When Faneuil questioned whether he could disclose the Waksals' trades to Stewart, Bacanovic replied: "Of course! You must. That's the whole point!" *Id*. (same).

132. *See* DOJ Indictment, *supra* note 16, ¶ 17; *see also* SEC Complaint, *supra* note 16, ¶ 19.

133. SOLTES, *supra* note 27, at 320. Outsiders, however, may not provide the optimal check. *Id*. at 315 ("'When the CEO is in the room, directors—even independent directors—tend to want to try to please him,' [former Tyco CEO Dennis] Kozlowski explained. 'The board would give me anything I wanted. Anything.' Not surprisingly for Kozlowski, this created a feeling of entitlement.").

134. *See supra* note 125 and accompanying text. Stewart's broker sought her rubber-stamp on the sale of ImClone because he didn't want to risk another loss in her portfolio and possibly her loss as a client. Statman, *supra* note 98, at 57 (quoting email from Stewart to Bacanovic, dated Nov. 11, 2000) ("The account is a mess . . . . I think it's time for me to give my money to a professional money manager who will take a bit more care about overall market conditions and political and economic problems.").

ines cognitive biases and concludes that such biases would not have meaningfully affected the board's consideration of Beam's claims.

1.

Corporate law entrusts boards of directors with the management of the corporation's business, including the pursuit of lawsuits on the corporation's behalf.[135] Corporate law contemplates that, prior to initiating a derivative cause of action, a shareholder generally must make a demand on the board of directors to seek the desired relief.[136] If a shareholder pursues a derivative cause of action without first making a demand on the board of directors, then, when the corporation moves to dismiss the complaint for failure to make a demand, the court reviews the complaint to determine whether the plaintiff pled facts with particularity giving reason to doubt that a majority of the board is disinterested or independent regarding a pre-suit demand.[137] In *Beam*, the shareholder failed to make a demand on the board comprised of six individuals, so the plaintiff had to meet the requisite pleading threshold regarding a trio of directors.[138]

The plaintiff raised a reasonable doubt about the disinterestedness and independence of Stewart and Patrick. Stewart was the target of governmental enforcement actions regarding her trades and there was a significant likelihood that she would be civilly and criminally liable.[139] Patrick was a full-time employee of MSLO, and, given Stewart's controlling interest, Stewart could affect Patrick's employment and compensation, which raised reasonable doubts about Patrick's disinterestedness and independence.[140]

The plaintiff-shareholder still had to raise a doubt regarding one of the remaining directors, none of which was an employee of MSLO. If those outside directors, on behalf of MSLO, had pursued an action against Stewart, they would have jeopardized their directorial positions with MSLO. Stewart was known to fire people with whom she disagreed,[141] and, as majority shareholder, she was empowered to remove any or all directors, with or without cause.[142] The plaintiff did plead facts regarding Stewart's controlling interest and her

135. *See* DEL. CODE ANN. tit. 8, § 141(a) (2016); *see also* Levine v. Smith, 591 A.2d 194, 200 (Del. 1991).

136. *See* DEL. CH. CT. R. 23.1; *Levine*, 591 A.2d at 200.

137. *See* Aronson v. Lewis, 473 A.2d 805, 813–15 (Del. 1984).

138. Beam v. Stewart, 833 A.2d 961, 977 (Del. Ch. 2003). At the time that the complaint was filed, August 15, 2002, MSLO's board was comprised of six individuals. *Id.* Those six individuals constituted the board for purposes of evaluating demand futility. *Id.*

139. *Id.*

140. *Id.* at 977–78.

141. *See* Jeff Bercovici, *Don't Blame Greedy Martha Stewart for MSLO's Crummy Stock*, FORBES (Aug. 1, 2011, 6:12PM)), https://www.forbes.com/sites/jeffbercovici/2011/08/01/dont-blame-martha-stewart-for-mslos-crummy-stock/#7f5d92e614bf ("Martha Stewart is a control freak who . . . fires anyone who disagrees with her.").

142. DEL. CODE ANN. tit. 8, § 141(k) (2016).

ability to remove directors.[143] However, the plaintiff did not plead facts regarding the materiality to any outside directors of the fees paid by MSLO for such service. In fact, the financial condition of each of the outside directors appears to render immaterial the director fees paid by MSLO. At MSLO, outside directors received an annual retainer of $20,000, attendance fees for board and committee meetings, and additional fees for service as committee chair.[144]

Before joining the MSLO board of directors in January 2001, Martinez served as the CEO of Sears Roebuck & Co. As CEO of Sears, Martinez earned over $1 million annual salary in 1995, 1996, 1997, 1998, and 1999.[145] During that five-year period, he received a bonus that averaged more than $1 million annually, "other" compensation that averaged more than $300,000 annually, and long-term incentive payouts that averaged more than $850,000 annually.[146] As of January 2000, Martinez also had in-the-money options to acquire shares of Sears valued at over $8.3 million.[147] Martinez served as a director of other corporations, including PepsiCo, Inc. As an outside director at PepsiCo, Inc., Martinez annually received a retainer comprised of options to acquire $210,000 of PepsiCo, Inc. stock, which could immediately be exchanged for cash in the maximum amount of $70,000.[148] In addition, Martinez annually received options to acquire $150,000 of PepsiCo, Inc. stock, three-fifths of which could be immediately exchanged for cash of $30,000.[149] Martinez's financial independence was secure, regardless of whether he served on MSLO's board.[150]

Darla Moore, who was a successful banker in her own right, married billionaire Richard Rainwater in 1991, and eventually assumed managerial respon-

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143. *See* Beam v. Stewart, 845 A.2d 1040, 1054 (Del. 2004); Beam v. Stewart, 833 A.2d at 978.

144. *Beam*, 833 A.2d at 967–68; Martha Stewart Proxy Statement, *supra* note 60, at 11. Note, however, that those amounts do not compare favorably with amounts paid to directors of large publicly-traded corporations. Theo Francis & Joann S. Lublin, *Directors' Pay Ratchets Higher As Risks Grow*, WALL ST. J. (Feb. 24, 2016), https://www.wsj.com/articles/corporate-directors-pay-ratchets-higher-as-risks-grow-1456279452 ("The median pay of an S&P 500 board member is $255,000 a year.").

145. *E.g.*, Sears, Roebuck & Co., Proxy Statement (Schedule 14A) 15 (Mar. 20, 1997) [hereinafter 1997 Sears Proxy Statement]; Sears Roebuck & Co., Proxy Statement (Schedule 14A) 15 (Mar. 17, 2000) [hereinafter 2000 Sears Proxy Statement].

146. *See, e.g.*, 1997 Sears Proxy Statement, *supra* note 145, at 15; 2000 Sears Proxy Statement, *supra* note 145, at 15.

147. *See* 2000 Sears Proxy Statement, *supra* note 145, at 18.

148. PepsiCo, Inc., Proxy Statement (Schedule 14A) 6 (Mar. 24, 2000).

149. *Id.* at 7.

150. The Delaware Supreme Court indicated that the plaintiff abandoned the claim regarding Martinez's disinterested and independence. Beam v. Stewart, 845 A.2d 1040, 1053 n.33. (Del. 2004). The allegations against Martinez necessarily failed because the allegations against him were weaker than those against Moore and Seligman, and because the allegations against that duo were inadequate. *Id.*

sibilities for an entity that he founded.[151] Her financial independence was secure, regardless of her service on MSLO's board.

Naomi Seligman was a senior partner at an e-commerce consulting firm; her salary at that firm has not been disclosed to the public. She also served on numerous boards of directors, several of which disclose director fees to the public. For her service as a non-employee director at Dun & Bradstreet Corp., Seligman received, in 2002, stock options with a nominal grant value of $80,000 and an annual retainer of $75,000.[152] As a non-employee director at Akamai Technologies, Inc., Seligman received an option to acquire 50,000 shares of stock upon joining the board and options to acquire 20,000 shares for each year of service.[153] As a non-employee director at John Wiley & Sons, Inc., Seligman received, in 2002, an annual retainer of $30,000 and an option to acquire stock worth half of that amount.[154] As a non-employee director at Sun Microsystems, Inc., Seligman received nominal cash amounts for attending board and committee meetings, an option to acquire at least 10,000 shares upon joining the board and an option to acquire 10,000 shares for each additional year of service.[155] As a non-employee director at Exodus Communications, Inc., Seligman received, for 2001, nominal cash consideration, and, in 2000, an option to acquire 20,000 shares.[156] As a non-employee director at Ventro Corp., Seligman received an option to acquire 12,500 shares and an additional option to acquire 5,000 shares for each year of service.[157] The plaintiff-shareholder faced the burden of raising reasonable doubt regarding Seligman's presumed disinterestedness, and the plaintiff pled no facts regarding the materiality of the director fees that Seligman received from MSLO. Seligman must be treated as disinterested regarding the receipt or loss of director fees from MSLO.

The plaintiff's amended complaint included no allegations specific to Ubben, so his presumed disinterestedness and independence remained unrebutted.[158]

151. Peter Elkin & Patricia Sellers, *Richard Rainwater: Remembering a Billionaire Dealmaker*, FORTUNE (Sept. 28, 2015), http://fortune.com/2015/09/28/richard-rainwater-obituary/.

152. *See* The Dun & Bradstreet Corp., Proxy Statement (Schedule 14A) 18 (Mar. 14, 2002). In 2001, she received stock options with a nominal grant value of $50,000 and an annual retainer of $50,000. *Id.*

153. Akamai Tech., Inc., Proxy Statement (Schedule 14A) 7 (Apr. 16, 2002).

154. *See* John Wiley & Sons, Inc., Proxy Statement (Schedule 14A) 4 (Aug. 6, 2002).

155. Sun Microsys., Inc., Proxy Statement (Schedule 14A) (Sept. 30, 2002).

156. Exodus Commc'n, Inc., Proxy Statement (Schedule 14A) (Apr. 26, 2001).

157. Ventro Corp., Proxy Statement (Schedule 14A) (Apr. 26, 2001).

158. *See* Beam v. Stewart, 845 A.2d 1040, 1046 n.6 (Del. 2004); *see also* Beam v. Stewart, 833 A.2d 961, 969 n.9 (Del. Ch. 2003). L. John Doerr served as a director of MSLO, but his service ended in March 2002, prior to the time that Beam filed her complaint. The complaint against Doerr was dismissed with prejudice and not appealed. *Beam*, 845 A.2d at 1044 n.2. Nonetheless, Doerr's financial independence was secure, regardless of his service on MSLO's board. He was a general partner with Kleiner, Perkins, Caufiled & Byers, a successful venture capital firm. In 2002, Doerr was worth hundreds of millions, on his way to becoming a billionaire. *The Forbes 400: #391 L.*

Aside from financial considerations giving reason to doubt a director's disinterestedness, one's independence may be questioned due to a personal relationship of a bias-producing nature.[159] For example, co-ownership of a private plane, given the requisite expense to acquire and coordination to use, suggested a bias-producing relationship between those owners.[160] Or, a *fifty*-year friendship, which was accompanied by political donations totaling thousands of dollars from one to the other, suggested a bias-producing relationship.[161] However, a bald assertion by a plaintiff-shareholder that a director is a "friend" of the targeted individual proves inadequate for pleading purposes. Otherwise, any shareholder could too easily overcome the demand requirement and too easily supplant the board as the decision-maker regarding corporate litigation. In *Beam*, the plaintiff did offer additional facts regarding Moore and Seligman. Regarding Moore, the plaintiff asserted that both Stewart and Moore attended a wedding reception honoring the daughter of Stewart's personal attorney.[162] Even if the reception was limited to close friends, the requisite link is missing. Accepting that B is close friends with A and that B is also close friends with C does not support the conclusion that A is sufficiently close to C that their relationship is of a bias-producing nature. Regarding Seligman, the plaintiff pled that, in her capacity as a director of Wiley, Seligman—at Stewart's request—"express[ed] concern" regarding a biography that would be critical of Stewart.[163] However, "express[ing] concern" would be consistent with Seligman's duties as a director of MSLO and Wiley. First, in her capacity as a director of MSLO, Seligman would be fulfilling her duties to MSLO by acting to protect Stewart's reputation as Stewart was the face of MSLO and any damage to her reputation would be harmful to MSLO and its shareholders.[164] Second, in her capacity as a director of Wiley, Seligman would be fulfilling her duties to Wiley by "express[ing] concern" regarding any biography critical of its subject because such biographies give rise to litigation that could harm Wiley and its shareholders.[165]

By appeasing Stewart and forgoing a meritorious claim against her on the corporation's behalf, the outside directors would preserve their positions and the

John Doerr, FORBES (Sept. 13, 2002); *The Forbes 400: #91 John Doerr*, FORBES (2018), https://www.forbes.com/forbes-400/.

159. *See Beam*, 845 A.2d at 1050.

160. Sandys v. Pincus, 152 A.3d 124, 130 (Del. 2016).

161. Del. Cty. Emps. Retirement Fund v. Sanchez, 124 A.3d 1017, 1021 (Del. 2015); *id.* at 1022–24 (supplementing its conclusion regarding the parties' personal relationship with the inference that the interested director could have affected the other's employment and compensation).

162. *Beam*, 845 A.2d at 1045, 1054.

163. *Id.* at 1046.

164. *Beam*, 833 A.2d at 980–81; *see* Martha Stewart Living Omnimedia, Inc., Registration Statement (Form S-1) (July 29, 1999) ("Our business would be adversely affected if Martha Stewart's public image or reputation were to be tarnished. . . . Our continued success and the value of our brand name therefore depends, to a large degree, on the reputation of Martha Stewart.").

165. *Beam*, 833 A.2d at 981.

attendant fees, which, as set forth above, were not material, and preserve their personal relationships with Stewart, which, as set forth above, were not deep relationships of a bias-producing nature. Regarding the costs borne by outside directors of appeasing Stewart and forgoing a meritorious claim against her, the Chancery Court and the Delaware Supreme Court correctly emphasized the importance of reputation.[166] "[O]utside directors . . . have considerable investments in reputation;"[167] they are "the most reputationally sensitive people in the world."[168] Attaining a sterling reputation generally requires time, effort, and money.[169] Investments in reputation amount to sunk costs with minimal salvage value.[170] Rational actors generally are unlikely to gamble with their reputations.[171] Consequently, the Delaware courts inquire whether a "non-interested director would be more willing to risk his or her reputation than risk the relationship with the interested director."[172] Because the outside directors had made a lifetime of investments in their reputations,[173] and would not rationally squander them, the Delaware courts correctly concluded that there was no reason to doubt the disinterestedness or independence of the outside directors.[174]

2.

Although cognitive biases seemingly contributed to Stewart's decision to sell ImClone stock, when CBA counseled against such a sale, cognitive biases

166. *See Beam*, 845 A.2d at 1051; *Beam*, 833 A.2d at 879–86.

167. Michael P. Dooley & E. Norman Veasey, *The Role of the Board in Derivative Litigation: Delaware Law and the Current ALI Proposals Compared*, 44 BUS. LAW. 503, 535 (1989).

168. David A. Skeel, Jr., *Shaming in Corporate Law*, 149 U. PA. L. REV. 1811, 1812 (2001) (quoting Nell Minow).

169. *See* Fiflis, *supra* note 80, at 515 ("[T]he investment-banking industry's stock in trade is its reputation and assets, which provide a valuable bond, already incurred, to assure that the banker will act carefully and skillfully.").

170. *See* Benjamin Klein & Keith B. Leffler, *The Role of Market Forces in Assuring Contractual Performance*, 89 J. POL. ECON. 615, 617 (1981); *see generally* EASTERBROOK & FISCHEL, *supra* note 101, at 97 (discussing firm-specific investments of human capital).

171. *See* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 137 (Erwin Cherminsky et al. eds., 6th ed. 2003) ("Most contracts are complied with not out of fear of legal action but out of concern with reputation . . . .").

172. Beam v. Stewart, 845 A.2d 1040, 1052 (Del. 2004). *See generally* Skeel, *supra* note 168, at 1818 & n.23 (discussing a printer who was acquitted of insider trading, Chiarella v. United States, 445 U.S. 222 (1980), but who was devastated and drifted from job to job); Bryan Burrough, *After the Fall*, WALL ST. J., Nov. 18, 1987, at A1.

173. *See* Beam v. Stewart, 833 A.2d 961, 980 (Del. Ch. 2003) ("One might say that Martinez's reputation for acting as a careful fiduciary is essential to his career–a matter in which he would surely have a material interest. . . . [I]t is clear that Moore's professional reputation similarly would be harmed if she failed to fulfill her fiduciary obligations.").

174. *But see* Skeel, *supra* note 168, at 1834 (noting that "[i]f a manager's skills are so valuable that people will transact with her regardless of her reputation, . . . shaming sanctions are less likely to prove effective"). While this logic may apply to Stewart, who returned to MSLO after the five-year ban, it is not clear that it applies to any of the outside directors.

seemingly would not have meaningfully affected the consideration by the outside directors of any pre-suit demand to pursue a remedy against Stewart.[175]

The Delaware courts acknowledge the possibility that cognitive biases may affect a board's decision-making process regarding a suit against an insider.[176] The decision to sue is complex, increasing the potential effect of bias. Nonetheless, the biases that seemingly impacted Stewart seemingly would not have impacted the board in deciding whether to initiate a cause of action against Stewart. Regarding Stewart's trade, the victim was unknown and unknowable because the trade was not face-to-face but occurred in the market. Moreover, Stewart arguably did not victimize the counterparty to the trade, as that individual would have traded anyway at the same price with another trader in the market. If MSLO's cause of action against Stewart was meritorious, then the board would harm MSLO and its shareholders by failing to pursue that suit. The directors would be harming the very parties to which they owed fiduciary duties, not unknown nor unknowable parties.[177] The directors would have been keenly aware of MSLO's falling stock price in the wake of the news regarding Stewart's trades, so the harm suffered by MSLO and its shareholders was known.

Whereas Stewart did not sufficiently scrutinize Merrill Lynch's suggestion that she sell her ImClone stock (an "anchor") due to time pressure and an absence of alternative viewpoints, the board, in considering an action against Stewart, would not be subject to disabling time pressure and would be presented with alternative viewpoints. One might argue that a shareholder's demand sets the anchor at the pursuit of the shareholder's requested remedy. However, the board may be predisposed not to sue the corporation's managers, especially the CEO, who is appointed by the board.[178] Unlike Stewart who was prompted to

175. *Beam*, 845 A.2d at 1048–49 ("In the context of presuit demand, the burden is upon the plaintiff . . . to overcome the presumption . . . that [directors] were faithful to their fiduciary duties.").

176. *See In re* Oracle Deriv. Litig., 824 A.2d 917, 938 (Del. Ch. 2003) ("[C]orporate directors are generally the sort of people deeply enmeshed in social institutions. Such institutions have norms, expectations that, explicitly and implicitly, influence and channel the behavior of those who participate in their operations."); *see also* Dooley & Veasey, *supra* note 167, at 529 ("[I]n cases in which demand is required, the possibility must be recognized that the board in at least some instances may be subject to a bias . . . that would not be overtly discernible to the court, but which would make the justifications advanced for dismissal appear implausible to the court (if substantive review of those reasons were permissible).") (quoting ALI PRINCIPLES OF CORP GOV, Tentative Draft No. 8, at 65-66 (1988)); Donald C. Langevoort, *Resetting the Corporate Thermostat: Lessons from the Recent Financial Scandals about Self-Deception, Deceiving Others and the Design of Internal Controls*, 93 GEO. L.J. 285, 286 n.6 (2004) ("Courts occasionally remark about the psychology of those [directors] they are about to find responsible, suggesting the capacity for delusion and obsession."). *See generally Air Prods.*, 16 A.3d at 112 n.430 ("I admit empirical studies show that corporate boards are subject to error in firm value projections, usually on the overconfident side of the equation.").

177. Certainly, daily trading volume renders many shareholders unknown and unknowable to the board members. Nonetheless, the board members face shareholders at annual meetings and likely interact with large shareholders, including institutions with which they may have existing relationships.

178. *See* DEL. CODE ANN. tit. 8, § 142(b) (2017).

make a quick decision to sell her ImClone stock because she was briefly on the tarmac as her plane refueled, because she just learned that ImClone's CEO was selling his shares, and because the market price would soon reflect such non-public news, the board would not be subject to similar time pressures regarding the initiation of a potential suit against Stewart. The limitations period would allow for assemblage of information and a methodical decision.[179] Even though the agendas for board meetings tend to be full,[180] the board need not act at any particular meeting and can always convene a special meeting.

Whereas Stewart heard a recommendation to sell ImClone and no alternative viewpoints, the board, in considering an action against Stewart, would hear alternative viewpoints. First, the board would hear advocacy for a position—the demand from the plaintiff-shareholder to seek remedy against Stewart[181]—that might be contrary to the position to which they might otherwise be disposed, and almost certainly contrary to the position advocated by Stewart. Moreover, directors commonly retain counsel (or create a committee (a Special Litigation Committee, or SLC), which retains counsel) to address any shareholder demand.[182] Counsel would advise the directors by offering the pros and cons of various courses of action, that is, alternative viewpoints. Moreover, counsel could offer expertise. Exposure to expertise as well as alternative viewpoints should inform the board's or SLC's decision and lessen the risk of cognitive bias.[183]

Cognitive bias may also be muted by subsequent review.[184] If a board refuses a shareholder's demand or if the board delegates to an SLC which moves to dismiss the derivative complaint, the board or SLC knows that its decision is

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179. *See In re* Tyson Foods, Inc., 919 A.2d 563, 584 (Del. Ch. 2007) ("A three-year statute of limitations applies to breaches of fiduciary duty."); *see also* DEL. CODE ANN. tit. 10, § 8106 (2017) (providing for a three-year limitations period).

180. *See* Langevoort, *supra* note 176, at 293.

181. If the plaintiff failed to make a demand on the board, then the plaintiff bypassed an opportunity to present the case to the board, thereby requiring her to plead particularized facts giving reason to doubt that a majority of the board was disinterested and independent.

182. *See* DEL. CODE ANN. tit. 8, § 141(c) (2017); *see generally* Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981) (discussing the creation of the special litigation committee of the board); Maher v. Zapata Corp., 490 F. Supp. 348, 350–51 (S.D. Tex. 1980) (discussing the creation of an independent committee, its retention of counsel, its investigation, and a report documenting its conclusion).

183. *See* Jennifer Arlen, *The Future of Behavioral Economic Analysis of Law*, 51 VAND. L. REV. 1765, 1768–69 (1998); Stephanos Bibas, *Plea Bargaining Outside the Shadow of Trial*, 117 HARV. L. REV. 2463, 2502 (2004). *But see* Arlen, *supra*, at 1784 (noting that experts may suffer from the same cognitive biases as lay people).

184. *See* Kenneth B. Davis, *Structural Bias, Special Litigation Committees, and the Vagaries of Director Independence*, 90 IOWA L. REV. 1305, 1326–29 (2005); *id.* at 1317 ("[T]he decision is being closely monitored by shareholders, lawyers and the financial press, and . . . the decision will likely be challenged if it favors the other directors . . . .").

subject to judicial (and nonjudicial) review.[185] Judicial scrutiny may mute the cognitive bias of the board or SLC.[186]

A Delaware court would review deferentially a board's refusal of a demand unless the shareholder could meet the pleading standard of *Aronson*.[187] However, when considering an SLC's motion to dismiss the derivate suit, the court would, in effect, review the SLC's decision *de novo*, exercising its own business judgment.[188] Unlike the review of a typical decision of the board—e.g., whether to sell widgets—which would merit deference, a court is well-equipped to consider whether litigation should be pursued. Consider the factors proffered by an SLC in moving to dismiss, virtually all of which seem within a court's competence:

> (1) the asserted claims appeared to be without merit; (2) costs of litigation, exacerbated by likelihood of indemnification; (3) wasted senior management time and talents on pursuing litigation; (4) damage to company from publicity; (5) that no material injury appeared to have been done to company; (6) impairment of current director-defendants' ability to manage; (7) the slight possibility of recurrence of violations; (8) lack of personal benefit to current director-defendants from alleged conduct; (9) that certain alleged practices were continuing business practices, intended to be in company's best interests; (10) legal question whether the complaints stated a cause of action; (11) fear of undermining employee morale; (12) adverse effects on the company's relations with employees and suppliers and customers.[189]

"[T]he decision whether to continue a derivative suit is not, strictly speaking, one uniquely within the directors' natural business aptitude and beyond the abilities of the court."[190]

Some scholars assert that board decisions regarding suits against insiders are not the product of CBA and result from cognitive biases.[191] For example,

185. Levine v. Smith, 591 A.2d 194 (Del. 1991); Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981); *see also* Davis, *supra* note 184, at 1316 ("highly visible setting").

186. *See* Jennifer S. Lerner & Philip E. Tetlock, *Accounting for the Effects of Accountability*, 125 PSYCHOL. BULL. 255, 259 (1999); Robert B. Thompson & Randall S. Thomas, *The Public and Private Faces of Derivative Lawsuits*, 57 VAND. L. REV. 1747, 1787 (2004) ("The prospect of judicial review helps stiffen the backbone of the independent director."). *See generally* Dynamics Corp of Am. v. CTS Corp., 794 F.2d 250, 256 (7th Cir. 1986) (Posner, J.), *rev'd on other grounds*, 481 U.S. 69 (1987) (Judicial review of directors' decisions "makes directors overcautious . . . .").

187. Aronson v. Lewis, 473 A.2d 805 (Del. 1984); *Levine*, 591 A.2d at 212; *cf.* Grimes v. Donald, 673 A.2d 1207, 1219 (Del. 1996) (limiting *Levine* by recognizing that, "[i]f there is reason to doubt that the board acted independently or with due care in responding to the demand, the stockholder may have the basis *ex post* to claim wrongful refusal" (footnote omitted)), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

188. *Zapata*, 430 A.2d at 789 & n.18 (quoting the chancery court); *id.* at n.18. ("Under our system of law, courts and not litigants should decide the merits of litigation.").

189. Maldonado v. Flynn, 485 F. Supp. 274, 284 n.35 (S.D.N.Y. 1980), *rev'd on other grounds*, 617 F.2d 729 (2d Cir. 1982).

190. James D. Cox & Harry L. Munsinger, *Bias in the Boardroom*, 48 L. & CONTEMP. PROBS. 83, 109 (1985).

the board or SLC may be biased in favor of another member of its group and against any non-member of that group. Such an in-group bias could prejudice the members of the board or SLC against the plaintiff-shareholder's assertions and in favor of their peer, Stewart, who was targeted by the plaintiff-shareholder.[192] However, one might conceive of the in-group so that any bias favors initiation of a suit against the insider: What if the in-group is comprised of minority shareholders, such the in-group includes the plaintiff-shareholder and the outside directors, who would then be biased against Stewart, the majority shareholder?[193] What if the in-group is comprised of members of the SLC who would then be biased against a defendant like Stewart, who would be excluded from membership on that committee?[194]

Other biases support those who remain skeptical of the conclusions reached by boards and SLCs. If the board or SLC begins its process with minds closed to the plaintiff's assertion, then the board or SLC may view evidence through a biased lens and rationalize its pre-determined outcome.[195] For example, the board or SLC may underestimate the value of the plaintiff's suit and overestimate the costs of the suit, in reaching a biased conclusion that the suit should not be pursued.[196] However, the board or SLC likely will be advised counsel, who may mute erroneous estimations of those benefits and costs. Moreover, in the *Zapata* setting, the SLC will, with the assistance of counsel, justify to the court its conclusion that the shareholder's suit should be dismissed via a written

191. *Id.* at 90 ("The near perfect record of derivative suit defendants before their boards or committees is statistically so unexpected as to suggest that the defendants' colleagues have simplified the complex decision by editing the choices to foreclose further consideration of the choice to continue suit.") (footnote omitted); Victor Brudney, *The Independent Director—Heavenly City or Potemkin Village?*, 95 HARV. L. REV. 597, 620 & n.60 (1982) ("Rarely" do independent directors conclude that continuation of a derivative suit furthers the interests of the corporation. "Undoubtedly, there are occasions on which counsel opined so favorably with respect to the plaintiff's claims or the independent directors examined the facts so critically that they felt obliged to seek repayment from the insiders, or to seek some form of settlement, or to permit part or all of the suit to continue.").

192. Cox & Munsinger, *supra* note 190, at 99; Anthony Page, *Unconscious Bias and the Limits of Director Independence*, 2009 ILL. L. REV. 237, 249-53. *See generally* Davis, *supra* note 184, at 1308 ("These factors include the CEO's and other corporate insiders' practical control over nominating new directors and removing incumbents; business relationships that may exist between outside directors and the corporation; the common cultural and professional background of many directors, and the frequent social ties among them; SLC members may often be CEOs or directors of other corporations and in that capacity be themselves defendants in a derivative suit (or see themselves as potential defendants); SLC members will have an ongoing collegial relationship with the director-defendants after possibly subjecting them to liability; a 'circle the wagons' ethic among board members when confronted with a challenge from the outside; and the role of the defendant-directors in selecting the SLC membership.").

193. *Cf.* Page, *supra* note 192, at 251.

194. *Zapata*, 430 A.2d at 788 ("First, the Court should inquire into the independence . . . of the committee . . . ."); Davis, *supra* note 184, 1322-24.

195. Page, *supra* note 192, at 262.

196. Cox & Munsinger, *supra* note 190, at 85–91; Page, *supra* note 192, at 262–72.

report.[197] Professor Davis argues that plaintiffs' derivative suits generally do not provide opportunities where the benefits exceed the costs; otherwise institutions would commonly be the plaintiffs, which does not occur.[198] Instead, he continues, deterrence commonly is the goal, but derivative litigation need not provide that deterrence.

> [B]oards and board committees with larger numbers of more independent directors, activism by institutional investors, private enforcement of the federal securities laws, and white-collar criminal prosecution [serve] . . . as powerful deterrents to corporate misconduct . . . . [The] task of inquiry and reporting is a primary focus of several national newspapers with expanded business and financial coverage, 24-hour television news along with cable networks, and web sites devoted exclusively to business and financial news. All stand ready and able to pursue and keep alive any serious story of corporate misdeed.[199]

Nonetheless, given the dearth of instances in which the board or SLC embraces the shareholder's assertion,[200] the critics may be right, but the attack is so broad-sided that it may prove too much. Over time, the law responded to critics by increasing the number and role of outside, disinterested directors.[201] Both statutes and common law encourage decisions by outside, disinterested directors when there is self-interest by an insider.[202] Giving credence to theoretical cognitive biases of directors in the area of derivative litigation jeopardizes the validity of their widespread use elsewhere.[203] So, while the *Beam* court reached an internally inconsistent and ironic result, cognitive biases may explain the court's unacknowledged disparate treatment of Stewart and the outside directors.

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197. *See* Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981).

198. Davis, *supra* note 184, at 1355–56.

199. Davis, *supra* note 184, at 1353–54.

200. *Contra* Brudney, *supra* note 191, at 620 n.60 ("Undoubtedly, there are occasions on which counsel opined so favorably with respect to the plaintiff's claims or the independent directors examined the facts so critically that they felt obliged to seek repayment from the insiders, or to seek some form of settlement, or to permit part or all of the suit to continue."); Steven J. Cleveland, *A Failure of Substance and a Failure of Process: The Circular Odyssey of Oklahoma's Corporate Law Amendments in 2010, 2012, and 2013*, 67 OKLA. L. REV. 221, 227–28 (2015); Russell Gold, *Chesapeake Tweaks Big Payday*, WALL ST. J., Nov. 3, 2011, at B1 (explaining how following a lawsuit by shareholders, Chesapeake rescinded its multi-million-dollar purchase of antique maps from its CEO, who had experienced financial difficulties, which prompted the initial transaction).

201. *See* 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, 1468 (2007).

202. *See* DEL. CODE ANN. tit. 8, § 144 (2017); Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304 (Del. 2015); Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110 (Del. 1994).

203. Dooley & Veasey, *supra* note 167, at 535 ("[T]he entire course of American corporation law has emphasized the importance of board independence and encouraged the appointment of outside directors." (footnote omitted)).

II.

Commentators have criticized the Delaware Supreme Court's conclusion in *Smith v. Van Gorkom* that the directors breached their duty of care.[204] Criticism commonly focuses on the court's conclusion that the board was grossly negligent in informing itself at the time of its initial decision to sell the company when it authorized the signing of a merger agreement. Part II addresses one aspect of the case that has drawn less attention—the court's analysis regarding the post-signing market check, which, in the court's opinion, did not cure the board's failure to be informed at the time of its initial decision. Though the *Van Gorkom* court concluded that the board was grossly negligent in informing itself, despite the post-signing market check,[205] the court's rationale was internally inconsistent and unintentionally ironic. Moreover, in subsequent, unrelated decisions, the court embraced the actions that the board took regarding its post-signing market check, further revealing the irony of the *Van Gorkom* decision.

Part A. briefly presents the facts of *Van Gorkom* and the court's analysis. Part B. presents the irony of the court's analysis regarding the post-signing market check. Part C. presents those subsequent legal developments that further reveal the irony of *Van Gorkom*.

A.

In *Van Gorkom*, Tran Union's Chairman and CEO (Jerome W. Van Gorkom)—without authorization by the board of directors—approached a noted deal-maker (Jay A. Pritzker) and suggested an acquisition of the corporation at $55 per share, when the corporation's stock was trading around $38 per share.[206] After minimal negotiation—and virtually no negotiation regarding the price[207]—Van Gorkom and Pritzker reached an agreement, which required approval by Trans Union's board and its shareholders.[208]

Van Gorkom convened a board meeting on one days' notice, but without providing notice of the purpose of the meeting, and without distributing any

204. 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, 70 n.3 (2017) (collecting sources). Because the court determined that directors did not benefit from the business judgment rule, it remanded, and the case settled. Smith v. Van Gorkom, 488 A.2d 858, 893 (Del. 1985).; WILLIAM M. OWEN, AUTOPSY OF A MERGER 261 (1986).

205. *Van Gorkom*, 488 A.2d at 881, 888 ("We conclude that Trans Union's Board was grossly negligent in that it failed to act with informed reasonable deliberation in agreeing to the Pritzker merger proposal on September 20 . . . . [W]e hold that the defendants' post-September conduct did not cure the deficiencies of their September 20 conduct.").

206. *Id.* at 865-67; *see* OWEN, *supra* note 204, at 206 ("Jay Pritzker makes the deals . . . and Robert Pritzker runs the companies afterwards."). Throughout the article, "Pritzker" includes the family and any entity controlled by the family.

207. *Van Gorkom*, 488 A.2d at 866 ("Van Gorkom then reviewed with Pritzker his calculations based upon his proposed price of $55 per share. Although Pritzker mentioned $50 as a more attractive figure, no other price was mentioned.").

208. *Id.* at 867; *see* DEL. CODE ANN. tit. 8, § 251 (2017).

documents regarding the contemplated transaction.[209] After a single, two-hour meeting, the board approved the agreement negotiated by Van Gorkom.[210] Almost five months later, during which time no suitors made an offer superior to that offered by Pritzker, Trans Union submitted the proposed transaction to shareholders, and immediately after their approval, the merger was consummated.[211] When a shareholder challenged the transaction, the Delaware Supreme Court held that the board was not entitled to the benefits of the business judgment rule because the board was grossly negligent in informing itself regarding the transaction.[212]

In reaching that conclusion, the court proceeded in two steps.[213] First, it addressed the actions that the board took, and failed to take, when the board authorized entry into the proposed merger agreement. Second, because the merger agreement could not be consummated immediately, the court also focused on the board's post-signing actions to determine whether the board became adequately informed, notwithstanding its initial failure to be adequately informed.

1.

The court focused on what occurred, and what did not occur, at that single two-hour meeting. First, the court noted that the board had not been considering a sale of the company, and when Van Gorkom gave the board notice one day before the special meeting, the notice did not include the purpose of the meeting.[214] The single meeting, at which the board decided to sell the corporation for approximately $690 million, lasted only two hours.[215] The board was not provided documentation regarding the transaction prior to that single, two-hour meeting, and was not provided time to review the limited documentation that it received during the meeting.[216] Having not reviewed any documents, the board placed heavy reliance on Van Gorkom's twenty-minute presentation.[217] Unfortunately, Van Gorkom had not read the merger agreement, so the board's

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209. *Van Gorkom*, 488 A.2d at 867.

210. *Id.* at 869.

211. The board originally approved the merger agreement at a meeting on September 20, 1980, *id.*, and the merger was consummated on February 10, 1981, OWEN, *supra* note 204, at 205, 208.

212. *Van Gorkom*, 488 A.2d at 888, 890–91.

213. *Id*. at 874.

214. *Id.*; *cf.* Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 67 (Del. 1989) (distinguishing *Van Gorkom*, and finding no *Revlon* violation, where the "[B]oard . . . had been considering the possibility that the company would be sold for two years prior to receipt of Gould's unsolicited first proposal.").

215. *Van Gorkom*, 488 A.2d at 874; *cf. Citron*, 569 A.2d at 67 (noting that the board discussed "the sale of the company at three separate board meetings over the course of three weeks"); Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1147 (Del. 1989) ("Over the following eight days, Time's board met three times to discuss Paramount's $175 offer.").

216. *Van Gorkom*, 488 A.2d at 868, n.7.

217. *Id.* at 868-69.

reliance on him was misplaced.[218] The court emphasized that boards should be active participants in any discussion regarding a significant transaction,[219] and that, if the board had asked questions of Van Gorkom, the board would have realized that he had not read the agreement and that their reliance upon him had been unreasonable.[220] Finally, the board agreed to a price without receipt of guidance that the price offered was good for shareholders.[221] Although the contract price of $55 represented a significant premium over the price at which the stock was trading in the market, all agreed that any acquirer would have to pay a premium over the price at which the stock was trading in the market.[222] The issue became the appropriateness of the offered premium (the "intrinsic value" of the company). According to the court, the board should have requested information regarding "intrinsic value" from a corporate insider or a non-employee expert.[223] The board did hear from an insider, but he opined regarding the price at which a leveraged acquisition might be financed, not regarding the corporation's "intrinsic value" or the fairness of the offered consideration.[224] The corporation had retained a non-employee expert, but the expert did not offer an opinion to the board regarding the offered consideration during the meeting.[225] The fact that, during the board meeting, the expert was available by phone, but never contacted, did not comfort the court.[226] If the board learned that the contract price resulted from aggressive negotiations, then the board might have been informed regarding the price;[227] however, there was virtually no negotiations between Van Gorkom and Pritzker regarding the price. Regard-

218. *Id.* at 875.

219. *See id.* at 872 (referencing an "affirmative duty . . . to proceed with a critical eye in assessing information"). *But see* Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981) (arguing in favor of director passivity and empowerment of shareholders). *See generally* Lawrence A. Hamermesh, *A Kindler, Gentler Critique of* Van Gorkom *and its Less Celebrated Legacies*, 96 NW. U.L. REV. 595, 597 (2002) (referencing *active* consideration by directors).

220. *Van Gorkom*, 488 A.2d at 875.

221. *Id.* at 875–78.

222. *Id.* at 876. Although the court gave the premium of almost fifty percent little weight, it was high for that period. *See* Fred S. McChesney, *A Bird in the Hand and Liability in the Bush: Why* Van Gorkom *Still Rankles, Probably*, 96 NW. U. L. REV. 631, 638 (2002) ("[F]rom 1980 to 1985 the average premium was 30 percent").

223. *See* DEL. CODE ANN. tit. 8, § 141(e) (2017); *cf. Citron*, 569 A.2d at 67 ("The board, also in contrast with the Trans Union board, received investment advice from four leading investment banking firms, [and] commissioned financial evaluations by three of them. . . . ").

224. *Van Gorkom*, 488 A.2d at 877.

225. *Id.* at 878.

226. *See id.*

227. *In re* Pennaco Energy, Inc. S'holders Litig., 787 A.2d 691, 693 (Del. Ch. 2001) (rejecting shareholders' claim that the board failed to secure the best value, where, "[a]lthough the board negotiated with a single bidder, it bargained hard . . . .").

less of whether the board reached an informed decision at the initial board meeting,[228] the focus here is upon the post-signing market check.

2.

Even if the board was grossly negligent in informing itself at the initial two-hour meeting, the board's subsequent actions could have cured its initial failure to be adequately informed.[229] However, the court concluded that those actions, including the post-signing market check, failed to cure the breach of fiduciary duty.[230]

A "market check" involves checking the contract price against any offers that other market participants would be willing to pay to acquire the corporation.[231] In *Van Gorkom*, there was time to conduct a market check prior to the contemplated merger because corporate law generally requires a temporal delay between an agreement to merge and the consummation of the merger. As an analogy, there is commonly a delay between the time that a couple agrees to marry and the time that they marry. Such a delay was necessary in *Van Gorkom*, because, even if the board approved the transaction with Pritzker, the shareholders of the corporation would have to vote on the proposed merger,[232] so, a future shareholder meeting would have to be convened,[233] and a disclosure document drafted and circulated to shareholders prior to that meeting.[234] The effectiveness of a market check may hinge on various factors, some of which are addressed in Part II.C. In *Van Gorkom*, the court focused on the board initially agreeing not to shop Pritzker's offer (the "no-shop"), and when the agreement was amended to permit the board to solicit competing bids (the "go shop"), concluding that the market check was not consistent with the board's duty to be informed.[235] According to the court, the amended agreement asked too much of the competing bidders (who were not expected simply to make a superior offer, but who were required to enter into a definitive agreement regarding that superior offer, which could not be subject to a financing condition) and gave too little time to accomplish what was required.[236] According to the

228. *See* Miller, *supra* note 204, at 70 n.3 (collecting sources in which many commentators argue that the board was informed).

229. *See Van Gorkom*, 488 A.2d at 888; Guhan Subramanian, *Deal Process Design in Management Buyouts*, 130 HARV. L. REV. 590, 592 (2016) ("The 'market-check' process is generally viewed as an important protection to ensure that existing shareholders receive fair value.").

230. *See Van Gorkom*, 488 A.2d at 888.

231. *See* Subramanian, *supra* note 229, at 592.

232. DEL. CODE ANN. tit. 8, § 251(c) (2017).

233. *Id.* § 211.

234. 15 U.S.C. § 78n(c) (2012); *accord* DEL. CODE ANN. tit. 8, § 212 (discussing shareholder proxies).

235. *See Van Gorkom*, 488 A.2d at 888.

236. *Id.* at 885–87.

court, the amendments foreclosed Trans Union and the board from effectively conducting a post-signing market check.[237]

Regarding the market check, the court discussed two bidders—Kohlberg, Kravis, Roberts & Co. (KKR) & General Electric Credit Corporation (GECC).[238] KKR joined with existing managers of Trans Union to propose a management buy-out (MBO).[239] KKR offered $60 per share, but its offer was subject to a financing condition.[240] Regardless, KKR withdrew the offer only three hours after it was made, when one of the corporation's existing managers withdrew from the group.[241] GECC did not develop interest in the corporation until November, never made a formal proposal, and stated that it believed that it could make a superior proposal if given two-to-three months more to investigate and confirm its valuation.[242] GECC's requested extension would have required Pritzker's consent to delay the Trans Union meeting at which shareholders would vote on Pritzker's proposal. When Pritzker denied an extension, GECC terminated negotiations.[243] Again, the court concluded that the amended agreement with Pritzker rendered the market check "virtually meaningless" and failed to cure the board's deficient information-gathering process.[244]

B.

In *Van Gorkom*, the analysis of the Delaware Supreme Court regarding the post-signing market check was internally inconsistent and unintentionally ironic. Moreover, given subsequent developments regarding post-signing market checks, the *Van Gorkom* decision appears even more ironic.

1.

The court concluded that, during the post-signing market check, the board lacked the time necessary to negotiate a definitive agreement regarding a superior offer, and that any superior bidder would lack the time necessary to arrange financing.[245] However, those conclusions are ironic, given that the post-signing

237. *Id.*

238. *See id.* at 884–85.

239. *Id.* at 884.

240. *Id.*

241. *See id.* at 885 (noting the court's suggestion that Van Gorkom prompted that manager's withdraw from the MBO group). *But* see OWEN, *supra* note 204, at 146 (noting a Trans Union insider's contradiction of the court's assertion regarding the manager's withdrawal).

242. *See Van Gorkom*, 488 A.2d at 885; OWEN, *supra* note 204, at 166.

243. *Van Gorkom*, 488 A.2d at 885.

244. *Id.*

245. *Id.* at 884 (questioning the "feasibility" of the market-check because "Trans Union could accept from a third party a better offer only if it were incorporated in a definitive agreement between the parties, and not conditioned on financing or on any other contingency"); *id.* at 885 ("[The] market test was virtually meaningless in the face of the terms and time limitations of Trans Union's Merger Agreement with Pritzker as amended . . . ."). Note that the time required for the

market check allowed much more time for negotiation and to arrange financing than was required by Pritzker. One week passed between the initial foray between Van Gorkom and Pritzker (September 13, 1980) and the execution of their definitive merger agreement (September 20, 1980).[246] Less than one month passed between the time that Pritzker learned of the possibility of acquiring Trans Union (September 13, 1980) and the time that he arranged financing of $600 million to acquire the corporation (October 9, 1980).[247]

In *Van Gorkom*, the post-signing market check ran almost five months. Potential bidders learned that Trans Union was for sale on September 22, 1980, the date of the public announcement regarding the deal with Pritzker.[248] The period of the market check effectively ended on February 10, 1981, the date of the meeting at which Trans Union's shareholders voted on the deal with Pritzker,[249] which was also the date on which the merger was consummated.[250] The post-signing market check period ran more than four-and-a-half months, or, to round down, four months.[251]

The court's analysis improperly shortened that four-month time frame from both ends. According to the court, the market check period did not begin until October 10, 1980, when the agreement was amended to permit the solicitation of competing bids.[252] Between September 22 (the date of the public announcement) and October 10 (the date of the amendments), during which time Trans Union was subject to a no shop, [253] an implicit market check was on-going. Though Trans Union could not solicit higher bids, Trans Union could consider unsolicited higher bids. The court misapprehended the aggressiveness with which individuals in the M&A realm operate. Once Trans Union publicly announced that it agreed to be acquired, potential acquirers felt invited to make competing bids;[254] they are the "least bashful people in the investment busi-

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board to become informed regarding a transaction agreement is independent of the time required for the principals to negotiate the agreement and for the bidder to arrange financing.

246. *Id.* at 866, 869.

247. *Id.* at 866, 870; *see* OWEN, *supra* note 204, at 196–97 (listing lenders and amounts).

248. *Van Gorkom*, 488 A.2d at 869.

249. *Id.* at 883.

250. OWEN, *supra* note 204, at 205, 208 (referencing the merger date and the closing date); *see* Guhan Subramanian, *Go-Shops v. No-Shops in Private Equity Deals: Evidence and Implications*, 63 BUS. LAW. 729, 735 (2008) (referencing the closing of the transaction as the end of the go-shop period).

251. Miller, *supra* note 204, at 178 (referring to the "four-month go-shop period").

252. *Van Gorkom*, 488 A.2d at 883.

253. A no shop bars a corporation, its directors and officers, and its advisors from soliciting competing bids, but generally permits the corporation to respond to *unsolicited* competing bids. *Accord* OWEN, *supra* note 204, at 74 (noting that TU's board retained the right to provide a third-party suitor the same sort of information provided to Pritzker, as well as other reasonably-requested information).

254. *Van Gorkom*, 488 A.2d at 879 (noting, but disagreeing, that "the entire financial community would know that Trans Union was for sale upon the announcement of the Pritzker offer, and anyone desiring to make a better offer was free to do so").

ness," rendering unimportant whether Trans Union was subject to a "no-shop."[255] Regardless, on October 10, the agreement permitted Trans Union to shop for higher bids, and it did so.[256] The court unconvincingly tried to shorten the market-check period on the front end; equally unavailing was its attempt to shorten the market-check period on the back-end.

According to the court, the market-check period did not run until February 10, 1981, but was effectively "circumscribed by other amendments which required Trans Union to file its preliminary proxy statement regarding the Pritzker merger proposal by December 5, 1980 and use its best efforts to mail the statement to its shareholders by January 5, 1981."[257] Those December and January dates are red herrings. Whether in December or January, Trans Union could have negotiated a transaction regarding a superior bid, not subject to financing, and then Trans Union could have terminated its agreement with Pritzker, cancelled the shareholder meeting scheduled on February 10, 1981, and solicited proxies for a new shareholders meeting to address the negotiated agreement regarding the superior bid.[258] While it would be expensive and wasteful to notice a shareholder meeting and distribute proxy statements,[259] only to cancel the meeting, the directors would do so only in pursuit of a transaction that would leave shareholders in a better financial position.[260] The court also referred to the agreement establishing the end of the go shop period at February 1,[261] not

255. OWEN, *supra* note 204, at 73; *see id.* at 74. *See generally In re* Topps Co. S'holders Litig., 926 A.2d 58, 85 (Del. Ch. 2007) (referencing "ravenous capitalists"); *In re* Toys R Us, Inc. S'holder Litig., 877 A.2d 975, 1006-07 (Del. Ch. 2005) ("The M & A market, as [plaintiffs] view it, is comprised of buyers of exceedingly modest and retiring personality, too genteel to make even the politest of uninvited overtures: a cotillion of the reticent. . . . I begin by noting my disagreement with the plaintiffs about the nature of players in the American M & A markets. They are not like some of us were in high school. They have no problem with rejection. The great takeover cases of the last quarter century—like *Unocal*, *QVC*, and—oh, yeah—*Revlon*—all involved bidders who were prepared, for financial advantage, to make hostile, unsolicited bids. Over the years, that willingness has not gone away.").

256. *Van Gorkom*, 488 A.2d at 883; OWEN, *supra* note 204, at 120, 122 (noting that Salomon Brothers—an investment bank—initially screened hundreds of companies, before compiling a list of 100 potential bidders, and eventually contacted those 100 potential bidders).

257. *Van Gorkom*, 488 A.2d at 883. A preliminary proxy statement—which is a disclosure document that would enable shareholders to cast an informed vote at the shareholder meeting on February 10—would be filed with the SEC well in advance of that meeting. *See* 15 U.S.C. § 78n(a) (2012); 17 C.F.R. § 240.14a-6 (2018). The SEC might require that Trans Union amend the proxy statement. *See generally* 17 C.F.R. § 240.14a-9 (2018) (barring the solicitation of proxies by materially misleading statements). Following any amendments and updates, Trans Union would then send the definitive proxy statement to shareholders.

258. *Van Gorkom*, 488 A.2d at 888 ("[T]he Board's only ground for release from its agreement with Pritzker was its entry into a more favorable definitive agreement to sell the Company to a third party.").

259. *See generally* EASTERBROOK & FISCHEL, *supra* note 101, at 66 ("Because voting is expensive, the participants in the venture will arrange to conserve on its use.").

260. *See generally Time Inc.*, 571 A.2d (Del. 1989) (cancelling shareholder meeting for which proxies had been solicited).

261. *Van Gorkom*, 488 A.2d at 870.

the date of the shareholder meeting and merger, February 10. However, what if, between February 1 and 10, a third party came forward with a fully-financed superior offer? *Van Gorkom* suggested that the transaction agreement could infringe on directors' fiduciary duties, but subsequent decisions have reached a contrary conclusion.[262] Regardless, if, in early February, a superior proposal was available, then, at the February 10 meeting, the shareholders likely would have voted against the inferior offer of Pritzker, rendering unnecessary the board's authority to terminate the agreement between February 1 and 10. Even in early February, the market would continue to provide a check on the price offered by Pritzker.

So, the post-signing market check period ran at least four months. Four months may not seem like a lengthy period, but in the realm of M&A, speed is critical.[263] The four-month post-signing market check dwarfed the time necessary for Pritzker to reach a definitive agreement (one week) and arrange financing (one month). Though every transaction is unique,[264] and though lengthy negotiation-and-financing periods are common, the Delaware courts repeatedly have analyzed sizeable transactions in which the parties reached a definitive agreement in less than four months and arranged financing in that amount of time.[265] Set forth below is a sampling of those transactions:

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262. Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 936 (Del. 2003) (requiring a "fiduciary out"); *see also* Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 48 (Del. 1993) (requiring a fiduciary out). According to *Van Gorkom*, a "board's compliance with its fiduciary duties is judged at the time it approves a merger agreement, and a board's ability to act subsequently in response to post-contracting events is governed by the terms of the merger agreement, not by generalized concepts of fiduciary duty." F. Franklin Balotti & A. Gilchrist Sparks, III, *Deal-Protection Measures and the Merger Recommendation*, 96 NW. U. L. REV. 467, 467-68 (2002). Note that, in subsequent developments, the Delaware courts have held that directors cannot enter into an agreement that requires them to breach their fiduciary duties. *QVC*, 637 A.2d at 51; cf. William T. Allen, *Understanding Fiduciary Outs: The What and the Why of an Anomalous Concept,* 55 BUS. L. 653, 659 (2000) (suggesting *QVC* gave too little credit to the contract rights of the bidder).

263. There's a reason that Wall Street lawyers and bankers work long hours. *See In re* Formica Corp. S'holders Litig., No. 10598, 1989 WL 25812, at *6 (Del. Ch. Mar. 22, 1989) (referencing "three days . . . of round-the-clock, intensive negotiations"); OWEN, *supra* note 204, at 64–65 (illustrating how parties race to reach an agreement because, in part, leaks may jeopardize their deal, exacerbated by the risk of insider trading). *See generally* Basic Inc. v. Levinson, 485 U.S. 224 (1988) (noting that delay may jeopardize a transaction).

264. Balotti & Sparks, *supra* note 262, at 474 (footnote omitted) ("[W]hen a deal-protection measure is ultimately reviewed by a Delaware court,it almost certainly will be in the context of a highly contextual, fact-intensive analysis. Thus, while it is possible to identify the strengths and weaknesses of arguments for or against a particular mechanism, the ultimate validity of the measure is virtually impossible to predict in the abstract. Moreover, the overarching obligation of the Delaware Court of Chancery to do equity in a given scenario means that, at times, nuanced legal theories and doctrinal niceties may be disregarded (and appropriately so) to address the equities of a particular case.").

265. As mentioned above, the board members would have to fulfill their fiduciary duties regarding any transaction agreements, but the time required for the board members to fulfill their duties is independent of the time required by the parties to reach those agreements.

- Pennaco Energy, Inc.: In a $500 million transaction,[266] the parties executed a confidentiality agreement on November 15, 2000, and executed a definitive transaction agreement the following month, on December 22, 2000.[267]
- Cogent, Inc.: Though due diligence had been on-going for some time, the parties—following the bidder's submission of a non-binding proposal on July 2, 2010—reached a definitive agreement in less than two months on August 29, 2010,[268] in a transaction that valued Cogent at $430 million.[269]
- Fairchild Camera & Instrument Corp.: After their initial meeting on May 1, 1979, the parties entered into a definitive transaction agreement on May 19, 1979,[270] in a transaction valued at $365 million.[271]
- Revlon, Inc.: In response to a hostile proposal on August 14, 1985, Revlon initiated negotiations with a favored bidder and reached an agreement in less than two months, on October 3, 1985,[272] in a transaction valued at more than $1.5 billion.[273]
- J.P Stevens & Co., Inc.: The bidder learned of the possibility of acquiring J.P. Stevens upon announcement that it was for sale on February 9, 1988, and, five weeks later, the parties entered into a definitive transaction agreement on March 14, 1998,[274] in a deal valued at $1.2 billion.[275]
- BioClinica, Inc.: In a $123 million transaction, the parties executed a confidentiality agreement in mid-October 2012, the bidder's first offer occurred on November 14, 2012, leading to a definitive agreement executed on January 29, 2013.[276]
- Macmillan, Inc.: In a multi-billion-dollar deal, KKR initiated discussions regarding an MBO on July 14, 1988, and the parties entered a de-

266. Susie Cruz, *Marathon to Buy Pennaco Energy for $500 Million*, OIL & GAS JOURNAL (Dec. 26, 2000), https://www.ogj.com/articles/2000/12/marathon-to-buy-pennaco-energy-for-500-million.html.

267. *In re* Pennaco Energy, Inc. S'holders Litig., 787 A.2d 691, 698, 702 (Del. Ch. 2001).

268. *In re* Cogent, Inc. S'holder Litig., 7 A.3d 487, 492-94 (Del. Ch. 2010).

269. *Id*. at 502 (reporting an equity value of $943 million, but an enterprise value of $430 million).

270. Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 60–63 (Del. 1989).

271. Charlotte Evans, *Schlumberger Reports a Plan to Acquire Fairchild*, N.Y. TIMES, May 20, 1979, at 30.

272. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 176–78 (Del. 1986).

273. Todd S. Purdum, *Forstmann Raises Bid for Revlon*, N.Y. TIMES (Oct. 14, 1985), at B1, https://www.nytimes.com/1985/10/14/business/forstmann-raises-bid-for-revlon.html.

274. *In re* J.P. Stevens & Co. S'holders Litig., 542 A.2d 770, 772-76 (Del. Ch. 1988).

275. Robert J. Cole, *3-Month Battle for J.P. Stevens Ends*, N.Y. TIMES, Apr. 26, 1988, at D1.

276. *In re* BioClinica, Inc. S'holder Litig., No. 8272-VCG, 2013 WL 5631233, at *2-3 (Del. Ch. Oct. 16, 2013).

finitive transaction agreement two months later, on September 11, 1988.[277]

As a contrast to the four-month period of *Van Gorkom*, a Delaware court expressed skepticism that a forty-five-day period was sufficient for the emergence of a competing bidder, investigation by that bidder, and execution of a definitive agreement.[278]

Noting again that transactions are unique, and that longer periods to secure financing commonly occur, Delaware cases indicate that a bidder may arrange financing to consummate the contemplated transaction in less than four months:

- Formica Corp.: In a $365 million transaction,[279] Formica and financial bidder Dillon Read entered into a confidentiality agreement on November 1, 1988, and Dillon Read had arranged financing approximately three months later, on February 2, 1989.[280]
- J.P Stevens & Co., Inc.: The bidder learned of the possibility of acquiring J.P. Stevens upon announcement that it was for sale on February 9, 1988, and the bidder had arranged financing in three months, during April 1988,[281] in a deal valued at $1.2 billion.[282]
- Revlon, Inc.: In response to a hostile proposal on August 14, 1985, Revlon initiated negotiations with a favored bidder, who arranged financing in less than two months, by October 12, 1985,[283] in a transaction valued at more than $1.5 billion.[284]
- Macmillan, Inc.: In a multi-billion-dollar deal, KKR initiated discussions regarding an MBO on July 14, 1988, and had arranged financing within two months.[285]

In *Van Gorkom*, Pritzker agreed to acquire Trans Union and quickly arranged financing,[286] in the fall of 1980, which was at the beginning of a decade-long merger wave. During that decade, money flowed freely; and KKR—which was trying to outbid Pritzker—secured lots of it.[287]

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277. Mills v. Macmillan, Inc., 559 A.2d 1261, 1272-75 (Del. 1989).

278. *In re* Lear Corp. S'holder Litig., 926 A.2d 94, 119–20 (Del. Ch. 2007) (referencing also the expiration of match rights).

279. *See Formica to Go Ahead with Management Takeout*, UPI (Apr. 13, 1989) , https://www.upi.com/Archives/1989/04/13/Formica-to-go-ahead-with-management-takeout/5339608443200/.

280. *In re* Formica Corp. S'holders Litig., No 10598, 1989 WL 25812, at *4–5 (Del Ch. Mar. 22, 1989).

281. *In re* J.P. Stevens & Co. S'holders Litig., 542 A.2d 770, 772-73 (Del. Ch. 1988).

282. Cole, *supra* note 275, at D1.

283. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 176–79 (Del. 1986).

284. *See* Purdum, *supra* note 273, at B1.

285. *See* Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1272–75 (Del. 1989) (referencing conditions to KKR's offer, but making no mention of a financing condition).

286. OWEN, *supra* note 204, at 196–97.

287. KKR had arranged financing of $800 million for three deals in the weeks before it pursued Trans Union. OWEN, *supra* note 204, at 123.

- Beatrice Cos.: In August 1985, KKR learned that Beatrice might be a willing target following the ouster of its chief executive officer, who had rebuffed earlier acquisition attempts.[288] By December 20, 1985, KKR had organized $4 billion in financing to consummate the $6.2 billion transaction, even though other stages of the acquisition would take an additional four months.[289]
- Safeway Stores, Inc.: In July 1986, over the course of four days, KKR received financing commitments of $6 billion, even though it sought only $3 billion, to acquire the grocery store chain.[290]
- Owens-Illinois Inc.: In February 1987, there was a "stampede by eager lenders" to provide more than $3 billion to KKR to finance the acquisition of "America's largest glass container company."[291] Lenders offered over $7 billion to finance the deal, and KKR turned away over $4 billion.[292]

Just as KKR required lots of financing to consummate its deals; Drexel Burnham Lambert Inc. organized the financing for lots of deals, including many KKR deals during the mid-to-late 1980s.[293] "With a single visit to [Drexel's Los Angeles office, where Michael Milken worked], corporate raiders [and] buyout specialists . . . could pick up vast amounts of money . . . ."[294]

- Cole National Corp.: KKR had arranged financing of $318 million to acquire Cole, but a lender and its $100 million commitment unexpectedly dropped out.[295] KKR received a commitment from Drexel for the $100 million shortfall in a single meeting.[296]

According to Milken, "Money isn't the scarce resource. Human capital is."[297] Because four months repeatedly has proven adequate for motivated parties to reach a definitive agreement and arrange financing, the court's bald assertion to the contrary appears incorrect and is ironic given that Pritzker required only one week to reach an agreement and one month to arrange financing. And, shifting from the facts to the law, four months would be more than adequate for a board of directors to follow the *Van Gorkom* landmarks of becoming adequately informed—e.g., multiple, long meetings; receipt of a fairness opinion; and active question-and-answer sessions with advisors.[298]

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288. George Anders, Merchants of Debt: KKR and the Mortgaging of American Business 68 (1992).

289. *Id.* at 71–73.

290. *Id.* at 77–78.

291. *Id.* at 81.

292. *Id.*

293. *Id.* at xviii.

294. *Id.* at 82.

295. *Id.* at 88–89.

296. *Id.* at 89.

297. *Id.* at 97.

298. *Cf. Citron*, 569 A.2d at 67 (distinguishing *Van Gorkom*, and finding no *Revlon* violation, where the "board . . . had been considering the possibility that the company would be sold for two

C.

Subsequent legal developments impact how one might view the market check of *Van Gorkom*. Certain legal developments lessen the demands on directors from those demands recognized in *Van Gorkom*, and those developments are addressed in Part C.1. Other legal developments effectively increase the demands on directors from those demands recognized in *Van Gorkom*, and those developments are addressed in Part C.2. Retroactive application of those more-demanding developments indicate that, if reviewed today, the post-signing market check employed by Trans Union's board would survive enhanced scrutiny, leaving the conclusion of the *Van Gorkom* court even more ironic.[299]

1.

Two subsequent legal developments—one statutory and one common-law—effectively lessened the demands on directors recognized in *Van Gorkom*. Following *Van Gorkom*, directors faced a new threat of personal liability. Given that threat of personal liability, some were concerned that talented individuals would refuse to serve as directors of Delaware corporations. Moreover, the rates for director-and-officer insurance increased significantly.[300] The Delaware legislature responded by enacting a provision that permitted the elimination of director liability for monetary damages to the corporation or shareholders for the breach of the duty of care, which was the duty at issue in *Van Gorkom*.[301] The statutory provision—Section 102(b)(7)—is not self-executing. A corporation's certificate of incorporation must include language permitted by Section 102(b)(7) for its directors to benefit. Inclusion in the certificate of incorporation means that shareholders expressly or implicitly approve of foregoing monetary damage claims of the sort at issue in *Van Gorkom*.[302] Delaware certificates of incorporation now routinely include director-protection language

years prior to receipt of [an] unsolicited first proposal. The board, also in contrast with the Trans Union board, received investment advice from four leading investment banking firms, commissioned financial evaluations by three of them, shopped the company to roughly 75 potential buyers, and discussed the sale of the company at three separate board meetings over the course of three weeks.").

299. Allen, Jacobs & Strine, *supra* note 1, at 459 n.39 ("[T]he broad market check conducted by the board in *Van Gorkom* would have satisfied its *Revlon* duties."). That article was authored by three Delaware jurists writing in their individual capacities. At that time, Allen was a former Chancellor; Jacobs was a former Vice Chancellor and a former Justice; and Strine was a Vice Chancellor and currently is Chief Justice.

300. Roberta Romano, *Corporate Governance in the Aftermath of the Insurance Crisis*, 39 EMORY L.J. 1155, 1155–60 (1990).

301. DEL. CODE ANN. tit. 8, § 102(b)(7) (2017).

302. Shareholders must expressly approve of any such amendment to the certificate of incorporation. *Id.* § 242. If the certificate of incorporation includes such director-protection language at the time that the shareholder acquires her shares, then she implicitly approves of that language.

permitted by Section 102(b)(7).[303] The protections afforded by Section 102(b)(7), however, have limits. Section 102(b)(7) does not permit the elimination of monetary damages in favor of the corporation or shareholders against any director that breaches the duty of loyalty or good faith. Moreover, Section 102(b)(7) does not prohibit injunctive relief.

Second, in *Lyondell*, which post-dated *Van Gorkom*, the Delaware Supreme Court addressed the impact of a charter provision permitted by Section 102(b)(7) when the board agreed to sell the corporation, which occurred in *Van Gorkom*. For summary judgment purposes, the Chancery Court concluded that, in approving that sale, the board was not sufficiently knowledgeable when it "never conducted a formal pre-signing market check to determine whether a better price could be obtained . . . , was not able to negotiate successfully for a post-signing go-shop period and . . . did nothing post-signing to confirm that a better price could not have been obtained."[304] On appeal, the Delaware Supreme Court reversed,[305] because the corporation's charter included language permitted by Section 102(b)(7), because the shareholder raised no issues of loyalty or good faith, and because the shareholder did not seek equitable relief as the merger had already been consummated.[306] According to the Delaware Supreme Court, "[a]t most, [the] record create[d] a triable issue of fact on the question of whether the directors exercised due care,"[307] but that claim was not cognizable. Given the prevalence of charter provisions permitted by Section 102(b)(7) and *Lyondell*, courts now typically focus upon loyalty and good faith when the board sells the corporation. A breach of the duty of good faith requires an intent to harm or the conscious disregard of a known duty to act, either of which is less demanding of directors than the principles set forth in *Van Gorkom*.[308]

2.

While some subsequent legal developments lessened the demands on directors in situations like *Van Gorkom*, other legal developments increased the demands on directors in situations like *Van Gorkom*. When the board agrees to a transaction that presents the shareholders with the last opportunity to collect a control premium, the board must act reasonably, gathering information and

303. *See, e.g.*, Facebook, Certificate of Incorporation art. VII (Oct. 1, 2010), https://perma.cc/TH82-TRWC.

304. Ryan v. Lyondell Chemical Co., No. 3176-VCN, 2008 WL 2923427, at *1 (Del. Ch. July 29, 2008), *rev'd*, 970 A.2d 235 (Del. 2009).

305. *Lyondell*, 970 A.2d at 237.

306. *Lyondell*, 2008 WL 29223427, at *1 n.4 ("The Merger has occurred and the Court cannot undo it. Ryan did not seek any interim equitable relief.").

307. *Lyondell*, 970 A.2d at 237.

308. Brehm v. Eisner (*In re* Walt Disney Co. Deriv. Litig.), 906 A.2d 27, 62-67 (Del. 2006).

maximizing the consideration to be received by shareholders.[309] These so-called *Revlon* duties demand more of directors than did *Van Gorkom* in two significant respects. First, while the business judgment rule at issue in *Van Gorkom* demands that the board act rationally, *Revlon* demands that the board act reasonably.[310] "Although linguistically not obvious, this reasonableness review is more searching than rationality review, and there is less tolerance for slack by the directors."[311] Second, in *Van Gorkom*, the shareholder bore the burden of proving the board acted with gross negligence in informing itself.[312] Conversely, after the shareholder proves that *Revlon* duties are implicated, the "directors have the burden of proving that they were adequately informed and acted reasonably."[313]

The Delaware Supreme Court decided in *Revlon* in 1986, after *Van Gorkom* in 1985. Although *Revlon* duties could not have been directly implicated in *Van Gorkom*, the Pritzker transaction resulted in shareholders being cashed out, which is a transaction that presented shareholder with the last opportunity to collect a control premium.[314] Thus, if *Van Gorkom* had been decided after *Revlon*, then the directors of Trans Union would have been subject to *Revlon* duties. In fact, courts and commentators consider *Van Gorkom* as an initial attempt to describe what became known as *Revlon* duties, as the Delaware courts struggled to address the legal issues arising in the increasingly frenetic era of friendly-and-hostile acquisitions.[315]

Recent judicial interpretations by the Delaware courts indicate that the post-signing market check employed by Trans Union's board would have survived the enhanced scrutiny of *Revlon*. That is, if a court retroactively applied *Revlon* to the facts of *Van Gorkom*, the court likely would conclude that the board fulfilled its fiduciary duties.[316] Such a conclusion proves both dramatic and ironic

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309. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182, 185 (Del. 1986); Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 45 (Del. 1993); *see* Miller, *supra* note 204, at 195 ("[A] board's *Revlon* duties include the *Van Gorkom* duty of care . . . .").

310. *Cf.* Unitrin Inc., v. American Gen. Corp., 651 A.2d 1361, 1375 (Del. 1995) ("The first aspect of the Unocal burden . . . required the board to demonstrate . . . a reasonable investigation . . . . "); *QVC*, 637 A.2d at 45.

311. *In re* NetSmart Technologies, Inc. S'holders Litig., 924 A.2d, 171, 192 (Del. Ch. 2007); *see In re* Toys R Us, Inc. S'holder Litig., 877 A.2d 975, 1000 (Del. Ch. 2005).

312. Smith v. Van Gorkom, 488 A.2d 858, 872–73 (Del. 1985).

313. *QVC*, 637 A.2d at 45.

314. *In re* Topps Co. S'holders Litig.,, 926 A.2d 58, 64 (Del Ch. 2007) ("The so-called *Revlon* standard is equally familiar. When directors propose to sell a company for cash . . . , they must take reasonable measures to ensure that the stockholders receive the highest value reasonably attainable.").

315. *See In re* Dollar Thrifty S'holder Litig., 14 A.3d 573, 602 (Del. Ch. 2010) ("*Van Gorkom*, after all, was really a *Revlon* case."); *see also* Jonathan R. Macey & Geoffrey P. Miller, *Trans Union Reconsidered*, 98 YALE L.J. 127 (1988) (arguing that *Van Gorkom* is better viewed as a takeover case, which presages *Revlon*, rather than a simple business-judgement-rule case).

316. *See* Allen, Jacobs & Strine, *supra* note 1, at 459 n.39 ("[T]he broad market check conducted by the board in *Van Gorkom* would have satisfied its *Revlon* duties."); *see also* Bernard Black & Reinier Kraakman, *Delaware's Takeover Law: The Uncertain Search for Hidden Value*, 96

as it reveals that the board could carry its burden that it acted reasonably, when the *Van Gorkom* court concluded that the shareholder carried his burden that the board was grossly negligent in informing itself.

When reviewing transaction agreements, Delaware courts generally find that boards have fulfilled their fiduciary duties, when no superior bid emerges following a post-signing market check,[317] so long as bidders have information, time to digest that information, and any deal protection that favors the initial bidder does not preclude a superior bid.[318]

a.

First, it may seem advisable for the board to canvass the market for the best offer, then negotiate with the bidder offering the highest price, and then enter into an agreement with that bidder.[319] However, the Delaware courts have concluded that, rather than canvass-then-sign, board members may fulfill their fiduciary obligations, even if the target negotiated a transaction agreement with a single bidder, and, after signing that agreement, canvassed the market.[320]

NW. U.L. REV. 521, 525 (2002) ("[T]he sale process was subject to a serious market check for whether someone else might pay more, including an effort by Trans Union's investment bankers to seek potential buyers.").

317. Miller, *supra* note 204, at 180–81 (footnote omitted) (Aside from failures of disclosure, "in the more than thirty years since *Revlon*, . . . the Delaware courts have never enjoined a transaction because the board had violated its *Revlon* duties, except when there had emerged another bidder who appeared to be willing to offer a superior price . . . ."); *see* Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1287 (Del. 1989) ("[W]hen it is widely known that some change of control is in the offing and no rival bids are forthcoming over an extended period of time, that fact is supportive of the board's decision to proceed."); *In re* Pennaco Energy, Inc., 787 A.2d 691, 707 (Del. Ch. 2001) (quoting Matador Capital Mgmt. Corp. v. BRC Holdings, Inc., 729 A.2d 280, 293 (Del. Ch. 1998)) ("[T]he fact that no higher bid has come forth in these circumstances is itself "evidence that the directors, in fact, obtained the highest and best transaction reasonably available. . . . The failure of any potential competitor to make a proposal . . . is evidence that the directors, in fact, obtained the highest and best transaction reasonably available.").

318. *See generally* Balotti & Sparks, *supra* note 262, at 474 (footnote omitted) ("[W]hen a deal-protection measure is ultimately reviewed by a Delaware court, it almost certainly will be in the context of a highly contextual, fact-intensive analysis. Thus, while it is possible to identify the strengths and weaknesses of arguments for or against a particular mechanism, the ultimate validity of the measure is virtually impossible to predict in the abstract. Moreover, the overarching obligation of the Delaware Court of Chancery to do equity in a given scenario means that, at times, nuanced legal theories and doctrinal niceties may be disregarded (and appropriately so) to address the equities of a particular case.").

319. *See, e.g.*, *Barkan* 567 A.2d 1288 (Del. 1989) ("[A] judicious market survey might have been desirable, since it would have made it clear beyond question that the board was acting to protect the shareholder's interests."); *see also* Miller, *supra* note 204, at 176 ("[A] passive market check performed after a deal is signed may in general be the least effective kind of market check . . . ."); Subramanian, *supra* note 250, at 734 (generally favoring pre-signing market check, rather than a post-signing go shop, in MBOs).

320. *See generally Barkan*, 567 A.2d at 1287 ("When the board is considering a single offer and has no reliable grounds upon which to judge its adequacy, this concern for fairness demands a canvas of the market to determine if higher bids may be elicited."); *In re* Dollar Thrifty S'holder Litig., 14 A.3d 573, 575–76 (Del. Ch. 2010) (rejecting *Revlon* challenge where targeted corporation

Revlon requires that the board act reasonably, not perfectly,[321] and it may be reasonable for the board to sign-then-canvass. For example, a board may be "worried that a failed [pre-signing] public auction could damage the company, including by distracting and creating anxiety among company employees."[322] In *Van Gorkom*, managers were distracted and anxious upon learning of Pritzker's planned acquisition of Trans Union.[323] The concerns of those managers were addressed when Pritzker agreed to retain their services for six months if Pritzker ultimately acquired Trans Union.[324] Absent another impediment of the sort discussed in the following subsections, a competing bidder could have topped Pritzker's offer.[325]

b.

To offer a superior bid, a competing bidder requires information about the targeted corporation and time to analyze that information. For example, a bidder would require additional time to consider the acquisition of a privately-held corporation relative to a publicly-traded corporation.[326] A privately-held corporation may not have disclosed meaningful information to the market, and there would be no pre-existing market price for the stock of a privately-held corporation, whereas federal law requires publicly-traded corporations to disclose specified information,[327] including financial statements,[328] and the market utilizes

did not conduct a pre-signing auction); Golden Cycle, LLC v. Allen, No. 16301, 1998 WL 892631, at *17 n.16 (Del. Ch. Dec. 10, 1998) (noting that board can fulfill its *Revlon* duty to be informed by performing a pre-signing market check or a post-signing market check); In re Fort Howard Corp. S'holders Litig., No. 9991, 1988 WL 83147, at *1 (Del. Ch. Aug. 8, 1988) (concluding that, in the context of an MBO, without a pre-signing auction, the post-signing market check "was effective to give the board an informed, dependable basis for the view that the Morgan Stanley offer is the best available transaction from the point of view of the Fort Howard shareholders").

321. Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 45–46 (Del. 1994).

322. *In re* Dollar Thrifty S'holder Litig., 14 A.3d at 576; *see also In re* MONY Grp. Inc. S'holder Litig., 852 A.2d 9, 21 (Del. Ch. 2004) ("Single-bidder approaches offer the benefits of protecting against the risk that an auction will be a failed one, and avoiding a premature disclosure to the detriment of the company's then-ongoing business.").

323. *See* Smith v. Van Gorkom, 488 A.2d 858, 867 (Del. 1985).

324. *See id.* at 882 ("Van Gorkom then advised Senior Management that the Agreement would be amended to give Trans Union the right to solicit competing offers through January, 1981, if they would agree to remain with Trans Union. Senior Management was temporarily mollified.").

325. *See In re* Pennaco Energy, Inc., 787 A.2d 691, 693 (Del. Ch. 2001) ("Although the board negotiated with a single bidder, it bargained hard and made sure that the transaction was subject to a post-agreement market check unobstructed by onerous deal protection measures that would impede a topping bid"). *But see* Miller, *supra* note 204, at 148–92 (arguing that the board could have secured significantly more if it had canvassed-then-signed, instead of signed-then-canvassed).

326. A confidentiality agreement protects against a bidder's misusage of non-public information. *See* Martin Marietta Materials, Inc. v. Vulcan Materials Co., 68 A.3d 1208, 1211–13 (Del. 2012).

327. 15 U.S.C. § 78m (2012).

328. U.S. SEC. & EXCH. COMM'N, FORM 10-K, https://www.sec.gov/files/form10-k.pdf (last visited Jan. 25, 2019).

that information to establish a per-share trading price. Shares of Trans Union were traded publicly,[329] and its filings with the SEC were available to the public, indicating that bidders would need less time to formulate a competing bid, relative to a privately-held company.

Even if the stock of the targeted corporation is traded publicly, a "micro-cap" corporation may not be followed widely by market participants, indicating that additional time and selling efforts may be required during a market check.[330] However, Trans Union was "widely followed by securities analysts,"[331] and it was no "microcap." From 1960 through 1977, Trans Union appeared in the Fortune 500.[332] In 1977, Trans Union ranked 278 in that list, with revenues of $746 million, assets of $1.4 billion, and more than 10,000 employees.[333] Moreover, Trans Union "had a cash flow of hundreds of millions of dollars annually."[334] While the negotiated acquisition price of $690 million for Trans Union might seem relatively small today,[335] one should account for the time value of money. The negotiated deal value of $690 million for Trans Union in 1980 translates to $1.7 billion in 2007 (the time of the *Netsmart* and *Topps* acquisitions referenced in the accompanying notes) or $2.1 billion in 2018. As expanded upon in the next subsection, insufficient access to information did not impede bidders' pursuit of Trans Union during the post-signing market check.

c.

A bidder that enters into an acquisition contract with the targeted corporation recognizes that, given the passage of time between their agreement and the anticipated consummation of the contemplated transaction, another bidder may emerge and successfully acquire the targeted corporation. The initial bidder may seek contractual protection to increase the likelihood of consummating its

329. *See, e.g.*, *Van Gorkom*, 488 A.2d at 864 ("Trans Union was . . . publicly-traded . . . .").

330. *In re* NetSmart Technologies, Inc. S'holders Litig., 924 A.2d, 171, 197 (Del. Ch. 2007) ("[B]ecause of the various problems . . . attract[ing] market attention as a micro-cap public company, an inert, implicit post-signing market check does not, on this record, suffice as a reliable way to survey interest by strategic players. Rather, to test the market for strategic buyers in a reliable fashion, one would expect a material effort at salesmanship to occur.").

331. Miller, *supra* note 204, at 176.

332. *See A Database of 50 Years of Fortune's List of America's Largest Corporation,* FORTUNE, http://archive.fortune.com/magazines/fortune/fortune500_archive/letters/T.html (last visited July 10, 2018).

333. *Trans Union: 1977, Fortune500, A Database*, FORTUNE (last visited July 10, 2018), http://archive.fortune.com/magazines/fortune/fortune500_archive/snapshots/1977/3612.html.

334. *Van Gorkom*, 488 A.2d at 864.

335. *In re* Topps Co. S'holders Litig., 926 A.2d 58, 61 (Del. Ch. 2007) ("Despite its household name, Topps is not a large public company. Its market capitalization is less than a half billion dollars [in 2007].").

acquisition of the targeted corporation (e.g., a "no shop").[336] The initial bidder may also seek contractual terms that compensate it for its time and efforts in identifying the targeted corporation and establishing a floor price for its acquisition (e.g., a termination fee or a stock option), if another bidder successfully acquires the targeted corporation.[337] Courts and commentators refer to such contractual terms as "deal protection."[338]

An initial bidder—who enters into a contract to acquire a targeted corporation—generally does not want the targeted corporation shopping for a higher bid: "We just got engaged. Why are you hunting for another suitor?"[339] Thus, the transaction contract commonly includes a no shop provision that bars the targeted corporation from soliciting offers from other bidders. The original agreement between Pritzker and Trans Union included a no shop provision.[340] A no shop provision may unduly limit the information available to the board of directors of the selling corporation and bar the directors' fulfillment of their fiduciary obligations.[341] While the original agreement with Pritzker barred Trans Union from soliciting competing offers, the parties understood that Trans Union could consider and respond to unsolicited competing offers.[342] A so-called implicit market check may be troubling if the targeted corporation is privately-held

336. *See* J. Travis Laster, Omnicare's *Silver Lining*, 38 J. CORP. L. 795, 804 (2013) ("Deal protection devices are defensive measures deployed by a board unilaterally to protect a chosen transaction from interlopers during the period before the stockholder vote.").

337. *In re* Toys R Us, Inc. S'holder Litig., 877 A.2d 975, 1015 (Del. Ch. 2005) ("[T]he first bidder has taken the risk, suffered the search and opportunity costs, and done the due diligence required to establish the bidding floor.").

338. Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 930 (Del. 2003); Guhan Subramanian, *The New Look of Deal Protection*, 69 STAN. L. REV. 1013 (2017).

339. To use the M&A analogy, the contract bidder does not want to be the "stalking horse" that enables another bidder to nab the prey. *Van Gorkom*, 488 A.2d at 866 (noting that Pritzker did not want to be a "stalking horse"); OWEN, *supra* note 204, at 51 (defining a "stalking horse" as "a horse a hunter hides behind while he stalks game").

340. *Van Gorkom*, 488 A.2d at 867–68.

341. *See* Paramount Commc'n's Inc. v. QVC Network Inc., 637 A.2d 34, 49 n.20 (Del. 1994) ("Whether or not [the no-shop provision] could validly have operated here at an early stage solely to prevent Paramount from actively 'shopping' the company, it could not prevent the Paramount directors from carrying out their fiduciary duties in considering unsolicited bids or in negotiating for the best value reasonably available to the stockholders."); Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1288 (Del. 1989) ("Where a board has no reasonable basis upon which to judge the adequacy of a contemplated transaction, a no-shop restriction gives rise to the inference that the board seeks to forestall competing bids."). *See generally* Phelps Dodge Corp. v. Cyprus Amax Minerals Co., No. 17398, 1999 WL 1054255, at *1–2 (Del. Ch. Sept. 27, 1999) (noting that a board's decision "not to negotiate . . . must be an informed one" and that a no-talk provision may be "the legal equivalent of willful blindness").

342. *See Van Gorkom*, 488 A.2d at 868 (Under the original agreement, "for a period of 90 days, Trans Union could receive, but could not actively solicit, competing offers . . . ."); OWEN, *supra* note 204, at 74 (noting that, though subject to a no-shop, the board retained the right to respond to unsolicited offers and provide third-party bidders with the same information provided to Pritzker as well as other reasonably requested information).

or not widely-followed,[343] but neither applied to Trans Union. When Trans Union publicly announced its agreement with Pritzker, Trans Union effectively put up a "for sale" sign,[344] and implicitly invited ravenous market participants to make unsolicited offers.[345]

Although the original agreement barred Trans Union from shopping for higher bids, the no shop was in place for less than three weeks, at which point the agreement was amended to authorize Trans Union to affirmatively shop for higher bids (a "go shop").[346] As mentioned above, the go shop period ran for four months.[347] Trans Union compensated its financial advisor in a manner that motivated it to locate a superior bid,[348] but none could be found, in part because the initial offer was generous and because the transaction size dramatically reduced the pool of potential bidders.[349]

A go-shop period may not withstand judicial scrutiny if the board deals with bidders selectively. For example, if the target's board excludes a broad category of bidders—say, financial bidders or strategic bidders—the court may determine that the board wrongly denied itself information necessary to fulfill its fiduciary duties.[350] In *Van Gorkom*, Trans Union's investment banker solicited

343. *See In re* NetSmart Technologies, Inc., 924 A.2d 171, 197 (Del. Ch. 2007) ("[B]ecause of the various problems . . . attract[ing] market attention as a micro-cap public company, an inert, implicit post-signing market check does not, on this record, suffice as a reliable way to survey interest by strategic players.")

344. *In re* Lear Corp. S'holder Litig., 926 A.2d 94, 18–19 (Del. Ch. 2007) (discussing importance of the market's knowledge that a large public company widely followed by analysts has entered into a merger agreement).

345. *See In re* Toys R Us, Inc. S'holder Litig., 877 A.2d 975, 1006 (Del. Ch. 2005) (rejecting any characterization of M&A players as a "cotillion of the reticent" "too genteel to make . . . uninvited overtures").

346. *See Van Gorkom*, 488 A.2d at 870 ("[On] October 9, Trans Union . . . issued a press release announcing . . . that Trans Union was . . . permitted to actively seek other offers and had retained Salomon Brothers for that purpose . . . .").

347. *See* Guhan Subramanian, *Go-Shops v. No-Shops in Private Equity Deals: Evidence and Implications*, 63 BUS. LAW. 729, 730 (2008) (explaining how go-shop periods often last thirty to fifty days); *see also Topps*, 926 A.2d at 86 (demonstrating that a go-shop period of forty days was upheld by the court) ("For forty days, the Topps board could shop like Paris Hilton."). *But see* Subramanian, *supra* note 229, at 602 (explaining that current go-shops do not require that a definitive agreement be executed during that period and further explaining that, during the go-shop period, the board commonly must determine that a competing bid is reasonably likely to lead to a superior transaction).

348. OWEN, *supra* note 204, at 118 ("[I]f Salomon Brothers were able to beat the Pritzkers' deal of $55 per share—even by as little as $1 per share—it would receive a fee of over $2,500,000."); *id.* (noting that the bank would receive $500,000 if it could not find a better deal).

349. *Id.* at 71–72 (noting that the control premium was consistent with national norms, but below regional norms); *id.* at 120 ("Only a relatively few could afford such a gargantuan deal."); McChesney, *supra* note 222, at 638 (comparing the premium offered by Pritzker of almost 50% to average premia of that time of 30%).

350. *E.g.*, *In re* BioClinica, Inc. S'holder Litig., No. 8272-VCG, 2013 WL 5631233, at *7 (Del. Ch. Oct. 16, 2013) ("[E]ven if the directors did initially favor private equity bidders, the directors later authorized Excel to solicit strategic bidders."); *NetSmart*, 924 A.2d at 196 ("[T]he Special Committee and Netsmart board did not have a reliable basis to conclude that the Insight deal was

one hundred bidders, including financial bidders and strategic bidders.[351] No category of bidder was excluded.

As referenced above, bidders need time to analyze information when formulating a bid, negotiating a transaction, and arranging financing. So, a go-shop period needs to be of sufficient duration so that competing bidders can accomplish within the contractually-specified period whatever the transaction contract requires. In *Van Gorkom*, "at no time during the market test period did any [bidder] complain of the time frame or availability of corporate records."[352]

Judicial review requires that the board act reasonably, so that it is armed with adequate information, not perfect information.[353] In *Van Gorkom*, GECC expressed a willingness to offer as much as $60 per share, significantly more than Pritzker's contract offer of $55 per share.[354] However, GECC required, in addition to the termination of Trans Union's contract with Pritzker, two or three more months to investigate Trans Union and finalize its offer.[355] Reasonableness does not require a board to walk away from a generous offer in pursuit of a higher offer that may never materialize.[356] Moreover, perfection may, but reasonableness does not, require the board to proceed at the pace of the slowest bidder.[357] GECC proceeded slowly. First, although General Electric, of which GECC was a subsidiary, had been considering a deal with Trans Union even

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the best one because they failed to take any reasonable steps to explore whether strategic buyers might be interested in Netsmart."); *In re* Fort Howard Corp. S'holders Litig., No. 9991, 1988 WL 83147, at *8 (Del. Ch. Aug. 8, 1988) (finding no *Revlon* breach when a serious financial bidder requested and received information beyond that provided to a favored financial bidder that paired with insiders in an MBO). *See generally Barkan*, 567 A.2d at 1288 ("[T]he crucial element supporting a finding of good faith is knowledge.").

351. *Van Gorkom*, 488 A.2d at 884–85 (discussing KKR, a financial buyer); *id.* at 896 (McNeilly, J., dissenting) (referencing strategic buyers, including General Electric, Borg-Warner, Bendix, and Genstar, Ltd., none of which made a firm proposal); OWEN, *supra* note 204, at 120, 122 (noting that Salomon Brothers screened hundreds of companies, and contacted one hundred potential bidders).

352. *Van Gorkom*, 488 A.2d at 896 n.1 (McNeilly, J., dissenting).

353. Paramount Commc'ns Inc. v. QVC Network, Inc., 637 A.2d 34, 45 (Del. 1993).

354. *Van Gorkom*, 488 A.2d at 885. Although GECC expressed a willingness to offer $60 per share, its offer would have taken longer to consummate, given regulatory hurdles, relative to the deal with Pritzker, and Pritzker offered cash, which GECC originally refused to do. *See also* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 184 (Del. 1986) (discussing the time value of money when comparing bids); OWEN, *supra* note 204, at 166. Given the time value of money and the high rate of interest, GECC would have had to outpace Pritzker's offer by a wide margin. *Id*.

355. *Van Gorkom*, 488 A.2d at 870, 885.

356. *In re* Dollar Thrifty S'holder Litig., 14 A.3d 573, 616 (Del. Ch. 2010) (collecting situations where, in pursuit of less certain, higher premia transactions, boards and shareholders bypassed more certain, lower premia transactions, and ended up with no transaction: "To pretend that there are not dangers in holding out for an even bigger blow out price when the market is fully valuing a target is . . . obtuse.").

357. In re Topps Co. S'holders Litig., 926 A.2d 58, 88 (Del. Ch. 2007) ("Upper Deck hardly moved with the speed expected of an interested buyer that has a limited time in which to secure a deal.").

before the announcement of the deal with Pritzker,[358] GECC was slow to reach out to Trans Union. Trans Union announced the deal with Pritzker on September 22, 1980, and announced its go-shop on October 10, 1980, but GECC did not contact Trans Union until November, and did not submit a written proposal until mid-January.[359] Second, once it began its review, GECC moved "glacial[ly]," conducting a "painstakingly thorough investigation."[360] (Recall that Pritzker completed his review in one week.) Finally, GECC refused to enter a bidding war for Trans Union,[361] which, to a certain extent, was one of the purposes of the go-shop period. During the go-shop period, GECC never submitted a firm offer,[362] and only KKR submitted a conditional offer,[363] but it withdrew its offer after only three hours. The following paragraphs address KKR and go-shop periods in MBO transactions.

Courts have expressed concern regarding MBOs because managers are insiders, who have access to information not generally available to competing bidders.[364] If the targeted corporation agrees to an MBO without first surveilling the market, the informational advantage enjoyed by the insider-managers may lessen the effectiveness of a post-signing market check, as outsiders may be hesitant to enter a bidding war against others who possess an informational advantage.[365] For outsiders to be comfortable outbidding insiders during a go-shop period, outsiders must have adequate time to review information that they likely are seeing for the first time, whereas the insiders have lived with that information. Courts may be troubled when insiders, who already have a deep understanding of the business and who have long had exposure to material non-

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358. OWEN, *supra* note 204, at 166 ("GECC also perceived a possible fit, for it apparently had been studying Trans Union's operations even before the Pritzker merger agreements were announced.").

359. *Van Gorkom*, 488 A.2d at 885.

360. OWEN, *supra* note 204, at 167 ("[T]he Pritzkers . . . act[ed] with breathtaking speed to conclude a merger agreement at the earliest possible moment. . . . General Electric . . . cautiously assess[ed] the situation and mov[ed] with 'glacial . . . speed' . . . ." (quoting Van Gorkom)); *id.* at 168 ("General Electric . . . seemed determined to make a painstakingly thorough investigation, probing into the far recess of Trans Union's operations.").

361. *Van Gorkom*, 488 A.2d at 885. Genstar, a Canadian conglomerate, emerged as a potential bidder in mid-January 1981, but it did not want to engage in a bidding war, it wanted information regarding the other bids and the other bidders, and ultimately never submitted a bid. OWEN, *supra* note 204, at 190–91.

362. A third party's "unwilling[ness] to make a binding offer to acquire [the targeted corporation] does not imply any [breach of fiduciary duty] on the part of the board of directors." *In re* BioClinica, Inc. S'holder Litig., No. 8272-VCG, 2013 WL 5631233, at *7 (Del. Ch. Oct. 16, 2013).

363. Paramount Commc'ns Inc. v. QVC Network, Inc., 637 A.2d 34, 44 (Del. 1993) (noting that, in a *Revlon* setting, the board can consider whether a bidder's offer is fully financed or subject to a financing condition).

364. *See* Dell, Inc. v. Magnetar Global Even Driven Master Fund Ltd., 177 A.3d 1, 32 (Del. 2017) (referencing the "information asymmetry").

365. *Id.* at 31 (acknowledging that, "when confronting a proposed MBO, possible bidders during go-shops purportedly rarely submit topping bids," but rejecting the assertion given the facts of that case).

public information, have lengthy periods to formulate their bid, but the transaction agreement subjects outsiders to only a short go-shop period.[366] *Van Gorkom* turns the typical concern on its head. Ironically, Pritzker, an outsider, quickly assembled a bid in a week (and arranged financing in less than a month), but insider-managers, who paired with KKR, in hopes of pursuing an MBO, could not assemble a topping bid over the course of several months. In *Van Gorkom*, Pritzker, the winning bidder, was at an informational disadvantage.

Pritzker agreed to buy Trans Union based upon a few days of conversation with Trans Union's consultant and two of its managers,[367] not by "send[ing] an army of lawyers and accountants into Trans Union's corporate office . . . to snoop around and verify what [he] had committed to buy."[368] Pritzker's investigation deviated significantly from the norm, where "a prospective bidder [would be expected] go through the company's books with its auditors and to review with Trans Union personnel the assumptions that underlay the [company's] forecast[s] to learn substantially more about the business and what its strategies and weaknesses were."[369] Instead, Pritzker obtained "very, very limited,"[370] "high[] level"[371] information, which information was accepted without challenge or confirmation.[372]

One would expect that insiders, who possess an informational advantage over an outsider like Pritzker that conducted only a limited review, and who viewed the price offered by Pritzker as inadequate, to assemble a superior bid. While KKR did submit an offer of $60 per share, it promptly withdrew that offer.[373] The *Van Gorkom* court noted that KKR withdrew its bid after one of Trans Union's managers (Jack R. Kruizenga) withdrew from the buyout group, and the court suggested that a conversation with Van Gorkom prompted his

366. *Id.* at 32 ("[T]he likelihood of a winner's curse can be mitigated through a due diligence process where buyers have access to all necessary information. And, here, Dell allowed Blackstone [a third-party bidder] to undertake 'extensive due diligence,' diminishing the 'information asymmetry' that might otherwise facilitate a winner's curse. Mr. Dell 'ultimately spent more time with Blackstone than any of the other participants, including [the contract bidder].''); Subramanian, *supra* note 229, at 638 ("In a March 30 email, a Senior Managing Director at Evercore reminded certain Dell employees: '[W]e all have to be mindful that Blackstone is looking to accomplish in 4–6 weeks what [S]ilverlake had 6 months to do, with the full support and insight of the CEO and [founder] behind them.'"); OWEN, *supra* note 204, at 144 ("[A] leveraged buyout proposal with management participation would likely discourage others from making offers.").

367. OWEN, *supra* note 204, at 56–67.

368. *Id.* at 160.

369. *Id.* at 58.

370. *Id.*

371. *Id.* at 160.

372. *Id.* at 58 ("very limited checking").

373. Smith v. Van Gorkom, 488 A.2d 858, 884 (Del. 1985) ("The offer was contingent upon completing equity and bank financing of $650 million, which Kravis represented as 80% complete.").

withdrawal.[374] However, an insider contradicts the court's suggestion.[375] Kruizenga—who was viewed as the "most important of Trans Union's 13,900 employees,"[376] as he managed divisions that gave rise to most of Trans Union's profits and cash flow[377]—opposed any acquisition that would privatize Trans Union because he wanted to continue running his divisions as he saw fit, not according to the directives of a new owner.[378] Undoubtedly the withdraw of Kruizenga contributed to the withdraw of KKR's offer, but so too did the changing market conditions. Interest rates rose dramatically from the time of the Pritzer-Trans Union agreement (and the time that Pritzker arranged his financing) to the time that competing bidders were assembling their bids and arranging their financing.[379] The increased interest rates would have increased KKR's expenses and lowered its bid, while leaving Trans Union (and its hundreds of millions in future cash flow) less valuable, hardly circumstances conducive to a topping bid. While it may have been beneficial to shareholders if Trans Union's board decided to canvass-then-sign,[380] instead of sign-then-canvass, KKR's inability to assemble a topping bid is not attributable to the length of the go-shop period negotiated by the board nor is the board responsible for Kruizenga's withdraw from the buyout group, which prompted the withdraw of KKR's offer.[381]

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374. *Id.* at 884-85 ("The offer was contingent upon completing equity and bank financing of $650 million, which Kravis represented as 80% complete.").

375. OWEN, *supra* note 204, at 146 ("Many seemed to think that Van Gorkom had somehow talked Kruizenga out of participating, even though Kruizenga himself said that Van Gorkom never attempted to influence his thinking on the leveraged buyout one way or the other. . . . Romans . . . gave [a] consistent account. . . .").

376. *Id.* at 13.

377. *Id.* at 86, 90.

378. *Id.* at 90–91. While Kruizenga did not want to be accountable to a private owner, other managers opposed the Pritzker acquisition for various reasons. Some managers believed that Pritzker's price was too low. *See Van Gorkom*, 488 A.2d at 867 (reporting the CFO's position). Some managers simply wanted to be consulted and involved in the decision-making process, rather than informed *ex post*. Some managers, perhaps sharing Kruizenga's concern, objected to heightened accountability. Some managers had financial concerns. OWEN, *supra* note 204, at 203 (noting golden parachute contracts enjoyed by office staff, not c-level officers); *id*. at 224 (noting that compensation and benefits at Trans Union were superior to those at Pritzker-owned entities, and that Pritzker's expectations of employees' production were much higher than it had been at Trans Union); *id*. at 220 ("It was a good deal for the shareholders, [b]ut from a career standpoint, it was a disaster [for me].") (quoting Trans Union's Chief Operating Officer). *See generally In re* Dollar Thrifty S'holder Litig., 14 A.3d 573, 597, 599-600 (Del. Ch. 2010) ("[T]here 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.").

379. OWEN, *supra* note 204, at 179–80 (noting an increase in the prime rate of 12.5% on September 20, 1980 to 21.5% on December 19, 1980, averaging more than 20% in January 1981).

380. Miller, *supra* note 204, at 189–92.

381. *Cf. In re* Fort Howard S'holders Litig., CV No. 9991, 1988 WL 83147, at *8, *14 (Del. Ch. Aug. 6, 1988) (finding no *Revlon* breach when serious financial bidder requested and received information beyond that provided to favored financial bidder, which paired with insiders).

If KKR could not assemble a topping bid, when given an informational advantage attributable to the participation of insiders, perhaps the post-signing market check served its purpose. If the $55 contract price withstands challenge from competing bidders,[382] then, absent another impediment of the sort described in Part C.2., the post-signing market check served its purpose and supports the conclusion that the board was adequately informed that Pritzker's offer was the best available.

d.

While a "no-shop" protects a negotiated deal by preventing the target from soliciting competing bids, a stock option rewards an initial bidder who loses the target to a higher bidder.[383] Pritzker and Van Gorkom understood that someone else could have purchased Trans Union for $55.10, slightly more than their negotiated price, which is why Pritzker negotiated for the stock option.[384]

The recipient of a stock option may purchase stock from the grantor at an agreed-upon exercise price within a specified time.[385] The exercise price commonly is set near the prevailing market price unaffected by the parties' acquisition negotiations. In *Van Gorkom*, Trans Union entitled Pritzker to acquire one million shares at $38 per share, which was slightly above the then-current market price.[386] If Pritzker ultimately acquired Trans Union via merger as agreed, then the stock option would not be valuable to him; he would own 100% of Trans Union stock,[387] so the acquisition of additional shares would simply leave each share worth less and not improve his financial position.[388] However, if Trans Union left Pritzker at the altar because a third party was going to acquire Trans Union at a higher price, then Pritzker's stock option would have great value. If KKR successfully acquired Trans Union at $60, then Pritzker's stock option would have been worth $22 million (($60 - $38 per share) X 1,000,000 shares). In effect, Pritzker would have bought the shares from Trans Union for $38 million and then sold them to KKR for $60 million, pocketing the difference of $22 million. Although Pritzker would have wanted to acquire Trans Union, he recognized that the fiduciary duties of Trans Union's board may have required the sale to the higher bidder, in which case, Pritzker would walk away

382. Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd., 177 A.3d 1, 33 (Del. 2017) ("[T]he lack of a higher bid [indicates] . . . that a topping bid involved a serious risk of overpayment. If a deal price is at a level where the next upward move by a topping bidder has a material risk of being a self-destructive curse, that suggests the price is already at a level that is fair.").

383. *Cf. In re* Toys "R" Us, Inc. 877 A.2d 975, 1015 (Del. Ch. 2005) ("[T]he first bidder has taken the risk, suffered the search and opportunity costs, and done the due diligence required to establish the bidding floor.").

384. OWEN, *supra* note 204, at 60–61.

385. *See* DEL. CODE ANN. tit. 8, § 157 (2015).

386. Smith v. Van Gorkom, 488 A.2d 858, 867 (Del. 1985).

387. The transaction was structured as a cash-out subsidiary merger. *See id.* at 863-64.

388. One doesn't enrich oneself by cutting a pizza into more, but smaller, slices.

with something for his efforts. The stock option may appease a jilted Pritzker, but, in effect, the stock option would increase KKR's acquisition price by, in the example above, $22 million. A stock option can deter subsequent bidding. Consequently, courts employ a reasonableness test, balancing the deterrent effect on subsequent bidders against inducing and compensating the original bidder.[389] In determining the reasonableness of such stock options, courts consider the magnitude of the payment in light of the magnitude of the overall transaction. Courts routinely uphold payments that induce and compensate the original bidder if those payments are three percent of the deal value.[390] Using the court's deal value of $690 million,[391] and KKR's withdrawn offer of $60 per share,[392] the stock option value of $22 million comprised approximately three percent of the deal value ($22 ÷ $690), and thus would be permissible under the rationale of the Delaware courts. The stock option did not impede bidders' pursuit of Trans Union during the post-signing market check.

e.

When reviewing a board's decision, one should consider the information reasonably available at the time of the decision, not necessarily subsequent factual developments. Nonetheless, subsequent factual developments may impact a court's decision. As conceded by the *Van Gorkom* court, the post-signing market check might have cured any failure by the board at the time of its original decision. Relatedly, as mentioned above, a court may emphasize the failure of a higher bid to emerge as support for a conclusion that the board members fulfilled their fiduciary duties. Moreover, a court may be hesitant to intervene if the shareholders—armed with sufficient information—have spoken.[393] In *Van Gorkom*, the shareholders overwhelming approved the transaction with Pritzker, which suggests that the shareholders were not optimistic about the emergence of

389. *See* Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 932 (Del. 2003); Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1288 (Del. 1989); *see also infra* Part III (noting that, according to Delaware Supreme Court precedent, courts first are to determine whether the deal protection is preclusive or coercive, and if not, whether the deal protection falls within a range of reasonableness).

390. *See infra* note 487 (collecting cases regarding termination fees). One may consider collectively a stock option and a termination fee. *See* Paramount Commc'ns. Inc. v. QVC Network Inc., 637 A.2d 34, 49 (Del. 1994) ("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."). *See generally* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1387 (Del. 1995) ("Where all of the target board's . . . actions are inextricably related, . . . such actions [are] scrutinized collectively . . . .").

391. *Van Gorkom*, 488 A.2d at 866 ("Having thus chosen the $55 figure, . . . , Van Gorkom multiplied the price per share by the number of shares outstanding to reach a total value of the Company of $690 million.").

392. *Id.* at 884–85.

393. *See* Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 308–09 (Del. 2015).

a superior bid.[394] The court did not credit the shareholders' approval because of disclosure problems,[395] but those problems did not concern the post-signing market check. Additionally, Delaware provided two avenues for relief to those Trans Union shareholders who believed that Pritzker failed to offer adequate consideration. First, those shareholders could sue for breach of fiduciary duty, but "no other stockholder . . . sought to intervene in [the] proceeding . . . oppos[ing] the merger,"[396] which the Chancellor considered significant. Second, those shareholders could sue for "fair value" in an appraisal proceeding,[397] but, out of the more than 12 million shares outstanding, less than 1,000 shares exercised appraisal rights.[398] The small number of dissatisfied shareholders suggests that the board members, armed with the results of the post-signing market check, fulfilled their fiduciary duties.

III.

When a shareholder challenges a decision of the board of directors, a court generally will defer to the board's decision under the business judgment rule.[399] When trying to overcome the presumptions afforded by the business judgment rule, a shareholder may prevail if, for example, the directors acted irrationally or for reasons of self-interest.[400] When a board defends against a hostile bidder or favors a preferred bidder, the board members may be acting for reasons of self-interest by, for example, preserving their positions.[401] If a board defends against a hostile bidder or favors a preferred bidder, courts more closely scrutinize actions by the board of directors of the targeted corporation and require them to act reasonably, not just rationally as under the business judgment rule.[402] The Delaware Supreme Court concluded that, in defending against a hostile bidder or favoring a preferred bidder, the board of directors of the targeted corporation cannot preclude the transaction proposed by the hostile or disfavored bidder.[403] Such preclusive action would be unreasonable and would not

394. OWEN, *supra* note 204, at 192–93 (noting that, of the votes cast, ninety percent voted in favor, and ten percent opposed, the transaction with Pritzker).

395. *See Van Gorkom*, 488 A.2d at 889–93.

396. OWEN, *supra* note 204, at 194 (quoting Chancellor Marvel).

397. DEL. CODE ANN. tit. 8, § 262 (2018).

398. OWEN, *supra* note 204, at 194.

399. *See*, *e.g*., Brehm v. Eisner (*In re* Walt Disney Co. Deriv. Litig.), 906 A.2d 27, 52 (Del. 2006).

400. *See id.* at 52, 74.

401. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) ("When a board [defends against] a pending takeover bid . . . [t]here [exists] . . . the omnipresent specter that a board may be acting primarily in its own interests. . . . .").

402. *See id.* at 954–55; Paramount Commc'ns Inc. v. QVC Network, Inc., 637 A.2d 34, 45 ("[A] court applying enhanced judicial scrutiny should be deciding whether the directors made a *reasonable* decision, not a *perfect* decision.").

403. *Unocal*, 493 A.2d at 955 ("[T]he board's exercise of corporate power to forestall a takeover bid . . . [is] not absolute.").

withstand judicial scrutiny.[404] Thus, the court's inquiry into preclusion precedes its inquiry into reasonableness: "The . . . directors must first establish that the [defensive action or] merger deal protection devices . . . were not coercive or preclusive, and then demonstrate that their response was within a range of reasonable responses . . . ."[405]

In the 1980s, when courts struggled to analyze the legal issues emerging from the burgeoning field of M&A,[406] the Delaware Supreme Court decided *Paramount Communications Inc. v. Time Inc.*, an early application of the aforementioned inquiry.[407] The Delaware Supreme Court concluded that the defensive actions of Time's board did not preclude Paramount, the hostile acquirer, from successfully proceeding with its bid, and were reasonable.[408] Ironically, however, the court upheld the action by Time's board that objectively precluded Paramount from successfully proceeding with its hostile bid.[409] Examining for the presence of preclusive action sometimes may enlighten the ultimate inquiry of reasonableness, but other times, an examination into preclusion proves misleading. In dicta, the Delaware Supreme Court has acknowledged that preclusive conduct may be reasonable.[410] As the inquiry into preclusion has yielded misleading, if not ironic, results, and as the Delaware Supreme Court has indicated that preclusive action may be reasonable, the court should re-examine the utility of the preclusion inquiry as outcome-determinative regarding reasonableness under *Unocal*. At a minimum, the Delaware Supreme court should more carefully articulate its intent and then adhere to that articulation.[411]

404. *See id.* at 955–57; Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1387–88 (Del. 1995). If the board cannot carry its burden under the intermediate scrutiny of *Unocal*, then a court applies heightened scrutiny under the fairness test. However, it is unclear how the board could carry its burden under the fairness test, which is more exacting, if the board could not carry its burden under *Unocal*, which is less exacting. *See* Paramount Commc'ns Inc. v. Time Inc., 571 A.2d 1140, 1154 n.18 (Del. 1989).

405. Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 935 (Del. 2003) (internal quotations omitted); *see also* Versata Enters., Inc. v. Selectica, Inc., 5 A.3d 586, 601 (Del. 2010); *Unitrin*, 651 A.2d at 1387–88.

406. *See* Leo E. Strine, Jr., *If Corporate Action is Lawful, Presumably There are Circumstances in which it is Equitable to Take that Action: The Implicit Corollary to the Rule of* Schnell v. Chris-Craft, 60 BUS. LAW. 877, 884 (2005).

407. *Time*, 571 A.2d 1140.

408. *See id.* at 1142.

409. "After the ruling, Paramount said it would end its $12.2 billion offer for Time. It also said it would not bid for the combined company." Geraldine Fabrikant, *Time Inc. Gains Control of Warner Within Hours of Court Approval*, N.Y. TIMES (July 25, 1989), https://www.nytimes.com/1989/07/25/business/time-inc-gains-control-of-warner-within-hours-of-court-approval.html; *see infra* note 440 (collecting sources).

410. *See, e.g.*, Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1284 (Del. 1988); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 184 (Del. 1986).

411. *See* Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 120 (Del. Ch. 2011) ("[A] poison pill is assuredly preclusive in the everyday common sense meaning of the word; indeed, its *rasion d'etre* is preclusion—to stop a bid (or this bid) from progressing."); *see also id.* at 122 n.480

Part A. briefly sets forth the facts of *Time* and the court's holding. Part B. explains the preclusive effect of the defensive actions by Time's board. Part C. examines theoretical and case-based scenarios where the preclusive inquiry yields misleading results.

A.

In *Paramount Communications Inc. v. Time Inc*., Time's board was considering expansion into the entertainment industry during the early 1980s.[412] Time—which was organized under Delaware corporate law—sought ownership and creation of video programming for its televisions channels as well as global expansion, but not at the cost of control over the "editorial integrity and journalistic focus of Time."[413] In 1987, Time's board considered a consolidation with Warner, but the transaction was abandoned temporarily.[414] In July 1988, Time's board considered a transaction with numerous companies, including Warner, Disney, 20th Century Fox, Universal, and importantly, Paramount.[415] At that point, the board did not definitively choose a particular transaction partner, but the "board's consensus was that a merger of Time and Warner was feasible . . . only if Time controlled the board of the resulting corporation and thereby preserved a management committed to Time's journalistic integrity."[416] When talks with Warner broke down, Time discussed a transaction with other companies, including Paramount, during the latter portion of 1988.[417] Capital Cities/ABC proposed a merger with Time, but Time ceased discussions when Capital Cities/ABC sought to acquire Time, which maintained that it was not for sale.[418] In January 1989, Time resumed negotiations with Warner, and on March 3, 1989, their respective boards approved a stock-for-stock merger of Warner into a wholly-owned subsidiary of Time. Time's shareholders would have to approve the contemplated transaction, not because of any section of the Delaware General Corporation Law (DGCL),[419] but because of the rules of the New York Stock Exchange (NYSE), on which Time's shares traded. Rule 312

("Our law would be more credible if the Supreme Court acknowledged that its later rulings have modified *Moran* and have allowed a board acting in good faith (and with a reasonable basis for believing that a tender offer is inadequate) to remit the bidder to the election process as its only recourse. The tender offer is in fact precluded and the only bypass of the pill is electing a new board. If that is the law, it would be best to be honest and abandon the pretense that preclusive action is *per se* unreasonable."). *See generally* Brian JM Quinn, Omnicare: *Coercion and the New* Unocal *Standard*, 38 J. CORP. L. 835, 837 (2013) ("By now, preclusivity and 'range of reasonableness' analyses are dead letters.").

412. *Time*, 571 A.2d at 1143.

413. *Id.* at 1143–44.

414. *Id.* at 1144

415. *Id.*

416. *Id.*

417. *Id.* at 1145.

418. *Id.*

419. *See* DEL. CODE ANN. tit. 8, § 251 (2017).

of the NYSE generally requires shareholder approval upon the issuance of twenty percent of a company's stock.[420] Because of their relative sizes and because Time would be paying a premium to acquire Warner, shareholders of Warner collectively would own more than sixty percent of Time's outstanding shares,[421] triggering the need for shareholder approval under the NYSE rules. The market responded favorably to the contemplated transaction. However, the originally-conceived transaction was doomed to fail when, on June 8, 1989, Paramount announced that it would buy any-and-all shares of Time for $175 (later upped to $200) per share, when Time's shares had been trading at $126 in the wake of the announcement of the planned Time-Warner transaction.[422] Time's shareholders would not vote in favor of a transaction that required the payment of a premium to others (the shareholders of Warner) when Paramount was prepared to pay a premium to them for their shares. Consequently, in hopes of effectuating the Time-Warner deal, the principals restructured the transaction to avoid the need to obtain the approval of Time's shareholders.[423] In the restructured deal, Time would pay cash to the shareholders of Warner to acquire a controlling stake in the company.[424] Thereafter, Time would effectuate a merger of Warner and a subsidiary of Time, with the merger consideration comprised of a mix of cash and stock of Time, but less than the twenty percent threshold of the NYSE.[425] Neither step—not the cash purchase of Warner stock, nor the cash-and-stock merger of Warner and a subsidiary of Time—required the approval of Time's shareholders.

When shareholders challenged the transaction, the Delaware Supreme Court concluded that Time's board fulfilled its fiduciary obligations. The original agreement between Time and Warner was the product of a valid exercise of

420. NYSE, INC., LISTED COMPANY MANUAL § 312.03(c).

421. *See Time*, 571 A.2d at 1146.

422. *Id.* at 1147. *Cf.* Black & Kraakman, *supra* note 316, at 528 n.21 (discussing how Time's acquisition of Warner could not have been better for Time's shareholders than Paramount's offer, "unless one assumes that the market made errors of implausible size in valuing Time, Warner, or the synergy between the two companies").

423. Initially, Warner cared a great deal about the structure of its transaction with Time. *Time*, 571 A.2d at 1145. However, when the control premium to be received by Warner's shareholders was in jeopardy, Warner's board cared more about effecting a deal to preserve its shareholders' receipt of a premium and cared less about the nature of the consideration that produced that premium.

424. Though Time's shareholders faced a high offer for their shares, Warner's shareholders had not been presented with a bid higher than Time's offer. The holders of a majority of Warner's shares were expected to, and ultimately did, accept Time's cash offer. Geraldine Fabrikant, *Time Inc. Gains Control of Warner Within Hours of Court Approval*, N.Y. TIMES, July 25, 1989, at A1 ("Time Inc. today gained control of Warner Communications Inc. . . . Time completed its tender offer for 51 percent of Warner's shares at 5:01PM. Three hours earlier, the [Delaware Supreme Court] unanimously upheld a ruling . . . that rejected attempts . . . to block the Time-Warner deal."). Thereafter, the second-step merger of Warner and a Time subsidiary was a foregone conclusion, as both board- and shareholder-approvals were guaranteed. *See* DEL. CODE ANN. tit. 8, § 251 (2017).

425. *Time*, 571 A.2d at 1147–49.

business judgment by Time's board.[426] Time's board methodically considered numerous transaction partners and rationally concluded that Warner was a good fit because of its solid entertainment unit and its international presence.[427] When Time restructured its deal with Warner, Time's board was defending against Paramount, which required the application of *Unocal* and its enhanced scrutiny.[428] Nonetheless, Time's board reasonably investigated and, in good faith, perceived that Paramount posed a threat to Time's journalistic integrity as well as its well-conceived transaction with Warner.[429] In restructuring the acquisition of Warner, Time's board did not, according to the court, preclude Paramount from buying Time; Paramount could still proceed with its offer for Time, but, of course, in buying Time, Paramount would also be buying Warner.[430] The court concluded that the defensive actions employed by Time's board were reasonable.[431]

B.

The *Time* court referenced only one means of Paramount effecting an acquisition of Time—a tender offer directly to Time's shareholders—and the *Time* court did not factor into its analysis the presence of Time's poison pill.[432] From the 1970s into the 1980s,[433] bidders commonly pursued hostile acquisitions via tender offers.[434] In 1982, Martin Lipton famously invented the poison pill,[435] which was approved by the Delaware Supreme Court in a series of decisions beginning with *Moran* in 1985.[436] The increasing prevalence of the poison pill prompted hostile bidders to utilize a proxy contest alone or in conjunction with a tender offer in hopes of effecting an acquisition.[437] The alternate means of

426. *Id.* at 1151–52.

427. *Id.* at 1143–46, 1151–52.

428. *Id.* at 1152.

429. *Id.* at 1153–54.

430. *Id.* at 1154–55.

431. *Id.* at 1155.

432. *Id.* at 1144 n.5 ("Time had in place a panoply of defensive devices, including a staggered board, a 'poison pill' preferred stock rights plan triggered by an acquisition of 15% of the company, a fifty-day notice period for shareholder motions, and restrictions on shareholders' ability to call a meeting or act by consent.").

433. Some trace the rise of hostile acquisitions, which once had been frowned upon, to Morgan Stanley's representation of a hostile bidder in 1974. *See* Melvin A. Eisenberg, *Corporate Law and Social Norms*, 99 COLUM. L. REV. 1253, 1287–91 (1999) (citing RON CHERNOW, THE HOUSE OF MORGAN 599-601 (1990)); John C. Coates IV, *Measuring the Domain of Mediating Hierarchy: How Contestable are U.S. Public Corporations?*, 24 J. CORP. L. 837, 850 (1999) (citing BRUCE WASSERSTEIN, BIG DEALS 470 (1998)).

434. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 957 (Del. 1985).

435. Martin Lipton, *Pills, Polls, and Professors Redux*, 69 U. CHI. L. REV. 1037, 1037 (2002).

436. *See* Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985).

437. *See* Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 STAN. L. REV. 857, 858 (1993).

pursuing a hostile acquisition—tender offer or proxy contest—prompted alternative analyses of preclusion: "A response is 'preclusive' if it deprives stockholders of the right to receive all tender offers or precludes a bidder from seeking control by fundamentally restricting proxy contests or otherwise."[438] If either avenue remains open to the hostile bidder, the defensive action (or favoritism towards the preferred bidder) is not preclusive. Part B.1. criticizes the preclusion analysis of *Time* on the court's own terms—without considering the presence of Time's poison pill. Part B.2. then reconsiders *Time* given the company's poison pill.

1.

Although the *Time* court technically was accurate—Paramount theoretically could have acquired Time—the Delaware courts require that, to prove that a hostile transaction was not precluded, the directors cannot simply establish a theoretical possibility of a hostile transaction, instead the hostile acquisition must be "realistically attainable."[439] Paramount's hostile acquisition of Time was realistically unattainable due to the preclusive, defensive action of Time's board.[440]

A defensive acquisition by the target "may change the nature of the business and financial picture of the target and may make it less desirable to the [hostile] bidder."[441] In acquiring Warner, Time changed both the nature of its business and its financial condition, making it less desirable to Paramount, and ultimately precluding its hostile acquisition. Though Time's acquisition of Warner *may*

438. *See* Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 935 (Del. 2003).

439. Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 113 (Del. Ch. 2011).

440. Tamar Frankel, *Presumptive Reasoning Applied to Legal Doctrine: Presumptions and Burdens of Proof as Tools for Legal Stability and Change*, 17 HARV. J.L. & PUB. POL'Y 759, 776 n.62 (1994) ("[I]n *Paramount v. Time-Warner*, . . . management was allowed to preclude shareholders from selling at $200 shares that traded at $126 . . . ."); Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785, 816 n.115 (2003) ("*Paramount Communications, Inc. v. Time, Inc*. . . . permit[ted] a particular defense—Time's tender offer for Warner—that, as a factual matter, was preclusive. The court dodged this problem with the assertion that, at least in principle, Paramount could bid for the merged company. . . . [T]his theoretical possibility solve[d] the preclusiveness problem" for the *Time* court.); Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporation Constituency Statutes*, 70 TEX. L. REV. 579, 610–11 (1992) ("*Paramount Communications, Inc. v. Time Inc*. . . . is a dramatic example of the extent to which the board is permitted to take a broad view of its corporate responsibilities by precluding stockholders from taking advantage of control transactions."); Julian Velasco, *Structural Bias and the Need for Substantive Review*, 82 WASH. U. L.Q. 821, 890 (2004) ("The board's conduct should not have been upheld because it was . . . preclusive in that it would prevent the combined company from being acquired for the foreseeable future.").

441. 1A MARTIN LIPTON & ERICA H. STEINBERGER, TAKEOUTS & FREEZEOUTS § 6.06[6], at 6-244 (1991).

have been reasonable,[442] it cannot have been preclusive, as preclusive action is *per se* unreasonable.[443]

Because Warner was about the same size as Time, Time doubled in size when it acquired Warner. Time's transaction did not simply involve some assets, even key assets, either of which may have withstood judicial scrutiny.[444] Time's increased size alone may have precluded Paramount from proceeding with its hostile offer,[445] but larger acquisitions certainly have occurred. Regardless of Time's increased size, the nature of the additional assets precluded Paramount from proceeding with its bid. By acquiring Warner, loosely-speaking a movie studio, Time added assets that would have been redundant to Paramount,[446] loosely-speaking a movie studio.[447] Paramount pursued Time, not Warner; Paramount never wanted Warner. The *Time* court held that Paramount could still acquire Time (and Warner), but the Delaware courts' preclusion analysis concerns whether the alternative transaction is "realistically attainable," not simply a theoretical possibility.

Time compelled Paramount to pay premia for things it could not utilize and upon which it could not realize fair value. A numerical example may prove helpful. Assume that, based solely upon their respective per-share trading prices, Peanut Butter Co. is worth 10 units and Grape Jelly Co. is worth 12 units. As the Delaware Supreme Court correctly noted, a bidder must pay a control premium above the per-share trading price to effect an acquisition.[448] So, assume that Peanut Butter Co. would pay 14 units to acquire Grape Jelly Co.[449] Peanut Butter Co. would do so because combining the two companies (PB&J Co.) creates synergistic value above the aggregate stand-alone values of those two companies.[450] If Bread Co. wanted to buy PB&J Co., it effectively would

442. Black & Kraakman, *supra* note 316, at 528 & n.21 ("[A]n objective observer would likely conclude that the Time board's decision was, in fact, crazy. . . .").

443. *Air Prods*., 16 A.3d at 122 n.480 ("[P]reclusive action is per se unreasonable."); *see also* Steven M. Davidoff & Christina M. Sautter, *Lock-Up Creep*, 38 J. CORP. L. 681, 683 (2013) ("[C]ertain types of preclusive lock-ups remain[] per se invalid . . . .").

444. *See* City Capital Assocs. Ltd. P'ship v. Interco Inc., 551 A.2d 787 (Del. Ch. 1988).

445. LIPTON & STEINBERGER, *supra* note 441, § 6.06[6], at 6-244.

446. Franklin A. Gevurtz, *Removing* Revlon, 70 WASH. & LEE L. REV. 1485, 1554–55 (2013) (discussing redundancy and potential for counterproductivity).

447. *See* Holman W. Jenkins, Jr., *CBS Scandal is Neatly Timed*, WALL ST. J., Aug. 1, 2018 at A15 ("CBS probably is not sellable to Comcast or Disney, both of which already own broadcast networks . . . ."). Moreover, antitrust considerations may have barred Paramount's acquisition of Time-Warner, but that is far from clear. *See* LIPTON & STEINBERGER, *supra* note 441, § 6.06[6], at 6-244.

448. Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1146 (Del. 1990); Smith v. Van Gorkom, 488 A.2d 858, 875–76 (Del. 1985).

449. Recall that Warner's shareholders would have owned more than sixty percent of Time under the original transaction structure, *Time*, 571 A.2d at 1146, which is consistent with this numerical example.

450. *See generally* Black & Kraakman, *supra* note 316, at 528 n.21 (discussing how Time's acquisition of Warner could not have been better for Time's shareholders than Paramount's offer,

pay a premium for each of Peanut Butter Co. (12 units) and Grape Jelly Co. (14 units), for the synergistic value created by the combination of those two companies (1 unit), and some portion of the synergistic value created by adding Bread Co. and those two other companies (1 unit). Bread Co. might have to pay 28 units to acquire PB&J Co. Now, if Bread Co. wanted to acquire only Peanut Butter Co. while it was still a stand-alone company, the acquisition price would have been the assumed 12 units. However, if Bread Co. wanted to acquire only Peanut Butter Co. after the formation of PB&J Co., then it would have to pay the assumed 28 units for PB&J Co. and then hopefully sell Grape Jelly Co. for 14 units, which was the assumed amount paid by Peanut Butter Co. to acquire Grape Jelly Co. Bread Co. would lose 2 units in the process, which is a significant amount over the 12 units required to acquire only Peanut Butter Co.[451] As a hyperbolic example, one does not buy a car to acquire a small box in which one may store gloves, only to sell everything but the glovebox.

Translating the discussion above to the Paramount-Time-Warner setting, Paramount would face additional, preclusive problems. While the combination of Bread Co. and Grape Jelly Co. may generate synergistic value, there appeared to be no synergy between Paramount and Warner.[452] So, Paramount would have to buy Warner and pay a premium to do so, and it would be paying premia on, first, Warner's combination with Time, and second, on Warner's combination with Paramount. However, Paramount would be paying for something that it would never receive.[453] Moreover, additional loss likely would result because Paramount would be in a poor negotiating position if it tried to sell Warner. Recall that, aside from Time, no other bidders emerged to buy Warner. So, after paying a premium, Paramount likely would sell Warner on the cheap.[454] Finally, after paying a premium for their three-way combination, Paramount would bust up the Time-Warner combination, which would result in a loss, not the gains seen from the 1980s of busting up mismatched conglomerates. These circumstances reveal that Time's acquisition of Warner precluded Paramount from bidding for the combined company, notwithstanding the conclusion of the *Time* court.[455]

"unless one assumes that the market made errors of implausible size in valuing Time, Warner, or the synergy between the two companies").

451. *See infra* note 488 and accompanying text (addressing preclusive termination fees well shy of 16% (2-unit loss/12-unit price)).

452. Gevurtz *supra* note 446, at 1554–55 (discussing redundancy and potential for counterproductivity).

453. *Id.* (discussing how gains would flow to shareholders of Warner, not Time nor Paramount).

454. *Id.* (discussing how Paramount could not pay a premium for Warner if Warner was redundant or counterproductive, and instead could pay no more than the price at which it could be spun off); *see* Holman W. Jenkins, Jr., *CBS Scandal is Neatly Timed*, WALL ST. J., Aug. 1, 2018 at A15 ("CBS probably is not sellable to Comcast or Disney, both of which already own broadcast networks . . . .").

455. Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1146 (Del. 1990).

Moving on from the impact of the defensive acquisition on the nature of the target's business, one should consider the financial condition of the target after it effected its defensive acquisition. After effecting the cash acquisition of a controlling interest in Warner, which was followed by a cash-and-stock merger to complete the acquisition, Time-Warner was saddled with over $10 billion in debt.[456] Paramount offered cash to acquire Time's shares. There is no indication that Paramount could have managed its own debt, while assuming the debt incurred by Time to acquire Warner, and Time's directors bore the burden of proof regarding preclusion.[457] Others believe that Time's resulting financial condition precluded Paramount from completing an acquisition,[458] notwithstanding the conclusion of the *Time* court.[459]

2.

The *Time* court never analyzed Time's poison pill, which is addressed in this section. Poison pills preclude tender offers,[460] by inflicting voting and economic dilution on a hostile bidder.[461] If Paramount pursued a hostile tender offer for control of Time, Paramount would have passed the fifteen percent trigger of Time's pill and suffered the dilutive impact.[462] Nonetheless, according to the Delaware Supreme Court, poison pills are not preclusive. First, the incumbent board may redeem the pill if the hostile bidder's offer becomes sufficiently generous.[463] Second, if the incumbent board refuses to redeem the poison pill, it must withstand judicial inquiry under *Unocal*.[464] Third, even if the incumbent board refuses to redeem the poison pill consistent with *Unocal*, the hostile bidder may launch a proxy contest to unseat the incumbent board; presumably the newly-elected board will be amenable to the bidder's proposed acquisition and

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456. *In re* Time Warner Inc. Sec. Litig., 9 F.3d 259, 262 (2d Cir. 1993) (noting that the company struggled to manage the $10 billion in debt, and that its stock price fell).

457. Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 113 (Del. Ch. 2011) ("Defendants bear the burden of showing that their defenses are not preclusive . . . .").

458. See Julian Velasco, *Structural Bias and the Need for Substantive Review*, 82 WASH. U. L.Q. 821, 890 (2004) (noting the incurrence of debt and concluding that the "radical . . . restructuring . . . would have serious operational consequences for the company").

459. *Time*, 571 A.2d at 1155.

460. *Air Prods*., 16 A.3d at 101 ("[T]he pill is serving the principal purpose of precluding the shareholders from tendering into Air Products' offer.").

461. Lucian A. Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887, 904 (2002); *see also* Strine, *supra* note 406, at 886.

462. *Time*, 571 A.2d at 1144 n.5 (noting 15% trigger).

463. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 179 (Del. 1986) ("The board further agreed to redeem the rights and waive the covenants on the preferred stock in response to any offer above $57 cash per share.").

464. *See* Versata Enters. v. Selectica, Inc., 5 A.3d 586, 599 (Del. 2010); Moran v. Household Int'l, 500 A.2d 1346, 1356–57 (Del. 1985).

will redeem the pill.[465] The preclusion inquiry accounts for the possibility of overcoming a poison pill via a proxy contest.[466] So, even if the hostile bidder's tender offer may be precluded, the board may withstand *Unocal* scrutiny if the hostile bidder may realistically attain success in a proxy contest.

Though the *Time* court never referenced the possibility of Paramount launching a proxy contest to secure control of Time, that possibility bolsters the court's rationale. Nonetheless, the court's conclusion remains problematic. Time's board noticed an annual meeting for June 23, 1989, at which Paramount theoretically could have launched a proxy contest.[467] When Time restructured its deal with Warner, however, the annual meeting of shareholders was deferred until after Time acquired a controlling interest in Warner,[468] which occurred on July 24, 1989.[469] Time's organizational documents effectively precluded Paramount from convening a meeting of shareholders at which Paramount could conduct a proxy contest prior to Time's acquisition of Warner.[470]

More importantly, Time featured a staggered board of directors,[471] which means that only one-third of its board of directors was elected in any single year.[472] Even if Paramount launched a successful proxy contest, which tends to be expensive,[473] those newly-elected directors would comprise a minority of the board, and the pill would remain in place. Paramount would have to wait another year and incur the expense of a second proxy contest to seat, over the two-year period, a majority of the board, which then presumably could redeem the poison pill to facilitate Paramount's acquisition of Time-Warner. Notwithstanding the deterrent effect of such time and expense, the Delaware Supreme Court, in *Versata*, concluded that the combination of a staggered board and a

465. The Delaware courts barred slow-hand and dead-hand pills. *See* Quickturn Design Sys., Inc. v. Shapiro, 721 A.2d 1281 (Del. 1998); Carmody v. Toll Bros., Inc., 723 A.2d 1180 (Del. Ch. 1998).

466. *See* Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 935 (Del. 2003).

467. *See* Paramount Commcn's Inc. v. Time Inc., No. 10866, 1989 WL 79880, at *10 (Del. Ch. July 14, 1989), *aff'd sub nom.* Literary Partners, L.P. v. Time Inc., 565 A.2d 280 (Del. 1989), and *aff'd*, 565 A.2d 280 (Del. 1989), and *aff'd sub nom.* In re Time Inc. S'holder Litig., 565 A.2d 281 (Del. 1989).

468. *See generally* DEL. CODE ANN. tit. 8, § 211(c) (2017) ("If there be a failure to hold the annual meeting . . . for a period of 30 days after the date designated for the annual meeting, . . . the Court of Chancery may summarily order a meeting to be held upon the application of any stockholder or director.").

469. Geraldine Fabrikant, *Time Inc. Gains Control of Warner Within Hours of Court Approval*, N.Y. TIMES, July 25, 1989, at A1 ("Time completed its tender offer for 51 percent of Warner's shares at 5:01PM. Three hours earlier, the [Delaware Supreme Court] unanimously upheld a ruling . . . that rejected attempts . . . to block the Time-Warner deal.").

470. *Time*, 571 A.2d at 1144 n.5.

471. *Id.* (noting Time's "panoply of defensive devices, including a staggered board").

472. DEL. CODE ANN. tit. 8, § 141(d) (2017). Moreover, if a board is staggered, shareholders may remove directors during their terms only "for cause." *Id.* § 141(k).

473. *See* Jeff Mordock, *DuPont Spent $15M to Keep Activist Investor Off Board*, USA TODAY (May 19, 2015, 10:37 AM), https://www.usatoday.com/story/money/business/2015/05/19/dupont-spent-15m-proxy-fight/27575179/.

poison pill was not preclusive.[474] Compelled to adhere to binding precedent, Chancellor Chandler questioned its wisdom: "[N]o bidder to my knowledge has ever successfully stuck around for two years and waged two successful proxy contests to gain control of a classified board in order to remove a pill."[475] If, with the passage of time, no bidder overcomes the combination of a staggered board and a poison pill, then the courts should reconsider whether overcoming that tandem is merely a theoretical possibility or realistically attainable.[476]

Notwithstanding the foregoing, the leading precedent of the Delaware Supreme Court addressing poison pills differs importantly from the facts of *Time*. In *Moran*,[477] *Quickturn*,[478] and *Versata*,[479] the targeted corporation was simply saying "no" to the hostile acquirer, not undertaking an alternative transaction. In those cases, the targeted corporation would be the same company at the time that it precluded the hostile tender offer as it would be at the time of a proxy contest. However, Time would differ dramatically; at the time of the hostile tender offer, Time was a stand-alone company, but at the time that Paramount might have launched a proxy contest, Time would have become Time-Warner. If, contrary to the holding of the *Time* court, we accept that facilitating the Time-Warner transaction precluded Paramount's tender offer, then the possibility of launching a proxy contest to gain control of Time-Warner should not yield a different outcome. As mentioned before, the theoretical possibility of launching a proxy contest does not mean that it was realistically attainable.[480]

C.

Beyond the *Time* court's ironic conclusion, the preclusion inquiry itself seems unhelpful. Presumably, the preclusion inquiry was intended as a helpful filtering device to avoid the inquiry into reasonableness—*ex post* judicial sec-

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474. Versata Enters. v. Selectica, Inc., 5 A.3d 586, 604 (Del. 2010) ("The fact that a combination of defensive measures makes it more difficult for an acquirer to obtain control of a board does not make such measures realistically unattainable, i.e., preclusive.").

475. Air Prods. & Chems. Inc. v. Airgas, Inc., 16 A.3d 48, 113 (Del. Ch. 2011); *see also id.* at 113 n.436 ("Indeed, Airgas's own expert testified that no bidder has ever replaced a majority of directors on a staggered board by winning two consecutive annual meeting elections."); Bebchuk, Coates & Subramanian, *supra* note 461, at 914 ("[T]o our knowledge, no bidder has successfully fought through two proxy contests to win control of a . . . target [with an effective staggered board].").

476. Perhaps the *Versata* case will be less troubling over time as the market has begun trending away from staggered boards. *See* Steven J. Cleveland, *A Failure of Substance and a Failure of Process: The Circular Odyssey of Oklahoma's Corporate Law Amendments in 2010, 2012, and 2013*, 67 OKLA. L. REV. 221, 235 (2015) ("In 2004, over 50% of the S&P 500 companies had staggered boards, but at the end of 2012, only 17% of the S&P 500 companies had staggered boards.").

477. *See* Moran v. Household Int'l, Inc., 500 A.2d 1346, 1349 (Del. 1985).

478. *See* Quickturn Design Sys. v. Shapiro, 721 A.2d 1281 (Del. 1998).

479. *See Versata*, 5 A.3d at 588.

480. *Air Prods*., 16 A.3d at 113.

ond-guessing by institutionally incapable actors.[481] If, however, the preclusion inquiry does not produce the intended benefits, or worse proves counterproductive, then the Delaware Supreme Court should reconsider its usage as an outcome-determinative filtering device. Part C. applies the preclusion inquiry to forms of deal protection and concludes that inquiry is not helpful.

1.

A termination fee is a form of deal protection, which incentivizes an initial bidder to expend resources negotiating an agreement with the targeted corporation, and which rewards the initial bidder if a different bidder ultimately acquires the targeted corporation after making a superior bid.[482] Technically, the targeted corporation pays the fee to the jilted bidder, but effectively the successful acquirer pays the fee. The Delaware courts acknowledge the conceptual soundness of a termination fee,[483] but recognize that a termination fee deters subsequent bidders.[484] At some point, the magnitude of the termination fee precludes subsequent bidders.[485] In determining the validity of termination fees, courts examine the magnitude of the fee in comparison to the deal value. Although the inquiry is contextual,[486] courts routinely conclude that termination fees that amount to three percent of the deal value are neither preclusive nor un-

481. *See* Paramount Commc'ns v. QVC Network, Inc., 637 A.2d 34, 45 (Del. 1994) ("[A] court should not ignore the complexity of the directors' task . . . . The board of directors is the corporate decisionmaking body best equipped to make these judgments. Accordingly, a court applying enhanced judicial scrutiny should be deciding whether the directors made a *reasonable* decision, not a *perfect* decision. If a board selected one of several reasonable alternatives, a court should not second-guess that choice even though it might have decided otherwise or subsequent events may have cast doubt on the board's determination. Thus, courts will not substitute their business judgment for that of the directors . . . .").

482. Brazen v. Bell Atl. Corp., 695 A.2d 43, 48–49 (Del. 1997).

483. *Id.* at 49 (upholding a termination fee that falls "within a range of reasonableness").

484. Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 930 (Del. 2003) ("*Deal Protection Devices Require Enhanced Scrutiny*").

485. In re Dollar Thrifty S'holder Litig., 14 A.3d 573, 613 (Del. Ch. 2010) ("The preclusive aspect of any termination fee is properly measured by the effect it would have on the desire of any potential bidder to make a topping bid.").

486. Louisiana Mun. Police Emps.' Ret. Sys. v. Crawford, 918 A.2d 1172, 1181 n.10 (Del. Ch. 2007) ("[A]nalysis [of a termination fee] will, by necessity, require the Court to consider a number of factors, including without limitation: the overall size of the termination fee, as well as its percentage value; the benefit to shareholders, including a premium (if any) that directors seek to protect; the absolute size of the transaction, as well as the relative size of the partners to the merger; the degree to which a counterparty found such protections to be crucial to the deal, bearing in mind differences in bargaining power; and the preclusive or coercive power of all deal protections included in a transaction, taken as a whole. The inquiry, by its very nature fact intensive, cannot be reduced to a mathematical equation. Though a '3% rule' for termination fees might be convenient for transaction planners, it is simply too blunt an instrument, too subject to abuse, for this Court to bless as a blanket rule.").

reasonable.[487] Courts have concluded that termination fees of six-to-seven percent of the deal value do not pass *Unocal* scrutiny.[488]

Determining whether a termination fee precludes a subsequent bidder may be helpful in some cases, but the inquiry misses the mark in other cases. Crafting an analysis that begins with preclusion and moves on to reasonableness only if the board proves that the defensive action was not preclusive yields false positives and false negatives.

Two numerical examples may prove helpful. Assume that we know, but the Target does not, that the highest value that any bidder places on Target is $100 per share. Target aggressively negotiates with Bidder 1 and extracts an offer of $99 per share, the absolute maximum amount that Bidder 1 is willing to pay, while Bidder 1 extracts a termination fee of three percent from Target. The termination fee would preclude Bidder 2, who values Target at a maximum of $99.50 per share, as well as Bidder 3, who values Target at a maximum of $100 per share. Nonetheless, such a termination fee would be deemed reasonable and pass *Unocal* muster, notwithstanding its preclusive effect.[489] The Delaware courts have acknowledged this possibility:

> Deal protections, of course, do provide a bidding cushion for merger partners that makes small, margin-topping bids non-viable. When that cushion results . . . from a good faith negotiation process in which the target board has reasonably granted

487. *Brazen*, 695 A.2d at 49 (holding that a 2% termination fee is not preclusive and "falls well within the range of termination fees upheld as reasonable by the courts of this State"); Kysor Indus. Corp. v. Margaux, Inc., 674 A.2d 889, 897 (Del. 1996) (upholding, as not preclusive, a reasonable termination fee of 2.8% of offer); Miramar Firefights Pension Fund v. AboveNet., Inc., No. 7376-VCN, 2013 WL 4033905, at *8 (Del. Ch. July 31, 2013) (upholding, as not preclusive, a "termination fee representing roughly two percent of the deal's equity value . . . [which] ha[d] been repeatedly upheld by the Court as reasonable under similar circumstances"); In re Plains Exploration & Prod. Co. S'holder Litig., No. 8090-VCN, 2013 WL 1909124, at *6 (Del. Ch. May 9, 2013) ("The three percent termination fee ($207 million) was also not unreasonable."); Goodwin v. Live Entm't, No. 15765, 1999 WL 64265, at *20 (Del. Ch. Jan. 25, 1999) (upholding, as not preclusive, a reasonable termination fee of 3.125% plus $1 million in expenses for a total percentage of 4.167%); *In re* Cogent, Inc. S'holder Litig., 7 A.3d 487, 503 (Del. Ch. 2010) (upholding, as not preclusive, a termination fee of 3% of the equity or transaction value).

488. *In re* Comverge, Inc. S'holders Litig., No. 7368-VCP, 2014 WL 6686570, at *1, *17 (Del. Ch. Nov. 25, 2014) (denying motion to dismiss where the "aggregate value of those termination payments reache[d] approximately 13% of the equity value of the transaction, well more than double the termination fee percentages that this Court has found to be at the upper bounds of reasonableness" which had an "impermissibly preclusive effect"); Phelps Dodge Corp. v. Cyprus Amax Minerals Co., No. 17398, 1999 WL 1054255 (Del. Ch. Sept. 27, 1999) (concluding, in dicta, that a termination fee of 6.3% is not reasonable).

As discussed above in Part II, the Delaware courts analyze stock options similarly. *See* Paramount Commc'ns v. QVC Network, Inc., 637 A.2d 34, 50 (Del. 1993) ("[T]he Stock Option Agreement had become 'draconian.'"). *See generally* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1387 (Del. 1995) ("Where all of the target board's . . . actions are inextricably related, . . . such actions [are] scrutinized collectively . . . .").

489. *See Crawford*, 918 A.2d at 1181 n.10 (listing preclusive effect as only one of many factors to be considered).

> these protections in order to obtain a good result for the stockholders, there is no grounds for judicial intrusion.[490]

In penning that language, then-Vice Chancellor Strine acknowledged preclusive action may be reasonable; the Delaware Supreme Court has also acknowledged this possibility.[491] Moreover, in examining termination fees, courts commonly undertake a reasonable analysis, without referencing preclusion.[492] Under the *Unocal* analysis, however, if the defensive action is preclusive, then the court never undertakes the reasonableness analysis. Yet, in this hypothetical, the defensive action seems preclusive but reasonable. The preclusion analysis presumably was intended as a helpful filtering device—if it is preclusive, then it cannot be reasonable[493]—but ultimately may yield erroneous results.

Consider another numerical example. Assume that we know, but the Target does not, that the highest value that any bidder places on Target is $90 per share. Target aggressively negotiates with Bidder 1 and extracts an offer of $60 per share,[494] the absolute maximum amount that Bidder 1 is willing to pay, and Target extracts a termination fee of fifteen percent, "more than double the termination fee percentages" approved by Delaware courts.[495] Though Bidder 2, who values Target at a maximum of $65 per share would be precluded from making a topping bid, Bidder 3, who values Target at a maximum of $90 per share, could easily make a topping bid of, say, $75 per share that would generate surplus for all involved. In this hypothetical, the termination fee would not be preclusive, but would be unreasonable.[496] In these examples, the preclusion analysis yields misleading results.

2.

Another form of deal protection—voting agreements—may operate to preclude subsequent bidders. In *Omnicare*, voting agreements precluded the hostile transaction, and failed the scrutiny of a 3-2 majority of the Delaware Supreme Court,[497] but, notwithstanding the majority's conclusion to the contrary,

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490. *In re* Toys "R" Us, Inc. S'holder Litig., 877 A.2d 975, 1021 (Del. Ch. 2005).

491. *See* Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1284 (Del. 1989); Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173, 184 (Del. 1986).

492. *See Brazen*, 695 A.2d 43*; see also Kysor Indus. Corp*., 674 A.2d 889.

493. *See* Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 122 n.480 (Del. Ch. 2011) ("[P]reclusive action is *per se* unreasonable.").

494. Great disparities may emerge between the price originally negotiated by the targeted corporation and the price that a hostile bidder will pay. *See Paramount Commc'ns v. QVC Network, Inc.*, 673 A.2d 34, 38–41 (Del. 1993) (noting that the initial contract price was $70 per share and the hostile bidder eventually offered $90 per share); *Macmillan*, 559 A.2d at 1270–71, 1277–78 (noting that original management restructuring valued target at $64.15 per share and that hostile bidder eventually offered $90.25 per share).

495. *In re* Comverge, Inc. S'holders Litig., No. 7368-VCP, 2014 WL 6686570, at *17 (Del. Ch. Nov. 25, 2014).

496. *See id.*

497. Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 918 (Del. 2003).

the deal protection, including the voting agreements, seemed reasonable given the facts of the case. According to the *Omnicare* court, the voting agreements of the controlling shareholders of NCS, who were also board members, precluded the hostile acquirer's superior bid, when the acquisition agreement included a force-the-vote provision and did not include a "fiduciary out" right of termination.[498] Two shareholders agreed to vote to approve the transaction with the favored bidder—Genesis—while retaining the right as directors to withdraw their recommendation of that transaction in favor of a superior bid.[499] Nonetheless, the transaction agreement required that a shareholder meeting be convened to enable the shareholders to vote on the transaction with Genesis, even if the directors no longer recommend that transaction, which occurred,[500] and which is permitted by the DGCL.[501] Moreover, the transaction agreement did not permit the board of directors of NCS to terminate the agreement if a superior bid emerged; that is, there was no "fiduciary out."[502] Thus, given the three deal-protective measures—voting agreements regarding a majority of votes, a force-the-vote provision, and no "fiduciary out"—NCS' transaction with Genesis was a *fait accompli*, even though a superior bid emerged.[503] Employing the *Unocal* analysis, a majority of the Delaware Supreme Court concluded that the deal protection was preclusive and unenforceable.[504]

Yet two dissenting justices and many commentators believe that the board's defensive actions should have been upheld as reasonable,[505] given the underlying facts, which briefly follow. Beginning in 1999, NCS experienced financial trouble,[506] and soon was in default on approximately $350 million in debt, with its stock trading as low as $0.09 (until the announcement of its deal with Genesis).[507] NCS retained an international investment bank to aid in its exploration of strategic alternatives.[508] The bank contacted potential acquirers and received only one indication of interest, but the initial offer failed to cover NCS' outstanding debt, and that already-low offer was lowered during due diligence.[509]

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498. *Id.*

499. *See id.*

500. *Id.* at 925.

501. DEL. CODE ANN. tit. 8, § 146 (2017) ("A corporation may agree to submit a matter to a vote of its stockholders whether or not the board of directors determines at any time subsequent to approving such matter that such matter is no longer advisable and recommends that the stockholders reject or vote against the matter.").

502. *Omnicare*, 818 A.2d at 936–39.

503. *Id.* at 936.

504. *Id.* at 939.

505. *Id.* at 943 (Veasey, C.J., dissenting) (joined by J. Steele); *see, e.g.*, Sean J. Griffith, *The Omnipresent Specter of* Omnicare, 38 J. CORP. L. 753, 755 (2013) ("In the wake of *Omnicare*, I argued . . . that the decision was a mistake. Ten years later, it still is.").

506. *Omnicare*, 818 A.2d at 920.

507. *Id.*

508. *Id.*

509. *Id.*

After its financial condition worsened, NCS considered a "pre-packaged" bankruptcy but the offers were inadequate.[510] "[A]ny recovery for NCS stockholders seemed impossible."[511] In 2001, Omnicare, which eventually became the hostile bidder, proposed an acquisition, but its offer would not have covered the outstanding debt (and thus provided nothing for shareholders),[512] and it required that the acquisition be structured under a specific provision of the bankruptcy code.[513] When its offer was not accepted, Omnicare began working with noteholders, rather than continuing to negotiate with NCS, and, in 2002, made another proposal that would not cover NCS' debt.[514] NCS began confidential negotiations with Genesis, which made a proposal that would repay NCS' debt and also provide consideration to NCS' shareholders.[515] However, Genesis, having previously lost to Omnicare a target with which it was negotiating, refused to be a stalking horse and required that its deal be locked up.[516] At the eleventh hour, fearing that another company would acquire NCS and pose a competitive threat, Omnicare tried to re-engage with NCS, but its offer included a due-diligence condition.[517] (Recall that, when NCS previously tried to sell itself, a bidder lowered its bid after conducting due diligence.[518]) NCS used Omnicare's appearance to extract additional consideration from Genesis, but not relief from the lock-ups.[519] After NCS and Genesis executed an agreement, Omnicare stepped forward with a superior proposal, but the NCS-Genesis deal was a *fait accompli*, precluding an acquisition by Omnicare.[520] The court was correct that the deal protection precluded a hostile acquisition by Omnicare,[521] but weren't the actions by NCS' board reasonable?

- Wasn't it reasonable for the NCS board to believe that Genesis would cease negotiations if NCS engaged with Omnicare, when Omnicare previously acquired a corporation with which Genesis was negotiating?[522]

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510. *Id.* at 921.

511. *Id.*

512. *Id.*

513. 11 U.S.C. § 363 (2012). Some are troubled by corporate acquisitions via Section 363 because they skirt the general disclosure-and-voting requirements of plans of reorganization. *See In re* Braniff Airways, Inc., 700 F.2d 935, 939 (5th Cir. 1983).

514. *Omnicare*, 818 A.2d at 921.

515. *Id.* at 922–23.

516. *Id.*

517. *Id.* at 924.

518. *Id.* at 920.

519. *Id.* at 924–25.

520. *Id.* at 936.

521. The majority did not discuss Omnicare's ability to acquire Genesis-NCS, as the *Time* court had discussed Paramount's ability to acquire Time-Warner.

522. *Omnicare*, 818 A.2d at 941 (Veasey, C.J., dissenting) ("[I]t is not disputed by the Majority that the NCS directors made a reasoned decision to accept as real the Genesis threat to walk away.").

- After Omnicare was given the opportunity to make a reasonable offer, and had only low-balled NCS, wasn't it reasonable for the NCS board to favor the certainty of a generous transaction with Genesis?[523]
- Wasn't it reasonable for the NCS board to refuse to re-engage with Omnicare based on its offer being subject to a due-diligence condition, when another company lowered its offer after conducting due diligence?[524]
- Wasn't it reasonable for the NCS board to lock up the transaction, given that Genesis offered consideration to NCS' shareholders, which previously seemed an "impossibility," and when no prior offer even covered NCS' debt?[525]
- Wasn't it reasonable for the NCS board to believe that, if Genesis walked away, Omnicare would lower its bid, given that its superior proposal emerged only because of the presence of Genesis?[526]
- Wasn't it reasonable for the NCS board to agree to forego possibly higher bids, when two of those board members—who had "no insidious, camouflaged side deals"—owned significant minority stakes?[527]

Notwithstanding the *Unocal* analysis, under which preclusive action is *per se* unreasonable, preclusive action may be reasonable. Even the Delaware Supreme Court has recognized this possibility in dicta. In *Macmillan*, the court wrote, "If the grant of an auction-ending provision is appropriate, it must confer a substantial benefit upon the stockholders in order to withstand exacting scrutiny by the courts."[528] "Auction-ending" means that one bidder was favored to the point that any other bidders were precluded, otherwise the auction would be on-going. Similarly, in *Revlon*, the court wrote, "Favoritism for a white knight to the total exclusion of a hostile bidder might be justifiable when the latter's offer adversely affects shareholder interests . . . ."[529] "To the total exclusion of

523. *Id.* at 942 (Veasey, C.J., dissenting) ("Certainty itself has value. The acquirer may pay a higher price for the target if the acquirer is assured consummation of the transaction. The target company also benefits from the certainty of completing a transaction with a bidder because losing an acquirer creates the perception that a target is damaged goods, thus reducing its value."); *see* Stephen M. Bainbridge, *Exclusive Merger Agreements and Lock-Ups in Negotiated Corporate Acquisitions*, 75 MINN. L. REV. 239, 328 (1990); Sean J. Griffith, *The Costs And Benefits Of Precommitment: An Appraisal of* Omnicare v. NCS, 29 J. CORP. L. 569, 613 (2004).

524. *Omnicare*, 818 A.2d at 941 (Veasey, C.J., dissenting) (noting that Omnicare's due-diligence condition was "crippling" to its offer).

525. *Id.* at 943 (Veasey, C.J., dissenting) ("The NCS board's actions—as the Vice Chancellor correctly held—were reasonable in relation to the threat because the Genesis deal was the 'only game in town.'").

526. *Id.* at 942 (Veasey, C.J., dissenting) ("Omnicare . . . could have changed its mind and again insisted on an asset sale in bankruptcy."); *id.* at 947 (Steele, J., dissenting) (noting that NCS faced anything from "silence [and] tepid interest to outright hostility from Omnicare").

527. *Id.* at 948 (Steele, J., dissenting). *Accord* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1380–81 (Del. 1995) (giving credence to the value perceptions of board members who owned significant stakes in the target).

528. Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1284 (Del. 1989).

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

a hostile bidder" certainly sounds like that bidder was precluded. Based upon that dicta, the Delaware Supreme Court endorsed preclusive conduct so long as the target's shareholders enjoyed a substantial benefit or averted substantial harm. In *Omnicare*, the locked-up deal with Genesis provided shareholders with substantial consideration when that previously was thought to be an "impossibility," and engaging with Omnicare risked the deal with Genesis, which could have resulted in substantial harm to NCS' shareholders.[530] The preclusive conduct seems reasonable, which possibility was foreordained by the Delaware Supreme Court. Again, the preclusion analysis seems counterproductive to the court's ultimate concern for reasonableness.

IV.

Beam exhibited unintentional irony as the court held that directors would not trade on their reputations for minimal gain, when one of them did trade on her reputation for minimal gain. Having failed to acknowledge the irony, the court failed to address its logical inconsistency. Cognitive biases seemingly explain Stewart's quick decision, but those biases are less persuasive regarding a board's deliberative response to a shareholder's demand, which response would be subject to judicial (and public) review.

Van Gorkom also exhibited unintentional irony as the court concluded that a competing bidder could not reach an agreement and finance its bid in the allotted period when that period significantly exceeded what was necessary for the favored bidder. Notwithstanding the prevalence of director-protective charter provisions authorized by DGCL Section 102(b)(7), *Van Gorkom* remains an important and misleading data point, given its relevance in the *Revlon* setting and the courts' emphasis that plaintiffs pursue injunctive relief for such claims.[531]

Time also exhibited unintentional irony, concluding that preclusive conduct was not preclusive. Perhaps the preclusive inquiry should be eliminated as a "dead letter," but that seems overkill, as preclusive conduct commonly is not reasonable and should be struck down.[532] Perhaps, the preclusive inquiry should remain as an outcome-determinative precursor to the reasonableness inquiry, but more limited in scope.[533] But that fails to account for the Delaware Supreme Court's dicta that preclusive conduct may be reasonable, as well as the practice—in the termination-fee setting—of examining reasonableness without reference to preclusion. Perhaps, the preclusion inquiry should inform the reasonableness inquiry without being outcome-determinative of the matter. Then-

530. *Omnicare*, 818 A.2d at 943 (Veasey, C.J., dissenting) ("The Vice Chancellor correctly found that they reasonably perceived the threat that NCS did not have a viable offer from Omnicare—or anyone else—to pay off its creditors, cure its insolvency and provide some payment to stockholders.").

531. *See* Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 312 (Del. 2015).

532. *See, e.g.*, Quinn, *supra* note 411, at 837 (describing preclusivity as a "dead letter").

533. *See* Laster, *supra* note 336, at 811.

Vice Chancellor Strine disfavored complicated redundant inquiries, advocating for elimination of *Blasius*' compelling-justification inquiry, when *Unocal*'s reasonableness inquiry could do the necessary work.[534] That is, if, as in *Blasius*, the directors impede the shareholders' franchise—an extreme action by directors—the threat to those shareholders must be extreme. *Unocal*'s reasonableness/proportionality inquiry suffices to fulfill the goal of *Blasius*. So, too, with preclusion, which generally will be found to be unreasonable, but, as the Delaware Supreme Court notes, may be reasonable in limited circumstances.[535]

534. Mercier v. Inter-Tel (Del.), Inc., 929 A.2d 786, 788 (Del. Ch. 2007).

535. *See* Strine, *supra* note 406, at 885, 892 (disfavoring bright-line, *per se* inquiries for issues of fiduciary duty and equity).