

2014

The Effect of Stockholder Approval on Enhanced Scrutiny

J. Travis Laster

Follow this and additional works at: <http://open.mitchellhamline.edu/wmlr>

Recommended Citation

Laster, J. Travis (2014) "The Effect of Stockholder Approval on Enhanced Scrutiny," *William Mitchell Law Review*: Vol. 40: Iss. 4, Article 8.

Available at: <http://open.mitchellhamline.edu/wmlr/vol40/iss4/8>

This Article is brought to you for free and open access by the Law Reviews and Journals at Mitchell Hamline Open Access. It has been accepted for inclusion in William Mitchell Law Review by an authorized administrator of Mitchell Hamline Open Access. For more information, please contact sean.felhofer@mitchellhamline.edu.

© Mitchell Hamline School of Law

**THE EFFECT OF STOCKHOLDER APPROVAL ON
ENHANCED SCRUTINY**

J. Travis Laster[†]

I. INTRODUCTION 1443
II. THREE STANDARDS OF REVIEW 1446
III. SHIFTING BETWEEN THE STANDARDS 1450
 A. *From the Business Judgment Rule, to Entire Fairness, and
 Back Again*..... 1451
 B. *The Special Case of a Controlling Stockholder* 1460
 C. *Moving In and Out of Enhanced Scrutiny* 1463
IV. POTENTIAL IMPEDIMENTS 1470
 A. Santa Fe 1471
 B. Gantler 1477
 C. *A Quarter Century of Effort at Clarification* 1484
V. CONCLUSION..... 1491

I. INTRODUCTION

When a stockholder plaintiff claims that a corporate decision constituted a breach of fiduciary duty, a court applying Delaware law searches for an independent, disinterested, and sufficiently informed decision maker.¹ If one exists, then the court defers to the decision that the qualified decision maker made. Only in the absence of a qualified decision maker will the court assume that role for itself.

This animating principle drives the selection of the standard of review that the court uses to determine whether a corporate

[†] Vice Chancellor, Court of Chancery of the State of Delaware. On October 8, 2013, Vice Chancellor Laster delivered the Dorsey & Whitney Foundation Lecture at William Mitchell College of Law. Portions of this article formed the basis for his remarks.

1. To shorten the list of necessary attributes, this article refers to an independent, disinterested, and sufficiently informed decision maker as a “qualified decision maker.”

fiduciary has breached its duties. Delaware law has three basic standards of review for evaluating fiduciary decision making: the business judgment rule, enhanced scrutiny, and entire fairness. A court applying Delaware law moves among the standards depending on the degree to which a qualified decision maker exists.

Delaware decisions explain how the standard of review escalates from the business judgment rule to entire fairness and back again. Delaware decisions similarly identify the specific situations that call for augmenting the standard of review from the business judgment rule to enhanced scrutiny. But Delaware cases address to a far lesser degree how the standard of review can diminish from enhanced scrutiny to the business judgment rule.

As a matter of first principles, in a situation where enhanced scrutiny applies, stockholder approval by a disinterested, uncoerced, and fully informed stockholder majority should restore the business judgment rule. To the extent the board is compromised by the situational pressures that trigger enhanced scrutiny, the collective body of disinterested and informed stockholders should be able to act as a qualified decision maker to which a court would defer. This should be true even if stockholder approval was required under the Delaware General Corporation Law (DGCL) for the act to become effective.²

To date, the Delaware Supreme Court has not yet addressed this issue, and at least two Delaware Supreme Court decisions arguably indicate that an organic vote will not affect the standard of review when enhanced scrutiny applies. The *Santa Fe*³ opinion could be read to hold that an organic vote on a merger otherwise reviewable under enhanced scrutiny will not change the standard of review that governs defensive measures adopted separately or as

2. For simplicity, this article uses the term “organic vote” to refer to a stockholder vote that is required under the DGCL for the corporate action to become effective. This article uses the term “voluntary vote” to refer to a stockholder vote that is not required for the corporate action to become effective. An example of the former is the vote on a long-form merger. *See* DEL. CODE ANN. tit. 8, § 251(b) (West, Westlaw through 79 Laws 2014). An example of the latter is the vote to adopt a stock option plan. *See id.* § 157. The adjective “organic” is suggested by the Delaware Supreme Court’s decision in *Williams v. Geier*, which referred to a statutorily required vote as part of the “organic act.” 671 A.2d 1368, 1379 n.24 (Del. 1996).

3. *In re Santa Fe Pac. Corp. S’holder Litig.*, 669 A.2d 59 (Del. 1995).

part of the merger agreement. The *Gantler v. Stephens*⁴ decision could be read to hold more broadly that an organic vote will never have any effect on the standard of review.

A thorough examination of *Santa Fe* and *Gantler* reveals them to be part of a quarter-century effort by the Delaware courts to clarify confusion inadvertently created by loose language about stockholder ratification in *Smith v. Van Gorkom*.⁵ As *Gantler* makes clear, ratification is a narrow legal concept that comes into play when one decision maker has made a decision unilaterally. If the decision is challenged, a second decision maker with equal or greater authority can ratify the original decision by agreeing formally with the first decision maker. If a decision requires two approvals to be effective, then technically the second approval is not a form of ratification, but rather part of the original decision. Ratification, therefore, cannot strictly apply to an organic vote required under the DGCL for corporate action to become effective.

In *Gantler*, the Delaware Supreme Court limited the use of the term “ratification” to its “classic” sense, namely, situations where one decision maker has made a decision unilaterally.⁶ The *Gantler* decision expressly overruled *Van Gorkom* to the extent it used the term “ratification” to refer to an organic vote, such as the stockholder vote on charter amendment or a long-form merger.⁷ The high court incorporated *Santa Fe* into this more limited view of ratification and took pains to specify that its decision did not alter other aspects of stockholder approval jurisprudence, such as case law interpreting section 144 of the DGCL or decisions holding that only unanimous stockholder approval can validate acts of waste. In doing so, the *Gantler* decision sharpened the distinction drawn in *Williams v. Geier*⁸ between the doctrine of “classic” ratification, which applies to voluntary votes, and the concept of stockholder approval, which encompasses organic votes. As the *Williams* court

4. 965 A.2d 695 (Del. 2009).

5. 488 A.2d 858, 889–90 (Del. 1985), *overruled in part by Gantler*, 965 A.2d at 713 n.54.

6. *Gantler*, 965 A.2d at 713.

7. *See id.* at 713 n.54; *see also* DEL. CODE ANN. tit. 8, §§ 242, 251 (Westlaw) (detailing amending certificates of incorporation after receipt of payment for stock, and mergers and consolidations, respectively).

8. 671 A.2d 1368 (Del. 1996).

admonished, the former are “entirely different” from and “not relevant” to the latter.⁹

Authorities on “classic” ratification, including *Santa Fe* and *Gantler*, simply do not speak to the separate issue of the effect that an organic vote has on the applicable standard of review. Consistent with the premise of deference to a qualified corporate decision maker, if a fully informed, uncoerced, and disinterested stockholder majority votes in favor of a merger otherwise subject to enhanced scrutiny, then the business judgment rule should become the operative standard of review. This should be true even when the stockholder approval comes from an organic vote. Consequently, any complaint challenging such a transaction should no longer benefit from enhanced scrutiny’s reasonableness standard or the shifting of the burden of proof to the defendants. Instead, the plaintiff should be required to plead facts sufficient to overcome the business judgment rule’s presumptions.

II. THREE STANDARDS OF REVIEW

Delaware has three basic standards of review for evaluating decisions made by fiduciaries: the business judgment rule, enhanced scrutiny, and entire fairness. Together, they form a pyramid of narrowing deference to corporate decision making and increasing judicial intrusiveness. Travel aficionados can imagine a three-step Mayan pyramid. The gastronomically inclined can picture a three-tiered wedding cake.

At the bottom of the pyramid is the business judgment rule, which gives the pyramid a capacious broad foundation. For decisions at this level, a qualified corporate decision maker exists, so a reviewing court effectively abstains from reviewing the substance of the corporate decision.¹⁰ The only residuum for

9. *Id.* at 1379 (distinguishing between (1) cases “where stockholders are called upon to ratify action which may involve a transaction with an interested director or where the transaction approved by the board may otherwise be avoidable,” and (2) cases involving “the effect of corporate action which, in order to become operative, requires and receives both approval by the board of directors and the stockholders,” and “put[ting] to one side” the former category of cases as “not relevant” and “entirely different” when considering an organic vote under section 242 of the DGCL).

10. *In re Trados Inc. S’holder Litig. (Trados I)*, Civ. A. No. 1512-CC, 2009 WL 2225958, at *6 (Del. Ch. July 24, 2009) (noting that the business judgment rule is a principle of judicial nonreview that “reflects and promotes the role of the

judicial review is limited to decisions so irrational as to suggest bad faith.¹¹ Irrationality is an extreme standard, making the bottom layer of the pyramid expansively wide.

At the top of the pyramid is the narrowest tier, representing entire fairness. At this level, the plaintiff has shown that the board could not act as a qualified decision maker, so the court must use its own judgment. Under entire fairness, the defendant directors have the burden “to demonstrate that the challenged act or transaction was entirely fair to the corporation and its shareholders.”¹² To meet this test, they must show that the action they took was both procedurally and substantively fair by establishing “to the *court’s* satisfaction that the transaction was the product of both fair dealing *and* fair price.”¹³ “Not even an honest belief that the transaction was entirely fair will be sufficient to establish entire fairness. Rather, the transaction itself must be objectively fair, independent of the board’s beliefs.”¹⁴

board of directors as the proper body to manage the business and affairs of the corporation”). *See generally* Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83 (2004) (exploring the necessary balance between authority and accountability in judicial review of operational business decisions).

11. *In re* Walt Disney Co. Derivative Litig. (*Disney II*), 906 A.2d 27, 52 (Del. 2006) (“[W]here business judgment presumptions are applicable, the board’s decision will be upheld unless it cannot be ‘attributed to any rational business purpose.’” (quoting *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971))); *Brehm v. Eisner*, 746 A.2d 244, 264 (Del. 2000) (“Irrationality is the outer limit of the business judgment rule. Irrationality may be the functional equivalent of the waste test or it may tend to show that the decision is not made in good faith, which is a key ingredient of the business judgment rule.” (footnotes omitted)); *In re* Dollar Thrifty S’holder Litig., 14 A.3d 573, 598 (Del. Ch. 2010) (explaining that unless one of the elements of the business judgment rule is rebutted, “the court merely looks to see whether the business decision made was rational in the sense of being one logical approach to advancing the corporation’s objectives”); *In re* J.P. Stevens & Co. S’holders Litig., 542 A.2d 770, 780–81 (Del. Ch. 1988) (“A court may, however, review the substance of a business decision made by an *apparently* well motivated board for the limited purpose of assessing whether that decision is so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith.”).

12. *Disney II*, 906 A.2d at 52; *accord* *Emerald Partners v. Berlin*, 787 A.2d 85, 91 (Del. 2001); *see Brehm*, 746 A.2d at 264 n.66.

13. *Cinerama, Inc. v. Technicolor, Inc. (Technicolor Plenary IV)*, 663 A.2d 1156, 1163 (Del. 1995).

14. *Gesoff v. IIC Indus., Inc.*, 902 A.2d 1130, 1145 (Del. Ch. 2006).

Even under entire fairness, however, a lingering degree of deference to the corporate decision maker remains, so the top level of the pyramid should be imagined as a narrow tier rather than a spire. “[P]erfection is not possible, or expected’ as a condition precedent to a judicial determination of entire fairness.”¹⁵ The board must act in a procedurally fair manner, but directors will not be held to have breached their duties simply because they failed to deploy an idealized level of protection. The same is true for the substantive terms of a transaction. “The value of a corporation is not a point on a line, but a range of reasonable values”¹⁶ Consequently, when conducting the fair price aspect of entire fairness, the court asks whether the transaction was one “that a reasonable seller, under all of the circumstances, would regard as within a range of fair value; one that such a seller could reasonably accept.”¹⁷ On both price and process, there is play in the joints, and the two dimensions are interrelated: “A strong record of fair dealing can influence the fair price inquiry, reinforcing the unitary nature of the entire fairness test. The converse is equally true: process can infect price.”¹⁸ These unavoidable ambiguities in the test, combined with the inherent vagaries of litigation and a natural reluctance to substitute judicial judgment for business persons’ decision making, preserve a de facto element of deference even under the entire fairness test.¹⁹

Sandwiched between the top and bottom is a middle tier, representing enhanced scrutiny. “Enhanced scrutiny applies to specific, recurring, and readily identifiable situations involving

15. *Technicolor Plenary IV*, 663 A.2d at 1179 (citing *Weinberger v. UOP, Inc.*, 457 A.2d 701, 709 n.7 (Del. 1983)).

16. *Cede & Co. v. Technicolor, Inc. (Technicolor Appraisal III)*, Civ. A. No. 7129, 2003 WL 23700218, at *2 (Del. Ch. Dec. 31, 2003), *aff’d in part, rev’d in part on other grounds*, 884 A.2d 26 (Del. 2005).

17. *Cinerama, Inc. v. Technicolor, Inc. (Technicolor Plenary III)*, 663 A.2d 1134, 1143 (Del. Ch. 1994), *aff’d*, 663 A.2d 1156; *see also Kahn v. Tremont Corp.*, Civ. A. No. 12339, 1996 WL 145452, at *1 (Del. Ch. Mar. 21, 1996) (“A fair price is a price that is within a range that reasonable men and women with access to relevant information might accept.”), *rev’d on other grounds*, 694 A.2d 422 (Del. 1997).

18. *Reis v. Hazelett Strip-Casting Corp.*, 28 A.3d 442, 467 (Del. Ch. 2011).

19. *See Ams. Mining Corp. v. Theriault*, 51 A.3d 1213, 1243–44 (Del. 2012) (“[J]udicial review for entire fairness of how the transaction was structured, negotiated, disclosed to the directors, and approved by the directors will be significantly influenced by the work product of a properly functioning special committee of independent directors.”).

potential conflicts of interest where the realities of the decisionmaking context can subtly undermine the decisions of even independent and disinterested directors.”²⁰ Those conflicts are not sufficiently strong to trigger entire fairness, but they also do not comfortably permit business judgment deference.²¹ In those

20. *In re Trados Inc. S’holder Litig. (Trados II)*, 73 A.3d 17, 43 (Del. Ch. 2013); *accord Reis*, 28 A.3d at 457–59; *see Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 176, 180–82 (Del. 1986) (applying *Unocal* test to the sale of a corporation in light of concern that the directors rebuffed a premium acquisition offer and agreed to a white knight transaction, because (i) the target CEO felt a “strong personal antipathy” towards the acquirer, and (ii) the directors feared potential litigation by noteholders); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985) (creating enhanced scrutiny to address the “omnipresent specter” that when resisting a hostile takeover, target directors may be influenced by and act to further their own interests or those of incumbent management, “rather than those of the corporation and its shareholders”); *see also In re El Paso Corp. S’holder Litig.*, 41 A.3d 432, 439 (Del. Ch. 2012) (“[T]he potential sale of a corporation has enormous implications for corporate managers and advisors, and a range of human motivations, including but by no means limited to greed, can inspire fiduciaries and their advisors to be less than faithful . . .”). The Delaware Supreme Court extended the rubric of enhanced scrutiny to incorporate the principles that animated Chancellor Allen’s decision in *Blasius Industries* and directed that they be applied “within the . . . enhanced standard of judicial review.” *MM Cos., Inc. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1129 (Del. 2003) (relying on *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988)); *accord Stroud v. Grace*, 606 A.2d 75, 92 n.3 (Del. 1992). Commentators have argued that judicial review of the special litigation committee (SLC) process under *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981), is best understood as a form of enhanced scrutiny. *See Gregory V. Varallo et al., From Kahn to Carlton: Recent Developments in Special Committee Practice*, 53 BUS. LAW. 397, 423 n.121 (1998) (explaining that the two-step *Zapata* test is “reminiscent of the enhanced scrutiny courts use to examine the actions of directors engaged in a sale of a corporation or other like transactions”); Julian Velasco, *Structural Bias and the Need for Substantive Review*, 82 WASH. U. L.Q. 821, 851 (2004) (discussing standard and concluding that “*Zapata* is thus quite similar to *Unocal*”).

21. *See Paramount Commc’ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 42 (Del. 1993) (“[T]here are rare situations which mandate that a court take a more direct and active role in overseeing the decisions made and actions taken by directors. In these situations, a court subjects the directors’ conduct to enhanced scrutiny to ensure that it is reasonable.”); *In re Dollar Thrifty S’holder Litig.*, 14 A.3d 573, 597 (Del. Ch. 2010) (“Avoiding a crude bifurcation of the world into two starkly divergent categories—business judgment rule review reflecting a policy of maximal deference to disinterested board decisionmaking and entire fairness review reflecting a policy of extreme skepticism toward self-dealing decisions—the Delaware Supreme Court’s *Unocal* and *Revlon* decisions adopted a middle ground.”).

contexts, “the predicate question of what the board’s true motivation was comes into play,” and “[t]he court must take a nuanced and realistic look at the possibility that personal interests short of pure self-dealing have influenced the board.”²² Framed generally, enhanced scrutiny requires that the defendant fiduciaries “bear the burden of persuasion to show that their motivations were proper and not selfish” and that “their actions were reasonable in relation to their legitimate objective.”²³

Reasonableness review is an objective standard, but not one that contemplates a single, “reasonable” answer. Rather, a court determines whether the challenged corporate decision falls within a reasonable range of objectively constrained discretion:

[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, but will determine if the directors’ decision was, on balance, within a range of reasonableness.²⁴

The resulting standard creates a middle tier narrower than the rationality standard of the business judgment rule but broader than the entire fairness test.²⁵

III. SHIFTING BETWEEN THE STANDARDS

In a corporation, generally speaking, there are two decision makers that potentially can address an issue: the board of directors and the stockholders.²⁶ A court applying Delaware law determines

22. *Dollar Thrifty*, 14 A.3d at 598.

23. *Mercier v. Inter-Tel (Del.) Inc.*, 929 A.2d 786, 810 (Del. Ch. 2007).

24. *QVC Network Inc.*, 637 A.2d at 45.

25. *See Dollar Thrifty*, 14 A.3d at 598 (“In that middle ground [of enhanced scrutiny], the reviewing court has leeway to examine the reasonableness of the board’s actions under a standard that is more stringent than business judgment review and yet less severe than the entire fairness standard. Moreover, the defendants themselves are allocated the burden to show that they acted reasonably.”).

26. This article puts to the side the issue of whether a CEO or other senior manager qualifies for similar deference. *Compare* A. Gilchrist Sparks, III & Lawrence A. Hamermesh, *Common Law Duties of Non-Director Corporate Officers*,

the standard of review by examining to what degree a qualified decision maker exists at either or both levels.

A. *From the Business Judgment Rule, to Entire Fairness, and Back Again*

For a Delaware corporation, the DGCL designates the board of directors as the primary corporate decision maker. Section 141(a) provides that “[t]he business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation.”²⁷ “The business judgment rule is an acknowledgment of the managerial prerogatives of Delaware directors under Section 141(a).”²⁸

The business judgment rule presumes that “in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.”²⁹ In other words, the business judgment rule presumes that the board served as a qualified decision maker, including that the directors were independent, disinterested, appropriately informed, and acted for a proper corporate purpose. “[T]he burden of pleading and proof

48 BUS. LAW. 215, 215 (1992), and Lawrence A. Hamermesh & A. Gilchrist Sparks III, *Corporate Officers and the Business Judgment Rule: A Reply to Professor Johnson*, 60 BUS. LAW. 865, 865 (2005), with Lyman P.Q. Johnson, *Corporate Officers and the Business Judgment Rule*, 60 BUS. LAW. 439, 456 (2005).

27. DEL. CODE ANN. tit. 8, § 141(a) (West, Westlaw through 79 Laws 2014).

28. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984). In *Brehm v. Eisner*, 746 A.2d 244, 253–54 (Del. 2000), the Delaware Supreme Court overruled seven precedents, including *Aronson*, to the extent they reviewed a Rule 23.1 decision by the Delaware Court of Chancery under an abuse of discretion standard or otherwise suggested deferential appellate review. *Id.* at 253 n.13 (overruling in part on this issue *Scattered Corp. v. Chi. Stock Exch.*, 701 A.2d 70, 72–73 (Del. 1997); *Grimes v. Donald*, 673 A.2d 1207, 1217 n.15 (Del. 1996); *Heineman v. Datapoint Corp.*, 611 A.2d 950, 952 (Del. 1992); *Levine v. Smith*, 591 A.2d 194, 207 (Del. 1991); *Grobow v. Perot*, 539 A.2d 180, 186 (Del. 1988); *Pogostin v. Rice*, 480 A.2d 619, 624–25 (Del. 1984); *Aronson*, 471 A.2d at 814). The *Brehm* court held that appellate review of a Rule 23.1 determination would be *de novo* and plenary. 746 A.2d at 253. The seven partially overruled precedents otherwise remain good law. This article does not rely on any of them for the standard of appellate review and, therefore, omits the cumbersome subsequent history.

29. *Aronson*, 473 A.2d at 812 (citing *Kaplan v. Centex Corp.*, 284 A.2d 119, 124 (Del. Ch. 1971); *Robinson v. Pittsburgh Oil Refinery Corp.*, 126 A. 46 (Del. Ch. 1924)).

is on the party challenging the decision to allege facts to rebut the presumption.”³⁰ Each element of the business judgment rule has its own test.

To rebut the business judgment rule’s presumption of care, a plaintiff must plead and later prove gross negligence.³¹ When considering whether a lack of care is sufficient to rebut the business judgment rule, “[c]ourts do not measure, weigh or quantify directors’ judgments. We do not even decide if they are reasonable in this context. Due care in the decisionmaking context is *process* due care only.”³²

To show a lack of disinterestedness sufficient to rebut the business judgment rule, a plaintiff must plead and later prove that a director received “a personal financial benefit from a transaction that is not equally shared by the stockholders.”³³ A plaintiff also can show that a director has a compromising interest by pleading and later proving that the director is a dual fiduciary and owes a competing duty of loyalty to an entity that itself stands on the other side of the transaction or that will receive a unique benefit not shared with the stockholders.³⁴ To show a lack of independence, a

30. Solomon v. Armstrong, 747 A.2d 1098, 1111–12 (Del. Ch. 1999) (citing Aronson, 473 A.2d at 812), *aff’d*, 746 A.2d 277 (Del. 2000).

31. See *Brehm*, 746 A.2d at 259.

32. *Id.* at 264.

33. Rales v. Blasband, 634 A.2d 927, 936 (Del. 1993) (citations omitted); *accord* Cede & Co. v. Technicolor, Inc. (*Technicolor Plenary II*), 634 A.2d 345, 362 (Del. 1993) (“Classic examples of director self-interest in a business transaction involve either a director appearing on both sides of a transaction or a director receiving a personal benefit from a transaction not received by the shareholders generally.”); *Pogostin*, 480 A.2d at 624 (“Directorial interest exists whenever . . . a director either has received, or is entitled to receive, a personal financial benefit from the challenged transaction which is not equally shared by the stockholders.”). “[A] subjective ‘actual person’ standard [is used] to determine whether a ‘given’ director was likely to be affected in the same or similar circumstances.” *McMullin v. Beran*, 765 A.2d 910, 923 (Del. 2000) (citing *Technicolor Plenary IV*, 663 A.2d 1156, 1167 (Del. 1995)).

[T]he benefit received by the director and not shared with stockholders must be “of a sufficiently material importance, in the context of the director’s economic circumstances, as to have made it improbable that the director could perform her fiduciary duties . . . without being influenced by her overriding personal interest.”

Trados I, Civ. A. No. 1512-CC, 2009 WL 2225958, at *6 (Del. Ch. July 24, 2009) (quoting *In re Gen. Motors Class H S’holders Litig.*, 734 A.2d 611, 617 (Del. Ch. 1999)).

34. Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983) (holding that

plaintiff must show that a director is sufficiently loyal to, beholden to, or otherwise influenced by an interested party to undermine the director's ability to judge the matter on its merits.³⁵

A plaintiff also may seek to rebut the presumption that a director acted subjectively for the proper corporate purpose of serving the best interests of the corporation and its stockholders.

officers of parent corporation faced conflict of interest when acting as subsidiary directors regarding transaction with parent); *accord* Sealy Mattress Co. of N.J. v. Sealy, Inc., 532 A.2d 1324, 1336 (Del. Ch. 1987) (same); *see also* *Trados I*, 2009 WL 2225958, at *8 (treating directors as interested for pleading purposes in transaction that benefited preferred stockholders when “each had an ownership or employment relationship with an entity that owned Trados preferred stock”).

35. *Aronson*, 473 A.2d at 815 (stating that one way to allege successfully that an individual director is under the control of another is by pleading “such facts as would demonstrate that through personal or other relationships the directors are beholden to the controlling person”); *Friedman v. Beningson*, Civ. A. No. 12232, 1995 WL 716762, at *4 (Del. Ch. Dec. 4, 1995) (“The requirement that directors exercise *independent judgment*, (*insofar as it is a distinct prerequisite to business judgment review from a requirement that directors exercise financially disinterested judgment*), directs a court to an inquiry into all of the circumstances that are alleged to have inappropriately affected the exercise of board power. This inquiry may include the subject whether some or all directors are ‘beholden’ to or under the control, domination or strong influence of a party with a material financial interest in the transaction under attack, which interest is adverse to that of the corporation.”). Classic examples involve familial relationships, such as a parent’s love for and loyalty to a child. *See, e.g.*, *Harbor Fin. Partners v. Huizenga*, 751 A.2d 879, 889 (Del. Ch. 1999) (“That Hudson also happens to be Huizenga’s brother-in-law makes me incredulous about Hudson’s impartiality. Close familial relationships between directors can create a reasonable doubt as to impartiality. The plaintiff bears no burden to plead facts demonstrating that directors who are closely related have no history of discord or enmity that renders the natural inference of mutual loyalty and affection unreasonable.”); *Chaffin v. GNI Grp.*, Civ. A. No. 16211-NC, 1999 WL 721569, at *5 (Del. Ch. Sept. 3, 1999) (holding that father-son relationship was sufficient to rebut presumption of independence and observing that “[i]nherent in the parental relationship is the parent’s natural desire to help his or her child succeed” and “most parents would find it highly difficult, if not impossible, to maintain a completely neutral, disinterested position on an issue, where his or her own child would benefit substantially if the parent decides the issue a certain way”); *see also* *London v. Tyrrell*, Civ. A. No. 3321-CC, 2010 WL 877528, at *14 n.60 (Del. Ch. Mar. 11, 2010) (“[I]n the pre-suit demand context, plaintiffs can often meet their burden of establishing a lack of independence with a simple allegation of a familial relationship. Surely then . . . it will be nigh unto impossible for a corporation bearing the burden of proof to demonstrate that an SLC member is independent in the face of plaintiffs’ allegation that the SLC member and a director defendant have a family relationship.”).

“[T]he duty of loyalty mandates that the best interest of the corporation and its shareholders takes precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the stockholders generally.”³⁶ The presumption of good faith can be rebutted by a showing that the directors failed to pursue the best interests of the corporation and its stockholders.³⁷ Bad faith, which is a subsidiary element of the fiduciary duty of loyalty,³⁸ encompasses both “an intent to harm but also intentional dereliction of duty.”³⁹

“A failure to act in good faith may be shown, for instance, where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation”⁴⁰

36. *Technicolor Plenary II*, 634 A.2d at 361.

37. *See In re Walt Disney Co. Derivative Litig. (Disney I)*, 907 A.2d 693, 760–79 (Del. Ch. 2005) (conducting a director-by-director analysis to determine if the individual members of the board, none of whom were directly interested in the hiring or termination of corporation’s President, acted in bad faith), *aff’d*, 906 A.2d 27 (Del. 2006); *see also Disney II*, 906 A.2d at 53 (“Our law clearly permits a judicial assessment of director good faith for that former purpose [of rebutting the business judgment rule].”); *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 40 (Del. Ch. 2010) (“Under Delaware law, when a plaintiff demonstrates the directors made a challenged decision in bad faith, the plaintiff rebuts the business judgment rule presumption, and the burden shifts to the directors to prove that the decision was entirely fair to the corporation and its stockholders.”).

38. *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 370 (Del. 2006).

39. *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 240 (Del. 2009); *accord Disney II*, 906 A.2d at 64–66 (defining “subjective bad faith” as “conduct motivated by an actual intent to do harm,” which “constitutes classic, quintessential bad faith,” and “intentional dereliction of duty” as “a conscious disregard for one’s responsibilities”); *see also Stone*, 911 A.2d at 370 (holding, in the context of an oversight claim, that “utter[] fail[ure] to implement any reporting or information system or controls,” or “having implemented such a system or controls, conscious[] fail[ure] to monitor or oversee its operations” demonstrated “a conscious disregard” for their fiduciary responsibilities).

40. *Disney II*, 906 A.2d at 67; *accord Stone*, 911 A.2d at 369 (“A failure to act in good faith may be shown, for instance, where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation”); *see also Gagliardi v. TriFoods Int’l, Inc.*, 683 A.2d 1049, 1051 n.2 (Del. Ch. 1996) (defining a “bad faith” transaction as one “that is authorized for some purpose other than a genuine attempt to advance corporate welfare or is known to constitute a violation of applicable positive law” (emphasis omitted)); *In re RJR Nabisco, Inc. S’holders Litig.*, Civ. A. No. 10389, 1989 WL 7036, at *1159 (Del. Ch. Jan. 31, 1989) (explaining that the business judgment rule would not protect “a fiduciary who could be shown to have caused a transaction to be effectuated (even

“It makes no difference the reason why the director intentionally fails to pursue the best interests of the corporation.”⁴¹ Bad faith can be the result of “any . . . emotion [that] may cause a director to [intentionally] place his own interests, preferences or appetites before the welfare of the corporation,” including greed, “hatred, lust, envy, revenge, . . . shame or pride.”⁴²

To change the standard of review from the business judgment rule to entire fairness, a plaintiff must show that there were not enough independent, disinterested, and sufficiently informed individuals who acted in good faith when making the challenged decision to constitute a board majority.⁴³ If a board is evenly divided between compromised and noncompromised directors, then the plaintiff has succeeded in rebutting the business judgment rule.⁴⁴ In selecting a majority as the requisite number, the Delaware Supreme Court recognized that it had to draw a line and made a conscious policy decision.⁴⁵ It is, therefore, not sufficient for a plaintiff to show that a minority of the board was compromised.⁴⁶

one in which he had no financial interest) for a reason unrelated to a pursuit of the corporation’s best interests”).

41. *Disney I*, 907 A.2d at 754; *see* *Nagy v. Bistricher*, 770 A.2d 43, 48 n.2 (Del. Ch. 2000) (finding that “regardless of his motive, a director who consciously disregards his duties to the corporation and its stockholders may suffer a personal judgment for monetary damages for any harm he causes,” even if for a reason “other than personal pecuniary interest”).

42. *RJR Nabisco, Inc.*, 1989 WL 7036, at *1159; *see* *Guttman v. Huang*, 823 A.2d 492, 506 n.34 (Del. Ch. 2003) (“The reason for the disloyalty (the faithlessness) is irrelevant, the underlying motive (be it venal, familial, collegial, or nihilistic) for conscious action not in the corporation’s best interest does not make it faithful, as opposed to faithless.”).

43. *See* *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) (noting that if “the transaction is not approved by a majority consisting of the disinterested directors, then the business judgment rule has no application”).

44. *See* *Gentile v. Rossette*, Civ. A. No. 20213-VCN, 2010 WL 2171613, at *7 n.36 (Del. Ch. May 28, 2010) (“A board that is evenly divided between conflicted and non-conflicted members is not considered independent and disinterested.”); *see also* *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1046 n.8 (Del. 2004) (noting for demand futility purposes that a board evenly divided between interested and disinterested directors could not exercise business judgment on a demand); *Beneville v. York*, 769 A.2d 80, 85 (Del. Ch. 2000) (same).

45. *Aronson*, 473 A.2d at 815 n.8 (“We recognize that drawing the line at a majority of the board may be an arguably arbitrary dividing point.”).

46. The exception is where a minority of the directors faces a material conflict of interest or other loyalty issue and fail to disclose their compromised

Consequently, to determine whether to escalate from the business judgment rule to entire fairness, a court counts heads.⁴⁷ If a director-by-director analysis leaves insufficient directors to make up a board majority, then the board cannot act as the qualified decision maker, and the court will review the board's decision for entire fairness. To reverse that process and reestablish the business judgment rule, the defendants must show that despite the failures identified by the plaintiff, there actually was a qualified decision maker, such as a board committee or the fully informed stockholders.

If a board of directors lacks an independent and disinterested majority, then the standard of review will de-escalate from entire fairness if the board exercised its authority under section 141(c) to empower a committee of independent and disinterested directors to make the relevant decision.⁴⁸ If the board delegates its full power to address an issue to a committee, then the judicial search for a qualified decision maker shifts from the board to the committee. The same principles that govern the inquiry at the board level apply at the committee level, and the court will determine whether there were sufficient directors who voted in favor of the decision to make up a disinterested, independent, and informed majority of the committee. So long as the board has not retained some residual approval right or otherwise limited the committee's authority, in which case the board's retention of a portion of its authority undermines the committee's ability to decide the issue and keeps the judicial focus on the board, then a decision made by a disinterested, independent, and informed majority of the committee receives business judgment deference.⁴⁹

status to the other directors. *See Technicolor Plenary IV*, 663 A.2d 1156, 1168 (Del. 1995). Under those circumstances, the other directors are not able to take into account the directors' conflicted status and become compromised themselves because they are not sufficiently informed.

47. *See Technicolor Plenary II*, 634 A.2d 345, 361, 364 (Del. 1993) (requiring director-by-director analysis); *Disney II*, 906 A.2d 27, 52 (Del. 2006) (affirming director-by-director analysis); *cf. Orman v. Cullman*, 794 A.2d 5, 25 n.50 (Del. Ch. 2002) (explaining that materiality is required for a breach of fiduciary duty claim but not for a violation of section 144 of the DGCL).

48. *See DEL. CODE ANN. tit. 8, § 141(c)* (West, Westlaw through 79 Laws 2014); *Aronson*, 473 A.2d at 813; *see also Oberly v. Kirby*, 592 A.2d 445, 467 (Del. 1991) ("The key to upholding an interested transaction is the approval of some neutral decision-making body.").

49. *See In re W. Nat'l Corp. S'holders Litig.*, No. 15927, 2000 WL 710192,

More importantly for present purposes, a compromised board can substitute the stockholders as the necessary qualified decision maker and, thereby, restore the protections of the business judgment rule. This alternative does not imply that an up-or-down vote by stockholders is the functional equivalent of the careful, deliberative investigation into and weighing of alternatives that should be the hallmarks of a board's decision-making process. Rather, it recognizes that the stockholders collectively are well-positioned to decide whether to endorse what the board did, and that for purposes of determining how easy it should be for a stockholder plaintiff to challenge the action taken by the board (i.e., to determine the standard of review), a court should take into account and defer to an uncoerced endorsement from fully informed, disinterested stockholders.⁵⁰

There is also an important caveat as to the legal implications of stockholder approval, which can have a variety of effects. A stockholder vote can validate an insufficiently authorized act that otherwise would be voidable.⁵¹ It also provides one of the statutory

at *27 (Del. Ch. May 22, 2000); *see also* *Puma v. Marriott*, 283 A.2d 693, 696 (Del. Ch. 1971).

50. There is a gut-level sense of fairness to this result. If the fully informed stockholders conclude collectively that they want an outcome, why should self-appointed stockholder plaintiffs be able to seek to hold directors liable for a decision that a majority of the stockholders endorsed? Absent disclosure violations or coercion, there is something contradictory about stockholders collectively saying, "Yes, I want this merger" and then for the stockholder plaintiffs to seek damages from the directors for having approved the deal and recommended it to the stockholders in the first place. An alternative means of addressing this concern would be to exclude consenting stockholders from the class, but that approach would be inconsistent with the democratic concept of majority rule. Rather than the stockholder vote acting as a vote, it would operate as a class action opt-out mechanism. To give effect to the vote *qua* vote (i.e., as a mechanism for democratic decision making), the vote must also have some effect on the dissenters. My thanks go to David McBride for raising these points.

51. Under Delaware law, insufficiently authorized acts can be either void or voidable. A void act is an action that is beyond the power of the corporation under any circumstances. *See* *Michelson v. Duncan*, 407 A.2d 211, 218–19 (Del. 1979) (distinguishing between void and voidable acts); *Solomon v. Armstrong*, 747 A.2d 1098, 1114 (Del. Ch. 1999) ("Void acts are those acts that the board, or more generally the corporation, has no implicit or explicit authority to undertake or those acts that are fundamentally contrary to public policy."). A voidable act is one that the corporation as an entity has the power to accomplish, but which the decision maker approving the transaction lacked the power to effectuate under the corporation's bylaws, certificate of incorporation, or the DGCL. *See* *Harbor*

safe harbors established by section 144 of the DGCL.⁵² And even when the subject matter is limited to the standard of review for a fiduciary challenge, stockholder approval can have different consequences depending on pertinent factors, such as whether the underlying claim alleges a breach of the duty of loyalty or care, and whether the corporation has a controlling stockholder or de facto controller.⁵³ Cases have also touched on the key difference addressed here: whether there should be a distinction between an organic vote and a voluntary vote.

But what has never been disputed is the effectiveness of so-called “classic” ratification in defeating a stockholder plaintiff’s

Fin. Partners v. Huizenga, 751 A.2d 879, 896 (Del. Ch. 1999) (explaining that voidable acts are ones that “the corporation can lawfully accomplish . . . if it does so in the appropriate manner”). “The practical distinction, for our purposes, is that voidable acts are susceptible to cure by [majority] shareholder approval while void acts are not.” *Michelson*, 407 A.2d at 219. I have added the word “majority” to the quotation from *Michelson* because it is customarily said (and the *Michelson* decision later noted) that certain categories of void acts, such as waste or matters that are *ultra vires*, can be approved by unanimous stockholder vote. *See id.* (“It is only where a claim of gift or waste of assets, fraud or [u]ltra vires is asserted that a less than unanimous shareholder ratification is not a full defense.”). To my mind, the latter is more akin to universal acquiescence by all possible stockholder plaintiffs. The act remains void, but there is no one left to challenge it.

52. At common law, an interested transaction between the corporation and one of its directors or officers was voidable. Blake Rohrbacher et al., *Finding Safe Harbor: Clarifying the Limited Application of Section 144*, 33 DEL. J. CORP. L. 719, 719 (2008). Section 144 was adopted to “rescue” such transactions “from per se voidability under the common law.” *Id.* at 720. Section 144 deals solely with the “problem of per se invalidity; that is, as addressing only the common law principle that interested transactions were entirely invalid and providing a road map for transactional planners to avoid that fate.” *In re Cox Commc’ns, Inc. S’holders Litig.*, 879 A.2d 604, 614–15 (Del. Ch. 2005). The separate determination of “when an interested transaction might give rise to a claim for breach of fiduciary duty—i.e., to a claim in equity—was left to the common law of corporations to answer.” *Id.* at 615. Notwithstanding its narrow purpose, and likely because approval by disinterested and independent directors, or by disinterested and independent stockholders, can be relevant to the common law fiduciary duty analysis, section 144 has “been misconstrued to provide business-judgment protection to transactions complying with its terms.” Rohrbacher, *supra*, at 746; *see also id.* at 741–46 (discussing cases interpreting section 144 beyond its limited scope). This overextension of section 144 is problematic because the standards for director approval and stockholder ratification under section 144 differ from the common law of fiduciary duty. *See id.* at 737–39.

53. *See infra* Part III.

claim for breach of fiduciary duty.⁵⁴ If the board makes a business decision on an issue within its authority and submits the matter to the stockholders for a voluntary vote, and if the stockholder vote is fully informed and noncoerced, then the resulting stockholder approval not only causes the business judgment rule to protect the board's decision, but also has the additional effect of barring a stockholder plaintiff from seeking to rebut the presumptions of the business judgment rule.⁵⁵ Under those circumstances, a court only will look to whether the decision served some rational business purpose, and because the stockholders already have approved it, a plaintiff will find it difficult to convince a court that no rational person could agree with the board's judgment.⁵⁶ In those circumstances, the stockholders collectively function as the qualified decision maker to which the reviewing court defers.⁵⁷

54. See *In re Wheelabrator Techs., Inc. S'holders Litig. (Wheelabrator II)*, 663 A.2d 1194, 1200 (Del. Ch. 1995).

55. See *id.* at 1200 (holding that "(1) the effect of the informed shareholder vote was to extinguish the plaintiffs' due care claim; (2) that vote did not operate either to extinguish the duty of loyalty claim (as defendants contend), or to shift to the plaintiffs the burden of proving that the merger was unfair (as plaintiffs contend); and (3) the effect of the shareholder vote in this case is to invoke the business judgment standard, which limits review to issues of gift or waste with the burden of proof resting upon the plaintiffs").

56. See *Harbor Fin. Partners*, 751 A.2d at 895, 901 (questioning "the vestigial right to prove that a transaction that a majority of fully informed, uncoerced independent stockholders approved by a non-unanimous vote was wasteful" and offering several convincing reasons that the doctrine has lost its utility, including the difficulty of "prov[ing] a waste or gift claim in the face of a decision by fully informed, uncoerced, independent stockholders to ratify the transaction," given that "[t]he test for waste is whether any person of ordinary sound business judgment could view the transaction as fair"); *Saxe v. Brady*, 184 A.2d 602, 612 (Del. Ch. 1962) (observing that stockholder vote approving transaction was "[s]urely . . . some indication" that terms of transaction were reasonable).

57. This article discusses the concept of stockholder approval in terms of a stockholder vote, which is the typical context in which the issue arises. Stockholders also can consent to a transaction by tendering their shares. See *Bershad v. Curtiss-Wright Corp.*, 535 A.2d 840, 842 (Del. 1987) (equating the act of "vot[ing] in favor of a merger" with tendering and "accept[ing] the benefits of the transaction"). If the first-step tender offer in a two-step transaction is conditioned on tenders of a majority of the outstanding shares, and if sufficient stockholders tender to satisfy the condition, then it should have the same effect as an affirmative stockholder vote. See *In re Orchid Cellmark Inc. S'holder Litig.*, Civ. A. No. 6373-VCN, 2011 WL 1938253, at *13 (Del. Ch. May 12, 2011) ("Tendering, of course, is a substitute for shareholder vote."); *Matador Capital Mgmt. Corp. v. BRC Holdings, Inc.*, 729 A.2d 280, 294 (Del. Ch. 1998) (recognizing that

B. *The Special Case of a Controlling Stockholder*

The Delaware Supreme Court has recognized a situation-specific exception to the general principle that the business judgment rule is rebutted by counting heads to determine if a qualified board majority exists. If the challenged transaction confers a unique benefit on a majority stockholder or other party that exercises de facto control over the corporation, then that decisional context triggers “the entire fairness standard *ab initio*.”⁵⁸

The presence of a controller creates a special case because the controller’s influence operates at both the board and stockholder levels. It is not uncommon for a controller to nominate a majority of the corporation’s directors. Agents, employees, and other fiduciaries of the controller, who serve on the corporation’s board, face a conflict of interest arising from their respective dual fiduciary statuses.⁵⁹ The controller’s influence also undercuts the independence of otherwise independent and disinterested directors, because the controller has the power to determine whether those individuals will remain directors.⁶⁰ At the stockholder level, the controller can simply dictate the outcome of a vote.⁶¹

stockholders were, as a practical matter, “being asked to decide to approve the sale of their corporation as a part of their decision whether or not to tender shares in the first-step tender offer”).

58. *Emerald Partners v. Berlin*, 787 A.2d 85, 93 (Del. 2001); *accord Kahn v. Lynch Commc’n Sys., Inc.*, 638 A.2d 1110, 1116 (Del. 1994).

59. *See generally Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983); *Gottlieb v. Heyden Chem. Corp.*, 91 A.2d 57, 58 (Del. 1952).

60. *See Kahn*, 638 A.2d at 1116 (“[I]n a merger between the corporation and its controlling stockholder—even one negotiated by disinterested, independent directors—no court could be certain whether the transaction terms fully approximate what truly independent parties would have achieved in an arm’s length negotiation.”). *But see Aronson v. Lewis*, 473 A.2d 805, 815–16 (Del. 1984) (presuming that independent directors are capable of exercising a disinterested business judgment in deciding whether to cause the company to sue a controlling stockholder).

61. *See Paramount Commc’ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 42–43 (Del. 1993) (“[S]tockholder votes are likely to become mere formalities where there is a majority stockholder. For example, minority stockholders can be deprived of a continuing equity interest in their corporation by means of a cash-out merger. Absent effective protective provisions, minority stockholders must rely for protection solely on the fiduciary duties owed to them by the directors and the majority stockholder, since the minority stockholders have lost the power to influence corporate direction through the ballot.” (citing *Weinberger*, 457 A.2d

Because the controller's influence operates at both the board and stockholder levels, neither a special committee nor a majority-of-the-minority vote, standing alone, is sufficient to sterilize the controller's influence and reestablish the presence of a qualified decision maker. A special committee alone is not sufficient because of the controller's influence over the members of the committee, whom the controller can remove using its stockholder-level authority. The controller also has special negotiating advantages, such as the ability to obtain information about the corporation through its agents and employees on the board or simply through its status as a dominant stockholder, the opportunity to time any transactional proposal advantageously, and the power to use its stockholder voting power or other rights to veto transactional alternatives to the controller's chosen transaction.⁶² If push comes to shove, the controller has the ability to neutralize or bypass the committee by using its board majority to push the transaction through or by taking a transaction directly to the stockholders.⁶³

An independent stockholder vote, implemented through, for example, a condition that a transaction with the controller be approved by a majority of the unaffiliated minority stockholders, is also not sufficient. The Delaware Supreme Court has held that

at 703)).

62. See, e.g., *Rabkin v. Phillip A. Hunt Chem. Corp.*, 498 A.2d 1099, 1103, 1107 (Del. 1985) (permitting fairness challenge to merger based on controller's allegedly unfair manipulation of the timing of the transaction); *Weinberger*, 457 A.2d at 711 (noting that factors affecting fairness include "questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained"); *In re Cox Commc'ns, Inc. S'holders Litig.*, 879 A.2d 604, 617 (Del. Ch. 2005) (positing that the entire fairness standard for controlling stockholder transactions rests on "a sincere concern that mergers with controlling stockholders involve an extraordinary potential for the exploitation by powerful insiders of their informational advantages and their voting clout").

63. See, e.g., *Kahn*, 638 A.2d at 1118 (noting that the controller threatened "to proceed with an unfriendly tender offer at a lower price" if the committee did not agree to a negotiated transaction); *In re Siliconix Inc. S'holders Litig.*, Civ. A. No. 18700, 2001 WL 716787, at *3-4 (Del. Ch. June 21, 2001) (noting that controller made no-premium exchange offer after failing to reach agreement with special committee over premium cash offer); see also *In re Ocean Drilling & Exploration Co. S'holders Litig.*, Civ. A. No. 11898, 1991 WL 70028, at *5 (Del. Ch. Apr. 30, 1991) (noting that special committee rejected merger proposal as unfair, and controller later proceeded with unilateral two-step freeze out that special committee recommended against in this pre-*Kahn* case).

minority stockholders face a threat of implicit coercion when voting on a controlling stockholder's proposal such that they cannot act freely and independently in the face of the controller:

Parent subsidiary mergers . . . are proposed by a party that controls, and will continue to control, the corporation, whether or not the minority stockholders vote to approve or reject the transaction. The controlling stockholder relationship has the potential to influence, however subtly, the . . . minority stockholders in a manner that is not likely to occur in a transaction with a noncontrolling party.

Even where no coercion is intended, shareholders . . . might perceive that their disapproval could risk retaliation of some kind by the controlling stockholder. For example, the controlling stockholder might decide to stop dividend payments or to effect a subsequent cash out merger at a less favorable price, for which the remedy would be time consuming and costly litigation. At the very least, the potential for that perception, and its possible impact upon a shareholder vote, could never be fully eliminated.⁶⁴

Even accepting that the minority stockholders can reject a controller's proposal, collective action problems prevent diffuse minority stockholders from bargaining affirmatively for better terms.⁶⁵

The Delaware Supreme Court has recognized that using either a special committee or a majority-of-the-minority vote provides some procedural protections and, therefore, warrants some change in the standard of review. But the high court has held that using only one of the protections will not restore the business judgment rule. Rather, the effect of using only one such device is to shift the burden of proof on the issue of fairness so that, instead of the defendants having to prove fairness, the plaintiffs have to prove unfairness.⁶⁶

64. *Kahn*, 638 A.2d at 1116 (quoting *Citron v. E.I. Du Pont de Nemours & Co.*, 584 A.2d 490, 502 (Del. Ch. 1990)).

65. *Cox Commc'ns*, 879 A.2d at 618 ("The active agency of centralized management to test the market and bargain is not something that the stockholders can do for themselves.").

66. *Williams v. Geier*, 671 A.2d 1368, 1382 (Del. 1996) (citing *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 937 (Del. 1985)); see *Kahn*, 638 A.2d at 1116-17. Recent case law has minimized the importance of the burden shift. See, e.g., *Ams.*

To reestablish the presence of a sufficiently qualified decision maker to restore business judgment deference, the controller must take affirmative steps, at the outset of the transaction process, to remove the potential taint at both the board and the stockholder levels. This requires that the transaction be both (1) negotiated and approved by a fully authorized special committee of independent directors and (2) conditioned on an affirmative vote of a majority of the minority stockholders. If the transaction incorporates both protections from the outset, then the business judgment standard of review presumptively applies.⁶⁷ This combination of requirements is designed “to mirror *both* elements of an arms’ length merger, *viz.* approval by disinterested directors *and* approval by disinterested stockholders.”⁶⁸ “If the transaction does not incorporate both protective devices, or if a plaintiff can plead particularized facts sufficient to raise a litigable question about the effectiveness of one of the devices, then the transaction [remains] subject to entire fairness review.”⁶⁹

C. *Moving In and Out of Enhanced Scrutiny*

Enhanced scrutiny, Delaware’s intermediate standard of review, is triggered by specific, readily identifiable situations in which the realities of the decision-making context can subtly undermine the decisions of even independent and disinterested directors. The Delaware Supreme Court first recognized the need for enhanced scrutiny in situations when a board resists a hostile takeover. In that scenario, there is an “omnipresent specter” that

Mining Corp. v. Theriault, 51 A.3d 1213, 1243 (Del. 2012) (“The failure to shift the burden is not outcome determinative under the entire fairness standard of review. . . . [T]he only ‘modest’ effect of the burden shift is to make the plaintiff prove unfairness under a preponderance of the evidence standard . . .”). An alternative approach that could further harmonize and simplify Delaware law would be for the Delaware Supreme Court to hold that using a single protective device lowers the standard of review one step from entire fairness to enhanced scrutiny, with the burden of proof remaining on the defendants to show that they achieved an outcome falling within a range of reasonableness. Using two protective devices would continue to lower the standard of review two steps from entire fairness to the business judgment rule.

67. *In re MFW S’holders Litig.*, 67 A.3d 496, 502 (Del. Ch. 2013), *aff’d*, – A.3d –, 2014 WL 996270 (Del. Mar. 14, 2014); *In re CNX Gas Corp. S’holders Litig.*, 4 A.3d 397, 412–13 (Del. Ch. 2010) (citing *Cox Commc’ns*, 879 A.2d at 606).

68. *CNX Gas*, 4 A.3d at 412 (citing *Cox Commc’ns*, 879 A.2d at 606).

69. *Id.* at 413 (citing *Cox Commc’ns*, 879 A.2d at 606).

target directors may be influenced by and act to further their own interests or those of incumbent management, “rather than those of the corporation and its shareholders.”⁷⁰

Directors facing a proxy contest have a similar positional conflict.

A candidate for office, whether as an elected official or as a director of a corporation, is likely to prefer to be elected rather than defeated. He therefore has a personal interest in the outcome of the election even if the interest is not financial and he seeks to serve from the best of motives.⁷¹

Enhanced scrutiny also applies in other situations where the law provides stockholders with a right to vote and the directors take action that intrudes on the space allotted for stockholder decision making.⁷²

Final-stage transactions for stockholders provide another situation where enhanced scrutiny applies.⁷³ Final-stage transactions give rise to what economists refer to as the last period problem.

Simply put, in a situation where parties expect to have repeated transactions, the recognition that a party who cheats in one transaction will be penalized by the other party in subsequent transactions reduces the incentive to cheat. However, when a transaction is the last (or only) in a series—that is, the final period—the incentive to cheat reappears because, by definition, the penalty for doing so has disappeared.⁷⁴

In the corporate context, the ability of managers to shirk or self-deal ordinarily is constrained not only by legal duties but also by a range of markets, including the product markets, capital

70. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985).

71. *Aprahamian v. HBO & Co.*, 531 A.2d 1204, 1206 (Del. Ch. 1987).

72. *See Mercier v. Inter-Tel (Del.), Inc.*, 929 A.2d 786, 804–10 (Del. Ch. 2007) (discussing the application of enhanced scrutiny to board action affecting stockholder voting); *State of Wis. Inv. Bd. v. Peerless Sys. Corp.*, Civ. A. No. 17637, 2000 WL 1805376, at *10–11 (Del. Ch. Dec. 4, 2000) (applying enhanced scrutiny to meeting adjournment that kept polls open for vote on increasing shares allocated to stock option plan).

73. *See McMullin v. Beran*, 765 A.2d 910, 918 (Del. 2000); *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986).

74. RONALD J. GILSON & BERNARD S. BLACK, *THE LAW AND FINANCE OF CORPORATE ACQUISITIONS* 720 (David L. Shapiro et al. eds., 2d ed. 1995). *See generally* Sean J. Griffith, *Deal Protection Provisions in the Last Period of Play*, 71 *FORDHAM L. REV.* 1899, 1942–53 (2003) (describing divergence of interests resulting from the last period problem).

markets, employment markets, and the market for corporate control. But when managers are in their final period, market consequences have less traction, making managers more likely to favor their own interests. In connection with a final-stage transaction,

the target corporation's board and management may demand side payments from the acquiror, thus effectively diverting a portion of the merger consideration from the shareholders to the management team. If the management team is able to protect the self-serving transaction with deal protection provisions, it will be further insulated from the disciplinary effect of the market for corporate control, leaving the outgoing management team free to serve their own self-interest with relative impunity.

In addition to the unrestrained pursuit of their own self-interest, directors and managers in the last period may depart from the best interests of the corporation and its shareholders due to a variety of non-pecuniary, but equally selfish, motivations. Directors and managers may favor one deal over another because it is more in line with their self image and view of the world or because it is more likely to cause them to be remembered fondly by employees or the business press.⁷⁵

The Delaware courts have held that at least three types of final-stage transactions carry the risk of subtle conflicts warranting enhanced scrutiny: "a cash sale, a break-up, or a transaction like a change of control that fundamentally alters ownership rights."⁷⁶ The Delaware Supreme Court also has held that the defensive aspects of a stock-for-stock merger agreement warrant enhanced scrutiny.⁷⁷

Only one Delaware Court of Chancery decision has held that an organic vote on a merger lowers the standard of review from enhanced scrutiny to the business judgment rule.⁷⁸ Nevertheless, as

75. Griffith, *supra* note 74, at 1947.

76. See, e.g., Lonergan v. EPE Holdings L.L.C., 5 A.3d 1008, 1019 (Del. Ch. 2010).

77. Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 934–36 (Del. 2003) (applying enhanced scrutiny to deal protection devices).

78. *In re* Lukens Inc. S'holders Litig., 757 A.2d 720, 736–38 (Del. Ch. 1999) (holding that fully informed stockholder vote on a merger triggered business judgment standard of review resulting in dismissal of claim that the directors of a corporation breached their duty of care in selling the corporation).

a matter of first principles, this makes sense. The stockholder collective functions as a qualified decision maker to which a court applying Delaware law should give deference. Nor should it matter whether the vote is voluntary or organic. As discussed, an organic vote lowers the standard of review from entire fairness to the business judgment rule when the corporation does not have a controlling stockholder or de facto controller.⁷⁹ An organic vote should have the same effect for enhanced scrutiny, which is a less intrusive, intermediate standard of review.

The Delaware Supreme Court precedent that most strongly supports this view is *Stroud v. Grace*.⁸⁰ The *Stroud* decision involved a family-owned, privately held Delaware corporation, Milliken Enterprises, Inc.⁸¹ Two different family factions had competing visions for Milliken. A faction that controlled a majority of the corporation's outstanding voting power proposed a package of charter and bylaw amendments that, among other things, imposed qualifications for service as a director and advanced notice requirements for stockholder-nominated candidates.⁸² Nine of Milliken's ten directors, including five out of six outside directors (unaffiliated with either faction) approved the amendments.⁸³ At the Milliken annual meeting, 97.8% of the shares entitled to vote were present, and 78.0% of the outstanding shares approved the amendments.⁸⁴ The minority faction—the Strouds—challenged the amendments, contending that they should be reviewed under the enhanced scrutiny test and that the board had breached its

79. See *Harbor Fin. Partners v. Huizenga*, 751 A.2d 879, 890 (Del. Ch. 1999); *Cole v. Nat'l Cash Credit Ass'n*, 156 A. 183, 187 (Del. Ch. 1931) (“As long as ‘[the directors] act in good faith, with honest motives, for honest ends,’ the exercise of their discretion will not be interfered with. . . . The same presumption of fairness that supports the discretionary judgment of the managing directors must also be accorded to the majority of stockholders whenever they are called upon to speak for the corporation in matters assigned to them for decision, as is the case at one stage of the proceedings leading up to a sale of assets or a merger.” (citation omitted)).

80. 606 A.2d 75 (Del. 1992).

81. *Id.* at 79.

82. *Id.*

83. *Id.* at 80.

84. *Id.* at 80–81.

fiduciary duties.⁸⁵ The Delaware Court of Chancery granted summary judgment in favor of the defendants.⁸⁶

On appeal, the Delaware Supreme Court affirmed the Delaware Court of Chancery's holding that enhanced scrutiny did not apply. In doing so, the Delaware Supreme Court gave dispositive effect to the stockholder vote. As the high court explained, "[i]nherent in [enhanced scrutiny] is a presumption that a board acted in the absence of an informed shareholder vote ratifying the challenged action."⁸⁷ Importantly, for mergers that are subject to enhanced scrutiny, the stockholder vote that the Delaware Supreme Court held dispositive in *Stroud* was required by section 242 of the DGCL.⁸⁸ The fact that section 242 required both prior board approval and subsequent stockholder approval did not alter the effect of the vote on the standard of review.⁸⁹

Further support for this view can be found in *Williams v. Geier*,⁹⁰ where the Delaware Supreme Court explained the importance of the organic vote on a charter amendment:

Like the statutory scheme relating to mergers under 8 *Del.C.* § 251, it is significant that two discrete corporate events must occur, in precise sequence, to amend the certificate of incorporation under 8 *Del.C.* § 242: First, the board of directors must adopt a resolution declaring the

85. *Id.* at 81.

86. *Id.*

87. *Id.* at 83.

88. *Id.* at 85.

89. *Id.* at 83–84. Although enhanced scrutiny did not apply because of the stockholder vote, the Delaware Supreme Court treated the majority faction as a controlling stockholder and proceeded to review the recapitalization for entire fairness. *Id.* at 91. Consistent with other Delaware Supreme Court precedent, the *Stroud* court held that the fully informed stockholder vote shifted the burden of proving unfairness to the plaintiff. *Id.* at 90 ("Since there was no breach of any fiduciary duty in connection with the shareholder vote at the 1989 annual meeting, a fully informed majority of the shareholders adopted the Amendments and effectively ratified the board's action. This shifts the burden of proof to the Strouds to prove that the transaction was unfair. They have utterly failed in that regard." (citing *Bershad v. Curtiss-Wright Corp.*, 535 A.2d 840, 846 (Del. 1987); *Smith v. Van Gorkom*, 488 A.2d 858, 890 (Del. 1985); *Weinberger v. UOP, Inc.*, 457 A.2d 701, 703 (Del. 1983); *Michelson v. Duncan*, 407 A.2d 211, 224 (Del. 1979); *Gottlieb v. Heyden Chem. Corp.*, 91 A.2d 57, 58–59 (Del. 1952); *Saxe v. Brady*, 184 A.2d 602, 610 (Del. Ch. 1962); *Gerlach v. Gillam*, 139 A.2d 591, 593 (Del. Ch. 1958))).

90. 671 A.2d 1368 (Del. 1996).

advisability of the amendment and calling for a stockholder vote. Second, a majority of the outstanding stock entitled to vote must vote in favor. The stockholders may not act without prior board action. Likewise, the board may not act unilaterally without stockholder approval. Therefore, the stockholders control their own destiny through informed voting.⁹¹

The supreme court described this procedure as “the highest and best form of corporate democracy.”⁹² The *Williams* court did not discount the quality of the vote because it was an organic requirement of the DGCL.⁹³

As noted, the Delaware Court of Chancery has held on at least one occasion that an organic vote on a merger reduces the standard of review from enhanced scrutiny to the business judgment rule.⁹⁴ More commonly, the Delaware Court of Chancery has simply deferred to the stockholder vote in situations where enhanced scrutiny applies. Numerous decisions have given deference to stockholder decision making when determining whether to issue an injunction against a pending merger *before* the stockholder vote has taken place.⁹⁵ This is because

91. *Id.* at 1381.

92. *Id.*

93. *See id.* at 1380–81.

94. *See In re Lukens Inc. S’holders Litig.*, 757 A.2d 720, 736–38 (Del. Ch. 1999) (holding that fully informed stockholder vote on a merger triggered business judgment standard of review resulting in dismissal of claim that the directors of a corporation breached their duty of care in selling the corporation).

95. *See, e.g., In re Delphi Fin. Grp. S’holder Litig.*, Civ. A. No. 7144-VCG, 2012 WL 729232, at *21 (Del. Ch. Mar. 6, 2012) (“Nonetheless, given that the meritorious allegations discussed above are remediable by damages, I find it in the best interests of the stockholders that they be given the opportunity to decide for themselves whether the Merger negotiated by Rosenkranz and the Director Defendants offers an acceptable price for their shares.”); *In re El Paso Corp. S’holder Litig.*, 41 A.3d 432, 434–35 (Del. Ch. 2012) (“Although the pursuit of a monetary damages award may not be likely to promise full relief, the record does not instill in me the confidence to deny, by grant of an injunction, El Paso’s stockholders from accepting a transaction that they may find desirable in current market conditions, despite the disturbing behavior that led to its final terms.”); *In re Cogent, Inc. S’holder Litig.*, 7 A.3d 487, 515 (Del. Ch. 2010) (“At the other end of the spectrum, where a selling Board’s alleged *Revlon* violations occur in the absence of another viable bid, this Court often finds injunctive relief to be inappropriate because it would be imprudent to terminate the only deal available, when the stockholders can make that decision for themselves.”); *In re Dollar Thrifty S’holder Litig.*, 14 A.3d 573, 618 (Del. Ch. 2010) (ruling that balance of

Delaware corporate law strives to give effect to business decisions approved by properly motivated directors and by informed, disinterested stockholders. By this means, our law seeks to balance the interest in promoting fair treatment of stockholders and the utility of avoiding judicial inquiries into the wisdom of business decisions. Thus, doctrines like ratification and acquiescence operate to keep the judiciary from second-guessing transactions when disinterested stockholders have had a fair opportunity to protect themselves by voting no.⁹⁶

Conversely, where there is coercion or a disclosure deficiency, the Delaware Court of Chancery will find irreparable harm and enjoin a transaction.⁹⁷ “By issuing an injunction requiring additional

harms tilted against injunction because stockholders could decide for themselves to vote deal down and take the chance of receiving an actionable higher bid); *In re Netsmart Techs. S’holders Litig.*, 924 A.2d 171, 208 (Del. Ch. 2007) (“[W]hen [the] court is asked to enjoin a transaction and another higher-priced alternative is not immediately available, it has been appropriately modest about playing games with other people’s [(i.e., the stockholders’)] money.”); *In re Pennaco Energy S’holders Litig.*, 787 A.2d 691, 715 (Del. Ch. 2001) (“After all, even when a sufficient merits showing is made by a plaintiff, this court is justifiably reluctant to enjoin a premium-generating transaction when no other option is available, except insofar as is necessary for the disclosure of additional information to permit stockholders to make an informed decision whether to tender.”).

96. *Netsmart*, 924 A.2d at 207.

97. *See, e.g., Berger v. Pubco Corp.*, Civ. A. No. 3414-CC, 2008 WL 2224107, at *4 (Del. Ch. May 30, 2008) (“A disclosure violation results in an irreparable injury, which implicates the jurisdiction of this Court.”), *rev’d on other grounds*, 976 A.2d 132 (Del. 2009); *Netsmart*, 924 A.2d at 207 (“[T]his court has typically found a threat of irreparable injury to exist when it appears stockholders may make an important voting decision on inadequate disclosures.”); *Allen v. News Corp.*, Civ. A. No. 969-N, 2005 WL 415095, at *1 (Del. Ch. Feb. 3, 2005) (“At this early stage, plaintiffs have demonstrated a ‘sufficiently colorable claim’ that the disclosures contained in News’ proxy materials are materially deficient or misleading and that there is a ‘possibility of a threatened irreparable injury,’ namely the loss of the ability by the Fox shareholders to have all pertinent information available at the time they decide whether to tender their shares into the exchange offer, if expedition is not granted.” (quoting *U.S. Surgical Corp. v. Circon Corp.*, Civ. A. No. 15223, 1997 WL 33175025, at *2 (Del. Ch. Sept. 17, 1997))); *In re MONY Grp. S’holder Litig.*, 852 A.2d 9, 18 (Del. Ch. 2004) (“This disclosure violation threatens irreparable harm because stockholders may vote ‘yes’ on a transaction they otherwise would have voted ‘no’ on if they had access to full or nonmisleading disclosures regarding the CICs.”); *ODS Techs., L.P. v. Marshall*, 832 A.2d 1254, 1262 (Del. Ch. 2003) (“The threat of an [uninformed] stockholder vote constitutes irreparable harm.”); *In re Pure Res., Inc., S’holders Litig.*, 808 A.2d 421, 452 (Del. Ch. 2002) (“[I]rreparable injury is threatened when

disclosure, the court gives stockholders the choice to think for themselves on full information, thereby vindicating their rights as stockholders to make important voting and remedial decisions based on their own economic self-interest.”⁹⁸ If stockholder voting did not have any pertinence in situations where enhanced scrutiny applies, it would be odd for judges to defer to the stockholder vote or to insist that it be fully informed. Instead, in situations governed by enhanced scrutiny, “Delaware corporation law gives great weight to informed decisions made by an uncoerced electorate.”⁹⁹ This deference implicitly recognizes the stockholders as qualified decision makers to which the court can defer.

Taken together, these authorities make a strong case in favor of a stockholder vote lowering the standard of review from enhanced scrutiny to the business judgment rule. The vote should have this effect regardless of whether or not it is required by the DGCL.¹⁰⁰

IV. POTENTIAL IMPEDIMENTS

The logical implications of a fully informed stockholder vote encounter potential impediments in the Delaware Supreme Court’s decisions in *In re Santa Fe Pacific Corp. Shareholder Litigation*¹⁰¹ and *Gantler v. Stephens*.¹⁰² If read broadly, *Santa Fe* appears to hold that

a stockholder might make a tender or voting decision on the basis of materially misleading or inadequate information.”).

98. *Netsmart*, 924 A.2d at 207.

99. *In re Lear Corp. S’holder Litig.*, 926 A.2d 94, 114 (Del. Ch. 2007).

100. This article addresses only the doctrinal question of whether stockholders can act as qualified decision makers for purposes of changing the standard of review. It does not attempt to operationalize the doctrine by articulating the requirements for stockholders to act as qualified decision makers, such as whether the denominator should be the shares outstanding, versus only those voting, or whether shares held by particular individuals or entities, such as shares owned by the directors, should be excluded from the vote. *See, e.g., In re John Q. Hammons Hotels Inc. S’holder Litig.*, Civ. A. No. 758-CC, 2009 WL 3165613, at *12–13 (Del. Ch. Oct. 2, 2009) (holding that majority-of-the-minority vote that could be waived by a special committee and that required a majority of the shares voting rather than the shares outstanding would not affect the standard of review). At a minimum, the stockholder approval must be fully informed and free of any coercion. *See, e.g., In re MFW S’holders Litig.*, 67 A.3d 496, 502 (Del. Ch. 2013), *aff’d*, – A.3d –, 2014 WL 996270 (Del. Mar. 14, 2014); *Hammons Hotels*, 2009 WL 3165613, at *12 n.38.

101. 669 A.2d 59 (Del. 1995).

102. 965 A.2d 695 (Del. 2009).

when enhanced scrutiny applies to a board decision, stockholder approval is not sufficient to reduce the standard of review to the business judgment rule, unless stockholders are given a specific, unbundled vote on the defensive measures otherwise subject to enhanced scrutiny. *Gantler* can be read as potentially limiting the effect of stockholder approval even further. An aggressive interpretation of *Gantler* might suggest that if a stockholder vote is required organically by the DGCL, it cannot alter the standard of review.

These readings of *Santa Fe* and *Gantler* ignore their placement within a lengthy line of Delaware decisions that have attempted to correct confusing language about ratification that appeared in *Smith v. Van Gorkom*.¹⁰³ The Delaware Supreme Court's most recent pronouncement in *Gantler* is best understood as rejecting earlier loose usages of ratification and limiting that term to the effect of a stockholder vote not otherwise required by the DGCL on a voidable act.¹⁰⁴ *Gantler* leaves open the possibility that stockholder approval, even in the form of an organic vote required by the DGCL, will reduce the standard of review from enhanced scrutiny to the business judgment rule.

A. Santa Fe

Santa Fe grew out of a battle for control of Santa Fe Industries, a publicly traded Delaware corporation “with interests in railway transportation and petroleum pipelines.”¹⁰⁵ In June 1994, Santa Fe entered into a merger agreement with Burlington Northern, Inc., another railroad company, that contemplated a stock-for-stock merger between the two corporations.¹⁰⁶ The original transaction would have provided Santa Fe stockholders with Burlington stock with a market value of approximately \$13.50 per share.¹⁰⁷ The original merger agreement contained a force-the-vote provision and did not permit Santa Fe to terminate the merger agreement to

103. *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985), *overruled in part by Gantler*, 965 A.2d at 713 n.54.

104. *Gantler*, 965 A.2d at 713.

105. *Santa Fe*, 669 A.2d at 63.

106. *Id.*

107. *Id.*

accept a superior proposal, although the board could change its merger recommendation.¹⁰⁸

Union Pacific Corporation then contacted Santa Fe and proposed a combination of its own.¹⁰⁹ The Union Pacific proposal would have provided Santa Fe stockholders with Union Pacific stock with a market value of approximately \$18.00 per share, 33.0% more than the Burlington proposal.¹¹⁰ The Santa Fe board rejected the proposal because of inadequacy of price, antitrust concerns, and the board's determination that "Santa Fe was prevented by the First Merger Agreement from considering the Union Pacific offer. Santa Fe also refused to provide Union Pacific with non-public information to assess the value of Santa Fe."¹¹¹ Santa Fe and Burlington also responded by increasing the exchange ratio in their merger agreement so that Santa Fe stockholders would receive Burlington stock with a market value of approximately \$17.00 per share.¹¹² Union Pacific countered by increasing its offer to 0.407 shares of stock, worth approximately \$20.00 per share, and proposing to establish a voting trust to address the antitrust risk.¹¹³

When Santa Fe continued to refuse to engage, Union Pacific launched a cash tender offer for 57.1% of Santa Fe's outstanding shares at \$17.50 per share, to be followed by a second-step merger in which Santa Fe stockholders would receive 0.354 shares of Union Pacific stock.¹¹⁴ Union Pacific also received preliminary approval for its voting trust structure.¹¹⁵ The Santa Fe board nevertheless recommended that stockholders not tender their shares to Union Pacific, and Santa Fe's CEO advised Union Pacific that "Santa Fe was not for sale."¹¹⁶

The Santa Fe board then adopted a rights plan with a 10.0% trigger.¹¹⁷ Santa Fe and Burlington also amended their merger agreement to (1) make the exchange ratio still more favorable to Santa Fe; (2) pay a fifty million dollar termination fee to

108. *Id.*

109. *Id.*

110. *Id.*

111. *Id.*

112. *Id.* at 64.

113. *Id.*

114. *Id.*

115. *Id.*

116. *Id.*

117. *Id.*

Burlington if Santa Fe accepted a higher offer; and (3) commence a joint tender offer for up to 33.0% of Santa Fe's common stock, with Burlington purchasing up to 13.0% and Santa Fe up to 20.0% of the Santa Fe shares.¹¹⁸ Burlington would own 16.0% of the outstanding shares of Santa Fe if the joint offer were fully completed.¹¹⁹

Union Pacific again raised the price of its tender offer, this time to \$18.50 per share.¹²⁰ The Santa Fe board again recommended against the offer, and Burlington and Santa Fe revised their merger agreement to allow Santa Fe to purchase up to ten million shares *after* the joint tender offer and before the merger.¹²¹ Santa Fe also amended its rights plan to allow Allegheny Corporation to purchase up to 14.9% of Santa Fe shares without triggering the rights and announced that Allegheny had agreed to vote in favor of the Santa Fe-Burlington merger.¹²² The proposed Allegheny purchases, the joint tender offer, and the repurchase program would place 33.0% of the shares of Santa Fe in the hands of parties committed to the Burlington-Santa Fe merger.¹²³

Union Pacific and various Santa Fe stockholder plaintiffs sued in the Delaware Court of Chancery to challenge the actions of the Santa Fe board.¹²⁴ The court of chancery twice declined to expedite the proceedings, initially ruling that the challenge came too soon, then subsequently ruling that the challenge came too late.¹²⁵ Stymied, Union Pacific withdrew its offer and dropped its lawsuit, leaving the stockholder litigants as the only plaintiffs.¹²⁶ After the Santa Fe stockholders approved the merger, the plaintiffs amended their complaint to allege that the Santa Fe board had breached its fiduciary duties when reviewed under enhanced scrutiny and failed to disclose all material facts in connection with the merger vote.¹²⁷

118. *Id.*

119. *Id.*

120. *Id.* at 65.

121. *Id.*

122. *Id.*

123. *Id.*

124. *Id.*

125. *Compare* Union Pac. Corp. v. Santa Fe Pac. Corp., No. 13778, 1994 WL 586924 (Del. Ch. Oct. 18, 1994), *with In re* Santa Fe Pac. Corp. S'holder Litig., No. 13778, 1995 WL 54428 (Del. Ch. Jan. 30, 1995).

126. *Santa Fe*, 669 A.2d at 65.

127. *Id.*

The Delaware Court of Chancery dismissed the complaint as failing to state a claim on which relief could be granted.¹²⁸ The court of chancery found that the fully informed stockholder vote extinguished any claim that the board breached its duty of care.¹²⁹ The court of chancery held that the plaintiffs' challenges to the actions taken by the Santa Fe board to defend against the competing Union Pacific deal implicated the duty of loyalty and were not extinguished by a fully informed stockholder vote.¹³⁰ The court dismissed those claims on the merits on the grounds that enhanced scrutiny did not apply to a stock-for-stock merger.¹³¹

On appeal, the Delaware Supreme Court affirmed the dismissal of the disclosure claims, thereby determining that the vote was fully informed.¹³² The plaintiffs did not appeal from the Delaware Court of Chancery's ruling that the fully informed stockholder vote extinguished any claims that the Santa Fe board breached its duty of care.¹³³ The defendants argued that the stockholder vote also extinguished any loyalty-based challenge to the Santa Fe board's actions.¹³⁴ The supreme court rejected this argument.¹³⁵

Initially, the Delaware Supreme Court declined to determine whether the actions of the Santa Fe board should be categorized as breaches of loyalty or care, stating "*Revlon* and *Unocal* and the duties of a Board when faced with a contest for corporate control do not admit of easy categorization as duties of care or loyalty."¹³⁶ The supreme court posited that "[i]n any event, categorizing these more specific duties as primarily arising from due care or loyalty would not be nearly as helpful in determining the effect of a fully-informed stockholder vote as would an examination of their underlying purposes."¹³⁷

On this latter point, the Delaware Supreme Court ruled as follows:

128. *Id.* at 62.

129. *Id.* at 67.

130. *Id.*

131. *Id.* at 68.

132. *Id.* at 67.

133. *Id.*

134. *Id.*

135. *Id.*

136. *Id.*

137. *Id.*

Permitting the vote of a majority of stockholders on a merger to remove from judicial scrutiny *unilateral* Board action in a contest for corporate control would frustrate the purposes underlying [enhanced scrutiny]. Board action which coerces stockholders to accede to a transaction to which they otherwise would not agree is problematic. Thus, enhanced judicial scrutiny of Board action is designed to assure that stockholders vote or decide to tender in an atmosphere free from undue coercion.

In voting to approve the Santa Fe-Burlington merger, the Santa Fe stockholders were not asked to ratify the Board's unilateral decision to erect defensive measures against the Union Pacific offer. The stockholders were merely offered a choice between the Burlington Merger and doing nothing. The Santa Fe stockholders did not vote in favor of the precise measures under challenge in the complaint. Here, the defensive measures had allegedly already worked their effect before the stockholders had a chance to vote. In voting on the merger, the Santa Fe stockholders did not specifically vote in favor of the Rights Plan, the Joint Tender or the Termination Fee.¹³⁸

The supreme court concluded that “[s]ince the stockholders of Santa Fe merely voted in favor of the merger and not the defensive measures, we decline to find ratification in this instance.”¹³⁹

The Delaware Supreme Court then proceeded to review the actions of the Santa Fe board under the enhanced scrutiny standard.¹⁴⁰ In examining the defensive actions taken by the Santa Fe board, the supreme court noted that “[t]his case differs from cases where the presumption of the business judgment rule attaches *ab initio* and to survive a Rule 12(b)(6) motion, a plaintiff must allege well-pleaded facts to overcome the presumption.”¹⁴¹ The court quoted the following allegation from the complaint:

The Individual Defendants breached their fiduciary duties of loyalty and care by proceeding with and completing the Joint Offer, which placed approximately 16% ownership in the hands of BNI, adopting the Poison

138. *Id.* at 68 (emphasis added).

139. *Id.*

140. *Id.*

141. *Id.* at 71.

Pill and applying it in a discriminatory manner by exempting its application as to one bidder but maintaining it as to all other interested parties, amending the Poison Pill to allow Allegheny to increase its ownership of Santa Fe to 14.9%, and authorizing the Repurchase Program.¹⁴²

The court then observed that:

The complaint does not admit that the Board had proper grounds for its decision. Nor does the Board enjoy a presumption to that effect. The complaint does not adopt as true the facts set forth in the Proxy Statement. Thus, without benefit of the Joint Proxy, the Board cannot rely on any allegations of the complaint to meet its burden under *Unocal* and *Unitrin* to come forward with evidence supporting the reasonableness of its perception of the threat posed by Union Pacific and the proportionality of the response thereto.¹⁴³

Having made these preliminary rulings, the Delaware Supreme Court reversed the Delaware Court of Chancery's dismissal of the complaint with the following caution:

This case may very well illustrate the difficulty of expeditiously dispensing with claims seeking enhanced judicial scrutiny at the pleading stage where the complaint is not completely conclusory. . . . Here, there are well-pleaded allegations on the *Unocal* claim. As the terminology of enhanced judicial scrutiny implies, boards can expect to be required to justify their decisionmaking, within a range of reasonableness, when they adopt defensive measures with implications for corporate control. This scrutiny will usually not be satisfied by resting on a defense motion merely attacking the pleadings.¹⁴⁴

The court remanded the case for further proceedings.¹⁴⁵

Under *Santa Fe*, it would appear that enhanced scrutiny will continue to apply "at the pleading stage," notwithstanding a fully informed stockholder vote.¹⁴⁶ It also would appear that the burden would remain on the directors "to justify their decisionmaking,

142. *Id.* at 71–72.

143. *Id.* at 72.

144. *Id.*

145. *Id.* at 73.

146. *Id.* at 72.

within a range of reasonableness, when they adopt defensive measures with implications for corporate control,” regardless of whether those defensive measures were separate from the merger agreement, such as the rights plan and joint tender, or part of the merger agreement itself, such as the termination fee.¹⁴⁷ It would further seem that the pleading burden in such a case “differs from cases where the presumption of the business judgment rule attaches *ab initio* and to survive a Rule 12(b)(6) motion, a plaintiff must allege well-pleaded facts to overcome the presumption.”¹⁴⁸

Another of *Santa Fe*'s teachings would appear to be that “the duties of a Board when faced with a contest for corporate control do not admit of easy categorization as duties of care or loyalty.”¹⁴⁹ The ambiguity results from the fact that the same types of defensive devices can be used for good (e.g., to enhance stockholder value) or for ill (e.g., as entrenchment measures or to steer a deal to a favored bidder), and that until there is an opportunity to hear evidence and take the case beyond the pleadings stage, it would be impossible for a court to make a motive-based distinction. Moreover, at the pleadings stage, the plaintiff is entitled to all reasonably conceivable inferences, and Delaware Court of Chancery Rule 8(b) provides that motive can be pleaded generally.¹⁵⁰

The Delaware Supreme Court has never explicitly called into question, much less overruled these aspects of *Santa Fe*. As long as they remain good law, the case stands as an apparent impediment to the view that a fully informed stockholder vote on a merger otherwise subject to enhanced scrutiny causes the transaction to be reviewed under the business judgment rule.

B. Gantler

The *Gantler* decision arguably takes matters further than *Santa Fe*. *Gantler* involved a challenge to a reclassification that would uniquely benefit the incumbent board members of First Niles Financial, Inc.¹⁵¹ In 2003 the board of directors of First Niles

147. *Id.*

148. *Id.* at 71.

149. *Id.* at 67.

150. See DEL. CT. CH. R. 8(a); Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Holdings L.L.C., 27 A.3d 531, 536 (Del. 2011).

151. *Gantler v. Stephens*, 965 A.2d 695, 704 (Del. 2009).

“decided that First Niles should put itself up for sale.”¹⁵² Management disagreed, arguing against a sale and in favor of delisting the company from NASDAQ, reincorporating in Maryland, and continuing to operate as a standalone entity.¹⁵³ The board initially declined to pursue management’s proposal, opting instead to retain an investment advisor and solicit third-party bids.¹⁵⁴

Three potential acquirers submitted bid letters.¹⁵⁵ Farmers National Banc Corp. made a proposal, but stated in its bid letter that it had no plans to retain the First Niles board.¹⁵⁶ Both the Delaware Supreme Court and the Delaware Court of Chancery cited this fact and noted that “the Board did not further pursue the Farmers’ offer.”¹⁵⁷ Cortland Bancorp offered consideration of \$18.00 per share, comprised of forty-nine percent in cash and fifty-one percent in stock.¹⁵⁸ First Place Financial Corp. proposed an all-stock transaction valued at \$18.00 to \$18.50 per share.¹⁵⁹ The investment advisor opined that all three bids were within the range of value suggested by its financial models.¹⁶⁰ Management again proposed its privatization strategy.¹⁶¹

The board instructed management to provide due diligence to Cortland and First Place, but management dragged its feet during due diligence.¹⁶² Cortland withdrew.¹⁶³ First Place increased the value of exchange offer.¹⁶⁴ The board’s financial advisor described the offer “in positive terms.”¹⁶⁵ According to the Delaware Supreme Court’s decision, “[w]ithout any discussion or deliberation . . . the

152. *Id.* at 700.

153. *Id.*

154. *Id.*

155. *Id.*

156. *Id.*

157. *Id.* Neither decision describes the terms of the Farmers proposal. The complaint did not describe it either.

158. *Id.*

159. *Id.*

160. *Id.*

161. *Id.*

162. *Id.*

163. *Id.*

164. *Id.* at 701.

165. *Id.*

Board voted 4 to 1 to reject that offer.”¹⁶⁶ Management then renewed its privatization proposal in modified form.¹⁶⁷

Under the new privatization proposal, holders of 300 or fewer shares would have their shares converted into Series A Preferred Stock on a one-to-one basis.¹⁶⁸ The Series A Preferred Stockholders would receive a higher dividend than the common stock holders, but would not have any preference on liquidation.¹⁶⁹ The Series A Preferred Stockholders also would not have any voting rights except in connection with a sale of the company.¹⁷⁰ Management argued that the privatization proposal

was the best method to privatize the Company because it allowed maximum flexibility for future capital management activities, such as open market purchases and negotiated buy-backs. Moreover, First Niles could achieve the Reclassification without having to buy back shares in a fair market appraisal.¹⁷¹

Several months later, the board approved the reclassification proposal substantially in the form proposed by management.¹⁷²

Because the reclassification required a charter amendment, section 242 of the DGCL mandated that the proposal receive stockholder approval.¹⁷³ A majority of the outstanding shares (57.30%) approved the transaction.¹⁷⁴ After taking judicial notice of the voting counts, the Delaware Court of Chancery determined that 50.28% of the unaffiliated shares voted in favor.¹⁷⁵ For a range of reasons, including the doctrine of ratification, the court of chancery held that the complaint challenging the reclassification failed to state a claim for breach of fiduciary duty.¹⁷⁶

166. *Id.*

167. *Id.*

168. *Id.*

169. *Id.*

170. *Id.*

171. *Id.*

172. *Id.* at 702.

173. DEL. CODE ANN. tit. 8, § 242 (West, Westlaw through 79 Laws 2014).

174. *Gantler*, 965 A.2d at 703.

175. *Id.*; *see also* *Gantler v. Stephens*, Civ. A. No. 2392-VCP, 2008 WL 401124, at *16–17 (Del. Ch. Feb. 14, 2008) (calculating 50.28% figure as a percentage of the unaffiliated shares outstanding).

176. *See Gantler*, 2008 WL 401124, at *23.

On appeal, the Delaware Supreme Court reversed the Delaware Court of Chancery's ratification ruling.¹⁷⁷ The Delaware Supreme Court found that the complaint pled material misrepresentations, but also held that "because a shareholder vote was required to amend the certificate of incorporation, that approving vote could not also operate to 'ratify' the challenged conduct of the interested directors."¹⁷⁸

Justice Jacobs authored the appellate decision.¹⁷⁹ While serving as a Vice Chancellor in 1995, Justice Jacobs had authored another influential opinion, known as *Wheelabrator II*, that identified various difficulties in Delaware's stockholder approval jurisprudence.¹⁸⁰ The *Wheelabrator II* opinion traced these difficulties¹⁸¹ to the Delaware Supreme Court's decision in *Van Gorkom*, where the defendant directors argued to the Delaware Supreme Court that "the stockholders' 'overwhelming' vote approving the Pritzker Merger Agreement had the legal effect of curing any failure of the Board to reach an informed business judgment in its approval of the merger."¹⁸² Agreeing with this legal proposition but not its application on the facts, the Delaware Supreme Court observed that "[t]he parties tacitly agree that a discovered failure of the Board to reach an informed business judgment in approving the merger constitutes a voidable, rather than void, act."¹⁸³ Unfortunately, this language confusingly implied that a care-based challenge to a decision that the board undeniably had the power to make implicated the quite different concepts of voidness and voidability. The *Van Gorkom* decision reinforced this implication by stating that "[h]ence, the merger can be sustained, notwithstanding the infirmity of the Board's action, if its approval by majority vote of the shareholders is found to have been based on an informed electorate."¹⁸⁴ But as *Wheelabrator II* explained, a more

177. *Gantler*, 965 A.2d at 699.

178. *Id.* at 712.

179. *Id.* at 698.

180. See *Wheelabrator II*, 663 A.2d 1194 (Del. Ch. 1995).

181. *Id.* at 1200.

182. *Smith v. Van Gorkom*, 488 A.2d 858, 889 (Del. 1985), *overruled in part by Gantler*, 965 A.2d at 713 n.54.

183. *Id.*

184. *Id.* In fairness to the *Van Gorkom* court, there was linguistic precedent for using the concepts of voidness and voidability to refer to fiduciary breaches. In its 1979 decision in *Michelson v. Duncan*, the Delaware Supreme Court suggested that a board decision made in bad faith and not in the best interests of the corporation

fundamental problem with *Van Gorkom* was simply the terminology that the Delaware Supreme Court used when discussing the effectiveness of the vote, which repeatedly included the terms “ratify” and “ratification.”¹⁸⁵

In *Wheelabrator II*, then-Vice Chancellor Jacobs criticized *Van Gorkom*’s imprecise use of the term “shareholder ratification” and argued for the need to distinguish between (1) ratification in its “‘classic’ or paradigmatic form,” which “describes the situation where shareholders approve board action that, legally speaking, could be accomplished without any shareholder approval,” and (2) “the effect of an informed shareholder vote that was statutorily required for the transaction to have legal existence.”¹⁸⁶ Justice Jacobs nevertheless implied that a stockholder vote would have the

was “void.” 407 A.2d 211, 218–19 (Del. 1979). Delaware Court of Chancery decisions have picked up on this language by describing decisions tainted by breaches of the duty of loyalty as “void” and decisions tainted by breaches of the duty of care as “voidable.” See, e.g., *Solomon v. Armstrong*, 747 A.2d 1098, 1114 (Del. Ch. 1999) (citing *Michelson* and *Van Gorkom* in support of this distinction); *Apple Computer, Inc. v. Exponential Tech., Inc.*, No. 16315, 1999 WL 39547, at *6–7 (Del. Ch. Jan. 21, 1999) (citing *Michelson*). I personally understand the concepts of voidness and voidability to be directed towards whether the corporate actor had authority to make the challenged decision under the DGCL, charter, or bylaws. If the authority exists, then a fiduciary challenge could result in an order rescinding the action and declaring it invalid, but it would not be either voidable or void. The concepts are inapt for fiduciary analysis, where the question is not whether the board had the power to act, but rather whether the board exercised its power equitably. Put differently, using Professor Berle’s concept of “twice tested” actions, the issues of voidness and voidability go to the first (legal) test, not to the second (equitable) test. See generally Adolph A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1049 (1931) (“[I]n every case, corporate action must be twice tested: first, by the technical rules having to do with the existence and proper exercise of the power; second, by equitable rules somewhat analogous to those which apply in favor of a *cestui que trust* to the trustee’s exercise of wide powers granted to him in the instrument making him a fiduciary.”).

185. *Van Gorkom*, 488 A.2d at 890. The Delaware Supreme Court wrote:

The settled rule in Delaware is that “where a majority of fully informed stockholders ratify action of even interested directors, an attack on the ratified transaction normally must fail.” The question of whether shareholders have been fully informed such that their vote can be said to ratify director action, “turns on the fairness and completeness of the proxy materials submitted by the management to the . . . shareholders.”

Id. (quoting *Gerlach v. Gillam*, 139 A.2d 591, 593 (Del. Ch. 1958); *Michelson*, 407 A.2d at 220).

186. *Wheelabrator II*, 663 A.2d 1194, 1201–03, n.4 (Del. Ch. 1995).

same legal effect “irrespective of whether that shareholder vote is legally required for the transaction to attain legal existence.”¹⁸⁷ In other words, although different terminology should be used to describe the legal effect, an organic vote could change the standard of review.

In *Gantler*, quoting extensively from his decision in *Wheelabrator II*, Justice Jacobs observed on behalf of the Delaware Supreme Court that the doctrine of ratification “might be thought to lack coherence because the decisions addressing the effect of shareholder ‘ratification’” had used the term in different ways.¹⁸⁸ There was ratification in its “classic” form, which described a situation where stockholders approved board action that, “legally speaking, could be accomplished without any shareholder approval.”¹⁸⁹ But there were also cases that used the term “to describe the effect of an informed shareholder vote that was statutorily required for the transaction to have legal existence.”¹⁹⁰

Speaking for the unanimous court, Justice Jacobs stated that going forward, only “classic” ratification would be recognized:

To restore coherence and clarity to this area of our law, we hold that the scope of the shareholder ratification doctrine must be limited to its so-called “classic” form; that is, to circumstances where a fully informed shareholder vote approves director action that does *not* legally require shareholder approval in order to become legally effective. Moreover, the only director action or conduct that can be ratified is that which the shareholders are specifically asked to approve. With one exception, the “cleansing” effect of such a ratifying shareholder vote is to subject the challenged director action to business judgment rule, as opposed to “extinguishing” the claim altogether (*i.e.*, obviating all judicial review of the challenged action).¹⁹¹

The *Gantler* decision expressly overruled *Van Gorkom* “[t]o the extent that [it] holds otherwise.”¹⁹²

187. *Id.* at 1201 n.4.

188. *Gantler v. Stephens*, 965 A.2d 695, 713 (Del. 2009) (quoting *Wheelabrator II*, 663 A.2d at 1201–02, n.4).

189. *Id.* (quoting *Wheelabrator II*, 663 A.2d at 1201–02, n.4).

190. *Id.* (quoting *Wheelabrator II*, 663 A.2d at 1201–02, n.4).

191. *Id.*

192. *Id.* at 713 n.54.

Consistent with his discussion in *Wheelabrator II*, Justice Jacobs explained that nothing in *Gantler* “should be read as altering the well-established principle that void acts such as fraud, gift, waste and ultra vires acts cannot be ratified by a less than unanimous shareholder vote.”¹⁹³ Justice Jacobs also explained that nothing in *Gantler* was “intended to affect or alter our jurisprudence governing the effect of an approving vote of disinterested shareholders under [section 144].”¹⁹⁴

Applying these principles, the Delaware Supreme Court rejected the Delaware Court of Chancery’s dismissal of the challenge to the reclassification:

The Court of Chancery held that although Count III of the complaint pled facts establishing that the Reclassification Proposal was an interested transaction not entitled to business judgment protection, the shareholders’ fully informed vote “ratifying” that Proposal reinstated the business judgment presumption. That ruling was legally erroneous . . . [T]he ratification doctrine does not apply to transactions where shareholder approval is statutorily required. Here, the Reclassification could not become legally effective without a statutorily mandated shareholder vote approving the amendment to First Niles’ certificate of incorporation. . . . Therefore, the approving shareholder vote did not operate as a “ratification” of the challenged conduct in any legally meaningful sense.¹⁹⁵

The supreme court held that the complaint sufficiently alleged that a majority of the board was interested in the reclassification, that entire fairness therefore applied, and that the complaint could not be dismissed.¹⁹⁶

If read in isolation, *Gantler* might be construed to suggest by negative implication that an organic vote required by the DGCL does not have any effect on an underlying fiduciary challenge or the applicable standard of review. If interpreted in that fashion, then *Gantler* could be seen as broadening *Santa Fe*, rather than limiting it, so that after *Gantler*, the stockholder vote addressed in *Santa Fe* would not even cleanse a challenge to the merger price.

193. *Id.*

194. *Id.*

195. *Id.* at 714.

196. *Id.*

C. *A Quarter Century of Effort at Clarification*

Rather than being seen as holding that an organic vote cannot affect the standard of review, *Gantler* should be seen as a definitive step in a quarter century of judicial effort to clarify *Van Gorkom*'s loose language about stockholder ratification. As then-Vice Chancellor Jacobs explained in *Wheelabrator II*, Delaware decisions addressing stockholder voting sometimes conflated separate issues or deployed unclear terminology, such as (1) using the term "ratification" to refer to an organic vote, (2) referring to board decisions involving a breach of fiduciary duty as void, (3) importing concepts and procedures from the safe harbor of section 144, and (4) speaking in terms of claims being extinguished or barred in their entirety.¹⁹⁷ In *Wheelabrator II*, Justice Jacobs distinguished between stockholder votes that were not required for the corporate action to be effective, which he termed "classic ratification," and organic votes, which should not be termed ratification.¹⁹⁸ Again, and critically, the *Wheelabrator II* decision indicated that a stockholder vote would have the same legal effect "irrespective of whether that shareholder vote is legally required for the transaction to attain legal existence."¹⁹⁹

After *Wheelabrator II*, the Delaware Supreme Court and the Delaware Court of Chancery made attempts to address the confusion in this area. In *Williams v. Geier*,²⁰⁰ the Delaware Supreme Court sought to eliminate any confusion over the use of the term "ratification." Plainly cognizant of *Wheelabrator II*, which it cited, the Delaware Supreme Court carefully distinguished between (1) "cases . . . where stockholders are called upon to ratify action which may involve a transaction with an interested director or where the transaction approved by the board may otherwise be voidable," and (2) cases involving "the effect of corporate action which, in order to become operative, requires and receives both approval by the board of directors and stockholders."²⁰¹ The *Williams* case involved a challenge to a charter amendment, so the Delaware Supreme Court "put to one side" the first category of cases, which it described as "not relevant" and "entirely

197. *Wheelabrator II*, 663 A.2d 1194, 1200–05 (Del. Ch. 1995).

198. *Id.* at 1201 n.4.

199. *Id.*

200. 671 A.2d 1368 (Del. 1996).

201. *Id.* at 1379.

different.”²⁰² In a footnote, the *Williams* court took on the question of terminology:

The term “ratification” is, in the dictionary sense, a generic term connoting official approval, confirmation or sanction. Thus, it is not incorrect to consider broadly that stockholder approval in either sense may be called “ratification.” But where the organic act (such as those occurring under Section 242) necessarily requires stockholder approval for its effectuation, it may be preferable to employ the statutory usage—*viz.*, “to vote in favor” or, simply, stockholder approval.²⁰³

The Delaware Supreme Court did not, however, take action beyond expressing this cautionary note.

Next came Chancellor Allen’s opinion in *Lewis v. Vogelstein*.²⁰⁴ Like *Williams* and *Wheelabrator II*, *Lewis* began by distinguishing the stockholder vote at issue from “those instances in which shareholder votes are a necessary step in authorizing a transaction.”²⁰⁵ The *Lewis* case challenged a stock option plan under which the members of the board of Mattel, Inc. would receive options.²⁰⁶ The board indisputably had the power to adopt the plan without a stockholder vote, but the board had obtained a vote regardless.²⁰⁷ Chancellor Allen made clear that “the law of ratification as here discussed has no direct bearing on shareholder action to amend a certificate of incorporation or bylaws; nor does that law bear on shareholder votes necessary to authorize a merger, a sale of substantially all the corporation’s assets, or to dissolve the enterprise.”²⁰⁸

Initially, Chancellor Allen held that absent the vote, the standard of review would be entire fairness with the burden of proof on the defendants.²⁰⁹ He then explained the four possible

202. *Id.*

203. *Id.* at 1379 n.24.

204. 699 A.2d 327 (Del. Ch. 1997).

205. *Id.* at 334.

206. *Id.* at 329.

207. *Id.* at 330.

208. *Id.* at 334 (comparing this case to *Williams*, 671 A.2d 1368).

209. *Id.* at 333 (“As the Plan contemplates grants to the directors that approved the Plan and who recommended it to the shareholders, we start by observing that it constitutes self-dealing that would ordinarily require that the directors prove that the grants involved were, in the circumstances, entirely fair to the corporation.”).

effects that the stockholder vote on an interested transaction could have:

First, one might conclude that an effective shareholder ratification acts as a complete defense to any charge of breach of duty. *Second*, one might conclude that the effect of such ratification is to shift the substantive test on judicial review of the act from one of fairness . . . to one of waste. *Third*, one might conclude that the ratification shifts the burden of proof of unfairness to plaintiff, but leaves that shareholder-protective test in place. *Fourth*, one might conclude (perhaps because of great respect for the collective action disabilities that attend shareholder action in public corporations) that shareholder ratification offers no assurance of assent of a character that deserves judicial recognition.²¹⁰

The Chancellor observed that “[e]xcepting the fourth of these effects, there are cases in this jurisdiction that reflect each of these approaches.”²¹¹

After broadly surveying the concept of ratification and its origins, Chancellor Allen held that the effect of the stockholder vote approving the option plan was to extinguish any challenge to the plan other than on grounds of waste.²¹² He nevertheless denied the motion to dismiss, finding that the directors’ grants of options to themselves seemed at the pleadings stage “sufficiently unusual to require the court to refer to evidence before making an adjudication of their validity and consistency with fiduciary duty.”²¹³

210. *Id.* at 334.

211. *Id.*

212. *Id.* at 338.

213. *Id.* at 339. Notably, Chancellor Allen’s list of alternatives in *Lewis v. Vogelstein* did not identify the possibility that the stockholder vote could change the standard of review from entire fairness to the business judgment rule, at which point the plaintiff would have the burden to rebut one of its presumptions. Presumably this was because the plaintiffs in *Lewis* easily could have rebutted the presumption of loyalty: because all of the directors would receive options under the plan they approved, they were interested in that decision. If the effect of the vote was merely to restore the business judgment rule but then to allow the plaintiff to overcome the rule by pleading the same director interest that was disclosed to stockholders, then the vote would have no effect at all.

It might seem that this analytical problem could be sidestepped by requiring the plaintiff to plead a different basis, other than the disclosed conflicts, to rebut the presumptions of the business judgment rule. In other words, to give the vote meaning, a plaintiff would not be able to rely on the disclosed conflict. But if the

Wheelabrator II, *Williams*, and *Lewis* settled for a time the taxonomy of stockholder approval under Delaware law. The cases enforced the traditional meaning of ratification, limited it to voluntary votes, and sharply distinguished voluntary votes from organic votes. But the cases did not hold that an organic vote would have no effect. To the contrary, *Wheelabrator II* recognized that a stockholder vote would have the same effect “irrespective of whether that shareholder vote is legally required for the transaction to attain legal existence.”²¹⁴

The next generation of Delaware Court of Chancery opinions, however, did not maintain the careful distinction in terminology.²¹⁵ In *General Motors Class H*, the court of chancery declined to distinguish between a voluntary vote and an organic vote.²¹⁶ The case involved a vote on a charter amendment pursuant to section 242 of the DGCL, but the opinion used the language of ratification and described the organic vote as operating to “bar” claims for breaches of care and loyalty.²¹⁷ Similarly in *Harbor Finance Partners v.*

plaintiff would have to identify an undisclosed conflict, then the vote would not have any effect in the first place because it would not be fully informed. Consequently, the practical effect of restoring business judgment review is to change the standard of review to one of waste, as Chancellor Allen’s list suggested.

214. *Wheelabrator II*, 663 A.2d 1194, 1201 n.4 (Del. Ch. 1995).

215. See, e.g., *In re Lear Corp. S’holder Litig.*, 926 A.2d 94, 114–15 (Del. Ch. 2007) (addressing effect of organic merger vote and stating “[w]hen disinterested stockholders make a mature decision about their economic self-interest, judicial second-guessing is almost completely circumscribed by the doctrine of ratification”); *In re PNB Holding Co. S’holders Litig.*, Civ. A. No. 28-N, 2006 WL 2403999, at *14 (Del. Ch. Aug. 18, 2006) (considering merger and explaining that “outside the *Lynch* context, proof that an informed, non-coerced majority of the disinterested stockholders approved an interested transaction has the effect of invoking business judgment rule protection for the transaction and, as a practical matter, insulating the transaction from revocation and its proponents from liability”); *In re Lukens Inc. S’holders Litig.*, 757 A.2d 720, 736–38 (Del. Ch. 1999) (using language of ratification in holding that fully informed stockholder vote approving a merger otherwise subject to enhanced scrutiny restored business judgment standard of review and resulted in dismissal of complaint); *Solomon v. Armstrong*, 747 A.2d 1098, 1115–17 (Del. Ch. 1999) (explaining that when a transaction requires an organic vote under the DGCL, “shareholder ratification can have a penetrating legal effect,” to wit “an informed and uncoerced shareholder vote on the matter provides an independent reason to maintain business judgment protection for the board’s acts”).

216. *In re General Motors Class H S’holders Litig.*, 734 A.2d 611, 612–13 (Del. Ch. 1999).

217. *Id.* at 616. The *General Motors Class H* decision distinguished *Santa Fe* as a

Huizenga,²¹⁸ the court of chancery gave ratifying effect to an organic vote required by section 251.²¹⁹

The author of both decisions, then-Vice Chancellor Strine, noted in *Harbor Finance* that he was “keenly aware that ‘classic ratification’ involves the ‘voluntary addition of an independent layer of shareholder approval in circumstances where such approval is not legally required.’”²²⁰ Nevertheless, “[f]or want of better nomenclature” he used the term to describe “a stockholder vote sufficient to invoke the business judgment rule standard of review,” which would include a statutorily required stockholder vote.²²¹

Against this background, *Gantler* appears to be an effort to return to the taxonomy of *Wheelabrator II*, *Williams*, and *Lewis* by reestablishing the sharp distinction in terminology that was suggested in *Wheelabrator II*. Only the effect of a voluntary vote is properly termed “ratification,” and the effect of the vote is to “subject the challenged director action to business judgment review.”²²² Read in this fashion, *Gantler* does not imply that an organic vote has no effect. It rather recognizes that whatever the effect may be, it is not properly called ratification. As in *Williams*, voluntary vote cases and organic vote cases are “entirely different” and “not relevant” to each other.²²³

By contrast, if *Gantler* actually held that an organic vote cannot affect the standard of review, then the decision would have represented a radical break with precedent. For the price of clarifying the linguistic confusion that *Van Gorkom* created, the decision would have overruled the parade of precedents—including *Wheelabrator II*—that held that an organic vote does affect the standard of review. Nothing about *Gantler* suggests an intention

case involving a situation where “the defendants are attempting to use the stockholder vote to insulate themselves from responsibility for decisions not directly at issue in the vote.” *Id.* at 617. The decision also distinguished situations where there are “concerns about ‘implied coercion’ such as has been found to exist where a controlling stockholder dominates the corporation.” *Id.*

218. 751 A.2d 879 (Del. Ch. 1999).

219. *Id.* at 881.

220. *Id.* at 900 n.78 (quoting *Wheelabrator II*, 663 A.2d 1194, 1201–02, n.4 (Del. Ch. 1995)).

221. *Id.*

222. *Gantler v. Stephens*, 965 A.2d 695, 713 (Del. 2009).

223. *Williams v. Geier*, 671 A.2d 1368, 1379 (Del. 1996); see *supra* text accompanying notes 201–03.

to overrule so many cases or such a significant aspect of Delaware doctrine. To the contrary, it appears that *Gantler* intended to elevate the trial court level discussion in *Wheelabrator II* to the status of authoritative Delaware Supreme Court precedent.

Gantler's treatment of *Santa Fe* similarly indicates that the Delaware Supreme Court did not intend to suggest that an organic vote cannot affect the standard of review. Recall that in *Santa Fe*, the Delaware Supreme Court agreed that the organic vote on the Santa Fe-Burlington merger provided grounds for dismissing the complaint to the extent it alleged claims that the board breached its duty of care.²²⁴ If the *Gantler* court intended that an organic vote could never affect the standard of review, then the *Gantler* decision would have overruled *Santa Fe* on this issue, just as it overruled *Van Gorkom*. Instead, the *Gantler* decision cited *Santa Fe* with approval in support of the proposition that “the only director action or conduct that can be ratified is that which the shareholders are specifically asked to approve.”²²⁵ In a footnote, the *Gantler* decision stated:

We previously so held in [*Santa Fe*], which involved a claim that by adopting defensive measures to block an unsolicited takeover bid, the directors of the target corporation breached their fiduciary duties. The Court of Chancery held that that claim had been extinguished by the “ratifying” shareholder vote approving a subsequent merger of the target corporation. Reversing that ruling, this Court held that “[s]ince the stockholders of Santa Fe merely voted in favor of the merger and not the defensive measures, we decline to find ratification in this instance.”²²⁶

The *Gantler* court did not hold that the *Santa Fe* decision’s analysis of the effect of the organic approval required for the merger was otherwise wrong.

Most tellingly, Justice Jacobs included a footnote in *Gantler* that took pains to explain the confirmatory nature of the decision: “This Opinion clarifies that ‘ratification’ legally describes only corporate action where stockholder approval is not statutorily required for its effectuation.”²²⁷ Consistent with the clarifying nature of the

224. *In re Santa Fe Pac. Corp. S’holder Litig.*, 669 A.2d 59, 67 (Del. 1995).

225. *Gantler*, 965 A.2d at 713.

226. *Id.* at 713 n.53 (quoting *Santa Fe*, 669 A.2d at 68).

227. *Id.* at 714 n.55.

decision, Justice Jacobs went out of his way to explain that the *Gantler* opinion did not alter Delaware law regarding the unanimous approval standard for ratifying fraud, gift, waste, or *ultra vires* acts, nor stockholder approval jurisprudence under section 144.²²⁸ It would be strange to think that despite these careful efforts, the Delaware Supreme Court intended to hold that stockholder approval of a merger could have no effect on the standard of review. Subsequent Delaware Court of Chancery decisions have not interpreted *Gantler* as having this implication.²²⁹

Viewed from this perspective, *Gantler* is primarily a decision about terminology—which is not to minimize its importance. Language matters greatly in law. As Chancellor Allen once noted, “in the law, to an extent present in few other human institutions, there may be in the long run as much importance ascribed to the reasoning said to justify action, as there is in the actions themselves.”²³⁰ On two other occasions, the Delaware Supreme Court has gone out of its way to alter terminology. In *Stroud v. Grace*, the Delaware Supreme Court rejected the term “duty of candor,” which Delaware decisions frequently deployed, finding that it had “no well accepted meaning in the disclosure context” and that “[i]ts use is both confusing and imprecise.”²³¹ The *Stroud* opinion instructed courts to instead “speak of a duty of disclosure based on a materiality standard.”²³² In *Arnold v. Society for Saving Bancorp*,²³³ the Delaware Supreme Court made a similar effort to squash colloquial phrases like “*Revlon* duties” and “*Revlon*-land,”

228. *Id.* at 713 n.54.

229. See *In re Morton’s Rest. Grp., Inc. S’holders Litig.*, 74 A.3d 656, 663 n.34 (Del. Ch. 2013) (“[I]t is plain that, when disinterested approval of a sale to an arm’s-length buyer is given by a majority of stockholders who have had the chance to consider whether or not to approve a transaction for themselves, there is a long and sensible tradition of giving deference to the stockholders’ voluntary decision, invoking the business judgment rule standard of review, and limiting any challenges to the difficult argument that the transaction constituted waste.”); *In re S. Peru Copper Corp. S’holder Derivative Litig.*, 52 A.3d 761, 793 n.113 (Del. Ch. 2011) (expressing the view that in the absence of a majority stockholder or de facto controller, “the approval of an uncoerced, disinterested electorate of a merger (including a sale) would have the effect of invoking the business judgment rule standard of review”).

230. *In re RJR Nabisco, Inc. S’holders Litig.*, Civ. A. No. 10389, 1989 WL 7036, at *1156 n.13 (Del. Ch. Jan. 31, 1989).

231. 606 A.2d 75, 84 (Del. 1992).

232. *Id.*

233. 650 A.2d 1270 (Del. 1994).

describing them as inappropriate references “to the enhanced scrutiny courts accord to certain types of transactions.”²³⁴ *Gantler* appears to be a similar attempt to clarify an area of the law by starting with terminology.

V. CONCLUSION

Delaware decisions identify certain specific, recurring, and readily identifiable situations that call for enhanced scrutiny—Delaware’s intermediate standard of review. The Delaware courts’ recognition that particular scenarios require more careful judicial review than business judgment deference does not trump the foundational premise of judicial deference to a qualified corporate decision maker. If a fully informed and disinterested stockholder majority votes in favor of a transaction otherwise subject to enhanced scrutiny, then the business judgment rule should become the operative standard of review. This is true regardless of whether the vote is an organic requirement of the DGCL or a voluntary addition. Any complaint challenging such a transaction should no longer benefit from enhanced scrutiny’s reasonableness standard or the shifting of the burden of proof to the defendants. Instead, the plaintiff should be required to plead facts sufficient to overcome the business judgment rule’s presumptions.

234. *Id.* at 1289 n.40.