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Delaware as Deal Arbiter

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Delaware as Deal Arbiter

Christina M. Sautter*

Abstract

Most would agree that the Delaware courts are the leading jurists in the resolution of corporate conflicts, particularly in the Mergers & Acquisitions (M&A) context. Arguably a greater role that Delaware plays is that of a norm setter, both with respect to the expectations of management conduct in the M&A process and with respect to deal terms, particularly deal protection devices. Like in any relationship, there is a "give and take" between practitioners and Delaware. That is, practitioners are "on the front lines," often innovating with respect to new deal structures and deal terms. After some time, Delaware has the opportunity to review these innovations. As the Delaware courts render decisions, they comment on behavior in the deal process and on the legality of contractual provisions. In turn, practitioners take heed. They not only comply with these deal norms but, at least in the context of deal protection devices, they slowly push the boundaries. Delaware tends not to take issue with this boundary pushing as practitioners are largely complying with deal norms. This Article examines this relationship between practitioners and Delaware and argues that this circular effect has had the

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* Cynthia Felder Fayard Professor of Law, Byron R. Kantrow Professor of Law, & Vinson & Elkins Professor of Law, Louisiana State University Paul M. Hebert Law Center. This article was developed for the *Washington and Lee Law Review* 2019–2020 Lara D. Gass Symposium, *The Changing Role of Delaware in Corporate Governance*. I am thankful to the *Washington and Lee Law Review* and Professor Carliss Chatman for the invitation and for the opportunity to still publish this article despite the necessary cancellation of the Symposium. Thank you to Jessica Erickson and Jay Mirostaw for their very helpful comments. Last, but certainly not least, thank you to my research assistant, Addison Hollis, and to Todd Venie, Assistant Dean and Director of the LSU Law Center Library, for their invaluable research assistance.

result of eroding the very enhanced scrutiny standards which the courts have announced.

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I. Introduction

> arbiter
> *n.* a person or force that settles a dispute or has ultimate authority in a matter . . . . (usu. arbiter of) someone whose views or actions have great influence over trends in social behavior: *an arbiter of taste*
> —The Oxford Dictionary of Difficult Words[1]

There is no question that judges and the courts are considered the epitome of arbiters. The Delaware Supreme Court and Delaware Court of Chancery are no exception with many considering the Delaware courts the ultimate arbiters of corporate law.[2] The uniqueness of Delaware courts and their expertise in the resolution of transactional law disputes, particularly arising from Mergers & Acquisitions (M&A) deals,

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1. *Arbiter*, THE OXFORD DICTIONARY OF DIFFICULT WORDS 29 (OXFORD UNIV. PRESS 2004).

2. *See* Randy J. Holland, *Delaware's Business Courts: Litigation Leadership*, 34 J. CORP. L. 771, 771–72 (2009)

> Delaware's courts offer litigants a forum with an extensive and well-developed jurisprudence that creates predictability and expediency in adjudication, allowing for efficient business planning. Delaware's independent judiciary is essential to securing these values, and its practice of appointing judges and maintaining a balance of power between political parties on its high court has yielded dividends in both the expertise and independence of its judiciary.

See also William H. Rehnquist, *The Prominence of the Delaware Court of Chancery in the State-Federal Joint Venture of Providing Justice*, 48 BUS. LAW. 351, 354 (1992)

> In light of its 200 year history, the Delaware Court of Chancery deserves our celebration, not only as a unique and vibrant Delaware institution, but as an important contributor to our national system of justice. The Delaware state court system has established its national preeminence in the field of corporation law due in large measure to its Court of Chancery.

Joseph R. Slights III & Elizabeth A. Powers, *Delaware Courts Continue to Excel in Business Litigation with the Success of the Complex Commercial Litigation Division of the Superior Court*, 70 BUS. LAW. 1039, 1039 (2015) ("Over its more than two-hundred-year history, Delaware's Court of Chancery has emerged as the world's most respected forum for adjudicating highly complex business disputes.").

has been well documented.[3] However, the Delaware courts' role in M&A goes well beyond having the final "power to decide disputes" arising from these transactions.[4] The judicial opinions rendered by the Delaware courts have not only announced intermediate and enhanced scrutiny standards but, possibly more importantly, have strongly hinted at the types of conduct which may or may not be acceptable in the negotiation of a transaction.[5] As a result, Delaware[6] has strongly influenced both the behavior of dealmakers[7] as well as the contractual provisions to which dealmakers agree. In other words, Delaware is an arbiter in every sense of the word—it is not only settling disputes but also setting deal norms.

In setting deal norms, there is a "give and take" relationship between dealmakers and Delaware.[8] That is, practitioners are "on the front lines," often innovating with respect to new deal structures and deal terms. After some time, Delaware has the

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3. *See* Matthew D. Cain & Steven M. Davidoff, *Delaware's Competitive Reach*, 9 J. EMP. LEGAL STUD. 92, 96 (2012) (concluding through empirical analysis that Delaware dominates the law and adjudication of merger agreements in economically significant transactions); John C. Coates, IV & John F. Cogan, Jr., *Managing Disputes Through Contract: Evidence from M&A*, 2 HARV. BUS. L. REV. 295, 298 (2012) (finding that Delaware dominates as the choice of forum in M&A agreements involving publicly traded companies); Jill E. Fisch, *Leave it to Delaware: Why Congress Should Stay out of Corporate Governance*, 37 DEL. J. CORP. L. 731, 774 (2013) (explaining that recent studies have found that Delaware dominates as the choice of forum in M&A agreements).

4. *Arbiter*, MERRIAM-WEBSTER DICTIONARY (12th ed. 2019).

5. See *infra* Part IV.B for a discussion of these opinions.

6. Throughout this Article, Delaware will be used to refer generally to the Delaware courts, specifically the Delaware Supreme Court and the Delaware Court of Chancery.

7. For purposes of this Article, the term "dealmaker" will generally refer to those individuals largely responsible for the negotiation of M&A transactions, particularly the attorneys who are tasked with advising management, structuring the transaction, and drafting the ultimate deal terms.

8. *See* James D. Cox, *How Understanding the Nature of Corporate Norms Can Prevent Their Destruction by Settlements*, 66 DUKE L.J. 501, 513 (2016) ("The court's conclusions, which usually follow a narrative for the corporate actors' behavior, signal what practices are acceptable and unacceptable, and communicate the norms that are indeed shared by others in the belief group.").

opportunity to review these innovations. As the Delaware courts render decisions, they comment on behavior in the deal process and on the legality of contractual provisions.[9] In turn, practitioners take heed. They not only comply with these deal norms but, at least in the context of deal protection devices, they slowly push the boundaries. Delaware tends not to take issue with this boundary pushing as practitioners are largely complying with deal norms. But the circular effect of this symbiotic relationship has had the result of eroding the very enhanced scrutiny standards which the courts have announced.

This Article begins to track the effect that Delaware courts have had on dealmaking since the 1980s. In particular, this Article argues that, although the Delaware courts have announced enhanced or stricter scrutiny standards in the context of many mergers and acquisitions, in application the courts have evolved to a general reasonableness standard.[10] Instead of enforcing enhanced standards, the courts utilize their opinions to signal best practices in dealmaking.[11] Practitioners have responded by operating pursuant to a set of norms in both the deal process and the deal terms. Generally, as long as deals reflect these norms, the courts will uphold the transactions and deal terms as reasonable.[12]

Part II of this Article will examine social norms in the corporate context and describes the differences between obligational and nonobligational norms. Part III of this Article will recap the deal environment in the 1970s and 1980s prior to Delaware's announcement of enhanced scrutiny standards in the M&A context. In addition, this section will briefly examine the business and legal communities' reactions to leveraged buyouts, management-led buyouts, and hostile takeovers. Part IV of this Article will summarize Delaware case law announcing enhanced scrutiny standards. Perhaps more importantly, this Part will also discuss the norms the Delaware courts developed in announcing these enhanced scrutiny standards and will

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9. *See id.* (commenting that judicial opinions provide a "mechanism by which corporate actors receive social cues").

10. *See infra* Parts V.A., V.B.

11. *See infra* Part IV.B.

12. *See infra* Parts IV.B., V.A., V.B.

examine dealmakers' reaction to these standards. Then Part V will briefly review the progeny of this case law to demonstrate how the Delaware courts have moved to a general reasonableness standard which, in turn, has permitted dealmakers to adopt more intricate and more severe deal protection devices.

II. Corporate Norms

As an arbiter, one of Delaware's greatest contributions to M&A dealmaking has been Delaware's ability to "influence social behavior" in dealmaking.[13] That is, over the past three decades, Delaware has developed a comprehensive set of norms which attorneys have utilized in advising boards regarding fiduciary duties and in negotiating deal terms, particularly deal protection devices.[14] In describing the role of courts in resolving corporate disputes generally, Professor James Cox describes courts as "norm engineers."[15] He compares judicial opinions to "sermon[s] on the good, the bad, and the ugly."[16] These sermons convey a set of norms which become perpetuated through constant dealmaking. Prior to tackling the development of these dealmaking norms, however, I must first address the structure of social norms generally in corporate law. This Article will follow Professor Melvin Eisenberg's social norm framework which breaks norms down into obligational social norms and nonobligational social norms.[17]

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13. *Arbiter*, THE OXFORD DICTIONARY OF DIFFICULT WORDS 29 (OXFORD UNIV. PRESS 2004).

14. *See infra* Part IV.

15. Cox, *supra* note 8, at 514.

16. *Id.*

17. *See* Melvin A. Eisenberg, *Corporate Law and Social Norms*, 99 COLUM. L. REV. 1253, 1257–62 (1999) (characterizing norms as obligational or nonobligational). Other corporate law scholars have used differing terminology for norms. For example, Professor Cox divides corporate norms into aspirational norms and arbiter norms. Cox, *supra* note 8, at 514–21. He provides the business judgment rule and the materiality standard as examples of aspirational norms as they "exist because they are believed to best serve societal objectives." *Id.* at 519. On the other hand, arbiter norms "serve a quite different purpose: providing a party with a means to involve a court and

A. Obligational Social Norms

Obligational social norms are practices that individuals feel required to obey even though the practice is not a legally enforceable rule.[18] To determine whether a norm is obligational in nature, one may examine "whether a departure from the norm is likely to involve either self-criticism or criticism by others."[19] In Eisenberg's framework, obligational norms further break down into internalized obligational norms and noninternalized social norms.[20]

Just as the term suggests, internalized obligational norms are norms that individuals have internalized.[21] In other words, these are norms that become a part of one's character and prevent an individual from engaging in certain behavior or cause the individual to take some action.[22] As Eisenberg says, some things are "simply not done" while others are "simply done."[23] For example, moral norms are internalized obligational norms but internalized obligational norms are not confined to just moral norms.[24] Although, internalized obligational norms also "shape an actor's social character."[25] Eisenberg provides the example of not picking pockets as an internalized moral norm

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thereby obtain an impartial assessment of distinct transactions." *Id.* Cox uses the *Revlon* doctrine as an example of an arbiter norm. *Id.* at 519–20. The *Revlon* doctrine as a norm will be discussed more in Part IV.B.3 of the Article. In contrast, Professors Edward Rock and Michael L. Wachter utilized the term "nonlegally enforceable rules and standards" in their 2001 article exploring corporate norms. *See* Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619, 1641 (2001) (defining "nonlegally enforceable rules and standards").

18. *See* Eisenberg, *supra* note 17, at 1257 (discussing the different categories of social norms).

19. *Id.*

20. *See id.* at 1258–61 (comparing internalized norms to noninternalized norms).

21. *Id.* at 1258–59.

22. *See id.* (explaining that some norms prevent actions even when an individual would obtain some benefit from taking the benefit and some norms encourage some actions).

23. *Id.* at 1259.

24. *Id.*

25. *Id.*

while dressing formally for the opening night of the Metropolitan Opera would be an internalized obligational norm that is not moral in nature.[26]

Whether a party complies with a noninternalized obligational norm is a result of a cost-benefit analysis resulting from noncompliance.[27] More specifically, individuals will weigh the costs resulting from nonadherence, which may include "loss of reputation, including diminished esteem, public shame (as opposed to feeling ashamed), and disdain."[28] An individual will compare these costs to the benefits of adherence, which may include "enhanced reputation, including increased esteem, public recognition, and social acceptance."[29] Despite these differences between internalized and noninternalized obligational norms, Eisenberg argues that in order for a norm to persist, enough individuals in a group must ultimately internalize the norm.[30]

B. Nonobligational Social Norms

Nonobligational social norms represent practices that someone "ought" to do.[31] Eisenberg describes these as "behavioral patterns or practices" which either may or may not be "self-consciously adhered to" but which are not obligational in nature.[32] Nonobligational norms include patterns of conduct or certain routines, such as taking vitamins each morning.[33] They further include certain usages in language.[34] For example, with respect to the usage of terms in language, in the context of

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26. *Id.*
27. *Id.*
28. *Id.* at 1260.
29. *Id.*
30. *Id.* at 1261.
31. *Id.*
32. *Id.* at 1256.
33. *Id.*
34. *Id.* Eisenberg provides an example from the Restatement (Second) of Contracts, which explains that "San Domingo mahogany" is a term used in the mahogany industry to describe high quality mahogany of a "certain density." *Id.* However, San Domingo mahogany does not come from San Domingo. *Id.* Hence, the use of the term is a nonobligational norm. *Id.* at 1256–57.

deal protection devices, we refer to provisions prohibiting companies from actively soliciting, negotiating with, and providing information to third parties unless a target board's fiduciary duties so require as no shop provisions.[35] But as a technical matter, these contractual clauses include several different provisions: no shops (the anti-solicitation portion); no talks (the anti-negotiation and provision of information portion); and fiduciary outs (the portion allowing for negotiations if a board's fiduciary duties would so provide).[36] Through the repeated use of the term "no shop provision," dealmakers know that they are referring to not just anti-solicitation clauses but also to the no talk and fiduciary out clauses which virtually always appear with anti-solicitation clauses. Hence, using the term "no shop provision" is a nonobligational norm.

Eisenberg has noted that most legal and economics scholars have focused almost exclusively on obligational norms.[37] But, by focusing so narrowly on obligational norms, he argues that scholars miss the impact that nonobligational norms have on allowing certain behavior to take place.[38] More specifically,

35. *See, e.g.*, *No-Shops and Their Exceptions*, THOMSON REUTERS: PRACTICAL LAW (referring to covenants preventing the solicitation of other bids, the provision of information to other bidders, and the negotiation with other bidders as no shops) (on file with the *Washington and Lee Law Review*).

36. *See* Christina M. Sautter, *Shopping During Extended Store Hours: From No Shops to Go-Shops—the Development, Effectiveness, and Implications of Go-Shop Provisions in Change of Control Transactions*, 73 BROOK. L. REV. 525, 534–35 (2008) (explaining the technical differences between no shops and no talks and further explaining the role of fiduciary outs). Even more technically, a no shop provision paired with a fiduciary out is a window shop provision. *Id.* at 534. As I have described in a previous article, fiduciary out provisions may be drafted broadly like the one in the text which allows action when a board's fiduciary duties would require it. *See* Christina M. Sautter, *Rethinking Contractual Limits on Fiduciary Duties*, 38 FLA. ST. U. L. REV. 55, 80–83 (2010) (describing broad fiduciary outs in the context of a board's recommendation to the shareholders). But they also can be drafted more narrowly and allow action if there is a superior offer or an intervening event or even more narrowly and allow action only if there is a superior offer. *See id.* at 83–87 (describing narrower fiduciary outs).

37. *See* Eisenberg, *supra* note 17, at 1261 (comparing obligational norms to legal rules).

38. *See id.* at 1262 (providing different examples to show the effect nonobligational norms have on behavior).

certain patterns of behavior become socially permissible because of the prevalence of that behavior.[39] Finally, although social norms may be divided into obligational and nonobligational, norms are not necessarily so easily classifiable. That is, many norms could be both obligational and nonobligational in nature.[40] To explain these two types of norms, Eisenberg used the example of the hand signal used to hitchhike.[41] The usage of such a hand signal is a nonobligational norm.[42] However, if a hitchhiker finds that they are unable to obtain rides without using the same hand signal, the hitchhiker would then feel obligated to use the signal.[43]

III. Deal Environment Prior to Enhanced Scrutiny Cases

To better understand the norms developed by Delaware, I am going to first recap the deal environment leading up to some of the most significant cases in M&A. These cases not only announced more enhanced levels of scrutiny but also set forth fundamental norms for dealmakers. Delaware developed these norms largely in reaction to the 1970s and early 1980s deal environment, which saw an abundance of transactions utilizing new deal forms.

A. The Late 1970s and Early 1980s Deal Environment

The late 1970s and early 1980s were marked by the development of leveraged buyouts (LBOs), management-led buyouts (MBOs), and hostile transactions.[44] When speaking of

39. *See id.* ("[I]f smoking is a prevailing practice, it will be socially permissible.").

40. *Id.* (indicating that failure to follow established nonobligational practices "will be treated as a defeat of justified expectations," transforming practices into obligations).

41. *Id.* at 1257.

42. *Id.*

43. *Id.* at 1261–62.

44. *See* MICHELLE R. GARFINKEL, FED. RES. BANK OF ST. LOUIS, THE CAUSES AND CONSEQUENCES OF LEVERAGED BUYOUTS 23 (1989), https://perma.cc/5SF7-JURQ (PDF) (noting the increasing popularity of LBOs between 1979 and 1989); Joseph J. Allerhand & Bradley R. Aronstam, *New*

LBOs and MBOs during this period, many commentators attempted to distinguish between the two forms of transactions.[45] As these commentators noted, there is no clear definition for these different transactions and, many times, there may be no difference between an LBO and an MBO.[46] In a general sense, an LBO is the purchase of a target company (a standalone company or a subsidiary or division of another company) using a significant amount of debt financing (as much as 60 to 90 percent).[47] The assets of the acquired company are used to secure the debt so that following the purchase, the acquired company is highly leveraged.[48] In a typical LBO, the target's equity is owned by a smaller number of shareholders following the acquisition.[49] Going-private transactions, in which a publicly traded company is purchased using a significant amount of debt financing is a typical LBO.[50] Between 1979 and 1985 there were 246 going-private transactions representing a total dollar value of almost $49 billion.[51] More generally, during

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Wave of M&A Litigation Attacks Private Equity Deals, 238 N.Y.L. J. 9, 9 (2007) ("[M]erger and acquisition activity in the 1980s was epitomized by hostile takeovers and the 'omnipresent specter' of entrenched managed . . . .").

45. *See, e.g.*, GARFINKEL, *supra* note 44, at 23–24 (describing the ambiguous nature of LBOs).

46. *See id.* at 23 ("[T]here does not appear to be a single, clear definition of what an LBO really is.").

47. *See* Matthew D. Cain & Steven M. Davidoff, *Form Over Substance? The Value of Corporate Process and Management Buy-Outs*, 36 DEL. J. CORP. L. 849, 855 (2011) (stating that debt financing accounts for 60 to 90 percent of financing); GARFINKEL, *supra* note 44, at 24 (stating that debt financing accounts for 80 to 90 percent of the funding for an LBO); JONATHAN OLSEN, FOSTER CTR. FOR PRIV. EQUITY & ENTREPRENEURSHIP, NOTE ON LEVERAGED BUYOUTS 1 (2002), https://perma.cc/L3PH-PQTR (PDF) (describing the general structure of LBOs).

48. *See* OLSEN, *supra* note 47, at 2 (noting that the acquired company "generates cash flows which are used to service the debt incurred in its buyout").

49. *See* GARFINKEL, *supra* note 44, at 24 (reasoning that this is a distinguishing factor from other takeover and merger activities).

50. *See id.* ("In essence, the transaction involves a substitution of debt for equity.").

51. *See id.* at 25 (presenting a table with LBO activity each year from 1979 to 1988). The transaction and dollar value totals were achieved by adding the numbers for each year from 1979 to 1985. *Id.* As for total LBO activity

the 1980s, LBOs accounted for 24.5 percent of all acquisitions.[52] With numbers like these, there is no question that LBOs came to dominate the takeover market in the 1980s.

In addition to LBOs, MBOs also became popular. MBOs are LBOs in which management of the target company is part of the buyout group and will have an equity stake in the target company post-closing.[53] As a result of management's participation in the acquisition, MBOs carry a high potential for conflicts of interest.[54] MBOs are a subset of LBOs.[55] Although technically not all LBOs are also MBOs, LBOs do still carry a risk of a conflicted board of directors.[56] This risk arises mainly from the fact that management tend to keep their positions following an LBO.[57]

(including MBOs), one study provides there were 903 between 1981 and 1985 (the year in which the first Delaware case addressed LBOs) and there were 2,497 LBOs between 1981 and 1990. *See* GEORGE P. BAKER & GEORGE DAVID SMITH, THE NEW FINANCIAL CAPITALISTS: KOHLBERG KRAVIS ROBERTS AND THE CREATION OF CORPORATE VALUE 23 (1998) (displaying a chart containing number of LBOs in the United States).

52. Cain & Davidoff, *supra* note 47, at 855.

53. *See id.* at 857 (describing an MBO as a transaction in which "[m]anagement, either alone or with another acquisition group, would acquire a company under their control by arranging debt financing in leverage ranges equivalent to an LBO"); Guhan Subramanian, *Deal Process Design in Management Buyouts*, 130 HARV. L. REV. 590, 591 (2016) (indicating that senior managers of a target company have a buy-side interest in MBOs).

54. *See* Subramanian, *supra* note 53, at 591 ("MBOs are conflict transactions because senior managers have a fiduciary duty to maximize value for sell-side shareholders but also have buy-side interest.").

55. *See* Louis Lowenstein, *Management Buyouts*, 85 COLUM. L. REV. 730, 782 (1985) (recognizing the "definitional problem" in differentiating LBOs and MBOs and stating "not all leveraged buyouts are management buyouts").

56. *See* Daniel J. Morrissey, *Law, Ethics, and the Leveraged Buyout*, 65 U. DET. L. REV. 403, 406–07 (1988) (describing fiduciary duty concerns with LBOs).

57. *See, e.g.*, *In re* Lear Corp. S'holder Litig., 926 A.2d 94, 108, 114 (Del. Ch. 2007) (addressing conflict of interest in a LBO where the buyer entered into employment agreements with several officers and directors to retain positions post-closing); *In re* Topps Co. S'holder Litig., 926 A.2d 58, 82 (Del. Ch. 2007) (addressing a claim that existing management favored LBO buyer because it would allow management to retain their positions).

Not only did leveraged buyouts grow in the 1980s, but so did hostile transactions.[58] One third of deals valued at $1 million or more in the 1980s were hostile transactions.[59] One study revealed that of the eighty-two acquisitions of Fortune 500 companies which occurred between 1981 and 1985, almost half, or forty, "appear to have started out as hostile."[60] Many of these hostile transactions were highly leveraged, similar to LBOs and MBOs.[61]

The LBOs, MBOs, and hostile transactions which came to dominate the 1980s arose in response to the 1960s conglomerate merger wave.[62] During that period, "[e]xecutives filled boards of directors with subordinates and friendly 'outsiders' and engaged in rampant empire building. The ranks of middle management swelled and corporate profitability began to slide."[63] This was the perfect environment for highly leveraged deals and hostile transactions to take hold in order to "restructure" companies.[64] While earlier generations of managers were not open to using debt as a form of financing, this began to change in the late 1970s and early 1980s.[65] At the same time, private equity firms like Kohlberg Kravis Roberts were formed to engage in LBOs of inefficient, underperforming companies.[66] Following an LBO,

58. Robert B. Reich, *Leveraged Buyouts: America Pays the Price*, N.Y. TIMES, Jan. 9, 1989, at 32.

59. *Id.*

60. Randall Mørck, Andrei Shleifer, & Robert W. Vishny, *Characteristics of Targets of Hostile and Friendly Takeovers*, *in* CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES 102 (Alan J. Auerbach ed., 1988).

61. *See* PATRICK A. GAUGHAN, MERGERS, ACQUISITIONS, AND CORPORATE RESTRUCTURINGS 3 (3d ed. 2002) (noting "highly leveraged transactions that were common in the 1980s").

62. *See* Timothy M. Hurley, *The Urge to Merge: Contemporary Theories on The Rise of Conglomerate Mergers in the 1960s*, 1 J. BUS. & TECH. L. 185, 185 (2006) (stating the conglomerate merger wave "began quietly in the years following World War II and reached its peak in the 1960s and 1970s").

63. OLSEN, *supra* note 47, at 2.

64. *See* BAKER & SMITH, *supra* note 51, at 4 (stating that the merger wave of the 1980s was a response to "management suffering from luxuriant decadence").

65. *See* OLSEN, *supra* note 47, at 2 (stating that the new generation of management in the late 1970s was willing to use debt financing).

66. *See id.* (noting that many public companies were trading at a discount to net asset value at the time).

many acquired companies were broken up and sold off in pieces for a profit.[67]

Like LBOs and MBOs, hostile transactions also were used to dismantle conglomerates in the 1980s. However, unlike LBOs and MBOs, hostile transactions, or at least hostile cash tender offers, first arose in the early 1960s.[68] When they first arose, hostile cash tender offers often did not actually result in a liquidation of the target company's assets.[69] Instead, dealmakers used them as a way of quickly purchasing companies and building conglomerates.[70] But, during the 1980s, many bidders engaged in hostile acquisitions with the end goal of selling off portions, or all, of the target company.[71] Or, at least that was the perception that many had of the corporate raiders who had come to symbolize the 1980s.[72]

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67. *See id.* (explaining that "[t]his 'bust-up' approach" characterized early LBOs). In addition, LBOs also included acquisitions of unrelated divisions or subsidiaries of conglomerates, which were being spun off in order for the company to acquire companies in a related line of business. *See* Leslie Wayne, *Buyouts Altering Face of Corporate America*, N.Y. TIMES, Nov. 23, 1985, at A1 (attributing this new approach to regulatory changes from the Reagan administration).

68. For a detailed description of the growth of hostile cash tender offers, see Christina M. Sautter, *Tender Offers and Disclosure: The History and Future of the Williams Act*, *in* RESEARCH HANDBOOK ON MERGERS AND ACQUISITIONS 354 (Claire Hill & Steven Davidoff Solomon eds., 2016).

69. *See* Samuel L. Hayes, III & Russell A. Taussig, *Tactics of Cash Takeover Bids*, 45 HARV. BUS. REV. 135, 138 (1967) (presenting results of a study conducted in the 1960s which revealed that "two thirds of the acquiring firms retained at least 75% of the purchased assets five years after completion of the mergers").

70. *See* Sautter, *Tender Offers and Disclosure*, *supra* note 68, at 356–58 (describing the use of cash tender offers as a way of obtaining control).

71. *See* Mørck, et al., *supra* note 60, at 104 ("Bidders in hostile transactions may be more interested in shutting down, selling off, or redepreciating the physical capital of the target than they are in continuing business as usual.").

72. *See Delaware Bench, Bar Celebrate 225-Year-Old Chancery Court's Evolution*, 32 No. 7 WESTLAW J. DEL. CORP. 3, *1 (2017) (quoting Wachtell, Lipton, Rosen & Katz partner, Theodore Mirvis, as stating "[m]ost of the litigation of the 1970s and '80s involved such corporate raiders wanting to acquire control of companies so they could carve them up and sell off the pieces at a quick profit").

B. Reactions to LBOs, MBOs, and Hostile Transactions

Despite their popularity, the LBOs, MBOs, and hostile transactions which came to dominate the 1980s were met with mixed reactions from financial and business communities, the Securities and Exchange Commission (SEC), and academics.[73] Criticisms ranged from concerns regarding impact on the target company, including debt burdens, to concerns about the conflicts of interests inherent in many of the transactions.

With respect to leveraged transactions, many were concerned with the amount of debt incurred by the target company. For example, in 1984, John S. R. Shad, the then-Chairman of the SEC, warned that bankruptcies may increase as a result of LBOs, MBOs, and leveraged takeovers.[74] He pointed out that significant past bankruptcies had occurred as a result of taking on a large amount of debt to finance "aggressive takeover problems."[75] Further, he explained that when a company has limited cash flow, "even modest business problems" become magnified.[76]

An additional significant concern with leveraged buyouts, particularly MBOs, was potential conflicts of interests on the part of boards in evaluating such transactions. Unlike with traditional transactions, LBOs raise a particular set of issues for boards.[77] Boards had to consider the timing needed to arrange financing and to fully negotiate all interests in the transaction.[78] This could take between 90 and 120 days longer

73. *See, e.g.*, Fred R. Bleakley, *S.E.C. Chief Cautions on Leveraged Buyouts*, N.Y. TIMES, June 8, 1984, at D1 (noting that the SEC Chief "pointed out that . . . major past bankruptcies . . . had resulted from heavy debt incurred by aggressive takeover programs"); GARFINKEL, *supra* note 44, at 26–28 (referencing the concern that "LBO transaction[s] have no positive real effects on [a] firm's output," but rebutting those concerns by giving evidence that "LBOs *can* be productive").

74. *See* Bleakley, *supra* note 73, at D1 (explaining that leveraged buyouts "will magnify the adverse consequences of the next recession or significant rise in interest rates").

75. *Id.*

76. *Id.*

77. *See* Carl Ferech, *Leveraged Buyouts and the Board*, 9 DIRS. & BDS., 45, 46 (1984) (explaining concerns specific to LBOs).

78. *Id.*

than in a traditional transaction.[79] Because of the time required, the company was then subject to a fair amount of uncertainty from various constituencies and the possibility that the company may receive other bids.[80]

With any transaction, price is generally the most significant consideration. However, with LBOs and MBOs, what a group can pay is subject to "clear limitations," including financing, whether the price is competitive, what bankers may consider to be fair, and the group's "own requirements for a rate of return."[81] Inherent in all of these considerations are potential conflicts for management. Obviously, when management is involved in buying out the company, it is in the position to "influence the transaction" on multiple levels.[82] Management may act to try and prevent third parties who have previously expressed an interest in purchasing the company from making another offer.[83] Along these lines, the board of directors must evaluate whether other offers should be solicited, which the members of management who are part of the buyout group would likely fight.[84] Practitioners recognized that because of these numerous potential conflicts it would be very difficult for management to remain objective.[85]

With all of these concerns, the American Bar Association's Subcommittee of the Committee on Corporate Laws of the Section on Corporation, Banking and Business Law even prepared guidelines for boards and management to follow in going private transactions.[86] These guidelines included considerations of fairness of the price being received, a suggestion that outside shareholder votes should be considered

79. *Id.*

80. *Id.*

81. *Id.*

82. *Id.*

83. *Id.*

84. *Id.*

85. Edward S. Smith, *Getting to the Right Price: The CEO's View of LBOs and the Board*, 9 DIRS. & BDS., 47, 47 (1984) ("[S]ince incumbent management collectively end up as part owners of the newly formed business, it is impossible for them to be entirely objective.").

86. *See generally* Am. Bar Ass'n, *Guidelines on Going Private*, 37 BUS. LAW. 313 (1981).

separately from the insider votes (but would not be conclusive regarding the outcome of the deal), obtaining expert opinions, and using independent directors to negotiate.[87] These guidelines and other similar practitioner commentary acted as a set of norms before Delaware had an opportunity to review these various new deal forms.

IV. Delaware's Reaction to the "New" Deal Environment—Setting Deal Norms

Although scholars have examined Delaware's role in developing corporate norms generally, most scholars have not focused specifically on Delaware's role in setting norms in M&A deals.[88] This Part examines Delaware's initial reactions to leveraged transactions and hostile transactions. In reacting to these transactions, Delaware is most well-known for announcing new enhanced scrutiny standards. But in creating these standards it also crafted a set of norms. As dealmakers have responded to these norms, the norms themselves have evolved.

87. *See id.* (promulgating guidelines).

88. *See generally* Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735 (2001) (arguing that corporate norms cannot be understood without understanding trust behavior); Cox, *supra* note 8 (arguing that courts should position settlements in the corporate norm which it wishes to uphold); Eisenberg, *supra* note 17 (exploring corporate norms generally); Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061 (2000) (arguing that Delaware courts attract corporate charters and has developed a unique corporate lawmaking structure and process); Holland, *supra* note 2 (arguing that Delaware courts act to set norms through its jurisprudence that create "predictability and expediency in adjudication"); Rehnquist, *supra* note 2 (arguing that Delaware sets norms with its national superiority in corporate law); Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009 (1997) (exploring norms in the context of MBOs); Rock & Wachter, *supra* note 17 (arguing that corporations are governed mainly by norms which are not legally enforceable); Slights III & Powers, *supra* note 2 (discussing Delaware's role as a leader in adjudicating corporate disputes).

A. *What's a Court to Do?*

It was against the above described dealmaking backdrop in the late 1970s and early 1980s that the Delaware courts finally were able to respond in the mid-1980s. However, as Professor Edward B. Rock describes in his famous article, *Saint and Sinners: How Does Delaware Corporate Law Work?*, which examined norm-setting in the MBO context, there was a significant lag time between the development and popularity of MBOs and the Delaware cases reviewing them.[89] It is important to note, as Professor Rock does, that when a new transactional form (or provision) is at issue and is "rapidly developing," courts are unable to review the forms or provisions in "real time."[90] As such, the courts are left in the position of playing catch up.

When a court is playing catch up in the transactional law context, it will likely be restricted in aggressively policing a transaction structure or provision.[91] As Professor Rock explained in the context of MBOs, by the time the Delaware courts were able to review MBOs and provide standards, dealmakers were already engaging in MBOs for over a decade and had completed hundreds of transactions.[92] As such, the Delaware courts were not able to declare MBOs per se illegal.[93] Of course, if Delaware had had the opportunity to review MBOs earlier, it may not have declared the form illegal but it may have tightened the rules earlier and possibly differently. However, the lawyers had already been setting the "standards" for these

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89. *See* Rock, *supra* note 88, at 1095 ("Although MBOs of significant publicly held companies, as a transactional form, got going seriously around 1981, the cases came so slowly that the defining trilogy of *Macmillan*, *Fort Howard*, and *RJR Nabisco* was not written until 1988 and 1989.").

90. *Id.*

91. *See id.* (describing the consequences of the time lag between deal completion and judicial scrutiny).

92. *See id.* at 1096–97 (discussing the uncertainty of the law regarding MBOs at this time and the number of deals completed before Delaware had the opportunity to review MBOs).

93. *See id.* at 1097 (demonstrating how this lag in time "constrained judicial decisionmaking").

deals in the absence of any judicial opinions on point.[94] They were able to determine the structure, the typical merger agreement provisions, and the appropriate level of management oversight without judicial oversight. Hence, "what the business lawyer [told] the clients—rather than what the judge announce[d] to the world—is the law."[95] So, as Professor Rock argued, once the courts had the opportunity to review these deals, the courts were "influenced and probably constrained" by the deal lawyers' standards.[96]

This constraint echoes through judicial review of M&A not just in the context of MBOs. This constraint is particularly evident in the first Delaware Supreme Court case to review an LBO, *Smith v. Van Gorkom*,[97] which will be discussed in more detail in the next section. Because of the constraint that Delaware uses, Delaware often speaks through dicta which become deal norms.[98] In addition, and perhaps more importantly, the constraint Delaware exercises in upholding

94. *See id.* (indicating that "[b]y doing these sorts of deals, in the absence of controlling case law" lawyers played an integral role in shaping the legal landscape with regard to MBOs).

95. *Id.* at 1096.

96. *Id.* at 1097. Of course, this issue is not limited to Delaware courts, as all courts are interpreting laws not making them, and this interpretation often occurs years after people have begun to rely upon whatever has become commonplace practice relative to those laws.

97. 488 A.2d 858 (Del. 1985).

98. Delaware regularly speaks through dicta in corporate law more generally, not just in the M&A context. Two prime examples of Delaware's use of dicta are *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27 (Del. 2006) and *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996), in which the courts addressed executive compensation and board oversight, respectively. In these cases, the Delaware courts set expectations (i.e., norms) for future board and executive behavior. *See* Mohsen Manesh, *Damning Dictum: The Default Duty Debate in Delaware*, 39 J. CORP. L. 35, 58 (2013) ("*Disney*'s judicially blessed 'best practices,' for instance, provided not-so-subtle notice of the conduct that will be expected of corporate directors in future lawsuits."). These other areas of corporate law, however, do not reflect the same "give and take" relationship that exists in M&A between dealmakers and Delaware. This might be attributable to the M&A process itself, the contractual nature of M&A, and Delaware's recognition that boards are in a better position to judge the merits of a merger than the courts are. Of course, as is discussed in this Article, Delaware will step in if the court determines there is a conflict or unfairness.

board decisions and contractual provisions as long as they more or less follow deal norms results in an overall erosion of enhanced scrutiny standards.

B. *The Trifecta of Cases in 1985 Laying the Foundation for Deal Norms*

The Delaware Supreme Court seemed to come out of the gate relatively strongly in reacting to the hostile transactions and leveraged buyouts which had come to dominate the deal landscape by the early 1980s.[99] In a set of three cases in 1985, Delaware began to not only review hostile transactions and leveraged buyouts but to attempt to formulate some meaningful judicial review of M&A transactions.[100]

1. Smith v. Van Gorkom

The first case in 1985 was the Delaware Supreme Court's seminal decision in *Smith v. Van Gorkom*.[101] This controversial decision was significant for a number of reasons, the least of which being that it was the first decision in which the Delaware Supreme Court had the opportunity to review an LBO.[102]

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99. *See, e.g.*, Martin Lipton, *Pills, Polls and Professor Redux*, 69 U. CHI. L. REV. 1037, 1046 (2002) (explaining that the decisions in *Van Gorkom*, *Unocal*, *Revlon*, and *Household* "represented a set of compromises" in which Delaware "chose a middle ground" rather than giving in to either corporate raiders, advocating for takeover defenses to be outlawed, or corporate boards requesting a deferential business judgment rule apply).

100. *See* WILLIAM T. ALLEN & REINIER KRAAKMAN, COMMENTARIES AND CASES ON THE LAW OF THE BUSINESS ORGANIZATION 533 (5th ed. 2016) (explaining that in a set of cases argued in 1985, the Delaware Supreme Court began a "single effort to bring meaningful judicial review to control transactions").

101. 488 A.2d 858 (Del. 1985).

102. A search of both Westlaw and LexisNexis reveals that *Smith v. Van Gorkom* was the first Delaware Supreme Court case to not only contain the term "leveraged buyout" but to also review the sale process leading to the buyout. From my research, it does not appear that the Delaware Supreme Court had previously addressed MBOs either. The earliest Delaware Chancery Court case to address MBOs appears to have been the 1983 case of *Field v. Allyn*, 457 A.2d 1089 (Del. Ch. 1983). The Delaware Supreme Court affirmed that case *per curiam* for the reasons stated in the lower court's

Followers of Delaware law are well-versed in the facts of *Van Gorkom*—a leveraged buyout of Trans Union negotiated by Van Gorkom, the CEO, with no oversight by Trans Union's board.[103] In approaching Jay Pritzker, the buyer and a friend of Van Gorkom, Van Gorkom did not simply ask Pritzker about his interest in acquiring Trans Union in a LBO.[104] Rather, he provided Pritzker with a per share sale pricing and a financing structure, none of which he had run by the board or senior management.[105] Thus, the Delaware Supreme Court was not only faced with an LBO but one with a quite imperfect sales process. It was a case ripe for some preaching on what should have been done or, in other words, it was the perfect case to develop a set of deal norms.

A point that is often overlooked in discussing these cases, particularly *Van Gorkom,* is the norms which had governed director activity *prior* to 1985. Namely, there was a "nonobligational practice norm that directors do not do much."[106] In the words of one practitioner, "[m]ost boards were not much more than rubber stamps. The CEO said, 'Jump' and directors were allowed just one question: How high? It wasn't a matter of not arguing with the boss—you typically didn't even question him."[107] Thus, *Van Gorkom* marked not only a fundamental shift in fiduciary duty law but a fundamental shift

opinion and did not issue a separate opinion. *Field v. Allyn*, 467 A.2d 1274 (Del. 1983). Accordingly, *Smith v. Van Gorkom* was the first Delaware Supreme Court opinion issued in which the court took on leveraged buyouts in any form. *See generally Van Gorkom*, 488 A.2d 858.

103. *Van Gorkom*, 488 A.2d at 864–70. Of interest for this Article, the CFO briefly ran numbers to determine if an LBO was viable after seeing a "media article" about a management-led buyout. *Id.* at 865. In addition, Van Gorkom had rejected the idea of the sale of Trans Union being structured as an MBO because of the conflict of interest which would arise as a result. *Id.* at 865.

104. *Id.* at 866.

105. *Id.*

106. Eisenberg, *supra* note 17, at 1271 ("Although this norm was not obligational it had a significant effect on conduct, because it permitted a low level of directorial care by insulating directors who did not do much from both external criticism and self-criticism.").

107. *Roundtable: The Legacy of* Smith v. Van Gorkom, 24 DIRS. & BDS. 28, 33 (2000) (quoting Boris Yavitz).

in norms relating to directorial care.[108] As Professor Eisenberg has written, the nonobligational "low level of directorial care" changed to an "obligational norm that requires a higher level of care."[109]

Instead of adopting a rule prohibiting LBOs, the court scrutinized the process, or lack thereof.[110] In fact, the enduring legacy of *Van Gorkom* is the process, which the court implied the board *should have* followed in selling the company.[111] In particular, the court focused on the board's knowledge of Trans Union's value and on its failure to inform itself regarding Van Gorkom's "forcing" the deal and determining the price per share.[112] In scrutinizing the process the court focused on the number of board meetings held, the length of those meetings, and the questions asked during the meetings.[113] The court focused on the fact that the board did not have any documents relating to the proposed merger nor did it have a summary of the terms.[114] Furthermore, they had to rely on a twenty-minute presentation by Van Gorkom regarding the content of the merger agreement but he had never read the merger agreement.[115] Moreover, the court stressed that Van Gorkom

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108. *Id.* (indicating that in the *Van Gorkom* decision, Delaware raised the threat of liability in order to force boards to put certain procedures in place).

109. Eisenberg, *supra* note 17, at 1265.

110. *Van Gorkom*, 488 A.2d at 874–93.

111. *See* Robert T. Miller, Smith v. Van Gorkom *and the Kobayachi Maru: The Place of the TransUnion Case in the Development of Delaware Corporate Law*, 9 WM. & MARY BUS. L. REV. 65, 73 (2017) ("*Van Gorkom* was an attempt by the Delaware Supreme Court to begin working out a regime to regulate negotiated transactions.").

112. Smith v. Van Gorkom, 488 A.2d 858, 875 (Del. 1985).

113. *See id.* at 869 (stating that the meeting was two hours in length); *id.* at 875 (noting the meeting was called without providing the board members with a purpose for the meeting and that the board had never considered selling Trans Union prior to this one board meeting); *id.* at 877 (stating that the board had not asked any questions of the CFO regarding the "study" he had done, who had suggested the $55 price, nor the tax implications or how the acquirer's share option was calculated).

114. *See id.* at 875 (noting "the total absence of any documentation whatsoever").

115. *Id.* at 874.

had not told the board that the purpose of the meeting was to authorize a merger.[116]

In addition, the court implied that the board should have asked for an outside valuation study.[117] The court, however, specifically stated that such a study was not "essential to support an informed business judgment" and further emphasized that "fairness opinions by independent investment bankers are [not] required as a matter of law."[118] The court clarified that directors who were "familiar with the business of a going concern are in a better position than are outsiders to gather relevant information."[119] Despite this clarification, dealmakers have acted as though fairness opinions are required in almost every company sale.[120]

It was not just the court's statements about fairness opinions to which dealmakers reacted. Dealmakers were quick to take note of the entire opinion and to begin to advise their clients accordingly.[121] Bayless Manning may best represent the

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116. *Id.* at 867.

117. *Id.* at 876.

118. *Id.*

119. *Id.*

120. *See* Steven M. Davidoff, *Fairness Opinions*, 55 AM. L. REV. 1557, 1560 (2006) (noting that practitioners have treated fairness opinions as "virtually mandatory").

121. I would be remiss if I did not address the controversial nature of *Van Gorkom*. This decision represented the first time that a board of directors of a public company was held monetarily liable solely for breaching the duty of care by not being properly informed. *See* Krishnan Chittur, *The Corporate Director's Standard of Care: Past, Present, and Future*, 10 DEL. J. CORP. L. 505, 522 (1985) (stating that *Van Gorkom* was the first case to impose liability on directors for a failing to perform a "reasonable inquiry"); Charles J. Hartmann & Pamela Gayle Rogers, *The Influence of* Smith v. Van Gorkom *on Director's and Officer's Liability*, 58 J. RISK & INS. 525, 528 (1991) (stating that *Van Gorkom* "appears to be the first case" imposing liability "solely on the basis of the board's decision making processes" (citation omitted)). *But see* Cox, *supra* note 8, at 524 (stating that prior to *Van Gorkom* there were a "handful of cases" where the court found directors breached their duty of care but none of them "involved public companies"). Practitioners and academics alike criticized the decision, even calling it "surely one of the worst decisions in the history of corporate law." Daniel R. Fischel, *The Business Judgment Rule and the Trans Union Case*, 40 BUS. LAW. 1437, 1455 (1985); *see* Bernard S. Sharfman, *The Enduring Legacy of* Smith v. Van Gorkom, 33 DEL. J. CORP. L. 287, 289 (2008)

reaction by lawyers when he stated, in an article published shortly after *Van Gorkom*, that "[t]he opinion is a recital of explicit and implicit do's and don'ts."[122] In his article, Manning dissected the opinion, dividing the "do's" and "don'ts" into two columns taking up almost six and a half law review pages.[123] He explained that if dealmakers engaged in more activity under Column II (the "do" column) and less activity under Column I (the "don't" column), dealmakers would earn a better "grade."[124] However, the more they engaged in an activity listed in the "don't" column, the more likely a court would be to find that management has acted in a grossly negligent fashion.[125]

As Manning's equation implies, the "do's" and "don'ts" set forth in *Van Gorkom* are both a standard of conduct and a set of norms. More specifically, the court assembled a set of obligational norms—norms with which dealmakers felt obliged to comply. As practitioners moved forward in the wake of *Van Gorkom*, they had a checklist of best practices. They knew that the more they complied with this checklist, the more likely the transaction would be to pass Delaware's scrutiny.[126] Other practitioners were quick to acknowledge this checklist. For example, other practitioners advised that following the focus on process in *Van Gorkom*, "[d]irectors will not be able to satisfy this requirement by initiating a series of cosmetic decisional processes . . . merely parading a set of investment bankers, attorneys, and accountants through boardrooms will not be sufficient to protect corporate directors from potential

(noting that "from the beginning" the decision was "heavily criticized"). For a comprehensive listing of articles by both practitioners and scholars, see Miller, *supra* note 111, at 70 n.3.

122. Bayliss Manning, *Reflections and Practical Tips on Life in the Boardroom After* Van Gorkom, 41 BUS. LAW. 1, 3 (1985).

123. *See id.* at 8–14 (comparing actions that *Van Gorkom* disapproved to actions that should be taken by officers and directors).

124. *Id.* at 3.

125. *See id.* (noting that only performing a minority of the "do's" would be "grossly negligent").

126. *See, e.g.*, *Roundtable: The Legacy of* Smith v. Van Gorkom, *supra* note 107, at 32 ("The lesson for boards after this case is all about the process: Follow the right process and the board's actions in takeover settings will be relatively free from attack." (internal quotations omitted)).

liability."[127] Instead, they advised that boards must delve deeper and take the time necessary to understand reports, to read relevant documentation, to understand the background of the transaction, and to think about the decision they are making.[128] In other words, there was a set process on this checklist. Delaware would be able to look at a new transaction holding the *Van Gorkom* checklist in their hands and compare the two transactions. The less the transaction had the bad qualities of *Van Gorkom* and the more the transaction reflected the norms set forth by the Supreme Court, the more likely the directors' conduct would be to get the benefit of the business judgment rule.

2. Unocal *Enhanced Scrutiny Standard*

Van Gorkom was just the beginning of a big year for the Delaware Supreme Court in reviewing M&A transactions. About six months after its decision in *Van Gorkom*, the Delaware Supreme Court issued its now famous decision in *Unocal Corp. v. Mesa Petroleum Co.*[129] The court addressed Unocal's adoption of a self-tender offer which excluded Mesa Petroleum who had launched a two-tier front-end loaded tender offer for Unocal's stock.[130] The court stated that when the board is faced with a hostile takeover, it has an obligation to "determine whether the offer is in the best interests of the corporation and its shareholders."[131] Because there is a possibility that the board could be "acting primarily in its own interests," the board's decisions to take defensive measures to ward off a hostile takeover are subject to an enhanced standard

127. Herbert S. Wander & Alain G. LeCoque, *Boardroom Jitters: Corporate Control Transactions and Today's Business Judgment Rule*, 42 BUS. LAW. 29, 40 (1986).

128. *See id.* at 40–41 ("Directors must also make an extended effort to become informed about the background of the decision to be made and to read and understand the relevant documents involved.").

129. 493 A.2d 946 (Del. 1985).

130. *Id.* at 953 ([The issues are:] [d]id the Unocal board have the power and duty to oppose a takeover threat it reasonably perceived to be harmful to the corporate enterprise, and if so, is its action here entitled to the protection of the business judgment rule?").

131. *Id.* at 954.

of review.[132] More specifically, this enhanced scrutiny requires the directors to "show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed."[133] Once the danger is established, the defense "must be reasonable in relation to the threat posed."[134]

In a later case, *Unitrin, Inc. v. American General Corp.*,[135] the Delaware Supreme Court clarified that the proportionality prong of *Unocal* breaks down into a two-step analysis.[136] First, the court makes an inquiry into whether the defensive device is draconian, more specifically whether it is either coercive or preclusive.[137] If the device is not draconian, then the court determines whether the defensive mechanism falls "within a range of reasonableness."[138] This Article is not going to address the norms arising in the context of hostile transactions. However, the *Unocal/Unitrin* enhanced scrutiny standard is significant as Delaware later extended this standard to deal with protection devices in negotiated transactions, which will be discussed in Part V.A. below.

3. Revlon *& the Maximization of Stockholder Value*

Less than one year after *Unocal*, the Delaware Supreme Court issued another legendary decision, *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[139] Like with *Van Gorkom* and *Unocal*, scholars of corporate law are well-versed in the facts of *Revlon*—Pantry Pride's hostile takeover attempt of Revlon in which the Revlon board sought out a white knight.[140]

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132. *Id.*
133. *Id.* at 955.
134. *Id.*
135. 651 A.2d 1361 (Del. 1995).
136. *See id.* at 1387–88 (noting that cases applying *Unocal* reveal a "direct correlation between findings of proportionality or disproportionality and the judicial determination of whether a defensive response was draconian because it was either coercive or preclusive in character").
137. *See id.* ("[T]his Court has consistently recognized that defensive measures which are either preclusive or coercive are included within the common law definition of draconian.").
138. *Id.* at 1388 (citations omitted).
139. 506 A.2d 173 (Del. 1986).
140. *Id.* at 177.

The white knight, Forstmann Little & Co., and Pantry Pride ultimately ended up in a bidding war, in which the Revlon board of course favored Forstmann.[141] In reviewing the board's actions, the court stated that once the bidding war had begun, it was clear that Revlon was going to be broken up.[142] At that point, "[t]he directors' role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company."[143] This obligation to maximize stockholder value became known as a board's *Revlon* duties.[144] Similar to the decision in *Van Gorkom*, *Revlon* duties focus on the process the board follows in selling a company.[145] In other words, it created further obligational norms for companies engaging in a break-up of the company. However, since *Revlon* had not involved a friendly, negotiated transaction from the start, practitioners were not sure whether *Revlon* applied in those situations.[146] What was clear was that *Revlon* applied in the context of hostile transactions, if the board adopted a defensive strategy resulting in a sale of control.[147]

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141. *See id.* at 178 ("[T]he directors unanimously agreed to a leveraged buyout by Forstmann.").

142. *See id.* at 182 (explaining that when Pantry Pride continued increasing its offers, "it became apparent to all that the break-up of the company was inevitable").

143. *Id.*

144. *See* Clark W. Furlow, *Reflections on the Revlon Doctrine*, 11 U. PA. J. BUS. L. 519, 521 (2009) (stating that the board's fiduciary duties "are aimed at serving the short-term interests of the stockholders in achieving a transaction that will maximize the immediate value of their shares" and that these duties are called "*Revlon* duties").

145. *See id.* ("Under current Delaware law, if a business combination is deemed to constitute a 'sale of the company' or a 'sale of control' it is governed by the *Revlon* doctrine." (citations omitted)).

146. *See* Ronald J. Gilson & Reinier Kraakman, *What Triggers* Revlon?, 25 WAKE FOREST L. REV. 37, 46 (1990)

> Can a company agree to be acquired in what used to be the traditional manner—that is, an agreement negotiated at arm's length calling for a form of transaction, like a merger or sale of assets, that normally requires shareholder approval—without shopping the transaction or otherwise conducting an auction?

147. *Revlon* did not use the terms "sale of control" or "change of control." However, those terms quickly came into use following cases such as *Mills*

The Supreme Court did not just announce an enhanced obligation to maximize stockholder value. It also provided extensive guidance on the deal protection devices, which the Revlon board had adopted in its negotiations and agreement with Forstmann.[148] The Supreme Court applied the *Unocal* standard to these deal protection devices.[149] More specifically, Revlon had granted Forstmann a lock-up option to purchase two of Revlon's key divisions for a discount if another buyer acquired forty percent of Revlon's shares.[150] The court made clear that lock-ups were not *per se* illegal and that they could be used to help maximize stockholder value by drawing bidders into an auction.[151] However, in *Revlon*, the lock-up was not used in that manner but rather it was used to shut down an active bidding process.[152] The court found similarly with respect to a no shop provision and termination fee.[153] It noted that no shops, like lock-up options, are not *per se* illegal but that the no shop, like the lock-up, ended the bidding rather than increased it.[154] This, the court stated, was "impermissible under the *Unocal* standards."[155]

So, *Revlon* expanded upon the *Van Gorkom* checklist. *Revlon* not only created obligational norms for companies engaging in an auction, but it also created obligational norms

Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1989), *Paramount Communications, Inc. v. Time Inc.*, 571 A.2d 1140 (Del. 1989), and *Paramount Communications Inc. v. QVC Network Inc.*, 637 A.2d 34 (Del. 1994).

148. *See Revlon*, 506 A.2d at 182–84 (reviewing a crown jewel lock-up option, no shop provision, and termination fee).

149. *See id.* at 183–84 (stating that the merger agreement "was unreasonable in relation to the threat posed" and that the no shop provision was not permissible under *Unocal*).

150. *Id.* at 178.

151. *See id.* at 183 (noting that the use of a lock-up option had been approved in an earlier Delaware Court of Chancery case).

152. *See id.* (explaining that "measures which end an active auction and foreclose further bidding operate to the shareholders' detriment").

153. *See id.* at 184 ("The no-shop provision, like the lock-up option, while not per se illegal, is impermissible under the *Unocal* standards when a board's primary duty becomes that of an auctioneer responsible for selling the company to the highest bidder.").

154. *Id.* at 184.

155. *Id.*

for the use of deal protection devices.[156] However, *Revlon* left open some significant questions for dealmakers and academics alike; namely, when was *Revlon* triggered and how exactly does a board go about satisfying its *Revlon* duties.[157] It quickly became clear that *Revlon* applied in friendly, negotiated transactions involving a sale or change of control.[158] The evolution of the deal norms regarding how exactly a board may satisfy its *Revlon* duties in a sale or change of control transaction will be addressed in the next Part.

V. The Evolution of the Trifecta Deal Norms and Its Impact on Delaware Deal Law

A. The Extension of Unocal *to Deal Protection Devices and a Slide into Reasonableness*

Although Delaware developed the *Unocal/Unitrin* enhanced scrutiny standard in the context of hostile takeovers, in 2003 in *Omnicare, Inc. v. NCS Healthcare, Inc.*,[159] the Delaware Supreme Court made clear that this standard extended to deal protection devices in negotiated transactions.[160] Moreover, *Omnicare* represented the first case in which Delaware found that a board may not completely lock-up a transaction in a non-change of control situation.[161] The

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156. *See* Furlow, *supra* note 144, at 521 (describing the nature of the duties arising under *Revlon*).

157. *See* J. ANTHONY TERRELL, REVLON IN REVIEW 1 (2016), https://perma.cc/VMR6-YWSU (PDF) (describing questions in the aftermath of *Revlon*).

158. *See, e.g.*, Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989) (applying *Revlon* to a negotiated sale of control); Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1284–85 (Del. 1989) (applying *Revlon* to a negotiated transaction); Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 42–44 (Del. 1994) (stating that *Revlon* applies in negotiated, sale of control transactions).

159. 818 A.2d 914 (Del. 2003).

160. *See id.* at 932 (analogizing a board's decision to enter into deal protection devices to taking defensive measures in the context of a hostile takeover).

161. Barry G. Sher & Israel David, *Deal Protection Provisions in Mergers: A Discussion of* Omnicare v. NCS, *in* DIRECTORS' FIDUCIARY DUTIES IN TAKEOVERS AND MERGERS 60 app. at 63 (2003), https://perma.cc/ZDU5-QZW5 (PDF).

facts of *Omnicare* were quite unique. They involved the stock-for-stock sale of a financially distressed company, NCS, following a bidding process.[162] Due to its financial situation, NCS was left with only one viable bidder who demanded a no shop provision, a force-the-vote provision, termination fee, and, most importantly, a voting agreement locking up sixty-five percent of the vote.[163] The Delaware Supreme Court determined that these deal protection devices together acted as a "*fait accompli*," leaving the minority shareholders with no viable option to reject the proposed transaction.[164] As such, the court held that the transaction must include an effective fiduciary out.[165]

Commentators feared that *Omnicare* would have a negative impact on the market for mergers.[166] They predicted that dealmakers would use fewer and less restrictive deal protection devices.[167] Commentators also quickly suggested that the controversial holding in *Omnicare* would be limited to its facts.[168] This last prediction came true, at least in part, the following year, in *Orman v. Cullman*,[169] when the Delaware Court of Chancery had its first opportunity to apply

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162. *See Omnicare*, 818 A.2d at 920–22, 925 (describing NCS's financial situation, its search for strategic alternatives, initial proposals received from Omnicare and Genesis, and stock-for-stock ratio).

163. *See id.* at 924–26 (describing terms of deal with Genesis).

164. *Id.* at 936.

165. *See id.* (describing need of an effective fiduciary out).

166. *See* Megan W. Shaner, *Revisiting Omnicare: What Does its Status 10 Years Later Tell Us?*, 38 J. CORP. L. 865, 878 (2013) (explaining commentators believed that *Omnicare* would result in Delaware being an "option contract state" which would result in less bidding parties or lower prices being paid for targets); Steven M. Davidoff, *The Long, Slow Death of Omnicare*, N.Y. TIMES DEALBOOK (Aug. 28, 2008, 4:22 PM), https://perma.cc/F4KL-6CAN (stating that commentators thought bidders may bid less frequently due to a lack of certainty in transactions).

167. *See* Steven M. Davidoff & Christina M. Sautter, *Lock-Up Creep*, 38 J. CORP. L. 681, 702 (2013) (stating that practitioners were fearful that Delaware courts would "regularly scrutinize and strike down lock-ups, countering the trend in termination fee growth").

168. *See* Sher & David, *supra* note 161, at 63 (describing various viewpoints in the wake of *Omnicare*, including that it may be limited to its facts and, thus, not have an impact on most transactions).

169. No. Civ.A. 18039, 2004 WL 2348395 (Del. Ch. Oct. 20, 2004).

Omnicare.[170] *Orman* involved similar facts as *Omnicare* but there were some distinct differences. Namely, unlike in *Omnicare*, deal protection devices did not act as a *fait accompli* as the deal included a majority of the minority provision.[171] Thus, there was an effective fiduciary out in *Orman*. So, has *Omnicare* been limited to its facts? Many practitioners would say yes.[172] But, in reality, the parties in *Orman* took note of the obligational norm to have an effective fiduciary out and incorporated that into their transaction.[173] As such, the Delaware Court of Chancery was easily able to distinguish *Omnicare* because dealmakers complied with the obligational norm.

In reviewing practitioner reactions to *Orman*, it is evident that a few other norms arose out of the case. First, *Orman* involved a voting agreement with an eighteen-month duration, which the plaintiffs had argued was unreasonable due to its length.[174] The Chancery Court rejected this argument.[175] Practitioners interpreted this as "provid[ing] some comfort that a lock-up period of eighteen months will not be deemed unreasonable *per se*."[176] In addition, practitioners took a broader norm from *Orman*. That is, they interpreted the court's decision as "confirm[ing] that there is no preference in the law for any

170. *See id.* at *5 (distinguishing the voting agreement in *Orman* from the voting agreement in *Omnicare*); *see also* E. Norman Veasey & Christine T. Di Guglielmo, *What Happened in Delaware Corporate Law and Governance from 1993–2004? A Retrospective on Some Key Developments*, 153 U. PENN. L. REV. 1399, 1461 (2005) ("*Orman* indicates a possible trend toward limiting the majority holding in *Omnicare* to its facts.").

171. *Orman*, 2004 WL 2348395, at *7.

172. *See, e.g.*, LATHAM & WATKINS LLP, CLIENT ALERT NO. 418, REFUSING TO EXTEND OMNICARE, DELAWARE CHANCERY COURT UPHOLDS 18-MONTH LOCK-UP 6 (2004), https://perma.cc/6Y54-XXHN (PDF) [hereinafter CLIENT ALERT NO. 418] (stating that the holding in *Orman* was "consistent with some commentators' predictions that the Chancery Court would limit *Omnicare* to its facts").

173. *See Orman*, 2004 WL 2348395, at *1 (noting that "the board had negotiated an effective fiduciary out").

174. *Id.* at *8.

175. *Id.*

176. CLIENT ALERT NO. 418, *supra* note 172, at 6.

particular form of deal protection over any other."[177] They went on to explain that "assuming the overarching *Omnicare/Unocal* standards are satisfied, practitioners should have broad latitude in choosing what form of deal protection to use."[178]

In the years since *Omnicare*, practitioners have been careful not to completely lock-up deals in negotiated transactions.[179] But anyone who thought that practitioners would respond with less restrictive deal protection devices were sorely mistaken. Instead, dealmakers answered by using combinations of devices to lock-up merger agreements as much as possible without violating *Omnicare*.[180] In other words, so long as the suite of devices contained an effective fiduciary out dealmakers considered those devices to be consistent with the norms set forth by Delaware. But this is where the "give and take" between dealmakers and Delaware began to take effect and ultimately impacted the level of scrutiny applied to deal protection devices. More specifically, when these combinations of deal protection devices were challenged, Delaware generally responded by upholding the devices as being consistent with what is typical in the market and what Delaware had upheld in previous cases.[181] What Delaware was really saying is that these devices were in line with the norms which had been developed via case law and the interpretation of those norms by dealmakers.

By way of some examples, in 2015, in *In re Zale Corp. Stockholders Litigation*,[182] the Court of Chancery rejected an argument that the no shop, matching rights, and 2.75 percent

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177. *Id.*

178. *Id.*

179. *See* Shaner, *supra* note 166, at 885 (describing practitioners' reaction to *Omnicare* and how practitioners have drafted deal protection devices in a manner that they would not violate *Omnicare*).

180. *Id.*

181. See *infra* note 195 for examples of these cases. *See also* Megan W. Shaner, *How "Bad Law, Bad Economics and Bad Policy" Positively Shaped Corporate Behavior*, 47 AKRON L. REV. 753, 788 (2014) (describing how pre-*Omnicare* there was a focus on individual deal protection devices but *Omnicare* caused dealmakers and courts to consider the total package of deal protection devices).

182. Consolidated No. 9388-VCP, 2015 WL 5853693 (Del. Ch. Oct. 1, 2015).

termination fee were unreasonable.[183] The court specifically stated "[a] number of Delaware cases, however, have rejected similar, and even more stringent, collections of deal protection measures as a basis for a breach of fiduciary duty claim."[184] It went on to look favorably upon the board's inclusion of a fiduciary out provision, among other factors.[185] One of the cases on which the *Zale* court relied was *Dent v. Ramtron International Corp.*,[186] in which the Chancery Court reviewed a challenge to a no shop provision, standstill provision, change in recommendation provision, information rights, and a termination fee.[187] In upholding these devices, the court noted that the no shop provision was similar to ones the court had upheld in the past.[188] The court also noted the inclusion of a meaningful fiduciary out provision, and, like *Zale*, stated that "[s]imilar, if not more potent, combinations of deal protection devices often have been upheld by this Court."[189] In upholding the matching rights in *Ramtron*, the court quoted both *In re Toys "R" Us, Inc. Shareholder Litigation*[190] and *In re Smurfit-Stone Container Corp. Shareholder Litigation*.[191] In upholding the devices in both cases, the Chancery Court relied upon the customary nature of the deal protection devices at issue.[192] More specifically, in *Smurfit-Stone*, the court noted that the no shop and matching right provisions in the agreement

183. *Id.* at *16.

184. *Id.*

185. *See id.* ("[T]he Board's successful inclusion of both a fiduciary out provision and a reverse termination fee twice as large as the termination fee . . . are indicative of good faith negotiating on behalf of Zale's stockholders rather than bad faith.").

186. No. 7950-VCP, 2014 WL 2931180 (Del. Ch. June 30, 2014).

187. *Id.* at *8.

188 *Id.* ("The no-solicitation provision at issue does not appear to deviate in any meaningful way from similar types of provisions that repeatedly have been approved by this Court.").

189. *Id.* at *9.

190. 877 A.2d 975 (Del. Ch. 2005).

191. No. 6164-VCP, 2011 WL 2028076 (Del. Ch. May 24, 2011); *see Ramtron*, 2014 WL 2931180, at *9 n.32.

192. *See infra* notes 193–194 and accompanying text.

were "customary in public company mergers today."[193] Similarly, in *Toys "R" Us*, the court stated that the termination fee and matching rights were "common contractual feature[s]."[194] The listing of Delaware cases with comments similar to these could go on as the majority of cases in which there has been a challenge to deal protection devices invokes similar reasoning to these cases.[195]

Since Delaware heavily focuses on what is customary in terms of deal protection devices, practitioners also focus on what is customary, or, in other words, what the norms for these devices are. For example, Westlaw's Practical Law database

193. *Smurfit-Stone*, 2011 WL 2028076, at *21 n.141. In upholding the termination fee, the court in that case also stated that it had upheld "several termination fees of similar size." *Id.* at *21.

194. *In re* Toys "R" Us, 877 A.2d at 1017.

195. *See, e.g.*, *In re* BioClinica, Inc. S'holder Litig., No. 8272-VCG, 2013 WL 5631233, at *5 (Del. Ch. Oct. 16, 2013) ("In fact, the allegedly unreasonable deal-protection devices—a no-solicitation provision, a poison pill, a reasonable termination fee, information rights, and a top-up option—have been routinely upheld by this Court."); *In re* Novell, Inc. S'holder Litig., No. 6033-VCN, 2013 WL 322560, at *10 (Del. Ch. Jan. 3, 2013)

> The deal protection devices in the Merger Agreement—the no solicitation provision, the matching rights provision, and the termination fee—are customary and well within the range permitted under Delaware law. The mere inclusion of such routine terms does not amount to a breach of fiduciary duty. . . . Delaware courts have recognized that these provisions are common in merger agreements, and may sometimes be necessary to secure a strong bid.

In re Atheros Commc'ns, Inc. S'holder Litig., No. 6124-VCN, 2011 WL 864928, at *7 n.61 (Del. Ch. Mar. 4, 2011) (upholding a no shop, five business days matching rights, and 3.3 percent termination fee, stating "Delaware courts have repeatedly recognized 'that provisions such as these are standard merger terms, are not *per se* unreasonable, and do not alone constitute breaches of fiduciary duty,'" and there's no evidence these provisions bar bidders); *In re* 3Com S'holders Litig., No. 5067-CC, 2009 WL 5173804, at *7 (Del. Ch. Dec. 18, 2009) (upholding a more than four percent termination fee, five business days matching rights, and no shop, stating "this Court has repeatedly held that provisions such as these are standard merger terms, are not *per se* unreasonable, and do not alone constitute breaches of fiduciary duty" and there's no evidence these bar bidders); *see also* Christina M. Sautter, *The Golden Ratio of Corporate Deal-Making*, 41 J. CORP. L. 817, 845–55 (2016) (containing a chart setting forth Delaware cases available on Westlaw from 2003 to 2014 in which there were challenges to deal protection devices, including the deal protection devices, and the outcome of each case).

includes a "What's Market" database which summarizes deal provisions in recent deals.[196] In addition, each year the ABA publishes a Deal Points Study summarizing provisions in public company deals.[197] Moreover, over the years, numerous law firm memoranda and client materials have summarized recent deal protection devices and provided advice regarding the drafting of these devices.[198] These types of publications and summaries help to reinforce and perpetuate deal norms and provide more of a basis for Delaware to uphold deal protection devices as being consistent with deal norms.

But upholding deal protection devices on the basis that they are consistent with deal norms has a potentially detrimental effect. More precisely, it has resulted in a weakening of the

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196. *See What's Market*, THOMSON REUTERS: PRACTICAL LAW (on file with the *Washington and Lee Law Review*).

197. *See, e.g.*, M&A MARKET TRENDS SUBCOMMITTEE, MERGERS & ACQUISITIONS COMMITTEE OF THE AMERICAN BAR ASSOCIATION'S BUSINESS LAW SECTION, STRATEGIC BUYER/PUBLIC TARGET M&A DEAL POINTS STUDY (FOR TRANSACTIONS ANNOUNCED IN 2016), 43–77 (summarizing common wording of deal protection devices for transactions in 2016); M&A MARKET TRENDS SUBCOMMITTEE, MERGERS & ACQUISITIONS COMMITTEE OF THE AMERICAN BAR ASSOCIATION'S BUSINESS LAW SECTION, STRATEGIC BUYER/PUBLIC TARGET M&A DEAL POINTS STUDY (FOR TRANSACTIONS ANNOUNCED IN 2015), 37–72 (summarizing common wording of deal protection devices for transactions in 2015); M&A MARKET TRENDS SUBCOMMITTEE, MERGERS & ACQUISITIONS COMMITTEE OF THE AMERICAN BAR ASSOCIATION'S BUSINESS LAW SECTION, STRATEGIC BUYER/PUBLIC TARGET M&A DEAL POINTS STUDY (FOR TRANSACTIONS ANNOUNCED IN 2014), 22ND NATIONAL M&A INSTITUTE, Slides 44–74 (2017) (summarizing common wording of deal protection devices for transactions in 2014).

198. *See, e.g.*, David Fox & Daniel Wolf, *Deal Protection: One Size Does Not Fit All*, PRAC. L. (2010) https://perma.cc/H8PG-DDR2 (PDF) (discussing recent trends in deal protection and providing factors to consider in negotiating deal protection); Noah Kornblith, *Break-Up Fees in Delaware: A Delicate Balance for All Parties*, O'MELVENY & MYERS LLP (Apr. 10, 2015), https://perma.cc/3QFD-AMA4 (discussing termination fees); LATHAM & WATKINS LLP, DEAL PROTECTION MECHANISMS (Feb. 2016), https://perma.cc/DE7P-65HW (PDF) (providing descriptions of common deal protection devices); Abigail Pickering Bomba et al., *Termination Fees: Possible Expanded Judicial Flexibility*—Comverge, *Practice Tips and Ideas for Structuring*, 19 THE M&A LAWYER 15 (Feb. 2015) (discussing termination fees generally, providing a summary of Chancery Court decisions, and providing tips for structuring termination fees).

enhanced scrutiny standard.[199] The Delaware courts have been extremely deferential in their application of the *Unocal/Unitrin* enhanced scrutiny standard to deal protection devices.[200] Even though the courts, particularly the Court of Chancery, may use *Unocal/Unitrin* terminology such as "preclusive" or "coercive," the court generally does not engage in an *Unocal/Unitrin* analysis.[201] Instead, as alluded to above, it will uphold deal protection devices as reasonable largely because they are consistent with, or less restrictive than, a set of devices used in prior transactions.[202]

In *Lock-Up Creep*, Professor Davidoff Solomon and I argued that this deferential approach, in turn, has led to more extensive and more intricate deal protection devices becoming standard market practice.[203] We dubbed this phenomenon "lock-up creep."[204] In other words, the "give and take" between dealmakers and Delaware have resulted in a bit of a chicken and the egg situation. Dealmakers have followed Delaware norms and pushed the envelope ever so slightly while Delaware reacts in an extremely deferential fashion concluding that these practices are consistent with deal norms. Then, in turn, we have a slide into a reasonableness standard and lock-up creep.[205]

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199. *See* Davidoff & Sautter, *supra* note 167, at 683 ("The Delaware Court of Chancery in a series of cases after *Omnicare* and perhaps in response, adopted deferential standards of scrutiny for lock-ups.").

200. *See id.* at 703, 708 ("[The court] adopted what could be equated with a deferential standard for review of lock-ups.").

201. *See id.* at 702–03, 706 (explaining that the Delaware Chancery Court will use "preclusive" or "coercive" terminology, but a review of the cases reveals the court is not using enhanced scrutiny).

202. See *supra* notes 179–195 and accompanying text for a discussion of this reasoning and *supra* note 195 and accompanying text for examples of additional cases utilizing similar reasoning.

203. *See* Davidoff & Sautter, *supra* note 167, at 683 (arguing that following *Omnicare* the Delaware Court of Chancery "adopted deferential standards of scrutiny for lock-ups. . . . [T]hese decisions opened up space for lock-up creep to occur").

204. *Id.* at 681.

205. In *Lock-Up Creep*, we argued,

> Our review of [deal protection] cases thus leads us to conclude that repeatedly stating lock-ups are not *per se* unreasonable and continually upholding lock-ups so long as they are market terms,

B. *The Evolution of* Revlon*—A Slide into Reasonableness*

Similar to Delaware's slide into reasonableness in the deal protection context, a comparable slide has occurred in the instance of *Revlon* duties.[206] In the years following *Revlon*, Delaware refined what actions were required of boards when *Revlon* is applicable. In these cases, Delaware shifted away from the auctioneering language, which *Revlon* seemingly required,

> the Chancery Court has abandoned enhanced scrutiny analysis in favor of a reasonableness analysis. Of course, one can argue this is circular. If reasonableness is a market standard, then the market can change. And change it did as we have seen. In the period during and after these decisions, we have seen the *expansion* of market creep.

Id. at 708. *But see* Fernán Restrepo & Guhan Subramanian, *The New Look of Deal Protection*, 69 STAN. L. REV. 1013, 1023 (2007) (arguing that termination fee creep subsided by the 2000s).

206. Many commentators have argued that enhanced scrutiny standards have become nothing more than reasonableness standards. *See, e.g.*, Iman Anabtawi, *The Twilight of Enhanced Scrutiny in Delaware M&A Jurisprudence*, 43 DEL. J. CORP. L. 161, 198–205 (2019) (arguing that the Delaware Supreme Court's decision in *Corwin* ultimately erodes enhanced scrutiny standards); Lyman Johnson & Robert Ricca, *The Dwindling of* Revlon, 71 WASH. & LEE L. REV. 167, 210 (2014) (stating that "continuing assertions about the *Revlon* duty imposing a higher 'reasonableness' standard of scrutiny than ordinary business judgment rule review, and requiring that directors carry an initial burden of proof, are, in the personal liability context, outworn and faulty doctrinal vestiges" (citation omitted)); Paul L. Regan, *What's Left of Unocal*, 26 DEL. J. CORP. L. 947, 951–70 (2001) (arguing that the added fiduciary protections *Unocal* and *Moran v. Household International, Inc.*, 500 A.2d 1346 (Del. 1985), promoted have essentially been eliminated by case law through the years); Andrew D. Kinsey, Comment, *Hand-Waiving as a New Standard of Review: When Analyzing Matching Rights, Has the Delaware Court of Chancery Abdicated Its Review Process*, 121 PA. ST. L. REV. 907, 921 (2016) (arguing that although Delaware courts are supposed to use an intermediate standard of review on challenges to deal protection measures, the Delaware Court of Chancery dismisses matching rights without engaging in an analysis, which "stand[s] in stark contrast to how the courts have analyzed other deal protection measures"); Mary Siegel, *The Illusion of Enhanced Review of Board Actions*, 15 U. PA. J. BUS. L. 599, 624 (2013) (arguing that the *Unocal* standard has developed to allow "boards—especially independent ones—to enact all but the most egregious defensive tactics under the veneer of judicial review").

to a reasonableness requirement.[207] Basically, boards satisfy the reasonableness requirement if they engage in the process (i.e., the norms) outlined initially in *Van Gorkom* and *Revlon* and further refined in their progeny in cases like *Barkan v. Amsted Industries, Inc.*[208] and *Lyondell Chemical Company v. Ryan*.[209]

Four years after *Revlon*, the Delaware Supreme Court issued its decision in *Barkan* in which it reviewed a challenge to an MBO and clarified its expectations for boards in exercising their *Revlon* duties.[210] It famously stated that "there is no single blueprint that a board must follow to fulfill its duties" and that "*Revlon* does not demand that every change in the control of a Delaware corporation be preceded by a heated bidding contest."[211] The court went on to recognize that the corporate environment was dynamic and that dealmakers could be flexible in selling companies.[212] This flexibility not only allows a company to engage in an active bidding process, in which case the company would be prohibited from favoring a certain bidder, but also to consider an offer from a single bidder.[213] In the latter situation, the court indicated that if the board did not have "reliable grounds upon which to judge [the] adequacy" of a single

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207. For example, the Delaware Supreme Court in *Mills Acquisition Co. v. Macmillan, Inc.* seemed to favor an auction but left the door open to use other methods of sale. 559 A.2d 1261, 1286–87 (Del. 1989). More specifically, the court stated,

> Directors are not required by Delaware law to conduct an auction according to some standard formula, only that they observe the significant requirement of fairness for the purpose of enhancing general shareholder interests. . . . We recognize that the conduct of a corporate auction is a complex undertaking both in its design and execution. We do not intend to limit the broad negotiating authority of the directors to achieve the best price available to the stockholders. To properly secure that end may require the board to invoke a panoply of devices, and the giving or receiving of concessions that may benefit one bidder over another.

Id. (citations omitted).

208. 567 A.2d 1279 (Del. 1989).

209. 970 A.2d 235 (Del. 2009).

210. *Barkan*, 567 A.2d at 1279.

211. *Id.* at 1286.

212. *See id.* (acknowledging there were "evolving techniques and financing devices").

213. *Id.* at 1286–87.

offer, a canvas of the market would be required.[214] However, if the board did have a "body of reliable evidence," a canvas of the market is not needed.[215] But the court warned that the "circumstances in which this passive approach is acceptable are limited" and that "'[a] decent respect for reality forces one to admit that . . . advice [of an investment banker] is frequently a pale substitute for the dependable information that a canvas of the relevant market can provide.'"[216]

Despite this warning, however, the court then concluded that the board in *Barkan* had reliable evidence in the form of the special committee's advice from investment bankers, the fact that the market was aware that Amsted was "in play" and no other bidders had come forward, and that the tax advantages from the MBO offer allowed that offer to be higher than what other parties might possibly pay.[217] Allowing for such "reliable evidence" in lieu of a more active bidding process further refined the norms relating to process when a company is in *Revlon*-mode. These norms allowed for latitude deferring to the board members who are in the trenches each day and recognized that not every sale lends itself to an active bidding process.[218]

In the three-plus decades since *Barkan*, numerous other cases expanded upon *Barkan's* "no single blueprint" format, endorsing a reliance on the board's knowledge in lieu of a more active sales process.[219] Like *Barkan*, a number of other Delaware cases have permitted negotiations with only a single bidder, including allowing a reliance on window shops and go shop provisions to provide reliable evidence regarding deal

214. *Id.* at 1287.

215. *Id.*

216. *Id.* (quoting Letter Op. at 19–20, *In re* Amsted Indus. Litig., No. 8224, 1988 WL 92736 (Del. Ch. Aug. 24, 1988)),

217. *Id.* at 1287–88.

218. *See* Afra Afsharipour & J. Travis Laster, *Enhanced Scrutiny on the Buy-Side*, 53 GA. L. REV. 443, 465 (2019) (explaining that the Delaware Supreme Court has "reiterated that *Revlon* did not impose conduct obligations on directors").

219. In a prior article, I argued that despite the language of many Delaware opinions which appears to favor more extensive sales processes, the courts continue to treat deals following less extensive sales processes the same as deals involving more robust sales processes. Sautter, *supra* note 195, at 834.

value.[220] Like with deal protection devices, dealmakers have taken note of the norms set forth in the *Revlon* line of cases. For example, a 2007 Fenwick & West memorandum suggests that smaller microcap companies should engage in a pre-signing market check while larger public companies do not need to do so, particularly if they agree to a go shop provision.[221] It further suggests soliciting strategic bidders (in addition to private equity bidders), unless there is a "reasonable, factual basis for [not] doing so based on current information."[222] In addition, Fenwick & West reiterates the lesson first learned in *Revlon* itself—that is, to treat all bidders fairly.[223]

In 2009, in *Lyondell*, the Delaware Supreme Court further confirmed that "directors must 'engage actively in the sale process,' and they must confirm that they have obtained the best available price either by conducting an auction, by conducting a market check, or by demonstrating 'an impeccable knowledge of the market.'"[224] The court clarified the level of knowledge required when the issue is whether a board has acted in good faith to satisfy its *Revlon* duties.[225] Like the process emphasized in previous cases such as *Van Gorkom* and *Barkan*, the court

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220. *See In re* Plains Expl. & Prod. Co. S'holder Litig., No. 8090-VCN, 2013 WL 1909124, at *6 (Del. Ch. May 9, 2013) (addressing challenge to a single bidder transaction and stating "a post-agreement market check can be an effective way to ensure that a company obtains the best price reasonably available"); Sautter, *supra* note 36, at 542–57 (describing the reliance on post-signing market checks and go shop provisions and summarizing relevant case law).

221. David W. Healey, *Corporate and Securities Update: M&A Development-Deal Process and Protections (*Netsmart, Lear *and* Topps*): Lessons on What Not to Do When Selling Your Company*, Fenwick & West LLP, 1 (2007), https://perma.cc/FY7M-FKMD (PDF).

222. *Id.*

223. *Id.*

224. Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 243 (Del. 2009) (citations omitted).

225. The Lyondell charter contained an exculpation provision which protected the directors from personal liability arising from a breach of the duty of care. *Id.* at 239. Accordingly, the issue before the court was whether the board had acted consistent with its duty of loyalty. *Id.* The Delaware Supreme Court noted that if the issue had been whether the board had acted with due care, it would not have had an issue with the Chancery Court asking for "additional evidence." *Id.* at 243.

considered similar factors as well as the fact that there was no evidence the board was conflicted.[226] More specifically, it focused on the number of times the board met, their awareness of the company's value and the industry generally, their seeking out and following advice from financial and legal advisors, their attempt to "negotiate a higher offer" despite indications that the existing offer was a "'blowout' price," and their approval of the agreement "because 'it was simply too good not to pass along [to the stockholders] for their consideration.'"[227]

Five years after *Lyondell*, in *C&J Energy Services, Inc. v. City of Miami General Employees' & Sanitation Employees' Retirement Trust*,[228] the Delaware Supreme Court reviewed a case in which the Court of Chancery had "imposed a pre-signing solicitation requirement" despite the inclusion of a no shop paired with a fiduciary out.[229] The court stated, "as the years go by, people seem to forget that *Revlon* was largely about a board's resistance to a particular bidder and its subsequent attempts to prevent market forces from surfacing the highest bid."[230] The court went on to state that the target in *C&J Energy Services* had not erected such barriers to entry and there was sufficient time for another bidder to come forward.[231] Of course dealmakers took note. A Skadden Arps memo stated that "*C&J Energy* confirms that the Delaware courts will not lightly interfere with a disinterested board's decisions about how to pursue a change of control transaction."[232] More recently, the Senior Chairman of Sullivan & Cromwell stated that "[t]he general perception is that you do not [need to shop a company], provided that there are no obstacles of significance against

226. *Id.* at 243–44.

227. *Id.* at 244 (alteration in original).

228. 107 A.3d 1049 (Del. 2014).

229. *Id.* at 1069.

230. *Id.* at 1070.

231. *Id.*

232. Robert S. Saunders, & Arthur R. Bookout, *Delaware Supreme Court Reaffirms Important Protections for Corporate Directors*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP (Oct. 22, 2015), https://perma.cc/ARS4-GSLK.

somebody coming in over the top."[233] Despite that auctioneering language in *Revlon* and statements in other Delaware cases that more robust sales processes are favorable, a norm has clearly developed in Delaware that negotiations with a single bidder are sufficient so long as there are no major impediments to another bidder emerging.[234]

Many scholars, including myself, have spent countless hours researching and writing about the evolution of *Revlon* duties and many have come to the conclusion that *Revlon* has been eroded. To date, no one has specifically focused on deal norms as a path to the erosion although Professor Mohsen Monash has come close.[235] In response to an argument that *Revlon* has been diminished throughout the years, Professor Monash argued,

> [i]n fact, rather than reveal the erosion of the doctrine, the lack of judicial enforcement may show the opposite: *that* Revlon*, as a normative concern, is enduring and pervasive.* To be specific, it may be the case that *boards have fundamentally internalized* Revlon*'s core dictate*—that directors' sole fiduciary obligation is "to get[] the best price for the stockholders."' In an era of shareholder empowerment and intense investor activism, for better or worse, directors nowadays worship at the altar of shareholder value maximization.[236]

Professor Monash is correct when he states that boards have internalized the duty to maximize stockholder value. Although he also is correct that companies generally value shareholder maximization over everything else, something else also has occurred. That is, dealmakers have internalized the process repeatedly set forth in the *Revlon* line of cases.[237] These processes have become obligational norms. So much so that even in non-change of control transactions, dealmakers oftentimes

233. William D. Cohan, *"Many, Many States Have Explicitly Rejected* Revlon*": With Revlon for Sale, the Hostile Takeover Era Ron Perelman Started Comes to an End*, VANITY FAIR (Nov. 15, 2019), https://perma.cc/286M-ZZA6.

234. *See* Sautter, *supra* note 195, at 856–62 (describing sales processes in twenty-eight Delaware cases).

235. *See generally* Mohsen Monash, *Nearing 30, Is* Revlon *Showing its Age?*, 71 WASH. & LEE L. REV. ONLINE 107 (2014).

236. *Id.* at 136 (emphasis added) (citations omitted).

237. *See supra* note 234 and accompanying text.

follow the same deal process norms.[238] As dealmakers have internalized these norms and followed a checklist which Delaware has continually emphasized, Delaware has repeatedly upheld these sale processes, or really lack thereof, as reasonable.[239] Thus, there is a "give and take" between dealmakers following norms and Delaware's continued focus on a board's knowledge in lieu of a more robust sales process.[240] Combining this "give and take" with the fact that most companies include exculpation provisions within their charters has resulted in a shift back to a basic business judgment reasonableness standard.[241]

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238. *See, e.g.*, *In re* MeadWestvaco S'holders Litig., 168 A.3d 675, 685 (Del. Ch. 2017) (describing the lead-up to a stock-for-stock transaction in which the board held "at least six meetings," hired outside legal and financial advisors, "received numerous valuations of the Company," and "asked probing questions" regarding the potential merger).

239. *See* cases cited *supra* note 195 and accompanying text.

240. This "give and take" relationship between dealmakers and Delaware is analogous to the lawmaking partnership between the United States Congress and the United States Supreme Court in the context of federal securities laws, which Professor Jill Fisch has described. *See* Jill E. Fisch, *Federal Securities Fraud Litigation as a Lawmaking Partnership*, 93 WASH. U. L. REV. 453, 454 (2015) (stating that "it is well documented that Congress does not exercise exclusive federal lawmaking power. The federal courts play an important lawmaking role by interpreting federal statutes and creating interstitial law" (citation omitted)). Professor Fisch describes a collaborative relationship between Congress and the Court in which the parameters of private securities fraud litigation have developed. *Id.* at 469–74. More specifically, the Court and Congress have engaged in "sequential adjustments" with Congress adopting "responsive legislation" as a result of the Court's lawmaking. *Id.* at 469–70. Professor Fisch explains that "a lawmaking partnership is characterized by a common set of policy objectives. This distinguishes the lawmaking partnership as a common enterprise rather than two actors that are competing or working at cross-purposes." *Id.* at 470. The relationship between dealmakers and Delaware is similar as the Delaware courts and dealmakers are not competing entities. Although Delaware is ensuring the fairness of deals, Delaware is not trying to actively prevent transactions through its review. If anything, Delaware would like deals to move forward and close. Perhaps this very sentiment plays a role in Delaware upholding director's actions so long as those actions are reasonable and are taken by non-conflicted directors.

241. *See supra* Part V.B.

C. *The New Frontier: Delaware as Deal Arbiter Moving Forward*

To this point, I have focused on the development and evolution of deal norms from the 1980s through approximately 2015. This is for two reasons. First, the historical approach is necessary in order to be able to evaluate the interplay between Delaware and dealmakers with respect to deal norms and to be able to view the "big picture." Second, most of the Delaware cases developing the norms for *Revlon* and deal protection devices were decided prior to 2015 and involved pre-closing challenges to a board's actions. These cases often resulted in disclosure-only settlements. In 2015, the Delaware Supreme Court fundamentally altered deal litigation with its decision in *Corwin v. KKR Financial Holdings Inc.*[242] In that case, the Supreme Court upheld a lower court decision finding that the business judgment rule applies to transactions which have been "approved by a fully informed, uncoerced vote of the disinterested stockholders."[243] The Supreme Court made a point of stating that *Unocal* and *Revlon* were really only meant to provide "injunctive relief to address important M&A decisions in real time, before closing" and were not "designed with post-closing money damages claims in mind."[244]

Corwin came shortly after *C&J Energy Services*. In reversing the Chancery Court's grant of an injunction in *C&J Energy Services*, the Supreme Court made clear that injunctive relief should be cautiously employed and only in instances to "preserve the *status quo*" until a full trial may occur to determine if a breach of fiduciary duties has occurred.[245] The court further clarified that where the stockholders have the ability to vote no and there is no evidence that stockholders are inadequately informed or will be coerced into voting for the transaction, injunctive relief is not a remedy.[246] Then, in 2016,

242. 125 A.3d 304 (Del. 2015).

243. *Id.* at 306.

244. *Id.* at 312.

245. C&J Energy Servs., Inc. v. City of Miami Gen. Emps.' & Sanitation Emps.' Ret. Tr., 107 A.3d 1049, 1072 (Del. 2014).

246. *Id.* at 1072–73.

the Chancery Court issued its decision in *In re Trulia Stockholder Litigation*.[247] In that case, the court highly discouraged cases which result in disclosure-only settlements.[248] Together, *Trulia*, *Corwin*, and *C&J Energy Services*, dissuade challenges to deal protection devices and a board's actions under *Revlon*. However, it is too early to know what, if any, impact these cases will have on the deal norms which have been developed over the previous three decades.

Along these lines, Professors Matthew Cain, Sean Griffith, Robert Jackson, and Steven Davidoff Solomon address the continuing vitality of *Revlon* in a forthcoming paper utilizing a sample of transactions occurring between 2003 and 2017.[249] Through an empirical analysis of proxy statements, they have found that *Revlon* transactions were "more intensely negotiated, involve[d] more bidders, and result[ed] in higher transaction premiums than non-*Revlon* deals."[250] Although *C&J Energy Services* and *Corwin* came at the tail end of their sampling, they did not find a substantial impact on deals announced after the two cases were decided.[251] Indeed, they suggest that dealmakers who are planning transactions "may respond to norms more directly than changes in the law, and norms may change more slowly than law."[252]

So, will the three decades of developed norms change dramatically? It seems highly unlikely. These deal norms and processes have been firmly imbedded into dealmakers' playbooks. Although dealmakers have slowly incorporated more intricate deal protection devices resulting in a lock-up creep,[253]

247. 129 A.3d 884 (Del. Ch. 2016).

248. *See id.* at 887 (stating that the Chancery Court would be "increasingly vigilant in scrutinizing the 'give' and the 'get' of [disclosure only] settlements").

249. Matthew D. Cain et al., *Does* Revlon *Matter? An Empirical and Theoretical Study* (Eur. Corp. Governance Inst., Working Paper No. 466/2019), https://perma.cc/KJ52-5ECF (PDF).

250. *Id.* at 1.

251. *See id.* at 17 ("Together [*C&J Energy Services* and *Corwin*] seem to restore *Revlon* to its original factual context: the doctrine remains available for an intervening bidder seeking an injunction against board conduct in a competitive bidding situation.").

252. *Id.* at 49. They also suggest that it may take longer for dealmakers to "fully internalize *Corwin*." *Id.*

253. *See supra* note 205 and accompanying text.

Delaware has repeatedly made clear that effective fiduciary outs must be included in transactions.[254] The lack of an effective fiduciary out is exactly the type of egregious behavior that the Delaware Supreme Court suggests would be proper grounds for seeking and obtaining injunctive relief under *C&J Energy Services*.[255] With respect to *Revlon*, it has already been diminished to a reasonableness standard with various types of sale processes satisfying the duty to maximize shareholder value.[256] Delaware has repeatedly made clear that it would only step in if there was evidence of director conflict or of bidders not being treated fairly. Delaware will continue to be a deal arbiter by policing behavior and deal terms which are out of line with deal norms and by further setting norms by commenting on behavior that may not be a violation, but which may fall short of Delaware's expectations.

VI. Conclusion

For decades, Delaware has been the ultimate arbiter in M&A conflicts in every sense of the word. Not only does Delaware act as an arbiter in the traditional sense of the term, reviewing the legality of sales processes and contractual provisions, but Delaware is the ultimate originator of deal norms. One cannot ignore the symbiotic relationship between dealmakers and Delaware when considering the development and evolution of deal norms.[257] That is, dealmakers invent and transform deal structures and contractual provisions, particularly deal protection devices. After some time passes, Delaware has the opportunity to review these innovations.[258] Initially, in the 1980s, while reviewing leveraged and hostile transactions, Delaware announced stricter scrutiny standards

254. *See, e.g.*, Dent v. Ramtron Int'l Corp., No. 7950-VCP, 2014 WL 2931180 at *8 (Del. Ch. June 30, 2014) (noting the importance of a meaningful fiduciary out provision).

255. *See supra* note 245 and accompanying text.

256. *See supra* Part V.B.

257. *See supra* note 240 and accompanying text (describing the "give and take" relationship between dealmakers and Delaware).

258. *See* Rock, *supra* note 88, at 1095 (describing the significance of the time lag between when deals are made and when courts review those deals).

beyond the business judgment rule.[259] It also provided significant commentary on the "do's" and "don'ts" of the process which should be followed in selling a company as well as what types of deal protection devices may pass muster.[260] These "do's" and "don'ts" act as obligational norms in the deal context. The story, however, does not end there. As dealmakers comply with these norms, two things occur. One is that dealmakers begin to push the envelope ever so slightly with respect to deal protection devices.[261] When Delaware reviews those somewhat enhanced devices, they tend to uphold the devices as they are in line with the market and with the norms. Second, when Delaware reviews board actions taken during the sale process, Delaware will generally not take issue with those actions so long as they are largely in compliance with the norms that have been set forth over time.[262] This complicity in the review of both deal protection devices and board conduct results in an erosion of stricter scrutiny standards to a reasonableness standard.

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259. *See supra* Part III.

260. *See* Manning, *supra* note 122, at 3 (compiling a list of Delaware's "do's" and "don'ts").

261. *See supra* Part V.

262. *See supra* Part V.