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Proceduralism: Delaware's Legacy

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Proceduralism: Delaware's Legacy

*Dalia T. Mitchell**

"for law students or others who think of law as just a kind of a blunt instrument in which there are judgments and damages at the end of it, the fact is that the law grows through a sort of a conversation in the opinions . . ."[1]

This article examines the Delaware courts' 1980s shift from managerialism to a theory I label proceduralism. I argue that managerialism, which justified corporate law's deference to directors in the preceding fifty years, was corporate law's response to social, political, and cultural concerns outside corporations. At the turn of the twentieth century, corporations and their managers were empowered to fight socialism by protecting the interests of workers, while in the midcentury, corporations became the first line of defense against the threats of totalitarianism and later the Cold War. Corporate directors were viewed as heroes and their power justified as necessary for the survival of American democracy. By the 1980s, however, in response to numerous hostile acquisitions, decisions of the Delaware Supreme Court appeared to discard managerialism as the Court used the fairness standard to review, and even invalidate, directors' actions. Yet, as this Article demonstrates, the Court did not abandon its deference to corporate directors. Rather, the Court substituted proceduralism for managerialism as a theory justifying managerial power. Grounded in the concept of fairness, specifically fair dealing, proceduralism is the idea that certain procedures—for example, authorization by disinterested directors or ratification by shareholders—ensure maximization of value, and that corporate law should focus on incentivizing corporate directors to follow these procedures by assuring them that, when they so do, their actions will not be subject to judicial review. Proceduralism was cemented into law in the decades following the hostile takeover boom, as the Delaware Chancery Court enmeshed fair dealing, or fair procedure, with the presumption of the business judgment rule, assuring directors that if they followed the procedural frameworks suggested by the Court, their actions will receive the protection of the business judgment rule, whether such actions offered

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1 Interview by Paul K. Rowe with William T. Allen, former Chancellor, Court of Chancery of Delaware, at 7 (June 28, 2018) (transcript available at https://perma.cc/HYY3-G7QZ) (hereinafter "Transcript (Rowe, Allen)"); *see also* William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 279 (1992) ("The law, like ourselves, is always in flux, always 'becoming.'").

their shareholders a fair price or a price at all. By the twentieth century's end, Delaware corporate law became fixated on internal processes rather than discretion and expertise; proceduralism became Delaware's legacy.

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I. INTRODUCTION

The 1980s were a watershed moment in the history of corporate law. Faced with a wave of hostile takeovers, the Delaware Supreme Court overhauled its fiduciary duties jurisprudence, seemingly discarding managerialism. Managerialism, that is, the trust in corporate managers because of their expertise to run corporations, dominated corporate law in the preceding fifty years.[2] Developed amidst fears about threats external to corporate law, such as socialism and totalitarianism, managerialism was manifested in the courts' refusal to evaluate directors' actions unless

[2] *See, e.g.,* Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L. J. 439, 444 (2001) (explaining that managerialism held "that professional corporate managers could serve as disinterested technocratic fiduciaries who would guide business corporations to perform in ways that would serve the general public interest"). The term managerialism was likely coined in the 1940s. For its first appearances, see JAMES BURNHAM, THE MANAGERIAL REVOLUTION: WHAT IS HAPPENING IN THE WORLD (1941); H. S. Person, *Capitalism, Socialism, and Managerialism*, 8 S. ECON. J. 238, 238 (1941) (reviewing JAMES BURNHAM, THE MANAGERIAL REVOLUTION: WHAT IS HAPPENING IN THE WORLD (1941)).

plaintiffs rebutted the presumption that the directors exercised business judgment. But in the 1970s, managerialism as a legitimating idea came under fire;[3] and in the 1980s, it seemed to wobble, if not disappear.

Managerialism withered in a span of eighteen months, as the Delaware Supreme Court decided three cases that weakened the business judgment rule and with it the managerialist ideology. Sending shockwaves that reverberated across the business and legal communities, first came *Smith v. Van Gorkom*, in which the Delaware Supreme Court held that the directors of Trans Union were grossly negligent when they approved a merger agreement sight unseen, even though the merger provided Trans Union's stockholders an almost 50% premium over the market price of the stock.[4] Less than six months later, *Unocal Corp. v. Mesa Petroleum Corp.* addressed, for the first time, a target board's power to thwart hostile takeovers. Concluding that the board was so empowered, the Court also held that, when a target board adopts defensive measures, it must demonstrate that a threat to corporate policy existed and that its actions were reasonable given the nature of the threat.[5] A few months later, in *Revlon, Inc. v. MacAndrews & Forbes Holdings*, the Court declared that when a company's board decides to sell it, it must strive to ensure that the shareholders receive fair price. The Revlon board failed to meet this standard and was thus enjoined from pursuing its favored transaction.[6] In all, the Delaware Supreme Court's willingness to subject directors' actions to review and insist on fair price for the shareholders deviated from Delaware's historical deference to directors' business judgment.[7]

Yet, as this Article will demonstrate, the Delaware Supreme Court did not abandon its deference to corporate directors and

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3 Hansmann & Kraakman, *supra* note 2, at 444. The concept of legitimacy is commonly associated with governmental power. It is "what is needed to justify, in moral terms, the wielding of . . . enormous, monopolistic power" that governments exercise. But corporate power, too, given its magnitude, needs justification. Cary Coglianese, *Legitimacy and Corporate Governance*, 32 DEL. J. CORP. L. 159, 160 (2007).

4 Smith v. Van Gorkom, 488 A.2d 858, 893 (Del. 1985).

5 Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 957 (Del. 1985). The Unocal board met these requirements, it seems, because its response to Mesa's two-tier front-loaded tender offer provided the Unocal shareholders with a fair(er) price. *Id.*

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

7 Transcript (Rowe, Allen), *supra* note 1, at 1–2 ("I think, many lawyers—corporate lawyers, were surprised by the cases of 1985 in the Delaware Supreme Court that upset the status quo: Revlon, Unocal, and others, Smith v. Van Gorkom being the first one.").

executives. Rather, responding to growing demands on corporations to maximize value for their investors, the Court substituted what I label "proceduralism" for managerialism as a theory justifying managerial power. Grounded in the concept of fair dealing, proceduralism is the idea that certain procedures—for example, authorization by disinterested directors or ratification by shareholders—ensure maximization of value, and that corporate law should focus on incentivizing corporate directors and executives to follow these procedures by assuring them that, when they so do, their actions will not be subject to judicial review. Rather than emphasizing directors' discretion, à la managerialism, proceduralism focuses on internal corporate processes.

Proceduralism was cemented into law in the decades following the hostile takeover boom, as the Chancery Court, led by the late Chancellor William T. Allen, sought to ensure that Delaware corporate law continued to bolster corporate management's power to run corporations in the age of deals, both friendly and hostile. Describing corporate managers as agents of the shareholders, Allen focused on offering directors a procedural framework that, if followed, would guarantee their actions the protection of the business judgment rule, whether such actions offered their shareholders a fair price or a price at all. By the twentieth century's end, proceduralism replaced business judgment and managerialism as the legitimating principle for managerial power.

Using oral histories and narrative, an interpretive approach common in the study of history but rare in discussions of corporate law, this Article explores the shift from managerialism to proceduralism and its nuanced implications. Part II, *Managerialism in the Age of Fear*, explores the rise of managerialism as corporate law's legitimating norm. I argue that managerialism (and the business judgment norm) was corporate law's response to social, political, and cultural concerns outside the realm of corporate law. At the turn of the twentieth century, courts empowered corporations and their managers to fight the allure of socialism by protecting the interests of both investors and workers. In the midcentury, courts described corporations as the first line of defense against the threats of totalitarianism and later the Cold War. Corporate executives were viewed as heroes and their power justified as necessary for the survival of American democracy.[8]

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[8] Harwell Wells, *"Corporation Law is Dead": Heroic Managerialism, the Cold War, and the Puzzle of Corporation Law at the Height of the American Century*, 15 U. PENN. J. BUS. L. 305, 310 (2013) (arguing that "heroic managerialism, [which] . . . flourished during

Part III, The *Deal Decade*, examines the 1980s cases involving hostile takeovers and other acquisitions. I argue that receding concerns about global political threats and growing apprehension about the role the United States would play in the world economy helped shift jurists' attention inward. Responding to demands from institutional investors and concerned about the rapid increase in hostile acquisitions, the Delaware Supreme Court developed the concept of fairness as a standard of review applicable to directors' actions and decisions regarding fundamental transactions. Fairness, as defined in *Weinberger v. UOP*, included two elements—fair dealing and fair price,[9] and the Delaware Supreme Court prioritized the former. So long as directors followed certain scripts provided by the Court, the Court would deem their actions to constitute fair dealing (and thus presumed to produce fair price for the shareholders) and would not evaluate them. Rather than deferring to executives' business judgment, a principle that allowed corporate managers to address a variety of corporate interests, jurists as well as businesspeople focused on internal corporate processes (or fair dealing).

Part IV, *Agency, Legitimacy, and Proceduralism*, explores the decisions of the Delaware courts once the takeover blitz ended. I argue that as the sheer number of hostile bids abated, the Chancery Court of Delaware offered a new legitimating narrative for managerial power, enmeshing fair dealing, or fair procedure, with the presumption of the business judgment rule. As American liberal capitalism became fixated on ensuring efficient functioning of political and economic markets, the Delaware courts justified managerial power as offering the certainty that markets craved. To that end, the Delaware courts at the twentieth century's end defined procedures that corporate managers, now described as agents of the shareholders, should follow to ensure that they fulfilled their duties, specifically their duties to their principals. If the business judgment rule justified deference to the corporate elite by supporting the idea that corporate executives, as experts, could be trusted to run corporations for the benefit of the different corporate constituencies and society at large, proceduralism viewed corporate managers' duties as procedural, not substantive (nor based on expertise). Presumably shareholder-focused, proceduralism justified deference to the corporate elite not by reference

the decades around 1950 and then largely disappeared . . . carried an optimism about the role management could play that faded and then largely disappeared.").

[9] Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

to their expertise but by assuming that they could be trained to follow scripted processes.

The Delaware courts' embrace of proceduralism as a substitute for business judgment paralleled what sociologist Mark Mizruchi labeled the "fracturing of the American corporate elite."[10] According to Mizruchi, the corporate elite that dominated the post-World War II years was a cohesive group that, while not perfect, "helped society flourish, both economically and politically."[11] Since the 1970s, however, the group was fragmenting and fracturing and, while corporations remained powerful, the corporate elite has become too divided and "largely abandoned their concern with issues beyond those of their individual firms," a neglect that, according to Mizruchi, "is one of the primary causes of the economic, political, and social disarray that American society has experienced in the twenty-first century."[12]

This Article suggests that the Delaware courts offered a legitimization idea—proceduralism—that supported the corporate elite's inward turn. The doctrinal changes examined in this Article brought into boardrooms a new cohort of lawyers whose advice was consistent with post-1980s Delaware law. Focusing corporate executives' attention narrowly on procedure to the exclusion of all else, the Delaware courts helped deepen the fracturing of the corporate elite.[13] As CEOs of our largest corporations are signaling

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10 MARK MIZRUCHI, THE FRACTURING OF THE AMERICAN CORPORATE ELITE (2013).

11 *Id.* at xi–xii.

12 *Id.* at 4–5. According to Mizruchi

> The decline of the American corporate elite has played a major role in the crisis of twenty-first-century American democracy . . . . The gridlock in Washington, the prominent role of extremist elements who in earlier decades would have been considered outside the realm of legitimate political discourse, the inability to address serious problems such as health care, the deficit, financial reform, and global warming are all due in part to the absence of a committed, moderate elite capable of providing political leadership and keeping the destructive sectors of the American polity in check.

Id. at 9. *But see* G. William Domhoff, *Is the Corporate Elite Fractured, or is There Continued Corporate Dominance? Two Contrasting Views*, 3 CLASS, RACE AND CORPORATE POWER 1, 2 (2015) (rejecting the fracture theory and arguing that "common interests, common opponents . . . social interactions in exclusive settings, and meetings within policy-discussion groups lead both to social and policy cohesion, with social cohesion contributing to the ability to create policy cohesion").

13 In 1993, Melvin Eisenberg distinguished between standards of conducts and standards of review in Delaware Law. Melvin Aron Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 FORDHAM L. REV. 437 (1993). This Article argues that the shift from business judgment to fairness (as the standard of review), and from substantive to procedural duties (as standards of conduct), substantiated Delaware's embrace of proceduralism as an alternative to managerialism. As I

their interest in moving beyond shareholder wealth maximization and instead addressing the social and economic concerns of a variety of constituencies,[14] it is time for the Delaware courts to reexamine their 1980s legacy.

II. MANAGERIALISM IN THE AGE OF FEAR

This Part II explores the rise of managerialism in the first half of the twentieth century. I argue that, in deference to the corporate elite, courts developed the modern business judgment rule to ensure that corporations are not beholden only to the shareholders and that corporate power is exercised to achieve social and economic goals. Corporate managers were trusted to determine their corporations' affairs and able to do so without intervention from the shareholders, other constituencies, or the courts.

A. Managers against Socialism

While managerialism is often described as dominating corporate law in the midcentury, the initial steps toward corporate executives' empowerment took place amidst the growing labor agitation that characterized the end of the nineteenth century. As private corporations were taking on important public functions, the role and plight of these corporations' wage workers became highly visible, demanding the attention of managers (and legislatures).[15]

Faced with ruinous and at times violent strikes, private and publicly held businesses introduced reforms "aimed at alleviating labor conflict, improving worker morale, and cultivating employee loyalty"[16] so as to dissuade their employees from joining unions or, worse, the ranks of socialists and anarchists. Between 1898 and 1903, corporate moderates and leaders from the

further suggest, the turn from managerialism to proceduralism significantly impacted corporations and our society.

14 *Our Commitment,* BUS. ROUNDTABLE, https://perma.cc/2D4R-NKM7 (last visited March 5, 2023). The statement was signed by more than 180 CEOs, who committed to "[d]elivering value to [their] customers," "[i]nvesting in [their] employees," "[d]ealing fairly and ethically with [their] suppliers," "[s]upporting the communities in which [they] work," and "[g]enerating long-term value for shareholders." *Id*. The statement concluded by noting: "Each of our stakeholders is essential. We commit to deliver value to all of them, for the future success of our companies, our communities and our country." *Id*.

15 Carl Schurz, *Corporations, Their Employees, and the Public*, 138 N. AM. REV. 101 (1884).

16 Gerald Zahavi, *Negotiated Loyalty: Welfare Capitalism and the Shoeworkers of Endicott Johnson, 1920–1940*, 70 J. AM. HIST. 602, 602 (1983).

American Federation of Labor sought to use "trade union agreements" to eliminate management-labor conflicts.[17] Then, when it became apparent that negotiations between labor and management often came to a standstill, the National Civil Federation—formed by a group of businessmen, labor leaders, and public activists—advocated for a broader approach, loosely labeled welfare capitalism. Viewing labor as "a partner,"[18] they called on businesses to offer their workers a "broad array of services, including housing, subsidized company eating facilities, and in some cases pensions and health care."[19] "The business corporation . . . takes millions of dollars each year and spends the money for the benefit of its workmen," Raynal Bolling wrote on behalf of United States Steel Corporation, counting among such benefits employee stock subscription plans, accident prevention and relief, medical care, pensions, as well as general community welfare.[20] "By 1910, more than 60 companies had instituted pension plans, a number that grew to more than 300 by 1925, and by 1920 more than 100 had instituted employee stock ownership plans."[21]

State courts eagerly embraced corporate leaders' welfare capitalism. For one, when the Steinway corporation was sued by one of its minority shareholders who claimed that Steinway's construction of a company town in Astoria to entice its employees from Manhattan to Queens was *ultra vires*, the Supreme Court of New York dismissed the suit. (Steinway constructed houses for employees and "contributed specific property and money towards the establishment of a church, a school, a free library, and a free

[17] Domhoff, *supra* note 12, at 3.

[18] Zahavi, *supra* note 16, at 602.

[19] MIZRUCHI, *supra* note 10, at 30. *See also* Joseph L. Castrovinci, *Prelude to Welfare Capitalism: The Role of Business in the Enactment of Workmen's Compensation Legislation in Illinois, 1905–12*, 50 SOC. SERV. REV. 80, 81 (1976) ("Confronted early in this century with economic uncertainties which threatened to overwhelm them, businessmen endorsed and even formulated many of the demands normally associated with labor and reformers, hoping thereby to restore a stability lost in the frenzy of turn-of-the-century competitive activity."). Ronald Marchand explained that businesses wanted to demonstrate that corporations exhibited "compassionate concern for [their] employees" as a means of demonstrating that they "possessed human feeling." ROLAND MARCHAND, CREATING THE CORPORATE SOUL: THE RISE OF PUBLIC RELATIONS AND CORPORATE IMAGERY IN AMERICAN BIG BUSINESS 15 (2000).

[20] Raynal C. Bolling, *The United States Steel Corporation and Labor Conditions*, 42 ANNALS AM. ACAD. POL. & SOC. 38, 39–43 (1912); *see also* DOUGLAS M. EICHAR, THE RISE AND FALL OF CORPORATE SOCIAL RESPONSIBILITY 43–49 (2017) (describing employee benefits programs at the end of the nineteenth century as "voluntary practices of CSR," or corporate social responsibility).

[21] MIZRUCHI, *supra* note 10, at 30.

bath . . . ."[22]) William Steinway, the corporation's president and controlling shareholder, explained that the move to Astoria was intended to "escape the machinations of the anarchists and socialists . . . [who] were continually breeding discontent among [Steinway's] workmen, and inciting them to strike,"[23] and Judge Beekman agreed, holding that:

> . . . a close and practical business relation subsisted between the provision made by the defendants for their employees and the object for which the corporation was organized . . . . It was also desirable (it may, I think, be said to have been necessary) . . . that some provision should be made for the moral as well as the material needs of this new and isolated community, thus brought, by the exigencies of their employment, into a measure of social dependence upon their employer.[24]

In a similar manner, "[e]xpenditures resulting in stimulating the employees to better work, and promoting faithfulness and loyalty to the employer," were rendered "tributary to the promotion of corporate objects."[25] Corporations could maintain "relief funds" to support employees injured at work before Workmen's Compensation legislation was enacted, as well as pay bonuses to enhance employee "morale" and encourage more "energetic efforts."[26] In 1909, the Supreme Court of New York, Appellate Division, Third Department, announced that "[t]he enlightened spirit of the age, based upon the experience of the past, has thrown upon the employer other duties, which involve a proper regard for the comfort, health, safety and well-being of the employee."[27] And in 1922, in *Armstrong Cork Co. v. H. A. Meldrum Co.*, contributions by a corporation doing business in Buffalo, New York, to the endowment funds of a college and a university in Buffalo were deemed *intra vires* because they would allow for the creation of opportunities

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[22] Steinway v. Steinway & Sons, 40 N.Y.S. 718, 719 (N.Y. Sup. Ct. 1896). *But see* RICHARD K. LIEBERMAN, STEINWAY & SONS 79–80 (1995) (adding that, at least in part, William Steinway, the corporation's president, built "Steinway Village" so that the corporation could sell and rent homes on the land it owned in Queens).

[23] LIEBERMAN, *supra* note 22, at 77 (quoting William Steinway's testimony before a Senate Committee on the relations between labor and capital in 1883).

[24] Steinway, 40 N.Y.S. at 721.

[25] Note, *Donations by a Business Corporation as Intra Vires*, 31 COLUM. L. REV. 136, 136 (1931).

[26] *Id.* at 137–38.

[27] People ex. rel. Metro. Life Ins. Co. v. Hotchkiss, 120 N.Y.S. 649, 651 (N.Y. App. Div. 1909).

for business training.[28] In 1931, an article in the *Columbia Law Review* concluded that courts were "more ready to adjudge gratuitous corporate contributions *intra vires* where the immediate benefit is received by employees than in any other situation."[29]

Adolf A. Berle's and Gardiner C. Means's *The Modern Corporation and Private Property* cemented managerialism as a legitimating concept into corporate law's fiduciary duties discourse. Like many of their Progressive brethren, Berle and Means acknowledged that "the corporation director who would subordinate the interests of the individual stockholder to those of the group more nearly resembles the communist in mode of thought than he does the protagonist of private property."[30] But an appropriate description of the directors' role, according to Berle and Means, could ensure that corporations would not lead the way toward communism. Having documented the rapid separation of ownership from control in large publicly held corporations, Berle and Means suggested that managers were empowered as trustees for the community and argued that shareholders, "by surrendering control and responsibility over the active property, have surrendered the right that the corporation should be operated in their sole interest[]—they have released the community from the obligation to protect them to the full extent implied in the doctrine of strict property rights."[31]

At a time when states were still struggling to pass labor-protective legislation that the *Lochner*-era U.S. Supreme Court would not strike down as unconstitutional, Progressive jurists made corporations laboratories for potential solutions for the social and economic problems that permeated American society. In portraying corporate managers as trustees for the community, they helped legitimate corporate and managerial power. As the following Section II.B. elaborates, this trend continued through the midcentury. As fears about socialism were replaced by concerns that American democracy would capitulate to the forces of

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28 Armstrong Cork Co. v. H. A. Meldrum Co., 285 F. 58 (W.D.N.Y. 1922).

29 *Donations by a Business Corporation as Intra Vires*, *supra* note 25, at 136.

30 ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 245 (1932).

31 *Id.* at 356–57. Notably, despite their recognition of the power inequalities associated with the modern corporation, Berle and Means were reluctant to admit that workers were a distinct class whose interests might differ from the interests of the community. They also seemed to believe that unions could sufficiently protect workers' interests. Accordingly, the corporation was to exercise its power to benefit the community at large, not workers as a class. Dalia Tsuk, *Corporations without Labor: The Politics of Progressive Corporate Law*, 151 U. PENN. L. REV. 1861, 1890 (2003).

totalitarianism that were sweeping through Europe, corporate managers altered their rhetoric but not the general message. In the early decades of the twentieth century, corporate leaders were able to portray corporations as the force that would save American capitalism from socialism; by midcentury, the corporate elite focused on marketing corporations as the best line of defense against totalitarianism. And jurists, again, acquiesced, further solidifying the power of corporate managers in the name of American democracy.

B. Corporations and the Survival of American Democracy

By midcentury, corporate managers became the "strategic center" of the large corporation and, by derivation, society.[32] In 1941, historian James Truslow Adams boldly announced that "big business," as it developed during the war (which Adams distinguished from big business earlier in the twentieth century), "is the function of the American congeries of resources, people, democracy . . . which has given it characteristics that are unique compared with big business at other times and in other areas." Using General Motors ("GM") to illustrate the intricate relations between corporations and American ideals, Adams called attention to GM's "leaders" who came "from the outside or up from the ranks," to the multiplicity of GM stockholders, to the corporation's "decentralized operations under coordinated control," to its support of its employees, especially through high wages, and its self-assumed "responsibility of keeping a large corporation going and giving an improved product to consumers."[33]

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[32] William W. Bratton, Jr., T*he New Economic Theory of the Firm: Critical Perspectives from History*, 41 STAN. L. REV. 1471, 1476 (1989). Corporate boards, typically composed of "senior managers of the firm and of outsiders related by business to the company—bankers, lawyers or suppliers" were deemed to have an advisory role. William T. Allen, *Engaging Corporate Boards: The Limits of Liability Rules in Modern Corporate Governance, in* THE EMBEDDED FIRM: CORPORATE GOVERNANCE, LABOR, AND FINANCE CAPITALISM 82, 93 (Cynthia A. Williams & Peer Zumbansen eds., 2011) (hereinafter "Engaging Corporate Boards"). Peter Drucker reportedly described corporate boards as "an important ceremonial and legal fiction" that "do not function." William T. Allen, *Independent Directors in MBO Transactions: Are They Fact or Fantasy*, 45 BUS. LAW. 2055, 2056 (1990).

[33] JAMES TRUSLOW ADAMS, BIG BUSINESS IN A DEMOCRACY (1941); Harold Williamson, *Book Review*, 244 ANNALS OF AM. ACAD. POL. & SOC. SCI. 196, 196 (1946). Ironically, in 1936, Flint, Michigan was the site of a heated sit-down strike between GM and the United Auto Workers ("UAW"), seeking recognition for their union. While the UAW gained union recognition, GM was able to win the support of public opinion by charging the union with interference with GM's possession of property. COLOSSUS: HOW THE CORPORATION CHANGED AMERICA 285 (Jack Beatty ed., 2001).

While some labeled Adams's book a blind "apologetic,"[34] its message resonated with many. Corporate managers were deemed to possess the expertise required to lead corporations and the country.[35] As historian Richard Hofstadter wrote, "business structure has brought into life a managerial class of immense social and political as well as market power."[36] Business experts asserted that corporations were to be managed by multiple loyal leaders, "men of ability and initiative" capable of fighting or evading "bureaucratic ossification and bureaucratic timidity" and pursuing corporate policy,[37] and the term "free enterprise"—in use since the 1930s—came to symbolize the free reign of managers, who in cultural imagination replaced the small producers and entrepreneurs of the nineteenth century.[38]

Shareholders found little role in this free enterprise. Litigation was often costly and by the 1940s, beginning with New York, states adopted statutory provisions limiting standing in derivative litigation and requiring shareholder plaintiffs to post security for costs suffered by the defendants should the litigation be found to have been meritless.[39] The shareholder proposal rule, which the Securities and Exchange Commission adopted in 1942, rarely, if ever, proved useful, as the Commission and the courts repeatedly limited its use.[40]

When litigants were able to pass the hurdles and reach the courts, they were often met with judges that one commentator described as "probably more prepared to question managerial

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34 George A. Kelly, *Book Review*, 32 CATHOLIC HIST. REV. 110, 111 (1946); *see also* Edward C. Kirkland, *Book Review*, 70 PENN. MAGAZINE OF HIST. AND BIOGRAPHY 222 (1946).

35 SCOTT R. BOWMAN, THE MODERN CORPORATION AND AMERICAN POLITICAL THOUGHT: LAW, POWER, AND IDEOLOGY 185–91 (1996).

36 RICHARD HOFSTADTER, *What Happened to the Antitrust Movement?*, in THE PARANOID STYLE IN AMERICAN POLITICS AND OTHER ESSAYS 188, 236 (1965).

37 PETER F. DRUCKER, CONCEPT OF THE CORPORATION 33, 36 (1946); *see also* Harwell Wells, *The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-First Century*, 51 U. KAN. L. REV. 77, 105–06 (2002).

38 *See* Nelson Lichtenstein, *Taft-Hartley: A Slave-Labor Law?*, 47 CATH. U. L. REV. 763, 771 (1998) (explaining the use of the term "free enterprise" to describe the American capitalist system).

39 *See, e.g.,* Act of April 9, 1944, ch. 668, § 61-b, 1944 N.Y. Laws 1455. By 1949, the U.S. Supreme Court held that "these state procedural statutes applied in federal court as well to corporations incorporated in these states." JOHN C. COFFEE, ENTREPRENEURIAL LITIGATION: ITS RISE, FALL AND FUTURE 40–41 (2015); *see also* Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541, 555–57 (1949) (holding that a New Jersey statute requiring shareholder plaintiffs to post security for litigation costs applied in federal courts).

40 Dalia T. Mitchell, *Shareholders as Proxies: The Contours of Shareholder Democracy*, 63 WASH. & LEE. L. REV. 1503 (2006) (narrating the history of the shareholder proposal rule).

decisions than at any time before or since."[41] This is not to say, however, that the litigants were successful. Rather, judges merely sought to ensure that managers acted as business experts. "Instead of fearing bureaucratic discretion," Gerald Frug explains, midcentury jurists "welcomed it because they perceived the managers and employees who exercised it to be 'experts' whose professionalism simultaneously limited the scope of their power, prevented personal domination, and made possible creativity and flexibility necessary to the effectiveness of the bureaucratic form."[42]

Building on traditional exceptions to directors' liability, the midcentury courts developed the modern jurisprudence of business judgment to defer to management's expert opinion. In *Litwin v. Allen*, a case involving allegations of breaches of the duty of loyalty as well as negligence, Justice Bernard Shientag, holding for the defendants, stressed that "whether or not a director has discharged his duty, whether or not he has been negligent, depends upon the facts and circumstances of a particular case, the kind of corporation involved, its size and financial resources, the magnitude of the transaction, and the immediacy of the problem presented."[43] A year later, Justice Joseph Callahan held that "if a director exercises his business judgment in good faith on the information before him, he may not be called to account through the judicial process, even though he may have erred in his judgment."[44] "However high may be the standard of fidelity to duty which the court may exact," Judge Irving Lehman wrote in *Everett v. Phillips*, "errors of judgment by directors do not alone suffice to demonstrate lack of fidelity. That is true even though the errors may be so gross that they may demonstrate the unfitness of the directors to manage the corporate affairs."[45] And in *Casey v. Woodruff*, another decision by Justice Shientag, the court held that directors had "a wide latitude in the management of the affairs of a corporation provided always that judgment, and that means an honest, unbiased judgment, is reasonably exercised by them."[46]

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[41] COFFEE, *supra* note 39, at 35.

[42] Gerald E. Frug, *The Ideology of Bureaucracy in American Law*, 97 HARV. L. REV. 1276, 1283 (1984).

[43] Litwin v. Allen, 25 N.Y.S.2d 667, 678 (Sup. Ct. 1940).

[44] Rous v. Carlisle, 26 N.Y.S.2d 197, 200 (App. Div. 1941).

[45] Everett v. Phillips, 43 N.E.2d 18, 19–20 (N.Y. 1942).

[46] Casey v. Woodruff, 49 N.Y.S.2d 625, 643 (Sup. Ct. 1944).

How could corporations (and corporate law) so easily remove shareholders from corporate affairs? In the 1940s, reliance on internal finance and bank loans helped shield the control group (both large shareholders and corporate executives) from the discipline of the stock market. Corporate management was running corporations for the sake of business, while federal and state legislators refrained from restraining American business so as not to disturb economic expansion. The business judgment rule, as it developed in midcentury, reflected the dominant business practice and the managerialist theory that legitimated it.[47]

Managerialism reached further. Excluding shareholders from participation, courts also allowed managers to use shareholder funds to attend to a variety of social issues. Beginning in the early 1940s, as the rise of totalitarianism in Europe forced American jurists to wonder whether democracy as embodied in the American form of government was ethically superior to other regimes,[48] justifying corporate power and the actions of those who exercised it became a means of explaining the strength of American institutions and democratic ideology. Corporations were described as defenders of American democracy and allowed to "contribute[] . . . corporate funds" to American causes.[49] By the 1950s, charitable contributions, traditionally deemed *ultra vires*, were sanctioned and left to managerial discretion.[50] Management could choose to make certain contributions, despite shareholders' disapproval, but it was not required to do so, even if the shareholders so wished. Corporations and their executives were free to exercise their power, with or without their shareholders' consent. As Adolf Berle put it, "modern directors [were] not limited to running business enterprise for maximum profit, but [were] in fact and recognized in law as administrators of a community system."[51]

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47 Dalia T. Mitchell, *From Tort to Finance: Delaware's Sedative Duty to Monitor*, *in* COMPLEXITY AND CRISIS IN THE FINANCIAL SYSTEM: CRITICAL PERSPECTIVES ON THE EVOLUTION OF AMERICAN AND BRITISH BANKING 121, 130 (Matthew Hollow, Folarin Akinbami and Ranald Michie eds., 2016). *See also* Dalia T. Mitchell, *Shareholder Wealth Maximization: Variations on a Theme*, 24 U. PENN. J. OF BUS. L. 700, 722–28 (2022) (exploring how the rhetoric of profit helped assuage shareholders that corporations were run for their benefit).

48 EDWARD A. PURCELL, THE CRISIS OF DEMOCRATIC THEORY: SCIENTIFIC NATURALISM AND THE PROBLEM OF VALUE 138 (1973).

49 A. P. Smith Mfg. Co. v. Barlow, 13 N.J. 145, 153 (1953).

50 *Id.* at 153–54. *See also* EICHAR, *supra* note 20, at 204.

51 Adolf A. Berle, Jr., *Foreword* to THE CORPORATION IN MODERN SOCIETY ix, xii (Edward S. Mason ed., 1960); *see also* Wolfgang G. Friedmann, *Corporate Power, Government by Private Groups, and the Law*, 57 COLUM. L. REV. 155, 171 (1957).

The expansion of the economy during World War II and business support for the regulatory state continued the collaboration between business leaders and policymakers that began during the New Deal.[52] With decentralization firmly in place, corporate leaders were able to focus attention on issues outside individual corporations. Sitting "atop the largest firms and [holding] positions in multiple organizations, which allowed them to see the world from a relatively cosmopolitan perspective," the corporate elite "participated actively in policy-making organizations, such as the [Committee on Economic Development], and they played a significant role in formulating ideas that were later adopted as national policy."[53] Joining with policymakers rather than resisting regulation, business leaders were able to help "form a plan for postwar reconversion of the American economy," helped convince Eisenhower "not only to maintain the core elements of the New Deal but to increase them," and in the 1960s, helped "provide[] the key support for an element of President Johnson's Great Society—the building of new, low-density public housing for the poor."[54] As Mark Mizruchi put it, "Even as many, perhaps the majority, of American businessmen continued to hold to the traditional views of laissez-faire, the leaders of the largest American corporations were in the vanguard of moderate, pragmatic solutions to pressing economic and social problems."[55]

Social and political critics pointed to power inequities that permeated American corporations and that were reinforced by the celebration of managerialism.[56] And corporate law scholars noted that the rhetoric of corporate democracy was used to empower

[52] MIZRUCHI, *supra* note 10, at 6–7; *see also id.* at 43 (noting that by the end of the 1930s, most businesspeople "had come to grudgingly accept . . . most of the New Deal policies" and the inevitable reality that "government was going to play a significant role in . . . economic policy.").

[53] *Id.* at 7.

[54] *Id.* at 2.

[55] *Id.*

[56] *See, e.g.,* C. WRIGHT MILLS, THE POWER ELITE 28–29 (1956) (decrying "the rise of an elite of power" whose "decisions . . . carry more consequences for more people than has ever been the case in the world history of mankind," and arguing that the postwar years witnessed "[t]he top of the American system of power . . . [becoming] much more unified and much more powerful, the bottom . . . much more fragmented, and in truth, impotent"); GABRIEL KOLKO, THE TRIUMPH OF CONSERVATISM: A REINTERPRETATION OF AMERICAN HISTORY, 1900–1916, 3, 8, 286 (1963) (describing the regulatory laws of the Progressive era as reflecting the efforts of conservative corporate leaders to maintain the social and political status quo amidst changing economic conditions, and portraying the modern American state as the result of business efforts to explain capitalism in a way that allowed the corporate elite to maximize their profits).

managers and remove shareholders from any meaningful position in the corporation.[57] But the general acceptance of managerialism was not undermined. Worried about totalitarianism and, later, the Cold War, most scholars discounted concerns about business and its potential threat to democracy and instead assumed a harmonious relationship between corporations, the corporate elite, and society.[58] At the 1956 meeting of the American Economic Association, economist Carl Kaysen noted that "[t]he modern corporation is a soulful corporation"[59]:

> No longer the agent of proprietorship seeking to maximize return on investment, management sees itself as responsible to stockholders, employees, customers, the general public, and, perhaps most important, the firm itself as an institution . . . . [Moreover, its] responsibilities to the general public are widespread: leadership in local charitable enterprises, concern with factory architecture and landscaping, provision of support for higher education, and even research in pure science, to name a few.[60]

Corporations were the engine that made American democracy thrive.

III. THE DEAL DECADE

This Part III explores how, beginning in the 1970s, growing concerns among business leaders that the government was no longer "attuned to business and industry problems" and instead was "dominated by special interest groups of environmentalists, welfare rights organizations, and consumer activists such as

57 *See, e.g.*, Robert A. Kessler, *The Statutory Requirement of a Board of Directors: A Corporate Anachronism*, 27 U. CHI. L. REV. 696, 697–701 (1960) (noting that "the status of the board of directors is analogous to that of a legislative body under a 'delegative' theory of democratic government. The directors have been held to be the 'representatives' of the entire body of shareholders and hence not subject to the dictates of even a majority of their 'constituents,' the shareholders"); Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L. J. 223, 226 (1962) (exploring the mundane appraisal remedy to demonstrate that rather than fulfilling the democratic task it was presumed to fulfill, the remedy became a vehicle by which managers could justify their undemocratic power).

58 KAREN HO, LIQUIDATED: AN ETHNOGRAPHY OF WALL STREET 195 (2009); Gerald F. Davis, *The Twilight of the Berle and Means Corporation*, 34 SEATTLE U. L. REV. 1121, 1125 (2011).

59 Carl Kaysen, *The Social Significance of the Modern Corporation*, 47 AM. ECON. REV. 311, 314 (1957).

60 *Id.* at 313.

Ralph Nader,"[61] led corporate managers to turn their gaze onto their corporations, focusing on their corporations' inner working (and conflict) to the exclusion of broader social and political concerns. Using narrative to interrogate a few renowned 1980s cases, this Part further demonstrates how the Delaware Supreme Court supported the corporate elite's inward turn by substituting fairness, that is, fair dealing, for the traditional business judgment rule. Directors and officers were no longer granted broad discretion; rather, they were asked to follow procedures that the Court assumed would protect the interests of their shareholders, to the exclusion of all else (workers, the community, and even other investors).

A. The Roaring 1980s

By the 1970s, managerialism was under attack. Increased government spending, "global competition in product markets" coupled with "powerfully renewed national economies," especially Japan's and Germany's,[62] and the 1973 energy crisis "created an unprecedented combination of high inflation and unemployment," undermining the postwar trust in Keynesian economics.[63] "External economic shocks, compounded by a drop in productivity growth, cost-of-living adjustments built into union contracts, and an economy shifting toward services" led to dramatic wage and profitability drops.[64] New regulatory agencies—particularly the Environmental Protection Agency and the Occupational Safety and Health Administration—triggered businesses' ire,[65] while the Vietnam War and the Watergate scandal created "a legitimacy crisis among major American institutions, including business."[66] Americans lost faith in their federal and state governments as well as in their industrial corporations and their ability to improve the economy.[67]

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[61] Nikolas Bowie, *Corporate Democracy: How Corporations Justified Their Right to Speak in 1970s Boston*, 36 L. & HIST. REV. 943, 953 (2018) (quoting Memorandum from Lewis F. Powell, Jr., to Eugene B. Sydnor, Jr., Chairman, Educ. Comm., U.S. Chamber of Com. 24–25 (Aug. 23, 1971)).

[62] Allen, *Engaging Corporate Boards*, *supra* note 32, at 90–92.

[63] MIZRUCHI, *supra* note 10, at 8.

[64] *Id.*

[65] *Id.*

[66] *Id.*

[67] RAKESH KHURANA, FROM HIGHER AIMS TO HIRED HANDS: THE SOCIAL TRANSFORMATION OF AMERICAN BUSINESS SCHOOLS AND THE UNFULFILLED PROMISE OF

Business and government responded by turning to markets rather than better planning. After the election of Ronald Reagan, the federal government embraced "a more laissez faire attitude about the marketplace."[68] Reagan "railed against government regulation, took pride in breaking up the power of public-sector unions, and ushered in an era in which people were encouraged to feel good about making money."[69] "Air, truck, and rail transportation were deregulated" as were "oil and gas prices, electricity, telecommunications and of course banking and finance."[70] Whether a cause for celebration or concern, markets became "a whole lot freer and [a] lot more competitive."[71]

The stock market, though, was low. After the bull market of the 1960s helped keep the growing numbers of investors satisfied, in the 1970s, the stock market slumped[72] and stocks remained undervalued through the early 1980s.[73] Back in the 1960s, Henry G. Manne, then a young law professor at the George Washington University, argued that a firm's stock price was an indication of managerial efficiency. When the price was lower "relative to what it could be with more efficient management," Manne wrote, "the more attractive the takeover becomes to those who believe that they can manage the company more efficiently."[74] In the 1980s, as the Reagan administration staffers in the Justice Department's Antitrust Division and the Securities and Exchange Commission lessened restrictions against horizontal and vertical mergers and were less likely to intervene in antitrust cases,[75] Manne's prophecy soon became a reality. With lax enforcement of antitrust laws[76] and "stocks [falling] to five-or-six times earnings and often

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MANAGEMENT AS A PROFESSION 298–99 (2007). *See also* William T. Allen & Leo E. Strine, Jr., *When the Existing Economic Order Deserves a Champion: The Enduring Relevance of Martin Lipton's Vision of the Corporate Law*, 60 BUS. LAW. 1383, 1387 (2005) (noting that "American confidence in the federal government's capacity to manage the national economy so as to produce continued growth, smooth the business cycle, include more Americans in the comforts of middle-class life, and satisfy a host of emerging social expectations, had begun to flag.").

68 KENT GREENFIELD, CORPORATIONS ARE PEOPLE TOO 44 (2018).

69 *Id.* at 44–45.

70 William T. Allen, *Modern Corporate Governance and the Erosion of the Business Judgment Rule in Delaware Corporate Law*, 4 COMPARATIVE RSCH. L. & POL. ECON., no. 8, at 8 (2008).

71 *Id.*

72 COMMITTEE FOR ECONOMIC DEVELOPMENT, SOCIAL RESPONSIBILITIES OF BUSINESS CORPORATIONS 13–14 (1971); EICHAR, *supra* note 20, at 243.

73 MIZRUCHI, *supra* note 10, at 208.

74 Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. OF POL. ECON. 110, 113 (1965).

75 MIZRUCHI, *supra* note 10, at 208–9.

76 *Id.* at 9.

traded for less than a company's book value, tender-offer raids became financially feasible" as raiders could offer premium above market price and "[t]he outlay could be recouped in a half-dozen years, or even sooner, by selling off some of the acquired assets."[77] Almost overnight, "all the largest corporations were up for grabs to the highest stock-price bidder, thus forcing them to be immediately responsive to the exigencies of the stock market."[78]

Investment bankers were up to the challenge, spinning "a compelling narrative of how in the postwar era an elite, complacent, and self-serving managerial class squandered corporate resources extravagantly on themselves or on ill-advised expansions, and allowed foreign competitors to overtake the United States in productivity, innovation, and strategy."[79] To save corporations, the narrative continued, one had to "'unlock[]' the value of 'underperforming' stock prices" to the benefit of the victims in this narrative—the shareholders,[80] who by then were largely institutional investors.[81] Hostile takeovers were the solution to corporate America's growing crisis of legitimacy. "Fueled by a combination of Michael Milken's discovery of the financing potential of high yield debt, deregulation, and a gentler approach by the Reagan administration to antitrust regulation," John Armour and David

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77 PAUL HOFFMAN, THE DEALMAKERS: INSIDE THE WORLD OF INVESTMENT BANKING 143 (1984).

78 HO, *supra* note 58, at 129.

79 *Id.* at 130.

80 *Id. See also* Allen & Strine, *supra* note 67, at 1387 ("[H]istorically high interest rates in the 1970s had kept stock market valuations floating in an essentially static range for over a decade. When, under Paul Volcker's lead, the Federal Reserve Board broke the inflationary cycle in the early 1980s, financially sophisticated players recognized that stocks were cheap. What followed was an historic wave of finance-driven corporate acquisitions.").

81 While the percentage of households that directly own equities has remained at about 20% since the late 1970s, mutual funds investment (including but not limited to retirement investment) "increased the percentage of households that own equities directly or through mutual funds by 30% to a total of 50%" by the middle of the first decade of the twenty-first century. Moreover, while in the 1950s, "equities were still held predominantly by households" with institutional investors holding "only approximately 6.1% of U.S. equities," by the 1980s, "institutional investors held 28.4% of U.S. equities." By the end of the first decade of the twenty-first century, "institutional investors held 50.6% of all U.S. public equities, and 73% of the equity of the thousand largest U.S. corporations." Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Reevaluation of Governance Rights*, 113 COLUM. L. REV. 863, 874–84 (2013).

Skeel write, "takeover activity soared to a level not seen since the great merger wave at the end of the Gilded Age."[82]

The legal profession supported the warring factions—CEOs of target companies on the one side, and CEOs of hostile bidders on the other. In the 1950s and 1960s, "old-line Wall Street law firms" considered it "scandalous" for a company to buy another one "without the target agreeing to be bought."[83] When in 1954, Robert Young launched "a hotly contested and ultimately successful proxy contest for control of the New York Central Railroad," he was viewed as attacking "existing norms of Wall Street behavior."[84] Even as hostile tender offers became more common in the 1960s, "rising from seventy-nine from 1956–1960 to nearly twice that number from 1964–1966 . . . Wall Street investment banks and law firms refused to represent bidders in a hostile takeover."[85] As Malcolm Gladwell writes, "Wall Street law firms had a very specific idea about what it was that they did. They were corporate lawyers . . . represent[ing] the country's largest and most prestigious companies."[86] That meant that "they handled the taxes and legal work behind the issuing of stocks and bonds and made sure their clients did not run afoul of federal regulators."[87] But in the 1980s, hostile takeovers became, almost overnight, acceptable and "what every law firm wanted to do."[88]

With large Delaware and New York law firms involved, cases landed in the Delaware courts at a dizzying pace, propelling the courts to the world stage. The front pages of major national newspapers dissected their decisions. "Tiny Delaware's Corporate Clout," read a title in the New York Times.[89] "The complex, often precedent-setting corporate suits involving billions of dollars, thousands of shareholders and issues of corporate control" made the Delaware bench special, the article declared.[90] The questions that came before the courts were novel: Under Delaware law, can directors defend against a hostile takeover? If so, at what cost? And litigation quickly became "superheated, . . . conducted within

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[82] John Armour & David A. Skeel, Jr., *Who Writes the Rules for Hostile Takeovers and Why?: The Peculiar Divergence of U.S. and U.K. Takeover Regulation*, 95 GEO. L. J. 1727, 1755 (2007).

[83] MALCOLM GLADWELL, OUTLIERS: THE STORY OF SUCCESS 124–25 (2008).

[84] Armour & Skeel, *supra* note 82, at 1752–53.

[85] *Id.* at 1753.

[86] GLADWELL, *supra* note 83, at 124.

[87] *Id.*

[88] *Id.* at 127–28.

[89] Lindsey Gruson, *Tiny Delaware Corporate's Clout*, N.Y. TIMES, June 1, 1986, at F6.

[90] *Id.*

short time frames compelled by market forces."[91] Courtrooms were "overflowing with armies of lawyers for the litigants and for arbitrageurs, who had, in effect, bet large sums on the outcome, along with members of the press and spectators."[92] It was the Delaware courts' time to shine, and they made careful use of their newly acquired fame—transforming legal doctrine to fit a rapidly changing corporate world.[93]

In a famous attack on the Delaware courts in the 1980s, Marty Lipton accused them (especially the Delaware Supreme Court) of rejecting the business judgment rule. "Delaware has misled corporate America," Lipton charged. "It lured companies in with a promise that the business judgment rule would govern corporate law. It's obvious that the state has reneged."[94] The hostile takeover cases, especially the *Van Gorkom*, *Unocal*, *Revlon* trilogy, seemed to move away from the absolute deference to managerial expertise that characterized the midcentury and postwar years. *Van Gorkom* held directors liable for breach of the duty of care, *Unocal* subjected a target's directors' defensive actions to heightened scrutiny, and *Revlon* seemed to impose on directors a duty to maximize shareholder profit.[95] "The . . . thrust of these opinions," William T. Allen would note twenty years later, "was the willingness of the Delaware Supreme Court to push the business judgment rule aside in order more actively to review board engagement."[96]

Indeed, as the following Section III.B elaborates, Delaware transformed its business judgment rule. Recognizing that cases involving friendly and not-so-friendly acquisitions raised issues outside the scope of the traditional business judgment jurisprudence, the Delaware Supreme Court developed a unique jurisprudence, at the center of which was the concept of fairness.

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91 Helen L. Winslow et al. ed., *The Delaware Bar in the Twentieth Century* 598 (1994).

92 *Id.*

93 Allen, *Engaging Corporate Boards*, *supra* note 32, at 96.

94 William Meyers, *Showdown in Delaware: The Battle to Shape Takeover Law*, INSTITUTIONAL INVESTOR, Feb. 1989, at 64, 75.

95 *See* discussion *infra* Section III.B.; *see also* Transcript (Rowe, Allen), *supra* note 1, at 2 (noting that "in *Revlon*, we had a case where what looked like a disinterested board was not accorded the business judgment rule respect, but some other form of review was being applied, and it wasn't clear in the case . . . whether there was a duty of care that had been violated or whether some other aspect of good faith was involved; loyalty?").

96 Allen, *supra* note 70, at 10.

Uncharacteristically moralistic[97] and willing to overturn several key decisions of the Chancery Court, the Delaware Supreme Court shifted away from the traditional business judgment jurisprudence and, instead, embraced the fairness standard of review to evaluate directors' actions involving fundamental transactions.[98] Yet, as the following Section III.B further demonstrates, the standard of fairness was not used to undermine directors' discretion. Rather, fairness, as defined in *Weinberger,* involved two aspects—fair dealing and fair price—and in their decisions, the Delaware courts prioritized the former. Gradually, the limited test of fair dealing or procedural fairness substituted for business judgment as the norm legitimating corporate executives' power.

B. From Business Judgment to Fair Dealing

i. *Weinberger v. UOP, Inc.*: Fair Dealing and Fair Price

The requirement that those in control of the corporation not act unfairly developed midcentury, as courts moved away from a strict prohibition of conflict-of-interest transactions. Allowing executives to balance their interests against the corporation's interests, courts subjected such transactions to scrutiny under a test of fairness, a standard that one commentator described as "measured by the 'Chancellor's foot.'"[99] In the 1980s, seeking perhaps to bring a measure of certainty to the fairness standard, the Delaware Supreme Court in *Weinberger v. UOP* redefined it.

Weinberger addressed the elimination of UOP's minority shareholders by a cash-out merger between UOP and its majority owner, The Signal Companies, Inc.[100] The stockholders voted to approve the deal on May 26, 1978, and the litigation began two

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97 *See, e.g.*, Edward B. Rock, *Saints and Sinners: How Does Corporate Law Work*, 44 UCLA L. REV. 1009 (1997) (arguing that Delaware's decisions offer instructions to management in a variety of contexts).

98 *See* Lawrence A. Cunningham & Charles M. Yablon, *Delaware Fiduciary Duty Law After* QVC *and* Technicolor*: A Unified Standard (and the End of Revlon Duties?)*, 49 BUS. LAW. 1593–94 (1994) (arguing that, in the 1980s, the Delaware courts turned "Delaware fiduciary law toward a single, more unified standard, and away from doctrinal fragmentation").

99 Note, *The Fairness Test of Corporate Contracts with Interested Directors*, 61 HARV. L. REV. 335, 337 (1948). The difference between strict prohibition and fairness is noteworthy. A rule of strict prohibition required voiding transactions between the corporation and a director or an officer simply because they involved the self-interest of the latter. In turn, the fairness standard of review allowed courts to validate such transactions, even though they were the result of breach of trust (that is, they involved the self-interest of the fiduciary), if the result of such transactions was fair to the corporation.

100 Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

months later.[101] William Weinberger, the shareholder who sued on behalf of the minority shareholders, was a familiar litigant. By 1978, he "had already been involved in at least 90 federal securities law cases as a plaintiff. And in a number of Delaware cases, including at least one or two that Vice-Chancellor Brown commented that he had decided."[102] According to Gil Sparks, who represented UOP, Weinberger was at least eighty when he filed the class action.[103]

The Delaware Chancery Court, twice, dismissed the case, as did the Delaware Supreme Court on appeal. But Weinberger would not budge, nor would his attorney, William Prickett (of Prickett, Jones, Elliott, Kristol & Schnee), and because Justice Duffy, who heard the appeal, dissented, the case was re-heard en banc.[104] The Delaware Supreme Court vacated the early decision and decided the case on the original briefs and oral argument.[105]

At the time, there were few Delaware cases addressing fundamental transactions,[106] so Justice Andrew G.T. Moore, who wrote the Court's opinion, turned to the traditional framework of controlling shareholders' duties, explaining that the actions of Signal and its appointed directors on the UOP board were sufficient to require that the controlling shareholder and the board prove the entire fairness of the transaction.[107] "When directors of a Delaware corporation are on both sides of a transaction," Moore, a Wilmington attorney for 18 years before his appointment to the

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[101] Interview by A. Thompson Bayliss with A. Gilchrist Sparks, III, Morris Nichols Arsht & Tunnell LLP, at 3 (Jan. 29, 2019) (transcript available at https://perma.cc/26QD-J8V5) (hereinafter "Transcript (Bayliss, Sparks)").

[102] *Id.*

[103] *Id.*

[104] *Id.* at 30 (noting that "at some point in time, the court, as a matter of policy, came up with a policy that if there were a dissent, then there would be a re-hearing en banc"). By the time the case was re-heard, Justice Duffy had retired, and Justice Moore was appointed.

[105] *Id.* at 33–34.

[106] Peter Atkins et al., Panel on Insights from Practice: Did Delaware Get It Right or Mess Up in Addressing the Takeover Boom of the 1980s? at 4 (Sept. 25, 2018) (transcript available at https://perma.cc/MED3-P6FN) ("[T]he law was essentially around control shareholders and what was expected of control shareholders and corporate opportunity.").

[107] Weinberger v. UOP, Inc., 457 A.2d 701, 701, 703 (Del. 1983). Because in cash-out mergers, statutory appraisal was already available to dissenting shareholders, the Court limited the plaintiffs' ability to demand that the directors prove the fairness of the transaction. The Court held that before requiring the directors or controlling shareholders to demonstrate the entire fairness of the cash-out merger, the plaintiff shareholder "must allege specific acts of fraud, misrepresentation, or other items of misconduct to demonstrate the unfairness of the merger terms to the minority." *Id.*

Delaware Supreme Court in 1982,[108] wrote, "they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain."[109]

Significantly, Moore eliminated the controlling shareholders' need to prove that there was a business purpose for the merger.[110] "In view of the fairness test which has long been applicable to parent-subsidiary mergers," Moore explained, "we do not believe that any additional meaningful protection is afforded minority shareholders by the business purpose requirement."[111] Instead, Moore, seeking to buttress the fairness test, offered a clearer definition of the concept of fairness in the new age of the deal. According to Moore, to show that their actions were entirely fair, directors and controlling shareholders would have to demonstrate both fair dealing and fair price. As he held:

> The concept of fairness has two basic aspects: fair dealing and fair price. The former embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. The latter aspect of fairness relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock.[112]

The two prongs were interwoven. Because Signal did not follow the required procedures, it failed to meet the first prong of the test; it thus could not demonstrate that its offer was fair.[113]

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[108] *Former Delaware Supreme Court Justice Dies at 83*, WBOC TV (Dec. 13, 2018) https://perma.cc/Q4JT-ACGQ.

[109] *Weinberger*, 457 A.2d at 710.

[110] *Id.*

[111] *Id.* at 714.

[112] *Id.* at 711.

[113] To say that Signal did not follow appropriate (or fair) procedure is an understatement. In determining the price per share that it was willing to offer the public shareholders of UOP, Signal used a feasibility study conducted by two of Signal's members on the UOP board. The study revealed that the merger would be beneficial to Signal at any price up to $24 per share. The study was never disclosed to the other members of the UOP board or to UOP's shareholders before they approved the merger at $21 per share. *Id.* at 705. Moreover, it turned out that Lehman Brothers (the investment banker that provided UOP with a fairness statement) was also a financial advisor to Signal and in that role advised that it would be worth it for Signal to buy UOP for $21 per share; Lehman Brothers then advised UOP that $21 was fair. Transcript (Bayliss, Sparks), *supra* note 101, at 13–14. This information was unearthed during discovery. *Id.* at 17.

Singlehandedly, Justice Moore seemed to change Delaware's path, diverting from the traditional deference to directors' discretion, embracing instead a fairness test.[114] But the decision was not a victory to future shareholders. "The Supreme Court of Delaware significantly limited the rights of shareholders who dissent to the merger of a subsidiary into its parent company," the New York Times reported.[115] A victory for Weinberger on the facts, "the new opinion will in most such cases make it impossible for such shareholders to bring a class action to stop the merger, limiting them instead to a financial claim for the fair value of their stock."[116] When the dust settled, the shareholders received a nominal $1 per share added to the price they received in the merger.[117]

Indeed, as the following subsections suggest, *Weinberger*'s fair dealing was a modified business judgment rule; so long as managers followed the procedural requirements that fulfilled the fair dealing prong, the Delaware courts were unlikely to review the substance of their decision or the fairness of the price they offered their shareholders. Only when managers strayed, the court brought them back onto the managerial path with additional instructions. Jerome W. Van Gorkom, the CEO of Trans Union, was among the first CEOs to learn this lesson, the hard way.

ii. *Smith v. Van Gorkom*: Fair Dealing and the Duty of Care

Trans Union traced its origins to a small nineteenth-century "rail line handling oil shipments to Chicago," known as the Union Tank Line Company.[118] In the 1880s, it came under John D. Rockefeller's Standard Oil conglomerate, only to be spun off as a publicly traded company two decades later, changing its name in 1919 to Union Tank Car Company.[119] It became a leading lessor of railcars, dealing with Standard Oil as well as other oil companies. During the conglomerate wave of the late 1960s, a corporate

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114 According to Gil Sparks, "the court had sort of ceded the lead position in these corporate transaction type cases that it reviewed to Justice Moore. He was, by far, the most influential Justice on the court. And particularly, the relationship between he [sic] and the Chief Justice meant that every time Justice Moore said something, the Chief Justice sort of echoed it." Transcript (Bayliss, Sparks), *supra* note 101, at 33.

115 *Delaware Merger Suit is Curbed*, N.Y. TIMES, Feb. 7, 1983, at D1.

116 *Id.*

117 Transcript (Bayliss, Sparks), *supra* note 101, at 45.

118 Stephen Bainbridge, *The Story of* Smith v. Van Gorkom, in CORPORATE LAW STORIES 197, 201 (J. Mark Ramseyer, ed., 2009).

119 *Id.* at 201–2.

reorganization turned the Union Tank Car Company into a subsidiary of a holding company, Trans Union.[120]

By the late 1970s, Trans Union found itself in "an unusual tax quandary": "Its core railroad car leasing business generated substantial depreciation deductions, which significantly reduced its taxable income," but under the Investment Credit provisions of the Internal Revenue Act, "the business also generated substantial investment tax credits . . . with no taxable income against which to use the tax credits," which "had a five-year life."[121]

Seeking ways to use its growing cash surplus, Trans Union actively looked for a suitor for an acquisition or merger; reportedly, in 1980 it "contacted more than 100 companies as possible acquirers" to no avail.[122] This predicament led its soon-to-retire CEO, Jerome Van Gorkom, who had been with Trans Union since 1956 and its CEO since 1963, to reach out to Jay Pritzker, a "prominent Chicago businessm[a]n and philanthropist[]," and a colleague.[123] "On Saturday, September 20, 1980, Van Gorkom hosted a gala party at the 25th floor penthouse of the Trans Union building in Chicago to celebrate the opening of the Lyric Opera's 26th season at Chicago's Civic Opera House."[124] At some point during the event, "Van Gorkom and Pritzker . . . signed an agreement under which Pritzker would buy out Trans Union's shareholders at $55 per share in cash."[125] Van Gorkom came up with the price.[126]

To business executives trained prior to the 1980s, there was nothing wrong with Van Gorkom's (or Pritzker's) actions. Van Gorkom was "something of an autocrat who made decisions in a solitary . . . fashion," but many saw that as a plus, believing that "strong leadership, quick action and avoidance of red tape make the business world work better."[127] "He was the CEO and he acted like a CEO. He was in control," Robert Payson, who represented Trans Union, noted.[128] And Joseph Winski, writing for the Chicago Tribune, suggested that while Van Gorkom did not publicly

[120] *Id.* at 202.

[121] *Id.*

[122] William Gruber, *Marmon May Lose Trans Union Deal*, CHI. TRIB., Jan. 29, 1981, at C7.

[123] Bainbridge, *supra* note 118, at 206.

[124] *Id.*

[125] *Id.*

[126] Smith v. Van Gorkom, 488 A.2d 858, 866 (Del. 1985).

[127] Bainbridge, *supra* note 118, at 218.

[128] Interview by Joel Friedlander with Robert Payson, Potter, Anderson, & Corroon, at 4 (Jan. 11, 2017) (transcript available at https://perma.cc/93YC-87Y9) (hereinafter "Transcript (Friedlander, Payson)").

discuss the reasons for the deal, "he was an extremely ethical, moral type of guy, and he probably realize[d] that his shareholders simply [weren't] going to get proper value for their stock in the market."[129] Nor would the board be at fault for approving the agreement sight unseen. The Delaware Supreme Court admitted that they did not expect board members "to read *in haec verba* every contract or legal document" which they approve,[130] and acknowledged that all ten directors were "well informed about the Company and its operations as a going concern. They were familiar with the current financial condition of the Company, as well as operating and earnings projections reported in the recent Five Year Forecast."[131]

But on December 19, 1980, represented by William Prickett (of *Weinberger* fame), B. Alden Smith, who sold his business to Trans Union and held 54,000 shares of its common stock (by comparison, Van Gorkom owned 75,000 shares), brought a class action seeking to enjoin the deal. (Smith was later joined by John W. Gosselin, who, with his family, owned about 43,000 shares.)[132] The plaintiffs argued that Van Gorkom "pushed through the merger without giving the company's directors and shareholders a fair opportunity to seek a better deal."[133] And the fact that thirty of Trans Union's executives "threatened to quit"[134] when they heard about the merger did not help matters.

Chancellor Marvel for the Delaware Chancery Court rejected Smith's request for a preliminary injunction, concluding in the

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[129] Joseph Winski, *Marmon Can't Lose in Trans Union Deal*, CHI. TRIB., Sept. 28, 1980, at W5. *See also* Interview by Joel Friedlander with A. Gilchrist Sparks, III, Morris Nichols Arsht & Tunnell, LLP, at 41 (Jan. 24, 2017) (transcript available at https://perma.cc/C5HW-8LBB) (hereinafter "Transcript (Friedlander, Sparks)") (suggesting that Van Gorkom thought a leveraged buyout would be wrong, a position that was common in the 1970s, especially "if the public stockholders suffered along with the company and . . . just before the company turned the corner that you bought them out in a forced transaction, that was problematic."). A more cynical view suggests that Van Gorkom, who feared that he was going to be replaced, was looking for a way out. *Id.* at 19; *see also* Interview by Joel Friedlander with Michael Hanrahan, Prickett, Jones & Elliot, at 11 (May 16, 2017) (transcript available at https://perma.cc/M7VJ-96PH) (hereinafter "Transcript (Friedlander, Hanrahan)"). By Sept. 1982, at 65, Van Gorkom was appointed Under Secretary of State for Management which entailed a move from Chicago to Washington. Jerry Crimmins, *School Finance Head Named to U.S. Post*, CHI. TRIB. Sept. 15, 1982, at B5.

[130] *Van Gorkom*, 488 A.2d at 883 n.25.

[131] *Id.* at 868.

[132] *Id.* at 864–65.

[133] William Gruber, *Test of Trans Union Deal*, CHI. TRIB., Feb. 11, 1981, at C3.

[134] Meg Cox, *Trans Union Tells of Possible New Suitor as Dissent Surfaces over Marmon's Offer*, WALL ST. J., Jan. 29, 1981, at 3.

spirit of managerialism: "The provisions of 8 Del. C. section 141 place the management of a Delaware corporation under the direction of a board of directors and where there is no indication of fraud or ultra vires conduct, this Court will not interfere with questions of policy and business management."[135]

At the time, few, if any, cases held directors liable for breach of a duty of care. As Gil Sparks, who represented the Trans Union board, reportedly said during oral argument: "Your honor, this is an arm's length merger. We've looked at the cases. We haven't found a case in which this court has enjoined an arm's length merger."[136] Or, as Sparks put it more recently, "this was new ground and . . . it . . . really hadn't ever quite made it to the court system in Delaware . . . in terms of the possibility that you might be liable, personally liable for money damages, for something other than the breach of duty of loyalty or bad faith."[137] So Marvell also rejected the suit on the merits.[138]

William Prickett, attorney for the shareholders, was not deterred. Relying on an article by Samuel Arsht about the business judgment rule that had just been published, he appealed.[139] "It is one thing to make a decision, and another thing to make an informed decision. It is only the latter type of decision that the business judgment rule protects," Arsht proclaimed.[140] (Arsht founded Morris Nichols Arsht & Tunnell, the firm that represented the Trans Union board.)

Three re-arguments later,[141] the shareholders won. Rejecting the legal conclusions of the Chancery Court, a rare occurrence in Delaware, the Delaware Supreme Court, citing *Weinberger* among other cases, concluded that the directors were not informed (that is, they breached their duty of care).[142] "Representation of the financial interests of others imposes on a director an affirmative duty to protect those interests and to proceed with a critical eye in assessing information of the type and under the

[135] Smith v. Pritzker, No. C.A. 6342, 1981 WL 15145, at 4 (Del. Ch. 1981).

[136] Transcript (Friedlander, Payson), *supra* note 128, at 13–14.

[137] Transcript (Friedlander, Sparks), *supra* note 129, at 8.

[138] Smith v. Pritzker, No. 6342, 1982 WL 8774 (Del. Ch. 1982).

[139] S. Samuel Arsht, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93 (1979).

[140] *Id.* at 120. Ironically, Arsht is also said to have proposed that the law be simplified to the following principle: "Directors of Delaware corporations can do anything they want, as long as it is not illegal, and as long as they act in good faith." Rock, *supra* note 97, at 1015.

[141] Transcript (Friedlander, Sparks), *supra* note 129, at 10.

[142] Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985).

circumstances present here," Justice Horsey wrote.[143] As Stephen Bainbridge put it, "The *Van Gorkom* majority . . . had little regard for so-called imperial CEOs like Van Gorkom."[144] The qualifications of members of the board also did not matter. "It was a big deal," Gil Sparks noted.[145] "And the idea that honest directors of this caliber could be personally liable based on a court's finding that they had been negligent or grossly negligent was a wake-up call to corporate America."[146]

Yet, it is important to note that despite its reference to the duty of care, the Court's discussion focused only on the directors' decision-making process, in fact, on their fair dealing. Justice Moore, who joined the *Van Gorkom* majority opinion, explained that the case did not "stand for new law. The court was just applying old law to egregious facts."[147] The directors of Trans Union were found liable, "not because the court believed that the board's decision to sell the company was a bad decision. Rather, the directors . . . were held to have breached their duty of care because they reached their decision too hastily, without the right information, and without asking the right questions."[148] In other words, the directors were liable because their actions did not constitute fair dealing.[149]

Requiring directors to ask questions and ensuring that they had sufficient information would not have necessarily guaranteed better (or even fair) price to the shareholders of Trans Union, but it would have ensured directors that the Delaware courts would not overrule their decision. Significantly, the fact that the price the shareholders of Trans Union were to receive in the planned merger was almost 50% above market price did not matter. (Trans Union stock was trading at $37.50 prior to the merger, and

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143 *Id.*

144 Bainbridge, *supra* note 118, at 218.

145 Transcript (Friedlander, Sparks), *supra* note 129, at 5.

146 *Id.*

147 Stephen A. Radin, *The Director's Duty of Care Three Years after Van Gorkom*, 39 HASTINGS L. J. 707, 719 (1988).

148 Lynn Stout, *In Praise of Procedure: An Economic and Behavioral Defense of* Smith v. Van Gorkom *and the Business Judgment Rule* (UCLA Sch. L., Research Paper No. 01-21, 2001).

149 Almost a decade later, the Delaware Supreme Court clarified that when a plaintiff shareholder rebuts the presumption of the business judgment rule in a suit involving allegations of breach of the duty of care, the burden shifts to the defendant directors to prove entire fairness. Cede & Co. v. Technicolor, Inc., 634 A.2d 345 (Del. 1993). Notably, the *Cede* litigation began shortly after *Van Gorkom* was decided; Justice Horsey wrote the decision in both cases.

never above $41 in the preceding six years.)[150] Fair dealing or fair procedure eclipsed fair price. As the following subsections suggest, nowhere was it clearer than in the context of the two cases that followed, each addressing directors' responses to hostile bids: *Unocal v. Mesa Petroleum Co.*[151] and *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[152]

iii. *Unocal*: Fair Dealing and Defensive Tactics

Unocal, "one of the most important corporate law cases," was the first case to address a target board's defensive measures against a hostile takeover.[153] When T. Boone Pickens, the controlling shareholder of Mesa Petroleum, announced Mesa's two-tier front-loaded tender offer for all of Unocal's stock, the Unocal board quickly reacted.[154] The board, composed of "eight independent outside directors and six insiders,"[155] met several times, for long hours, and after receiving advice from the corporation's legal counsel and investment bankers, "unanimously agreed to . . . reject Mesa's tender offer as inadequate" and, among other things, "pursue a self-tender to provide the stockholders with a fairly priced alternative to the Mesa proposal."[156] Mesa was not permitted to tender its stock into Unocal's self-tender, and it sued to challenge its exclusion.[157]

Again, the Chancery Court and Supreme Court of Delaware were at odds. Given that Unocal's directors would most likely be replaced should Mesa succeed in its hostile tender offer to Unocal's shareholders, the decision of Unocal's board to adopt a defensive measure, on its face, was tainted with a conflict of interest. Inside directors, in particular, were likely to be concerned about losing their livelihoods. (While outsiders might experience reputational loss, their well-paid positions were with their own corporations, corporations where they were insiders.)

[150] Transcript (Friedlander, Sparks), *supra* note 129, at 27.

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

[152] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986). Interestingly, Gil Sparks, who represented Pritzker, called *Van Gorkom* "a Revlon case before Revlon." Transcript (Friedlander, Sparks), *supra* note 129, at 5.

[153] Jeffrey N. Gordon, *The Story of* Unocal v. Mesa Petroleum*: The Core of Takeover Law*, in CORPORATE LAW STORIES 227, 227 (J. Mark Ramseyer ed., 2009).

[154] The front-end offer would have allowed Mesa to purchase "approximately 37% of Unocal's outstanding stock at a price of $54 per share. The 'back-end' was designed to eliminate the remaining publicly held shares by an exchange of [highly subordinated] securities purportedly worth $54 per share." *Unocal*, 493 A.2d at 949.

[155] *Id.* at 950.

[156] *Id.*

[157] *Id.* at 950–51.

Recognizing, perhaps, the potential conflict of interest, Vice Chancellor Carolyn Berger, the first woman on the Delaware Chancery Court (and later the Delaware Supreme Court), held that the decision of the board to exclude Mesa should have been analyzed under the fairness standard of review like any other form of self-dealing. Examining Unocal's actions under this standard, the Chancery Court concluded that Unocal's self-tender "violated the customary rules regarding equal treatment in distributions for members of the same class of stock."[158]

The Delaware Supreme Court reversed. Seeking to empower managers to engage in defensive tactics, the Court first held that the board's power to adopt defensive measures, though not expressly authorized in the Delaware Code, was derived from the Section 141(a) mandate (that a corporation was to be "managed by or under the direction of the board of directors"[159]) and the board's "fundamental duty and obligation to protect the corporate enterprise, which includes stockholders, from harm reasonably perceived, irrespective of its source."[160]

Then, wary, perhaps, of the complexities of substantive fairness analysis, Justice Moore adopted a more lenient standard of review: directors defending against a hostile bid could enjoy the protective presumption of the business judgment rule provided they could demonstrate, first, that they "had reasonable grounds for believing that a danger to corporate policy and effectiveness existed" and, second, [that] the defensive tactic the board adopted was "reasonable in relation to the threat posed."[161] Ensuring, as he did in *Weinberger*, that process trumps substance, and recognizing the shifting nature of the board (from advisory to monitoring), Moore further emphasized that, if a majority of the independent outside directors endorsed the defensive tactic, then the board's action would likely meet the burden of the test.[162] Notably, authorization of independent directors has been the hallmark of fair dealing and is enshrined in Section 144(a)(1) of the Delaware General Corporation Law.[163]

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[158] Gordon, *supra* note 153, at 230; Mesa Petroleum Co. v. Unocal Corp., No. C.A. 7997, 1985 WL 44691 (Del. Ch. 1985).

[159] *Unocal*, 493 A.2d at 954.

[160] *Id.*

[161] *Id.* at 955.

[162] *Id.* at 955. On the monitoring board, *see* Dalia T. Mitchell, *Status Bound: The Twentieth Century Evolution of Directors' Liability*, 5 NYU J. L. & BUS. 63, 132–39 (2009).

[163] Del. Code Ann. Tit. 8 § 144(a)(1) (2023).

Justice Moore's inclination toward fairness reached deeper. In addition to offering a standard that appeared to mirror the fair dealing standard he had articulated in *Weinberger*, Moore also commented on the matter of fair price. Having concluded that the directors met the *Unocal* test, that is, that "the selective exchange offer [was] reasonably related to the threats posed," Moore wrote that the exchange offer "[was] consistent with the principle that 'the minority stockholder shall receive the substantial equivalent in value of what he had before.'"[164] While this principle of fair price was derived from the merger context, Moore applied it to hostile takeovers, holding that:

> the board's decision to offer what it determined to be the fair value of the corporation to the 49% of its shareholders, who would otherwise be forced to accept highly subordinated "junk bonds," is reasonable and consistent with the directors' duty to ensure that the minority stockholders receive equal value for their shares.[165]

The comment was *dicta*, merely acknowledging that directors may, but they were not required to, use a defensive mechanism to offer their shareholders fair price. What mattered was the process in which they made their decisions. And, to Moore, the process was an aspect of business judgment. As if to emphasize the correlation between *Unocal*'s version of fair dealing and managerialism, Moore acknowledged that in determining how to respond to a hostile bid, a target's directors could consider the offer's impact "on the corporate enterprise," including "the impact on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)."[166] *Revlon*, a case following on the heels of *Unocal* and discussed in the following subsection, ostensibly limited the directors' broad discretion. Yet, as Part IV will elaborate, the Delaware courts fully endorsed Moore's procedural fairness to legitimize managerial power.

iv. *Revlon*: Fair Dealing and the Duty of Loyalty

Revlon was the epitome of the hostile takeover decade. Ronald Perelman, controlling shareholder of Pantry Pride, a company with "assets of $407 million . . . a net worth of about $145

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[164] *Unocal*, 493 A.2d at 956.
[165] *Id.* at 956–57.
[166] *Id.* at 955.

million . . . and a huge tax-loss carryforward of over $300 million," wanted to purchase *Revlon*, a company with "over $2.3 billion in assets and net worth excess of $1 billion."[167] Revlon was "a sitting duck because its stock was cheap in comparison with the company's earning power or its worth if broken and resold."[168] Perelman's ability to buy it rested on "a new breed of bond investors . . . [who] back[ed] aggressive corporate executives . . . by buying high yield securities known as 'junk bonds,'"[169] which horrified Michel Bergerac, Revlon's CEO. "Can you imagine this guy, saying he's going to make me a rich man?" Bergerac reportedly commented after meeting Perelman.[170] So they went to war.

Perelman, frustrated that his attempts at a friendly transaction were not reciprocated, made a hostile tender offer to Revlon's shareholders. Revlon responded by implementing a poison pill and a defensive stock repurchase plan, involving an exchange of notes for shares of Revlon's stock. The notes included serious limitations on Revlon's ability to incur additional debt (these restrictions could be waived by a majority of the independent directors on the Revlon board). When Perelman did not back down and continued to bid on Revlon's stock, the Revlon board responded by negotiating a merger agreement with their chosen knight (Forstmann Little & Co.); the agreement included Revlon's promise to remove the notes' covenants. When angered noteholders threatened suit, Revlon solicited Forstmann's support for the notes' par value. In exchange, Revlon granted Forstmann an option to purchase certain Revlon assets at "some $100–$175 million" below their value if "another acquiror got 40% of Revlon's shares" and a $25 million dollar cancellation fee "if another acquiror got more than 19.9% of Revlon's stock."[171] Perelman went to court to "challenge the lock-up, the cancellation fee . . . and the Notes covenants."[172]

Justice Moore, writing for the Delaware Supreme Court, began his decision by noting that when the Revlon board reached out to Forstmann, thus recognizing "that the company was for

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[167] CONNIE BRUCK, THE PREDATORS' BALL: THE INSIDE OF DREXEL BURNHAM AND THE RISE OF THE JUNK BOND RAIDERS 193–94 (1989).

[168] Robert J. Cole, *High Stakes Drama at Revlon: Giant Was Sitting Duck*, N.Y. TIMES, Nov. 11, 1985, at D1.

[169] *Id.*

[170] BRUCK, *supra* note 167, at 194.

[171] Revlon, Inc. v. MacAndrews & Forbes Holding, Inc., 506 A.2d 173, 178–79 (Del. 1986).

[172] *Id.* at 179.

sale," the duty of the board "changed from the preservation of Revlon as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit."[173]

Notably, Moore's was not a statement about corporate purpose. Rather, similarly to *Weinberger*, *Van Gorkom*, and *Unocal*, Moore's analysis focused on the decision-making process that Revlon's directors followed in response to Perelman's bid and the concerns that influenced their decisions. When the directors allowed their concerns about the noteholders to cloud their judgment, they failed to meet the fair dealing standard that Moore had established in *Weinberger* and thus breached their duty of loyalty. As Moore explained:

> The impending waiver of the Notes covenants had caused the value of the Notes to fall, and the board was aware of the noteholders' ire as well as their subsequent threats of suit. The directors thus made support of the Notes an integral part of the company's dealings with Forstmann, even though their primary responsibility at this stage was to the equity owners . . . . The principal benefit went to the directors, who avoided personal liability to a class of creditors to whom the board owed no further duty under the circumstances. Thus, when a board ends an intense bidding contest on an insubstantial basis, and where a significant by-product of that action is to protect the directors against a perceived threat of personal liability for consequences stemming from the adoption of previous defensive measures, the action cannot withstand the enhanced scrutiny which Unocal requires of director conduct.[174]

Fair dealing, again, overshadowed fair price. Or as Stuart Shapiro, one of Perelman's attorneys, put it, the decision affirmed that "when directors sell a company, they have to run a fair auction."[175] Fair dealing was presumed to ensure fair price, but the Delaware Supreme Court did not impose an affirmative duty on directors to maximize shareholder wealth. Moore's fair dealing or fair process was simply a modified business judgment—a business judgment fit for friendly and hostile acquisitions.

Fair dealing was also different from business judgment. The business judgment presumption was historically justified by reference to directors' expertise. As the following Part IV suggests,

[173] *Id.* at 182.
[174] *Id.* at 182, 184.
[175] Robert J. Cole, *Revlon Loses a Takeover Ruling*, N.Y. TIMES, Oct. 24, 1985, at D1.

during the deal decade and, more so, in its aftermath, both the corporate elite and the Delaware courts shifted their attention away from expertise toward process. Concerns about efficiency and certainty replaced earlier concerns about capitalism and democracy. Fair dealing, and fairness more broadly, became internally focused, and as such lacked the legitimating narrative that supported managerial power or the business judgment rule prior to the 1980s. Proceduralism became the alternative.

IV. AGENCY, LEGITIMACY, AND PROCEDURALISM

This Part IV focuses on the decisions of Chancellor William T. Allen, who was appointed to the bench just as the Delaware Supreme Court issued its decision in *Unocal*[176] and joined the Delaware Chancery Court shortly before the decision in *Revlon* was announced.[177] More than two decades later, Leo Strine, the retired Chief Justice of the Delaware Supreme Court, noted that Allen "brought to Chancery not only a deep understanding of Delaware's corporate law tradition and culture, but a scholarly bent that inclined him to be receptive to the emerging influence of economics on legal scholarship and to . . . [its] utility in helping courts address newly emerging issues."[178] Drawing on academic insights, Allen sought "to forge a coherent body of corporate common law,"[179] to offer a "predictable basis for resolving cases" so as to "preserve[] the wealth generating benefits of the corporate form," and encourage directors "to structure . . . transactions in a manner that . . . increase[d] the likelihood that they were fair to stockholders."[180] As I argue below, in his twelve years on the

176 Leo E. Strine, Jr., *The Story of* Blasius Industries v. Atlas Corp.*: Keeping the Electoral Path to Takeover Clear*, *in* CORPORATE LAW STORIES 197, 243, 245 (J. Mark Ramseyer, ed., 2009).

177 D. Gordon Smith, *Chancellor Allen and the Fundamental Question*, 21 SEATTLE U. L. REV. 577, 582 (1998).

178 Strine, *supra* note 176, at 245.

179 *Id.*

180 *Id. See also* Ruth Minner, introduction to William T. Allen, *The Pride and The Hope of Delaware Corporate Law*, 25 DEL. J. CORP. L. 70, 71 (2000) (introduction by Delaware Lieutenant Governor Ruth Minner to symposium address given by Chancellor Allen) ("[B]ecause of William Allen, Delaware is the place to incorporate. It's because he felt that sincere dedication to this state and to our corporate laws. He's proudly served, diligently served, willingly served and excelled as he served the Court of Chancery of this state."); Stephen J. Massey, *Chancellor Allen's Jurisprudence and the Theory of Corporate Law*, 17 DEL. J. CORP. L. 683, 687 (1992) (reporting that during the oral argument before Allen in the RJR Nabisco case, an attorney commented: "It is difficult for me to stand here and talk

bench, Allen clarified and solidified proceduralism as a theory legitimating the power of the corporate elite.

Allen's jurisprudence was three-fold: first, he drew on a new economic theory of the firm to describe managers as agents of the shareholders; second, because managers were agents of the shareholders, Allen held that they did not owe fiduciary duties to any other corporate constituency; and third, building on the 1980s' redefinition of fairness, especially fair dealing, Allen reimagined directors' duties. Using decisions involving allegations of breaches of fiduciary duties, Allen carefully delineated the procedures that managers should follow so that their actions are held valid (passing muster under a fair dealing standard of review) and immune from *ex-post* judicial review.[181] By the time Allen retired, discussions of directors' duties and business judgment no longer focused on directors' discretion or the corporation's social role, but rather on the narrow scripts that the Delaware courts provided directors presumably so they would maximize shareholder wealth. Proceduralism has replaced managerialism as corporate law's legitimating theory.

A. Agency

The takeover wave lasted through the 1980s and "peaked from 1984 through 1989."[182] By the end of the decade, "one-third of the Fortune 500" disappeared and CEO turnover dramatically increased ("average tenure among Fortune 500 CEOs dropped nearly 25 percent between the early 1980s and 2000").[183] CEOs felt battered and vulnerable. Long-term relationships were broken, and the cohesive vision about the role of corporate leadership in protecting political and economic interests, which seemed to characterize the midcentury and postwar years, was fractured.[184] As Mark Mizruchi writes, CEOs "were no longer thinking about the long-term interests of the business community but rather about their own short-term survival."[185]

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to you about the law of the State of Delaware, and cite all of the decisions and the only decisions see[m] to be your decisions, but you will accept my apology for constantly referring to those cases.").

[181] *See, e.g.*, Transcript (Rowe, Allen), *supra* note 1, at 39–40 ("[W]hat the chancery judges are driven to do is to try and look to the integrity of the procedures. Because they don't want to have to find out if a price is fair . . . . So, Chancery judges tend to look to the process.").

[182] MIZRUCHI, *supra* note 10, at 209.

[183] *Id.* at 9.

[184] *Id.*

[185] *Id.*

Focusing on the short-term, the corporate elite, rapidly growing conservative since the 1970s, solidified a "counteroffensive, a full-scale mobilization in which corporations, large and small, found an increasingly unified voice."[186] Seeking to thwart present and future hostile bids, corporate executives embraced a myopic vision that was anti-regulatory and pro shareholder wealth.[187] "The social responsibility of business is to increase its profits," Milton Friedman memorably announced in 1970,[188] and end-of-the-twentieth century CEOs obliged. If previous business campaigns, which courts and scholars supported, focused on working with the government, in the 1980s, the corporate elite's goals became limited: executives, many of whom were compensated with stock options, turned to shareholder wealth maximization with a vengeance.

Stock price became the medium for evaluating corporate performance and the ultimate corporate goal, while "tax bias that favored debt over equity" made it easier (and appealing) for corporations to "borrow[] money to finance hostile takeovers."[189] Takeovers, stock buybacks, and leverage became management's principal techniques to satisfy stock price appreciation, and stockholders—especially the powerful institutional shareholders and arbitrageurs—demanded it. Corporations began using their retained earnings and debt to return value to shareholders, defend against hostile tender offers, and finance successful takeovers. Internal finance dropped to forty percent in the 1960s, thirty percent in the 1970s, twenty percent in the 1980s, and to the teens in the 1990s. Debt replaced retained earnings as corporate America's main means of finance, while the stock market was becoming the principal governor of corporate behavior and stock price appreciation—an end in and of itself.[190]

A new economic theory of the corporation—namely, the nexus-of-contracts theory—substantiated shareholder primacy. Traced back to the 1960s and 1970s writings of a group of law and economics scholars, this theory of the firm offered an image of the corporation that fit the market-centered economic policies of the

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186 *Id.*

187 *Id.* at 164.

188 Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES MAG. (Sept. 13, 1970).

189 Winslow et al., *supra* note 91, at 598.

190 Lawrence E. Mitchell, *Who Needs the Stock Market? Part I: The Empirical Evidence* (2008) (unpublished manuscript) (available at https://perma.cc/DD2U-TWAZ).

1980s.[191] Drawing on microeconomics, the new theory painted a picture of the corporation as a nexus of private, contractual relationships, making presumably egalitarian economic markets the relevant focal point of corporate law.[192] The corporation was deemed to be a collection of "disaggregated but interrelated transactions" among individuals or the convenient fiction of a corporate entity in free and efficient markets.[193]

"This view of firms as simply a nexus of contracts," Mark Mizruchi writes, "had serious implications for the role of management."[194] If "the firm was not an institution but rather a constellation of contractual relations that were at least potentially episodic," if "the idea of the firm as institution was . . . a legal fiction," then managers were not "qualified professionals but rather mere agents of shareholders . . . who had no specific claim to their status beyond what ownership had decided, however temporarily, to grant them."[195] "The relationship between the stockholders and managers of the corporations," economists Michael C. Jensen and William H. Meckling wrote in their pathbreaking *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, "fit the definition of a pure agency relationship."[196] Indeed, in the aftermath of the hostile takeovers, "agency logic replaced managerial logic as a rationale for firm action."[197] In *Blasius Industries, Inc. v. Atlas Corp.*, a case involving a conflict between Atlas's board and Atlas's largest shareholder, Chancellor Allen astutely brought agency theory to Delaware corporate law.[198]

The *Blasius* story began when, in May 1987, "with Drexel Burnham serving as underwriter," Blasius raised "$60 million through the sale of junk bonds," using "a portion of these funds . . . to acquire a 9% position in Atlas."[199] Following this acquisition, Blasius had tried to gain control of Atlas's board so as to

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191 Patrick J. Akard, *Corporate Mobilization and Political Power: The Transformation of U.S. Economic Policy in the 1970s*, 57 AM. SOC. REV. 597, 597 (1992) (noting that despite "record inflation," "the worst recession since the 1930s," and multiple proposals for economic planning at the state and federal levels, by the early 1980s, U.S. economic policy heavily relied on market allocation of resources).

192 William W. Bratton, Jr., *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407, 416–20 (1989).

193 *Id.* at 420; *see also* Bratton, *supra* note 32, at 1498; Oliver E. Williamson, *Organization Form, Residual Claimants, and Corporate Control*, 26 J. L. & ECON. 351, 365 (1983).

194 MIZRUCHI, *supra* note 10, at 206.

195 *Id.* at 207.

196 Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305, 309 (1976).

197 MIZRUCHI, *supra* note 10, at 207.

198 Blasius Industries, Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988).

199 *Id.* at 653.

force "Atlas to engage in a leveraged restructuring and distribute cash to the shareholders."[200] Atlas had just emerged from its own reorganization and its board found Blasius's plan problematic, at the least. When Atlas's board rejected Blasius's proposals, the latter sent Atlas "a signed written consent," urging the board to "develop and implement a restructuring proposal," adopt a bylaw amendment to increase the board's size from seven to fifteen members (the maximum allowed by Atlas's charter), and "elect[] eight named persons to fill the new directorships."[201] To prevent Blasius from placing a majority of new directors on the board, Atlas's board, in an emergency meeting, increased its size by two and filled the newly created directorships.[202] Blasius brought suit challenging this action.

Allen's decision began by reiterating the rule adopted in *Unocal Corp. v. Mesa Petroleum Co.*[203] "A board may take certain steps," Allen wrote, "that have the effect of defeating a threatened change in corporate control, when those steps are taken advisedly, in good faith pursuit of a corporate interest, and are reasonable in relation to a threat to legitimate corporate interests posed by the proposed change in control."[204] Directors were empowered to manage a corporation, even when making decisions that affected the shareholders' ability to sell their shares at a premium.

The question in *Blasius*, though, was different than the one addressed in *Unocal*. Allen framed the question as follows: "can the board act to fill in—to create two new directorships? . . . when . . . at least part of their purpose in doing it, was to stop the effectiveness of the shareholder consent that had just been redone?"[205] Despite the fact that Atlas's board "was absolutely acting in good faith," and was "motivated by an honest belief that what . . . Blasius was proposing, was bad for the company," Allen, who described the case as "the hardest decision he had to make in corporate law," answered in the negative.[206]

The directors' power to respond to a hostile takeover, as any other power they possessed, Allen explained, was conferred upon them "as the agents of the shareholders."[207] Corporate law, Allen

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200 *Id.* at 654.
201 *Id.*
202 *Id.* at 655.
203 *See* discussion *supra* circa notes 153–166.
204 *Blasius*, 564 A.2d at 659.
205 Transcript (Rowe, Allen), *supra* note 1, at 30.
206 *Id.* at 29, 31.
207 *Blasius*, 564 A.2d at 663.

stressed, "does not create Platonic masters."[208] The shareholders, as principals, could view issues such as the one before the court differently than did the board and "[i]f they do, or did, they are entitled to employ the mechanisms provided by the corporation law and the Atlas certificate of incorporation" to advance their views.[209] Specifically, the shareholders were entitled "to restrain their agents, the board, from acting for the principal purpose of thwarting that action."[210] Accordingly, Atlas's attempt to prevent Blasius from engaging in a proxy contest, "constituted an unintended violation of the duty of loyalty that the board owed to the shareholders."[211]

It is important to stress that Allen's decision in *Blasius* did not fully embrace the idea that directors were agents of the shareholders. If this were the case, directors would not be able to act without the explicit or, at least, implied consent of their principals. But, while Allen would not allow directors to affect the shareholders' ability to elect their agents, he was content to permit directors to prevent shareholders from selling their stock to a hostile bidder at a high premium.[212] "A corporation," Allen said in an interview almost thirty years later, "is . . . a republican form of government, it's not a town meeting. The shareholders don't get to have a say every time they want to have a say."[213]

Notably, a year after *Blasius*, Allen allowed Time's directors to block Paramount's hostile bid to Time's shareholders, a bid that would have provided the latter with close to a 100% premium on the market price of Time's stock.[214] "Plaintiffs' reliance upon *Blasius* is misplaced," Allen wrote in *Paramount Commc'ns, Inc. v. Time, Inc.*[215] "[T]he financial vitality of the corporation and the value of the company's shares is in the hands of the directors and managers of the firm," he explained, adding: "[t]he corporation law does not operate on the theory that directors, in exercising their powers to manage the firm, are obligated to follow the wishes of a majority of shares. In fact, directors, not shareholders,

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[208] *Id.*

[209] *Id.*

[210] *Id.*

[211] *Id.*

[212] *See also* Robert B. Thompson, *Shareholders as Grown-Ups: Voting, Selling, and Limits on the Board's Power to "Just Say No*," 67 U. CIN. L. REV. 999, 1011–14 (1999) (noting the apparent inconsistencies between the Delaware courts' disempowerment of shareholders in the hostile takeover cases and their approach in cases such as *Blasius*).

[213] Transcript (Rowe, Allen), *supra* note 1, at 13.

[214] Paramount Commc'ns, Inc. v. Time, Inc., Civil Action Nos. 10866, 10670, 10935 (Consolidated), 1989 Del. Ch. LEXIS 77 (Del. Ch. July 14, 1989).

[215] *Id.*

are charged with the duty to manage the firm."[216] "That many, presumably most, shareholders would prefer the board to do otherwise than it has done" did not, in the context of a hostile bid, "afford a basis to interfere with the effectuation of the board's business judgment."[217]

Moreover, in *Blasius*, just as he held that the Atlas directors breached their fiduciary duties by acting to prevent Blasius from engaging in a proxy contest, Allen also held that Blasius, who continued this consent solicitation, albeit with modification, "failed to get the required votes" that would have allowed it to control the board. That the directors breached their duties thus had no practical consequences in *Blasius*.[218]

Indeed, for Allen, *Blasius* was an opportunity to address a broader matter: the legitimation of managerial power at a century's end. Allen used agency theory to explain Delaware's continued empowering of corporate directors (and, as Section IV.C. will elaborate, Delaware's embrace of proceduralism). As Allen put it, the "shareholder franchise" was "the ideological underpinning upon which the legitimacy of directorial power rests."[219] While admitting that the shareholders' vote had often been dismissed "as a vestige or a ritual of little practical importance," Allen nonetheless stressed:

> [A] decision by the board to act for the primary purpose of preventing the effectiveness of a shareholder vote inevitably involves the question who, as between the principal and the agent, has authority with respect to a matter of internal corporate governance . . . . Judicial review of such action involves a determination of the legal and equitable obligations of an agent towards his principal. This is not . . . a question that a court may leave to the agent finally to decide so long as he does so honestly and competently; that is, it may not be left to the agent's business judgment.[220]

The balance was in the detail. Derived from economic theory, the principal-agent notion was grounded in the idea that shareholders as principals had to grant their agents, that is, managers, great latitude to make decisions without consulting with the

216 *Id.* at 89.
217 *Id.* at 90.
218 Strine, *supra* note 176, at 276–79.
219 *Blasius*, 564 A.2d at 659.
220 *Id.* at 659–60.

principals.[221] As Leo Strine writes: "[w]hile in office, directors were free to take a myriad of business decisions that stockholders might not favor. But what directors were not free to do was to . . . impair [stockholders'] ability to choose a new set of directors to manage the company."[222] Directors were agents of the shareholders, but the obligations derived from their status as agents were limited to allowing shareholders to exercise their voting power, a process that some have described as a meaningless ritual.[223]

As the following Section IV.B explores, by turning to agency theory to support managerial power, Allen also seeded the shareholder primacy vision of corporate law, that is, the idea that fiduciary duties were owed only to the shareholders. All other constituencies were excluded.

B. For Whom Are Corporate Managers Agents?

Early in the twentieth century, directors were expected to consider the "entire community of interests" when making business decisions.[224] When (in 1939), Ms. Pepper, a creditor of the Dixie Splint Coal Company, argued that Mr. Litton, the company's controlling shareholder, caused the company to file for bankruptcy so as to avoid paying Pepper royalties due under a lease, the U.S. Supreme Court ruled in her favor.[225] Writing for the court, Justice William O. Douglas provided a strong and memorable statement about the duties of corporate fiduciaries. According to Douglas, the powers of directors, officers and controlling shareholders were "powers in trust . . . . Their dealings with the corporation are subjected to rigorous scrutiny" and when challenged, "the burden is on the director or stockholder not only to prove the good faith of the transaction, but also to show its inherent fairness from the viewpoint of the corporation and those interested therein."[226] Moreover,

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[221] NORBERT HÄRING AND NIALL DOUGLAS, ECONOMISTS AND THE POWERFUL: CONVENIENT THEORIES, DISTORTED FACTS, AMPLE REWARDS 107 (2012).

[222] Strine, *supra* note 176, at 269.

[223] *Blasius*, 564 A.2d at 659.

[224] Pepper v. Litton, 308 U.S. 295, 307 (1939).

[225] In 1931, Ms. Pepper sued the Dixie Splint Coal Company and Mr. Litton, its controlling shareholder, "for an accounting of royalties due Pepper under a lease." *Id.* at 298. Anticipating that Pepper would prevail, "Litton caused Dixie Splint Coal Company to confess a judgment in Litton's favor in the amount of $33,468.89, representing alleged accumulated salary claims dating back at least five years." *Id.* When Pepper, as expected, obtained judgment, Litton "caused an execution to issue on his confessed judgment and levy to be made thereunder." *Id.* Litton then caused the company to file for bankruptcy, the sole purpose of which was to avoid payment to Pepper. *Id.*

[226] *Id.* at 306. Douglas subordinated Litton's claim to Pepper's. *Id.*

> while normally that fiduciary obligation is enforceable directly by the corporation, or through a stockholder's derivative action, it is, in the event of bankruptcy of the corporation, enforceable by the trustee. For that standard of fiduciary obligation is designed for the protection of the entire community of interests in the corporation — creditors as well as stockholders. [227]

Douglas's statement reflected the early-twentieth-century belief that those in control of a corporation owed fiduciary duties to all the corporation's investors, if not to all corporate constituencies. "The expectations of bondholders, preferred stockholders, or common shareholders must all be satisfied to some degree if an enterprise is to grow," Berle and Means wrote in 1932.[228] Shareholders could enforce such duties when the corporation was solvent, while the trustee in bankruptcy enforced them in insolvency. Still, the duties of those in control always ran to the entire corporate community, including, most significantly, the individual shareholders and creditors.[229]

The hostile takeover decade transformed the question of fiduciary obligations and the associated fairness standard from one focused on the relationship between directors and investors to one centered on the allocation of benefits, or balance of interests, between shareholders and other corporate constituencies. In a trilogy of cases that Allen authored, the shareholders' interest became front and center of Delaware corporate law. Each case addressed a conflict between shareholders and other investors, each group vying for the directors' attention. Each case concluded that directors had to focus on the shareholders alone. Other investors—including holders of debt securities, convertible debt, and preferred stock—were told to protect their own interests contractually, even if contractual freedom remained a mere illusion for most.

Katz v. Oak Industries, Inc. was one of the first decisions that Allen authored and the first Delaware case to use the term

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[227] *Id.* at 307.

[228] BERLE & MEANS, *supra* note 30, at 247. *See also* William E. Nelson, *The Law of Fiduciary Duty in New York, 1920–1980*, 53 S.M.U. L. REV. 285, 291 (2000) (noting that "it was settled, for example, that corporate officers and directors were responsible not only to stockholders, but also to a corporation's creditors, and the interests of these two groups sometimes were in conflict").

[229] Adolf A. Berle, Jr., *Subsidiary Corporations and Control of Credit Resources*, *in* STUDIES IN THE LAW OF CORPORATION FINANCE 153, 160 (1928).

shareholder wealth maximization. Oak Industries was in "deep financial trouble."[230] The price of its common stock "had plummeted from thirty dollars to two dollars per share. Its debt traded at substantial discounts to par."[231] Hoping to breathe new life into the company, Oak Industries entered into an agreement with Allied-Signal, according to which the latter would purchase some of Oak Industries' assets and would also purchase newly issued common stock and warrants.[232] "Allied-Signal conditioned the deal on a restructuring of Oak's debt to be effected through a tender offer in which Oak would buy back some debt at a premium over the debt's then current market price, but at a discount to par."[233] Tendering noteholders had to "consent to amendments in the indentures governing the securities," amendments that would remove "significant negotiated protections to holders of the Company's long-term debt including the deletion of all financial covenants."[234] These modifications would affect noteholders who chose not to tender into the exchange offers, but not the ones who tendered for cash or stock. Failure to obtain the required consents from the noteholders would have allowed Allied-Signal to decline to complete the planned acquisition. Moise Katz, an owner of long-term debt securities, sought to enjoin consummation of Oak Industries' exchange offers.[235]

The issue in *Katz* reached beyond the traditional scope of corporate law. At stake was an interpretation of Section 316(b) of the Trust Indenture Act, which guarantees to each holder of an "indenture security" veto power over potential changes to the indenture or security (outside of bankruptcy) affecting "the right to receive payment of the principal of and interest on such indenture security."[236]

Allen, however, viewed *Katz* through the post-1980s inward-looking and agency-focused corporate law prism. Historically, bonds were deemed to provide "fixed, assured income for lenders," while the bond markets were viewed as providing "ready liquidity or cash for both lenders and borrowers."[237] By the 1980s, markets

[230] Stephen M. Bainbridge, *Twilight in the Zone of Insolvency: Fiduciary Duties and Creditors of Troubled Companies*, 1 J. OF BUS. & TECH. L. 281, 285 (2007).

[231] *Id.*

[232] Katz v. Oak Indus., Inc., 508 A.2d 873 (Del. Ch. 1986).

[233] Bainbridge, *supra* note 230, at 285.

[234] *Katz*, 508 A.2d at 877.

[235] *Id.* at 877–78.

[236] Trust Indenture Act of 1939 § 316(b), 15 U.S.C. § 77 (b).

[237] E. RAY CANTERBERY, WALL STREET CAPITALISM: THE THEORY OF THE BONDHOLDING CLASS 33–45 (2000).

were different. Like stock, bonds were bought for profit; their buyers, like shareholders, were speculators.[238] (This transformation was fueled by the inflation of the 1970s, coupled with the role that junk bonds played in the takeovers of the 1980s.[239]) Nonetheless, in addressing the obligations of corporate managers towards bondholders, Allen drew a legal distinction between shareholders and debtholders. As Allen explained, "arrangements among a corporation, the underwriters of its debt, trustees under its indentures and sometimes ultimate investors are typically thoroughly negotiated and massively documented."[240] Therefore, "the terms of the contractual relationship agreed to and not broad concepts such as fairness define the corporation's obligations to its bondholders."[241] In other words, the plaintiffs' claims were contractual and did "not involve the measurement of corporate or directorial conduct against the high standard of fidelity required of fiduciaries with respect to the beneficiaries of their trust."[242] In a world committed to agency costs, fiduciary obligations were extended only to the shareholders.

Legal labels—bondholders were owed contractual obligations and shareholders were extended fiduciary ones—determined results. Acknowledging that the "purpose and effect" of Oak Industries' exchange offers were to "benefit Oak's common stockholders at the expense of the holders of its debt," Allen did not find the plaintiff's claims to "allege any cognizable wrong."[243] As he put it: "It is the obligation of directors to attempt, within the law, to maximize the long-run interests of the corporation's stockholders."[244] If they do so "at the expense" of others, here the debtholders, that "does not for that reason constitute a breach of duty."[245] Reducing the plaintiff's rights to contractual claims, Allen further held that Oak Industries did not breach the implied covenant of good faith in its dealing with its debtholders.[246] "While it is clear that Oak has fashioned the exchange offer and consent solicitation in a way designed to encourage consents," Allen wrote, the exchange offer did not "violate[] the intendment of any of the express contractual

238 On this transformation, see *id*.
239 *Id.* at 67–68.
240 *Katz*, 508 A.2d at 879.
241 *Id.*
242 *Id.*
243 *Id.*
244 *Id.*
245 *Id.*
246 *Id.* at 879–82.

provisions . . . or . . . an implied obligation of good faith and fair dealing."[247]

The distinction between contractual and fiduciary obligations reached further. In *Jedwab v. MGM Grand Hotels, Inc.*, decided the same year as *Katz*, Allen held that preferences and limitations associated with preferred stock were also contractual, not fiduciary, in nature.[248] *Jedwab* was a class action, brought by Marilyn Jedwab on behalf of all owners of MGM Grand Hotels' preferred stock, seeking to enjoin a cash out merger in which the common and preferred stock received different cash amounts. Jedwab argued that "the effectuation of the proposed merger would constitute a breach of a duty to deal fairly with the preferred shareholders owed to such shareholders by the directors of MGM Grand and its controlling shareholder."[249] Specifically, Jedwab argued that "the directors of a Delaware corporation have a duty in a merger transaction to negotiate and approve only a merger that apportions the merger consideration fairly among classes of the company's stock."[250] Accordingly, the directors could not "unfairly favor one class of stock over another" without violating the duty of loyalty that they owed "to the corporation and, by extension . . . to all of its shareholders."[251]

Allen acknowledged that preferred shareholders' claims addressing the fair allocation of the proceeds of a merger implicated fiduciary duties.[252] Careful, however, to limit the scope of such duties, Allen also asserted that "with respect to matters relating to preferences or limitations that distinguish preferred stock from common, the duty of the corporation and its directors is essentially contractual and the scope of the duty is appropriately defined by reference to the specific words evidencing that contract."[253]

A year later, Allen wrote the Chancery decision in *Simons v. Cogan*, a case involving an attempt by Louise Simons, a holder of convertible subordinated debentures of Knoll International, Inc., to hold Knoll's controlling shareholder liable for breach of fiduciary duties associated with a cash-out merger. Citing his decision in *Katz*, Allen began his analysis by distinguishing debtholders from shareholders. As he wrote: "It has now become *firmly fixed*

247 *Id.* at 881.

248 Jedwab v. MGM Grand Hotels, Inc., 509 A.2d 584, 593 (Del.Ch. 1986).

249 *Id.* at 587.

250 *Id.* at 591.

251 *Id.*

252 *Id.* at 594.

253 *Id.* at 595.

in our law that among the duties owed by directors of a Delaware corporation to holders of that corporations' debt instruments, there is no duty of the broad and exacting nature characterized as a fiduciary duty."[254] According to Allen, convertible bonds were not different from bonds.[255]

Earlier cases were not at all clear-cut, suggesting that perhaps a duty of fair treatment should be extended to convertible bondholders. "[T]here exists a body of judicial opinion willing to extend the protection offered by the fiduciary concept to the relationship between an issuer and the holders of its convertible debt securities," Allen admitted.[256] Finding fault in such precedents, he concluded nonetheless that "these seeds . . . have fallen upon stones . . . [P]laintiff has failed to state a claim of breach of fiduciary duty upon which relief may be granted."[257]

The Delaware Supreme Court affirmed. Justice Walsh reasoned: "A debenture is a credit instrument which does not devolve upon its holder an equity interest in the issuing corporation."[258] A convertible debenture was not different. It represented "a contractual entitlement to the repayment of a debt and . . . not . . . an equitable interest in the issuing corporation necessary for the imposition of a trust relationship with concomitant fiduciary duties."[259] To trigger a fiduciary duty, Walsh concluded, "an existing property right or equitable interest supporting such a duty must exist."[260]

The debentures in *Simons*, like many other debentures and bonds, were publicly issued and thus subject to an indenture, a contract (and in publicly held corporations typically standardized contract) to which the issuing corporation and a trustee, nominated by the issuer to represent the interests of the debentureholders, were parties. The contract upon which Allen relied was drafted and negotiated by the issuing corporation's management. Louise Simons and those in her class did not negotiate this contract, nor could they enforce it (the trustee represented them for that purpose).

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[254] Simons v. Cogan, 542 A.2d 785, 786 (Del. Ch. 1987) (emphasis added).
[255] *Id.*
[256] *Id.* at 790.
[257] *Id.* at 791.
[258] Simons v. Cogan, 549 A.2d 300, 303 (Del. 1988).
[259] *Id.*
[260] *Id.* at 304.

Again, agency theory influenced Allen's decisions. The theory worked only if the principals indeed selected their agents, and under Delaware law, only shareholders voted. Corporate law became focused on the shareholders; other investors, workers, even the community at large were told to protect their own interests outside corporate law. But, as already noted and as the following Section IV.C will demonstrate, the rhetoric of shareholder primacy was a means of empowering management, not of assuring shareholders a say in corporate affairs, or even profits. Three cases that Allen authored at the end of his term on the bench—*Gagliardi v. TriFoods International, Inc.*, *In re Caremark*, and *Lewis v. Vogelstein*—will be used to demonstrate how proceduralism helped bond together shareholder and director primacy.[261]

C. Proceduralism

Developments in finance theory were critical to Delaware's post-1980s turn to proceduralism as a theory legitimating managerial power. In the first part of the twentieth century, economists justified investment by reference to the intrinsic value of corporations. Beginning in the 1950s, however, the newly developed modern portfolio theory suggested that investors could create "an efficient portfolio," that is, a portfolio that would achieve maximum returns by diversifying non-systematic risk, and that the portfolio, rather than individual corporations, should be the focus of investment analysis.[262] The Capital Asset Pricing Model, which was developed in the 1960s, offered a regression analysis of a stock's historical movement in relation to the market to help investors diversify even the systematic risk inherent in the market. Rather than study the fundamentals of companies in which they were interested, investors were advised to study the historical performance of their companies' stock prices.[263]

Finance justified shielding directors from liability. Shareholders, Allen wrote in *Gagliardi* v. *TriFoods International, Inc.*,

[261] Shareholder primacy is the idea that corporate law should prioritize shareholder interests, while director primacy emphasizes the directors' (almost) absolute power and discretion. *See, e.g.*, Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547 (2003).

[262] James R. Hackney, Jr., *The Enlightenment and the Financial Crisis of 2008: An Intellectual History of Corporate Finance Theory*, 54 ST. LOUIS U. L. J. 1257, 1260–62 (2010).

[263] Kent L. Womack & Ying Zhang, *Understanding Risk and Return, the CAPM, and Fama-French Three-Factor Model* (Dartmouth Tuck Sch. of Bus. Case & Teaching Paper Series, Case Note No. 03-111, 2003), https://perma.cc/244X-8NF9.

"can diversify the risks of their corporate investments."[264] Their "economic interests" are maximized "if corporate directors and managers honestly assess risk and reward and accept for the corporation the highest risk adjusted returns available that are above the firm's cost of capital."[265] It was thus "in the shareholders' economic interest to offer sufficient protection to directors from liability" so that directors knew that "if they act in good faith and meet minimal proceduralist standards of attention," they would not face liability.[266]

Gagliardi was "a shareholders action . . . to recover corporate losses allegedly sustained by reason of 'mismanagement' unaffected by directly conflicting financial interests."[267] Two decades later, Allen described it as "a small, ordinary case" that he used "as an opportunity to write something to say that the duty of care, if you implemented it with a damage action, . . . would scare the hell out of directors."[268] "The law *protects shareholder investment interests* against the uneconomic consequences that the presence of such second-guessing risk would have on director action and shareholder wealth," Allen stressed in *Gagliardi*.[269] Put differently, shareholder wealth maximization required judicial deference to directors' decisions.

Allen recognized that shareholder primacy and director primacy could be at odds. "I wanted to write in *Gagliardi* that the business judgment rule is meant to protect directors in order to serve shareholder interests," he noted two decades later.[270] "So, how does the law solve this problem of incentivizing [directors] to be engaged and attentive, but not scaring them with liability risks?" Allen asked.[271] The solution was proceduralism: ask more of directors and assure them that if they followed the courts' guidelines, they would not be held liable. As Allen put it, directors "are essentially good people. They need to be told what to do. And if they are told what their duty is, they will tend to do it."[272]

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[264] Gagliardi v. TriFoods Int'l., Inc., 683 A.2d 1049, 1052 (Del. Ch. 1996).

[265] *Id.*

[266] *Id.*

[267] *Id.*

[268] Transcript (Rowe, Allen), *supra* note 1, at 40–41.

[269] *Gagliardi*, 683 A.2d at 1052.

[270] Transcript (Rowe, Allen), *supra* note 1, at 40–41.

[271] *Id.*

[272] *Id.* at 45. Allen, here, seems to embrace Melvin Eisenberg's careful distinction between standards of conduct which "state[] how an actor should conduct a given activity or

Take, for example, *Caremark*, a case involving the settlement of a shareholders' derivative suit to recover damages from Caremark's directors for fines the corporation incurred in settling federal and state lawsuits addressing kickback payments that violated the terms of the Anti-Referral Payments Law.[273] The plaintiff shareholder argued that the losses were a result of the board's failure to monitor Caremark's officers and employees. Holding that the directors were not likely to be held liable, Allen approved the settlement. In the process, he also offered a clear summary of the directors' duty of care, describing the procedures directors had to follow to ensure that their actions would not be evaluated *ex post*.[274]

Three decades before *Caremark*, *Graham v. Allis-Chalmers Mfg. Co.* addressed a similar scenario. *Graham* was a derivative suit against the directors of the Allis-Chalmers Manufacturing Company for damages caused to the corporation by the non-director employees' and the corporation's violations of antitrust regulations on a price-fixing conspiracy in the electrical equipment industry.[275] The plaintiffs charged that the directors were liable for breach of their duties by "reason of their failure to take action designed to learn of and prevent anti-trust activity on the part of any employees of Allis-Chalmers."[276]

The Allis-Chalmers Manufacturing Company (like Caremark) was a highly decentralized corporation with authority delegated to the "lowest possible management level capable of fulfilling the delegated responsibility."[277] Given "the extent and complexity of the company's operations," the board's role was limited to considering and deciding "matters concerning the general business policy of the company."[278] Writing for the Delaware Supreme Court, Justice Wolcott concluded that, due to the company's structure, the board did not "consider in detail specific

play a given role," and standards of review which are "the test[s] a court applies when it reviews an actor's conduct to determine whether to impose liability or grant injunctive relief." Melvin A. Eisenberg, *Corporate Law and Social Norms*, 99 COLUM. L. REV. 1253, 1269 (1999); *see also* William T. Allen, Jack B. Jacobs, & Leo E. Strine, Jr., *Realigning the Standard of Review of Director Due Care with Delaware Public Policy: A Critique of Van Gorkom and its Progeny as a Standard of Review Problem*, 96 NW. U. L. REV. 449, 451 (2002).

[273] In re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996).

[274] *Id.* at 967–70.

[275] Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125 (Del. 1963).

[276] *Id.* at 127.

[277] *Id.* at 128.

[278] *Id.*

problems of the various divisions."[279] And in fact, the board could not be expected to do so. Wolcott accepted that "by force of necessity," the directors could not know all the company's employees or be aware of their actions.[280] "The very magnitude of the enterprise required them to confine their control to the broad policy decisions," and entitled them (by virtue also of Section 141(f) of the Delaware General Corporations Law) to rely on "summaries, reports, and corporate records."[281] Hence, "directors are entitled to rely on the honesty and integrity of their subordinates . . . [and] in the absence of cause for suspicion there is no duty upon the directors to install and operate a corporate system of espionage to ferret out wrongdoing."[282]

Graham was a product of the traditional business-judgment-rule era, so it is not surprising that three decades later, in *Caremark*, Allen chose to develop a new rule to legitimize managerial power. Allen began his analysis by noting that the duty to monitor (and duty of care more broadly) was "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment."[283] Referencing *Gagliardi* he reiterated that there were "good policy reasons why it is so difficult to charge directors with responsibility for corporate losses for an alleged breach of care, where there is no conflict of interest or no facts suggesting suspect motivation involved."[284]

Moving to the duty of care, Allen separated the directors' decision-making role from their duty to monitor. "Director liability for a breach of the duty to exercise appropriate attention," he wrote, "may arise in two distinct contexts:" when "*a board decision* . . . results in a loss because that decision was ill advised or 'negligent,'" or when the board "*fail*[*s*] . . . *to act* in circumstances in which due attention would, arguably, have prevented the loss."[285] According to Allen, this distinction was significant for determining the appropriate standard of review. Noting that "the first class of cases will typically be subject to review under the director-protective business judgment rule," Allen elaborated:

[279] *Id.* at 128.

[280] *Id.*

[281] *Id.*

[282] *Id.* at 130.

[283] In re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996).

[284] *Id.* In *Gagliardi*, Allen explained that shielding directors from liability would benefit shareholders. *See* discussion *supra* circa notes 264–272.

[285] *Caremark*, 698 A.2d at 967.

> What should be understood . . . is that compliance with a director's duty of care can never appropriately be judicially determined by reference to *the content of the board decision* that leads to a corporate loss, apart from consideration of the good faith *or* rationality of the process employed . . . . To employ a different rule—one that permitted an "objective" evaluation of the decision—would expose directors to substantive second guessing by ill-equipped judges or juries, which would, in the long-run, be injurious to investor interests. Thus, the business judgment rule is process oriented and informed by a deep respect for all *good faith* board decisions.[286]

Finance—investor interests—superseded law, and procedure superseded substance. Shareholder primacy became director primacy. "If the shareholders thought themselves entitled to some other quality of judgment than such a director produces in good faith exercise of the powers of office," Allen added in a nod to *Blasius*, "the shareholders should have elected other directors."[287]

As to the duty to monitor, Allen refused to endorse *Graham*'s duty to respond and instead imposed on the board an affirmative duty to ensure systematic monitoring. "It would . . . be a mistake," he explained, to conclude that *Graham* "means that corporate boards may satisfy their obligation to be . . . informed . . . , without assuring themselves that information and reporting systems exist in the organization . . . to allow management and the board . . . to reach informed judgments concerning both the corporation's compliance with law and its business performance."[288]

Yet, just as Allen had imposed a heightened duty on directors to be informed, he ensured that proving directors' failure to do so would be nearly impossible. *Graham* used a negligence standard to evaluate directors' failure to monitor. But if, as Allen held, directors had an affirmative duty to design information and

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[286] *Id.* Allen's usage—perhaps overuse—of the term good faith here is significant. After *Van Gorkom* shocked the legal and business communities by holding directors liable for breach of the duty of care, the Delaware legislature enacted Section 102(b)(7) of the Delaware General Corporation Law. The section allows corporations to include in their charters provisions that limit, or even eliminate, the personal liability of directors for monetary damages for breaches of the duty of care. Left out of Section 102(b)(7)'s reach are breaches of the duty of loyalty and actions not in good faith. Given the limited reach of the duty of loyalty, cases such as *Caremark* had to reckon with the definition of good faith. Delaware's interpretation of good faith was a manifestation, yet again, of its turn to proceduralism as a theory of legitimacy.

[287] *Id.* at 968.

[288] *Id.* at 970.

reporting systems, so long as the board exercised "a good faith judgment" as to the adequacy of the corporation's information and reporting system, it could not be held liable for the system's failure to reveal violations of law or duties by officers or employees.[289] Significantly, the standard of good faith did not require an assessment of the substance of the board's decision but, rather, a determination by the court that the process in which a compliance system was adopted "was either rational or employed in a *good faith* effort to advance corporate interests."[290] As Allen explained, "only a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to ensure a reasonable information and reporting system exists—will establish the lack of good faith that is a necessary condition to liability."[291] And while the test was quite high, Allen, repeating what he said in *Gagliardi*, stressed: "a demanding test of liability in the oversight context is . . . beneficial to corporate shareholders as a class . . . since it makes board service by qualified persons more likely, while continuing to act as a stimulus to *good faith performance of duty* by such directors."[292]

It is with this in mind that we can turn to *Lewis v. Vogelstein*, a case addressing the duty of care's twin duty, namely the duty of loyalty, and one of the last decisions Allen authored.[293] Harry Lewis, a repeat plaintiff shareholder, "challenged a stock option compensation plan for the directors of Mattel, Inc.," arguing that "solicited shareholder proxies to vote in favor of the adoption of the 1996 Mattel Stock Option Plan were materially incomplete and misleading, because they did not include an estimated present value of the stock option grants to which directors might become entitled under the Plan."[294] In addressing Lewis's arguments, Allen turned the duty of loyalty procedural, too.

Section 144 of the Delaware General Corporation Law, adopted in 1967, focuses on transactions "between a corporation and 1 or more of its directors or officers, or between a corporation and any other corporation, partnership, association, or other

[289] *Id.* at 967–970; *see also* Sarah Hellene Duggin & Stephen M. Goldman, *Restoring Trust in Corporate Directors: The Disney Standard and the "New" Good Faith*, 56 AM. U. L. REV. 211, 232–37 (2006); Hillary A. Sale, *Monitoring Caremark's Good Faith*, 32 DEL. J. CORP. L. 719 (2007).

[290] *Caremark*, 698 A.2d at 971.

[291] *Id.*

[292] *Id.*

[293] Lewis v. Vogelstein, 699 A.2d 327 (Del. Ch. 1997).

[294] *Id.* at 329.

organization in which 1 or more of its directors or officers, are directors or officers, or have a financial interest."[295] The provision rescues such transactions from *per se* voidability so long as they qualify for protection under its subsections.[296]

In the first case to address the effects of Section 144, the Delaware Supreme Court concluded that following the requirements of Section 144 merely removed "the specter of invalidity of an interested transaction," leaving the courts to assess the substantive fairness of the transaction.[297] By the 1980s, however, the Chancery Court of Delaware described Section 144 as creating a safe harbor for the interested transactions within its scope that were approved by an informed vote of a majority of the disinterested directors acting in good faith or by an informed vote of a majority of the disinterested shareholders. Such approval or ratification, according to the Court, granted the actions of the directors and officers the presumption of the business judgment rule.[298]

Procedure, again, triumphed, and *Vogelstein* extended the victory. The transaction in *Vogelstein* did not fall within the scope of transactions covered under Section 144,[299] but Allen reached a similar result. Summarily dismissing the claim that directors needed to disclose the value of their stock options,[300] Allen went on to explore the nature of the duty of loyalty. "As the Plan contemplate[d] grants to the directors that approved the Plan and who recommended it to the shareholders," Allen wrote, "it constitute[d] self-dealing that would ordinarily require that the directors prove that the grants involved were, in the circumstances, entirely fair to the corporation."[301] But since the shareholders of Mattel ratified the plan, Allen framed the question as follows: "What is the effect under Delaware corporation law of shareholder ratification of an interested transaction?"[302] Turning to the theory of agency with a nod to *Blasius,* Allen concluded that because, in the law of agency, "the effect [of] informed ratification is to validate or affirm the act of the agent as the act of the

[295] Del. Code Ann. Tit. 8 § 144 (2023).

[296] Blake Rohrbacher, John Mark Zeberkiewicz & Thomas A. Uebler, *Finding Safe Harbor: Clarifying the Limited Application of Section 144*, 33 DEL. J. CORP. L. 719, 719–20 (2008).

[297] *Id.* at 723–24; *see also* Fliegler v. Lawrence, 361 A.2d 218, 221 (Del. 1976).

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

[299] Rohrbacher et al., *supra* note 296, at 726.

[300] *Vogelstein*, 699 A.2d at 333.

[301] *Id.*

[302] *Id.* at 333–34.

principal,"[303] in corporate law, "informed, uncoerced, disinterested shareholder ratification of a transaction in which corporate directors have a material conflict of interest has the effect of protecting the transaction from judicial review except on the basis of waste."[304]

Just as he made the duty of care procedural under *Caremark*'s analysis, Allen turned the duty of loyalty into a procedural concept: so long as directors solicited shareholders' ratification (or independent directors' authorization) of a conflict-of-interest transaction, they will be extended the protection of the presumption of the business judgment rule and the substance of their decision will not be reevaluated. By the time Allen retired from the bench, proceduralism was enshrined in Delaware law.

V. EPILOGUE

In the years since Chancellor Allen retired, the Delaware courts continued to chip away at the substance of fiduciary duties in favor of procedural requirements. In 2013, twenty years after *Weinberger* and coming full circle, then-Vice Chancellor Strine brought Allen's proceduralism to bear on the court's analysis of parent-subsidiary mergers and fairness.

Weinberger, we will recall, held the controlling shareholder, Signal, liable because it did not meet the fair dealing requirement.[305] *Weinberger* left unresolved the question as to what might have happened had the requirement been met. For example, it was unclear what standard of review would apply if a disinterested, independent body such as a majority of the disinterested directors approved the transaction. Would the shareholder plaintiff have to show that the transaction was unfair, or would the transaction be protected under the presumption of the business judgment rule?

Cases immediately following *Weinberger* continued to use the fairness standard of review even when a majority of the independent directors or a majority of the disinterested shareholders approved the merger. Such independent approval, however, permitted burden shifting. As the Delaware Supreme Court held in *Kahn v. Lynch Communications Systems, Inc.*, once the defendant directors demonstrated that the transaction was either

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303 *Id.* at 335.
304 *Id.* at 336.
305 *See* discussion *supra* circa notes 100–117.

negotiated by a "truly independent, fully informed" and free to negotiate special committee, or ratified by a majority of the minority shareholders, the burden would shift to the plaintiffs to demonstrate that the transaction was entirely unfair.[306] (An independent committee negotiating "with what could be considered a quick surrender" or under threats from the controlling shareholders would not meet such requirements and the burden would not be shifted.[307])

Then, in *In re Cox Communications*, Strine, highly critical of what he viewed as the plaintiff lawyers' misuse of litigation over fairness gratuitously to raise the price offered to shareholders in cash out mergers, recommended that the courts allow the invocation of the business judgment rule if both an independent special committee negotiating at arm's-length and the majority of the disinterested (minority) shareholders approved the merger. Given that the business judgment rule made any transaction almost insusceptible to challenge, Strine was confident that his recommended approach would motivate directors to use both procedures. Echoing Allen, Strine stressed that it "would promote the universal use of a transactional structure that is very favorable to minority stockholders—one that deploys an active, disinterested negotiating agent to bargain for the minority coupled with an opportunity for the minority to freely decide whether to accept or reject their agent's work product."[308] At the same time, it would dissuade plaintiff lawyers from misusing derivative litigation.[309]

Almost a decade later, Ronald Perelman, MacAndrews & Forbes' controlling shareholder, did exactly as Strine advised, offering the Vice Chancellor an opportunity to turn his recommendation into law. MacAndrews & Forbes owned 43% of M&F Worldwide (MFW) and wanted to cash out the public shareholders for $24 per share.[310] "Upfront, MacAndrews & Forbes said it would not proceed with any going private transaction that was not approved: (i) by an independent special committee; and (ii) by a vote of a majority of the stockholders unaffiliated with the controlling stockholder."[311] A special committee of MFW was formed, it picked legal and financial advisors, met eight times and negotiated with MacAndrews & Forbes, causing it to raise its bid by

[306] Kahn v. Lynch Commc'ns Sys., Inc., 638 A.2d 1110, 1117 (Del. 1994).
[307] *Id.* (citing Rabkin v. Phillip A. Hunt Chem. Corp., 498 A.2d 1099, 1106 (Del. 1985)).
[308] In re Cox Commc'ns, Inc. S'holders Litig., 879 A.2d 604, 644 (Del. 2005).
[309] *Id.*
[310] In re MFW S'holders Litig., 67 A.3d 496, 499 (Del. Ch. 2013).
[311] *Id.*

$1 per share. 65% of the minority stockholders of MFW approved the merger.[312] But, Strine pointedly wrote, "MacAndrews & Forbes, Perelman, and the other directors of MFW were, *of course*, sued by stockholders alleging that the merger was unfair."[313] Strine dismissed the plaintiffs' claim.

The Delaware Supreme Court, sitting en banc, endorsed Strine's ruling. Entire fairness, the Court stressed, was "the highest standard of review in corporate law;" hence, it applied only as "a substitute for the dual statutory protections of disinterested board and stockholder approval."[314] Following two decades of Delaware's changing standards, the Court made procedural fairness the norm and substantive fairness the exception. So long as both procedural requirements (resembling the requirements of Sections 144(a)(1) and 144(a)(2) of Delaware General Corporation Law) were met, a cash-out merger, the Court announced, will be reviewed not under a fairness standard, but under the extremely deferential business judgment rule.[315]

A keen interest in removing cash-out mergers from judicial review motivated the Delaware Supreme Court. To that end, Justice Holland emphasized that the dual protections embedded in the independent committee approval and a majority-of-the-minority vote effected "two price related pretrial determinations: first, that a fair price was achieved by an empowered, independent committee that acted with care; and second, that a fully-informed, un-coerced majority of the minority stockholders voted in favor of the price that was recommended by the independent committee."[316] Moreover, the Court reasoned, if both independent reviews agreed that the price was right, shareholders (and their attorneys) would have no reason to challenge their directors' actions (and would fail if they tried).[317]

Proceduralism and the shareholder wealth maximization norm, as the quote from *Kahn v. M&F Worldwide Corp.* illustrates, were conjoined. By uncoupling corporations from society and allowing the corporate elite to focus exclusively on procedure, Delaware's approach, if inadvertently, supported the top executives' self-interested rhetoric of fair price and shareholder wealth

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312 *Id.*

313 *Id.* (emphasis added).

314 Kahn v. M&F Worldwide Corp., 88 A.3d 635, 644 (Del. 2014).

315 *Id.*

316 *Id.* at 645.

317 *Id.*

maximization,[318] and with it the assertion that "if corporations were run to maximize the profits of stockholders, and to be highly responsive to their demands, that would benefit all of society."[319] But, as Strine more recently wrote, this conclusion assumes much that is incorrect—most significantly, that there are effective protections to other stakeholders outside corporate law, that stockholders are prevented from externalizing costs to other constituencies, that product markets ensure "robust and healthy competition," and that "financial markets value the contributions and risks generated by corporations, so that share prices reflect and reward sustainable, durable growth, not short-term opportunities for harvest."[320] None of these assumptions has ever been true. Instead, "gains to stockholders have come at the expense of debt holders, communities of operation, and taxpayers, as corporations have shifted costs to them, and bubble behavior has caused the need for repeated societal bailouts of the investor and financial class."[321]

"What's past is prologue,"[322] and what's past can instruct. For much of the twentieth century, courts legitimized the power of the corporate elite to ensure the growth of the American economy to the benefit of the corporations' different constituencies (particularly labor) and the community at large. Delaware's post-1980s turn to proceduralism legitimized corporate executives' turn inward and their fixation on the maximization of wealth for the shareholders. If we want corporations and their executives to address broader cultural, social, and economic interests, we must reevaluate Delaware's legacy.

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[318] In fact, managers were trained to think of themselves as shareholders, and their compensation package reflected that. Ernie Englander & Allen Kaufmann, *Executive Compensation, Political Economy, and Managerial Control: The Transformation of Managerial Incentive Structures and Ideology, 1950–2000*, at 9 (Geo. Wash. U. SMPP Working Paper No. 03-01, 2003), https://perma.cc/DM3G-464A.

[319] Aneil Kovvali & Leo E. Strine, Jr., *The Win-Win That Wasn't: Managing to the Stock Market's Negative Effects on American Workers and Other Corporate Stakeholders*, 1 U. CHI. BUS. L. REV. 307, 308 (2022).

[320] *Id.* at 309.

[321] *Id.* at 310.

[322] WILLIAM SHAKESPEARE, THE TEMPEST act 2, sc. 1, l. 289.