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Explicit and Implicit Bundling in Shareholder Voting on Cleansing Acts

Law Working Paper N° 823/2025
February 2025

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Abstract

Delaware courts have expanded the cleansing effect of a shareholder vote, thereby endowing shareholder votes with greater normative weight than at any time in the modern period. Outside the context of a conflicted transaction involving a controlling shareholder, a fully informed uncoerced disinterested shareholder vote on a transaction is treated as a full defense against any claim for breach of fiduciary duty. This implicitly bundles the consummation of the transaction with the cleansing of fiduciary duty breaches. We argue that this weight is misplaced from an internal corporate law perspective and represents a departure from the traditional treatment of shareholder ratification. A vote by a majority of target shareholders in favor of a transaction can be seen at most as evidence that shareholders believe that the value of their shares will be higher if the transaction takes place than if it does not take place as of the time of the vote—but such a vote does not indicate fairness and should not substitute for a fairness analysis. As a more rational regime, we suggest holding separate votes on the transaction and cleansing. Importantly, though separate, a board may decide to couple these votes by making consummation of the transaction contingent on an affirmative vote to cleanse. This explicit private ordering bundling has two advantages over the present implicit bundling by judicial fiat: boards can limit the scope of breaches submitted for a cleansing vote; and the board's decision to condition a transaction on a cleansing vote could itself be analyzed for whether it amounts to coercion. Given the conceptual problems with imputing a cleansing effect to a vote on the transaction, what then explains the judicial confidence in the normative significance of shareholder votes? We suggest that judges adopted a legal fiction in response to what was perceived to be excessive deal litigation. If that is the case, the question becomes whether it is a useful legal fiction or whether relying on other measures to reduce deal litigation would have been preferable.

Keywords: Shareholder voting, ratification, cleansing, fiduciary duties, mergers, conflict transactions, bundling, uncoupling, coercion, deal litigation, Corwin

JEL Classifications: K22, K41, D72

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Abstract

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Introduction

Over the last forty years, there have been fundamental shifts in the academic views on shareholder voting. Up to the 1980s, shareholder voting in publicly traded companies was not taken very seriously.[1] Given their small stake in the companies and the accompanying low likelihood of casting an outcome-determinative vote, most shareholders had virtually no incentive to acquire any information or put any effort into voting.[2] Over the following decades, two major changes occurred that made commentators more confident that shareholder voting could act as a check on board decisions: shareholdings became increasingly institutionalized and concentrated;[3] and shareholders increasingly disregarded board recommendations on how to vote.[4]

Courts are also placing greater weight on shareholder votes.[5] In 2015, the Delaware Supreme Court's decision in *Corwin* expanded the ratifying (or "cleansing") effect of a shareholder vote, thereby endowing shareholder votes with greater normative significance than at any time in the modern period.[6] In particular, outside the context of a conflicted transaction involving a controlling shareholder, a fully informed uncoerced disinterested shareholder vote is treated as a full defense against any claim for breach of fiduciary duty.[7] In the face of a shareholder vote, a case will thus be dismissed unless the vote

[1] See, e.g., Adolf A. Berle, Power without Property (1959); Adolf A. Berle, Modem Functions of the Corporate System, 62 Colum. L. Rev. 433 (1962); Lucian Arye Bebchuk, Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments, 102 HARV. L. REV. 1820, 1836-40 (1989) (arguing that shareholders will often approve charter amendments that are value-decreasing); Jeffrey N. Gordon, The Mandatory Structure of Corporate Law, 89 Colum. L. Rev. 1549 (1989) ("Proposed charter amendments will be sponsored by a relatively cohesive proponent, the insiders, who will argue that the proposed change will improve the corporation's functioning in a way that will significantly enhance shareholder wealth, i.e., is wealth-increasing. A diffuse group of public shareholders must evaluate this claim against the possibility that the amendment is merely "wealth-neutral," because all or almost all of the gain inures to the insiders, or "wealth-reducing," because it will transfer cash flow or control from public shareholders to insiders. In these circumstances, shareholder voting as a means of evaluating and consenting to a proposed charter amendment is fraught with severe problems, in particular, collective action problems in acquiring and disseminating information among shareholders, and strategic behavior by insiders that amounts to economic coercion. Thus, insiders can exploit their advantages to obtain approval even for wealth-reducing amendments.")

[2] See, e.g., Robert C. Clark, Corporate Law 390 – 393 (discussing collective action problem).

[3] See, e.g., Marcel Kahan & Edward Rock, Embattled CEOs, 88 Tex. L. Rev. 987 (2010).

[4] See, e.g., Randall S. Thomas & James F. Cotter, Shareholder Proposals in the New Millennium: Shareholder Support, Board Response, and Market Reaction, 13 J. Corp. Fin. 368, 369 (2007); Marcel Kahan & Edward Rock, Embattled CEOs, 88 TEXAS L. REV. 987 (2010).

[5] Anabtawi, Iman, The Limits of Shareholder Ratification (September 19, 2023). UCLA School of Law, Law-Econ Research Paper No. 23-06, Available at SSRN: https://ssrn.com/abstract=4576584 at 1 ("Courts are increasingly transferring to shareholders the traditional judicial role of evaluating the substantive fairness of decisions of conflicted boards."); Iman Anabtawi, The Twilight of Enhanced Scrutiny in Delaware M&A Jurisprudence, 43 Del. J. Corp. L. 161, 210 (2019)

[6] See Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304 (Del. 2015); In re Volcano Corp. S'holder Litig., 143 A.3d 727, 741 (Del. Ch. 2016) (extending *Corwin* cleansing effect to majority tender decisions); Singh v. Attenborough, 137 A.3d at 152 (Del. 2016) (ORDER)); Larkin v. Shah, 2016 WL 4485447 (Del. Ch. Aug. 25, 2016).

[7] See Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 313-14 (Del. 2015) (holding that disinterested shareholder approval reinstates the business judgment rule for conflict transactions not involving a controller). In the context of a conflict involving a controlling shareholder, a shareholder vote on its own enjoys lesser but still substantial weight, weight equivalent to approval by a properly functioning committee consisting exclusively of disinterested and independent directors. Kahn v. Lynch, 638 A.2d 1110 (1994). And a shareholder vote in conjunction with

was either not informed, coerced, or not cast by a majority of disinterested shareholders—and dismissal will often take place before plaintiffs have a change to engage in any discovery.[8]

While the commentators' enthusiasm for shareholder voting has started to cool—with commentators focusing on the fact that institutions' incentives to acquire information are much lower than the incentives of an individual shareholder with equivalent holdings[9] and suffer from or contribute to conflicts of interest[10]—it still runs high in the Delaware judiciary.

Is the Delaware courts' embrace of the normative significance of a shareholder vote in conflict transactions justified? Can a shareholder vote approving a merger reasonably be interpreted as approval of the deal process or the fairness of the result of that process? Or is the embrace of the shareholder vote best understood as a legal fiction that has been adopted to discourage what some view as abusive litigation? And if the latter view is correct, is it a useful legal fiction even if it cannot be justified in traditional terms?[11] These are the questions that this this article addresses.

In Part I, we argue that even in the circumstances most favorable to shareholder decision-making—when shareholders suffer from no information deficit and have no conflicts—a target shareholder vote in favor of a transaction does not show that the transaction is fair (or even that a majority of shareholders *believe* that the transaction is fair) or that the shareholders do not have serious fiduciary duty claims against those involved in the deal process. A vote by a majority of target

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approval by disinterested director is treated as a full defense against any claim for breach of fiduciary duty. Kahn v. M&F Worldwide Corp., 88 A.3d 635 (2014).

[8] See, e.g., In re Tesla Motors, Inc Stockholder Litigation, 2018 WL 1560293, at * (noting that plaintiffs need to plead the *ab initio* inapplicability of *Corwin* to be permitted to engage in discovery).

[9] Dorothy S. Lund, The Case Against Passive Shareholder Voting, 43 J. CORP. L. 493, 500 (2018); Lucian Bebchuk & Scott Hirst, Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy, 119 COLUM. L. REV. 2029 (2019); Marcel Kahan & Edward B. Rock, Index Funds and Corporate Governance: Let Shareholders Be Shareholders, 100 B.U. L. REV. 1771 (2020) (arguing that incentives of institutional shareholders in general and index funds in particular are comparatively high).

[10] See, e.g., Sean J. Griffith & Dorothy S. Lund, Conflicted Mutual Fund Voting in Corporate Law, 99 B.U. L. REV. 1151 (2019); Marcel Kahan & Edward Rock, The Cleansing Effect of Shareholder Approval in a World of Common Ownership; Henry T. C. Hu & Bernard S. Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. Cal. L. Rev. 811 (2006); Henry T.C. Hu & Lawrence A. Hamermesh, Decoupling and Motivation: Re-Calibrating Standards of Fiduciary Review, Rethinking "Disinterested" Shareholder Decisions, and Deconstructing "De-SPACs", 78 Bus. Law. 999 (2023) (arguing that courts' deference to "disinterested" shareholder decisions needs rethinking, due to the overwhelming institutional ownership of public companies). This literature is not entirely new. See Edward B. Rock, The Logic and (Uncertain) Significance of Institutional Shareholder Activism, 79 Geo. L.J. 445, 468-478 (1991); Bernard S. Black, Agents Watching Agents: The Promise of Institutional Investor Voice, 39 UCLA L. Rev. 811 (1992).

[11] There is a rich literature analyzing, praising or critiquing *Corwin* and its progeny. See, e.g., Charles Korsmo, Delaware's Retreat from Judicial Scrutiny of Mergers, 10 U.C. Irvine L. Rev. 55 (2019); Matthew D. Cain et al., The Shifting Tides of Merger Litigation, 71 VAND. L. REV. 603, 620 (2018 Franklin A. Gevurtz, The Shareholder Approval Conundrum, 60 B.C. L. Rev. 1831(2019) (arguing that the binary nature of shareholder votes explains the conundrum of shareholders approving deals that sacrifice their interest in getting the best price); Matteo Gatti, Did Delaware Really Kill Corporate Law? Shareholder Protection in a Post-Corwin World, 16 N.Y.U. J. L. & Bus. 345 (2020); James D. Cox and Randall S. Thomas, *Delaware's Retreat: Exploring Developing Fissures and Tectonic Shifts in Delaware Corporate Law,* 42 Del. J. Corp. L. 323 (2018), Anabtawi, Twilight, supra note _; Itai Fiegenbaum, Taking Corwin Seriously, 26 Lewis & Clark L. Rev. 791 (2022 (arguing that *Corwin* is founded on a misunderstanding of the channels and consequences of shareholder empowerment.)

shareholders in favor of a transaction is, at best, evidence that shareholders believe that the value of their shares will be higher if the transaction takes place than if it does not take place *as of the time of the vote*. But as we will argue, once a transaction is entered into, it will often be in the interest of shareholders to vote in favor of the transaction even though shareholders would have been better off had the transaction never been entered into. Moreover, a shareholder vote on the proposed transaction cannot be understood as expressing a view on the completely separate question whether those involved in the deal process – the target board and management, their advisers, and sometimes the acquirer – behaved appropriately or, if they did not behave appropriately, whether they nevertheless achieved a fair outcome.

Corwin and its progeny represent both a sharp departure from Delaware's traditional treatment of shareholder ratification and a highly implausible account of shareholder preferences. By interpreting a fully informed shareholder vote approving the transaction as also constituting a "cleansing" vote (that is, a vote that changes the standard for review by which fiduciary duty claims are analyzed), *Corwin* effectively bundles the votes on these two separate questions by judicial fiat.

In Part II, we will examine the issue of a shareholder vote from an internal corporate law perspective: how should a board of directors structure the shareholder vote if we think a shareholder vote can cleanse fiduciary breaches? If votes are a valuable mechanism for shareholders to express their views, why not leave the decision on how to structure the shareholder vote—whether to make consummation of the transaction contingent on ratification/cleansing or not and, if so, what scope to accord to such ratification/cleansing—to the target board of directors? In Part II, we analyze such a (hypothetical) two-vote system from the perspective of the target board and consider the board's fiduciary obligations when directors make an affirmative choice to condition a transaction on some sort of vote in favor of cleansing, that is, to "couple" the two votes.[12] Part II is somewhere between a "thought experiment" and a proposal for reform.

A key takeaway from Part II is that, if left to private ordering, directors' own interests and fiduciary obligations would constrain the scope of cleansing votes that could properly be bundled or coupled. In particular, a board may not *want* to absolve its own advisors from liability for certain conduct through a ratification/cleansing vote and a board's decision to condition consummation of a (presumptively favorable) transaction on shareholders ratifying/cleansing the board's own conduct would likely be held to be improper. By contrast, boards would have significant leeway to couple a transaction with a vote cleansing a counterparty from liability. We conclude that *Corwin's* comprehensive bundling by judicial fiat does not approximate what targets and acquirers could and would agree to consistent with their fiduciary duties.

Finally, in Part III, we consider the possibility that *Corwin* and its progeny do not, in fact, reflect judicial confidence in the normative significance of shareholder votes but, rather, a legal fiction adopted in response to what was perceived to be excessive deal litigation. If that is the case, the question becomes whether it is a useful legal fiction. From this perspective, *Corwin* may be more defensible because it (along with other measures) seems to have resulted in higher quality deal litigation by

[12] We thus draw a distinction between "bundling" (when a *single* vote expressly covers or is interpreted as covering two topics, as in *Corwin*) and "coupling" (when shareholders have *two* votes but implementation of one proposal is conditioned on the second one passing).

eliminating very weak cases.[13] In addition, the requirements that the shareholder vote be fully informed and uncoerced allow substantial scope for judicial review when courts suspect wrongdoing. However, it remains an open question how many high-merit claims are eliminated by *Corwin* and whether alternative ways to deal with low-merit claims would have produced superior results.

I. Critique of Current Law: Does Shareholder Approval of a Proposed Merger Demonstrate Transactional "Fairness"? Shareholder approval of fiduciary conduct?

a. Introduction: A Stylized Deal Process Claim under Corwin

In the years since the 1985 *Revlon* decision, claims alleging flaws in the deal process became common in Delaware. To understand the scope of *Corwin*, and the alternative "private" remedies, it is useful to keep in mind the following stylized deal process claim, drawn from *Firefighters' Pension System of the City of Kansas City, Missouri Trust v. Presidio, Inc*.[14]

> Target has entered into a merger agreement with Acquirer. A shareholder class action complaint alleges that shareholders received $5 per share less than they would have had the selling process not been corrupted. Some of the directors were not disinterested. The CEO, in particular, had a conflict of interest because she was negotiating with Acquirer about her continued employment during the sale process. Target's Investment Banker had a conflict because she was seeking a very lucrative assignment from Acquirer in a different transaction. Other disinterested Target directors failed to deal reasonably with these conflicts, left some key decisions in the hands of the CEO and did not sufficiently monitor the Investment Bank. Among others things, Investment Banker falsely claimed that Alternative Bidder was focused on closing another acquisition and would not be interested in acquiring Target and tipped-off Acquirer as to the bids for target made by other parties. Acquirer exploited the CEO's and Investment Banker's conflicting interests in order to buy Target for less than it was worth. The merger was approved by a majority of disinterested shareholders.
>
> Plaintiffs bring the following claims.
>
> (a) Against the disinterested directors: no unexculpated claims. While the complaint alleges that they breached their duty of care and acted unreasonably in violation of their *Revlon* duties, no claims are brought because Target's charter would exculpate them for these claims under § 102(b)(7) unless they acted in bad faith.
> (b) Against the interested directors: breach of the duty of loyalty.
> (c) Against the CEO: breach of the duty of loyalty.

[13] There has been a decline in the success rate of motions to dismiss under MFW. https://www.rlf.com/wp-content/uploads/2024/07/MFW-Just-Turned-10.pdf . VC Laster, in a LinkedIn post, suggests that this is likely "due to plaintiffs' lawyers doing a better job triaging cases and only filing relatively strong complaints. When we started the MFW decade, we were still in an era that saw frequent filers challenging virtually any controller deal. That, at least, has changed… It suggests to me that MFW has done its work. But its main effect has been to deter weak cases from being filed." https://www.linkedin.com/feed/update/urn:li:activity:7219036181068423171/

[14] Firefighters' Pension System of the City of Kansas City, Missouri Trust v. Presidio, 251 A.3 212 (2021).

(d) Against the Investment Banker: aiding and abetting the directors' breaches of their duties of care and loyalty.
(e) Against the Acquirer: aiding and abetting the directors' breaches of their duties of care and loyalty.

Under *Corwin* and its progeny, if the deal proxy contains sufficient disclosures, the claims against the CEO and the interested directors are clearly extinguished.[15] Whether the merger vote cleanses aiding and abetting liability is somewhat less clear but, assuming full disclosure to shareholders (which may not often occur in a decent aiding and abetting case),[16] the case law as it exists supports the view that these claims would also be cleansed.[17]

b. The Pre-*Corwin* Law of Shareholder Ratification

Corwin significantly changed Delaware law in two ways.[18] First, treating the vote on the merger as also ratifying the conduct of those involved in the deal process was a departure from the then-existing law of shareholder ratification. As the Delaware Supreme Court held in *Gantler v. Stephens*, Delaware case law did not view a shareholder vote required for approval of a transaction as cleansing alleged fiduciary breaches. Rather, for cleansing to occur, a separate shareholder vote was needed.[19] In so holding, the Delaware Supreme Court reaffirmed its earlier decision in *Santa Fe Pacific* which held that the shareholders' approval of the Santa Fe-Burlington merger did not ratify the board's unilateral decision to adopt defensive measures. In *Santa Fe Pacific*, the court rejected the "implied bundling" claim that lies at the heart of *Corwin*: the idea that, in approving the merger, the shareholders are also approving the directors' conduct in negotiating the merger. As the court put it, "The stockholders were merely offered a choice between the Burlington Merger and doing nothing. The Santa Fe stockholders did not vote in favor of the precise measures under challenge in the complaint. . . . Since the

[15] See, e.g., English v. Narang, No. 2018-0221-AGB, 2019 WL 1300855 (Del. Ch. 2019) (holding that alleged breaches of fiduciary duty claims and associated aiding and abetting were cleansed under *Corwin*); In re Merge Healthcare Inc., 2017 WL 395981 (Del. Ch. 2017) (holding that alleged breach of fiduciary duty based on buyer's promise of continued employment incentivized the company's fiduciaries was cleansed under *Corwin*); *Singh v. Attenborough*, 137 A.3d 151 (Del. 2016) ("When the business judgment rule standard of review is invoked because of a vote, dismissal is typically the result."); Teamster Members Retirement Plan v. Dearth, 2022 WL 1744436 (Del. Ch. 2022) (holding that alleged breach of fiduciary duty based on buyer's promise of continued employment for company's fiduciaries was cleansed under *Corwin*); Larkin v. Shah, 2016 WL 4485447 (Del. Ch. Aug. 25, 2016) (holding that alleged breach of fiduciary duty based on a flawed sales process designed to permit venture capital firms with which several board members were affiliated to monetize their investments was cleansed under *Corwin*); Galindo v. Stover, 2022 WL 226848 (Del. Ch. 2022) (holding that alleged breach of fiduciary duty by directors and duty of care by CEO were cleansed under *Corwin*); In re Volcano Corp. S'holder Litig., 143 A.3d 727 (Del. Ch. 2016) ((holding that alleged breaches of *Revlon* duties and associated aiding and abetting were cleansed under *Corwin*).

[16] It did occur at least once, in *Del Monte*.

[17] Only few cases have dealt with this issue, but in all of them aiding and abetting claims have been dismissed after a fully informed uncoerced vote. See *Singh v. Attenborough*, 137 A.3d 151 (Del. 2016); English v. Narang, No. 2018-0221-AGB, 2019 WL 1300855, at *13 (Del. Ch. 2019) (dismissing aiding and abetting claim as cleansed under *Corwin*); In re Volcano Corp. S'holder Litig., 143 A.3d 727 (Del. Ch. 2016) (same)

[18] See also Korsmo, supra note __, at 82-88 (discussing law prior to *Corwin*)

[19] It is not clear how often two separate votes were actually held.

stockholders of Santa Fe merely voted in favor of the merger and not the defensive measures, we decline to find ratification in this instance."[20]

Second, in construing the merger vote as a vote on both the merger and the directors' behavior, the *Corwin* court departed from the standard pattern of shareholder voting: shareholder voting is typically "single issue." Consider when shareholders vote under Delaware law: directors (§§ 211-219); charter amendments (§ 242); bylaws (§ 109); mergers (§ 251); sales of all or substantially all the assets (§ 271). Federal securities law adds a few additional topics: shareholder and board proposals; compensation; auditors; and say on pay. In each of these instances, shareholders vote on a single issue: should candidate X be a director (and not should this *slate* of directors be elected)? Should this merger be approved? Should this amendment be made to the charter?[21] Indeed, the SEC even has anti-bundling provisions to maintain the single issue focus of shareholder votes.[22]

c. The Key *Corwin* Justifications

A key justification offered for giving shareholder approval of a merger cleansing effect is that the shareholder vote demonstrates that the shareholders considered the transaction to be a "fair exchange." As then- Vice Chancellor Strine put it in *Harbor Fin. Partners v. Huizenga* : "If fully informed, uncoerced, independent stockholders have approved the transaction, they have, it seems to me, made the decision that the transaction is 'a fair exchange.'" Fifteen years later, Strine, now Chief Justice of the Delaware Supreme Court, would author *Corwin* and enshrine this principle into Delaware law. Citing to his earlier opinion in *Huizenga*, Chief Justice Strine reasoned: "When the real parties in interest—the disinterested equity owners—can easily protect themselves at the ballot box by simply voting no, the utility of a litigation-intrusive standard of review promises more costs to stockholders in the form of litigation rents and inhibitions on risk-taking than it promises in terms of benefits to them."[23]

But, as we argue in this section, that is not a reasonable interpretation of the shareholders' vote. Even if one were to accept a fully-informed disinterested shareholder vote as conclusive evidence that the merger makes shareholders better off—a conclusion that would require ignoring various imperfections in the voting system[24]— this would mean at most that shareholders are better off than in

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[20] In re Santa Fe Pac. Corp. S'holder Litig., 669 A.2d 59, 68 (Del. 1995).

[21] That said, there can be multiple sub-parts within a proposal such as an amended and restated certificate of incorporation or an incentive compensation plan.

[22] 1934 Act Rule 14a-4(a)(3)("the form of proxy . . . Shall identify clearly and impartially each separate matter intended to be acted upon, whether or not related to or conditioned on the approval of other matters, and whether proposed by the registrant or by security holders."); Nicholas O'Keefe, SEC Guidance on Unbundling in M & A Context, https://corpgov.law.harvard.edu/2015/12/30/sec-guidance-on-unbundling-in-ma-context/ .

[23] Corwin, 125 A.3d 313.

[24] To constitute a *legally* fully informed vote, it suffices that the relevant information has been *provided to* shareholders. In light of the collective action problem, whatever its scope, that shareholders have access to information obviously does not mean that shareholders will in fact acquire the information and make an informed judgment. Thus, a legally fully-informed vote may not be a factually fully-informed vote and hence not even mean that shareholders believe that the transaction makes them better off. See also Korsmo, supra note __, at 98-99 (highlighting information asymmetries even after the rise in institutional shareholdings). In addition, there are various conflicts of interests that, under present jurisprudence, may not disqualify a shareholder from being considered disinterested. See supra note __. Thus, as we have written elsewhere, it is unclear if and when conflicts due to common shareholdings can result in a shareholder being deemed to be "interested." Marcel Kahan & Edward Rock, The Cleansing Effect of Shareholder Approval in a World of Common Ownership, supra note __. If

the immediately available alternative, namely, the value of the company if the merger is voted down.[25] That decision cannot reasonably be interpreted as a desire by shareholders to cleanse fiduciary conduct when the company would have been better off never pursuing the merger in the first place, pursuing a different merger instead, or insisting on a less skewed division of the surplus generated by the merger.[26]

Consider the stylized example we posed earlier. The example draws attention to the difference in circumstances, and the accompanying differences in firm value, between the time the transaction was entered into and the substantially later time when shareholders vote on whether to approve the transaction. Even if, at the time of the vote, Target shareholders preferred a merger with Acquirer on the proposed terms over not merging with Acquirer, they were clearly harmed by the misconduct of Investment Banker who induced the board not to pursue Alternative Bidder and enabled Acquirer to make the minimally required topping bid. If shareholders had been asked to approve the misconduct (and the resulting deal) in advance, they presumably would have voted against it. But, several months later, the losses generated by the conduct could not be easily recaptured by voting down the deal.[27]

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we set aside these problems and assume that shareholders have in fact both full information and the same objective (to maximize the value of their shares), as we do for purposes of this article, a vote by a majority of shareholders in favor of a transaction can be seen as strong evidence—strong enough to be treated as conclusive—that the value of their shares will be higher if the transaction takes place than if it does not take place.

[25] See also Gevurtz, supra note __.

[26] If a transaction generates surplus, the concept of fairness may require that the surplus be shared fairly between the parties. This is particularly the case when one side in a transaction had an undue influence over how the surplus should be divided. What constitutes a fair division can be determined by the process through which it is decided how the surplus is divided. Thus, a fair price is often said to be a price that results from arm's length bargaining between unaffiliated parties. One cannot predict the division of surplus that such arm's length bargaining would generate. In any particular case, the surplus may be divided in a highly lopsided way. More generally, bargaining can produce any division of surplus, and any division of surplus is thus *potentially* the product of arm's length bargaining. But that does not mean that, in the absence of arm's length bargaining, any division of surplus is fair. If a lopsided division of surplus is generated by a process that does not resemble arm's length bargaining, that division may be unfair. See ACP Master, Ltd. v. Sprint Corp., 2017 WL 3421142, at *19 (Del. Ch. 2017) (it absence of procedural fairness, shareholders may be entitled "fairer price"). Unlike a board or a special committee of disinterested and independent directors, shareholders of a public corporation are generally not well constituted to obtain professional advice and cannot actively negotiate with another party. A context in which such shareholders are presented with a proposal that they can vote up or down thus does not resemble arm's length bargaining. Rather, as shown in a recent article by Ryan Bubb, Emiliano Catan and Holger Spamann, it is closer to a take it or leave it offer. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4929197 A take it or leave it offer framing, however, enables the party capable of making such an offer to extract the bulk of surplus. From that perspective, approval by a majority of fully informed disinterested shareholders, while strong evidence that the value of their shares will be higher if the transaction takes place than if it does not take place, is significantly less strong evidence that the transaction is fair.

[27] To be sure, shareholders could under current law vote down the deal and instead pursue (or have Target pursue) a damage claim against Investment Banker. But this would force shareholders to forgo any gains that would be generated from the transaction at the time of the vote (which would be inefficient) and risk that Investment Banker may not be able to pay full damages. We therefore see no reason why shareholders should be required to vote down the transaction as a condition for pursuing their damage claim. In fact, approving the transaction may be required to mitigate damages from Investment Banker's misconduct. As an analogy, assume that a conflicted financial advisor invest a client's funds at a 3% interest rate when he could have invested it at a 5% rate. The proper way to deal with this is for the client to take the 3% interest and sue for advisor for damages (the remaining 2), rather than for the client to void the investment, get no interest, and sue for the entire 5% as damages.

Voting in favor of the transaction, as the Delaware Supreme Court noted in *Santa Fe Pacific*, thus merely reflects the circumstances and options at the time of the vote. To determine whether the transaction was a fair exchange, on the other hand, one should look at the terms of the transaction and compare it to the value of the company that could have been attained had no breaches of fiduciary duty occurred—that is, one has to shift the focus from the time of the vote to the earlier time when the transaction was negotiated and entered into, the time when the alleged breaches in fiduciary duty took place.

The gap in value of the company between the time of the vote and the earlier time when the transaction was negotiated and entered into is not just an artifact of our stylized example. There are fundamental reasons why shareholders may, after the fact, vote in favor of a transaction even if, before the fact, they would have disapproved the conduct the produced the transaction had they been given the chance.[28] We discuss five reasons why a company whose shareholders vote down a proposed transaction will correctly be viewed by the market to be "damaged goods."

1. Termination Fees

One straightforward reason why shareholders may, after the fact, vote in favor of a transaction that they would have disapproved before the fact is that a vote against the transaction triggers the payment of termination or similar fees or grants the counterparty other valuable rights. Acquisition agreements often contain provisions for such fees if the requisite shareholder approvals are not obtained. Standard termination fees range from 3-5% of the transaction value, but may in some cases be higher.[29]

Consider a company that would have a value of $1,030 million if not acquired by any party. Assume that the board of the company approves a merger agreement pursuant to which the company will be sold for $1 billion. In case shareholders do not approve the merger, the company has to pay a

[28] Empirical evidence on failed transactions is consistent with this assessment. A study by Paul Asquith has found that targets in unsuccessful bids suffered a negative 8.1% return in the period between the bid announcement and the announcement that the acquisition attempt failed, another negative -6.4% upon the announcement that the bid did not succeed, and a further -8.7% in the following 240 days. These negative returns substantially exceeded the positive 7.0% return upon the announcement of the bid. Paul Asquith, Merger Bids, Uncertainty, and Stockholder Returns, 11 J. Fin. Econ. 51 (1983). Note, however, that the returns on transactions that actually failed may not be reflective of the hypothetical returns on "failed" transactions that did in fact fail. In particular, one reason may transaction fail may be negative information about target value that emerged after bid announcement. Moreover, transaction that fail because a bid was not accepted may not reflect transactions that failed after a bid was accepted.

[29] In fact, termination fees serve as a perfect illustration for why a transaction that fully-informed, disinterested shareholders approve *ex post* is not *ipso facto* a fair transaction. If the termination fee is high enough, shareholders can be induced to approve any transaction. Ian Ayres, Analyzing Stock Lock-Ups: Do Target Treasury Sales Foreclose or Facilitate Takeover Auctions?, 90 Colum. L. Rev. 682 (1990) (examining effect of lockup on target value). Courts, of course, are aware of this effect and would presumably find that excessive termination fees are coercive. But any termination fee induces shareholders to vote for transactions in some range of value that they would not have voted for absent the fee. The difference in the amount of fee is a difference in degree, rather than one in kind.

$40 million termination fee to the acquirer. At the time at which the merger agreement is signed, the sale makes shareholders clearly worse off. But if the company has to pay a $40 million termination fee if shareholders vote against the acquisition, shareholders would vote in favor: they prefer to receive $1 billion from the sale of the company to voting against a sale and owning a company with a value of $990 million ($1,030 million less the $40 million termination fee).[30]

2. Loss of Transaction Opportunities

Another reason why the value may decline from the time the transaction is entered into to the time of the vote is that the company has lost the opportunity to engage in alternative transactions. Our stylized example illustrates such a loss.

More generally, assume that a board, at the time of the transaction, has a firm offer by Bidder A for $120 per share and the prospect of getting a higher offer from Bidder B, say a 50% chance of getting a $130 bid. The expected value of the company at that time would be $125, a 50% chance of getting $130 from Bidder B and, if no bid by Bidder B materializes, the fallback opportunity to sell to Bidder A for $120. The value of the company if it is not sold at that point does not enter the analysis.

But assume that the board fails to follow up on Bidder B, whether because of board conflicts or because of board advisor conflicts (as was the case in *Presidio*) and agrees to Bidder A's offer of $120 per share, and that Bidder B turns its attention elsewhere. By the time of the shareholder vote, there may be only a low, say 10%, chance of finding some other Bidder C willing to pay $130. Moreover, if the transaction is voted down and no such other bidder materializes, it will be far from certain that Bidder A would still be willing to buy the company for $120. Assume that chance is only 50%. The value of the company if the transaction is voted down would then be $10\% \cdot \$130 + 90\% \cdot 50\% \cdot \$120 + 90\% \cdot 50\% \cdot SAV$ where SAV stands for the stand-alone value of the company if it is not sold. If SAV < $117.78, shareholders are better off voting in favor of the transaction.

In this example, two factors account for the decline in value. First, the likelihood that an alternative bidder will emerge declined from the time of the breach to the time of the vote (in our example, from 40% to 10%). Such a decline is likely if, at the time of the breach, there was a particularly strong reason to believe that another party would be interested in acquiring the company, as was the case in *Presidio*. Second, the likelihood that the deal with Bidder A falls through if the transaction is voted down and no alternative bidder turns out to come through is lower than the likelihood that the deal will fall through if the board had used a proper process before entering into a merger agreement with Bidder A (50% compared to 0%). That is, voting a transaction down because the board did not engage in a proper market check is more likely to kill a transaction than engaging in a proper market

[30] Notably, the termination fee may be payable even if the board of the company violated its fiduciary duties in agreeing to sell the company for $1 billion. In particular, unless the party entitled to receive the termination was itself tarnished by the breach of duty, for example because it aided and abetted the breach, it would be entitled to receive the fee it contracted for. Assume, for example, that the company had negotiated a sale for $1 billion and a 4% termination fee and, shortly before signing the deal, receives an offer for $1,030 from another bidder. But the CEO of the company, because she prefers to sell the company to the first bidder, fails to inform the board of the higher offer or misrepresents its term. In such circumstances, the CEO's breach of duty of loyalty (and the potential breach by other directors of their duty of care) would not affect the company's obligation to pay the termination fee.

check before entering into a deal. Importantly, that means that there would be a systematic loss of transaction opportunities even if the likelihood of an alternative opportunity had not changed.

3. Reduced Bargaining Power

Our stylized example illustrates yet another reason why value may decline: the fact that the company entered into a merger agreement reduces the company's bargaining power.

In the example, this reduction took place due to Investment Banker leaking to Acquirer the bids by other bidders. This disloyal action made it harder for Target's board to induce Acquirer to make a higher offer.

But bargaining power can also decline independently of misconduct. *In re Del Monte Foods Shareholders Litigation*,[31] Barclays, Del Monte's financial advisor, had an interest in KKR acquiring Del Monte as Barclays had a long-standing relationship with KKR and thus hoped to earn additional fees for arranging buy-side financing for KKR. Without the approval of Del Monte's board and in violation of contractual no-teaming provisions, Barclays helped pair KKR with Vestar, another private equity firm that had previously expressed an interest in acquiring Del Monte. By pairing KKR and Vestar, Barclays reduced the possibility of competing bids by these companies. Del Monte's board, uninformed about Barclays' conflicts and the breach of the no teaming provision, agreed to be acquired by KKR for $19 per share.

If the Del Monte board, or Del Monte' shareholders, had rejected the KKR deal after learning all of this, any potential bidder would know that, if push came to shove, Del Monte's board was willing to sell the company for $19—a valuable piece of information that KKR did not have when it negotiated the $19 transaction. The result of abandoning the KKR deal (compared to not having entered it), in other words, would be to make it harder for Del Monte to elicit a price higher than $19 in negotiating with a potential subsequent acquirer.

4. Disruptions

Transactions create uncertainty about how a company will change as a result of the transaction.[32] Employees, in particular employees in managerial positions, [33] may be worried that they

[31] 25 A.3d 813 (Del. Ch. 2011).

[32] https://blog.thinkherrmann.com/4-pain-points-employees-will-face-during-a-merger-or-acquisition ("There are also likely to be personnel departures during a merger or acquisition. Sometimes these departures can have ripple effects. A favorite manager leaving, for example, might be the impetus for lower-level employees to jump ship as well.")

[33] See https://hbr.org/2017/03/surviving-ma "For individual managers and employees, a merger or acquisition is not just a corporate strategy; it's a personally disruptive—often traumatic—event. What C-suite executives and consultants euphemistically call 'postmerger integration' is typically a period of tension, uncertainty, and even chaos. Workloads ramp up, as do pressure and stress. You may have to quickly adapt to unfamiliar policies, practices, and politics; work with strangers from different corporate or even national cultures; or report to new

will be terminated,[34] that they will be asked to move to a less desirable location,[35] or that their work conditions may otherwise change for the worse.[36] As a result, key employees may pre-emptively look for new jobs (and competitors may recruit key employees) as soon as a transaction is announced.[37] Customers and suppliers of a company may likewise be concerned about their relationship with the company.[38]

The potential for such disruptions is one important and legitimate reason why companies often want to keep merger negotiations private until an agreement is reached and disclosure is required. But those disruptions also mean that, once a company that has announced that it has entered into a transaction, voting the transaction down will leave the company worse than had it not entered into the transaction in the first place.

5. Operating Restrictions

Acquisition agreements contain explicit and implicit restrictions to a target's operations until shareholder and regulatory approval for the transaction is obtained and the acquisition is consummated.[39] The most significant of these restrictions, the "ordinary course of business" covenant,

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bosses who know nothing about your track record or ambitions. Meanwhile, there is no guarantee of a job with the resulting organization, let alone a long-term career.")

[34] https://hbr.org/2017/03/surviving-ma ("On average, roughly 30% of employees are deemed redundant after a merger or acquisition in the same industry.")

[35] https://blog.thinkherrmann.com/4-pain-points-employees-will-face-during-a-merger-or-acquisition ("People don't like upheaval in their professional lives, and a lot of workers see mergers and acquisitions as a threat (with good reason — many M&As are followed by layoffs). If the change requires relocation, this can become especially problematic. Many workers would rather move on than take a risk.")

[36] See https://www.americanexpress.com/en-ca/business/trends-and-insights/articles/the-effects-of-mergers-and-acquisition-on-employees/ . ("Let's look at some of the effects of merger and acquisition on employee performance and how to retain and motivate employees in the face of change.

As employees watch their co-workers laid off, they might face uncertainty.

Employees from the two organizations may compete instead of working together.

Employee morale may suffer as a result of merging two corporate cultures.

Employee motivation may drop as frustration with new roles and new co-workers or management increases.)" https://blogs.lse.ac.uk/businessreview/2020/06/17/many-mergers-end-up-as-a-bad-experience-for-employees/ ("Major organisational changes like mergers and acquisitions (M&A), restructures, and spin-offs often leave a bad taste in the mouth of employees."); http://bgspartner.com/mergers-and-acquisitions/ ("mergers have a tendency to cause a higher turnover rate than planned for" "Many M&A employees fear that they will lose their job. When companies merge, new business leaders may want to bring their own teams onboard. There could also be less opportunity for their skillset once the teams are consolidated.")

[37] https://www.businessinsider.com/5-ways-to-keep-top-employees-from-quitting-during-a-merger-2015-9 ("At the mention of a merger many employees automatically go on high-alert. 20% percent of employees voluntarily leave the company soon after a merger announcement.")

[38] Del Monte, 25 A.3d 813, 824 ("the Board was concerned that a renewed process could have detrimental effects on employees, customers").

[39] https://www.yalelawjournal.org/forum/a-proposed-postpandemic-framework-for-ordinary-course-and-mae-provisions-in-merger-agreements-reviewing-recent-market-practice-changes-and-addressing#_ftnref13

prohibits the target from making any significant changes to its operations without the acquirer's consent.[40]

Operating restrictions are a nuisance. They impose an additional layer of review, the need to explain the rationale to the acquirer's managers, and accompanying delay even to the extent that there is no conflict between the target and the acquirer. As a result, while the acquisition is pending, target management may not even bother to seek permission to engage in some changes to operations.

Moreover, the target's and the acquirer's interests are likely to conflict to some extent. The acquirer will want the target to be managed in a way that maximizes target value *conditional on the acquisition being consummated*.[41] Absent an acquisition agreement, however, it would be optimal to manage in the target in a way that strikes a balance between maximizing the target's value to potential acquirers and the maximizing the target's free-standing value.

While some managerial decisions maximize target value regardless of whether the target is acquired or not, others are likely to generate conflicts. For example, some target operations may be duplicative of or incompatible with operations of the acquirer. Some products that the target may develop may compete with products of the acquirer. Some equipment that target may purchase may work well for the target, but not for acquirer. And so on. In such cases, target operating restrictions will prevent the target from making decisions that are in its best interest should the transaction fail.[42]

6. A Note on Deterrence

Having legal rules that make sure that shareholders are paid a fair price is important also from a deterrence perspective. Doing so assures that fiduciaries cannot appropriate value to themselves and then hope for a shareholder approval that cleanses any breach of fiduciary duties because shareholders would be even worse off if they voted against a transaction.

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[40] See, e.g., AB Stable VIII LLV v. MAPS Hotels & Resorts One LLC, C.A. No. 71, 2021, 2021 WL 5832875 (Del. Dec. 8, 2021) (finding that changes instituted by a luxury hotel business in response to COVID-19 nevertheless violated the ordinary course covenant in the sale agreement even though these changes were reasonable and warranted). The covenant also often prohibits certain type of actions that are per se prohibited whether or not they are significant. In addition to the ordinary course of business covenant, target operations are restrained by the various representations and warranties that must be true as of the closing.

[41] Relatedly, target managers lack will lack incentives to take actions that maximize the value of the company in the event the transaction does not take place. Pending an acquisition, planning for the contingency that the transaction may fail is not foremost on their mind. The lack of incentives combined with the ordinarily course of business covenant means that targets, in the period between the agreement is signed and the transaction is either consummated or abandoned, are managed conservatively, with minimal changes, rather than to maximize its value if the transaction fails.

[42] Even though ordinary course of business covenants typically provide that the acquirer may not "unreasonably" withhold its consent, see https://www.yalelawjournal.org/forum/a-proposed-postpandemic-framework-for-ordinary-course-and-mae-provisions-in-merger-agreements-reviewing-recent-market-practice-changes-and-addressing#_ftnref13 at fn 153, it would not be unreasonable for the acquirer to refuse to consent to an action that would lower the value of the target in the acquirer's hands.

Assume that company A has a standalone value of $1 billion and that an acquirer is willing to pay up to $1.2 billion for the company. But instead of selling the company for $1.2 billion, the board negotiates a deal in which shareholders will receive $1.15 billion and management will receive the remaining $50 million. Shareholders are likely be better off voting in favor of that transaction. In theory, they could vote against it, replace the disloyal board, and try to strike another deal to sell the company for $1.2 billion without any side payments to management. But this would take time and the outcome would be uncertain.

Permitting shareholder vote in such a case to cleanse the board from any wrongdoing would result in shareholders receiving less than a fair exchange, a result that is ex post unfair. In addition, it would also fail to deter fiduciaries from deriving profits from their wrongdoing and thereby incentivize wrongdoing. Put differently, from an ex ante perspective, it is desirable to adopt a fiduciary law regime that does not enable directors, officers, and controllers to siphon off value for their own benefit.

7. What Does a Shareholder Vote on a Transaction Signify?

While we have been critical of inferring from an ex post shareholder vote approving a transaction that shareholders have ratified misconduct or concluded that the transaction is a fair exchange, we do not take the view that such a vote is irrelevant from a fiduciary duty perspective. A fully-informed, disinterested shareholder vote in favor of a transaction can justify the inference that shareholders are better off if the transaction takes place than if it does not. To return our termination fee example, a shareholder vote in favor of a $1 billion merger with a $40 million termination fee can justify the inference that shareholder believe that the value of the company (before taking account of the fee) if the merger is voted down is not above $1,040 million.

Assume that shareholder plaintiffs attacking a merger claim, based on a discounted cash flow analysis, that the fair value of the company at the time the parties agreed to merge was $1.2 billion (before taking account of the fee). In response to such a claim, defendants would press plaintiffs to account for the difference between the $1.2 billion asserted value at the time of the transaction and the $1,040 million value at the time of the vote. Although plaintiffs should be permitted to argue that the difference in value can be attributed to factors such as the ones we discuss in this part or that the purchase price does not reflect a fair division of the joint gains produced by the transaction, shareholders should be estopped from claiming that the fair value at the time of the vote exceeded $1,040 million.

II. Our Alternative: Let the Board Structure the Shareholder Vote

From a doctrinal perspective, *Corwin* is an odd case. Under the pre-*Corwin* law of shareholder ratification, as summarized in *Gantler*, a vote that is required to complete a transaction did not cleanse alleged fiduciary breaches. Only a separate, fully informed shareholder vote will cleanse a potential fiduciary breach. Thus, for example, in a typical related party transaction between an officer or director and the corporation – a transaction that, under the statute, typically does not require a shareholder

vote – a fully informed shareholder vote will validate the transaction.[43] *Corwin*, in other words, bundles the vote on the transaction and the vote on ratification/cleansing by judicial fiat.[44]

Compare this bundling by judicial fiat to a private ordering world. In a private ordering world, it is the board that must decide what questions to present for a shareholder vote. This requires the board to decide *whether* to ask shareholders to ratify/cleanse any conduct and, if so, *to set the scope* of the conduct that is to be ratified/cleansed. It also requires the board to decide how to structure those decisions: whether to have separate, *uncoupled* votes on cleansing; whether to have *coupled* votes where approval of ratification/cleansing is a condition for consummation of the transaction; or possibly (assuming arguendo that they have the power to do so) whether to have a *bundled* vote in which shareholders cast a single vote on both the transaction and on ratification/cleansing.

To be sure, in a merger transaction, the acquirer will also be involved in these decisions: first, an acquirer may demand that the acquirer and its affiliates, and perhaps others, be cleansed of any potential liability as a condition to proceeding with the merger; second, an acquirer may object to a vote structure that may jeopardize deal completion. But while the acquirer may ask for or object to a ratification/cleansing vote as part of the deal negotiations, it is ultimately the board that decides whether to accede to these request and whether to seek ratification/cleansing for any potential defendants or claims when the acquirer has not expressed any views.

As we argue below, coupling (and bundling, for that matter) shareholder ratification to approval of a transaction raises a host of issues. In particular, using approval of an attractive merger to cleanse target management's conduct as fiduciaries would generally be considered coercive under current Delaware case law. Put differently, what is generally understood to be the main "contribution" of *Corwin* – cleansing deal process claims against target fiduciaries – would be ineffective (and possibly itself a fiduciary breach) had its functional equivalent – coupling the vote on the merger with a vote on cleansing – been initiated by the board. By contrast, a board has more leeway when it is the acquirer that seeks to require ratification/cleansing of its own conduct as a condition for going forward with the transaction.

A. Voting on the Transaction versus Voting on Ratification/Cleansing

In a private ordering world, the first question facing a board will be whether to conduct two separate votes—one on the transaction and the other on ratification/cleansing—or whether to bundle the decisions on approval of the transaction and on ratification/cleansing into a single vote. Whether a board even has the statutory power to bundle the two items—approval of the transaction and ratification cleansing—into a single vote is unclear.[45] But for our purposes, the difference between

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[43] ALI Draft Restatement of Corporate Governance, Section 5.02. When, for example, the related party transaction is a merger that requires a shareholder vote, then the vote on the transaction would not cleanse under *Gantler*. For another article arguing or a two-vote regime, see Anabtawi, Twilight, supra note __, at 205-209.

[44] We are not the first to note that *Corwin* bundles transaction approval with ratification/cleansing. See James D. Cox, Tomas J. Mondino & Randall S. Thomas, Understanding the (Ir)relevance of Shareholder Votes on M&A Deals, 69 Duke L. J. 503, 542; Anabtawi, Twilight, supra note __, at 202; Korsmo, supra note __, at 100-102.

[45] Boards clearly lack the power to bundle approval of the transaction and approval of ratification/cleansing implicitly, as *Corwin* does, simply by *deeming* that approval of the transaction has a cleansing effect. Only courts would have the power to do so. It is equally clear that a board has the power to bundle different provisions into a single vote as, for example, in recommendation to the shareholders to amend the certificate of incorporation

bundling and coupling is less significant than the difference between private ordering coupling and bundling on one hand and bundling by judicial fiat, as under *Corwin*, on the other hand. In this section, we address the difference between private-order coupling and judicial fiat bundling; in the next section, we discuss why private-order coupling is preferable to judicial fiat bundling.

Unlike under *Corwin*, where approval of the transaction and cleansing are bundled by judicial fiat, in a private ordering world a board will start with a blank slate: Which, if any, potential fiduciary claims should be presented to the shareholders for ratification? And which, if any, claims should be coupled to the transaction by making an affirmative vote on ratification/cleansing a condition for consummation of the transaction. As a result, shareholders can be asked to vote in favor of a motion to ratify/cleanse only conduct by certain parties or only certain claims and that vote can be either coupled to the consummation of the transaction or be entirely separate.[46]

1. Uncoupled Votes

under DGCL § 242 in which shareholders approve a dual-class recapitalization accompanied by a $0.10 dividend preference for the low voting stock. Jeffrey Gordon, Ties that Bond: Dual Class Common Stock and the Problem of Shareholder Choice, 76 Calif. L. Rev. 1 (1988), On the SEC's anti-bundling rules (some of which are inconsistent with Delaware law), see Greenlight Capital, L.P. v. Apple, Inc., 2013 WL 646547 (S.D.N.Y. Feb. 22, 2013)(court enjoined Apple from combining four charter amendments into a single shareholder proposal); and Nicholas O'Keefe, SEC Guidance on Unbundling in M & A Context, https://www.arnoldporter.com/en/perspectives/publications/2015/12/20151202_sec_guidance_on_unbundling_in_m_12493.

But what about explicit bundling? Suppose the board announces to the shareholders that their vote on a merger will also cleanse the deal process fiduciary claims. Does the board have the power to do this in a way that it will be effective? Under *Gantler v. Stephens*, the answer seems to be negative: the shareholder vote on the reclassification did not cleanse the fiduciary duty claims because the vote was required for the reclassification to become legally effective and not because shareholders had not been informed of its cleansing effect. Even in *Corwin*, which overruled or limited *Gantler*, the question was whether the facts were properly disclosed to shareholders and not whether they were informed that a vote for the transaction would also cleanse deal process claims. In both cases, the issue was the legal effect of the shareholder vote on the standard of review of the fiduciary duty claims, a question for the court. On the other hand, the spirit of Corwin is that a fully informed and uncoerced shareholder vote can cleanse anything short of controlling shareholder misconduct. If that is right, one cannot exclude the possibility that a board could bundle cleansing by board decision with a shareholder vote (e.g., by expanding or limiting the default cleansing effects applied by courts), inform shareholders of that decision, and then submit that decision to the shareholders for approval. Even if boards have the power to bundle these items, they will be constrained in the exercise of that power by fiduciary duty law.

[46] As noted, *Gantler* also embraces a two-vote regime. See supra TAN. The separation of the vote on cleansing/ratification from the vote on the transaction that we are proposing is both narrower and broader than the *Gantler* approach. It is narrower in as much we would accord even a single vote—that is, a vote on the transaction only—*some* evidentiary effect. An affirmative vote on the transaction could preclude any argument that the value of the shares if the transaction takes place is lower than the value if it does not, as of the time of the shareholder vote. But it is broader in as much we would require, to cleanse any claims, a separate vote on ratification/cleansing even when the vote on the transaction is not *statutorily* required. To be sure, when the vote on the transaction is not statutorily required, the board may be able to have only a single vote, on ratification/cleansing, and forego the vote on the transaction. However, if the board chooses to condition the transaction on shareholder approval, or if a vote on the transaction is required by stock exchange rules, then a separate vote on ratification/cleansing would be required to cleanse any residual fairness claims.

Two separate, uncoupled votes would pose the issue of cleansing to shareholders in a direct way independent of the transaction itself.[47] In our view, independent, uncoupled votes on ratification/cleansing are the gold standard.

But uncoupled voting entails the risk that shareholders will always vote no on ratification/cleansing—whether or not they favor the transaction—as doing otherwise would give up a potential claim for no consideration. While there is some risk that shareholders will do so, we do not think that this will inevitably be the case. For one, when there are no viable claims for damages, shareholders give up little by voting in favor of cleansing. Incentives to vote in favor of ratification/cleansing when the shareholders view the transaction as desirable in comparison to what would have been achieved by a board that had complied with its duties (and not just in comparison to the value of the target in the event the transaction is rejected) are particularly strong for institutional investors. Institutional investors are likely to face votes on ratification/cleansing in many transactions. They are thus unlikely to approach such votes from a myopic ex post perspective of whether they want to give up a remote damage claim in a single transaction that has already been negotiated and that they favor. Rather, they are likely to adopt an ex ante perspective of what voting policy on ratification/cleansing will maximize share values across transactions generally. And we would venture that even individual shareholders, whether out of common decency or because they fail to understand their strategic interests, would vote in favor of ratification/cleansing if they believe that the transaction was a good deal and no misconduct was evident.

Moreover, we do not think it is fully accurate that shareholders have nothing to gain from voting in favor of ratification/cleansing. Litigation can lead to the distraction of management that may adversely affect the value of the target. This would be relevant for an acquisition of the target for stock and even for a cash acquisition to the extent that consummation is not guaranteed. If a damage claim is not material, shareholders may thus be better off, even from an ex post perspective, to vote in favor of ratification/cleansing.

The most significant difficulty in a separate cleansing vote is ensuring that shareholders have confidence that they have been fully informed. Shareholders have few sources of information on the deal process beyond the proxy statement. When there were serious deficiencies in the deal process, those deficiencies may not be fully disclosed in the proxy statement and only be detected if a suit is permitted to proceed. Shareholders worried about this possibility may adopt a rebuttable presumption against voting for ratification/cleansing to permit discovery even if the proxy statement does any contain any indication of a flawed process. Alternatively, shareholders might expect that serious deal process deficiencies will subsequently come to light and prevent the shareholder vote from cleansing the conduct, and thus vote based on the disclosed information.

[47] Under current doctrine, the cleansing effect of a shareholder vote depends on the type of transactions. In transactions with controlling shareholders, a shareholder vote on its own shifts the burden of proving fairness under the entire fairness standard and a shareholder vote together with disinterested director approval reinstates the business judgment rule. MFW. In transactions not involving a controlling shareholder, a shareholder vote on its own reinstates the business judgment rule. The rationale for according a different cleansing effect to a shareholder vote depending on the type of transaction relates to issues not addressed in this article.

2. Coupled Votes

Rather than having two independent, uncoupled votes—where the vote on ratification/cleansing has no bearing on the consummation of the transaction itself—the consummation of the transaction could be made contingent on shareholders voting in favor of ratification/cleansing. Here, the *Corwin* problem re-emerges: in a coupled vote, shareholders who favor the transaction (because the value of the shares if the transaction takes place is higher than the value if it does not) should also vote in favor of ratification/cleansing of misconduct even if they believe that such misconduct resulted in a less favorable transaction than would have resulted from a proper deal process and even if the proposed transaction is worse than the (now unrecoverable) pre-process firm value. Coupling the two separate votes on the transaction and on ratification/cleansing by making consummation of the transaction contingent on receiving an affirmative vote on ratification/cleansing is thus similar to bundling the two issues into a single vote.

But the crucial differences between the regime we propose and *Corwin* is not the distinction between bundling and coupling (although we think that they are somewhat distinct). Rather, the fundamental difference is the difference between coupling or bundling *by private ordering* and bundling *by judicial fiat*. Private ordering coupling (or bundling) raises two issues not present in bundling by judicial fiat. First, boards have to determine the scope of conduct to be ratified/cleansed. Second, boards have to make an *affirmative decision* to couple consummation of the transaction with ratification/cleansing. Unlike in the case of implicit bundling by judicial fiat, these board decisions can be subjected to fiduciary review of whether the coupling (or bundling) was coercive or otherwise improper.[48]

1. The Scope of Ratification/Cleansing

As with separate, independent votes, it would be wrong to assume that any vote on ratification/cleansing would encompass all breaches of fiduciary duties by all parties. Rather, moving from judicially-imposed implicit bundling to explicit separate votes enables the target board to determine the scope of any ratification/cleansing vote. For various reasons, a board may not want ratification/cleansing to encompass for all breaches of fiduciary duties by all potential defendants.

Under the private ordering regime we favor, one should think about the scope of ratification/cleansing along three dimensions: the potential defendants who may have breached their fiduciary duties; the type of claim and remedy; and the time when the information underlying the breach was disclosed.

Potential defendants can be divided into three groups: directly conflicted fiduciaries; other fiduciaries; and aiders and abettors. Directly conflicted fiduciaries include target directors, officers, and controlling shareholders who stand to gain personally from an unfair transaction. Other fiduciaries are target directors, officers, and controlling shareholders who are not so conflicted. Aiders and abettors

[48] Cox et al. argue that even implicit bundling can be viewed as coercive. See Cox et al., supra note __, at 543. ("We do not believe it is a long step--indeed, we view it as a logical step--to view the shareholders' approval of a merger with awareness that such approval cures any possible misconduct in the transaction as similarly coercive.") But since implicit bundling is a product of judicial fiat, we do not see how the board can be held responsible for any coercion.

are non-fiduciaries who may face potential claims for aiding and abetting in a breach of fiduciary duties. In deal process litigation, aiders and abettors are typically disloyal financial advisors to the board or third party acquirers that exploit conflicted target fiduciaries or disloyal advisors for their own purposes.

Claims and remedies can be divided into claims for breaches of the duty of care or of "*Revlon* duties" that involve no breaches of duty of loyalty; breaches of duty of loyalty claims, including bad faith claims; and aiding and abetting claims.[49] As to the first set of claims, directors would ordinarily face no personal liability since most companies have adopted an exculpatory charter provision covering directors authorized by Section 102(b)(7). Ratification/cleansing, however, could extend to claims for injunctive relief. Moreover, officers and controlling shareholders, however, could conceivably face personal liability for these claims.[50] As to the claims in the other settings, absent ratification/cleansing, both damage and injunctive relief would be available as remedies.

Finally, two periods are relevant as to the time when information about a breach was disclosed: the period before boards agree to enter into a transaction conditioned on ratification/cleansing and the period between such board approval and the shareholder vote. Cleansing is unavailable for breaches as to which the relevant information was disclosed only after shareholders voted on ratification/cleansing.

It is easy to see why private ordering coupling may not encompass the maximal scope of cleansing, the scope currently accorded by judicially-imposed bundling. Take our stylized example, in which Investment Banker may have aided and abetted the board's breach of its *Revlon* duties and the relevant facts were not known to the board when it entered into the transaction. Or take claims that a CEO trying to acquire her company breached her duties of loyalty by supplying lowball forecasts to a committee of disinterested directors.[51]

Boards of targets, concerned about their shareholders and their reputations, may well be reluctant to condition the transaction on ratification/cleansing extending to such "fraud on the board" claims, whether they are aware of the underlying facts or whether they are asked to extend ratification/cleansing to any as-yet undisclosed potential claims. Indeed, it is unclear whether the board could legally extend ratification/cleansing to undisclosed conduct. Parties can generally not waive protection against fraud and agreeing to sue the acquirer when the specific conduct that forms the basis for the suit has not been disclosed is tantamount to a waiver of fraud. To be sure, the board extending ratification/cleansing to as-yet undisclosed claims does not by itself waive anything; it merely enables shareholders to ratify/cleanse conduct that, by the time of the shareholder vote, will be disclosed. But under Section 251, the board must affirmatively recommend a merger to the shareholders. It cannot stay neutral and leave it up to the shareholders.[52] When the merger agreement is conditioned upon

[49] Under long-standing principles, waste claims are not subject to ratification/cleansing except by unanimous shareholder vote.

[50] Section 102(b)(7) has recently been amended to permit exculpation of direct claims against officer. CITE But many companies have not amended their charters. It is unclear to what extent unconflicted controlling shareholders would be exposed to personal liability for breaches of duty of care or *Revlon* duties. CITE to restatement.

[51] *In re Dole Food Co., Inc. S'holder Litig,* 2015 WL 5052214

[52] Smith v. van Gorkom, 488 A.2d 858, 887-88 (Del. 1985). While the DGCL was subsequently amended to allow a board to commit in a merger agreement to submit a merger to a shareholder vote even if the board subsequently changes its mind (e.g., because of a competing bid), this does not change the requirement that, in the first instance, a board must recommend a merger. DGCL § 146; DGCL § 251(b).

ratification/cleansing, a board may not be able to fulfil its duty if it is uninformed about what claims are ratified/cleansed and effectively.

More generally, once ratification/cleansing is moved from the realm of judicially-mandated complete cleansing to the realm of private ordering, one would expect the scope of cleansing to become part of the negotiations between a target board and an acquirer. As in other contractual and quasi-contractual settings, the parties may agree to waive certain claims but not others. Thus, in other contexts, liability waivers often exclude intentional misconduct or actions taken in bad faith and generally do not extend to third parties.[53]

2. The Board Decision to Couple Votes

A board's explicit decision to make consummation of a transaction contingent on cleansing/ratification brings to the fore the coercive potential of coupled votes. This is very different from the *Corwin* situation in which a cleansing effect is attributed to a vote in favor of a transaction by judicial fiat and does not entail any affirmative board decision.[54] As a result, an affirmative board decision to couple the two votes necessitates further analysis.[55] In the remainder of this subsection, we consider preliminarily what such an analysis could look like. Our main point, however, is not that any particular scenario we discuss should be treated in the fashion that we propose but that coercion is the proper framework for evaluating whether and when it is proper to condition a transaction on obtaining a ratifying/cleansing vote.

We divide our analysis by the potential defendant whose misconduct would be cleansed by a ratification/cleansing vote. We consider four types of defendants: board members who are neither themselves nor affiliated with counterparties in the transaction; arguable aiders and abettors of fiduciary duty breaches who are neither themselves nor affiliated with counterparties in the transaction; counterparties that are not themselves fiduciaries; and counterparties that are also fiduciaries. To make this more concrete, we consider the stylized deal process claim outlined above in which the counterparty is the acquirer.

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[53] See, e.g., Lloyd L. Drury, Publicly-Held Private Equity Firms and the Rejection of Law as a Governance Device, 16 U. Penn. J. Bus. L. 57, 75 (noting that KKR partnership agreement limits general partner's liability to bad faith, fraud, or willful misconduct; Blackstone's to fraud or willful misconduct; and Och-Ziff to fraud, gross negligence, or willful misconduct); Byron F. Egan, Communicating with Auditors after the Sarbanes-Oxley Act, 41 Tex. L. Bus. L. 131, 218 (noting that engagement letters with auditors limit liability to fraud or willful misconduct).

[54] The only affirmative board decision is to enter into the transaction, but this decision involves no coercion.

[55] Compare Kaufman v. Alexander, 62 F.Supp.3d 395, 399-400 (D. Del. 2014) (holding that statement that informed shareholders that failure to approve new long-term incentive plan would result in continuation of old incentive plan which would "not achieve its intended objectives of helping to attract and retain employees" did not render vote coercive); Brazen v. Bell Atl. Corp., 695 A.2d 43, 50 (Del. 1997) (disclosure of termination fee payable upon shareholder failure to approve merger found not be coercive) with Sciabacucchi v. Liberty Broadband Corp., No. CV 11418-VCG, 2017 WL 2352152, at *20-24 (Del. Ch. May 31, 2017) (finding that conditioning acquisitions of Bright House Networks and Time Warner Cable on approval of certain extraneous self-dealing transactions amounted to structural coercion); Lacos Land Co. v. Arden Grp., Inc., 517 A.2d 271, 276-79 (Del. Ch. 1986) (threat by director and principal shareholder to oppose transactions beneficial to company if shareholders did not approve recapitalization rendered vote coercive).

a. Target Directors unaffiliated with the Acquirer

Coercion in a shareholder vote is generally present when a fiduciary creates "undue pressure … that distracts [shareholders] from the merits of the decision under consideration,"[56] induces stockholders to vote in favor "for some reason other than the merits of that transaction"[57] or conditions consummation of a beneficial transaction on shareholder approval of matters unrelated to the transaction.[58]

Under these principles, target board members should generally not be permitted to couple/condition the transaction on a vote cleansing *themselves* from damage claims for their own misconduct. If the target board believes that the transaction is in the best interest of the company and its shareholders, it is its duty to present it to the shareholders. Making a beneficial transaction contingent on receiving a personal benefit in the form of avoidance of potential liability would be coercive and violate the board's fiduciary duties. The target board may, however, condition a transaction on a waiver of an injunctive relief remedy if doing so is designed to facilitate the consummation of the transaction.

Similarly, the acquirer should be not be able to insist on conditioning the transaction on ratifying/cleansing of misconduct by directors not affiliated with the acquirer, except to the extent that the target would have to indemnify the directors for any liability they may face. Such directors are supposed to faithfully represent the interest of the target shareholders unaffiliated with the acquirer in negotiations with the acquirer. To be sure, even if the target would not have to indemnify the directors, the acquirer has some economic interest in avoiding litigation against unaffiliated target directors as the target may have to cover the directors' legal fees. But this interest is attenuated as these fees would in the first instance be covered by D&O insurance. On the other hand, permitting an acquirer to insist on conditioning the transaction on ratifying/cleansing that covers unaffiliated directors carries severe disadvantages. First, it would undermine the incentives by these target directors to comply with their fiduciary duties in dealing with the acquirer and looking out for the best interest of unaffiliated target shareholders (rather than, in the extreme, being in cahoots with the acquirer and counting on ratification/cleaning). Second, an informal practice may evolve between acquirers and target directors

[56] In re Rouse Properties, Inc., No. CV 12194-VCS, 2018 WL 1226015, at *20 (Del. Ch. Mar. 9, 2018); In re Saba Software, Inc. S'holder Litig., No. CV 10697-VCS, 2017 WL 1201108, at *15 (Del. Ch. Mar. 31, 2017).
[57] Williams v. Geier, 671 A.2d 1368, 1382-83 (Del. 1996)
[58] In re Dell Techs. Inc. Class V S'holders Litig., No. CV 2018-0816-JTL, 2020 WL 3096748, at *31-33 (Del. Ch. June 11, 2020) (finding that threat to proceed with an initial public offering which would trigger a "forced conversion" of Class V stock of Dell Technologies was improper threat that coerced holders of Class V stock to approve the redemption of Class V stock); Sciabacucchi v. Liberty Broadband Corp., No. CV 11418-VCG, 2017 WL 2352152, at *20-24 (Del. Ch. May 31, 2017). (finding that conditioning acquisitions of Bright House Networks and Time Warner Cable on approval of certain extraneous self-dealing transactions amounted to structural coercion); Lacos Land Co. v. Arden Grp., Inc., 517 A.2d 271, 276-79 (Del. Ch. 1986) (threat by director and principal shareholder to oppose transactions beneficial to company if shareholders did not approve recapitalization rendered vote coercive); but see In re Gen. Motors [Class H S'holders Litig.], 734 A.2d 611, 620-21 (finding no coercion where split off of Hughes Electronic Corp. was conditioned on approval by holders of Hughes tracking stock of charter amendment eliminating right to receive a premium upon disposition of Hughes since board had to duty to trigger such right and shareholders could have opted to maintain status quo).

that, while it is notionally acquirers who claim to insist or ratification/cleansing for their own benefit, they do so for the benefit of (or sometimes even at the behest of) the target directors.

b. Aiders and Abettors unaffiliated with the Acquirer

For similar reasons, it should generally not be permitted to condition the transaction on ratification/cleansing of misconduct by aiders and abettors unaffiliated with the acquirer. The acquirer has no legitimate interest on conditioning the transaction on such ratification/cleansing. Rather, seeking such ratification/cleansing may reflect an attempt by the acquirer to reward the board's advisors for betraying the target's shareholders for the benefit of the acquirer. And we think it would be unlikely for a board acting in good faith to condition a transaction on ratification/cleaning of misconduct committed by the company's own advisors on its own accord.

c. Acquirers that are not fiduciaries

Acquirers that are not themselves fiduciaries should generally be free to insist that their own misconduct, and the misconduct of any of their affiliates, be ratified/cleansed as a condition to consummating a transaction. For acquirers that are not themselves fiduciaries, the potential fiduciary duty claims affected by any ratification/cleansing would extend only to claims for aiding and abetting a breach of fiduciary duties.

The decision of the board to agree to such a request should ordinarily be subject to the business judgment rule. However, in exercising its judgment to agree to such a request, the board must be informed. As a result, it should consider whether the scope of any ratification/cleansing includes only conduct that has been disclosed *to the board* by the time it agrees to a ratification/cleansing condition or also includes other potential misconduct, including conduct that has not been disclosed to the board or conduct that has been affirmatively misrepresented to the board.[59]

If the scope of any ratification/cleansing includes only conduct that has been disclosed to the board, the board would have to take that conduct into account both in evaluating the financial terms of the transaction and in deciding whether to agree to a ratification/exculpation condition. Absent unusual circumstances, the board's decision to agree to a ratification/cleansing condition should stand.

But if the acquirer insists that ratification/cleansing encompass as yet-undisclosed conduct, this should raise a yellow flag. At a minimum, the board should take extra precaution to investigate whether board members, members of the special committee, any officers, and in particular any advisors to the board had improper communications with the acquirer and its affiliates or representatives or otherwise participated in a breach of fiduciary duties that the acquirer may have aided or abetted. But even if the board takes these precautions, it is unclear how the law should deal with as yet-undisclosed conduct. Under general principles of contract law, one cannot waive fraud. This general principle also animates

[59] For ratification/cleansing to be effective, such conduct would, of course, have to be disclosed to the shareholders prior to the shareholder vote. See supra note __.

the rule that ratification/cleansing cannot extend to breaches that were undisclosed by the time of the shareholder vote. But under the private ordering regime we propose, ratification/cleansing entails two steps: the board agreeing to enter into a transaction conditioned on ratification/cleansing; and shareholders voting in favor of ratification/cleansing. If the board becomes aware, after agreeing to the transaction but before the shareholder vote takes place, that the acquirer has aided and abetted a breach of duty, one option is to permit the board to terminate the transaction and sue the acquirer for damages. A second option would be to let the deal go forward but limit the scope of cleansing to conduct disclosed to the board. The arguments in favor of the first option is that it is the board's responsibility to examine the acquirer's conduct before agreeing to cleansing and that, at least when the acquirer did not make any affirmative misrepresentations, the board's decision to agree to cleanse undisclosed conduct should not be second-guessed. The arguments in favor of the second option are, from a doctrinal perspective, that a board cannot agree to enter into a transaction conditioned on ratification/cleansing of conduct that the board is not aware of and, from a policy perspective, that this rule would encourage the acquirer to disclose the relevant information to the board.

d. Acquirers who are also fiduciaries

Acquirers who are fiduciaries—such as managers who participate in an MBO—owe duties to the target company and its shareholders. As a result of such duties, there should be greater limitations on conditioning transactions on ratification/cleansing for acquirers who are themselves fiduciaries.

Consider the acquisition of Dole Foods by David Murdock, a director and controller of the company.[60] When the independent committee tasked with negotiating the purchase price asked for company information, Michael Carter, the COO of Dole Foods as well as a director, provided it with "lowball" forecasts. Subsequently, Carter took various measures to make sure that the committee stayed in the dark, including instructing senior management not to circulate information prepared in the annual budgeting process and denying that changes had been made to the budget. In addition, unbeknownst to the committee, Carter was advising Murdock on negotiations over the merger agreement. In light of these disclosure failures, the court found that approval by the independent committee was not sufficient to cleanse the transaction even if the disinterested shareholder vote was upheld. As the court put it, "fraus omnia corrumpit—fraud vitiates everything."

In considering whether ratification/cleansing should be available, assume first that, however unrealistically, Murdock and Carter had come clean with the committee before the committee approved an acquisition but made the acquisition offer conditioned on a ratification/cleansing vote. At this point, the wrongful actions by Murdock and Carter may not have caused any significant harm and the committee could ask for updated projections and renegotiate the terms. The committee could also decide to abandon the deal and sue Murdock and Carter for any damages caused by their breach of fiduciary duties. As long as ratification/cleansing only extends to facts that have been disclosed to the committee, we would permit a committee of disinterested directors to agree to the acquisition contingent on ratification/cleansing of an acquirer who is also a fiduciary.

[60] *In re Dole Food Co., Inc. S'holder Litig,* 2015 WL 5052214

But assume, as was the case, that Murdock and Carter made no disclosures to the committee. Should ratification/cleansing extend to wrongdoing hidden from the committee when it agreed to an acquisition offer conditioned on a ratification/cleansing vote? The question—should the committee merely be permitted to terminate the deal and sue or should it also have the option to let the deal go forward with a limited scope of ratification/cleansing—and the arguments are similar to the case of acquirers that are not themselves fiduciaries. But here the case for limiting the scope of ratification/cleansing is stronger. First, the type of misconduct that could expose a fiduciary-acquirer to liability is wider than for a non-fiduciary acquirer, making it harder for the committee to detect such misconduct on its own. Second, as the acquirer is an insider, there is always a concern that the rest of the board may have failed to investigate the acquirer's conduct sufficiently or that it is reluctant to cancel the transaction and pursue its legal remedies. Finally, unlike non-fiduciary acquirers, fiduciaries owe a duty of disclosure. Insiders' withholding of material information regarding their wrongful acts from the board may constitute "fraud on the board" that vitiates the cleansing effect of the shareholder vote.[61]

B. Bundling versus Coupling

Unlike in bundled votes, in coupled votes shareholders have the option to vote in favor of the transaction but against ratification/cleansing. While coupling two issues is in many other respects similar to bundling them into a single vote, separating the two votes makes the structure of the approval process clearer and more informative. By casting a vote in favor of the transaction itself but against ratification/cleansing, shareholders would convey a clear message, namely, that they prefer the transaction over voting it down but have serious concerns about potential misconduct in the deal process. Even if the transaction overall is approved by, say, an 80% vote in favor of the transaction and a 60% vote in favor of ratification/cleansing, and there are no further legal consequences, such a message is, at a minimum, embarrassing to the people engaged in the potential misconduct. In this regard, the percentage of no votes may have a similar effect to no votes on "say on pay" resolutions: although they do not affect the outcome, directors are highly sensitive to the votes and that sensitivity can affect their conduct.

But it is not a foregone conclusion that there would be no further legal consequences. A high (but less than majority) vote against ratification/cleansing would raise a yellow flag that courts may consider when deciding whether the vote qualifies as a proper cleaning act[62]—whether shareholders were fully informed, whether they were disinterested, and whether their votes were uncoerced.[63] And a majority vote *against* ratification/cleansing would send a clearer message to courts than, in a single vote system, a majority vote against the transaction that the problem is potential misconduct rather than the economics of the deal per se.

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[61] Joel Edan Friedlander, Confronting the Problem of Fraud on the Board, 75 Bus. Law. 1441 (2019-2020).

[62] In transactions subject to MFW that were also approved by a special committee of disinterested directors, a high vote against ratification/cleansing may also induce courts to probe more deeply into whether a special committee functioned properly. Or, if there was no proper committee approval and entire fairness remains the applicable standard, a high vote against ratification/cleansing would lend support to claims of unfairness.

[63] By the same token, a vote in favor of ratification/fairness that exceeds the vote in favor of the transaction could be taken as additional evidence of fairness.

III. An Alternative Justification for *Corwin*

As the earlier discussion demonstrates, *Corwin* is both inconsistent with the earlier Delaware law on stockholder ratification and unconvincing on its own terms. Interpreting a merger vote as also cleansing the conduct of fiduciaries and aiders and abettors is an implausible interpretation of shareholders' intentions. Moreover, as our discussion of privately ordered ratification/cleansing shows, if target boards were tasked with determining whether to hold a cleansing/ratifying vote—whether to couple it with approval of the transaction, and how broadly to structure the scope of ratification/cleansing—, a board may well choose a more limited version of ratification/cleansing than the full-blown *Corwin* scope and, to the extent a board choses the full-blown *Corwin* scope, a vote could be viewed as coercive.

Yet Chancellor Bouchard and Chief Justice Strine, two of the brightest and most accomplished members of the Delaware judiciary, blithely held that the shareholder vote on the merger extinguished the fiduciary duty claims on the grounds that this is what shareholders wanted. What explains and potentially justifies their decisions?

Here, context matters. Beginning in 1985 with *Van Gorkom*, *Revlon* and *Unocal*, mergers with a non-fiduciary counterparty were no longer subject to review under the old, very deferential business judgment rule, but became subject to what is now referred to as "enhanced scrutiny." This vastly increased the potential for deal process litigation over injunctions and damages. Over time, deal process claims against target managers and directors, acquirers, and advisers became common.

As Matt Cain, Jill Fisch, Steven Davidoff Solomon and Randall Thomas document,[64] by 2010, merger litigation had exploded, with more than 90% of deals challenged. This trend peaked in 2013 when 96% of completed deals were attacked. The claims typically included claims for breach of fiduciary duty (including claims that the board failed to satisfy its *Revlon* duties in selling the company) as well as claims challenging the company's disclosures. At the same time, litigation became multi-jurisdictional.

The overwhelming majority of these cases settled, often for additional "corrective" disclosures, a global release of all merger related claims, and the acquirer's agreement not to challenge a "mootness" fee for the plaintiffs' lawyers. These settlements were beneficial to plaintiffs' law firms, which received a fee for little work, and perhaps also to defendants, who could resolve all conceivable disputes by paying off these law firms. At settlement hearings, all parties favored approval of the settlement and presented facts and arguments to the court justifying it.

Shareholders, alas, were generally short-changed because the additional disclosures were of little if any value. In some cases, they released valuable claims as to which more discovery would have produced evidence of greater misconduct. This racket also undermined respect for the legal system and annoyed the judges who were asked to approve settlements.

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[64] Matt Cain, Jill Fisch, Steven Davidoff Solomon and Randall Thomas, The Shifting Tides of Merger Litigation, 71 Vand. L. Rev. 603 (2018). See, also, Steven Davidoff Solomon & Randall S. Thomas, The Rise and Fall of Delaware's Takeover Standards, in THE CORPORATE CONTRACT IN CHANGING TIMES (Steven Davidoff Solomon & Randall S. Thomas eds., 2018).

Eventually, there was a multi-part backlash. The criticism of disclosure-only settlements grew, ultimately resulting in Chancellor Bouchard's 2016 *Trulia* opinion that announced a clear intention to reject attorney fees unless the settlement provided substantial benefit to shareholders—a benefit that disclosure-only settlements lacked.[65] The Delaware legislature addressed the problem of multi-jurisdictional litigation with a new statutory provision providing for forum selection bylaws.[66] Finally, *Corwin* changed the substantive law governing deal process claims.

From this perspective, *Corwin*'s reliance on stockholder "ratification" can be understood as a legal fiction invoked in order to make it easier to dismiss claims that were viewed, at the time, as having no legitimate value. On this interpretation, it was not that Chancellor Bouchard or Chief Justice Strine genuinely thought that shareholders, in approving a merger, were actually also indicating approval of the deal process. Rather, on this interpretation, they thought that the shareholder vote was a useful doctrinal hook for ridding themselves and their fellow judges of vexatious litigation and eliminating an unjustifiable "tax" on mergers that harmed shareholders.

If this interpretation is correct, the central issue is not whether *Corwin* and its progeny indulge in a fiction but whether that fiction is a *useful* fiction. Here, the question becomes the practical one: does *Corwin* allow for the dismissal of vexatious litigation without eliminating the possibility of identifying genuine fiduciary misconduct?[67]

It is impossible to resolving this question with great confidence, but we want to point out two sets of considerations that bear on it. On the one hand, to result in cleansing, *Corwin* requires that the shareholder vote be fully informed and uncoerced. These are malleable requirements—indeed, our earlier analysis was based on the argument that, properly understood, *Corwin* itself inherently entails a form of coercion. In the hands of Delaware's expert judiciary, these requirements can be employed to allow claims against target management and directors for directly or indirectly diverting merger proceeds to their own benefit or against unfaithful investment bankers for aiding and abetting.[68] Indeed, although on its face, *Corwin* looks like it should eliminate deal process litigation – and was largely understood to do so – in practice, it has had less drastic effects because of the multiple cases in which courts determined that disclosures were incomplete or the vote was coerced.[69] So, the potential for

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[65] In re Trulia, Inc. Stockholder Litigation, 129 A.3d 884 (2016).

[66] DGCL § 115.

[67] Others have argued that Corwin was unnecessary because cases like Trulia were already reducing the number of challenged mergers by limiting the value of "disclosure only" settlements. See, e.g., Korsmo.

[68] Korsmo at 61.

[69] See, e.g., In re Pattern Energy Group Inc. Stockholders Litigation, 2021 WL 1812674 (del. Ch. 2012) (holding that claims were not exculpated under Section 102(b)(7) because plaintiffs adequately pled that defendants acted in bad faith and were not cleansed under *Corwin* because pivotal shareholder had contractual duty to vote in favor of transaction and its vote therefore was neither fully-informed nor uncoerced); In re Columbia Pipeline Group, Inc., 2021 WL 772562 (Del. Ch. 2021) (holding that claims against CEO and CFO were not exculpated under Section 102(b)(7) because plaintiffs adequately pled that they breached their duty of loyalty and claims against CEO and CFO and associated aiding and were not cleansed under *Corwin* because proxy statement failed to disclose material information); Presidio, supra note __ (holding that claims against CEO were not exculpated under Section 102(b)(7) because plaintiffs adequately pled that he breached their duty of loyalty and claims against CEO and CFO and associated aiding and were not cleansed under *Corwin* because proxy statement failed to disclose material

expert judges to avoid the potential overbreadth of *Corwin* cleansing is a reason to be less concerned about the possibility that *Corwin* cleansing erodes deterrence and gives free reign to engage in misconduct.

On the other hand, whether *Corwin* cleansing was needed to stop the avalanche of lawsuits depends on the other ways to do so. In this regard, the most important doctrinal move against low-merit lawsuits was *Trulia*, which largely eliminated disclosure-only settlements. Even before *Corwin*, *Revlon* "deal process" damage claims against target fiduciaries were very weak because Section 102(b)(7) exculpated gross negligence. The problem was that briefing and arguing a motion to dismiss was substantially more expensive than a disclosure-only settlement. Once, however, disclosure-only settlements were no longer an option, the cost of briefing and arguing a motion to dismiss a *Revlon* claim under Section 102(b)(7) or under *Corwin* became similar and, indeed, the arguments could be combined. An overview of cases in which the court was asked to dismiss claims under *Corwin* shows that many claims could be dismissed under Section 102(b)(7).[70]

Finally, even apart from *Corwin*, claims based on a material conflict of interest by some directors or claims that an officer breached the duty of care could be cleansed by the vote of fully-informed disinterested directors. To be sure, dismissal of these cases would be easier under *Corwin* since outside of *Corwin*, plaintiffs would be entitled to engage in some discovery on the disinterested-director approval process. But courts could limit discovery to the propriety of the approval process. Disinterested director cleansing thus provides another viable alternative for dismissing cases early on in a litigation.

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information); Goldstein v. Denner, 2022 WL 1671006 (Del. Ch. 2022) (holding that claims against some directors were not exculpated under Section 102(b)(7) because plaintiffs adequately pled that they had material conflict or acted in bad faith and claims were not cleansed under *Corwin* because of failure to disclose material information but that claims again one directors were exculpated under Section 102(b)(7)); In re Saba Software, Inc. Stockholder Litigation, 2017 WL 1201108 (Del. Ch. 2017) (holding that claims against directors were not exculpated under Section 102(b)(7) because plaintiffs adequately pled that they breached their duty of loyalty or acted in bad faith and were not cleansed under *Corwin* because shareholder vote was not fully informed and was coerced); Sciabacucchi v. Liberty Broadband Corporation, 2017 WL 2352152 (Del. Ch. 2017) (holding that claims against directors were not cleansed under *Corwin* because shareholder vote was coerced); In re USG Corporation Stockholder Litigation, 2020 WL 7041190 (Del. Ch. 2020) (holding that claims against directors were not cleansed under *Corwin* because of failure to disclose material information but that claims were exculpated under Section 102(b)(7)); In re Tangoe, Inc. Stockholders Litigation, 2018 WL 6074435 (Del. Ch. 20818) (holding that claims against directors were not exculpated under Section 102(b)(7) because plaintiffs adequately pled that they breached their duty of loyalty and were not cleansed under *Corwin* because shareholder vote was not fully informed).

[70] See In re USG Corporation Stockholder Litigation, 2020 WL 7041190 (Del. Ch. 2020) (holding that claims against directors were not cleansed under *Corwin* because of failure to disclose material information but that claims were exculpated under Section 102(b)(7)); Goldstein v. Denner, 2022 WL 1671006 (Del. Ch. 2022) (refusing to dismiss claims under *Corwin* but dismissing claims against one director under Section 102(b)(7); English v. Narang, No. 2018-0221-AGB, 2019 WL 1300855 (Del. Ch. 2019) (rejecting argument that chairman and former CEO had conflict of interest before dismissing claims under *Corwin*); Teamster Members Retirement Plan v. Dearth, 2022 WL 1744436 (Del. Ch. 2022) (alleging conflict of interest only with respect to management defendants); Galindo v. Stover, 2022 WL 226848 (Del. Ch. 2022) (noting that plaintiffs did not even specify which fiduciary duty board breached and not reciting any allegations suggesting breach would be non-exculpated); In re Volcano Corp. S'holder Litig., 143 A.3d 727 (Del. Ch. 2016) (alleging breaches of both the duty of care and the duty of loyalty).

In measuring *Corwin*'s marginal impact, then, it is necessary to focus on the claims that *Corwin* extinguishes that could not be easily dismissed otherwise. As to those claims, the question is the balance between the costs of *Corwin*'s elimination of worthwhile claims compared to the benefits of *Corwin*'s expedited dismissal of worthless claims. This is a classic type I/type II error framework.

So, at the margin, when does *Corwin* matter? On the cost side of the ledger, *Corwin* allows the dismissal of valuable claims in three main situations in which private ordering might not lead to dismissal. First, *Corwin* matters for claims that could, in the private ordering regime we propose, not be ratified/cleansed by shareholders and could also not be cleansed by a disinterested director vote. This category includes claims where the board did *not* have the all relevant information when it entered into the transaction— as was the case in *Del Monte*—or did not satisfy its duties in obtaining that information (but the information was disclosed to shareholders prior to the shareholder vote). It also includes cases in which the entire board was interested or lacked independence or in which the disinterested and independent board members devoted so little attention to the matter that their vote to cleanse was ineffective. These cases, we would suggest, deserve judicial scrutiny.

Second, *Corwin* matters for claims that could, in the private ordering regime we propose, in principle be ratified/cleansed by shareholders but which the board determined *not* to include in the scope of claims submitted for ratification/cleansing. This category presumably includes most cases in which the company's own advisors committed fraud on the board and may include cases in which a non-fiduciary acquirer asks for blanket ratification/cleansing that includes conduct undisclosed to the board. These cases, in our view, most clearly deserve judicial scrutiny.

Third, *Corwin* matters when disinterested directors voted to ratify/cleanse, but discovery on the disinterested-director approval process turns out to produce additional evidence that was not known to the disinterested directors at the time of their vote and thus rendered the directors' vote uninformed. Under *Corwin*, these cases would most likely be dismissed before discovery can take place.

Ex ante, of course, one does not know what evidence discovery will yield. In many of these cases, discovery would not produce sufficient evidence and the case would be dismissed. Under *Corwin*, these cases could have been dismissed at lower cost on a motion to dismiss for failure to state a claim, as the court could often determine from the complaint whether plaintiffs had plead sufficient facts which, if true, would render the disclosures materially incomplete.

Any overall analysis of the utility of the *Corwin* fiction requires a judgment on the costs and benefits associated with the cases in these categories.

Conclusion

Delaware courts have expanded the cleansing effect of a shareholder vote, thereby endowing shareholder votes with greater normative weight than at any time in the modern period. In particular, under *Corwin*, a fully informed uncoerced disinterested shareholder vote on the transaction is treated as a full defense against any claim for breach of fiduciary duty in transactions not involving a conflicted controlling shareholder.

From an internal corporate law perspective and from a conceptual perspective, this weight is misplaced. Doctrinally, treating the vote on the merger as also ratifying/cleansing the conduct of those involved in the deal process was a departure from the then-existing law of shareholder ratification. Conceptually, a vote by a majority of target shareholders in favor of a transaction can be seen at most as evidence that shareholders believe that the value of their shares will be higher if the transaction takes place than if it does not take place *as of the time of the vote*. But once a transaction is approved by the board, the value of a company if shareholders fail to vote in favor of the transaction will systematically be lower than the value would have been had the transaction never been entered into in the first place. As result, a shareholder vote in favor does not signify that the transaction was fair to shareholders or that any violation of duties caused no harm to the shareholders. The courts, by deeming a shareholder vote on the transaction to have a ratifying/cleansing effect bundle two separate issue—whether the transaction should go forward and whether breaches of fiduciary duty should be cleansed—by judicial fiat.

A more rational approach to ratification/cleansing would entail separating these two issues. Separating transaction approval from cleansing would mean giving shareholders two votes, one vote on the transaction and another vote on ratification/cleansing. But while shareholders will have two votes, the votes can in principle be coupled by making consummation of the transaction contingent on shareholders also voting in favor of ratification/cleansing.

We see two advantages of this approach over the present regime of bundling by judicial fiat. First, it shifts the issue of ratification/cleansing to the realm of private ordering. The board of the company entering into a transaction, in conjunction with the other party to the transaction, will determine whether to submit any ratification/cleansing vote to the company's shareholders, what scope to accord to any affirmative vote, and whether to condition consummation of the transaction on such a vote. In such a private ordering regime, we would expect that boards would often limit the effect of a cleansing vote to certain parties or to certain types of misconduct. For example, the vote may not encompass claims for aiding and abetting breaches of duty by the board's own advisors or conduct that had not been disclosed to the board.

Second, an explicit decision by the board to condition consummation on cleansing can be subjected to fiduciary review of whether it amounted to coercion and was otherwise proper. Coercion in a shareholder vote is generally present when a fiduciary ties beneficial transaction on shareholder approval of matters unrelated to the transaction. Thus, for example, coercion will generally be present when a board makes exculpation from liability for its own misconduct a condition to consummation of a beneficial transaction.

Given *Corwin*'s shortcoming's, what accounts for the fact that it was penned by some of the brightest Delaware jurists? We conjecture that it is best understood as a response to the explosion in merger litigation. As virtually every deal spawned a lawsuit, these suits were increasingly seen as a tax on mergers that benefitted plaintiff lawyers but no one else. In response, *In re Trulia* litigation disclosure-only settlement, the legislature validated forum-selection provisions, and *Corwin* all made cases easier to dismiss. The notion that shareholder ratification establishes fairness should thus be seen as a fiction in the service of the goal of reducing vexatious litigation.

Taken together, these measures have contributed to a significant decline in deal litigation. So it is time now to ask whether, given the other measures, the benefits of *Corwin* in making it easier to

dismiss (and thus reducing incentives to file) non-meritorious suits outweigh the costs of not permitting discovery in potential meritorious suits (and thus reducing incentives to comply with fiduciary duties). It is impossible to resolve this question with great confidence, but two factors bear on it. Pointing in one direction, Delaware's expert judges have become skilled in applying the *Corwin* prerequisites—that shareholders were disinterested and fully informed and that the vote was uncoerced—to permit suits that make credible claims of serious breaches to proceed, thereby reducing the problem of false negatives. Pointing in the other direction, these same expert judges are skilled at dismissing weak cases by relying on other tools such as exculpation under Section 102(b)(7), disinterested director cleansing and, for that matter, a private ordering cleansing regime like the one we propose, thereby limiting the problem of false positives.

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