

The Importance of Being Dismissive: The Efficiency Role of Pleading Stage Evaluation of Shareholder Litigation

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It has been claimed that the risk/reward dynamics of shareholder litigation have encouraged quick settlements with substantial attorneys' fee awards but no payment to shareholders, regardless of the merits of the case. Fee-shifting charter and bylaw provisions may be too blunt a tool to control agency costs associated with excessive shareholder litigation and are, in any event, now prohibited by Delaware statute. We claim, however, that active judicial supervision of public company shareholder litigation at an early stage reduces the costs of frivolous litigation to shareholders by separating meritorious from unmeritorious litigation before the full costs of discovery are incurred. Using procedures and doctrines that have not previously been catalogued and appreciated as a coherent set of interrelated dynamics, the Delaware Court of Chancery has relied on the motion to dismiss as the primary procedural vehicle for accomplishing that early stage triage, while the litigation costs to the parties are still relatively small. Such early stage analysis depends upon consideration of essentially undisputed facts and upon the availability of such facts to the plaintiff shareholder through sources that compensate for the problem of asymmetric access to relevant information. The motion to dismiss in representative shareholder litigation has thus come to resemble, and substitute for, the motion for summary judgment. The Delaware courts' atypical demand for, and unusual willingness to consider, extensive facts in resolving motions to dismiss encourage defendants to supply relevant information voluntarily, on a cost efficient basis that avoids largely unlimited discovery. Where time constraints preclude disposition via a motion to dismiss, the motion for expedited discovery must necessarily come to serve the same efficiency promoting functions as the motion to dismiss, and the Court of Chancery has come to apply essentially the same level of substantive factual review of the merits encountered in resolving motions to dismiss. The result is a system in which cases are dismissed or settled at the motion to dismiss stage: from 2011 through 2015, for example, there were only five public company shareholder class or derivative suits in which the Court of Chancery resolved the case after trial. With the likely concentration of deal litigation in the Delaware courts resulting from increasingly prevalent exclusive forum charter and bylaw provisions, the motion to dismiss and the motion to expedite discovery are likely to become even more important in promoting the efficient conduct of shareholder class and derivative litigation involving public companies.

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I. OVERVIEW

A. A Public Solution to the Problem of Unmeritorious Shareholder Litigation

The torrid pace of recent merger and acquisition activity has heartened—and enriched—the lawyers, bankers, and financial advisers who negotiate, craft, and finance those transactions.¹ At the same time, however, many observers have noted and criticized the fact that litigation by shareholders challenging those transactions has become ubiquitous: at least until recently, almost every deal valued at over \$100 million was subjected to litigation.² Given the size of the financial stakes involved, and the prospect that even modestly successful litigation in that arena can yield substantial fee awards for the plaintiffs' counsel who initiate it,³ the frequency of such litigation is not surprising. The rampant phenomenon

1. See, e.g., Dana Mattioli & Dana Cimilluca, *Fear of Losing Out Drives Deal Boom*, WALL ST. J. (June 26, 2015), <http://www.wsj.com/articles/fear-of-losing-out-drives-deal-boom-1435361072> (“Companies are merging at a pace unseen in nearly a decade.”); Jesse Solomon, *Boom time for mergers and acquisitions*, CNN MONEY (June 26, 2015, 7:33 PM), <http://money.cnn.com/2014/06/16/investing/mergers-and-acquisitions-boom/index.html> (reporting “\$786 billion worth of mergers and acquisitions in the United States” in just the first half of 2014, substantially higher than any year since 2007). M&A activity in 2016 declined somewhat from 2015 levels but ended up “the third-busiest year on record.” Andrew Brownstein & Steven Rosenblum, *Mergers and Acquisitions—A Brief Look Back and a View Forward*, HARV. L. SCH. FORUM CORP. GOVERNANCE & FIN. REG. (Jan. 10, 2017), <https://corpgov.law.harvard.edu/2017/01/10/mergers-and-acquisitions-a-brief-look-back-and-a-view-forward/>.

2. Robert M. Daines & Olga Koumrian, *Shareholder Litigation Involving Mergers and Acquisitions*, CORNERSTONE RES., (Feb. 2013), <https://www.cornerstone.com/GetAttachment/9d8fd78f-7807-485a-a8fc-4ec4182dedd6/2012-Shareholder-Litigation-Involving-M-and-A.pdf> (stating that, in 2012, shareholders challenged 93% of merger and acquisition deals valued over \$100 million and 96% of transactions valued over \$500 million); Matthew D. Cain & Steven Davidoff Solomon, *A Great Game: The Dynamics of State Competition and Litigation*, 100 IOWA L. REV. 465, 475 tbl.I (2015) (stating that, in 2011, 92.1% of public company merger and acquisition deals were challenged whereas in 2007, 38.7% of deals were challenged; this occurred even as the number of total deals sharply declined from 248 deals in 2007 to 127 deals in 2011). The number of suits brought per deal is also on the rise. In 2007, the mean number of independently filed suits brought per deal was 3.1. *Id.* In 2011, this incidence had risen to 5 suits per deal. *Id.* at 476 tbl.II; see also Daines & Koumrian, *supra* note 2 (finding, among deals valued over \$100 million, an average of 4.8 lawsuits filed per deal; for deals valued over \$500 million, an average of 5.4 lawsuits filed per deal). Another recent trend has been a sharp increase in the incidence of appraisal petitions. See generally Charles R. Korsmo & Minor Myers, *Appraisal Arbitrage and the Future of Public Company M&A*, 92 WASH. U. L. REV. 1551 (2015). Approximately 5% of appraisal-eligible transactions led to some form of appraisal litigation from 2004 through 2010. *Id.* at 1570. By 2013, more than 15% of appraisal-eligible transactions attracted an appraisal petition. *Id.* There is some recent evidence, however, that the frequency of deal litigation may be declining. Matthew D. Cain & Steven M. Davidoff Solomon, *Takeover Litigation in 2015*, BERKELEY CTR. L., BUS. & ECON. 2–3, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2715890 (finding that, although 87.7% of deals were targets of shareholder litigation in 2015, the percentage fell to 21.4% in the fourth quarter of 2015, perhaps due to increased unwillingness to approve settlements based solely on supplemental disclosure); see also Ravi Sinha, *Shareholder Litigation Involving Acquisitions of Public Companies*, CORNERSTONE RES. 1 (2016), <https://www.cornerstone.com/Publications/Reports/Shareholder-Litigation-Involving-Acquisitions-2016> (“In 2015 and the first half of 2016, 84 and 64 percent of M&A deals valued over \$100 million were litigated, respectively. This is the first time since 2009 that the rate has dipped under 90 percent.”).

3. Cain & Solomon, *A Great Game*, *supra* note 2, at 481–82, tbls.IV.A and IV.B.

of early settlements of such litigation, however, usually for modified disclosure only,⁴ with no improvement in the deal price, has led some to claim that Delaware “hasn’t done enough to curb” a “growing tide of shareholder litigation,”⁵ and that such litigation amounts to a wasteful “merger tax” ultimately borne by shareholders and collected by the plaintiffs’ class action bar.⁶

A tax on mergers, however, is not a deadweight loss to the system if the litigation that it funds encourages managerial conduct that enhances shareholder value. But that enhancement could be more than offset if corporate defendants (and, indirectly, their shareholders) were required to bear the substantial costs of discovery and trial (or pay substantial plaintiff’s attorneys fees in settlements to avoid such costs) in cases with little or no merit. And given the high percentages of deal transactions that lead to complaints, it would be difficult to conclude that all deal litigation has substantial merit. That problem, in turn, presents the central conundrum addressed in this Article: how can the corporate litigation system separate meritorious shareholder derivative and deal claims from those that lack merit, and do so early enough in the proceedings to avoid the costs of discovery and trial?

One possible approach surfaced prominently after the Delaware Supreme Court’s 2014 opinion in *ATP Tour Inc. v. Deutscher Tennis Bund*.⁷ Some corporations and their advisers engaged in a brief dalliance with bylaws that purported to shift the costs of defending shareholder litigation to plaintiff shareholders whose lawsuits were anything other than totally successful.⁸ At least in Delaware, that dalliance was thwarted before it became

4. *Id.* at 478 tbl.III. *But see* Sinha, *supra* note 2, at 5 (following the *Trulia* decision described *infra* note 32, only “a small number of disclosure-only settlements have been approved in various state courts” and “[i]t is not yet clear whether such approvals will continue to occur in cases where the settlement was reached after the *Trulia* decision”).

5. Liz Hoffman, *Dole and Other Companies Sour on Delaware as Corporate Haven*, WALL ST. J. (Aug. 2, 2015, 10:38 PM), <https://www.wsj.com/articles/dole-and-other-companies-sour-on-delaware-as-corporate-haven-1438569507>.

6. Andrew J. Pincus, *The Trial Lawyers’ New Merger Tax: Corporate Mergers and the Mega Million-Dollar Litigation Toll on Our Economy*, U.S. CHAMBER INST. LEGAL REFORM 1–9 (Oct. 24, 2012), http://www.instituteforlegalreform.com/uploads/sites/1/M_and_A.pdf (describing merger litigation as “extortion through litigation, plain and simple”) (emphasis in original).

7. *ATP Tour Inc. v. Deutscher Tennis Bund*, 91 A.3d 554 (Del. 2014).

8. *See e.g., Delaware Supreme Court Endorses “Fee-Shifting” Bylaw in Certified Question of Law*, WILSON SONSINI GOODRICH & ROSATI LLP 2 (May 12, 2014), <https://www.wsgr.com/publications/PDF-Search/wsgalrt-fee-shifting.pdf> (“The practical effect of [the *ATP*] decision . . . is that many boards of directors of private and public Delaware corporations should seriously consider adopting fee-shifting bylaws of their own.”); Claudia H. Allen, *Fee-Shifting Bylaws: Where Are We Now?*, BLOOMBERG BNA (Feb. 2, 2015), <http://www.bna.com/feeshifting-bylaws-n17179922685/> (noting that, between May 2014 and February 2015, 39 public companies, 30 incorporated in Delaware, adopted fee-shifting charter or bylaw provisions); *see also* Letter from Lisa Rickard, President of U.S. Chamber Inst. for Legal Reform, to Norman Monhait, Chairman of Section of Corp. Law Del. State Bar Ass’n, at 4 (Apr. 8, 2015), http://www.instituteforlegalreform.com/uploads/sites/1/de-bar-letter-4_8_2015.pdf (“What is needed are solutions—either in terms of bylaw authorization or additional tools for the Court of Chancery—that eliminate the incentive to file meritless lawsuits in the first place Limiting corporations’ authority to adopt fee-shifting bylaws, and thereby depriving them of the ability to protect shareholders against the cost of these claims . . . is unjustified and unwise . . .”).

a commonly adopted practice: the use of such bylaws has now been prohibited by legislation.⁹ The Delaware State Bar Association committee that drafted that legislation nevertheless recognized that it was important to identify ways “to address and deter litigation of limited merit.”¹⁰ Instead of private ordering, however, that committee advocated a solution based on public ordering—specifically, it urged that “courts can and should be trusted to address real problems effectively when and if they arise on a case by case basis.”¹¹ That public ordering solution is the focus of this Article. To assure, or at least make it more likely, that only meritorious cases reach the stage of full discovery and trial, the Delaware courts have developed an intricate but highly efficient system for managing the flow of shareholder complaints.

This Article presents for the first time an inventory and analysis of the interrelated procedures and doctrines that constitute this system and resolves disputes in a relatively efficient manner. Most fundamentally, this system resolves shareholder litigation by encouraging the early presentation of relevant facts pleaded in the complaint and by either dismissing the complaint if those facts fail to demonstrate legal merit,¹² or identifying how the complaint is meritorious, in a fashion that encourages the protagonists to settle. With its emphasis on early, and often extensive, factual inquiry, the motion to dismiss in Delaware representative shareholder litigation—specifically, derivative litigation and class actions asserting breaches of fiduciary duty by the corporation’s directors—functions in a fashion similar to the motion for summary judgment, but with substantially less pre-motion discovery and its associated costs.

B. Notice Pleading, Fact Pleading, and Early Stage Triage

At least until fairly recently, those familiar with principles of civil procedure would not ordinarily have expected the motion to dismiss to be such an important tool for early stage triage:¹³ to survive a motion to dismiss, a complaint is only required to set forth “a

9. S.B. No. 75, 148th Gen. Assemb. (Del. 2015), *amending* DEL. CODE ANN. tit. 8, §§ 102, 109(b) (providing that the certificate of incorporation and the bylaws “may not contain any provision that would impose liability on a stockholder for the attorneys’ fees or expenses of the corporation or any other party in connection with an internal corporate claim”).

10. *Explanation of Council Legislative Proposal*, DEL. CORP. L. COUNCIL 7 (Mar. 2015), <http://www.corporatedefensedisputes.com/files/2015/03/COUNCIL-SECOND-PROPOSAL-EXPLANATORY-PAPER-3-6-15-U0124513.pdf>.

11. *Id.* at 8.

12. For the proponents of the legislation precluding fee-shifting by charter or bylaw provisions, the first item on their list of judicial tools to limit unmeritorious shareholder litigation were “[m]otions to dismiss, which enable the court to terminate litigation at the outset, before expensive discovery proceedings, where the complaint lacks merit on its face.” *Id.*

13. See, e.g., William M. Lafferty & W. Leighton Lord III, *Toward a Relaxed Summary Judgment Standard for the Delaware Court of Chancery: A New Weapon Against “Strike” Suits*, 15 DEL. J. CORP. L. 921, 927 (1990) (“A motion to dismiss is usually easily defeated by the plaintiff, because of the minimal requirements for a complaint to state a claim under the ‘notice pleading’ standard in the Delaware Chancery Court Rules.”). The Supreme Court’s opinions in *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007) and *Ashcroft v. Iqbal*, 556 U.S. 662 (2009) have intensified the federal courts’ scrutiny of pleadings by establishing that “[t]o survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to ‘state a claim to relief that is plausible on its face.’” *Iqbal*, 556 U.S. at 678 (quoting *Twombly*, 550 U.S. at 570). As discussed in Part III.F

short and plain statement of the claim showing that the pleader is entitled to relief.”¹⁴ As first year law students have been taught for decades, this embrace of “notice pleading” is intended to promote the resolution of disputes based on facts presented in evidence at trial, rather than based on the content of pleadings.¹⁵ And in litigation in which both sides generally bear the costs of litigation equally, and the burdens of gathering evidence fall upon them more or less equally, the “notice pleading” concept makes sense as a means to avoid unnecessarily costly attention to the formulation of pleadings when the resolution of the dispute ought to turn instead on an evaluation of actual facts.¹⁶

In representative stockholder litigation, however, the burdens of discovery fall almost exclusively on the defendants. Thus, one cannot count on symmetry of litigation costs to generate an efficient equilibrium in which unmeritorious cases are either dismissed or not brought at all: the one-sided threat of unchecked discovery costs¹⁷ becomes a source of leverage for extracting settlement payments without regard to the merits of the litigation.¹⁸

below, however, we question whether the federal courts’ approach to motions to dismiss can replicate the benefits we identify in the Delaware courts’ system of handling motions to dismiss in stockholder class and derivative actions.

14. DEL. CH. CT. R. 8(a) (requiring that a pleading contain only “a short and plain statement of the claim showing that the pleader is entitled to relief”). The Delaware Supreme Court has explained, moreover, that “[t]he pleading standards governing the motion to dismiss stage of a proceeding in Delaware . . . are minimal.” Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Holdings LLC, 27 A.3d 531, 536 (Del. 2011). *See also* A. Benjamin Spencer, *Plausibility Pleading*, 49 B.C. L. REV. 431, 484–85 (2008) (“Before the shift to ‘notice pleading’ accomplished by the Federal Rules, motions to dismiss a complaint or to strike a defense were the principal tools by which factually insufficient claims or defenses could be isolated and prevented from going to trial with the attendant unwarranted consumption of public and private resources. But with the advent of ‘notice pleading,’ the motion to dismiss seldom fulfills this function anymore.”).

15. *See* Conley v. Gibson, 355 U.S. 41, 48 (1957) (“[T]he purpose of pleading is to facilitate a proper decision on the merits.”); *see also* Richard L. Marcus, *The Revival of Fact Pleading Under the Federal Rules of Civil Procedure*, 86 COLUM. L. REV. 433, 454 (1986) (“[T]he problem with common law pleading practice was that, while it led to actual decisions, it often did not lead to merits decisions because cases were frequently resolved on technicalities.”).

16. Paul Stancil, *Balancing the Pleading Equation*, 61 BAYLOR L. REV. 90, 146 (2009) (“To the extent there exist some cases or claim types for which pretrial costs are typically balanced or favor the defendant, the model demonstrates that the pleading standard should err on the side of correcting informational asymmetries. For those claim types, the risk of strike suit is minimal, and thus the pleading standard can and should legitimately focus upon correcting plaintiff’s presumed knowledge deficit. Notice pleading often works.”).

17. The costs of discovery can be significant. *See e.g.*, *Judicial Conference Adopts Rules Changes, Confronts Projected Budget Shortfalls*, ADMIN. OFF. U.S. CTS. 2–3 (Sept. 15, 1999), <http://www.uscourts.gov/news/1999/09/15/judicial-conference-adopts-rules-changes-confronts-projected-budget-shortfalls> (“Discovery represents 50 percent of the litigation costs in the average case and up to 90 percent of the litigation costs in cases in which it is actively used.”); Frank H. Easterbrook, *Discovery as Abuse*, 69 B.U. L. REV. 635, 636 (1989) (noting how the high costs of discovery shape litigants’ decisions). The costs and abuses of discovery were also a key focus of the debates concerning the Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (1995) [hereinafter PSLRA].

18. *Twombly*, 550 U.S. at 559 (“[T]he threat of discovery expense will push cost-conscious defendants to settle even anemic cases before reaching [summary judgment] proceedings.”); Jonah B. Gelbach, Note, *Locking the Doors to Discovery? Assessing the Effects of Twombly and Iqbal on Access to Discovery*, 121 YALE L.J. 2270, 2285 (2012) (“When discovery costs are asymmetrically high for defendants, a plaintiff’s ability to get through the answer[motion to dismiss] stage can be a powerful club. Liberal pleading rules may have an *in terrorem*

In that setting, efficiency depends upon a system of judicial supervision and triage at an early stage of the litigation, so that cases lacking merit are dismissed and thereby deprived of their extortive effect, and meritorious cases are identified as such early on and settled so that the enormous costs of discovery and trial can be avoided.

This Article describes the unique and highly evolved system employed in the Delaware courts to achieve that efficiency. For good reasons, that system is notably different from the “notice pleading” system extolled in civil procedure courses. As we demonstrate below, Delaware’s system affirmatively encourages reliance on factually specific pleadings as a basis for substantive evaluation of shareholder litigation at an early stage of the proceedings. On the other hand, the Delaware system provides or depends on mechanisms that enable and encourage the plaintiff and the defendants as well to supply relevant information that meaningfully assists the courts in improving the fairness and utility of that substantive, pleading stage evaluation.

As we explain more fully below, the role served by the motion to dismiss in Delaware representative shareholder litigation has come to more closely resemble the role of the motion for summary judgment: it has evolved into a procedure in which, despite occurring at the pleading stage and before formal discovery, the court often evaluates the merits with the benefit of a substantial record, assembled from publicly available information or provided by defendants, consisting of facts essentially beyond dispute. In essence, with the benefit of significant factual inquiry, the motion to dismiss has evolved in Delaware shareholder litigation practice to constitute something of a proxy for a trial: a relatively inexpensive inquiry that approximates the result of a trial, and either avoids further litigation and its attendant costs altogether, or provides the parties with an informed prediction of the result at trial that facilitates rational settlement at an early stage, again, before the bulk of litigation costs is incurred.

Also, as we explain more fully below,¹⁹ where time pressures in shareholder litigation make the motion to dismiss unavailable as a practical matter—typically, where a shareholder plaintiff seeks a preliminary injunction against completion of a merger—the efficiency-promoting function of the motion to dismiss has been taken over by the motion to expedite discovery. Instead of examining whether a complaint sets forth facts establishing a “reasonably conceivable” basis for relief,²⁰ the court on a motion to expedite discovery engages in a similar evaluation to determine whether the plaintiff has presented “colorable” claims on the merits.²¹ Denial of the motion to expedite enables the defendants to pursue a

effect on defendants in these cases, possibly inducing more, and more one-sided, settlements.”); Stancil, *supra* note 16, at 133 (“When cost disparity significantly favors the plaintiff, the expected trial value of her claim becomes irrelevant to her filing decision. In the extreme, the economic model predicts that a plaintiff may file suit—and the defendant may settle the claim—even when the plaintiff’s claim is wholly frivolous.”).

19. *Infra* Part III.C.

20. Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Holdings LLC, 27 A.3d 531, 536 (Del. 2011) (court must deny a motion to dismiss “unless the plaintiff could not recover under any reasonably conceivable set of circumstances susceptible of proof”).

21. *E.g.*, Cty. of York Emps. Ret. Plan v. Merrill Lynch & Co., 2008 Del. Ch. LEXIS 162, *16 (Del. Ch. Oct. 28, 2008) (to be entitled to expedited discovery, “a plaintiff must articulate a sufficiently colorable claim . . .”); *see also infra* Part III.C.

motion to dismiss, and a typically attendant stay of discovery,²² without incurring immediate discovery costs; and denial or grant of the motion to expedite informs the parties of the court's preliminary assessment of the merits, and can facilitate prompt settlement.²³

In both procedural contexts, the assessment of the merits largely focuses on whether the facts reflect conflicts of interest or some other circumstances sufficient to preclude the judicial deference ordinarily required by the business judgment rule.²⁴ In the absence of such facts, the motion to dismiss is granted and the motion to expedite discovery is denied; but if such facts are presented, the parties are told so and can approach settlement with a better assessment of their prospects at trial.

C. The Efficiency Role of Pleading Stage Evaluation

In the remainder of this Article, we examine the rationale, evolution, and components of the system that engages in pleading stage triage of Delaware shareholder class and derivative litigation. We begin with another, somewhat deeper look at the efficiency considerations associated with such litigation.

Corporate governance rules and practices prominently include judicial articulation of director and officer fiduciary duties, and enforcement of those duties through private litigation is supported by something of a bounty system for shareholder plaintiff lawyers.²⁵ Such shareholder litigation can generate wealth-producing disciplinary effects.²⁶ Those effects are only partly expressed through judgments and settlements in such litigation: there are also unquantifiable benefits where corporate managers and transactional lawyers plan, negotiate and structure transactions with an eye to avoiding the cost and uncertainty of

22. See *infra* Part II.C.

23. See *infra* Part III.D.

24. This is because the business judgment rule is normally applied in the absence of a showing of interest-ness or lack of independence of a majority of directors. When the business judgment rule is applied, a case challenging the actions of directors is likely to be dismissed. “[T]he business judgment rule insulates directors when they make what, in hindsight, turn out to be poor business decisions.” Donald F. Parsons & Jason S. Tyler, *Docket Dividends: Growth in Shareholder Litigation Leads to Refinements in Chancery Procedures*, 70 WASH. & LEE L. REV. 473, 483 (2013). See also *Orman v. Cullman*, 794 A.2d 5, 22 (Del. Ch. 2002) (“To rebut successfully business judgment presumptions in this manner, thereby leading to the application of the entire fairness standard, a plaintiff must normally plead facts demonstrating ‘that a majority of the director defendants have a financial interest in the transaction or were dominated or controlled by a materially interested director.’”) (quoting *Crescent/Mach I Partners v. Turner*, 846 A.2d 963, 979 (Del. Ch. 2000)). *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984) sets forth the now-standard definitions for the terms “interested” and “independent.” Interestedness means that the directors “appear on both sides of a transaction [or] expect to derive any personal financial benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally.” *Id.* at 812. “Independence means that a director’s decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influences.” *Id.* at 816.

25. See generally John C. Coffee, Jr., *Understanding the Plaintiff’s Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669 (1986).

26. See, e.g., Randall S. Thomas & Robert B. Thompson, *A Theory of Representative Shareholder Suits and Its Application to Multijurisdictional Litigation*, 106 NW. U. L. REV. 1753, 1755 (2012) (summarizing the important role of shareholder litigation in controlling opportunistic managerial behavior and reducing managerial agency costs).

litigation, and therefore heed judicial definitions of appropriate managerial conduct, thereby presumably promoting shareholder wealth-maximizing corporate conduct.²⁷

On the other hand, shareholder litigation, particularly in the form of class and derivative actions, presents agency cost issues.²⁸ Participants in such litigation (plaintiffs' lawyers, defense lawyers, and director defendants) may have incentives to act in concert to initiate and resolve litigation in ways that impair the interests of the investors who do not directly participate in the litigation and are not individually represented in it.²⁹ If the equity interests of stockholder plaintiffs themselves were sufficiently large to encourage them to monitor and supervise their counsel in such litigation and to reject lawsuits that lack merit, the resulting system might well be reasonably efficient.³⁰ By all accounts, however, stockholder plaintiffs rarely exercise that degree of monitoring and control of stockholder class and derivative litigation. Thus, some external input or constraints are necessary to minimize unproductive proceedings that create enormous costs—ultimately borne by the shareholder—without contributing meaningful systemic or case-specific benefits.³¹ At the same time, those inputs or constraints must be tailored to preserve the accountability benefits that arise from stockholder litigation.

How does the law handle this efficiency issue? As previously noted, it is the motion to dismiss that provides the primary solution,³² and in public company shareholder class

27. Judicial definitions of appropriate managerial conduct reign supreme in a system where “fiduciary attacks on announced deals are now the primary vehicle through which the Court develops the rules that govern director conduct and that provide transaction planners (and plaintiffs’ lawyers) the basis to plan (or attack) the next deal.” William Savitt, *The Genius of the Modern Chancery System*, 2012 COLUM. BUS. L. REV. 570, 571 (2012).

28. See, e.g., Thomas & Thompson, *supra* note 26, at 1753 (describing how representative shareholder litigation has two important underlying characteristics that have the potential to increase agency costs: (1) the multiple sources of the legal rights being redressed (creating dynamic opportunities for arbitrage) and (2) the ability of multiple shareholders to seek to represent the collective group in such litigation (creating an increased risk of litigation-related agency costs by those representatives and their attorneys)).

29. *Id.* at 1755 (describing “a serious principal-agent problem that gives the plaintiff’s attorney, not the client, the real discretion as to whether to commence suit” and noting that “[t]his is the likely situation in class and derivative actions where the number of clients is large and the individual injuries small”).

30. See Richard A. Posner, *Some Uses and Abuses of Economics in Law*, 46 U. CHI. L. REV. 281, 292 (1979) (“Just as people were maximizing utility before the terms were invented by economists, judges may have been maximizing efficiency before the language of economics gained currency in judicial opinions (indeed, it still has not).”).

31. See Daines & Koumrian, *supra* note 2 (finding that only a small fraction of lawsuits challenging a merger or acquisition resulted in payments to shareholders; the majority settled for additional disclosures or, less frequently, changes in merger terms, such as deal protection provisions); see also Leo E. Strine, Jr. et al., *Putting Stockholders First, Not the First-Filed Complaint*, 69 BUS. LAW. 1, 5 (2013) (“Unless a consistent incentive system can be implemented that encourages representative litigation that benefits stockholders, the representative litigation system may on balance hurt investors more than it protects them.”).

32. Also relevant to this issue are other rules and requirements that have been identified as judicial tools to curb rent-seeking behavior by litigation agents. Such tools include requirements of notice and judicial supervision of class certification and settlement, as well as fee-shifting sanctions and control over awards of representative counsel’s attorney’s fees. DEL. CORP. L. COUNCIL, *supra* note 10, at 8. Chancery Court Rules 23(e) and 23.1(c) prohibit dismissal of suits without approval of the court and notice to members of the class, thereby allowing the court to supervise any side-dealing on the part of other litigation agents. Supervision of settlements by

and derivative litigation, the Delaware courts have managed the efficiency-promoting function of the motion to dismiss and the motion to expedite discovery particularly well.³³ Such litigation only very rarely proceeds to trial: from 2011 through 2015, for example, there are only five instances of such litigation in which the Court of Chancery resolved the case

the Court of Chancery in shareholder litigation is becoming more robust, and attentive to avoiding the encouragement of unmeritorious deal litigation. *In re Trulia, Inc. Stockholder Litig.*, 129 A.3d 884, 887 (Del. Ch. 2016) (noting “the concerns that scholars, practitioners and members of the judiciary have expressed that these settlements rarely yield genuine benefits for stockholders and threaten the loss of potentially valuable claims that have not been investigated with rigor” and holding that “disclosure claims arising in deal litigation optimally should be adjudicated outside of the context of a proposed settlement so that the Court’s consideration of the merits of the disclosure claims can occur in an adversarial process without the defendants’ desire to obtain an often overly broad release hanging in the balance”); *Acevedo v. Aeroflex Holding Corp.*, C.A. No. 7930-VCL, slip op. at 66 (Del. Ch. July 8, 2015) (“[w]hat we thought was a nice way of getting rid of meritless Delaware litigation, in fact, sweeps much more broadly and has overall significant deleterious effects leading to the types of levels of litigation documented by Professor Davidoff and by the Cornerstone Research studies [cited in note 2 above.]”); *In re Aruba Networks, Inc. S’holder Litig.*, Cons. C.A. No. 10765-VCL, slip op. at 65, 70, 72 (Del. Ch. Oct. 9, 2015) (describing disclosure-only settlements in deal litigation as a “real systemic problem” in which “pseudo-litigation” has created a “misshapen legal regime”); Joel Edan Friedlander, *How Rural/Metro Exposed the Systemic Problem of Disclosure Settlements*, 40 DEL. J. CORP. L. 877, 904 (arguing that there are “systemic problems posed by judicial policies favoring the release of *Revlon* claims in exchange for supplemental disclosures”); *see also In re Walgreen Co. Stockholder Litig.*, 832 F.3d 718, 725 (7th Cir. 2016) (endorsing *Trulia*).

33. We do not assert, however, that Delaware is the only jurisdiction that attempts to employ the motion to dismiss to improve the efficiency of representative litigation. Although the motion to dismiss may or may not operate more efficiently in Delaware shareholder litigation than it does under the scheme established under the Private Securities Litigation Reform Act of 1995 (Pub. L. 104-67, 109 Stat. 737), that Act does establish features that resemble the approach taken in Delaware, including heightened pleading standards (15 U.S.C. § 78u-4(b)(2)(A) (2010)) (requiring that the complaint identify each alleged misstatement and “state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind”) and largely mandatory stays of discovery pending disposition of the motion to dismiss (15 U.S.C. § 78u-4(b)(3)(B) (2010)) (requiring that “all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss,” absent a finding of necessity “to preserve evidence or to prevent undue prejudice”). The Canadian framework regulating securities fraud litigation is even more explicit in its focus on the use of a preliminary inquiry into the merits of the litigation as a tool to manage the efficiency of such litigation. *See* DAVIES WARD PHILLIPS & VINEBERG, LLP, SECONDARY MARKET LIABILITY: SUPREME COURT OF CANADA CLARIFIES THE SCREENING MECHANISM FOR CLASS ACTIONS (Apr. 21, 2015), <https://reaction.dwpv.com/rs/vm.ashx?ct=24F76F1AD2E30AEDC1D180A9D12E9010DCBE7BB3D38714DD4CF371647BF8D90DDD78035> (describing the opinion of the Canadian Supreme Court in *Theratechnologies Inc. v. 121851 Canada Inc.*, [2015] S.C.R. 18 (Can.), applying Article 225.4 of the Quebec Securities Act, which requires that the court preliminarily determine whether “there is a reasonable possibility that it will be resolved in favour of the plaintiff,” and holding that “the gatekeeping role of the courts under article 225.4 requires that the courts ‘undertake a reasoned consideration of the evidence to ensure that the action has some merit’”).

after trial.³⁴ The Delaware courts have achieved this efficiency for well-documented reasons: the litigation is supervised by a specialized court that hears hundreds of these cases,³⁵ can understand the setting, evaluate the facts, and thus offer a highly predictive assessment, at the pleading stage, of who would win at trial. The Delaware courts accomplish this procedural streamlining through a variety of means, which combine to make the motion to dismiss and the motion to expedite discovery a meaningful “test run,” even if not a perfect replica, of the trial. This is achieved primarily by reducing the information gap between the two stages: in various ways, Delaware law and practice result in providing a good deal of critical information to the court at the pleading stage. The court can in turn render an assessment of the case that will better approximate the result that would ensue if a trial were held but without incurring the costs of that process. In derivative suits, for example, the Delaware courts have actively encouraged shareholder plaintiffs to use the “tools at hand”—i.e., statutory rights to inspect corporate books and records—to provide a fuller factual foundation for the pleading stage evaluation of the derivative case.³⁶ In class actions challenging mergers (“deal cases”), the factual foundation for the motion to dismiss (and the motion to expedite discovery) is typically enriched by a proxy statement, a Schedule 14D-9, or even by discovery taken in parallel statutory appraisal litigation.³⁷

What we find, in general, is that the Delaware courts dismiss cases or grant expedited discovery, or not, based on whether the pleaded facts create some reasonable doubt that the corporate decision makers (usually the directors) were disinterested, independent, and acting in good faith.³⁸ More specifically, our essential claim is that the Delaware courts have developed and applied a rubric for evaluation that is similar in multiple procedural contexts: whether examining a complaint for “colorability” for purposes of a motion to expedite discovery, assessing “reasonable conceivability” for purposes of a motion to dismiss a deal case for failure to state a claim, or applying the pre-suit demand requirement of Rule 23.1 in a derivative suit, the courts are essentially engaging in the same evaluation, namely whether the available facts create some reasonable doubt that the corporate decision makers were disinterested and acted in good faith.

After a brief review of the two principal types of representative shareholder litigation, we turn below to identify the categories of procedural rules that enable this triage system

34. See generally *In re Dole Food Co., Inc. Stockholder Litig.*, C.A. No. 8703-VCL, C.A. No. 9079-UCI, 2015 WL 5052214 (Del. Ch. Aug. 27, 2015); *In re Rural Metro Corp. Stockholder Litig.*, 88 A.3d 54 (Del. Ch. 2014); *In re Trados Inc. S'holder Litig.*, 73 A.3d 17 (Del. Ch. 2013); *In re S. Peru Copper Corp. S'holder Derivative Litig.*, 52 A.3d 761 (Del. Ch. 2011); *S. Muoio & Co. LLC v. Hallmark Entm't Invs. Co.*, No. 4729-CC, 2011 WL 863007 (Del. Ch. Mar. 9, 2011); *In re John Q. Hammons Hotels Inc. S'holder Litig.*, 2011 WL 227634 (Del. Ch. Jan. 14, 2011).

35. See Parsons & Tyler, *supra* note 24, at 473 (“Delaware’s volume of corporate and alternative business entity cases and the responsiveness of its courts, its legislature, and the legal marketplace generally accelerate the development of refined doctrine, measured balance, and valuable predictability. In short, with repeat experience comes ready expertise and real efficiency.”); William H. Rehnquist, *The Prominence of the Delaware Court of Chancery in the State-Federal Joint Venture of Providing Justice*, 48 BUS. LAW. 351, 354 (Nov. 1992) (praising the Court of Chancery for refining the law so that business planners may order their affairs to avoid lawsuits).

36. See Section II.A.1.

37. *Id.*

38. See *infra* notes 101, 113, 121–22, 135–36, 154, 182, 187 and accompanying text.

to work fairly, and to describe how those rules accomplish that goal. We next trace the remarkable evolution of the use of fact pleading in the triage system, beginning with derivative litigation applying the pre-suit demand requirement of Court of Chancery Rule 23.1, and continuing into other areas of representative shareholder litigation in which more generally applicable rules of civil procedural control. Next, we examine the increasing importance, but logical development in the context of the Delaware system for controlling excessive litigation, of the motion to expedite discovery as a means of pleading stage triage. Finally, to show how this system works in detail, we examine several cases in which the denial of a motion to dismiss or the ruling on a motion to expedite discovery in representative shareholder litigation aided in the efficient resolution of the case.

D. Mapping the Territory: Derivative Suits and Deal Cases

Understanding how the Delaware courts perform the triage function in stockholder litigation requires examination of two critical procedural contexts: the motion to dismiss and, less obviously, the motion to expedite discovery. It is also necessary to appreciate that stockholder litigation under Delaware law comes in two flavors: derivative suits that assert claims of liability for harm done to the corporation, whether through neglect, insufficient oversight, or waste or misappropriation of corporate assets; and, on the other hand, cases (which we refer to as “deal cases”) that challenge the validity of transactions (primarily mergers) that involve the acquisition or conversion of publicly held shares. This categorization of derivative cases and deal cases may appear unfamiliar or inapt to students of the subject who more typically differentiate between derivative claims and direct, or individual, claims. We do not believe, however, that this categorization excludes any significant aspect of representative shareholder litigation. Although some such litigation involves direct claims not addressing any particular merger or acquisition, deal litigation constitutes the bulk of representative shareholder litigation under state corporate law that is not brought derivatively on behalf of the corporation.³⁹ Conversely, we are not aware of any derivative suits challenging a transaction in which the shares of the plaintiff shareholder are being acquired, so there appears to be no overlap between derivative suits and what we identify as deal cases.

We return, then, to a description of the two principal forms of representative shareholder litigation in the public company. Cases complaining of harm to the corporation itself, where the relief sought is therefore typically a judgment for monetary damages in favor of the corporation, are brought as derivative suits.⁴⁰ Those suits are therefore subject to the various requirements of Court of Chancery Rule 23.1, notably the requirement that a pre-suit demand be made on the board of directors, or that the allegations of the complaint establish that such demand is excused. In addition, such cases typically seek a monetary

39. Robert B. Thompson & Randall S. Thomas, *The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions*, 57 VAND. L. REV. 133, 135 (2004).

40. See, e.g., *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1036 (Del. 2004) (stating that a derivative suit “enables a stockholder to bring suit on behalf of the corporation for harm done to the corporation. Because a derivative suit is being brought on behalf of the corporation, the recovery, if any, must go to the corporation”).

recovery on account of some action (or inaction where action was required) after it has occurred, and do not involve requests for preliminary injunctive relief. Therefore, in the absence of a request for preliminary injunctive relief, it is the motion to dismiss, and not the motion to expedite discovery, that plays the most important role in determining which derivative suits are permitted to proceed toward discovery and trial.

In contrast, deal cases involve claims of impairment of the stockholders' shares, and any monetary award redounds to the benefit of the stockholders themselves rather than the corporation. These cases therefore are brought by stockholders asserting individual (or direct) claims, rather than derivative claims on behalf of the corporation. Accordingly, they are not subject to Rule 23.1, and are evaluated using the generally applicable rules of civil procedure. In the case of deals involving publicly traded companies, these cases are typically brought as class actions.⁴¹ Notably, however, and unlike the typical derivative suit, deal cases frequently involve a request for preliminary injunction against the transaction and are accompanied at the outset by a motion to expedite discovery in aid of the application for a preliminary injunction. Thus, courts in this situation typically do not have the opportunity, before substantial discovery costs have been incurred, to engage in a formal evaluation of whether to dismiss the litigation. Accordingly, in deal cases involving motions for a preliminary injunction, the primary occasion to evaluate whether discovery costs should be incurred is the motion to expedite discovery—a procedural context that has therefore taken on a significant efficiency-policing role, in the form of increasingly rigorous assessment of whether the asserted claims are “colorable”—i.e., whether the available facts indicate that they have substantive merit.⁴²

II. THE PROCEDURAL FOUNDATIONS OF PLEADING STAGE EVALUATION

Derivative suits and deal cases in the Delaware courts both proceed under a set of procedural rules and doctrines that are indispensable to the operation of the triage system that we examine. These rules and doctrines serve three interrelated purposes: first, they promote the availability of relevant information at the pleading stage so that the information gap between that stage and trial is reduced; second, they otherwise advance the informational function of the disposition at the pleading stage, in the sense that they increase the value of the pleading stage determination as a predictor of the ultimate outcome at trial and, thus, as a basis for encouraging voluntary settlements; and finally, they promote

41. Daines & Koumrian, *supra* note 2 (studying litigation challenging M&A transactions and finding that lawsuits filed by shareholders of large U.S. public target companies usually take the form of class actions).

42. See *infra* Part III.C (explaining the importance of motion to expedite discovery and cases in which granting the motion to dismiss ends the litigation).

the cost-saving function of pleading stage evaluation by avoiding costs that would otherwise be incurred in proceeding to trial.

A. Information Gap-Reducing Measures

It is a common lament that it is difficult for courts to assess whether litigation is meritorious at the pleading stage, before discovery has occurred.⁴³ It may be particularly difficult to make such an assessment where the relevant facts are primarily within the possession and control of the defendants.⁴⁴ That asymmetry is typical of the shareholder/management relationship in general, given the centering of managerial responsibility in the board of directors and the relatively limited informational rights accorded to shareholders.⁴⁵ In these circumstances, it might be natural to conclude that courts would be particularly ill-equipped to assess the merits of shareholder litigation at the pleading stage, before the shareholder has had an opportunity, through discovery, to overcome the informational disadvantage described above.

That informational disadvantage, however, may be overstated, at least as it relates to the courts' ability to assess the merits of shareholder litigation at the pleading stage. In the numerous ways described below, the Delaware system helps fill in informational gaps at

43. See, e.g., James J. Park, *Rules, Principles, and the Competition to Enforce the Securities Laws*, 100 CAL. L. REV. 115, 175 (2012) ("Assessing the merits is an inherently difficult task, not because the courts do not have expertise that the SEC has, but because at the screening stage before discovery, the facts are undeveloped."); Michael J. Kaufman & John M. Wunderlich, *The Unjustified Judicial Creation of Class Certification Merits Trials in Securities Fraud Actions*, 43 U. MICH. J.L. REFORM 323, 372 (2010) ("Neither defendants nor plaintiffs could adequately assess the strength of their own claim or their opponent's claim absent discovery requests.' And neither can the court adequately assess the strength of the claims absent discovery."); Geoffrey Edwards, Comment, *Preemption Gone Wrong: Reconsidering ERISA Preemption of Wrongful Termination Claims in the Ninth Circuit*, 32 U.C. DAVIS L. REV. 1079, 1096 n.115 (1999) ("At the removal stage, the parties have usually not conducted any discovery Thus, the court has no evidence with which to judge the plausibility of the plaintiff's complaint.").

44. See Stancil, *supra* note 16, at 92 ("An informational asymmetry favoring defendants over plaintiffs drives a preference for liberal pleading standards. That is, the typical defendant often has sole possession of relevant information, and plaintiffs often cannot know critical details of their claims before discovery.").

45. ABA Section of Business Law Corporate Governance Committee, *Report of the Task Force on Delineation of Governance Roles & Responsibilities*, 65 BUS. LAW. 107, 113, 116, 118 (2009) ("Control of, and responsibility for, the business and affairs of the corporation is vested in the board of directors, rather than in the company's shareholders"; and shareholders have "key but limited rights," including "significant information rights").

that stage, making the motion to dismiss a meaningful and generally fair tool for promoting efficiency in shareholder litigation.

1. Mechanisms of Pleading Stage Access to Information

Although stockholders' information rights are limited, they are not a null set: by statute, stockholders have basic rights to inspect corporate books and records.⁴⁶ Where the Delaware courts have found shareholder complaints lacking in detailed factual content, they have repeatedly admonished the plaintiffs to use the "tools at hand"—principally statutory inspection rights—to elicit information sufficient to determine the merits of a claim.⁴⁷ A virtue of this system is that it is tailored to avoid the enormous costs of the broad discovery available in litigation under generally applicable rules of procedure: unlike discovery under Rule 26,⁴⁸ inspection requests must be "circumscribed with rifled precision,"⁴⁹ and stockholders are entitled to inspect only those corporate records that are "essential and sufficient" or "necessary and essential" to the stockholder's purpose for inspection.⁵⁰ De-

46. *E.g.*, DEL. CODE ANN. tit. 8, § 220 (2010) (permitting stockholder inspection of corporate books and records for a "proper purpose").

47. *Ash v. McCall*, No. Civ. A. 17132, 2000 Del. Ch. LEXIS 144, at n.56 (Del. Ch. Sept. 15, 2000) ("As the Delaware Supreme Court has repeatedly exhorted, shareholder plaintiffs should use the 'tools at hand,' most prominently § 220 books and records actions, to obtain information necessary to sue derivatively."); *Brehm v. Eisner*, 746 A.2d 244, 262 n.57 (Del. 2000) ("Plaintiffs have the opportunity to use the 'tools at hand' to learn facts relating to [a corporate compensation expert's] report and the Board's consideration through an interview with [the expert] or by seeking appropriate and precisely identified corporate records in a Section 220 proceeding.").

48. Like its counterpart in the Federal Rules of Civil Procedure, Chancery Court Rule 26(b)(1) provides that "[p]arties may obtain discovery regarding any matter, not privileged, which is relevant to the subject matter involved in the pending action," and that information may be sought if it "appears reasonably calculated to lead to the discovery of admissible evidence." DEL. CH. CT. R. 26(b)(1).

49. *Sec. First Corp. v. U.S. Die Casting & Dev. Co.*, 687 A.2d 563, 570 (Del. 1997).

50. *Kaufman v. CA, Inc.*, 905 A.2d 749, 753 (Del. Ch. 2006) ("relief under Section 220 is limited only to the inspection of books and records that are necessary and essential to the satisfaction of the stated purpose"); *Helmsman Mgmt. Servs., Inc. v. A&S Consultants, Inc.*, 525 A.2d 160, 167 (Del. Ch. 1987) (permitting inspection only of "records that are 'essential and sufficient' to the shareholder's purpose").

spite these scope limitations, the statutory inspection right has enabled stockholder plaintiffs to gain access to facts sufficient to support pleadings that can overcome a motion to dismiss.⁵¹

Although the statutory inspection right is an important tool for enabling the motion to dismiss to serve as a useful predictor of ultimate outcomes after trial,⁵² there are two important limitations on its utility for this purpose. First, it may require the outlay of substantial resources by both stockholders and corporations. Even though exercise of the right does not necessarily result in judicial proceedings,⁵³ disputes frequently arise that require the expense of court proceedings to resolve issues like the propriety of the stockholder's purpose for inspection, whether the scope of the requested inspection is appropriate, and what limits on use of the information (confidentiality, for example) are appropriate.⁵⁴ The second and related limitation is the time required for exercising the statutory inspection right. Again, in theory the right can be expeditiously utilized: the statute requires the corporation to respond to an inspection demand in a week, and the courts treat proceedings to enforce

51. The Disney litigation is a notable example of this: in that case, after a stockholder's initial complaint was dismissed, use of the statutory inspection right unearthed additional information sufficient to permit the filing of an amended complaint that overcame a motion to dismiss. *In re Walt Disney Co. Derivative Litig.*, 825 A.2d 275, 279 (Del. Ch. 2003) ("After the Supreme Court's remand regarding plaintiffs' first amended complaint, plaintiffs used the 'tools at hand,' a request for books and records as authorized under DEL. CODE ANN. tit. 8, § 220 (2010), to obtain information about the nature of the Disney Board's involvement in the decision to hire and, eventually, to terminate Ovitz. Using the information gained from that request, plaintiffs drafted and filed the new complaint.") The plaintiff shareholders' new complaint survived a motion to dismiss.

52. The Delaware Court of Chancery has recently imposed a condition on a stockholder's inspection rights that explicitly aims to enhance the efficacy of the motion to dismiss. *See Amalgamated Bank v. Yahoo! Inc.*, 132 A.3d 752, 796–97 (Del. Ch. 2016). In that case, the court required that in any subsequent derivative suit arising out of the matter as to which inspection was sought, all documents produced for inspection would be deemed to be incorporated by reference into the derivative complaint and, thus, appropriate for consideration on a motion to dismiss. *Id.* at 797 (stating that the incorporation condition "protects the legitimate interests of both Yahoo and the judiciary by ensuring that any complaint that Amalgamated files will not be based on cherry-picked documents"; it also "permits a court to review the actual document to ensure that the plaintiff has not misrepresented its contents and that any inference the plaintiff seeks to have drawn is a reasonable one").

53. The governing statute requires only that the stockholder make and deliver to the corporation a written demand under oath stating a proper purpose for inspection, and the corporation is required to provide the appropriate records within five business days. DEL. CODE ANN. tit. 8, §§ 220(b)–(c) (2010).

54. *E.g.*, *CM & M Grp., Inc. v. Carroll*, 453 A.2d 788, 792 (Del. 1982) ("The Court of Chancery is to determine the propriety of the purpose from the facts in each case."); *Thomas & Betts Corp. v. Leviton Mfg. Co.*, 681 A.2d 1026, 1035 (Del. 1996) (noting "the trial court has wide latitude in determining the proper scope of inspection"); *United Techs. Corp. v. Treppel*, 109 A.3d 553, 558 (Del. 2014) ("[T]he ability to limit the use of information gathered from an inspection—not just the scope of the inspection itself—has long been recognized as within the Court of Chancery's discretion."); *Sahagen Satellite Tech. Grp. v. Ellipso, Inc.*, 791 A.2d 794, 796, 799 (Del. Ch. 2000) (Plaintiff's right of inspection under § 220 depended on the propriety of his stated purpose, which the court found was proper. But plaintiff failed to meet its burden of proving, by a preponderance of the evidence, a credible basis for the wide-ranging request. The court therefore ordered a limited inspection.); *Jefferson v. Dominion Holdings, Inc.*, C.A. No. 8663-VCN, 2014 Del. Ch. LEXIS 184, *3 (Del. Ch. Sept. 24, 2014) ("Confidentiality agreements provide a rational, reasonable, and enforceable methodology for dealing with corporate books and records that otherwise would not be subject to public review.").

inspection rights as summary in nature, justifying expedited procedures.⁵⁵ As a practical matter, however, contested demands for inspection often require a fair amount of time to resolve,⁵⁶ and this limits their utility in shareholder litigation in two notable ways: first, there is often pressure on stockholder plaintiff lawyers to forgo use of statutory inspection rights when even a relatively short delay will give a first-filing advantage to a less diligent plaintiff's lawyer;⁵⁷ second, where preliminary injunctive relief is sought (most typically in deal litigation), even relatively expeditious litigation to enforce statutory inspection rights will not generate information in a timely way.

These limitations on the utility of the statutory inspection right are greatly mitigated, at least for public companies, by the disclosure regime under the federal securities laws. Unlike the state inspection right, those laws generate information for stockholders (and others) at no direct incremental cost, and with no need to request or demand the information. The informational requirements of the federal disclosure system, moreover, address actions and transactions that are the most likely targets of representative shareholder litigation. Among other things, they expressly require ongoing disclosure of related party transactions,⁵⁸ as to which judicial scrutiny is most likely to be enhanced, and extensive disclosures concerning merger proposals, through current reports on Form 8-K, proxy statements and public responses to tender offers. Thus, even without a state law right of inspection, stockholders have considerable informational resources with respect to publicly held companies and the most likely targets of shareholder litigation.⁵⁹

In deal cases there is often an additional potential source of information from which a class action complaint can be enriched with factual specificity: in cash acquisitions, the

55. DEL. CODE ANN. tit. 8, § 220(c) (2010) ("The Court may summarily order the corporation to permit the stockholder to inspect the corporation's . . . books and records."); *Quantum Tech. Partners IV v. Ploom, Inc.*, C.A. No. 9054-ML, 2014 Del. Ch. LEXIS 78, at *24 (Del. Ch. May 14, 2014) (stating that after refusal by the corporation to permit the requested inspection, "the stockholder may petition this Court in a summary proceeding to compel such inspection"); *Loppert v. Windsortech, Inc.*, 865 A.2d 1282, 1290 (Del. Ch. 2004) ("[T]he 220 Action was proceeding at an expeditious pace because actions under 8 Del. C. § 220 are summary in nature."); *Troy Corp. v. Schoon*, 959 A.2d 1130, 1136 (Del. Ch. 2008) (discussing the "summary nature of 220 actions"); *Scattered Corp. v. Chi. Stock Exch.*, 671 A.2d 874, 879 (Del. Ch. 1994) ("[S]tockholders of stock corporations are entitled to enforce their inspection rights under the streamlined, summary procedures afforded by § 220.").

56. See, e.g., *Wal-Mart Stores, Inc. v. Indiana Elec. Workers Pension Tr. Fund IBEW*, 95 A.3d 1264, 1268–70 (Del. 2014) (demand made June 6, 2012; suit filed August 13, 2012; depositions in fall 2012; final hearing on May 20, 2013; appeal decided July 23, 2014).

57. See *Strine, Jr. et al.*, *supra* note 31, at 18 ("Plaintiffs' counsel who opts for investigation and deliberation may find herself the 'loser' under rules of jurisdictional priority that favor the first-filed lawsuit.").

58. See 17 C.F.R. § 229.404 (Item 404)(a) (2008) (requiring narrative disclosure of "material" related party transactions); 17 C.F.R. § 229.407 (Item 407)(a)(3) (2012) (requiring disclosure of all related party transactions, material or not, with its "independent" directors to ensure those transactions do not impair the directors' exercise of independent judgment); 17 C.F.R. § 229.402 (Item 402) (2015) (requiring disclosure of executive compensation).

59. In contrast, shareholder suits alleging lack of care or failure of oversight are likely to involve sources of relevant information that are not readily available to the public (for example, board meeting minutes or other documents reflecting internal deliberations). That lack of readily available information makes pursuit of such claims more difficult, and makes the system of pleading stage triage studied in this Article more likely to result in occasional dismissals of suits that might prove to have merit if full discovery were permitted. No system can achieve perfect results in all cases, however, and some agency costs are irreducible. Michael C. Jensen & William

appraisal remedy is typically available, and a petition seeking appraisal need not lay out a claim of director or controlling stockholder misconduct in order to permit discovery to proceed. To be sure, discovery through appraisal proceedings, as with the statutory inspection right, requires a significant investment of time and effort, and its informational yield is likely to come too late to facilitate formulation of a complaint in an expedited matter in which a preliminary injunction is sought. It is undoubtedly useful, however, at least occasionally, as a source of information for complaints seeking monetary damages after a deal has closed.⁶⁰ Indeed, there have been significant class action deal cases that have followed and been facilitated by previously commenced appraisal litigation.⁶¹

2. Requiring Particularized Pleading

As previously noted, litigation in the Delaware Court of Chancery is generally guided by the liberal “notice pleading” rules that are designed to avoid, rather than generate, a factually detailed evaluation of the strength of a case based solely on the formal pleadings.⁶² Where a “short and plain statement of the claim” suffices to proceed to discovery and trial—and a complaint may not be dismissed unless there is no “reasonably conceivable”⁶³ cause of action appearing from that “short and plain statement”—the resulting concern is that shareholder plaintiffs’ lawyers will exploit those burdens to extract settlements unrelated to the merits of the case, to the ultimate detriment of the shareholders whose interests are purportedly advanced by shareholder litigation. A plausible response to that

H. Meckling, *The Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 343 (1976). But claims of lack of care or failure of oversight are rarely successful, even with the benefit of full access to relevant information. *See, e.g., Brehm v. Eisner (In re Walt Disney Co. Derivative Litig.)*, 906 A.2d 27, 52 (Del. 2006) (applying the business judgment rule to validate executive compensation, after extensive discovery and a 37-day trial). Thus, a system that sought to rectify informational asymmetry in regard to claims of director negligence or oversight failure could impose greater costs than the rare benefits it might achieve.

60. *See Virtus Capital L.P. v. Eastman Chem. Co.*, C.A. No. 9808-VCL, 2015 Del. Ch. LEXIS 34, *29 (Del. Ch. Feb. 11, 2015) (noting that plaintiff’s complaint alleging breach of fiduciary duty was based on information derived from discovery in a previously filed statutory appraisal proceeding). The court pointedly noted that, while dismissal was sought based on claimed lack of personal jurisdiction, “[n]one of the defendants have moved to dismiss the complaint for failing to state a claim on which relief could be granted.” *Id.* at *2–3.

61. *E.g., Cinerama, Inc. v. Technicolor, Inc.*, C.A. No. 8358, 1991 Del. Ch. LEXIS 105, *2 (Del. Ch. June 21, 1991), *rev’d on other grounds*, 634 A.2d 345 (Del. 1993) (“During the course of the pretrial phase of that appraisal proceeding, plaintiff developed testimony apparently leading it to the belief that misconduct had occurred in the sale of the company.”).

62. *Supra* Part I.B.

63. By reversing a dismissal that adopted the developing federal requirement that the complaint demonstrate a “plausible” cause of action, the Delaware Supreme Court has appeared to adopt a more permissive approach to pleading. *Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Holdings LLC*, 27 A.3d 531, 537 (Del. 2011) (rejecting the “plausibility” standard articulated in *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 556 (2007), finding it “higher” than the “reasonable conceivability” standard adopted by the Delaware Supreme Court). We suggest, however, that *Central Mortgage*’s articulation of a distinction from the *Twombly* standard has little if any substance, given the adoption of the requirement that a cause of action be “reasonably” conceivable—not “outlandishly” or “speculatively” conceivable—from the specific factual allegations of the complaint.

concern could be a greater insistence that, as a prerequisite to going forward with discovery, complaints demonstrate a more detailed factual basis for the claims they assert.⁶⁴

And indeed, that is precisely the procedural approach that the Delaware courts have adopted. We detail more fully below how this approach has developed, in both derivative suits and deal cases.⁶⁵ In general, however, what we find are judicially developed requirements for pleading specific facts that would rebut the substantive deference to director conduct afforded by the business judgment rule.⁶⁶ In representative shareholder litigation, particularized pleading is now the rule, notwithstanding the generally applicable “notice pleading” approach of the rules of civil procedure. As a result, shareholder plaintiffs’ counsel are encouraged to provide in the complaint itself as extensive as possible a recitation of facts supporting their claims, a recitation that better enables the court to assess, on a motion to dismiss, the likely outcome if the case were ultimately tried.

3. Considering Facts Not Specifically Pleading in the Complaint

Encouraging factual specificity and particularity in formulating complaints has a significant collateral effect in Delaware shareholder litigation practice: allegations in the complaint that refer to or even just recite information contained in other documents may permit the defendants to supplement the factual basis for resolving the motion to dismiss by bringing other facts referred to in those other documents to the court’s attention. Indeed, knowing that shareholder plaintiffs frequently rely in their complaints on documents, like a merger proxy statement or a special litigation committee report, to supply the requisite factual specificity about the challenged action or transaction, it may be prudent for transactional advisers to draft those documents with a view to presenting, rather than withholding for later disclosure, detailed facts about the corporate decision makers and the background of the transaction or decision. Using that approach, likely targets of shareholder litigation may be able to shape the “record” on the motion to dismiss in a way that enables the court to determine whether a majority of the board of directors is disinterested and independent, or to be able to access the full terms of a transaction, rather than a partial description of it in a complaint.

Two Delaware cases described below⁶⁷ illustrate this approach to the motion to dismiss. But before examining those cases, it will be helpful to describe the foundation and evolution of the Delaware case law prescribing when facts not expressly pleaded in the complaint can be considered on a motion to dismiss. The “purist” approach to this subject begins with Court of Chancery Rule 12(b), which (in subsection (6)) provides for dismissal for failure to state a claim upon which relief can be granted, but importantly qualifies that provision by specifying that if “matters outside the pleading” are presented in support of

64. Stancil, *supra* note 16, at 147 (where defendants disproportionately bear the costs of discovery, “it would be economically preferable if the default rule required the plaintiff to allege facts tending to support each element of her claim”).

65. *Infra* Part III.B.

66. *Id.*

67. Stone v. Ritter, 911 A.2d 362 (Del. 2006); *In re* Morton’s Rest. Grp., Inc. S’holders Litig., 74 A.3d 656 (Del. Ch. 2013).

the motion to dismiss, the motion is to be treated as one for summary judgment.⁶⁸ The consequence of that treatment can be quite significant: under Court of Chancery Rule 56(f), a plaintiff can argue that discovery is necessary in order to respond adequately to the factual matters presented by the defendants “outside the pleading.”⁶⁹

Obviously, the efficiency promoting function of the motion to dismiss could be largely eliminated if (1) every fact referred to by a defendant on a motion to dismiss converted the motion into one for summary judgment and (2) full discovery on the merits, and its attendant costs, were to ensue as a result. Nevertheless, the Delaware Supreme Court at one time expressed a fairly stringent view that indeed, every reference by a defendant on a motion to dismiss to any fact not specifically alleged in the complaint does convert the motion to one for summary judgment. In *Malpiede v. Townson*,⁷⁰ discussed in more detail below, the court in 2001 addressed a motion to dismiss that relied in part on an exculpatory charter provision pursuant to section 102(b)(7) of the Delaware General Corporation Law.⁷¹ Perhaps eager to avoid inviting discovery by openly presenting that provision formally through an affidavit, the defendants simply referred to it in their brief on the motion to dismiss, even though the complaint itself, not surprisingly, made no reference to it.

The Delaware Supreme Court recognized the gambit and applied Rule 12(b) literally: it insisted that the presentation of the provision converted the motion into a motion for summary judgment, “by clear force of the pleading rules.”⁷² The court qualified that insistence, however, in two important ways: first, it suggested that the charter provision might have been taken into consideration on the motion to dismiss, without creating an opening for discovery, if the defendants had requested that the trial court take judicial notice of the

68. DEL. CH. CT. R. 12. Rule 12(b) provides in relevant part:

If, on a motion asserting the defense numbered (6) to dismiss for failure of the pleading to state a claim upon which relief can be granted, matters outside the pleading are presented to and not excluded by the Court, the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall be given reasonable opportunity to present all material made pertinent to such a motion by Rule 56.

69. DEL. CH. CT. R. 56. Rule 56(f) provides in relevant part:

Should it appear from the affidavits of a party opposing the motion that the party cannot for reasons stated present by affidavit facts essential to justify the party's opposition, the Court may refuse the application for judgment or may order a continuance to permit affidavits to be obtained or depositions to be taken or discovery to be had or may make such other order as is just.

70. See generally *Malpiede v. Townson*, 780 A.2d 1075 (Del. 2001) (applying an exculpatory charter provision); see also *In re Santa Fe Pac. Corp. S'holder Litig.*, 669 A.2d 59, 68–70 (Del. 1995) (ruling that even though the trial court may consider a proxy statement to determine, in evaluating nondisclosure claims, what the document actually stated, “[t]he Court of Chancery should not have considered the assertions in the [proxy statement] in support of defendants' motion to dismiss the *Revlon* and *Unocal* claims,” because “[i]f the [proxy statement] were relied upon for the truth of the matters contained therein, it would be hearsay with respect to claims other than the disclosure claims”).

71. DEL. CODE ANN. tit. 8, § 102(b)(7) (2015) (permitting a provision in the certificate of incorporation that limits or eliminates monetary liability of directors for breach of duty, with limited exceptions including breach of the duty of loyalty or conduct not in good faith).

72. *Malpiede*, 780 A.2d at 1092.

provision, which was embodied in a public record.⁷³ More importantly, the court recognized that just because the defendants proffer a fact outside the complaint, “it does not follow that the ‘floodgates of discovery’ have to be opened. The Rule 56 opportunity to present affidavits or engage in discovery is not absolute.”⁷⁴ Noting that the plaintiffs did not contest the authenticity or validity of the charter provision, the court concluded that “the plaintiffs were not deprived of any important procedural right arising from the fact that the trial court considered [the] 102(b)(7) charter exculpation provision in connection with the Rule 12(b)(6) motion to dismiss.”⁷⁵

In the fifteen years since *Malpiede* was decided, the Delaware courts have developed a number of approaches, in addition to judicial notice, enabling them to consider unpleaded facts in deciding motions to dismiss for failure to state a claim, without “opening the floodgates of discovery.”⁷⁶ For example, if a complaint attaches a document, the court may consider the assertions in that document in resolving a motion to dismiss.⁷⁷ And even if a document is not attached as an exhibit to the complaint, the court may consider it on a motion to dismiss if the complaint refers to it and substantially includes facts drawn from the document.⁷⁸

The Delaware Supreme Court’s 2006 opinion in *Stone v. Ritter*, far better known for its affirmation of *Caremark* standards for assessing the directors’ oversight responsibilities, nicely illustrates how the Delaware courts have come to handle use of extrinsic material on motions to dismiss. The core claim in that case was that the directors had acted in bad faith by failing to take steps to implement a Bank Secrecy Act (BSA) compliance and reporting system. In their complaint, the plaintiffs “explicitly incorporated by reference into their

73. *Id.* at 1090 (noting that the provision “could easily be found in the public files in the Secretary of State’s office and could properly be noticed judicially by the court”).

74. *Id.* at 1091.

75. *Id.* at 1092.

76. This inventory of approaches is drawn from *In re Morton’s Restaurant Group, Inc. Shareholder Litigation*, 74 A.3d 656, 658 nn.3–4 (Del. Ch. 2013), discussed more fully below, which helpfully collects the Delaware cases employing them.

77. *DeLuca v. AccessIT Grp., Inc.*, 695 F. Supp. 2d 54, 59 (S.D.N.Y. 2010) (“Pleadings include not just the four corners of the complaint, but also ‘any written instrument attached to it as an exhibit or any statements or documents incorporated in it by reference.’”) (quoting *Chambers v. Time Warner, Inc.*, 282 F.3d 147, 152 (2d Cir. 2002)).

78. *Freedman v. Adams*, C.A. No. 4199-VCN, 2012 Del. Ch. LEXIS 74, at *16 (Del. Ch. Mar. 30, 2012) (“When a plaintiff expressly refers to and heavily relies upon documents in her complaint, these documents are considered to be incorporated by reference into the complaint[.]”); *In re Tyson Foods, Inc. Consol. S’holder Litig.*, 2007 Del. Ch. LEXIS 120, *5–6 (Del. Ch. Aug. 15, 2007) (“A plaintiff may not base a claim upon a contract or similar document, describe that contract in its complaint, but prevent a court from reviewing the plain terms of that agreement by omitting the document from the complaint itself. Such a rule would promote the crafting of misleading complaints containing strategic omissions.”); *e4e, Inc. v. Sircar*, C.A. No. 1106-CC, 2003 Del. Ch. LEXIS 119, at *9 (Del. Ch. Oct. 9, 2003) (concluding that the court could consider a letter not attached to the complaint because “the wrongful conduct alleged to have been engaged in by [the defendant] was taken directly from the . . . letter”); *White v. Panic*, 783 A.2d 543, 547 n.5 (Del. 2001) (approving use of facts recited in a newspaper article where “the plaintiff affirmatively placed the facts in the article before the Court of Chancery by attaching the full text of the article to his answering brief opposing the defendants’ motion to dismiss. By doing so without any express limitation on the court’s use of the document, the plaintiff acquiesced in the court’s consideration of the entire article in deciding the motion to dismiss”).

derivative complaint”⁷⁹ a report prepared for the company by KPMG assessing the company’s BSA compliance. Plaintiffs also included in the appendix to their brief on the motion to dismiss a board-adopted policy on BSA compliance, which the plaintiffs had obtained in response to a demand for inspection under DGCL Section 220.⁸⁰ In that circumstance, the court found it appropriate to examine and rely on the entirety of the KPMG report and the BSA policy, concluding that those documents “reflect[] that the directors not only discharged their oversight responsibility to establish an information and reporting system, but also proved that the system was designed to permit the directors to periodically monitor [the company’s] compliance with the BSA and [anti-money laundering] regulations.”⁸¹

Perhaps the high water mark for use of facts not directly pleaded in the complaint was the Court of Chancery’s 2013 opinion in *Morton’s Restaurant Group, Inc.*⁸² In that case, perhaps the least controversial step was the court’s reliance on management’s tender offer recommendation statement, from which the complaint drew “pervasive references.”⁸³ More remarkably, the court also indicated that it could consider the content of depositions taken in the matter, because they “must be considered as fully incorporated into the Complaint given the plaintiffs’ extensive use of them.”⁸⁴

Obviously, the more extensive the courts’ willingness to consider a record of facts outside the complaint in resolving a motion to dismiss, the more the motion to dismiss begins to serve the same function as a motion for summary judgment: namely, as a substitute for a trial, where dispositive facts are not reasonably in dispute.⁸⁵ In fact, the Delaware Court of Chancery’s increasingly muscular reliance on extrinsic facts in resolving motions to dismiss demonstrates that the motion to dismiss is being increasingly relied upon as an efficiency-promoting substitute for a trial, in which, despite the absence or paucity of formal discovery, the court is able to rely on a reasonably substantial factual record, at least where (1) there is no indication or assertion by the plaintiff that information presented from outside the four corners of the complaint is disputable in a relevant way; and (2) substantial

79. *Stone v. Ritter*, 911 A.2d 362, 372 (Del. 2006).

80. *Id.*

81. *Id.* at 371–72.

82. *In re Morton’s Rest. Grp., Inc. S’holders Litig.*, 74 A.3d 656 (Del. Ch. 2013).

83. *Id.* at 659.

84. *Id.* at 658. The court explained as follows its willingness to rely on the depositions:
Here, the plaintiffs have relied on the four depositions, which they took in conjunction with these proceedings, to construct their Complaint, citing them 28 times. Those substantial references, which include selective quotations, incorporated the depositions by reference. Where, as here, there is no concern that the plaintiffs would not have notice that the defendants would want to put those selective quotations in context, the exceptions to the general rule that extraneous evidence should not be considered have particular force.

Id. at 658 n.3. The court ultimately concluded, however, that it was unnecessary to rely on the depositions.

85. *Crawford-El v. Britton*, 523 U.S. 574, 600 (1998) (“[S]ummary judgment serves as the ultimate screen to weed out truly insubstantial lawsuits prior to trial.”).

relevant information is available through publicly available sources, stockholder inspection rights, or voluntary production by the corporation.⁸⁶

B. Measures to Improve the Predictive Value of Pleading Stage Evaluation

In the previous Part we examined aspects of Delaware's procedural system that are designed to promote an evaluation of pleadings in representative shareholder litigation that is more fully factually informed than one would normally encounter under generally applicable rules of civil litigation. In this Part we examine other aspects of Delaware's procedural system that facilitate the exploitation of that richer factual base at the pleading stage. These aspects share the common purpose of improving the reliability of the decision on the motion to dismiss as a predictor of the outcome at trial. The more reliable and transparent the prediction, the greater the likelihood of a voluntary settlement and the avoidance of additional litigation costs.

1. Judicial Assignment

Cases in the Delaware Court of Chancery are assigned to the same chancellor for their duration: litigants know that the same judge who decides the motion to dismiss will (barring retirement) preside over any trial to be held in the case.⁸⁷ Thus, an opinion rendered on the motion to dismiss will reflect the assessment and likely attitude of the judge who will render the decision after trial (there being no jury in proceedings in the Court of Chancery). This practice eliminates most of the uncertainty arising where denial of a motion to dismiss is followed by proceedings in which a different decision-maker (a different judge, or a jury), whose likely assessment of the case is then largely unknown, takes control of the decision-making process.⁸⁸ This practice also eliminates any incentive on the part of the pleading stage judge to disfavor dismissal in the hopes of avoiding reversal while being able to reduce workload by passing off the case to a judicial colleague.

86. And as noted in note 78, *supra*, the Delaware Court of Chancery has now gone so far as to require, as a condition to granting inspection of corporate records under the stockholder inspection statute, that the documents produced be deemed incorporated by reference into any subsequent complaint by the stockholder relating to the matter as to which inspection was sought. *Amalgamated Bank v. Yahoo! Inc.*, 132 A.3d 752, 798 (Del. Ch. 2016) (the incorporation condition will "ensure that the plaintiff cannot seize on a document, take it out of context, and insist on an unreasonable inference that the court could not draw if it considered related documents. It will allow the court to address complaints that should not advance past the pleading stage, but it will not prevent a plaintiff from stating a well-pled claim").

87. DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, *CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY* § 1.05 ("Cases brought in the Court of Chancery are assigned to a specific Chancellor or Vice Chancellor from the outset.").

88. See *Report of the South Carolina Bar's Task Force on Courts re: The Creation of a Business Court Pilot Program*, ABA 2 (Aug. 1, 2007), <http://apps.americanbar.org/buslaw/committees/CL150011pub/materials/reports/SouthCarolinaBusinessCourtReport2007.pdf> ("The current case-assignment system for civil matters in South Carolina does not lend itself to the prompt and efficient resolution of traditional business disputes. For example, Circuit Court judges who are assigned to a case at the beginning of the matter are not required to stay with that case until its final resolution. In a business dispute, the reassignment of a new judge in the middle of a lawsuit requires the parties to expend additional resources re-educating a new judge on what is often complex subject matter.").

2. Disposition of Motions to Dismiss

In addition to the predictive value added by assigning a case to a single judge, the Delaware system provides several other mechanisms that promote the predictive value of the disposition of motions to dismiss. First, motions to dismiss are almost always decided on the basis of extensive, reasoned written opinions.⁸⁹ The importance of this practice can hardly be overstated. An explanation of the reasons for a dismissal is a signal to plaintiffs' lawyers and transactional advisers about what sort of suits to bring and not bring in the future, and how transactions should be structured to minimize the risk of litigation.⁹⁰ In addition, a reasoned written opinion denying a motion to dismiss alerts the parties to the court's analysis of the case in a way that, much more than a terse grant or denial of the motion, illuminates the likely ultimate outcome of the case and better enables the parties to settle the case without having to expend the extensive resources necessary to try the case. The Delaware Court of Chancery is by no means the only trial court in the nation to render substantial written opinions on motions to dismiss, but not all courts follow this practice,⁹¹ and the regularity and extent of the Delaware courts' commitment to the practice is a substantial element of its system for dealing with and maximizing the value of motions to dismiss.

Delaware's experience with dismissal practice has also resulted in the development of a significant body of rules that clarify and improve the operation of that practice. For example, the Court of Chancery in 2001 adopted a unique rule⁹² that strongly encourages plaintiffs' counsel to withdraw or amend a complaint if the defendants' opening brief in support of a motion to dismiss appears persuasive. Specifically, the rule provides that if a plaintiff continues to resist a motion to dismiss and fails to amend its complaint promptly after reviewing the defendants' opening brief, and the motion is subsequently granted, the dismissal is with prejudice, and, absent good cause, prevents further attempts to amend the complaint. A plaintiff is thus encouraged to put the "best foot forward" in resisting the

89. STATE OF DELAWARE, LITIGATION IN THE DELAWARE COURT OF CHANCERY AND THE DELAWARE SUPREME COURT, <http://corplaw.delaware.gov/eng/litigation.shtml> (last visited Mar. 29, 2017) ("[A]ll cases are decided by the Chancellor or a Vice Chancellor, who explain their decisions in comprehensive and reasoned written opinions. The Court of Chancery's tradition of written opinions stretches back more than a hundred years.").

90. *Id.* ("The quantity and quality of the Court of Chancery's opinions confer a substantive advantage on Delaware business entities by providing them with a thorough and predictable body of interpretive case law. Managers and lawyers of Delaware business entities can use this extensive case law to guide in planning their business and affairs.").

91. See, e.g., Andrew R. Jones, Note, *Toward A Stronger Economic Future For North Carolina: Precedent And The Opinions Of The North Carolina Business Court*, 6 ELON L. REV. 189, 193–94 (2014) ("[In North Carolina,] [n]on-Business Court trial courts enter short orders upon the disposition of matters before them, typically drafted by one of the attorneys appearing before the court, exchanged with opposing counsel, and submitted for the presiding judge to sign. In civil bench trials, and in other select circumstances, these orders must contain findings of fact and conclusions of law. Detailed findings of fact and conclusions of law are generally not required in other trial court orders.").

92. DEL. CH. CT. R. 15(aaa).

motion to dismiss, providing some assurance that the complaint will take maximum advantage of available facts before the motion to dismiss is decided.⁹³

C. Cost-Avoidance Measures

Despite these procedural rules and doctrines, the motion to dismiss would fail to perform its efficiency promoting function if the full costs and burdens of litigation were not substantially avoided while the motion is pending. Accordingly, a system that relies effectively on the motion to dismiss as a triage tool must include a strong preference to stay discovery pending the outcome of motions to dismiss. And indeed, that strong preference is clearly manifested by the Delaware Court of Chancery. In representative shareholder litigation in that court, a stay of discovery pending disposition of a motion to dismiss, while not quite automatic, is at the very least routine.

In fact, the Delaware courts have explicitly identified efficiency as a function of the motion to dismiss, and that a stay of discovery is necessary to achieve that efficiency: “efficiency is promoted by the rule that, absent special circumstances, discovery will be stayed pending determination of a motion to dismiss where the ground for the motion offers a reasonable expectation that if the motion is granted litigation in this or another forum will be avoided.”⁹⁴ Consistent with this view, the Delaware cases indicate that “[o]rdinarily, where a motion to dismiss is made a Court will direct that discovery be held in abeyance in the absence of a showing of a need that the discovery continue because it is always desirable to avoid the cost and inconvenience of unnecessary discovery.”⁹⁵ Of course, there is no rule in the Delaware courts that the filing of a case-dispositive motion automatically requires that discovery be stayed; conversely, the concept of staying all discovery pending resolution of a motion to dismiss (under Rule 23.1 in derivative suits, or Rule 12(b)(6) in other litigation) is not unique to Delaware.⁹⁶ But the Delaware courts’ seemingly ready acceptance of such requests to stay discovery is an important predicate for the use of the motion to dismiss as an efficiency-promoting procedure.

III. PLEADING-STAGE EVALUATION OF REPRESENTATIVE SHAREHOLDER LITIGATION

93. *Zucker v. Andreessen*, No. Civ. A. 6014-VCP, 2012 WL 2366448, at *2 (Del. Ch. June 21, 2012) (granting motion to dismiss derivative action, and invoking Rule 15(aaa), rejecting plaintiff’s reliance on a special committee report that could have been, but was not, included in the pleadings via an amended complaint).

94. *Wallace v. Durwood*, C.A. No. 12855, C.A. No. 12939, 1993 Del. Ch. LEXIS 239, at *9 (Del. Ch. Nov. 1, 1993), *quoting In re McCrory Parent Corp.*, C.A. No. 12006, 1991 Del. Ch. LEXIS 112, at *2 (Del. Ch. July 3, 1991).

95. *Weinberger v. Amstar Corp.*, C.A. No. 7322, 1984 Del. Ch. LEXIS 445, at *2 (Del. Ch. Jan. 16, 1984).

96. *See, e.g., Mann v. Brenner*, 375 F. App’x. 232, 239 (3d Cir. 2010) (“In certain circumstances it may be appropriate to stay discovery while evaluating a motion to dismiss where, if the motion is granted, discovery would be futile.”); *see generally* Kevin J. Lynch, *When Staying Discovery Stays Justice: Analyzing Motions to Stay Discovery When a Motion to Dismiss is Pending*, 47 WAKE FOREST L. REV. 71 (2012) (reviewing approaches for determining when to grant a stay of discovery pending disposition of a motion to dismiss).

The foregoing complex and highly evolved procedural framework for pleading-stage triage is only half the story, however: that framework is merely the vehicle by which substantive standards of review are applied. To fully appreciate the operation of the Delaware triage system, it is necessary to examine the evolution of the courts' willingness to engage in substantive review of the merits of the case at the pleading stage, and before significant discovery occurs. We trace below how that willingness emerged, first and most clearly in derivative litigation, and then in deal cases challenging transactions ranging from the most clearly legally defensible to transactions to which the most stringent form of judicial scrutiny ("entire fairness") would initially apply.

A. Aronson: Building the Triage System for Derivative Litigation

We begin our treatment of pleading-stage evaluation of representative shareholder litigation with an appreciative assessment of *Aronson v. Lewis*,⁹⁷ the Delaware Supreme Court's important 1984 decision that established the foundation for the modern system of triage in such litigation. In that case, the court addressed head on the fact that the governing rule of procedure (Chancery Court Rule 23.1)⁹⁸ and its requirement of pre-suit demand on the board of directors had evolved to become toothless: a derivative complaint could always effectively avoid that requirement by using one or more "shorthand shibboleths" that would demonstrate that such a demand would be futile, in that directors who engaged in or approved the challenged conduct could not be expected to cause the corporation to sue themselves over that conduct.⁹⁹

Practically *ex nihilo*, however, *Aronson* conjured a rule of dismissal that rendered pre-suit demand, and the literal text of Rule 23.1, essentially irrelevant: henceforth, whether a derivative suit would proceed would not depend on the outcome of some perfunctory pre-suit petitionary minuet between the stockholder plaintiff and the board of directors. Instead, such suits would proceed, or not, according to the court's own direct assessment of whether the allegations of the complaint indicate that the suit will be meritorious.¹⁰⁰ The governing rubric, more specifically, is whether there is reasonable doubt that the board of directors lacked a disinterested, independent majority, or otherwise would not be protected by the

97. See generally *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984); see also David A. Skeel Jr., *The Accidental Elegance of Aronson v. Lewis*, in *THE ICONIC CASES IN CORPORATE LAW* 167 (Jonathan R. Macey ed., 2008) ("Aronson v. Lewis is nested deep within the longstanding effort to devise a framework that sensibly mediates between the competing concerns of encouraging meritorious litigation and screening out strike suits.").

98. DEL. CH. CT. R. 23.1(a) ("The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort.").

99. *Aronson*, 473 A.2d at 816 (concluding that in the demand-futile context, a plaintiff charging domination and control of one or more directors must allege particularized facts and that the "shorthand shibboleth" of dominated and controlled directors is insufficient).

100. See M. Todd Henderson, *Justifying Jones*, 77 U. CHI. L. REV. 1027, 1048 (2010) ("[T]he Federal Rules of Civil Procedure do not obviously permit federal courts to weed out cases in the way that the Delaware Court of Chancery can. Delaware courts employ the demand requirement to give their expert judges a peek at the merits before discovery, and the Court of Chancery is known for dismissing cases quickly and at early stages of the litigation, as soon as it believes the merits can be evaluated.").

business judgment rule.¹⁰¹ The first prong of this standard reinforced that the litigation engine would engage if a derivative plaintiff could plead that the relevant decision maker could not be trusted to have made a disinterested decision with regard to the challenged conduct. On top of that standard litmus test, the court grafted a second, more open-ended test, inviting the trial court to find in the complaint any other set of circumstances that would deprive the directors' decision of the traditional deference of the business judgment rule. That test introduced an opportunity for considerable judicial discretion,¹⁰² which the Delaware courts have frequently employed to decline to dismiss derivative litigation.¹⁰³ With respect to stockholder derivative litigation, at least, *Aronson* gave the courts a doctrinal tool sufficient to rein in inefficient lawsuits and identify meritorious ones at the pleading stage.

B. Extending the Fact Pleading Approach to Other Cases

The use of a fact pleading approach to litigation triage did not end, however, within the boundaries of Rule 23.1 and derivative litigation. In various ways described in this Section, the Delaware courts have extended the fact pleading approach to a variety of settings in which the specific pleading particularity requirement of Rule 23.1 does not apply.

I. Trifoods

Former Chancellor Allen's 1996 decision in *Gagliardi v. Trifoods International, Inc.*¹⁰⁴ took the next step in extending the fact pleading approach by using it under the more generally applicable rule of civil procedure providing for dismissal, namely Rule 12(b)(6).¹⁰⁵ Plaintiff Eugene Gagliardi was the founder of Trifoods.¹⁰⁶ After he lost control of the board he was removed as board chair and his employment relationship was terminated, although he continued to own approximately 13% of the company's common stock.¹⁰⁷ The new management group implemented a restructuring of the company, which included buying assets, increasing spending on research, and moving the company's operations to a new state.¹⁰⁸ Ordinarily, one would applaud a board's efforts to rethink and rejuvenate corporate strategy. But the strategy failed, and Gagliardi alleged that these new

101. *In re Ebix, Inc. Stockholder Litig.*, C.A. No. 8526-UCN, 2014 WL 3696655, at *19 (Del. Ch. July 24, 2014) (stating that in derivative suits, a "court must determine under *Aronson* whether, under the particularized facts alleged, a reasonable doubt is created that: (1) the directors are disinterested and independent [or] (2) the challenged transaction was otherwise the product of a valid exercise of business judgment") (internal quotations omitted) (quoting *Aronson*, 473 A.2d at 814).

102. *Grimes v. Donald*, 673 A.2d 1207, 1217 n.15 (Del. Ch. 1996) ("Judging whether demand is excused 'is inescapably a question of judgment' The exercise of discretion by experienced and capable judges is a satisfactory screening mechanism, in our view.").

103. *Id.* at 1217 n.19 (collecting cases denying motions to dismiss under Rule 23.1).

104. *Gagliardi v. Trifoods Int'l, Inc.*, 683 A.2d 1049 (Del. Ch. 1996).

105. DEL. CH. CT. R. 12(b) ("[T]he following defenses may at the option of the pleader be made by motion: . . . (6) failure to state a claim upon which relief can be granted").

106. *Trifoods*, 683 A.2d at 1050.

107. *Id.*

108. *Id.* at 1051. These actions formed the basis of plaintiff's negligent mismanagement claim.

management initiatives caused an immediate, sharp deterioration in the business of the company.¹⁰⁹

At its most cogent, the complaint alleged specific instances of what it called mismanagement and waste of corporate assets. And on a broad view what might have been “reasonably conceivable”—to use the appropriate pleading standard—the plaintiff could ultimately have adduced facts in discovery sufficient to demonstrate at trial that no person of sound judgment could rationally have considered the challenged actions to have been appropriate in the interests of the corporation and its stockholders.¹¹⁰ Given that reasonable conceivability, one could have argued that dismissal of the lawsuit, before discovery, would have been inappropriate.

But in a move that has never been criticized as an inappropriate application of Rule 12(b)(6), Chancellor Allen dismissed most of the mismanagement claims asserted in the complaint on the grounds that there were no allegations that those responsible for the challenged business conduct suffered from any disabling conflict of interest or improper motivation.¹¹¹ He did so while expressing concern that director liability for mismanagement alone would unduly discourage optimal risk-taking.¹¹² Of course, he would have reached the same result even if he had allowed the case to go to trial, as long as he ultimately applied the business judgment rule to preclude liability.

What he did as a practical matter, though, was different: rather than simply avoiding a finding of director liability after trial, he took the business judgment rule and applied it to avoid proceeding with litigation at all. In effect, what was a rule of substantive law was put to use as a pleading rule as well: as the Chancellor put it, “to allege that a corporation has suffered a loss as a result of a lawful transaction, within the corporation’s powers, authorized by a corporate fiduciary acting in a good faith pursuit of corporate purposes, *does not state a claim for relief* against that fiduciary no matter how foolish the investment may appear in retrospect.”¹¹³

109. *Id.*

110. See *In re MFW S’holders Litig.*, 67 A.3d 496, 526 (Del. Ch. 2013) (stating that “the business judgment rule standard of review . . . precludes judicial second-guessing so long as the board’s decision ‘can be attributed to any rational business purpose’”) (citing *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971)).

111. *Trifoods*, 683 A.2d at 1053 (“Certainly these allegations state facts that, if true, constitute either mistakes, poor judgment, or reflect hard choices facing a cash-pressed company, but where is the allegation of conflicting interest or suspect motivation? . . . There are none. Nothing is alleged other than poor business practices. To permit the possibility of director liability on that basis would be very destructive of shareholder welfare in the long-term.”).

112. *Id.* at 1052–53 (“The law *protects shareholder investment interests* against the uneconomic consequences that the presence of such second-guessing risk would have on director action and shareholder wealth in a number of ways. It authorizes corporations to pay for director and officer liability insurance and authorizes corporate indemnification in a broad range of cases, for example. But the first protection against a threat of sub-optimal risk acceptance is the so-called business judgment rule. That ‘rule’ in effect provides that where a director is independent and disinterested, there can be no liability for corporate loss, unless the facts are such that no person could possibly authorize such a transaction if he or she were attempting in good faith to meet their duty.”) (citing *Saxe v. Brady*, 184 A.2d 602 (Del. Ch. 1962)) (emphasis in original).

113. *Trifoods*, 683 A.2d at 1052 (emphasis added).

The result was to eliminate the costs of going to trial by enhancing the “motion to dismiss” step in the litigation. Chancellor Allen quite clearly described the rationale for this approach, in a passage addressing an assertion that no reasonable business person would have engaged in the transaction complained of:

Under the general notice pleading rules this conclusory addition to allegations that otherwise clearly fall within the ambit of the business judgment rule might perhaps be regarded as sufficient to proceed to discovery But it is not clear that, where derivative claims are involved, good policy supports the same result. Asserting a derivative claim allows an attorney in the role of agent for shareholders to exert substantially magnified settlement pressure on a defendant. The risk/reward situation of the individual director defendants . . . , coupled with the ordinary workings of indemnification rights and insurance, means that very, very few derivative suits reach trial. Strike suits are a greater threat in this context than in civil litigation between two principals. Thus, in such cases the consequences of surviving a motion to dismiss are, as a practical matter, substantially more significant than in garden variety civil litigation.

It is rational and good policy for the law to filter such cases at an early stage more finely than the Rule 12(b)(6) test permits. This in effect can be done through the operation of Rule 23.1, which modifies the notice pleading standard by requiring plaintiff to plead with particularity either that plaintiff has sought to induce the board to bring the action and that the board has failed or refused to do so for no good reason *or* the reason plaintiff has not sought the board's action.¹¹⁴

Chancellor Allen thus made many of the points that we noted above (although he did it about twenty years earlier): he acknowledged the asymmetry of costs of benefits of representative shareholder litigation as between defendants, on one hand, and plaintiffs and their counsel on the other; he acknowledged that this asymmetry magnifies the pressure that representative shareholder plaintiffs and their counsel are able to bring to bear; he acknowledged that, as a result of such pressure, strike suits are a greater threat than in cases involving two opposing principals; he acknowledged that the motion to dismiss therefore takes on a special importance, as a “filter,” in the case of representative shareholder litigation; and, finally, he acknowledged that the pre-suit demand requirement of Rule 23.1 was particularly well suited to serve as such a “filter” (but relied on Rule 12(b)(6) anyhow).

The facts of the case made this major procedural change easy to accomplish. The plaintiff, as former board chair, had intimate knowledge of the corporation and its businesses. With the central facts known and undisputed at this stage in the proceeding, the court could easily conclude that the trial would accomplish nothing more than having the plaintiff allege in greater detail the foolishness of the new management's business strategy. Even if the plaintiff's claim could have been characterized as “conceivable,” it could not

114. *Id.* at 1054.

satisfy the more demanding, subsequently articulated standard of being “*reasonably* conceivable.”¹¹⁵ Critical, however, to achieving this procedural jump was that the essential facts were already before the court at the motion to dismiss stage and that the court was experienced in evaluating complex business transactions.

2. Caremark and Stone v. Ritter: Fact Pleading in Oversight Cases

The approach taken by Chancellor Allen in *Trifoods* set the stage for a great deal of the triage system’s evolution described below. That approach—in which the Court of Chancery dismisses a stockholder derivative suit unless the complaint alleges specific facts from which it is reasonably conceivable (not just wildly conceivable) that judicial deference in the form of the business judgment rule will not apply—was extended to the not uncommon form of derivative litigation in which the plaintiff claims that the corporation was harmed due to the directors’ failure to exercise adequate oversight. We examine that extension, in admittedly truncated fashion, with a review of two key Delaware cases, *Caremark*¹¹⁶ and *Stone v. Ritter*.¹¹⁷

Caremark, a much discussed, watershed Delaware opinion,¹¹⁸ did not involve a motion to dismiss (although the court, evaluating a proposed settlement, observed that the plaintiff’s derivative claims “quite likely were susceptible to a motion to dismiss.”).¹¹⁹ Nevertheless, the opinion was a critical step in establishing the substantive standards governing claims of director liability for alleged oversight failures.

One of the curiosities of the *Caremark* case is that it began, conventionally enough, as a case asserting director liability for breach of the duty of care, specifically in failing to take steps to avoid exposing the corporation to regulatory sanctions.¹²⁰ Describing it as “possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment,” the court noted the absence of “either director self-dealing or the more difficult

115. Cent. Mortg. Co. v. Morgan Stanley Mortg. Cap. Holdings LLC, 27 A.3d 531, 538 (Del. 2011) (emphasis added).

116. *In re Caremark Int’l, Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996).

117. *Stone v. Ritter*, 911 A.2d 362 (Del. 2006).

118. A number of scholars have analyzed *Caremark* at length. E.g., Jennifer Arlen, *The Story of Allis-Chalmers, Caremark, and Stone: Directors’ Evolving Duty to Monitor* (N.Y.U. Law and Economics Working Paper No. 160, 2008), http://lsr.nellco.org/nyu_lewp/160; Hillary A. Sale, *Delaware’s Good Faith*, 89 CORNELL L. REV. 456, 467 (2004); Matthew R. Berry, *Does Delaware’s Section 102(b)(7) Protect Reckless Directors from Personal Liability? Only if Delaware Courts Act in Good Faith*, 79 WASH. L. REV. 1125, 1131 (2004); Mark J. Loewenstein, *The Corporate Director’s Duty of Oversight*, 27-MAY COLO. LAW. 33, 33–34 (1998) (discussing two leading Delaware cases on the duty of oversight, including *Caremark*); Kimberly D. Baker & Arissa M. Peterson, *Post-Caremark Implications for Health Care Organization Boards of Directors*, 3 SEATTLE J. SOC. JUST. 387, 390–95 (2004).

119. *Caremark*, 698 A.2d at 971.

120. *Id.* at 960 (“The suit involves claims that the members of Caremark’s board of directors (the ‘Board’) breached their fiduciary duty of care to Caremark in connection with alleged violations by Caremark employees of federal and state laws and regulations applicable to health care providers.”).

loyalty-type problems arising from cases of suspect director motivation, such as entrenchment or sale of control contexts.”¹²¹ In essence, the court concluded, as in *Trifoods*, that claims asserting bad judgments are inherently dismissible, if “there was good faith effort [by the directors] to be informed and exercise judgment.”¹²²

Of course, a key claim in the case did not involve an attack on any director decision; rather, it asserted a failure to become aware of concerns requiring board attention. And in that regard, Chancellor Allen famously concluded that “a director’s obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists.”¹²³ In describing what would be required to establish liability for breach of that duty, however, the court again drew on the concept of good faith, defining the “test of liability” as “lack of good faith as evidenced by sustained or systematic failure of a director to exercise reasonable oversight.”¹²⁴ Thus, what started out as a claim of breach of the duty of care became redefined, in the Chancellor’s analysis, as necessarily involving a claim of “lack of good faith.”¹²⁵

That redefinition in turn shaped the Delaware Supreme Court’s opinion in *Stone v. Ritter*, in which the court did address a motion to dismiss a shareholder derivative complaint, also alleging a board’s failure to monitor and prevent regulatory liability. Affirming dismissal of the complaint, the court relied heavily on two aspects of the case: first, the presence of a provision in the company’s certificate of incorporation precluding director liability for money damages to the full extent permitted by statute;¹²⁶ and second, the proposition that Court of Chancery Rule 23.1 required dismissal in the absence of “particularized factual allegations” creating a reasonable inference that the directors were subject to personal liability.¹²⁷ And in that regard, the court in *Stone* fully embraced *Caremark*’s adoption of the principle that director liability for a failure of oversight depended on proof of lack of good faith; indeed, with the following holding, the court completed the metamorphosis of oversight claims from duty of care-based to duty of loyalty-based: “[B]ecause a showing of bad faith conduct . . . is essential to establish director oversight liability, the fiduciary duty violated by that conduct is the duty of loyalty.”¹²⁸

Combining these two critical legal premises, the court found little difficulty dismissing the complaint. Indeed, the availability of an outside report assessing the company’s

121. *Id.* at 967.

122. *Id.* at 968.

123. *Id.* at 970.

124. *Caremark*, 698 A.2d at 971.

125. It is perhaps curious, therefore, that Chancellor Allen did not directly rely on an exculpatory provision in *Caremark*’s certificate of incorporation based on Section 102(b)(7). In asserting that a director might be held “liable for losses caused by non-compliance with applicable legal standards,” however, he acknowledged that “questions of waiver of liability under certificate provisions authorized by 8 Del.C. § 102(b)(7) may also be faced.” *Id.* at 970 n.27.

126. Section II.A.3 above describes the nature of this provision and how it came before the court on the motion to dismiss.

127. *Stone v. Ritter*, 911 A.2d 362, 367 (Del. 2006).

128. *Id.* at 370.

relevant compliance efforts and a board-adopted oversight policy enabled the court to conclude that the derivative complaint merely “seeks to equate a bad outcome with bad faith.”¹²⁹

3. Krim: Fact Pleading Emerges in Deal Cases

Thus far we have identified cases in which the Delaware courts have dismissed shareholder derivative suits due to insufficient pleading of specific facts establishing likely director liability. As we will see now, however, the Delaware courts have taken a similar approach to deal litigation. To demonstrate this, we begin with a review of *Krim v. ProNet, Inc.*, a stockholder class action challenge to a merger, and the court’s decision on the defendants’ motion to dismiss the case for failure to state a claim on which relief could be granted.¹³⁰

We begin with *Krim* because it involved an arm’s length stock for stock merger, and thus was uncomplicated by any issue of enhanced judicial scrutiny under *Revlon*.¹³¹ The gravamen of the plaintiff’s case was the allegation that the directors of ProNet, the target company, failed to create an active and open auction for ProNet’s shares and therefore failed to achieve an appropriate premium recognizing recent upswings in ProNet’s business.¹³² In support of these allegations, the complaint cited SEC filings, analysts’ reports assessing the value of ProNet’s shares, and media accounts.¹³³ Importantly, the complaint did not allege any failure to disclose any conflict of interest involving the directors or, for that matter, any other material information necessary for a fully informed stockholder

129. *Id.* at 373. The evolution of oversight liability as based in the duty of loyalty, and the life and death of the concept of the duty of good faith as an element of a “triad” of fiduciary duties, are reviewed more fully in Leo E. Strine, Jr. et al., *Loyalty’s Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 GEO. L.J. 629, 631 (2010).

130. *Krim v. ProNet, Inc.*, 744 A.2d 523 (Del. Ch. 1999). At an earlier stage of the litigation, the court had denied the plaintiff’s motion to expedite discovery. *Krim v. ProNet, Inc.*, C.A. No. 15873 (Del. Ch., Dec. 5, 1997) (bench ruling), slip op. at 45–47. We address more fully below the treatment of such motions in deal cases.

131. *Infra* text at note 136 (describing DEL. CODE ANN. tit. 8, § 251(c) (2016)).

132. Amended Class Action Complaint at ¶ 45–46, *Krim v. ProNet, Inc.*, Civ. A. No. 15873 (hereinafter “*Krim Compl.*”). The plaintiff also alleged that the directors breached their fiduciary duties in order to entrench themselves in office. *Id.* at ¶¶ 47–50.

133. The complaint referred to ProNet’s low industry leverage ratios, a number of recent lucrative contracts entered into by ProNet, and positive statements by ProNet’s CEO and COO in ProNet’s 1996 Annual Report to Stockholders. *Id.* at ¶¶ 23–31. Analysts from Principal and Prudential provided values for ProNet’s shares on a discounted cash flow basis between \$7 and \$12 per share, which respectively are 30% and 122% higher than the merger price of \$5.40 per share. *Id.* at ¶¶ 30–34. Additionally, a Bear Stearns analyst familiar with ProNet valued it at \$8 per share on August 5, 1997, just days before the agreement was announced. *Id.* at ¶ 16.

vote.¹³⁴ Finding no disabling conflict of interest,¹³⁵ the court could well have viewed the plaintiff's theory as an assertion that he was a better judge of the merger's fairness than the majority of ProNet's fully informed and disinterested stockholders whose approval was necessary to accomplishment of the deal.¹³⁶ What made the complaint in *Krim* particularly easy to dismiss, moreover, was the stock for stock structure of the deal: the business judgment rule protects defendants who make a presumptively informed, disinterested decision in a stock for stock merger, and the more stringent requirements of *Revlon* do not attach in such a merger because there is no change in control.¹³⁷ Thus, as in *Trifoods*—*Krim*'s derivative suit counterpart—the court dismissed the complaint because it concluded, at the pleading stage, that “plaintiff has failed to demonstrate any reason why the presumption of the business judgment rule should not be afforded the defendant directors.”¹³⁸

There is good reason to believe that this pleading stage triage approach does not unduly limit the prosecution of meritorious cases. Mergers and acquisitions, at least those involving publicly traded companies, typically provide all the information required by the trial judge to assess the worthiness of the plaintiff's case. SEC filing requirements reliably elicit extensive, publicly available information about the transaction. A plaintiff who cannot find in that mass of information specific facts calling into question the motivations of the decision makers is most unlikely to be able to succeed at trial in any event. Although, as in *Krim*, a plaintiff may allege a violation of the duty to disclose by omitting material

134. Although the plaintiff's Amended Class Action Complaint did not assert a non-disclosure claim, the plaintiff made a belated assertion of non-disclosure in the plaintiff's Answering Brief to the Defendant's Motion to Dismiss. *Krim*, 744 A.2d at 528. This non-disclosure claim alleged that the defendant directors failed to confirm or deny that discussions took place with suitors besides MetroCall and failed to provide details if such discussions did occur. *Id.* The *Krim* court held that even if such “discussions or negotiations” did exist, they need not be disclosed and that “[the court] can only conclude that what the plaintiff is really trying to do by asserting the disclosure claim is to prolong discovery in the hope of framing a new cause of action.” *Id.* at 528–529. See also *Bershad v. Curtiss-Wright Corp.*, 535 A.2d 840, 847 (Del. 1987) (“Efforts by public corporations to arrange mergers are immaterial under the *Rosenblatt v. Getty* standard, as a matter of law, until the firms have agreed on the price and structure of the transaction.”).

135. The complaint sought to challenge the disinterestedness of ProNet's directors based on matters disclosed in the proxy statement: three of the directors would be named directors of MetroCall after the merger; options held by the board not vested prior to the merger would become fully exercisable and vested on consummation of the merger; and two directors had entered into non-competition agreements in exchange for payments totaling, in the aggregate, \$421,800 and \$317,400, over a three-year period. The court found that none of these matters created a conflict of interest. *Krim*, 744 A.2d at 528 n.16 (“The vesting of options does not create a conflict as a high exchange ratio for ProNet shares benefits the option-holding directors as much as, if not more than, the regular stockholders. Further, the fact that several directors would retain board membership in the merged entity does not, standing alone, create a conflict of interest. See *Grobow v. Perot*, 526 A.2d 914, 921–24 (Del. Ch. 1987) (discussing plaintiff's allegations of directors' interest in “self-perpetuation in office”).

136. DEL. CODE ANN. tit. 8, § 251(c) (2016). See also *Williams v. Geier*, 671 A.2d 1368, 1381 (Del. 1996) (“[T]he stockholders control their own destiny through informed voting. This is the highest and best form of corporate democracy.”).

137. *Krim*, 744 A.2d at 528.

138. *Id.* at 527.

facts,¹³⁹ the absence of specific allegations of conflict of interest or other improper director motivation appropriately results in dismissal of litigation.

4. Dismissing Non-Revlon Revlon Cases¹⁴⁰

It has not always been evident, however, that the motion to dismiss could serve that triage function in deal cases governed by *Revlon*.¹⁴¹ Beginning with its 1986 opinion in that case, the Delaware Supreme Court has made it clear that when the company is sold,¹⁴² the directors' conduct must be subjected to enhanced judicial scrutiny, the "key features" of which are:

(a) a judicial determination regarding the adequacy of the decisionmaking process employed by the directors, including the information on which the directors based their decision; and (b) a judicial examination of the reasonableness of the directors' action in light of the circumstances then existing. The directors have the burden of proving that they were adequately informed and acted reasonably."¹⁴³

Given the requirement of "enhanced scrutiny" in deal cases, and the burden on directors to prove that they "acted reasonably," one could have easily concluded that a complaint challenging a transaction involving a sale of control automatically states a claim upon which

139. The plaintiff in *Krim* alleged that the defendants omitted to disclose material facts about discussions with other potential suitors, but the court dispatched that assertion on the grounds that the plaintiff offered only conclusory allegations about such other discussions or negotiations. *Id.* at 528.

140. We acknowledge Delaware Supreme Court Chief Justice Leo E. Strine, Jr. as the source of this pithy description of this line of cases. The Chief Justice recently admonished students of the subject that "[i]t is too often forgotten that *Revlon*, and later cases like *QVC*, primarily involved board resistance to a competing bid after the board had agreed to a change of control, which threatened to impede the emergence of another higher-priced deal." *C&J Energy Servs., Inc. v. City of Miami Gen. Emps. & Sanitation Emps. Ret. Tr.*, 107 A.3d 1049, 1053 (Del. 2014). Thus, even though *Revlon* doctrine applies to any cash sale of the company, a plain vanilla sale, supervised by indisputably independent directors, is clearly far less deserving of judicial scrutiny than the situation faced in *Revlon* itself. See, e.g., Paul L. Regan, *The Unimportance of Being Earnest: Paramount Rewrites the Rules for Enhanced Scrutiny in Corporate Takeovers*, 46 HASTINGS L.J. 125, 126 (1994) (suggesting that the courts should "limit enhanced scrutiny to those instances of director conduct that raise suspicion about the directors' motivations, such as a target board's adoption of defensive measures or unequal treatment of competing bidders"). Hence, the plain vanilla case can be fairly described as a "non-*Revlon Revlon*" case.

141. *Revlon, Inc. v. Macandrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

142. "Sold," for purposes of *Revlon*, implies a sale of control or break-up of the company. *Paramount Commc'ns Inc. v. QVC Network, Inc.*, 637 A.2d 34, 47–48 (Del. 1993) ("There are few events that have a more significant impact on the stockholders than a sale of control or a corporate break-up. Each event represents a fundamental (and perhaps irrevocable) change in the nature of the corporate enterprise from a practical standpoint. It is the significance of each of these events that justifies: (a) focusing on the directors' obligation to seek the best value reasonably available to the stockholders; and (b) requiring a close scrutiny of board action which could be contrary to the stockholders' interests.") (emphasis omitted).

143. *Id.* at 45.

relief can be granted, and that the complaint therefore cannot be dismissed on motion; rather, the directors must establish (either at trial or at best on a motion for summary judgment) that they “acted reasonably” in approving the transaction.¹⁴⁴

Indeed, that is essentially what the plaintiffs argued in the critically important case of *Malpiede v. Townson*,¹⁴⁵ in which the directors of Frederick’s of Hollywood were sued in a challenge to the acquisition of the company for cash. In the Court of Chancery, the plaintiffs advanced the claim, among others, that the directors had breached their duty of care.¹⁴⁶ Defendants moved to dismiss the complaint for failure to state a claim upon which relief could be granted. According to the plaintiffs in that case, however, dismissal of the duty of care claim was inappropriate and premature, despite the undisputed existence of an exculpatory charter provision relieving the directors of monetary liability for breach of the duty of care.¹⁴⁷ Specifically, the plaintiffs contended that “Frederick’s exculpatory provision cannot provide the basis to dismiss the complaint at the pleading stage, because the applicability of the charter provision can be determined only on a developed factual record.”¹⁴⁸ In this regard, the plaintiffs invoked the Delaware Supreme Court’s opinion in *Emerald Partners, Inc. v. Berlin*,¹⁴⁹ in which the Court stated that “the shield from liability provided by a certificate of incorporation provision adopted pursuant to 8 Del.C. § 102(b)(7) is in the nature of an affirmative defense,” and that “[d]efendants seeking exculpation under such a provision will normally bear the burden of establishing each of its elements.”¹⁵⁰

Faced with these contentions and the assignment of the burden of proof to the director defendants, the court could easily have agreed with the plaintiffs and insisted that the “enhanced scrutiny” required by *Revlon* and its progeny could only occur after development and presentation of a factual record, with the directors bearing the burden of proof. In short, the court could have easily determined that a motion to dismiss could not serve a pleading stage triage function in deal cases in which *Revlon* requires “enhanced scrutiny.”

It was striking, then, that the Court of Chancery reached the opposite conclusion. Having separately concluded that claims of breach of the duty of loyalty were not sufficiently

144. A relatively early post-*Revlon* case demonstrated that defendant directors could win summary judgment in deal cases, but in that case the plaintiffs had taken expedited discovery and the dismissal appears to have been based on an undisputed factual record generated through that discovery effort. *Yanow v. Sci. Leasing, Inc.*, C.A. Nos. 9336, 9561, 1991 Del. Ch. LEXIS 134, *19 (Del. Ch. July 31, 1991). More recently, the Delaware Supreme Court directed that summary judgment be entered in favor of the defendant directors in a case challenging the acquisition of Lyondell Chemical Company. *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235 (Del. 2009). Again, however, the judgment followed discovery and the development of an evidentiary record. One can speculate that competing litigation in Texas might have induced the defendants to go forward with discovery and a motion for summary judgment, rather than present a motion to dismiss that might have been less effective in centering the litigation in the Delaware courts. *See id.* at 242–44.

145. *Malpiede v. Townson*, 780 A.2d 1075 (Del. 2001).

146. *In re Frederick’s of Hollywood, Inc. S’holders Litig.*, 2000 Del. Ch. LEXIS 19 (Del. Ch. Jan. 31, 2000).

147. *Id.* at *11.

148. *Id.* at *20.

149. *Emerald Partners v. Berlin*, 726 A.2d 1215 (Del. 1999).

150. *Id.* at 1223–24.

pleaded,¹⁵¹ the court held that “where the complaint only alleges a breach of the duty of care, that claim may be dismissed at the pleading stage” based on the exculpatory charter provision.¹⁵² The Delaware Supreme Court affirmed, stating that “[a]lthough the *Revlon* doctrine imposes enhanced judicial scrutiny of certain transactions involving a sale of control, it does not eliminate the requirement that plaintiffs plead sufficient facts to support the underlying claims for a breach of fiduciary duties in conducting the sale.”¹⁵³ Concluding the point, the Court explained:

[W]e have held that the amended complaint here does not allege a loyalty violation or other violation falling within the exceptions to the Section 102(b)(7) exculpation provision. Likewise, we have held that, even if the plaintiffs had stated a claim for gross negligence, such a well-pleaded claim is unavailing because defendants have brought forth the Section 102(b)(7) charter provision that bars such claims. This is the end of the case.¹⁵⁴

Thus, as the Delaware Supreme Court much more recently explained, in a case seeking money damages against a director protected by an exculpatory charter provision, a complaint must affirmatively plead non-exculpated claims, regardless of the standard of judicial review that might apply:

A plaintiff seeking only monetary damages must plead non-exculpated claims against a director who is protected by an exculpatory charter provision to survive a motion to dismiss, regardless of the underlying standard of review for the board’s conduct—be it *Revlon*, *Unocal*, the entire fairness standard, or the business judgment rule.¹⁵⁵

It would be a mistake to dismiss these rulings as a fortuitous application of exculpatory charter provisions in a limited context, namely in suits limited to damages claims against directors. To the contrary, *Malpiede* and its progeny¹⁵⁶ represent a significant extension of fact pleading requirements to deal cases. Exculpatory charter provisions are nearly ubiquitous in publicly traded Delaware corporations,¹⁵⁷ and once an arm’s length

151. *Frederick’s of Hollywood, Inc.*, 2000 Del. Ch. LEXIS 19, at *24 (“Because the complaint fails to allege facts that establish that the merger was not approved by a majority of disinterested directors, the breach of loyalty claims cannot survive a motion to dismiss.”).

152. *Id.* at *21.

153. *Malpiede v. Townson*, 780 A.2d 1075, 1083–84 (Del. 2001).

154. *Id.* at 1094–95.

155. *Leal v. Meeks*, 115 A.3d 1173, 1175–76 (Del. 2015); *see also id.* at 1187 (in a challenge to a transaction governed by the entire fairness standard of judicial review, remanding “to determine if the plaintiffs have sufficiently pled facts suggesting that the independent directors committed a non-exculpated breach of their fiduciary duty”).

156. *See generally In re NYMEX S’holder Litig.*, No. 3621-VCN, 2008 Del. Ch. LEXIS 227 (Del. Ch. July 29, 2008) (dismissing *Revlon*-based claims of breach of fiduciary duty in the sale of the company); *Wayne Cty. Emps.’ Ret. Sys. v. Corti*, No. 3534-CC, 2009 Del. Ch. LEXIS 126 (Del. Ch. July 24, 2009); *In re BJ’s Wholesale Club, Inc. S’holders Litig.*, No. 6623-VCN, 2013 Del. Ch. LEXIS 28 (Del. Ch. Jan. 31, 2013).

157. Andrew C.W. Lund, *Rethinking Aronson: Board Authority and Overdelegation*, 11 U. PA. J. BUS. L. 703, 704 (2009) (exculpatory charter provisions “have been adopted by the vast majority of Delaware corporations”); Claire A. Hill & Brett H. McDonnell, *Disney, Good Faith, and Structural Bias*, 32 J. CORP. L. 833, 837

acquisition has been consummated, the only potential defendants in deal litigation are (i) the directors who are protected by such provisions, and (ii) the buyer—who can typically secure dismissal of the claims against it (aiding and abetting a breach of fiduciary duty) because of the requirement, applied in *Malpiede* and many other cases,¹⁵⁸ that the complaint demonstrate “knowing participation” by the buyer in the target directors’ breach of a fiduciary duty.¹⁵⁹

In short, deal cases challenging arm’s length acquisitions can be dismissed at the pleading stage, despite the application of *Revlon* “enhanced scrutiny.” Indeed, the Delaware Supreme Court has recently so held.¹⁶⁰

5. Dismissing Deal Cases Involving Controlling Stockholders

In the previous Section we examined the extension of fact pleading requirements to motions to dismiss deal cases in which the acquisition is by an unaffiliated third party, and there are no viable claims of conflict of interest or otherwise disloyal motivation. As we saw, that extension depended significantly on the application of exculpatory charter provisions that eliminate monetary liability on claims not involving disloyalty or other narrow exceptions. Such provisions would of course not protect controlling stockholders, or directors affiliated with them, in cases in which the controller is the acquiring party. In a number of situations, however, the courts have employed the motion to dismiss as a triage tool even in cases in which the merger is supported by an allegedly controlling stockholder. We identify and examine three such situations below: (1) claims against disinterested directors in a controller freeze-out transaction; (2) claims against directors and controlling stockholders where both the controller’s shares and the publicly held shares are sold to an unaffiliated third party; and, most controversially (3) claims against the directors and controller, where the controller has irrevocably conditioned the freeze-out acquisition upon approval by both a special committee of disinterested directors and a majority of the outstanding minority shares. In each of these situations, the Delaware courts have come to require pleading of

(2007) (“personal liability for pure care violations” has been waived by most corporations); Robert B. Thompson & Randall S. Thomas, *The Public and Private Faces of Derivative Suits*, 57 VAND. L. REV. 1747, 1786 (2004) (“It is very rare for a public company not to have taken advantage of this exculpation.”).

158. *E.g.*, *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 817 A.2d 160, 172 (Del. 2002) (holding that elements of a claim for aiding and abetting a defendant include establishing that a defendant “who is not a fiduciary, knowingly participated in a breach”); *In re Nine Sys. Corp. S’holders Litig.*, No. 3940-VCN, 2014 Del. Ch. LEXIS 171, at *146 (Del. Ch. Sept. 4, 2014) (“Under Delaware law, to recover on a claim for aiding and abetting another’s breach of fiduciary duty, a plaintiff must prove . . . knowing participation in the breach by the non-fiduciary defendants.”); *accord In re Rural Metro Corp. Stockholders Litig.*, 88 A.3d 54, 80 (Del. Ch. 2014).

159. *Malpiede v. Townson*, 780 A.2d 1075, 1096 (Del. 2001).

160. *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304, 306 (Del. 2015) (“[T]he Chancellor was correct in finding that the voluntary judgment of the disinterested stockholders to approve the merger invoked the business judgment rule standard of review and that the plaintiffs’ complaint should be dismissed.”). The Delaware courts have repeatedly applied *Corwin*’s approach to dismissal of *Revlon* claims. *E.g.*, *Singh v. Attenborough*, 137 A.3d 151 (Del. 2016); *In re OM Grp., Inc. Stockholders Litig.*, No. 11216-VCS, 2016 Del. Ch. LEXIS 155 (Del. Ch. Oct. 12, 2016); *City of Miami Gen. Emps.’ & Sanitation Emps.’ Ret. Tr. v. Comstock*, No. 9980-CB, 2016 Del. Ch. LEXIS 133 (Del. Ch. Aug. 24, 2016).

facts sufficient, on a motion to dismiss, to rebut the application of an exculpatory charter provision or the business judgment rule.

a. Claims Against Disinterested Directors

Until this year, it was unclear as a matter of Delaware law whether, in a freeze-out merger by a controlling stockholder, unaffiliated directors could be dismissed as defendants in the absence of pleaded facts establishing a non-exculpated claim against them.¹⁶¹ The Court of Chancery, aware of the uncertainty on this point but guided by statements in the Delaware Supreme Court's opinion in *Emerald Partners*, declined to grant such dismissals, given that the underlying transaction would be subject to review under the demanding standard of entire fairness.¹⁶² The Delaware Supreme Court accepted interlocutory appeals from those denials in order to clear up that uncertainty.¹⁶³ In *Leal v. Meeks*, the court established that disinterested directors were entitled to dismissal, even in a case challenging a controller freeze-out transaction, in which the most searching form of judicial review would apply to the transaction, unless non-exculpated claims were specifically pleaded against those directors.¹⁶⁴

That holding is instructive, but does not advance the larger thesis advocated here. On one hand, it is instructive because it identifies yet another arena in which the Delaware courts have manifested a willingness to dismiss claims because of a failure to plead specific facts sufficient to imply a basis for liability. That willingness flows logically from the courts' earlier rulings in arm's length deal cases, particularly *Malpiede*, which pointedly distinguish the applicable standard of judicial review from the governing pleading standard, and establish that non-exculpated claims must be pleaded with specificity even if *Revlon* ultimately calls for enhanced judicial scrutiny. Indeed, it is no accident that the court in *Cornerstone* repeatedly relies on and quotes the court's earlier opinion in *Malpiede*.¹⁶⁵ On the other hand, pointing out the willingness to dismiss individual disinterested

161. *In re Cornerstone Therapeutics Inc. Stockholder Litig.*, No. 8922-VCG, 2014 Del. Ch. LEXIS 170, at *19 (Del. Ch. Sept. 10, 2014), *rev'd*, *Leal v. Meeks*, 115 A.3d 1173 (Del. 2015) (noting "[t]he lack of congruity in our case law with respect to transactions subject to entire fairness").

162. *Cornerstone*, 2014 Del. Ch. LEXIS 170 at *41 ("[C]ontrolling precedent requires me to deny the Motion to Dismiss under these circumstances."); *In re Zhongpin Inc. Stockholders Litig.*, No. 7393-VCN, 2014 Del. Ch. LEXIS 252, *36 (Del. Ch. Nov. 26, 2014) ("Although *In re Cornerstone* questioned the merit of forcing disinterested directors to face the same pleading standard as interested fiduciaries in cases subject to entire fairness, the Court's examination of precedent left it with no other choice.").

163. In both *Cornerstone* and *Zhongpin* the Court of Chancery granted, and the Delaware Supreme Court accepted, defendants' requests that the denial of their motion to dismiss be taken up in an interlocutory appeal. *Leal v. Meeks*, 115 A.3d 1173, 1179 (Del. 2015) ("These cases . . . exemplify a benefit of careful employment of the interlocutory appeal process: to enable this Court to clarify precedent that could arguably be read in two different ways before litigants incur avoidable costs."); *Cornerstone*, 2014 Del. Ch. LEXIS 185; *Zhongpin*, 2014 Del. Ch. LEXIS 267.

164. *Leal*, 115 A.3d at 1187 ("[W]hen the plaintiffs have pled no facts to support an inference that any of the independent directors breached their duty of loyalty, fidelity to the purpose of Section 102(b)(7) requires dismissal of the complaint against those directors.").

165. *Id.* at 1176 n.4, 1177 n.12, 1180 nn.26–27, 1181 n.33–34.

directors in a controller freeze-out case is something of a digression from the main thesis of this Article: dismissing disinterested directors while allowing the case to go forward against the controller and its affiliated directors does little or nothing to avoid the costs of litigation, which would generally continue despite dismissal of the disinterested directors; nor can that dismissal be expected to assist the parties to predict the ultimate disposition of the litigation, because the claims against the controller would be governed by fairness considerations independent of those on which liability of the disinterested directors would have to be premised.¹⁶⁶ Accordingly, this particular application of the motion to dismiss does not significantly exemplify the previously described efficiency functions of the motion to dismiss. The other two areas identified below, however, are more relevant to the efficiency thesis we advance.

b. Sales by a Controller to a Third Party

In some situations, the controlling stockholder becomes a seller. Where that occurs and the company is sold to a third party in an arm's length transaction in which the controller receives the same consideration per share as the minority stockholders, one would ordinarily expect that judicial review of the sale would be at least as favorable to the proponents of the transaction as in an ordinary arm's length acquisition: the controller has a powerful incentive to achieve exactly what *Revlon* calls for, namely the highest currently available sale price.

The Delaware Supreme Court's 2000 opinion in *McMullin v. Beran*,¹⁶⁷ however, called into question the viability of a motion to dismiss as a triage tool in cases in which a controlling stockholder is a seller, along with the minority stockholders. In that case, the court reversed the grant of a motion to dismiss that emphasized the alignment of economic interest between the controller (ARCO) and the minority in a sale of the company (Chemical) to a third party (Lyondell). The court rejected dismissal in part because of its conclusion that the complaint's allegations "suggest that the directors of Chemical breached their duty of care by approving the merger . . . without adequately informing themselves about the transaction and without determining whether the merger consideration equaled or exceeded Chemical's appraisal value as a going concern."¹⁶⁸ In this case decided shortly before *Malpiede*, the court oddly declined to consider the impact of the company's exculpatory charter provision¹⁶⁹—oddly, because under the subsequent reasoning of *Malpiede* that provision would have provided an independent basis for affirming the lower court's dismissal of the complaint, at least as against the directors. More importantly, the court found the allegations of the complaint sufficient to implicate a conflict of interest on the part of the controller, despite the equal treatment of all shares in the merger: the controller was

166. *Id.* at 1183 n.40 ("Interested fiduciaries, often the proverbial deep-pocketed defendants, will continue to be required to prove that the transaction was entirely fair to the minority stockholders, because the plaintiffs' well-pled claims against the interested parties in a controller transaction cannot be dismissed before trial, regardless of whether the independent directors remain as defendants.").

167. *McMullin v. Beran*, 765 A.2d 910 (Del. 2000).

168. *Id.* at 922.

169. *Id.* at 926.

allegedly in need of cash, and “its insistence on an all-cash bid conflicted with the interests of the public shareholders to receive maximum consideration for their shares in a sale of the Company.”¹⁷⁰ If a controller’s ostensible preference for (or against) liquidity were automatically a basis for finding a conflict of interest and therefore a viable claim for breach of the duty of loyalty, dismissal of a challenge to even an arm’s length sale would seem to be difficult or impossible.

McMullin was not the last word, however, on cases of this sort: twelve years later, then Chancellor Strine addressed a similar complaint challenging a sale to a third party, where the controller received the same per share consideration as the public stockholders.¹⁷¹ In that case (*Synthes*), the court did grant defendants’ motion to dismiss a complaint challenging the sale.¹⁷² The opinion nicely illustrates elements of the procedural system described above, including the courts’ evolving insistence in representative shareholder litigation that the complaint demonstrate with reasonable specificity a basis for further judicial inquiry into the merits of the claims.

The operative complaint in *Synthes* was a second amended complaint, and the plaintiffs had been “afforded some written discovery.”¹⁷³ Perhaps more importantly, the plaintiffs had received, and drew heavily in their complaint from, the defendants’ proxy statement, and plaintiffs’ reliance on that document in pleading their claims enabled the court to rely on the facts it recited, in the absence of specifically pleaded facts contradicting those recitations.¹⁷⁴

As in *McMullin*, the plaintiffs alleged that the putative controller (Wyss) had a “unique” need for liquidity that “infected the entire sale process.”¹⁷⁵ Rather than infer a conflict of interest arising from that alleged liquidity preference, however, the court’s analysis proceeded from the premise that “a fiduciary’s financial interest in a transaction as a stockholder (such as receiving liquidity value for her shares) does not establish a disabling conflict of interest when the transaction treats all stockholders equally.”¹⁷⁶ The court allowed that there might be “very narrow circumstances in which a controlling stockholder’s immediate need for liquidity could constitute a disabling conflict of interest irrespective of

170. *Id.* at 921 n.50.

171. *In re Synthes, Inc. S’holder Litig.*, 50 A.3d 1022 (Del. Ch. 2012).

172. *Id.* at 1024.

173. *Id.* In a similar case, discovery appears to have been considerably further advanced. *In re Morton’s Rest. Grp., Inc. S’holders Litig.*, 74 A.3d 656, 658 (Del. Ch. 2013) (“[T]he plaintiffs have received substantial discovery, including depositions.”). Although the court granted a motion to dismiss, as it did in *Synthes*, the court’s reliance on deposition testimony as well as SEC filings deemed to have been incorporated into the complaint, *id.* at 658–59, resulted in a disposition that may have resembled summary judgment more than a motion to dismiss.

174. *Synthes*, 50 A.3d at 1026 (“Having premised their recitation of the facts squarely on that document and incorporated it, the plaintiffs cannot fairly, even at the pleading stage, try to have the court draw inferences in their favor that contradict that document, unless they plead non-conclusory facts contradicting it.”) (citing *In re BHC Commc’ns, Inc. S’holder Litig.*, 789 A.2d 1, 13 (Del. Ch. 2001)) (emphasis omitted).

175. *Synthes*, 50 A.3d at 1026.

176. *Id.* at 1035.

pro rata treatment,”¹⁷⁷ but it insisted on—and found no—specific allegations that such narrow circumstances (like an exigent need for cash to meet a margin call) existed. To the contrary, the court found that the undisputed facts about the sale process—its relatively deliberate pace and its effort to reach both strategic and private equity buyers—contradicted any claim that any unique liquidity preference on the part of the controller motivated the sale.¹⁷⁸

The court also rejected a challenge to the deal protections in the transaction, including “a 3.05% termination fee; a no-solicitation provision with a fiduciary out; matching rights; a ‘force-the-vote’ provision; and the Voting Agreement locking up 37% (or 33% upon a change in the Board’s recommendation) of Wyss’ and his affiliates’ shares in favor of the Merger.”¹⁷⁹ The court reasoned that the plaintiffs had “made no attempt to show how the deal protections would have unreasonably precluded the emergence of a genuine topping bidder willing to make a materially higher bid, and thus fail to state a claim.”¹⁸⁰ In the same vein, the court concluded that the board’s approval of the deal protections was the “sort of tactical judgment [that] is freighted with none of the concerns about disloyalty that animate *Unocal* and *Revlon*, and is one that courts are ill-equipped to second guess as unreasonable.”¹⁸¹

In sum, *Synthes* is a classic illustration of the Delaware courts’ evolved approach to dismissal motions: using a liberal but fair identification of the universe of relevant facts (especially where the plaintiffs had relied on the defendants’ proxy statement), the court engaged in a factually nuanced assessment of claims of disloyal motive and, finding the alleged facts an insufficient basis from which to infer such disloyalty, dismissed the complaint.¹⁸² That sort of robust factual analysis would undoubtedly unsettle those accustomed

177. *Id.* at 1036.

178. *Id.* at 1037.

179. *Id.* at 1048 n.118.

180. *Synthes*, 50 A.3d at 1048.

181. *Id.* at 1049.

182. The court in *Synthes* did not, on the other hand, deeply inquire into whether Wyss was indeed a controlling stockholder for purposes of legal analysis: his ownership of 38% of the shares, plus “his control of 13.25% of the company’s shares owned by family members and trusts,” was evidently enough to persuade the court that further inquiry into Wyss’ control was unnecessary. *Id.* at 1025. Where the putative controller owns less than an absolute majority of the voting shares, however, the Delaware courts engage in a robust analysis of pleaded facts to evaluate whether actual control has been exercised. See *In re Crimson Exploration, Inc. Stockholder Litig.*, No. 8541-VCP, 2014 Del. Ch. LEXIS 213, at *32–33 (Del. Ch. Oct. 24, 2014) (collecting Delaware cases examining controller status). In *Crimson*, the court expressed considerable doubt that the alleged controller in fact exercised the required actual control—an expression of doubt that would surely have guided the parties in considering settlement had the case not been dismissed for other reasons—but noted that plaintiffs “only need to show it is reasonably conceivable that Oaktree controlled Crimson.” *Id.* at *56. The court then grudgingly stated: “I am hesitant to conclude that Plaintiffs could not conceivably make that showing.” *Id.* Subsequently, however, the court in *In re KKR Financial Holdings LLC Shareholder Litigation*, dismissed a merger challenge based on the proposition that KKR was a controller of KKR Financial Holdings (KFN), finding that “there are no well-pled facts from which it is reasonable to infer that KKR could prevent the KFN board from freely exercising its independent judgment in considering the proposed merger.” *In re KKR Fin. Holdings LLC S’holder Litig.*, 101 A.3d 980, 995 (Del. Ch. 2014).

to liberal notice pleading concepts; but it demonstrates a salutary recognition that undue fealty to those concepts imposes substantial costs on investors.

c. Controller Freeze-Outs Conditioned on Special Committee and Minority Stockholder Approval

In contrast to the sale addressed in *Synthes*, transactions in which the controlling stockholder is acquiring the minority's shares—and where the economic interests of the controller and the minority are thus antithetical—are tested by standards of “entire fairness,”¹⁸³ and motions to dismiss complaints challenging such transactions are understandably close to non-existent.¹⁸⁴ The Delaware courts have come to recognize, however, that the prospect of avoiding litigation could supply a useful incentive to employ deal techniques that provide protection to minority stockholders that is substantially equivalent to arm's length bargaining.¹⁸⁵ That recognition was most clearly articulated by the Court of Chancery only fairly recently, when it granted summary judgment to a defendant controller which had from the inception of the transaction conditioned its acquisition of the minority shares upon approval by an appropriately empowered special committee of disinterested, independent directors *and* the favorable, uncoerced, fully informed vote of a majority of the minority stockholders.¹⁸⁶ In that case, the court reasoned that, with this approach:

[A]n across-the-board incentive would be created to provide minority stockholders with the best procedural protections in all going private transactions. Whether proceeding by a merger or a tender offer, a controlling stockholder would recognize that it would face entire fairness review unless it agreed not to proceed without the approval of an independent negotiator with the power to say no, and without the uncoerced, fully informed consent of a majority of the minority.¹⁸⁷

In that case, however, the court entered judgment for the defendants only after extended discovery, and on a motion for summary judgment; left open was the question of whether use of the two-part procedure outlined by the court would provide a basis for a motion to dismiss for failure to state a claim. On appeal, that question was addressed in

183. See, e.g., *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983) (“The requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts.”).

184. As the Delaware Supreme Court recently explained, when the complaint alleges facts sufficient to implicate the entire fairness standard “at the pleading stage, the plaintiffs will be able to survive a motion to dismiss by interested parties regardless of the presence of an exculpatory charter provision because their conflicts of interest support a pleading-stage inference of disloyalty.” *Leal v. Meeks*, 115 A.3d 1173, 1180–81 (Del. 2015).

185. This idea emerged most famously in *Weinberger v. UOP, Inc.*, 457 A.2d 701, 704, 710–11 (Del. 1983), where the Delaware Supreme Court suggested that the result in the case might have favored the defendants had the directors established a special committee of disinterested, independent directors to negotiate the terms of the merger with the controlling stockholder.

186. *In re MFW S'holders Litig.*, 67 A.3d 496, 500 (Del. Ch. 2013), *aff'd*, *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014).

187. *Id.* at 504.

dictum, in a footnote, and in a way that cast doubt on the utility of the two-step procedure as a basis for dismissal at the pleading stage: specifically, the Delaware Supreme Court's opinion indicated that the complaint in the case would have withstood a motion to dismiss, largely because of allegations that the merger price was inadequate.¹⁸⁸ Of course, if allegations of price inadequacy will be sufficient to prevent dismissal, the litigation-avoidance incentive identified by the Court of Chancery would likely be substantially weakened, if not rendered trivial.

There have been indications, however, that the motion to dismiss may yet have some vitality as an incentive for controlling stockholders to use the two-step procedure in freeze-outs. First, recent rulings in the Court of Chancery suggest a willingness to dismiss on that basis. In one of those cases, the court granted a motion to dismiss, noting that "the whole point of encouraging this structure was to create a situation where defendants could effectively structure a transaction so that they could obtain a pleading-stage dismissal against breach of fiduciary duty claims."¹⁸⁹ The court felt that when the elements of the two-step process are established, the complaint can avoid dismissal only where "the plaintiffs have pled facts sufficient to call into question the existence of those elements, at least when those elements have been described in a public way suitable for judicial notice, such as board resolutions and a proxy statement"¹⁹⁰ In another case, albeit in dictum, the Court of Chancery indicated that "a motion to dismiss may be granted where the transaction is conditioned *ab initio* on a majority-of-the-minority vote and is negotiated by a facially disinterested and independent special committee."¹⁹¹

The second, and perhaps more forceful, basis for believing that the Delaware Supreme Court will support pleading stage dismissal based on use of the two-step process—apart from the forceful logic that such dismissal will encourage controllers to use a process that protects minority stockholders—is the thrust of the court's subsequent opinion in *Leal v. Meeks*. As noted above, that opinion embraces the idea that the independence and care of directors serving on a special committee is to be presumed, and if the efficacy of the committee approval process is to be questioned on the ground that its members failed to act with care and independence, the complaint must set forth some specific facts on which such questioning can be based.

188. *Kahn*, 88 A.3d at 645 n.14.

189. Transcript of Oral Argument at 66–68, *Swomley v. Schlecht*, C.A. No. 9355-VCL, 2015 WL 1186126 (Del. Ch. Aug. 27, 2014).

190. *Id.* at 69–70.

191. *In re Cornerstone Therapeutics Inc. Stockholder Litig.*, C.A. No. 8922-VCG, 2014 Del. Ch. LEXIS 170, at *37–38 (Del. Ch. Sept. 10, 2014), *rev'd on other grounds*, *Leal v. Meeks*, 115 A.3d 1173 (Del. 2015); *see also In re Books-A-Million, Inc. Stockholders Litig.*, C.A. No. 11343-VCL, 2016 Del. Ch. LEXIS 154, at *2–3 (Del. Ch. Oct. 10, 2016) (where defendants "followed the framework approved by the Delaware Supreme Court in [*Kahn v. M&F Worldwide Corp.*] . . . unless the plaintiffs can plead facts supporting a reasonable inference that one of the elements of the framework was not met, the business judgment rule provides the operative standard of review").

C. The Evolution and Importance of the Motion to Expedite Discovery

We have now observed how the Delaware courts have expanded the role of the motion to dismiss in representative shareholder litigation. As previously noted, however, the motion to dismiss, although certainly less time-consuming than trial, cannot ordinarily be presented and resolved in the fairly short time in which the typical corporate acquisition occurs. And if a shareholder plaintiff brings a class action seeking to enjoin the consummation of such an acquisition, the court can scarcely call a transactional “time out” while it is deciding a motion to dismiss, on the theory that doing so could efficiently eliminate further litigation expense or promote an informed settlement. Instead, the court is typically called upon to schedule a hearing on a motion for a preliminary injunction against the transaction, and, in that connection, to authorize the plaintiff to accelerate the discovery time frame prescribed in the rules of civil procedure.

Not too long ago, such a motion to expedite discovery might have been routinely granted, where the plaintiff sought to enjoin a pending merger. As Chancellor Allen explained in such a case, “[t]he presence of a transaction of some sort, a shareholders meeting, the closing of a tender offer or the closing of some structural transaction (a recapitalization, sale of substantial assets, etc.), is typically the reason in such cases to permit expedited discovery.”¹⁹² If the pendency of a merger transaction were routinely sufficient to justify expedited discovery, however, the efficiency of the motion to dismiss in deal cases would largely be eliminated: a plaintiff could simply seek to enjoin a pending deal and, on the barest and most conclusory of allegations of misconduct, set into motion a hugely expensive discovery process in the hope that it would drive defendants to offer a (cosmetic?) settlement and a fee award.

Perhaps that scenario could never have played out in the Delaware courts, despite the liberality of granting motions to expedite discovery in deal cases.¹⁹³ But with typical insight and prescience, Chancellor Allen, in a 1994 ruling, recognized and articulated the concern that efficiency considerations required that, at least to some degree, a motion to expedite discovery had to clear some substantive hurdle involving an evaluation of the merits of the case. In *Giammargo v. Snapple Beverage Corp.*,¹⁹⁴ Chancellor Allen denied a motion to expedite discovery in a case seeking to enjoin the sale of Snapple to Quaker Oats. In a memorable analysis, Chancellor Allen explained his ruling as follows:

The court is not required or able on this application to judge the merits or even the legal sufficiency of these pleadings. The question presented is a more specialized one: whether in the circumstances the plaintiff has articulated a suffi-

192. *Am. Stores Co. v. Lucky Stores, Inc.*, 1988 Del. Ch. LEXIS 182, at *4 (Del. Ch. Apr. 13, 1988). See also Kurt Heyman, *Expedited Proceedings in the Delaware Court of Chancery: Things of the Past?*, 23 DEL. J. CORP. L. 145, 146 (1998) (“[A]pplications for expedited proceedings . . . prior to this decade, were granted almost routinely and occasionally on an ex parte basis.”).

193. Heyman, *supra* note 192, at 149–56 (reviewing pre-1994 cases in which the Court of Chancery denied a motion to expedite discovery notwithstanding the pendency of a transaction).

194. *Giammargo v. Snapple Beverage Corp.*, C.A. No. 13845, 1994 Del. Ch. LEXIS 199 (Del. Ch. Nov. 15, 1994).

ciently colorable claim and shown a sufficient possibility of a threatened irreparable injury, as would justify imposing on the defendants and the public the extra (and sometimes substantial) costs of an expedited preliminary injunction proceeding. This court traditionally has acted with a certain solicitude for plaintiffs in this procedural setting and thus has followed the practice of erring on the side of more hearings rather than fewer. We continue that tradition of solicitude. But our responsibility to all parties and to the public's interest in efficient justice requires, nevertheless, that where there clearly is no demonstrable need for the remedy of preliminary injunction or, in the rarer case when there is not even any colorable claim pleaded, that we decline to impose the costs associated with such a proceeding.¹⁹⁵

With that ruling it became clear that the court could—indeed, was obliged to—evaluate the merits of the claims presented before granting a motion to expedite discovery.¹⁹⁶ That evaluation is necessarily limited—the issue is merely whether the claims presented are “sufficiently colorable”—but just as has occurred with the motion to dismiss, the court engages in substantive triage.¹⁹⁷ Indeed, no other approach would make sense, given the possibility that the defendants and the public would have to bear “the extra (and sometimes substantial) costs of an expedited preliminary injunction proceeding” despite the absence of any meritorious claim.

The obvious question, then, is whether and to what extent the substantive inquiry on a motion to expedite differs from the substantive inquiry on a motion to dismiss. Can a complaint be “sufficiently colorable” to warrant expedited discovery, yet, not articulate “reasonably conceivable” claims sufficient to resist a motion to dismiss? One would expect that if a court finds that a complaint is not sufficiently “colorable” to support granting a motion to expedite discovery, it is unlikely that it would set forth “reasonably conceivable” claims sufficient to overcome a motion to dismiss.¹⁹⁸ But should the two standards be significantly different? In both situations, the plaintiff ordinarily has not had the benefit of discovery.

195. *Id.* at *5–6.

196. It is not clear under the Federal Rules of Civil Procedure that the court inquires into the substantive merits in deciding motions to expedite discovery. In one approach, the court considers the same factors as applied in deciding a motion for preliminary injunction, including whether there is “some probability of success on the merits.” 6 JAMES WM. MOORE ET AL., *MOORE’S FEDERAL PRACTICE* § 26.121[2] (3d ed. 1999). The more liberal “reasonableness” test, however, does not explicitly call for examination of the merits of the underlying claims being asserted. *Id.* (“Among the factors to be considered by the court are: (1) whether a preliminary injunction motion is pending; or another legally cognizable urgency exists, (2) the breadth of the discovery requests; (3) the purpose for requesting the expedited discovery; (4) the burden on the defendants to comply with the requests; and (5) how far in advance of the typical discovery process the request was made.”).

197. *Parsons v. Dig. River, Inc.*, C.A. No. 10370-VCG, 2015 Del. Ch. LEXIS 10, at *7 (Del. Ch. Jan. 12, 2015) (“The disclosure violation posited by the Plaintiff is speculative; thus, the chance of receiving injunctive relief based on it is low, and I do not find that the value of any potential disclosure to stockholders outweighs the cost of expedition.”).

198. *See In re Bioclinica, Inc. S’holder Litig.*, C.A. No. 8272-VCG, 2013 Del. Ch. LEXIS 250, at *12 n.46 (Del. Ch. Oct. 16, 2013) (“The standard for a motion to expedite is ‘colorability’ and the standard for a motion to

We perceive only two differences between the two procedural contexts. First, a motion to dismiss is ordinarily a more deliberate affair, usually affording sufficient time to permit the gathering of facts through means (such as exercise of inspection rights) not involving discovery; the time frame of a motion to expedite discovery, in contrast, may not permit that more leisurely gathering of information.¹⁹⁹ Second, in deal cases, at least, the application for preliminary injunctive relief is not precluded by any exculpatory charter provision, as a post-closing damages case may be. For these two reasons, courts might appropriately be more likely to find “colorable” claims on a motion to expedite, while demanding more cogent showings of “reasonably conceivable” claims on a motion to dismiss.

Regardless of minute differences in the standard of substantive review, it is important to appreciate that in both procedural contexts the Delaware courts are engaging in a substantive evaluation of the merits of the underlying claims. Thus, just as the Delaware courts have demonstrated a willingness to dismiss even cases governed by the *Revlon* standard of “enhanced scrutiny,” they have also sometimes declined to set the discovery process in motion on an expedited basis even when a shareholder plaintiff seeks a preliminary injunction in such a case. In its 2013 opinion *In re BioClinica, Inc.*,²⁰⁰ for example, the Court of Chancery denied a motion to expedite discovery in connection with a complaint seeking to preliminarily enjoin a merger in which the company would be acquired on a cash for stock basis (thus implicating enhanced judicial scrutiny). As might be expected in a case asserting a *Revlon*-based claim, the complaint alleged that the merger agreement and related arrangements included a “combination of devices—a no-shop clause, a top-up feature, matching rights, a termination fee, a poison pill, and a standstill agreement— [that were] preclusive to other potential bidders.”²⁰¹ Nevertheless, after an extended analysis rejecting a claim that the company’s shareholder rights plan would effectively preclude competing bids that would enable the board to exercise a fiduciary out in the merger agreement, the court concluded that the deal protection devices at issue were conventional, and that “the Plaintiffs have not pled a colorable claim that these deal-protection devices, when combined, impermissibly lock up the Merger Agreement.”²⁰²

dismiss under Rule 12(b)(6) is ‘reasonable conceivability’—in my view, a higher, although still minimal, pleading burden.”).

199. On a motion to dismiss, therefore, it may be appropriate to demand greater “conceivability” than mere colorability, to the extent that a plaintiff has had an opportunity to gather supporting information but fails to present such information in the complaint. See *Thermopylae Capital Partners, L.P. v. Simbol, Inc.*, No. 10619-VCG, 2016 Del. Ch. LEXIS 15, at *39–40 (Del. Ch. Jan. 29, 2016) (“[A]t the motion to dismiss stage of a proceeding, the Court must deny the motion unless, drawing all reasonable inferences in favor of the plaintiff, the plaintiff could not recover under ‘any reasonably conceivable set of circumstances susceptible of proof.’ For the ‘reasonableness’ part of the standard to have meaning, a complaint, in this context, that omits necessary facts available pre-discovery to a plaintiff—relying instead on mere conclusory assertions—cannot survive a motion under Rule 12(b)(6).”).

200. *In re BioClinica, Inc. S’holder Litig.*, 2013 Del. Ch. LEXIS 52 (Del. Ch. Feb. 25, 2013).

201. *Id.* at *7.

202. *Id.* at *16–17.

D. Cases Denying Motions to Dismiss, and the Promotion of Efficient Settlements

Thus far we have examined Delaware's triage system for representative shareholder litigation with a somewhat one-sided view of efficiency: specifically, we have focused on cases in which the grant of a motion to dismiss, or denial of a motion to expedite discovery, either ends the litigation or at least defers and perhaps avoids costly discovery. These are the cases that the court preliminarily finds lack substantive merit. But what about the converse situation, where the motion to dismiss is denied or expedited discovery is permitted, because the court finds the claims presented to be either "reasonably conceivable" or "substantially colorable?"

We claim that even in this converse situation, the system has promoted efficiency by enhancing the opportunity for inexpensive disposition of the litigation through voluntary settlement. To be sure, not every denial of a motion to dismiss so accurately predicts the outcome of trial that settlement inevitably ensues. Like unhappy families, each lawsuit that fails to settle is unhappy in its own way:²⁰³ opposing parties can have irreconcilably heterogeneous expectations about what the facts will ultimately establish at trial, about how witness credibility will be assessed, or about how the court will ultimately apply legal principles to the facts presented; and the factual "record" on a motion to dismiss (or to expedite discovery) is necessarily incomplete, to some degree, relative to the record that would be presented at trial. Settlement may be deterred by the fact that parties have different appetites for risk, or for current versus future expenditures. And, parties are not always perfectly rational (quite an understatement, to anyone who has ever been a lawyer more than briefly). So, there are many reasons why any given case might not settle, even after the denial of a motion to dismiss provides the clearest of articulations of the court's preliminary assessment of the facts and the law, and even where the court is able to consider a substantial body of undisputed facts.

Our claim, however, is that preliminary assessments of the merits in Delaware's triage system can facilitate settlement, even if they do not invariably result in settlement. We review examples of this result below, but the reasons to believe that such efficiencies exist derive from the assessment of the Delaware system described above. We posit first that rational clients and their counsel, given reasonably clear legal principles and a shared understanding of the relevant facts, will prefer to settle on a basis that they predict would emerge after trial, rather than incur the substantial costs of going through with a trial. And because Delaware's triage system in representative shareholder litigation provides (1) a substantive assessment of the merits of the claims, that is (2) presented by the same judge who will hear and decide the case after trial, and (3) based on a substantial body of relevant and essentially undisputed facts, that system enables the parties to make a much more informed prediction about the likely outcome after trial, which contributes to making the parties' expectations in that regard much more congruent than in a system with a less searching preliminary inquiry into the merits on a motion to dismiss.

Recent litigation involving a challenge to a "dead hand proxy put" approved by the board of directors of Healthways illustrates the settlement-promoting role of the motion to

203. LEO TOLSTOY, *ANNA KARENINA* 2 (1877) ("Happy families are all alike; every unhappy family is unhappy in its own way.").

dismiss. In that case,²⁰⁴ a shareholder of Healthways, Inc. sought to invalidate an agreement that was entered into after a threatened proxy contest emerged in which the company's principal creditor would be entitled to accelerate the company's debt obligations if in the prior two years directors elected by dissident stockholders came to comprise a majority of the board. Suing both on behalf of a class of Healthways stockholders and, in the alternative, derivatively on behalf of the company, the plaintiff named both the directors of the company and the lender as defendants, the latter on the theory that it aided and abetted the directors' breach of fiduciary duty. All defendants moved to dismiss, with the lender defendant asserting that the complaint failed to state a claim against it, and the directors asserting that the plaintiff's claims were not ripe for adjudication. Plaintiff had sought and obtained, pursuant to statutory inspection rights, documents relating to the adoption of the proxy put, none of which reflected any "substantive negotiation" about the provision or any "extraordinarily valuable economic benefits" received by Healthways on accounting of granting the put.²⁰⁵

In a ruling from the bench, the court denied the motion to dismiss.²⁰⁶ In addressing the viability of the aiding and abetting claim, the court rejected the lender's assertion that its arm's length status insulated it from liability: prior rulings on proxy puts, said the court, "should have put people on notice that there was a potential problem here such that the inclusion of the provision was, for pleading-stage purposes, knowing."²⁰⁷ That ruling, if nothing else, alerted the lender that its ability to enforce the loan agreement, with the proxy put, was no longer secure. And indeed, on February 11, 2015—less than four months after the denial of the motion to dismiss—the parties filed a stipulation of settlement providing for the cancellation of the proxy put. The settlement was approved on May 8, 2015.²⁰⁸ In sum, after having used its statutory inspection rights to establish the absence of any negotiated benefit from the proxy put, the plaintiff was able to survive a motion to dismiss its complaint which, in turn, led to a nearly immediate settlement in which the plaintiff obtained essentially the relief that it would have sought at trial. And according to the court's docket in the case, all of this occurred without a single formal discovery request.

The motion to expedite discovery can serve the same sort of function as the motion to dismiss. We begin with a case where the motion was granted. In *Police & Fire Retirement System of Detroit v. Bernal*,²⁰⁹ the plaintiff sought expedited discovery in aid of a motion for a preliminary injunction against a merger with an arm's length acquirer. In some respects the deal protections in the merger agreement seemed conventional—a matching right, a no-shop agreement, and a termination fee—and defendants opposed expedition, arguing that such deal protections did not give rise to a colorable claim. The court rejected

204. *Pontiac Gen. Emps. Ret. Sys. v. Ballantine*, C.A. No. 9789-VCL, 2015 Del. Ch. LEXIS 139 (Del. Ch. May 8, 2015).

205. Transcript of Oral Argument at 71, *Pontiac Gen. Emps. Ret. Sys. v. Ballantine* (C.A. No. 9789-VCL).

206. *Id.* at 68–81.

207. *Id.* at 81.

208. *Ballantine*, 2015 Del. Ch. LEXIS 139, at *3–5.

209. *Police & Fire Ret. Sys. of Detroit v. Bernal*, C.A. No. 4663-CC, 2009 Del. Ch. LEXIS 111 (Del. Ch. June 26, 2009).

defendants' argument, however, and while its expedited opinion does not analyze the merits extensively, it does recite some facts that could explain why refined judicial antennas might have picked up a signal of breach of duty: the merger agreement, including its deal protections, was entered into *after* a competing bidder had expressed interest and a meeting with that potential bidder had been scheduled, but before the meeting took place.²¹⁰ The potential bidder then outbid the merger partner by \$5 per share, and after the partner exercised its match right, the target insisted that it was precluded from negotiating further with the competing bidder. In short, the court could well have concluded (and evidently did) that this was a case where the deal protections prematurely stifled the bidding.

In any event, less than two weeks after the court granted the motion to expedite discovery, the competing bidder raised its offer by another \$3.50 per share, and two days later the target entered into a merger agreement with the competing bidder, with none of the challenged deal protections²¹¹—doing exactly what it had previously told the court it was precluded from doing. Evidently, in the face of the court's ruling on the motion for expedited discovery, neither the target nor the original merger partner felt confident that the no-shop provision in the original merger agreement would be enforced. Once the new topping deal was announced, the plaintiff in the litigation thereupon concluded that the litigation had fully served its function, and moved for a dismissal of the case (and an award of attorney's fees). That motion was granted, and the case ended, without further proceedings and attendant costs. The court's ruling granting expedited discovery contributed to the prompt, effective, and efficient resolution of the litigation.

Where it is denied, a motion to expedite discovery can also promote the efficient resolution of litigation, much as if it were the grant of a motion to dismiss. *Stourbridge Investments LLC v. Bersoff*²¹² is a remarkable example of this, remarkable because the defendants did not even oppose expedition.²¹³ In this litigation "challenging an arm's length, third party merger agreement," entered into "after an extensive market canvass,"²¹⁴ the court responded to plaintiff's motion for expedited discovery by noting that it "conducts a truncated determination of the merits" and inquires whether the merits "are sufficient to impose on both the parties and also on the public and the Court, the increased burden an expedited proceeding entails."²¹⁵ Noting that the plaintiff's claim must be "sufficiently colorable," and that "not just any claim will do," the court ruminated that the liberal attitude toward expedition that Chancellor Allen described in 1994 seemed "quaint," in light of the "dramatic transformation" in the volume of public company merger litigation described at

210. *Id.* at *1–3.

211. Stipulation of Settlement and Dismissal, *Police & Fire Ret. Sys. of Detroit v. Bernal*, C.A. No. 4663-CC, 2010 WL 151635 (Del. Ch. Jan. 13, 2010).

212. *Stourbridge Investments LLC v. Bersoff*, C.A. No. 7300-VCL (Del. Ch. Mar. 13, 2012), <http://www.delawarelitigation.com/files/2012/04/stourbridge-teleconference-motion-to-expedite.pdf>.

213. This was apparently due to a desire to foster activity in the Delaware litigation in an effort to preserve the Court of Chancery as the primary forum, in preference to a parallel case pending in federal court in Virginia. *Id.* at 5 (according to defendants' counsel, "We weren't confident we could successfully oppose expedition in both jurisdictions, so we agreed to not oppose in Delaware and have moved to stay in Virginia based upon the pendency of the Delaware case.").

214. *Id.* at 7.

215. *Id.* at 9.

the outset of this article.²¹⁶ Expressing the view that the sheer numbers of deal cases indicate “that there are market imbalances here and externalities that are being exploited,”²¹⁷ the court pointedly denied expedition, describing the case as “really a harvesting case and not a litigating case,” and avowing that “I am not going to facilitate leverage to create a harvest settlement in a case like this where there’s been absolutely no colorable reason for anyone to be concerned about this deal.”²¹⁸

Having received the court’s preliminary (and harsh) assessment of the merits, plaintiff voluntarily dismissed its complaint on April 17, 2012, just about a month after the court denied its motion to expedite discovery. According to the docket in the matter, no formal discovery requests were ever filed.

E. Limits of Pleading Stage Evaluation of Shareholder Litigation

Despite our enthusiasm for the Delaware system of pleading stage evaluation of shareholder litigation, we recognize and review in this section several categories of cases in which such evaluation is, for various reasons, impractical or unavailable. As explained below, perhaps none of these categories involves costs that could be efficiently eliminated through improvements in the pleading stage triage system we describe. It is important, however, to recognize the limitations of that system.

Closely held companies. Shareholder litigation of course exists in closely held companies as well as in publicly traded companies.²¹⁹ But in the case of the closely held corporation the need for pleading stage evaluation of shareholder litigation is far less compelling than in the case of the publicly held company. Because the typical minority shareholder in the closely held corporation indirectly bears a more significant share of the corporation’s litigation costs than is the case for a typical shareholder plaintiff in a public company, there is less concern that plaintiffs in closely held companies will exploit a disproportionate burden of litigation expense in order to extract settlements in private company litigation. Moreover, shareholder litigation in the closely held corporation is not amenable to class action treatment because similarly situated shareholders are few in number,²²⁰ and the plaintiffs’ bar is unlikely to take on such cases where the financial stakes are typically smaller than in public company litigation and fee awards are therefore also likely to be smaller. In short, there is no significant “merger tax” problem in closely held company shareholder litigation, and policing such litigation by means of pleading stage evaluation of the sort we describe is largely unnecessary.²²¹

216. *Id.* at 9–10.

217. *Stourbridge*, slip op. at 12.

218. *Id.* at 14. The court also referred to “the profound weakness of this complaint.” *Id.* at 16.

219. *E.g.*, *Zutrau v. Jansing*, C.A. No. 7457-VCP, 2014 WL 3772859 (Del. Ch. July 31, 2014); *Zimmerman v. Crothall*, C.A. No. 6001-VCP, 2013 WL 398946 (Del. Ch. Jan. 31, 2013); *Gould v. Gould*, C.A. No. 3332-VCP, 2012 WL 3291850 (Del. Ch. Aug. 14, 2012); *Dweck v. Nasser*, C.A. No. 1353-VCL, 2012 WL 161590 (Del. Ch. Jan. 18, 2012).

220. *See* DEL. CH. CT. R. 23(a) (providing in pertinent part that a class action may be maintained “only if . . . the class is so numerous that joinder of all members is impracticable . . .”).

221. This is not to say that such early evaluation, based on a robust factual record, is necessarily inappropriate in shareholder litigation involving a closely held company. It may be, in fact, that a minority shareholder

Statutory appraisal. In recent years, statutory appraisal proceedings have become an increasingly common form of litigation that, like the class action deal litigation we examine, challenges the terms of mergers.²²² Like class action deal litigation, appraisal litigation has generated detractors, who focus on perceived abuse by those who purchase shares after a deal is announced, in an effort to profit through receipt of “fair value” in the appraisal litigation that exceeds the deal price.²²³ Others defend appraisal litigation on the grounds that, unlike class actions, it is an opt-in affair, in which participating shareholders’ incentives incline them to target deals that are underpriced, thereby minimizing or avoiding the “merger tax” problem of unmeritorious litigation.²²⁴ We do not take a position here on that debate; what we note, however, is that the motion to dismiss and the motion to expedite discovery—the key procedural vehicles for early stage triage in shareholder class and derivative actions—are essentially foreign to statutory appraisal litigation, because the petitioners in such litigation (a) need not plead any breach of fiduciary duty,²²⁵ and (b) do not typically seek expedited discovery because appraisal aims at a post-deal cash award, rather than any injunction preventing the deal from going forward. As a result, the pleading stage evaluation system we describe is irrelevant in appraisal litigation.

Entire fairness cases. We previously noted²²⁶ that the Delaware courts have now afforded controlling shareholders a road map of procedures that would restore the application of the deferential business judgment rule even to a freeze-out merger. It is unclear, however, whether and to what extent controlling shareholders will choose to travel that road, and controller freeze-out mergers that do not employ the procedures invited by the Delaware courts will continue to be subject to scrutiny for entire fairness.²²⁷ That strict standard of judicial scrutiny will also apply to other transactions in which a director, officer, or

in a closely held corporation, especially an employee-shareholder, is better situated than her public company counterpart to provide specific factual allegations to support claims of breach of fiduciary duty.

222. Korsmo & Myers, *supra* note 2, at 1553 (“Appraisal activity involving public companies is undergoing explosive growth in Delaware, driven by sophisticated parties who specialize in bringing appraisal claims.”).

223. Liz Hoffman, *Wall Street Law Firms Challenge Hedge-Fund Deal Tactic*, WALL ST. J., <http://www.wsj.com/articles/wall-street-law-firms-challenge-hedge-fund-deal-tactic-1428362171> (updated Apr. 6, 2015, 8:53 PM) (reporting major New York law firm advocacy of statutory change that would “reduce the unseemly claims-buying that is rampant and serves no legitimate equitable or other purpose”).

224. Korsmo & Myers, *supra* note 2, at 1556 (“[T]he choice to initiate appraisal proceedings appears strongly focused on litigation merit.”).

225. *Ala. By-Products Corp. v. Neal*, 588 A.2d 255, 257 (Del. 1991) (“[C]laims for unfair dealing cannot be litigated in the context of a statutory appraisal.”) (emphasis omitted); *Turner v. Bernstein*, 776 A.2d 530, 545 n.37 (Del. Ch. 2000) (“[A] statutory appraisal action is different from an equitable action in several respects. In an appraisal, the defendant is the resulting or surviving corporation and is bound to pay the fair value of the petitioners’ shares as determined by the court. 8 Del. C. § 262(i). In an equitable action, the defendants are the persons (typically the directors) who are alleged to have breached fiduciary duties owed to the plaintiffs, and the plaintiffs must prove a breach to obtain relief.”).

226. *Supra* Section III.B.5.c.

227. *See, e.g., In re Cornerstone Therapeutics Inc. Stockholders Litig.*, 115 A.3d 1173, 1177 (Del. 2015) (“[T]he companies did not follow the process established in *Kahn v. M&F Worldwide Corporation* as a safe harbor to invoke the business judgment rule in the context of a self-interested transaction. Thus, the entire fairness standard presumptively applied.”).

controlling shareholder obtains a benefit at the expense of the corporation or its other shareholders.²²⁸ In such cases, it seems unlikely, or even unthinkable, that a challenge to such a transaction would be dismissed at the pleading stage; even where an ostensibly independent committee of directors approves the transaction, uncertainty about the independence of the directors ordinarily will prevent dismissal at the pleading stage.²²⁹ But we do not urge that the pleading stage triage system needs to expand to reach such cases; these cases are likely to have substantial merit and are thus unlikely to present the merger tax problem of extracting settlements or imposing other costs in litigation lacking merit.

F. Comparison to the Federal Pleading System

The perception that one-sided discovery burdens lead to extortive settlements in unmeritorious cases—the perception addressed by the Delaware courts’ treatment of motions to dismiss in stockholder class and derivative actions—is not unique to that form of litigation; it figured prominently in the evolution of pleading standards in the federal courts.²³⁰ Indeed, it might be argued that this evolution, triggered by the Supreme Court’s 2007 and 2009 opinions in *Twombly* and *Iqbal*, respectively, demonstrates that the federal courts are now no less able than the Delaware Court of Chancery to achieve the efficiencies identified above in the Delaware system for dealing with representative stockholder litigation.

There are at least two reasons to be skeptical, however, that the more demanding pleading standards developed in recent years in the federal courts will work as well as the Delaware system’s approach to stockholder litigation. Most importantly, for institutional

228. See, e.g., *Paramount Commc’ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 42 n.9 (Del. 1994) (“Where actual self-interest is present and affects a majority of the directors approving a transaction, a court will apply . . . exacting scrutiny to determine whether the transaction is entirely fair to the stockholders.”); *In re Nine Sys. Corp. S’holders Litig.*, C.A. No. 3940-VCN, 2014 Del. Ch. LEXIS 171, at *99 (Del. Ch. Sept. 4, 2014) (“Absent certain procedural protections not implicated here [namely, the process outlined in *Kahn v. M&F Worldwide*], a minority stockholder’s challenge to a transaction in which a controlling stockholder stands on both sides implicates the entire fairness standard of review.”).

229. See, e.g., *Cornerstone*, 115 A.3d at 1180–81 (when the entire fairness standard “is invoked at the pleading stage, the plaintiffs will be able to survive a motion to dismiss by interested parties regardless of the presence of an exculpatory charter provision because their conflicts of interest support a pleading-stage inference of disloyalty”); *Krasner v. Moffett*, 826 A.2d 277, 286 (Del. 2003) (“The independence of the special committee involves a fact-intensive inquiry that varies from case to case. Thus, we cannot assume at the pleading stage that the defendants will carry the burden of establishing independence. Beyond that, it is premature to determine the legal effect—and the resulting standard of review—that would apply if a special committee that operated independently recommended a merger to the full board.”).

230. Gelbach, *supra* note 18, at 2286–87 (noting that the opinions in *Twombly* and *Iqbal* “make repeated and extensive references to the burden of discovery borne by large corporations (as in *Twombly*) or government officials (as in *Iqbal*),” and citing the finding in *Twombly*, 550 U.S. at 559, that “the threat of discovery expense will push cost-conscious defendants to settle even anemic cases before reaching those proceedings”); see also Mark Herrmann et al., *Plausible Denial: Should Congress Overrule Twombly And Iqbal?*, 158 U. PA. L. REV. 141, 146–47 (2009) (“Every incentive exists for plaintiffs to abuse discovery because many defendants choose settlement when faced with its high cost. It is entirely proper to prevent plaintiffs who cannot state even ‘plausible’ claims from inflicting massive discovery costs on defendants—and on society.”).

reasons and not through any fault or lack of qualification, federal judges lack the specialized familiarity with the subject matters they address that enables the members of the Court of Chancery to accomplish the effective early triage described above. The caseload of the Court of Chancery is heavily centered on stockholder litigation.²³¹ As a result, the members of that court, often already familiar with such litigation before they join the bench, are in any event thoroughly familiarized through their work as judges with the factual and legal context of such litigation. Indeed, the Court of Chancery, as the first to encounter new issues in that field, often leads the development of the law in that area, sometimes even ahead of the Delaware Supreme Court.²³² In contrast, the judges of the federal district courts have a diverse set of subject matter responsibilities, and there is little opportunity for them to develop the kind of intense specialization and familiarity with a particular field that the Delaware Chancellors are able to achieve. Yet that specialization and familiarity are likely to be critical to the efficient accomplishment of the task of early triage described in this Article. Thus, even when presented (via *Twombly*) with a doctrinal tool encouraging such early triage, one thoughtful federal judge questioned the ability of a federal judge to apply that tool effectively, observing that “no one quite understands what the case holds We district court judges suddenly and unexpectedly find ourselves puzzled over something we thought we knew how to do with our eyes closed: dispose of a motion to dismiss a case for failure to state a claim.”²³³

A second reason to be skeptical that the federal pleading system will work as efficiently as the Delaware system of handling representative stockholder litigation involves the matter of pre-pleading access to relevant information. One of the principal concerns about applying a more demanding standard for pleading facts is that informational asymmetry between plaintiffs and defendants, particularly in cases of harm to individuals (civil

231. See, e.g., Curtis Alva, *Delaware and the Market for Corporate Charters: History and Agency*, 15 DEL. J. CORP. L. 885, 903 (1990) (“[E]ach judge spends about seventy-five percent of his or her time on corporate matters.”).

232. For example, the Chancellor’s analysis of the oversight responsibility of directors in *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996), was ultimately adopted by the Delaware Supreme Court, ten years later, in *Stone v. Ritter*, 911 A.2d 362, 365 (2006) (“[W]e hold that *Caremark* articulates the necessary conditions for assessing director oversight liability.”). Similarly, the Chancellor’s suggestion in *In re Cox Commc’ns, Inc. S’holders Litig.*, 879 A.2d 604, 618 (Del. Ch. 2005) that the business judgment standard of review should apply to a controller-sponsored freeze-out when approved by both independent directors and a majority of the minority stockholders was adopted by the Delaware Supreme Court nine years later in *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635, 644 (Del. 2014) (“[B]usiness judgment is the standard of review that should govern mergers between a controlling stockholder and its corporate subsidiary, where the merger is conditioned *ab initio* upon both the approval of an independent, adequately-empowered Special Committee that fulfills its duty of care; and the uncoerced, informed vote of a majority of the minority stockholders.”). Finally, the notion that the corporation’s charter and bylaws, viewed as a contract among the stockholders and the corporation, could effectively limit stockholder litigation through forum selection, fee shifting, or otherwise, was first expressed by the Chancellor in *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 956 (Del. Ch. 2013) (“[S]tockholders have assented to a contractual framework established by the DGCL and the certificates of incorporation that explicitly recognizes that stockholders will be bound by bylaws adopted unilaterally by their boards.”), and only later adopted by the Delaware Supreme Court, in *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 560 (Del. 2014).

233. Colleen McMahon, *The Law of Unintended Consequences: Shockwaves in the Lower Courts After Bell Atlantic Corp. v. Twombly*, 41 SUFFOLK U. L. REV. 851, 852–53 (2008).

rights claims and product liability claims), unduly deters valid claims.²³⁴ As discussed above,²³⁵ a key element in the efficient operation of the Delaware system is the relatively low-cost availability to stockholders (through state law inspection rights and federal disclosure requirements) of information needed to satisfy fact pleading requirements. In the absence of low-cost access to information that is relevant to one or more of the sundry claims within the jurisdiction of the federal courts, the *Twombly/Iqbal* regime now prevailing in the federal system may be less efficient than the Delaware system.

IV. CONCLUSION

In recent years, merger and acquisition activity has generated nearly ubiquitous litigation that to some considerable extent lacks substantive merit. That litigation may well reflect an agency problem that such litigation is initiated and controlled largely by plaintiff's attorneys rather than by stockholders having equity investments sufficient to enable and motivate them to reject inefficient litigation. Whatever the reason, however, the risk/reward dynamics of such litigation encourage the defendants to agree to quick settlements with substantial attorneys' fee awards but no payment to shareholders, whether there is a good case, a bad case, or no case at all. Because stockholder clients cannot be counted on to fulfill the necessary supervisory role, some external inputs or constraints are necessary to avoid this inefficiency, described as a "merger tax." Some have suggested that fee-shifting charter and bylaw provisions are an appropriate constraint of this sort. But while such provisions would certainly discourage the plaintiff's lawyer from bringing a bad case, they would also discourage the plaintiff's lawyer from bringing even a very good case as well.

Active judicial supervision of public company shareholder litigation, at an early stage, provides a better solution that reduces the costs of frivolous litigation to shareholders, while maintaining the incentive for the plaintiffs' bar to search for cases where directors have breached a fiduciary duty owed to shareholders. Using procedures and doctrines that have not previously been catalogued and appreciated as a coherent set of interrelated dynamics, the Delaware Court of Chancery provides a model for such a solution: it is a specialized court whose docket is primarily business transaction cases, and whose judges become experts at evaluating a complaint and defendants' responses and deciding quickly whether the case has substantive merit.

We show above that in the hands of the Court of Chancery, the motion to dismiss has become the primary procedural vehicle for accomplishing that early stage triage of shareholder litigation. We demonstrate that the Court of Chancery employs the motion to dismiss to engage in a factually robust analysis of the merits, despite liberal pleading standards

234. E.g., Alexander A. Reinert, *The Costs of Heightened Pleading*, 86 IND. L.J. 119, 159 (2011) ("[C]ases in which state of mind plays a large role or in which there are large information asymmetries, such as civil rights, constitutional, and employment discrimination cases, are most likely to be vulnerable to accusations of thin pleading.").

235. *Supra* Section II.A.1.

that ostensibly preclude dismissal where the pleaded facts make a viable claim appear “reasonably conceivable” or “colorable.” We demonstrate that such early stage analysis depends upon a judicial insistence on pleading, or allowing for dismissal stage consideration of, essentially undisputed facts, and upon the availability of such facts to the plaintiff shareholder through sources that compensate for the problem of asymmetric access to relevant information.

We thus suggest that the motion to dismiss in representative shareholder litigation has come to resemble, and substitute for, the motion for summary judgment. The Delaware courts’ atypical demand for, and unusual willingness to consider, extensive facts in resolving motions to dismiss encourage defendants to supply relevant information voluntarily, on a cost efficient basis that avoids largely unlimited discovery. Finally, our assessment of the pleading stage triage system suggests that where time constraints, most notably in deal litigation, preclude disposition via a motion to dismiss, the motion for expedited discovery must necessarily come to serve the same efficiency promoting functions as the motion to dismiss. And indeed, we observe that in resolving motions to expedite discovery in deal litigation, the Court of Chancery has come to apply essentially the same level of substantive factual review of the merits encountered in resolving motions to dismiss.

The result is a system in which cases settle at the motion to dismiss stage and few make it to trial on the merits. In the period from 2011 through 2015, only five public company class and derivative cases were decided after trial. The Delaware system thus has already achieved a high degree of efficiency in resolving such litigation. There are areas—closely held company shareholder litigation, statutory appraisal litigation, and entire fairness cases—in which the efficiency of early stage resolution is not or cannot be achieved, and perhaps appropriately so. But with the likely concentration of deal litigation in the Delaware courts resulting from increasingly prevalent exclusive forum charter and bylaw provisions, the motion to dismiss and the motion to expedite discovery are likely to become even more important in promoting the efficient conduct of shareholder class and derivative litigation involving public companies.

Even in the class and derivative litigation in which the merger tax problem arises, however, Delaware’s pleading stage triage system does not entirely eliminate that problem. Briefing and arguing a motion to dismiss is not cost-free, and rational defendants could conclude that they are better off settling early based on supplemental disclosures and paying a plaintiff’s attorney fee, rather than pursue even a viable motion to dismiss. And despite increased judicial scrutiny of such settlements,²³⁶ and increasing use of exclusive forum selection bylaws that will alleviate the tendency of multi-forum litigation to encourage such “merger tax” settlements,²³⁷ some level of “merger tax” is unavoidable, as long as

236. See *supra* notes 2, 4 (noting the substantial decline in deal litigation frequency following the Court of Chancery’s ruling in *Trulia* developing a more rigorous standard for approval of disclosure-only settlements).

237. Lawrence A. Hamermesh, *How Long Do We Have to Play the “Great Game?”*, 100 IOWA L. REV. BULL. 31, 34–36 (2015); *Explanation of Council Legislative Proposal*, *supra* note 10, at 9 (“To the extent the prevalence of multi-forum litigation has made the Delaware courts reluctant to police stockholder litigation, [the proposed legislation’s] enhanced means to end the multi-forum litigation problem should increase judicial confidence to use the tools available to supervise stockholder litigation more effectively”). See also Cain & Solomon, *Takeover Litigation in 2015*, *supra* note 2, at 3 (“Multi-jurisdictional litigation continued to decrease significantly

class and derivative litigation is to remain a viable tool to enforce fiduciary duties. But no system is perfect, and agency costs in representative shareholder litigation, as in any setting, cannot be expected to be reduced to zero.

in 2015 with 23.4% of transactions with litigation experiencing litigation in multiple states. This compares to 53.6% of transactions with multi-state litigation in 2012. Multistate litigation rates have now been sliding for the past four years. This decrease is likely due to the effectiveness and increasing use of forum selection by-laws”).