Out with Fiduciary Out?

Guy Firer[*] & Adi Libson[**]

In one of the most renowned and highly controversial decisions in Delaware in the last 20 years, Omnicare, Inc. v. NCS Healthcare, Inc., *the Delaware Supreme Court ruled that the board of a publicly traded target company cannot completely lock up a merger. According to the court's ruling, the merger must include a fiduciary out clause that enables the board and the company to terminate the agreement if a better offer is proffered before the deal is approved by the company's shareholders. The* Omnicare *decision has been widely criticized by practitioners and scholars who argue that it prevents the execution of time-sensitive deals that cannot take place without a complete lock-up of the agreement. The requirement also introduces a high degree of uncertainty into M&A transactions. No persuasive justification has been provided to explain this anomaly, which led the Delaware courts to narrow the scope of the requirement as much as possible. Vice Chancellor Lamb went as far as noting that "*Omnicare *is of questionable continued vitality."*

In this Article, we offer a novel justification for the Omnicare *ruling: shareholders are unable to effectively monitor the functioning of the board when deals are insulated from market forces. Shareholders lack the requisite information to assess whether the price the board approved is the best price the company could receive. The only meaningful check on the board in making this crucial decision is the market. The emergence of a better offer prompts shareholders to question the desirability of the transaction that the board has approved. A complete lock-up of a deal prevents the emergence of competing offers and leaves the board without effective oversight in this crucial decision. In this Article, we discuss the implications of the oversight rationale for fine-tuning the* Omnicare *ruling. We argue that transactions in which directors and managers commit to having no role in the company after the merger or acquisition should be exempt from the* Omnicare *ruling. Further, by contrast to the narrow interpretation of* Omnicare *adopted by courts in subsequent cases, which treated mergers lacking an intervening bidder more leniently, we argue that even in such cases, the merger should be enjoined if it did not include a fiduciary out. Finally, we expand the* Omnicare *ruling to apply to mergers approved by immediate shareholder written consent.*

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INTRODUCTION

Merger and acquisition (M&A) agreements play a crucial role in the life cycle of a corporation. They determine the direction in which a corporation is heading and have a direct impact on shareholders' returns. Consequently, corporations invest considerable resources in M&A transactions. Corporations must pay for financial advice, legal representation, due diligence services, and debt financing—all of which result in extremely high transaction costs. The process is further complicated by the time gap between the signing of the agreement after the board's approval and the closing of the deal after the shareholders' approval. The high transaction costs that accompany the process, together with the uncertainty that engulfs it, make companies cautious to engage in the M&A process. A potential acquirer does not want to incur significant expenses only to find that it was outbid by a competitor. Thus, managers and boards often prefer to avoid the uncertainty of M&A transactions by locking up the agreement—namely, by agreeing not to consider other offers once the deal is signed.

The legal legitimacy of this measure is questionable and has received much attention from courts, practitioners, and legal scholars due to its far-reaching implications for M&A transactions. In one of the most renowned and controversial decisions on this issue in the last 20 years, *Omnicare, Inc. v. NCS Healthcare, Inc.*, the Delaware Supreme Court (in a rare, 3-2, split decision) ruled that the board of a public target company cannot decide to completely lock up a merger.[1] Hence, the merger agreement must include a fiduciary out clause that enables the board and the company, inter alia, to terminate the agreement if a superior offer arrives before the deal is approved by the shareholders.[2] If the agreement does not include such an exit clause, the deal may be deemed "preclusive and coercive,"[3] and the board would be deemed to have failed to discharge its duties.[4]

The *Omnicare* decision has since had an immense impact on M&A agreements. The requirement to add a fiduciary out clause complicates M&A transactions by preventing the parties from "sealing the deal" and forcing them to address contingencies associated with the emergence of a superior offer that would force the company to back out of the deal. The fiduciary out requirement has generated considerable frustration among practitioners.[5] It is not only practitioners who have questioned the decision. Many scholars, too, have criticized it, echoing the opinion of the dissenting minority in *Omnicare* that prohibiting a complete lock-up would be detrimental to the interests of the company in a myriad of cases.[6] There may be parties to whom the value of the deal's certainty is extremely high. Eliminating the ability to lock up the deal would discourage them from making an offer or significantly reduce the price they would be willing to pay for the company.[7] A fiduciary out clause is essentially an option that allows the company to terminate the deal if a superior offer is proffered. Mandating the inclusion of a fiduciary out clause is no different from forcing the target to purchase an exit option. In such cases, the price of the option may be too high, as any option could be, and not worthwhile for the company to purchase. Mandating such a purchase invariably generates a social loss.[8]

Can there be any other justification for a fiduciary out requirement? Some scholars have suggested additional justifications for the *Omnicare* ruling: Professor Sean Griffith

1. Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 939 (Del. 2003).

2. For the different aspects of fiduciary-out mechanisms, see generally William T. Allen, *Understanding Fiduciary Outs: The What and the Why of an Anomalous Concept*, 55 BUS. LAW. 653 (2000).

3. *Omnicare*, 818 A.2d at 935.

4. Even if the deal does not include a fiduciary out clause, fiduciaries may allegedly still be able to opt out from inferior contracts by employing "efficient breach" claims. For a detailed explanation of the advantages of fiduciary outs over the utilization of "efficient breach" claims, see Allen, *supra* note 2, at 655–56.

5. *See, e.g.*, Edward Herlihy & David Shapiro, *Court Holds No Duty to Include a "Fiduciary Out" in Extra-Ordinary Transaction Agreements*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 18, 2011), https://corpgov.law.harvard.edu/2011/04/18/court-holds-no-duty-to-include-a-fiduciary out-in-extra-ordinary-transaction-agreements/ [https://perma.cc/HX4G-X6SB] (supporting the decision of the California Court of Appeals in *Monty v. Leis*, 123 Cal. Rptr. 3d 641 (Cal. Ct. App. 2011) that rejected the *Omnicare* ruling requiring a fiduciary out provision in mergers).

6. *See, e.g.*, Stephen M. Bainbridge, *Precommitment Strategies in Corporate Law: The Case of Dean Hand and No Hand Pills*, 29 J. CORP. L. 1, 32 (2003); Wayne O. Hanewicz, *Director Primacy,* Omnicare*, and the Function of Corporate Law*, 71 TENN. L. REV. 511, 561–62 (2004); Thanos Panagopoulos, *Thinking Inside the Box: Analyzing Judicial Scrutiny of Deal Protection Devices in Delaware*, 3 BERKELY BUS. L.J. 437, 474 (2006); Sean J. Griffith, *The Omnipresent Specter of* Omnicare, 38 J. CORP. L. 753, 755 (2013); Julian Velasco, *Fiduciary Duties and Fiduciary Outs*, 21 GEO. MASON L. REV. 157, 203–04 (2013); Steven M. Davidoff & Christina M. Sautter, *Lock-Up Creep*, 38 J. CORP. L. 681, 682 (2013); Megan Wischmeier Shaner, *How "Bad Law, Bad Economics and Bad Policy" Positively Shaped Corporate Behavior*, 47 AKRON L. REV. 753, 768 (2014).

7. For lock-up devices, see Christina M. Sautter, *Shopping During Extended Store Hours: From No Shops to Go-Shops: The Development, Effectiveness, and Implications of Go-Shop Provisions in Change of Control Transactions*, 73 BROOK. L. REV. 525, 534 (2008).

8. Allen, *supra* note 2, at 655. A different aspect of such a question is "[h]ow much is enough?" Sautter, *supra* note 7, at 525.

explained it as stemming from a fiduciary's duty to be fully informed in their decision-making.[9] Professor Julian Velasco justifies it through the lens of the protection of shareholder rights.[10] We argue that these justifications do not fully answer the problem that the *Omnicare* decision generates.

In this Article, we provide an alternative justification that has important legal ramifications. The problem with a merger agreement that does not include a fiduciary out clause is not that it forecloses the possibility of receiving a better offer in the future, but that it bars the most effective method of monitoring the functioning of the board—namely, the market test. Directors, like any other agent, might prefer their own self-interests over those of the shareholders. This fear is especially relevant in end-game decisions. In such situations, directors may focus on external opportunities, such as securing new positions for themselves after the merger, to just "get the transaction over with." It is quite difficult for shareholders to know whether the deal the board has pursued is optimal. Because information regarding the potential value of the company to various market actors is very costly to obtain, shareholders have no way to directly ascertain whether the price is the highest one possible. Lacking such information, they cannot monitor the board effectively, which may lead them to approve unfavorable or suboptimal deals. The most effective mechanism that reins in opportunistic behavior on the part of the board and provides monitoring over its decisions is the market. Fiduciary out clauses invite market actors to submit bids on the target even after a deal with another acquirer is finalized. In the presence of such clauses, the board knows that if the deal it is pursuing is not optimal for shareholders, the market may reflect that fact via the emergence of a superior offer. The complete lock-up of a merger insulates it from market oversight. No potential acquirer will invest in presenting a better proposal if no deal can be made in any case. Absent market oversight, the board functions without effective monitoring at a time when such monitoring is critical. The prohibition on complete lock-ups is intended to prevent the board from functioning without effective oversight. It does not stem from a conventional understanding of fiduciary duties but from a broader consideration of not enabling the board to circumvent effective oversight.

This rationale, which we suggest underlies the prohibition of complete lock-ups, has important legal implications. There may be situations in which no oversight is needed. If the board does not stand to gain even indirect benefits from the deal—such as maintaining their board seats in the merged company or enjoying any other direct or indirect gain—the rationale behind restricting a complete lock-up of the deal is weakened. On the other hand, the proposed rationale may still warrant enjoining a merger for which there is no fiduciary out clause, even when there is no intervening bidder. This approach is contrary to post-*Omnicare* rulings that have exempted the full application of *Omnicare* from such cases. According to the oversight rationale, the fact that there is no intervening bidder only exacerbates the oversight problem and does not serve as a mitigating factor. Similarly, the rationale also calls for the full application of *Omnicare* in cases of immediate shareholder consent, which is in contrast with rulings that exempted such cases from the fiduciary out requirement. The reason is that such immediate consent does not mollify the oversight concern, and thus the fiduciary out requirement should also apply to such cases.

9. Griffith, *supra* note 6, at 783–84.
10. Velasco, *supra* note 6, at 202–04.

This Article will unfold in four Parts. In Part I, we present the *Omnicare* ruling, the problem it raises, and how this problem was dealt with in the interpretation of the ruling by subsequent court decisions. In Part II, we explore the possible theoretical justifications for the *Omnicare* ruling and the problems that each of the justifications raises. In Part III, we introduce the novel monitoring rationale for the *Omnicare* ruling, which addresses the problems mentioned in the previous part. In Part IV, we discuss the policy implications of the monitoring rationale—how it may require limiting the *Omnicare* ruling in some cases and expanding it in others. A conclusion will ensue.

I. FIDUCIARY OUT: THE *OMNICARE* RULING AND FOLLOWING DECISIONS

A. The Omnicare *Ruling*

The issue of complete lock-up of merger agreements arose in *Omnicare, Inc. v. NCS Healthcare, Inc.*[11] NCS was immersed in debt and was searching for an acquirer that would save the company.[12] Omnicare was willing to offer $270 million in its improved offer for NCS as a sale of assets in bankruptcy.[13] It would thus only pay existing debtors of NCS and not leave any consideration for the shareholders.[14] This led NCS to reject the offer.[15] Consequently, NCS entered into negotiations with Genesis, which was willing to offer a price exceeding Omnicare's offer, which would also provide consideration to shareholders.[16] The rivalry between Genesis and Omnicare and the fact that Genesis had previously lost a bitter bidding war with Omnicare led Genesis to insist on exclusivity agreements and lock-ups in its negotiation with NCS.[17] Genesis emphasized that it wanted to insure it would not be used as a "stalking horse."[18] As a result, when Omnicare sent an improved offer that was conditional on due diligence, NCS received an improved offer from Genesis and did not negotiate with Omnicare.[19] Genesis's offer was made conditional upon its approval by midnight the next day; otherwise, it would terminate discussions and withdraw the offer.[20] The board of NCS decided to approve the agreement, which, as the legal counsel emphasized, "would prevent NCS from engaging in any alternative or superior transaction in the future"[21] given its complete lock-up provisions—the lack of a fiduciary out clause and the agreement with NCS' major shareholders which held over 50% of its shares, obligating them to vote in favor of the agreement. Omnicare once again sent an improved offer.[22] The NCS board withdrew its recommendation that shareholders vote in favor of the NCS/Genesis merger in view of this improved offer.[23] Yet, due to its contractual obligation to submit the merger to a stockholder vote and Genesis's voting

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11. *See generally* Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914 (Del. 2003).
12. *Id.* at 920.
13. *Id.* at 921.
14. *Id.*
15. *Id.*
16. *Omnicare*, 818 A.2d at 922.
17. *Id.* at 921.
18. *Id*. at 922–23.
19. *Id.* at 924.
20. *Id*. at 925.
21. *Omnicare*, 808 A.2d at 925.
22. *Id*. at 926.
23. *Id.*

agreement with the major shareholders, together with the lack of a fiduciary out clause, the rejection of the Genesis merger was deemed impossible.[24]

Omnicare filed a lawsuit to prevent the consummation of the Genesis merger, claiming that the approved merger was inferior to the one they offered, and thus the NCS fiduciaries violated their fiduciary duty of care in their decisions leading to the acceptance of the inferior offer.[25] The Delaware Chancery Court rejected Omnicare's claim, determining that "the NCS board of directors had not breached their duty of care by entering into the exclusivity and merger agreements with Genesis."[26] The Chancery Court held that complete lock-ups constitute defensive measures that require special scrutiny under the two-part test set in *Unocal Corp. v. Mesa Petroleum Co.*[27] Still, the Chancery Court found that the NCS directors survived the *Unocal* two-part test: "the directors acted in conformity with their fiduciary duties in seeking to achieve the highest and best transaction that was reasonably available to [the stockholders]."[28] The Delaware Supreme Court overruled the Chancery Court, determining that the NCS directors' conduct did not comply with the *Unocal* test.[29] The second part of the *Unocal* test is that the defensive measure is "reasonable in relation to the threat posed."[30] In *Unitrin, Inc. v. American General Corp.*, the court held that a preclusive response that deprives stockholders of the right to receive all tender offers falls outside the scope of *Unocal*'s reasonableness test.[31] The Delaware Supreme Court in *Omnicare* found the board's defense of the transaction coercive because it is absolute:

> Genesis made the NCS board's defense of its transaction absolute by insisting on the omission of any effective fiduciary out clause in the NCS merger agreement.
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> . . . .
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> . . . Deal protection devices that result in such coercion cannot withstand *Unocal's* enhanced judicial scrutiny standard of review because they are not within the range of reasonableness.[32]

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24. *Id.* at 927.

25. *Id.*

26. *Omnicare*, 818 A.2d at 929.

27. *Id.* at 918. According to *Unocal*, the enhanced business judgment rule applies to board decisions to adopt defensive measures, which constitutes a two-part test. First, the directors must have had reasonable grounds for believing that a danger to corporate policy and effectiveness existed. Second, their response must have been reasonable in relation to that threat, meaning that it was neither preclusive nor coercive and fell within a range of reasonableness. Unocal Corp. v. Mesa Petrol. Co., 493 A.2d 946, 955 (Del. 1985).

28. *Omnicare*, 818 A.2d at 929 (alterations in original) (quoting the Chancery Court opinion *In re* NCS Healthcare, Inc., S'holders Litig., 825 A.2d 240, 261 (Del. Ch. 2002). The Chancery Court held that the enhanced scrutiny standard of Revlon does not apply to the *Omnicare* case because there was no change in control as a result of the merger, but it also held that even if the *Revlon* rule did apply, it would make no difference because the board complied with the rule in seeking the highest transaction price. *Id.*

29. *Id.* at 939.

30. *Id.* at 935 (describing the second prong of *Unocal*).

31. *See* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1387 (Del. 1995) (noting that defensive measures which "strip" stockholders of the right to receive all tender offers are preclusive and thus fail to pass the second part of *Unocal*).

32. *Omnicare*, 818 A.2d at 934, 936.

In addition to the unenforceability of the protective measures, because they are preclusive and coercive, the court held that the protective measures are unenforceable because they prevent the board from discharging its fiduciary responsibility:

> [T]he provision in the merger agreement requiring the board to submit the transaction for a stockholder vote and the omission of a fiduciary out clause in the merger agreement completely prevented the board from discharging its fiduciary responsibilities to the minority stockholders when Omnicare presented its superior transaction.[33]

The court based its position on its ruling in *Paramount Communications Inc. v. QVC Network Inc.*, where it held that "to the extent that a [merger] contract, or a provision thereof, purports to require a board to act or not act in such a fashion as to limit the exercise of fiduciary duties, it is invalid and unenforceable."[34] The Delaware Supreme Court concluded that boards do not have the authority to accept absolute lock-ups: "[w]e hold that the NCS board did not have the authority to accede to the Genesis demand for an absolute 'lock-up.'"[35] The court ruled that the NCS board was required to negotiate a fiduciary out clause:

> [T]he NCS board was required to negotiate a fiduciary out clause to protect the NCS stockholders if the Genesis transaction became an inferior offer. By acceding to Genesis' ultimatum for complete protection *in futuro*, the NCS board disabled itself from exercising its own fiduciary obligations at a time when the board's own judgement is most important, i.e. receipt of a subsequent superior offer.
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> . . . .
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> The NCS board was required to contract for an effective fiduciary out clause to exercise its continuing fiduciary responsibilities to the minority stockholders.[36]

The weakness in the majority's opinion was pointed out by the dissent. Chief Justice Veasey, joined by Justice Steele, opposed the determination that failing to negotiate a fiduciary out clause constitutes a breach of the board's fiduciary duties *per se*:

> The beauty of the Delaware corporation law, and the reason it has worked so well for stockholders, directors and officers, is that the framework is based on an enabling statute with the Court of Chancery and the Supreme Court applying principles of fiduciary duty in a common law mode on a case-by-case basis. Fiduciary duty cases are inherently fact-intensive and, therefore, unique.[37]

This position led them to object the conclusion that fiduciary out clauses should be mandatory: "We respectfully disagree with the Majority's conclusion that the NCS board breached its fiduciary duties to the Class A stockholders by failing to negotiate a 'fiduciary out' in the Genesis merger agreement."[38] The dissenting opinion emphasizes that the

33. *Id.* at 936.
34. Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 51 (Del. 1994).
35. *Omnicare,* 818 A.2d at 938.
36. *Id.* at 938–39 (footnote omitted).
37. *Id.* at 939 (Veasey, C.J., dissenting).
38. *Id.* at 945.

directors were fully pursuing the interests of the shareholders when committing to a complete lock-up, stating that, "this conclusion is indisputable."[39] For some parties, the certainty of the deal may be crucial, and without that certainty no deal would be executed.[40] "A lock-up permits a target board and a bidder to 'exchange certainties.' . . . . Situations will arise where business realities demand a lock-up so that the wealth-enhancing transactions may go forward."[41] The dissent held that the business judgment rule should apply to such cases, but even if the enhanced business judgment rule of *Unocal* is applied, the complete lock-up meets its test: the complete lock-up is a reasonable response to the threat as Genesis's offer was the "only game in town" and was the only path for saving NCS from insolvency.[42] Keeping that path viable by committing to a complete lock-up should be deemed within the scope of reasonability.[43]

The problematic features of the decision in *Omnicare* have not escaped the attention of scholars and practitioners. Professor Sean J. Griffith has raised the positive-law problem with a rule that does not enable the board to commit itself to a particular decision in the future. He argues that making lock ups *per se* unlawful unjustifiably privileges the decision in the future over the decision in the present:

> The trouble, of course, with adopting a *per se* rule that the board cannot act at T1 to inhibit information available at T2 is that such a rule privileges T2 over T1. Barring the board from so acting necessarily constrains the board's choice-set at T1. The rule, in other words, inhibits the board's authority and interferes with the exercise of its duties at T1 in favor of the "unremitting" duties at T2. However, why should the board's duties at T2 trump its duties at T1? What is the basis for allowing the board's authority at either time to trump the other?[44]

Professor Julian Velasco notes that the Delaware Supreme Court's elimination of the ability of the board to commit to a bidder, irrespective of later bids, limits the board to a certain form of auction: an English auction where bidders continuously attempt to top each other.[45] It removes the possibility of other forms of auction, like a blind auction when bidders secretly submit their highest offers.[46] Unlike in a blind auction, in an English auction, bidders have no incentive to offer the best price. Because of the rule that limits the board's commitment to any bid, they are vulnerable to a topping bid.[47] Although there is no clear-cut answer to which of the two bidding processes generates a higher price, it is not appropriate that the court determine the bidding process, which is a pure business issue, on a *per se* basis.[48]

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39. *Id.* at 940.
40. *Omnicare*, 818 A.2d at 950 (Veasey, C.J., dissenting).
41. *Id.* at 942.
42. *Id.* at 943.
43. *Id.*
44. *See* Griffith, *supra* note 6, at 783–84 (concluding that "there is no doctrinal basis to interpret that duty to trump other powers and responsibilities of the board").
45. *See* Velasco, *supra* note 6, at 204.
46. *Id.*
47. *Id.*
48. *Id.*

B. Interpretation of Omnicare *in Subsequent Decisions*

The problematic *Omnicare* ruling has led subsequent court decisions to distinguish it, yet it has not been overruled. In *Orman v. Cullman*, the court distinguished between the actions of the board and management to lock up a deal, and the actions of shareholders to lock up a deal.[49] The court ruled that the restrictions of *Omnicare* apply to the former and not the latter.[50] In *Orman*, Swedish Match merged with General Cigar, buying out the public shareholders of General Cigar for cash and leaving the controlling party of General Cigar with a 36% stake in Swedish Match and maintaining control over General Cigar.[51] In order to prevent the offer from being shopped to other bidders, Swedish Match required the controlling party of General Cigar, the Cullman family, who held a majority of the voting rights, to sign a voting agreement in which they agreed to vote their shares pro rata concomitant with the vote of the public shareholders and against any alternative merger for a period of 18 months.[52] The agreement included a "majority of the minority" provision, which enables the public shareholders to exercise the power of veto over the merger.[53] A majority of the public shareholders approved the merger.[54]

The General Cigar public shareholders who voted against the merger objected to the merger proceeding on the grounds of *Omnicare*, claiming that the voting agreement together with the merger coerced the public shareholders' vote and amounted to a breach of fiduciary duties.[55] The court rejected the argument of the minority shareholders, noting two central points that distinguished the case from *Omnicare*. The first is that the shareholder vote was still an effective "out" mechanism; unlike *Omnicare*, the shareholder approval was not mathematically certain due to the effective majority of the minority provision.[56] Even though the shareholders' approval was influenced by the protective measures, such as the limitation on accepting any other offers in the 18-month window, it still posed a viable check on the agreement.[57] The second is that the lock-up agreement was with the Cullmans as shareholders and not in their capacity as fiduciaries.[58] The limitation on lock-up agreements in *Omnicare* applies to fiduciaries and not to shareholders.[59]

An important additional limitation of the *Omnicare* ruling was raised in *Optima International of Miami, Inc. v. WCI Steel, Inc.*[60] It excluded from the fiduciary out requirement cases when an immediate written vote by shareholders takes place.[61] WCI, a

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49. Orman v. Cullman, No. Civ.A. 18039, 2004 WL 2348395, at *3 (Del. Ch. Oct. 20, 2004).

50. *Id.* at *5.

51. *Id.* at *2.

52. *Id.* at *3 n.44, *8.

53. *Id.* at *3 n.44.

54. *Orman*, 2004 WL 2348395, at *3.

55. *Id.* at *6.

56. *Id.* at *3 n.44 ("[T]he public shareholders were a 'minority' in terms of voting power. But the provision in the agreement requiring the Cullmans to vote their Class A shares *pro rata* in accordance with the public shareholders effectively gave the public shareholders a 'veto' power over the proposed transaction.").

57. *Id*. at *7–8.

58. *Id.* at *3.

59. *Orman*, 2004 WL 2348395, at *8.

60. Transcript of Oral Argument on Plaintiff's Motion for Preliminary Injunction and Ruling of the Court, Optima Int'l of Miami, Inc., v. WCI Steel, Inc., No. 3833 (Del. Ch. June 27, 2008) (ruling from the bench).

61. *Id.* at 140–41.

troubled steel company, canvassed the market for potential buyers and identified two companies with which it initiated a bidding process: Optima and Severstal.[62] The United Steelworkers Union had a veto right on any change of control under its collective bargaining agreement with WCI.[63] Severstal won the required approval of the union, but Optima outbid it by over $101 million with a bid of $150 million.[64] Consequently, Severstal increased its bid to $136 million, to which Optima reacted by circumventing the board of WCI and initiating a hostile takeover by offering to purchase shares directly from the shareholders at a premium. WCI asked Severstal to support its bid, due to its higher certainty after WCI had obtained the required consent of the labor union, if it agreed to either allow a 20-day solicitation period after signing the agreement or increase its bid. Severstal opted for the latter and increased its bid to $140 million, conditioned on shareholder consent within 24 hours of signing. WCI agreed and provided the immediate written consent of the major shareholders constituting a majority, essentially locking up the transaction. Optima joined shareholder plaintiffs in a suit to enjoin the Severstal transaction. Their claim was that the complete lock-up, enabled by the requirement for approval within 24 hours and the willingness of two shareholders holding a majority of voting rights to approve the deal, violates the *Omnicare* restriction on complete lock-ups and therefore constitutes a violation of the fiduciaries' duties.

The Chancery Court refuted their claim, distinguishing between actual voting through written consent and a voting agreement in which shareholders commit to support the agreement in a future vote. Vice Chancellor Lamb emphasized that there is no legal requirement to separate the signing of the agreement from the shareholder vote.[65]

If there is no significant time between the two, fiduciary out is simply irrelevant. This ruling essentially enables companies to circumvent the *Omnicare* requirement if the two following conditions apply: first, the target's charter enables shareholder action by written consent; second, it is possible to aggregate the votes of large shareholders to form a majority of votes. Vice Chancellor Lamb conceded that the written consent of shareholders circumvents *Omnicare*: "it's really not my place to note this, but *Omnicare* is of questionable continued validity."[66]

In *In re OPENLANE, Inc.*, the court reaffirmed the *Optima* ruling, that if the agreement is effectively locked-up by an immediate shareholder vote via written consent, the agreement need not include a fiduciary out.[67] In *OPENLANE*, the board, which effectively held a majority voting control over the company, solicited prospective strategic acquirers due to financial distress.[68] It entered into an agreement with KAR under which KAR would acquire OPENLANE for $210 million in cash.[69] The agreement included a

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62. *Id.* at 63.

63. *Id.* at 42–43.

64. *Id.* at 18.

65. Transcript of Oral Argument on Plaintiff's Motion for Preliminary Injunction and Ruling of the Court, *supra* note 60, at 127–28 ("Nothing in the DGCL requires any particular period of time between board's authorization of a merger agreement and the necessary stockholder vote. And I don't see how the board's agreement to proceed as it did could result in a finding of a breach of duty.").

66. *Id.* at 127.

67. *In re* OPENLANE, Inc., S'holders Litig., C.A. No. 6849, 2011 WL 4599662, at *9 (Del. Ch. Sept. 30, 2011).

68. *Id.* at *2.

69. *Id.* at *15.

stringent non-solicitation clause and lacked any type of fiduciary out clause.[70] The agreement was approved by a majority of shareholders, which the directors controlled, the day after the signing by written consent, but it required a supermajority of at least 75% of the outstanding shares.[71] The shareholders sued to enjoin the transaction on the basis that the defensive devices—the non-solicitation clause without a fiduciary out and the immediate vote of shareholders—were impermissible under the *Omnicare* holding. Vice Chancellor Noble rejected their claim based on the *Optima* ruling that an immediate vote of shareholders does not conflict with the *Omnicare* decision.[72] Similarly to *Optima*, Vice Chancellor Noble interpreted *Omnicare* narrowly: a lock-up is problematic only when there is no fiduciary out, together with shareholder voting agreements that the board promises to deliver.[73] The immediate written consent of shareholders is not an act of the board and thus does not pose the problem of a board-initiated lock-up.[74]

Furthermore, Vice Chancellor Noble emphasized that even if the absence of a fiduciary out is prohibited *per se* according to *Omnicare*, it does not provide sufficient grounds for enjoining the merger if no superior offer has emerged.[75] The absence of a fiduciary out provision does not preclude the possibility that other offers will emerge.[76] Potential bidders are aware that the Delaware courts may not enforce a merger agreement that lacks a fiduciary out if they present a superior offer to the board.[77]

These three decisions following *Omnicare* demonstrate that the Delaware courts do not feel comfortable with the *Omnicare* decision.[78] While they did not overrule *Omnicare*, they strove to limit it as much as possible by permitting a lock-up through shareholder agreement if the outcome is not certain and enabling companies to completely lock-up the deal without a fiduciary out if it is approved through the written consent of shareholders.[79] Delaware courts have even suggested overruling *Omnicare* given the analytical problem it poses in applying a blanket restriction on the board and management to eliminate risk regardless of the circumstances that may justify such elimination of risk. However, this opinion was expressed only as an obiter in a footnote by (then) Vice Chancellor Strine in *In re Toys "R" Us, Inc.*, pointing out that *Omnicare* is an aberration from the principle that what matters in the adoption of defensive mechanisms is whether the "board acted reasonably based on the circumstances then facing it."[80]

70. *Id.* at *3.

71. *Id.*

72. *OPENLANE*, 2011 WL 4599662, at *10 & n.51.

73. *Id.* at *24.

74. *See* Griffith, *supra* note 6, at 766 ("Shareholder voting is in no way an act of the board, as opposed to shareholder voting agreements . . . .").

75. *OPENLANE*, 2011 WL 4599662, at *4.

76. *Id.*

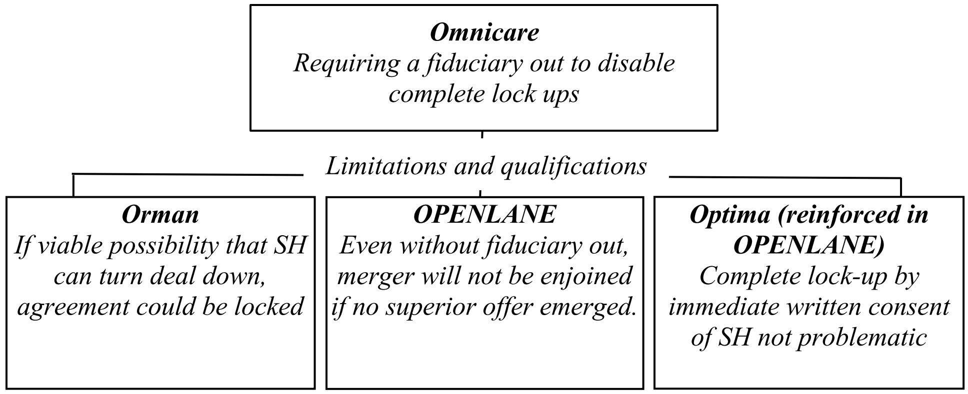
77. *Id.* at *10.

78. *See infra* Table 1.

79. *See* Griffith, *supra* note 6, at 767 ("[T]he 'OPENLANE structure' represents an important, if narrow, qualification to *Omnicare*, which can no longer plausibly be read to bar all forms of transactional certainty.").

80. *In re* Toys "R" Us, Inc. S'holder Litig., 877 A.2d 975, 1016 (Del. Ch. 2005); *id.* at 1016 n.68 ("[*Omnicare*] represents . . . an aberrational departure from [the] long accepted principle [that the board must act reasonably under the circumstances]."); *see also* Monty v. Leis, 123 Cal.Rptr.3d 641, 646 (Cal. Ct. App. 2011) ("But *Omnicare* has been criticized even by Delaware courts.").

Table 1. The Narrowing of the *Omnicare* Ruling by Subsequent Court Decisions



The big question is: why have the Delaware courts left the *Omnicare* decision standing, notwithstanding its "aberrational departure" from the previous reasoning of the Delaware courts?[81] What is the underlying justification for leaving this problematic ruling intact?

II. JUSTIFICATION FOR THE *OMNICARE* DECISION

As noted in the previous Part, the *Omnicare* decision is highly problematic because it prevents potential deals in which the value of certainty for the acquirer is high. While the Delaware courts have limited *Omnicare*, they have not overturned the decision. What is the rationale behind *Omnicare* that justifies its persistence? Scholars have provided a few distinctive explanations for the *Omnicare* decision. We decipher weaknesses in each of these explanations, which leads us to offer our novel explanation for the decision.

A. Fulfilling the Duty to Be Fully Informed

Professor Sean Griffith places *Omnicare* among a wider set of cases that impose an unremitting duty on fiduciaries to always be "fully informed"—a duty that can never be abdicated.[82] Griffith points to the *Phelps Dodge Corp. v. Cyprus Amax Minerals Co.* decision as the "ancestral spirit" of *Omnicare*.[83] In *Phelps Dodge*, shareholders sued to enjoin an agreement in which the management agreed to a no-talk provision, which eliminated the possibility of communicating with any other party besides the potential acquirer.[84] Chancellor Chandler decided to enjoin the agreement, determining that agreeing to such a provision violates the fiduciaries' "duty to take care to be informed of all material information reasonably available."[85] Griffith also considers cases that limited the use of

81. *See* cases cited *supra* note 80.
82. Griffith, *supra* note 6, at 759. For a similar view, see also Shaner, *supra* note 6, at 789.
83. Griffith, *supra* note 6, at 777.
84. Phelps Dodge Corp. v. Cyprus Amax Mins. Co., Nos. CIV.A. 17398, CIV.A. 17383, CIV.A. 17427, 1999 WL 1054255 (Del. Ch. Sept. 27, 1999).
85. *Id.* at *2.

"don't ask, don't waive" (DADW) standstill provisions as part of a wider family of cases establishing the board's duty to stay informed.[86] Standstill provisions prevent a bidding party from approaching shareholders directly in order to launch a hostile bid.[87] DADW standstill provisions limit the parties' ability to communicate with the target, sometimes even privately, in order to regain permission to approach shareholders. In *In re Complete Genomics, Inc.*, Vice Chancellor Laster ordered an injunction against the merger agreement because of the impermissibility of DADW provisions.[88] As Griffith emphasizes,[89] Vice Chancellor Laster did not base his ruling on a violation of a *Revlon* duty to remain open to superior offers, but on a violation of the board's duty to stay informed: "By agreeing to this provision, the Genomics board impermissibly limited its ongoing statutory and fiduciary obligations to properly evaluate a competing offer, disclose material information, and make a meaningful merger recommendation to its stockholders."[90] The DADW provision prevents the board from being informed regarding other bids before making its recommendation. The problem did not seem to be the exclusivity in the merger agreement, but rather, willful blindness.[91]

Less than a month later, in *In re Ancestry.com, Inc.*, the Chancery Court eased Vice Chancellor Laster's position in *Complete Genomics*.[92] With respect to a shareholder's claim against an acquisition that included a DADW standstill provision, which should be viewed as illegitimate, Strine emphasized that DADW standstills are not prohibited *per se* and may be used as commitment devices in some cases.[93] The test is highly context-sensitive. He struck down the application of the DADW standstill provision, finding that the board was not fully informed of the potency of the DADW standstill provision.[94] This could be remedied by a detailed description of the deal process, including the number of bidders that signed on such standstills, so that shareholders would have an indication of the possibility of an alternative deal even if the present one falls through. Thus, although *Ancestry* deviates from *Complete Genomics*, they both identify the problem of DADW standstill provisions as an impediment to the flow of information.[95]

Griffith notes that an "unremitting duty" to be informed in the future which bars the board from making commitments in the present effectively privileges future decisions over present ones.[96] Corporate law does not support attributing higher value to decisions in the

86. Griffith, *supra* note 6, at 770, 774.

87. For an explanation regarding standstill provisions, see Davidoff & Sautter, *supra* note 6, at 687.

88. Telephonic Oral Argument and the Court's Ruling at 18, *In re* Complete Genomics, Inc. S'holder Litig., C.A. No. 7888 (Del. Ch. Nov. 27, 2012).

89. Griffith, *supra* note 6, at 774–75.

90. Oral Argument and Court's Ruling, *supra* note 88, at 18.

91. Griffith, *supra* note 6, at 775. Griffith attributes this "pre-*Omnicare*" position, which does not object to exclusive agreement *per se*, but only as much as they bar the board from being informed as per *Smith v. Van Gorkom*, 488 A.2d 858, 873 (Del. 1985).

92. *See* The Court's Ruling on Plaintiffs' Motion for Preliminary Injunctions at 22, *In re* Ancestry.com, Inc. S'holder Litig., C.A. No. 7988 (Del. Ch. Dec. 17, 2012) ("I think what *Genomics* . . . say[s], though, is Woah, this is a pretty potent provision. . . . [D]irectors need to use these things consistently with their fiduciary duties, and they better be darn careful about them.").

93. *Id.*

94. *Id.* at 24–25.

95. Griffith, *supra* note 6, at 778.

96. *Id.* at 783.

future than to decisions in the present.[97] Griffith suggests employing enhanced scrutiny for deal protection without a fiduciary out.[98] This would provide greater flexibility than the current *Omnicare* doctrine but still impose considerable limits on DADW provisions. The board would be justified if it could prove that it had acted reasonably to prevent the loss of a deal that might be beneficial to shareholders.[99] The focus should be on both the motive and the means, unlike the traditional enhanced scrutiny that focuses on threats and proportionality.[100] Before approving protective measures, one must rule out the existence of any impermissible motives for directors—subtle variations of personal interest.[101] Next, the chosen means should fall within a range of reasonable alternatives.[102] According to Griffith, the alternatives should also be examined in light of the sale process.[103] Both *Revlon* and *Unocal* should be understood as points along the continuum of enhanced scrutiny, in which different contexts require different ways to examine the motivation and means through which protective measures are implemented.[104] Deal protection provisions should be placed somewhere on this spectrum.

Enabling greater flexibility in examining deal protection provisions, including the exclusion of a fiduciary out clause, addresses the problem of privileging future decisions of the board over present ones and the inefficiency of the outright ban on complete lock-ups. At the same time, the application of enhanced scrutiny in such cases maintains the important advantages of the *Omnicare* decision, uprooting the practice of complete lock-ups and providing certainty regarding what is a legitimate means and what is not.[105] While it may seem that an enhanced scrutiny test would impose considerable limitations very similar to those of the complete ban on lock-ups in *Omnicare*, this is far from the case. The reasonableness test is very broad and may include many more cases than the few in which the transaction would not materialize without a complete lock-up. One can almost always raise the argument that the expected increase in price attributable to the certainty that a complete lock-up provides is greater than the expected increase in price because of an

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97. *Id.*

98. *Id.* at 785.

99. *Id.* Unlike the distinction in *Revlon*, the test should apply independently of whether there was a change in control as a consequence of the transaction.

100. Unocal Corp. v. Mesa Petrol. Co., 493 A.2d 946, 955–56 (Del. 1985).

101. Griffith, *supra* note 6, at 789.

102. *Id.*

103. *Id.* at 789–90.

104. *Id.* at 790.

105. *Omnicare*, 818 A.2d at 936–38. The trade-off between the predictability of rules and the precision of standards has been much discussed in the literature on rules and standards. *See generally* WARD FARNSWORTH, THE LEGAL ANALYST: A TOOLKIT FOR THINKING ABOUT THE LAW 163–71 (2007); JOSEPH RAZ, PRACTICAL REASON AND NORMS 149–55 (photo. reprt. 1990) (1975); Cass R. Sunstein, *Problems with Rules*, 83 CALIF. L. REV. 953, 961–62 (1995); Isaac Ehrlich & Richard A. Posner, *An Economic Analysis of Legal Rulemaking*, 3 J. LEGAL STUD. 257 (1974); Kathleen M. Sullivan, *Foreword: The Justices of Rules and Standards*, 106 HARV. L. REV. 22 (1992); Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557 (1992). There are two central considerations regarding why the cost of rules is lower than standards in the case of M&A transactions. As Professor Louis Kaplow notes, from an economic perspective if the case to which the two apply is of high frequency, rules are cheaper than standards—rules save the expensive case-by-case determination of the law. *See* Kaplow, *supra* note 105, at 563. M&A cases are frequent, and thus, rules are advantageous in this context. The second consideration is the cost of the unpredictability of standards. *See id.* at 622. The cost of unpredictability is especially high with typical transaction amounts of hundreds of millions or even billions in many M&A transactions in public companies.

additional offer. This argument may not be applicable when there are indications of other potential players willing to pay a greater price, but there may be cases in which there are no such indications.

Furthermore, applying the enhanced scrutiny test to complete lock-ups that do not contain a fiduciary out will generate considerable uncertainty and high litigation costs. As noted above, in most cases, it could be claimed that the complete lock-up will generate value for shareholders due to the greater certainty it generates for the acquiring party, which would be willing to bid higher amounts given that certainty. As a rule, the reasonable test is not an effective filter for cases *ex ante*, and mainly provides guidance for courts *ex post facto*.[106] Of course, this claim would not be accepted by the courts in all cases. Yet it is very difficult to determine in which cases the assumption that the lock-up generates value for shareholders would be accepted, due to the inherently ambiguous nature of the reasonableness test. Thus, replacing the clear-cut *Omnicare* rule with an enhanced scrutiny test in relation to the exclusion of a fiduciary out provision will generate high uncertainty and considerably increase the costs of negotiating and the expense of litigation that would follow.[107]

B. Protecting Shareholder Rights

Professor Julian Velasco offers a different justification for the problematic decision in *Omnicare*.[108] Although the requirement for a fiduciary out may prevent certain efficient deals from taking place, the requirement is justified based on the purpose of protecting shareholder rights from abuse at the hands of directors.[109] Shareholders have been vested with the right to vote and approve certain fundamental transactions, specifically M&A transactions of the company.[110] Merger agreements require the approval of shareholders of both merging companies.[111] Shareholder approval is also required in the case of the sale of a substantial part of a company's assets.[112] Tender offers do not require a shareholder vote at the corporate level, but shareholders can directly express their consent or rejection through their decision of whether or not to tender their shares.[113] The ability of shareholders to vote on crucial corporate decisions represents that the "stockholder franchise" is the "'ideological underpinning' upon which the legitimacy of the directors managerial power rests."[114] The Delaware court in *Paramount Communications Inc. v. QVC Networks Inc.* also confirmed the importance of shareholder voting rights and the need to protect them: "Because of the overriding importance of voting rights, [the courts]

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106. Regarding the lower compliance with standards in comparison to rules, due to the higher costs of prediction, see Kaplow, s*upra* note 105, at 621.

107. *See* Travis J. Laster, Omnicare*'s Silver Lining*, 38 J. CORP. L. 795, 827 (2013) (identifying that *Omnicare* can be called a "'rule[] of the game,' to be taken into account by the negotiators and drafters of merger agreements").

108. *See generally* Velasco, *supra* note 6.

109. Velasco, *supra* note 6, at 189–90.

110. DEL. CODE ANN. tit. 8, § 251(c) (2023).

111. *Id.* § 141(a).

112. *Id.* § 271(a).

113. *Id.* § 203(b)(6).

114. MM Cos. v. Liquid Audio, Inc., 813 A.2d 1118, 1126 (Del. 2003) (citing Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988)).

have consistently acted to protect stockholders from unwarranted interference with such rights."[115]

Management and directors who exclude a fiduciary out provision may well be motivated exclusively by the ambition to further the interests of the company and its shareholders by obtaining an optimal deal that could not have been obtained if a fiduciary out was included in the agreement. The problem with the exclusion of a fiduciary out provision cannot be that it represents a violation by directors of their fiduciary duties by acting in a way that harms the company. The exclusion may not harm the company but actually further its interests. Velasco suggests that the problem with such action is not the damage done to the company and its shareholders by preventing them from accepting subsequent, potentially preferable, offers, but the infringement of the right of shareholders to determine whether to approve the deal.[116] Although shareholders still vote on M&A transactions that do not include a fiduciary out, Velasco claims that the exclusion of a fiduciary out may considerably restrict shareholders' ability to vote as they like and render such a vote largely meaningless.[117] Shareholders may approve a deal that they consider suboptimal purely because they know there would not be any other option due to lock-up mechanisms. According to Velasco, "[f]or directors to agree to provisions that interfere with shareholder voting rights is not only unseemly but actually strikes at the very foundations of corporate law."[118]

There are two main problems with Velasco's shareholder rights justification of the *Omnicare* ruling. The first is whether the exclusion of a fiduciary out actually imposes a serious impediment to shareholders' rights to approve or disapprove the merger. In our eyes, the answer to this question is negative. Shareholders may still vote against the merger, and the merger still requires their consent. Even if there is no fiduciary out, if shareholders are under the impression that there are better deals in the market, they can vote against the merger. If there is a player willing to bid a significantly higher value, it is most likely that it will wait until the prior offer is rejected by shareholders before making the new offer. [119] There are two reasons why shareholders would opt not to reject an offer. The first is the opportunity cost of the rejection; while there is a chance that the company will receive a higher bid after the rejection of the initial offer, there is also a possibility that the company and shareholders will find themselves left empty-handed with no offer at all. If such an outcome is a serious consideration, the agreement that the management and the board reached is likely the best, and while they *could* reject it, it is *preferable* that they do not. The fact that shareholders value the present offer more than the possibility of future offers does not imply that their rights as shareholders were infringed. It is true that they cannot accept an additional offer without rejecting the prior offer, and, in this respect, shareholders do not have the opportunity to respond to a potential second offer if they have fully accepted the first. But, by the same token, a mandatory inclusion of a fiduciary out could

115. Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 42 (Del. 1994).

116. Velasco, *supra* note 6, at 189–90.

117. *Id.* at 175.

118. *Id.*

119. *See* Shaner, *supra* note 6, at 759–60 (describing a situation where a buyer-company initially proposed a low offer, was rejected, and subsequently sent a much higher "last-minute" bid).

have prevented the initial offer from being made. [120] In this case, shareholders would not be able to have any input on responding to an initial offer, either. Not being able to have any input on the missed first offer could also be viewed as an infringement of shareholder rights, to the same extent that missing the opportunity to respond to a second offer is interpreted as such an infringement. In this respect, there is no difference between missing the second offer due to the acceptance of the first and missing the first offer due to a mandated fiduciary out clause.

The second reason why shareholders may not reject the first deal is the high cost of breaking the initial agreement. Even if shareholders are confident there is a higher offer just around the corner, they may not reject the initial agreement because the break-up fee would cause them to lose even if they received a higher offer. This, of course, is a valid concern: certain breakup fees may make it impossible to receive a higher offer because the net gain would most likely be negative. Yet this is a separate concern from that of the issue of fiduciary outs. It is an alternative lock-up mechanism that could be dealt with and monitored separately. There are standard break-up fees (around 3%), and any fee that exceeds the standard range should be abolished or at least reviewed critically.[121] As long as the break-up fee does not significantly exceed the standard rate, there is still the potential that a higher bidder may emerge, and, thus, shareholders do have a real choice even when there is a breakup fee.[122]

The second problem with Velasco's justification is that referring solely to existing shareholder rights is not necessarily determinative. Why should shareholders have the right to vote on mergers, especially if doing so may work to their detriment, raising the risk of losing more advantageous deals? There are many important decisions that the board makes without the need for shareholder approval. On the other hand, even if the law strives to provide shareholders with a voice in some matters, why is it necessarily required that they voice their preferences in all mergers? In the next Part, we will delve more deeply into this question and provide an alternative justification for the *Omnicare* ruling.

III. MONITORING OF THE BOARD AS JUSTIFICATION FOR THE *OMNICARE* RULING

A. Introducing the Oversight Justification for Omnicare

The *Omnicare* ruling does preclude certain mergers that may be more beneficial to the company; some bidders value the certainty of a completely locked-up agreement without a fiduciary out more highly than the company and its shareholders value having the option to exit the merger. Even though shareholders may want a transaction in which they forgo the exit option for the highest value they can derive, corporate law, as exemplified by the *Omnicare* ruling, prohibits this possibility.[123] The reason for imposing

120. Genesis's demand in the *Omnicare* case serves as a good example. Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 923 (Del. 2003).

121. *See In re* Toys "R" Us, Inc., S'holder Litig., 877 A.2d 975, 1015–16 ("[Scholars] do not advocate that courts strike down any termination fee above X% of equity or enterprise value, suggesting instead that 'deals with break-up fees over 3% of deal value should be given a particularly hard look.'").

122. For break-up fees, see Guhan Subramanian & Annie Zhao, *Go-Shops Revisited*, 133 HARV. L. REV. 1215, 1220 (2020).

123. This is due to the *per se* rule based on the majority decision in *Omnicare. See* Griffith, *supra* note 6, at 759.

this limitation is to ensure an effective monitoring mechanism over the board by shareholders in crucial decisions for the company. Boards are tasked with monitoring management on behalf of shareholders, but in some cases they themselves are monitored, especially when there is a structural conflict of interest on the board and the decision is crucial for the company. This is the central rationale for *Unocal* and *Revlon*: in situations involving crucial end-game decisions and structural conflicts of interest (where directors maintain their seats on the board by adopting defensive mechanisms against a hostile takeover or preferring a bid that does not necessarily offer the highest price for shareholders), the board must be monitored more closely by the court.[124] Similarly, complete lock-ups in merger or acquisition agreements are also important decisions in which there may be a structural conflict of interest.[125] Yet the conflict of interest is subtler in the case of complete lock-ups than in those of the protective measures in *Unocal* or the rejection of the highest offer in *Revlon*. Unlike *Unocal* and *Revlon*, in which a higher offer lurks in the background, in cases such as *Omnicare*, there are no indications that a better offer than the one the board has agreed to actually exists. In such circumstances, there is less risk that the board is prioritizing one offer based on its own interests over an alternative offer that would be more beneficial to shareholders. However, the problem is that there is no mechanism available to monitor whether the offer the board is pursuing is the optimal offer for the company. Although merger agreements are approved by shareholders, a merger agreement that is completely locked up by the exclusion of a fiduciary out provision (and assuming no competitive process was performed prior to signing) does not enable shareholders to effectively monitor the board's decision. The main tool through which shareholders can ascertain whether an agreement is the best the company can receive is the market mechanism. In order to be able to determine the best price a company can receive, one needs thorough knowledge, not only of the selling company but also of the potential acquirers, as well as the ability to estimate the potential synergies that acquirers may derive by purchasing the company. This information is highly complex and costly for shareholders to obtain. Market exposure is the main vehicle through which shareholders can be assured that the company received the highest price possible.[126] As long as the company is fully exposed to the market, shareholders can presume that the offer they received is the best offer; otherwise, a bidder that attributes higher value to their company would have made a higher bid.

Furthermore, if boards understand that the merger or acquisition they would like to promote will be exposed to the market, they may be more careful and selective in the deals they bring to the table. If the acquisition price is relatively low, another potential acquirer may very well bring a higher offer to the table. This will put any board that presses for a less lucrative deal in a tough spot.[127] In order to avoid such a scenario, boards will make an extra effort to bring lucrative offers to the table that are very hard to beat.

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124. *See supra* note 59 and accompanying text (applying and discussing the ramifications of the *Omnicare* holding in the *Orman* case).

125. For more on CEO incentives to discourage third-party bids, see Subramanian & Zhao, *supra* note 122, at 1240–52 (discussing executive incentives).

126. For the difference in decision-making by boards and shareholders, see Guhan Subramanian, *Fixing Freezeouts*, 115 YALE L.J. 2, 50–51 (2005).

127. A court may (even mistakenly) conclude that the agreement does not appear reasonable when entered into. *See* Allen, *supra* note 2, at 657, 660.

The need to monitor the board in merger transactions stems not only from the suspicion of structural conflicts of interest, whereby the board may be promoting its own interests in pursuing a specific transaction. The need to monitor may also stem from a basic feature of corporate law: the principle that the actions of agents in the corporation should be overseen by other organs within the corporation to ensure that the actions promote the interests of the corporation.[128] Actions may be detrimental to the company not only because of conflicts of interest but also due to bad judgment or negligence. The board is the main monitoring entity within the corporation, charged with monitoring management and management's oversight over other employees. However, when the board is the decision-maker and the stakes of the decisions are high, such as in end-game decisions, some monitoring is required over the board. This is the main reason shareholders must approve important decisions such as mergers—having a monitoring layer on such important decisions. Yet the monitoring layer need not be the shareholders. As noted above, shareholders do not have sufficient information to determine whether transactions represent the best possible offer available. The market can assist them in monitoring the board; if a suboptimal transaction is exposed to the market, a better offer may emerge. This would shed a bad light on the functioning of the board, which was willing to pursue a suboptimal offer.

Essentially, it is the market and not necessarily the shareholders that monitor the board's merger decisions. Even without the need for shareholder approval, the market itself functions as a monitoring mechanism, holding boards accountable for poor decision-making.[129] The reputation of boards that have pushed for a certain deal where a better deal subsequently emerged would be tainted. There is ample evidence that the market for board members is sensitive to tainted reputations, which would increase the likelihood that such board members would not hold on to their seats, diminish their chances of being nominated to serve on the boards of other companies, and impact their potential compensation as well.[130] The more that board members push for a suboptimal deal, the more their reputation will be tainted. But when they push especially hard to promote a certain transaction—agreeing to a complete lock-up of the transaction, including the omission of a fiduciary out clause—they shield themselves from monitoring by the market and reduce their accountability. Even if it is a bad deal, it is most likely that this will never become known by anyone; because of the complete lock-up, it is most likely that no better offer will emerge. This is the central problem that we believe the *Omnicare* ruling addresses. There is no reason to automatically assume that an agreement with a complete lock-up is bad for the company. As noted above, it is certainly possible that the acquirer values the transaction's certainty to a greater extent than the company and its shareholders value the exit option, and the compensation offered for a complete lock-up is worthwhile for the

128. For the allocation of power between management and shareholders, see generally Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005).

129. *See id.* (describing governance by "the market").

130. *See, e.g.*, Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301, 302 (1983) (arguing that preserving and enhancing reputation in the labor market for directorships is a primary motivation of directors); Ronald W. Masulis & Shawn Mobbs, *Independent Director Incentives: Where Do Talented Directors Spend Their Limited Time and Energy?*, 111 J. FIN. ECON. 406, 407 (2014) ("Our results deepen the understanding of the role of reputation as a strong motivating force in enhancing a director's monitoring incentives.").

company and its shareholders.[131] Even if a complete lock-up may be worthwhile in a specific case, it would remove the central mechanism for monitoring crucial decisions by the board. Such a complete ban is similar to other cogent features of corporate law, which do not enable companies to opt out of certain corporate governance practices even though shareholders may be interested in opting out because the cost of the element is greater than its benefit. For example, shareholders of public companies cannot do away with the existence of a board even if they think its cost is greater than its benefit.[132] The reason for these cogent rules is the basic principle of corporate law that agents must be monitored.[133] This principle applies also to boards' decision-making, especially crucial endgame decisions. As explained above, the most effective mechanism for monitoring such board decisions is the market.[134] This is an additional and important reason for the *Omnicare* ruling: the board's decision should be effectively monitored by the market.[135] The board is not permitted to completely lock up its decision by the exclusion of a fiduciary out provision in order to maintain exposure to monitoring by the market.[136]

Although the monitoring justification may seem related to the justification based on voting rights,[137] the perspective it presents on the importance of a fiduciary out clause is completely different. The voting rights justification emphasizes shareholders' rights to influence and control crucial decisions, especially those involving the sale of their

131. *See* discussion *infra* Part III.A (evaluating the implications of the exit option).

132. DEL. CODE ANN. tit. 8, § 141(a) (2023); MODEL BUS. CORP. ACT § 10.03(a), (b)(l) (AM. BAR ASS'N, rev. 2016) (requiring changes in the corporate charter to be approved by the board). *See also* Edward P. Welch & Robert S. Saunders, *Freedom and Its Limits in the Delaware General Corporation Law*, 33 DEL. J. CORP. L. 845, 846, 857–58 (2008) ("[W]e identify three significant remaining mandatory provisions that stockholders may not contract around: the stockholders' right to elect directors . . . ."). The Columbia Law Review published a symposium on mandatory provisions in corporate law in 1989. The following scholars have supported and justified mandatory corporate provisions: John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, 1690–91 (1989); Melvin Aron Eisenberg, *The Structure of Corporation Law*, 89 COLUM. L. REV. 1461, 1524–25 (1989); Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549, 1598–99 (1989). The Symposium included "contractarian" scholars who represented the more critical view toward mandatory provisions. *See* Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1446–48 (1989); Fred S. McChesney, *Economics, Law, and Science in the Corporate Field: A Critique of Eisenberg*, 89 COLUM. L. REV. 1530, 1544 (1989); Roberta Romano, *Answering the Wrong Question: The Tenuous Case for Mandatory Corporate Laws*, 89 COLUM. L. REV. 1599, 1615–16 (1989).

133. *See* Bebchuk, *supra* note 128, at 911 (describing the monitoring of corporate agents).

134. *See* Maria Maher & Thomas Andersson, *Corporate Governance: Effects on Firm Performance and Economic Growth*, ORG. FOR ECON. CO-OPERATION & DEV. [OECD] 1, 18 (1999), https://www.oecd.org/sti/ind/2090569.pdf [https://perma.cc/DZC8-RUFU] ("The monitoring of management relies largely on the discipline of capital markets . . . .").

135. Brian JM Quinn, Omnicare*: Coercion and the New* Unocal *Standard*, 38 J. CORP. L. 835, 835 (2013) ("*Omnicare*, for all its faults, was helpful because it placed fiduciary limits on sellers in situations in which sellers are not able to credibly resist buyer demands for additional transactional certainty. These fiduciary limits, by pre-committing sellers to a process that ensures a minimal degree of competition, or at least the threat of it, force buyers to reveal private information about their valuations of the sellers." (footnote omitted)).

136. *See generally Fiduciary Out*, THOMSON REUTERS PRAC. L. GLOSSARY (2023), Westlaw 5-382-3460 ("Consequently, even though the directors may negotiate several deal-protection mechanisms (such as a no-shop), they still need to be able to accept a better deal for the stockholders without being fully locked up by the terms of the merger agreement.").

137. *See supra* notes 109–18 and accompanying text (discussing Professor Velasco's argument regarding fiduciary out clauses and shareholder rights).

investment.[138] In this sense, a shareholder's right to vote is comparable to a property right in that they areable to exert some control over the asset in which you have a stake.[139] This right seems to have intrinsic value—the ability of shareholders to have some degree of control over their stakes in the company. In contrast, the value of shareholder voting according to the monitoring justification is not intrinsic; rather, it is one of the means through which oversight of managers and directors is provided.[140] According to the monitoring justification, it is not even required to have shareholders vote in order to monitor managers and directors.[141] As mentioned above, the most effective mechanism for the oversight of managerial and board actions is the market mechanism.[142] In some instances, shareholder voting is merely a means of facilitating an effective market mechanism. The fact that there is an additional decision-making layer motivates market players to make offers even when they feel that the board is biased against them.

The central premise of the monitoring justification—that shareholders are interested in mechanisms that provide oversight of directors, even if there are quite a few cases in which that mechanism may generate a suboptimal deal for the company[143]—has been utilized by one of us in a different context, also to explain what may seem to be a legal anomaly. We will turn to that example in order to demonstrate how the justification works.

B. Monitoring Justification: Analogy to the Case of Legal Risk

The presentation here of a novel justification for a problematic legal practice in corporate law through the lens of monitoring is not unique to the case of the *Omnicare* ruling. A similar explanation has been provided by one of us to clarify a similarly problematic legal practice in corporate law: the legal distinction between business uncertainty and legal uncertainty.[144] This differentiation is one of the central anomalies in corporate law. Let us compare two similar decisions of management and the board—in both, there is an assumption of risk in order to obtain greater expected returns with a similar risk and return profile. The only difference between the two decisions is the source of risk: in the former, the risk is a conventional business risk, and in the latter, the risk is a legal one. In the event the risk materializes, in the former case, shareholders cannot sue the

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138. Transcript of Oral Argument on Plaintiff's Motion for Preliminary Injunction and Ruling of the Court, *supra* note 60, at 141 (discussing what constitutes a shareholder's vote, temporally).

139. Julian Velasco, *Taking Shareholder Rights Seriously*, 41 U.C. DAVIS L. REV. 605, 609 (2007) ("Shareholders have various rights, among which are the right to vote on a limited number of issues and the right to sell their shares. . . . In addition, because shares are the personal property of shareholders, general principles of property law allow shareholders to sell them freely." (footnote omitted)).

140. *Id.* at 608.

141. Fiduciary Duties Regarding Proxy Voting and Shareholder Rights, 85 Fed. Reg. 81658, 81664 (Dec. 16, 2020) (to be codified at 29 C.F.R. pts. 2509, 2550).

142. *See, e.g.*, Adam Meirowitz & Shaoting Pi, *Voting and Trading: The Shareholder's Dilemma*, 146 J. FIN. ECON. 1073, 1073 (2022) ("We find that voting for the policy that one believes is better for the firm maximizes portfolio value only when pivotal; otherwise, it is better to vote against one's information, distort the market, and then trade at the distorted price.").

143. Ernst Maug, *Large Shareholders as Monitors: Is There a Trade-Off Between Liquidity and Control?*, 53 J. FINANCE 65, 66 (1998) (discussing the desire of shareholders to maintain control and monitor their company in the context of a liquid market).

144. Adi Libson & Gideon Parchomovsky, *Are All Risks Created Equal? Rethinking the Distinction Between Legal and Business Risk in Corporate Law*, 102 B.U. L. REV. 1601, 1624–34 (2022).

fiduciaries via a derivative suit for the exposure to the risk due to the business judgment rule that protects fiduciaries, so they will not be deterred from assuming risks that increase the expected gains.[145] In contrast, if legal risk materializes, then shareholders *can* sue the fiduciaries via a derivative suit for assuming the legal risk even though the risk had a positive expected return for the company.[146]

This distinction raises questions: why should the shareholders be able to sue in the latter case and not in the former? Conversely, given the strong rationale for not enabling them to sue in order not to deter the assumption of risk with a positive expected return, why are shareholders not able to sue in the former case but are able to sue in the latter? Why should the source of the risk matter to them? Presumably, shareholders should care only about the profile of the risk and not its source—whether the risk stems from a business or legal context.

Scholars have attempted to provide an answer to this intriguing question,[147] but, as one of us has demonstrated elsewhere, no satisfactory justification has been found[148] with all of the answers suggested suffering from major weaknesses.[149] We offer an alternative answer that provides a solid justification for the intriguing distinction between legal and business risk: the oversight and monitoring gap between business decisions and legal decisions. The main function of the board is to oversee and monitor major managerial decisions. This oversight will typically take place in a business decision context; the board will assess whether the risk taken is worthwhile. In contrast, decisions regarding the assumption of legal risk would not be brought to the board and would not be monitored. The reason for this is that managers understand that if they bring a decision to assume a legal risk to the board, the board will rule it out regardless of the probability of illegality and the potential upside.[150] Board members realize that a decision to assume legal risk could expose them to personal criminal liability. Even if there is an extremely small risk that, based on a cost-benefit analysis, the company should take, board members tend to be completely risk-averse when it comes to personal criminal liability. Because managers know that the board will never approve the assumption of legal risk, they will not present such risks for board approval. If the risk is low and the returns for the risk are especially high, managers who want the company to assume the risk know that they should not bring it to the board for approval.[151]

145. *See, e.g.*, Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984); *In re* Citigroup, Inc. S'holder Litig., 964 A.2d 106, 125 (Del. Ch. 2009) ("The presumption of the business judgment rule . . . function[s] to place an extremely high burden on a plaintiff to state a claim for personal director liability for a failure to see the extent of company's business risk."). Regarding the effective protection of the BJR, see Lori McMillan, *The Business Judgment Rule as an Immunity Doctrine*, 4 WM. & MARY BUS. L. REV. 521 (2013).

146. Libson & Parchomovsky, *supra* note 144, at 1604–05.

147. *See* Stephen M. Bainbridge, Caremark *and Enterprise Risk Management*, 34 J. CORP. L. 967, 988 (2009) (distinguishing between the two risks on the epistemic level); Elizabeth Pollman, *Corporate Oversight and Disobedience*, 72 VAND. L. REV. 2013, 2029 (2019) (providing an expressive justification for the distinction).

148. *See* Libson & Parchomovsky, *supra* note 144, at 1609–22.

149. *Id.* at 1606.

150. *Id.* at 1624.

151. The assumption that managers have a greater interest in the maximization of profits despite legal risks is based on the greater sensitivity of their pay to the performance of the company in comparison to directors' compensation, which is much less sensitive to performance. A study comparing the compensation of CEOs and

Thus, even though business risk and legal risk may have the same risk profile and expected return for the company and its shareholders, there is a difference in the degree of oversight they receive: decisions involving business risk receive board oversight, while decisions involving legal risk tend to elude board oversight. This difference justifies the legal distinction between the two forms of risk. Even though a decision involving legal risk *may* benefit shareholders, such a decision is prohibited because it will not receive the board's oversight. The same form of justification also applies to the *Omnicare* ruling regarding the mandated fiduciary out provision in mergers. Even though the company and its shareholders may benefit from deals that enable complete certainty—by excluding fiduciary out provisions because such provisions eliminate oversight over important board decisions—they are viewed as categorically antithetical to the interests of the company and shareholders. Oversight over crucial decisions is a vital component of fair corporate governance. In the next Part of this Article, we will delineate the possible legal policy ramifications of the oversight justification.

IV. LEGAL POLICY IMPLICATIONS

A. Exclusion of Fiduciary Out Provisions When Directors and Managers Are Not Involved in the Company After the Execution of the Deal

The oversight justification explains why there is a need to include a fiduciary out provision even in transactions where it is likely that shareholders would benefit more by excluding a fiduciary out provision to secure the deal. The question is whether there is always a need for market oversight. There are a few possible answers to that question. It is arguable that there is always a need for oversight, and that is the point of *Omnicare*: even when there are substantive reasons to believe that a certain deal is the best deal possible for shareholders, we still require market oversight. As already remarked, market oversight is a basic element of corporate law.[152] On the other hand, it is also arguable that shareholder and market oversight are not required for every corporate action. There are many actions that do not require such oversight, such as entering into consumer contracts. There are two main reasons for requiring the oversight of an additional entity. The first is the possibility

directors that examined panel data of over 1,000 firms between 1992 and 2001 found that the cash element in CEOs' compensation is almost double that of directors' compensation: over 40% for the former and only 26% for the latter. *See* Ivan E. Brick, Oded Palmon & John K. Wald, *CEO Compensation, Director Compensation, and Firm Performance: Evidence of Cronyism?*, 12 J. CORP. FIN. 403, 408 (2006). However, the gap in the sensitivity of their compensation to performance is much larger. In general, independent directors' compensation, unlike executive's compensation, rarely includes an option component. *See id.* at 410 (concluding that directors' total compensation is "positively related to the need for firm monitoring and the difficulty of the directors' tasks"). Even when it includes a stock component, in many cases it is a fixed value stock component, which is not sensitive to the performance of the stock. This is more prevalent than the fixed-number stock component which is sensitive to performance. The prevalence of the fixed-value component at the expense of the fixed-number component has only grown in recent years. *See, e.g.*, Kathleen A. Farrell, Geoffrey C. Friesen & Philip L. Hersch, *How Do Firms Adjust Director Compensation?*, 14 J. CORP. FIN. 153, 157 (2008) (comparing the fixed-value equity from 1998 to 2004). The literature on director compensation is relatively modest in comparison to that of CEO compensation and thus does not provide a detailed picture of directors' compensation packages. *Cf.* SANJAI BHAGAT, FINANCIAL CRISIS, CORPORATE GOVERNANCE, AND BANK CAPITAL 101 (2017) ("While the theoretical and empirical literature on executive compensation is extensive, the literature on director compensation is relatively modest.").

152. *See supra* Part III.A.

of making grave mistakes that will be detrimental to the company. This rationale is especially relevant to endgame decisions, which are the most important decisions in the life of the corporation and are key in determining the outcome of the shareholders' investment in the company. Of course, private individuals may also make mistakes, and they do not necessarily have a second tier of oversight to supervise their decisions. However, there are two reasons why we are more concerned with mistakes in the corporate context than in the individual context. First, individuals generally make decisions for themselves, and therefore they are the ones bearing the consequences of their decision-making. Because they directly internalize the full economic impact of their decision, they are less likely to make erroneous decisions than are the directors of a corporation, whose decisions affect third parties and not necessarily only themselves. Furthermore, the potential economic impact of an erroneous decision by an individual is relatively small, while the impact of erroneous decisions by corporations may be immense.

The second reason for oversight is the potential for an actual or structural conflict of interest. Settings in which there is a structural conflict of interest require oversight so that the decision-maker is careful to prevent bias in favor of his or her own interests. In the case of bias, an overseeing entity may correct the decision-maker's decision. [153] An example of oversight based on this reasoning is the approval of the CEO's compensation by both the board and shareholders. Needless to say, CEOs have an interest in making their compensation package as large as possible. Even directors have an interest in approving a large compensation package for the CEO, both for the sake of augmenting their own compensation package, which may be pegged or related to that of the CEO,[154] and to fulfill a sense of obligation to the CEO created by the relationship between the two.[155]

In the context of a fiduciary out requirement in mergers and end-game decisions, both rationales seem to apply, but the second rationale of the structural conflict of interest dominates. The terms of a merger are a complex matter that the directors and managers may get wrong, especially if there is no input from the market. On the other hand, end-game decisions are also crucial for directors and managers because they generally have a strong impact on their compensation. In fact, managers and directors may have a structural interest in shielding the terms of a merger from the influence of market forces.[156] Their

153. An example of oversight based on this reasoning is the approval of the CEO's compensation by both the board and shareholders. *See* 15 U.S.C. § 78n-1(a).

154. *See* Brick, Palmon & Wald, *supra* note 151, at 421 ("[W]e also find a highly significant positive relation between CEO and director compensation.").

155. Anil Shivdasani & David Yermack, *CEO Involvement in the Selection of New Board Members: An Empirical Analysis*, 54 J. FINANCE 1829, 1830 (1999) (finding that when CEOs are on the nominating committee, or if there is no nominating committee, more insiders or "gray" outsiders with conflicts of interest are chosen for the board); Joseph V. Carcello et al., *CEO Involvement in Selecting Board Members, Audit Committee Effectiveness, and Restatements*, 28 CONTEMP. ACCT. RSCH. 396, 397 (2011) (finding that CEOs participation in an independent nominating committee curtails its independence); David H. Zhu & James D. Westphal, *How Directors' Prior Experience With Other Demographically Similar CEOs Affects Their Appointments onto Corporate Boards and the Consequences for CEO Compensation*, 57 ACAD. MGMT. J. 791, 792 (2014) (demonstrating how CEOs push for the nomination of board members who served under other CEOs with similar demographic attributes).

156. *See* Subramanian & Zhao, *supra* note 122, at 1254 (explaining a banker may not have an incentive to find a higher bidder or may discourage bidders from participating in the process to please the banker's real client).

power enables them to protect an agreement that maintains their positions even if the terms for the company are suboptimal.[157]

In extreme cases where there is no structural conflict of interest, there may be no need for market oversight given the central role of the second rationale in justifying the oversight of end-game decisions by management and directors through market exposure. There is a structural conflict of interest in most cases, but not in every case. If the agreement does not include a reference to the role of the current managers and directors in the merged company or the company after the acquisition, the potential for a structural conflict of interest is significantly diminished. The main cause of structural conflicts for management and directors in end-game decisions is that they may prefer an agreement with a specific party because of the role they would have in the future under that transaction. If the purchaser does not refer to the roles in the new business structure, the structural concern is significantly diminished, and the need for market oversight also decreases considerably. As a result, in cases where there is no commitment made to management or directors concerning their roles in the new business structure, a complete lock-up with the exclusion of a fiduciary out provision may be legitimate even if we accept the general rule that the agreement should include a fiduciary out provision.

A possible objection is that, even if there is no direct commitment or reference made to the role of management and the directors in the new business entity, there may be a tacit understanding that the merging or acquiring party has a commitment toward management or the directors, especially if they have prevented other parties from competing with the proposal by locking up the agreement and excluding a fiduciary out provision. This may well be true; a structural conflict of interest, albeit weaker, may remain even if there is no explicit reference to the role of directors and managers. Yet it is possible to eradicate even this weak structural conflict of interest. Directors and management can commit not to take any position in the company after the merger for a certain period of time (for example, three years). Such commitment on the part of directors and managers would eliminate any potential conflict of interest. In such cases, directors and managers would have no expectation of any role because of the agreement. Thus, even if we accept the objection to the ability to exclude a fiduciary out provision when there is no reference to the roles of management and directors, there are no grounds for such an objection when management and directors commit themselves not to take any role in the company after the merger or acquisition, and the exclusion of a fiduciary out clause in such a case can be permitted.

It is true that a commitment by management and directors not to take any role in the merged entity is inefficient and undesirable in most cases. The experience of management and the board with the company provides them with an important advantage if they are involved in the company after the merger or acquisition and facilitate its transformation. This may well be true. We do not call for managers and directors to sign such commitments. What we are saying is that if managers and directors make such a commitment, the exclusion of a fiduciary out provision may be legitimate.[158] Even though a commitment such as this may seem unusual and insignificant, it could address situations where the potential acquirer attributes a very high value to the certainty of the deal. In such cases, the

157. *Id.*

158. We assume that this option exists mainly for strategic investors and is less plausible for financial investors.

potential acquirer may offer such a large premium for the company if it receives a complete lock-up, including the exclusion of a fiduciary out provision, that directors and managers may be willing to make such a commitment. If the policy recommendation offered here is accepted—that a fiduciary out provision could be excluded if managers and directors commit to non-involvement in the merged or acquired company—it raises an interesting question: what happens if a party offers a high premium for a completely locked-up agreement without a fiduciary out provision under which the managers and directors would commit to non-involvement in the merged company, but the managers and directors are not willing to make such a commitment? Would they be violating their fiduciary duty by effectively blocking the best deal the company can receive, or do their current fiduciary duties not require them to make personal commitments for the period when they are no longer fiduciaries? This is an interesting question that we will not pursue in this Article but plan to address in the future.

B. Enjoining a Merger with No Fiduciary Out Provision Even Without an Intervening Bidder

In the *OPENLANE* decision, Vice Chancellor Noble seemed to have supported limiting the *Omnicare* ruling to cases in which there was an intervening bidder offering to outbid the initial bidder with the locked-up agreement.[159] Scholars support this view, which is primarily based on the notion that the main purpose for requiring a fiduciary out provision is to obtain the optimal deal for the company.[160] This rationale applies when an intervening bidder is present, signaling that, at the current point in time, the existing deal may not be optimal for the shareholders. In contrast, when there is no intervening bidder, there is no indication that the current locked-up agreement is not the optimal deal, and thus there are no strong grounds for enjoining the merger even if the agreement did not include a fiduciary out provision.

The analysis here is quite different from the perspective of the oversight rationale for fiduciary out provisions. The main concern is that there is no effective oversight of the decisions made by management and directors. In this sense, a case in which there is no intervening bidder may be worrisome. When an intervening bidder emerges, there is oversight of the management and the board's decision to enter into the lock-up agreement. As noted above, the market mechanism is the most effective mechanism for the oversight of management and the board.[161] Even if the company cannot accept the offer of the second bidder due to the locked-up agreement, management and the board are held accountable for not maximizing returns for shareholders. They will suffer a reputational loss if they cannot explain to shareholders why the locked-up agreement was the optimal strategy for the company, without which it would not have received the later offer. In contrast, in cases in which there is no intervening bidder, managers and the board will not be held accountable for "missing" a better deal as a result of the complete lock-up—although it is perfectly possible that there exist such potential offers—but that the exclusion of a fiduciary out provision discouraged prospective acquirers from bringing their offers

159. *See In re* OPENLANE, Inc., S'holders Litig., C.A. No. 6849, 2011 WL 4599662, at *19 (holding not to extend *Omnicare* beyond its specific facts).

160. Griffith, *supra* note 6, at 766–67.

161. *Supra* Part III.A.

forward. It is plausible that such prospective acquirers might conclude that it would be futile to bring forward an alternative offer when the initial agreement did not include a fiduciary out provision. From the perspective of the oversight rationale, the case of no intervening bidder is more problematic than the case in which there is an intervening bidder, and it requires greater involvement of the court by enjoining the merger and not *less* involvement. Thus, the limitation of the *Omnicare*[162] ruling to cases with an intervening bidder, as suggested in the *OPENLANE*[163] decision and by supporting scholars, is unwarranted according to the oversight justification.

The application of the oversight rationale to cases with no intervening bidders has a surprising result. While the main application of the rationale (noted above in Part I.A) is the narrowing of the *Omnicare* ruling and a justification for circumventing it in cases in which managers and board members have no involvement in the post-merger company, the application to contexts with no intervening bidder broadens the applicability of the *Omnicare* ruling, or, more precisely, negates the possibility of limiting its applicability to such cases. The fact that no actual bidder is blocked by the locked-up agreement does not ameliorate the fiduciary transgression but, rather, exacerbates the violation of fiduciary duties. Thus, even in such cases with no intervening bidder, shareholders should be able to sue the fiduciaries for violating their fiduciary duties by locking up the agreement and preventing oversite by market actors. The ramifications of the oversight rationale are more nuanced than they may appear at first glance.

C. Immediate Shareholder Written Consent

As noted above, in *Optima*, Vice Chancellor Lamb distinguished between agreements with locking-up mechanisms such as fiduciary outs in which there is a time lag between the signing of the agreement and shareholder approval and agreements that are approved almost immediately (less than 24 hours after signing) by the written consent of shareholders.[164] The *Omnicare* restrictions apply to the former but not to the latter. In the former case, the time lag considerably increases the impact of the lock-up mechanisms. Without the lock-up mechanisms, the company may have received additional offers. In the latter case of immediate shareholder approval, because there is no time lag, the existence of lock-up mechanisms is insignificant, as there essentially is no time to receive alternative offers. As Vice Chancellor Lamb observed, there is no requirement in corporate law that there should be a time lag between the signing of the agreement and shareholder approval.[165] Thus, no problem arises if the agreement is conditioned on approval by shareholders via written consent within 24 hours, and if such a condition is made, any limitation on lock-up mechanisms including the exclusion of a fiduciary out mechanism is completely irrelevant. An additional rationale for such a distinction is that a shareholder vote is not an act of the board, and thus, especially from the perspective of the shareholder rights' rationale, no limitations should be imposed on such a vote. *OPENLANE* has continued the line of reasoning in *Optima* and extended the ruling that the *Omnicare*

162. Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914 (Del. 2003).

163. *OPENLANE*, 2011 WL 4599662, at *19.

164. Transcript of Oral Argument on Plaintiff's Motion for Preliminary Injunction and Ruling of the Court, *supra* note 60, at 127–28.

165. *Id.* at 37–38, 137.

decision does not apply in cases of immediate shareholder approval to cases where the agreement has no fiduciary out provision.[166]

According to the oversight rationale, the distinction between agreements in which a shareholder vote is obtained immediately by a vote expressed in written consent and those subject to conventional shareholder approval is weaker than it may seem. From an oversight perspective, the fact that the agreement was approved immediately by shareholders does not necessarily increase oversight of the merger. Quite to the contrary, a short time frame for approval only limits and restricts the ability to oversee the agreement by limiting its exposure to a market test. The time frame may be even more crucial in examining the agreement than the lock-up mechanisms included in the agreement. Immediate approval does not improve shareholders' ability to monitor the agreement compared to later approval. The only difference that may justify such a distinction is if shareholders are more proactive in a vote that requires written consent than in a regular vote. While in a conventional shareholder vote, shareholders tend to be passive, in a written consent, a majority of the shareholders must be convinced, in advance, to support the transaction and, thus, actively express support for the agreement.[167] In any event, according to the oversight rationale, there is no justification for excluding immediate voting by shareholder written consent from the *Omnicare* rule.[168]

CONCLUSION

Vice Chancellor Lamb noted in *Optima* that "Omnicare is of questionable continued vitality."[169] There was a good reason for this skepticism regarding the *Omnicare* ruling, which seems to have imposed an obligation to include a fiduciary out provision in all merger agreements. Such an obligation suffers from an analytical weakness that is hard to justify: a complete lock-up, including the exclusion of a fiduciary out provision, may serve the interests of shareholders. The bidder may attribute very high value to deal certainty, for which it may be willing to compensate shareholders more than any other offer.

Scholars have provided various explanations to overcome this analytical problem with the *Omnicare* decision.[170] In this Article, we provide a new perspective on the *Omnicare* ruling. Its main purpose is not necessarily to maximize shareholder returns, protect shareholders' rights, or fulfill the board's duty to be fully informed. Rather, its main purpose is to enable effective oversight over end-game decisions by exposing such decisions to market powers. The oversight justification has policy implications that both narrow and widen the application of the *Omnicare* decision. On the one hand, it may narrow the *Omnicare* ruling and exclude its application to cases in which management and directors have no relationship with the post-merger company—which significantly reduces the need for market oversight. On the other hand, it may widen the *Omnicare* ruling or,

166. *Id.* at 127–28.

167. DEL. CODE ANN. tit. 8, § 228 (2023).

168. It is possible to argue that, typically, shareholders who agree to immediately sign the approval of the merger are "closer" to the management and may be more influenced by it. Accordingly, they may not be regarded in such a case as an effective factor in supervising the management's conduct. *See* Shaner, *supra* note 6, at 799–800 (discussing director's duties relating to minority shareholder limitations and susceptibilities).

169. Transcript of Oral Argument on Plaintiff's Motion for Preliminary Injunction and Ruling of the Court, *supra* note 60, at 127.

170. *See* sources cited *supra* note 6.

more precisely, challenge proposals to limit the ruling and exclude its application from enjoining a merger without an intervening bidder or an agreement with immediate shareholder written consent. The *Omnicare* decision is still with us, and the oversight justification may place it on firmer ground.