The Limits of Shareholder Ratification

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In this Article, I analyze the expanding common law doctrine of shareholder ratification, whereby shareholder approval can, for all practical purposes, absolve directors of fiduciary liability for their conflicted business decisions. Delaware law now allows a shareholder vote to perform substantially more work than ever before. Under prevailing doctrine, in transactions between a company and any party other than a controlling shareholder, shareholder ratification reinstates the business judgment rule and makes it irrebuttable, other than for waste. Substantive judicial review is effectively avoided for such transactions.

Despite its extraordinary importance in corporate governance, the shareholder ratification doctrine's foundations are feeble and its limits uncertain. Theoretically, there is no well-established basis for equating shareholder approval with either the informed, disinterested, and good-faith decision of a board or judicial review. Doctrinally, shareholder ratification's expansion beyond its traditional context of self-dealing has been a judicial innovation, rather than an elaboration of precedent. And historically, the shareholder ratification doctrine, which originated in early 20th-century state interested-director statutes, was motivated by fairness principles that were lost in translation into the common law.

This Article recovers the fairness genealogy of the shareholder ratification doctrine and, in doing so, provides useful guidance for the doctrine's development, limits, and future application.

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INTRODUCTION

Courts are increasingly transferring to shareholders their traditional role of evaluating the substantive fairness of conflicted board decisions. Business decisions of an unconflicted board receive judicial deference under the business judgment rule because courts presume the board's objectivity unless the plaintiff can show waste. In contrast, courts are not willing to presume that a conflicted board is making objective decisions. In these instances, they replace the business judgment standard of review with heightened scrutiny, evaluating board decisions based on their substantive fairness to the corporation and its shareholders.

Shareholder ratification can shield conflicted board decisions from substantive judicial review. According to the shareholder ratification doctrine, disinterested, fully-informed, and uncoerced shareholder approval of a decision by a board tainted by conflicts cleanses the board decision of the taint and reinstates the business judgment rule. If the shareholders ratify the board's decision, the court will review it only for waste.

Historically, courts applied the shareholder ratification doctrine to board decisions only in instances involving explicit conflicts (i.e., where a majority of the board is actually interested, rather than where the potential for conflicts is inherent in the decision-making context) and in which the board voluntarily sought shareholder approval (i.e., where shareholder approval was not statutorily required). In recent years, however, courts have steadily expanded the reach of the shareholder ratification doctrine to encompass board

decisions on matters where the conflict is inherent and for which shareholder approval is statutorily required. In these instances, if the shareholders approve a transaction previously approved by the board, they are also deemed to be approving the board's fiduciary conduct for that transaction. As a result, assuming the shareholder ratification doctrine's preconditions are met, the board's decision receives business judgment rule scrutiny even if heightened scrutiny would have applied absent the shareholder approval.

To illustrate the expanded scope of the shareholder ratification doctrine, suppose that the board of directors of XYZ, Inc. (XYZ) has agreed to sell XYZ to Acquisition Co. in an all-cash merger transaction. Under applicable state corporate law, assuming each share gets one vote, a majority of the outstanding shares of XYZ must be voted in favor of the deal as a condition precedent to its closing.[1] Before recent changes to the shareholder ratification doctrine, XYZ's shareholders could approve the merger and still be entitled to substantive judicial scrutiny of the board's fiduciary conduct in connection with it. Heightened scrutiny would apply to the board's decision because of concerns that XYZ's directors acted under inherent conflicts of interest in the sale process arising from their potential desire to protect their own, personal, interests after the sale.[2] Directors of XYZ might, for example, support the sale to Acquisition Corp. over a superior bid if they thought Acquisition Corp. was more likely to retain their services after becoming XYZ's new owner. As a result, the board would be charged with obtaining the highest value reasonably attainable for XYZ to fulfill its fiduciary duties to XYZ's shareholders.[3] Under the updated interpretation of the shareholder ratification doctrine, however, shareholder approval instead triggers the application of the business judgment rule to the XYZ board's sale decision. The rationale for this result is that XYZ's shareholders cleansed any taint in the board's decision making when they approved the merger, leaving no need for a court to scrutinize it.[4]

What does it mean under corporate law for shareholders to "cleanse" conflicted board decision making? When should shareholder approval have a cleansing effect? Is every conflicted board decision suitable for shareholder ratification?

Legal scholars disagree over both the principles underlying the shareholder ratification doctrine and the answers to the foregoing questions.[5] Without a sound

1. *See, e.g.*, DEL. CODE ANN. tit. 8, § 251(c) (West 2019).

2. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) (stating that a board should consider only shareholder interests in a sale for cash).

3. *Id.*

4. *See* Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 313–14 (Del. 2015) (dismissing need to review a board's business decision on a transaction that stockholders ratified).

5. *Compare* James D. Cox, Thomas J. Mondino & Randall S. Thomas, *Understanding the (Ir)Relevance of Shareholder Votes on M&A Deals*, 69 DUKE L.J. 503, 579–80 (2019) (questioning the judiciary's growing deference to shareholders), *and* Itai Fiegenbaum, *Taking* Corwin *Seriously*, 26 LEWIS & CLARK L. REV. 791, 825–26 (2022) (proposing to limit shareholder cleansing to friendly sales of control by companies that have previously been targets of shareholder activism), *with* Amir N. Licht, *Farewell to Fairness: Towards Retiring Delaware's Entire Fairness Review*, 44 DEL. J. CORP. L. 1, 56 (2020) (endorsing expansion of the shareholder ratification doctrine). *See* Honorable J. Travis Laster, Vice Chancellor, Del. Court of Chancery, Purpose, Power and Fiduciary Duty: Dimensions of Delaware's Corporate Law Regime, at Univ. of Del. (May 11, 2021), https://capture.udel.edu/media/The+Honorable+J.+Travis+Laster%2c+Vice+Chancellor+of+the+Delaware+Court+of+Chancery%2c+2021+John+L.+Weinberg+Distinguished+Speaker++-+5+12+2021/1_hfhderor (calling a question posed at approximately 01:20 of the Q&A about whether a stockholder vote can cleanse a duty of loyalty violation "a tough one").

theoretical foundation, the shareholder ratification doctrine will remain inadequately tethered to corporate fiduciary law. As a result, it may be underutilized, leading to inefficiently high levels of shareholder litigation against corporate boards. Or it may be overutilized, insulating directors from liability for conflicted decisions that they are not making in the shareholders' best interests. Currently, the latter risk seems dominant. Courts have held that shareholder approval can reinstate business judgment rule protection to board decisions in an ever-widening array of settings. They have even suggested that shareholder approval can cure a board's wasteful decisions. Allowed to proceed unchecked, the shareholder ratification doctrine is likely to go too far in reducing board accountability to shareholders and lead to suboptimal corporate governance.

In this Article, I argue that shareholder approval should cleanse the taint of a conflicted board decision only if the shareholders reasonably regard the board decision as substantively fair to them. The foregoing principle allows shareholders to continue to play a meaningful role in corporate governance while preventing the shareholder ratification doctrine from undermining the basis for heightened judicial scrutiny.

Part I analyzes the contemporary legal landscape of U.S. corporate fiduciary duties of boards of directors, focusing on the duty of loyalty. Here, my objective is to demonstrate that the judicial review standards applicable to a board's business decisions are all designed to counteract the risk that the decisions will produce unfair outcomes for shareholders. Judicial review simply adjust as needed to hold directorial decisions to the fairness benchmark.

Part II reviews the existing mechanisms for cleansing a tainted board decision: approval by a special committee of the board and shareholder ratification. It then examines the conventional rationales for the shareholder ratification doctrine and argues that they lack a sound theoretical foundation.

Part III presents a fairness theory of shareholder ratification, motivated by the corporate legal history of state statutes that protect transactions between a corporation and its directors from *per se* voidability. Such so-called "interested-director statutes" were enacted in the United States to facilitate value-enhancing transactions, which benefit shareholders despite a board conflict. Interested-director statutes made available procedural mechanisms—namely, approval of the transaction by either disinterested directors or shareholders—for allowing self-dealing transactions to go forward. Although the statutes did not, by their terms, apply to the question of whether directors breached their common law fiduciary duties, state courts generally adopted their framework for such purposes. Careful analysis of state interested-director statutes and their subsequent importation into the common law shows that the shareholder ratification doctrine is most accurately viewed as a means for confirming the substantive fairness to the shareholders of the board's underlying decision. Part III goes on to analyze theory and empirical evidence bearing on the effectiveness, from a fairness perspective, of current shareholder ratification jurisprudence. The analysis suggests that there is room for better aligning the shareholder ratification doctrine with shareholder interests.

Part IV develops the key implications of the fairness theory for the future application, development, and limits of the shareholder ratification doctrine. First, stronger procedural safeguards are needed to ensure that when shareholders approve a conflicted board decision, they are opining that the decision is, indeed, fair to them. Second, shareholder ratification has inherent limits. Specifically, the fairness theory would not allow a

shareholder vote to cleanse board decisions that are wasteful or made in subjectively bad faith because such decisions generally destroy shareholder value. Finally, open questions exist about the shareholder ratification doctrine's application outside the contexts in which it has traditionally been applied, which the fairness theory can help resolve.

I. A FAIRNESS PERSPECTIVE ON THE JUDICIAL REVIEW OF BOARD DECISIONS

The judicial standards of review applicable to board decisions under the duty of loyalty, which governs conflicted decision making, are based on whether the board acted objectively.[6] Thus, arm's-length bargaining conditions imply judicial abstention, while conflicted bargaining conditions lead to judicial intrusion commensurate with the degree of the conflict. Part I situates this standard formulation within a fairness framework, in which courts review a board's decisions as warranted to achieve the equivalent of an arm's-length outcome for shareholders.

The business judgment rule specifies the preconditions under which courts abstain from questioning the business decisions of boards.[7] Under it, courts do not second guess boards when a majority of directors are informed, loyal, and act in good faith. A board's business decisions become suspect, however, when a majority of the board is disabled in some way from acting in the best interests of the shareholders. The deferential stance of the business judgment rule then gives way to judicial intrusion. Specifically, if a shareholder-plaintiff successfully calls into question a board's decision by rebutting any one of the rule's preconditions, then courts will review its substance unless the business judgment rule is reinstated.[8] As discussed in Part III, the circumstances under which courts allow the business judgment rule to be reinstated after it has been rebutted have grown in recent years. Today, only if the board has not taken an available procedural path back to the business judgment rule will a court review its conflicted business decisions.[9]

Because the business judgment rule serves as the default in defining the parameters of the board's decision-making discretion, it provides a logical starting point for framing judicial standards of review of board decisions in fairness terms. The business judgment rule's preconditions closely resemble what the law considers to be "arm's-length"

6. *See* J. Travis Laster, *The Effect of Stockholder Approval on Enhanced Scrutiny*, 40 WM. MITCHELL L. REV. 1443, 1446–47 (2014) (describing Delaware's standards of review in terms of a "pyramid" of narrowing deference based on the existence of a qualified decision maker).

7. *See generally* Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 119 (2004).

8. *In re* KKR Fin. Holdings LLC S'holder Litig., 101 A.3d 980, 990 (Del. Ch. 2014) (stating that if the business judgment rule presumption is rebutted, dismissal would generally not be appropriate).

9. *See* D. Gordon Smith, *The Modern Business Judgment Rule*, *in* RESEARCH HANDBOOK ON MERGERS AND ACQUISITIONS 83, 83–85 (Claire A. Hill & Steven Davidoff Solomon eds., 2016) (describing the path away from and back to the business judgment rule). While the business judgment rule can technically be rebutted by a showing that the directors did not act with the precondition of due care, many state corporation laws permit a corporation to provide in its charter that a director does not have monetary liability to the company for breaches of the fiduciary duty of care. *See, e.g.*, DEL. CODE ANN. tit. 8, § 102(b)(7) (West 2019) (allowing, subject to certain exceptions, a certificate of incorporation to include a provision "eliminating or limiting the personal liability of a director or officer to the corporation or its stockholders for monetary damages for breach of fiduciary duty"). Smith refers to the current landscape of business judgment rule accessibility through procedural mechanisms such as shareholder approval as the "modern" business judgment rule. *See* Smith, *supra* note 9, at 84.

bargaining conditions. In an arm's-length relationship, the parties have adverse economic interests when dealing with each other.[10] In a bilateral arm's-length transaction, for example, each side is wholly self-interested, negotiating vigorously for the outcome that most favors it.[11] Business decisions by boards made under arm's-length bargaining conditions are generally regarded as being fair to shareholders.[12] As a result, courts generally do not review the substantive merits of board decisions that satisfy the business judgment rule's preconditions.[13] Restated in fairness terms, the business judgment rule is a presumption that a board that has met the rule's preconditions has achieved a fair outcome for the shareholders.[14]

At common law, directors owed strict trustee-like duties to shareholders, under which conflict-of-interest transactions were suspect without regard to fairness.[15] Rather than being evaluated according to their merits, such transactions were simply voidable on the ground that directors were required to deal in the sole interest of shareholders.[16] In the 20th century, a judicial determination that a transaction was fair to the shareholders was introduced as a way to protect it from voidability.[17] Replacing the earlier absolute proscription of conflict-of-interest transactions with a standard that allowed fair ones to go forward made it possible for corporations to enter into shareholder value-enhancing business arrangements that would otherwise have been prohibited. It was no longer

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10. *See* Andrew F. Tuch, *Reassessing Self-Dealing: Between No Conflict and Fairness*, 88 FORDHAM L. REV. 939, 946–47 (2019) (discussing fairness in terms of decision-making processes).

11. A fair outcome is presumed because each party "has dealt with the other party . . . exactly as a stranger would have done, taking no advantage of his influence or knowledge, putting the other party on his guard, bringing everything to his knowledge which he himself knew." Hunter v. Atkins [1834] 47 Eng. Rep. 166, 166–67.

12. Pepper v. Litton, 308 U.S. 295, 306 (1939) (equating fairness to the corporation and its shareholders with an arm's-length bargain); *see also* Note, *Corporate Fiduciary Doctrine in the Context of Parent-Subsidiary Relations*, 74 YALE L.J. 338, 340 (1964) ("The principal doctrine derived from the concept of the model contractual transaction is: . . . whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain."); Leo E. Strine, Jr. et al., *Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 GEO. L. J. 629, 643 (2010) ("Because even a subjectively well-motivated fiduciary might deal with himself less aggressively than he would with a third party, Delaware law requires that the interested party prove that the transaction was entirely fair to the corporation, in the sense that it was on terms as favorable as could have been achieved in an arm's-length deal subject to market competition."); David Kershaw, *The Path of Corporate Fiduciary Law*, 8 N.Y.U. J.L. & BUS. 395, 450 (2012) ("However, when the court gets to the question of remedies, then fairness – understood as it is today as arm's-length contracting – enters through the back door."); Smith, *supra* note 9, at 94 (describing fairness to the corporation in terms of arm's-length dealing).

13. *See* Bainbridge, *supra* note 7, at 90 ("The court therefore abstains from reviewing the substantive merits of the directors' conduct unless the plaintiff can rebut the business judgment rule's presumption of good faith.").

14. This restatement is consistent with the distinction courts make between standards of conduct, which specify aspirational goals for how directors should manage corporations, and standards of review, which specify the tests they use to determine whether directors have met the applicable standard of conduct. *See* Melvin Aron Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 FORDHAM L. REV. 437, 437 (1993) ("A standard of conduct states how an actor should conduct a given activity or play a given role. A standard of review states the test a court should apply when it reviews an actor's conduct to determine whether to impose liability or grant injunctive relief."). Any wedge between the two reflects a policy decision, such as reflected in the business judgment standard of review, to presume fairness rather than to evaluate it directly.

15. *See* Tuch, *supra* note 10, at 946 ("[T]he United States is said to have adopted the U.K. common law no-conflict rule before 'rapidly diverg[ing]' from it." (quoting Kershaw, *supra* note 12, at 400)).

16. *Id.* at 945.

17. *Id.* at 946–47.

required that boards deal at arm's length as long as their actions were consistent with arm's-length dealings.[18]

Over time, courts developed various standards of review for evaluating the substantive fairness to shareholders of different types of transactions. These standards are usually treated as discrete tests organized along a sliding scale of rigor,[19] but they can alternatively be viewed together as a single fairness test tailored to the specific contextual categories typically involved in conflicted board decision making: (1) explicit board conflicts, (2) transactions involving a conflicted controlling shareholder, (3) defensive maneuvers by target boards, and (4) sales of control.

"Entire fairness" is commonly referred to as the highest judicial standard of review applicable to a business decision made by a corporation's board of directors.[20] This version of the fairness test applies to the first category of conflicted board decision making above, explicit conflicts; i.e., where a majority of the board either has an actual interest in the decision that differs from the interest of the other shareholders or lacks independence from an interested director or a conflicted controlling shareholder.[21]

"Interestedness" refers to whether a director has a personal financial interest in the matter being decided.[22] Such an interest may, for example, involve receipt of a financial benefit or the imposition of a financial burden.[23] In either case, the interest must be material to the director and not be shared proportionately by the corporation or the other shareholders.[24]

"Independence" refers to whether a director can exercise judgment based solely on the merits of the matter under consideration.[25] A director lacks independence when the director is "beholden" to an interested party.[26] Circumstances giving rise to being beholden include compensatory relationships,[27] familial relationships,[28] or, potentially, close personal relationships.[29] A board with a majority of directors that is either interested or lacks independence will be deemed to be acting under the influence of the personal

18. *Id.*

19. *See, e.g.*, R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 4.19[A] (4th ed. supp. 2024) ("Delaware has three tiers of review for evaluating director decision-making: the business judgment rule, enhanced scrutiny, and entire fairness." (citing Reis v. Hazelett Strip-Casting Corp., 28 A.3d 442, 457 (Del. Ch. 2011))).

20. *See* Kahn v. M & F Worldwide Corp., 88 A.3d 635, 644 (Del. 2014) (calling entire fairness "the highest standard of review in corporate law").

21. BALOTTI & FINKELSTEIN, *supra* note 19, § 4.19[B][2], n.1185.

22. *Id.*

23. *Id.*

24. *Id.*

25. *Id.*

26. Rales v. Blasband, 634 A.2d 927, 936 (Del. 1993) (citing Aronson v. Lewis, 473 A.2d 805, 815 (Del. 1984)).

27. *See In re* Emerging Commc'ns, Inc. S'holders Litig., No. 16415, 2004 WL 1305745 (Del. Ch. June 4, 2004) (questioning the independence of a special committee member who was paid consulting fees by an affiliate of the controlling stockholder).

28. *See* Harbor Fin. Partners v. Huizenga, 751 A.2d 879 (Del. Ch. 1999) (holding that a director lacked independence where he was the brother-in-law of, and involved in various business dealings with, the CEO).

29. *See* Del. Cnty. Emps. Ret. Fund v. Sanchez, 124 A.3d 1017, 1019 (Del. 2015) (holding a half-century-long friendship was relevant in determining a director's independence).

consequences of the decision, and the compromised director-defendants will have the burden of proving that their decision was entirely fair.[30]

Under the entire fairness standard, courts conduct a searching inquiry into the substance of what the board decided to determine whether it was, in fact, fair to the shareholders. The entire fairness inquiry takes into consideration whether a transaction was concluded both at a fair price and through fair dealing. The fair price inquiry involves determining whether the price fell within a range of values consistent with ones generated by methods generally accepted by financial valuation experts.[31] Fair dealing refers to whether the process leading up to the negotiated transaction was designed to generate a fair price.[32] Courts consider the two components of the entire fairness standard together, in an integrated fashion, to determine whether the conflicted directors who voted in favor of a transaction achieved a fair outcome for shareholders.[33]

A second category of board decisions invoking entire fairness scrutiny involves transactions between corporations and conflicted controlling shareholders. A shareholder, or group of shareholders, is deemed to exercise control when it has the power to direct corporate decision making through its influence over the corporation's board of directors.[34] Such influence can arise from the possession of majority voting control.[35] Alternatively, it can result from the de-facto power to dominate the corporate decision-making process.[36] Because controlling shareholders can determine board membership, the presence of a conflicted controller raises structural concerns that a board will give the controlling shareholder benefits that are not shared proportionately with the non-controlling shareholders.[37]

There are two general ways in which a conflicted controlling shareholder can use its control to benefit itself at the expense of non-controlling shareholders. It can disproportionately appropriate the corporation's earnings, or it can opportunistically eliminate the non-controlling shareholders.[38] In the foregoing circumstances, if the corporation's board of directors approves a transaction, its decision is not entitled to the protection of the business judgment rule because the conflicted controlling shareholder has the power to punish board members who do not favor its private interests. Such concerns

30. BALOTTI & FINKELSTEIN, *supra* note 19, § 4.16[A].

31. *Id.*

32. *Id.*

33. *See* Eisenberg, *supra* note 14, at 453 (arguing that the strictness of entire fairness review is justified to confirm a transaction's arm's-length equivalence in the context of self-interested transactions).

34. *See* Superior Vision Servs., Inc. v. ReliaStar Life Ins. Co., No. 1668-N, 2006 WL 2521426 (Del. Ch. 2006) (explaining that even a shareholder lacking a majority share of a corporation can be deemed to be a controlling shareholder if the plaintiff can establish the actual exercise of control over the corporation by the minority shareholder). A "control group" exists where those shareholders are "connected in some legally significant way—e.g., by contract, common ownership, agreement or other arrangement—to work toward a shared goal." Frank v. Elgamal, No. 6120, 2014 WL 957550, at *18 (Del. Ch. Mar. 10, 2014) (quoting Dubroff v. Wren Holdings, LLC, No. 3940, 2009 WL 1478697, at *3 (Del. Ch. May 22, 2009)).

35. Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1344 (Del. 1987).

36. *See, e.g.*, Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1115 (Del. 1994) (holding that a 43% shareholder exercised control).

37. Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785, 785 (2003).

38. *See id.* at 786 (discussing the ability of controlling shareholders to interfere with the interests of non-controlling shareholders).

are analogous to those surrounding the fairness to shareholders of a board decision where a majority of the board is explicitly conflicted. In both instances, the board's decision is suspect because self-interested considerations of the board are at play. As a result, courts require directors who voted in favor of a conflicted controller transaction to prove its entire fairness.[39]

Third-party mergers and acquisitions, in which the acquiror is not a controlling shareholder, are involved in the third and fourth conflict-of-interest contexts in which courts scrutinize the substance of a board's decision for fairness.[40] Specifically, courts apply enhanced, or intermediate, scrutiny to boards that implement takeover defenses or deal protections or that effectuate sales of control. The situational dynamics of mergers and acquisitions can distort the incentives of directors, leading them to act in their own best interests rather than those of shareholders. For example, directors can use defensive measures, such as poison pills, to protect their companies against unwanted takeovers or so-called "deal protections"—features that effectively construct a moat around a pending transaction—to favor a preferred bidder over competing bidders in a negotiated acquisition.[41]

In *Unocal Corp. v. Mesa Petroleum Co*.,[42] the Delaware Supreme Court referred in the takeover context to "the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders."[43] The law responds to such concerns about inherent conflicts by trying to sort out defensive actions that are taken to advance shareholder welfare from those that are taken for self-interested purposes.[44] Courts have established supplemental preconditions to the application of the business judgment rule when boards implement defensive measures. Directors who voted in favor of the defenses must carry the initial burden of proving the elements of a two-prong test announced by the Delaware Supreme Court in *Unocal*. Directors must show both that they had "reasonable grounds for believing that a danger to corporate policy and effectiveness existed" and that the defenses were "reasonable in relation to the threat posed."[45] If directors succeed in meeting the *Unocal* test, then courts will refrain from evaluating the merits of their actions.[46] If they do not, then the entire fairness test applies.[47]

39. *See id.* at 791, 797 (discussing the "intrinsic fairness standard" and its application).

40. *See* J. Travis Laster, *Changing Attitudes: The Stark Results of Thirty Years of Evolution in Delaware M&A Litigation*, *in* RESEARCH HANDBOOK ON REPRESENTATIVE SHAREHOLDER LITIGATION 202, 202 n.6 (Sean Griffith et al. eds., 2018) (defining third-party transactions as those not involving a controlling shareholder or a traditional conflict of interest).

41. *See* Sean J. Griffith, *Deal Protection Provisions in the Last Period of Play*, 71 FORDHAM L. REV. 1899, 1901 (2003) (discussing methods for parties to a merger agreement to protect themselves from hostile interference).

42. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).

43. *Id.* at 954.

44. Stephen M. Bainbridge, Unocal *at 20: Director Primacy in Corporate Takeovers*, 31 DEL. J. CORP. L. 769, 830 (2006) (arguing that courts will defer to boards that act from proper motives even if their decisions are mistaken).

45. *Unocal*, 493 A.2d at 955.

46. *See* Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1153 (Del. 1989) (upholding target board defenses under *Unocal*). *Cf.* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1367 (Del. 1995) (requiring courts first to determine whether the defensive action is "preclusive or coercive").

47. *See* Shamrock Holdings, Inc. v. Polaroid Corp., 559 A.2d 257, 271 (Del. Ch. 1989) (stating that entire fairness scrutiny applies where target board does not carry its burden under *Unocal*).

In the context of sales of control, different inherent conflicts arise. When control of a company changes hands, the board becomes accountable to a new owner. Directors might therefore be tempted to choose one prospective deal over another based not on the value it offers the shareholders but, rather, on the value it offers the directors.[48] In *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,[49] the Delaware Supreme Court held that in the change-of-control setting, directors are charged with obtaining the highest-value transaction available upon sale.[50] Once they embark on the sale process, directors are not permitted to take into consideration factors unrelated to the financial interests of the selling shareholders. To do otherwise would, as the *Revlon* Court put it, be "playing favorites,"[51] potentially introducing self-interested considerations into the selection of a merger partner.

The special concerns regarding director conflicts of interest that are present when a company sells control prompted the courts to create a specific application of enhanced scrutiny for board decisions in the change-of-control context.[52] The resulting jurisprudence takes account of the unique incentives facing directors who have shifted strategic priorities from operating an independent, stand-alone, company to pursuing a sale. Under *Revlon*-enhanced scrutiny, the court will review the substance of a board's sale decision for whether it fetched the highest value for shareholders by requiring the directors who voted in favor of the transaction to carry the burden of showing both "(a) the adequacy of the decision-making process employed by the directors, including the information on which the directors based their decision; and (b) the reasonableness of the directors' action in light of the circumstances then existing."[53]

The particulars of each form of judicial scrutiny described above differ, but their primary goal is the same. Courts inquire initially into the objectivity of the board's decision making. Where concerns over self-interest are present, either explicit or inherent, they recognize the need for judicial intervention based on the principle that arm's-length bargaining conditions are necessary to produce fair outcomes for shareholders. Courts then apply a substantive standard of review to the board's decision specifically designed to evaluate whether that decision was, in fact, fair to shareholders in the context in which it was made.

The willingness of courts to scrutinize suspect board decisions for fairness is subject to an important qualification, however. Using procedural safeguards that are deemed to

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48. *See In re* El Paso Corp. S'holder Litig., 41 A.3d 432, 439 (Del. Ch. 2012) (noting that directors' actions in connection with a sale of control might be compromised by self-interest); *In re* Dollar Thrifty S'holder Litig., 14 A.3d 573, 597 (Del Ch. 2010) (same).

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

50. *Id.* at 182, 184 n.16.

51. *Id.* at 184 ("[W]hen bidders make relatively similar offers, or dissolution of the company becomes inevitable, the directors cannot fulfill their enhanced *Unocal* duties by playing favorites with the contending factions.").

52. Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989) ("It is true that a court evaluating the propriety of a change of control or a takeover defense must be mindful of 'the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders.'" (quoting Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985))).

53. Paramount Commc'ns v. QVC Network, 637 A.2d 34, 44–45 (Del. 1994)*; see also* Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 243–44 (Del. 2009) (noting that to hold directors personally liable for post-closing monetary damages, plaintiffs must first allege deliberate wrongdoing to state a claim for breaching their duty of good faith under the duty of loyalty).

cleanse the effects of a board's conflicts reinstates the business judgment rule. If directors employ these safeguards, courts will drastically limit their substantive review of board decisions.[54]

II. PROCEDURAL ALTERNATIVES TO HEIGHTENED JUDICIAL REVIEW FOR CONFIRMING FAIRNESS

Even if a plaintiff successfully rebuts the business judgment rule and invokes a heightened standard of review, a board can reclaim judicial deference by implementing certain procedural measures. Such measures include obtaining disinterested director approval, disinterested shareholder approval, or both. If the board uses these mechanisms as judicially prescribed, then the taint affecting its decision making is treated as "cleansed." This Part reviews existing procedural alternatives to substantive judicial review of conflicted board decisions and argues that using disinterested shareholder approval as a basis for cleansing is under-theorized.

A. *Special Committee Approval*

Corporate law statutes allow boards to delegate most of their powers to committees comprised of one or more directors.[55] Using a special committee comprised of unconflicted directors is one way for a board to avoid the heightened judicial scrutiny that it would otherwise face in conflict-of-interest transactions.[56] By installing a special committee to act, for all practical purposes, in its stead, a board can limit its interested directors from influencing the decision-making process.[57] The extent of a special committee's cleansing power depends on both the nature of the board conflict and how the special committee functions. The closer a special committee comes to replicating the functions of an objective board under the circumstances, the more credit it will receive toward reinstating the business judgment rule. At its most potent, using a special committee fully restores the application of the business judgment standard of review to a conflicted board's decision.

1. *Varying Effects of Special Committee Approval*

When a transaction is initially subject to entire fairness review because the board has explicit conflicts, a special committee has full cleansing power. Unlike the conflicted board, the special committee is not motivated to sacrifice shareholder interests to benefit

54. *See* Smith, *supra* note 9, at 84 (stating that the court's objective in these circumstances is to "satisfy itself that a board decision is worthy of respect, not because the decision was substantively correct, but because the effect of the procedural infirmities was sufficiently muted").

55. *See, e.g.*, DEL. CODE ANN., tit. 8, § 141(c) (West 2019). Section 141(c) does not allow delegation of the final authority to approve mergers, asset sales, and other transactions requiring a stockholder vote. In such circumstances, the board can delegate to a committee the full power to negotiate a transaction and the authority to determine whether to recommend the transaction to the full board. John F. Grossbauer & Michael K. Reilly, *Special Committees: A Primer*, CORP. GOVERNANCE ADVISOR, Mar.–Apr. 2007, at 18, 23 n.10.

56. *See* BALOTTI & FINKELSTEIN, *supra* note 19, § 9.35 (stating that use of a special committee reinstates the business judgment rule).

57. *See* Weinberger v. UOP, Inc., 457 A.2d 701, 709 n.7 (Del. 1983) (suggesting that fairness to minority shareholders of a parent-subsidiary merger "can be equated to conduct by a theoretical, wholly independent, board of directors acting upon the matter before them").

itself. Using a special committee in these circumstances reinstates the business judgment rule to the board.[58]

Conflicted controlling shareholder transactions are also subject to entire fairness review.[59] Again, the initial standard of review for those transactions can be reduced through appropriate procedural protections. Using only a special committee, however, is not enough to reinstate fully the business judgment rule. Instead, it shifts the burden of proof back to the plaintiff to show that the transaction was not entirely fair.[60]

The cleansing effect of appointing a special committee in *Unocal* or *Revlon* settings is similarly limited. It will not wholly eliminate concerns that directors are favoring their personal interests when making decisions. Courts have, however, held that approval by a majority of non-management, or "outside,"[61] disinterested and independent directors will "materially enhance" the board's ability to demonstrate that it has met its burden of proof in cases controlled by *Unocal* or *Revlon*.[62] The distinction between outside (non-management) and inside (management) directors is particularly relevant in the third-party M&A context because inside directors are more likely than outside directors to be sensitive to their relationships with new owners.[63] Unlike outside directors, who typically have other employment or sources of income, inside directors are company executives who are likely to prefer that the company continue as a stand-alone entity or sell itself to a benevolent acquirer so that they can secure ongoing employment and perquisites.[64]

2. *Preconditions for the Effectiveness of a Special Committee*

Whether using a special committee will have the desired cleansing effect depends crucially on the committee's design. A special committee that is nothing more than an appendage of the full board because it is either beholden to the same competing interests

58. *See, e.g.*, *In re* PNB Holding Co. S'holders Litig., No. 28-N, 2006 WL 2403999, at *14 n.69 (Del. Ch. Aug. 18, 2006) (commenting in dicta that the rationale for business judgment level review of disinterested board decisions would seem to apply to decisions based on the recommendations of a special committee); *In re* Western Nat'l Corp. S'holders Litig., No. 15927, 2000 WL 710192, at *26 (Del. Ch. May 22, 2000) (same).

59. *See* Kahn v. Lynch Commc'n Sys., 638 A.2d 1110, 1115 (Del. 1994) ("A controlling or dominating shareholder standing on both sides of a transaction, as in a parent-subsidiary context, bears the burden of proving its entire fairness.").

60. *Id.* at 1117.

61. Selectica, v. Versata Enters., No. 4241, 2010 WL 703062, at *13–14 (Del. Ch. Feb. 26, 2010), *aff'd*, 5 A.3d 586 (Del. 2010) (defining an "outside" director as a non-employee and non-management director who derives no income other than ordinary directors' fees).

62. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985); Mary Siegel, *The Illusion of Enhanced Review of Board Actions*, 15 U. PA. J. BUS. L. 599, 624 (2013) (commenting that when conducting *Revlon* review, Delaware courts follow *Unocal* in deferring to a board consisting of a majority of outside directors).

63. *Selectica*, 2010 WL 703062, at *14 ("Where decisions are made by outside independent directors instead of members of management who have a presumptive desire to retain their employment, the concern that the board's decisions are tainted by self-serving motives is mitigated, and there naturally follows a greater presumption of good faith and reasonable investigation. This is the essence of the material enhancement rubric in *Unocal* and its progeny.").

64. *Id.* For the contrary view that the susceptibility to conflicts of interest in M&A transactions of outside and inside directors is similar, see Zachary J. Gubler, *What's the Deal with Revlon?*, 96 IND. L.J. 429, 466 (2021) ("However, the types of concerns over conflicts that animate *Revlon* could occur even on a board consisting of a majority of outside directors and even among those with a lot of money on the line.").

or cannot exercise powers equivalent to the board's is deemed merely "perfunctory" and, as such, gets no sanitizing credit.[65] To be regarded as a real cleansing mechanism, the committee must meet standards for both its composition and functioning.[66] Special committees that do so are referred to as "effective."[67]

An effective special committee must be both disinterested and independent in composition.[68] An effective special committee must also be well-functioning. How well a special committee functions is context-specific. However, three factors are generally considered relevant: (1) the special committee's access to information, (2) the outside financial and legal resources available to the special committee, and (3) the autonomy of the special committee.[69] The special committee should be fully informed of all material information about the company. If the special committee must negotiate without the benefit of data, such as financial information, to which the board has access, it will not be in a position to bargain effectively for the shareholders.[70] The special committee must also have access to its own legal, financial, and other advisors. Reliance on the company's advisors raises questions about the committee's independence and whose interests it will prioritize in negotiations.[71] Finally, the cleansing effect requires that the special committee be sufficiently empowered so as not to be under the sway of the board.[72]

3. Justifications for a Special Committee's Cleansing Power

The special committee arose in the 1980s as a procedural device with the potential to reduce or eliminate conflicts of interest that compromised a majority of the board.[73] Courts have since embraced special committees and encouraged their use.[74] Scott Simpson and Katherine Brody, two transactional attorneys who have written extensively on special committees, regard them as the procedural measure "most likely to replicate the results of arm's-length bargaining by a disinterested board that would traditionally be entitled to the benefit of the business judgment rule."[75]

Because the effectiveness of a special committee depends crucially on its ability to serve as an arm's-length negotiator, the precise legal effect of establishing a special

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65. BALOTTI & FINKELSTEIN, *supra* note 19, § 9.59 n.1072 (quoting Kahn v. Tremont Corp., 694 A.2d 422, 429 (Del. 1997)).

66. *Id.* § 9.59.

67. Scott V. Simpson & Katherine Brody, *The Evolving Role of Special Committees in M&A Transactions: Seeking Business Judgment Rule Protection in the Context of Controlling Shareholder Transactions and Other Corporate Transactions Involving Conflicts of Interest*, 69 BUS. LAW. 1117, 1123 (2014).

68. *Id.* at 1135.

69. Kahn v. Lynch Commc'n Sys., 638 A.2d 1110, 1120 (Del. 1994).

70. *See In re* Dole Food Co., Inc. S'holder Litig., No. 8703, 2015 WL 5052214, at *18 (Del. Ch. Aug. 27, 2015) (holding that provision of false information to the special committee undermined its ability to negotiate effectively).

71. *In re* Tele-Commc'ns, Inc. S'holder Litig., No. 16470, 2005 WL 3642727, at *10 (Del. Ch. Dec. 21, 2005).

72. Gesoff v. IIC Indus., 902 A.2d 1130, 1145–48 (Del. Ch. 2006).

73. *See* Simpson & Brody, *supra* note 67, at 1118.

74. *See id.* at 1118 ("For more than thirty years the Delaware courts have continued to emphasize the importance of the special committee and refine the jurisprudence surrounding the benefits of a robust special committee process.").

75. *Id.* at 1126.

committee varies according to the circumstances in which it is used.[76] Where a board operates under an explicit conflict, such as in a transaction in which a majority of the board has a direct financial interest, it is appropriate to defer to an effective special committee because that committee is not similarly disabled. Consider, for example, an interested-director transaction between the corporation and another entity owned by a majority of the corporation's directors. The board's only deficiency as a fiduciary in this instance (assuming the disinterested directors are also independent) is that the interested directors have competing loyalties. An effective special committee squarely addresses these concerns. It thus serves as a proxy for a disinterested board and cleanses the taint of the explicit conflict.

In contrast, when a controlling shareholder is on both sides of a transaction, courts are unwilling to treat a special committee as an arm's-length bargaining agent for the corporation and its non-controlling shareholders because, structurally, the controller exerts influence over all directors, who make their decisions under the inherent threat of reprisal by a disgruntled controlling shareholder with the ultimate power to deprive them of their board seats.[77] In such a situation, using a special committee provides only a burden shift on the entire fairness question.[78]

In cases governed by *Unocal*, the inherent conflict directors face occurs in the context of implementing either defensive measures to ward off unwanted bidders or deal protective measures to favor one bidder over another. Here, courts also give substantial, but not complete, deference to special committees composed of outside directors. As the *Unocal* Court remarked, after pointing out that directors defending against a hostile takeover "are of necessity confronted with a conflict of interest,"[79] proof of the first prong of the *Unocal* test (whether the board had reasonable grounds for believing that a danger to corporate policy and effectiveness existed) is "materially enhanced . . . by the approval of a board comprised of a majority of outside independent directors."[80] The interplay between enhanced judicial scrutiny and special committees gives "heavy credit for empowering the independent elements of the board."[81]

In the enhanced-scrutiny setting of *Revlon*, directors also face an inherent conflict of interest, so a special committee without any additional procedural safeguards again gives a board only partial protection from heightened judicial scrutiny. The concern about the disinterestedness of boards of target corporations in the third-party M&A setting arises because of the inherent threat to all directors that they may lose their existing positions if the company is acquired. As a result, the directors may selfishly sacrifice shareholder value in exchange for receiving private benefits from the acquirer after the sale.

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76. *See* Stephen M. Bainbridge, *The Geography of* Revlon-*Land*, 81 FORDHAM L. REV. 3277, 3303 (2013) (noting that Delaware courts impose "varying [levels of scrutiny] according to the likelihood that the actions of the board or managers were tainted by conflicted interests in a particular transactional setting").

77. *See In re* MFW S'holders Litig., 67 A.3d 496, 530 (Del. Ch. 2013), *aff'd sub nom.* Kahn v. M & F Worldwide Corp., 88 A.3d 635 (Del. 2014) (acknowledging that "even impartial directors acting in good faith and with due care can sometimes come out with an outcome that minority investors themselves do not find favorable"); *see also* Claire Hill & Brett McDonnell, *Sanitizing Interested Transactions*, 36 DEL. J. CORP. L. 903, 924 (2011) (noting that controlling shareholders can remove directors at will).

78. *See supra* note 59 and accompanying text.

79. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).

80. *Id.*

81. *In re MFW*, 67 A.3d at 527, *aff'd sub nom. Kahn*, 88 A.3d 635 (citation omitted).

As previously discussed, if the special committee consists of disinterested and independent outside directors, courts will view it as being a close, but not perfect, substitute for an unconflicted board.[82] While even such outside directors might be compromised by the threat that their positions will be taken away from them, they are less likely than inside directors to depend on board service for financial security, power, or prestige. As the Delaware Supreme Court observed in *Paramount v. QVC*, in a sale of control governed by *Revlon*, "the role of outside, independent directors becomes particularly important because of the magnitude of a sale of control transaction and the possibility, in certain cases, that management may not necessarily be impartial."[83]

In *Unocal* and *Revlon* cases, all directors are inherently at risk of acting adversely to the disinterested shareholders. The cleansing power of an effective special committee is thus an incomplete solution to board conflicts. Part II.B explains how courts instead turn to shareholder ratification as a cleansing device in these settings.

B. Shareholder Ratification

Courts also regard the approval of a board's decision by disinterested, fully-informed, and uncoerced shareholders as a cleansing device, known as "shareholder ratification," for purposes of reinstating the business judgment rule when it has initially been rebutted.[84] Although shareholders have only limited involvement in U.S. corporate governance, they enjoy specific voting rights under state corporation statutes,[85] including the right to approve fundamental corporate changes, such as mergers,[86] sales of all or substantially all of the firm's assets,[87] and dissolutions,[88] as well as amendments to the firm's certificate of incorporation under state corporation statutes.[89] In addition, a corporation can voluntarily solicit shareholder votes (or proxies) at an annual or special meeting of shareholders or through action by written consent.[90]

Shareholders are thus a potential alternative to a special committee for cleansing a transaction with respect to which the board is compromised. Indeed, in *Oberly v. Kirby*,[91] the Delaware Supreme Court seemed to equate the two cleansing mechanisms as instances of "the approval of some neutral decision-making body,"[92] which is the "key to upholding an interested transaction."[93] This Part II.B describes the shareholder ratification doctrine and critiques existing theoretical justifications for its standard of review-shifting ("standard-shifting") effect.

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82. *See supra* notes 61–64 and accompanying text (explaining the difference between outside and inside directors and the differential treatment of the two).

83. Paramount Commc'ns v. QVC Network, 637 A.2d 34, 44 (Del. 1994).

84. Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 310 n.19 (Del. 2015).

85. Unless otherwise specified, I refer to the state corporate law of Delaware, which applies to the majority of U.S. publicly-traded companies. *See* Lucian Arye Bebchuk & Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 J.L. & ECON. 383, 391 (2003).

86. DEL. CODE ANN. tit. 8, § 251(c) (West 2019).

87. *Id.* § 271(a) (West 2020).

88. *Id.* § 275(b) (West 2022).

89. *Id.* § 242(b) (West 2023).

90. *Id.* § 211 (West 2009) (stockholder meetings); § 228 (West 2023) (written consents).

91. Oberly v. Kirby, 592 A.2d 445, 467 (Del. 1991).

92. *Id.*

93. *Id.*

1. Varying Effects of Shareholder Approval

Although a special committee is generally a conflicted board's preferred procedural device for reclaiming business judgment rule protection, it may not be available or sufficient as a cleansing device.[94] In some circumstances, most or all of the directors have explicit conflicts of interest so that no special committee can practically be formed.[95] A case in point is when directors make stock-based compensation decisions for themselves. Self-compensation, the court stated in *Stein v. Blankfein*, "involves the quintessence of director self-interest."[96] Although section 141(h) of the Delaware General Corporation Law empowers a corporation's board of directors to fix director compensation,[97] it does not relieve directors of their common law fiduciary duties of care and loyalty when they do so.[98] Self-compensation decisions are subject to review under the entire fairness standard,[99] but approval by a fully-informed majority of disinterested shareholders, cleanses them.[100]

In other circumstances, special committee approval can help but is insufficient on its own to cleanse suspect board decisions. Recall that in conflicted controller transactions, special committee approval merely shifts the burden of proof from the defendant (to prove fairness) to the plaintiff (to prove unfairness).[101]A board may still be able to obtain business judgment rule protection for its decision in such transactions, however, by complementing the special committee approval with the approval of a majority of the minority disinterested shareholders and conditioning *ab initio* the transaction on both approvals as provided in *Kahn v. M&F Worldwide* (*MFW*).[102] In *MFW*, a controlling shareholder consummated a going-private transaction that was so conditioned. The Delaware Supreme Court analyzed the dual-approval process in that deal and concluded that it produced arm's-length bargaining conditions between the parties.[103] The Court thus applied the business judgment standard to the board's decision to approve the transaction. Absent the joint implementation of both protections, however, the entire fairness standard would have continued to apply, subject to only a burden shift in the case of special committee approval.[104]

94. *See* Simpson & Brody, *supra* note 67, at 1123 (contrasting the practical time and expense of calling a special shareholder meeting and the risk of non-approval, on the one hand, with the relative ease of forming a special committee, on the other hand).

95. Courts have also disfavored the use of a special committee comprised of too few members. *See id.* at 1137 (discussing the infirmities of a single-member or two-member committee but noting the possibility of adding directors to the board for the specific purpose of serving on the committee).

96. Stein v. Blankfein, No. 2017-0354, 2019 WL 2323790, at *1 (Del. Ch. May 31, 2019).

97. DEL. CODE ANN. tit. 8, § 141(h) (West 2019).

98. *Stein*, 2019 WL 2323790, at *14.

99. *Id.*

100. BALOTTI & FINKELSTEIN, *supra* note 19, § 4.11[A].

101. *See supra* notes 59–60 and accompanying text (providing context on controlling shareholder transactions).

102. *See* Kahn v. M & F Worldwide Corp. (*MFW*), 88 A.3d 635 (Del. 2014). For a discussion of the cleansing regime applicable to controlling shareholder transactions, see Ann M. Lipton, *The Three Faces of Control*, 77 BUS. LAW. 801, 811–12 (2022).

103. *MFW*, 88 A.3d at 646.

104. *Id.* at 640. While *MFW* arguably left open the question of whether its dual-approval cleansing regime applies outside the controlling-shareholder freezeout setting to controlling-shareholder non-freezeout self-dealing transactions, in *Match Group*, the Delaware Supreme Court confirmed the applicability of the *MFW* framework

In circumstances controlled by *Unocal* or *Revlon*, where enhanced scrutiny is the standard of review because of inherent conflicts that operate in the M&A context, a special committee alone provides strong evidence of the reasonableness of the board's decision but is insufficient to reinstate the business judgment rule.[105] At least in a *Revlon* suit for post-closing money damages, under *Corwin v. KKR Financial Holdings LLC*, the business judgment standard can, however, be reclaimed by the board through shareholder ratification alone; i.e., without using a special committee.[106]

In *Corwin*, the Delaware Supreme Court held that a disinterested, fully informed, uncoerced vote of the target shareholders approving a third-party M&A transaction that would otherwise be reviewed under *Revlon*-enhanced scrutiny in a post-closing suit for money damages reinstated the business judgment standard of review.[107] The *Corwin* court indicated only in dicta that its reasoning encompassed *Unocal*-enhanced scrutiny as well.[108] It thus remains an open question whether *Corwin* applies to cases subject to *Unocal* in a post-closing suit for money damages.[109] Where *Corwin* applies, a court will not review the board's decision other than for waste. In other words, the shareholder approval reinstates the business judgment rule and makes it effectively irrebuttable.[110]

With the handing down of *MFW* and *Corwin*, shareholder ratification acquired new significance. In conflicted controller transactions, it previously could only shift the burden to the plaintiff on the entire fairness question.[111] In *Unocal* and *Revlon* transactions, it previously had no standard-shifting effect.[112] After *MFW* and *Corwin*, boards could use procedural devices to insulate themselves from liability for business decisions not only in explicit conflict-of-interest transactions but also in transactions involving inherent conflicts of interest.

2. *Preconditions for the Effectiveness of Shareholder Approval*

To ratify either explicit or inherent conflicts at the board level, a shareholder vote approving a board decision must satisfy certain preconditions. The shareholder vote must

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even where a conflicted controlling shareholder is a party to a transaction other than a freezeout of the minority shareholders. *In re* Match Group, Inc. Derivative Litig., No. 368, 2024 WL 1449815, at *4–5 (Del. Apr. 4, 2024).

105. *See supra* notes 61–64 and accompanying text (drawing a distinction between the biases of non-management and management directors).

106. Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 308 (Del. 2015).

107. *Id.* at 314.

108. *Id.* at 312 (analyzing the effect of shareholder ratification on both *Unocal* and *Revlon*).

109. *In re* Paramount Gold & Silver Corp. S'holders Litig., No. 10499, 2017 WL 1372659, at *15 (Del. Ch. Apr. 13, 2017) (raising the question of whether *Corwin* extends to deal protections subject to *Unocal* but finding it unnecessary to decide the issue). *See* ARTHUR FLEISCHER, JR., GAIL WEINSTEIN & SCOTT B. LUFTGLASS, TAKEOVER DEFENSE: MERGERS AND ACQUISITIONS § 3.03 (9th ed. 2021) ("In our view, given that *Corwin* overrides the heightened scrutiny of *Revlon* and applies the business judgment rule even if all of the directors are not independent, we expect that the court will find that it overrides *Unocal* heightened scrutiny as well, at least absent unusual facts."). Note, however, that *Corwin* has been held not to apply to a post-closing *Unocal*-based claim seeking injunctive relief against defensive measures. *See In re* Edgio, Inc. S'holders Litig., No. 2022-0624, 2023 WL 3167648, at *1 (Del. Ch. May 1, 2023).

110. *See* Singh v. Attenborough, 137 A.3d 151, 152 (Del. 2016) (observing that in such cases "dismissal is typically the result").

111. Kahn v. Lynch Commc'n Sys. (Lynch I), 638 A.2d 1110, 1117 (Del. 1994).

112. *See* Gantler v. Stephens, 965 A.2d 695, 713 (Del. 2009) (limiting the shareholder ratification doctrine to its "classic form" of an organic vote that is not legally required to make the board's action legally effective).

be (1) disinterested, (2) fully informed, (3) uncoerced, and (4) specifically related to the matter being ratified.[113] Given the dramatic reduction in judicial scrutiny of boards conferred by shareholder ratification, courts examine closely whether the foregoing preconditions are met.[114]

Cleansing by shareholder vote generally requires approval by a majority of disinterested shareholders.[115] Unlike the concept of a '"disinterested director," the requirements for shareholder disinterestedness have only recently begun to attract attention in corporate fiduciary law.[116] Historically, the definition of an "interested shareholder" has been relatively narrow.[117] The American Law Institute (ALI) previously took the position that a shareholder should be deemed interested in a transaction or conduct only if either the shareholder or, to the shareholder's knowledge, an associate of the shareholder is a party to the transaction or conduct, or if the shareholder is also an interested director or officer with respect to the transaction or conduct.[118] The ALI's more recent Restatement of the Law, Corporate Governance, takes a more expansive approach to the definition of the "interested shareholder" but continues to define "interested" more narrowly for a shareholder than for a director.[119]

In recent years, Delaware courts have also expanded the scope of what constitutes "shareholder interestedness" in the context of *Corwin* cleansing.[120] In *Pattern Energy*, the Delaware Chancery Court stated, "A stockholder is interested if it may derive pecuniary interest from one particular result or is otherwise unable to be fair-minded, unbiased, and impartial."[121] The pecuniary interest that the Court seemed to be troubled by, as Professors

113. *See* RONALD J. COLOMBO, LAW OF CORPORATE OFFICERS & DIRECTORS: RIGHTS, DUTIES, & LIABILITIES § 3:13 (2023–2024 ed.).

114. *See* Morrison v. Berry, 191 A.3d 268, 274 (Del. 2018) (emphasizing that *Corwin* must be applied carefully because of its "potentially case-dispositive impact").

115. PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 1.16 (AM. L. INST. 1994).

116. *See* Henry T. C. Hu & Lawrence A. Hamermesh, *Decoupling and Motivation: Re-Calibrating Standards of Fiduciary Review, Rethinking 'Disinterested' Shareholder Decisions, and Deconstructing 'De-SPACs'*, 78 BUS. LAW. 999, 1021–22 (2023) (submitting that courts' interpretation of "disinterestedness" in the shareholder context would benefit from further refinement); Matteo Gatti, *Interested Voting*, 48 BYU L. REV. 1619, 1629 (2023) ("[D]etermining when interested voting is in fact detrimental and actionable remains a rather complex issue for interpreters to grasp and for policymakers to regulate."); Brandon Mordue, *The* Revlon *Divergence: Evolution of Judicial Review of Merger Litigation*, 12 VA. L. & BUS. REV. 531, 571 (2018) (pointing out the dearth of case law on the issue); Robert Brown, Jr., *Speaking with Complete Candor: Shareholder Ratification and the Elimination of the Duty of Loyalty*, 54 HASTINGS L.J. 641, 642 (2003) ("Delaware courts have not defined 'disinterested' shareholder.").

117. PRINCIPLES OF CORP. GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 1.23(b) (AM. L. INST. 1994).

118. *Id.*

119. *See* RESTATEMENT OF CORP. GOVERNANCE § 1.23(b) (AM. L. INST., Tentative Draft No. 1, 2022) (defining "interested" shareholder); *id.* § 1.23 cmt. b (describing rationale for defining "interested" shareholder more narrowly than "interested" director).

120. *See, e.g.*, Delman v. GigAcquisitions3, LLC, 288 A.3d 692, 721–22 (Del. Ch. 2023) (holding that *Corwin* did not apply to a de-SPAC merger because redemption rights of public stockholders created perverse voting incentives with respect to the merger).

121. *In re* Pattern Energy Grp. Inc. S'holders Litig., No. 2020-0357, 2021 WL 1812674, at *63 (Del. Ch. May 6, 2021); *see also* Lockton v. Rogers, No. 2021-0058, 2022 WL 604011, at *10 (Del. Ch. Mar. 1, 2022) (quoting *Pattern Energy*).

Henry Hu and Lawrence Hamermesh explain, is "idiosyncratic to that specific shareholder."[122] It is not yet clear how *Pattern Energy's* seemingly wide-ranging articulation of "interested shareholders" will be applied in future cases, but it is likely to shape the definition of the "disinterested shareholder" for cleansing purposes.

On whether the shareholder vote was fully informed, a plaintiff challenging the board's decision to approve a transaction must first identify a deficiency in the applicable disclosure document.[123] The defendant then has the burden to demonstrate that the deficiency did not undermine the legitimacy of the shareholder vote.[124] Under Delaware law, directors who solicit a shareholder vote are required to disclose "fully and fairly all material information within the board's control."[125] In determining whether an alleged omission or misrepresentation is material, Delaware courts use the standard of materiality of federal securities law.[126] For information to be material under that standard, there must be a substantial likelihood that it would alter the overall assessment of the matter being presented to a reasonable shareholder in deciding how to vote.[127]

In the context of evaluating whether a shareholder vote was fully informed for purposes of applying *Corwin*, the Delaware Chancery Court noted that "fully informed does not mean infinitely informed."[128] Even "troubling facts" relating to directors' conduct are not sufficient to undermine the cleansing effect of an affirmative shareholder vote as long as those facts are not material.[129] The board is required to disclose only those troubling facts that would have been material to a voting shareholder.[130] Finally, as long as directors disclose material facts from which shareholders can draw inferences of fiduciary misconduct, they are not required to state explicitly that they acted for an improper purpose or even how their differing incentives relative to other shareholders could have motivated them to act in a self-interested way.[131]

Even if disinterested and fully informed, shareholder approval does not satisfy *Corwin* if the vote is coerced. The coercion condition recognizes that a shareholder's voting decision is contextual and occurs subject to any constraints to which the shareholder is subject. If these constraints cause a shareholder to approve a deal for reasons other than its economic merits, then the shareholder's vote cannot be said to reflect the underlying logic

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122. *See* Hu & Hamermesh, *supra* note 116, at 1021.

123. *In re* Solera Holdings, Inc. S'holder Litig., No. 11524, 2017 WL 57839, at *8 (Del. Ch. Jan. 5, 2017). In *Lavin v. West Corp.*, the Delaware Chancery Court declined to invoke *Corwin* as a basis to bar a stockholder's demand to inspect books and records under Section 220 of the DGCL. Lavin v. W. Corp., No. 2017-0547, 2017 WL 6728702, at *10 (Del. Ch. Dec. 29, 2017).

124. *Solera Holdings*, 2017 WL 57839, at *8.

125. *Id.* at *9 (quoting Stroud v. Grace, 606 A.2d 75, 84 (Del. 1992)).

126. *Id.*

127. *See id.* (quoting Arnold v. Soc'y for Sav. Bancorp, 650 A.2d 1270, 1277 (Del. 1994)).

128. *In re* Merge Healthcare S'holder Litig., No. 11388, 2017 WL 395981, at *9 (Del. Ch. Jan. 30, 2017).

129. *See In re* Solera Holdings, Inc. S'holder Litig., No. 11524, 2017 WL 57839, at *9 (Del. Ch. Jan. 5, 2017) (discussing the precondition of a fully informed vote under Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304 (Del. 2015)).

130. *See In re* Saba Software, Inc. S'holder Litig., No. 10697, 2017 WL 1201108, at *7 (Del. Ch. Mar. 31, 2017, revised Apr. 11, 2017) (citing *Corwin*, 125 A.3d 304).

131. *In re* Columbia Pipeline Grp., Inc., No. 12152, 2017 WL 898382, at *3 (Del. Ch. Mar. 7, 2017) ("The duty of disclosure demands that fiduciaries disclose facts. It does not demand that fiduciaries 'engage in "self-flagellation" and draw legal conclusions' as to the inferences to be drawn from those facts." (quoting Stroud v. Grace, 606 A.2d 75, 84 n.1 (Del. 1992))).

of *Corwin* cleansing: that shareholder approval is an endorsement of a board decision's fairness. Thus, where there is coercion, shareholder approval does not reinstate the business judgment rule. Courts have rejected a *Corwin* defense on coercion grounds, however, only in extreme fact patterns.[132]

Finally, Delaware courts have emphasized that shareholder approval satisfies *Corwin* only when it is sufficiently specific. In two cases, *Seinfeld v Slager*[133] and *Citrix v. Templeton*,[134] the Delaware Chancery Court applied the entire fairness standard of review to a compensation committee's decision granting restricted stock units to outside directors under shareholder-approved plans where the plans did not include any "meaningful limits" on directors' discretion to make awards.[135] The shareholder-approved plan was deemed nothing other than a "carte blanche" to directors to set their own compensation.[136] In addition, the shareholder ratification doctrine does not cleanse director actions that are unrelated or extraneous to the matter the shareholders approved.[137]

3. Justifications for Shareholder Ratification's Cleansing Power

Despite its growing power to cleanse the taint of director self-interest, the shareholder ratification doctrine remains under-theorized. There are three primary approaches courts use to explain why shareholder ratification can cleanse a transaction. Some courts take the position that shareholders are qualified to evaluate the merits of board action because, like special committees and courts, shareholders are a neutral decision-making body.[138] Other courts suggest that shareholders are entitled to act with the authority of beneficiaries in trust relationships or of principals in agency relationships.[139] Yet others defer to

132. *See In re* Pattern Energy Grp. Inc. S'holders Litig., No. 2020-0357, 2021 WL 1812674, at *63 (Del. Ch. May 6, 2021) (shareholder subject to a voting agreement the breach of which might have exposed it to liability); *Saba Software*, 2017 WL 1201108, at *1 (shareholder vote was structurally coerced because board manipulated circumstances such as to give shareholders no practical alternative to approving board decision); Sciabacucchi v. Liberty Broadband Corp., No. 11418, 2017 WL 2352152, at *2 (Del. Ch. May 31, 2017) (same).

133. Seinfeld v. Slager, No. 6462, 2012 WL 2501105 (Del. Ch. June 29, 2012).

134. Citrix Sys., Inc. v. Templeton, 114 A.3d 563 (Del. Ch. 2015).

135. *See id.* at 578, 587; *Seinfeld*, 2012 WL 2501105, at *12.

136. *See Seinfeld*, 2012 WL 2501105, at *12 ("If a board is free to use its absolute discretion under even a stockholder-approved plan, with little guidance as to the total pay that can be awarded, a board will ultimately have to show that the transaction is entirely fair."). In 2017, the Delaware Supreme Court decided *In re Investors Bancorp, Inc. Stockholder Litigation*, which retained the "meaningful limits" rhetoric of prior cases but suggested that any director discretion to make awards under a plan would fail the "meaningful limits" standard. *In re* Invs. Bancorp, Inc. S'holder Litig., 177 A.3d 1208 (Del. 2017). After *Investors Bancorp*, it appears that directors will receive business judgment rule protection only when either specific awards have been approved by shareholders or shareholders have approved a self-executing plan based on a formula and not left the details to director discretion.

137. *See In re* Massey Energy Co. Derivative & Class Action Litig., 160 A.3d 484, 508 (Del. Ch. 2017) (requiring a "far more proximate relationship" than was present between the matter voted on and the allegations of breach to support a cleansing claim).

138. *See, e.g.*, Oberly v. Kirby, 592 A.2d 445, 467 (Del. 1991) (referring to "some neutral decision-making body" as "[t]he key to upholding an interested director transaction").

139. *See, e.g.*, Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 313 (Del. 2015) (referring to the disinterested equity owners of the target corporation as the "real parties in interest" in merger transactions); Harbor Fin. Partners v. Huizenga, 751 A.2d 879, 901 (Del. Ch. 1999) ("In this day and age in which investors also have access to an abundance of information about corporate transactions from sources other than boards of

shareholders based on their economic stake in the transaction.[140] None of these approaches provides a sound basis in corporate fiduciary law for the shareholder ratification doctrine.

Consider first the theory that shareholders act as neutral decision makers. While neutrality is relevant to why special committee approval should cleanse conflicted board decisions, it does not explain why courts should give boards credit for obtaining shareholder approval. Boards, shareholders, and courts each play distinct roles in corporate governance. Shareholder power is limited: Boards propose; shareholders dispose.[141] Courts backstop the allocation and exercise of power between boards and shareholders as needed to ensure that each body is fulfilling its proper role.[142] Shareholders do not function as surrogates for either boards or courts.[143]

Grounding the shareholder ratification doctrine in trust or agency law is also problematic. Although fiduciary law embodies certain over-arching principles, such as the duties of care and loyalty, regardless of the type of fiduciary relationship, its content varies by context. The fiduciary relationship between boards and shareholders in corporate law has long been understood to be *sui generis*. While fiduciary principles in trust law and agency law bear on fiduciary principles in corporate law, corporate fiduciary law has developed differently from both.

Corporate fiduciary law has roots in trust fiduciary law and is occasionally still analogized to it, but there are notable differences between the two.[144] In a trust fiduciary relationship, the trustee holds and administers certain property in trust for the trust's beneficiaries.[145] Under the sole interest rule of trust law, the trustee must administer the trust solely in the beneficiaries' interests.[146] Conflict-of-interest transactions are categorically prohibited irrespective of fairness because they create a wedge between the interests of trustees and their beneficiaries.[147] The only exceptions available to a trustee seeking to engage in such a transaction are (1) where a court approves the transaction on

directors, it seems presumptuous and paternalistic to assume that the court knows better in a particular instance than a fully informed corporate electorate with real money riding on the corporation's performance.").

140. *See, e.g.*, *Corwin*, 125 A.3d at 314 (noting that informed, disinterested stockholders have "an actual economic stake in the outcome" of a transaction).

141. *See* Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 569 (2003) (describing the limited circumstances under which shareholders have the power to initiate corporate action).

142. *See generally* Lawrence A. Hamermesh & Leo E. Strine, Jr., *Delaware Corporate Fiduciary Law: Searching for the Optimal Balance*, *in* THE OXFORD HANDBOOK OF FIDUCIARY LAW 871, 884 (Evan J. Criddle, Paul B. Miller & Robert H. Sitkoff eds., 2019) (describing judicial review as an accountability mechanism to protect shareholders).

143. *See* Matteo Gatti, *Did Delaware Really Kill Corporate Law? Shareholder Protection in a Post-*Corwin *World*, 16 N.Y.U. J.L. & BUS. 345, 380 (2020) (discussing limitations on relying on a shareholder vote to protect investor interests); Charles R. Korsmo, *Delaware's Retreat from Judicial Scrutiny of Mergers*, 10 U.C. IRVINE L. REV. 55, 94–97 (2019) (highlighting qualitative differences between shareholder voting and board decision making); Jennifer Hill, *Visions and Revisions of the Shareholder*, 48 AM. J. COMPAR. L. 39, 67–72 (2000) (analyzing the use of shareholder consent under Australian law as a monitoring device).

144. *See, e.g.*, Licht, *supra* note 5, at 17–18 (examining perspectives on the relationship between directors and trustees).

145. *See* RESTATEMENT (THIRD) OF TRUSTS § 2 (AM. L. INST. 2003).

146. *Id.* § 78(1).

147. *Id.*; *see also id.* § 78 cmt. b.

the basis that it is in the interest of the beneficiaries to do so,[148] (2) by the terms of the trust,[149] or (3) upon approval of all of the trust's beneficiaries.[150]

The separation of ownership and control in the corporate and trust settings invites comparisons between boards and shareholders, on the one hand, and trustees and beneficiaries, on the other. Applying the third exception above in the shareholder context suggests that shareholders should have the power to authorize director conflict-of-interest transactions, just as "the informed consent of the *cestui que trust* . . . could authorize a self-dealing transaction or validate a voidable agreement."[151] However, to the extent trust fiduciary law has any continuing relevance to corporate fiduciary law, the ability of the beneficiary to authorize a trustee's breach of fiduciary duty is conceptually different from shareholder approval in that *all* beneficiaries must consent to the breach.[152] Non-unanimous approval of the beneficiaries of a trust "ordinarily . . . does not preclude other beneficiaries of the trust; that is, nonconsenting present or future beneficiaries, from holding the trustee liable for a breach of trust."[153] Moreover, the dealings between trustees and beneficiaries allow beneficiaries to represent their own interests in a conflict-of-interest transaction to a far greater extent than do the dealings between directors and shareholders, the latter of whom are asked only to approve or reject a transaction that was likely to have been initiated, structured, and negotiated by the board.[154] In general, shareholders are at a substantial disadvantage compared to trust beneficiaries in monitoring rent-seeking behavior by directors.

Corporate fiduciary law is also sometimes analogized to agency fiduciary law.[155] According to agency fiduciary law, a principal's consent after the fact to a transaction by an agent that would otherwise constitute a breach of the agent's fiduciary duty to the principal does not constitute a breach of duty.[156] Adopting a principal-agent framework would imply that shareholder approval similarly absolves directors of breaches of their fiduciary duties to shareholders.

However, there are important distinctions between the shareholder-director relationship in corporate law and the principal-agent relationship in agency law.[157] Paramount among these is the absence of any mechanism by which shareholders can exercise full control over the board's decision making. The Restatement (Third) of Agency makes control over the agent's actions an element of the agency relationship when it

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148. *Id.* § 78(3), § 78 cmt. c(1) notes, however, that a court will ordinarily not permit a self-dealing transaction where there are alternative purchasers available and willing to enter into a transaction on equivalent terms and counsels that appointment of a trustee *ad litem* is advisable, especially in significant matters involving complexity and business judgment.

149. RESTATEMENT (THIRD) OF TRUSTS § 78 cmt. c(2) (AM. L. INST. 2003).

150. *Id.* § 78 cmt. c(3).

151. Kershaw, *supra* note 12, at 433.

152. *See* Norwood P. Beveridge, Jr., *The Corporate Director's Fiduciary Duty of Loyalty: Understanding the Self-Interested Director Transaction*, 41 DEPAUL L. REV. 655, 658–59 (1992).

153. RESTATEMENT (THIRD) OF TRUSTS § 97 cmt. c(1) (AM. L. INST. 2012).

154. Harold Marsh, Jr., *Are Directors Trustees? Conflict of Interest and Corporate Morality*, 22 BUS. LAW. 35, 49 (1966).

155. *See, e.g.*, Citrix Sys., Inc. v. Templeton, 114 A.3d 563, 579 (Del. Ch. 2015); Lewis v. Vogelstein, 699 A.2d 327, 334 (Del. Ch. 1997); Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 315 (Del. 2015).

156. RESTATEMENT (THIRD) OF AGENCY §§ 8.06, 8.06 cmt. b (AM. L. INST. 2006).

157. Deborah A. DeMott, *Shareholders as Principals*, *in* KEY DEVELOPMENTS IN CORPORATE LAW AND TRUSTS LAW 105, 106–08 (Ian Ramsay ed., 2002).

defines agency as the fiduciary relationship that arises when "one person (a 'principal') manifests assent to another person (an 'agent') that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act."[158]

The temptation to think of shareholders as principals and directors as their agents arises from a theory of the firm in which directors manage the corporation under the control of the shareholders. Indeed, historically, directors were in a subordinate relationship relative to shareholders.[159] Professor Deborah DeMott has noted that it thus "seems natural to think that shareholders are principals and that directors act as their agents."[160] As DeMott goes on to argue, however, "contemporary corporate law does not treat directors as shareholders' agents other than in a loose or metaphorical sense."[161]

The primary distinction relates to the oversight of agents and directors, respectively. Agency control embodies rights to establish initially what the agent shall and shall not do, to give interim directions to the agent, and to revoke the agent's actual authority at any time through a manifestation to the agent.[162] In contrast, directors possess primary managerial power separate and distinct from the shareholders, with shareholders retaining only those limited rights conferred upon them by statute.[163] Two other distinctions are also relevant to the applicability of agency principles to corporate fiduciary law. First, an agent's actions can cause the principal to become bound to a transaction entered into on the principal's behalf.[164] Second, principals in an agency relationship are vicariously liable for the torts of employees acting within their scope of employment.[165] In contrast, the consequence of incorporation is to create a legal entity separate from the shareholders and to insulate shareholders from personal liability for the corporation's obligations.[166]

Courts have also asserted that shareholders are uniquely well-suited to evaluate a transaction's merits because they have an economic stake in it. The shareholders' equity interest in a company does, indeed, expose them to the financial consequences of a bad bargain. As I discuss in more detail below, however, there are numerous reasons shareholders might rationally ratify an unfair deal.[167]

If shareholders do not resemble either special committees or courts in regard to their qualifications as neutral decision makers and are not in a privileged position to serve as arbiters of fairness, then we need a new theory for giving standard-shifting effect under corporate fiduciary law to an affirmative shareholder vote.

III. SHAREHOLDER RATIFICATION AS A JUDICIAL PRESUMPTION OF FAIRNESS

Part III explains why the shareholder ratification doctrine should be understood as a judicial presumption that a board decision approved by the shareholders is substantively

158. RESTATEMENT (THIRD) OF AGENCY § 1.01 (AM. L. INST. 2006).
159. Hill, *supra* note 143, at 42.
160. DeMott, *supra* note 157, at 105.
161. *Id.*
162. RESTATEMENT (THIRD) OF AGENCY §§ 1.01, 3.10, 3.10 cmt. f(1) (AM. L. INST. 2006).
163. *See supra* notes 85–90 and accompanying text.
164. RESTATEMENT (THIRD) OF AGENCY § 1.01 (AM. L. INST. 2006).
165. *Id.* § 7.07.
166. DeMott, *supra* note 157, at 107.
167. *See* discussion *infra* Part III.B.2.

fair. Framing shareholder approval in terms of fairness motivates the following standard for applying the shareholder ratification doctrine: Courts should abstain from second-guessing a business decision of a conflicted board based on shareholder approval only if the shareholder vote reliably indicates that the shareholders regarded the decision as substantively fair to them as investors. The theory and evidence on whether shareholder ratification reflects arm's-length decision making by boards indicate that the shareholder ratification doctrine requires further refinement to satisfy this standard.

A. Interested-Director Statutes

Interested-director statutes address the legal validity of transactions between a corporation's directors and the corporation or another entity on whose board the directors also serve or in which they have a material financial interest. The legislative histories of California's and Delaware's interested-director statutes, which were especially influential in developing shareholder ratification jurisprudence, shed light on the theoretical basis for the shareholder ratification doctrine. California's statute is notable because it played a formative role in the development of similar statutes enacted in other states, while Delaware's corporate law is widely recognized as being highly influential in the United States. These statutes' respective legislative histories suggest that shareholder approval of a board decision was understood to mean that the shareholders had concluded that the decision fairly represented their interests.

Corporate legal historians have thoroughly debated the question of whether contemporary corporate fiduciary duty-of-loyalty principles followed a revolutionary or evolutionary development path.[168] Harold Marsh advanced a revolutionary account of the development of the entire fairness doctrine in the United States, under which self-dealing transactions were initially voidable without regard to whether they were substantively fair to shareholders.[169] By 1910, such transactions were voidable unless they were fair and approved by a disinterested board majority.[170] By 1960, disinterested board approval was no longer required to protect a self-dealing transaction from voidability. The modern rule had been adopted that self-dealing transactions could be avoided only if unfair.[171] Marsh contended that replacing the voidability standard with the fairness standard was rooted in neither precedent nor reason.[172]

Norwood Beveridge challenged Marsh's account of the fairness standard. Reviewing 19th-century U.S. corporate case law and the trust and agency law principles to which they were often analogized, he concluded that "according to the great weight of authority, interested director transactions were never thought to be voidable without regard to

168. For a review of the debate as well as a discussion of its normative relevance in today's corporate governance context, see William W. Bratton, *Reconsidering the Evolutionary Erosion Account of Corporate Fiduciary Law*, 76 BUS. LAW. 1157, 1170, 1214 (2021) (evaluating the outcomes of each mechanism relative to an arm's-length transaction).

169. Marsh, *supra* note 154, at 36.

170. *Id.* at 39–40.

171. *Id.* at 44.

172. *Id.* at 40.

fairness."[173] According to Beveridge, corporate fiduciary law always provided that evidence of a transaction's fairness shielded it from voidability.[174]

Looking back on the debate, David Kershaw took the position that neither Marsh nor Beveridge had captured fully the history of the fairness standard in the United States.[175] Such an undertaking, he claimed, necessitated juxtaposing U.S. and U.K. self-dealing law. Kershaw began with the observation that both bodies of law initially prohibited self-dealing irrespective of the transaction's fairness, then contrasted the United Kingdom's continued refusal to subject self-dealing transactions to a fairness exception with the United States' eventual willingness to do so.[176] He attributed the divergence to a difference in the ability of the two countries' corporate laws to accommodate contractual departure from the default rule in a company's charter.[177]

According to Kershaw, there were commercial pressures in both countries to allow corporations to avail themselves of potentially beneficial self-dealing contracts.[178] U.K. law responded by allowing companies' articles of association to permit directors to engage in conflict-of-interest transactions as long as those transactions were approved by the disinterested directors after full disclosure.[179] In contrast, Kershaw argued, fairness review arose in the United States as a response to the limited ability of companies to opt out of strict voidability in their charters:

> [I]n the United States, general incorporation was viewed as an extension of statutory chartering. Each generally incorporated company was viewed as a product of legislative action; the state's creation and empowerment of an entity and its empowerment of a board of directors. This understanding of the corporation placed clear limits on the extent to which the parties themselves could change the rules, including those applicable to self-dealing transactions, without permission from the state to do so.[180]

Kershaw concluded that without a readily available mechanism for amending corporate charters to create procedures that allowed conflict-of-interest transactions by directors that were fair to the company, U.S. courts, led by New Jersey and New York in the latter half of the 19th century, responded to pressures to allow beneficial self-dealing contracts by reviewing them for fairness.[181]

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173. Beveridge, *supra* note 152, at 659–61.
174. *See id.* at 660.
175. *See* Kershaw, *supra* note 12.
176. *Id.* at 401, 405, 441.
177. *Id.* at 458.
178. *Id.* at 438.
179. *Id.* at 433–34.
180. Kershaw, *supra* note 12, at 404–05.
181. *Id.* at 438–79, 482. One of the main points of contention between Marsh and Kershaw, on the one hand, and Beveridge, on the other hand, is whether the incorporation of fairness review into U.S. corporate fiduciary law was a historical anomaly. Both Marsh and Kershaw took the position that in the United States, director self-dealing transactions were originally voidable without inquiry into their fairness. *Id.* at 441. Beveridge contested that description, invoking U.S. legal authority that he argued demonstrated that interested-director transactions were not always voidable. Beveridge, *supra* note 152, at 659. The authorities Beveridge cited provide evidence that such transactions were permissible if both were approved by a majority of disinterested directors and fair. *Id.* at 659 n.18.

While their respective historical accounts differed, Marsh, Beveridge, and Kershaw all concluded that in the United States, a judicial fairness determination ultimately came to protect an interested-director transaction from voidability other than for waste.[182] In other words, the dual requirement of both disinterested-director approval and fairness to prevent voidability was replaced by a fairness-only requirement. The disinterested-director element of the earlier two-pronged standard of review did not disappear, however. Rather, it re-emerged in state statutes as one of two alternative non-judicial safe harbors for upholding interested-director transactions, the second being shareholder ratification.[183] These statutes typically provided that interested-director transactions would not be voidable if they were (1) approved by disinterested directors, (2) approved by shareholders, or (3) fair to the corporation.[184]

Some commentators have suggested that interested-director statutes undermined the common law fairness imperative upon which director self-dealing was historically permitted by allowing approval of disinterested directors or shareholders to substitute for a judicial fairness determination.[185] On the contrary, such statutes did not remove fairness as a consideration in reviewing interested-director transactions. For example, California embedded fairness considerations into its statutory scheme for insulating interested-director transactions.[186] Delaware took a different approach to the non-judicial validation of interested-director transactions, but it similarly included fairness considerations in its statutory design. The common law rule that directors may enter into transactions with their corporations as long as they are fair thus persisted, although fairness was no longer to be determined exclusively by the courts.

182. Kershaw, *supra* note 12, at 477–79; Beveridge, *supra* note 152 at 672–73; Marsh, *supra* note 154, at 44.

183. Beveridge, *supra* note 152, at 662–67.

184. *Id.* at 665.

185. *See* Licht, *supra* note 5, at 24–25 (discussing how Delaware's interested-director statute is at odds with fundamental principles of fiduciary law); Lawrence E. Mitchell, *Fairness and Trust in Corporate Law*, 43 DUKE L.J. 425, 455 (1993) (describing a procedural conception of fairness based on states passing interested-director statutes); HENRY W. BALLANTINE, CALIFORNIA CORPORATION LAWS § 122, § 123 (1932) (describing the effects of adverse interest on a director's fiduciary duties).

186. *See* Sammis v. Stafford, 48 Cal. App. 4th 1935, 1943 (Cal. Ct. App. 1996) (describing the court's statutory analysis of fairness in this case).

The legislative history of California's first interested-director statute, California Civil Code Section 311,[187] which served as a model for many other state statutes,[188] provides evidence that the statute was not intended to eliminate the common law fairness requirement for interested-director transactions. Henry Ballantine described the relationship between the California statute and the common law as follows:

> Directors should not be permitted to abuse their position. It was the view of the majority of the committee on corporations, however, that transactions with a director or between corporations with common directors should be merely voidable for unfairness and not void or voidable at the option of the corporation by reason of the fact that such director participated in a quorum or in a majority.[189]

In *Remillard Brick Co. v. Dandini Co.*,[190] the California Supreme Court espoused Ballantine's position, stating that the successor statute to Section 311, California Corporations Code Section 820,[191] did not "automatically validate transactions within its scope" or permit a director to, "by reason of his position, drive a harsh and unfair bargain with the corporation he is supposed to represent."[192] Subsequently, the California

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187. California Civil Code § 311 reads as follows:

> Fiduciary duty of directors; Directors and officers shall exercise their powers in good faith, and with a view to the interests of the corporation.
>
> Transactions between directors and corporation. No contract or other transaction between a corporation and one or more of its directors, or between a corporation and any corporation, firm or association in which one or more of its directors are directors or are substantially interested, shall be either void voidable by reason of the fact that such director or directors are present at the meeting of the board of directors or committee which authorizes or approves such contract or transaction, or that his or their votes are counted for such purpose, if (a) the fact of such participation shall be disclosed or known to the board of directors or committee, and noted in the minutes, and the board or committee shall authorize, approve or ratify such contract or transaction in good faith by a vote sufficient for such purpose without counting the vote or votes of such director or directors; or (b) If the fact of such participation shall be disclosed or known to the shareholders, and they approve or ratify such contract or transaction in good faith, by a majority vote of holders of shares entitled to vote; or (c) If the contract or transaction be as to the corporation just and reasonable at the time it was authorized or approved.
>
> Such interested director or directors may be counted in determining the presence of a presence at such meeting.

CAL. CIV. CODE § 311 (West 1931).

188. Beveridge, *supra* note 152, at 664.

189. Henry W. Ballantine, *Questions of Policy in Drafting a Modern Corporation Law*, 19 CALIF. L. REV. 465, 476 (1931). Ballantine was the principal draftsperson for the California State Bar Committee on Corporations of California's first modern General Corporation Law, which contained Section 311. HAROLD MARSH, JR., R. ROY FINKLE & KEITH P. BISHOP, MARSH'S CALIFORNIA CORPORATION LAW § 1.01[C] (5th ed. 2020). In their detailed analysis of the California model, Professors Bulbulia and Pinto concluded that California retained fairness as a requirement for insulating transactions against voidability. *See* Ahmed Bulbulia & Arthur R. Pinto, *Statutory Responses to Interested Directors' Transactions: A Watering Down of Fiduciary Standards?*, 53 NOTRE DAME L. REV. 201, 208–10 (1977).

190. Remillard Brick Co. v. Remillard-Dandini Co., 241 P.2d 66 (Cal. Ct. App. 1952).

191. CAL. CORP. CODE § 820 (West 1947).

192. *Remillard Brick*, 241 P.2d at 74.

Legislature codified *Remillard*'s common law fairness requirement in Section 310 of its amended and restated interested-director statute (replacing California Civil Code Section 311 and California Corporations Code Section 820), which became part of a new General Corporation Law that took effect in 1977.[193] The principal changes in the new version were to (1) require full disclosure of the material facts of both the director's interest and the transaction, (2) provide that where only disinterested board approval (and not shareholder approval) was obtained, the transaction also had to be "just and reasonable to the corporation" at the time of approval,[194] and (3) exclude any shares owned by interested directors for purposes of shareholder approval.

The revisions in Section 310 established the conditions under which the non-judicial bases for upholding an interested-director transaction would presumptively yield a fair outcome for shareholders.[195] This reading is consistent with the development of

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193. According to the Assembly Select Committee's Report, "[t]here is an additional requirement that the transaction be just and reasonable as to the corporation at the time it is approved, which is intended to codify a judicial decision indicating that the courts in any event will review the transaction for fairness." CAL. LEG., REPORT OF THE ASSEMBLY SELECT COMMITTEE ON THE REVISION OF THE CORPORATIONS CODE, AB 376, Assemb. 1975, at 55 (1975) (citing *Remillard Brick*, 241 P.2d 66). The 1975 revision of Section 311 was renumbered as Section 310 and read as follows:

> 310. No contract or other transaction between a corporation and one or more of its directors, or between a corporation and any corporation, firm or association in which one or more of its directors has a material financial interest, is either void or voidable because such director or directors or such other corporation, firm or association are parties or because such director or directors arc present at the meeting of the board or a committee thereof which authorizes, approves or ratifies the contract or transaction, if
>
> The material facts as to the transaction and as to such director's interest are fully disclosed or known to the shareholders and such contract or transaction is approved by the shareholders (Section 153) in good faith, with the shares owned by the interested director or directors not being entitled to vote thereon, or
>
> The material facts as to the transaction and as to such director's interest are fully disclosed or known to the board or committee, and the board or committee authorizes, approves or ratifies the contract or transaction in good faith by a vote sufficient without counting the vote of the interested director or directors and the contract or transaction is just and reasonable as to the corporation at the time it is authorized, approved or ratified, or
>
> As to contracts or transactions not approved as provided in subdivision (a) or (b), the person asserting the validity of the contract or transaction sustains the burden of proving that the contract or transaction was just and reasonable as to the corporation at the time it was authorized, approved or ratified. Interested directors may be counted in determining the presence of a quorum at a meeting of the board or a committee thereof which authorizes, approves or ratifies a contract or transaction. A mere common directorship does not constitute a material financial interest.

CAL. CIV. CODE § 310 (West 1975).

194. Disinterested board approval shifts the burden on fairness to the party challenging the transaction. C. HUGH FRIEDMAN ET AL., CALIFORNIA PRACTICE GUIDE—CORPORATIONS, Ch. 6 (2019).

195. CAL. LEG., REPORT OF THE ASSEMBLY SELECT COMMITTEE ON THE REVISION OF THE CORP. CODE 1–2 (1975), *reprinted in* MARSH, JR., FINKLE & BISHOP, *supra* note 189, § 1.02[B] ("The procedure for validating 'interested' transactions provides independent procedures for the approval of such transactions and reflects the case law in this area."). California's use of the term "just and reasonable" in its interested-director statute is generally understood to mean "fair." Bulbulia & Pinto, *supra* note 189, at 206 n.42; *see also* Sedaghat-Pour v. Pezeshki, No. B232584, 2012 WL 5207487, at *6 (Cal. Ct. App. Oct. 23, 2012) ("The essence of the test is

California's common law, according to which the sole criterion for upholding an interested-director transaction was fairness. It is also consistent with the structure of Section 310, which refers to shareholder approval, board approval, and judicial review as independent mechanisms for validating an interested-director transaction. The symmetry of the statute suggests that it was meant to provide alternative bases for confirming the transaction's fairness.

Notably, Section 310 does not presume the fairness of interested-director transactions that are merely approved by a disinterested majority of directors. It requires that those transactions *also* be "just and reasonable," with the burden of proof on the complaining party. This dual requirement reflects historical concerns in California about the independence of even disinterested directors. Disinterested directors enjoy a pre-existing relationship with the interested directors and might be inclined to favor the latter's interests. In contrast, approval by a disinterested majority of shareholders, who are less likely to be subject to the influence of interested directors, suffices to establish the fairness of the transaction. Understood as such, the California statute's innovation was not to provide an *alternative* to fairness as a basis for validating interested-director transactions but, rather, to provide an alternative mechanism to judicial review for *evaluating* fairness.

Delaware's interested-director statute, Section 144 of the Delaware General Corporation Law,[196] was first enacted in 1967 as part of the State's new General Corporation Law.[197] Structurally, it followed California's interested-director statute, which

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whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain. If it does not, equity will set it aside.").

196. Section 144 establishes that:

> (a) No contract or transaction between a corporation and 1 or more of its directors or officers, or between a corporation and any other corporation, partnership, association, or other organization in which 1 or more of its directors or officers, are directors or officers, or have a financial interest, shall be void or voidable solely for this reason, or solely because the director or officer is present at or participates in the meeting of the board or committee which authorizes the contract or transaction, or solely because any such director's or officer's votes are counted for such purpose, if:
>
> (1) The material facts as to the director's or officer's relationship or interest and as to the contract or transaction are disclosed or are known to the board of directors or the committee, and the board or committee in good faith authorizes the contract or transaction by the affirmative votes of a majority of the disinterested directors, even though the disinterested directors be less than a quorum; or
>
> (2) The material facts as to the director's or officer's relationship or interest and as to the contract or transaction are disclosed or are known to the stockholders entitled to vote thereon, and the contract or transaction is specifically approved in good faith by vote of the stockholders; or
>
> (3) The contract or transaction is fair as to the corporation as of the time it is authorized, approved or ratified, by the board of directors, a committee or the stockholders.
>
> (b) Common or interested directors may be counted in determining the presence of a quorum at a meeting of the board of directors or of a committee which authorizes the contract or transaction.

DEL. CODE ANN. tit. 8, § 144 (West 2019).

197. S. Samuel Arsht & Walter K. Stapleton, *Delaware's New General Corporation Law: Substantive Changes*, 23 BUS. LAW. 75, 75 (1967).

Ernest Folk, the Reporter for the Delaware Corporation Law Revision Commission tasked with drafting the 1967 statute for Delaware's Legislature,[198] regarded as influential.[199]

Following California's approach, Delaware's statute provides three independent bases for validating interested-director transactions—disinterested director approval, shareholder approval, or proof of fairness of the transaction. The statute also follows California's tripartite construction, indicating that all three of its tests were intended to serve equally as indicia of the transaction's fairness. Folk indicated as much, claiming that a fair outcome would follow from either disinterested director or shareholder approval as long as the decision was made in good faith.[200]

The California and Delaware statutes protect transactions against only *per se* voidability and not claims of breach of fiduciary duty under common law.[201] The common law in both California and Delaware tracks the basic framework of the safe harbors in those states' respective interested-director statutes to address the standards of review for breach of directors' fiduciary duties. When boards act under conflicts of interest, their decisions are considered suspect and are subject to substantive judicial fairness review. However, non-judicial approval of a conflicted board decision by directors or shareholders can give rise to the presumption that the board's decision was fair to the shareholders and thereby limit the need for judicially reviewing its substance.

B. Presumed Versus Adjudicated Fairness

While a presumption of fairness most accurately explains why courts abstain from intruding on a conflicted board decision that has been ratified by the shareholders, it bears noting that a fair outcome as presumed from a cleansing mechanism is not necessarily equivalent to a fair outcome as adjudicated by a court.[202] Special committees, shareholders, and courts are not perfect substitutes. In a judicial determination of fairness, a court assesses directly whether the substance of a conflicted board's decision was fair to the shareholders.[203] In contrast, when a conflicted board obtains special committee or disinterested shareholder approval, courts apply the business judgment rule to the board's decision in reliance on the procedural safeguard of review for fairness by a non-judicial decision maker purportedly acting in the shareholders' best interests.[204] As explained in more detail below, special committees are presumed to be fair on the grounds that they are independent and owe fiduciary duties to shareholders, and disinterested shareholders are relied upon on the grounds that they are pursuing their own investment interests.

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198. Comment, *Law for Sale: A Study of the Delaware Corporation Law of 1967*, 117 U. PA. L. REV. 861, 863, 865 (1969).

199. ERNEST L. FOLK III, REVIEW OF THE DELAWARE CORPORATION LAW 67 (1968).

200. *Id.* at 70.

201. *See* Gaillard v. Natomas, 208 Cal. App. 3d 1250, 1273 (Cal. Ct. App. 1989); Arsht & Stapleton, *supra* note 197, at 82.

202. *See* Bratton, *supra* note 168, at 1170, 1214 (evaluating the outcomes of each mechanism relative to an arm's-length transaction); *see also* Dalia T. Mitchell, *Proceduralism: Delaware's Legacy*, 2 U. CHI. BUS. L. REV. 333, 354 (2023) (distinguishing between entire fairness, which involves both fair dealing and fair price, and procedural fairness, which involves only fair dealing).

203. *See supra* note 29 and accompanying text.

204. *See* discussion *supra* Part II (reviewing special committee and shareholder approval bases for reclaiming judicial deference).

Courts are willing to rely on special committees or shareholders to legitimate suspect board decisions even when the outcomes of those processes might differ from the exercise of substantive judicial review. There are at least two policy reasons motivating courts to substitute procedural safeguards for substantive judicial review for fairness. First, deferring to non-judicial bodies relieves courts of the challenges involved when "law-trained courts" are asked to perform functions outside of their core competencies.[205] Second, such deference reduces inefficient litigation to the extent a court would merely be replicating functions that can be performed by existing corporate governance mechanisms.[206] By presuming fairness instead of adjudicating it, courts can achieve both fair and efficient outcomes if the doctrine for doing so is well designed.

1. Fairness Presumed from Special Committee Review

Consider first the mechanism of the special committee as a procedural safeguard for reinstating the business judgment rule when a majority of the board has an explicit conflict of interest. The special committee serves as an independent board surrogate that can conduct arm's-length negotiations. In other words, the "surrogate" board meets the preconditions of the business judgment rule that lead courts to presume a fair outcome for shareholders when the traditional business judgment rule applies.[207] Accordingly, it is reasonable for courts to presume that special committee approval signifies that the transaction is in the shareholders' best interests despite the board conflict. A board that relies on the recommendations of an effective special committee thus receives deference under the business judgment rule.[208]

2. Fairness Presumed from Shareholder Ratification

Like a special committee, disinterested shareholders can also restore business judgment rule protection to a conflicted board in a transaction not involving a conflicted controlling shareholder.[209] In this instance, however, shareholders do not serve as a surrogate for boards in the same way special committees do. Special committees exercise primary decision-making authority delegated to them by the board or make recommendations to the board.[210] In contrast, shareholders approve or reject decisions made, in the first instance, by boards.[211]

The difference between the special committee function and the shareholder approval function raises the following question: Why should courts defer to a *conflicted board's*

205. *See In re* Toys "R" Us, Inc. S'holder Litig., 877 A.2d 975, 1000 (Del. Ch. 2005) (expressing the court's reluctance to second-guess the business decisions of directors); Harbor Fin. Partners v. Huizenga, 751 A.2d 879, 901 (Del. Ch. 1999) (expressing the court's reluctance to second-guess the investment decisions of shareholders).

206. *See Huizenga*, 751 A.2d at 901 (bemoaning the costs to shareholders of unproductive fiduciary duty litigation).

207. Cooke v. Oolie, No. 11134, 2000 WL 710199, at *13 (Del. Ch. May 24, 2000) (noting that disinterested directors have no incentive to act disloyally).

208. *See* discussion *supra* Part II.A.3.

209. *See supra* note 109 and accompanying text.

210. *See supra* note 55 and accompanying text.

211. *See supra* notes 85–90 and accompanying text.

decision based on the *disinterested shareholders'* approval of it?[212] According to this Article's fairness theory, it is because shareholder approval of a conflicted board's decision has the potential, given appropriate safeguards, to confirm that the decision was fair to the shareholders as investors.

In some respects, shareholders are institutionally poor arbiters of fairness.[213] Relative to directors, shareholders suffer from informational disadvantages, as they must rely exclusively on the corporation to provide them with non-public material information about the potential transaction and any conflicts of interest. Because management controls both what to deem material and the narrative of the transaction for which shareholder approval is being solicited, even sophisticated shareholders may overvalue managerial preferences. In addition, diffuse shareholders have limited incentives to undertake a thorough evaluation of a transaction before voting. Doing so is time and resource-intensive, and shareholders must fund 100% of their research costs and expenses in exchange for only a pro-rata benefit.[214] Finally, divergent interests among shareholders make it possible that even disinterested shareholders, who owe no fiduciary duties to other shareholders unless they are controllers, will approve a transaction based on their private interests even if the transaction is not in the best interests of shareholders generally.[215]

In other respects, however, shareholders are institutionally well situated to evaluate the fairness of a conflicted board's decision. Shareholders are more sophisticated than ever before because of increased institutional shareholdings, the emergence of proxy advisors, and the rise of activist investors.[216] They have also become less passive as equity ownership by institutional investors has become more concentrated.[217] Concentrated shareholdings encourage investment in research and analysis by increasing the share of the gains generated by increased knowledge. Finally, shareholders are powerfully motivated to evaluate transactions for fairness because they bear directly the cost of underpricing.

Critics of *Corwin* argue that a bundled shareholder vote, which simultaneously approves a transaction for statutory law purposes and ratifies the board's conduct for

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212. *See* Korsmo, *supra* note 143, at 94 ("The business judgment rule is generally concerned with deference to the business decisions of managers, not stockholders, who are not typically vested with the power to make business decisions in the first place.") (citation omitted).

213. For the view that boards are superior to shareholders in protecting against self-dealing, see Cox, Mondino & Thomas, *supra* note 5, at 579–80.

214. *See, e.g.*, Lucian A. Bebchuk, Alma Cohen & Scott Hirst, *The Agency Problems of Institutional Investors*, 31 J. ECON. PERSP. 89, 90 (2017) (arguing that such factors disincentivize even large institutional investors from policing corporate governance). For a discussion of the ability of the growing category of passive investors to surmount obstacles to shareholder engagement, see Jill Fisch, Assaf Hamdani & Steven Davidoff Solomon, *The New Titans of Wall Street: A Theoretical Framework for Passive Investors*, 168 U. PA. L. REV. 17 (2019) (discussing engagement of passive investors).

215. *See* Tuch, *supra* note 10, at 970 (questioning the rigor with which shareholders review directorial self-dealing); Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 564–55 (2006) (questioning whether shareholders have uniform motives to maximize shareholder value when voting their shares).

216. *See* Bratton, *supra* note 168, at 1198–99.

217. *See* Jill E. Fisch & Jeff Schwartz, *Corporate Democracy and the Intermediary Voting Dilemma*, 102 TEX. L. REV. 1 (2023) (pointing out that increased intermediation of equity voting power has increased institutional investors' influence in corporate governance).

fiduciary law purposes, muddles the meaning of the vote.[218] They point out that shareholders may prefer the deal presented to them over no deal and yet believe that the board violated its fiduciary duties to them in making the deal.[219] On this view, the bundling of the two issues into a single vote calls into question whether the shareholders, in fact, endorsed the board's conduct.[220]

Bundling concerns about the shareholder ratification doctrine, while real, may be overstated. Corporate fiduciary law is designed to provide shareholders with a bargain that is consistent with an arm's-length decision, not an optimal deal.[221] Courts do not insist on perfection even when reviewing the substantive fairness of directors' business decisions. They approach the fairness inquiry holistically, taking into consideration both the deal process and the deal price.[222] The operative question is whether the combination of how the board went about reaching its decision and the outcome of that process support a "unitary conclusion" of a fair transaction.[223] A bundled shareholder vote on both process and price similarly entails a holistic evaluation of a transaction's fairness—one in which shareholders have the opportunity to consider how any flaws they discern in the sale process may have affected the proposed sale price.

While *Corwin* denies shareholders the ability to ratify a deal and subsequently sue for breach of fiduciary duty, it nevertheless allows them to reject the transaction with the goal of either (1) remaining investors in a stand-alone business or (2) waiting for a superior transaction that would win their support. In theory, long-term investors in a non-controlled company should always prefer either of the foregoing options to a bargain that they view as unfair because both these options represent higher-value alternatives to the deal at hand.

The empirical evidence on whether shareholders tend to ratify unfair deals is mixed. Based on a data set compiled by Professor Morgan Ricks of all mergers and acquisitions with U.S. public company targets from January 1, 1996, to March 31, 2017, Professors Cox, Thomas, and Mondino found a substantial shift in share ownership from long-term investors to short-term arbitrageurs between the announcement of a merger and the

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218. *See, e.g.*, Fiegenbaum, *supra* note 5, at 819–20 (criticizing *Corwin* for conflating a vote on the transaction with ratification of an alleged fiduciary duty breach); Cox, Mondino & Thomas, *supra* note 5, at 543 (viewing the bundling of a shareholder vote on director conduct and deal approval as inherently coercive); James D. Cox & Randall S. Thomas, *Delaware's Retreat: Exploring Developing Fissures and Tectonic Shifts in Delaware Corporate Law*, 42 DEL. J. CORP. L. 323, 340 (2018) ("Bundling the certainty of a deal, but perhaps not an optimal one, with disclosure of board laxity in pursuing the best deal reasonably available, hardly sends a clarion image of unwavering approval of each."); David C. McBride, *Rebalancing the Merger Litigation Landscape*, DEL. LAW., Summer 2017, at 24, 28 (making a similar argument with specific reference to deal protections).

219. *See, e.g.*, Cox, Mondino & Thomas, *supra* note 5, at 513 (raising doubts about whether shareholder approval of a merger reliably indicates that the shareholders approved of the board's conduct with respect to the merger).

220. *Id.* at 542–44 (likening bundling to coercion).

221. *See* 4 JAMES D. COX & THOMAS LEE HAZEN, TREATISE ON THE LAW OF CORPORATIONS § 23:8 (3d ed. 2010) (referring to the courts' responsibility in the *Revlon* context as deciding whether the board's decision was reasonable as opposed to perfect).

222. *See* Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983) (noting that the entire fairness test is "not a bifurcated one as between fair dealing and price" and that "[a]ll aspects of the issue must be examined as a whole since the question is one of entire fairness").

223. *In re* Nine Sys. Corporation S'holders Litig., No. 3940, 2014 WL 4383127, at *47 (Del. Ch. Sept. 4, 2014), *aff'd sub nom.* Fuchs v. Wren Holdings, LLC, 129 A.3d 882 (Del. 2015).

statutorily required shareholder vote on the deal.[224] Controlling for risks that arbitrageurs price in, Cox and coauthors found that an increase in such turnover was statistically significantly associated with an increase in the probability of deal completion.[225] They interpreted their results as evidence that short-term shareholders are more inclined than long-term shareholders to push for deal completion.[226]

On the other hand, Cox and coauthors also found that short-term shareholders avoid participating in the most problematic mergers—self-dealing transactions and management buyouts.[227] The impact of merger arbitrage on deal approval rates in unfair transactions may, therefore, be muted. Moreover, although arbitrageurs may vote their shares for a deal that offers them any premium over their purchase price, without regard to its fairness, the long-term investors who sell their shares to arbitrageurs should consider the fairness of the deal price when choosing between selling to arbitrageurs and holding their shares until the deal closes or is terminated. These long-term shareholders might be foregoing only the premium associated with having to wait until closing to receive their merger proceeds and the risk that the deal will not close.

Cox and coauthors also found that only a small fraction of deals overall did not gain shareholder approval. As the authors state, "If shareholder approval of the deal is the first (and per *Corwin* the only) line of defense to managerial misconduct in connection with M&A transactions, we would expect that activist investors would be regularly turning down bad deals."[228] In Cox and coauthors' view, shareholder approval of a merger is more likely to mean that the shareholders voting on the deal are taking "the sparrow in the hand over the pheasant in the bush" than that the deal presented is an arm's-length one.[229]

It is nevertheless possible that *Corwin* has made directors more honest brokers.[230] As mentioned above, after *Corwin*, shareholders could no longer approve a deal and then sue for money damages based on a breach of fiduciary duty. Cox and coauthors assume that when *Corwin* took a shareholder fiduciary duty lawsuit off the table, shareholders would respond by voting down more deals. But if they did so, they would presumably also want to replace the board. Thus, even if Cox and coauthors' findings of extraordinarily high shareholder approval rates in mergers were found to have persisted after 2015, when the Delaware Supreme Court decided *Corwin*, those high approval rates might reflect *Corwin's* efficacy, rather than its inefficacy, as a deterrent of director misconduct.[231]

Professors Cain, Griffith, Jackson, and Solomon analyzed data from mergers with public targets announced between 2003–2017 to assess whether mergers subject to enhanced judicial scrutiny under *Revlon* were associated with more effective sale processes

224. Cox, Mondino & Thomas, *supra* note 5, at 563–65.

225. *Id*. at 572–75.

226. *Id*. at 575.

227. *Id*. at 568–71.

228. *Id.* at 511.

229. *See* Cox, Mondino & Thomas, *supra* note 5, at 513.

230. *See* Hill, *supra* note 143, at 42 (raising the possibility, under Australian corporate law, that a shareholder approval requirement for facially uncommercial transactions may have a prophylactic effect of disciplining managers).

231. The Delaware Court of Chancery's decision in *Corwin* was handed down on October 14, 2014, *In re* KKR Fin. Holdings LLC S'Holder Litig., 101 A.3d 980 (Del. Ch. Oct. 14, 2014). This decision was affirmed by the Delaware Supreme Court on October 2, 2015, Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304 (Del. 2015).

by target boards.[232] They found that, for target companies incorporated in Delaware, they were.[233] Delaware target boards subject to *Revlon* negotiated for longer periods, conducted more bidding rounds, interacted with more bidders, and ultimately obtained higher deal premiums.[234] Professor Fernán Restrepo analyzed mergers that triggered *Revlon* before and after *Revlon* was decided and, like Cain and coauthors, found that target shareholder gains increased after *Revlon*.[235]

If, as Cox and coauthors conclude, statutory shareholder merger votes do not constrain managerial agency costs, and, as Cain and coauthors and Restrepo conclude, *Revlon* constrains managerial agency costs, then we should observe that Delaware target boards conducted weaker sale processes and produced worse outcomes for target shareholders after *Corwin.* To investigate the effect of *Corwin* on managerial agency costs, Matthew Schoenfeld compared merger premia relative to targets' 52-week highs in the six years before and the two years after *Corwin* was decided.[236] He found that the merger premia dropped by about 50%, despite an overall increase in market values.[237] Schoenfeld concluded that *Corwin* facilitated self-interested behavior by managers.[238] In contrast, Cain and coauthors found no "*Corwin* effect" on merger transactions: "In unreported tests we find no statistically significant differences in our models, including bidding rates, before or after . . . *Corwin*."[239] In other words, they did not find that *Corwin* was associated with reduced target board effectiveness in merger transactions.

Despite the mixed theoretical and empirical evidence on whether shareholder ratification is effective at blocking unfair deals, courts have enthusiastically embraced *Corwin* and are increasingly willing to presume the substantive fairness of conflicted board decisions based on shareholder approval rather than judge for themselves whether the decisions were fair.[240] Relying on a procedural device to confirm the fairness of a suspect transaction requires confidence that the procedural device produces its presumed outcome. Then-Vice Chancellor Strine expressed such confidence when he stated in *Harbor Finance Partners v. Huizenga*, "If fully informed, uncoerced, independent stockholders have approved the transaction, they have, it seems to me, made the decision that the transaction

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232. Matthew D. Cain et al., *Does* Revlon *Matter? An Empirical and Theoretical Study*, 108 CALIF. L. REV. 1683, 1684–85 (2020).

233. *Id.* at 1713–14.

234. *Id.* at 1712 (summarizing results). Professor Zachary Gubler examined data over the period from 2009–2016, during which *Revlon* scrutiny arguably weakened, and found that deals that triggered *Revlon* were associated with better processes, but not better target shareholder returns. Gubler, *supra* note 64, at 432, 447 n.130. For an account of *Revlon's* weakening, see Cox & Thomas, *supra* note 218 and accompanying text. However, Cain et al. did not identify any difference in their results before and after 2009. *See* Cain et al., *supra* note 232, at 1722 n.130 (discussing *Lyondell Chemical Corp. v. Ryan* and finding no difference before or after the case was decided).

235. Fernán Restrepo, The Impact of the Duty to Maximize Short-term Value in Mergers and Acquisitions: An Analysis of *Revlon* 15 (Nov. 29, 2023) (unpublished manuscript), http://ssrn.com/abstract=462639.

236. Matthew Schoenfeld, From *Corwin* to *Dell*: The Cost of Turning a Blind Eye (Feb. 12, 2018) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3122511.

237. *Id.* at 15–16.

238. *See id.* at 14.

239. *Id.* at 1722.

240. *See* Bratton, *supra* note 168, at 1198–99.

is 'a fair exchange.'"[241] The shareholder ratification doctrine reflects the belief that shareholders who satisfy the doctrine's preconditions would not approve an unfair bargain. Without stronger evidence that the conceptual underpinnings of the shareholder ratification doctrine are accurate, however, courts should be more cautious in placing so much stock in a shareholder approval.

3. Partial Cleansing and Hybrid Mechanisms for Presuming Fairness

As noted in Part II, there are some types of transactions for which neither special committee approval nor shareholder ratification, alone, is sufficient to reinstate the business judgment rule to a conflicted board. Courts have determined that in these instances, a single mechanism can only partially cleanse the taint disabling the board, shifting the burden of proving entire fairness from the defendant to the plaintiff but not warranting reinstatement of the business judgment rule. An additional corrective is needed before business judgment rule protection for the board is warranted.

MFW held that conditioning the transaction *ab initio* on the dual protections of special committee approval and shareholder ratification by a majority of the minority shareholders is needed to obtain full cleansing in a going-private merger by a controlling shareholder.[242] The two procedural safeguards complement one another:

> The "or" structure does not replicate the protections of a third-party merger under the DGCL approval process, because it only requires that one, and not both, of the statutory requirements of director and stockholder approval be accomplished by impartial decisionmakers. The "both" structure, by contrast, replicates the arm's-length merger steps of the DGCL by "requir[ing] two independent approvals, which it is fair to say serve independent integrity-enforcing functions."[243]

Recall from Part I that the entire fairness standard applies to a conflicted controlling shareholder transaction because board members who have no explicit conflict of interest may feel pressured to favor the controller over the minority shareholders to protect their individual interests. A special committee merely inherits that problem. Disinterested shareholders also act under the influence of the controller because they may suffer retribution from the controller should they oppose the transaction.

The dual-protection framework ensures that the controller cannot circumvent the special committee by dealing directly with the minority shareholders and that the controller cannot circumvent the minority shareholders by dealing directly with the special committee. Thus, each body backstops the other, limiting the controller's ability to take advantage of either. The Delaware Supreme Court has stated that it regards the resulting sale process as comparable to an arm's-length one, so that the board is entitled to the protection of the business judgment rule.[244] An empirical study by Professor Fernán Restrepo bears out this view. Restrepo explored the effect of *MFW* on the gains of target

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241. Harbor Fin. Partners v. Huizenga, 751 A.2d 879, 901 (Del. Ch. 1999) (*quoted in* Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 313 n.28 (Del. 2015)).

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

243. *Id.* at 643 (citations omitted).

244. *Id.* at 644.

shareholders before and after the decision and found no significant change.[245] Moreover, he found no significant difference in the target's gains between deals that were subject to only entire fairness review and those that were subject to only the dual protections of special committee approval and shareholder ratification by a majority of the minority. He concluded that "enhanced judicial scrutiny and the combination of SC [special committee] and MOM [majority-of-the-minority] approval offer similar levels of protection" to minority shareholders.[246]

MFW teaches us that there are no pre-determined procedural safeguards that can be used to achieve arm's-length-bargaining equivalence for all types of conflict-of-interest transactions. The Delaware Supreme Court noted in *MFW* that the question of what should be the standard of review in light of the dual procedural protections used in the transaction was one of first impression.[247] The Court of Chancery below had opined that, in making that determination, fiduciary duty principles should be applied in light of "current corporate practices."[248] In the specific context of *MFW*, the Chancery Court found it relevant that shareholders had ready access to information and could easily communicate. These market realities gave the Chancery Court confidence that a majority-of-the-minority approval condition would discourage rent-seeking by the special committee and incentivize the special committee to negotiate a deal that the minority shareholders would want to approve, a view which the Delaware Supreme Court reiterated on appeal.[249] Generalizing from *MFW*, in deciding on an appropriate cleansing mechanism for a conflict-of-interest transaction, courts should consider carefully the various mechanisms used to achieve a fair outcome in the transaction and determine how well they protected shareholders

To summarize, I have argued in this Part that state interested-director statutes established a corporate governance-based framework within which disinterested directors or shareholders could confirm the fairness of conflict-of-interest transactions, thereby limiting the need for courts to rule on their substantive fairness for purposes of insulating them from voidability. The common law extended this framework to the fiduciary duty arena and developed rules governing the ability of special committees or disinterested shareholders to cleanse the taint of a conflicted board decision. According to this Article, the shareholder ratification doctrine is based on the belief that shareholder approval, subject to the doctrine's preconditions, confirms the fairness of conflicted board decisions. The theory and evidence analyzed in this section suggest that, while this belief is plausible, it has uneven empirical support. The shareholder ratification doctrine continues to evolve, as courts respond to changing market conditions and their implications for shareholders' ability to protect themselves from managerial opportunism. The next Part proposes placing additional safeguards on the shareholder ratification doctrine to better align it with the fairness principles in which it is rooted.

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245. Fernán Restrepo, *Judicial Deference, Procedural Protections, and Deal Outcomes in Freezeout Transactions: Evidence from the Effect of MFW*, 6 J.L. FIN. & ACCT. 353, 385 (2021).

246. *Id.* at 389.

247. *Id.*

248. *In re* MFW S'holder Litig., 67 A.3d 496, 531 (Del. Ch. 2013), *aff'd sub nom.* Kahn v. M & F Worldwide Corp. (*MFW*), 88 A.3d 635 (Del. 2014).

249. *In re MFW*, 67 A.3d at 532; *MFW*, 88 A.3d at 644.

IV. IMPLICATIONS

As courts and litigants increasingly invoke the shareholder ratification doctrine and do so in new contexts, questions about the doctrine's preconditions, outer limits, and applicability to open issues are arising. Answers to these questions are being ventured by courts, practitioners, and scholars without the benefit of sound theoretical underpinnings.[250] This Article has tethered the shareholder ratification doctrine to its fairness roots in corporate statutory and fiduciary law. To this end, the doctrine's preconditions should be elaborated to ensure that shareholder ratification indeed supports the presumption that the shareholders who approve a board's decision believe that it is fair to them as investors. Substantive constraints on the outer limits of the shareholder ratification doctrine should complement these procedural constraints to keep board decisions that are patently unfair to the shareholders from eluding heightened judicial scrutiny. Part IV develops both sets of constraints and identifies open questions that this Article's recommendations can help address.

A. Procedural Constraints: Bolstering Corwin's Preconditions

For *Corwin* to apply, the shareholder vote must be (1) disinterested, (2) fully informed, (3) uncoerced, and (4) related specifically to the matter being ratified.[251] Just as special committee approval must satisfy certain preconditions to warrant deference, so too must shareholder approval. The importance of correctly specifying *Corwin's* preconditions cannot be overstated. Shareholder ratification reinstates the business judgment rule to board decisions, heavily influencing litigation outcomes.

Despite *Corwin's* potent implications for corporate governance, the preconditions of the *Corwin* rule remain underexamined. Among them, only *Corwin's* disclosure requirement has been substantially probed.[252] Courts have responded harshly to inadequate disclosure in the ratification process. If a plaintiff adequately alleges that material facts were not disclosed to shareholders or that the disclosures made were materially misleading, the "fully informed" precondition of *Corwin* will not be met.[253] As a result, defendants will not be able to rely on the shareholder ratification doctrine to invoke the business judgment rule.

The "disinterestedness" precondition has been elaborated in other contexts—namely, in applying the business judgment rule to directors and in evaluating the effectiveness of special committees—but with only limited utility as a guide for evaluating shareholder disinterestedness. A disinterested director is a director without a material private financial interest in the decision.[254] Under *Corwin*, the definition of a disinterested shareholder is potentially more open-ended.[255] The murkiness surrounding shareholder disinterestedness

250. *See* discussion *supra* Part II.B.3.

251. *See* discussion *supra* Part II.B.2.

252. *See* Mordue, *supra* note 116, at 560 (noting that litigation surrounding *Corwin's* preconditions have focused largely on its "fully informed" requirement). *But see* Cox, Mondino & Thomas, *supra* note 5, at 553 (pointing out that *Corwin* does not provide details regarding the level of disclosure required to fulfill *Corwin*'s precondition that shareholders be "fully informed").

253. *In re* USG Corp. S'holder Litig., No. 2018-0602, 2020 WL 5126671, at *26 (Del. Ch. Aug. 31, 2020).

254. *See supra* notes 22–24 and accompanying text.

255. *See supra* notes 115–122 and accompanying text.

is especially problematic in the context of institutional shareholders. Such shareholders often have stakes in a vast web of financial assets, which can have correlations with one another that are zero, positive, or negative.[256]

In analyzing voting by institutional investors, Professors Sean Griffith and Dorothy Lund argue that when there is a "disabling economic conflict . . . the institutional investor, like conflicted management, should not qualify as disinterested" for purposes of *Corwin* cleansing.[257] Griffith and Lund's concern about conflicted intermediary voting by institutional investors stems, in part, from instances in which an institution is voting on a matter concerning one company while holding a conflicting financial interest in one or more other companies.[258] Professors Hu and Hamermesh favor a narrower approach to shareholder disinterestedness for institutional investors. They point out that what matters for cleansing purposes is whether the voting shareholder is motivated to maximize firm value.[259] Hu and Hamermesh would thus consider an institutional shareholder to be disinterested regarding a vote at a company as long as it has a material, overall-positive, economic interest in the company's shares.[260] Other scholars, too, have proposed approaches to analyzing shareholder disinterestedness.[261]

The substantial role that institutional investors play in United States equity markets underscores the importance of constructing a clear definition of "disinterested" in the shareholder context. As Hu and Hamermesh have observed, if shareholders are deemed interested any time they receive a material private financial interest as a result of a transaction, institutional shareholders would routinely be disqualified from being "disinterested."[262] On the other hand, unlike directors, non-controlling shareholders do not owe any fiduciary duties to shareholders as a group. It is therefore especially important for shareholders to be held to a rigorous standard of disinterestedness before their approval of a conflicted board decision can serve as a reliable proxy for its fairness.

Voting patterns and practices of institutional shareholders undermine the shareholder ratification doctrine's premise that disinterested shareholder approval of a board decision reliably indicates that the decision was substantively fair to the shareholders. For a shareholder vote to indicate fairness, the shareholder's voting incentives must, at a minimum, be aligned with the voting incentives of the shareholders as a group. A definition of shareholder disinterestedness that reflects this principle increases the likelihood that the ratified decision furthers the shareholders' collective best interests.

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256. *See* Hu & Hamermesh, *supra* note 116, at 1024–31 (discussing the complex financial stake patterns of institutional investors).

257. Sean J. Griffith & Dorothy S. Lund, *Conflicted Mutual Fund Voting in Corporate Law*, 99 B.U. L. REV. 1151, 1158 (2019).

258. *Id.* at 1158, 1189.

259. *See* Hu & Hamermesh, *supra* note 116, at 1022 ("The concerns expressed here regarding disinterested shareholder voting have focused primarily on institutional investors, rather than individual/retail investors, and we do not advocate subjecting retail investors' holdings to the scrutiny for disinterestedness that we advocate for institutional investors.").

260. *Id.*

261. For a survey and examination of various regimes for curbing interested voting, see Gatti, *supra* note 116, at 1619–20.

262. *See* Hu & Hamermesh, *supra* note 116, at 1027–28 (remarking that such a result would shift the composition of disinterested shareholders from institutional to retail investors).

As Professors Cox, Thomas, and Mondino have argued, the "uncoerced" precondition of the *Corwin* rule also needs further consideration.[263] Cox and coauthors raise the specific problem of the "bundled resolution," discussed in Part III.B.2 above, in which shareholders are asked to cast a single vote that effectively both approves a merger and cleanses the board's conduct.[264] They suggest that it is logical to view the tying together of these two legal results in a single resolution as inherently coercive.[265] According to this Article's fairness theory, courts should question the ratification effect of a shareholder approval that was distorted by the structure of the vote. Additional empirical evidence would help shed light on the impact of bundling on shareholder approval of mergers.

Finally, Corwin includes the precondition that a shareholder vote must specifically address the matter as to which the board is seeking ratification effect. Under current case law, shareholders who provide a grant of general authority to a board, without any explanation of how that authority is to be exercised in the future, are deemed to lack sufficient facts with which to assess the fairness of board actions taken later under such authority.[266] The fairness theory endorses the current requirement that the matter put to a vote be presented to the shareholders with sufficient specificity for them to signal clearly what it is they are approving.[267]

B. Substantive Constraints: Marking Outer Limits

The inevitable imperfections in the preconditions described above allow for even shareholder-ratified board decisions to raise fairness concerns. Thus, procedural constraints should be backstopped by substantive constraints that place outer limits on the shareholder ratification doctrine. These limits have not yet been marked. According to the prevailing understanding of current doctrine, shareholder ratification insulates board decisions not involving a conflicted controller from substantive judicial review other than for waste.[268] The fairness theory implies that the shareholder ratification doctrine should not apply so ubiquitously and would further limit its reach.

Courts sometimes evaluate whether a board decision is susceptible to ratification by shareholders for corporate fiduciary law purposes based on the distinction between "void" and "voidable" board decisions, holding that only voidable acts are ratifiable.[269] Void acts are those that were beyond the power of the agent to undertake in the first place.[270] In

263. *See* Cox, Mondino & Thomas, *supra* note 5, at 542 (stating that "courts have yet to explore the meaning of coercion fully in the context of shareholder voting on mergers").

264. *Id.* at 541–44.

265. *Id.* at 544.

266. *See supra* text accompanying notes 132–35.

267. *Id.*

268. *See supra* note 110 and accompanying text.

269. *See, e.g.*, Solomon v. Armstrong, 747 A.2d 1098, 1114 (Del. Ch. 1999), *aff'd*, 746 A.2d 277 (Del. 2000) ("Other than void acts precluded by public policy concerns, fully informed shareholder ratification will insulate a board action from subsequent legal attack by shareholders.").

270. *See id.* ("Void acts are those acts that the board, or more generally the corporation, has no implicit or explicit authority to undertake or those acts that are fundamentally contrary to public policy."). *See also* CompoSecure v. CardUX, 206 A.3d 807, 816–17 (Del. 2018) ("The common law rule is that void acts are *ultra vires* and generally cannot be ratified, but voidable acts are acts falling within the power of a corporation, though not properly authorized, and are subject to equitable defenses.").

corporate law, these have generally consisted of fraud, gift, waste, or *ultra vires* acts.[271] For example, entering into an illegal contract is a void act. Ratification cannot give a void act legal effect. Voidable acts, on the other hand, are within the legal authority of the agent to undertake but were not properly authorized at the time. For example, entering into a legal contract without the proper corporate approvals is voidable.[272] Common law ratification allows a principal to confer authority ex-post to an agent for a voidable act, with the authority relating back to the time when the act was taken.[273]

There are several difficulties with applying the void/voidable distinction to the effect of shareholder ratification.[274] First, under Delaware law, such a distinction is all but defunct after enactment of statutory provisions that expressly provide for ratification of defective corporate acts, regardless of whether they would otherwise be "void" or "voidable" under common law.[275] These statutes allow a corporate act that is either void or voidable to be made legally effective through ratification.[276]

Second, the void/voidable distinction for ratification purposes comes from the common law of agency, under which a principal can cure an act taken by the agent on behalf of the principal that the principal could have authorized at the time the action was taken. As discussed in Part II.B, however, the shareholder-director relationship in corporate law and the principal-agent relationship in agency law are different.[277] In particular, the weaker control that shareholders exert over directors relative to the control of principals over agents makes shareholders more vulnerable than principals to disloyal behavior by those whose actions they ratify. While principals control all aspects of their agents' conduct within the scope of the agency relationship, shareholders who are asked to ratify directors' actions are presented with a *fait accompli*. Shareholder ratification of a board decision is therefore not necessarily an endorsement of the board's decision-making process, over which shareholders have no formal power.

A third limitation of relying on the void/voidable distinction in determining what board actions can be ratified by shareholders for corporate fiduciary law purposes is that board actions must be not only legal but also equitable. A legal board decision is not necessarily equitable, because it may satisfy the letter of the law yet violate settled fairness norms. The breach of a fiduciary duty is an equitable claim. Indeed, courts have referred to it as "*the* quintessential equitable claim."[278] Under Delaware law, board actions must be

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271. *See Solomon*, 747 A.2d at 1114 (referring to the list of void acts as "very restricted").

272. *See CompoSecure,* 206 A.3d at 819 (applying New Jersey law).

273. DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, CORPORATE & COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY § 15.05 (T. Brad Davey, J. Matthew Belger & Jacqueline A. Rogers eds., 2024).

274. For a thorough discussion of the ratification statutes and the impetus for their enactment, see C. Stephen Bigler & John Mark Zeberkiewicz, *Restoring Equity: Delaware's Legislative Cure for Defects in Stock Issuances and Other Corporate Acts*, 69 BUS. LAW. 393 (2014).

275. DEL. CODE ANN. tit. 8, § 204 (West 2019).

276. *See* Bigler & Zeberkiewicz, *supra* note 274, at 402 ("Section 204(a), therefore, legislatively overturns . . . cases that stock issued or acts taken in contravention of the DGCL are void and not voidable and thus not susceptible to ratification or validation on equitable grounds or otherwise.").

277. See text accompanying notes 155–65.

278. ATO Enters. of Del. v. Cabrera, No. 2021-0966, 2022 WL 2678613, at *2 (Del. Ch. July 12, 2022) (quoting QC Commc'ns v. Quartrone, 2013 WL 1970069, at *1 (Del. Ch. May 14, 2013) (citation omitted)).

"twice-tested," once for legal authorization, and again to determine whether the board breached its fiduciary duties.[279]

The void/voidable framework is thus both over-inclusive and under-inclusive as a framework for delineating the limits of the shareholder ratification doctrine. It is over-inclusive because, like interested-director transactions, some board decisions that would be void under common law may nevertheless be in the shareholders' best interests and should be ratifiable by those shareholders. It is under-inclusive because transactions that are merely voidable—such as entering into a contract without due authorization—may breach the board's fiduciary duties. The fairness theory of shareholder ratification comports better than the void/voidable framework with Delaware law's distinction between law and equity and its requirement that board decisions be "twice-tested" to clear both bars.[280]

Under the fairness theory, if the disinterested shareholders could not reasonably have concluded that a conflicted board decision was fair to them, the board decision should be *per-se* unratifiable. Allowing the reach of the shareholder ratification doctrine to extend any further would conflict with the conclusion in Part III that the shareholder ratification doctrine was intended to encompass only board decisions that the shareholders regarded as being fair to them as investors. This limited reading of the shareholder ratification doctrine, which I call the "semi-strong-form," holds that shareholder approval insulates a board decision from judicial review other than for waste or subjective bad faith. It goes further than limiting shareholder ratification to its so-called "classic," or what I call "weak," form, under which only a shareholder vote that is not statutorily required has cleansing power. But it stops short of what I call "strong-form" ratification, which currently makes the business judgment rule irrebuttable other than for waste. Some strong-form advocates have proposed eliminating even the waste exception to the shareholder ratification doctrine so that shareholder ratification would both reinstate the business judgment rule and make it absolutely irrebuttable.[281]

Under semi-strong-form ratification, *Revlon* transactions, for example, are merely suspect. In other words, they raise concerns about the motives of directors, but there is no *a priori* reason to believe that they *cannot* be in the best interests of shareholders. Consistent with existing doctrine, shareholders would be allowed to ratify such transactions. In contrast, shareholder ratification would not insulate board decisions that irrationally or intentionally trade off shareholder interests for non-shareholder interests. I argue in the remainder of this section that transactions that are either wasteful or undertaken in subjectively bad faith fall into this category.

Waste. Transactions that constitute waste are those in which the consideration received by the corporation is so inadequate that the transaction is effectively a gift of corporate assets. The exchange of corporate assets must be for consideration "so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade."[282] The terms of a wasteful transaction are obviously unfair to the corporation.

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279. *See* Coster v. UIP Cos., Inc., 255 A.3d 952, 960 (Del. 2021) (citing cases).

280. *Id.*

281. *See supra* notes 271–79 and accompanying text.

282. Lewis v. Vogelstein, 699 A.2d 327, 336 (Del. Ch. 1997).

Wasteful decisions cannot be in the shareholders' best interests and should therefore not be entitled to judicial deference.[283] In *Solomon v. Armstrong*,[284] the Delaware Chancery Court characterized wasteful transactions as void acts—"those acts that the board, or more generally the corporation, has no implicit or explicit authority to undertake or those acts that are fundamentally contrary to public policy. As defined by decisional law, void acts are those acts that are not performed in the interest of the corporation . . . ."[285] Shareholders must unanimously approve a board's decision to extinguish a waste claim.[286] According to Professor Harwell Wells, "the most sensible explanation for this rule is that unanimous ratification is 'akin to universal acquiescence by all possible stockholder plaintiffs. The act remains void, but there is no one left to challenge it.'"[287]

The Delaware courts have long regarded waste claims as being exceedingly challenging for plaintiffs to prove.[288] Nevertheless, in *Harbor Finance Partners v. Huizenga,*[289] then-Vice Chancellor Strine entertained eliminating waste as a cause of action in transactions approved by a majority of the shareholders. Indeed, he found it "logically difficult" to imagine how a plaintiff could ultimately prove waste when there has been ratification.[290]

This Article's fairness theory of shareholder ratification would allow plaintiffs to bring waste claims against boards notwithstanding shareholder ratification. It is unreasonable for shareholders to conclude that a wasteful decision was a fair one. There may be instances, even if rare, in which the shareholders ratify a wasteful board decision, but the plaintiff cannot rebut a *Corwin* defense. These instances are most likely to arise where there is either a (1) design defect in the preconditions (such as the vote bundling identified in Part IV.A), (2) misspecification of the preconditions (such as an under-inclusive definition of shareholder "disinterestedness"), or (3) latent violation of the preconditions (such as one that existed but was not identified because dismissal on *Corwin* grounds prevented its discovery).[291]

The waste exception is just as necessary in the context of shareholder ratification as it is in the context of the traditional business judgment rule, where it acts as "an equitable

283. *Id.* (citations omitted).

284. Solomon v. Armstrong, 747 A.2d 1098, 1099 (Del. Ch. 1999).

285. *Id.* at 1114.

286. *See* Harwell Wells, *The Life (and Death?) of Corporate Waste*, 74 WASH. & LEE L. REV. 1239, 1246, 1269 (2017).

287. *Id.* at 1269 n.171 (quoting Laster, *supra* note 6, at 1457 n.51).

288. *See* Singh v. Attenborough, 137 A.3d 151, 152 (Del. 2016) (commenting that "the vestigial waste exception has long had little real-world relevance").

289. Harbor Fin. Partners v. Huizenga, 751 A.2d 879, 901 (Del. Ch. 1999). The MBCA takes this approach. *See* MODEL BUS. CORP. ACT § 8.61(b)(2) (AM. BAR ASS'N 2023) (following shareholder approval, a transaction may not be enjoined, set aside, or give rise to an award of damages or other sanctions against a director). *Id.* § 8.61 cmt. As the commentary notes, a director is "immune from attack" following shareholder approval. *Id.*

290. *Huizenga*, 751 A.2d at 901; *see also Singh*, 137 A.3d at 151–52 ("[T]he vestigial waste exception has long had little real-world relevance, because it has been understood that stockholders would be unlikely to approve a transaction that is wasteful."); *In re* Volcano Corp. S'holder Litig., 143 A.3d 727, 750 (Del. Ch. 2016) ("[I]t is logically difficult to conceptualize how a plaintiff can ultimately prove a waste . . . claim.").

291. *See* James D. Cox, Kenneth J. Martin & Randall S. Thomas, *The Paradox of Delaware's 'Tools at Hand' Doctrine: An Empirical Investigation*, 75 BUS. LAW. 2123, 2126–27 (2020) (noting the crucial importance of obtaining pre-filing discovery to maintain a breach of fiduciary duty claim in the face of a *Corwin* defense).

safety valve" against shareholder value destruction.[292] In the context of the traditional business judgment rule, then-Vice Chancellor Strine described the role of the waste exception as follows:

> [T]he doctrine of waste is a residual protection for stockholders that polices the outer boundaries of the broad field of discretion afforded directors by the business judgment rule. The wording of the test implies as much, as it condemns as wasteful a transaction that is on terms so disparate that no reasonable person acting in good faith could conclude the transaction was in the corporation's best interest. When pled facts support an inference of waste, judicial nostrils smell something fishy and full discovery into the background of the transaction is permitted. In the end, most transactions that actually involve waste are almost [sic] found to have been inspired by some form of conflicting self-interest. The doctrine of waste, however, allows a plaintiff to pass go at the complaint stage even when the motivations for a transaction are unclear by pointing to economic terms so one-sided as to create an inference that no person acting in a good faith pursuit of the corporation's interests could have approved the terms.[293]

A wasteful board decision does not metamorphose into a non-wasteful one by going through the shareholder ratification process. On the contrary, a wasteful board decision's ability to survive that process points to something being amiss with the process itself. Making an exception to the shareholder ratification doctrine for waste claims backstops *Corwin's* preconditions to ensure that the shareholder ratification doctrine does not shield directors from substantive judicial review when it is "logically difficult to imagine" that an affirmative shareholder vote genuinely endorsed the fairness of the board's decision.

Bad Faith. Waste, which is tantamount to giving away corporate assets, can be viewed as a subset of bad faith: Directors who negotiate wasteful deals do so either with the subjective intent to harm, or in conscious disregard of their duties to benefit, the corporation. Then-Vice Chancellor Strine couched waste in faithlessness terms in the above excerpt from *Sample v. Morgan* when he described it as so "one-sided as to create an inference that no person acting in a good faith pursuit of the corporation's interests could have approved the terms."[294] In *In re MeadWestvaco Stockholders Litigation*, Chancellor Bouchard similarly noted that waste implied bad faith:

> Our Supreme Court has equated showing that the substance of a board's decision is an act of bad faith to meeting the onerous burden of proving a waste claim: "To prevail on a waste claim or a bad faith claim, the plaintiff must overcome the general presumption of good faith by showing that the board's decision was so egregious or irrational that it

292. BALOTTI & FINKELSTEIN, *supra* note 19. *See also In re* Merge Healthcare S'holder Litig., No. 11388, 2017 WL 395981, at *1, n.1 (Del. Ch. Jan. 30, 2017) (suggesting that the waste standard in the *Corwin* context is "best viewed as a kind of 'judicial out,' a way around the strictures of the [*Corwin*] cleansing rule given a fact situation of some undefined level of egregiousness, such that equity would intervene").

293. Sample v. Morgan, 914 A.2d 647, 669–70 (Del. Ch. 2007) (citations omitted).

294. *Id.* at 670.

> could not have been based on a valid assessment of the corporation's best interests."[295]

Whether bad-faith decisions other than waste are ratifiable by shareholders is unsettled.[296] On the one hand, the Delaware Supreme Court has never squarely held that shareholder ratification cleanses a board decision made in bad faith.[297] In fact, several prominent cases cited by *Corwin* involving explicit conflicts of interest describe the effect of shareholder ratification as shifting the standard of review to the business judgment rule without extinguishing duty of loyalty claims.[298] Under this line of cases, shareholder ratification would cleanse interested board decisions, but both waste and bad-faith claims would survive.

On the other hand, *Corwin* held that the shareholder ratification doctrine applies to a *Revlon* breach.[299] A *Revlon* breach, in turn, arguably arises from bad-faith conduct. The Delaware Supreme Court made clear in *Lyondell Chemical Co. v. Ryan* that directors do not violate their duty of loyalty where *Revlon* applies unless "they knowingly and completely failed to undertake their responsibilities" or "utterly failed to attempt to obtain the best sale price."[300] Such "dereliction of duty" constitutes bad faith.[301] *Corwin* thus implicitly endorsed a strong-form version of the shareholder ratification doctrine, in which the only transactions that shareholders cannot ratify, other than those with a controlling shareholder, are wasteful ones.[302] In addition, the Delaware Chancery Court in *In re Columbia Pipeline Stockholder Litigation* dismissed a duty of loyalty claim against directors even where the plaintiffs' complaint included well-pleaded factual allegations that directors had acted to further their own, rather than the shareholders', best interests.[303]

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295. *In re* MeadWestvaco, 168 A.3d 675, 686 (Del. Ch. 2017) (citing White v. Panic, 783 A.2d 543, 554 n.36 (Del. 2001)). Others, too, have referred to waste as a category of bad faith. *See* WOLFE, JR. & PITTENGER, *supra* note 273, § 15.05 (citing cases for the proposition that waste is "a specific category of bad faith conduct").

296. *Compare In re MeadWestvaco*, 168 A.3d 675 (finding it unnecessary to apply *Corwin* because plaintiffs did not meet burden of pleading bad faith), *with In re* Columbia Pipeline Group, Inc., No. 12152, 2017 WL 898382, at *5–6 (Del. Ch. Mar. 07, 2017) (relying on *Corwin* to dismiss plaintiff-shareholder claim on well-pleaded facts that board acted to further its own interests in structuring sale of the company); *In re* USG Corp. S'holder Litig., No. 2018-0602, 2020 WL 5126671, at *2 (Del. Ch. Aug. 31, 2020) (interpreting, in dicta, *Corwin* to cleanse subjective-bad-faith board actions); Goldstein v. Denner, No. 2020-1061, 2022 WL 1671006, at *18–19, 41 (Del. Ch. May 26, 2022) (reaching the *Corwin* defense in the face of well-pleaded facts of bad faith but refusing to dismiss under *Corwin* based on failure of preconditions); *In re* Pattern Energy Grp. Inc. S'holders Litig., No. 2020-0357, 2021 WL 1812674, at *64 (Del. Ch. May 6, 2021) (same); Chester Cnty. Emps. Ret. Fund v. KCG Holdings, Inc., No. 2017-0421, 2019 WL 2564093, at *2, 17 (Del. Ch. June 21, 2019) (same).

297. WOLFE, JR. & PITTENGER, *supra* note 273, § 15.05 ("It is one thing to credit a positive vote by holders owning that percentage of outstanding shares minimally necessary a corporate act for purposes of statutory law. It is quite another to do so when the issue involves the fundamental fairness of a fiduciary's act, and where the applicable duties at issue are owed to each individual stockholder in equal measure.").

298. *See, e.g.*, *In re* Wheelabrator Techs., Inc. S'holders Litig., 663 A.2d 1194, 1204 (Del. Ch. 1995) (citing cases).

299. Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 311–12 (Del. 2015).

300. Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 243–44 (Del. 2009).

301. *Id.* at 240.

302. *See Corwin*, 125 A.3d at n.13, n.19 (citing with approval the view that shareholder ratification of a transaction with a non-controlling shareholder insulates the transaction from challenge other than for waste).

303. *In re* Columbia Pipeline Grp., Inc., No. 12152, 2017 WL 898382, at *2 (Del. Ch. Mar. 7, 2017) (order granting motion to dismiss). For further discussion of *Columbia Pipeline*, see *infra* text accompanying notes 319–22.

Corwin and *Columbia Pipeline* suggest that there is a judicial appetite for strong-form ratification, encompassing all types of bad-faith board decisions within the shareholder ratification doctrine. Assessing the doctrinal status of bad-faith claims under the shareholder ratification doctrine, practitioners Gail Weinstein and coauthors concluded that the decision in *MeadWestvaco* discussed above "may signal . . . some uncertainty as to whether *Corwin* 'cleanses' bad faith by directors."[304] They went on to summarize the prevailing view on that question:

> [T]he likelihood of a successful bad-faith claim is highly remote. Even if a bad-faith claim is successful, however, it has been thought that *Corwin* would in any event cleanse the bad faith (subject only to the uncertainty arising from the fact that the Delaware Supreme Court has not addressed the issue).[305]

While placing bad-faith claims beyond the scope of shareholder ratification might at first blush appear to violate *Corwin*'s application of the shareholder ratification doctrine to *Revlon* claims, that is not necessarily the case. As discussed below, the Delaware Supreme Court has identified specific categories of fiduciary conduct that constitute "bad faith."[306] Applying the fairness theory of shareholder ratification to each category, it is possible to reconcile the semi-strong form of the shareholder ratification doctrine with *Corwin.*

In *In re Walt Disney Co. Derivative Litigation*, the Delaware Supreme Court parsed bad-faith fiduciary behavior broadly into two, non-exclusive, categories: (1) its "classic sense" of "conduct motivated by subjectively bad intent" and (2) "intentional dereliction of duty, a conscious disregard for one's responsibilities."[307] The *Disney* Court characterized the latter category of bad faith as less extreme than subjective bad faith by calling it an "intermediate category" of fiduciary misconduct between subjective bad faith and gross negligence.[308] While subjective bad faith is "motivated by an actual intent to do harm" to the corporation by privileging a conflicting interest over the interest of the corporation, a conscious disregard for the corporation's interest involves misconduct that does not necessarily privilege an adverse interest but is "more culpable than simple inattention or failure to be informed of all facts material to the decision."[309] It is characterized by intentionally ignoring shareholder value. In *Stone v. Ritter*, the Delaware Supreme Court placed directors' obligation to act in good faith within the duty of loyalty.[310]

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304. Gail Weinstein & Philip Richter, MeadWestvaco *Highlights the Extremely High Bar to Personal Liability of Disinterested Directors*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 31, 2017), https://corpgov.law.harvard.edu/2017/08/31/meadwestvaco-highlights-the-extremely-high-bar-to-personal-liability-of-interested-directors/ [https://perma.cc/L8E5-GX2P].

305. Gail Weinstein et al., *Delaware Sets High Bar to Personal Liability of Independent Directors*, INSIGHTS, Sept. 2017, at 28, 30.

306. *See In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 63–69 (Del. 2006).

307. *Id.* at 63–67.

308. *Id.* at 67.

309. *Id.* at 64, 66. *See also* Hillary A. Sale, *Delaware's Good Faith*, 89 CORNELL L. REV. 456, 488 (2004) (explaining that liability based on lack of good faith "moves the bar from negligent behavior to deliberately indifferent, egregious, subversive, or knowing behavior, and thereby raises issues related to the motives of the actors" (citation omitted)).

310. Stone v. Ritter, 911 A.2d 362, 369–70 (Del. 2006).

When directors consciously disregard their responsibilities, they are not necessarily acting unfairly to shareholders. Consider, for example, a board of a public company that receives an unsolicited cash merger bid from a non-controlling shareholder with price and terms that it considers uniquely attractive. Assume that no board member has any explicit conflict of interest in the transaction. After deliberating, the board takes the initial offer, subject only to obtaining statutory, regulatory, and other legally required approvals. It decides not to seek a fairness opinion from a valuation expert. It also does not engage in any effective market check of the competitiveness of the bid.

Based on the stylized facts of the foregoing scenario, the transaction would likely violate the board's duties under *Revlon* to obtain the best sale price.[311] The board did not attempt to negotiate a better deal with the bidder. The board also failed to educate itself on the range of values that the company could expect to obtain in a sale transaction. Finally, the board did not conduct a sale process designed to elicit market data on the company's value. The board's deliberate indifference towards the company's market value in a sale transaction, together with its considered decision not to make a counter-offer to the bidder, forms a strong basis for concluding that the directors "knowingly and completely failed to undertake their responsibilities" in managing the sale of the company, falling short of even the low bar under *Lyondell* which directors must clear to meet their fiduciary duty of loyalty in a sale to which *Revlon* applies.[312]

Despite its apparent failure to satisfy its *Revlon* duties, the board could still have entered into a fair transaction. The fairness theory of shareholder ratification would allow a shareholder vote to dispense with a judicial inquiry into whether directors took reasonable steps to maximize the company's sale value. As long as *Corwin's* preconditions were satisfied, shareholders could assess for themselves whether the board struck a deal favorable to them or, instead, allowed its inherent self-interest to favor the bidder.[313] As in explicit conflict-of-interest transactions, where shareholder approval cleanses the taint of self-interest, shareholder approval should cleanse the taint of directors' conscious disregard of their fiduciary duties.[314]

On the other hand, the fairness theory would not permit shareholder approval to cleanse bad-faith conduct motivated by a subjective intent to harm shareholders. After *Corwin* was decided, commentators raised the concern that the case would insulate

311. *See* C&J Energy Servs. v. City of Miami Gen. Emps., 107 A.3d 1049, 1067 (Del. 2014) (requiring target board to permit an effective market check of a deal to pass *Revlon* scrutiny).

312. Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 243–44 (Del. 2009).

313. *See* discussion *supra* Part II.B.2.

314. A similar analysis under the fairness theory would allow shareholders to ratify intentional violations of law by directors taken to further the best interests of the corporation. Under current doctrine, directors who knowingly engage in illegal conduct in managing the corporation violate their fiduciary duty of loyalty to the shareholders. *See In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 67 (Del. 2006) (citing *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 754–55 (Del. Ch. 2005), *aff'd*, 906 A.2d 27 (Del. 2006)). As Professor Elizabeth Pollman argues in *Corporate Disobedience*, however, while directors may intend some unlawful corporate conduct to deceive or defraud the corporation and its shareholders, they may intend other unlawful conduct to benefit them. Elizabeth Pollman, *Corporate Disobedience*, 68 DUKE L.J. 709, 755 (2019) ("[C]orporate disobedience may violate the law, but that does not necessarily mean it hurts the corporation's shareholders or even its stakeholders, and it is possible that in some instances the disobedient activity could provide some other social benefit."). Moreover, society as a whole may benefit when companies resort to law-breaking as a tool to disrupt traditional business models. *Id.* at 716 (noting that corporate disobedience has the potential to promote socially desirable legal change and innovation).

subjectively bad-faith conduct as long as it was disclosed to shareholders.[315] The prospect that shareholders would ever ratify actions intended to harm them was initially considered remote:

> *Corwin's* progeny has dealt with breaches of the duty of loyalty in the context of a director's interest or independence, but not bad faith. While interesting, this issue should not be alarming. Delaware courts have generally excelled at ferreting out serious misconduct. If there are specific and credible allegations that directors intentionally harmed a corporation, a Delaware judge is likely to allow the case to proceed beyond a motion to dismiss. Moreover, it seems unrealistic to think that bad faith conduct would ever be disclosed at the level that would be required by Delaware courts to insulate it. Nevertheless, assuming that bad faith conduct was fully disclosed and the transaction was still approved, it remains to be seen whether the directors still could obtain dismissal.[316]

Notwithstanding the foregoing optimism, under existing law, it is a real possibility that shareholders would approve a board's subjectively bad-faith actions. Shareholders might do so knowingly in a merger transaction, for example, because they prefer a sale premium over remaining invested in the standalone company, and, as Professors Cox and coauthors have stressed, their approval of the transaction, which is bundled with their approval of the sale process, could be inherently coerced without formally violating *Corwin's* preconditions.[317] Alternatively, shareholders might approve a board's subjectively bad-faith decisions unknowingly because the directors did not reveal their malevolent intent, and the shareholders did not discern it, possibly because, as one practitioner put it, "there is one defect that is never disclosed to stockholders—that directors are acting for some reason other than the best interest of the stockholders of the corporation."[318] Delaware law does not require directors to disclose to shareholders that they acted based on self-interested motives.[319] Shareholders need only be given those facts from which they "can readily stitch together" the inference of the directors' motives.[320] Such facts may not be enough, however, to give shareholders a viable avenue at the pleading stage to allege material deficiencies in the company's disclosure documents.

Both of the foregoing scenarios were likely at play when the shareholders of Columbia Pipeline Group, Inc. (CPG) approved an all-cash merger with TransCanada Group (TransCanada) on July 1, 2016.[321] In *Columbia Pipeline*, CPG shareholder-plaintiffs alleged that the directors of TransCanada diverted sale proceeds to themselves by engineering the sale of CPG as a spin-off from its former parent company followed by a

315. *See, e.g.*, Steven Haas, *The* Corwin *Effect: Stockholder Approval of M&A Transactions*, 11 DEAL LAWS., Mar.–Apr. 2017, at 1, 1.

316. *Id.* at 6.

317. *See supra* notes 61–63 and accompanying text.

318. McBride, *supra* note 218, at 27.

319. *In re* Columbia Pipeline Grp., No. 12152, 2017 WL 898382, at *6 (Del. Ch. Mar. 7, 2017) ("When a proxy statement describes the facts that create differing incentives for fiduciaries, it need not explain how those differing incentives could produce a self-interested outcome.").

320. *Id.* at *3.

321. *Id.* at *1.

sale rather than as a sale of CPG while it was still a subsidiary of the parent company. The back-to-back spin-off and sale triggered change-of-control benefits for the CPG directors that the sale of the subsidiary would not have. Over 95% of CPG's outstanding shares were voted in favor of the merger. Although the Delaware Chancery Court held that the allegations of the complaint in support of the foregoing diversion theory stated, "a pleadings-stage claim for breach of the duty of loyalty against the defendants," the court dismissed the claim based on *Corwin.*[322] Thus, concerns that shareholders will approve board decisions intended to compromise shareholder value are not merely theoretical.

While directors can act fairly while being interested in a decision or even when consciously disregarding their duties, directors who seek to harm the corporation cannot. Managing the corporation in subjectively bad faith entails intentionally destroying shareholder value. Analogous to the context of waste, the shareholder ratification process cannot transmute a subjectively bad-faith decision into a shareholder-regarding one. If shareholders approve a board decision that was made in subjectively bad faith, they are either knowingly (for example, as a result of inherent coercion) or unknowingly (for example, as a result of inadequate discovery) approving a board decision that was not equivalent to an arm's-length one. In either case, the core premise of the fairness theory's account of the shareholder ratification doctrine—that shareholders who approved the decision believed it was fair to them as investors—would be violated.[323]

Public policy considerations reinforce the argument that board decisions made in subjectively bad faith should not be ratifiable by shareholders. Professor Michael Dooley described the promotion of fairness as "one of the most important goals of corporate law."[324] Were the shareholder ratification doctrine to encompass subjectively bad-faith decisions, directors would have incentives to thwart detection of their disloyalty through opaque disclosures in the hope that shareholders will approve their bad-faith acts without knowledge of their disloyal motives. Placing subjectively bad-faith decisions beyond the scope of shareholder ratification would safeguard against director manipulation of the shareholder ratification process to pursue improper motives with impunity.[325]

Proponents of strong-form ratification, whereby shareholder ratification would reinstate the business judgment rule and make it irrebuttable other than for waste, claim that a more litigation-friendly version of the shareholder ratification doctrine would reduce

322. *Id.* at *2. Note that, in so doing, the Court stated that, under *Corwin*, "if stockholders approved the conflict of interest after full disclosure, then the business judgment rule applies." *Id.* It is therefore unclear whether the Court distinguished for ratification purposes between allegations of a conflict of interest, which merely call into question the directors' loyalty, and allegations of bad faith, which assert a violation of the duty of loyalty.

323. David McBride objects to preclusion of bad-faith claims based on the broader ground that "stockholders are entitled to expect that their directors—however conflicted and however imperfectly—are trying to do the right thing." *See* McBride, *supra* note 218, at 28.

324. MICHAEL P. DOOLEY, FUNDAMENTALS OF CORPORATION LAW 580 (1995).

325. Professor Andrew Verstein has put forward a motive-based vocabulary that helps elucidate the limits of shareholder ratification prescribed by the fairness theory. According to Verstein, the business judgment rule shields directors' decisions from judicial review "if their motives were primarily loyal even if they had some personal interest in the decision." Andrew Verstein, *The Jurisprudence of Mixed Motives*, 127 YALE L.J. 1106, 1136 n.104 (2018). Adopting Verstein's motive categories, the fairness theory supports delineating the scope of the shareholder ratification doctrine to encompass all board decisions for which any motive was to benefit the shareholders. *See id.* at 1139–43 (defining "Sole Motive," and its complement, "Any Motive," liability rules).

shareholder value. As former Delaware Supreme Court Chief Justice Strine summarized the argument:

> [W]hen a transaction is not subject to the entire fairness standard, the long-standing policy of our law has been to avoid the uncertainties and costs of judicial second-guessing when the disinterested stockholders have had the free and informed chance to decide on the economic merits of a transaction for themselves. There are sound reasons for this policy. When the real parties in interest—the disinterested equity owners—can easily protect themselves at the ballot box by simply voting no, the utility of a litigation-intrusive standard of review promises more costs to stockholders in the form of litigation rents and inhibitions on risk-taking than it promises in terms of benefits to them.[326]

The fairness theory proposed in this Article would not open the floodgates of litigation. First, the semi-strong form of the shareholder ratification doctrine that follows from it is consistent with the *Corwin* doctrine in all cases not involving subjective bad faith, with the caveat that *Corwin's* preconditions be bolstered to better ensure that shareholder approval of a board decision signifies the shareholders' belief in its fairness. Shareholder ratification would thus continue to serve as a mechanism for reducing inefficient shareholder litigation in the vast majority of cases.[327] Indeed, the fairness theory leaves room to continue extending the shareholder ratification doctrine to contexts in which conflicted directors are plausibly advancing shareholder interests.

Second, stating a claim of subjective bad faith is onerous, requiring an "extreme set of facts"[328] that demonstrates either intentional disregard of directorial duties or a decision that strays "so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith."[329] Moreover, to resist applying the shareholder ratification doctrine to claims of waste or subjective bad faith is not to prevent any weight from being given in these cases to the disinterested, fully-informed, and uncoerced approval of the shareholders. Recall that a wasteful decision is one in which the consideration is so inadequate that no rational person would regard it as a fair exchange. As one treatise notes, "majority stockholder ratification of an allegedly wasteful transaction must have a devastating effect on the plaintiff's ability to succeed, or even to proceed to trial with respect to such a claim."[330] Claiming subjective bad faith in the face of shareholder ratification will be similarly challenging but not precluded.[331]

Instead of giving shareholder ratification near-absolute cleansing power, fiduciary considerations counsel limiting its cleansing effect to conflict-of-interest decisions that

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326. Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 312–13 (Del. 2015).

327. *See* Matthew D. Cain et. al., *The Shifting Tides of Merger Litigation*, 71 VAND. L. REV. 603, 605–06 (2018) (noting the negative impact of *Corwin* on the ability of shareholder-plaintiffs to prevail in their fiduciary duty lawsuits).

328. *In re* MeadWestvaco S'holders Litig., 168 A.3d 675, 684 (Del. Ch. 2017) (citing cases and referring to the claim of bad faith as involving "a difficult standard to meet").

329. *Id.* (quoting *In re* Chelsea Therapeutics Int'l Ltd. S'holders Litig., No. 9640, 2016 WL 3044721, at *7 (Del. Ch. May 20, 2016) (internal quotations omitted)).

330. WOLFE, JR. & PITTENGER, *supra* note 273, § 15.05.

331. *See* Laster, *supra* note 6, at 1457 (noting that shareholder endorsement should make it harder for a plaintiff to challenge board action).

shareholders reasonably regarded as fair to them. Only in such circumstances is shareholder approval of a board decision tantamount to an endorsement of its fairness from an investor perspective. Accordingly, when plaintiff shareholders have insufficient evidence at the pleading stage to allege a failure of *Corwin's* preconditions but can nevertheless allege facts sufficient to support a claim of waste or subjective bad faith, their complaint should not be dismissed. Shareholder-ratified decisions would thus remain subject to the twice-tested regime of compliance with both statutory rules and equitable principles.

C. Open Questions

There are currently several open questions relating to the effect of shareholder approval on board action. These include whether (1) shareholder ratification has any cleansing power where shareholders' voting incentives and economic incentives are imperfectly aligned,[332] (2) the shareholder ratification doctrine should apply to post-closing money damages claims to which *Unocal* applies,[333] and (3) shareholder ratification can cleanse bad-faith or wasteful board decisions.[334] These open questions demonstrate that the shareholder ratification doctrine has the potential to touch on an ever-widening variety of contexts. The stakes involved in how the shareholder ratification doctrine develops are high, and the absence of a coherent theoretical foundation to inform it could lead to a considerable erosion of corporate fiduciary law. The ultimate success of the doctrine requires simultaneously placing meaningful guardrails around it while continuing to discourage non-meritorious fiduciary duty litigation.

CONCLUSION

The shareholder ratification doctrine is at an inflection point. Critics raise concerns that it undermines board accountability to shareholders, while enthusiasts see it as an effective way to discourage non-meritorious shareholder litigation, particularly in the M&A arena.[335] This Article has advanced a theoretical foundation for the shareholder ratification doctrine that can guide its future development.

Although substantive judicial review of a board decision is one mechanism for dealing with conflicts of interest that can compromise directors' performance of their fiduciary duties, it is not the only one. Both special committees and shareholder approval are procedural devices that emerged as alternatives to judicial review.[336] These alternatives can cleanse the taint of self-interested decision making and reinstate the business judgment rule to the board even after it has initially been lost.[337]

Courts and commentators have struggled to provide a satisfactory theoretical foundation for shareholder-based cleansing of conflicted board decisions through ratification. One approach characterizes disinterested shareholders as neutral decision

332. *See* discussion *supra* Part II.B.2.
333. *See supra* notes 108–09 and accompanying text.
334. *See* discussion *supra* Part IV.B.
335. *See* sources cited *supra* note 5.
336. *See* discussion *supra* Part II (reviewing special committee and shareholder approval bases for reclaiming judicial deference).
337. *Id.*

makers who can weed out self-interested board behavior.[338] Another approach analogizes corporate fiduciary law to trust law or agency law.[339] This Article has argued that the shareholder ratification doctrine is not adequately explained by these approaches and should instead be viewed as a judicial presumption that shareholder ratification confirms that the board's underlying decision was fair to the shareholders as investors.

The implications of this Article's fairness theory are both conceptually and practically useful. In recent years, courts have extended the shareholder ratification doctrine beyond its traditional scope of explicit conflict-of-interest transactions to inherent conflict-of-interest transactions.[340] This extension has prompted questions about whether the shareholder ratification doctrine's cleansing power should be constrained. According to the fairness theory, the short answer is yes, and the long answer is that specifying appropriate constraints involves both bolstering the doctrine's preconditions and placing board decisions that are wasteful or made in subjectively bad faith outside the limits of shareholders' cleansing power.[341]

The constraints on shareholder ratification implied by the fairness theory leave ample room for further developing the doctrine. The effect of shareholder approval on judicial scrutiny of board actions is powerful but under-theorized. The appropriate cleansing power of a shareholder vote when the shareholders' voting interests are decoupled from their economic interests, when the board takes defensive measures under *Unocal*, and when the board makes bad-faith or wasteful business decisions are all in judicial play. These and future questions about how shareholder approval affects judicial scrutiny of a board's actions can benefit from this Article's fairness theory of the shareholder ratification doctrine.

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338. Oberly v. Kirby, 592 A.2d 445, 467 (Del. 1991).

339. *See* cases cited *supra* note 139.

340. *See* discussion *supra* Part II.B.1 (discussing how, in cases post-*MFW* and *Corwin*, "boards could use procedural devices to insulate themselves from liability for business decisions not only in explicit conflict-of-interest transactions but also in transactions involving inherent conflicts of interest").

341. *See* discussion *supra* Part IV (arguing that plaintiffs should still be permitted to bring waste claims against conflicted boards notwithstanding shareholder ratification, as it is unreasonable to treat wasteful decisions as fair).