ISSN 1936-5349 (print)
ISSN 1936-5357 (online)

HARVARD

JOHN M. OLIN CENTER FOR LAW, ECONOMICS, AND BUSINESS

CONFRONTING THE PROBLEM OF FRAUD ON THE BOARD

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Discussion Paper No. 984

12/2018

Harvard Law School
Cambridge, MA 02138

This paper is also Discussion Paper 2018-11 of the
Harvard Law School Program on Corporate Governance

Draft of December 13, 2018

CONFRONTING THE PROBLEM OF FRAUD ON THE BOARD

Joel Edan Friedlander*

Recent precedents make it difficult to challenge transactions approved by a board of directors and a stockholder majority. When should such cases be filed, proceed beyond the pleading stage, and prevail? My answer is that litigation rules should remedy and deter tortious misconduct that corrupts board decision-making. Commission of fraud on the board is an omnipresent temptation for self-interested controllers, activist stockholders, officers, financial advisors, and their legal counsel. Fraud can be used to put a company in play, steer a sale process toward a favored bidder, suppress the sale price to a controller, or make a favored bid look more attractive. Successful stockholder actions in recent decades can be reinterpreted as occasions when courts made tentative or final determinations that a board decision was corrupted by fraud or related tortious misconduct. Going forward, problematic legal rules bearing on fraud on the board need to be confronted. Stockholder plaintiffs should be permitted to inspect contemporaneously created electronic books and records to test whether the publicly disclosed narrative of a sale process conceals undisclosed fraud on a board. A non-fiduciary's corruption of a board's decision-making processes should be considered a free-standing tort, without the need to establish that duped fiduciaries breached their fiduciary duties. Recognizing a tort of fraud on the board would be consistent with tort principles and a sound stockholder litigation regime.

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INTRODUCTION

Corporate law litigation has entered a new phase. Decades-old canonical cases—*Weinberger*,[1] *Unocal*,[2] *Revlon*,[3] *Blasius*,[4] and *Unitrin*[5]—and the associated procedural weapons of enhanced judicial scrutiny and expedited discovery no longer carry much salience to a corporate law litigator. Under the current dispensation, and the new leading cases of *Synthes*,[6] *MFW*,[7] *C&J*,[8] *Corwin*,[9] *Trulia*,[10] and *Dell*,[11] the default litigation landscape for a variety of transaction structures is judicial consideration of defendant-drafted public filings at the pleading stage, no discovery, dismissal in the event of an affirmative stockholder vote, and a worse outcome if pursuing appraisal.

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[1] Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983) [hereinafter *Weinberger*].
[2] Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985) [hereinafter *Unocal*].
[3] Revlon v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).
[4] Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988) [hereinafter *Blasius*].
[5] Unitrin, Inc. v. American General Corp., 651 A.2d 1361 (Del. 1995) [hereinafter *Unitrin*].
[6] *In re* Synthes, Inc. S'holder Litig., 50 A.3d 1022 (Del. Ch. 2012) [hereinafter *Synthes*].
[7] Kahn v. M & F Worldwide Corp., 88 A.3d 635 (Del. 2014) [hereinafter *MFW*].
[8] C & J Energy Servs., Inc. v. City of Miami Gen. Emps.' & Sanitation Emps.' Ret. Trust, 107 A.3d 1049 (Del. 2014) [hereinafter *C&J*].
[9] Corwin v. KKR Financial Holdings LLC, 125 A.3d 304 (Del. 2015) [hereinafter *Corwin*].
[10] *In re* Trulia, Inc. S'holder Litig., 129 A.3d 884 (Del. Ch. 2016) [hereinafter *Trulia*].
[11] Dell Inc. v. Magnetar Global Event Driven Master Fund Ltd., 177 A.3d 1 (Del. 2017) [hereinafter *Dell*].

The rationale for the new litigation regime is that managerial preference for a particular form of change-of-control transaction, or no transaction at all, is an obsolete problem. Stockholder activism is rampant, CEO and director compensation is tied to the stock price, and stockholder value maximization is a deeply embedded norm. No longer is the central question in corporate law how to adjudicate between the presumptive authority of a board of directors and a temporary stockholder majority. Cases are not filed by hostile bidders claiming to speak for the best interests of stockholders. There are almost no occasions to refine levels of judicial scrutiny for board decisions that alter a battle for corporate control. Virtually all deal litigation this century challenged transactions approved by a unanimous board of directors and supported by the great majority of stockholders.

The current litigation environment reflects an unchallenged consensus about the parameters of judicial review. A board of directors consisting almost exclusively of independent outsiders should have broad discretion when overseeing a sale process, or to reject a sale process. Decisions of disinterested and independent directors should not be second-guessed as unreasonable.[12] A fully

[12] In the most recent significant case filed by a hostile bidder, the Court of Chancery deferred to fully informed, independent directors who supported maintenance of a poison pill for a company with a staggered board of directors. *See* Air Products & Chemicals, Inc. v. Airgas, Inc., 16 A.3d 48, 123 (Del. Ch. 2011) ("Air Products['] … three nominees got elected to the Airgas board and then

informed stockholder majority, consisting largely of sophisticated institutions, approves a third-party transaction conclusively. As stated in *Corwin*, "the core rationale of the business judgment rule … is that judges are poorly positioned to evaluate the wisdom of business decisions and there is little utility to having them second-guess the determination of impartial decision-makers with more information (in the case of directors) or an actual economic stake in the outcome (in the case of informed, disinterested stockholders)."[13]

These premises raise the question of what proper role exists for stockholder deal litigation. For transaction structures that implicate irrebuttable business judgment rule review, when should stockholder litigation be filed, proceed beyond the pleading stage, and prevail on the merits? What cases and doctrines should retain their vitality and be further developed?

My short answer is that stockholder litigation, properly administered, should remedy and deter tortious misconduct that corrupts board decision-making. Such tortious misconduct can take several forms. As Vice Chancellor Laster recently

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questioned the directors about their assumptions. (They got answers.) They looked at the numbers themselves. (They were impressed.) They requested outside legal counsel. (They got it.) They requested a third outside financial advisor. (They got it.) And in the end, they *joined in the board's view* that Air Products' offer was inadequate. John Clancey, one of the Air Products Nominees, grabbed the flag and championed Airgas's defensive measures, telling the rest of the board, '*We have to protect the pill.*'") (emphasis in original).

[13] *Corwin*, 125 A.3d at 313-14.

observed, “coercion, the misuse of confidential information, secret conflicts, or fraud” can lead to liability and damages, notwithstanding negotiation of a fair price.[14] In this essay I use the shorthand descriptor “fraud on the board.”

If not detected and disclosed while a deal is pending, fraud on the board becomes a fraud on the stockholders. Deference to the decision-making of independent directors and sophisticated stockholders necessarily presumes the absence of fraud. Yet, commission of fraud on the board is an omnipresent temptation for self-interested controllers, activist stockholder/directors, officers, financial advisors, and their legal counsel. Fraud can be used to put a company in play, steer a sale process toward a favored bidder, suppress the sale price to a controller, or make a favored bid look more attractive.[15] In notable cases, fraud on the board has been revealed. When discovered, fraud on the board is not countenanced.

My thesis in this article is that corporate law governing stockholder litigation should be focused on deterring and redressing fraud on the board. Embedded within that thesis are two propositions.

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[14] ACP Master, Ltd. v. Sprint Corp., 2017 WL 3421142, at *19 (Del. Ch. July 21, 2017, corrected Aug. 8, 2017), *aff'd*, 184 A.3d 1291 (Del. 2018) (Table).

[15] Fiduciaries may also commit fraud on an arms-length counter-party to obtain an unwarranted sale price for a company, a problem dealt with by contract drafting and common law fraud doctrine.

First, fraud on the board is an enduring and central problem for corporate governance. It has not been eradicated by evolution in the market for corporate control. In Part I of this article, I argue that the presence of fraud on the board lies at the heart of the most meritorious breach of fiduciary duty cases adjudicated in recent decades. Well-pled allegations of fraud on the board are also central to significant settled cases and pending cases. Corporate law doctrine is not articulated in these terms, but standards of enhanced scrutiny can be reinterpreted as determinations of when it is appropriate to inquire into whether a board decision was corrupted by fraud or related tortious misconduct. Put differently, I wonder whether any board decision would be invalidated as unreasonable, unfair, disloyal, or the product of bad faith absent some element of fraud or coercion.[16]

Second, I argue that problematic aspects of legal rules bearing on fraud on the board need to be confronted. In Parts II and III, I discuss two legal reforms that would aid judicial inquiry into, and redress for, fraud on the board.

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[16] Two clarifications to this general statement come to mind. First, elements of fraud and coercion are present when a board or special committee is populated with directors who are denominated as "independent" but lack disinterest or independence. Second, a close cousin of coercion is when directors of a controlled company operate "in the altered state of a controlled mindset." *In re* Southern Peru Corp. S'holder Deriv. Litig., 52 A.3d 761, 802 (Del. Ch. 2011), *aff'd sub nom.*, Americas Mining Corp. v. Theriault, 51 A.3d 1213 (Del. 2012).

Building on a prior article, I discuss in Part II what I refer to as the "*El Paso* problem."[17] The *El Paso* problem is that *MFW, Synthes, C&J*, *Corwin*, *Trulia*, and *Dell* operate in combination to diminish the opportunities and incentives that existed when *El Paso* was litigated for contingently compensated stockholder plaintiffs' counsel to discover and establish fraud on the board. A proposed solution has evolved in response to *Corwin.* Stockholder plaintiffs now seek to inspect corporate books and records underlying proxy disclosures for the purpose of testing whether a stockholder vote was fully informed. Nascent case law supports this innovative application of Section 220 of the Delaware General Corporation Law. This development is vital to the integrity of the current stockholder litigation regime. For it to be effective, use of Section 220 requires access to contemporaneously created electronic records. Section 220 should also be amended to allow former stockholders to file suit post-merger for inspection of books and records regarding the merger.

In Part III, I discuss what I refer to as the "*TIBCO* problem."[18] As a matter of substantive law, as currently enunciated in *TIBCO* and other cases, a third-

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[17] Joel E. Friedlander, *Vindicating the Duty of Loyalty: Using Data Points of Successful Stockholder Litigation As a Tool for Reform*, 72(3) BUS. LAW. 623, 642-48 (Summer 2017) (discussing evolutions in corporate law since *In re* El Paso Corp. S'holder Litig., 41 A.3d 432 (Del. Ch. 2012) [hereinafter *El Paso*]) [hereinafter *Vindicating the Duty of Loyalty*].
[18] *See In re* TIBCO Software Inc. S'holders Litig., 2015 WL 6155894l (Del. Ch. Oct. 20, 2015) [hereinafter *TIBCO*].

party's duping of an innocent (or merely negligent) board of directors may present a wrong without a remedy.

Fraud on a board, if committed by a fiduciary, is a breach of the duty of loyalty. If committed by a non-fiduciary in league with a fiduciary, such tortious misconduct is aiding and abetting a breach of fiduciary duty. But what if a non-fiduciary intentionally dupes an innocent board of directors into making a value-destroying decision?

Under current law, there is no extra-contractual stockholder claim against the non-fiduciary absent a finding that the board breached its duty of care. Establishing a breach of the duty of care is no small feat, creating a gap in the law that could allow a financial advisor to escape penalty for having duped a board of directors for self-interested purposes. Misconduct by a financial advisor in connection with the sale of a corporation may only give rise to a breach of contract claim by the client corporation—a claim that will not be enforced by the acquirer who benefited at the expense of the selling corporation's former stockholders.

This gap in the law has been hidden by the legal fiction that duped boards of directors breached their duty of care. To close the gap when the legal fiction is untenable, I advocate a new legal rule. A non-fiduciary's corruption of a board's decision-making processes should be considered a free-standing tort, without the need to establish a breach of fiduciary duty by the board. Recognizing such a tort would be consistent with tort principles and a sound stockholder litigation regime.

I. THE ENDURING PROBLEM OF FRAUD ON THE BOARD

The nomenclature of stockholder claims shifts over time. Cases are rarely overruled, but older conceptions gradually disappear or no longer shape the manner in which a case is presented or decided. Categories with lost or diminished meaning include constructive fraud, the improper purpose test, *Revlon* claims, *Unocal/Unitrin* claims, *Blasius* claims, the duty of good faith, fair dealing claims, and intermediate scrutiny. A practitioner today analyzes whether a given transaction fits within the paradigms of *Corwin* or *MFW*.

Fraud on the board is a phrase that appears in some cases, but has not been thought of as a free-standing claim. It is a form of prohibited behavior, which may be conceptualized as triggering entire fairness review, creating liability under *Revlon*, or forming the basis for a claim of aiding and abetting a breach of the duty of care.

Fraud on the board is better considered a foundational tort at the center of corporate law. The standards of prohibited conduct by fiduciaries may expand or shrink, but such debates operate within a common assumption that fraud is forbidden. The statutes and contracts governing the operation of mergers and their legal effect are subordinate to the rights of stockholders not to be compelled to submit to a transaction tainted by fraud. The formulations of fiduciary duties and standards of review may change, but no one defends a right to defraud a special committee, a board of directors, or unaffiliated stockholders. If established, fraud on the board cannot be defended within the rubrics of entire fairness, the business judgment rule, or stockholder ratification. Defending a claim of fraud on the board is more akin to defending a claim of common law fraud. Operative questions include the pleading of requisite facts, scienter, and proximate causation of damages to the corporation or its stockholders.

The foundational nature of fraud was expressed in 1931 by Chancellor Josiah Wolcott, relying on cases from outside of Delaware:

> [I]f consent to the merger be induced by fraud practiced upon a consenting company, a stockholder is under no duty to elect whether he will abide by a merger so induced or take his money. In such a case equity holds that no just alternatives are presented to him for a choice…. The exercise of the statutory right of merger is always subject to nullification for fraud. The cases so hold.[19]

This dicta does not discriminate based on the origin of the fraud – whether it was committed by the counter-party to the merger, or by the corporation's own fiduciaries. The rules of corporate law operate within a legal universe that respects a general prohibition against fraud.

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[19] Cole v. National Cash Credit Ass'n, 156 A. 183, 187 (Del. Ch. 1931) (citations omitted).

Chancellor Wolcott dilated on the distinction between "actual fraud" and "constructive fraud": "The fraud charged [in the present case] however is not actual fraud on the part of the directors and majority stockholders. It is constructive fraud based on an alleged discriminatory undervaluation of assets …."[20] Actual fraud is in the nature of common law fraud. Constructive fraud is a defect in board decision-making that is deemed to be the legal equivalent of actual fraud. Our evolving fiduciary duty case law can be thought of as elaborations of what Chancellor Wolcott described as constructive fraud:

> When the fraud charged is of this nature [*i.e.*, constructive fraud] it must be so plainly made out as to disclose a breach of trust or such maladministration as works a manifest wrong to the dissentients. The overvaluation or undervaluation as the case may be must be such as to show a conscious abuse of discretion before fraud in law can be made out….
>
> … [M]ere inadequacy of price will not reveal fraud. The inadequacy must be so gross as to lead the court to conclude that it was due not to an honest error of judgment but rather to bad faith, or to a reckless indifference to the rights of others interested….[21]

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[20] *Id.*

[21] *Id.* at 187-88 (citation omitted). *See also id.* at 188-90 ("There is a presumption that the judgment of the governing body of a corporation, whether at the time it consists of directors or majority stockholders, is formed in good faith and inspired by a bona fides of purpose…. I fail to see anything in the proposed plan of merger which reveals any fraud, actual or constructive."). *See also* 3 JOHN NORTON POMEROY, A TREATISE ON EQUITY JURISPRUDENCE § 922, at 626 (5th ed. 1941) ("Constructive fraud is simply a term applied to a great variety of transactions, having little resemblance either in form or nature, which equity regards as wrongful, to which it attributes the same or similar effects as those which follow from actual fraud . . . .").

More than 75 years later, I wonder whether the outcome of breach of fiduciary duty litigation today turns on anything other than tortious interference with a board's deliberative processes (*e.g.*, fraud on the board). Extensive case law and dicta elaborating fiduciary duty principles obscure the fundamental question whether independent directors were deprived of decision-making power based on all reasonably available material information. Corporate law may prohibit additional forms of misconduct. It should never prohibit less.

To develop this argument, I discuss three groups of cases. First, I consider leading corporate law precedents that resulted in judgments in favor of the plaintiff for which the presence of fraud on the board was critical to the outcome. Second, I discuss significant settled cases in which an important issue left open for adjudication was whether fraud on the board occurred. Third, I discuss two pending cases that survived a motion to dismiss in which fraud on the board is alleged. I argue that black-letter rules and standards in breach of fiduciary duty cases respecting merger and acquisition transactions are subordinate to the question of the presence or absence of actual fraud.

A. LEADING DECISIONS FINDING FRAUD ON THE BOARD

Some of the most significant decisions favoring stockholder plaintiffs in the past 35 years featured findings of fraud committed against independent directors.

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1. *Weinberger v. UOP, Inc.*

The Delaware Supreme Court's decision in *Weinberger* is best known for setting forth the now-familiar, multi-factor, non-bifurcated test of entire fairness for evaluating an interested merger, such as the parent-subsidiary, cash-out merger between UOP, Inc. ("UOP") and its majority owner, The Signal Companies, Inc. ("Signal").[22] In the same opinion, the Supreme Court jettisoned the "business purpose" test and liberalized the rules governing the judicial valuation of stock.[23]

For purposes of disposing of the appeal before them, which challenged the Court of Chancery's finding that the merger between UOP and Signal was fair, the Supreme Court ruled that reversal was mandated by a fraud on the UOP board. Certain Signal-affiliated directors had not disclosed to UOP's outside directors an analysis they had prepared for the benefit of Signal, the "Arledge-Chitiea report":

> A primary issue mandating reversal is the preparation by two UOP directors, Arledge and Chitiea, of their feasibility study for the exclusive use and benefit of Signal. This document was of obvious significance to both Signal and UOP. Using UOP data, it described the advantages to Signal of ousting the minority at a price range of \$21–\$24 per share.[24]

In holding that fair dealing was not established, the Supreme Court noted the absence of an independent committee of outside directors negotiating at arms-

[22] 457 A.2d 701, 711 (Del. 1983).
[23] *Id.*
[24] *Id.* at 712-15.

length, and the non-disclosure to the other UOP directors of the price range set forth in the Arledge-Chitiea report:

> As we have noted, the matter of disclosure to the UOP directors was wholly flawed by the conflicts of interest raised by the Arledge-Chitiea report. All of those conflicts were resolved by Signal in its own favor without divulging any aspect of them to UOP.
>
> This cannot but undermine a conclusion that this merger meets any reasonable test of fairness. The outside UOP directors lacked one material piece of information generated by two of their colleagues, but shared only with Signal.[25]

This undisclosed fraud on the board foreclosed a finding of entire fairness. Absent fraud, the defendants could have established entire fairness based on the fairness of the price. The Court observed that "in a non-fraudulent transaction we recognize that price may be the preponderant consideration outweighing other features of the merger."[26]

2. *Smith v. Van Gorkom*

Smith v. Van Gorkom does not strictly belong in this group of cases. There was no factual finding that the board of directors of Trans Union Corporation ("Trans Union") was defrauded or coerced into approving the merger agreement on

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[25] *Id.* at 712.

[26] *Id.* On remand, the Court of Chancery awarded damages of $1 per share, as a matter of equity, in light of Signal's non-disclosure to the minority stockholders of the substance of the Arledge-Chitiea report, which might have been "done unintentionally, as Signal claims, rather than deliberately." Weinberger v. UOP, Inc., 1985 WL 11546, at *2 (Del. Ch. Jan. 3, 1985), *aff'd*, 497 A.2d 792 (Del. 1985) (Order).

September 20, 1980, the same day that the board was informed of the proposed transaction, and the day before Pritzker's offer was set to expire.

The Supreme Court majority held that the directors, "at a minimum, were grossly negligent in approving the 'sale' of the Company upon two hours' consideration, without prior notice, and without the exigency of a crisis or emergency."[27] Justice McNeilly disagreed, writing in dissent:

> Directors of this caliber are not ordinarily taken in by a "fast shuffle." I submit they were not taken into this multi-million dollar corporate transaction without being fully informed and aware of the state of the art as it pertained to the entire corporate panorama of Trans Union…. These men knew Trans Union like the back of their hands and were more than well qualified to make on the spot informed business judgments concerning the affairs to Trans Union including a 100% sale of the corporation. Lest we forget, the corporate world of then and now operates on what is so aptly referred to as "the fast track."[28]

I include this controversial stockholder plaintiff victory on liability in light of abundant scholarship about the case.[29] A subsequently developed rationale for ruling in favor of the plaintiff is that Van Gorkom's conduct was tantamount to tortious corruption of the board's deliberative processes. Professor Jonathan

[27] Smith v. Van Gorkom, 488 A.2d 858, 874 (Del. 1985).
[28] *Id.* at 895.
[29] A recent law review article gathers the "vast scholarly and professional commentary" about the case and analyzes it in light of subsequent developments in Delaware law. Robert T. Miller, Smith v. Van Gorkom *and the Kobayashi Maru: The Place of the Trans Union Case in the Development of Delaware Corporate Law*, 9 WM. & MARY BUS. L. REV. 65, 70 & n.3 (2017).

Macey utilized two insider accounts, including a book written in 1986 by a former inside lawyer at Trans Union, to conclude:

> In other words, it appears as though Mr. Van Gorkom acted autocratically and self-interestedly in the way he approached this transaction. He also appears to have provided limited opportunities for his fellow directors and managers to become involved either in negotiating the transaction or in discussing its merits.
>
> …
>
> … Van Gorkom placed pressure on the board. He maneuvered the board into a position from which it was virtually impossible to exercise its duty of care.[30]

Professor Robert Miller argues, also based on the former inside lawyer's book, that the clearest ground for liability is that Van Gorkom prevented his subordinates from developing a competing management buyout offer with KKR:

> [Van Gorkom] practically rejected the [KKR] offer because of the financing contingency…. [T]he board and Van Gorkom hamstrung the buyout group by requiring that Van Gorkom be involved in all its internal discussions…. Rather than taking reasonable steps to allow his executives to participate in the KKR transaction if they wished to do so, Van Gorkom interrogated them as if they had done something wrong and created the impression that participating in the offer could endanger their futures with the company.[31]

[30] Jonathan R. Macey, Smith v. Van Gorkom*: Insights About C.E.O.s, Corporate Law Rules, and the Jurisdictional Competition for Corporate Charters*, 96 NW. U.L. REV. 607, 613-14 (2002) (citing WILLIAM M. OWEN, AUTOPSY OF A MERGER (1st ed. 1986), and Herbert Greenberg, *Behind the Turmoil at Trans Union*, CRAIN'S BUS. DAILY, Jan. 12, 1981)).
[31] Miller, *supra* note 29, at 186; *see id.* at 181-85 (citing OWEN, *supra* note 30).

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Professor Miller also notes that "it was widely believed that anything Van Gorkom learned about the [KKR] buyout effort would immediately be channeled to Pritzker."[32]

The full facts of Van Gorkom's involvement in the senior management discussions respecting a management buyout with KKR were not provided to the Board. The Board was told the following on that subject on January 26, 1981, when asked to vote on whether the Board continued to recommend the proposed merger with Pritzker:

> (n) The fact that certain members of senior management had had extensive discussions with the firm of Kohlberg, Kravis, Roberts & Co. ("KKR") about the possibility of a "leveraged buyout" of Trans Union pursuant to which certain members of senior management would become members of senior management of the acquiring company.
>
> (o) The fact that at initial discussions among certain members of senior management concerning the possibility of a leveraged buyout, Messrs. Van Gorkom and Chelberg had expressed concern about the potential conflicts of interest in a transaction in which members of senior management would have an interest.
>
> (p) The fact that on December 2, 1980, KKR had proposed, in writing, the acquisition of Trans Union at $60 per share in cash, subject to the obtaining by KKR of financing, and that such proposal had been withdrawn about three hours following its receipt, in part because a senior official at Union Tank Car Company, Trans Union's most important subsidiary, had declined to participate in the KKR proposal.[33]

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[32] *Id.* at 185 (quoting OWEN, *supra* note 30, at 143).

[33] Affidavit of William B. Moore at para. 4, Smith v. Pritzker, C.A. No. 6342, 1980 (Del. Ch. Jan. 29, 1981), available at https://www.law.upenn.edu/live/news/6989-smith-v-van-gorkom-488-a2d-848-del-1985/news/delaware-news.php#opinions

Assuming a hypothetical trial in which the soon-to-be-obsolete liability theory of unexculpated gross negligence was unavailable, but in which the plaintiff had access to the full factual record filled in by subsequent scholarship, one can imagine a hypothetical post-trial ruling based on the rationales recorded above—coercion of the Board on September 20, 1980, and fraud on the Board on January 21, 1981. Such a hypothetical ruling would be less controversial than the actual holding and would support my thesis that the factual scenarios of successful stockholder litigation can be reinterpreted as cases in which the plaintiff established misconduct amounting to fraud or coercion respecting the board's deliberative process.

3. *Mills Acquisition Co. v. Macmillan, Inc.*

In *Mills Acquisition Co. v. Macmillan, Inc.*,[34] the Delaware Supreme Court analyzed a fraud on the board of directors of Macmillan, Inc. ("Macmillan") in the context of an auction for corporate control. The fraud was the non-disclosure by the insiders and their financial advisor of tips given to the favored bidder. The Supreme Court reversed the Court of Chancery's denial of a preliminary injunction sought by the competing bidder.

The Supreme Court stated that the insider directors breached their fiduciary duties in a manner that "tainted the evaluative and deliberative processes of the

[34] 559 A.2d 1261 (Del. 1989) [hereinafter *Macmillan*].

Macmillan board, thus adversely affecting general stockholder interests."[35] The Court reasoned that "illicit manipulation of a board's deliberative processes" triggered entire fairness review:

> [T]his judicial reluctance to assess the merits of a business decision ends in the face of illicit manipulation of a board's deliberative processes by self-interested corporate fiduciaries. Here, not only was there such deception, but the board's own lack of oversight in structuring and directing the auction afforded management the opportunity to indulge in the misconduct which occurred. In such a context, the challenged transaction must withstand rigorous judicial scrutiny under the exacting standards of entire fairness.[36]

"Fair dealing" was described as encompassing a duty on the part of fiduciaries "to disclose all material information relevant to corporate decisions from which they may derive a personal benefit."[37] "Fair price" in this context was a duty to obtain "the highest price reasonably available."[38]

To issue an injunction, the Supreme Court did not need to invoke the concept of entire fairness, much less the "enhanced duty imposed by this Court in *Unocal*," or the "slightly different" two-part test that becomes applicable "[w]hen *Revlon* duties devolve upon directors[.]"[39] The real work in the opinion was performed by fraud law.

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[35] *Id.* at 1264.
[36] *Id.* at 1279.
[37] *Id.* at 1280.
[38] *Id.*
[39] *Id.* at 1287, 1288 (discussing *Unocal* and *Revlon*).

In holding that corporate insiders and their financial advisor may not deceive a board of directors into approving a merger agreement, the Court relied on fraud cases, not corporate law precedents:

> Evans' and Reilly's knowing concealment of the tip at the critical board meeting of September 27th utterly destroys their credibility. Given their duty of disclosure under the circumstances, this silence is an explicit acknowledgment of their culpability. *See Nicolet, Inc. v. Nutt*, Del.Supr., 525 A.2d 146, 149 (1987); *Stephenson v. Capano Development, Inc.*, Del.Supr., 462 A.2d 1069, 1074 (1983); *Gibbons v. Brandt*, 170 F.2d 385, 391 (7th Cir.1948).[40]
>
> * * *
>
> Given the materiality of these tips, and the silence of Evans, Reilly and Wasserstein in the face of their rigorous affirmative duty of disclosure at the September 27 board meeting, there can be no dispute but that such silence was misleading and deceptive. In short, it was a fraud upon the board. *See generally Nicolet v. Nutt*, 525 A.2d at 149; *Stephenson v. Capano*, 462 A.2d at 1074.[41]

Nicolet involved an alleged conspiracy among asbestos manufacturers to intentionally misrepresent and suppress information concerning the health hazards of asbestos. *Nicolet* relied on *Stephenson*, a case about damages for false advertising under Delaware's Consumer Fraud Act:

> To establish a prima facie case of intentional misrepresentation (fraudulent concealment), the following elements must be proven:
>
> (1) Deliberate concealment by the defendant of a material past or present fact, or silence in the face of a duty to speak;
>
> (2) That the defendant acted with scienter;
>
> (3) An intent to induce plaintiff's reliance upon the concealment;

[40] *Id.* at 1282-83.
[41] *Id.* at 1283.

> (4) Causation; and
> (5) Damages resulting from the concealment.
>
> *See Stephenson v. Capano Development, Inc.,* Del. Supr., 462 A.2d 1069, 1074 (1983). Generally, there is no duty to disclose a material fact or opinion, unless the defendant had a duty to speak. However, where one *actively* conceals a material fact, such person is liable for damages caused by such conduct.
>
> In *Stephenson,* this Court outlined the different theories upon which a tort action for fraud may be based: "... [F]raud does not consist merely of overt misrepresentations. It may also occur through *deliberate concealment* of material facts, *or* by silence in the face of a duty to speak ..." *Id.* at 1074 (emphasis added). Further, one who actively and fraudulently conceals information is liable for the physical harm caused by such conduct. Thus, it has also been said that:
>
> > A single word, even a nod or a wink or a shake of the head or a smile or gesture intended to induce another to believe in the existence of a nonexisting fact may be fraud.
>
> *Gibbons v. Brandt*, 170 F.2d 385, 391 (7th Cir. 1948), *cert. denied,* 336 U.S. 910, 69 S. Ct. 511, 93 L. Ed. 1074, *reh'g denied,* 336 U.S. 929, 69 S. Ct. 643, 93 L. Ed. 1090 (1949).[42]

The finding of a fraud on the board of directors meant that the merger agreement with the winning bidder could be enjoined:

> [W]hen a board is deceived by those who will gain from such misconduct, the protections girding the decision itself vanish. Decisions made on such a basis are voidable at the behest of innocent parties to whom a fiduciary duty was owed and breached, and whose interests were thereby materially and adversely affected.
>
> …
>
> … Moreover, where the decision of the directors, granting the lockup option, was not informed or was induced by breaches of fiduciary duties, such as those here, they cannot survive.[43]

[42] Nicolet, Inc. v. Nutt, 525 A.2d 146, 149 (Del. 1987).
[43] *Macmillan*, 559 A.2d at 1284.

The lengthy discussion in *Macmillan* about standards of enhanced scrutiny was unnecessary to the result. Whatever guidance that dicta may have provided for judicial evaluation of corporate control contests, it is now obsolete. What survives is judicial enforcement of a prohibition against fraud on a board.

4. *In re Emerging Communications, Inc. Shareholders Litigation*

Justice Jacobs' post-trial decision in *In re Emerging Communications, Inc. Shareholders Litigation*[44] was a rare occurrence in which a stockholder plaintiff successfully challenged a freeze-out merger through final judgment. The Court's lengthy post-trial opinion thoroughly analyzed the accompanying appraisal claim, various procedural issues, the many elements of entire fairness, and whether each of the directors was exculpated from monetary liability.

Liability for breach of fiduciary duty against the company's controller, Jeffrey Prosser, turned on, among other things, a fraud he committed. Prosser did not disclose recent projections to the special committee, the board of directors, or the minority stockholders:

> Prosser withheld the June projections, and knowledge of their existence, from the Committee and its advisors, Houlihan and Paul Hastings. As a consequence, Goodwin and Houlihan were deprived of information that was essential to an informed assessment of the fair value of ECM and of the gross inadequacy of [the] merger price Prosser was offering…. That nondisclosure, without more, was enough to render the Special Committee ineffective as a bargaining agent for the minority stockholders.

[44] 2004 WL 1305745 (Del. Ch. May 3, 2004, revised, June 4, 2004).

> …
>
> … The board's approval was not informed, however, because the voting board members were ignorant of the existence of the June Projections and of the inadequacy of the Houlihan valuation that was based upon the March projections.
>
> …
>
> … [T]he Proxy Statement omitted to disclose to the minority shareholders the existence of the June projections and the fact that those projections had been furnished to [Prosser's financial advisor and lender], but were withheld from the Special Committee and its advisors.[45]

These findings, among others, meant that the merger was "the product of unfair dealing" and was "not entirely fair to the minority stockholders of ECM."[46]

5. *In re Dole Food Company, Inc. Stockholder Litigation*

More than a decade later, a challenge to the squeeze-out merger of the public stockholders of Dole Food Company, Inc. ("Dole") by its controlling stockholder, David Murdock, was litigated under new legal rules. The business judgment rule would apply under the following conditions:

> *if and only if:* (i) the controller conditions the procession of the transaction on the approval of both a Special Committee and a majority of the minority stockholders; (ii) the Special Committee is independent; (iii) the Special Committee is empowered to freely select its own advisors and to say no definitively; (iv) the Special Committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority.[47]

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[45] *Id.* at *35-37.

[46] *Id.* at *38.

[47] *In re* Dole Food Co., Inc. S'holder Litig., 2015 WL 496534, at *2 (Del. Ch. Feb. 5, 2015) (citing Kahn v. M & F Worldwide Corp., 88 A.3d 635, 651 (Del. 2014)).

After fact discovery, the defendants moved for summary judgment on the ground that the conditions were satisfied for invocation of the business judgment rule. Vice Chancellor Laster denied the motions, reasoning that fact issues existed respecting satisfaction of various conditions. None of the stated reasons implicated fraud on the board.[48]

After trial, Vice Chancellor Laster held that defendants had not satisfied the above-stated conditions for applicability of the business judgment rule or *Weinberger*'s multi-factor test for entire fairness.[49] The formalism of the applicable legal standards does not best explain the outcome. Vice Chancellor Laster made clear that the case was really about the plaintiffs having established at trial a fraud on Dole's special committee perpetrated by Murdock and his right-hand man, director and officer C. Michael Carter:

> [W]hat the Committee could not overcome, what the stockholder vote could not cleanse, and what even an arguably fair price does not immunize, is fraud…. [A]fter Murdock made his proposal, Carter provided the Committee with lowball management projections…. Carter gave Murdock's advisors and financing banks more positive and accurate data…. Critically for purposes of the outcome of this litigation, the Committee never obtained accurate information about Dole's ability to improve its income by cutting costs and acquiring farms.[50]

* * *

[48] *See id.* at *2-3.
[49] *In re* Dole Food Co., Inc. S'holder Litig., 2015 WL 5052214 (Del. Ch. Aug. 27, 2015).
[50] *Id.* at *2.

> This is not a case that requires an overly granular analysis of the *Weinberger* factors. Carter engaged in fraud…. According to the common law nostrum, *fraus omnia corrumpit*—fraud vitiates everything.[51]
>
> * * *
>
> [B]y engaging in fraud, Carter deprived the Committee of its ability to obtain a better result on behalf of the stockholders, prevented the Committee from having the knowledge it needed to potentially say "no," and foreclosed the ability of the stockholders to protect themselves by voting down the deal.[52]

Fraud on the board dictated the findings of personal liability and damages. The doctrinal frameworks of *MFW* and *Weinberger* were conceptually extraneous.

6. *RBC Capital Markets, LLC v. Jervis*

The only *Revlon* case litigated successfully by a stockholder plaintiff through final judgment and appeal arose out of the acquisition of Rural/Metro Corporation ("Rural/Metro"). The Delaware Supreme Court affirmed a damages award against RBC Capital Markets, LLC ("RBC"), the primary financial advisor to Rural/Metro's board of directors. The damages award was calculated based on post-trial rulings that two director defendants were joint tortfeasors with RBC who would have been personally liable for damages had they not settled before trial.[53]

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[51] *Id.* at *26.
[52] *Id.* at *38.
[53] RBC Capital Markets, LLC v. Jervis, 129 A.3d 816, 869-71 (Del. 2015) [hereinafter *Rural/Metro*] (affirming *In re* Rural Metro Corp. S'holders Litig., 88 A.3d 54 (Del. Ch. 2014) (finding liability against RBC), and *In re* Rural/Metro Corp. S'holders Litig., 102 A.3d 205 (Del. Ch. 2014) (determining damages)).

The liability rulings invoked a variety of corporate law doctrines. The board of directors of Rural/Metro was found to have breached its fiduciary duties under *Revlon* when putting Rural/Metro up for sale and when approving the merger. The board also was found to have breached its duty of disclosure to the stockholders. Two Rural/Metro directors—Chairman of the Board and Chair of the Special Committee Christopher Shackelton and CEO Michael DiMino—were found to have acted self-interestedly when putting Rural/Metro up for sale. RBC was found to have aided and abetted the board's breaches of its duty of care, in the dual contexts of *Revlon* and the duty of disclosure.

An alternative reading of the post-trial rulings is that Shackelton, DiMino, and RBC each committed frauds on the board that were not disclosed to Rural/Metro's stockholders. Shackelton and DiMino put Rural/Metro up for sale without board approval and without disclosing their personal interests in a prompt sale. RBC committed fraud in multiple respects. Each fraud is identified below.

For various reasons relating to his role as managing director of an activist hedge fund he had co-founded, "Shackelton's personal circumstances inclined him to favor a near-term sale."[54] "[W]hen seeking successfully to put Rural into play without Board authorization, Shackelton was … motivated by his personal interests

[54] *In re* Rural/Metro Corp. S'holders Litig., 102 A.3d at 255.

and those of his fund …."[55] In the midst of "campaign[ing] for a near-term sale" of Rural/Metro, "Shackelton told the Board that he had not formulated a preference among [three strategic alternatives]."[56] Instead of carrying out a directive of the Board to analyze strategic alternatives, "the Special Committee hired RBC to sell the Company, [and] then RBC and Shackelton put Rural in play without Board authorization."[57]

DiMino supported a near-term sale of Rural/Metro, "in deference to Shackelton and [another director] and because it advanced his personal financial interests."[58] DiMino had opposed a near-term sale until he was "chastised by Shackelton and [another director]," after which "he fell into line."[59] One of the outside directors described DiMino's unexplained change of heart as follows:

> [T]he light bulb finally went over his head that [a private equity buyer would] probably ask him to run it, and given the way that his relationship with the Board—our Board had deteriorated, I think at some point, he came to the conclusion he would be better off with a different Board, and a new owner would bring a different Board, on top of which he was going to prematurely cash out on the equity that he had received less than a year earlier. And probably if he was given the job back, would get more equity. It was a very good deal for him. He finally figured it out.[60]

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[55] *Id.*
[56] *Id.* at 256 (internal quotation omitted).
[57] *In re* Rural Metro Corp. S'holders Litig., 88 A.3d at 91.
[58] *In re* Rural/Metro Corp. S'holders Litig., 102 A.3d at 258.
[59] *Id.* at 258-59.
[60] *In re* Rural Metro Corp. S'holders Litig., 88 A.3d at 66.

RBC engaged in "illicit manipulation of the Board's deliberative processes for self-interested purposes[.]"[61] When retained by Rural/Metro's Special Committee, RBC "did not disclose that it planned to use its engagement as Rural's advisor to capture financing work from the bidders for [Rural/Metro's competitor,] EMS."[62] "RBC designed [a sale process for Rural/Metro] that favored its own interest in gaining financing work for EMS…. RBC did not disclose the disadvantages of its proposed schedule."[63] "Rural's Board was unaware of the implications of the dual-track structure of the bidding process and that the design was driven by RBC's motivation to obtain financing fees in another transaction with Rural's competitor."[64]

At the conclusion of the sale process, when private equity firm Warburg Pincus LLC ("Warburg") submitted the only bid, "RBC did not disclose to its client that it continued to seek a buy-side financing role with the private equity firm."[65] "When directed by the Special Committee to engage in final price negotiations with Warburg, RBC again did not disclose that it was continuing to seek a buy-side financing role with Warburg."[66] "[W]hen the Board approved the

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[61] *Rural/Metro*, 129 A.3d at 863.
[62] *Id.* at 830.
[63] *Id.*
[64] *Id.* at 855.
[65] *Id.* at 841.
[66] *Id.* at 842.

merger, the directors were unaware of RBC's last minute efforts to solicit a buy-side financing role from Warburg[.]"[67]

Meanwhile, "RBC worked to lower the analyses in its fairness presentation so Warburg's bid looked more attractive."[68] "[W]hen the Board approved the merger, the directors … did not know about RBC's manipulation of its valuation metrics."[69] RBC's precedent transaction analysis was "artificial and misleading, and … the information that RBC provided for the Proxy Statement about its precedent transaction analysis was material and false."[70]

"[T]he stockholders—and the Board—were unaware of RBC's conflicts and how they potentially impacted the Warburg offer…. [B]oth the board and the stockholders were operating on the basis of an informational vacuum created by RBC."[71]

7. *In re PLX Technology Inc. Stockholders Litigation*

The recent post-trial decision in *In re PLX Technology Inc. Stockholders Litigation*[72] found liability (but not damages) against activist investor Potomac Capital Partners II, L.P. and its director designee, Eric Singer, the Chair of the Strategic Alternatives Special Committee of the Board of Directors of PLX

[67] *Id.* at 845.
[68] *Id.* at 842.
[69] *Id.* at 845.
[70] *Id.* at 860.
[71] *Id.* at 856.
[72] 2018 WL 5018535 (Del. Ch. Oct. 16, 2018) [hereinafter *PLX*].

Technology Inc. ("PLX"). Singer learned about the possibility of selling PLX to a particular buyer ("Avago") in a particular future time frame at a particular price, but he did not so inform his fellow board members or the PLX management team. On schedule, several months later, Singer arranged a sale transaction to Avago at the specified price.[73]

Vice Chancellor Laster discussed the operative legal framework. Potomac and Singer were being sued for aiding and abetting breach of fiduciary duty, the underlying standard of review for director conduct in the sale process was enhanced scrutiny (*i.e.*, whether the directors' conduct fell outside the range of reasonableness, with added skepticism in the event of undisclosed conflicts of interest), and in the absence of full disclosure to the stockholders the standard of review would not shift to business judgment review.[74] Plaintiffs' satisfaction of these legal standards for liability ultimately turned on one fact—Singer's fraud on the board:

> Taken as a whole, this evidence suggests that Potomac and Singer undermined the Board's process and led the Board into a deal that it otherwise would not have approved. Yet in spite of this evidence, I could not conclude that the Board's decisions fell outside the range of reasonableness without one other critical fact: Krause's secret tip to Deutsch[e] Bank in December 2013 about Avago's plans for PLX. In my view, ***by withholding this information from the rest of the Board, Singer breached his fiduciary duty and induced the***

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[73] *Id*. at *1.
[74] *Id*. at *27-32, 38-41, 44, 47-50.

> ***other directors to breach theirs.*** For present purposes, by withholding this information, he fatally undermined the sale process.
>
> No one can tell what would have happened if Singer and Deutsche Bank had been candid, but the Board might well have proceeded differently.…
>
> …
>
> Viewing the record as a whole, and ***with particular emphasis on Singer and Deutsche Bank's failure to disclose Krause's tip***, …. plaintiffs … proved a breach of duty in connection with the sale process.
>
> …
>
> … By failing to share Krause's tip with the Board, Singer created a critical informational gap that contributed to the Board's breach of duty.[75]

The key precedents cited by the Court were *Macmillan*, *Rural/Metro*, and two of the cases discussed below, *In re Del Monte Foods Co. Stockholder Litigation*[76] and *El Paso*.[77]

B. SETTLED CASES IMPLICATING FRAUD ON THE BOARD

In various cases that resulted in substantial settlements, plaintiffs obtained discovery suggesting that a defendant had committed fraud on the board, or had otherwise tortiously interfered with the board's deliberative processes. These cases were litigated under various theories of breach of fiduciary duty, but in each case evidence of fraud on the board was instrumental in achieving the result. This list of settled cases is hardly exhaustive, but it is illustrative of the importance of adducing evidence of fraud of coercion in order to obtain a significant settlement.

[75] *Id.* at *47-49 (footnotes omitted).
[76] 25 A.3d 813 (Del. Ch. 2011) [hereinafter *Del Monte*].
[77] *See PLX* at *47 n.554, 49 n.566.

1. *In re TeleCorp PCS, Inc. Shareholders Litigation*

In the fall of 2001, TeleCorp PCS, Inc. ("Telecorp") entered into a merger agreement with its 23% stockholder and operational partner, AT&T Wireless Services, Inc. ("AT&T"). Two Telecorp directors voted against the merger. In discovery, plaintiffs uncovered facts inimical to the proper functioning of a board of directors. Prior to any pertinent Telecorp board meeting, AT&T secretly negotiated merger terms with large Telecorp stockholders who were looking for an orderly way to liquidate their shares.

Then-Vice Chancellor Strine discussed the manipulation of the Telecorp board's deliberative processes when denying a motion to dismiss filed by two defendants, a subsidiary of Conseco and Gary Wendt, Conseco's CEO:

> Conseco had desired to liquidate its Telecorp holdings in order to meet increasingly pressing cash needs….
>
> In September of 2001, Conseco was able to procure a board seat at Telecorp … which it was anticipated that Wendt would fill once the Telecorp met again….
>
> Most important, when … the merger dance began between AT&T Wireless and … Telecorp …, Conseco was permitted to have one of its executives participate in the key deliberations by certain Telecorp directors and officers [that] really facilitated the most important response in many ways to AT&T Wireless' interest in the merger….
>
> ***[W]hat is most notable about Conseco's ability to have an executive on the inside is that*** these deliberations to what seems to be a time-sensitive and serious interest on the part of AT&T Wireless on the merger was that … ***these deliberations preceded any meeting of the full Telecorp board. Indeed, the record supports the conclusion that the chairman of the Telecorp board was deliberately kept in the dark during these early discussions***….

> Now, during these deliberations that preceded any … full meeting of the Telecorp board, a negotiating strategy was forged. And the inference can be drawn that this negotiating strategy was designed to allow Telecorp's largest investors to accomplish their objective of rapid liquidity at a price that was acceptable to them but which was below the intrinsic or fair market value of Telecorp as a going concern….
>
> AT&T Wireless didn't just fall off the turnip truck, and they had to know this group's support would go a long way to securing full board support. In fact, by the time that Wendt was formally elected to the board … the basic economic terms of the merger … were already sort of understood, because ***this so-called consensus position*** was on the table ***of what the largest stockholders, including Conseco, would accept****….* [I]f that is true, then that ***really compromised the ability of the Telecorp board to do much***, because … it's an unlikely strategy to get someone to pay more than that price….
>
> AT&T Wireless was driving a hard bargain. AT&T Wireless … was putting … the negotiators under great pressure by threatening to veto any other deal [and] by threatening to abandon merger talks … if Telecorp's negotiators didn't give up, frankly, a very hasty assent to a hasty transaction….[78]

Arrangement of, or participation in, secret, ad hoc merger negotiations with conflicted persons can entail both fraud and coercion against a target's board of directors. Shortly before trial, AT&T agreed to pay $47.5 million to settle the entire case. That cash payment equated to a "4.3 percent improvement of the deal

[78] Oral Argument on Defendants' CTIHC, Inc. and Gary C. Wendt's Motion To Dismiss and Ruling of the Court at 83-87, *In re* TeleCorp PCS, Inc. S'holders Litig., C.A. No. 19260 (Del. Ch. June 17, 2002) (emphasis added).

terms … in a case that had … subtle and difficult liability and standard of review questions, not to mention … difficult damage questions."[79]

Any allegation that stockholder-directors breached their fiduciary duties will present difficult questions of black-letter law.[80] What made *Telecorp* a compelling case to litigate was evidence that defendants with idiosyncratic economic interests had preempted the deliberative processes of Telecorp's board of directors.

2. *In re Chaparral Resources, Inc. Stockholders Litigation*

Chaparral Resources, Inc. ("Chaparral") owned an interest in an oil field in Kazakhstan. The minority stockholders of Chaparral were bought out by Chaparral's majority stockholder, a subsidiary of the Russian oil giant Lukoil. Unbeknownst to the special committee and the consultants the special committee were relying upon, a Lukoil "special project team" had been exploring ways to expand production from the oil field. Lukoil's director designees also made undisclosed threats to the special committee to shut-in the field if a buyout deal was not struck.[81]

The fraud and coercion were discovered during expedited discovery. At trial, the special committee defendants defended the case on the basis that they had

[79] Settlement Hearing, Plaintiff's Motion for Class Certification and Award of Attorneys' Fees and Expenses, and Rulings of the Court at 92, *In re* TeleCorp PCS Inc. S'holders Litig., C.A. No. 19260 (Del. Ch. Aug. 20, 2003).
[80] *See Vindicating the Duty of Loyalty*, *supra* note 17, at 652-55.
[81] Affidavit of Joel Friedlander at paras. 6, 8, *In re* Chaparral Res., Inc. S'holders Litig., C.A. No. 2001-VCL (Del. Ch. Mar. 6, 2008).

no knowledge of Lukoil's plans to accelerate and enhance production at the oil field prior to plaintiff's discovery of Russian-language documents to that effect, the special committee had requested additional information from Lukoil, which Lukoil did not provide, and the special committee had caused these facts to be disclosed in a proxy supplement.[82] The claim against Lukoil settled after trial for an amount equivalent to 45 percent above the merger price.[83]

3. *In re Del Monte Foods Company Shareholders Litigation*

In 2010, the board of directors of Del Monte Foods Company ("Del Monte") approved the sale of Del Monte to a consortium of private equity firms led by Kohlberg, Kravis, Roberts & Co. ("KKR"). Stockholder plaintiffs filed suit, obtained expedited discovery, and moved for a preliminary injunction.

In his opinion granting a limited injunction, Vice Chancellor Laster explained how discovery had uncovered a fraud committed by Del Monte's financial advisor, Barclays Capital ("Barclays"), against the Del Monte board. Barclays' fraud allowed it to be retained originally by Del Monte and then by KKR, as a provider of buy-side financing:

> ***Barclays secretly and selfishly manipulated the sale process to engineer a transaction that would permit Barclays to obtain lucrative buy-side financing fees.*** On multiple occasions, Barclays

[82] Special Committee Defendants' Pretrial Brief at 2, 25–27, 43, *In re* Chaparral Res., Inc. S'holders Litig., C.A. No. 2001-VCL (Del. Ch. Oct. 15, 2007).
[83] Settlement Hearing at 3-7, *In re* Chaparral Res., Inc. S'holders Litig., C.A. No. 2633-VCL (Del. Ch. Mar. 13, 2008).

> protected its own interests by withholding information from the Board that could have led Del Monte to retain a different bank, pursue a different alternative, or deny Barclays a buy-side role. Barclays did not disclose the behind-the-scenes efforts of its Del Monte coverage officer to put Del Monte into play. Barclays did not disclose its explicit goal, harbored from the outset, of providing buy-side financing to the acquirer. Barclays did not disclose that in September 2010, without Del Monte's authorization or approval, Barclays steered Vestar into a club bid with KKR, the potential bidder with whom Barclays had the strongest relationship, in violation of confidentiality agreements that prohibited Vestar and KKR from discussing a joint bid without written permission from Del Monte.[84]

The Court analogized Barclays' misconduct to that of the conflicted officers in *Macmillan*: "Like the directors in [*Macmillan*], the Del Monte Board was deceived…. As in [*Macmillan*], 'there can be no dispute that such silence was misleading and deceptive. In short, it was a fraud upon the board.'"[85]

Vice Chancellor Laster ruled preliminarily that Del Monte's board of directors "sought in good faith to fulfill its fiduciary duties, but failed because it was misled by Barclays."[86] The board's good faith meant that no director was exposed to monetary liability. However, the board was preliminarily found to have breached its fiduciary duties "[b]y failing to provide the serious oversight that

[84] *Del Monte*, 25 A.3d at 817.
[85] *Id*. at 836.
[86] *Id*. (quoting *Macmillan*, 559 A.2d at 1283).

would have checked Barclays' misconduct."[87] That ruling enabled the Court to issue an injunction: "For purposes of equitable relief, the Board is responsible."[88]

The Court enjoined the merger vote for 20 days, in order to allow an alternative bidder to emerge.[89] The Court also enjoined the parties to the merger agreement from enforcing its deal protection measures during the pre-vote period.[90] No higher bid emerged, and the original merger agreement closed.[91] Amidst post-closing discovery, the case settled for $89.4 million.[92]

4. *In re El Paso Corporation Shareholder Litigation*

In 2011, Kinder Morgan, Inc. ("Kinder Morgan") negotiated a merger agreement to buy El Paso Corporation ("El Paso"). Kinder Morgan intended to keep El Paso's pipeline business and sell its exploration and production ("E & P") business.[93] Stockholder plaintiffs filed suit, obtained "truncated, expedited discovery,"[94] and moved for an injunction that would allow El Paso to sell itself,

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87 *Id*.
88 *Id*.
89 *Id*. at 840.
90 *Id*.
91 *In re* Del Monte Foods Co. S'holder Litig., C.A. No. 6027-VCL, 2011 WL 2535256, at *6 (Del. Ch. June 27, 2011).
92 *See In re* Del Monte Foods Co. S'holder Litig., C.A. No. 6027-VCL, 2011 WL 6008590 (Del. Ch. Dec. 1, 2011) (approving settlement and awarding attorneys' fees of $ 22,300,000).
93 *El Paso*, 41 A.3d at 434.
94 *Id*. at 452.

either in parts or in whole. Then-Chancellor Strine "reluctantly"[95] denied the injunction application, finding that plaintiffs had a reasonable likelihood of success proving that the merger "was tainted with disloyalty."[96]

The opinion identified several troubling aspects of the transaction. What Chancellor Strine deemed "[w]orst of all"[97] was evidence that El Paso's CEO and lead negotiator, Doug Foshee, had defrauded his board of directors by not disclosing his interest in pursuing with Kinder Morgan a potential management buyout of the E & P business:

> The CEO did not disclose to the El Paso board of directors … his interest in working with other El Paso managers in making a bid to buy the E & P business from Kinder Morgan. He kept that motive secret, negotiated the Merger, and then approached Kinder Morgan's CEO on two occasions to try to interest him in the idea. In other words, when El Paso's CEO was supposed to be getting the maximum price from Kinder Morgan, he actually had an interest in not doing that.[98]

Separately, the lead banker at Goldman, Sachs & Co., which was advising El Paso, "failed to disclose his own personal ownership of approximately $340,000 in

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[95] *Id.*
[96] *Id.* at 434.
[97] *Id.* at 443.
[98] *Id.* at 434. I represented Doug Foshee after issuance of the opinion denying the injunction application. Nothing in this essay should be construed as personal commentary about the merits of the claim against him.

Kinder Morgan stock, a very troubling failure that tends to undercut the credibility of his testimony and of the strategic advice he gave."[99]

El Paso adjourned its stockholder meeting by three days for the express purpose of providing stockholders additional time to evaluate the Court's opinion.[100] The third-largest proxy advisory firm changed its recommendation and opposed the merger,[101] but the great majority of El Paso's stockholders voted in favor of it. During post-closing fact discovery, the stockholder plaintiffs settled their claims for $110 million.[102]

5. *In re Activision Blizzard, Inc. Stockholder Litigation*

The transaction by which Vivendi S.A. ("Vivendi") sold its controlling stake in Activision Blizzard, Inc. ("Activision") was of a unique structure. Vivendi retained some of its Activision shares, sold most back to Activision, and sold a significant portion (approximately 25% of the Activision shares outstanding post-

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99 *Id.* at 442.

100 El Paso Corporation to Adjourn and Reconvene Special Meeting of Stockholders (Mar. 5, 2012), https://www.sec.gov/Archives/edgar/data/1066107/000089882212000094/pressrelease_adjournmeeting3.htm.

101 Proxy adviser opposes El Paso-Kinder Morgan deal, Reuters (Mar. 6, 2012), https://www.reuters.com/article/us-elpaso-kindermorgan-vote/proxy-adviser-opposes-el-paso-kinder-morgan-deal-idUSTRE8251EK20120307

102 *See In re* El Paso Corp. S'holder Litig., C.A. No. 6949-CS, 2012 WL 6057331 (Del. Ch. Dec. 3, 2012) (approving settlement and awarding attorneys' fees of $26 million).

closing) to a newly created investment vehicle controlled by two Activision senior officers, Robert Kotick and Brian Kelly, who each invested $100 million in it.

A stockholder plaintiff brought class and derivative claims that did not fit squarely into any familiar paradigm.[103] The case settled shortly before trial for payment of $275 million to Activision. In a lengthy opinion approving the settlement, Vice Chancellor Laster did not discuss any particular line of cases respecting liability. Instead, he wrote: "The magnitude of the Settlement reflects that Lead Counsel advanced strong claims for breach of the duty of loyalty."[104]

The duty of loyalty claims against Kotick and Kelly can be characterized as challenging fraud and coercion directed by them against Activision's board and independent directors. Kotick and Kelly secretly put together a proposed transaction over a period of months, a form of fraud on the board:

> In July 2012, Vivendi announced its interest in selling its Activision stake. In August, Kotick and Kelly began pursuing a transaction that would benefit themselves. They prepared a pitch book to raise $2-3 billion for an investment vehicle that would buy 38-44% of Activision. They presented the idea to Peter Nolan, then the Managing Partner of Leonard Green & Partners, L.P. ("Leonard Green"). They also approached other parties with whom Activision had relationships, including Activision's strategic partners in China. The independent directors were unaware of Kotick and Kelly's efforts.[105]

[103] *See In re* Activision Blizzard, Inc. S'holder Litig., 124 A.3d 1025, 1072 (Del. Ch. 2015) ("[T]he Restructuring was a bespoke transaction; it was not a familiar scenario such as a controller squeeze-out or a third-party M & A deal.").
[104] *Id.* at 1064.
[105] *Id.* at 1032.

{FG-W0446007.}

Kotick and Kelly waited until Activision was under pressure from Vivendi before unfurling their proposed alternative, a form of coercion:

> In December 2012, Vivendi's CEO informed Kotick … that at the next meeting of the Board, the Vivendi representatives would propose a special dividend of roughly $3 billion to be funded with cash on hand and new debt.
>
> …
>
> At a Board meeting on February 14, 2013, Kotick informed the independent directors about [his and Kelly's] proposal and asked that the Board form a special committee (the "Committee") to oversee the transaction process….[106]

Kotick and Kelly ratcheted up their coercion by threatening not to support an alternative transaction under consideration by the special committee. The special committee interpreted Kotick's stance as a threat to resign as CEO at a time of corporate vulnerability:

> On May 25, 2013, the Committee discussed Kotick and Kelly's positions and decided that a debt or equity offering "would not be actionable" without Kotick's support. The Committee again discussed the risk that Kotick would resign if Activision agreed to a transaction he did not like, as well as JP Morgan's refusal to finance a deal without Kotick. To avoid a special dividend—the worst possible outcome for Activision's unaffiliated stockholders—the Committee asked Vivendi to propose a transaction that included Kotick and Kelly.[107]

[106] *Id.*

[107] *Id.* at 1034.

Kotick then forced the disbandment of the special committee and negotiated terms directly with Vivendi that the board ultimately accepted.[108]

After the transaction terms were fully negotiated, Kotick obtained a board seat for Elaine Wynn, without disclosing the closeness of their friendship:

> After the Stockholders Agreement was finalized but before it became effective, Kotick arranged for Nolan and Elaine Wynn to join the Board….
>
> Wynn was a longtime friend of Kotick whose personal relationship with Kotick rose to the level of an immediate family member-…. Kotick refers to [Steve] Wynn as "Uncle Steve" and has said [Steve] Wynn is "like my dad." Kotick makes a point of buying a Mother's Day gift for Elaine Wynn, just as he does for his mother and his wife….[109]

The challenged transaction structure was the product of undisclosed fraud on the board and undisclosed coercion of the special committee. Stockholder approval was not required or obtained, though Activision did file a preliminary proxy statement, due to a subsequently reversed preliminary injunction ruling that Activision's charter required a stockholder vote.[110] The preliminary proxy statement omitted the secret efforts by Kotick and Kelly to put together the transaction structure, as well as Kotick's threat to resign.[111] When approving the

[108] *See id.* at 1034-35.
[109] *Id.* at 1036-37.
[110] *Id.* at 1037-39.
[111] *Id.* at 1039.

settlement, the Vice Chancellor noted that "Lead Counsel had to engage in careful detective work to understand what happened."[112]

6. *Virtus Capital L.P. v. Eastman Chemical Co.*

The sale of Sterling Chemicals, Inc. ("Sterling") to an unaffiliated third party was a transactional structure that could have been subject to the business judgment rule under *Synthes*.[113] No such motion to dismiss was filed, however, because the class action litigation arose out of an appraisal petition. Information learned during appraisal discovery allowed claims for breach of fiduciary duty and aiding and abetting to be brought against (i) the fund complex that controlled Sterling ("Resurgence"), its controller ("Sass"), the other Resurgence designees on Sterling's board, (ii) Sterling's financial advisor ("Moelis"), (iii) Sterling's CEO, (iv) a non-director officer of Sterling, (v) the members of Sterling's special committee, and (vi) the purchaser of Sterling ("Eastman").

The case settled shortly before trial. Vice Chancellor Laster's summary of the claims at the settlement hearing can be interpreted as variants of fraud on Sterling's special committee. Evidence was adduced that (i) Resurgence had a keen interest in selling Sterling that was not disclosed to the entirety of the special committee, (ii) conflicted Sterling fiduciaries (including one member of the special committee) tipped Eastman about Resurgence's keen interest in selling Sterling,

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[112] *Id.* at 1073.
[113] *See Vindicating the Duty of Loyalty*, *supra* note 17, at 654-55.

and (iii) Moelis had an undisclosed conflict of interest respecting Eastman and provided misleading analyses to Sterling's special committee. This combination of facts allegedly disabled the special committee from negotiating effectively with Eastman and undermined the special committee's approval of the merger:

> The gist of the complaint was that Resurgence breached its duty of loyalty by causing Sterling to be sold at a fire sale price to address a liquidity crisis at the Resurgence funds. The complaint contained numerous e-mails between Sass and others that corroborated this allegation.
>
> The complaint also identified various procedural deficiencies in the negotiation process that had been led by a special committee. These included allegations that one of the Sterling directors, who was a member of the committee and had close ties to Sass, was, in fact, conflicted in that role and was seeking to serve Resurgence's liquidity needs. It was alleged that ***the special committee's financial advisor met with the acquirer to discuss future work while representing the special committee.*** It was alleged that ***disclosures were made by the committee and other sell-side fiduciaries to the effect that Resurgence needed to sell, thereby undermining their negotiating position.*** It was further alleged that ***Moelis aided and abetted breaches of fiduciary duty by manipulating its fairness opinion to undervalue Sterling and make the merger appear fair.*** And, finally, Eastman was alleged to have aided and abetted the breaches of fiduciary duty by exploiting the conflicts that the sell-side fiduciaries had and Moelis' desire for future work.
>
> At the pleading stage, these claims were quite strong….
>
> Notwithstanding these difficulties, the plaintiffs obtained a settlement fund [that] amounts to a 565 percent premium over what the common stock received in the merger.[114]

[114] Settlement Hearing and Rulings of the Court at 42-44,Virtus Capital L.P. v. Eastman Chem. Co. (Del. Ch. Dec. 9, 2016) (C.A. No. 9808-VCL) (emphasis added).

7. *In re Good Technology Corp. Stockholder Litigation*

The original complaint challenging the sale of Good Technology Corporation ("Good"), a privately held Silicon Valley technology company, focused on alleged conflicts of interest of venture capital investors on the Good board who held Good preferred stock, following the precedent of *In re Trados Inc. Shareholder Litigation*.[115] During discovery, plaintiffs amended their complaint to assert a claim of aiding and abetting breach of fiduciary duty against Good's financial advisor, J.P. Morgan Securities LLC ("JP Morgan").

Shortly before trial, Vice Chancellor Laster denied defendants' requests for leave to file motions for summary judgment.[116] Plaintiffs presented evidence that JP Morgan had steered Good's board of directors away from certain transaction alternatives for self-interested reasons.

In rejecting summary judgment, the Court identified evidence that JP Morgan had "[lied] to the Board about the prospects for completing an IPO in March 2015."[117] "Shortly before the scheduled launch, J.P. Morgan concluded that the IPO should be delayed until the Company received its first quarter results. J.P. Morgan did not immediately advise the Board to delay the IPO, instead telling the

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[115] 73 A.3d 17 (Del. Ch. 2013).
[116] *In re* Good Technology Corp. S'holder Litig., 2017 WL 2537347 (Del. Ch. May 12, 2017).
[117] *Id.* at *3.

Board that the IPO could proceed as scheduled."[118] A few days later, "J.P. Morgan at last told the Company that it would not launch the IPO the next day," notwithstanding evidence that the IPO could have proceeded as scheduled.[119]

Separately, the Court identified evidence that "J.P. Morgan favored Blackberry when the Company began negotiating with potential buyers in June and July 2015."[120] "There is evidence J.P. Morgan provided Blackberry with a lower asking price than it gave other bidders. There is also evidence that J.P. Morgan lied to the Board about providing Blackberry with price guidance."[121]

Two partial settlements followed. The officers, directors, and venture capital firms settled collectively for $17 million, while JP Morgan settled for $35 million.[122]

C. PENDING CASES IMPLICATING FRAUD ON THE BOARD

Important precedents have radically shrunk the docket of stockholder litigation, but they have not eliminated occasions for the Delaware courts to consider allegations of fraud committed against a board of directors. Two recent

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[118] *Id.*
[119] *Id.*
[120] *Id.*
[121] *Id.*
[122] *See* Telephonic Settlement Conference at 3, *In re* Good Technology Corp. S'holder Litig., C.A. No. 11580-VCL (Del. Ch. June 1, 2017); *In re* Good Technology Corp. S'holder Litig., 2018 WL 1672986 (Del. Ch. Apr. 5, 2018) (approving JP Morgan settlement); *In re* Good Technology Corp. S'holder Litig., C.A. No. 11580-VCL (Del. Ch. Nov. 9, 2018) (approving fiduciary settlement).

decisions in pending cases on motions to dismiss are illustrative of situations in which allegations of fraud on a board are central to the prospect for establishing liability in stockholder plaintiff litigation.

1. *In re Oracle Corporation Derivative Litigation*

At the beginning of 2016, senior management of Oracle Corporation ("Oracle") raised orally at a board retreat the idea of acquiring NetSuite, Inc. ("NetSuite"), a company controlled by Oracle founder and Chairman Lawrence Ellison. Oracle had recently begun competing against NetSuite in the marketplace, and was doing so successfully. On the spot, the Board authorized Oracle's co-CEOs to contact NetSuite, but told them not to discuss price.[123]

In a decision denying a motion to dismiss as to Ellison and co-CEO Safra Catz, Vice Chancellor Glasscock described the allegations of what happened next:

> Less than a week after the Board first discussed the possibility of acquiring NetSuite, Catz reached out to NetSuite's CEO, Zach Nelson. Catz apparently ignored the Board's instruction not to discuss price, because Nelson later described his discussion with Catz "as a loose, pre-due-diligence, exploratory conversation where a price range of $100–$125 was discussed." That price range represented a premium of 42% to 78% above NetSuite's $70.21 per share closing price on January 21, 2016, the day of the conversation.
>
> …
>
> … ***Catz violated the Board's instruction not to discuss price with NetSuite's CEO, and she later concealed her secret negotiations from the other directors.*** Moreover, Catz allegedly

[123] *In re Oracle Corp. Deriv. Litig.*, 2018 WL 1381331, at *5 (Del. Ch. Mar. 19, 2018).

> attempted to manipulate the sale process to steer the Special Committee toward Ellison's preferred price range.[124]

Catz admitted that in her initial conversation with her counterpart, "NetSuite's CEO may have mentioned a price range that NetSuite might be willing to consider."[125] The case is currently stayed pending investigation by a special litigation committee.

2. *Morrison v. Berry*

In 2016, Apollo Global Management, LLC ("Apollo") purchased The Fresh Market, Inc. ("Fresh Market") in collaboration with Ray Berry, the founder and Chairman of Fresh Market, and his son, former Fresh Market CEO Brett Berry. The Berrys owned 9.8% of Fresh Market's shares in the aggregate and rolled over their equity to end up with an approximate 20% stake in the company upon closing.

A board meeting in October 2015 addressed Apollo's expressed interest in buying Fresh Market in exclusive partnership with the Berrys. Ray Berry denied having any agreement with Apollo. The board then authorized a public exploration of strategic alternatives. Several weeks later, after Apollo submitted a second letter expressing interest in buying Fresh Market with the Berrys, Ray Berry's

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[124] *Id.* at *5, 22 (emphasis added) (footnotes omitted).

[125] Defendants Lawrence J. Ellison and Safra A. Catz's Answer to Verified Derivative Complaint at para. 5, *In re Oracle Corp. Deriv. Litig.*, Cons. C.A. No. 2017-0337-SG (Del. Ch. May 4, 2018).

lawyer acknowledged in a November 28 email to Fresh Market's counsel that Ray Berry had agreed in October 2015, "that, in the event Apollo agreed on a transaction with Fresh Market, he would roll over his equity interest over into the surviving entity."[126] The same November 28 email stated that if the Board did not authorize a sale of Fresh Market, Ray Berry "will give serious consideration to selling his stock."[127] The Board authorized the solicitation of bids for Fresh Market. Only Apollo submitted a bid.

The Delaware Supreme Court reversed a dismissal that had been granted on *Corwin* grounds and remanded the case for further proceedings. The Court concluded that "Plaintiff's complaint alleges facts showing that the Company failed to disclose troubling facts regarding director behavior … [that] would have shed light on the depth of the Berry's commitment to Apollo, the extent of Ray Berry's and Apollo's pressure on the Board, and the degree that this influence may have impacted the structure of the sale process."[128]

A subheading in the Supreme Court's opinion highlights the allegation of fraud on the board of directors of Fresh Market: "*Plaintiff alleges serious misrepresentations—both to the Board, and to stockholders—about Ray Berry's*

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[126] *Morrison v. Berry*, 191 A.3d 268, 278 (Del. 2018) [hereinafter *Morrison*].
[127] *Id.* at 281, 286 n.90.
[128] *Id.* at 275 (internal quotation and footnotes omitted).

'agreement' with Apollo."[129] A separate subheading highlights an allegation that Fresh Market's board of directors was coerced or pressured by Ray Berry into initiating a sale process: *"Plaintiff adequately alleges that the 14D-9's omission of Ray Berry's 'threat' to sell his shares is material*."[130] The Court characterized the relevant portion of Ray Berry's lawyer's email of November 28 as not necessarily a threat, but rather "an economically relevant statement of intent."[131]

II. CONFRONTING THE *EL PASO* PROBLEM

El Paso and the earlier-settled cases discussed in Part I.B. above, such as *Telecorp*, *Chaparral*, and *Del Monte*, were litigated during a prior era of stockholder class action litigation. In that era, the legal landscape created opportunities and incentives for contingently compensated plaintiff's counsel to challenge pending transactions. Enhanced judicial scrutiny was the default legal standard, and expedited discovery was freely available. Information learned during expedited discovery could be presented to the Court of Chancery during the pendency of a transaction without fear of triggering a case-dispositive affirmative defense. The Court of Chancery would evaluate the merits of a *Revlon* challenge at a preliminary injunction hearing, with the potential for some form of injunctive relief, as in *Del Monte*, or for dicta critical of the loyalty of a participant in the sale

[129] *Id.* at 277.
[130] *Id.* at 286.
[131] *Id*.

process, as in *El Paso*. Either outcome could lead to a post-closing monetary settlement and a fee award proportionate to that recovery. Less ambitious plaintiff counsel knew that challenges to pending transactions could be resolved through disclosure settlements.[132]

That comparatively permissive stockholder litigation regime created opportunities for stockholder plaintiffs to ferret out evidence of fraud on the board, whether through expedited discovery, appraisal discovery, post-closing third-party discovery, or objector discovery. Such evidence does not reveal itself in proxy statements. As Vice Chancellor Laster stated in *Del Monte*, "discovery disturbed the patina of normalcy surrounding the transaction."[133]

The comparatively permissive litigation environment that enabled *El Paso* and *Del Monte* no longer exists in Delaware. The prior legal regime incentivized the mass filing of unproductive litigation, as well as instances of productive litigation, creating a backlash.[134] What I refer to as the *El Paso* problem is a consequence of the abandonment of the prior regime. The new leading cases—*Synthes*, *MFW*, *C&J*, *Corwin*, *Trulia*, and *Dell*—operate in combination to

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[132] *See generally* Joel E. Friedlander, *How* Rural/Metro *Exposed the Systemic Problem of Disclosure Settlements*, 40 DEL. J. CORP. L. 877 (2016) (discussing history of disclosure settlements and advocating for their rejection).
[133] *Del Monte*, 25 A.3d at 817.
[134] *See generally Vindicating the Duty of Loyalty*, *supra* note 17 (discussing stockholder litigation reforms in the context of empirical observations of frequent paltry litigation outcomes and infrequent data points of successful litigation outcomes for stockholder plaintiffs).

diminish incentives and eliminate scenarios by which, as in *El Paso*, stockholder plaintiffs can discover and present evidence of fraud on the board. Consider:

- *Synthes* and *MFW* enabled pleading-stage dismissals for challenges to certain transaction structures involving the sale of controlled companies or the freeze-out of public stockholders in controlled companies;
- *C&J* eliminated blue-penciling of deal protections in merger agreements, eliminating a rationale for expedited discovery and the ability to test deal protections and obtain judicial review of deal protection disputes in real time;
- *Corwin* created a complete defense for a fully-informed and un-coerced stockholder vote, meaning that presenting during the pendency of a transaction evidence of undisclosed material facts about flaws in the board's deliberative process (as in *El Paso*) would lead to supplemental disclosures and dismissal;
- *Trulia* all but eliminated disclosure settlements, thereby eliminating occasions for expedited discovery as well as potential objector discovery into that expedited discovery; and

- *Dell* dis-incentivized the filing of appraisal petitions, thereby decreasing occasions when appraisal discovery can be used to pursue a breach of fiduciary duty claim.

In 2017, I wrote that "there is no clear path for pleading a case that a sale process has been disloyally manipulated by an insider or a financial advisor."[135] In the same paragraph of that article, I hinted at a new path then being forged by my colleagues for pleading a stockholder class action–the use of Section 220 of the Delaware General Corporation Law.[136]

Previously, the availability of expedited discovery from parties and non-parties meant that stockholder class action plaintiffs had no need for Section 220. After all, a Section 220 action, if successful, would only allow a plaintiff to obtain limited books and records of the corporation itself. Discovery casts a wider net. Only electronic discovery from a financial advisor, for example, could be expected to reveal direct evidence that the financial advisor committed fraud on the board.

Post-*Corwin*, recourse to Section 220 is often a practical necessity for stockholder plaintiffs. A corporation's internal documents, such as board minutes, board presentations, and emails, may be the only means to call into question the accuracy and completeness of a proxy statement. Another potential virtue of a

[135] *Id.* at 648.
[136] *See id.* ("Section 220 inspections are a pale substitute for expedited discovery.").

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Section 220 inspection (from the stockholder plaintiff's perspective) is that the corporate documents often are not produced until after a stockholder vote, by which time it is too late for defendants to satisfy *Corwin* by making supplemental disclosures.

It was unknown in 2017 whether Section 220 could be utilized successfully to present evidence of undisclosed fraud on the board. Questions abounded, such as (i) can a Section 220 action be maintained after a target corporation is merged out of existence?, (ii) is the hope of circumventing a *Corwin* defense a proper purpose under Section 220?, and (iii) is a stockholder permitted to inspect a sufficient quantity of documents to call into question the integrity of a board's deliberative process?

The Fresh Market litigation presented these issues. The stockholder plaintiff alleged in a pre-closing Section 220 complaint that public information about the Fresh Market acquisition created "a credible basis to suspect wrongdoing,[137] based in part on disclosures in Apollo's tender offer materials calling into question whether Ray Berry had been candid to his fellow directors about his interactions and relationship with Apollo.[138] Fresh Market's answer in the Section 220 action,

[137] Def's. Ans. to Verif. Compl., Morrison v. Fresh Market, Inc., C.A. No. 12243-VCG, ¶ 3 (May 9, 2016).
[138] *Id.* ¶ 8.

filed post-closing, asserted numerous defenses, including lack of standing and failure to state a proper purpose for inspection.[139]

Fresh Market promptly moved for judgment on the pleadings, arguing that the closing of the merger erased plaintiff's standing to obtain relief under Section 220. Fresh Market made textual arguments of statutory construction and urged the Court of Chancery not to follow two cases that had granted post-closing Section 220 relief: "To the extent *Cutlip* or *Deephaven* would be deemed to cover this scenario, this Court should decline to follow them as contrary to the plain language of Section 220."[140] Fresh Market also made a public policy argument that the Court should not make it easy for a stockholder to challenge a transaction:

> Allowing a former stockholder to proceed in this circumstance would also lead to absurd results, opening the floodgates to enterprising plaintiffs' lawyers who could submit Section 220 demands on the eve of deals in the hopes of generating leverage or circumventing discovery rules. Indeed, that appears to be precisely what is driving this case.[141]

The parties settled the Section 220 action. Fresh Market made a limited production of documents, which included board minutes that referenced a key email that Fresh Market ultimately agreed to produce. That email, dated

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[139] *Id.* at pp. 21-23.
[140] Def's. Mot. for J. on Pleadings, *Morrison v. Fresh Market, Inc.*, C.A. No. 12243-VCG, ¶ 12 (Del. Ch. May 11, 2016) (citing Cutlip v. CBA International, Inc. I, 1995 WL 694422 (Del. Ch. Oct. 27, 1995), and Deephaven Risk Arb Trading Ltd. v. UnitedGlobalCom, Inc., 2005 WL 1713067 (Del. Ch. July 13, 2005)).
[141] *Id.* ¶ 13.

November 28, 2015, was later described by the Delaware Supreme Court as "a crucial email from Ray Berry's counsel to the Company's lawyers."[142] With that crucial email in hand, the stockholder plaintiff decided not to press for additional documents and not to test the boundaries of Section 220 law in this setting.

The Fresh Market litigation demonstrates how, in one particular case, a limited Section 220 inspection that includes board minutes and one email can be sufficient to overcome a *Corwin* defense and to reveal evidence of fraud on a board of directors. A passage in the Delaware Supreme Court opinion reversing a *Corwin* dismissal addresses both issues:

> Plaintiff alleges that the phrase "as he did in October" in the November 28 E-mail should have informed directors that Ray Berry "lied" at their October 15 meeting, but that agreement and its eventual disclosure to the directors was never disclosed to the Company's stockholders….
>
> We agree with the Plaintiff that this Agreement Omission was material. ***A reasonable stockholder would want to know the facts showing that Ray Berry had not been forthcoming about his agreement with Apollo*** (among other information discussed below), ***as directors have an "unremitting obligation" to deal candidly with their fellow directors***….[143]

The Delaware Supreme Court had no reason to address the propriety of a Section 220 action filed pre-closing with the objective of inspecting contemporaneous documents that would allow the stockholder to overcome a *Corwin* defense. Nothing in the Court's opinion called the litigation tactic into

[142] *Morrison*, 191 A.3d at 273.
[143] *Id.* at 284 (citations and footnotes omitted) (emphasis added).

question. The Court noted: "Plaintiff's allegation that Ray Berry lied to the directors is not based on disclosed facts, but rather on [the] November 28 Counsel E-mail obtained through her Section 220 Litigation—particularly the portions omitted from the description of the e-mail in the 14D-9."[144]

During the pendency of the *Corwin*-stage Fresh Market litigation in the Court of Chancery and the Delaware Supreme Court, the Court of Chancery issued two important decisions about the propriety of Section 220 as a means to overcome *Corwin*. One decision dealt with the statutory language of Section 220 respecting post-merger standing. The other decision dealt with the proper purpose requirement.

In *Weingarten v. Monster Worldwide, Inc.*,[145] Vice Chancellor Glasscock addressed what he described as a "discrete issue of law that appears to be of first impression."[146] The question was whether a former stockholder could proceed with a Section 220 action based on a demand letter served prior to the date of the merger, despite the complaint having been filed after the merger closed. The Vice Chancellor dismissed the case for lack of standing, due to non-compliance with the statutory requirement that the plaintiff establish that "[s]uch stockholder is a

[144] *Id.* at 284 n.74.
[145] 2017 WL 752179 (Del. Ch. Feb. 27, 2017).
[146] *Id.* at *1.

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stockholder."[147] Importantly, the Court distinguished *Cutlip* and *Deephaven* on the ground that the plaintiffs in those cases were stockholders "at the time suit was filed."[148] *Weingarten* thus created no legal barrier for future plaintiffs who filed Section 220 actions prior to the closing of a merger and pursued them post-closing.

The holding of *Weingarten*, however, creates a practical constraint for stockholder plaintiffs and their counsel. To make use of Section 220, and obtain documents that might allow for the pursuit of a class claim that survives a motion to dismiss under *Corwin*, a potential stockholder plaintiff must be educated about the strategy of filing a Section 220 action before the transaction closes. Given the 2013 adoption of Section 251(h) of the Delaware General Corporation Law, and subsequent amendments thereto, which allow for expansive use of tender offers followed by a second-step merger,[149] getting a Section 220 action on file is essentially a race against the closing of the tender offer. Such a race would be unnecessary if Section 220 were amended to allow merged-out stockholders to pursue inspection rights relating to the merger.[150]

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[147] 8 *Del. C.* § 220(c)(1)

[148] *Weingarten*, 2017 WL 752179, at *5.

[149] *See*, *e.g.*, Neil R. Markel, *Smoothing the Pathway to Use of Tender Offers in Private Equity Acquisitions*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (Dec. 20, 2016), https://corpgov.law.harvard.edu/2016/12/20/smoothing-the-pathway-to-use-of-tender-offers-in-private-equity-acquisitions/.

[150] In the alternative entity context, the Revised Uniform Limited Partnership Action provides for a dissociated partner to inspect books and records for the

In *Lavin v. West Corp.*,[151] a recent case decided by Vice Chancellor Slights, the defendant corporation challenged the propriety of a Section 220 action filed with the aim of inspecting documents that would allow the plaintiff to plead around *Corwin*. The Vice Chancellor rejected that argument, and encouraged the use of Section 220, reasoning:

> [I]t would be naïve to believe, in most instances, that the stockholder plaintiff will not face significant challenges to meet her pleading burden in anticipation of a *Corwin* defense if all she has in hand to prepare her complaint are the public filings of the company whose board of directors she proposes to sue. That is …. precisely the reason this court should encourage stockholders, if feasible, to demand books and records before filing their complaints when they have a credible basis to suspect wrongdoing in connection with a stockholder-approved transaction and good reason to predict that a *Corwin* defense is forthcoming.[152]

Vice Chancellor Slights added that standing problems could be avoided "in the merger or tender offer context if the stockholder moves promptly."[153]

Clearing away the issues of law discussed above, the critical factual questions that remain in Section 220 litigation are whether the plaintiff establishes a credible basis to infer wrongdoing and, if so, what is the proper scope of the inspection. Vice Chancellor Slights held that the complaint in *Lavin* satisfied the

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period when the person was a partner, and seventeen states and the District of Columbia have extended inspection rights to disassociated members of LLCs. Allen Sparkman, *Information Rights – A Survey*, 2 BUS. ENTREPRENEURSHIP & TAX L. REV. 41, 52-54, 93, 97 & n.311 (2018).

[151] 2017 WL 6728702 (Del. Ch. Dec. 29, 2017).

[152] *Id.* at *9 (citing *Vindicating the Duty of Loyalty*, *supra* note 17, at 644-48).

[153] *Id.* at *9 n.70.

"low Section 220 evidentiary threshold"[154] on the question whether the Board, for self-interested reasons, favored a less valuable sale of the company over an allegedly more valuable sale of its segments. Five of the thirteen requested categories of documents were deemed "necessary and essential" for pursuit of the stockholder's stated purposes.[155] Vice Chancellor Slights ordered the production of communications, including emails, of certain individuals on a particular topic over a period of eighteen months.[156]

The use of Section 220 demands as a potential means to plead around *Corwin* has become a settled practice. What remains to be seen is whether Section 220 inspections will yield information sufficient to plead facts that withstand a motion to dismiss under *Corwin* and sufficient to establish the seeming predicate for liability, fraud on the board.

The answer to the recurring factual question of what scope of requested documents must be made available for inspection will determine whether there exists a practicable solution to the *El Paso* problem. Board minutes, like proxy statements, are drafted after the fact by lawyers for prospective defendants. They are subject to manipulation. Contemporaneous communications, on the other hand, such as emails or text messages, can provide insight into the unedited

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[154] *Id.* at *13.
[155] *Id.* at *14.
[156] *Id.*

thoughts of the defendants themselves, especially if they are created and produced in bulk.

A post-closing Section 220 inspection is an appropriate setting for a plaintiff to inspect electronic documents and determine whether or not a claim is worth pursuing. It is arguably a more equitable and efficient setting for exploring the scope of electronic discovery than was expedited discovery challenging pending transactions in the prior era of stockholder litigation. Multiple defendants and third parties are not faced with expedited time pressure to review and produce massive amounts of documents. The plaintiff lacks the negotiating leverage of a pending transaction and the twisted incentives created by the ability to confer a release. As in stockholder derivative actions, the parties are well situated to negotiate and litigate step by step and assess the cost and benefit associated with further litigation over the extensiveness of the inspection. For these reasons, the inspection of electronic documents in a post-closing Section 220 action (filed before or after the closing of the merger) should be considered a default setting for stockholder litigation. Absent that default setting, the *El Paso* problem will surely persist.

III. CONFRONTING THE *TIBCO* PROBLEM

A. IDENTIFYING THE *TIBCO* PROBLEM

Establishing fraud on the board may be a predicate for liability in a stockholder class action, but fraud on the board is not recognized as a tort.

Delaware law only recognizes fraud on the board as wrongful when it is committed by a fiduciary or when it is committed by a third person who is aiding and abetting a fiduciary's breach of duty. Absent an underlying breach of fiduciary duty, there is no recognized basis for liability against, for example, a financial advisor who deceives a board of directors for personal gain and to the detriment of the corporation or its stockholders.

The Delaware Supreme Court's most recent pronouncement on aiding and abetting liability points to this hole in Delaware law. In *Singh v. Attenborough*,[157] the Court spoke forcefully about the need to hold to account financial advisors who, in bad faith, dupe directors into breaching their fiduciary duties, even if the directors were merely grossly negligent and therefore exculpated from monetary liability. In doing so, the Court reinforced the liability hurdle that the plaintiff must plead and prove that the duped directors breached their fiduciary duties:

> [T]o the extent the Court of Chancery purported to hold that an advisor can only be held liable if it aids and abets a non-exculpated breach of fiduciary duty, that was erroneous. Delaware has provided advisors with a high degree of insulation from liability by employing a defendant-friendly standard that requires plaintiffs to prove scienter and awards advisors an effective immunity from due-care liability. As held in *RBC Capital Markets, LLC v. Jervis*, however, ***an advisor whose bad-faith actions cause its board clients to breach their situational fiduciary duties*** (e.g., the duties Revlon imposes in a change-of-control transaction) ***is liable for aiding and abetting***. The advisor is not absolved from liability simply because its clients' actions were taken in good-faith reliance on misleading and

[157] 137 A.3d 151 (Del. 2016).

> incomplete advice tainted by the advisor's own knowing disloyalty. ***To grant immunity to an advisor because its own clients were duped by it would be unprincipled*** and would allow corporate advisors a level of unaccountability afforded to no other professionals in our society. In fact, most professionals face liability under a standard involving mere negligence, not the second highest state of scienter—knowledge—in the model penal code.[158]

The phrase "situational fiduciary duties" refers to the differing black-letter liability rules that may apply respecting the underlying breach of fiduciary duty. If the financial advisor's fraud on the board occurs in the *Revlon* sale-of-control context, the stockholder plaintiff must establish that the board failed to act within a range of reasonableness, which is the rough equivalent of a negligence standard.[159] If the fraud occurred in a context that does not trigger *Revlon* enhanced scrutiny, then the plaintiff must establish grossly negligence, which has been described as requiring "a wide disparity between the process the directors used … and that which would have been rational."[160] The difficulty of establishing either a *Revlon* violation or gross negligence gives rise to the *TIBCO* problem.

The *TIBCO* litigation concerned a $100 million share count error discovered shortly after execution of the merger agreement between TIBCO Software Inc. ("TIBCO") and an affiliate of private equity firm Vista Equity Partners ("Vista").

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[158] *Id.* at 152-53 (footnotes omitted) (emphasis added).
[159] *See In re* Rural Metro, 88 F.3d at 89-99 (discussing how board conduct failed under "range of reasonableness" standard and how aiding and abetting liability can be predicated on an underlying breach of fiduciary duty that sounds in negligence).
[160] Guttman v. Huang, 823 A.2d 492, 507 n.39 (Del. Ch. 2003) (Strine, V.C.).

{FG-W0446007.}

Both parties operated under the mistaken belief that the aggregate equity value implied by the transaction was approximately $4.244 billion. However, the price expressed in the merger agreement was $24 per share, a share count error left TIBCO approximately $100 million short, and the TIBCO board did not recover the $100 million from Vista.[161]

TIBCO stockholders brought a variety of claims, including (i) breach of fiduciary duty against TIBCO's directors, (ii) aiding and abetting breach of fiduciary duty against TIBCO's financial advisor, Goldman, Sachs & Co. ("Goldman"), and (iii) professional malpractice against Goldman. Chancellor Bouchard's adjudication of those three claims in a post-closing motion to dismiss frames the *TIBCO* problem.

The Chancellor ruled that factual allegations about the board's failure to explore a reformation claim or to ask basic questions of Goldman respecting the share count error were insufficient to state a claim for breach of the duty of loyalty as to the disinterested and independent members of the board, but were sufficient to state a claim for breach of the duty of care.[162] The Chancellor explained what types of facts are needed to plead gross negligence:

> [T]he Complaint's well-pled allegations … portray a sufficiently wide gulf between what was done and what one rationally would expect a board to do after discovering a fundamental flaw in a sale process ….

[161] 2015 WL 6155894l, at *1-2.
[162] *Id.* at *23.

> One rationally would expect, for example, the Board to press Goldman … for a complete explanation concerning the circumstances of the share count error … and for whatever information it could provide concerning Vista's understanding of the share count error.
>
> … [T]he failure to make such basic inquiries does raise litigable questions over whether the Board … failed to satisfy its duty of care during the period between the discovery of the share count error and closing of the Merger.[163]

For the aiding and abetting claim, the Chancellor held that the plaintiff adequately alleged Goldman's knowing participation in the board's failure to inform itself. Goldman had learned "that Vista had relied on the erroneous share count in the Final Cap Table in making its Final Bid, but never informed the Board about this critical fact."[164] Goldman's contingent fee of approximately $47 million and its close relationship with Vista, the ultimate payer of the contingent fee, created an incentive for Goldman to "intentionally create[] an informational vacuum by failing to disclose material information to the Board" respecting its options in seeking to secure the $100 million in additional equity value.[165]

The Chancellor rejected the malpractice claim against Goldman under the law of California, the jurisdiction in which TIBCO was headquartered. The Chancellor interpreted California law as recognizing a "classic distinction in tort law, where in 'situations in which the plaintiff has neither suffered personal injury

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[163] *Id.*
[164] *Id.* at *24.
[165] *Id.* at *26.

nor damage to tangible property … American law is generally opposed to recovery on a negligence theory.'"[166]

The disposition of the above claims allows liability to attach only in one factual scenario – if the TIBCO board made no "basic inquiries" of Goldman (triggering a duty of care violation) and Goldman intentionally and selfishly chose not to inform the board of material information. But what if Goldman intentionally and selfishly withheld information that the board had requested (such that the board satisfied its duty of care)? Would liability attach to Goldman in that scenario? No claim in *TIBCO* addressed that hypothetical set of facts. The absence of such a recognized claim is what I mean by the *TIBCO* problem.

The *TIBCO* problem arises whenever defrauded directors acted in conformity with their duty of care. Consider Vice Chancellor Lamb's decision in *San Antonio Fire & Police Pension Fund v. Amylin Pharmaceuticals, Inc.*[167] The *Amylin* case concerned "proxy puts"—provisions in debt instruments by which the election of a new board majority can trigger acceleration of the debt. The

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[166] *Id.* at *29 (quoting Herbert Bernstein, *Civil Liability for Pure Economic Loss Under American Tort Law*, 46 Am. J. Comp. L. 111, 112 (1998)). For a recent article summarizing the conclusions reached by the American Law Institute respecting the economic loss rule, see Ward Farnsworth, *The Economic Loss Rule*, 50 VAL. U. L. REV. 545 (Winter 2016). The article notes that an exception to the economic loss rule allows negligence claims against providers of professional services, but only by their clients, and that such a negligence claim is typically duplicative of a breach of contract claim. *Id.* at 560-61.
[167] 983 A.2d 304 (Del. Ch.), *aff'd*, 981 A.2d 1173 (Del. 2009) (table) [hereinafter *Amylin*].

stockholder plaintiff claimed that the proxy put was an entrenchment device and that the directors on the Pricing Committee had breached their duty of care in approving an indenture without discovering the provision.

Vice Chancellor Lamb held that the directors were not grossly negligent, because they had retained advisers and because a director had asked a pertinent question of outside counsel:

> The board retained highly-qualified counsel. It sought advice from Amylin's management and investment bankers as to the terms of the agreement. ***It asked its counsel if there was anything "unusual or not customary" in the terms of the Notes, and it was told there was not.*** Only then did the board approve the issuance of the Notes under the Indenture.[168]

If director compliance with the duty of care bars a challenge to the adoption of a contract that infringes on stockholder voting rights, then financial advisors and outside counsel have an incentive to enable the board of directors to remain in office by keeping them in the dark.

Vice Chancellor Lamb recognized the problem of proliferating, undiscovered proxy puts, which he characterized as a "troubling reality" and "particularly troubling."[169] His proposed solution was to exhort outside counsel to bring proxy puts to the attention of boards of directors:

> This case does highlight the troubling reality that corporations and their counsel routinely negotiate contract terms that may, in some

[168] *Id.* at 318 (emphasis added) (footnote omitted).
[169] *Id.* at 319.

> circumstances, impinge on the free exercise of the stockholder franchise. In the context of the negotiation of a debt instrument, this is particularly troubling, for two reasons. First, as a matter of course, there are few events which have the potential to be more catastrophic for a corporation than the triggering of an event of default under one of its debt agreements. Second, the board, when negotiating with rights that belong first and foremost to the stockholders (i.e., the stockholder franchise), must be especially solicitous to its duties both to the corporation and to its stockholders. This is never more true than when negotiating with debtholders, whose interests at times may be directly adverse to those of the stockholders. ***Outside counsel advising a board in such circumstances should be especially mindful*** of the board's continuing duties to the stockholders to protect their interests. Specifically, ***terms which may affect the stockholders' range of discretion in exercising the franchise should***, even if considered customary, ***be highlighted to the board***. In this way, the board will be able to exercise its fully informed business judgment.[170]

This judicial rhetoric is no solution. It lacks the force of legal sanction and it fails to take into account the interest of outside counsel in ***not*** flagging the existence of an entrenchment device embedded in a corporate contract. Lack of disclosure serves the interest of the client representatives serving in office. Vice Chancellor Lamb's dicta fails the Holmesian "bad man" test of what is law: "If you want to know the law and nothing else, you must look at it as a bad man, who cares only for the material consequences which such knowledge enables him to predict, not as a good one, who finds his reasons for conduct, whether inside the law or outside of it, in the vaguer sanctions of conscience."[171]

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[170] *Id*. (emphasis added).
[171] Oliver Wendell Holmes, Jr., *The Path of the Law*, 10 HARV. L. REV. 457, 459 (1897).

Proxy puts continued to proliferate after *Amylin*, which may be evidence that a well-publicized judicial exhortation to bring material facts to the attention of a board of directors actually operates as a roadmap for unscrupulous counsel to obtain uninformed board approval of an entrenching contract provision. In litigation challenging the subsequent adoption of a proxy put at ARRIS Group, Inc., a senior officer submitted an affidavit setting forth the same script as in *Amylin*:

> … I did not focus on the Continuing Directors Provision during my negotiations with BANA….
>
> … Prior to approving the Credit Agreement, the Arris Board asked me regarding whether the Credit Agreement contained any terms that were unusual or required the special attention of the Arris Board. I responded that the Credit Agreement's terms were typical for agreements of this nature and did not require special attention. At no time during the board meeting did anyone identify the Continuing Director Provision for consideration by the Arris Board….[172]

What prompted some boards to eliminate proxy puts was a subsequent transcript ruling involving Healthways, Inc. holding that, in certain factual circumstances, fiduciaries could be held liable for breach of the duty of loyalty, and the lender could be held liable for aiding and abetting.[173] In the Healthways

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[172] Aff. of David B. Potts ¶¶ 10-11, *Fire and Police Pension Fund, San Antonio v. Stanzione*, Cons. C.A. No. 10078-VCG (Del. Ch. Jan. 30, 2015).

[173] *See, e.g.*, F. William Reindel, *"Dead Hand Proxy Puts"—What You Need to Know*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (June 10, 2015) (discussing effects of *Healthways* decision), https://corpgov.law.harvard.edu/2015/06/10/dead-hand-proxy-puts-what-you-need-to-know/.

case, the proxy put "arose in the context of a series of pled events and after decisions of this Court that should have put people on notice that there was a potential problem here such that the inclusion of the provision was, for pleading-stage purposes, knowing."[174] The essential element of fiduciary knowledge could be inferred at the pleading stage. Surmounting the *TIBCO* problem at a later stage of litigation would have turned on factual questions, such as what inquiries were made and what facts were known concerning potential entrenchment measures.

The salient question for Delaware law is whether a non-fiduciary's duping of an uninformed board of directors is a legal wrong or a perfect crime. This problem is of particular concern as applied to financial advisors. As in *TIBCO*, it is commonly the case that the financial advisor to an acquisition target (i) is retained on terms that contemplate a large contingent fee if the corporation is sold, (ii) has substantial, ongoing business relationships with various prospective buyers, (iii) has no expectation of working again for the target company, and (iv) interacts with prospective buyers outside of the direct supervision of any fiduciary. If the financial advisor commits misconduct that is hidden from the board, and the company is sold to a particular bidder at an unfair price, the direct beneficiaries of that misconduct will be the new owners, who will not pursue a claim on behalf of

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[174] Oral Argument on Defendants' Motions To Dismiss and Rulings of the Court at 81, *Pontiac General Employees Retirement System v. Ballantine*, C.A. No. 9789-VCL (Del. Ch. Oct. 14, 2014).

the company against its former financial advisor and its former fiduciaries.[175] Under current law, redress requires the former stockholders to establish that the financial advisor aided and abetted a former director's breach of fiduciary duty.

B. DELAWARE'S HALF-SOLUTION TO THE *TIBCO* PROBLEM

In the *Revlon* context of enhanced scrutiny respecting sale-of-control transactions, Delaware law has innovated and developed a half-solution. When imposing liability on bankers who defrauded boards of directors (or finding potential liability on a preliminary basis), the Court of Chancery and the Supreme Court have declared that the board breached its duty of care. Such a declaration of limited wrongdoing by the board has the following practical effects: (i) it establishes a predicate element of aiding and abetting liability against the financial advisor; (ii) it creates a basis for injunctive relief; and (iii) it allows disinterested and independent directors to be exculpated from an award of money damages. Only the financial advisor is answerable in damages. In *Del Monte*, Vice

[175] A similar problem arises when a financial advisor to a special committee is retained on a contingent basis to evaluate the purchase of a company or asset from an affiliate. The special committee is not well-positioned to pursue a claim that the financial advisor misled them by providing corrupt advice that enabled an overpayment to the affiliated company. *See In re El Paso Pipeline Partners, L.P. Deriv. Litig.*, 2015 WL 1815846, at *24 (Del. Ch. Apr. 20, 2015) ("Instead of helping the Committee develop alternatives, identify arguments, and negotiate with the controller, Tudor sought to make the price that Parent proposed look fair. Tudor's real client was the deal, and the firm did what it could to justify the Fall Dropdown, get to closing, and collect its contingent fee."), *rev'd*, *El Paso Pipeline GP Co., L.L.C. v. Brinckerhoff*, 152 A.3d 1248 (Del. 2016) (reversing due to lack of post-merger standing to maintain the derivative claim).

Chancellor Laster explained the doctrinal utility of finding that the board breached its duty of care:

> Unless further discovery reveals different facts, the one-two punch of exculpation under Section 102(b)(7) and full protection under Section 141(e) makes the chances of a judgment for money damages [against the directors] vanishingly small. The same cannot be said for the self-interested aiders and abetters. But while the directors may face little threat of liability, they cannot escape the ramifications of Barclays' misconduct. For purposes of equitable relief, the Board is responsible.[176]

The expedient of finding a breach of the duty of care bears the hallmarks of a legal fiction. Legal fictions pervade the common law and have been indispensable to its development. Sir Henry Maine used the term "to signify any assumption which conceals, or affects to conceal, the fact that a rule of law has undergone alteration, its letter remaining unchanged, its operation being modified."[177] Lon Fuller defined a legal fiction as "either (1) a statement propounded with a complete or partial consciousness of its falsity, or (2) a false statement recognized as having utility."[178] Declaring a defrauded board to have been in breach of its duty of care has a ring of falseness, but it innovates in a practical way by allowing relief to be granted in extraordinary circumstances not previously confronted.

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[176] 25 A.3d at 818.
[177] HENRY SUMNER MAINE, ANCIENT LAW: ITS CONNECTION WITH THE EARLY HISTORY OF SOCIETY, AND ITS RELATION TO MODERN IDEAS 25 (A. Montegu ed. 1986) (1861).
[178] LON L. FULLER, LEGAL FICTIONS 9 (1967).

No legal fiction was required in the foundational fraud-on-the-board case of *Macmillan*. The elements for liability were factually established against all relevant actors. Inside directors Evans and Reilly were primary wrongdoers. Financial advisor Bruce Wasserstein was held liable for "knowingly join[ing] with a fiduciary" in disloyal conduct.[179] The entire board was found to have breached "its fundamental duties of loyalty and care in the conduct of this auction," due to its "virtual abandonment of its oversight functions in the face of Evans' and Reilly's patent self-interest."[180] "The board was torpid, if not supine, in its efforts to establish a truly independent auction, free of Evans' interference and access to confidential data. By placing the entire process in the hands of Evans, through his own chosen financial advisors, with little or no board oversight, the board materially contributed to the unprincipled conduct of those upon whom it looked with a blind eye."[181]

Contrast those facts with *Del Monte*. Vice Chancellor Laster candidly acknowledged that "the Board predominantly made decisions that ordinarily would be regarded as falling within the range of reasonableness for purposes of enhanced

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[179] 559 A.2d at 1284 n.33.
[180] *Id.* at 1284 n.32.
[181] *Id.* at 1280. *See also id.* at 1282 (pointing to lack of "board planning and oversight to insulate the self-interested management from improper access to the bidding process, and to ensure the proposer conduct of the auction by truly independent advisors selected by, and answerable only to, the independent directors").

scrutiny"[182] and "sought in good faith to fulfill its fiduciary duties, but failed because it was misled by Barclays."[183] The Vice Chancellor extended the affirmative obligation of board oversight to support a finding of a breach of the duty of care. He faulted the Del Monte board for not making an informed decision respecting the "surreptitious and unauthorized pairing of Vestar and KKR" into a single bidding group.[184] Yet, the opinion strongly suggests that the board was unaware of the pairing. The opinion quotes a colloquy of deposition testimony by the Chairman of the Strategic Committee about how he did not recall any board discussion or knowledge of the subject.[185]

The Vice Chancellor drew the following legal conclusion: "Although the blame for what took place appears at this preliminary stage to lie with Barclays, the buck stops with the Board."[186] The seeming falseness of that legal conclusion is surpassed only by its utility. The Court granted a preliminary injunction delaying closing of the deal and allowing a superior bid to emerge, while also setting the stage for a potential damages award against Barclays, the principal wrongdoer, in the event the challenged merger was consummated.

[182] 25 A.3d at 817.
[183] *Id.* at 818.
[184] *Id.* at 833-34.
[185] *Id.* at 834.
[186] *Id.* at 835.

In *Rural/Metro*, the Delaware Supreme Court affirmed the adoption of this doctrinal half-solution to the *TIBCO* problem. RBC was found to have committed fraud on the board, for which RBC was held solely liable for the resulting damages to Rural/Metro's former stockholders. The board was found to have breached its duty of care, principally through lack of proper oversight of RBC. Findings of negligence by the Board allowed RBC to be held liable for aiding and abetting breaches of fiduciary duty. In the words of the Delaware Supreme Court, "RBC's illicit manipulation of the Board's deliberative processes for self-interested purposes was enabled, in part, by the Board's own lack of oversight[.]"[187]

Various doctrinal aspects of Delaware law had to fall into place to permit the result that RBC was held responsible for a claim predicated on findings of breach of fiduciary duty committed by Rural/Metro's board. Slightly different contextual facts and legal rulings would present the *TIBCO* problem and allow RBC to escape liability.

The determination that the board's conduct in *Rural/Metro* was subject to *Revlon*'s enhanced judicial scrutiny (*i.e.*, applying a range of reasonableness standard akin to negligence, rather than gross negligence) was not foreordained. *Corwin* had been decided just three months earlier, immediately after oral argument in *Rural/Metro*, and *Corwin* called into question the continuing vitality

[187] *Rural/Metro*, 129 A.3d at 863.

of *Revlon* in the absence of a real-time battle for corporate control. In a footnote, *Rural/Metro* quoted the following passage from *Corwin*:

> *Unocal* and *Revlon* are primarily designed to give stockholders and the Court of Chancery the tool of injunctive relief to address important M & A decisions in real time, before closing. They were not tools designed with post-closing money damages in mind, the standards they articulate do not match the gross negligence standard for director due care liability under *Van Gorkom* ….[188]

Other questions existed about the applicability of *Revlon*. Neither party had argued in the Court of Chancery that *Revlon* governed the board's conduct. In the Supreme Court, RBC argued that a due care violation required a finding of gross negligence – not unreasonableness. RBC acknowledged the applicability of *Revlon* to the ultimate decision to sell Rural/Metro, but argued that *Revlon* scrutiny was inapplicable at the initiation of the sale process, when the board had charged the special committee with evaluating strategic alternatives.[189]

The Supreme Court held that *Revlon* applied from the outset of the sale process, but confined its holding to the "unusual facts" of the case.[190] An unusual fact of particular importance was that the board subsequently ratified the initiation

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[188] *Id.* at 857 n.139 (quoting *Corwin*, 125 A.3d at 312). *But cf. In re* PLX Technology Inc. S'holders Litig., 2018 WL 747180, at *2-3 (Del. Ch. Feb. 6, 2018) (collecting cases regarding the application of enhanced scrutiny post-closing).
[189] *Rural/Metro*, 129 A.3d at 848-49.
[190] *Id.* at 853.

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of a sale process by certain key individuals without prior board authorization.[191] The Supreme Court also put weight on "the parties' agreement on appeal that *Revlon* applies" and the parties' acceptance of "the predicate 'facts as found.'"[192]

More important than the above idiosyncratic aspects of the case, the Court appeared persuaded by the utility of what I refer to as the legal fiction that board oversight is subject to *Revlon* scrutiny and will be deemed inadequate when necessary to create liability for those who committed fraud on the board. The Court was troubled by the practical consequences of not applying *Revlon*:

> ***To sanction an argument that Revlon applies only at the very endpoint of the sale process***—and not during the course of the overall sale process—***would afford the Board the benefit of a more lenient standard of review where the sale process went awry***, partially due to the Board's lack of oversight. Such a result would potentially incentivize a board to avoid active engagement until the very end of a sale process by delegating the process to a subset of directors, officers, and/or advisors…. [T]o sanction RBC's contention would allow the Board to benefit from a more deferential standard of review during the time when, due to its lack of oversight, ***the Special Committee and RBC engaged in a flawed and conflict-ridden sale process***.[193]

The presence of a legal fiction is suggested by the Court's acknowledgement that, from the perspective of the disinterested members of the board, the sale process appeared to be objectively reasonable:

[191] *Id.*
[192] *Id.* at 854.
[193] *Id.* at 853-54 & n.121 (emphasis added).

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> We agree with the trial court's suggestion that the reasonableness of ***initiating a sale process to run in tandem with the EMS auction, absent conflicts of interest,*** would be one of the many debatable choices that fiduciaries and their advisors must make … and it ***would fall within the range of reasonableness***….
>
> The record indicates that ***Rural's Board was unaware of the implications of the dual-track structure of the bidding process*** and that the design was driven by RBC's motivation to obtain financing fees in another transaction with Rural's competitor.[194]

A combination of factors in *Rural/Metro* permitted a determination that enhanced judicial scrutiny applied to the board's oversight of RBC. Applying *Revlon* was consistent with earlier case law, the parties agreed on appeal that *Revlon* scrutiny was triggered at some point, there were unusual facts about the initiation of the sale process, and *Revlon* scrutiny allowed for a liability finding against RBC. One can imagine related scenarios in which *Revlon* scrutiny would not fit (*i.e.*, a stock-for-stock merger, a financing transaction, or an acquisition of another company). In such circumstances, the *TIBCO* problem arises.

A second legal conclusion that solved the *TIBCO* problem in *Rural/Metro* was that the board breached the duty of disclosure. The transaction structure in *Rural/Metro* required an affirmative vote by public stockholders, which allowed for a finding that the board was negligent respecting false and misleading disclosures about RBC's wrongdoing and conflicts. The two sets of disclosure violations in *Rural/Metro* were (i) the disclosure of an RBC-created valuation

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[194] *Id.* at 854-55 (emphasis added).

range that was "artificial and misleading" and the disclosure of EBITDA information that was "material and false";[195] and (ii) the failure to disclose conflicts of interest and misconduct by RBC (*i.e.*, "how RBC used the Rural sale process to seek a financing role in the EMS transaction"[196] and "RBC's "pursuit of Warburg's financing business"[197]).

The breach of the duty of disclosure in *Rural/Metro* is itself a form of legal fiction. The breach of fiduciary duty by the directors exists in name only as to the directors and is of questionable grounding in fiduciary principles.[198] The information in question was deemed "reasonably available" to the directors,[199] but it was not gathered by the directors and it was not known to them. RBC hid information from the board. The directors were deemed negligent without the possibility of damages against them. That violation of fiduciary duty, however, had the immense utility of allowing the Court to hold RBC liable in damages for aiding and abetting.

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[195] *Id.* at 860.
[196] *Id.* at 860-61.
[197] *Id.* at 861.
[198] *See generally* Lawrence A. Hamermesh, *Calling Off the* Lynch *Mob: The Corporate Director's Fiduciary Disclosure Duty*, 49 VAND. L. REV. 1087, 1172-73 (1996) ("In the absence of lack of care in gathering and presenting material information, there simply is no fiduciary 'wrong' in this context [the fiduciary recommendation disclosure duty] at all.").
[199] *Rural/Metro*, 129 A.3d at 859.

RBC was deemed solely responsible for damages flowing from its various frauds on the board. The Supreme Court affirmed the Court of Chancery's ruling that, as a matter of equity, RBC was foreclosed from availing itself of Delaware's joint tortfeasor statute to reduce its liability, despite the common liability of certain director defendants, and despite RBC being the only non-settling defendant, to the extent RBC's liability was predicated on fraud on the board.[200] "[I]f RBC were permitted to seek contribution for these claims from the directors, then RBC would be taking advantage of the targets of its own misconduct."[201]

But what if a financial advisor commits fraud on the board in a context in which there is no *Revlon* scrutiny and no public stockholder vote? In such circumstances, the financial advisor can make a strong argument that it is not liable because there is no underlying breach of fiduciary duty.

Additionally, if the fraud on the board is too attenuated from a sale of the company, there may be no direct claim that can be brought by former stockholders. In the *Good Technology* litigation a claim of fraud on the board against the financial advisor arose from a failed IPO several months prior to the sale of a private company. The sale was approved by written consent of the venture capital investors, prior to the solicitation of consents from widely dispersed stockholders.

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[200] *Id.* at 876. Shackelton and DiMino shared liability for approving an unreasonable sale process that served their respective personal agendas.
[201] *Id.*

A critical ruling in the case was that evidence existed of a breach of fiduciary duty in connection with the failed IPO (aided and abetted by the financial advisor) that proximately caused the merger to be negotiated in exigent circumstances several months later, giving rise to a direct claim.[202]

The duty of care does not create director liability in damages when disinterested directors negligently oversee conflicted financial advisors, or when they fail to disclose all material facts reasonably available about a financial advisor's conflicts and wrongdoing. *Rural/Metro* reaffirmed that gross negligence is the liability standard for a money judgment against disinterested directors,[203] and the ubiquity of exculpation from money damages for due care violations under Section 102(b)(7) raises the bar for a money judgment significantly higher. The legal innovation in *Rural/Metro* was to elaborate on how directors' duties in a sale process governed by *Revlon*[204] include financial advisor oversight that can trigger a finding of a due care breach:

> [D]irectors need to be active and reasonably informed when overseeing the sale process, including identifying and responding to actual or potential conflicts of interest…. A board's consent to the conflicts of its financial advisor necessitates that the directors be especially diligent in overseeing the conflicted advisor's role in the sale process…. [T]he board should require disclosure of, on an ongoing basis, material information that might impact the board's

[202] *In re* Good Technology Corp. S'holder Litig., 2017 WL 2537347, at *2 (Del. Ch. May 12, 2017).
[203] *Rural/Metro*, 129 A.3d at 857.
[204] *Id*.

> process. For instance, the board could, when faced a conflicted advisor, as a contractual matter, treat the conflicted advisor at arm's-length, and insist on protections to ensure that conflicts that might impact the board's process are disclosed at the outset and throughout the sale process.[205]

In sum, the Supreme Court's elaboration of director oversight obligations in a sale process solved the *TIBCO* problem in the factual and legal context of *Rural/Metro*. It confirmed a path for monetary liability against RBC, an active wrongdoer that was not found to have conspired with any fiduciary. The Supreme Court did not create rules that would allow for monetary liability whenever a financial advisor engages in "illicit manipulation of the Board's deliberative processes for self-interested purposes,"[206] regardless of the transaction structure.

C. A PROPOSED GENERAL SOLUTION TO THE *TIBCO* PROBLEM

A general solution to the *TIBCO* problem requires a theory of liability against financial advisors that does not depend on the culpability of directors. The principle of not "grant[ing] immunity to an advisor because its own clients were duped by it"[207] implies the sufficiency of pleading and proving that the corporation or its stockholders were harmed as a consequence of a fraud perpetrated against a duped board of directors.

[205] *Id.* at 855-56 & nn.129-30.
[206] *Id.* at 863.
[207] *Singh*, 137 A.3d at 153.

My proposed solution to the *TIBCO* problem is recognition of a tort for knowing misconduct that corrupts board decision-making. Recognizing fraud on the board as a distinct tort would eliminate an element of proof that is not logically an aspect of the wrong. If an advisor's fraud proximately causes a distinct injury to the corporation's stockholders, then a stockholder should be able to assert a direct claim against the advisor for fraud on the board. The stockholder plaintiff should not have to prove that a duped board of directors breached its fiduciary duties. This extension of *Rural/Metro*, I argue, is informed by a scholarly debate that arose during the *Rural/Metro* litigation and is consistent with tort law principles.

The *Rural/Metro* litigation gave rise to various doctrinal debates about financial advisor liability, including whether any proper claim existed against financial advisors outside of a hypothetical contract claim by their corporate clients (which would pass to the acquirer in a merger).[208] A lightning rod for controversy

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[208] *See, e.g.*, Martin Lipton, *The Delaware Courts and the Investment Banks*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (Oct. 30, 2015) (during pendency of *Rural/Metro* appeal identifying "difficult policy and doctrinal questions raised by this line of decisions" for the Supreme Court to address, including "Does recognizing this new form of banker liability induce courts to find due care violations by directors that would seem unjustified were the reviewing court being asked to hold directors themselves personally liable?" and "Does the use of tort principles to allow stockholder plaintiffs to directly challenge the work of bankers impair the ability of boards and financial advisors to privately order their affairs through contract"), https://corpgov.law.harvard.edu./2015/10/30/.the-delaware-courts-and-the-investment-banks/.

was dicta by Vice Chancellor Laster characterizing financial advisors as corporate "gatekeepers," supported by citations to academic articles on "gatekeeper liability."[209] This dicta, if accepted as a matter of Delaware law, would create a basis for claims against financial advisors in a wide variety of situations.

During the twenty-one months that elapsed between the Vice Chancellor's liability opinion and the Delaware Supreme Court's opinion on appeal, scholars who agreed with the outcome of *Rural/Metro*, but disagreed with the dicta about gatekeeper liability, debated over how to conceptualize the role of financial advisors in mergers and acquisitions transactions. The conceptual question would have practical import for the assertion of future claims against financial advisors.

Professors William Bratton and Michael Wachter focused on banker-client contracting.[210] They argued that boards should deal with advisors at "arms-length" and oversee them proactively, "monitoring the advisor's activities and using contract to facilitate oversight and position the board to take appropriate action."[211] Their approach was championed by two practitioners who counseled corporations on how to draft their banker engagement letters.[212]

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[209] *In re* Rural Metro Corp. S'holders Litig., 88 A.3d at 88-89 & nn.14-15.
[210] William W. Bratton & Michael L. Wachter, *Bankers and Chancellors*, 93 TEX. L. REV. 1, 64-65 (2014).
[211] *Id.* at 61.
[212] Eric S. Klinger-Wilensky and Nathan P. Emeritz, *Financial Advisor Engagement Letters: Post-*Rural/Metro *Thoughts and Observations*, 71 BUS. LAW. 53 (Winter 2015-2016).

On the other side of the scholarly debate was Professor Andrew Tuch. He argued that "the more plausible characterization of the bank is that it remains a fiduciary of its client" and owes a duty of loyalty during the course of an M&A engagement.[213] According to Tuch, "the gatekeeper label is inapposite to the M&A advisors' role," because "the wrong here is inflicted by the M&A advisor upon the client," while the gatekeeper label "targets the wrongs of the client by imposing responsibilities on the gatekeeper to deter those wrongs."[214]

The debate was crystalized in an appellate brief filed by the Securities Industry and Financial Markets Association ("SIFMA"), as *amicus curiae*. SIFMA argued that "'gatekeeper' inaccurately characterizes the role of the financial advisor, and that … label should not become a fulcrum to superimpose a new quasi-fiduciary common law structure on relationships that have long been based on contracts negotiated between sophisticated parties."[215]

In a lengthy footnote 191, the Delaware Supreme Court rejected the "gatekeeper" characterization and adopted the contractual framework advocated by Bratton and Wachter and SIFMA:

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[213] Andrew F. Tuch, *Disclaiming Loyalty: M&A Advisors and Their Engagement Letters: In Response To William W. Bratton & Michael L. Wachter, Bankers and Chancellors*, 93 TEX. L. REV. SEE ALSO 211 (2015).
[214] Andrew F. Tuch, *Banker Loyalty in Mergers and Acquisitions*, 94 TEX. L. REV. 1079, 1154 (2016) [hereinafter *Banker Loyalty*].
[215] *See* Brief of the Securities Industry and Financial Markets Association As *Amicus Curiae* in Support of Appellant in Support of Reversal at 7, RBC Capital Markets, LLC v. Jervis, C.A. No. 140, 2015 (Del. May 28, 2015).

> The trial court's [gatekeeper] description does not adequately take into account the fact that the role of a financial advisor is primarily contractual in nature, is typically negotiated between sophisticated parties, and can vary based upon a myriad of factors. Rational and sophisticated parties dealing at arm's-length shape their own contractual arrangements and it is for the board, in managing the business and affairs of the corporation, to determine what services, and on what terms, it will hire a financial advisor to perform in assisting the board in carrying out its oversight function.[216]

The next move in the scholarly debate was by Professor Deborah DeMott, who wrote two essays in the aftermath of the Supreme Court decision in *Rural/Metro*.[217] Both essays argued that RBC was an intentional tortfeasor and that the finding of liability against RBC fell comfortably within established categories of intentional tort. "Thus framed, the outcomes in recent M&A cases are not departures from well-established tort doctrine."[218] Professor DeMott added the following gloss to footnote 191 of the Supreme Court decision: "knowingly to dupe one's client to its detriment constitutes an intentional tort that carries legal consequences, which are likely to follow regardless of how the parties' contractual arrangements defined the advisor's responsibilities."[219]

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[216] *Rural/Metro*, 129 A.3d at 865 n.191 (citing Bratton & Wachter, *supra* note 211, at 36).
[217] Deborah A. DeMott, *Fiduciary Breach, Once Removed*, 94 TEX. L. REV. SEE ALSO 238 (2016) [hereinafter, "*Once Removed*"]; Deborah A. DeMott, *Culpable Participation in Fiduciary Breach*, ch. 11 in RESEARCH HANDBOOK ON FIDUCIARY LAW (D. Gordon Smith & Andrew S. Gold eds. 2018) [hereinafter, "*Culpable Participation*"].
[218] DeMott, *Culpable Participation*, *supra* note 218, at 219.
[219] DeMott, *Once Removed*, *supra* note 218, at 248.

DeMott's grounding of banker misconduct under the heading of intentional tort helps explain why intentional misconduct by a financial advisor is actionable outside of contract law. "By committing an intentional tort, accessory actors breach duties they themselves owe."[220] Stockholders of the financial advisor's client are logical plaintiffs for a claim of intentional tort. "[W]e have a right 'good against the world' not to be the subject of another's action that constitutes an intentional tort."[221] "Actors who culpably participate in a fiduciary's breach themselves, as intentional tortfeasors, breach a duty to the fiduciary's beneficiary; they contravene the beneficiary's right not to be mistreated in this particular fashion."[222]

DeMott's two essays identify three intentional torts that can be applicable to financial advisor misconduct—aiding and abetting breach of fiduciary duty, fraud, and intentional interference with contract. Each of these torts has its shortcomings for purposes of identifying a claim of general applicability.

DeMott defends the Delaware courts' reliance on aiding and abetting doctrine. "[T]he salience of this tort to recent M&A litigation represents neither a doctrinal innovation nor an extension of prior law, just the application of well-settled tort doctrine to conduct in connection with a large transaction in which

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[220] DeMott, *Culpable Participation*, *supra* note 218, at 219.
[221] *Id.* at 229 (quoting ROBERT STEVENS, TORTS AND RIGHTS 100 (2007)).
[222] *Id.* at 237.

most—but not all—of the target's directors were negligent, not conflicted or otherwise disloyal."[223] But as discussed above in Parts III.A. and III.B., outside of the *Revlon* context or the duty of disclosure context, negligence by a fiduciary is not sufficient to state a claim for breach of fiduciary duty.

DeMott notes that the intentional tort of fraud has particular resonance in *Rural/Metro*. "[T]he Supreme Court's factual narrative underlies its parsing of elements requisite for aiding-and-abetting liability in terms that appear congenial to a complementary account of liability—fraud—to sustain the judgment against the appellant…. Knowingly to mislead another through a material misrepresentation to induce that person to act or refrain from acting is a predicate of common law fraud."[224] However, it is problematic for the stockholder of the client corporation to assert a claim of fraud against the financial advisor:

> [O]nly the recipient of a fraudulent misrepresentation may recover against the maker of the statement. The required match between the recipient, reliance, and loss suffered through reliance is not a perfect fit with the configuration in *RBC Capital*, in which the target's directors were the recipients of the misrepresentations but the loss was suffered by the shareholders whose company was sold. For this reason (and no doubt others) aiding and abetting a breach of fiduciary duty is a more plausible theory of liability.[225]

[223] *Id.* at 231.

[224] DeMott, *Once Removed*, *supra* note 218, at 243-44 (footnotes omitted).

[225] *Id.* at 244 n.39 (citing RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. HARM § 11 (Tentative Draft No. 2, 2014)). This doctrinal issue does not appear insuperable, especially if a stockholder/director is defrauded, or if the fraud is transmitted to the stockholder through a proxy statement. "To recover under this Section, a plaintiff's reliance may be indirect; in other words, the plaintiff may in

DeMott points to wrongful interference with contract as an intentional tort that may apply to financial advisor misconduct when the client is an alternative entity that disclaims the existence of fiduciary duties. "It's hard to see a principled basis for a categorical exclusion of accessory liability in the alternative-entity world. After all, unjustified interference with another party's contractual rights is a well-established tort."[226] The absence of an express contractual standard in a limited liability company agreement or limited partnership agreement is no barrier to accomplice liability in tort against the financial advisor: "[T]ortious interference claims are not limited to expressly delineated contractual terms but extend to the implied covenant of good faith and fair dealing…. By attempting to take advantage of a procedure specified in a contractual variant of fiduciary duty—such as obtaining a fairness opinion from a qualified financial advisor to bless a conflicted M&A transaction—a general partner may breach the implied covenant when its conduct is arbitrary or unreasonable."[227] Again, accomplice liability

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some cases rely on a statement received second-hand." RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. HARM § 11 cmt. b (Tentative Draft No. 2, 2014). The doctrine of *Lewis v. Anderson*, 477 A.2d 1040 (Del. 1984), is a sturdy barrier against the maintenance post-merger of a stockholder derivative claim for fraud, professional negligence, or breach of contract against a financial advisor.

[226] DeMott, *Culpable Participation*, *supra* note 218, at 237.

[227] *Id.* at 227-36 (citing NAMA Holdings, LLC v. Related WMC LLC, 2014 WL 6436647 (Del. Ch. Nov. 17, 2013), and Gerber v. Enterprise Holdings, LLC, 67 A.3d 400, 420 (Del. 2013), *overruled on other grounds by* Winshall v. Viacom Int'l, Inc., 76 A.3d 808 (Del. 2013)).

against the financial advisor depends on a finding of misconduct by the general partner.[228]

DeMott's discussion of how the above doctrines of intentional tort support existing Delaware case law suggests a basis for extending the law. The *TIBCO* problem exists due to the lack of a recognized intentional tort for knowing misconduct that corrupts board decision-making, regardless of the culpability of the board. Such a claim of intentional tort would allow a stockholder of a corporation whose board was duped by a self-interested financial advisor to sue the financial advisor without running afoul of the economic loss rule.[229]

Recognizing a tort of fraud on the board is tantamount to recognizing that stockholders have a protected expectancy that disinterested, fully informed directors, when presented with a potential M&A transaction, will choose what they perceive to be the value-maximizing alternative.[230] A financial advisor that

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[228] The Court of Chancery recently sustained a claim against a financial advisor to a special committee established by a general partner of a limited partnership for aiding and abetting the general partner's breach of contractual fiduciary duties, *see* Mesirov v. Enbridge Energy Co., Inc., 2018 WL 4182204, at *13-16 (Del. Ch. Aug. 29, 2018), while dismissing a claim for intentional interference with contract, in the absence of allegations that the financial advisor's "sole motivation in providing its fairness opinion was to interfere with the [contract]," or that the financial advisor "intentionally acted against the best interests of its client" or "actually counseled" the general partner to breach the limited partnership agreement, *id.* at *17.

[229] *See supra* note 166 and accompanying text.

[230] *See, e.g.*, *In re Activision Blizzard, Inc. S'holder Litig.*, Cons. C.A. No. 8885-VCL, tr. at 112 (Del. Ch. June 6, 2014) ("What the stockholders had before was

defrauds a board into making a value-destroying choice would be answerable in tort to any proper plaintiff who suffers an injury proximately caused by the fraud.

Section 17 of the draft RESTATEMENT (THIRD) OF TORTS: LIABILITY FOR ECONOMIC HARM, entitled "Interference with Economic Expectation," provides as follows:

> A defendant is subject to liability for interference with economic expectation if:
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> (a) the plaintiff had a reasonable expectation of an economic benefit from a relationship with a third party;
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> (b) the defendant committed an independent and intentional legal wrong;
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> (c) the defendant intended to interfere with the plaintiff's expectation; and
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> (d) the defendant's wrongful conduct caused the expectation to fail.[231]

Section 17 "generally involves cases in which a defendant's intentional wrong prevents the plaintiff from making a contract with another party or otherwise pursuing economic gain."[232] Notably, the plaintiff may be injured as a consequence of a defendant's fraud directed at a third party:

> ***The rationale for such liability is strongest when a defendant commits a wrong that injures the plaintiff, but for which the plaintiff cannot sue directly because the immediate victim of the wrong was someone else.*** If a defendant commits a fraud against a

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shares that included a range of possible expectancies. Even in the nonfiduciary context, we recognize claims when people tortiously interfere with business expectancies.")

[231] RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON HARM § 17 (Tentative Draft No. 3, 2014).

[232] *Id*. cmt. a.

> third party, and as a result the third party cancels a planned transaction with the plaintiff, the plaintiff cannot sue the defendant for fraud. But the fraud may have caused great damage to the plaintiff, and less damage—possibly none—to the third party who was the immediate victim…. It is true that a plaintiff ordinarily cannot sue to recover for economic losses that result from a tort committed against someone else…. But ***when the defendant's misconduct is intentional and satisfies the other elements of this Section, the case for recovery is compelling***.
>
> …
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> … For example, a defendant may be held liable under this Section for making fraudulent statements to a third party that interfere with the plaintiff's business expectation, and the claim survives even if the third party suffered no damage and so would not be able to sue for fraud….[233]

One fact situation that falls within the language and stated rationale of Section 17 would be a disappointed suitor who is injured by a financial advisor who fraudulently foists an alternative, inferior merger transaction on its client. The disappointed suitor can assert a claim against the financial advisor. One of the illustrations to Section 17 reads in part: "Consultant receives an attractive bid from Buyer and is poised to submit the bid with a favorable recommendation to Corporation. Rival then bribes Consultant to make Buyer's bid less attractive by falsifying its terms."[234] In such circumstances, Consultant is subject to liability to Buyer.

Put differently, Section 17 allows a disappointed suitor to sue the financial advisor of a prospective merger partner for fraud on the board of directors of the

[233] *Id.* cmt. b (citations omitted) (emphasis added).
[234] *Id.* ill. 19.

prospective merger partner. There exists a strong analogy between a fraud-on-the-board claim brought by a disappointed suitor and the same claim brought on behalf of a stockholder of the prospective merger partner. The immediate victim of the fraud is the board of directors of the prospective merger partner, but the duped directors suffer no injury. A permissible plaintiff is the disappointed suitor. Can a stockholder of the prospective merger partner also bring suit?

The stockholders are injured by having an inferior transaction foisted on them. The stockholders have a reasonable expectation that a deal will be pursued if and only if it is superior to the available alternatives. If the financial advisor has committed an "independent and intentional legal wrong" (*e.g.*, fraud on the board), and has done so for the purpose of selfishly pursuing an inferior alternative, then the stockholders are deprived of the benefit from the superior alternative. The case for recovery would seemingly be as compelling as the claim brought against the financial advisor by the disappointed suitor.

It would be incongruous for the law to give greater protection to the disappointed suitor than it does to the stockholder of the prospective merger partner. After all, the most sympathetic plaintiffs in the hostile takeover battles of the 1980s were disappointed suitors who were being prevented from consummating superior transactions. The disappointed suitors, such as Mills Acquisition Co. in the *Macmillan* litigation, sued in their capacity as minority stockholders who had purchased nominal stakes in their prospective merger partners, not as disappointed bidders. They brought breach of fiduciary duty claims, not claims for interference with economic expectation.

Tort law (*i.e.*, Section 17) does not require that the defrauded immediate victim be culpable in order for the injured plaintiff to maintain a claim against the defendant that committed the fraud. It would be consistent with tort law to eliminate the element of director culpability in a stockholder claim based on tortious interference with the deliberative process of disinterested, independent directors.

Moreover, as discussed in Part I, *supra*, our current stockholder litigation regime can be reconceived as protecting an expectancy of stockholders that the board of directors (or special committee of the board) negotiating on their behalf has not been defrauded or coerced and is not engaged in fraud or coercion. Judicial protection of that stockholder expectancy should not turn on the identity of the person or persons who are committing tortious misconduct directed against the board of directors. A stockholder's ability to challenge a transaction tainted by fraud on the board should not turn on whether the fraud was committed by a fiduciary or a financial advisor, or whether the directors were culpable participants in the fraud committed by the financial advisor. The operative claim is that a defendant's intentional misconduct that constitutes an independent legal wrong (*i.e.*, fraud or coercion) tortiously interfered with the deliberative processes of the board of directors and proximately caused damage to the stockholders or the corporation.

CONCLUSION

This article is the third in a trilogy about the contested legacy of *Rural/Metro*.[235] Is *Rural/Metro* a case about an aberrant set of facts litigated under near-obsolete procedural rules (*i.e.*, expedited discovery in anticipation of a disclosure settlement, objector discovery, *Revlon* enhanced scrutiny, no *Corwin* defense), or is its affirmed finding of an "illicit manipulation of the Board's deliberative processes for self-interested purposes"[236] revelatory of an omnipresent temptation for fiduciaries and their advisors that corporate law properly aims to deter and remedy? This article argues in favor of confronting the enduring problem of tortious misconduct that corrupts board decision-making.

[235] *See* Friedlander, *How* Rural/Metro *Exposed the Systemic Problem of Disclosure Settlements*, *supra* note 132; Friedlander, *Vindicating the Duty of Loyalty*, *supra* note 17 (arguing that *Rural/Metro* and other recent data points of successful stockholder litigation should be considered in any discussion of stockholder litigation reform).

[236] *Rural/Metro*, 129 A.3d at 863.