HOW UNDERSTANDING THE NATURE OF CORPORATE NORMS CAN PREVENT THEIR DESTRUCTION BY SETTLEMENTS

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ABSTRACT

Scholars have long celebrated the importance of norms in corporate law. Indeed, norms likely guide corporate actors more than the omnipresent threat of shareholder suits. This Article divides corporate norms into two distinct groups: aspirational norms and arbiter norms. Aspirational norms announce socially desirable objectives for corporate managers and encourage certain disclosure practices; arbiter norms identify distinct transactions for closer scrutiny by an independent body, the court. This Article shows that even though aspirational norms and arbiter norms serve different objectives, they share a common characteristic—overbreadth. This feature exists whether the norm is set forth by statute or found in judicial doctrine. Such overbreadth explains some, but by no means all, of the problems accompanying shareholder litigation, including the frequency of suits and inconsequential settlements. This Article also develops the paradoxes that accompany corporate norms.

The inherent overbreadth of both aspirational and arbiter norms can be of great assistance to their protection against inconsequential settlements. Using the recent decision In re Trulia, Inc. Stockholder Litigation*, this Article addresses how courts can fulfill their role in the non-adversarial setting of the settlement hearing. When asked to approve a settlement, the court should anchor its scrutiny of the adequacy and reasonableness of a settlement in the norm that is central to the suit. By doing so, the court can more positively contribute to the ongoing development of corporate norms.*

INTRODUCTION

We are now in the fifth decade of lamenting our litigious society; critics claim we are in the grips of a self-interested legal profession that

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feeds itself on the rising tide of litigation, profiting lavishly by both the prosecution and defense of baseless suits.[1] Even though this is a proposition that is hotly debated, a variety of legal reforms have nonetheless been founded on the idea that there are too many suits brought in every imaginable arena.[2]

Beginning in 1973, judges and academics raised attention—indeed, alarm—regarding the litigiousness of American society based on the perceived explosion of civil litigation that was burying the courts.[3] For the next fifty years there was concern that the demand for justice was growing at a faster pace than society's willingness to provide resources to meet the rising demand. There are multiple causes of the increase in suits, including the explosion of rights created by courts and legislatures; the concomitant rise in expectations fed by law reform efforts throughout the 1950s, 1960s, and 1970s; the growing attention that the media has accorded the law; the explosive growth in the number of lawyers (and their newly recognized freedom to advertise); and the ability to vindicate mass torts such as asbestos and intrauterine-device claims.[4] Court backlogs grew visibly, as did the cries that too

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1. For an early claim of excessive civil litigation, see Maurice Rosenberg, *Let's Everybody Litigate?*, 50 TEX. L. REV. 1349, 1349–51 (1972). Even a former vice president boldly embraced the view of the country being overtaken by an avalanche of litigation. *See* Dan Quayle, *Civil Justice Reform*, 41 AM. U. L. REV. 559, 560 (1992) ("Few would dispute the proposition that America has become a litigious society . . . ."). For a critical analysis of the data on which the litigiousness claims are based, see WILLIAM HALTOM & MICHAEL MCCANN, DISTORTING THE LAW: POLITICS, MEDIA, AND THE LITIGATION CRISIS 73–109 (2004); *see also* Marc Galanter, *Reading the Landscape of Disputes: What We Know and Don't Know (and Think We Know) About Our Allegedly Contentious and Litigious Society*, 31 UCLA L. REV. 4, 69–71 (1983) (combatting the "litigation explosion" theory and instead arguing that the rise in litigation is "an adaptive (but not necessarily optimal) response to a set of changing conditions").

2. *See, e.g.*, Class Action Fairness Act of 2005, Pub. L. No. 109-2, §§ 2, 4, 119 Stat. 4, 4–5, 10 (amending 28 U.S.C. §§ 1332, 1339(d), 1453, 1711–15) (granting federal courts jurisdiction over class action suits in which at least one hundred plaintiffs seek damages in excess of $5 million, and calling for closer review of settlements, as part of a tort reform effort sparked by concerns about abuses within the state judicial system); Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, § 2, 112 Stat. 3227, 3227 (amending scattered sections of 15 U.S.C.) (authorizing the removal of class actions to federal court in certain securities contexts, so as to prevent plaintiffs from avoiding the restrictions introduced by the Private Securities Litigation Reform Act); Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, § 101, 109 Stat. 737, 737–43 (codified as amended in 15 U.S.C.) (adding provisions directed to the prosecution of securities fraud claims).

3. *See, e.g.*, HENRY J. FRIENDLY, FEDERAL JURISDICTION: A GENERAL VIEW 20–23 (1973) (discussing a range of social, legislative, and judicial developments contributing to a significant increase in cases before the federal courts); John H. Barton, *Behind the Legal Explosion*, 27 STAN. L. REV. 567, 567 (1975) (discussing the recent "legal explosion" and growth in caseloads).

4. *See* Arthur R. Miller, *The Pretrial Rush to Judgment: Are the "Litigation Explosion," "Litigation Crisis," and Efficiency Clichés Eroding Our Day in Court and Jury Trial*

many complaints found their way into the courts. Leading commentators, such as Professors Arthur Miller and Marc Galanter, have produced substantial scholarship and supporting data demonstrating that the litigation explosion is more myth than reality.[5] Nonetheless, the image of a litigation explosion continues today.

Corporate law is very much a part of, if not now central to, the litigation-explosion debate. Congress addressed a rather narrow corner of the litigation spectrum—securities fraud suits, particularly those maintained as class actions—with the Private Securities Litigation Reform Act of 1995 (PSLRA).[6] The hearings leading up to the passage of the PSLRA,[7] and the committee report accompanying the final version of the legislation,[8] are replete with calls to winnow the number of securities fraud suits. Unlike other areas in which congressional action produced few observable impacts, the PSLRA changed the landscape dramatically. For example, in just a few years following the passage of the PSLRA, the rate at which defendants prevailed on motions to dismiss in securities class actions nearly doubled.[9]

Commitments?, 78 N.Y.U. L. REV. 982, 989–92 (2003) (identifying these and other reasons for the salience the litigation-explosion charge enjoys).

5. Professor Miller observes that despite the U.S. litigation rate increasing since the 1950s, the rate is "not higher than it has been during other periods of American history, and, per capita, is in the same range as other industrialized countries' rates." *Id.* at 993–94 (footnote omitted). Professor Galanter observes that growth in case filings can be the result of unique developments; for example, he reports that 75 percent of the cases between 1975 and 1985 were explained by five categories that included prisoner petitions, social security, and civil rights cases. Marc Galanter, *The Day After the Litigation Explosion*, 46 MD. L. REV. 3, 17 (1986). His point is that the clustering of cases occurs over time and reflects not a societal predisposition to litigation, but rather the "ebb-and-flow" societal forces and developments that produce injuries and claims for redress. *Id.* at 28. For example, more than a quarter of the tort filings (one of the five categories he identified as driving most of the increase in filings) were prompted by the publicity of the harms of asbestos and the approaching expiration of the statute of limitations. *Id.* at 24.

6. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.).

7. *See, e.g.*, *Securities Litigation Reform: Hearings Before the H. Subcomm. on Telecomm. and Fin. of the Comm. on Energy and Commerce*, 103d Cong. at 18 (1994) (statement of Hon. Ralph Hall); *Private Litigation Under the Federal Securities Laws: Hearings Before the Subcomm. on Secs. of the S. Comm. on Banking, Housing, and Urban Affairs*, 103d Cong. at 2 (1993) (statement of Sen. Chris Dodd); STAFF OF S. SUBCOMM. ON SECS. OF THE COMM. ON BANKING, HOUSING & URBAN AFFAIRS, 103D CONG., REP. ON PRIVATE SECURITIES LITIGATION (May 17, 1994).

8. *See generally* H.R. REP. NO. 104-369 (1995) (Conf. Rep.) (discussing the inclusion of numerous sections intended for the "reduction of abusive litigation").

9. *Compare* RONALD I. MILLER, TODD FOSTER & ELAINE BUCKBERG, NERA ECON. CONSULTING, RECENT TRENDS IN SHAREHOLDER CLASS ACTION LITIGATION: BEYOND THE MEGA-SETTLEMENTS, IS STABILIZATION AHEAD? 4 (2006), http://www.nera.com/content/dam/nera/publications/archive1/BRO_RecentTrends2006_SEC979_PPB-FINAL.pdf [https://perma.

But not all efforts to reduce the frequency of corporate litigation are legislative. The Supreme Court has weighed in mightily to reduce the scope of the fraud provisions of the Securities Act[10] and the Securities Exchange Act,[11] and has justified the resulting standard as a means of reducing the frequency of litigation.

Most recently, the litigation-explosion debate has centered on state-based litigation in connection with mergers and acquisitions transactions.[12] Most noticeable in this area are the dramatic changes in corporate deal litigation. Consider that from 1999 to 2000 only 12 percent of deals involved litigation, and most of the deal litigation not only involved Delaware firms but also took place in Delaware.[13] Suits were consequential then, because firms that were sued experienced a statistically significant higher incidence of deals that did not close, and deals that did close yielded their shareholders increased returns. Hence, the deal-focused suits in that former era could be seen, on the whole, as positive.[14]

However, at the beginning of this decade, the frequency and composition of deal-focused litigation dramatically changed. For example, Matthew Cain and Professor Steven Davidoff Solomon report that in 2012, there were 121 transactions worth over $100

cc/N9BM-BWFQ] (reporting a dismissal rate of 40.3 percent for securities class actions filed from 1998 to 2003), *with* ELAINE BUCKBERG, TODD FOSTER & RONALD I. MILLER, NERA ECON. CONSULTING, RECENT TRENDS IN SHAREHOLDER CLASS ACTION LITIGATION: ARE WORLDCOM AND ENRON THE NEW STANDARD? 3 (2005), http://www.nera.com/content/dam/nera/publications/archive1/Recent_Trends_07.2005.pdf [https://perma.cc/6ZRK-6KEQ] (reporting a dismissal rate of 20.3 percent for securities class actions filed from 1991 to 1995).

10. Gustafson v. Alloyd Co., 513 U.S. 561, 583–84 (1995) (narrowing the scope of Securities Act section 12(a)(2) to public offers that are registered or that are public in nature but qualify for an exemption from registration); Pinter v. Dahl, 486 U.S. 622, 654–55 (1988) (limiting defendants under Securities Act section 12 to those who transfer title or solicit for financial gain).

11. Stoneridge Inv. Partners, LLC v. Sci.-Atlanta, Inc., 552 U.S. 148, 158–63 (2008) (explaining that if one actively participates in a scheme to defraud, but does not make the document that misled the plaintiff, there is no violation of the antifraud provision); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 731–55 (1975) (limiting standing under the antifraud provision to those who purchase or sell in connection with the fraud).

12. Indeed, within the long shadow of securities litigation, we find seemingly parasitic tagalong derivative suits that seek relief based on failures of oversight on the part of the board of directors of companies settling securities fraud suits, in which plaintiffs allege that various lapses contributed to the misrepresentations that gave rise to the securities violation. *See* Stephen J. Choi, Jessica Erickson & Adam C. Pritchard, *Piling On? An Empirical Study of Parallel Derivative Suits* 2–4 (NYU Law and Econ. Research Paper Series, Working Paper No. 16-05, 2016), https://ssrn.com/abstract=2703509 [https://perma.cc/Z4QV-WGJ8].

13. C.N.V. Krishnan, Ronald W. Masulis, Randall S. Thomas & Robert B. Thompson, *Shareholder Litigation in Mergers and Acquisitions*, 18 J. CORP. FIN. 1248, 1250–54 (2012).

14. *Id.*

million, and 111 of them experienced deal litigation.[15] They also found that shareholder suits accompanied 92 percent of mergers and acquisitions transactions in excess of $100 million.[16] Moreover, about 50 percent of these deals resulted in litigation in more than one jurisdiction.[17] Thus, we find ample reason to believe that more is afoot in corporate litigation than an abundance of potential wrongdoing. The combined evidence of tagalong suits, the rapid increase in the percentage of deals breeding litigation, and the fact that multiple suits are filed in multiple forums invite the supposition that the explosion of litigation is driven by the quest for fees and not a rise in fiduciary misconduct.

The explosion in the volume of deal-related litigation is not the only suggestion that such litigation is an abuse of process. An important study by Professors Jill Fisch, Sean Griffith, and Steven Davidoff Solomon also piques concern. The study closely examined 453 acquisitions from 2005 through 2012, 319 of which involved deal-related litigation.[18] The authors found that amendments of the merger terms did not appear to increase shareholder approval of the merger. This is startling because improving merger terms would be expected to increase support among shareholders.[19] The authors also studied the impact of additional disclosure that was provided through settlement

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15. Matthew D. Cain & Steven M. Davidoff Solomon, *Takeover Litigation in 2013*, at 1–2 (The Ohio State Univ. Moritz Coll. of Law Pub. Law & Legal Theory Working Paper Series, Paper No. 236, 2014), https://ssrn.com/abstract=2377001 [https://perma.cc/TSF4-S738]; *see also* ROBERT M. DAINES & OLGA KOUMRIAN, CORNERSTONE RESEARCH, SHAREHOLDER LITIGATION INVOLVING MERGERS AND ACQUISITIONS: REVIEW OF 2012 M&A LITIGATION 1 (2013) http://www.cornerstone.com/Publications/Reports/2012-Shareholder-Litigation-Involving-M-and-A.pdf [https://perma.cc/5HFW-UBGJ] ("Among deals valued over $100 million, 93 percent were challenged, with an average of 4.8 lawsuits filed per deal."). For speculation on the underlying causes of these developments, see John Armour, Bernard Black & Brian Cheffins, *Is Delaware Losing Its Cases?*, 9 J. EMPIRICAL LEGAL STUD. 605, 643–51 (2012); Sean J. Griffith & Alexandra D. Lahav, *The Market for Preclusion in Merger Litigation*, 66 VAND. L. REV. 1053, 1066–70 (2013); Randall S. Thomas & Robert B. Thompson, *A Theory of Representative Shareholder Suits and Its Application to Multijurisdictional Litigation*, 106 NW. U. L. REV. 1753, 1788–91 (2012).

16. Cain & Davidoff Solomon, *supra* note 15, at 2.

17. *Id.*

18. Jill E. Fisch, Sean J. Griffith & Steven Davidoff Solomon, *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 TEX. L. REV. 557, 579 (2015).

19. *Id.* at 585–87. While disclosure-only settlements yielded no statistically significant impact on negative voting, as hypothesized, the amendment of merger agreements prompted more votes overall, including more "yes" votes. *Id.* Settlements that improved merger consideration produced more observable voting changes than settlements that changed merger terms, but they did not change the amount of consideration. *Id.*

of the litigation. Information provided through settlements customarily reveals negative information about the deal or qualifies the information provided by management. Even though the authors expected that such additional disclosures would negatively impact shareholder approval, they found only slight evidence of such an impact.[20] In combination, their findings raise the question of whether deal litigation resulting only in additional disclosure is socially harmful because it produces no observable benefits.

We thus see history repeating itself in the corporate deal context, as we witness another explosion of litigation in a very short time period. Part I of this article reviews recent trends in deal-focused litigation, highlighting recent reforms that impact the frequency of suits. Others have noted that a possible explanation for the earlier rise, and the more recent ebb, of deal litigation is the ways in which these legal developments have affected the incentives of plaintiffs' counsel in these suits. This Article, while not disagreeing with this assessment, adds a new perspective on what we witnessed. Part II argues that corporate norms are at the core of any perceived litigiousness in the corporate realm. The Article separates the norms into two distinct groups: "aspirational norms" and "arbiter norms." While these two groups are distinct from one another, they share a common feature—inherent overbreadth—which invites litigation that produces inconsequential results. Part III probes several paradoxical qualities of corporate norms. These paradoxes suggest that corporate norms are more fragile than we might believe desirable, so courts should be even more attentive to nurturing them. In Part IV, the Article concludes by examining how to prevent weaknesses in the settlement process from consuming corporate norms. It proposes that any review of a settlement must focus on the norm that is central to the suit, rather than on the settlement's terms themselves.

I. STEPS TAKEN TO STEM THE RISING TIDE OF DEAL LITIGATION

The most glaring statistic within the deal-litigation data set is that deals invariably attract not only litigation, but litigation occurring in multiple forums. In 2012, 93 percent of mergers and acquisitions deals worth more than $100 million were accompanied by shareholder suits (the percentage rose to 96 percent for deals exceeding $500 million),

20. *Id*. at 561.

with an average of 4.8 suits filed per transaction.[21] Although Delaware's share of multiforum suits grew from 2009 to 2012, a significant percentage of such suits spilled across state lines,[22] challenging comity as competing forums each jealously regarded their jurisdictional interests. Invariably, the court of the corporation's domicile believes it should enjoy the dominant voice in the dispute.[23]

The multiforum aspect of the litigation-explosion debate has now been sensibly dealt with by the prevalence of forum-selection bylaws.[24] Since 2015, a Delaware statute[25] has authorized forum-selection bylaws, and such provisions have been judicially approved since at least 2013.[26] Though there are many varieties of forum-selection bylaws, the

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21. DAINES & KOUMRIAN, *supra* note 15, at 1.

22. *Id.* at 2.

23. *See generally* La. Mun. Police Emps., Ret. Sys. v. Pyott, 46 A.3d 313 (Del. Ch. 2012), *rev'd*, 74 A.3d 612 (Del. 2013) (illustrating that a court of corporate domicile, Delaware, cannot ignore another court's dismissal of a case, even when the Delaware court believes that the other court misapplied Delaware law). While the Delaware-based litigation resulted in a dismissal, the California federal district court was reversed. *See* Rosenbloom v. Pyott, 765 F.3d 1137, 1141–42 (9th Cir. 2014). *See generally* George S. Geis, *Shareholder Derivative Litigation and the Preclusion Problem*, 100 VA. L. REV. 261 (2014) (describing the preclusive nature of shareholder litigation).

24. The call for such bylaws and their justification was sensibly developed in Joseph A. Grundfest, *The History and Evolution of Intra-Corporate Forum Selection Clauses: An Empirical Analysis*, 37 DEL. J. CORP. L. 333 (2012), which traces the development and pattern of early forum-selection bylaws.

25. Act of June 24, 2015, 80 Del. Laws, ch. 40, § 3 (codified at DEL. CODE ANN. tit. 8, § 109 (2015)). Although I recognize the desirability of forum-selection bylaws, I continue to take issue with the notion that such bylaw provisions are contractually based. Although the statute in Delaware now authorizes such provisions, that statute only applies to Delaware corporations, does not directly address the propriety—let alone the wisdom—of the board unilaterally initiating a provision that changes a long-standing feature of the shareholder franchise, and it does not address other bylaw initiatives that boards may undertake that intrude on prerogatives of the shareholders. *See* James D. Cox, *Corporate Law and the Limits of Private Ordering*, 93 WASH. U. L. REV. 257, 290–91 (2015). And the question of consent related to the board's unilateral adoption of such a provision is questionable. *See* Deborah A. DeMott, *Forum-Selection Bylaws Refracted Through an Agency Lens*, 57 ARIZ. L. REV. 269, 274–75 (2015) (explaining that a grant of authority to a board to amend bylaws is too attenuated for shareholders to expect that the authority would be exercised to change the rules by which shareholder suits can be maintained); Lawrence A. Hamermesh, *Consent in Corporate Law*, 70 BUS. LAW. 161, 168–73 (2014) (explaining that consent is central to governance so that such a bylaw provision is vulnerable on this requirement). Indeed, a board's unilateral adoption of such a sensible provision raises important governance questions flowing from why the board did not seek shareholder approval.

26. Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 942–43, 963 (Del. Ch. 2013). An important impetus for the widespread early adoption of forum-selection bylaws was dicta provided by Vice Chancellor Laster. *See In re* Revlon, Inc. S'holders Litig., 990 A.2d 940, 960 (Del. Ch. 2010) ("[I]f boards of directors and stockholders believe that a particular forum would provide an efficient and value-promoting locus for dispute resolution, then corporations are free to respond with charter provisions selecting an exclusive forum for intra-entity disputes.").

most common provision reflects a preference for the forum of the state of incorporation[27] while also according the board of directors authority to "waive" the selected forum in favor of another forum where a suit is pending.[28]

Another significant development is a 2016 Delaware decision, *In re Trulia, Inc. Stockholder Litigation*,[29] which confronted concerns associated with the rise of disclosure-only settlements. The court established a new and heightened standard by which "disclosure-only settlements" are evaluated.[30] The previously well-established standard in Delaware for judicial review of settlements inquired broadly into "the reasonableness of the 'give' and the 'get'"[31] when evaluating the claim and possible defenses. But in *Trulia, Inc.*, Chancellor Bouchard aimed squarely at the concerns captured in the data examined by Fisch, Griffin, and Davidoff Solomon, holding that disclosure-only settlements must satisfy a newly established "plainly material" standard whereby

> the supplemental disclosures address a plainly material misrepresentation or omission, and the subject matter of the proposed release is narrowly circumscribed to encompass nothing more than disclosure claims and fiduciary duty claims concerning the sale process, [provided that] the record shows that such claims have been investigated sufficiently.[32]

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27. *See, e.g.*, CLAUDIA H. ALLEN, CONF. BD. GOVERNANCE CTR., TRENDS IN EXCLUSIVE FORUM BYLAWS 4 (2014), http://ssrn.com/abstract=2411715 [https://perma.cc/Y9CK-YFFW] (relating a shift from specifying the Delaware Court of Chancery as the exclusive forum to naming courts in the state as a whole). A bylaw choosing the state court of the company's principal place of business has also been upheld. City of Providence v. First Citizens BancShares, Inc., 99 A.3d 229, 240 (Del. Ch. 2014) (upholding a North Carolina designation for a Delaware-incorporated firm).

28. *See* Joseph A. Grundfest & Kristen A. Savelle, *The Brouhaha over Intra-Corporate Forum Selection Provisions: A Legal, Economic, and Political Analysis*, 68 BUS. LAW. 325, 402 (2013) (observing that such a waiver provision is akin to the "fiduciary out" clause that is frequently required for contracts and bylaw provisions that can restrain boards from choosing a course of action that on the particular set of facts is in the better interests of the corporation).

29. *In re* Trulia, Inc. Stockholder Litig., 129 A.3d 884 (Del. Ch. 2016).

30. *Id.* at 891. The broad criteria for settlements is set forth in *Kahn v. Sullivan*, 594 A.2d 48, 53–58 (Del. 1991).

31. *In re Trulia, Inc.*, 129 A.3d at 891 (quoting *In re* Activision Blizzard Inc. S'holder Litig., 124 A.3d 1025, 1043 (Del. Ch. 2015)).

32. *Id.* at 898. *Trulia, Inc.* and Chancellor Bouchard join a distinctive line of recent cases questioning such settlements. *See* Joel Edan Friedlander, *How* Rural/Metro *Exposed the Systemic Problem of Disclosure Settlements*, 40 DEL. J. CORP. L. 877, 904 (2016) (closely reviewing numerous recent Delaware opinions that have not only cast a skeptical eye toward settlements

Trulia, Inc. is a structured response to the malaise among courts that have increasingly approached disclosure-only settlements skeptically.[33] Disclosure-only settlements provide supplemental disclosures to the shareholders but do not change the amount of consideration or other deal terms for the challenged transactions, and are quite common in suits in the mergers and acquisitions context.[34] Indeed, some commentators have even suggested a prophylactic approach of denying fee awards when only this remedy is extracted.[35] Disclosure-only settlements, especially in the context of the dramatic rise in deal-focused litigation, cast a dark shadow over shareholder litigation.[36] As discussed earlier, the study by Fisch, Griffin, and Davidoff Solomon found that disclosures provided as a consequence of settlements had very little impact on shareholder voting. This invites the question of why suits would be brought to produce a settlement—disclosure—that is inconsequential.

An irresistible explanation is the well-known problem of attorneys' incentives: defense lawyers are eager to enable their clients' transactions to proceed as agreed, so they offer plaintiffs' counsel insignificant disclosures as a small price to overcome the uncertainty of a trial and the costs of delaying the transaction until the matter is tried.

but many times have either rejected settlements or considered their weakness when considering fee requests from their counsel).

33. *See, e.g.*, *In re* Riverbed Tech., Inc. Stockholders Litig., No. 10484-VCG, 2015 WL 5458041, at *6 (Del. Ch. Sept. 17, 2015) (approving, reluctantly, support of such settlements in light of past precedents, but suggesting the force of the past is waning); *In re* Allied Healthcare S'holder Litig., No. 652188/2011, 2015 WL 6499467, at *2 (N.Y. Sup. Ct. Oct. 23, 2015) (rejecting a settlement with the observation that "in the area of derivative litigation, a culture has developed that results in cases of relatively worthless settlements (derivative actions are rarely tried to a verdict) that discontinue the action (with releases) resulting in the corporate defendants not opposing an agreed upon legal fee to class counsel").

34. One study found that in 81 percent of the settlements studied that disclosure was the only result produced in merger cases. DAINES & KOUMRIAN, *supra* note 15, at 6.

35. *See* Fisch et al., *supra* note 18, at 615 (suggesting that because disclosure-only settlements provide no change in voting outcomes, fee requests in disclosure-only settlements should be denied and disclosure-focused deal litigation should be transferred to the federal courts).

36. One deeply experienced jurist, Vice Chancellor Laster, laments that disclosure-only settlements are characterized by their nonadversarial nature, with pressures to settle created by expedited discovery as well as the deal's own timetable. J. Travis Laster, *A Milder Prescription for the Peppercorn Settlement Problem in Merger Litigation*, 93 TEX. L. REV. SEE ALSO 129, 149 (2015). Chief Justice Strine also emphasizes deal-related pressures adversely affecting the court or parties' ability to fully assess the benefits of disclosure. *See* Transcript of Settlement Hearing at 1, *In re* Monogram Biosciences, Inc. S'holder Litig., No. 4703-CC 2010 WL 9044697 (Del. Ch. Jan. 26, 2010) ("I'm not going to blow up this settlement about [the potential lack of corporate benefit]. This type of litigation puts defendants in an awkward situation and actually puts investors as a class in an awkward situation, because of the potential toll it extracts.").

Plaintiffs' counsel, preferring the certainty of a settlement and the award of fees, accepts the inconsequential settlement. Thus, disclosure-only settlements are an efficient medium for addressing deal litigation: the defense lawyers' clients are happy, and the plaintiffs' counsel are paid. As developed in the next Part, this perspective could be accurate, but cannot be assessed fully without a deep consideration of the underlying norms that are central to the dispute.

Disclosure-only settlements have caused concern because they frequently provide release of not just claims raised in the complaint, but of future claims that are broader than those alleged in the complaint.[37] The potential abuse here is in allowing defendants to escape penalties for their misconduct too easily because of a hasty settlement by plaintiffs' counsel. In this regard, note that under *Trulia, Inc.*, the release must be "narrowly circumscribed" to claims made regarding the challenged transaction, and those claims must have been "investigated sufficiently."[38] This is an important contribution of *Trulia, Inc.*'s formulation, and this feature of its approach is connected to the waiver provision that is prevalent in forum-selection clauses.

A fear endemic to multiforum litigation is the reverse auction, whereby defense counsel wrests a global settlement from one of the litigants, which leads to dismissal of suits in other forums where attorneys demanded better terms.[39] The Supreme Court entered this area in *Matsushita Industrial Co. v. Epstein*,[40] holding that full faith and credit must be accorded settlements, unless it is shown that the settled claim lacked adequate representation.[41] This is a difficult showing to

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37. Indeed, this was very much an issue in *In re* Trulia, Inc. Stockholder Litig., 129 A.3d 884, 890 (Del. Ch. 2016). *See, e.g.*, Transcript of Settlement Hearing and Rulings of the Court at 12, Haverhill Ret. Sys. v. Asali, No. 9474-VCL, 2015 WL 3582361 (Del. Ch. June 8, 2015) ("I mean, the biggest problem I have here is, it seems to me that you got a bunch of very little, and what you're giving is a broad release in the context of a company where its corporate governance doesn't inspire any confidence whatsoever." (quoting Vice Chancellor Laster)); s*ee* Sean J. Griffith, *Correcting Corporate Benefit: How to Fix Shareholder Litigation by Shifting the Doctrine on Fees*, 56 B.C. L. REV. 1, 16–17 (2015) ("Defendants typically insist upon and receive releases extending to 'all possible claims, known or unknown, asserted or unasserted, arising out of or relating to the events that were the subject of the litigation.'").

38. *In re Trulia, Inc.*, 129 A.3d at 898.

39. For an account of how a disclosure-only settlement was barely avoided in a matter that ultimately yielded a settlement approaching $100 million, see *supra* note 32.

40. Matsushita Elec. Indus. Co. v. Epstein, 516 U.S. 367 (1996).

41. *Id.* at 386–87 (upholding a Delaware state court's approval of a settlement that barred the prosecution of all claims, including those under federal securities law, arising from the same transaction, even though the jurisdiction for the prosecution of the securities law claims was exclusively in federal courts).

establish.[42] The waiver provisions in forum-selection clauses allow corporate counsel to sample the appetite for settlement among competing shareholder suits, raising the prospect that even meritorious claims will not be adequately redressed or inquiries into whether there are unasserted claims will never be allowed. Thus, wresting a sweeping settlement from an eagerly compliant plaintiff's counsel can be seen as purchasing "deal insurance."[43] *Trulia, Inc.* addresses the reverse auction by rejecting the settlement's inclusion of claims not framed in the complaint. To the extent *Trulia, Inc.* is followed, defendants are deterred from shopping among multiple plaintiffs raising differing claims with the intent of settling all claims with the most compliant plaintiff.

There is already evidence that growing skepticism of disclosure-only settlements and the ubiquity of forum-selection bylaws are having an impact on the volume and conduct of deal litigation. In 2015, the percentage of such suits declined to 87.7 percent of deals over $100 million, and the rate for the fourth quarter was 21.4 percent. There also was about a 50 percent decline in multijurisdiction litigation from the 2012 high.[44] The apparently downward trend in the volume of deal litigation caused by these two procedural developments is calming; however, the decline observed may be aberrational and, in any case, a decline in scale does not eradicate concern that the current approach nurtures bad settlements. This Article, by discussing how corporate norms facilitate seemingly inconsequential litigation, suggests how settlements can better be reviewed to strengthen norms and improve the conduct of shareholder suits.

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42. *See* Epstein v. MCA, Inc., 179 F.3d 641, 648 (9th Cir. 1999) (holding that the state court had addressed adequacy of counsel when approving the global settlement, so there could be no collateral attack on that determination).

43. Transcript of Settlement Hearing at 20, *In re* Intermune, Inc. Stockholder Litig., No. 10086-VCN, 2015 WL 9481182 (Del. Ch. July 8, 2015) ("This is a universal problem. The defendants want total peace. They do some . . . relatively minimal disclosures, and they buy deal insurance." (quoting Vice Chancellor Noble)); *see also* Transcript of Settlement Hearing at *1, *In re* Monogram Biosciences, Inc. S'holders Litig., No. 4703-CC, 2010 WL 9044697 (Del. Ch. Jan. 26, 2010) (expressing a reluctance to "blow up" a disclosure-only settlement because doing so would create uncertainty regarding whether a value-enriching transaction would occur, given the ongoing litigation risks (quoting Vice Chancellor Strine)).

44. Mathew D. Cain & Steven Davidoff Solomon, Takeover Litigation in 2015, at 1, 3 (Jan. 14, 2016) (unpublished manuscript) (on file with the *Duke Law Journal*).

II. THE NATURE OF CORPORATE NORMS

Corporate law is but a component of the larger body of organizational law whose focus extends beyond identifying the rights and obligations of the organization's participants; corporate law embraces governance mechanisms that mediate the different utility curves of managers and owners and among owners. Because corporations are now more likely to be formed where there is a substantial group of nonmanager owners, corporate law is a challenging arena for mediating the vastly different utilities.

Not all regulation of managers, however, comes out of the barrels of state corporate statutes and legal doctrine. Incentives arising through private ordering, such as bonuses that await high-performing managers, address the objectives of corporate law. Such arrangements are nurtured by legal rules that accord great deference to employment agreements. Indeed, the deference that is customarily accorded actors in corporate law is so substantial as to suggest that much of corporate law is lawless, except for the latent power of owners to vote their representatives out of office.

So viewed, commentators question why, given the lax standards by which officers and boards of directors are judged, we do not observe a greater number of badly managed firms than we do.[45] The answer to this question is that managers do not live by bread (that is, financial gain) alone; they act with a high awareness of social norms. Managers garner satisfaction from doing the "right" thing and avoid the sting of

45. *See, e.g.*, Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619, 1626 (2001) (arguing that the business judgment rule is designed and applied to assure that enforcement is almost entirely nonlegal, resulting in many fewer reported cases of director "malpractice" than in other areas of law); *see also* Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1016–17 (1997) (examining how traditional legal constraints work as well as they do and making the case that judicial opinions contribute to the construction of social norms that impact actors' behavior in corporate transactions). The duty of care is the lens through which stewardship is evaluated. The obligation of care lacks any substantive content by its requirement that actors have a "rational," as contrasted with a "reasonable," basis for their actions. In place of a substantive inquiry, courts regularly review the processes employed by the board to reach the decision, an orientation whose narrative can be expected to have wider application to practices followed by others than the more focused examination of whether the decision made was a reasonable one. There is indeed more substantive bite with respect to the officers and directors' duty of loyalty. However, with rescission or restitution customarily prescribed as the remedy for a breach, there are ample grounds to question whether the sanction is set at too inefficient a level. Nonetheless, if reported decisions are evidence of the prevalence of disloyal aspiration by corporate managers, the instances of unfaithfulness are quite low.

loss of reputation that accompanies conduct deemed "wrong."[46] The level of care by directors, therefore, is largely driven not by a fear of liability or desire for financial gain, but rather by directors' expectations of what other actors would do in like circumstances.[47] With this understanding of where norms fall within the corporate law constellation, we can see that the belief system of corporate actors is an important component of the highly textured realm of corporate law. That is, the guidance that corporate actors respond to is what they believe others will do, as well as how they believe they will be regarded if they act otherwise.

Of course, the degree to which attention will be given to expectations is proportional to the actor's understanding of how widely held a particular norm is. A disputed or weak norm cannot be expected to have as much (or any) impact as one that is believed to be adhered to by a significant portion of the relevant social group.[48] From this perspective, judicial opinions have a dual impact. The court's conclusions, which usually follow a narrative of the corporate actors' behavior, signal what practices are acceptable and unacceptable, and communicate that norms are indeed shared by others within the belief group.[49] Judicial opinions are thereby a bully pulpit for constructing corporate norms, serving as a central mechanism by which corporate actors receive social cues.

In this way, courts are important norm intermediaries. Judicial opinions celebrate role models and define and condemn skullduggery. They map the straight road that fiduciaries should follow.[50] These messages elevate the norm's impact. Therefore, corporate litigation serves functions aside from directly disciplining management misbehavior when ownership and management are separated. They

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46. Melvin A. Eisenberg, *Corporate Law and Social Norms*, 99 COLUM. L. REV. 1253, 1259–60 (1999) (explaining that actors "weigh the pain of shame, the pleasure of conformity, and the external costs and benefits of adherence and nonadherence" when considering whether to follow a social norm).

47. *Id*. at 1263.

48. *Id*. at 1291.

49. Whether it is the rule that arises or is confirmed in a particular case, or the narrative's confirmation of practices deemed acceptable or unacceptable, the result can be expected to impact the internal preferences of corporate actors. Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1807–10 (2001) (stressing that the norms of trust and trustworthiness are central to efficient operations).

50. *Id*. at 1796–97.

also contribute to extra judicial enforcement through the production of social norms.[51]

The role and recognition of norms is especially desirable in business organizations. The presence of multiple actors in an ever-changing environment contributes mightily to the inability of the parties to protect their interests through contracting. Furthermore, even though some participants within the organization necessarily enjoy significant information, the volatile business environment makes resort to contracting a less than fulsome response. Because parties are necessarily subject to the bounded rationality of their present environment, their contracts are necessarily incomplete.[52] With the inability to write "good" or complete contracts, social norms add body to open-textured standards and can be thought of as providing an efficient response. In the absence of norms influencing a board's action, much of the contract would remain indeterminate and unreviewable.

In light of both the importance of social norms and the role of courts in transmitting norms to corporate actors, we should view courts as norm engineers when they resolve corporate disputes. A holding in an individual case is important, but it is the end of a sermon on the good, the bad, and the ugly. To the extent these characteristics can be supported by references to practices embraced by others, there can be a stronger expectation that the prescribed norm will be internalized. This would be the true import of the case.

A. Aspirational Norms

The most ubiquitous norms in the corporate setting are the materiality standard and the business judgment rule. The former straddles the federal and state arenas, whereas the latter does its duty solely in the state corporate context. While the content of each norm is quite different from the other, they share a common characteristic: each embodies an aspirational standard, the breach of which does not necessarily lead to an injury, or at least not one that is compensable.

We need look no further than the Supreme Court's materiality standard to understand that it reaches information that would not alter

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51. *See* Rock & Wachter, *supra* note 45, at 1650 (reasoning that what governs a firm's internal affairs and the aspirations of its actors are norms, which the authors refer to as nonlegal enforceable rules and standards).

52. Oliver Hart, *Norms and the Theory of the Firm*, 149 U. PA. L. REV. 1701, 1703 (2001) (explaining the many forces that cause contracts in the organizational setting to be incomplete).

how a shareholder voted, had the information not been misstated or omitted:

> An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. . . . *It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote*. What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.[53]

It should be noted that the above quote arose in the context of a challenge to a merger, so the definition established was very much connected not only to the explosion of such deal-related litigation, but also to the findings of Fisch, Griffith, and Davidoff Solomon, as Delaware is among the states that embrace the federal materiality formulation.[54] The resulting standard, as reflected by the italicized portion above, deems material many pieces of information that have no consequential effects on the investor or shareholder's ultimate action in reliance on the "total mix" of information presented.

The Supreme Court has fed concerns about overbreadth by holding that causality in aggregate decisionmaking, such as stockholders' approval via a proxy solicitation, does not turn on "the particular defect in the solicitation materials" but on whether the act of solicitation "was an essential link in the accomplishment of the transaction."[55] In both state and federal litigation, this oblique guidance has come to mean that, when proxies allegedly contain a material omission or misstatement, causality is determined objectively by asking whether votes of the solicited stockholders were necessary to

53. TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1975) (emphasis added).

54. It should be noted that Delaware, in its initial development of the duty of candor for corporate fiduciaries, applied a somewhat narrower test whereby the duty of candor mandated that fiduciaries disclose "all information in their possession germane to the transaction in issue. And by 'germane' [the court] mean[t] . . . information such as a reasonable shareholder would consider important in deciding whether to sell or retain stock." Lynch v. Vickers Energy Corp., 383 A.2d 278, 281 (Del. 1977). Later the court substituted "material facts" for "germane facts." *See* Rosenblatt v. Getty Oil Co., 493 A.2d 929, 944 (Del. 1985).

55. Mills v. Elec. Auto-Lite, Co., 396 U.S. 375, 385 (1970).

approve the transaction;[56] the focus is not whether any shareholder vote was acquired because of the alleged misrepresentation.

The operation of the business judgment rule mirrors the materiality standard, as it too calls for much higher standards than are ultimately actionable. In this way, the rule houses both an aspirational standard and a standard of review. The aspirational standard specifies how actors should carry out an activity or discharge a particular role. By contrast, the standard of review is the manner by which a court should judge the actor's actual conduct to determine whether to grant relief. The similarity between the business judgment rule and materiality standard is that, just as a violation of the aspirational standard for directors does not itself establish liability on the part of the director, the commission of a material misrepresentation in a proxy solicitation is not actionable when the outcome would not have been changed if the correct information were known by the shareholder when the defendant holds the requisite number of shares for approval (or for that matter, a material misstatement in a company's annual report is not actionable without evidence that it caused an economic loss to the investor).

An excellent example of the distinction between an aspirational norm and a standard of review is the Model Business Corporation Act (Model Act), which sets forth aspirational standards for directors, such as the obligation to "discharge their duties with the care that a person in a like position would *reasonably* believe appropriate under similar circumstances."[57] This standard is indistinguishable from the standard of negligence in tort, an area of law in which the aspirational standard and standard of review do not separate. In contrast, the Model Act separately identifies the considerations for determining when a breach of the aspirational standard is actionable.[58] Here, a claim sounding in negligence only arises when "the director was not informed to an extent the director reasonably believed appropriate in the circumstances."[59] A circumstance in which a director was reasonably informed of the facts, but made the wrong decision, would not be

56. *See* Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1107–08 (1991) (dismissing a suit where state law required a bare majority of the shares to approve a merger, and the defendant owned 85 percent of the voting power).

57. MODEL BUS. CORP. ACT § 8.30 (AM. BAR ASS'N 1984) (emphasis added).

58. *Id.* § 8.31.

59. *Id.* § 8.31(a)(2)(ii)(B).

actionable under the Model Act (although it would be in a tort-based negligence action).

The gap between the business judgment rule and the negligence standard is explained by the differing contexts in which they are applied. In many tort actions, bad results are highly correlated with bad decisionmaking:

> In the paradigm negligence case involving a relatively simple decision, such as an automobile accident, there is often little difference between decisions that turn out badly and bad decisions. In such cases, typically only one reasonable decision could have been made under the circumstances, and decisions that turn out badly therefore almost inevitably turn out to have been bad decisions.[60]

As the choices before the decisionmaker increase, as they do in business decisions, so do the possible outcomes; hence, it does not necessarily follow that a bad result following the Ford Motor Company directors' decision to build the Edsel was necessarily the product of a bad decision.[61] More likely it was the product of a risky decision. Moreover, within this context, there is a grave risk that the judgment of whether the aspirational standard was breached will be subject to hindsight bias.[62] This reality in judging the actors' actual conduct needs to be balanced against the understanding that in many instances, the shareholders' interests are best served by the directors preferring riskier choices. Thus, the difference between the aspirational standard and the standard of review furthers the interests of shareholders.

We should also understand that materiality serves goals broader than protecting shareholders and investors from transactions that will adversely impact their wealth. In the proxy context, materiality guides the information reasonably believed necessary to apprise the reasonable shareholder of the choices before her. Whether we adhere to the view that shareholder voting assumes importance because it addresses the "incomplete contract" problem that is embedded in the "nexus of contract" perspective of the corporation, or serves a legitimizing function in the "director primacy" view of the corporation, or is rationalized as the owners' ability to reward or discipline

60. MELVIN ARON EISENBERG & JAMES D. COX, BUSINESS ORGANIZATIONS: CASES AND MATERIALS 625 (11th unabr. ed. 2014).

61. For fascinating accounts of the Edsel's failure and the multiple forces contributing to it, see generally ROBERT DAINES, EDSEL: THE MOTOR INDUSTRY'S TITANIC (Atlantic 1994); Tom Dicke, *The Edsel: Forty Years as a Symbol of Failure*, 43 J. POPULAR CULTURE 486 (2010).

62. EISENBERG & COX, *supra* note 60, at 625.

management through their reliance on the simplifying heuristic of changes in the firm's share price, the ritual of voting depends on ex ante determinations of information the shareholders need to vote.[63] Thus, the standard calls for counsel preparing the proxy statement to include a range of information that is broader than that which would determine the outcome of a vote.

But why is this so? To answer this question, we begin with the indeterminacy of a materiality standard that includes only facts so significant to the objectively qualified investor as to change her vote or decision to purchase. Similar to the prevailing, more inclusive standard from *TSC Industries, Inc. v. Northway, Inc.*,[64] a standard focused on what would change behavior, would itself be an indeterminate standard that invites hindsight bias.[65] When judging ex post what should have been disclosed, events that had come to pass would be seen as having a higher probability or magnitude than would have been assigned ex ante to the same disclosure item.

The heterogeneity of shareholders and investors can be seen as calling for a broader disclosure test. It is also likely easier to reach agreement on the types of information users wish to consider than it is to isolate items so significant as to change their choice. And the outcome under either standard can be expected to be context-specific, a reality recognized by the standard's reference to the "total mix" of information. Because the standard is an objective one, the "total mix" does not sweep in the peculiar information needs of the individual user. This prevents sampling among investors as a means of establishing a microcosm by which to discern materiality to the objectively qualified investors; unless carefully crafted, the sample would not be statistically representative. Moreover, in a large corporation, street-name holdings

63. Corporate law academics are of course not monolithic; we approach corporate problems with very different perspectives on what a corporation is and more specifically the content and purpose of good corporate practices. Building on the work of Ronald Coase, the contractarian school views the corporation as little more than a web of contracts. Contracting is of course not costless, and prescience does not exist. Thus, voting is a way of filling gaps in the contract, hence the view that many issues that arise among owners and managers in the corporation are the product of incomplete contracts. Academics also have widely differing views on the relative power and prerogatives of shareholders versus managers (officers and directors). Some favor the former, being adherents of the shareholder primacy view, while others favor the latter, the director primacy view. *See generally* Robert B. Thompson & Paul H. Edelman, *Corporate Voting*, 62 VAND. L. REV. 129 (2009) (reviewing various theories on why shareholders enjoy the right to vote).

64. TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438 (1975).

65. *Id.* at 449 ("An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.").

with a large group of objecting beneficial owners, coupled with the inherent difficulties of learning the unique endowments of all holders, would likely not ensure that the sample chosen was a representative one.

Most importantly, the materiality standard embodies an important public policy choice of favoring the market in the case of materiality's role in securities transactions, or investors' collective judgment in the case of disclosures regarding transactions that call for a shareholder vote. That is, a narrower materiality standard would naturally cover an equally narrower range of information users, such as shareholders and investors. The current formulation of materiality, whereby actionable material misrepresentations are less inclusive than disclosures that are mandated because they are material, is something of a social compromise. The compromise provides information users with disclosures they wish while at the same time insulating individuals and transactions from legal consequences, except when the misrepresentation rises to a level believed to cause consequential harm.

B. Arbiter Norms

The business judgment rule and the materiality standard are illustrative of corporate norms that are aspirational and exist because they are believed to best serve societal objectives. Those objectives are defined by something other than compensable wrongdoing. While this can easily be said of norms generally, much of corporate law and corporate litigation (at least in Delaware) involve norms that serve a quite different purpose: providing a party with a means to involve a court and thereby obtain an impartial assessment of distinct transactions. Such a norm is referred to here as an arbiter norm.

The paradigmatic example of such a norm is the *Revlon* doctrine, which is implicated when the board of directors favors a transaction whose structure is such that, upon consummation, it will be the last opportunity for shareholders to receive a control premium upon disposition of the firm.[66] In this context, the directors' actions are subjected to higher judicial scrutiny to ascertain if they fulfilled their

66. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 184 (Del. 1986) (setting forth the ruling that serves as the progenitor of the "auctioneer" role that directors assume when a transaction is the last opportunity for the shareholders to participate in a control premium).

duty as "auctioneers" of the firm.[67] Inherent in the standard is ambiguity regarding what the auctioneer standard requires. In some contexts, this standard has been violated by the failure to actively pursue other bids for the firm, whereas in other contexts, the directors in the *Revlon* moment are excused from the need to "shop" the firm.[68] What we find in the *Revlon* jurisprudence is not a model of what constitutes an auction or conduct appropriate for an auctioneer; we instead find close assessments of whether the sum of the directors' conduct is consistent with the view that they acted to advance the stockholders' interests.[69]

A similar lack of definiteness surrounds courts' reviews of defensive measures by boards of directors. In Delaware, the operative standard is whether the challenged action was either preclusive or coercive.[70] Each of these terms is ambiguous, highly context-specific, and inquired into only after the court is satisfied that the independent directors approved the action and did so because they believed in good faith that the unwanted suitor posed a threat to the corporation or its stockholders. A significant feature of both auction and defensive-maneuver inquiries is that the burden of proof is on the board of directors, not the plaintiff.[71] This allocation of the burden of proof tilts in favor of the complaining party, at least to the extent of moving the salient facts to court.

Arbiter norms that today regulate so much of managers' conduct in takeovers can be traced to the rich case law surrounding the officers' and directors' duty of loyalty. There, the bedrock principle for addressing self-dealing transactions is the placement of the burden of explanation and persuasion on the fiduciary whenever the fiduciary

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67. *See id.* at 180.

68. *See* Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 243–44 (Del. 2009) (reversing a lower court holding that directors breached their *Revlon* duties by failing to either conduct a market check or undertake an auction). This result was also suggested in *Revlon* itself. *See Revlon*, 506 A.2d at 180 ("Favoritism for a white knight to the total exclusion of a hostile bidder might be justifiable when the latter's offer adversely affects shareholder interests, but when bidders make relatively similar offers, or dissolution of the company becomes inevitable, the directors cannot fulfill their enhanced *Unocal* duties by playing favorites . . . .").

69. *See, e.g.*, *Lyondell Chem.*, 970 A.2d at 243–44 (reviewing closely multiple steps taken by directors to obtain the best price for a firm).

70. Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1386–88 (Del. 1995) (modifying the second step of Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985)).

71. *Id.* at 1374.

transacts business with her own firm.[72] This principle was easily transferred to self-dealing in the acquisitions context so that in that setting, Delaware's "entire fairness" standard encompasses both price and process, and just as with classic self-dealing contracts, the burden of proof is on the interested party. In each instance, the presence of financial self-interest removes the presumptions that attend arms-length dealings.[73] Indeed, we can see that just as developments regarding self-dealing contracts informed the approach to self-dealing in acquisitions, when the Delaware courts were presented with defensive maneuvers, they viewed their holdings through the self-dealing lens, observing that directors' and officers' interests are affected by a change of control. The most recent developments in the acquisition area reinforce the self-interest orientation by focusing on whether certain governance procedures that are believed to remove the otherwise heavy hand of self-interest have been followed.[74]

We therefore see that when the norm of noninterested behavior is breached, even if only technically, the strong presumption of propriety that normally applies disappears. If the transaction is challenged, an "entire fairness" inquiry arises with the burden of proof on the fiduciary. Stated differently, the consequence of a self-dealing transaction or conduct that is pregnant with the possibility of self-interest is prophylactic, as these facts alone provide access to a neutral arbiter. Not surprisingly, therefore, claims of self-interest abound amidst mergers and acquisitions, because Delaware mergers and

72. *See generally* Norwood P. Beveridge, *Interested Director Contracts at Common Law: Validation Under the Doctrine of Constructive Fraud*, 33 LOY. L.A. L. REV. 97 (1999) (tracing the development of the treatment of voidable and nonvoidable conflicts in the context of constructively fraudulent self-dealing transactions); Harold Marsh, Jr., *Are Directors Trustees?: Conflict of Interest and Corporate Morality*, 22 BUS. LAW. 35 (1966) (describing a classic study tracing the courts' treatment of self-dealing transactions).

73. *See, e.g.*, Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983) (establishing, in a seminal way, the "entire fairness" standard for a parent company's acquisition of its subsidiary).

74. *See, e.g.*, DEL. CODE ANN. tit. 8, § 251(h) (2011) (authorizing the so-called "streamlined back-end merger" whereby a friendly tender offer that secures a majority of the shares is followed by a merger with the bidder, without triggering the entire fairness standard); Kahn v. M&F Worldwide Corp., 88 A.3d 635, 644 (Del. 2014) (stating that the entire fairness inquiry can be avoided if the parent agrees in advance to abide by the decision of a committee of the subsidiary that is truly independent and also conditions acquisition on an uncoerced vote of a majority of the minority shares); *In re* Pure Res., Inc. S'holders Litig., 808 A.2d 421, 445 (Del. Ch. 2002) (implying that the entire fairness inquiry can be avoided for a short-form merger following a tender offer by a controlling stockholder that increases its ownership to effect the merger when the provided tender offer and merger price are the same, the tender offer is conditioned on a majority of the minority holders' approval, and the controlling stockholder has not made retributive threats).

acquisitions jurisprudence is founded on broadly stated concerns regarding managerial self-interest. Delaware jurisprudence thus places a bullseye on deals, with the effect of inviting litigation consistent with the role of the arbiter norm. The result is not unexpected; it is endemic to the underlying substantive norm.

III. The Paradox of Corporate Norms

Because of their overbreadth, corporate norms give rise to some interesting paradoxes. By understanding these paradoxes, we can hopefully make some headway in addressing the costs they impose.

The foremost paradox discussed here flows from the fact that substantive standards intended to advance the interests of corporations and their owners by reducing managerial agency costs and facilitating corporate governance—such as full disclosure of material facts surrounding transactions—lead to seemingly inconsequential litigation. Thus, we are confronted by the complaint that well-meaning, albeit broad, norms merely give rise to another form of agency costs, namely those arising from spurious suits advanced by unscrupulous lawyers. As seen in Part II, aspirational and arbiter norms are of necessity broader than what constitutes culpable, and hence remediable, misconduct. The purposes served by the norms' very existence are founded on policy objectives and practical considerations that transcend the protectable economic rights of the corporation or its owners. Consequently, in the space between the indeterminate standards of each norm and instances of actionable violations, we will find seemingly inconsequential litigation. This feeds our fears that the resulting inconsequential litigation is an abuse of process.

One way to address the overbreadth conundrum is to reshape the substantive quality of the norms. The business judgment rule could be less hortatory, materiality could be narrowed to include only items that change decisions regarding how to vote, and deal-related norms could endow directors with the presumption of the business judgment rule in all instances. But obviously each substantive constriction of the norm sacrifices some of the social benefits of that norm. For example, ridding directors and officers of broad duties of care and loyalty may adversely impact their other-directedness. A narrower standard of materiality would produce less information that sectors of the investment community would find useful. And lifting the lash of possible scrutiny of change-of-control transactions may yield more problematic transactions.

Moreover, this course of action would reduce, likely substantially, the role courts play and can play in the production of norms. With less inclusive norms, there would be fewer opportunities for courts to affirm socially valuable conduct and condemn harmful behavior. Furthermore, the constriction of their content would make norms less aspirational. They would become disciplining standards, so that the benefits of aspirational norms in terms of prompting managers to excel beyond the minimal disciplinary standards would likely be compromised.

Three decades ago, states did pursue a reductionist approach to what was believed to be an overly demanding aspirational norm of care. They adopted immunity shields whereby directors were insulated from damages suits unless they engaged in certain forms of purposeful or self-enriching misbehavior.[75] Immunity shields were rapidly propelled into state corporate law by *Smith v. Van Gorkom*,[76] in which the Delaware Supreme Court held that directors' decision to sell a New York Stock Exchange–listed company at a nearly 50 percent premium was grossly negligent.[77] Coincidental with the decision, the cyclical directors' and officers' insurance industry was at a point of too few insurance carriers for the demand for coverage that surged after *Van Gorkom*; companies then seeking directors' and officers' insurance found both premiums and deductible limits to be high. Thus, at the same moment that directors of Delaware corporations were shocked out of their complacency by *Van Gorkom*, they also found that the protection they enjoyed through insurance was not only more expensive but also provided less protection because of constricted coverage limits. Legislatures acted rapidly to restore directors to their earlier, blissful life by insulating them from fears that a momentary lapse would give rise to disproportionately large liability.

Immunity shields, while shifting the focus of corporate litigation, did not dampen its frequency. Indeed, there are strong reasons to

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75. *See generally* Deborah A. DeMott, *Limiting Directors' Liability*, 66 WASH. U. L.Q. 295, 297–310 (1988) (reviewing forms of immunity shields closely). Immunity shields can also impact the materiality norm because directors who negligently commit a material misrepresentation in a proxy statement are protected from damages by the shield. Dixon v. ATI Ladish LLC, 667 F.3d 891, 895 (7th Cir. 2012).

76. Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985), *superseded by statute*, DEL. CODE ANN. tit. 8, § 102(b)(7), *as recognized in* Omnicare, Inc. v. NCS Healthcare Inc., 818 A.2d 914 (Del. 2003).

77. *Id.* at 874 (holding that the directors of a public company who hastily agreed to sell the firm without a reasonable inquiry into its value committed gross negligence)

suspect that a natural consequence of immunity shields is that directors' decisions are today subject to more frequent and closer judicial scrutiny than they were before this legislative development; that is, an unintended consequence of immunity shields is stimulating norm production by the courts. If this is correct, we see the ultimate paradox for corporate norms.

Before *Van Gorkom*, there were but a handful of cases holding that directors had breached their duty of care. Importantly, none of these cases involved public companies; most involved banks. The paucity of care violations in the long and rich history of corporate law (and related skullduggery) is regularly explained by the so-called deterrence trap, where it is reasoned that courts are unwilling to impose a sanction believed disproportionate to the defendant's culpability.[78] Translated to the corporate-care case, this means that courts will not impose liability on directors who negligently depart from the standard of care, even if that departure is deemed extreme, when the consequential damages are believed disproportionate to the level of fault. Immunity shields remove this concern when the court is asked to review a particular decision.

Immunity shields also encourage, rather than discourage, deal-based litigation. In a former era, an accusation that directors were careless in their approval of a transaction led to little judicial scrutiny because of the insulating qualities of the deterrence trap; courts resisted probing allegations which could expose well-meaning directors to liability grossly disproportionate to their momentary lapses of judgment. Following the wide adoption of immunity shields, with their preclusion of damages, equitable relief has been the common response to such challenges. We now witness more suits against deals and much more analysis of directors' actions than occurred prior to the ubiquity of immunity shields.[79] Thus, we see a second paradox of norms: a legislative response intended to insulate directors from liability has had the unintended effect of subjecting director actions to more and closer scrutiny. With courts freed of the deterrence trap, their production of norms is richer as they address what is commendable and condemnable director behavior. This enriches the tapestry of corporate law.

78. Stuart R. Cohn, *Demise of the Director's Duty of Care: Judicial Avoidance of Standards and Sanctions Through the Business Judgment Rule*, 62 TEX. L. REV. 591, 627–28 (1983). For the view that courts have struck the right balance, see John C. Coffee, Jr., *Litigation and Corporate Governance: An Essay on Steering Between Scylla and Charybdis*, 52 GEO. WASH. L. REV. 789, 798 (1984) (arguing that the value of the duty of care is in its "socializing and exhortative impact").

79. *See supra* notes 13–18 and accompanying text.

A further development in the production of norms is how society subsidizes the enunciation of rights, regardless of any consequential harm. In an early, celebrated securities case, *Mills v. Electric Auto-Lite Co.*,[80] the Supreme Court established that a plaintiff who proves a technical violation of the federal proxy rules is entitled to be compensated by the corporation on whose behalf the suit was maintained, regardless of whether any damages were incurred. Mills alleged that the proxy used to obtain the Electric Auto-Lite shareholders' approval of a merger with another company that owned 54 percent of Electric Auto-Lite failed to disclose that all of the Electric Auto-Lite directors were the nominees of its merger partner.[81] Despite there being no consequential damages as a result of the disclosure gaffe, the Supreme Court established the important precedent that equity called for the corporation to reimburse the plaintiff's reasonable litigation costs when the suit produced a benefit to the corporation.[82] The Court found that establishing that a material omission had occurred was such a benefit when the proxy solicitation was necessary to effect the merger.[83] Thus, the award of attorneys' fees was based on a causal connection between the need to solicit proxies and the merger's approval—not the omission itself.[84]

In *Tandycrafts, Inc. v. Initio Partners*,[85] the Delaware Supreme Court similarly awarded fees after emphasizing the benefit that the plaintiff's suit had conferred on the shareholders.[86] *Tandycrafts* should be seen as an even stronger embrace of the practice of awarding fees to the plaintiff when a suit has benefitted the corporation or its shareholders. In that case, the plaintiff's suit was brought on behalf of an individual, not on behalf of the corporation or its shareholders, and the plaintiff withdrew the suit after the corporation amended its proxy statement disclosures to address the omissions raised in the suit. Nonetheless, fees were awarded because the court believed the corrective disclosure benefitted the company and its shareholders and because the defendant was unable to establish that the supplemental disclosure was not a consequence of the plaintiff's suit.[87]

80. Mills v. Elec. Auto-Lite Co., 396 U.S. 375, 392–97 (1970).
81. *Id.* at 379–80.
82. *Id.* at 396–97.
83. *Id.* at 385.
84. *Id.* at 392.
85. Tandycrafts, Inc. v. Initio Partners, 562 A.2d 1162 (Del. 1989).
86. *Id.* at 1165.
87. *Id.* at 1166.

It should be observed that both *Mills* and *Tandycrafts*, while differing in their approaches to causation, require more than the violation of an aspirational norm to reward the norm's vindication. Nonetheless, causality in both cases is so loosely defined—requiring little more than correlative events—that the vindication of at least the norm of materiality calls for more than the violation of that aspirational norm. Indeed, *Mills* is even more liberal; there, the omission or misstatement of a material fact alone justified a fee award. In *Tandycrafts* there was the additional requirement that the suit must have prompted some corrective action. The harms arising from the laxity of either approach are obvious. The *Mills* decision invites suits when management controls too few shares to ensure a transaction's approval; in *Tandycrafts*, the hydraulic pressures of a suit threatening to delay and perhaps scuttle a transaction can force management to implement trivial disclosures or even procedures as a cost-effective response to a nettlesome suit.

Mills and *Tandycrafts* illustrate the central problem in the judicial production of norms: a weak inquiry into causality in the award of fees. Even this modest inquiry occurs without the benefit of an adversarial process, as the quick settlement fulfills litigants' quest for a win-win situation: the defendants proceed with the deal and the plaintiff's counsel is paid. Their haste to settle not only cheapens the asserted norm but poses the substantial risk that truly meritorious suits will be compromised by the weak incentives of the litigants.[88]

Courts have long lamented that when faced with a settlement, they are poorly positioned to distinguish between an inconsequential suit's expedient end and the premature demise of a valuable claim.[89] Thus, the final paradox discussed here is the fact that poor causal inquiries surrounding fee awards likely work against the production of corporate norms. As explained earlier, norm production depends on the court anchoring the litigation's outcome in a close analysis of whether the defendant's conduct did or did not violate the norm that was the

88. *See generally* John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669 (1986) (examining closely the weak incentives that surround lawyers' involvement in representative suits).

89. *See, e.g.*, Alleghany Corp. v. Kirby, 333 F.2d 327, 347 (2d Cir. 1964) (Friendly, J., dissenting) ("Once a settlement is agreed, the attorneys for the plaintiff stockholders link arms with their former adversaries to defend the joint handiwork . . . ."); *In re* Trulia, Inc. Stockholder Litig., 129 A.3d 884, 893 (Del. Ch. 2016) ("Once an agreement-in-principle is struck to settle for supplemental disclosures, the litigation takes on an entirely different, non-adversarial character.").

gravamen of the complaint. By contrast, the court's engagement of the settlement is typically divorced from this norm. Instead, it focuses on the benefits of the settlement to the corporation or its shareholders. As a result, fee awards, as currently conducted, have created such cynicism with respect to the process that they weaken the positive contributions associated with the underlying norm.

IV. THE PATH FORWARD

There are numerous rulings in any suit. Most judicial actions are ministerial in nature and provide little opportunity for the production of norms. Nonetheless, there are multiple moments in shareholder suits when norm production can occur: motions to dismiss, motions for interim relief such as preliminary injunctions, demand requirements in the context of derivative suits, and ultimately settlements. These procedural steps essentially act as a series of screens that separate suits along a spectrum extending from the meritorious to the baseless action. As examined below, even though judicial review of settlements has the potential to provide rich opportunity for norm production, current settlement procedures must be amended to fulfill this potential.

The most porous filter is the criteria applied in considering the defense's motion to dismiss. For example, in Delaware the complaint can be dismissed only when the court determines with "reasonable certainty" that the plaintiff could not prevail on any set of facts inferred from the complaint.[90] Matters outside the pleadings are not considered in ruling on a motion to dismiss; however, if the defendant moves for summary judgment, rather than a motion to dismiss, documents before the court other than the complaint are considered.[91] While it is hard to generalize, norms are more likely to be delineated in summary judgment proceedings; summary judgment requires the court to decide whether the undisputed facts show that the directors violated a rule of conduct. Nonetheless, a review of important motion-to-dismiss decisions reveals that motions to dismiss repeatedly involve norm production with respect to aspirational norms, but less so with arbiter

90. *See, e.g.*, Malpiede v. Townson, 780 A.2d 1075, 1082–83 (Del. 2001) (stating that the plaintiff is entitled to all reasonable inferences that logically flow from the face of the complaint). The complaint must, however, set forth "well-pleaded allegations"—that is, specific allegations of fact and conclusions. Solomon v. Pathe Commc'ns Corp., 672 A.2d 35, 38 (Del. 1996) (describing this standard as being inherent notice pleading). If a motion to dismiss is granted, the review on appeal is de novo. *Malpiede*, 780 A.2d at 1082.

91. *In re* Santa Fe Pac. Corp. S'holder Litig., 669 A.2d 59, 68–69 (Del. 1995).

norms.[92] For example, motions to dismiss are a weaker medium for resolving self-dealing matters, such as those that arise in mergers and acquisitions.

As seen earlier, upon a showing of a defensive maneuver or sale-of-control transaction, the burden of proof in Delaware shifts to management to demonstrate it acted reasonably. Because a motion to dismiss fails unless no reasonable inference of misconduct can be drawn from the complaint, the plaintiff can defeat the motion by showing fairly neutral facts, such as the use of a defensive maneuver or a change-of-control transaction. A leading defensive-maneuver case, *In re Santa Fe Pacific Corp. Shareholder Litigation*,[93] recognized the limited space courts enjoy to grant a motion to dismiss. The issue addressed there was whether the board, in the face of a hostile bid, had upheld its fiduciary obligations when it placed approximately 16 percent ownership in the hands of a friendly party, adopted a poison pill, applied the pill in a discriminatory manner to prefer one bidder over another, and engaged in a repurchase program.[94] In denying the defendant's motion to dismiss, the court reasoned:

> As the terminology of enhanced judicial scrutiny implies, boards can expect to be required to justify their decisionmaking, within a range of reasonableness, when they adopt defensive measures with implications for corporate control. This scrutiny will usually not be satisfied by resting on a defense motion merely attacking the pleadings.[95]

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92. *See, e.g.*, Gantler v. Stephens, 965 A.2d 695, 711–12 (Del. 2009) (holding that a proxy which stated that a transaction was approved after "careful deliberations" by the board contained a material misstatement because the board's review had in fact been very casual, and reasoning that the representation of careful deliberation addressed the reasonable shareholders' concerns of self-interested behavior); *Malpiede*, 780 A.2d at 1087 (explaining that the disclosure of the higher bid renders immaterial as a matter of law any misstatement regarding the board's rationale for not accepting the higher bid); *In re Santa Fe*, 669 A.2d at 68–70 (holding that *Revlon* was not triggered because the complaint had alleged that the acquisition was a stock-for-stock exchange and did not describe the ownership structure of the acquiring firm). Less clarity is more likely in motion-to-dismiss decisions. *See, e.g.*, Blackmore Partners, L.P. v. Link Energy LLC, 864 A.2d 80, 80–85 (Del. Ch. 2004) (reasoning that one possible interpretation of the allegations that the entire proceeds from selling the company would go to the creditors is that no other transaction could have been worse for the shareholders, but it could have been developed at trial that the directors believed in good faith after reasonable investigation that there was no future in continuing the business nor any better alternative for disposing of its assets).

93. *In re* Santa Fe Pac. Corp. S'holder Litig., 669 A.2d 59 (Del. 1995).

94. *Id.* at 71–72 (reversing the lower court's grant of the defendant's motion to dismiss).

95. *Id.* at 72; *see also In re* Ebix, Inc. Stockholder Litig., No. 8526-VCN, 2016 WL 208402, at *18 (Del. Ch. Jan. 15, 2016) ("[T]he activation of heightened scrutiny poses a systemic difficulty

Thus, in the heightened-scrutiny realm, norm enunciation occurs when the facts trigger a particular doctrine, as when the acts taken by the defendant are defensive maneuvers[96] or the transaction's structure triggers *Revlon* considerations.[97]

The "reasonable probability of ultimate success" requirement for a preliminary injunction[98] provides a better platform for norm production than rulings on motions to dismiss. For example, in instances of alleged disclosure violations, the reasonable-probability standard calls on courts to determine whether a disclosure was required in a specific context,[99] in addition to the types of disclosures that companies need to make generally.[100] There are considerations of the collateral consequences of such an order, however, that regularly weigh against such relief. For example, in cases where material misrepresentations are alleged, the general policy preference of ordering disclosure ex ante rather than determining damages ex post[101] is substantially qualified by the concern that an admittedly value-

for defendants seeking dismissal under Court of Chancery Rule 12(b)(6), given the limited record from which they might draw to demonstrate reasonableness.").

96. *See, e.g.*, *Gantler*, 965 A.2d at 705 (reversing a grant of a motion to dismiss and observing that the lower court overlooked financial interests of directors that supported plaintiff's claim that their defensive steps were driven by a motive to entrench themselves).

97. *See, e.g.*, *In re Santa Fe*, 669 A.2d at 71 (holding no facts were pleaded indicating that a transaction posed a change of control such that *Revlon* would apply).

98. *See* La. Mun. Police Emps.' Ret. Sys. v. Crawford, 918 A.2d 1172, 1185 (Del. Ch. 2007) (holding that to obtain a preliminary injunction, a plaintiff must demonstrate (1) a reasonable probability of ultimate success on the merits at trial, (2) that a failure to issue an injunction would result in immediate and irreparable injury before final hearing, and (3) that the balance of the hardships weighs in the plaintiff's favor). These factors, however, are greatly impacted by the court's concern for the collateral consequences of granting a preliminary injunction that stops or retards the transaction's occurrence. *See infra* note 101 and accompanying text. However, this preference is substantially qualified by concern that the admittedly value-increasing transaction may, in the face of the resulting delay or uncertainty of approval, disappear. *See* McMillan v. Intercargo Corp., No. 16963, 1999 WL 288128, at *4 (Del. Ch. May 3, 1999) ("The threat of Intercargo losing its only offer if the Court issues an injunction is real, and it far outweighs the risks created by denying injunctive relief.").

99. Hence, when a transaction is stated to have been adjudged fair by an investment bank, the Delaware court lists a range of collateral disclosures that must be made such as the valuation methods used, the key inputs into the determination, as well as the range of ultimate values. *In re* Netsmart Techs., Inc. S'holders Litig., 924 A.2d 171, 203–04 (Del. Ch. 2007).

100. *See* Arnold v. Soc'y for Saving Bancorp, Inc., 650 A.2d 1270, 1280 (Del. 1994) (holding that Delaware law does not require disclosure of unreliable or speculative information).

101. *See In re* Staples, Inc. S'holders Litig., 792 A.2d 934, 960 (Del. Ch. 2001) ("[A]n after-the-fact damages case is not a precise or efficient method by which to remedy disclosure deficiencies. A post-hoc evaluation will necessarily require the court to speculate about the effect that certain deficiencies may have had on a stockholder vote and to award some less-than-scientifically quantified amount of . . . damages . . . .").

increasing transaction may disappear in the face of the resulting delay or uncertainty of approval.[102] Nonetheless, the tension that surrounds a decision whether to grant a preliminary injunction disciplines the process and thus sharpens the resulting norm.[103]

When the action is a derivative suit, the court's engagement with the demand requirement—whether the demand is excused for futility or whether the response to a demand compels dismissal of the suit—regularly involves the court probing the facts and legal principles in ways that produce norms. *Rosenbloom v. Pyott*[104] illustrates how norm production is central to considering whether the derivative-suit plaintiff must make a demand on the board of directors.[105] For years, defendant Allergan, Inc.'s board of directors pursued a number of initiatives designed to promote off-label sales of its main product, Botox.[106] Such off-label sales were illegal; indeed, the board had received several warnings from the Food and Drug Administration that Allergan's practices violated the law.[107] When Allergan was eventually prosecuted and paid $600 million in the resulting civil and criminal enforcement actions, a derivative suit against its directors ensued.[108] The issue on appeal to the Ninth Circuit was whether the lower court, applying Delaware law, correctly held that the plaintiff must make a pre-suit demand on the board of directors.[109] Under the Delaware standard, demand is excused if facts are alleged with particularity that create a reasonable doubt that the directors are "disinterested or independent."[110] The Ninth Circuit held such a doubt

102. *See McMillan*, 1999 WL 288128, at *4 ("The threat of Intercargo losing its only offer if the Court issues an injunction is real, and it far outweighs the risks created by denying injunctive relief.").

103. A very different problem confronts the plaintiff and the court when defendants moot alleged disclosure violations by making supplementary disclosures. In this instance, lacking an opinion, a norm was not generated by the court, but clearly there is the basis for inviting an inquiry into causal connection to the suit as well as the probable benefits of the resulting finding. *See* Tandycrafts, Inc. v. Initio Partners, 562 A.2d 1162, 1163 (Del. 1989) (upholding the award of fees in such a case).

104. Rosenbloom v. Pyott, 765 F.3d 1137 (9th Cir. 2014).

105. *Id.* at 1148.

106. *Id.* at 1142–44.

107. *Id.* at 1146–47.

108. *Id.* at 1140.

109. *Id.* at 1140–41.

110. Aronson v. Lewis, 473 A.2d 805, 814 (Del. 1984), *overruled in part by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

was created by allegations showing a substantial likelihood that the directors were liable for failing to act when they had a duty to act.[111]

Following a close review of the factual allegations, the *Rosenbloom* court announced several standards of conduct in the context of directors' oversight responsibilities and fiduciary obligations not to engage in criminal conduct. For example, the court highlighted warnings from the FDA and an employee's resignation for ethical reasons that triggered the directors' obligation to inquire whether the company was violating the law.[112] By emphasizing that directors can be held liable when facts indicate that they turned a blind eye to compliance with respect to a critical product (off-label sales of Botox represented 70–80 percent of all Botox sales, and Botox accounted for nearly 40 percent of all Allergan's revenues during this period),[113] the court reinforced directors' obligations to ensure that there are robust and reliable information-compliance systems in place to prevent misconduct. The court also observed that the pervasiveness of Allergan's violations in the face of numerous red flags warning of illegal off-label sales sustained an inference that the directors "adopted a plan premised on illegal off-label marketing of Botox"[114]:

> Plaintiffs' particularized factual allegations . . . suffice to show that the Board either did nothing despite actual or constructive knowledge of wrongdoing at Allergan, or knowingly adopted a business plan premised on illegal conduct. In either case, Allergan's directors violated their duty of loyalty and would face a substantial likelihood of liability; in the latter case, they would also have forfeited the protection of the business judgment rule.[115]

This statement, and the effect of excusing a pre-suit demand, are important affirmations of what is required of directors in discharging their oversight responsibilities.

In each of the above-reviewed procedural contexts—motions to dismiss, petitions for preliminary injunctions, and the derivative suit's demand requirement—the court's analysis is anchored in the substantive allegations set forth in the complaint. This allows each of those procedures to be a forum in which norms are created. Because settlements, where so many shareholder suits end, do not share this

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111. *Rosenbloom*, 765 F.3d at 1151.
112. *Id.* at 1152–54.
113. *Id.* at 1142.
114. *Id.* at 1158.
115. *Id.* at 1159.

same mooring in the substance of the dispute, they are not nearly as useful for generating norms.

The facts of *Trulia, Inc.* are useful in illustrating how norms can be poorly produced by the current settlement procedures. The complaint alleged that the directors breached their fiduciary duties by approving a merger with a single bidder that allegedly failed to obtain the highest exchange ratio for the shareholders.[116] The parties reached an agreement in time for several supplemental disclosures to be added to the proxy statement circulated among shareholders; the merger was ultimately approved by 79.52 percent of the shares entitled to vote (99.15 percent of the votes cast).[117] In addition to agreeing to the supplemental disclosures, the defendants agreed not to oppose a fee request of $375,000 or less.[118] Chancellor Bouchard closely examined each of the supplementary disclosures that regarded distinct features of the valuation process used by the investment bank in its fairness opinion to the board. He found the supplementary disclosures were not meaningful in light of all the other information the company disclosed regarding the valuation process.[119] He rejected the settlement, thereby leaving the suit as it had started: a bald accusation of breach of fiduciary obligation. Although the right result was reached in *Trulia, Inc.*, the decision would have been more revealing if the court had analyzed whether the proposed settlement was consistent with the complaint's allegations.

Had the court linked the settlement to the complaint that established its jurisdiction, it could have further questioned how the proposed remedy—disclosure of facts surrounding a fiduciary's breach of duty—failed to complement corporate fiduciary-duty principles.[120] To be sure, a universal feature of fiduciary obligations is the duty of candor. The director's obligations, however, compel more than disclosure. They include an affirmative obligation to act in the interests of the corporation and its shareholders. The misconduct alleged in

116. *In re* Trulia, Inc. Stockholder Litig., 129 A.3d 884, 889 (Del. Ch. 2016).

117. *Id.*

118. *Id.* at 890.

119. *Id.* at 899–907.

120. Further disquiet over disclosure-only settlement arises from the fact that there does not appear to have ever been a request for a preliminary injunction seeking disclosure before the shareholders voted. The record recounts how the parties reached an agreement on supplementary disclosures without such a motion and, for that matter, without the defense raising a motion to dismiss. Thus, the defense sought the plaintiff's cooperation in settling the matter before the transaction was closed and proceeded to court only after the transaction had been approved (with the supplementary disclosures the court considered not meaningful).

Trulia, Inc. was not any want of disclosure, but the directors' failure to take steps to secure a higher exchange ratio.[121] Because nondisclosure was not a part of the alleged breach by the defendants, a settlement in which only disclosure was obtained naturally invited skepticism.

The disclosure provided in the proposed settlement was also irrelevant to the alleged misconduct because of Delaware's approach to the ratification of misconduct. A fiduciary's breach can be approved by shareholders following full disclosure, but under the strict equitable-ratification approach followed in Delaware, any such shareholder approval must occur in a vote distinct from the vote in which shareholders approve the transaction, such as the merger in *Trulia, Inc*.[122] In the absence of a separate vote to ratify the directors' conduct, the disclosures the parties agreed to were not a step toward excusing the alleged breach by the directors. Thus, the court should have raised another basis on which to reject the settlement: the terms of the settlement that were nonresponsive to the need under Delaware law for the shareholders to meaningfully address the misconduct alleged in the suit.

CONCLUSION

Shareholder litigation is frequently representative litigation, in the form of class actions or derivative suits. Such a suit's plaintiff typically has an insufficiently small stake in the outcome to serve as an adequate monitor of its counsel. This sets the stage for agency costs that can lead to inconsequential settlements. And, as illustrated by *Trulia, Inc.*, such a settlement can be viewed as the efficient and hence desirable end of the suit by the defendant and its counsel. But this dynamic threatens the vitality of corporate norms.

Because of both the importance of norms and the frequency with which corporate disputes are settled, courts should probe settlements to ensure that the relief provided in the settlement is worthy of the norm raised in the complaint. In the case of arbiter norms, the issue is whether there is a self-dealing relationship or type of transaction that otherwise rids the transaction of propriety and invites judicial review for fairness. In reviewing the settlement, courts can not only highlight that which has established that an arbiter norm was involved, but more

121. This point is emphasized by Chancellor Bouchard in his careful qualification of the scope of the case's holding. He states that the review standard embraced in *Trulia, Inc.* is limited to instances in which the complaint does not raise "a plainly material misrepresentation." *Id.* at 898.

122. *See* Gantler v. Stephens, 965 A.2d 695, 713 (Del. 2009).

importantly how the case's facts align with the arbiter norm and how the settlement improves the fairness of the process and terms.

When a settlement results from an alleged violation of an aspirational norm, as was the case in *Trulia, Inc.*, norm overbreadth poses greater challenges than those present in suits involving arbiter norms only. As illustrated in *Trulia, Inc.*, courts should conduct a non-deferential assessment of the case's record to judge whether the settlement provides a substantial benefit other than bringing the suit to an amicable conclusion. Absent such a benefit, the court should withhold its approval. To be sure, courts do review settlements and frequently do so closely. What I argue is that judicial review is more likely to be closer to, and certainly more consistent with, the court's role of ensuring protection to the shareholders, if the judge views the settlement through the lens of the norm violations alleged in the complaint. If instead the review focuses on the worth of new disclosures or the governance procedures provided by the settlement, the review steps away from the question of what was proper or improper conduct and legitimates the process whereby the lawyers price their willingness to avoid the production of norms.