
So standing here in 2007 looking back over the changes of the past—those that have produced net financial gains to investors and those that cannot be shown to have done so—and forward to the future, my plea is for modesty on the part of corporate governance regulators and “experts.”

In the future, as in the past, firms will be forced to respond to dynamic changes in their markets. Some will do so well and prosper; some will fail to do so effectively and will atrophy. But diversification of investments is the first and strongest investor protection against the inevitable fact that there will be winners and losers in the competitive economy. We should hesitate to believe at any moment that we know enough to lay down a hard and fast rule to apply to all firms or presumptively to all firms—whether such view is advanced through regulation or through coordinated support for some “best practice” or another. Diversified investors will benefit from a regime in which firms, with shareholder approval, are afforded great freedom to structure their governance structures. In nature we know that diversity protects species and in economic structures too experimentation and diversity is the best way to advance the economic interests of all those who invest in the business corporation.

Gazing into the Crystal Ball of Future Developments in Delaware Corporate Law: What if the Past is Not Prologue?

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In the more than two decades following *Smith v. Van Gorkum*¹ and *Unocal Corp. v. Mesa Petroleum Co.*,² the practice of change of control transactions in Delaware—particularly in the context of squeeze-out mergers—has become highly stylized. The ritual of transactional practice often now includes: (1) a board appointed special committee of independent directors; (2) separate legal counsel to advise the special committee in regard to its fiduciary duties; (3) an independent financial advisor to advise the special committee with regard to the fairness of the proposed deal; (4) a “noncoercive”

offer, e.g., first-step all-cash-for-all-shares tender offer in conjunction with second-step cash-out merger, where the merger price equals the tender offer price; (5) express “fiduciary out” and, perhaps, a “go-shop” provisions; and (6) in some instances, a majority of the minority provision. Generally, minority stockholders have not explicitly bargained for these protections.

And these “protections” come with a cost to stockholders, including both the all too real cost of outside financial and legal advisors, and the implicit (and difficult to measure) cost that arises from deals that are never consummated in the first instance because of heightened transaction costs and more slow moving (albeit, more deliberative) director decision-making. Rather, our highly choreographed transactional practice, in its current form, has been prompted by the decisions of our courts and embraced by directors (and their legal advisors) as the best means to preclude attack on board-approved transactions, including suits against the directors themselves. Indeed, under the new learning, notwithstanding the presence of a controlling stockholder on both sides of the transaction, it appears that when the board properly utilizes both a special committee of independent directors and

the Corporate Governance L a d v i s o r

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a majority of the minority provision, a successful attack on director decision-making by the plaintiffs' bar becomes fairly difficult.³

That this result could not have been clearly foreseen in 1985 when *Van Gorkum* and *Unocal* were announced is hardly surprising. It may be that future developments will also take us into areas that cannot now be predicted with much certainty. But we can make an informed guess about what the shape of future Delaware corporate litigation may be like. Given that frontal structural attacks on major corporate transactions may have become more difficult, the plaintiffs' bar may focus on the quality of corporate disclosures, including disclosure of so-called "soft information," seeking stockholder votes or tenders. At first glance this too would seem to be an unexpected and, perhaps, unforeseeable development. After all, the General Corporation Law of the State of Delaware is reticent in regard to imposing affirmative disclosure requirements on boards when communicating with their stockholders.⁴ But Delaware courts have augmented these minimal disclosure requirements arising under state statutes with a common law fiduciary duty of disclosure.⁵

Indeed, it is not just plaintiffs who have started down the road seeking heightened disclosure requirements: the courts too may have already begun the journey. In *In re Pure Resources, Inc. Shareholders Litigation*,⁶ Vice Chancellor Strine held, without regard to whether the board's disclosure passed muster under the federal securities law, that the board's Securities and Exchange Commission filings were insufficiently forthcoming under Delaware law because they did not disclose "substantive portions" of the special committee's bankers' reports and that such information would be relevant to minority stockholders' decision to tender and/or to seek appraisal.⁷ *Pure Resources* is, of course, just one case, and like all cases, it is limited to its particular facts. Thus it becomes difficult to announce a full blown theory (or agenda) as to what is proper disclosure under the General Corporation Law in all instances. We suggest only the skeleton of what is now or might be required in the future under Delaware law.

Current practice suggests that where a board or special committee recommends a transaction for stockholder approval and that recommendation is based, in part, upon a financial advisor's report or board presentation, the advisor's "bottom line" range

of fair value should be disclosed for each model or scenario in the report. Additionally, it is common practice to disclose the major assumptions used in each model, including among other things, the discount rate or rates used, explanation with regard to any discounts related to minority positions or stock marketability,⁸ and the multipliers or range of multipliers used in analyses of comparable companies or comparable transactions, particularly where those numbers were used in terminal value calculations.

As to future practice, without opining on the desirability of such reform, it is possible that Delaware's courts will demand greater production of "soft information." In particular, where a financial advisor's report makes use of discounted cash flow analyses, it is possible that the courts will mandate disclosure of the estimates of the earnings projections used and the source of those estimates. Similarly, mandatory disclosure of fee arrangements might become the new norm.⁹ Lastly, even if not mandatory, it might nevertheless become sensible for the disclosure papers to indicate an internet site where the entirety of the advisor's report or board presentation materials¹⁰ might be made available to the public stockholder in conjunction with unambiguous representations to the effect that the board cannot warrant the accuracy of the advisor's report or any particular statement therein.¹¹

Notes

1. 488 A.2d 858 (Del. 1985) (Horsey, J.).
2. 493 A.2d 946 (Del. 1985) (Moore, J.).
3. See, e.g., *In re Cox Communications, Inc. S'holders Litig.*, 879 A.2d 604, 645-47 (Del. Ch. 2005) (Strine, V.C.).
4. But see 8 Del. C. § 222(a) (mandating that notice of the annual stockholders' meeting must include the place (if any), date, and hour of the meeting, and the means of remote communications, if any); 8 Del. C. § 242(b)(1) (requiring that notice of proposed charter amendments must include the "amendment in full or a brief summary of the changes to be effected"); 8 Del. C. § 262(d) (requiring, for example, that the notice of appraisal include a copy of Section 262).
5. Of course, there need be no identity between what is required under the relevant SEC disclosure filings and state law, particularly as those two systems (independently) evolve over time. See, e.g., *Polygon Global Opportunities Master Fund v. West Corp.*, 2006 WL 2947486, at *4 (Del. Ch. Oct. 12, 2006) (Lamb, V.C.) ("This is not to say that there is a *per se* rule that the disclosure requirements under Rule 13e-3 are coextensive with the 'necessary, essential and sufficient' information standard under section 220"); *Smith v. Shell Petroleum, Inc.*, 1990 WL 84218, at *25 (Del. Ch. June 19, 1990) (Hartnett, V.C.) (holding that "there is no Delaware precedent holding that the

test of materiality incorporates the specific disclosure requirements of the statutorily based S.E.C. rules.”)

6. 808 A.2d 421 (Del. Ch. 2002); *see also Gilliland v. Motorola, Inc.*, 859 A.2d 80 (Del. Ch. 2004) (Lamb, V.C.). *But see Skeen v. Jo-Ann Stores, Inc.*, 750 A.2d 1170 (Del. 2000) (Berger, J.) (taking the position that a summary of the bankers’ analyses and conclusions was not material to a stockholders’ decision whether to seek appraisal).

7. *In re Pure Resources, Ins. S’holders Litig.*, 808 A.2d at 448; *see also infra* note 9 and accompanying text.

8. *See, e.g., In re Staples, Inc. S’holders Litig.*, 792 A.2d 934, 955-56 & n.38 (Del. Ch. 2001) (Strine, V.C.).

9. Indeed, the disclosure of an investment banker’s *contingent* fee may already be the new norm. *See La. Mun. Police Employees’ Ret. Sys. v. Crawford*, 2007 WL 582510, at *11-12 (Del. Ch. Feb. 23, 2007) (Chandler, C.).

10. *But see supra* note 6 (citing *Skeen v. Jo-Ann Stores, Inc.*).

11. Indeed, if the production of the underlying report fulfills the duty of producing for stockholders a “fair summary of the substantive work performed” by the directors’ financial advisors, then directors, stockholders, and the courts will have the benefit of a bright-line rule around which to safely structure future transactions. *In re Pure Resources, Ins. S’holders Litig.*, 808 A.2d at 449. The benefit of such full disclosure would be to cut off at the pass litigation alleging insufficient or misleadingly partial disclosure. *See, e.g., In re the MONY Group Inc. S’holder Litig.*, 852 A.2d 9, 24-25 & n.39 (Del. Ch. 2004) (Lamb, V.C.) (citing *Arnold v. Soc’y for Sav. Bankcorp.*, 650 A.2d 1270, 1280 (Del. 1994) (Veasey, C.J.)).

Sea Change? Fundamental Duties Remain the Same

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The meteoric rise of corporate governance as an object of study and development among practitioners of corporate law does not result from any cosmic change in the fundamental responsibilities of corporate officers and directors. It has long been well established in corporate law that officers and directors are charged with fiduciary duties and responsibilities which must be fulfilled under penalty of legal accountability for failure to observe their obligations. While there have been certain developments in the statutory definition of those duties and in the legal and judicial interpretation thereof, it would be an exaggeration to say that there have been sea changes in the fundamental structure and demands of corporate law.

Even the Sarbanes-Oxley legislation, which mandated specific duties and reporting requirements for officers and directors of publicly traded corporations and expanded the penalties for failure

to conform with federally mandated requirements, cannot be said to have materially altered the fundamental construct of fiduciary obligations of officers and directors. Rather, the preoccupation about whether companies have established corporate governance standards and procedures which meet modern requirements is more nearly the consequence of a widespread failure of corporate managers, officers, directors and their professional advisers to pay adequate attention to, and to demand conformance with, requirements for adherence to fiduciary obligations which have been imbedded in American corporate law for decades. It has by now been pretty well agreed by most observers that the enactment of Sarbanes-Oxley was not required in order to charge and convict or impose legal liability upon virtually all of the persons and companies accused of corporate and securities fraud during the recent period of widespread litigation against companies, officers and directors. It has also by now been pretty well demonstrated that the consequences of compliance with Sarbanes-Oxley and with the superstructure of corporate governance safeguards has expanded the costs and burdens of operating publicly-owned corporations and policing and supervising adherence to fiduciary responsibilities.

The recent period through which the corporate community has hopefully now passed was witness to failures of conduct and performance by many elements of the corporate world. Some have characterized the period as a period of greed and overexuberance where compensation of senior corporate executives experienced a “race for the top”, and management practices in pursuit of real or apparent enhanced corporate performance encouraged business and reporting practices which exaggerated and distorted corporate earnings. The use of stock options and the granting of benefits and emoluments expanded and at the same time a spirit of complacency is said to have reigned in corporate board rooms where boards of directors did not adequately pursue or fulfill their oversight responsibility. Too often, it was thought, the relationships among directors and corporate management were so comfortable as to discourage the establishment and implementation of a vigorous oversight by the board of directors over the conduct, practices and performance of corporate management. It remains to be seen whether the recent requirements for the increased presence of independent directors will result in enhanced oversight and accountability.