

**RECENT DEVELOPMENTS CONCERNING STANDARDS
OF JUDICIAL REVIEW IN DELAWARE CORPORATION LAW**

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During the 1980's and 1990's, Delaware's corporate law jurisprudence, particularly in the area of directors' fiduciary duties, underwent a significant transformation, spawned in large part by the significant increase in hostile corporate takeovers, anti-takeover defensive measures, and merger and acquisition activity in general. Among other things, those decades witnessed many refinements of the standards of judicial review traditionally used in evaluating claims that directors had breached their fiduciary duties, the advent of new standards of judicial review, and a proliferation of burden shifting doctrines, multi-part tests, and other rules governing judicial review of fiduciary duty claims. While these developments were necessitated by the rapidly changing capital markets and business environment and generally were successful in balancing the interests of stockholders, directors, and other corporate constituencies, they resulted in what many practitioners and commentators now see as a complex and sometimes confusing web of legal rules. Not surprisingly, both courts and commentators recently have begun to reassess the relationship

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between the various standards of judicial review, the underlying fiduciary duties of due care, good faith, and loyalty, and the array of legal rules that govern their applicability.

One important article in particular, written by former Chancellor of the Delaware Court of Chancery, William T. Allen, and current Vice Chancellors Jack B. Jacobs and Leo E. Strine, Jr. (hereinafter the “Chancellors”), has proposed simplification of the existing standards of judicial review and related rules to reduce their number, increase their functionality, and better serve underlying corporate law policies.² This would be accomplished, among other ways, by abandoning the effort “to link the ‘intermediate’ and ‘entire fairness’ standards of review to a theoretically all-encompassing ‘business judgment rule’ standard,” which the Chancellors view as creating “dysfunctions that confuse, rather than aid, the resolution of fiduciary duty cases.”³

This article examines certain recent developments in Delaware fiduciary duty law that may evidence the beginning of a process by which the Delaware judiciary will reexamine the proliferation of review standards and related rules or,

article. The views reflected herein are those of the authors and may not reflect those of Potter Anderson & Corroon LLP or its clients.

² William T. Allen, et al., *Function over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 Bus. Law. 1287 (2001) (hereinafter *Standards of Review*).

³ *Id.* at 1298.

at least, that provide a framework for discussion of a “mid-course correction” of the type the Chancellors are advocating.

A. Going Private Transactions.

One of the areas of Delaware fiduciary duty law the Chancellors’ article suggests is in need of some fine tuning is that relating to going private mergers by controlling stockholders, particularly case law requiring entire fairness review of such transactions notwithstanding approval by a special committee of independent directors or ratification by a majority of the minority stockholders.⁴ Two recent cases – *In re Siliconix, Inc. Shareholders Litigation*⁵ and *Glassman v. Unocal Exploration Corporation*⁶ – suggest a simpler and more functional approach to going private transactions and may provide the impetus for a broader refinement of the judicial approach for evaluating such transactions, of the sort the Chancellors are advocating.

After the Delaware Supreme Court’s 1993 decision in *Weinberger v. UOP, Inc.*,⁷ corporate practitioners generally assumed that any transaction whereby a majority stockholder sought to acquire the minority interest through a merger would be governed by the entire fairness standard of review. Unlike the business

⁴ *Id.* at 1306-09.

⁵ C.A. No. 18700, 2001 WL 716787, Noble, V. C. (Del. Ch. June 21, 2001).

⁶ 777 A.2d 242 (Del. 2001).

⁷ 457 A.2d 701, 711 (Del. 1983).

judgment rule, pursuant to which a Delaware court will refrain from second-guessing the directors' business decision so long as it can be attributed to a rational business purpose,⁸ the entire fairness standard ordinarily requires fiduciaries to convince the court that their decision was the product of both a qualitatively fair process and a quantitatively fair price.⁹ The *Weinberger* court also suggested that this heavy burden could be satisfied by setting up a mechanism designed to replicate the type of arm's length negotiation that would occur if an entirely disinterested board were negotiating a buyout.¹⁰ The most common method by which this has been accomplished has been the formation of a committee of independent directors to negotiate the proposed transaction with the majority stockholder. In *Kahn v.*

⁸ See *Paramount Communications Inc. v. QVC Network, Inc.*, 637 A.2d 34, 45 n.17 (Del. 1994).

⁹ See, e.g., *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1162-63 (Del. 1995) ("*Technicolor III*") (quoting *Weinberger*, 457 A.2d at 711). Fair process, or "fair dealing," involves the actual conduct of the directors in connection with the challenged transaction, including the timing, initiation, structure, and negotiation of the transaction, as well as the manner in which disclosure was made to the directors and stockholders and the manner in which approvals of the directors and stockholders were obtained. See, e.g., *Technicolor III*, 663 A.2d at 1162-63 (quoting *Weinberger*, 457 A.2d at 711); *id.* at 1172-76. "Fair price" means a price that a reasonable seller, under all of the circumstances and in an arm's length transaction, would regard as within a range of fair value, and includes all relevant factors – asset value, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of the company's stock. See *Technicolor III*, 663 A.2d at 1162-63 (quoting *Weinberger*, 457 A.2d at 711); *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1134, 1143 (Del. Ch. 1994), *aff'd*, *Technicolor III*, 663 A.2d 1156.

Lynch Communication Systems, Inc.,¹¹ the Supreme Court settled a split in authority in the Court of Chancery,¹² finding that approval of a going private transaction by a well functioning independent committee will not result in the application of the business judgment rule to the challenged transaction, but will relieve the majority stockholder and the controlled board of the burden of proving the fairness of the transaction by shifting the burden of proof to the plaintiff challenging the transaction to show that the transaction was unfair to minority stockholders.¹³ However, the committee process can be expensive and time-consuming, as is the process of holding a stockholders' meeting or taking action by written consent,¹⁴ one of which

¹⁰ *Weinberger*, 457 A.2d at 709 n.7. (“[T]he result here could have been completely different if UOP had appointed an independent negotiating committee of its outside directors to deal with Signal at arm’s length”).

¹¹ 638 A.2d 1110 (Del. 1994).

¹² Compare *In re Trans World Airlines, Inc. Shareholders Litig.*, C. A. No. 9844, 1988 WL 111271, at *7, Allen, C. (Del. Ch. Oct. 21, 1988) (business judgment rule becomes applicable where independent committee functioned effectively) with *Citron v. E.I. Du Pont de Nemours & Co.*, 584 A.2d 490 (Del. Ch. 1990) (disagreeing with *TransWorld Airlines* and giving burden-shifting effect to committee action).

¹³ *Lynch Communication*, 638 A.2d at 1117.

¹⁴ Although the controlling stockholder can approve a back-end merger by written consent (assuming the certificate of incorporation does not restrict action by consent), the action may not be effective until the minority stockholders are provided with an information statement and 20 business days have passed, as required by federal securities law.

is ordinarily required to consummate the back-end merger that is the typical last step in such transactions.¹⁵

The recent decisions in *Siliconix* and *Unocal Exploration* have suggested a manner of structuring a going private transaction that eliminates the need to use a special committee but still does not saddle the majority stockholder or target board with the burden of proving the entire fairness of the transaction if it is challenged by a minority stockholder. *Siliconix* confirmed that a controlling stockholder making a tender offer for minority-held shares in the controlled corporation is generally under no obligation to offer any particular price for the minority-held stock and further held that neither the controlling stockholder nor the directors of the controlled company would be required to demonstrate the entire fairness of the tender offer. In *Unocal Exploration*, the Delaware Supreme Court held that the entire fairness standard of review is not applicable to challenges to short-form mergers effected pursuant to Section 253 of the DGCL. Together, these decisions may offer majority stockholders a roadmap – tender offer followed by a short-form merger – for accomplishing a cashout of the

¹⁵ A method by which acquirors (both controlling and non-controlling) have addressed the time lag caused by the need for a “back-end” long-form merger is through the use of a tender offer coupled with a “top-up” option granted by the target corporation’s board. A top-up option is designed to ensure that the acquiror will achieve 90% ownership of the target so as to enable the acquiror to utilize the “short-form” merger process prescribed by Section 253 of the Delaware General Corporation Law (the “DGCL”), which is discussed below in more detail.

minority without assuming the heavy burden of proving entire fairness and without the need for the use of a traditional special committee.

1. In re Siliconix, Inc. Shareholders Litigation.

Vishay Intertechnology, Inc. (“Vishay”), which indirectly held 80.4% of the common stock of Siliconix Incorporated (“Siliconix”), announced (i) a proposed all-cash tender offer for the remaining publicly held shares of Siliconix common stock, (ii) that it would consider a short-form merger of Siliconix into a Vishay subsidiary for the same price if it obtained over 90% of the Siliconix common stock in the tender offer, and (iii) that it would like the opportunity to discuss the tender offer with a special committee of independent Siliconix directors.¹⁶ Although Siliconix formed a special committee to negotiate the terms of the tender offer with Vishay, the negotiations failed to produce an agreement on an acceptable tender offer price¹⁷ and Vishay determined to proceed with a stock-for-stock exchange offer without obtaining the special committee’s approval.¹⁸

In its motion to enjoin preliminarily the exchange offer, plaintiff alleged that Vishay and the Siliconix board of directors had the burden to demonstrate the

¹⁶ *In re Siliconix, Inc. Shareholders Litig*, C.A. No. 18700, 2001 WL 716787, at *2, Noble, V.C. (Del. Ch. June 21, 2001).

¹⁷ *Id.* at *2-*4.

¹⁸ *Id.* at *4.

entire fairness of the offer price and, as a result of alleged breaches of fiduciary duties and the “oppressive” structure of the offer, the exchange offer. Rejecting plaintiff’s arguments, the Court noted that “a controlling shareholder extending an offer for minority-held shares in the controlled corporation is under no obligation, absent evidence that material information about the offer has been withheld or misrepresented or that the offer is coercive in some significant way, to offer any particular price for the minority-held stock.”¹⁹ Finding no disclosure violations and that the offer was not coercive, the Court held that the exchange offer was not subject to review under the entire fairness test. In reaching that conclusion, the Court distinguished a “long-form” merger under Section 251 or Section 252 of the DGCL,²⁰ which *would have required* board action (and therefore would have justified review under the entire fairness test), from an exchange or tender offer that may (or may not) have been followed by a short-form merger pursuant to Section 253, which *would not have required* board action (and therefore would not have justified review under the entire fairness test). For those reasons, the Court held that Vishay “was under no duty to offer any particular price, or a ‘fair’ price, to the minority shareholders of Siliconix” in its exchange offer.²¹ *Siliconix*, therefore, affirms that a bidder – whether or not it is the target’s controlling

¹⁹ *Id.* at *6.

²⁰ 8 *Del. C.* §§ 251, 252.

²¹ *Siliconix*, 2001 WL 716787, at *6.

stockholder – has no duty to offer any particular price in its tender or exchange offer.²²

2. **Glassman v. Unocal Exploration Corp.**

Section 253 of the DGCL authorizes the board of directors of a Delaware corporation that owns 90% or more of each of the outstanding classes of stock of a subsidiary that are entitled to vote on a merger to merge the subsidiary into itself without any requirement for action to be taken by the board of directors of the subsidiary. *Unocal Exploration* involved a challenge to such a “short-form” merger of Unocal Exploration Corporation (“UXC”) with and into its 96% stockholder, a wholly owned subsidiary of Unocal Corporation (“Unocal”). Plaintiff-appellants contended that Unocal, an earth resources corporation primarily engaged in the exploration and production of crude oil and natural gas, timed the merger of UXC into Unocal to take advantage of a decrease in natural gas prices. On appeal, plaintiff-appellants challenged the fairness of the merger, arguing that mergers effected under Section 253 should be reviewed under the entire fairness test – the same standard that is typically applied to cashout mergers effected by controlling stockholders under the long-form merger statutes, Sections 251 and 252 of the DGCL. Plaintiff-appellants based their argument on, among

²² The principle underlying the *Siliconix* decision is not new. Rather, it reaffirmed existing Delaware law precedent, including the Supreme Court’s

other things, the Supreme Court decisions in *Weinberger, Bershad v. Curtiss-Wright Corp.*,²³ and *Kahn*, each of which were mergers under the Delaware long-form statute but each of which seemingly supported, at least in some respect, the notion that the entire fairness standard of review should be applicable to short-form mergers.

The Delaware Supreme Court rejected plaintiff-appellants' reading of these cases, relying instead on the approach enunciated long ago in *Stauffer v. Standard Brands, Inc.*²⁴ The fundamental principle underlying *Stauffer* (and, therefore, underlying *Unocal Exploration*) is that Section 253 creates an affirmative right in a 90% stockholder to eliminate minority stockholders' participation in the controlled corporation, rather than merely representing a

decision in *Solomon v. Pathe Communications Corp.*, 672 A.2d 35, 39-40 (Del. 1996).

²³ 535 A.2d 840 (Del. 1987).

²⁴ 187 A.2d 78 (Del. 1962). As the Supreme Court noted in its opinion, the vitality of *Stauffer* ebbed and flowed over the years. It was nearly completely overruled in the 1970s, see *Singer v. Magnovox Co.*, 380 A.2d 969 (Del. 1977); *Roland Inter. Corp. v. Najjar*, 407 A.2d 1032 (Del. 1979), but was revitalized in *Weinberger*, in which the Court announced it was returning to the "well-established principles" of *Stauffer* and its progeny "mandating a stockholder's recourse to the basic remedy of appraisal." *Weinberger*, 457 A.2d at 715. After *Weinberger*, in cases such as *Rabkin v. Philip A. Hunt Chemical Corp.*, 498 A.2d 1099 (Del. 1985), as well as *Bershad* and *Kahn*, the Supreme Court appeared once again to retreat from the principles enunciated in *Stauffer*, focusing in those cases on the fiduciary duties possessed by a controlling stockholder and the concomitant requirement that self-dealing transactions involving fiduciaries be reviewed under an entire fairness analysis. However, neither *Weinberger* nor the

truncated procedure for effecting a merger in such circumstances. This statutorily-created right “authorizes the elimination of minority stockholders by a summary process that does not involve the ‘fair dealing’ component of entire fairness.”²⁵ Accordingly, Section 253 “effectively circumscribe[s] the parent corporation’s obligations to the minority in a short-form merger.”²⁶ As the Supreme Court explained:

Under settled principles, a parent corporation and its directors undertaking a short-form merger are self-dealing fiduciaries who should be required to establish entire fairness, including fair dealing and fair price. The problem is that §253 authorizes a summary procedure that is inconsistent with any reasonable notion of fair dealing.... The equitable claim plainly conflicts with the statute. If a corporate fiduciary follows the truncated process authorized by §253, it will not be able to establish the fair dealing prong of entire fairness.... In order to preserve its purpose, §253 must be construed to obviate the requirement to establish entire fairness.²⁷

Delaware Supreme Court cases following it involved a short-form merger effected under Section 253.

²⁵ *Unocal Exploration*, 777 A.2d at 242.

²⁶ *Id.*

²⁷ *Id.* at 247-248. It should be noted that Unocal did cause UXC to employ a special committee of the UXC board of directors to negotiate on behalf of the minority stockholders of UXC. According to both the Court of Chancery and the Supreme Court, Unocal did so in large part because of its awareness of the divergence that had arisen in the law and “engage[d] in a process that it believed would pass muster under traditional entire fairness review.” *Unocal Exploration*, 777 A.2d at 243. Vice Chancellor Lamb found that the use of a special committee did not affect his analysis of the appropriate standard of review, because the committee was established and operated in good faith and was not a “*sham*

The Supreme Court was careful, however, to note specifically that Section 253 does not eliminate the parent corporation's fiduciary duty to disclose to the minority stockholders all information that is reasonably necessary in order to enable them to decide, on a fully informed basis, whether to exercise their appraisal rights. The Court also reaffirmed the statements in *Weinberger* with respect to the scope of the matters that can be considered in an appraisal, stating that "fair value must be based *all* relevant factors, including damages and

designed to lull the public stockholders into believing that their interests have been protected." *In Re Unocal Exploration Corp. Shareholders Litigation*, C.A. No. 12453, 2000 WL 823376, at *13, Lamb, V.C. (Del. Ch. June 13, 2000) (quoting *Iseman v. Liquid Air Corp.*, C.A. Nos. 9694, 9833, 1989 WL 125234, at *3 Berger, V.C. (Del. Ch. Oct. 23, 1989) (emphasis in original). The Supreme Court, however, did not address this issue with specificity. In the authors' view, this silence should be taken as an acknowledgement by the Court of the uncertain nature of the law of short-form mergers prior to *Unocal Exploration*. It is not necessarily an endorsement of a broader approach under which the Court will decline to apply standard fiduciary duty analysis where a board (or committee) voluntarily assumes a role in a transaction with respect to which no board action otherwise would be required. *See, e.g., Freedman v. Restaurant Assocs. Indus., Inc.*, C.A. No. 9212, 1990 WL 135923, at *8, Allen, C. (Del. Ch. Sept. 21, 1990) ("Although management may have no general obligation to disclose its purpose or motivation, once it undertook to disclose its purpose in revising the offer, it had an obligation to do so truthfully and candidly."). Indeed, the focus of the Supreme Court in *Unocal Exploration* upon the lack of a requirement for subsidiary board involvement in a Section 253 "short form" merger reconciles *Unocal Exploration* with the Supreme Court's earlier opinion in *McMullin v. Beran*, 765 A.2d 910 (Del. 2000). In *McMullin*, the Supreme Court found that a controlling stockholder's decision to effect a sale of the subsidiary through a *long-form* merger requiring subsidiary board approval implicated the fiduciary duties of the subsidiary corporation's directors and the majority stockholder. However, in the course of so holding, the Court specifically noted that the majority

elements of future value, where appropriate.”²⁸ Thus, the Court made clear that certain factors that are often raised in an entire fairness claim, such as timing a merger to take advantage of a temporary depression in the stock price or other market fluctuations that affect the underlying value of the stock, may be considered in an appraisal proceeding.

3. A New “Road Map” for Going Private Transactions.

The focus in both *Unocal Exploration* and *Siliconix* on the rights of the majority stockholder strongly suggests that a majority stockholder that crosses the 90% threshold through stock purchases may avoid entire fairness review of both the purchase and any subsequent short-form merger. So viewed, *Siliconix*, coupled with *Unocal Exploration*, may offer majority stockholders a roadmap for accomplishing a cashout of the minority without assuming the heavy burden of proving entire fairness.²⁹ Of course, the success of such a plan is wholly dependent on the majority stockholder’s ability to convince a sufficient number of minority stockholders to tender their shares in order to achieve the 90% ownership level required by Section 253.

stockholder was free to sell its own subsidiary shares for whatever consideration may have been acceptable to it. *McMullin*, 765 A.2d at 920.

²⁸ *Unocal Exploration*, 777 A.2d at 248.

²⁹ Indeed, this “roadmap” was followed successfully (at least at the preliminary injunction stage) by UtiliCorp United Inc. in its acquisition of the

Just as *Weinberger* spawned a significant body of case law relating to use of long form mergers to effect going private transactions, *Siliconix* and *Unocal Exploration* are unlikely to be the last word with respect to going private transactions structured by use of a tender offer followed by a back end, short form merger. Each of *Siliconix* and *Unocal Exploration* leave a sufficient number of unanswered questions so as to anticipate continued case law development with respect to going private transactions structured in such a manner. For example, will *Siliconix* be applied to countenance non-review where a target board chooses not to remain neutral but instead recommends to its stockholders that they tender their shares? Will non-review under *Siliconix* pertain where the target board has independent directors but does not employ either a special committee or an independent investment banker to evaluate the controlling stockholder's offer? Are there circumstances in which an investment banker's fairness opinion should be required?

Another issue likely to arise is whether *Unocal Exploration* would prohibit fiduciary duty review of a Section 253 merger regardless of the means by which the 90% stock ownership threshold was achieved. While the Supreme Court's decision in *Unocal Exploration* makes clear that the entire fairness standard of review does not apply to short-form mergers in which the parent holds the

minority interest in Aquila Corp. See *In re Aquila Inc. Shareholders Litig.*, C.A. No. 19237, 2002 WL 27815, Lamb, V.C. (Del. Ch. Jan. 3, 2002).

requisite amount of subsidiary stock *at the time* that it determines to merge, its focus on the unilateral nature of this right leaves open the possibility that a different result may obtain in circumstances in which a parent corporation requires the assistance of the subsidiary's board of directors in order to reach the 90% threshold prior to consummating a short-form merger. *Unocal Exploration* does not resolve whether such "back-end" mergers, which are typically negotiated with the target board of directors as part of an overall transaction, avoid for the parent corporation altogether the need to accept the burden of proving entire fairness. Indeed, Vice Chancellor Lamb acknowledged this concern in a footnote to the trial court opinion in *Unocal Exploration*, in which he stated his belief that certain structures involving an ultimate merger under Section 253 might nevertheless implicate entire fairness review, including situations where the short-form merger was the second step in a two-step acquisition approved by the board of the target corporation.³⁰ Such transactions might well be viewed by a court as a unitary transaction requiring entire fairness review, with the merger viewed as the final step in a conspiracy to accomplish a lawful end by unlawful means.³¹

³⁰ *In Re Unocal Exploration Corp. Shareholders Litig.*, C.A. No. 12453, 2000 WL 823376, at *6 n.26, V.C. Lamb (Del. Ch. June 13, 2000).

³¹ See *Braasch v. Goldschmidt*, 199 A.2d 760, 764 (Del. Ch. 1964). See also *Andra v. Blount*, 772 A.2d 183, 197 n.30 (Del. Ch. 2000) (distinguishing a case in which a majority stockholder owns 90% of the outstanding shares *before* any of the challenged conduct occurred from "an essentially unitary tender offer/back-end [Section 253] merger transaction").

Another way to address this issue would be to subject to fairness review the transaction by which a majority stockholder acquired additional stock to achieve the 90% ownership threshold, provided that the target board was involved in that transaction (as would be the case if a “top-up option” or a negotiated merger agreement were involved), but not if the majority stockholder utilized a unilateral tender offer. At this point, the manner in which the Delaware courts ultimately will deal with this dilemma is uncertain.

4. Implications of Siliconix and Unocal Exploration for the Standard of Review Debate.

Although not directly responsive to the issues raised by the Chancellors in their *Standard of Review* article, the rationales of both *Siliconix* and *Unocal Exploration* implicate the themes raised in the article. Consistent with one of the goals of a standard of review articulated by the Chancellors, the rules enunciated in *Siliconix* and *Unocal Exploration* are functional and straightforward. Moreover, they evidence the type of “de-linking” of the business judgment rule from the standard of review applied in cases not involving duty of care violations advocated by the Chancellors.³² Indeed, they constitute instances of the

³² *Standards of Review*, 56 Bus. Law. at 1298. See also Lyman Johnson, *The Modest Business Judgment Rule*, 55 Bus. Law. 625 (2000) (arguing that the substantive aspect of the business judgment as a policy of non-review should be emphasized and that the duty of due care should be the primary vehicle by which board decisions not involving divided loyalties are reviewed.)

elimination of any review under business judgment principles as developed over the past two decades.³³

B. The Duty of Care and Section 102(b)(7) (*Emerald Partners v. Berlin*).

In their *Standards of Review* article, the Chancellors also have suggested reassessment of the principles currently applicable to judicial review of claims alleging breach of the fiduciary duty of care. We address below the current state of Delaware’s duty of care jurisprudence and a series of decisions by the Delaware Supreme Court in the long pending *Emerald Partners v. Berlin* litigation, the most recent of which may be read either as an express disavowal of one of the proposals in the Chancellor’s *Standards of Review* article or as the first step toward accepting another of those proposals, or perhaps both, depending upon how one reads the decision.

1. The Current State of Delaware’s Duty of Care Jurisprudence.

Generally speaking, the fiduciary duty of due care requires directors to inform themselves of all material information reasonably available to them before making a business decision and, having so informed themselves, to act with the

³³ On the other hand, these cases arguably run counter to the theme of simplification sounded by the Chancellors in that they may create yet another analytical “box” into which deal planners will attempt to fit their transactions.

requisite care in making such decision.³⁴ Historically, the duty of due care and the duty of loyalty were viewed as very distinct concepts and directors' compliance with those duties was measured by very different standards. In any breach of duty case, the threshold inquiry is whether the board of directors has a conflicting interest in the transaction. If so, the directors' conduct is viewed as potentially implicating the duty of loyalty, and it has long been the case that a conflicted board is required to prove the entire fairness of its decision. In contrast, it was long assumed that pure duty of care claims would be scrutinized quite differently, inasmuch as such claims do not involve conflicting interests or lack of good faith.

In fact, until the Delaware Supreme Court's landmark decision in *Smith v. Van Gorkom*,³⁵ few Delaware cases had considered claims of lack of due care apart from allegations of disloyalty and none had imposed liability on directors solely for the failure to exercise due care. The *Van Gorkom* decision sparked a revolution of sorts when it found outside, disinterested directors liable for money damages for failing to act in an informed and deliberate manner in connection with their approval of a merger. Although the directors were found liable in *Van Gorkom*, the Court

³⁴ See *Cede & Co. v. Technicolor, Inc.* ("Technicolor II"), 634 A.2d 345, 367 (Del. 1993); *Van Gorkom*, 488 A.2d at 872.

³⁵ 488 A.2d 858 (Del. 1985).

reaffirmed that a violation of the duty of due care would be found only upon a showing of “gross negligence.”³⁶

The Delaware Supreme Court’s next major decision addressing the duty of care, *Cede & Co. v. Technicolor, Inc.* (“*Technicolor II*”),³⁷ also involved a challenge to board approval of a merger and sought to place the duties of care and loyalty on an even more equal footing,³⁸ in the process all but eliminating what many practitioners had perceived as the fundamental differences between the two duties. The trial court in the Technicolor litigation had analyzed the plaintiff’s due care claims in a manner similar to traditional tort law negligence analysis – in other words, the plaintiff had the burden of demonstrating that the directors acted in a grossly negligent manner resulting in harm to the stockholders.³⁹ The trial court held that financial injury had not been shown and entered judgment in favor of defendants.⁴⁰ The Supreme Court reversed, holding that once a plaintiff has provided sufficient evidence that the directors had failed to act prudently, the burden shifts to the directors to prove the entire fairness of the transaction, both as to process and price. The Supreme Court explained:

³⁶ *Id.* at 812.

³⁷ 634 A.2d 345 (Del. 1993).

³⁸ *See* 634 A.2d at 367 (“Each of these duties is of equal and independent significance.”).

³⁹ *Cinerama, Inc. v. Technicolor, Inc.*, C.A. No. 8358, 1991 WL 111134, at *17-18, Allen, C. (Del. Ch. June 24, 1991).

⁴⁰ *Id.*, 1991 WL 111134, at *18, 26.

To rebut the [business judgment] rule, a shareholder plaintiff assumes the burden of providing evidence that directors, in reaching their challenged decision, breached any one of the triad of their fiduciary duty – good faith, loyalty or due care. If a shareholder plaintiff fails to meet this evidentiary burden, the business judgment rule attaches to protect corporate officers and directors and the decisions they make, and our courts will not second-guess these business judgments. If the rule is rebutted, the burden shifts to the defendant directors, the proponents of the challenged transaction, to prove to the trier of fact the “entire fairness” of the transaction to the shareholder plaintiff.⁴¹

Thus, while stating that a breach of the fiduciary duty of due care would result only upon a showing of gross negligence, the Supreme Court made clear that a stockholder plaintiff need only provide “evidence” (*i.e.* establish a prima facie case) of lack of due care to shift the burden of proof to the defendant directors to show that their decision was entirely fair. The *Technicolor II* holding thereby eases the pleading and evidentiary burden on the plaintiff and greatly increases the burden on the director defendants. But at the same time, the holding would seem to imply that the failure to give due consideration to all material information (or otherwise failing to act in a prudent manner under the circumstances) does not necessarily result in a breach of the duty of due care, thus effectively resulting in a watered down duty of care. In other words, even if directors have failed to inform themselves of all reasonably available information material to their decision, they nonetheless may be

⁴¹ *Technicolor II*, 634 A.2d at 361.

able to demonstrate the “entire fairness” of their decision and thereby negate a finding of breach of the duty of care.

It is one thing to find that a board’s failure to consider the requisite material information did not proximately cause harm to the corporation or its stockholders (as would be the result applying traditional tort law negligence principles, as advocated by the Chancellor in the *Technicolor* litigation). It is quite another to find that the lack of harm in such circumstances results in a finding that the duty of due care has not been breached in the first instance. For these and other reasons, the Supreme Court’s holding in *Technicolor II* has been questioned,⁴² including by the Chancellors in their *Standards of Review* article, who advocate treating duty of care claims under the tort law negligence principles advocated by the trial court in the *Technicolor* litigation rather than in the same vein as breach of loyalty claims.⁴³

2. Exculpatory Charter Provisions Under Section 102(b)(7) of the DGCL and the Holding in *Emerald Partners II*.

⁴² See, e.g., Lyman Johnson, *The Modest Business Judgment Rule*, 55 Bus. Law. 625 (Feb. 2000); Lyman Johnson, *Rethinking Judicial Review of Director Care*, 24 Del. J. Corp. Law 787 (1999); Bud Roth, *Entire Fairness Review for a “Pure” Breach of the Duty of Care: Sensible Approach or Technicolor Flop?*, 3 Del. L. Rev. 145 (2000).

⁴³ See Allen et al., *Standards of Review*, *supra* at 1299-1305.

The holding in *Technicolor II*, which treated breaches of the duties of care and loyalty as having similar (if not identical) practical and functional implications, stands somewhat at odds with the policy underlying Section 102(b)(7) of the DGCL, which was enacted in response to the Supreme Court’s holding in *Van Gorkom*. Section 102(b)(7) permits a Delaware corporation to include a provision in its certificate of incorporation limiting or eliminating its directors’ personal liability for monetary damages for breaches of the duty of care.⁴⁴ The statute, however, precludes elimination or limitation of liability for breaches of the duty of loyalty, the failure to act in good faith, intentional misconduct, knowing violations of law, obtaining improper personal benefits, or paying dividends or approving stock repurchases in violation of the DGCL.⁴⁵

In *Emerald Partners v. Berlin* (“*Emerald Partners IP*”),⁴⁶ the Delaware Supreme Court held that “the shield from liability provided by a certificate of incorporation provision adopted pursuant to 8 *Del. C.* § 102(b)(7) is in the nature of an affirmative defense.”⁴⁷ The Court emphasized that the burden of establishing each of the elements of the defense – that the conduct does not fall within any of the

⁴⁴ 8 *Del. C.* § 102(b)(7).

⁴⁵ 8 *Del. C.* § 102(b)(7); *see also, e.g., Zirn v. VLI Corp.*, 621 A.2d 773, 783 (Del. 1993) (Section 102(b)(7) provision in corporation’s certificate did not shield directors from liability where disclosure claims involving breach of the duty of loyalty were asserted).

⁴⁶ 726 A.2d 1215 (Del. 1999).

⁴⁷ 726 A.2d at 1223.

categories enumerated in Section 102(b)(7) for which exculpation is not permitted – falls upon the defendant directors seeking to invoke the provision.⁴⁸ The Court did note, however, that “where the factual basis for a claim *solely* implicates a violation of the duty of care, ... the protections of such a charter provision may properly be invoked and applied.”⁴⁹

Following *Emerald Partners II*, it was not entirely clear if or under what circumstances breach of fiduciary duty claims ever could be disposed of prior to a full trial on the merits on the basis of a Section 102(b)(7) defense. Nonetheless, several decisions of the Court of Chancery decided thereafter held that if a complaint seeking monetary damages alleges only breaches of the fiduciary duty of care, director defendants may properly raise an exculpatory charter provision under Section 102(b)(7), and the complaint may be dismissed on that basis, prior to trial, on a motion to dismiss under Rule 12(b)(6) for failure to state a claim upon which relief can be granted.⁵⁰ This line of cases was subsequently confirmed by the

⁴⁸ *Id.* at 1223-24.

⁴⁹ *Id.* at 1224.

⁵⁰ *See, e.g., In Re Frederick’s of Hollywood, Inc. Shareholders Litig.*, C.A. No. 15944, 2000 WL 130630, Jacobs, V.C. (Del. Ch. Jan. 31, 2000), *aff’d sub nom. Malpiede v. Townson*, 780 A.2d 1075 (Del. 2001); *McMillan v. Intercargo Corp.*, 768 A.2d 492, 501 n. 40 (Del. Ch. 2000); *In Re Lukens, Inc. Shareholders Litig.*, 757 A.2d 720, 724 n. 1 & 732-34 (Del. Ch. 1999); *see also Goodwin v. Live Enter., Inc.*, C.A. No. 15765, 1999 WL 64265, at *5 n.16, Strine, V.C. (Del. Ch., Jan. 25, 1999), (granting summary judgment on the basis of a Section 102(b)(7) exculpatory provision where plaintiff unable to create a genuine dispute

Supreme Court in *Malpiede v. Townson*.⁵¹ In *Malpiede*, the Supreme Court held that the complaint properly pleaded a residual due care claim “and nothing else,” and that such a complaint could be dismissed on a Rule 12(b)(6) motion because the Section 102(b)(7) exculpatory provision would bar the only well-pleaded claim.⁵²

3. Emerald Partners III.

Several months after its decision in *Malpiede*, the Supreme Court considered yet another appeal in the *Emerald Partners* litigation (“*Emerald Partners III*”).⁵³ That appeal arose from a decision of the Court of Chancery, after trial, granting judgment in favor of the remaining director defendants. The trial had taken place following the Supreme Court’s decision in *Emerald Partners II*, in which the Supreme Court had concluded that Craig Hall, the former chairman, CEO, and controlling stockholder of May Petroleum, Inc. “clearly stood on both sides of [a] transaction” involving the merger of May Petroleum and several corporations owned by Mr. Hall. Accordingly, the Supreme Court had remanded the case to the Court of Chancery for a trial pursuant to the entire fairness standard of review. The Supreme Court’s findings and remand decision resulted in a rather unique procedural posture, as Mr. Hall, the controlling

as to whether board approval was the product of bad faith or disloyalty), *aff’d*, 741 A.2d 16 (Del. 1999).

⁵¹ 780 A.2d 1075 (Del. 2001).

⁵² *Malpiede v. Townson*, 780 A.2d 1075, 1093-94 (Del. 2001).

stockholder, had been dismissed at an earlier stage of the proceedings as a result of his 1992 bankruptcy, effectively leaving the independent, “non-affiliated” directors to defend plaintiff’s breach of fiduciary duty claims.⁵⁴ The Court of Chancery, in a lengthy opinion and after extensive analysis, had concluded that the disinterested director defendants had carried their burden of establishing that a Section 102(b)(7) exculpatory provision applied and that none of the exceptions of that provision were applicable to the challenged conduct – *i.e.* that the challenged transaction resulted at most from breaches of the duty of care by those directors. Because the plaintiff sought only money damages, the Court of Chancery entered judgment in favor of the remaining defendants.

The Supreme Court reversed, holding that even where disinterested and independent directors raise a Section 102(b)(7) provision, the trial court must conduct an entire fairness analysis in any case that “requires application of the

⁵³ *Emerald Partners v. Berlin*, 787 A.2d 85 (Del. 2001).

⁵⁴ Another director, Mr. Berlin, had been employed by Mr. Hall’s corporations for many years and was not independent of Mr. Hall. Mr. Berlin, however, raised as an affirmative defense that he had abstained from participating in any significant way in the decision making process and could not be held liable. The Court of Chancery concurred with the defense and held that by not responding to the affirmative defense, plaintiff had effectively conceded the position. *Emerald Partners v. Berlin*, C.A. No. 9700, 2001 WL 115340, at *19, Jacobs, V.C. (Del. Ch. Feb. 7, 2001). In addition, the Supreme Court had previously affirmed the Court of Chancery’s grant of summary judgment in favor of one of the corporate defendants, Hall Financial, on the basis that plaintiff had waived any claims it had against Hall Financial by not raising them on appeal. *Emerald Partners II*, 726 A.2d at 1224.

entire fairness standard of judicial review *ab initio* at trial” and that in such a case, “a determination that director defendants are exculpated from paying monetary damages can be made only *after the basis* for their liability has been decided.”⁵⁵

The Supreme Court explained its reasoning as follows:

Although a Section 102(b)(7) provision does not operate to defeat the validity of a plaintiff’s claim on the merits, it can operate to defeat the plaintiff’s ability to recover monetary damages....

... [U]nless there is a violation of the duty of loyalty or the duty of good faith, a trial on the issue of entire fairness is unnecessary because a Section 102(b)(7) provision will exculpate director defendants from paying monetary damages that are exclusively attributable to a violation of the duty of care. The effect of our holding in *Malpiede* is that, in actions against the directors of Delaware corporations with a Section 102(b)(7) charter provision, a shareholder’s complaint must allege well-pled facts that, if true, implicate breaches of loyalty or good faith. Otherwise, in those cases that begin with the presumption of the business judgment rule, *ab initio*, our holding in *Malpiede* establishes that the proper invocation of a Section 102(b)(7) provision can obviate a trial pursuant to the entire fairness standard, even if the presumption of the business judgment rule is successfully rebutted by a duty of care violation, since liability for duty of loyalty violations or violations of good faith are not at issue.

* * *

... The rationale of our holding in *Malpiede* explains why an entire fairness analysis can never be avoided in any challenged transaction that requires an application of the entire fairness standard of judicial review *ab initio* at trial – as we held in our last *Emerald Partners* opinion – notwithstanding the existence of a Section 102(b)(7) provision. The category of transactions that require judicial

⁵⁵ *Emerald Partners III*, 787 A.2d at 93-94 (emphasis in original).

review pursuant to the entire fairness standard *ab initio* do so because, by definition, the inherently interested nature of those transactions are inextricably intertwined with issues of loyalty.⁵⁶

4. The Practical Impact of *Emerald Partners III* and Implications for the Standard of Review Debate.

The specific result in *Emerald Partners III* – that disinterested directors who the Court has found, after trial, to have violated at most their fiduciary duty of care nonetheless cannot be exculpated from liability on the basis of a Section 102(b)(7) charter provision until the Court has first conducted an entire fairness analysis⁵⁷ – has led to criticism by some commentators. For example, some commentators believe the decision “will significantly increase the burden on directors of Delaware corporations in a large category of stockholder litigation, and also undercuts the goal of providing Delaware directors with maximum

⁵⁶ *Id.* at 92-93 (footnotes omitted).

⁵⁷ *See In re The Student Loan Corp. Derivative Litigation*, C.A. No. 17799, 2002 WL 75479, at *4 n.8, Strine, V.C. (Del. Ch. January 8, 2002) (“Because this is a case to which the entire fairness standard applies “*ab initio*,” I hesitate to consider this [Section 102(b)(7) exculpation] defense at this stage given the recent opinion in *Emerald Partners v. Berlin*, Del. Supr., 787 A.2d 85 (2001). That opinion can be read to hold that when the entire fairness standard applies, even an independent director cannot obtain dismissal of damage claims against him until after the fairness of the transaction is determined, regardless of whether the independent director shows, on a Rule 12(b)(6) or Rule 56 motion, that the plaintiffs have submitted no facts or admissible evidence, as the case may be, supporting a finding that the independent director committed a non-exculpated breach of fiduciary duty.”).

protection from personal liability except where self-dealing is involved.”⁵⁸ In fact, the concerns expressed by the Chancellors in their critique of *Emerald Partners II* would seem to be equally applicable to the Supreme Court’s recent *Emerald Partners* decision. The Chancellors explain:

Imposing the burden to establish the exculpation defense upon the directors perversely requires them to disprove all of the duty of *loyalty*-related “exceptions” to the defense, to be relieved of liability for *due care* claims. That is not how the exculpation defense should work. Rather, to the extent a complaint seeks damages against directors for claimed duty of care violations, those claims should be deemed exculpated. All other claims will by definition be duty of loyalty claims that the *plaintiff* traditionally has the burden to establish. The unintended result of the *Emerald Partners* doctrine is to make those directors who interpose the exculpation defense worse off procedurally than those who do not. That creates disincentives to raising that statutory defense, as well as the potential for meritless cases to survive motions to dismiss, thereby perpetuating costly litigation having little or no countervailing social utility.⁵⁹

While concerns such as these are certainly compelling and the full meaning and effect of *Emerald Partners III* remains uncertain, we submit that the practical effect of the decision on corporate fiduciary duty litigation may not be as drastic as some suppose. First, the Supreme Court reaffirmed that the Section 102(b)(7) defense may be raised on a motion to dismiss for failure to state a claim or a motion for judgment on the pleadings in cases in which only a breach of the

⁵⁸ T.N. Mirvis and P.K. Rowe, *Delaware Decision on Director Exculpation Protection*, Corporation (vol. LXXIII, no. 2, January 15, 2002).

⁵⁹ Allen et al., *supra* at 1304-05 (emphasis in original).

duty of care is properly pleaded. Second, it does not appear that the decision would preclude the Court of Chancery from granting judgment on the basis of a Section 102(b)(7) exculpatory charter provision prior to a trial on the issue of entire fairness, if on a motion for summary judgment, plaintiffs are incapable of presenting *prima facie* evidence of disloyalty or bad faith sufficient to invoke the entire fairness standard of review.⁶⁰

Third, it appears that the rule of *Emerald Partners III* would be applicable only in those categories of cases that require “an application of the entire fairness standard of judicial review *ab initio* at trial.”⁶¹ While *Emerald Partners III* does not specify the types of cases that fall within this category, it would appear that there are three types of such cases, all implicating the duty of loyalty: (1) those cases in which a controlling stockholder is on both sides of the transaction,⁶² (2) those in which plaintiff is able to establish a *prima facie* case that directors constituting a majority of the board acted in bad faith, had a material conflicting interest in the transaction, or were not independent of directors who had such an interest, and (3) those in which plaintiff can establish a *prima facie* case that one

⁶⁰ See *Emerald Partners III*, 787 A.2d at 92 n.41 (“If the plaintiff were to establish by proof at trial a *prima facie* case of a loyalty violation, defendants would then have the burden to establish entire fairness.”) (quoting *Malpiede*).

⁶¹ See *id.* at 93.

⁶² Indeed, *Emerald Partners III* could be read narrowly to suggest that only cases in which a controlling stockholder stands on both sides of the transaction

or more directors (less than a majority) had a material interest in a transaction that was not disclosed to the other directors.⁶³ Accordingly, the applicability of the rule enunciated in *Emerald Partners III* would seem limited to a fairly narrow (though not insignificant) category of corporate cases. In such cases, the practical result of the *Emerald Partners III* decision would seem to be that outside, disinterested directors who have acted in good faith (and thereby can be said to have breached at most the duty of care), may not be dismissed from the case until after trial and after an evaluation by the Court of Chancery of the entire fairness of the transaction.

It is likely to be the rare case in which the controlling stockholder or interested directors are dismissed at an early stage of the litigation (as was the case in *Emerald Partners*), leaving only the disinterested directors to prove that the challenged transaction was entirely fair. Accordingly, in most cases in which the *Emerald Partners III* rule is implicated, the Court will be required to engage in an entire fairness analysis *vis a vis* the claims against the controlling stockholder or interested directors, regardless of the presence in the litigation of disinterested and independent directors. Moreover, where entire fairness is the applicable standard of review at trial, it has long been the case that the entire

require “an application of the entire fairness standard of judicial review *ab initio* at trial.”

⁶³ See discussion below analyzing the Supreme Court’s use of the term “entire fairness *ab initio*.”

board (not just the interested directors) ordinarily is required to demonstrate the entire fairness of the challenged transaction and that relative culpability will be taken into account, if at all, in granting a remedy.⁶⁴ Only on relatively few occasions has the Court of Chancery entered judgment or dismissed a complaint in favor of the disinterested directors, prior to trial, solely on the basis of a Section 102(b)(7) exculpatory provision, where the plaintiffs have adequately shown entire fairness to be the applicable standard of review as a result of a majority of directors having a material interest in the challenged transaction or the controlling stockholder being on the other side of the transaction.⁶⁵

⁶⁴ See *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1134, 1153 (Del. Ch. 1994) (“In my opinion ... the noninterested directors who are merely subject to the domination of the controlling, interested director or who are innocent victims of the non-disclosure of an interest that is both material to an interested director and significant to the board’s decision, would also be required to show the entire fairness of the transaction ..., but the particularities of the case (the directors’ good faith if present, for example) would be considered were the court required to fix a remedy with respect to such directors.”); see also *Strassburger v. Earley*, 752 A.2d 557 (Del. Ch. 2000) (finding after trial that director who had no conflicting interest in and received no personal benefit from a transaction, who acted in good faith, and who at most acted without due care could not be liable for rescissory damages, even though defendants had failed to demonstrate entire fairness of the challenged transactions).

⁶⁵ See, e.g., *Clements v. Rogers*, C.A. No. 15711, 2001 WL 946411, at *20, Strine, V.C. (Del. Ch. August 14, 2001) (rejecting defendants’ argument that a Section 102(b)(7) exculpatory provision insulated directors of target corporation who were also officers, directors, and stockholders of acquiring corporation because the duty of loyalty was implicated as to them, but finding that the conduct of the target corporation’s independent, special committee members could at most be ascribed to breach of the duty of care and, therefore, granting summary judgment in favor of those directors); *In re Ply Gem Indus., Inc. Shareholders Litigation*, C.A. No. 15779, 2001 WL 755133, at *10, Noble, V.C. (Del. Ch. June

Not only is *Emerald Partners III* unlikely to have the devastating effect on corporate fiduciary duty litigation that some have suggested, the decision arguably may signal the Delaware Supreme Court's first step away from the doctrine established in *Technicolor II*, which held that once a stockholder has made out a prima facie case of breach of the duty of care, the burden shifts to the directors to demonstrate the entire fairness of their conduct. As previously noted, that doctrine has been questioned by several commentators, including the Chancellors in their recent article on standards of review. Several passages of the *Emerald Partners III* decision emphasize the inherent differences between a category of transactions that requires "application of the entire fairness standard of judicial review *ab initio* at trial"⁶⁶ and a category of transactions with respect to which "the standard of review *ab initio* is the business judgment rule."⁶⁷ The Supreme Court's decision, however, nowhere specifically defines which types of cases fall within each of those categories. Nonetheless, the Supreme Court strives to characterize several of its prior decisions as involving application of the

26, 2001) (holding that complaint adequately alleged interest or lack of independence on the part of six of seven directors, but dismissing breach of due care claims against single director as to whom plaintiff had not adequately pleaded disloyalty on basis of Section 102(b)(7) exculpatory provision).

⁶⁶ *Emerald Partners III*, 787 A.2d at 93.

⁶⁷ *Id.*

“business judgment rule *ab initio*” or the “entire fairness standard *ab initio*.”⁶⁸

The cases cited and the Supreme Court’s overall analysis strongly suggest that the distinction between those two categories of cases lies in the nature of the underlying claim. Specifically, the Court appears to suggest that the standard of review “*ab initio*” for claims involving *solely* alleged breaches of the duty of care will be the business judgment rule, while claims implicating breaches of the duties of loyalty or good faith will involve “application of the entire fairness standard of judicial review *ab initio* at trial”⁶⁹ In fact, the Supreme Court

⁶⁸ None of those cases cited used the rubric “business judgment rule *ab initio*” or “entire fairness *ab initio*.” The only prior use of similar terminology by the Supreme Court was in *In re Santa Fe Pacific Corporation Shareholder Litigation*, 669 A.2d 59 (Del. 1995). In that case, the complaint stated a claim under *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985), to which enhanced judicial scrutiny was the applicable threshold standard of judicial review because the record reflected “that a board of directors took defensive measures in response to a ‘perceived threat to corporate policy and effectiveness which touches upon issues of control.’” 669 A.2d at 71. The Supreme Court noted in that regard that “[the] case differs from cases where the presumption of the business judgment rule attaches *ab initio* and to survive a Rule 12(b)(6) motion, a plaintiff must allege well-pleaded facts to overcome the presumption.” *Id.*

⁶⁹ The case cited by the Supreme Court as an example of one in which the business judgment rule would apply *ab initio* was *Malpiede v. Townsend*, which the Court described as a case in which the complaint “unambiguously assert[ed] only a due care claim.” *Emerald Partners III*, 787 A.2d at 91-92 (citing *Malpiede v. Townsend*, 780 A.2d 1075 (Del. 2001)). In contrast, the cases cited as involving examples of the “category of transactions that require review pursuant to the entire fairness standard *ab initio*” all involved transactions with a controlling stockholder or in which a majority of the board of directors had a material conflict of interest. See *Emerald Partners III*, 787 A.2d at 93 & n. 45 (citing *Emerald Partners II*, 726 A.2d 1215; *Kahn v. Lynch Comm. Sys., Inc.*, 638 A.2d 1110, 1117 (Del. 1994); *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710-11

emphasizes that “[t]he category of transactions that require judicial review pursuant to the entire fairness standard *ab initio* do so because, by definition, the inherently interested nature of those transactions are inextricably intertwined with issues of loyalty”⁷⁰

Still, the substantive and procedural impacts of characterizing particular claims as “business judgment rule *ab initio*” or “entire fairness *ab initio*” remain unclear. While the Supreme Court seems to have taken a first step in recognizing certain substantive differences between duty of care claims and duty of loyalty claims and that those differences may impact the standard of review at trial, the precise nature of those differences, aside from their implications for a Section 102(b)(7) defense, were not addressed in *Emerald Partners III*. Importantly, the Supreme Court in *Emerald Partners III* cited its prior decisions, including *Technicolor II*, specifically for the proposition that the burden shifts to defendants to show entire fairness once a plaintiff has rebutted the presumptions of the business judgment rule by establishing a prima facie case of breach of any of the

(Del. 1983); *Sterling v. Mayflower Hotel Corp.*, 93 A.2d 107, 110 (Del. 1952)); *see also id.* at 92 n.40 (referring to *McMullin v Beran*, 765 A.2d 910, 926 (Del. 2000) as a case not implicating solely breaches of the duty of care, but one in which the complaint “alleged facts, if true, that described a duty of care violation that could be attributed to the board of directors’ divided loyalties.”) (citing *Malpiede*).

⁷⁰ *Emerald Partners III*, 787 A.2d at 93.

duties of care, good faith, or loyalty.⁷¹ Accordingly, the suggestion in *Emerald Partners III* that duty of care claims may be subject to a different standard of review “ab initio” than duty of loyalty claims may reflect anything but an indication by the Delaware Supreme Court of its willingness to reconsider its holding in *Technicolor II*. Nonetheless, creative defense counsel are likely to seize on the *Emerald Partners III* decision as evidence of just that.

C. Conclusion.

While some recent Delaware decisions touch on themes raised by the Chancellors in their *Standards of Review* article, none of those decisions is directly responsive. Nonetheless, it is interesting to speculate that some of the recent decisions may provide a framework for re-evaluation of the existing precedent and possibly a starting point for a “mid-course correction” similar to that proposed by the Chancellors. It remains to be seen, however, whether any of the Chancellors’ observations or those of other recent commentators will find their way into future Delaware Supreme Court pronouncements or whether the Supreme Court will otherwise refine or re-evaluate the corporate law standards of review and related rules that have developed over the last 20 years.

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⁷¹ See *Emerald Partners III*, 787 A.2d at 91 (citing *Technicolor II*, 634 A.2d

at 361).