The Importance of a Competent and Principled Board of Directors for Maintaining Quality Corporate Governance

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The board of directors is one of the most important yet overlooked entities of the American corporation. While corporate executives continuously operate under the microscope, corporate boards, along with governments and shareholders, share the responsibility of overseeing the executives' activities. However, the board of directors is the primary body entrusted with protecting the company's livelihood and vetting, hiring, and monitoring its executives. "The notion that responsibility for governing a publicly held corporation ultimately rests in the hands of its directors is a defining feature of American corporate law; indeed, in a sense, an independent board is what makes a public corporation a public corporation."[1] Although senior management makes most of the company's policy decisions, investors often forget that "the ultimate decisionmaking authority rests with the board of directors."[2]

Specifically, an effective board of directors provides three major functions.[3] Firstly, and most importantly, a board must "monitor firm performance to prevent managerial self-dealing and shirking."[4] Secondly, effective board members use their expertise to advise executives on major policy decisions, ensuring that the shareholders' interests are always prioritized.[5] Finally, board members are responsible for hiring senior executives and should serve as a liaison between

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[1] Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 251 (1999).
[2] Bernard S. Sharfman & Steven J. Toll, *Dysfunctional Deference and Board Composition: Lessons from Enron*, 103 NW. L. REV. COLLOQUY 153, 155 (2008).
[3] Marleen A. O'Connor, *The Enron Board: The Perils of Groupthink*, 71 U. CIN. L. REV. 1233, 1242 (2002).
[4] *Id.*
[5] *Id.*

company management and shareholders.[6] However, many failures in corporate governance can be directly traced back to oversight failures by the board of directors. This Comment will explore two of the most difficult situations for corporate boards to navigate: hostile takeovers and fraudulent activity. These two situations have dominated financial headlines in the past year, with Elon Musk's acquisition of Twitter and the bankruptcy of cryptocurrency exchange firm FTX and the fraudulent activity of founder Sam Bankman-Fried. This Comment will begin by outlining a prime example of an effective, competent, and independent board and highlighting the profound financial impact a competent board can have on a company when faced with a difficult situation. Then, this Comment will briefly highlight how Twitter's board of directors likely learned important lessons from RJR Nabisco's board to not only convert a hostile takeover bid into a friendly merger, but also to secure a buyout with an extremely high premium.

This Comment will then explore situations in which boards of directors have discovered fraudulent activity and the respective boards' responses to the discovered fraud to highlight the importance of having a competent, independent board of directors. Namely, this Comment will revisit the infamous Enron bankruptcy and outline a series of lessons that FTX should have learned from Enron. By examining two classic case studies on corporate governance and comparing them to two recent case studies, this Comment will advocate for a heightened standard of composition and independence for corporate boards and serve to remind investors of the importance of the competence of the boards of companies in which they have placed their life's earnings.

I. Hostile Takeovers: RJR Nabisco and Twitter

Hostile takeover bids have been a hallmark of American corporate culture since the 1980's. Wall Street has never starved for top executives believing they could better manage an

[6] *See id.*

underperforming company with themselves at the helm. A hostile takeover is defined as the attempted acquisition of a target company that is opposed by the target company's board of directors.[7] A hostile takeover bid typically takes one of two forms: tender offer or proxy fight.[8] However, tender offers have provided more headlines and unique cases than proxy fights, so tender offers will be the primary focus of this section. The manner in which a company's board of directors handles the takeover plays a crucial role in determining whether shareholders will be better off or worse off after completing the merger. In fact, one could argue that a competent, responsive, and unbiased board of directors is the primary ingredient of a lucrative hostile takeover. Of course, by their very natures, hostile takeovers are not amicable as friendly mergers are, so the board will likely initially reject the notion that the company is underperforming and being mismanaged. However, the duty of a board of directors is to serve as an unbiased guardian of the company and its shareholders, always placing the company's interests above the board member's interests, for the board exists solely to maximize the value of the company for the benefit of the shareholders.[9] Thus, when a board of directors is confronted with a hostile takeover situation, it must have the fortitude and foresight to objectively evaluate the terms the offeror has proposed.

The Securities and Exchange Commission (SEC) defines a tender offer as a "widespread solicitation by a company or third party . . . to purchase a substantial percentage of the company's

[7] *See* Cheff v. Mathes, 199 A.2d 548, 554 (Del. 1964) (holding that so long as a board's decision to accept a buyout offer was motivated by a sincere and reasonable belief that the buyout was necessary to maintain proper business practices, the board will not be held liable for that decision); Akhilesh Ganti, *Hostile Takeover Explained: What It Is, How It Works, Examples*, INVESTOPEDIA https://www.investopedia.com/terms/h/hostiletakeover.asp (last updated June 20, 2022) [https://perma.cc/3NHK-C3BY].

[8] *See* Ganti, *supra* note 7.

[9] Boards of directors should serve the role of the village elder. The board is not involved in the company's day-to-day operations, but uses its wisdom and experience to advise the executives. *See* Lewis S. Black, Jr., *Why Corporations Choose Delaware*, DEL. DEPT. OF STATE 3 (2007).

securities."[10] The tender offer to shareholders will certainly represent a higher price per share than the current price and likely contained within a specified number of shares.[11] The point of contention for tender offers between the target board of directors and the offeror almost always comes down to a simple question: how high should the premium be?[12] From the offeror's perspective, a high premium will certainly garner the interest of both shareholders and the board, reducing the chance of the board initiating a takeover defense.[13] However, the higher the premium, the lower margin for error the offeror will have in running the company due to debt, should the tender offer prove successful. Even if a tender offer is made by a single individual, that individual will have billions of dollars of backing behind him in the form of banks, hedge funds, private equity firms, and possibly other companies.[14] Thus, the principal offeror will owe debts to the institutions that helped the offeror fund the buyout; and the higher the premium, the more debts the offeror will owe.[15]

On the opposite side of the negotiating table, the board owes a host of "unyielding fiduciary dut[ies] to the corporation and its shareholders," requiring the board to act competently and always place the interests of the corporation and its shareholders above the individual interests of board members.[16] Namely, case law has consistently outlined two specific duties owed by

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[10] *Tender Offer*, U.S. SECURITIES AND EXCHANGE COMMISSION https://www.investor.gov/introduction-investing/investing-basics/glossary/tender-offer [https://perma.cc/GK32-2G75].

[11] *See Cheff*, supra note 7, at 554; Adam Hayes, *Tender Offer Definition: How It Works, With Example*, INVESTOPEDIA https://www.investopedia.com/terms/t/tenderoffer.asp (last updated Apr. 15, 2022) [https://perma.cc/H568-DPML].

[12] "We argue in this Article that current legal rules allowing the target's management to engage in defensive tactics in response to a tender offer decrease shareholders' welfare." Frank H. Easterbrook and Daniel R. Fischel, *Management's Fiduciary Duty and Takeover Defenses*, 94 HARV. L. REV. 1161, 1164 (1981).

[13] "The reaction of shareholders to managerial resistance depends on the outcome. Few protest when resistance leads to a takeover at a higher price. When resistance thwarts the takeover attempt altogether, however, litigation usually follows." Easterbrook and Fischel, *supra* note 12, at 1163.

[14] *See* Cheff, 199 at 554; Hayes, *supra* note 11.

[15] "Acquirers with high debt levels are . . . less likely to pursue a tender offer, very likely due to decreased financing flexibility. We also find that tender offers are more likely to be made in cash than mergers." David Offenberg & Christo A. Pirinsky, *How Do Acquirers Choose between Mergers and Tender Offers?*, 116(2) J. FIN. ECON. 1, 24, 26 (2015).

[16] Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985).

boards to their shareholders: a duty of care and a duty of loyalty. Duty of care includes the board's obligation to stay informed of the company's dealings, which enables the ability to make informed decisions on the company's behalf.[17] Duty of loyalty includes each board member's responsibility to place the corporation's and shareholders' interests above her own interests.[18] However, Delaware law extends a rebuttable presumption that a board is acting within its duty of care known as the "business judgment rule."[19]

Delaware corporate law is immensely influential because the vast majority of major American corporations are based in Delaware due to the state's favorable corporate tax rate[20] and highly regarded, business-friendly chancery courts.[21] In fact, more than 66% of Fortune 500 companies are incorporated in Delaware, according to Delaware's Division of Corporations.[22] Therefore, Delaware corporate law represents the epicenter of American corporate law. The business judgment rule grants broad deference to boards by placing the burden of proving that the board breached its fiduciary duty to shareholders upon the plaintiff, rendering it difficult for plaintiffs to successfully challenge board decisions on the basis of breach of fiduciary duty.[23]

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[17] *Id.* at 872–73.

[18] Gantler v. Stephens, 965 A. 2d 695, 706–07 (Del. 2009).

[19] "The BJR [business judgment rule] is a rebuttable presumption that in making decisions directors act in accord with their fiduciary duties." Peter A. Atkins, Marc S. Gerber, & Edward B. Micheletti, *Directors' Fiduciary Duties: Back to Delaware Law Basics*, HARVARD L. SCH. F. ON CORP. GOVERNANCE (Mar. 10, 2020), https://corpgov.law.harvard.edu/2020/03/10/directors-fiduciary-duties-back-to-delaware-law-basics/ [https://perma.cc/EJ2T-ETKJ].

[20] Evan Tarver, *Why Delaware Is Considered a Tax Shelter*, INVESTOPEDIA https://www.investopedia.com/articles/personal-finance/092515/4-reasons-why-delaware-considered-tax-shelter.asp (last updated Dec. 31, 2020) [https://perma.cc/TFQ5-AWWG].

[21] *Why Do Companies Incorporate in Delaware: Everything You Need to Know*, UPCOUNSEL, https://www.upcounsel.com/why-do-companies-incorporate-in delaware#:~:text=Many%20Fortune%20500%20companies%20choose%20to%20incorporate%20their,of%20a%20company%2C%20which%20reduces%20corporate%20income%20tax [https://perma.cc/PX7W-7EG9].

[22] *About the Division of Corporations*, DELAWARE DIVISION OF CORPORATIONS https://corp.delaware.gov/aboutagency/ [h ttps://perma.cc/KM3R-X22X].

[23] "Relying on the business judgment rule, courts typically have held that the target's management has the right, and even the duty, to oppose a tender offer it. determines to be contrary to the firm's best interests." Easterbrook and Fischel, *supra* note 12, at 1163; Atkins, et al., *supra* note 19;

While the business judgment rule undoubtedly extends broad deference to boards of directors, case law has created a few hurdles that boards must clear for the business judgment rule to protect its decisions. Most importantly, boards of directors must ask all necessary questions to become fully informed on the issue before making the decision.[24] However, this requirement has proven to serve as a double-edged sword because this requirement "reduces directors' 'costs of confrontation' by allowing them to 'sugarcoat' their questions by appealing to the law as the reason for their inquiries, rather than distrust of management."[25] Additionally, the business judgment rule dictates the standard of review that Delaware courts use to evaluate board decisions and is one of broad deference to boards.

A Delaware court will only find that a board breached its fiduciary duties of care to shareholders if the court finds no "rational business purpose" for the board's decision under a standard of gross negligence.[26] "Thus, the party attacking a board decision as uninformed must rebut the presumption that its business judgment was an informed one."[27] Further, case law has emphasized that good faith attempts by the board to monitor management are sufficient."[28] However, a board's adherence to its fiduciary duties to the corporation and its shareholders is essential to maximize the value of the company and to insulate the board from any corporate raiders

[24] "Under Delaware law, the business judgment rule is the offspring of the fundamental principle . . . that the business and affairs of a Delaware corporation are managed by or under its board of directors." *Van Gorkum*, *supra* note 16, at 872.
[25] "After Smith v. Van Gorkom, boards use more rigorous decision making procedures in order to avoid liability for breach of the duty of due care." O'Connor, *supra* note 3, at 1247, 1248.
[26] "Ideally, directors should be disinterested (that is, free of any material financial or other benefit derived from the matter under consideration, except as a stockholder) and independent (that is, not having a relationship with an interested party that reasonably could influence the director's decision-making)." Atkins, et al., *supra* note 19.
[27] "The business judgment rule exists to protect and promote the full and free exercise of the managerial power granted to Delaware directors." *Van Gorkum*, *supra* note 16, at 872.
[28] O'Connor, *supra* note 3, at 1248.

scheming a hostile takeover of the company, which has re-established its popularity in recent years after losing its luster.[29]

If an individual or corporate raider feels that a company's board is underperforming, the raider may submit a tender offer to the company's board for approval.[30] Since the board owes fiduciary duties of care and loyalty to the corporation and its shareholders, the board must entertain any and all viable offers it receives.[31] Ignoring a viable tender offer that represents a significant premium over the current stock price would likely constitute a breach of the board's fiduciary duty of care to the corporation and its shareholders.[32] In this instance, a plaintiff shareholder could likely overcome the business judgment rule's presumption that the board's decision and take legal action against the board.[33] Furthermore, due to the terms of the Williams Act passed in 1968 in response to the rising prevalence of corporate raiders and mandated that all terms, source of funding, etc. of any cash tender offer must be disclosed both to the SEC and to the target company.[34]

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[29] *See* Nell McKenzie, *Bosses are wary of the return of the corporate raider*, BBC (Jan. 9, 2020) https://www.bbc.com/news/business-50609165 [https://perma.cc/8A3H-MYGA].

[30] A tender offer is normally great news for shareholders because it instantly raises the market price for the company's stock. Boards should only defend against a tender offer if the offer represents an inadequate premium over the current stock price. If the offer represents a value that the company could not reasonably hope to achieve in the open market, then a board should not defend against the tender offer. "Even resistance that ultimately elicits a higher bid is socially wasteful. Although the target's shareholders may receive a higher price, these gains are exactly offset by the bidder's payment and thus by a loss to the bidder's shareholders." Easterbrook and Fischel, *supra* note 12, at 1175.

[31] "[T]he board's power to act derives from its fundamental duty and obligation to protect the corporate enterprise, which includes stockholders, from harm reasonably perceived, irrespective of its source." *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 958 (Del. 1985).

[32] "The value of any stock can be understood as the sum of two components: the price that will prevail in the market if there is no successful offer (multiplied by the likelihood that there will be none) and the price that will be paid in a future tender offer (multiplied by the likelihood that some offer will succeed). A shareholder's welfare is maximized by a legal rule that enables the sum of these two components to reach its highest value." Easterbrook and Fischel, *supra* note 12, at 1164; *see* Kahn v. U.S. Sugar Corp., 11 DEL. J. CORP. L. 908, 916 (Del. Ch. 1985).

[33] *See id.*

[34] "Some experts believe the ongoing evolution of corporate governance calls for a comprehensive review of the Williams Act. For one thing, the enactment of federal and state antitakeover laws render the coercive tender offers the Williams Act sought to address ineffective." James Chen, *Williams Act*, INVESTOPEDIA https://www.investopedia.com/terms/w/williamsact.asp (last updated July 26, 2021) [https://perma.cc/2VS5-MKGS].

The Williams Act also requires any investor with greater than a 5% share in a publicly traded company to disclose the number of shares owned to the SEC.[35] "Prior to the enactment of the Williams Act in 1968, offerors were free to structure offers in a manner designed to force shareholders to decide quickly whether to sell all or part of their shares at a premium."[36] Thus, the Williams Act "has deprived the offeror of this advantage of speed by regulating the conditions under which the offer can be made."[37] Additionally, once the acquisition of a company is inevitable, the board must act simply as auctioneers that will work to maximize the company's value and sell the company not necessarily to the highest bidder, but to the bidder in which the board believes will be the "best transaction"[38] for the company with no credence paid to the people behind the offers.[39] This duty to act as an auctioneer once the sale of the company is inevitable is known as a board of directors' *Revlon* duty of care.

Although hostile takeovers have seen a small resurgence partially due to the market volatility caused by the COVID pandemic,[40] the 1980's were undoubtedly the heyday of the hostile takeover due to record corporate profits and the invention and improvement of takeover schemes such as the leveraged buyout, invented by Wall Street legend Henry Kravis.[41] Wall Street during

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[35] Andrew E. Nagel, Andrew N. Vollmer, and Paul R.Q. Wolfson, *The Williams Act: A Truly "Modern" Assessment*, HARVARD L. SCH. F. ON CORP. GOVERNANCE (Oct. 22, 2011), https://corpgov.law.harvard.edu/wp-content/uploads/2011/10/The-Williams-Act-A-Truly-Modern-Assessment.pdf [https://perma.cc/8PW5-JVZX].

[36] Easterbrook and Fischel, *supra* note 12, at 1162.

[37] *Id.*

[38] Citron v. Fairchild Camera and Instrument Corp., 569 A.2d 53, 68 (Del. 1989).

[39] Revlon, Inc. v. MacAndrews & Forbes Holding, Inc, 506 A.2d 173, 184 (Del. 1986) (holding that when the acquisition of the company is inevitable, the board's sole duty is to maximize the benefit to shareholders).

[40] "At the time of this article, more than a dozen unsolicited takeover bids are already underway. This is not surprising. Historically, hostile activity has increased following market downturns, most recently after the 2008 Financial Crisis. The COVID-19 crisis is similar in that regard." Kai Liekefett, *The Comeback of Hostile Takeovers*, HARVARD L. SCH. F. ON CORP. GOVERNANCE (Nov. 8, 2020), https://corpgov.law.harvard.edu/2020/11/08/the-comeback-of-hostile-takeovers/ [https://perma.cc/BU9F-5SGT].

[41] "[O]ne concern is that after an LBO [leveraged buyout] has taken a company over, then it is typically no longer public, meaning it no longer has publicly traded shares. As a result, it might be more difficult for the company to borrow money in the future to finance growth." John Cookson, *KKR Goes Public: What Is a Leveraged Buyout?*, BIGTHINK (July 15, 2010), https://bigthink.com/technology-innovation/kkr-goes-public-what-is-a-leveraged-buyout/ [https://perma.cc/P89W-7PZB].

this era was dominated by adventurous billionaires seeking to acquire as much stake in as many companies as possible. In particular, figures like Carl Icahn, Paul Bilzerian, and T. Boone Pickens embraced the "corporate raider" mantra and actively sought to initiate hostile takeovers against the boards of numerous corporations. In addition to financial motivations for targeting so many companies, these corporate raider figures wished to expose what they viewed as wasteful spending or poor asset allocation that occurred in virtually every corporate boardroom.[42]

Successfully completing the hostile takeover is only half the battle. Once a raider has taken control of the company, the real work begins of increasing the profitability of the company while managing a hefty slew of creditors that will start expecting returns on their investments. Layoffs, or "targeted downsizing," will ensue while others within the company will defect. Indeed, it requires a delicate combination of luck, foresight, and financial muscle to first orchestrate a successful hostile takeover via a tender offer, which inherently requires accumulating debt and laying off employees and accumulation of debt. The second half of the battle, increasing the profitability of a company, may prove even more challenging than the first. And sometimes, the raider bets too heavily on the first half of the battle that he has depleted the resources necessary to complete the second, and more important, half of the battle.

The modern example of Elon Musk and Twitter compared to the classic example of F. Ross Johnson and RJR Nabisco highlights how little has truly changed in American corporate culture despite the influx of regulations and heightened focus on optics. While the two boards were operated under extremely different circumstances with RJR Nabisco's board balancing multiple lucrative offers while Twitter's board only had one lucrative offer to consider, these two examples

[42] Corporate raiders "would go through a company's financial accounts and find the loss-making parts. Then they would buy up shares, take over the firm and carve those pieces out. Sometimes the process was brutal." *See* McKenzie, *supra* note 29.

teach the important lesson to corporate boardrooms that the highest bidder is not always the entity that is best suited to lead the company. However, corporate boards are also vulnerable to human nature, which is often hardwired towards arrogance and self-preservation, meaning that boards could also make the devastating mistake of alienating potential buyers of the company by refusing to appear open to the idea of placing someone new in charge of the company. Maintaining the delicate balance between upholding the board's fiduciary duties to the company's shareholders and exercising subjective judgment on what is in the best interests of the company while avoiding self-preservation is certainly not an easy task, which emphasizes the importance of a competent and independent board of directors.

A. RJR Nabisco's Board Sets the Standard

F. Ross Johnson's leveraged buyout of RJR Nabisco not only represented the largest buyout in corporate history at the time but also so epitomized the "relentless focus [of hostile takeovers] on dealmaking rather than investment" in the 1980's that a #1 New York Times bestselling book was written and an HBO movie adaptation was produced to detail the ordeal. In the case of RJR Nabisco, mere rumors that company President & CEO F. Ross Johnson was planning to offer to purchase the company for $75 per share were enough to send the public trading price of RJR Nabisco's stock to a record price of over $77 per share.[43] As Johnson saw it, his company would be better off as a private company since he would be able to sell off less profitable divisions of the business (Nabisco) while increasing the profitability of the company's high-margin divisions (R.J. Reynolds Tobacco).[44]

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[43] Steve Coll, *RJR Nabisco Executives Plan Buyout*, THE WASHINGTON POST (Oct. 21, 1988), https://www.washingtonpost.com/archive/politics/1988/10/21/rjr-nabisco-executives-plan-buyout/8de17099-5d35-4495-98c8-a36847f1ff67/ [https://perma.cc/X8BJ-NPQG].

[44] "F. Ross Johnson is a glad-handing chief executive who has become so used to private jets and other corporate perks that control of the company becomes an obsession, no matter what the cost, even in jobs. After discussing the

As rumors of Johnson's unconfirmed $75 per share tender offer quickly spread, other entities quickly joined the bidding war, which rendered the purchase of the company to be inevitable. Namely, Henry Kravis, who initially gave Johnson the idea of implementing a leveraged buyout of the company, felt insulted that Johnson decided to form his own management committee to submit the $75 per share offer.[45] Seeking not only revenge but also to protect his sandbox,[46] Kravis launched his own campaign to purchase RJR Nabisco for himself.[47] Kravis, in turn, submitted a tender offer to the board of $90 per share, dwarfing Johnson's already historic offer.[48] Rumors of the $90 offer propelled the publicly traded price of RJR Nabisco's stock to new heights, almost matching the $90 figure in Kravis' offer mere days after Kravis submitted the offer.[49]

After the board received Kravis' offer, this rendered the purchase of the company inevitably placed a "*Revlon* duty" upon the board of RJR Nabisco to act simply as auctioneers seeking the best available transaction for the company while giving no preferential treatment to any bidder, even the President and CEO of the company.[50] One would argue that the *Revlon* duty

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possibility of a leveraged buyout with Mr. Kravis . . . Mr. Johnson sets out on his own with an offer to buy the company. Mr. Kravis feels betrayed. The bidding war begins. Greedy barbarians of every stripe gather around the negotiations gate." *See* John J. O'Connor, *Those Good Old Takeover Days*, The New York Times (March 18, 1993), https://www.nytimes.com/1993/03/18/arts/review-television-those-good-old-takeover-days.html [https://perma.cc/X8BJ-NPQG].

[45] BRYAN BURROUGH & JOHN HELYAR, BARBARIANS AT THE GATE: THE FALL OF RJR NABISCO 165 (1990).

[46] Kravis subsequently denied that his motivation for purchasing RJR Nabisco was to protect his legacy. Colin Leinster, *'"GREED REALLY TURNS ME OFF"' Henry Kravis tells how his firm won the RJR Nabisco deal, how safe an investment it is, and why Washington should leave LBOs alone. He also has a few pointed words about the loser.*, FORTUNE, (Jan. 2, 1989), https://money.cnn.com/magazines/fortune/fortune_archive/1989/01/02/71449/ [https://perma.cc/459E-MLLQ].

[47] News of the $90 offer attracted even more bidders to the table, with firms like Forstmann Little & Co. and First Boston joining the bidding party before both firms ultimately, "but perhaps wisely, bowed out." Thomas J. Andre, Jr., Book Review, *Barbarians at the Gate: The Fall of RJR Nabisco* 59 U. CIN. L. REV. 479, 480 (1990).

[48] *See History of the RJR Nabisco Takeover*, THE NEW YORK TIMES (Dec. 2, 1988), https://www.nytimes.com/1988/12/02/business/history-of-the-rjr-nabisco-takeover.html [https://perma.cc/DXF2-VAQG].

[49] *Id.*

[50] In re RJR Nabisco, Inc. Shareholders Litigation, 1989 WL 7036 at *3 (Del. Ch. 1989).

was placed upon the board the instant the board received Kravis' valid $90 per share offer for two reasons. Firstly, the board would not have been able to justify rejecting a $90 per share offer to the company's shareholders, considering the stock price had just reached the $70 range, an all-time high.[51] Secondly, and relatedly, the massive increase in the RJR Nabisco's stock price was based solely on the speculation that the company would be sold for a hefty premium. If the board were to reject such an offer, not only would that render the board vulnerable to breach of fiduciary duty litigation, but the shareholders would revolt and swiftly negate the gains the stock price was enjoying. Once the board received Kravis' offer, no plausible option existed to not sell the company because that would simply be leaving too much money on the table for the shareholders. Thus, one would correctly argue that the Kravis offer imposed a *Revlon* duty upon the board, rendering the sale of the company inevitable and issuing the challenge of selling to the best bidder for the best price.

The chairman of RJR Nabisco's board of directors, Charles Hugel, had long disapproved of Johnson's flair for extravagance at the company's expense. Upon taking over RJR Nabisco, Johnson threw lavish parties with entertainment headliners such as Frank Sinatra and Bob Hope, in which each guest received Gucci watches along with other Nabisco-branded gear such as golf shoes.[52] Hugel did not subscribe to Johnson's philosophy of "what goes around comes around" and disagreed with Johnson at every turn, from calling Johnson's idea of a smokeless cigarette "nutty" to opposing the notion of a buyout from the inception of chatter regarding a buyout.[53] Hugel and the board were subsequently appalled after learning of Johnson's potential personal via

[51] *See* THE NEW YORK TIMES, *supra* note 48.
[52] "After eight months in Winston-Salem, Johnson was dying for a dose of the old glitz, and he arranged to get a double shot that March in Palm Springs . . . . Attendees gained admission to events by flashing the $1,500 Gucci watch each was given. That year's "Night with Dinah" gala featured Frank Sinatra crooning, Bob Hope joking, and Don Meredith emceeing." BURROUGH & HELYAR, *supra* note 45, at 73–74.
[53] *Id.* at 112.

profit from the buyout were the board to accept his then-current highest bid of $92 per share: a personal profit of nearly $2 billion.[54] The board did not believe it was possible for Johnson to take such a large personal profit while simultaneously maximizing the value of the company for its shareholders. Hugel grew increasingly skeptical of Johnson's motivations but did not allow his personal feelings to interfere with his role as chief auctioneer for the company, whose sole purpose was to maximize the value of the company.[55]

Due to the potential conflict of interest in having one of the company's bidders as the CEO of the company, the board prudently formed a special committee consisting of disinterested advisors to help the board find and accept the most lucrative offer for the company.[56] As the bidding war for RJR Nabisco continued, the board remained "scrupulous" in maintaining neutrality and managed to drive the price up to record-breaking heights, according to the Delaware Chancery Court.[57] Board Chairman Hugel, masterfully navigating his role as chief auctioneer on RJR Nabisco's behalf, managed to prolong the bidding war to secure two astronomical offers: $109 per share from Kravis' firm KKR vs. $112 per share from Johnson's management committee.[58] On its face, this should have been an easy decision for Hugel. "To the untrained eye, Johnson's group was the clear winner: $112 versus $109,"[59] which would have generated almost $1 billion more in revenue for the company and its shareholders.[60] However, as the board viewed the situation, when both figures are this high, (over $25 billion) more than mere dollar amounts should be considered. Ultimately, the board's decision ultimately hinged on a single question: 'who will look after the

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[54] *Id.* at 341–42.
[55] *See id.* at 343.
[56] *Id.* at 122.
[57] "Effectiveness cannot mean perfection. Moreover, there is no very persuasive record here that the auction did not result in the best deal prevailing." *In re* RJR Nabisco, Inc. Shareholders Litigation, *supra* note 50, at *21.
[58] BURROUGH & HELYAR, *supra* note 45, at 497.
[59] *Id.*
[60] *Id.* at 405.

employees better?'[61] The obvious answer to this question to the board was Kravis and KKR, so the board unanimously accepted Kravis' offer of $109 per share over Johnson's offer of $112 per share.[62]

Subsequently and expectedly, a group of RJR Nabisco shareholders brought a derivative lawsuit against the board of directors, alleging that the board did not allow Johnson's and Kravis' team to continue the bidding war to potentially drive the price even higher.[63] Emphasizing that the business judgment rule does apply to Revlon transactions in which the purchase of the company is inevitable, the court found that the RJR Nabisco board exercised sound business judgment in handling the entire buyout process and was thus not liable for breach of any fiduciary duties to shareholders.[64] The court found that the board adequately avoided bias and that the board's implementation of a deadline for offers was likely in the best interest of the company, as the current debt load of Kravis' deal was plenty hefty on its own. The board likely reasoned that any price higher than the two offers on the table would have resulted in too much debt and too many layoffs, which the court seemed to agree with.[65] Furthermore, with regards to the board's decision to accept Kravis' offer over Johnson's the court again held that the business judgment rule fully insulated the board from liability, for the court reasoned that the board certainly must have had its reasons for accepting Kravis' offer over Johnson's.[66]

The Johnson and RJR Nabisco debacle served to teach corporate boardrooms important lessons. Firstly, the business judgment rule is an extremely powerful protection that should ease

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[61] Johnson's team's "failure to guarantee its securities via a reset was mentioned. So, too, was the management group's inflexibility on guaranteeing employee benefits such as relocation expenses." *Id.* at 498.
[62] *Id.* at 499.
[63] *In re* RJR Nabisco, Inc. Shareholders Litigation, *supra* note 50, at *1.
[64] *Id.* at *20.
[65] *Id.*
[66] *Id.*

board members that are concerned with personal liability for making the "wrong" decision despite using their best judgment. Courts have continuously protected boards that made decisions to the best of their knowledge and ability, assuming they exercised due diligence and had no ulterior motives. In short, a board member acting honestly and in the company's best interests should not be concerned with liability if the board makes a decision that turns out to be costly. Secondly, in a takeover situation, the highest bidder is not always the same as the best bidder. Under Kravis' direction, Nabisco's profitability skyrocketed while R.J. Reynolds Tobacco struggled due to social and regulatory changes, just as Kravis feared years earlier. As opposed to Johnson, Kravis knew that the true value in RJR Nabisco lied in the "Nabisco" rather than the "RJR," and Kravis was correct. As opposed to Johnson, Kravis believed that spending large sums of money on parties and gifts to clients was wasteful, and Kravis was correct. "By 1990, Wall Street's party was over," and elaborate corporate spending came under the public microscope.[67] Kravis displayed foresight, restraint, and discipline where Johnson failed to. Rather than ostracizing the board of RJR Nabisco for not running up the score even higher than it already was, the board should be commended for so masterfully navigating the circus around it and landing the largest corporate merger of all time, all while sticking to its principles and always placing the shareholders' interests first.

In lieu of a tender offer, a corporate raider may initiate a proxy fight by soliciting existing shareholders to replace existing board members with the raider's appointees.[68] Proxy fights might appeal to would-be raiders because most shareholders are rationally ignorant about who runs the company and many would be happy to serve as a proxy for a raider if they believe their shares will

[67] "In the wake of RJR Nabisco, LBO activity had dropped sharply, and by the fall of 1989, neither Kohlberg Kravis nor Forstmann Little had initiated a single major buyout. The prospect of anti-LBO legislation, raised during RJR, delayed many deals. What came to be known as the 'Ross Johnson' factor nixed others: Few chief executives, after all, were willing to go through the public pillorying Johnson had endured." BURROUGH & HELYAR, *supra* note 45, at 511.
[68] Chen, *supra* note 34.

be worth more for having done so.[69] Proxy fights represent a more time-consuming and less-utilized alternative to tender offers perhaps because billionaires are not known for their patience or willingness to work with others.

B. Twitter's Board Navigates a Lucrative Offer from the Wealthiest Person on Earth

Throughout 2022, Tesla and SpaceX CEO Elon Musk dominated business headlines by purchasing a majority share of social media giant Twitter for $54.20 per share, a price tag of over $44 billion.[70] Although Musk purchased the company, (one might argue that Musk did not have much of a choice, which will be explored below) most commentators have labeled this transaction as a massive loss for Musk, due to the extremely high premium he paid and evidenced by Musk's efforts to back out of the deal.[71] Many believe that, similarly to F. Ross Johnson, Elon Musk allowed his ego, rather than financial analysis, to dictate the terms of his offer. In fact, Musk's purchase of Twitter cost him his status of "wealthiest person in the world" with a record-breaking loss of wealth year-over-year, stemming from the Twitter purchase.[72]

The saga began in early April 2022 with Musk's disclosure to the SEC that he had acquired 9.2% of Twitter's stock, rendering him the company's largest shareholder.[73] This news provided

[69] "Public choice, like economic theory in general, rests on the assumption that no matter what people's objectives may be, they are rational in pursuit of them. In other words, people will allocate their limited means among alternative pursuits to maximize their personal satisfaction." Michael E. DeBow & Dwight R. Lee, *Understanding (and Misunderstanding) Public Choice: A Response to Farber and Frickey*, 66 TEX. L. REV. 993, 997–999 (1988).

[70] Yaël Bizouati-Kennedy, *Elon Musk Offers To Buy Twitter for 'Premium' Price of $54.20 Per Share*, YAHOO! FINANCE (Apr. 14, 2022), https://finance.yahoo.com/news/elon-musk-offers-buy-twitter-125333026.html [https://perma.cc/5RDK-2E8C].

[71] Dan Milmo, *Musk's Twitter deal is his least bad option – but he must repair the damage he's done*, THE GUARDIAN (Oct. 4, 2022), https://www.theguardian.com/technology/2022/oct/04/elon-musk-twitter-deal-least-bad-option-analysis [https://perma.cc/R7B8-XWKE].

[72] Amazon founder Jeff Bezos reclaimed the title from Musk after Tesla's decline in stock price. Rohan Goswami, *Elon Musk is no longer the richest person in the world*, CNBC, https://www.cnbc.com/2022/12/12/elon-musk-is-no-longer-the-richest-person-in-the-world.html (last updated Dec. 14, 2022) [https://perma.cc/42AD-MXVD].

[73] Chris Isodore, *Elon Musk buys 9.2% stake in Twitter, making him the largest shareholder*, CNN BUSINESS https://www.cnn.com/2022/04/04/investing/elon-musk-twitter-shares-stake/index.html (Apr. 4, 2022), [https://perma.cc/K2HP-6T6L].

a temporary boon to Twitter's stock price, with Twitter's stock closing at $39.31/share on April 1 while closing at $50.98/share on April 6.[74] During this period, on April 5, Twitter announced that Musk would be joining the company's board of directors.[75] However, on April 10, Twitter CEO Parag Agrawal announced that Musk would not be joining Twitter's board after Musk expressed concerns over Twitter's declining usage and popularity.[76] Following this announcement, a Twitter shareholder sued Musk, alleging that that he Musk reached the 5% threshold requiring SEC disclosure in March while Musk did not disclose his ownership to the SEC until April, allowing Musk to purchase more shares at a discounted price.[77] Perhaps in efforts to avoid liability, Musk submitted a tender offer on April 14 to Twitter to purchase the entire company for $43.4 billion, or $54.20/share.[78] Given that the offer represented a 38% premium over the current stock price, from Twitter's perspective, this offer should have been seen as the equivalent of striking gold. Instead, however, the next day, on April 15, the Twitter board of directors initiated a "poison pill" hostile takeover defense to discourage Musk from continuing his takeover bid.[79]

The poison pill defense, or "shareholder rights plan," is a mechanism invented by corporate law legend Martin Lipton that attempts to dilute the raider's existing shares by allowing all

[74] Twitter's stock price fluctuated heavily during this period, but the stock never approached the $50 mark again after early April. *See Twitter, Inc. (delisted) (TWTR)*, YAHOO! FINANCE https://finance.yahoo.com/quote/TWTR/history?period1=1646092800&period2=1651363200&interval=1d&filter=history&frequency=1d&includeAdjustedClose=true [https://perma.cc/9V32-DJBY].

[75] Kate Conger, Mike Isaac and Lauren Hirsch, *Elon Musk Joins Twitter's Board, Pitching Ideas Big and Small*, THE NEW YORK TIMES (Apr. 4, 2022), https://www.nytimes.com/2022/04/04/business/twitter-elon-musk-directors.html [https://perma.cc/4CHT-FZ5L].

[76] Alyssa Stringer and Taylor Hatmaker, *A complete timeline of the Elon Musk-Twitter saga*, TECHCRUNCH (Apr. 24, 2022), https://techcrunch.com/2022/04/24/elon-musk-twitter-offer-timeline/ [https://perma.cc/V2UE-XRV2].

[77] Rebecca Bellan, *Twitter investor sues Elon Musk over delay in disclosure of stake*, TECHCRUNCH (Apr. 12, 2022), https://techcrunch.com/2022/04/12/twitter-investor-sues-elon-musk-over-delay-in-disclosure-of-stake/ [https://perma.cc/QK56-TRGP].

[78] Stringer and Hatmaker, *supra* note 76.

[79] "Twitter's former CEO and current board member Jack Dorsey tweeted that 'the real issue' is that 'as a public company, twitter has always been for sale.'" Lauren Feiner, *Twitter board adopts 'poison pill' after Musk's $43 billion bid to buy company*, CNBC (April 25, 2022) https://www.cnbc.com/2022/04/15/twitter-board-adopts-poison-pill-after-musks-43-billion-offer-to-buy-company.html [https://perma.cc/5CWD-2KPS].

shareholders except the raider to purchase more company stock at a deep discount.[80] Musk, likely surprised at the negative reaction to his $54.20/share offer, took to the very platform at issue to state tweet: “If the current Twitter board takes actions contrary to shareholder interests, they would be breaching their fiduciary duty. The liability they would thereby assume would be titanic in scale.”[81] Puzzlingly, not all Twitter shareholders were on board with Musk’s offer. Many shareholders were not on board with Musk’s free speech absolutist approach to the platform and specifically objected to Musk’s notions that he would reinstate Donald Trump’s Twitter account after Twitter suspended Trump’s account after the January sixth riots.[82] Undoubtedly, however, many of the less-vocal Twitter shareholders were ecstatic by Musk’s high-premium offer, considering the stock’s lagging performance and Musk’s track record of creating profitable and innovative companies. Thus, Twitter’s board had a fiduciary duty to review the offer and use its expertise to assess which course of action was in the best long-term interest of the company and its shareholders.[83]

At the time, Musk’s offer was not universally lauded as a bargain for Twitter, even amongst financial analysts that were less concerned with the social and political objections to Musk’s proposed buyout. “I don't think the Twitter board will have a really hard time saying no to this deal. It's not an excessive premium and it's not excessively valued now,” remarked an

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[80] Amanda Holpuch, *What Is a ‘Poison Pill’ Defense?*, THE NEW YORK TIMES (Apr. 15, 2022), https://www.nytimes.com/2022/04/15/business/twitter-poison-pill-explainer.html [https://perma.cc/K8NW-36ZP].

[81] Musk consistently voiced his criticisms of Twitter’s leadership on his favorite platform, Twitter, during the takeover fight. Elon Musk. (@ElonMusk), TWITTER Apr. 14, 2022), https://twitter.com/elonmusk/status/1514718700674306052?ref_src=twsrc%5Etfw%7Ctwcamp%5Etweetembed%7Ctwterm%5E1514718700674306052%7Ctwgr%5E49752deafecde61913df89e6d51177613b46a3fe%7Ctwcon%5Es1_&ref_url=https%3A%2F%2Fmarketrealist.com%2Fp%2Felon-musk-twitter-deal-timeline%2F [https://perma.cc/Q95S-AGRP].

[82] Caitlin O’Kane, *After Elon Musk bought Twitter, some stars said they'd leave the platform – and others vowed to come back*, CBS NEWS (Apr. 27, 2022), https://www.cbsnews.com/news/celebrities-activists-quit-return-twitter-elon-musk-purchase/ [https://perma.cc/QC7U-XWGX].

[83] *See Van Gorkum*, *supra* note 16, at 872.

expert.[84] In hindsight, Twitter's board acted competently by initiating the poison pill defense for three reasons. Firstly, the board required adequate time to evaluate Musk's offer and gauge "their support or disapproval of Musk's offer."[85] Secondly, Musk's $54.20/share offer, while a thirty-eight percent premium over the stock price at the time, was still below the stock's all-time high that it had achieved roughly a year earlier during the pandemic rally.[86] Finally, "it was initially unclear how Musk would fund the deal. Despite his being the world's richest person, much of his wealth is tied up in Tesla stock, meaning he would likely have to borrow against his holdings to fund the deal."[87]

Following the announcement of Twitter's implementation of a poison pill, Musk swiftly alleviated the board's concerns about his method of funding the buyout by announcing his intention to liquidate some of his Tesla shares as well as financial backing from several heavy hitters such as Morgan Stanley, Barclays, and Bank of America.[88] The only remaining matters for the board to consider were whether Musk's $54.20/share offer was the highest Twitter would receive and whether Musk was properly equipped to take Twitter private and lead the company.

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[84] "Twitter shares ended trading on Thursday at $45.08, a 1.75% drop since Musk unveiled his $54.20 per share offer, reflecting wide investor skepticism that a deal will happen." Krystal Hu, Anirban Sen, and David French, *Analysis: Why Musk's Buffett-like playbook won't work on Twitter*, REUTERS (Apr. 14, 2022), https://www.reuters.com/technology/why-musks-buffett-like-playbook-wont-work-twitter-2022-04-14/ [https://perma.cc/YQ2H-QVET].

[85] Greg Roumeliotis and Krystal Hu, *Twitter adopts 'poison pill' as challenger to Musk emerges*, CNBC (Apr. 15, 2022), https://www.cnbc.com/2022/04/15/twitter-board-adopts-poison-pill-after-musks-43-billion-offer-to-buy-company.html [https://perma.cc/2J6Z-NJNG].

[86] "Musk's interest in Twitter comes from his own frequent use of the platform. The Tesla and SpaceX CEO often uses his large platform to share jokes, engage with his 83.6 million followers and make business announcements. The latter has gotten him in some trouble." Lauren Feiner, *Twitter accepts Elon Musk's buyout deal*, CNBC (Apr. 25, 2022), https://www.cnbc.com/2022/04/25/twitter-accepts-elon-musks-buyout-deal.html#:~:text=Twitter%20accepts%20Elon%20Musk%E2%80%99s%20buyout%20deal%201%20Twitter%E2%80%99s,hostile%20takeover%20by%20adopting%20a%20so-called%20poison%20pill [https://perma.cc/2CPZ-D3AL].

[87] *Id.*

[88] Alex Wilhelm, *We just found out how Elon Musk may finance his $43B Twitter bid*, TECHCRUNCH (Apr. 21, 2022), https://techcrunch.com/2022/04/21/we-just-found-out-how-elon-musk-may-finance-his-43b-twitter-bid/ [https://perma.cc/92ZM-2HL9].

"I think if the company were given enough time to transform, we would have made substantially more than what Musk is currently offering," noted an institutional Twitter investor, but adding that "[i]f the public markets do not properly value a company, an acquirer eventually will."[89] Following Musk's financial reassurance, however, "Twitter changed its posture after Mr. Musk detailed elements of his financing plan for the takeover. On April 21, he said he had $46.5 billion in funding lined up. Twitter shares rose sharply, and company executives opened the door to negotiations."[90] Shortly thereafter, on April 25, Twitter announced that it had accepted Musk's offer for $54.20'share.[91] However, Musk's net worth suffered a massive setback in the form of a nearly 20% drop in Tesla's stock price due to investor concerns that Musk had traded much of his attention from Tesla to Twitter.[92]

Twitter's swift acceptance of Musk's offer, especially considering the acceptance occurred merely days after Twitter's implementation of a poison pill, shocked most experts. "A central mystery of Mr. Musk's acquisition of Twitter is how the company's board went from installing a poison pill to agreeing to sell to him in just 11 days. In most megadeals, the adoption of a poison

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[89] Greg Roumeliotis, *Musk gets Twitter for $44 billion, to cheers and fears of 'free speech' plan*, REUTERS (April 25, 2022) https://www.reuters.com/technology/exclusive-twitter-set-accept-musks-best-final-offer-sources-2022-04-25/ [https://perma.cc/FFY8-Q3X4].

[90] Cara Lombard, Meghan Bobrowsky, and Georgia Wells, *Twitter Accepts Elon Musk's Offer to Buy Company in $44 Billion Deal*, THE WALL STREET JOURNAL (Apr. 25, 2022), https://www.wsj.com/articles/twitter-and-elon-musk-strike-deal-for-takeover-11650912837#_=_ [https://perma.cc/4SBZ-KK7K].

[91] "Mr. Musk had lined up financing for his offer and was needling the company with his tweets. And after hours of discussions and reviewing Twitter's plans and finances, the questions the 11 board members were wrestling with — could the company be worth more than $54.20 a share? would any other bidder emerge? — were all leading to one dissatisfying answer: No." Lauren Hirsch and Mike Isaac, *How Twitter's Board Went From Fighting Elon Musk to Accepting Him*, THE NEW YORK TIMES (Apr. 30, 2022), https://www.nytimes.com/2022/04/30/technology/twitter-board-elon-musk.html?login=smartlock&auth=login-smartlock [https://perma.cc/FFY8-Q3X4].

[92] "Twitter's share price stood at about $32.64 as Monday trading closed - falling further below the $54.20-a-share takeover price agreed by Mr Musk and Twitter's board in April." *See* Michael Race, *Twitter shares fall as Elon Musk backs out of deal*, BBC NEWS https://www.bbc.com/news/business-62121226 [https://perma.cc/6UDW-GEHQ]; YAHOO! FINANCE, *supra* note 70 https://finance.yahoo.com/quote/TWTR/history?period1=1646092800&period2=1651363200&interval=1d&filter=history&frequency=1d&includeAdjustedClose=true [https://perma.cc/9V32-DJBY].

pill leads to a protracted fight."[93] However, the reason for Twitter's sudden reversal was apparently due to a disappointing lack of alternative offers.[94] According to the New York Times, Twitter's board of directors essentially settled with Musk's offer after failing to attract any other viable offers from anyone that would garner less controversy than Musk.[95] Despite Twitter's board's failure to utilize Musk's offer to attract competing offers, the board correctly determined that after the dust settled, Musk's offer represented the best interests of the company and its shareholders. Bret Taylor, chairman of Twitter's board, correctly concluded that Musk's $54.20/share valuation of the company was substantially higher than any valuation the company could hope to achieve through the publicly-traded route, considering Twitter had failed to turn a profit for eight of the previous ten years.[96]

Following Twitter's acceptance of Musk's offer, on May 13, 2022, the hostile-turned-friendly takeover turned hostile once again after Musk tweeted that he was placing the deal on hold until Twitter supplied Musk with data on "the volume of fake and spam accounts on the platform."[97] "In response, Twitter issue[d] a statement saying Musk already agreed to the $54.20 transaction and that it intended to close on and enforce the merger agreement."[98] Twitter's board acted prudently by positioning itself to enforce the agreement with a $54.20/share valuation considering Twitter's stock price at the time. On May 12, Twitter's stock price closed at $45.08

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[93] "Twitter's board did not quite know how to handle Mr. Musk's bid, the people with knowledge of the discussions said." Hirsch and Isaac, *supra* note 91.`

[94] *Id.*

[95] *See id.*

[96] "Mr. Musk also campaigned on Twitter for a deal. He hinted that he would take his proposal directly to shareholders in a so-called tender offer if the company's board did not accept his bid. On April 16, he tweeted, 'Love me tender.' Three days later, he tweeted '____ is the Night,' a reference to the F. Scott Fitzgerald novel, 'Tender Is the Night.'" *See* Hirsch and Isaac, *supra* note 91.

[97] Rob Wile, *A timeline of Elon Musk's takeover of Twitter*, NBC NEWS (Nov. 17, 2022), https://www.nbcnews.com/business/business-news/twitter-elon-musk-timeline-what-happened-so-far-rcna57532 [https://perma.cc/HTD2-PH9Y].

[98] *Id.*

while falling drastically to close at $40.72 on May 13 in response to Musk's tweet.[99] Even before the steep drop on May 13, Twitter's stock was trading at a price well below Musk's valuation, so Twitter's board had a fiduciary duty of care to its shareholders to enforce Musk's agreement with all its might while Musk understandably wished to find a way to avoid paying such a high premium for such a downtrodden company.[100] The merger agreement contained a $1 billion break-up fee, but Twitter chose to enforce the agreement rather than pursuing the break-up fee, suggesting that Twitter's board recognized how high Musk's valuation of the company was and how difficult it would be to ever reach that price again, considering the stock was trading around $38 at the time.[101] Thus, Twitter's board could have been subject to a lawsuit initiated by shareholders disappointed with the board's inability to retain the agreement.[102]

Most legal experts saw Musk's expressed concerns about spam accounts as merely a method to attempt to reduce the purchase price and saw no avenue for Musk to escape the agreement.[103] After months of stalemate negotiations, in July 2022, Twitter opted to sue Musk in Delaware court to enforce the original merger agreement.[104] Musk countersued, claiming that Twitter had materially breached "multiple provisions" of the agreement, seemingly wished to use this claim to relieve himself of his contractual obligation to purchase Twitter for $54.20/share.[105]

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[99] *See* YAHOO! FINANCE, *supra* note 74.
[100] *See* Kahn, supra note 32, at 916.
[101] *See* Race, *supra* note 92.
[102] *See* Kate Conger and Lauren Hirsch, *The Board Chair Squaring Up to Elon Musk in the Feud Over Twitter*, THE NEW YORK TIMES (Oct. 4, 2022), https://www.nytimes.com/2022/10/04/technology/twitter-board-elon-musk.html [https://perma.cc/BF3T-BF45].
[103] *See* Race, *supra* note 92.
[104] "Musk's lawyer alleged in Friday's letter that Twitter (TWTR) is "in material breach of multiple provisions" of the deal, claiming the company has withheld data Musk requested in order to evaluate the number of bots and spam accounts on the platform. Twitter (TWTR)'s legal team hit back in a letter on Monday, calling Musk's attempted termination "invalid and wrongful," claiming that Musk himself had violated the agreement and demanding that he follow through with the deal." Claire Duffy, *Twitter sues Elon Musk to force him to complete acquisition*, CNN BUSINESS https://www.cnn.com/2022/07/12/tech/twitter-elon-musk-acquisition-lawsuit/index.html (last updated July 13, 2022), [https://perma.cc/G2YQ-MEAH].
[105] *Id.*

Twitter's complaint did pull any punches. "Musk apparently believes that he—unlike every other party subject to Delaware contract law—is free to change his mind, trash the company, disrupt its operations, destroy stockholder value, and walk away," claimed Twitter's complaint.[106] "After the merger agreement was signed, the market fell . . . . [T]he value of Musk's stake in Tesla, the anchor of his personal wealth, has declined by more than $100 billion from its November 2021 peak . . . . So Musk wants out. Rather than bear the cost of the market downturn, as the merger agreement requires, Musk wants to shift it to Twitter's stockholders," the complaint continued.[107] With both sides giving no quarter, Judge Kathaleen McCormick scheduled a trial for October 2022 after granting Twitter's request for an expedited hearing.[108]

The stalemate continued until early October when Musk sent Twitter a letter stating that he would indeed purchase Twitter for the agreed-upon price.[109] Some legal experts speculated that perhaps the reason for Musk's decision to abandon the fight was to avoid a revealing deposition while others simply believed Musk finally realized that he stood no chance of successfully backing out of his commitment to purchase Twitter.[110] Regardless of the reason, however, Twitter's board successfully navigated Musk's public criticisms to enforce a seller-friendly merger agreement. Twitter's board fulfilled its duties to Twitter's shareholders by exercising due diligence in

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[106] Anna Restuccia, *Twitter vs. Musk: The Complaint*, HARVARD L. SCH. F. ON CORP. GOVERNANCE (July 14, 2022), https://corpgov.law.harvard.edu/2022/07/14/twitter-vs-musk-the-complaint/ [https://perma.cc/RC7F-C3U3].
[107] *Id.*
[108] "After initially saying he wanted to buy Twitter to eradicate bots, Musk has in recent weeks expressed concerns (without any apparent evidence) that there are more bots on the platform than Twitter has publicly reported. Some analysts, however, have suggested that Musk simply wants an excuse to get out of a deal that now seems overpriced following the downturn in Twitter shares and the overall tech market. Tesla (TSLA) shares, which Musk is relying on in part to finance the deal, have also declined sharply since he agreed to the acquisition deal." Duffy, *supra* note 104.
[109] Anirban Sen and Tom Hals, *Musk reverses course, again: he's ready to buy Twitter, build 'X' app*, REUTERS (Oct. 4, 2022), https://www.reuters.com/markets/europe/musk-said-go-ahead-with-5420-share-twitter-deal-bloomberg-reporter-2022-10-04/ [https://perma.cc/UR4X-HMD2].
[110] *See id.*

assessing Musk's offer and correctly determining that Musk's offer represented the best value for the company and its shareholders.

Taylor correctly emphasized speed throughout the board's cold war with Musk because Taylor understood that if Twitter's board allowed Musk to continue criticizing Twitter and the board, morale would suffer, especially considering the criticism was coming from the person Twitter's board was attempting to make the owner of the company.[111] Taylor and Twitter's board also correctly estimated that Musk had no viable method of avoiding his commitment to purchase Twitter for $54.20/share and that Musk's offer was the best offer the board would receive. Thus, Twitter's board fulfilled its fiduciary duties to the company and its shareholders by acting diligently to ensure the viability of Musk's offer but also swiftly accepting Musk's offer to bind Musk to the agreement before Musk had an opportunity to rescind his offer.[112] Twitter's board also fulfilled its fiduciary duty by enforce the merger agreement when Musk attempted to rescind his offer after Twitter accepted the offer. Twitter's board correctly recognized that Musk's offer represented a much higher premium over the current price than the company could reasonably hope to achieve in the public market, especially considering the strongly bearish market at the time.[113] Thus, Twitter's board navigated its unique situation quite well and swiftly delivered a lucrative value to all shareholders by not only securing the lucrative agreement but also by effectively enforcing it. Twitter's board not only fulfilled its fiduciary duties to Twitter's shareholders, but the board also delivered an extremely lucrative agreement for shareholders.

C. Corporate Governance Lessons from Hostile Takeovers

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[111] *See* Conger and Hirsch, *supra* note 102.
[112] *See Van Gorkum*, *supra* note 16, at 872–73.
[113] *See S&P 500 (^GSPC)*, YAHOO! FINANCE https://finance.yahoo.com/quote/SPY/history?p=SPY [https://perma.cc/X6SB-F4DU]

The aforementioned case studies of RJR Nabisco and Twitter provide two examples of competent boards that delivered fantastic deals for their respective shareholders. RJR Nabisco's board managed to attract a multitude of attractive offers while simultaneously possessing foresight into which entity was best suited to run the company moving forward.[114] RJR Nabisco's board correctly identified Kravis as best suited to lead the company due to his emphasis on Nabisco as opposed to Johnson's emphasis on the controversial RJR Tobacco. Similarly, Twitter's board made the correct move in initiating a poison pill in immediate response to Musk's offer to give the board time to assess the viability of Musk's offer.[115] Though Twitter's board failed to attract alternative offers like RJR Nabisco's board, this was to be expected considering market sentiment at the time, especially around tech companies such as Twitter.[116] Next, Twitter's board acted swiftly and competently in accepting Musk's offer after correctly determining that Musk's offer represented a great value to shareholders.[117] Twitter's board then vigorously defended the merger agreement after Musk's attempts to back out of the agreement and successfully forced Musk's hand by cornering him into a trial with low chances of success.[118] Twitter's board then secured the best scenario possible with Musk accepting the offer before trial and delivering a substantial premium to shareholders.[119] Thus, the boards of both RJR Nabisco and Twitter proved the value of a competent board of directors in hostile takeover situations and proved that they can indeed

[114] *See In re* RJR Nabisco, Inc. Shareholders Litigation, *supra* note 50, at *20.
[115] *See* Feiner, *supra* note 79.
[116] *See* YAHOO! FINANCE, *supra* note 113.
[117] "[I]nterviews with a dozen people close to the transaction, who were not authorized to speak publicly, show just how few options Twitter's board had. And while there are many types of buyers that deal advisers are prepared to fend off — hostile ones, aggressive ones, those who lowball and then are willing to negotiate — Twitter faced an acquirer in Mr. Musk who was not in any deal playbook. In essence, he was an "unknown quantity" acquirer, one who would not budge on price and was prepared to publicly trash the company and wield his considerable fortune to get an agreement done with limited diligence." *See* Hirsch and Isaac, *supra* note 86.
[118] *See* Duffy, *supra* note 104.
[119] Sen and Hals, *supra* note 109.

deliver massive value to shareholders, which should always be the ultimate goal of a board of directors.[120]

Boards that fulfill their *Revlon* duties to act as auctioneers and maximize the company's value will undoubtedly place the company in a better position than a board that merely accepts the first offer presented, or worse yet, refuses to entertain viable offers. Corporate boards should take lessons from both types when faced with hostile takeover situations. As will be explained in further detail *infra*, boards that are mostly independent, have minimum and maximum term lengths, and limit the number of former CEOs will place themselves in a much better position for difficult situations than those who do not.[121] This is no easy task, but situations such as these are why corporate executives earn the type of salaries they earn. A company's board of directors is only as competent as the people the board decides to work with and it is difficult to overstate the importance of hiring competent executives and properly overseeing them. When a company boss is granted unfettered power with minimal oversight from the board, the house of cards can be torn down instantaneously, as evidenced by examples such as Enron and FTX. However, as evidenced by companies such as Waste Management[122] that discovered fraud amongst its executives and successfully eliminated the fraud to keep the company afloat, a competent board of directors can be the difference between implosion and survival. Nevertheless, fraudulent activity is one of the most difficult situations for a board of directors to navigate.

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[120] *See Van Gorkum*, *supra* note 16, at 872–73.
[121] "We certainly endorse the board member independence requirements of the stock exchanges and the enhanced independence guidelines as recommended by proxy advisory companies that have developed as a response to the Enron scandal. Nevertheless, it is our position that corporate boards of publicly held firms would be better off and less prone to error if other rules or guidance were in place that required or strongly encouraged corporate board nominating committees to select members who were less prone to what we refer to below as 'dysfunctional deference.'" Sharfman & Toll, *supra* note 2, at 154–55.
[122] News Release, Securities and Exchange Commission, *Waste Management Founder and Five Other Former Top Officers Sued for Massive Fraud*, 2002 WL 459850 (March 26, 2002).

II. Fraud: Enron and FTX

In cases of fraudulent activity conducted by a corporation's C-suite, the board's duty of care requires the board to identify the specific fraudulent activities and terminate the perpetrators.[123] A board's failure to sniff out fraud will likely open the board to liability and, if the fraud is pervasive and continuous, could collapse the entire company. A board's ability to maintain a critical eye over its executives, even when the company is seemingly performing well, could decide whether the company will survive and thrive like Waste Management[124] or collapse like Enron[125] when the company's board discovers fraudulent activity. While no board of directors expects to discover fraudulent activity within its company, the board's response to this information undoubtedly will determine whether the company survives. If the board swiftly addresses and eliminates the fraud, the board may minimize the financial and PR damage, but if the board is complicit or seeks to conceal the fraud, the efficient capital market hypothesis would suggest that the fraud will eventually become public through the grapevine of the stock market and the company's stock price will suffer once the information inevitably becomes public.[126] Two well-documented instances of utter failures in corporate governance in response to fraud highlight the importance of a principled, unbiased board of directors. One had a model board of directors while the other had no board of directors at all, but both met the same grandiose yet unceremonious

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[123] *See Van Gorkum*, *supra* note 16, at 872–73.

[124] Securities and Exchange Commission, *supra* note 122.

[125] CNN, *Enron employees ride stock to bottom*, CNN LAW CENTER (Jan. 14, 2002), https://edition.cnn.com/2002/LAW/01/14/enron.employees/ [https://perma.cc/E8PY-X8QX].

[126] "Several versions of the efficient market hypothesis exist. The strong form of the hypothesis holds that all information, whether public or non-public, is incorporated in the secondary market securities price. The semi-strong version of the efficient capital markets hypothesis in turn posits that the secondary market price of companies reflects all publicly available information on the company." *See* Ian Ayres & Stephen Choi, *Internalizing Outsider Trading*, 101 MICH. L. REV. 313, 318 n.18 (2002).

downfall. These two examples are, of course, the headline-dominating bankruptcies of Enron in 2001 and FTX in 2022.

A. Enron: A Masterclass in Corporate Groupthink

In 2001, a shock to the financial system was inflicted in the form of inflated earnings and bogus accounting at the hands of Enron. Having been named Fortune's Most Innovative Company for six consecutive years in addition to countless other accolades,[127] Enron's stock was selling around fifty-five times trailing earnings,[128] an astronomical valuation. Using an accounting scheme that was legal but ripe for abuse known as "mark to market" accounting, Enron consistently beat analyst earnings estimates by essentially claiming projected future revenue as current revenue.[129] "Under mark-to-market accounting, assets are carried on the balance sheet at their market or fair value. Changes in asset value from one period to the next (unrealized gains and losses) are reported in the firm's income statement for the period."[130] This method of accounting is uncontroversial and promotes transparency by valuing company assets in real-time rather than waiting for the asset to be sold for its value to appear on the company's balance sheet.[131]

[127] *Corporate Awards*, ENRON PRESS ROOM https://enroncorp.com/corp/pressroom/awards/corporate.html [https://perma.cc/L66P-DJDK].

[128] "First Call says that 13 of Enron's 18 analysts rate the stock a buy. But for all the attention that's lavished on Enron, the company remains largely impenetrable to outsiders, as even some of its admirers are quick to admit. Start with a pretty straightforward question: How exactly does Enron make its money? Details are hard to come by because Enron keeps many of the specifics confidential for what it terms 'competitive reasons.' And the numbers that Enron does present are often extremely complicated. Even quantitatively minded Wall Streeters who scrutinize the company for a living think so." Bethany McLean, *Is Enron Overpriced?*, FORTUNE (Mar. 5, 2001), https://fortune.com/2015/12/30/is-enron-overpriced-fortune-2001/ [https://perma.cc/F7K2-KMV5].

[129] Stan Hanks, *How Analysts Figured Out That Enron Was Fudging Its Numbers*, FORBES (Nov. 9, 2017), https://www.forbes.com/sites/quora/2017/11/09/how-analysts-figured-out-that-enron-was-fudging-its-numbers/?sh=182d9a5819cb [https://perma.cc/8ZF7-4J55].

[130] Although the practice is legal and can promote transparency, Enron essentially turned "mark-to-market" accounting into an obscenity after its fraudulent accounting practices using mark-to-market accounting were uncovered. Stuart L. Gillan and John D. Martin, *Financial Engineering, Corporate Governance, and the Collapse of Enron* 9 (U. of Del. Coll. of Bus. and Econ. Ctr. for Corp. Governance, Working Paper No. 2002-001, Jan. 16, 2003) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=354040 [https://perma.cc/4K68-VYHF].

[131] *See id.* at 10.

"However, if market values are unavailable, mark-to-market becomes mark-to-model, and the requisite valuations frequently involve subjective estimates. Such was the case at Enron when, on numerous occasions, it recorded values of complex transactions for which there were no observable market values."[132] Using this accounting scheme, Enron rapidly increased profitability to become the United States' seventh largest company and one of the stock market's most sought-after names.[133]

In March of 2001, Enron was trading at fifty-five times trailing earnings, a valuation of more than double the average valuation of an S&P 500 stock.[134] However, nobody at the company could (or was willing to) provide a coherent answer to the question: "how does Enron make money?"[135] While publicly branding itself as a "logistics company," Enron's executives, seemingly with the board's knowledge and approval, withheld specifics for "competitive reasons."[136] Thus, Enron proved a difficult stock for Wall Street to analyze.[137] When questions arose regarding how Enron was consistently beating revenue estimates, Enron executives arrogantly alleged characterized skeptics as motivated by ignorance and "sour grapes."[138] Likening Enron's 1,217 trading books as a trade secret to that of Coca-Cola's secret recipe, Enron CFO Andrew Fastow plainly stated: "[w]e don't want anyone to know what's on those books. We don't want to tell anyone where we're making money."[139] Meanwhile, in the Enron board room,

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[132] *Id.*
[133] Lesley Curwin, The collapse of Enron and the dark side of business, BBC (Aug. 3, 2021), https://www.bbc.com/news/business-58026162 [https://perma.cc/5GXN-WUMX].
[134] Fortune columnist Bethany McLean was credited by many as being the first to raise questions about Enron's business practices. *See* McLean, *supra* note 128.
[135] *See id.*
[136] *See id.*
[137] "[D]escribing what Enron does isn't easy, because what it does is mind-numbingly complex. CEO Jeff Skilling calls Enron a "logistics company" that ties together supply and demand for a given commodity and figures out the most cost-effective way to transport that commodity to its destination. Enron also uses derivatives, like swaps, options, and forwards, to create contracts for third parties and to hedge its exposure to credit risks and other variables." *Id.*
[138] *Id.*
[139] *Id.*

Enron's board "allowed, and even encouraged, Enron executives to" implement its perverted version of mark-to-market accounting and to withhold financial details from the public.[140]

Enron's board appeared to be the gold standard for board composition: former executives that had run companies from a wide array of industries, most of whom were disinterested.[141] Of the fourteen, only two were employees of the company: former CEO Kenneth Lay and CEO Jeffrey Skilling, the two individuals viewed to be the masterminds of the ordeal.[142] The twelve outside directors comprised of five current CEOs, four academics, "a professional investor, the former president of Enron's wholly owned subsidiary Belco Oil & Gas, and a former U.K. politician."[143] On paper, the Enron board was 86% independent, compared to the national average of 56%.[144] Additionally, Enron's board structure represented the cutting edge of board structure and was considered to be a model for best practices for a board of directors as the board included comprehensive committees for auditing, nominating compliance, corporate governance, executive, finance, and compensation.[145] Notably, Enron's well-regarded audit committee had "direct access" to key personnel and had the authority to hire "additional accountants, lawyers, and consultants,"[146] suggesting the audit committee was in position to detect the fraudulent activity. In fact, "Enron was even named [in 2000] as having one of the five best boards by Chief Executive magazine."[147]

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[140] Gillan and Martin, *supra* note 130, at 2.
[141] *Id.* at 21.
[142] *See id.*
[143] *Id.*
[144] *Id.*
[145] *Id.*
[146] "Enron's board appeared to be experienced, structured in a manner to closely monitor management activities, and comprised of directors with a financial interest to carry out their monitoring duties." Gillan and Martin, *supra* note 130, at 22–23.
[147] Reed Abelson, *ENRON'S COLLAPSE: THE DIRECTORS; Eyebrows Raised in Hindsight About Outside Ties of Some on the Board*, THE NEW YORK TIMES (Nov. 30, 2001), https://www.nytimes.com/2001/11/30/business/enron-s-collapse-directors-eyebrows-raised-hindsight-about-outside-ties-some.html [https://perma.cc/V74C-YSHM].

Beneath the surface, however, lay conflicts of interest for several board members. Among the most obvious, two directors "had consulting arrangements with Enron."[148] Of the twelve "independent" board members as of May 2001, six members "had potential conflicts of interest through financial ties, suggesting that less than 43% of the board may have been independent of management.[149] Enron's board was compensated at a rate of roughly triple that of Enron's competitors, further suggesting that "some board members' financial interests may have attenuated any inclination to aggressively monitor management's practices."[150] Two members of the audit committee "worked for institutions that received substantial donations from Enron and its officials."[151] While the consulting arrangements clearly represented conflicts of interest, the charitable contributions also "create[d] the optics of impropriety," according to Charles Elson, director of the Center for Corporate Governance at the University of Delaware.[152] However, the most dangerous aspect of Enron's board was not its composition. Rather, it was the collective blind eye the board turned toward the business practices of Enron's executives. How could a group of some of the world's premier business minds fail to detect what in hindsight is such brazen fraud?

Of course, the conflicts of interest contributed to the board's oversight failure.[153] However, some scholars have drawn from social psychology[154] to primarily attribute the board's failure to a phenomenon called "dysfunctional deference."[155] These experts posit that the Enron board "exhibited such extreme deference to Company management that there was little or no deliberation

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[148] *Id.*
[149] Gillan and Martin, *supra* note 130, at 23.
[150] *Id.* at 24.
[151] Abelson, *supra* note 147.
[152] *Id.*
[153] Sharfman & Toll*, supra* note 2, at 154.
[154] O'Connor, *supra* note 3, at 1237.
[155] "[I]t is our position that corporate boards of publicly held firms would be better off and less prone to error if other rules or guidance were in place that required or strongly encouraged corporate board nominating committees to select members who were less prone to what we refer to below as —dysfunctional deference." Sharfman & Toll*, supra* note 2, at 155.

preceding some of the board's most important decisions."[156] Conventional wisdom correctly suggests that a small group of individuals is less prone to cognitive biases than a single individual would be[157] when: "(1) the group consists of equal status peers, (2) the group has nondirective leadership, (3) members feel free to ask questions, and (4) members have assigned roles in small task groups."[158] However, behavioral science also suggests that "small deliberative groups are prone to error in their decisionmaking if these groups are made up of a majority of members who are similar in position prior to deliberations."[159] Thus, a board is vulnerable to "group polarization," in which a similarly situated group of individuals will push each other to increasingly extreme positions.[160] However, the Enron board's refusal to properly discuss some of the board's most crucial decisions that a dangerous version of groupthink was pervasive among the Enron board.[161] Further, evidence from social psychology suggests that CEO-dominated boards may be "beholden to the CEO" and grant too much deference to the company CEO.[162]

Groupthink is defined as a phenomenon in which "groups believe that their goals are based on ethical principles, and they stop questioning the morality of their behavior."[163] This "causes members to ignore negative information by viewing messengers of bad news as people who "'don't get it."'[164] This phenomenon essentially negates the advantages of groups over individuals since each member of the group is thinking alike. Groups suffering from groupthink also suffer from an

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[156] *Id.* at 154.
[157] "In sum, [Alan] Blinder and [John] Morgan conclude "two heads-or, in this case, five-are indeed better than one. Society is, in that case, wise to assign many important decisions to committees." Still, Blinder and Morgan's research cannot conclusively establish that society is wise to assign corporate decisionmaking to boards rather than individuals. Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 VAND. L. REV. 1, 3, 16 (2002) ("A wealth of experimental data suggests that groups often make better decisions than individuals.").
[158] O'Connor, *supra* note 3, at 1243.
[159] Sharfman & Toll, *supra* note 2, at 155.
[160] *Id.*
[161] *Id.* at 159.
[162] O'Connor, *supra* note 3, at 1244.
[163] *Id.* at 1258.
[164] *Id.*

illusion of invincibility in which groups ignore risk and allow past success to eliminate future concerns.[165] Enron's board undoubtedly suffered from illusions of invincibility thanks to the financial media's incessant fawning over the company and further entrenched the board into an overly optimistic mentality.[166] The business judgment rule can also serve to create an illusion of invincibility amongst board members, for board members know that they must merely identify any "rational business purpose" for the decision to be shielded from liability.[167]

Evidence suggests that the Enron board, drawing from its executives, developed a culture that prioritized profits over following the rules.[168] For instance, "one Enron employee received a promotion after violating company policy in making an investment that turned out to be successful."[169] Further, given the Enron board only gathered to meet five times per year, the board was heavily incentivized to rely on the outstanding (but fabricated) financial reports generated by the company executives and complicit accounting firm, Arthur Andersen.[170] Groupthink theory would suggest that even if any board member was privately suspicious of Enron's financial performance, the board member would be disincentivized from making these suspicions public over fear of being outcast from the extremely exclusive and lucrative club.[171] The Enron board and executives desperately desired to maintain an "illusion of normalcy," which caused the board to ignore thirteen red flags, according to the U.S. Senate special committee tasked with

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[165] "With an understanding of groupthink, we can see that the Enron Board did not prevent the Enron debacle because of psychological processes that lead cohesive boards to avoid seriously scrutinizing managerial policy. Thus, examination of the cognitive factors surrounding the Enron Board's decision making is significant because such human foibles may affect other corporate boards." *Id.* at 1270.
[166] *See id.* at 1272–73.
[167] *Id.* at 1247.
[168] *See* O'Connor, *supra* note 3, at 1273.
[169] *See id.*
[170] *See id.* at 1273–74.
[171] *See id.* at 1273.

investigating the Enron fallout,[172] including several conflicts of interest.[173] While social psychology helps determine why the board displayed such dysfunctional deference towards the company's executives, the larger question remains of what corporate governance measures should have been implemented within Enron's board so that the board would have discovered and eliminated the pervasive fraud within the company. This is why the competence, independence, and integrity of board members are so crucial.

B. FTX: A Child with No Chaperone

For a sobering modern reminder of the importance of a competent board of directors, one must simply look at the recent fallout involving Sam Bankman-Fried and cryptocurrency exchange firm FTX, in which CEO Bankman-Fried managed to fleece investors and skip town with no board of directors to answer to, because conveniently, FTX did not have a board of directors.[174] This alarming fact should have caught the attention of investors, but instead they seemed to be mesmerized with Bankman-Fried's honeyed words about the supposed future of cryptocurrency. Though FTX investors undoubtedly deserve blame for placing their assets into an exchange run by a scam artist, these investors were also led astray by the traditional financial media. Every financial news outlet such as CNBC and Bloomberg breathlessly fawned over Bankman-Fried as

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[172] WILLIAM POWERS, JR., BOARD OF DIRECTORS OF ENRON, REPORT OF THE SPECIAL INVESTIGATIVE COMMITTEE OF ENRON (Feb. 1, 2002).

[173] "[I]ndependent directors often make decisions to trust the CEO of the company in deciding to accept a board seat. This initial determination to rely on the CEO, however, creates the possibility of cognitive dissonance because facing up to negative information may lead to an ego-threatening realization that the independent director originally had poor judgment." O'Connor, *supra* note 3, at 1278–79.

[174] Britney Nguyen, *Chamath Palihapitiya said Sam Bankman-Fried once pitched him, but after the investor suggested changes like forming a board, FTX told him to get lost*, BUSINESS INSIDER (Nov. 15, 2022), https://www.businessinsider.com/ftx-told-chamath-palihapitiya-social-capital-go-fuck-yourself-recommendations-2022-11#:~:text=Sam%20Bankman-Fried%20once%20pitched%20Social%20Capital%2C%20but%20Chamath,firm%20to%20%22go%20fuck%20yourself%22%20for%20suggesting%20changes. [https://perma.cc/6ESY-FHEL].

"the next Warren Buffett,"[175] which highlights the need for not only a board of directors but also a competent, unbiased board of directors that is motivated by greed for the company's benefit rather than greed for his benefit. The tale of FTX's bankruptcy is one of greed, deceit, and willful blindness.

FTX's story is inherently linked to the stratospheric rise in the popularity of cryptocurrency. FTX operated as a cryptocurrency exchange and hedge fund in which customers would place money into their FTX brokerage account to purchase cryptocurrencies such as Bitcoin and Ethereum, but "FTX's main business [was] running a market for crypto derivatives—risky instruments that allow traders to place leveraged bets on whether digital currencies will rise or fall."[176] FTX was the second largest cryptocurrency exchange in the world behind Coinbase.[177] Unlike Coinbase, however, FTX was a private company, allowing founder Sam Bankman-Fried unfettered power with no requirement to disclose financial statements to the public.[178] This allowed Bankman-Fried to incorporate the company and house the company's headquarters in the Bahamas, outside the jurisdiction of the SEC.[179] Before November 2022, FTX was portrayed as a savior of the cryptocurrency industry due to his political activism and advocacy for a more heavily regulated cryptocurrency industry, with even some traditional financial outlets dubbing him the

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[175] Jeff John Roberts, *Exclusive: 30-year-old billionaire Sam Bankman-Fried has been called the next Warren Buffett. His counterintuitive investment strategy will either build him an empire—or end in disaster*, FORTUNE (Aug. 1, 2022), https://fortune.com/2022/08/01/ftx-crypto-sam-bankman-fried-interview/ [https://perma.cc/P4NJ-JAH4].

[176] Bankman-Fried embraced the image of the "adult in the room" for the crypto industry, advocating for tougher regulations within the crypto industry in hopes for the industry to establish credibility. Ironically, Bankman-Fried's fraudulent activity decimated the public's perception of cryptocurrencies. Alexander Osipovich, *Crypto Exchange FTX Valued at $18 Billion in Funding Round*, THE WALL STREET JOURNAL (July 20, 2022), https://www.wsj.com/articles/crypto-exchange-ftx-valued-at-18-billion-in-funding-round-11626800455 [https://perma.cc/R9AF-CEBQ].

[177] Joe Rennison, *A Traditional Exchange? FTX Was Anything But.*, THE NEW YORK TIMES (Dec. 16, 2022), https://www.nytimes.com/2022/12/16/business/ftx-exchange.html [https://perma.cc/6KJ8-HYWX].

[178] Tarver, *supra* note 20.

[179] Nelson Wang, *FTX Moves Headquarters From Hong Kong to Bahamas*, COINDESK https://www.coindesk.com/business/2021/09/24/ftx-moves-headquarters-from-hong-kong-to-bahamas-report/ (last updated Sep. 27, 2022) [https://perma.cc/TYC8-4ECT].

"next Warren Buffett."[180] Sentiment such as this undoubtedly attracted retail investors and institutional investors alike to cryptocurrency and margin trades with FTX, but these investors allowed greed to cloud their judgment either failed to exercise due diligence into FTX's business practices or merely assumed the risk, but the former seems more likely than the latter.

Before November 2022, FTX appeared to be an extremely profitable company and viewed by many to be the most trustworthy cryptocurrency exchange platform. FTX's logo could be seen on MLB umpires' uniforms, the Mercedes-Benz Formula One racecar, and FTX's logo even adorned the Miami Heat's basketball arena.[181] However, appearances can often prove misleading, for beneath the surface lay serious liquidity issues for FTX.[182] "At its most recent valuation in fall 2022, it was believed to be worth about $32 billion—–a valuation that proved to be inaccurate."[183] In November 2022, reports surfaced regarding the composition of FTX's assets. Thanks to investigative reporting, investors learned of co-mingling of funds between FTX and Bankman-Fried's trading arm, Alameda Research.[184] Alameda's $14.6 billion balance sheet was primarily comprised of FTX's novel cryptocurrency token, FTT, designed to maintain a stable price.[185] This meant that Alameda's financial viability was heavily determined by the stability of FTT.[186] This

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[180] *See, e.g.*, Kate Rooney, *How crypto billionaire Sam Bankman-Fried survived the market wreckage and still expanded his empire*, CNBC https://www.cnbc.com/2022/09/16/how-billionaire-bankman-fried-survived-the-slump-and-still-expanded.html (last updated Sep. 19, 2022) [https://perma.cc/G494-89E5].
[181] The naming rights to the Miami Heat's arena alone cost FTX $135 million. FTX also individually sponsored several major athletes such as Steph Curry, Tom Bray, and Naomi Osaka. Lora Kelley, *FTX Spent Big on Sports Sponsorships. What Happens Now?*, THE NEW YORK TIMES (Nov. 10, 2022), https://www.nytimes.com/2022/11/10/business/ftx-sports-sponsorships.html [https://perma.cc/B6VK-6BLV].
[182] *Ekto Mourya, FTX liquidity gap widens to $8 billion, here's what this means for the future of crypto*, FXSTREET (Nov. 17, 2022), https://www.fxstreet.com/cryptocurrencies/news/ftx-liquidity-gap-widens-to-8-billion-heres-what-this-means-for-the-future-of-crypto-202211172018 [https://perma.cc/KQ8K-77QG].
[183] Paul Tierno, CONG. RSCH. SERV., IN12047, WHAT HAPPENED AT FTX AND WHAT DOES IT MEAN FOR CRYPTO? 1 (2022).
[184] Ian Allison, *Divisions in Sam Bankman-Fried's Crypto Empire Blur on His Trading Titan Alameda's Balance Shee*t, COINDESK https://www.coindesk.com/business/2022/11/02/divisions-in-sam-bankman-frieds-crypto-empire-blur-on-his-trading-titan-alamedas-balance-sheet/ (last updated Nov. 9, 2022) [https://perma.cc/6AGV-24K7].
[185] *Id.*
[186] *See id.*

worked so long as FTT maintained stability, but if FTT were to drop in value, Alameda's assets would be decimated. Naturally, that is exactly what happened.

On November 8, the price of FTT dropped nearly 14% in one day and 44% within one week, raising serious liquidity concerns over FTX and Alameda Research.[187] On November 10, Bankman-Fried took to Twitter to calm the fears of investors, assuring investors that their "funds [were] fine" but that Alameda Research would be closing shop.[188] However, Bankman-Fried did not reveal the whole truth: that FTX had consistently loaned billions of dollars in customer funds to Alameda to protect Alameda's solvency.[189] Furthermore, FTX prohibited customer withdrawals of about $5 billion, leaving about $5 billion worth of withdrawal orders unfulfilled while the money seemed to vanish.[190]

Around the same time, "Changpeng Zhao, the CEO of rival exchange Binance, tweeted that his exchange would sell its roughly $2.1 billion of FTT, essentially sparking a run on FTX."[191] This shrewd move by Zhao exposed the house of cards upon which FTX's fortune was built: the FTT token.[192] Zhao, a large holder of FTT, knew that if he liquidated his shares of FTT, this would destroy FTT's stability and cause a massive selling spree of FTT, which would, in turn, erase most

[187] "The meltdown sparked eery recollections of the crypto market's dizzying crash earlier this year, which was punctuated by the failures [fraud] of the Terra blockchain's UST stablecoin, the crypto lender Celsius Network." Sam Reynolds, *FTX Token Plummets on Withdrawal Concerns as Contagion Hits Broader Crypto Markets*, COINDESK https://www.coindesk.com/markets/2022/11/08/ftt-plummets-as-market-fears-possible-alameda-contagion/ (last updated Nov. 9, 2022) [https://perma.cc/9PSJ-QRF7].
[188] Danny Nelson, Nikhilesh De, Nick Baker, *Sam Bankman-Fried Says Alameda Winding Down, Promises FTX US Customers' Funds Are 'Fine'*, COINDESK (Nov. 10, 2022), https://www.coindesk.com/business/2022/11/10/sam-bankman-fried-says-his-trading-firm-alameda-research-is-winding-down/ [https://perma.cc/WNT8-3YSK].
[189] "The Wall Street Journal reported FTX lent more than half of its $16 billion in customer funds to Alameda in total." Brian Evans, *Sam Bankman-Fried secretly transferred FTX customer funds to Alameda Research after his trading firm suffered losses in the spring, report says*, MARKETS INSIDER (Nov. 10, 2022) https://markets.businessinsider.com/news/currencies/ftx-crash-client-funds-alameda-binance-sbf-sec-cftc-probe-2022-11. [https://perma.cc/K4R6-QHMP].
[190] *See* Tierno, *supra* note 183, at 1.
[191] *Id.*
[192] *See* Reynolds, *supra* note 187.

of FTX's assets.[193] Zhao had won the battle. Zhao sold his entire FTT holding worth about $2.1 billion, FTT collapsed, and FTX followed suit, filing for U.S. bankruptcy projections on November 11, 2022.[194] "The porous relationship between FTX and Alameda lay at the heart of the crypto exchange's collapse into bankruptcy, causing the loss of untold billions to the company's customers all over the world, the CFTC, the Securities and Exchange Commission and the U.S. Department of Justice have said."[195] Thus, the facts suggest that Bankman-Fried masterfully orchestrated a grand-scale theft of billions of dollars worth of customer funds through deceit and false credibility.

Alarmingly and quite unfortunately for FTX investors, FTX had no board of directors.[196] This fact alone should have raised red flags for investors, particularly the institutional investors that shelled over millions to Bankman-Fried clearly without conducting due diligence. Fear of missing out ("FOMO") seemed to be the driving force behind the massive influx of institutional investors to FTX rather than fundamental financial analysis.[197] While massive-scale fraud such as this is rarely predictable, a competent, independent board of directors and audit committee should detect any fraudulent activity or co-mingling of funds within the company. The board then has a

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[193] *See* Tierno, *supra* note 183, at 1.
[194] Nikhilesh De, *FTX Files for Bankruptcy Protection in US; CEO Bankman-Fried Resigns*, COINDESK (Nov. 11, 2022), https://www.coindesk.com/policy/2022/11/11/ftx-files-for-bankruptcy-protections-in-us/ [https://perma.cc/NE8P-RGKG].
[195] "In the end, that money was wiped out through risky bets made by Alameda and by Bankman-Fried himself, who treated the funds as his own to buy luxury homes, private jet rides and make political donations. That money was what FTX used to buy ads during the Super Bowl and to pay for the naming rights for the arena where the Miami Heat play, the CFTC said." Lukas I. Alpert, *A framework for fraud: How FTX was a scam from the very beginning*, MARKETWATCH (Dec. 14, 2022), https://www.marketwatch.com/story/a-framework-for-fraud-how-ftx-was-a-scam-from-the-very-beginning-11671029303 [https://perma.cc/9TZN-RHRQ].
[196] Nguyen, *supra* note 174.
[197] Carson Block, founder of short-selling investment firm Muddy Waters (an homage to the legendary blues musician of the same name), opined that "[Bankman-Fried] went from zero to, I'm worth 20 billion dollars, I'm putting our logo on major league baseball umpire uniforms and on the Miami Heat area. It seems like really trying hard to establish yourself as a household name." Jenni Reid, *FTX collapse an example of 'greed and FOMO,' says short-seller Carson Block*, CNBC (Nov. 17, 2022), https://www.cnbc.com/2022/11/17/ftx-collapse-an-example-of-greed-and-fomo-says-short-seller-carson-block.html [https://perma.cc/ZWL4-FWXW].

fiduciary duty to shareholders to eliminate the fraudulent and risky activity,[198] but this cannot happen if there is no board of directors. It seems too obvious to even state, but billions of dollars disappeared into thin air due to so many investors' refusal to even acknowledge the risk associated with FTX.

While private companies are quite common, investors' faith in Bankman-Fried proved to be misguided and FTX's corporate structure provided no protections for investors from misconduct by Bankman-Fried. An independent board of directors would have undoubtedly served investors well, for a competent, independent board could have discovered Bankman-Fried's fraudulent activity before Bankman-Fried completely fleeced investors' funds.[199] Investors would have immensely benefited from an independent board of directors because any remotely competent board would have required Bankman-Fried to extremely basic measures such as create a risk management department, which Bankman-Fried also failed to establish. Thus, Bankman-Fried was able to use FTX customer funds as his "personal piggy bank"[200] with little to no oversight and was only caught after the money was gone without a trace.

C. Lessons from Enron & FTX

The Enron scandal highlighted the dangers of a board of directors that extends too much deference to company management and displays willful blindness towards the fraudulent activity of its management.[201] The scandal also challenges the notion that capital markets are "efficient,

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[198] *See Van Gorkum*, *supra* note 16, at 872–73.
[199] *See* Securities and Exchange Commission, *supra* note 122.
[200] Allison Morrow and Matt Egan, *FTX founder Sam Bankman-Fried charged with fraud*, CNN BUSINESS https://www.cnn.com/business/live-news/ftx-sam-bankman-fried/h_8e294774a97caddbf7ab3aff41128703 (last updated Dec. 14, 2022) [https://perma.cc/Z65P-B4U5].
[201] "However, for all the research done, a satisfactory explanation has yet to be provided for why the Enron board once considered one of the best boards of a large publicly held firm in the United States-failed to detect the fraud that ultimately destroyed the company. Sharfman & Toll, *supra* note 2, at 153–54.

with prices moving so rapidly in response to new information that investors cannot consistently buy or sell fast enough to benefit."[202] This notion, known as the efficient capital markets hypothesis, "states that competition between sophisticated investors enables the stock market consistently to price stocks in accordance with our best expectations of the long-term earnings of the underlying businesses and assets."[203] The hypothesis contends that markets are efficient when stock prices "fully reflects" all available information about each company. This theory coincides with the "random walk theory," which suggests that due to the efficient capital markets hypothesis, investors are best served simply placing their money into broad-market index funds rather than taking an active approach and attempting to "beat the market."[204] The rationale behind the random walk theory is that the market is indeed efficient and with prices moving so rapidly, investors "cannot consistently buy or sell fast enough to benefit."[205]

While investors are typically extremely well-served following the advice of the random walk theory, occurrences such as Enron and FTX do suggest that markets are not always perfectly efficient. When all available information indicates that a fraudulent company is performing well, the efficiency of the market deteriorates, leaving a disconnect between the public's perception of a stock's value and the stock's actual value.[206] However, proponents of the random walk theory

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[202] Patrick J. Glen, *Efficient Capital Market Hypothesis, Chaos Theory, and the Insider Filing Requirements of the Securities Exchange Act of 1934: The Predictive Power of Form 4 Filings*, 11 FORDHAM J. OF CORP. AND FIN. L. 85, 97 (2005).

[203] Louis Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 COLUM. L. REV. 249, 269 (1983); Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. Fin. 383, 384–85 (1970).

[204] "On Wall Street, the term 'random walk' is an obscenity. It is an epithet coined by the academic world and hurled insultingly at the professional soothsayers. Taken to its logical extreme, it means that a blindfolded monkey throwing darts at the stock listings could select a portfolio that would do just as well as one selected by the experts." BURTON GORDON MALKIEL, A RANDOM WALK DOWN WALL STREET 16 (1973).

[205] Glen, *supra* note 202, at 97.

[206] "Enron was a clear favorite of Wall Street analysts. Even after it began to unravel during the fall of 2001, sixteen out of seventeen security analysts covering Enron had 'buy' or 'strong buy' ratings on the stock." *See* MALKIEL, *supra* note 199, at 70.

would posit that the Enron and FTX scandals further prove the merits of the theory since a principled random walk investor would have ignored the incessant media hype around Enron and FTX rather than becoming caught in the trap.[207]

In response to the brazen accounting fraud committed by companies such as Enron, Congress enacted the Sarbanes-Oxley Act in 2002 to heavily increase oversight and penalties for fraudulent accounting.[208] However, rather than increased government oversight, investors would be better served if the boards of directors for the companies in which they are invested can effectively self-regulate their executives by implementing five proposed standards of best practice designed to reduce the risk of dysfunctional deference.[209]

First, companies should limit the number of current or former CEOs that may serve on a board.[210] This would limit the impact of "over-identification" of these board members with the current CEO and likely increase the level of scrutiny displayed toward the CEO.[211] Second, companies should impose term limits upon board members to prevent over-identification and a consolidation of authority around senior members.[212] Third, and conversely, companies should impose minimum time requirements for board membership.[213] "Although board membership is considered a part-time position, there is a need for a minimum time commitment to ensure that outside board members gain the confidence to deliberate and vote on an issue without total reliance

[207] *See id.* at 72.
[208] "Federal lawmakers enacted the Sarbanes-Oxley Act in large part due to corporate scandals at the start of the 21st century. One such scandal involved energy firm Enron Corp. Enron was considered one of the largest, most successful and innovative companies in the United States." Ben Lutkevich, *Sarbanes-Oxley Act*, TECHTARGET https://www.techtarget.com/searchcio/definition/Sarbanes-Oxley-Act; [https://perma.cc/2K4F-UJ4F] (accessed Feb. 12, 2023).
[209] Sharfman & Toll, *supra* note 2, at 160.
[210] *Id.*
[211] *Id.*
[212] *Id.*
[213] *Id.*

on management recommendations."[214] Fourth, companies should require an individual to possess intricate knowledge of the business to become a board member to ensure that the board member can properly understand the decisions being made by the board and company executives.[215] Fifth, companies should seek directors with a wide variety backgrounds and skillsets so that board members may benefit from a multiple perspectives on a given issue and prevent groupthink.[216] A company following these five guidelines will undoubtedly reduce the risk of dysfunctional deference amongst a board to the company's executives and can achieve a greater level of transparency and market efficiency than would government regulation.

Board members will inevitably and understandably grant a certain amount of deference to the company's executives since the executives should have a much better understanding of the company's day-to-day operations as the executives work full-time for the company whereas board members do not.[217] The FTX collapse teaches investors many important lessons, with the most important perhaps being the importance of sometimes shirking the instinct to be rationally ignorant and vet companies in which they are invested. The simple fact that FTX did not have a board of directors should have served as a glaring red flag to investors. Additionally, however, the Enron scandal teaches investors that although a board of directors may appear independent and well-credentialed, conflicts of interest may lie beneath the surface and groupthink may be collectively preventing anyone from voicing any concerns about the company's practices, particularly when the company's stock price has been performing so well.[218]

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[214] Sharfman & Toll, *supra* note 2, at 161.
[215] *Id.* at 161.
[216] *Id.*
[217] "[D]eference to board insiders and executive management can also lead to serious errors in decisionmaking if the deference is so pronounced that it stifles deliberation of a corporate board's most controversial decisions." *See id.* at 156.
[218] *See id.* at 159.

III. Conclusion

In short, boards of directors serve as more than advisors for their respective companies. In many ways, they serve as guardians and gatekeepers, using meritocracy and objective data to determine who is worthy of running the company. By working to implement the proposed standards of board composition, corporate boards may begin to gain more exposure and trust from investors while also lowering the chances of catastrophe. We as investors place much more trust in a company's board of directors than we realize, so we as investors would be well-served by perhaps abandoning our rational ignorance for a moment to inquire into the quality of the boards of directors of the companies in which we are invested because a competent, independent board of directors is crucial to the success of a company when faced with a difficult situation, such as a hostile takeover or fraudulent activity. By adhering to the proposed standards, corporate boards may begin to establish an identity and trust amongst investors.