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A COMPARATIVE ANALYSIS OF "RED FLAGS" IN SECURITIES OFFERINGS AND NEGOTIATED TRANSACTIONS

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I. ABSRACT

Due diligence, at its core, involves reasonable investigation and reliance consistent with the care of a prudent person in managing their own property. However, this universal standard of "reasonableness" varies across multiple dimensions of context, including the transactional context.

In a registered securities offering, Section 11 of the Securities Act of 1933 ("Securities Act") offers affirmative due diligence defenses for material misstatements and omissions to certain defendants who conducted a "reasonable investigation" and had a "reasonable ground to believe" the information in the registration statement was accurate.[2] Furthermore, the SEC's Rule 176 specified circumstances relevant in a court's reasonableness inquiry.[3]

Decades of guidance from, among others, case law, the Securities and Exchange Commission ("SEC"), the Financial Industry Regulatory Authority ("FINRA") and its predecessor the National Association of Securities Dealers ("NASD"), as well as interpretive guidance drawn from American Bar Association ("ABA") task forces and committees and practitioner and academic literature address the concept of due diligence in the context of securities offerings.[4] This framework contemplates the exercise of professional judgment tailored to the context.

In contrast, negotiated transactions lack comparable prescriptive frameworks but also contemplate the exercise of judgment, specifically applying the business judgment rule under the

[1] J.D., Dedman School of Law, Southern Methodist University, May 2026.
[2] Securities Act of 1933 §§ 11(b)–(c), 15 U.S.C. §§ 77k(b)-(c).
[3] 17 C.F.R. § 230.176 (listing factors for assessing the reasonableness of investigations).
[4] *See, e.g.*, *In re* WorldCom, Inc. Sec. Litig., 346 F. Supp. 2d 628 (S.D.N.Y. 2004); Escott v. BarChris Constr. Corp., 283 F. Supp. 643, 696–98 (S.D.N.Y. 1968) (; 17 C.F.R. 230.176; FINRA, Regulatory Notice 10-22, *Obligation of Broker-Dealers to Conduct Reasonable Investigation in Regulation D Offerings* 4 (2010) [hereinafter Notice 10-22].

more general duty of care.[5] Because litigants and courts frequently conflate these two regimes,[6] it is essential that courts respect their differing contexts and guidance.

A matter commonly in dispute in litigation regarding transactional due diligence is the concept of "red flags." Notably, "red flag" definitions differ widely with context, and there is no universal definition applicable in all circumstances. Therefore, "red flags" guidance, both authoritative and interpretive, varies.

Part II of this paper surveys the multiple context-specific definitions of a "red flag" that have emerged in securities offerings, explains the statutory bifurcation between reasonable investigation and reliance, and analyzes how cases such as *WorldCom*, *BarChris*, and *Nomura* integrate "red flags" into those defenses. Next, Part III turns to negotiated transactions, describes the regulatory vacuum, and demonstrates how "red flags" are shaped by a buyer's investment objective and risk tolerance and influenced by guidance such as judicial decisions in *Smith v. Van Gorkom* and the Refco case. Furthermore, Part IV explains how misapplying the securities-offering framework to negotiated transactions often overlooks the central role of business judgment and misapplies regulatory logic. Then, Part V argues that in the context of a negotiated transaction, the fiduciary duty of care is the correct lens, and that courts should ask whether the information encountered by the buyer would, for that particular buyer in its specific context, reasonably compel further inquiry. Finally, Part VI concludes by summarizing these arguments and stressing that functional similarity does not justify doctrinal convergence.

II. "RED FLAGS" IN SECURITIES OFFERINGS

A. Multiple Definitions but One Analytical Core

A critical point regarding "red flags" in securities offerings is that no single definition governs, even within this regulated context. For example, Judge Cote's 2004 summary judgment ruling in *In re WorldCom, Inc. Securities Litigation* recognized that "[t]here is no category of information which can always be ignored," and whether a given fact constitutes a "red flag" depends on the

[5] Gary M Lawrence, *Confusion by Conflation: Due Diligence in Negotiated Transactions vs. Securities Offerings*, Bus. L. Today (ABA, May 30, 2025), https://www.americanbar.org/groups/business_law/resources/newsletters/2025-spring-ma/due-diligence-negotiated-transactions-vs-securities-offerings/ (explaining that due diligence in negotiated transactions should be assessed through the lens of the duty of care rather than statutory compliance).

[6] *Id.*

surrounding circumstances.[7] Nonetheless, courts consistently agree that encountering a true "red flag," absent countervailing considerations, triggers a duty of further inquiry appropriate in the context.[8] Even then, the concept is inherently based on judgment regarding, for example, what constitutes a "red flag" and what an appropriate response to it might be. Thus, whether the defendant must take further action after encountering a specific fact or circumstance depends on a range of factors, including but not limited to the nature of the information, the type of material at issue, and the participant's role.

The definition of a "red flag" that has been employed most often is derived directly from Section 11(c), which provides that "the standard of reasonableness shall be that required of a prudent man in the management of his own property."[9] While this may be the most common formulation, it is certainly not the only one. For example, *WorldCom* refined that standard, holding that a "red flag" exists where information "strips a defendant of his confidence in the accuracy of those portions of a registration statement premised on audited financial statements."[10] Other courts, as noted in the *WorldCom* decision, have employed the "storm warnings" concept, which reflects the idea that accumulating public and private information may collectively reach a threshold that triggers a duty to take further action, including further investigation or disclosure in the offering documents.[11]

Similarly, FINRA's Regulatory Notice 10-22, which addresses broker-dealer obligations in unregistered Regulation D offerings, defines a "red flag" as "any information that [the broker-dealer] encounters that could be considered a 'red flag' that would alert a prudent person to conduct further inquiry."[12] This formulation tracks the prudent man language in Section 11(c); however, it does not prescribe what that information might be or the precise nature of further action indicated. Instead, it allows broker-dealers to exercise professional judgment, informed by the particular offering context, in identifying and responding to "red flags."[13] And, the NASD's *Special Report on Due Diligence Seminars* acknowledged that while "there is no 'magic formula' to determine reasonableness in a particular case," the presence of "red flags" gives rise to a duty to act, with

[7] *WorldCom*, 346 F. Supp. 2d at 679–80.
[8] *Id.*; *see also* Fed. Hous. Fin. Agency v. Nomura Holding Am., Inc., 873 F.3d 85, 131 (2d Cir. 2017).
[9] Securities Act of 1933 § 11(c), 15 U.S.C. § 77k(c).
[10] *WorldCom*, 346 F. Supp. 2d at 673.
[11] *Nomura*, 873 F.3d at 119–22.
[12] Notice 10-22, *supra* note 4, at 6.
[13] *See id.*

each broker-dealer expected to determine the appropriate response in light of the facts and circumstances.[14]

What is most notable about this body of guidance is what it does *not* contain. Although FINRA and its predecessor, the NASD, issued investigative guidance for a wide range of offering contexts, neither has defined a "red flag" specifically for a registered public offering.[15] The regulatory silence at the exact point where the statutory defense is most litigated is not an oversight. It illustrates a deliberate institutional division of labor, with Congress and the SEC providing the statutory architecture and the courts and other sources of guidance supplying the content of the red-flag concept through case-by-case analysis. As such, cases like *WorldCom* and *BarChris* surpass mere illustration and serve as functional regulatory guidance.

Despite the variety of definitions, the underlying analysis remains consistent. A "red flag" does not indicate the end of an investigation; instead, it marks the point at which further action—such as additional inquiry or disclosure—is required. Regardless of whether courts or regulators apply terms such as "prudent person," "confidence stripping," "storm warnings," or "indicators of suspicious activity," the essential function is to identify the threshold at which failure to take further action becomes unreasonable. The existence of multiple definitions is intentional, as the appropriate threshold depends on the subject of investigation, the investigator's identity, and the legal defense asserted.

B. Statutory Affirmative Defenses: Reasonable Investigation and Reasonable Reliance

To understand why the analysis of "red flags" in securities offerings looks the way it does, one must understand the statutory architecture within which it operates. Section 11 imposes strict liability on issuers for material misstatements or omissions in a registration statement, but it provides certain enumerated non-issuer defendants, such as directors, underwriters, and experts, with an affirmative defense that splits into two based on the type of material at issue.[16]

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[14] National Association of Securities Dealers, Inc., Special Report: Due Diligence Seminars at 5 (July 1981) [hereinafter NASD Special Report].

[15] *See* Notice 10-22, *supra* note 4; *see* NASD Special Report, *supra* note 14.

[16] Securities Act of 1933 § 11(b)(3), 15 U.S.C. § 77k(b)(3).

First, for non-expertised materials, the defendant must prove that it conducted a "reasonable investigation" and that it had reasonable grounds to believe the statement was accurate.[17] Second, for expertised portions, the defendant does not need to investigate; instead, she must show that she had "no reasonable grounds to believe" that the expertised material contained a material misstatement or omission.[18] This reasonable reliance prong recognizes the economic and practical limits on second-guessing auditors and other experts, such as a lack of expertise or education.[19] However, the reliance prong only permits her to defer to an expert to a certain extent.

Furthermore, Section 12(a)(2) of the Securities Act applies a parallel "reasonable care" standard to sellers in registered offerings and asks essentially the same question under different doctrinal labels.[20] Additionally, Rule 176 enumerates "circumstances" the Commission believes courts should consider when assessing reasonableness, including the type of issuer, the type of security, the defendant's relationship to the issuer, and the availability of information.[21]

Moreover, judicial cases help defendants understand what is reasonable. *Escott v. BarChris Construction Corp.* was one of the earliest cases to apply the statutory framework. There, the court faulted outside directors who conducted a limited review of the prospectus and an underwriter who failed to appropriately consider key information that the court concluded would have revealed the misstatements.[22] Judge McLean worked through each defendant individually, holding that the underwriter's sole reliance on management representations did not satisfy the investigation prong[23] and that the directors' minimal conduct fell short of reasonableness.[24]

Later, *WorldCom* held that, despite the statute's express language, an underwriter could rely on audited financials (a form of expertised material) when publicly available information strips her confidence in the audit.[25] The "red flags" in *WorldCom*, such as anomalous expense-to-revenue ratios relative to industry competitors, did not, in the court's opinion, require audit expertise to recognize.[26]

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[17] *Id.* § 11(b)(3)(A).
[18] *Id.* § 11(b)(3)(C).
[19] *WorldCom*, 346 F. Supp. 2d at 679.
[20] Securities Act of 1933 § 12(a)(2), 15 U.S.C. § 77l(a)(2).
[21] 17 C.F.R. § 230.176.
[22] Escott v. *BarChris*, 283 F. Supp. 643, 687–88, 694, 704 (1968).
[23] *Id.* at 696–697.
[24] *Id.* at 686–92.
[25] *WorldCom*, 346 F. Supp. 2d at 672, 673, 677–80.
[26] *Id.* at 684–85.

FHFA v. Nomura extended the logic. The court concluded that Nomura's sampling of residential mortgage-backed bonds (RMBS) revealed unacceptably high "kick-out" rates in mortgage pools, yet it did not increase the sample to test where defects were pervasive.[27] The Second Circuit upheld the lower court's ruling that this failure was unreasonable as a matter of law.[28]

Together, *BarChris*, *Worldcom*, and *Nomura* establish three basic principles for "red flags" in securities offerings, including (1) a "red flag" creates an affirmative duty to further action; (2) for expertised material, reliance on experts is permitted unless a "red flag" appears, and once it does, further action is required; and (3) conformity with industry customs, while a relevant consideration in the reasonableness inquiry, does not on its own establish statutory reasonableness for purposes of the affirmative due diligence defenses. These all reject the mechanical, check-the-box approach to diligence, even with the guidance-rich framework of securities offerings, and foreshadow the contrast with negotiated transactions, where industry custom plays a more central role.

III. "RED FLAGS" IN NEGOTIATED TRANSACTIONS

A. The Regulatory Vacuum and the Buyer's Role

If securities offerings are defined by a well-developed framework of guidance regarding due diligence and "red flags," negotiated transactions are defined by the absence of such guidance. Currently, there is no SEC rule or FINRA notice prescribing how much diligence a buyer must conduct before acquiring a company, no statutory defense requiring proof of a reasonable investigation, and no self-regulatory organization defining "red flags" or appropriate responses to them.[29] Instead, parties allocate risks contractually through representations, warranties, indemnities, and purchase price adjustments based on their respective investment objectives and risk tolerance. Therefore, unlike defendants in securities offerings, buyers decide for themselves how deeply to probe and which risks to assume, guided by their own unique strategic plans, risk tolerance, industry knowledge, competitive pressures, and the economics of the transaction. The law does not tell them what to investigate or how to respond to their findings.

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[27] Fed. Hous. Fin. Agency v. Nomura Holding Am., Inc., 104 F. Supp. 3d 441, 475–77 (S.D.N.Y. 2015); *aff'd in part*, 873 F.3d 85 (2d Cir. 2017).
[28] *Nomura*, 873 F.3d at 132.
[29] Lawrence, *supra* note 5.

Instead, courts analyze such matters through the lens of the duty of care, which requires directors to inform themselves of material information reasonably available to them and to exercise business judgment regarding it before approving a transaction.[30] However, the duty of care functions as a process standard rather than a checklist. It evaluates whether the buyer's decision-making process was reasonable under the circumstances, rather than adherence to a prescribed protocol.[31] As a result, the buyer, not the government, determines the depth of investigation and the risks to accept. Unlike in securities offerings, there is no authoritative or informative guidance to anchor these decisions. Each buyer must independently determine, through the exercise of its business judgment, the appropriate scope and type of due diligence based on a complex array of contextual factors.

B. Buyer-Defined "Red Flags" and the Strategic Buyer versus the Financial Buyer Distinction

In the absence of formal guidance, "red flags" in negotiated transactions are defined organically by buyers through their experience, industry knowledge, and deal context, with reference to their investment objectives and risk tolerance. Late financial reporting, unexplained related-party transactions, key-person dependency, or management resistance to document requests may each signal elevated risk.[32] However, whether they rise to the level of "red flags" depends on contextual matters such as who is buying and why.[33] Thus, in negotiated transactions, what constitutes a "red flag" versus a mere manifestation of a contextually desirable risk-reward relationship is buyer-defined in the exercise of business judgment.[34]

The contrast between a strategic buyer and a financial buyer illustrates this point. A strategic acquirer with deep industry expertise may view certain risk factors as well-understood features of the target's business that are manageable once the deal closes or even as attractive features of the business opportunity. For example, a strategic buyer in the industrial gas industry may treat a target's aging compliance infrastructure as acceptable or even attractive because it understands the cost and timeline of remediation, and has already priced the matter into the

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

[31] Lawrence, *supra* note 5 ("[I]n a negotiated transaction . . . the scope and character of due diligence is contextual and judgment-based and does not involve mandates or mandatory conduct.").

[32] *Id.*

[33] *Id.*

[34] *Id.*

purchase price. However, the same facts may raise alarm bells for a financial buyer with no operational experience in that industry, as they lack a benchmark to assess the severity, experience in addressing such concerns, or other distinguishing factors. Thus, the financial buyer may view them as "red flags" triggering deeper inquiry or even abandonment of the transaction. Neither assessment is objectively right or wrong, as both hypotheticals assume reasonable exercises of business judgment informed by the different knowledge bases, risk tolerance, and other factors.

Thus, negotiated transaction due diligence, and the concept of "red flags" that accompany it are "buyer-defined." This does not, however, mean that anything goes. Rather, it signals that courts evaluating diligence must consider all the various dimensions of context, including the buyer's identity, expertise, and strategic-oriented posture, as well as its investment objectives and risk tolerance. As such, a reasonable buyer is not an abstract prudent investor; instead, she is a real acquirer with specific attributes, capabilities, concerns, and objectives. Consequently, "red flags" in negotiated transactions cannot be cataloged in advance or defined in a way that applies to all buyers in all circumstances. They must emerge from the relationship between information and the buyer's context.

C. Case Studies

In the absence of regulatory or statutory mandates, buyers have broad discretion to determine what a "red flag" is and whether to conduct further investigation in a negotiated transaction. *Smith v. Van Gorkom*, for example, demonstrates how the duty of care operates as a process standard. There, the board of directors approved a cash-out merger after a two-hour meeting without advance notice, financial analyses, a fairness opinion, or review of the merger agreement.[35] The Delaware Supreme Court held that the board was negligent because it failed to inform itself about the company's value or understand the price determination.[36] The "red flags" were procedural, as evidenced by the timeline, the absence of certain valuation data, and the dependence on an untested oral presentation.[37] Notably, instead of asking whether any particular warning sign should always trigger additional inquiry, the court asked whether the board's *process*, in light of information reasonably available, was reasonable.[38]

[35] *Van Gorkom*, 488 A.2d at 868–69.
[36] *Id.* at 874.
[37] *Id.*
[38] *Id.* at 871–72.

While *Van Gorkom* involved a judicially determined inadequate due diligence process, the 2004 Refco leveraged buyout involved the opposite, as the buyer investigated thoroughly, identified warning signs, and ultimately elected not to act on them. There, a prominent private equity sponsor conducted a seven-month, $10 million investigation with external accountants and numerous interviews.[39] The diligence exposed ostensible areas of concern, including incomplete financial information from management and auditors;[40] longstanding regulatory concerns;[41] opaque ownership structures used to conceal liabilities;[42] and a whistleblower's allegations of impropriety.[43] After the IPO, it emerged that members of Refco's management concealed $430 million in bad debts, and the company collapsed into bankruptcy.[44] Refco therefore represents a substantive abdication, as the buyer investigated, encountered "red flags," and, as the court determined, ignored them.

Together, *Van Gorkom* and Refco illustrate the spectrum of duty-of-care failures in negotiated transactions. On the one hand, *Van Gorkom* exemplifies procedural abdication, where the court found that the board largely failed to investigate at all. On the other hand, Refco represents a substantive abdication, where the buyer investigated, identified "red flags," and then disregarded them. However, both failures are evaluated under the same standard and do not require reference to the securities offering framework.

IV. WHY SECURITIES OFFERINGS' GUIDANCE SHOULD NOT CONTROL NEGOTIATED TRANSACTIONS

The differences portrayed above are not stylistic; instead, they reflect fundamentally different policy goals, regulatory postures, and dimensions of the burden of proof. On the one hand, securities law exists to protect public investors who lack bargaining power, cannot negotiate deal terms, and must rely on the accuracy of disclosure documents prepared by others.[45] The statutory

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[39] *See* Edward Pekarek, *The Due Diligence Defense and the Refco IPO* at 22 (Apr. 27, 2007), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1145930.

[40] Amended Complaint at ¶ 237, *In* re Refco, Inc. Sec Litig., 503 F. Supp. 2d 611 (S.D.N.Y. 2007) (No. 05 Civ. 8626).

[41] *In re* Refco, Inc. Sec. Litig., 503 F. Supp. 2d 611, 652 (S.D.N.Y. 2007).

[42] *Id.* at 618–20.

[43] Mathew Goldstein, *Refco: When Smart Money Isn't So Smart*, BLOOMBERG BUSINESS (July 16, 2007), https://www.bloomberg.com/news/articles/2007-07-13/refco-when-smart-money-isnt-so-smartbusinessweek-business-news-stock-market-and-financial-advice?embedded-checkout=true.

[44] *See id.*; *see also In re* Refco, Inc., 336 B.R. 187, 191 (Bankr. S.D.N.Y. 2006).

[45] *See* Escott v. BarChris, 283 F. Supp. 643, 697 (S.D.N.Y. 1968).

defenses of Sections 11 and 12(a)(2), the "circumstances affecting the determination of reasonableness" of Rule 176, and FINRA's context-specific investigative mandates are all oriented toward preserving disclosure integrity in a setting where the investor does not have a seat at the table.[46]

On the other hand, negotiated transactions sit at the opposite end of the spectrum. They are exercises in business judgment by sophisticated parties who negotiate representations, warranties, indemnities, and purchase price adjustments to allocate risk as they deem appropriate in their specific context.[47] The duty of care and the business judgment rule exist precisely to give corporate decision-makers room to exercise informed judgment without being second-guessed on substance.[48] As such, importing the prescriptive framework for securities offerings into negotiated transactions would disrupt that design in three concrete ways.

First, it would deter transactions. If courts evaluated diligence in negotiated transactions against the standards applied to underwriters, where a "red flag" is more clearly defined (albeit contextually), and further action in accord with the prudent person is mandated, buyers would face substantial liability exposure for exactly the context, risk-tolerant judgment that characterizes healthy dealmaking. Strategic acquirers routinely proceed despite known risks because they believe they have the operational capacity to manage them post-closing. Thus, treating every known risk as a "red flag" that necessitates exhaustive investigation would chill exactly the informed risk-taking that the business judgment rule is designed to protect.[49]

Second, it would ignore the central role of business judgment itself. A buyer who identifies a concern, evaluates it against the deal's economics and its own post-closing capabilities, and decides to proceed has exercised judgment. Removing that distinction would strip negotiated transaction diligence of its essential character.

Third, it would misapply regulatory logic. The SEC and FINRA prescribe due diligence standards, which are themselves primarily principles-based, because the offering process is standardized enough to support them. Every registered offering involves a registration statement,

[46] Securities Act of 1933 § 11(b)(3), 15 U.S.C. § 77k(b)(3); 17 C.F.R. § 230.176; Notice 10-22, *supra* note 4.
[47] Larence, *supra* note 5.
[48] *See Van Gorkom*, 488 A.2d at 872.
[49] Lawrence, *supra* note 5 ("[A]ttempting to apply regulatory or judicial interpretations of what is reasonable or prudent in the securities offering context to the negotiated transaction context ignores the profound differences in the regulatory regime and applicable legal standard.").

a prospectus, defined categories of participants, and a known set of statutory defenses. Negotiated transactions lack this homogeneity, as each deal involves a unique target, risks, contractual protections, and buyer capabilities. Mandating a particular scope of diligence across this variety would, as Professor Lawrence argued, be unworkable.[50]

V. THE DUTY OF CARE AS THE PROPER ASSESSMENT STANDARD IN NEGOTIATED TRANSACTIONS

If not the framework used in securities offerings, then what? The response is the duty of care. Reasonableness and prudence are universal benchmarks, and the fiduciary duty of care is the doctrinal vehicle through which courts should, and commonly do, apply those benchmarks in negotiated transactions. Although the underlying concept of reasonableness shares many attributes in both settings, its application is fundamentally different. In the offering context, reasonableness is measured against an organized framework of cases, statutes, rules, and SRO guidance. In negotiated transactions, reasonableness is measured against the totality of the circumstances, with the duty of care serving as both the floor and the ceiling.

A court evaluating a buyer's diligence under the fiduciary duty of care—seen through the lens of business judgment—asks a two-part question. First, the court analyzes whether the information the buyer actually or constructively encountered may reasonably be found to have risen to the level of a "red flag," which information would cause a reasonable buyer in this buyer's exact same position to act further, and not simply a routine risk factor that the buyer could reasonably assess and accept.[51] Second, if a "red flag" existed, the court should ask whether the buyer's response to it was reasonable under all the elements of the circumstances.[52] This two-step analysis is contextual and fact-intensive, as opposed to a checklist-like exercise. In conducting that analysis, courts may weigh numerous factors, such as the nature and severity of the "red flag" itself, the cost and feasibility of further investigation, the sophistication of the buyer, any time restrictions imposed by competitive forces or deal structure, the adequacy of the contractual risk-allocation mechanisms available to the buyer, and the prevailing industry practices, often referred to as the

[50] *See id.* (describing the application of a prescriptive investigative standard to negotiated transactions as unworkable).

[51] *Id.*

[52] Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000) ("Due care in the decisionmaking context is *process* due care only.").

"standards of the street."[53] None of these factors is dispositive, and each is a consideration in analyzing the totality of the circumstances.

The key principle is that the duty of care demands a contextually reasonable response to known risks, not perfection. A buyer who identifies a concern, evaluates it in context, consults appropriate advisors, and makes an informed decision to move forward or walk away satisfies the duty, even if hindsight reveals the decision led to undesirable outcomes. What the duty of care will not tolerate, however, is indifference or lack of process, meaning a buyer who encounters a genuine warning sign and fails to interact with it at all has not exercised business judgment but abdicated it.[54] That is the distinction between *Van Gorkom*, where the court concluded that the board never investigated, and a properly functioning board that investigates, identifies, evaluates, and decides in the exercise of contextually applied business judgment. It is also the distinction between Refco, where the court concluded that the buyer identified warning signs but ignored them, and a reasonably functioning buyer that responds to what its diligence surfaces.

VI. CONCLUSION

A "red flag" is fundamentally a context-dependent trigger that necessitates escalatory action proportional to the risk it signals. This principle applies to both securities offerings and negotiated transactions. The distinction between the two contexts lies in the way the concept is defined and applied.[55] In securities offerings, "red flags" are contextually defined and illuminated by decades of regulatory, judicial, and other forms of guidance, and a failure to respond is assessed against a well-defined framework of obligations. In negotiated transactions, "red flags" are far more fluid and, at bottom, defined by the buyer, with the response evaluated under the contextual, fact-intensive duty of care viewed through the lens of business judgment.

This paper contends that courts should maintain the distinction between these regimes. The two frameworks are not rivals; they address different questions arising from distinct transactional postures in distinctly different contexts. Securities law is designed to protect the investors who lack bargaining power, while corporate law seeks to preserve the informed discretion of parties

[53] *See in re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 968–70, 971–72. (Del. Ch. 1996) (evaluating directorial oversight obligations in the context of known risks).
[54] *Brehm*, 746 A.2d at 258–59.
[55] Lawrence, *supra* note 5.

who possess such power. Conflating these regimes produces analytically unsound outcomes, either by imposing prescriptive rigidity on transactions that require contextual flexibility or by granting excessive discretion in regulatory settings where mandatory investigative obligations are essential. When courts analyze due diligence in a negotiated transaction, the appropriate question is whether the buyer's process was reasonable given the specific circumstances. That is a different question that warrants a different answer.