MFW AND THE LEGAL FICTION OF MARKET EQUIVALENCY

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ABSTRACT

Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court.[2]

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[2] Meinhard v. Salmon, 164 N.E. 545, 546 (1928) (Cardozo, C.J.). This particular quote is used here because these are probably the most cited and best-known words on fiduciary duties. *See* Robert W. Hillman, *Closely-Held Firms and the Common Law of Fiduciary Duty: What Explains the Enduring Qualities of a Punctilio?*, 41 TULSA L. REV. 441, 445 (2006) (as of 2006, *Meinhard* had been cited in more than 1,000 reported opinions). While these were the words of a New York judge in a case under New York law, and *MFW* is a Delaware case, the Delaware Supreme Court has cited to *Meinhard* (particularly, the words about "the morals of the market place") with approval. *See* Guth v. Loft, Inc., 5 A.2d 503, 515 (Del. 1939) ("The fiduciary relation demands something more than the morals of the market place.") (citing Meinhard v. Salmon, 164 N.E. 545 (N.Y. 1928)); *accord* Estate of Eller v. Bartron, 31 A.3d 895, 898 (Del. 2011); *see also In re* Goldstein, 85 A.2d 361, 364 (Del. 1951).

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I. INTRODUCTION

This article concerns the process approved by the Delaware Supreme Court in the M&F Worldwide case ("MFW")[3] whereby a controlling shareholder can obtain dismissal at the pleading stage in a case challenging such controlling shareholder's buyout of the shares of the target company that it does not already own.[4] The article concludes that this process squarely contradicts Cardozo's description of fiduciary duties as "stricter than the morals of the market place"[5] and represents a significant and inappropriate deferral to those who would welcome the "disintegrating erosion"[6] of such high standards. The backbone for this process is the supposed benefits of two protections when combined in the controller's initial proposal: (1) approval by an independent special committee of the board and (2) approval by an informed and uncoerced majority of the minority shareholders ("MOM").[7] As argued in this article, these two required proposed provisions are regularly—but should not be—taken for granted as together providing the equivalent of an arm's-length transaction. Thus, as one commentator stated, "This two-prong approach

[3] Kahn v. M&F Worldwide Corp., 88 A.3d 635 (Del. 2014) ("*MFW Sup. Ct.*"). While certain legal resources indicate that Flood v. Synutra Int'l, Inc., 195 A.3d 754 (Del. 2018), "overruled" the Delaware Supreme Court's *MFW* decision, in fact, *Flood* merely overruled *MFW*'s footnote 14 (to the extent it was not dicta) and otherwise reiterated and clarified its *MFW* decision. *See Flood,* 195 A.3d at 766 n.81; *supra* note 59.

[4] *MFW Sup. Ct.*, 88 A.3d at 653-54.

[5] *Meinhard*, 164 N.E. at 546.

[6] *Id.*

[7] *See MFW Sup. Ct.,* 88 A.3d at 644.

is the controlled-company equivalent of board approval and shareholder approval in the arm's-length context."[8] This article reviews the case law and commentary that preceded MFW and the arguments concerning those protections, reviews both the Delaware Court of Chancery and Delaware Supreme Court decisions in MFW, demonstrates why the use of these two protections does not, in fact, usually transform a controller transaction into the equivalent of an arms-length transaction, and proposes a traditional alternative that would align such court's review of controller transactions with Cardozo's ideal.

Part I relates the relevant pre-MFW history; Part II describes the MFW litigation, both in the Delaware Court of Chancery and the Delaware Supreme Court; Part III describes the dual "protections" that are touted by the courts in both decisions as together supposedly replicating an arm's-length transaction and provides reasons such protections do not, in fact, usually replicate an arm's-length transaction; and Part IV describes the author's proposal, which emphasizes the controller's fiduciary duty in this context to propose and consummate a transaction that is fair to the minority shareholders, and which the author believes should, in keeping with Cardozo's definition, be the courts' priority, rather than using some artificial mechanism to help controllers obtain dismissal at the pleading stage.

II. PRE-MFW HISTORY

A. *Kahn v. Lynch*

In 1994, the Delaware Supreme Court issued its iconic decision Kahn v. Lynch.[9] In that decision, the Supreme Court reversed a post-trial

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[8] Guhan Subramanian, *Deal Process Design in Management Buyouts*, 130 HARV. L. REV. 590, 650 (2016); *see also In re* Cornerstone Therapeutics Inc., S'holder Litig., No. CV 8922-VCG, 2014 Del. Ch. LEXIS 170, at *32 (Del. Ch. Sept. 10, 2014), *rev'd sub nom. In re* Cornerstone Therapeutics Inc, S'holder Litig., 115 A.3d 1173 (Del. 2015) (using both protections renders such a transaction "in effect, an unconflicted, arm's-length transaction"); *In re* CNX Gas Corp. S'holders Litig., 4 A.3d 397, 412 (Del. Ch. 2010) ("*Cox Communications* rendered the *Lynch* and *Siliconix* standards coherent by explaining that the business judgment rule should apply to any freeze-out transaction that is structured to mirror *both* elements of an arms' length merger, *viz*. approval by disinterested directors *and* approval by disinterested stockholders. . . . Doctrinally, the use of both structural protections results in the controller standing only on one side of the transaction–as the buyer–and renders entire fairness inapplicable.") (emphasis in original); *In re* Pure Res., Inc. S'holders Litig., 808 A.2d 421, 444 n.43 (Del. Ch. 2002) ("This dual method of protection would replicate the third-party merger process under 8 *Del. C.* § 251.").

[9] *See* Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110 (Del. 1994).

decision that had entered judgment in favor of the defendants.[10] The Court of Chancery had concluded that defendant Alcatel, which owned 43.3% of Lynch Communication Systems, Inc. ("Lynch"), was a de facto controlling shareholder of Lynch and, as a result, owed fiduciary duties to Lynch's other shareholders, but that Alcatel had not breached those fiduciary duties.[11]

The Supreme Court's legal analysis started with the accepted proposition that "[a] controlling or dominating shareholder standing on both sides of a transaction, as in a parent-subsidiary context, bears the burden of proving its entire fairness."[12] The importance of Kahn v. Lynch is the resolution by the Court of the then "differing views" of the Court of Chancery "regarding the effect that an approval of a cash-out merger by a special committee of disinterested directors has upon the controlling or dominating shareholder's burden of demonstrating entire fairness."[13] According to the Court, one view was that "such approval shift[ed] to the plaintiff the burden of proving that the transaction was unfair."[14] The second view was that "such an approval renders the business judgment rule the applicable standard of judicial review."[15]

Siding with the first view, the Supreme Court held that "the exclusive standard of judicial review in examining the propriety of an interested cash-out merger transaction by a controlling or dominating shareholder is entire fairness."[16] The Court held that while approval by an independent special committee or an informed majority of the minority shareholders "shifts the burden of proof on the issue of fairness from the

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[10] *See* Kahn v. Lynch Commc'n Sys., Inc., No. C.A. 8748, 1993 WL 290193 (Del. Ch. July 9, 1993), *reprinted in* 19 DEL. J. CORP. L. 784, *rev'd*, 638 A.2d 1110 (Del. 1994).

[11] *See Kahn*, 638 A.2d at 1111. For a description of how controlling shareholders came to owe fiduciary duties to minority shareholders, *see generally Cornerstone*, 2014 Del. Ch. LEXIS 170, at *20-35.

[12] *Kahn*, 638 A.2d at 1115 (citing Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983) and Rosenblatt v. Getty Oil Co., 493 A.2d 929, 937 (Del. 1985)). For a history of relevant pre-*Kahn* jurisprudence, *see generally* Randy J. Holland, *Delaware Directors' Fiduciary Duties: The Focus on Loyalty,* 11 U. PA. J. BUS. L. 675 (2009); Clark W. Furlow, *Back to Basics: Harmonizing Delaware's Law Governing Going Private Transactions*, 40 AKRON L. REV. 85 (2007).

[13] *Kahn*, 638 A.2d at 1115.

[14] *Id.* (citing Citron v. E.I. Du Pont de Nemours & Co., 584 A.2d 490, 500-02 (Del. Ch. 1990); Rabkin v. Olin Corp., No. C.A. 7547, 1990 Del. Ch. LEXIS 50, at *17 (Del. Ch. Apr. 17, 1990), *reprinted in* 16 DEL. J. CORP. L. 851).

[15] *Kahn*, 638 A.2d at 1115 (citing *In re* Trans World Airlines, Inc. S'holders Litig., No. C.A. 9844, 1988 Del. Ch. LEXIS 139, at *19 (Del. Ch. Oct. 21, 1988), *reprinted in* 14 DEL. J. CORP. L. 870).

[16] *Id.* at 1116-17 (emphasis added).

controlling or dominating shareholder" to the plaintiff, "even when an interested cash-out merger transaction received the informed approval of a majority of minority stockholders or an independent committee of disinterested directors, an entire fairness analysis is the only proper standard of judicial review."[17]

In support of its holding, the Court quoted at length from its earlier decision in Citron v. E.I. Du Pont de Nemours & Co.[18] According to the Citron Court, and as quoted by the Lynch Court:

> The controlling stockholder relationship has the potential to influence, however subtly, the vote of [ratifying] minority stockholders in a manner that is not likely to occur in a transaction with a noncontrolling party. Even where no coercion is intended, shareholders voting on a parent subsidiary merger might perceive that their disapproval could risk retaliation of some kind by the controlling shareholder…. At the very least, the potential for that perception, and its possible impact upon a shareholder vote, could never be fully eliminated. [19]

The Citron Court concluded:

> Consequently, in a merger between the corporation and its controlling stockholder—even one negotiated by disinterested, independent directors—no court could be certain whether the transaction terms fully approximate what truly independent parties would have achieved in an arm's length negotiation. Given that uncertainty, a court might well conclude that even minority shareholders who have ratified a . . . merger need procedural protections

[17] *Id.* at 1117. According to the Court, "The same policy rationale which requires judicial review of interested cash-out mergers exclusively for entire fairness also mandates careful judicial scrutiny of a special committee's real bargaining power before shifting the burden of proof on the issue of entire fairness." *Id.* Also concerning burden shifting, the Court stated: "[T]he performance of the Independent Committee merits careful judicial scrutiny to determine whether Alcatel's demonstrated pattern of domination was effectively neutralized so that 'each of the contending parties had in fact exerted its bargaining power against the other at arm's length.'" *Id.* at 1118 (quoting *Weinberger,* 457 A.2d at 709-10 n.7).

[18] 584 A.2d 490 (Del. Ch. 1990).

[19] *Kahn*, 638 A.2d at 1116 (quoting *Citron*, 584 A.2d at 502).

> beyond those afforded by full disclosure of all material facts.[20]

The implication of this quotation is that the Supreme Court believed that even in a case where there is both an independent special committee and a majority-of-the-minority provision, entire fairness should be the standard of review.[21]

B. *Cox*

Eleven years after Kahn v. Lynch, then-Vice Chancellor Strine, in In re Cox Communications, Inc. Shareholders Litigation,[22] proposed a change to Kahn v. Lynch's bright-line rule that "the exclusive standard of judicial review in examining the propriety of an interested cash-out merger transaction by a controlling or dominating shareholder is entire fairness."[23]

The Cox Court proposed the following "relatively modest alteration" to the Kahn v. Lynch rule:

> Put simply, if a controller proposed a merger, subject from inception to negotiation and approval of the merger by an independent special committee and a Minority Approval Condition, the business judgment rule should presumptively apply. In that situation, the controller and the directors of the affected company should be able to

[20] *Id.* at 1116-17 (quoting *Citron*, 584 A.2d at 502) (emphasis added).

[21] *See* Emerald Partners v. Berlin*,* 787 A.2d 85, 96 (Del. 2001) (recognizing "*Weinberger*'s restatement of a venerable and fundamental principle of our common law corporate fiduciary jurisprudence: there is no safe harbor for divided loyalties in Delaware") (quotations and ellipses omitted); *see also Guth*, 5 A.2d at 510 ("Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests . . . . The rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest.").

[22] 879 A.2d 604 (Del. Ch. 2005).

[23] *Kahn*, 638 A.2d at 1117. In defense of the proposed change to the *Kahn* rule, the *Cox* Court stated, "Although it is an undeniable reality that *Lynch* stated that any merger with a controlling stockholder, however structured, was subject to a fairness review, it would be unfair not to make explicit another reality. No defendant in *Lynch,* and no defendant since, has argued that the use of an independent special committee *and* a Minority Approval Condition sufficiently alleviates any implicit coercion as to justify invocation of the business judgment rule. For this reason, it is important not to assume that the Supreme Court has already rejected this more precisely focused contention." *Cox.*, 879 A.2d at 617 (emphasis in original). Then-Vice Chancellor Strine had earlier proposed the same change in the tender offer context in *In re* Pure Res., Inc., S'holders Litig., 808 A.2d 421, 444 n.43 (Del. Ch. 2002).

> obtain dismissal of a complaint unless: 1) the plaintiffs plead particularized facts that the special committee was not independent or was not effective because of its own breach of fiduciary duty or wrongdoing by the controller (e.g., fraud on the committee); or 2) the approval of the minority stockholders was tainted by misdisclosure, or actual or structural coercion. [24]

According to the Court, using this process would "mirror[] both elements of an arms-length merger: 1) approval by disinterested directors; and 2) approval by disinterested stockholders."[25] The Court also described using this process as "replicat[ing] fully both elements of the arms-length merger process."[26]

In support of this proposed change, the Court of Chancery pointed to the supposed complementary nature of the two mechanisms:

> These steps are in important ways complements and not substitutes. A good board is best positioned to extract a price at the highest possible level because it does not suffer from the collective action problem of disaggregated stockholders. But boards are rarely comprised of independent directors whose own financial futures depend importantly on getting the best price and, history shows, are sometimes timid, inept, or . . ., well, let's just say worse. Although stockholders are not well positioned to use the voting process to get the last nickel out of a purchaser, they are well positioned to police bad deals in which the board did not at least obtain something in the amorphous "range" of financial fairness.
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> In the context of a merger with controlling stockholder, the complementary role of disinterested director and disinterested stockholder approval is difficult to conceive

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[24] *Cox.*, 879 A.2d at 643-44 (emphasis in original; footnote omitted). The concept that these conditions be "from inception" was adopted in the *MFW* Court of Chancery decision, *see MFW Chancery*, 67 A.3d at 502-03 ("when a controlling stockholder merger has, *from the time of the controller's first overture,* been subject to . . .") (emphasis added). This requirement was subsequently dialed back by the Supreme Court in Flood v. Synutra Int'l, Inc., 195 A.3d 754, 765 (Del. 2018) ("the two key procedural protections [must]be in place at the beginning of the deal process and before economic negotiations commenced").

[25] *Cox*, 879 A.2d at 606.

[26] *Id.*

> of as less important. For a variety of obvious reasons (e.g., informational asymmetries, the possibility that the outside directors might be more independent in appearance than in substance, or might lack the savvy to effectively counter the controller), the integrity-enforcing utility of a Minority Approval Condition seems hard to dispute. And, with increasingly active institutional investors and easier information flows, stockholders have never been better positioned to make a judgment as to whether a special committee has done its job. At the same time, the ability of disaggregated stockholders to reject by a binary up or down vote obviously "unfair" deals does not translate into their ability to do what an effective special committee can do, which is to negotiate effectively and strike a bargain much higher in the range of fairness. As a practical matter, however, the effect of Lynch in the real world of transactions was to generate the use of special committees alone.[27]

Despite recognizing the often-flawed special committee process, especially in the controller buyout context, the Court argued that adding a majority-of-the minority provision to the mix would somehow "replicate" an arm's-length merger process.[28]

According to the Cox Court, "The incentive system that Lynch created for plaintiffs' lawyers is its most problematic feature."[29] Thus, "Unlike any other transaction one can imagine -- even a Revlon deal -- it was impossible after Lynch to structure a merger with a controlling stockholder in a way that permitted the defendants to obtain a dismissal of the case on the pleadings."[30] The Court next described the litigation/settlement paradigm that developed in the eleven years between Kahn v. Lynch and Cox.[31] Generally speaking, in these "Cox-like" situations, plaintiffs file one or more lawsuits challenging the proposed transaction upon the controller's proposal and before a special committee has had a chance to negotiate an increase in the buyout consideration.[32] Then, the litigation lies dormant while the special committee hires bankers

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[27] *Id.* at 619.
[28] *Id.* at 606.
[29] *Cox*, 879 A.2d at 619.
[30] *Id.*
[31] *See id.* at 620-21.
[32] *See id.* at 620.

and negotiates with the controller.[33] At the time that the special committee believes it has come close to a meeting of the minds, counsel for plaintiffs is contacted with an offer to settle for partial credit for the proposed increase in merger consideration, which was invariably accepted and invariably approved by the Court of Chancery.[34] As to this paradigm, the Cox Court stated as follows:

> As the objectors point out and this court has often noted in settlement hearings regarding these kind of cases in the past, the ritualistic nature of a process almost invariably resulting in the simultaneous bliss of three parties -- the plaintiffs' lawyers, the special committee, and the controlling stockholders -- is a jurisprudential triumph of an odd form of tantra. I say invariably because the record contains a shocking omission -- the inability of the plaintiffs, despite their production of expert affidavits, to point to one instance in the precise context of a case of this kind (i.e., cases started by attacks on negotiable going-private proposals) of the plaintiffs' lawyers refusing to settle once a special committee has agreed on price with a controller. [35]

In describing the "simultaneous bliss of three parties," the Court curiously left out its own slightly delayed "bliss" in that – with possibly a few exceptions – the Court of Chancery, when faced with these settlements, invariably not only approved them, but approved significant fees for the plaintiffs' lawyers, despite the plaintiff's counsel's acknowledgement that the action was not "meritorious-when-filed."[36] In fact, the settlement before the Court in Cox, which precisely reflected the

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[33] *See id.* at 620.

[34] *See id.* at 621.

[35] *Id.*; *see In re* Prodigy Commc'ns Corp. S'holders Litig., No. C.A. 19113, 2002 Del. Ch. LEXIS 95, at *4-6 (Del. Ch. July 26, 2002) (describing the *Cox*-like process leading to settlement); *see also In re* AXA Fin., Inc. S'holders Litig., No. C.A. 18268, 2002 Del. Ch. LEXIS 57, at *6-7 (Del. Ch. May 16, 2002).

[36] *See* Transcript of Oral Argument at 22-23, *In re* Cox Commc'ns, Inc. S'holders Litig., (Del. Ch. May 9, 2005) (C.A. No. 613-N) ("THE COURT: I'm asking at the time the lawsuit was filed, you didn't even state a claim; did you? MR. ABBEY: On the question of fairness because of the special committee? THE COURT: Because there was no transaction. And there was no -- there was no action by the controlling stockholder to inequitably coerce or bull rush anyone into -- into anything. MR. ABBEY: I think that is probably true."); *see generally* Chrysler Corp. v. Dann, 223 A.2d 384, 387 (Del. 1966) ("To justify an allowance of fees[,] the action in which they are sought must have had merit at the time it was filed."); *accord Cox*, 879 A.2d at 637 ("The complaints were therefore unripe and without merit.").

paradigm the Court was describing and criticizing, was approved and the Court awarded plaintiffs' counsel fees of $1.275 million.[37]

Rather than simply refusing to approve the settlement in Cox, or approving it and awarding plaintiffs' counsel a nominal fee, the Court proposed an option that the Lynch Court appeared to have rejected.[38] In dicta, the Cox Court stated: "Put simply, if a controller proposed a merger, subject from inception to negotiation and approval of the merger by an independent special committee and a Minority Approval Condition, the business judgment rule should presumptively apply. [39]

C. *Revlon II*

In the years following the decision in Cox, "Cox-type settlements" slowed as criticism of settlements that followed the Cox pattern increased. However, these types of settlements ground to a screeching halt in Delaware a little less than five years after Cox with the publication of the decision by Vice Chancellor Laster in In re Revlon, Inc. Shareholders Litig.,[40] where the Court of Chancery replaced lead counsel because, in part, of what it believed to be a Cox-type settlement.[41] The Court was highly critical of the counsel it replaced, referring to them as "frequent filers"[42] and "Pilgrims (i.e., "early settlers"),"[43] and the specific lawyer who appeared in Court for the plaintiffs as "a used-car salesman."[44] The Court's main criticism of these counsel, however, was that they didn't "litigate[] anything."[45]

In the years following Revlon II, the plaintiffs' bar took Vice Chancellor Laster's words to heart. Cases were no longer filed in

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[37] *See Cox*, 879 A.2d at 642 ("For those reasons -- the size of the benefit and the negotiation of the fee by defendants -- I have awarded a fee larger than I otherwise would have. I do so by awarding a total award of fees and expenses of $ 1.275 million."); *see also In re* AXA Fin., Inc. S'holders Litig., 2002 Del. Ch. LEXIS 57, at *26 (awarding $3 million in attorneys' fees after *Cox*-like process).

[38] *See Cox*, 879 A.2d at 642.

[39] *Id.* at 643-44 (emphasis in original); *see id.* at 644 n.85 (citing "Subramanian, *Fixing Freezeouts* at 48 (arguing for business judgment rule treatment for controlling stockholder mergers when these conditions exist)"); *see also In re* Pure Res. Inc., S'holders, 808 A.2d 421, 444 n.43 (Del. Ch. 2002); *In re* Cysive, Inc., S'holders Litig., 836 A.2d 531, 550-51 (Del. Ch. 2003).

[40] 990 A.2d 940, 956-58 (Del. Ch. 2010) (*Revlon II*).

[41] *Id.*

[42] *Id.* at 943 n.1, 944.

[43] *Id.* at 945.

[44] *Revlon II*, 990 A.2d at 942.

[45] *Id.* at 945.

Delaware immediately after a controller's proposal. Instead, financial experts were hired and detailed complaints were filed, but only after a fully negotiated transaction was entered into and announced.[46] In keeping with Vice Chancellor Laster's guidance to actually litigate, actual litigation ensued, including document productions, depositions, and motions.[47] As a result, significant cash recoveries were obtained for shareholders either as a result of settlement or judgments after trial, on top of any increase that the special committee had negotiated.[48]

III. MFW

A. *The Court of Chancery Decision*

Eight years after then-Vice Chancellor Strine first proposed changing Lynch's well-known paradigm in Cox, he was finally faced, in MFW, with a fact pattern that permitted him to consider making that change.[49] In MFW, MacAndrews & Forbes, which was owned by Ronald Perelman and who, in turn, owned 43% of M&F Worldwide, made a proposal to buy the shares of M&F Worldwide that it didn't already own for $24 per share.[50] This proposal was obviously modeled on the Cox paradigm in that it was

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[46] *See, e.g., In re* Jefferies Group, Inc. S'holders Litig., Consol. C.A. No. 8059-CB, 2015 Del. Ch. LEXIS 158, at *2 (Del. Ch. June 5, 2015) (first cases filed after transaction announced); *id.* at *9 (reviewed approximately 72,000 pages; took seven fact and one expert deposition; overcame two dispositive motions); *In re* Rural/Metro Corp. S'holders Litig., 102 A.3d 205, 213 (Del. Ch. Oct. 10, 2014) (lawsuits filed after the merger announced) , *aff'd sub nom.* RBC Capital Mkts., LLC v. Jervis, 129 A.3d 816 (Del. 2015).

[47] *See, e.g.,* ACP Master, Ltd. v. Sprint Corp., C.A. No. 8508-VCL, 2017 Del. Ch. LEXIS 125, at *2-3 (Del. Ch. July 21, 2017), *aff'd* 184 A.3d 1291 (Del. 2017) (after four years of litigation: "Trial lasted ten days. The parties introduced over 2,500 exhibits and lodged twenty-nine depositions. Eleven fact witnesses and seven experts testified live. The laudably thorough pre-trial order contained 547 paragraphs. The pre-trial and post-trial briefing totaled 766 pages"); *In re* Rural/Metro Corp. S'holders Litig., Consol. C.A. No. 6350-VCL, at 3 (Del. Ch. Oct. 29, 2014) ("Plaintiff's counsel reviewed over 1,830,000 pages of documents and took thirteen fact depositions.").

[48] *See, e.g.*, *In re* Rural/Metro Corp. Stockholders Litig., 102 A.3d 205, 263 (Del. Ch. 2014) (finding damages of $91 million after trial), *aff'd sub nom.* RBC Capital Mkts., LLC v. Jervis, 129 A.3d 816 (Del. 2015); *In re* Dole Food Co., Inc. S'holder Litig., 2015 Del. Ch. LEXIS 223, 2015 WL 5052214, at *47 (Del. Ch. Aug. 27, 2015) (finding $148 million in damages after trial); *In re* Jefferies Grp., Inc. S'holders Litig., 2015 Del. Ch. LEXIS 158, 2015 WL 1414350 (Del. Ch. Mar. 26, 2015) (ORDER) (approving $70 million settlement); *In re* Del Monte Foods Co. S'holder Litig., Cons. C.A. No. 6027-VCL (Del. Ch. Dec. 1, 2011) (ORDER) (approving $89 million settlement); *see also* Joel Edan Friedlander, *Vindicating the Duty of Loyalty: Using Data Points of Successful Stockholder Litigation as a Tool for Reform*, 72 BUS. LAW. 623, 624-25 (2017) (listing eight successful duty of loyalty outcomes in 2015).

[49] *See In re* MFW S'holders Litig., 67 A.3d 496 (Del. Ch. 2013) ("*MFW Chancery*") *aff'd sub nom.* Kahn v. M & F Worldwide Corp., 88 A.3d 635 (Del. 2014).

[50] *MFW Chancery*, 67 A.3d at 505-06.

conditioned on approval of both an independent special committee and a majority of the unaffiliated shareholders.[51] According to the Court of Chancery:

> Although rational minds may differ on the subject, the court concludes that when a controlling stockholder merger has, from the time of the controller's first overture, been subject to (i) negotiations and approval by a special committee of independent directors fully empowered to say no, and (ii) approval by an uncoerced, fully informed vote of a majority of the minority investors, the business judgment rule standard of review applies.[52]

The court found that both protections were "complementary and effective in tandem," because "[a] special committee alone ensures only that there is a bargaining agent who can negotiate price and address the collective action problem facing stockholders, but it does not provide stockholders any chance to protect themselves."[53] On the other hand, a MOM provision allows stockholders a chance to vote down "a merger proposed by a controller-dominated board," but alone it does not give the stockholders "an independent bargaining agent."[54]

B. *The Delaware Supreme Court Decision*

In Kahn v. M&F Worldwide Corp., the Delaware Supreme Court affirmed the Court of Chancery's decision and expanded on, and clarified, its holding.[55] Thus, the Court concluded:

> To summarize our holding, in controller buyouts, the business judgment standard of review will be applied if and only if: (i) the controller conditions the procession of the transaction on the approval of both a Special Committee and a majority of the minority stockholders; (ii) the Special Committee is independent; (iii) the Special Committee is empowered to freely select its own advisors

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[51] *See id* at 506. The key portion of the proposal stated: "*We will not move forward with the transaction unless it is approved by such a special committee. In addition, the transaction will be subject to a non-waivable condition requiring the approval of a majority of the shares of the Company not owned by M&F or its affiliates*…." (emphasis in original).
[52] *Id.* at 502.
[53] *Id.* at 503.
[54] *Id.* at 503.
[55] *MFW Sup. Ct.*, 88 A.3d 635 (Del. 2014).

> and to say no definitively; (iv) the Special Committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority.[56]

The Court explained that the operative complaint in that particular case "would have survived a motion to dismiss under this new standard."[57] According to the Court, allegations in the complaint "about the sufficiency of the price call into question the adequacy of the Special Committee's negotiations, thereby necessitating discovery on all of the new prerequisites to the application of the business judgment rule."[58]

IV. THE DUAL "PROTECTIONS"

In both the Court of Chancery and the Supreme Court decisions in MFW, the Courts repeat multiple times that the condition of the "dual protections" of approval by both an independent special committee and the majority of the independent shareholders "replicate the key elements of the arm's-length merger process."[59] However, there is no discussion in either decision as to why "replication" of an arm's-length process should be the sole goal in a controller transaction. Moreover, as discussed below, this supposed "replication" as outlined by both courts is, in fact, a legal fiction that seems to have been created to justify handing a controlling shareholder a procedural mechanism to obtain dismissal at the pleading stage.[60] Otherwise, the transaction would be an entire fairness case likely without the possibility of dismissal at the pleading stage[61] but providing

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[56] *MFW Sup. Ct.*, 88 A.3d at 645 (emphasis in original).

[57] *Id.* at 645 n.14.

[58] *Id.* Footnote 14 was subsequently overruled in *Flood*, 195 A.3d 754, 766 n.81 (Del. 2018) ("to the extent that note 14 is inconsistent with this decision, *Swomley*, or the Court of Chancery's opinion in *MFW*, it is hereby overruled"); *see also* Matter of Baltic Trading S'holders Litig., 76 N.Y.S.3d 117, 119 (N.Y. App. Div. 2018) (rejecting the plaintiffs' reliance on footnote 14 for proposition that alleging inadequate price is sufficient, as "[i]t is not enough to argue that the financial press published objections to the adequacy of the sale price" and that "[t]here is no rule that a low premium represents a bad deal, much less bad faith") (citing Miramar Firefighters Pension Fund v. AboveNet, Inc., No. C.A. 7376-VCN, 2013 Del. Ch. LEXIS 200, at *13 (Del. Ch. July 31, 2013); *In re* MeadWestvaco S'holders Litig., 168 A.3d 675, 687 (Del. Ch. 2017)).

[59] *See MFW Sup. Ct.*, 88 A.3d at 639, 643, 651; *MFW Chancery*, 67 A.3d at 499-501.

[60] *See* discussion *infra* Part III.A, III.B.

[61] *But see* Monroe Cty. Emps. Ret. Sys. v. Carlson, No. C.A. 4587-CC, 2010 Del. Ch. LEXIS 132, at *4-5 (Del. Ch. June 7, 2010) (granting defendants' motion to dismiss, stating: "Delaware law is clear that even where a transaction between the controlling shareholder and the company is involved--such that entire fairness review is in play--plaintiff

leverage to minority shareholders at least to seek to obtain fair compensation for their shares on a class-wide basis outside of the appraisal context.[62]

A. *The Special Committee*

A special committee of supposedly independent directors formed to negotiate with a controlling shareholder is rarely, if ever, the equivalent of negotiating in an arm's-length transaction.[63] First, when a Board negotiates with a third-party in an actual arm's-length transaction, the board members are, in most instances, negotiating with a stranger or competitor.[64] On the other hand, in a controller transaction, the members

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must make factual allegations about the transaction in the complaint that demonstrate the absence of fairness. Simply put, a plaintiff who fails to do this has not stated a claim. Transactions between a controlling shareholder and the company are not *per se* invalid under Delaware law. Such transactions are perfectly acceptable if they are entirely fair, and so plaintiff must allege facts that demonstrate a lack of fairness.").

[62] Some have argued that the availability of appraisal sufficiently polices self-dealing by controllers. However, the risk to a controller who wants to buy at an unfair price is small. Appraisal proceedings typically involve only a small percentage of the shares being bought, and the worst-case scenario for the controller is that she will have to pay a fair price only for that small number of shares. *See, e.g., In re* Appraisal of Solera Holdings, Inc., Consolidated C.A. No. 12080-CB, 2018 WL 3625644, at *2 (Del. Ch. July 30, 2018), *judgment entered*, (Del. Ch. 2018) (seven funds with a total of approximately four million shares out of a float of approximately sixty-six million shares); *In re* Appraisal of SWS Grp., Inc., C.A. No. 10554-VCG, 2017 WL 2334852, at *2 (Del. Ch. May 30, 2017) (seven funds with a total of approximately 7.4 million shares out of a float of approximately 28.6 million shares); *In re* Appraisal of PetSmart, Inc., Consolidated C.A. No. 10782-VCS, 2017 WL 2303599, at *3 (Del. Ch. May 26, 2017) (group of funds with total of approximately 10.7 million shares out of a float of approximately 98.9 million shares). Thus, even if the controller ends up settling or being forced to pay a higher amount for this small amount of shares, the controller will end up buying the vast majority of the minority shares at an unfairly insufficient price. While the possibility of appraisal might be one consideration of a controller, in most instances, this possibility does not sufficiently incentivize controllers not to be unfair if they can get away with it. In addition, appraisal does not apply to stock-for-stock transactions, and those who prosecute appraisal actions may be forced to forego all or some of the merger consideration during the proceeding, which, for many, might not make economic sense. *See* Glob. GT LP v. Golden Telecom, Inc., 993 A.2d 497, 508 (Del. Ch. 2010) (As then-Vice Chancellor Strine recognized, "Appraisal claims are expensive to pursue, and the petitioners get none of the merger consideration during the pendency of the case, making such claims beyond the means of some investors to fund."), *aff'd*, 11 A.3d 214 (Del. 2010).

[63] *See Cox*, 879 A.2d at 619 ("[B]oards are rarely comprised of independent directors whose own financial futures depend importantly on getting the best price and, history shows, are sometimes timid, inept, or . . ., well, let's just say worse.").

[64] *See* The Business Professor, *Arm's Length Transaction – Definition,* https://thebusinessprofessor.com/knowledge-base/arms-length-transaction-definition/ ("[A]n arm's length transaction[] refers to a business deal where parties involved have no previous relationship . . . . These types of transaction are free from influence and the property being sold is likely to attract a fair market value compared to when parties are related . . . . Consequently, transactions involving family members or companies with related shareholders

of the board, even the supposedly "independent" ones, have often known and worked closely with the controller for years,[65] or fear retribution if they dare oppose the controller's deal.[66] Despite the analysis the courts use to determine whether those board members are conflicted, common sense tells us that these negotiations cannot in any sense be mistaken for arms-length negotiations with strangers.[67] Moreover, in most, if not all,

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(Subsidiaries) are not considered arm's length transactions. This is because it's highly unlikely that a transaction involving such a group would yield a sale price that is close to a fair market value compared to a deal between strangers.").

[65] *See* Yaron Nili, *The "New Insiders": Rethinking Independent Directors' Tenure*, 68 HASTINGS L.J. 97, 100 (2016) ("investors are becoming increasingly concerned with the potential negative impact that long tenure of directors may have on their independence."); Theo Francis & Joann S. Lublin, *Boards Get More Independent, but Ties Endure,* WALL ST. J. (Jan. 19, 2016), https://www.wsj.com/articles/boards-get-more-independent-but-ties-endure-1453234607; *see also* Claire Hill & Brett McDonnell, *Sanitizing Interested Transactions*, 36 DEL. J. CORP. L. 903, 926 (2011) ("[W]e think that independence is too easily presumed or accepted in Delaware law. The broader problem is structural bias: Nominally disinterested and independent directors are nevertheless inclined—because of a desire to retain their board seats, because they share a mindset and common interests with other executives, and/or because of their ties with these particular directors—not to exercise independent and critical judgment as to matters involving their peers."); Nicola Faith Sharpe, *The Cosmetic Independence of Corporate Boards,* 34 SEATTLE U. L. REV. 1435, 1449 (2011) ("[S]tructural bias and groupthink may constrain [a] director's independent judgment . . . . [B]oard members form close relationships that make it unlikely that a director will voice an opinion that runs contrary to the position taken by the majority of other board members. Directors value their close relationships and will work to maintain them even at the expense of optimal decision-making.").

[66] *See In re* Ezcorp Inc. Consulting Agreement Derivative Litig., No. CV 9962-VCL, 2016 WL 301245, at *41 (Del. Ch. Jan. 25, 2016) ("Delaware decisions have long worried about a controller's potential ability to take retributive action against outside directors if they did not support the controller's chosen transaction and whether it could cause them to support a deal that was not in the best interests of the company or its stockholders."); *In re* Dole Food Co., Inc. S'holder Litig., No. CV 8703-VCL, 2015 WL 5052214, at *28, 47 n.15 (Del. Ch. Aug. 27, 2015) (describing threats that controlling shareholder made against director who opposed transaction proposed by controller). Recently, at Berkshire Hathaway's 2019 annual meeting, Warren Buffett explained the lack of independence of many supposedly independent directors. "'The independent directors in many cases are the least independent,'" Mr. Buffett said. He explained that many independent directors need the money that comes with being a director, usually an annual fee of about $250,000. "'They aren't going to upset the apple cart,'" he said, explaining that these independent directors get put on the compensation committee because they can be controlled. Andrew Ross Sorkin, *Warren Buffett's Case for Capitalism,* N.Y. TIMES (May 5, 2019), https://www.nytimes.com/2019/05/05/business/warren-buffett-capitalism.html?smid=nytcore-ios-share.

[67] *See* Lucian A. Bebchuk & Assaf Hamdani, *Independent Directors & Controlling Shareholders*, 165 U. PA. L. REV. 1271, 1274 (2017) (Because controlling shareholders have "decisive power to appoint independent directors and decide whether to retain them, independent directors have significant incentives to side with the controller and insufficient countervailing incentives to protect public investors in conflicted decisions."). Regardless of the context, Delaware courts analyze director independence in a way that does not replicate, or even approximate, the independence that exists in an arms'-length transaction. Thus, it is clear

that the gap is substantial between negotiations with a stranger or competitor, which is what happens in a true arm's-length transaction, and the required showing by a plaintiff in Delaware in any context. In *In re* Oracle Corp. Derivative Litig. 824 A.2d 917, 937-38 (Del. Ch. 2003), then-Vice Chancellor Strine set out a common-sense discussion of director independence: "But, in my view, an emphasis on 'domination and control' would serve only to fetishize much-parroted language, at the cost of denuding the independence inquiry of its intellectual integrity. Take an easy example. Imagine if two brothers were on a corporate board, each successful in different businesses and not dependent in any way on the other's beneficence in order to be wealthy. The brothers are brothers, they stay in touch and consider each other family, but each is opinionated and strong-willed. A derivative action is filed targeting a transaction involving one of the brothers. The other brother is put on a special litigation committee to investigate the case. If the test is domination and control, then one brother could investigate the other. Does any sensible person think that is our law? I do not think it is.

"And it should not be our law. Delaware law should not be based on a reductionist view of human nature that simplifies human motivations on the lines of the least sophisticated notions of the law and economics movement. *Homo sapiens* is not merely *homo economicus.* We may be thankful that an array of other motivations exist that influence human behavior; not all are any better than greed or avarice, think of envy, to name just one. But also think of motives like love, friendship, and collegiality, think of those among us who direct their behavior as best they can on a guiding creed or set of moral values.

"Nor should our law ignore the social nature of humans. To be direct, corporate directors are generally the sort of people deeply enmeshed in social institutions. Such institutions have norms, expectations that, explicitly and implicitly, influence and channel the behavior of those who participate in their operation. Some things are 'just not done,' or only at a cost, which might not be so severe as a loss of position, but may involve a loss of standing in the institution. In being appropriately sensitive to this factor, our law also cannot assume-absent some proof of the point-that corporate directors are, as a general matter, persons of unusual social bravery, who operate heedless to the inhibitions that social norms generate for ordinary folk."

Significantly, none of these motivations (except for trying to get the best deal possible) are likely to come into play in an actual arms'-length transaction with strangers or competitors for counterparties. Moreover, then-Vice-Chancellor Strine's common-sense recitation is rarely, if ever, taken to heart in analyzing director independence in real cases challenging conflicted deals. *See, e.g.*, Sandys v. Pincus, C.A. No. 9512-CB, 2016 WL 769999, at *13 (Del. Ch. Feb. 29, 2016) ("Plaintiff does not allege that Doerr is beholden to Gordon or that they have any relationship *aside from being partners at the same venture capital firm*. Without more, these allegations do not cast a reasonable doubt on his independence from Gordon.") (emphasis added), *rev'd*, 152 A.3d 124 (Del. 2016). Then-Chancellor Strine contradicted his lesson about director motivation in *Oracle* ("*Homo sapiens* is not merely *homo economicus*") in his own Court of Chancery decision in *MFW*. *See MFW Chancery,* 67 A.3d at 514 (conceding the "business success that [special committee member] Webb enjoyed alongside Perelman [the controller]," but rejecting challenge to Webb's independence because he might be "seriously rich," and thus "his current relationship with Perelman would likely be economically inconsequential to him."). For a narrative that contains many various motivations as to why people turn a blind eye to, go along with, or participate in corporate wrongdoing, *see generally* JOHN CARREYROU, BAD BLOOD: SECRETS AND LIES IN A SILICON VALLEY STARTUP (Alfred A. Knopf ed., 2018) (recounting the Theranos saga); *see also In re* RJR Nabisco, Inc. Shareholders Litig., Consol. C.A. No. 10389, 1989 Del. Ch. LEXIS 9, at *46 (Del. Ch. Feb. 14, 1989) ("Neither case [cited by the Special Committee] . . . can be read to hold that the protections of the business judgment rule would be available to a fiduciary who could be shown to have caused a transaction to be effectuated (even one in which he had no financial interest) for a reason unrelated to a pursuit of the corporation's best interests. Greed is not the only human emotion that can pull one from the controller buyouts, the controller has implemented the ultimate deal-protection device, i.e., the announcement that he or she has no interest in selling his or her shares to a third-party.[68] This announcement strips the Special Committee of one of its most potent weapons—and one of the most potent weapons in any actual arm's-length negotiation—the ability to canvass the market with the possibility (a possibility of which potential bidders are certainly aware) of a third-party making a topping bid[69] and gives the controller the power to use his or her inside information to control the timing of the transaction without fear of being outbid.[70] Prior

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path of propriety; so might hatred, lust, envy, revenge, or, as is here alleged, shame or pride. Indeed any human emotion may cause a director to place his own interests, preferences or appetites before the welfare of the corporation.").

[68] *See In re* Dole Food Co., S'holder Litig., 2015 Del. Ch. LEXIS 223, at *109 (Del. Ch. Aug. 27, 2015) (that controller would not sell his Dole shares or partner with potential bidders made go-shop "cosmetic"); *MFW Sup. Ct.*, 88 A.3d 635, 652 (controllers "stated unwillingness to sell its MFW stake meant that the Special Committee did not have the practical ability to market MFW to other buyers")

[69] *See* Flood v. Synutra Int'l, Inc., 195 A.3d 754, 759 ("The Special Committee met…and decided to have Houlihan initiate a market check. None of the 25 potential bidders Houlihan contacted were interested, which is not surprising given Zhang's 63.5% voting control and the lack of any promise that he was a willing seller."); *In re* Appraisal of Dell Inc., No. CV 9322-VCL, 2016 WL 3186538, at *36 n.37 (Del. Ch. May 31, 2016) (quoting Brian JM Quinn, *Bulletproof: Mandatory Rules for Deal Protection,* 32 J. CORP. L. 865, 879-80 (2007)) ("surveying literature on auction theory and concluding that '[t]he two key insights are that competition, or the threat of competition, will lead to a price closer to the buyer's reservation price and that the price effect of one additional competitor is greater than the price effects attributable to bargaining'"), *aff'd in part*, *rev'd in part sub nom.* Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd, 177 A.3d 1 (Del. 2017); *see also* James Ang, Irena Hutton & Mary Anne Majadillas, *Managerial Divestment in Leveraged Buyouts*, 20 EUR. FIN. MGMT., 435 ("the mergers and acquisitions literature suggests that auctioned-off firms can generate greater wealth effects and higher likelihood of merger completion than firms sold th[r]ough negotiations with a sole buyer."); Merion Capital L.P. v. Lender Processing Servs., No. CV 9320-VCL, 2016 Del. Ch. Lexis 189, at *45 (Del. Ch. Dec. 16, 2016) ("The first factor supporting the persuasiveness of the Company's sale process is the existence of meaningful competition among multiple bidders during the pre-signing phase.").

[70] *See In re* Dole Food Co., S'holder Litig., 2015 WL 5052214, at *26 ("concept of fair dealing encompasses an evaluation of how the transaction was timed and initiated"); *id.* at *26 n.13 (listing academic research concerning "measures that reduce the apparent performance of a company during periods before the announcement of the buyout"); *accord* Yaping Mao & Luc Renneboog, *Do Managers Manipulate Earnings Prior to Management Buyouts?* 5 (CentER, Tilburg University, Discussion Paper No. 2013-055) ("[t] he US literature on accounting manipulation states that downward earnings management prior to MBOs is expected."). Although a statistical analysis is outside of the scope of this article, anecdotally, it appears to the author that consistent with the old saw to buy low and sell high, controllers generally do just that—buying low from the minority and selling high when they can. For example, when the controlling shareholder of AmTrust, Inc. offered to buy out the minority, its original offer was at a 22% discount to the 52-week average and a 54% discount to the 52-week high. When Synutra's controlling shareholder offered to buy out the minority, the original offer was approximately 25% below the 52-week high. When Baltic Trading's controller decided to buyout the minority, the deal was valued at approximately 60% below the

to MFW, it was the controlling shareholder's burden to "do more than establish a perfunctory special committee of outside directors"[71] to obtain burden shifting, and courts were generally unable to decide the issue prior to trial.[72] After MFW, despite supposedly being owed a fiduciary duty by the controller, it became the plaintiff's burden to demonstrate a conflicted special committee or, as discussed below, a material misstatement in the proxy materials, in its complaint in order to merely survive a motion to dismiss.[73]

B. *The Majority-of-the-Minority ("MOM") Provision*

"[C]ertain institutional investors may be happy to take a sizeable merger-generated gain on a stock for quarterly reporting purposes, or to offset other losses, even if that gain is not representative of what the company should have yielded in a genuinely competitive sales process."[74]

Despite the unsupported legal fiction to the contrary, and as then-Vice Chancellor Strine explained in another context in his above-quoted Golden Telecom decision, in most instances, a MOM provision provides no real backstop to an ineffectual Special Committee, because it is not, in

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52-week average and approximately 75% below the 52-week high. On the other hand, when JetPay's controller decided to *sell*, the price was at a 146% premium to the 52-week average and a 68% premium to the 52-week high. *See also* Steven Davidoff, *The Management Buyout Path of Less Resistance,* N.Y. TIMES (June 12, 2013), http://dealbook.nytimes.com/2013/06/12/the-management-buyout-path-of-less-resistance ("[T]ransactions initiated by third-party bidders were associated with premiums that were 12.8 percent higher, on average, than those initiated by management. These findings appear to bear out the hypothesis that management can use its knowledge of the company and position to obtain lower premiums. This occurs even when there is an independent committee of directors.").

[71] Americas Mining Corp. v. Theriault, 51 A.3d 1213, 1240 (Del. 2012).

[72] *Id.* at 1241 ("[T]he general inability to decide burden shifting prior to trial is directly related to the reason why entire fairness remains the applicable standard of review even when an independent committee is utilized, *i.e.*, because the underlying factors which raise the specter of impropriety can never be completely eradicated and still require careful judicial scrutiny.") (quotations and footnote omitted).

[73] *Compare Flood,* 195 A.3d at 766 n.81 ("The whole point of *MFW* is to give a pathway whereby judicial review of the economics of a transaction can be avoided if the correct parties . . . are given the appropriate authority.") *with Americas Mining Corp.*, 51 A.3d at 1241, where the Court explained the Court of Chancery's factual inquiry at trial that despite possibly having "the best of intentions," and "although the independence of the Special Committee was not challenged, 'from inception, the Special Committee fell victim to a controlled mindset and allowed Grupo Mexico to dictate the terms and structure of the merger.'" (quoting *id.*at 1245). The analysis in *Americas Mining* is hardly one that a plaintiff would have the ability to include in its initial pleading prior to conducting discovery.

[74] Glob. GT LP v. Golden Telecom, Inc., 993 A.2d 497, 508-09 (Del. Ch.), *aff'd*, 11 A.3d 214 (Del. 2010).

fact, a referendum on the fairness of the transaction being voted on.[75] In the real world, almost every deal that gets announced is consummated at the price announced.[76] Moreover, whether a deal gets consummated or not, the announcement of the deal generally causes the stock to rise to a level just below the announced deal price, and the price generally trades sideways until usually months later when the deal is almost always consummated, but only occasionally falls apart or is topped.[77] Most public shareholders understand the likely "inevitability" of consummation of the transaction and the fact that for perhaps months, the price of the stock is not going to change significantly.[78] The huge spike in volume that always accompanies these deal announcements[79] demonstrates that a significant portion of the public shareholders would rather accept a few cents below the deal price now (which almost always includes some kind of premium to the recent trading price) and have the opportunity to immediately reinvest the proceeds in other investment vehicles, rather than wait a few months or more to get the full deal price, which again they rightfully believe to be inevitable, or take the chance the deal will fall through and the stock price dropping back to pre-announcement levels.[80]

Most public shareholders have no allegiance to any particular company that is strong enough for them to wait around just to voice their opposition in what almost always ends up being a hollow gesture and to risk retribution by the controller if the transaction fails.[81] The buyers of

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[75] *See id.* at 505-08.

[76] *See* M&A Research Centre at Cass Business School, *Abandoned Acquisitions, Why Do Some Deals Fail to Complete*, at 23 file:///C:/Users/CStine/Downloads/intralinks_cass_abandoned_acquisitions_en.pdf_ (between 1992 and 2016, only 6.4% of U.S. mergers failed).

[77] *See* Gaurav Jetley & Xinyu Ji, *The Shrinking Merger Arbitrage Spread: Reasons & Implications,* 66 Fin'l Analysts J. 54, 62-63 (2010) (hereinafter "*Shrinking Merger Arbitrage*") ("In our sample [all mergers between 1990 and 2007], the average time from bid announcement to transaction resolution was 129 calendar days."); Mark Mitchell, Todd Pulvino & Erik Stafford, *Price Pressure Around Mergers*, 59 J. Fin. 31, 35 (Feb. 2004) ("As a result of a merger announcement . . . the target firm's stock trades at a small discount to the consideration offered by the acquiring company. If the merger is successful, this discount diminishes as the merger approaches consummation . . . . However, if the merger fails, the target firm's stock price usually falls dramatically . . . .").

[78] *See supra* note 77.

[79] *See Shrinking Merger Arbitrage,* at 62-63 (median first-day volume for deals announced between 2001 and 2007 was 10.02-14.50 times normal trading volume).

[80] *See* Keith C. Brown & Michael v. Raymond, *Risk Arbitrage & the Prediction of Successful Corporate Takeovers*, Fin'l Management, at 55 (Autumn 1986) (if deal falls through, "it is likely that the target stock will return to its pre-announcement level").

[81] *See* Sciabacucchi v. Liberty Broadband Corp., No. CV 11418-VCG, 2017 Del. Ch. LEXIS 93, at *47-48 (Del. Ch. May 31, 2017) ("[C]ontroller transactions are inherently coercive, and a transaction with a controller cannot be ratified by a vote of the unaffiliated

the shares sold by those seeking to get, immediately, slightly less than the deal price are, by definition, merger arbitrageurs, who are betting, and therefore hoping, that the deal will go through, not be voted down.[82] The last thing those "arbs" want is for the deal to fail, in which case the price will likely fall to where it was before the deal was announced (at least temporarily).[83] They are looking to profit the few cents per share where they bought versus the deal price and, therefore, have no incentive to vote against the deal, even if they do believe the price is unfair. They are simply not in that line of work. Of course, there have been a few rare exceptions, but those are invariably situations where there are significant minority shareholders who care and are in a position to block, or at least hamper, an unfair deal.[84]

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majority; the concern is that fear of controller retribution in the face of a thwarted transaction may overbear a determination of best corporate interest by the unaffiliated majority. In such a case, the Court cannot determine that a vote ratifies the transaction on its own merits."); *see also In re* JCC Holding Co. S'holders Litig., 843 A.2d 713, 724 (Del. Ch. 2003) ("*Lynch* is premised on the notion that these stockholders [who are being bought out by a controller] lack the free will to cast votes ratifying the fairness of the transaction, even after receiving full disclosure of the material facts").

[82] *See* Mark Mitchell & Todd Pulvino, *Characteristics of Risk and Return in Risk Arbitrage*, 56 J. FIN. 2135, 2135 (2001). While the amount and effect of arbitrageur holdings varies, in some cases, such a significant number of a target's shares comes to be held by arbitrageurs that a majority-of-the-minority provision becomes illusive or, at least, substantially skewed in favor of approval of the transaction. The variable nature of M&A arbitrageur acquisitions is reflected in two case studies described in an article in The Journal of Alternative Investments. Keith M. Moore, Gene C. Lai & Henry R. Oppenheimer, *The Behavior of Risk Arbitrageurs in Mergers and Acquisitions*, J. OF ALTERNATIVE INV., 19, 20-21 (2006). In the first case study, both companies were in a regulated industry and the acquirer initiated a proxy fight and a "bear hug." By obtaining data from "a leading proxy solicitation firm," the authors of this article were able to establish that 14.4% of the target company's shares were acquired by arbitrageurs. *Id.* at 21. In the second case study, the authors examined the period from the announcement of a hostile tender offer that ultimately became a friendly merger transaction. In the three days following the announcement of the hostile tender offer, arbitrageurs acquired 19.1% of the target's shares, but by the time the merger was consummated, arbitrageurs owned over 50% of the target's outstanding shares. *Id.* While arbitrageurs buy in contexts other than controller freezeouts, it is only in this context that a MOM condition is thought to provide a needed protection for minority shareholders.

[83] *See* A.A. Sommer, Jr., *Whom Should the Corporation Serve? The Berle-Dodd Debate Revisited Sixty Years Later*, 16 DEL. J. CORP. L. 33, 50-51 (1991) ("The diversity of interests is seen most dramatically when rumors surface about the possible takeover of a company. Immediately arbitrageurs acquire large amounts of the stock of the rumored target; their perspective is a matter of days, at most weeks, and inevitably what the longer-term shareholders previously perceived as their best interests may go through a swift transformation.").

[84] *See, e.g.*, Bill Alpert, *Icahn Squeezes a Better Deal from AmTrust*, Barron's, June 7, 2018, https://www.barrons.com/articles/icahn-squeezes-a-better-deal-from-amtrust-1528379765 (significant minority shareholders, including Carl Icahn, cause a failure of the MOM vote and an increase in the transaction price).

V. THE AUTHOR'S PROPOSAL

While the MFW approach certainly results in a bright-line way for a controller to structure a deal that will lessen his or her litigation exposure, it ultimately will not necessarily result in the controller complying with Cardozo's vision of his or her fiduciary duty or, in that regard, in minority shareholders obtaining a fair price for their shares.[85] There is a better, more equitable, way to achieve both goals, although it is certainly a slower process.[86] We all remember that prior to Vice Chancellor Laster's Revlon decision in 2010, which was at least partially inspired by then-Vice Chancellor Strine's Cox decision, controller transactions were litigated in a way that rarely resulted in a cash recovery for shareholders, and the threat of that type of litigation was unlikely to provide any kind of motivation for a controller to offer a fair price.

After Vice Chancellor Laster's Revlon decision, which was only a little more than five years before the Chancery decision in MFW, the plaintiffs' bar had started to heed Vice Chancellor Laster's advice and actually litigate, or started to litigate, controller deal cases.[87] Maybe it's a case of "be careful what you wish for." Of course, before MFW, defendants pointed to the in terrorem effect of entire fairness litigation

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[85] *See* Fernán Restrepo, *Judicial Deference, Procedural Protections, and Deal Outcomes in Freezeout Transactions: Evidence from the Effect of MFW*, 27 (Jan. 19, 2018) (unpublished research, Stanford Law School), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3105169. (concluding, among other things, that "target shareholders' gains did not change significantly after *MFW*." *Id.* at 27). Moreover, the analysis underlying this paper was limited to short-term premiums, *id.* at 15, which left out any analysis of a controller's significant advantage of timing a transaction to take advantage of a dip in the stock price, which, in an actual arm's-length transaction might lead to the entrance of a competing bidder.

[86] *See* Appel v. Berkman, 180 A.3d 1055, 1062 (Del. 2018) (adopting, in another context, a "contextual approach" rather than "the stark *per se* approach the defendants advance"); Redeemer Comm. of the Highland Crusader Fund v. Highland Capital Mgmt., L.P., 2017 Del. Ch. LEXIS 30, *2 (Del. Ch. Feb. 23, 2017) (bright-line rules are "troubling to equity").

[87] *See, e.g.,* Plaintiffs' Brief in Support of Motion for Final Settlement Approval and Award of Attorneys' Fees and Expenses, *In re* Dole Food Co., Inc. S'holder Litig., Consol. C.A. No. 8703, 11, 14 (Del. Ch. Jan. 20, 2016) ("Plaintiffs litigated this matter through over a year of discovery and motion practice, nine days of trial, and significant pre- and post-trial briefing."); Plaintiff's Opening Brief in Support of Application for Fees and Expenses, *In re* Rural/Metro Corp. S'holders Litig., Consol. C.A. No. 6350-VCL, at 3 (Del. Ch. Oct. 29, 2014) ("Plaintiff's counsel reviewed over 1,830,000 pages of documents and took thirteen fact depositions."); *see also* Joel Edan Friedlander, *Vindicating the Duty of Loyalty: Using Data Points of Successful Stockholder Litigation as a Tool for Reform*, 72 BUS. LAW. 623, 624-25 (2017) (listing eight successful duty-of-loyalty outcomes in 2015).

with little prospect of pre-trial dismissal.[88] On the other hand, prosecuting a post-closing damage case through trial can cost a plaintiffs' counsel hundreds of thousands (if not millions) of dollars in expenses, not to mention the vast accumulation of lodestar, all the while not being reimbursed for expenses or being paid for their time.[89] If a controller actually makes an offer that is fair based on traditional methodologies used by the Delaware courts, it is unlikely that any expert would risk his or her reputation by telling a plaintiff's firm that it has a potential damage case.[90] Moreover, it wouldn't take many judgments in favor of defendants for plaintiffs' firms to start voluntarily dismissing their cases (or settling cheaply) when they get enough information to find out that their case is weak.

True, this whole process might have taken a few more years to reveal itself, but the five years between Revlon and MFW simply wasn't enough time to let natural selection take its course. With entire fairness always the standard of review in controller transactions, a controller would face years of litigation and a significant judgment if he or she entered into a buyout transaction at an unfair price.[91] On the other hand, a plaintiffs' attorney would face years of litigation and the prospect of not being reimbursed for significant expenses and making no fees for his or her time

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[88] *See MFW Chancery*, 67 A.3d at 504 (under the new rule, "suits will not have settlement value simply because there is no feasible way for defendants to get them dismissed on the pleadings").

[89] *See, e.g.,* Plaintiffs' Brief in Support of Motion for Final Settlement Approval and Award of Attorneys' Fees and Expenses, *In re* Dole Food Co., Inc. S'holder Litig., Consol. C.A. No. 8703, 11, 14 (Del. Ch. Jan. 20, 2016) (settlement, after trial, plaintiffs' counsel seeking reimbursement of $2,530,422.96 in expenses and fees based on lodestar of $14,416,582.25); Plaintiff's Opening Brief in Support of Application for Fees and Expenses, *In re* Rural/Metro Corp. S'holders Litig., Consol. C.A. No. 6350-VCL, 3 (Del. Ch. Oct. 29, 2014) (after trial, plaintiff's counsel seeking reimbursement of $1,116,263.04 in expenses and fees based on spending 6,953 hours prosecuting the action).

[90] *But see Clearwire,* 2017 Del. Ch. LEXIS 125, at *3 (judgment for defendant and appraised value at less than half of the merger price after a ten-day trial and testimony by seven experts); *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 72-73, 79 (Del. Ch. 2013) (after eight years of litigation, trial, including expert testimony, results in judgment for defendants and appraised value of $0).

[91] The threat of litigation has a known deterrent effect on corporate wrongdoing. *See* Hagit Levy, Ron Shalev & Emanuel Zur, *The Effect of CFO Personal Litigation Risk on Firms' Disclosure and Accounting Choices*, 35 CONTEMP. ACCT. RES., 434, 440-41 (2018) ("Taken together, the evidence provided in this study highlights the importance of litigation risk in directing managers' behavior."); C.S. Agnes Cheng, Henry He Huang & Yinghua Li, *Does Shareholder Litigation Deter Insider Trading?*, 1 J.L. FIN. & ACCT. 275, 280 ("We provide strong evidence that private securities class actions, especially those [that] have merits and are rigorously litigated, can effectively constrain future informed insider trading in both defendant firms and their industry peers.").

if he or she chose to pursue a "bet-the-firm" case against a controller who entered into a buyout transaction at a fair price.[92]

While it is undoubtedly true that if the Delaware Supreme Court somehow saw the error of its way and returned to entire fairness as the sole standard in controller buyout cases, some cases challenging a fair deal would certainly be settled for nuisance value. But isn't it more in keeping with Cardozo's vision to err on the side of fairness for minority shareholders than on the side of convenience for controllers?

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[92] *See, e.g., Trados*, 73 A.3d at 34, 79 (after over eight years of litigation, the court concluded after trial, that "defendants proved that the decision to approve the Merger was entirely fair"); *see also In re* Ezcorp Inc. Consulting Agreement Derivative Litig., No. CV 9962-VCL, 2016 WL 301245, at *28 n.21 (listing entire fairness cases where defendants prevailed after trial).While some have speculated that without the *MFW* framework, a controller would have no incentive to structure a transaction using both protections, as it stands now, using both protections has generally not resulted in improved deal results (see *supra* n.80). As argued in this article, the use of both protections does not replicate an arm's-length transaction and real protection for minority shareholders would be the prospect that a controller would be held accountable by a court of equity for violating his or her fiduciary duties by pushing through an unfair deal. On the other hand, the use of both protective devices would certainly be at least one factor considered by a court in determining the fairness of the process. *See Kahn,* 638 A.2d at 1115 (quoting *Weinberger,* 457 A.2d at 711) (Fair dealing "'embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained.'").