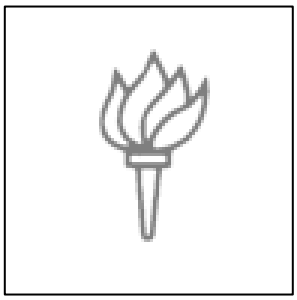
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Majority of the Minority Approval in a World of Active Shareholders

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V Conclusion

Preemptive rights are widely viewed as being effective at preventing a controlling shareholder from engaging in cheap-issuance tunneling. They can indeed prevent such tunneling when outside investors know that the offered securities are cheap. I have explained, however, that when outsiders cannot tell whether the securities are cheap or overpriced, preemptive rights cannot thwart cheap-issuance tunneling. Fearing that the securities are overpriced, outsiders may rationally refrain even when the securities are in fact cheap, and then suffer cheap-issuance tunneling. If outsiders exercise their preemptive rights, and the securities are in fact overpriced, they then suffer from overpriced-issuance tunneling.

I put forward a mechanism to make preemptive rights more effective at reducing cheap-issuance tunneling: requiring disclosure of a controller's subscription commitment before outsiders must decide their own. This presubscription disclosure rule, I have shown, would substantially reduce a controller's ability to engage in cheap-issuance (as well as overpriced-issuance) tunneling. In essence, the rule forces a controller to indirectly share some of her private information about firm value, reducing the amount of information asymmetry that the controller can exploit to divert value from outsiders via issuances. I hope that my analysis and proposal will be useful to regulators, legislatures, courts, practitioners, and researchers seeking to better understand and improve the governance of securities issuances by listed and unlisted firms.

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EDWARD B. ROCK

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I Introduction

Majority of the minority (MOM) approval is one of the key devices used in corporate law systems around the world to control controlling shareholder conflicts of interest. Taking Delaware corporate law's treatment of conflicted control transactions as a laboratory, I investigate how MOM approval functions in the presence of active shareholders (both hedge funds and actively managed mutual funds).[1]

I approach this question as follows. In Part I, I review the uses made of the MOM device, in general and in Delaware. In Part II, I survey the justifications given for reliance on MOM approval as a "cleansing device," and review criticisms of the use. In Part III, I provide a broad overview of the use of MOM provisions in going private transactions in the United States and then look closely at three deals that involved MOM and active shareholders: Carl Icahn's opposition to the Dell buyout; T. Rowe Price's opposition to the Oracle/Netsuite merger; and GAMCO, T. Rowe Price and ClearBridge's opposition to the Dolan's 2007 going private proposal at Cablevision. In Part IV, I consider the implications of the case studies for Delaware corporate law's reliance on MOM, and for the utility of MOM more generally. I close with a brief conclusion.

[1] The recognition in Delaware jurisprudence of the value of MOM, or, equivalently, disinterested shareholder approval in the freeze-out context, goes back at least to *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983).

In doing so, I ask a number of questions. First, what are the potential benefits of MOM approval? Are these realistic expectations? Second, does the presence of large, active shareholders make things better, worse or leave things as they are? In particular, if active shareholders make MOM approval more effective, does it make it sufficiently effective that we might want to give it more significance than we traditionally have? If it makes things worse, does it make things sufficiently worse that we should avoid MOM approval? Third, are the inadequacies or infirmities of MOM approval, alone or combined with other cleansing devices, such that we want to maintain a place for judicial review of the fairness of the transaction? To what extent does existing doctrine preserve the role of equity review?

II Majority of the Minority Approval

Controlling shareholders present a variety of conflicts of interest. I want to focus on two main categories. Controlling shareholders have a *direct conflict of interest* when they engage in transactions with the firm. This category includes the full range of related party transactions (RPTs), but is most significant when a controlling shareholder freezes out noncontrolling shareholders which, in the United States, is typically done through a parent subsidiary merger,[2] a triangular merger,[3] or a tender offer followed by a short form merger.[4] In all these cases, the conflict of interest is obvious: the controlling shareholder gets the full benefit of any mispricing while bearing only a pro rata share of the cost. Moreover, the magnitude of freeze-out transactions is very large, making the context both interesting and important.

A controlling shareholder faces an *indirect conflict of interest* when it uses its control position to benefit itself, potentially at the expense of the noncontrolling shareholders, through means other than direct related party transactions. Here again there are a myriad of ways in which

[2] In this structure, the controlling shareholder merges into the controlled subsidiary under Del. GCL § 251, with cash as the merger consideration for shareholders of the subsidiary.

[3] In this structure, the controlling shareholder established a wholly owned subsidiary that then merges with the controlled subsidiary under Del. GCL § 251, with cash as the merger consideration for shareholders of the subsidiary.

[4] In this structure, the controlling shareholder makes a tender offer to the noncontrolling shareholders of the subsidiary; if it acquires in excess of 90% of the outstanding shares, the remaining shares are acquired in a short form merger under Del. GCL § 253; if it acquires less than 90%, it acquires the remaining shares through the more cumbersome § 251 merger.

a controlling shareholder can take advantage of noncontrolling shareholders,[5] but among the most significant are control transactions in which the controlling shareholder may benefit at the expense of noncontrolling shareholders including mergers between controlled subsidiaries, sales of a control bloc to a third party at a premium, without offering the noncontrolling shareholders an opportunity to participate (leaving noncontrolling shareholders trapped in the company with a new controlling shareholder), or a sale of the company to a third party in which the controlling shareholder receives a premium for its controlling bloc that the noncontrolling shareholders do not share in (exposing them to potential underpricing for their shares). In these cases, while the controlling shareholder is not literally negotiating with itself, the controlling shareholder potentially or actually has fundamentally different interests than the noncontrolling shareholders.

Corporate law systems around the world recognize both categories of transactions as posing conflicts of interest that typically require special treatment of some sort.[6] Table 5.1 from the Anatomy of Corporate Law (Table 2–1) provides a useful "checklist" of different strategies that are used in corporate law.

These ten boxes help to identify a range of strategies that are deployed to control these conflicts of interest, in general and in the highly salient context of related party mergers:[7]

- **Rules**: Prohibition of conflicted transactions[8]; very high thresholds (90 percent plus shares for mandatory freeze-outs).[9]
- **Exit**: Mandatory bid rules[10]

[5] For a very good and concise recent survey of different techniques used in different jurisdictions, *see* Luca Enriques, *Related Party Transactions: Policy Options and Real-World Challenges*, 16 EUR. BUS. ORG. LAW REV. 1 (2015).

[6] Id.

[7] Here, I draw on Luca Enriques, Gerard Hertig, Hideki Kanda & Mariana Pargendler, Chapter 6, *Related Party Transactions*, in THE ANATOMY OF CORPORATE LAW (Reinier Kraakman et al. eds., 3d ed. 2017); Edward Rock, Paul Davies, Hideki Kanda, Reinier Kraakman & Wolf-Georg Ringe, Chapter 7, *Fundamental Changes*, in THE ANATOMY OF CORPORATE LAW (Reinier Kraakman et al. eds., 3rd ed. 2017); Paul Davies, Klaus Hopt & Wolf-Georg Ringe, Chapter 8, *Control Transactions*, in THE ANATOMY OF CORPORATE LAW (Reinier Kraakman et al. eds., 3d ed. 2017).

[8] For citations to various jurisdictions, *see* Luca Enriques, Gerard Hertig, Hideki Kanda & Mariana Pargendler, *supra* note 7, at 6.2.4.

[9] Edward Rock, Paul Davies, Hideki Kanda, Reinier Kraakman & Wolf-Georg Ringe, *supra* note 7, at 7.4.2.3 and Paul Davies, Klaus Hopt & Wolf-Georg Ringe, *supra* note 7, at 8.3.5.

[10] Paul Davies, Klaus Hopt & Wolf-Georg Ringe, *supra* note 7, at 8.3.4 and 8.4.

Table 5.1 *Strategies for Protecting Principals*

	Agent constraints	Affiliation terms	Incentive alignment	Appt rights	Decision rights
EX-ANTE	RULES	ENTRY	TRUSTEESHIP	SELECTION	INITIATION
EX-POST	STANDARDS	EXIT	REWARD	REMOVAL	VETO

- **Standards**: Judicial review of fairness.[11]
- **Trusteeship**: Independent director approval.[12]
- **Veto**: Disinterested shareholder approval.[13]

As we show in the Anatomy, all of these strategies have been deployed at various times in various systems.

Over the last thirty years, Delaware has developed a fairly intricate jurisprudence of controlling shareholder transactions. As of 2017, the approach is as follows (with some simplification). For direct conflicts, such as transactions between a controlling shareholder and the firm and controlling shareholder freeze-outs, the default is that the Delaware Chancery Court will review the transaction under the "Entire Fairness" standard, a holistic standard that looks at both "fair price" and "fair process," with the burden of establishing entire fairness placed on the conflicted controlling shareholder.[14] When the transaction has been approved by an effective, disinterested board or committee of the board ("Independent Special Committee approval" or ISCA), *or* has been approved by a majority of the outstanding disinterested shares (MOM), the standard remains Entire Fairness but the burden is shifted to the shareholder challenging the transaction.[15] Finally, as the Delaware Supreme Court recently held in *Kahn* v. *M & F Worldwide Corp.*, when the transaction has been structured so that it is conditioned upon the

[11] Luca Enriques, Gerard Hertig, Hideki Kanda & Mariana Pargendler, *supra* note 7, at 6.2.5 and Edward Rock, Paul Davies, Hideki Kanda, Reinier Kraakman & Wolf-Georg Ringe, *supra* note 7, at 7.4.2 (mergers).

[12] Luca Enriques, Gerard Hertig, Hideki Kanda & Mariana Pargendler, *supra* note 7, at 6.2.2.1 (generally) and Edward Rock, Paul Davies, Hideki Kanda, Reinier Kraakman & Wolf-Georg Ringe, *supra* note 7, at 7.4.2 (mergers).

[13] Luca Enriques, Gerard Hertig, Hideki Kanda & Mariana Pargendler, *supra* note 8, at 6.2.3 (generally) and Edward Rock, Paul Davies, Hideki Kanda, Reinier Kraakman & Wolf-Georg Ringe, *supra* note 7, at 7.4.2 (mergers).

[14] *Weinberger* v. *UOP, Inc.*, 457 A.2d 701 (Del. 1983).

[15] *Kahn* v. *Lynch Communications*, 638 A.2d 1110 (Del. 1994).

approval of an effective and disinterested special committee with the ability to say no, and the approval of a majority of the noncontrolling shares, then, if it satisfies some additional conditions, the transaction may be reviewed under the business judgment rule (BJR) with the burden falling on the shareholder challenging the transaction.[16] Finally, regardless of the cleansing devices utilized, in related party cash mergers, shareholders dissatisfied with the price may seek judicial appraisal of the value of their shares.[17]

For indirect conflicts, the jurisprudence is a bit more complicated and uncertain, and depends on the transaction. For sales of a control bloc, the formal rule is that a shareholder may sell its control bloc to a third party for whatever price it wants so long as it is not on notice that it is selling to a new controller who will take large non-pro rata distributions (a "looter"). In practice, the rule is more complicated and uncertain. Because few buyers are willing to buy a control block without doing due diligence on the company, and often need the board to approve the transaction in advance in order to avoid the limitations under Del. GCL § 203, Delaware's "anti-takeover" statute, the board's conduct in cooperating with a sale of control will often be the subject of fiduciary review.[18] In facilitating the transaction by a Section 203 waiver or by cooperating with due diligence (and making available to the buyer material nonpublic corporate information, access to employees, etc.), must the board get something from buyer for the non-controlling shareholders? May the board adopt a poison pill against the buyer and the controlling shareholder?[19] Must the board do so?[20] While there is a bit of case law

[16] *Kahn* v. *M & F Worldwide Corp.*, 88 A.3d 635, 645 (Del. 2014). There are some additional conditions that will be discussed below.

[17] Del GCL § 262; *see, e.g.*, In re Dole Food Co., 2015 Del. Ch. LEXIS 223 (Del. Ch. Aug. 27, 2015).

[18] *See, e.g., Omnicare* v. *NCS Healthcare, Inc.*, 818 A.2d 914 (Del. 2003). Del. GCL § 203 imposes limitations on mergers with "interested stockholders" unless the board gives prior approval to the merger or the transaction that results in someone becoming an interested stockholder.

[19] In *Hollinger*, the Delaware Chancery Court approved the adoption of a poison pill against a somewhat exceptional controlling shareholder, Conrad Black. 844 A.2d 1022 (2004), aff'd 872 A.2d 559 (Del. 2005). *See also* In *re CNX Gas Corp.* Shareholders Litigation, 4 A.3d 397 at **45–46 (Del. Ch. 2010).

[20] *See, e.g., Louisiana Municipal Police Employees' Retirement System* v. *Fertitta*, 2009 Del. Ch. LEXIS 144 *31–32 n.34 (Del. Ch. Jul. 28, 2009) ("the board's failure to employ a pill, together with other suspect conduct, supports a reasonable inference at the motion to dismiss stage that the board breached its duty of loyalty in permitting the creeping takeover").

on these topics, there is substantial uncertainty as to the current state of the law. This is, in part, because there are exceedingly few cases in Delaware involving sales of control blocks, perhaps because Delaware apparently does a good job at controlling self-dealing by controlling shareholders.[21] When private benefits of control are low, and financing is available, there is little incentive for a seller to sell, or a buyer to seek to buy, the control block rather than the whole company.

When the controlling shareholder engineers a sale of the whole company to a third party, and receives a premium over what the noncontrolling shareholders receive, the law is somewhat more settled. Under current law, when a controlling shareholder receives something different than the noncontrolling shareholders in a sale of the company, the controlling shareholder must establish the "Entire Fairness" of the difference.[22] If, on the other hand, the sale of the company is negotiated by an independent special committee and is approved by a majority of the non-controlling shares, then the transaction will be reviewed under the BJR, with the burden on the shareholder challenging the transaction.[23]

In the wake of the Delaware Supreme Court's opinion in M & F Worldwide, the question arises whether the "belt and suspenders" approach will suffice in other controlling shareholder situations. For example, when a firm with a controlling shareholder changes its capital structure in order to preserve and extend the controlling shareholder's control against the threat of dilution, will subjecting the recapitalization to ISCA plus MOM approval remove any substantive analysis of the terms of the transaction? The early indications are that the M & F Worldwide approach will be effective.[24]

[21] The magnitude of private benefits of control will be reflected in the value of control blocks versus noncontrolling shares. Tatiana Nenova, *The Value of Corporate Voting Rights and Control: A Cross Country Analysis*, 68 J. FIN. ECON. 325–51 (2003) (in Canada, Denmark, Finland, Sweden, and the US, median value of control block votes is below 1% of the total value of the company).

[22] In *re Tele-Communications, Inc. Shareholders Litigation*, 2005 Del. Ch. LEXIS 206, 2005 WL 3642727 (Del. Ch. Dec. 21, 2005); In *re John Q. Hammons Hotels, Inc. S'holder Litig.*, 2009 WL 3165613 (Del. Ch. Oct. 2, 2009).

[23] In *re John Q. Hammons Hotels, Inc. S'holder Litig.*, 2009 WL 3165613 (Del. Ch. Oct. 2, 2009); In *re Martha Stewart Living Omnimedia, Inc. Stockholder Litig.*, 2017 Del. Ch. LEXIS 151 (Del. Ch. Aug. 18).

[24] The abandoned recapitalizations at Facebook and IAC would have presented an opportunity for the Delaware courts to address this issue. In the recent case of *Ira Trust FBO Bobbie Ahmed* v. *Crane*, 2017 Del. Ch. LEXIS 843, the M & F approach resulted in the application of the BJR to an "entrenching" recapitalization.

III What Is Majority of the Minority Supposed to Do? What Can Majority of the Minority Do?

Delaware law, as we have seen, allows MOM to shift the burden of proof to the challenging shareholder, and, when combined with ISCA, may even result in the deferential BJR review. How exactly is MOM supposed to protect non-controlling shareholders? Assume, for these purposes, that at least some of the non-controlling shareholders are actively engaged in governance in the way that both activist hedge funds and actively managed mutual funds currently are.

The most optimistic view is that MOM will empower non-controlling shareholders to negotiate improved terms. Zohar Goshen, the principal proponent of this view, understands MOM as a form of "property rule" protection.[25] The primary benefit of property rules is that by requiring the consent of both parties to a transaction, only transactions that are acceptable to both sides go forward. Goshen thus argues that MOM has two primary benefits, "First, it prevents a self-dealer from imposing a transaction on an unwilling minority. Second, since such an approach is based upon consent, it is unnecessary to bring the transaction before the courts for an objective evaluation."[26] For Goshen, this "property rule" protection has a characteristic downside: it provides an incentive to "the minority or some of its members, [to] attempt to hold out for a larger piece of the transaction's expected profit." Negotiations may break down if holdouts push things too far and thus may block efficient transactions. The risk of strategic voting can also run the other way, as "even a 'reasonable' hold out will preclude a transaction if the interested majority refuse[s] to concede to the opposing minority's demands for strategic reasons such as guarding its reputation." In empowering the non controlling shareholders to negotiate for a higher price than the controlling shareholder has offered and, if not satisfied, to veto the transaction, Goshen claims that the MOM "arrangement assures the minority more than a minimum fair price, however. It empowers the minority to look after its own interests and to strive to obtain the maximum price it can achieve. Placing the decision in the minority's hands maintains a regime of voluntary transactions and preserves the role of subjective valuations."[27]

[25] After Guido Calebresi & Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972).

[26] Zohar Goshen, *The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality*, 91 CALIF. L. REV. 393, 402 (2003).

[27] Goshen, *supra* note 26, at 410 and 413 ("A property rule that requires the minority's approval for a transaction in which a conflict of interests arises empowers the minority to demand a larger portion of the surplus . . . than it would receive under the liability rule").

The Delaware courts have also taken a positive view of MOM, especially when combined with ISCA. In the parent-subsidiary freeze-out context, Delaware courts have argued that the "both" structure in which the merger is conditioned from the outset on ISCA and MOM replicates (or even exceeds) a third-party arms-length merger and should be analyzed under the same deferential business judgement rule:

> First, entire fairness is the highest standard of review in corporate law. It is applied in the controller merger context as a substitute for the dual statutory protections of disinterested board and stockholder approval, because both protections are potentially undermined by the influence of the controller. However, as this case establishes, that undermining influence does not exist in every controlled merger setting, regardless of the circumstances. The simultaneous deployment of the procedural protections employed here create a countervailing, offsetting influence of equal—if not greater—force. That is, where the controller irrevocably and publicly disables itself from using its control to dictate the outcome of the negotiations and the shareholder vote, the controlled merger then acquires the shareholder-protective characteristics of third-party, arm's-length mergers, which are reviewed under the business judgment standard.[28]

In this context, the MOM provision strengthens the hand of the Independent Special Committee (ISC) and, at the same time, gives shareholders an opportunity to accept or reject the outcome of the special committee's negotiations:

> [T]he adoption of this rule will be of benefit to minority stockholders because it will provide a strong incentive for controlling stockholders to accord minority investors the transactional structure that respected scholars believe will provide them the best protection, a structure where stockholders get the benefits of independent, empowered negotiating agents to bargain for the best price and say no if the agents believe the deal is not advisable for any proper reason, plus the critical ability to determine for themselves whether to accept any deal that their negotiating agents recommend to them. A transactional structure with both these protections is fundamentally different from one with only one protection.[29]

In the "indirect conflict" context in which a controlling shareholder uses control to sell the whole company and receives something different from the non-controlling shareholders, as in the *John Q. Hammons* case,

[28] *Kahn* v. *M & F Worldwide Corp.*, 88 A.3d 635, 644 (Del. 2014).

[29] In *re MFW Shareholders Litigation*, 67 A.3d 496, 503 (Del. Ch. 2013) quoted in and aff'd sub nom. *Kahn* v. *M & F Worldwide Corp.*, 88 A.3d 635, 644 (Del. 2014).

Chancellor Chandler likewise viewed the MOM as providing an important backstop to the ISC when he held that for a sale of the company in which the controlling shareholder gets something different from the non-controlling shareholders, the BJR will apply only if the transaction is conditioned from the beginning on approval by an effective independent committee and unwaivable MOM. In this context, the role served by the MOM is as a referendum on the performance of the committee:

> An effective special committee, unlike disaggregate stockholders who face a collective action problem, has bargaining power to extract the highest price available for the minority stockholders. The majority of the minority vote, however, provides the stockholders an important opportunity to approve or disapprove of the work of the special committee and to stop a transaction they believe is not in their best interests. Thus, to provide sufficient protection to the minority stockholders, the majority of the minority vote must be nonwaivable, even by the special committee.[30]

The Delaware courts' positive view of MOM, like the *Corwin* v. *KKR Financial* line of cases, seems to reflect a sense that, in the current environment, shareholders are sufficiently active and engaged that their approval or acquiescence carries significant weight.[31]

What are the misgivings about MOM? On the one hand, some argue that that MOM is not of much value and, as a result, should not justify much deference. First, because of legal and other impediments to collective action, non-controlling shareholders cannot bargain effectively on their own behalf, unlike an effective special committee. As Guhan Subramaniam puts it, "The market is not as effective a negotiator as a special committee."[32] Although in theory MOM "empowers" non-controlling shareholders to negotiate, in practice it cannot be done. Most investors do not want to be given material nonpublic information because its possession will typically preclude them from trading. Prior to the announcement of a transaction, conversations, much less negotiations, between the controlling shareholder and noncontrolling shareholders would contain material nonpublic information that would freeze the noncontrolling shareholders' ability to trade.[33] Once a deal

[30] In *re John Q. Hammons Hotels Inc. Shareholder Litigation*, 2009 Del Ch LEXIS 174, *42.

[31] *Corwin* v. *KKR Financial*, 125 A.3d 304 (Del. 2015).

[32] Guhan, Subramanian 2007, *Post-Siliconix freeze-Out: Theory and Evidence*, J. LEGAL STUD., 36, 1–26.

[33] Rule 10b-5 and Regulation FD are both relevant here. Regulation FD requires simultaneous public disclosure of any material information provided on behalf of an issuer unless the person receiving the information explicitly agrees to maintain the information in

has been announced, the limitations are somewhat relaxed but will still chill discussion.[34]

Second, even as a check on the performance of the ISC, one might worry that MOM may not be very effective. After all, when the ISC has performed poorly, noncontrolling shareholders will likely approve the transaction at even a small premium over the pre-transaction market price because, however bad a job the committee did, taking the premium is likely to be preferable to returning to life under the overreaching controlling shareholder.

Third, the process can be manipulated in a variety of ways. The "disinterested" directors on the ISC are ultimately elected by the controlling shareholder and thus may not be genuinely disinterested. Moreover, so long as the price is above the current market price, and there are no other alternatives, shareholders will almost certainly approve the transaction, even if a better process (e.g., an effective special committee) would have resulted in a substantially higher price.

Fourth, the courts have exaggerated the effect of MOM. There is simply no way that MOM, with or without an effective special committee, will ever *replicate* the protections that shareholders have in a genuine arms-length sale in which a disinterested board can, and is expected, to canvas the market to seek the highest value reasonably available. No market test of any sort is possible in the parent-subsidiary freeze-out context, and the controlling shareholder's conflict of interest is powerful and direct. Cleansing devices, even combined, cannot redress the inherent imbalance and likewise cannot assure that the price that noncontrolling shareholders receive is their pro rata share of the value of the subsidiary (the valuation standard in appraisal).[35]

On the other hand, there are those who worry that MOM does "too much" and will invite opportunistic behavior. If a deal is conditioned

confidence. 17 CFR 243.100. Having agreed to maintain information in confidence, the recipient of the information could not trade. Rule 10b-5. Few active shareholders are likely to welcome these restrictions.

[34] It is, of course, possible that there is a sort of "virtual" or "ex ante" negotiation that occurs: the presence of MOM may result in controlling shareholders offering higher prices for fear of rejection by the minority shareholders. Identifying situations in which there is negotiation "in the shadow" of MOM will be difficult.

[35] Luca Enriques points out that "disinterested shareholders may well approve a less than fair RPT when the alternative unconnected transaction would be less convenient to the company, once incurred and prospective transaction costs are taken into account." Luca Enriques, *Related Party Transactions: Policy Options and Real-World Challenges*, 16 EUR. BUS. ORG. L. REV. 1, 17 (2015).

from the beginning on MOM approval, will this invite market actors to acquire a blocking position and then use that position for personal gain? As a number of experienced practitioners have put it, "[T]here exist real risks that hedge funds and arbitrageurs will engage in open market purchases of equity sufficient to prevent the satisfaction of a majority of the minority condition."[36] Is this a realistic concern or is the threat overstated? After all, how credible is the "holdout" threat when the hedge fund has no good exit options if it fails to reach an agreement for a higher price? Will a hedge fund follow through on its threat to block a transaction if it will end up as a minority shareholder in a controlled firm indefinitely? Alternatively, will even sincerely motivated noncontrolling shareholders, in seeking to extract more consideration, end up blocking value enhancing transactions?[37] Deal lawyers, faced with either possibility, may forego the use of MOM (and the possibility of BJR review), in favor of sole reliance on ISC.[38] Because the use of MOM is optional in Delaware, this would render it irrelevant.

IV Case Studies: Majority of the Minority in Practice

As the previous discussion shows, the presence of highly engaged shareholders has an uncertain effect on MOM. In this section, I first examine the frequency of MOM approval (by vote or tender conditions) and then consider a variety of recent battles between highly engaged shareholders and controlling or near controlling shareholders, in the context of MOM conditions.

A The Big Picture

As noted earlier, MOM provisions have been a well-known device for cleansing conflicts of interests in freeze-outs at least since the 1983 *Weinberger* v. *UOP* decision. Of the approximately fifty controlling shareholder going private transactions between 2010 and 2017 tracked by Thomson ONE Banker, MOM voting or tender conditions appeared in the seventeen transactions listed in Table 5.2.[39] All of these involved

[36] Suneela Jain, Ethan Klingsberg & Neil Whoriskey, *Examining Data Points in Minority Buy-Outs: A Practitioners' Report*, 36 DEL. J. CORP. L. 939, 950 (2011).

[37] Goshen, *supra* note 26, at 402.

[38] Jain, Klingsberg & Whoriskey, *supra* note 36.

[39] Search was for "acquisition of remaining interest" which is limited to controlling shareholder transactions.

Table 5.2

Year	Target	Acquiror name	% of shares acq	Enterprise value at announcement ($mil)	
2017	Handy & Harman	Steel Partners	30	355	MOM tender condition
2017	Alliance Health Care Services	Tahoe Investment Group	48.9	664	MOM
2016	BBX Capital Corp	BFC Financial Corp.	18.77	253	MOM
2016	Federal-Mogul Holdings Corp	Icahn Enterprises Holdings	18	4,415	MOM tender condition
2016	Synutra International Inc.	Investor group	37.05	651	MOM
2016	National Interstate Corp.	Great American Ins Grp	48.3	572	MOM
2015	Books-A-Million	SPV	42	99	MOM
2014	NTS Realty Holdings LP	NTS Merger Parent	38.28	350	MOM
2013	Cornerstone Therapeutics Inc.	Chiesi Farmaceutici SpA	42	300	MOM
2012	Clearwire	Sprint Nextel	49.554	10,853	MOM
2012	Sauer-Danfoss Inc.	Danfoss A/S	24.44	2,571	MOM tender condition
2012	The Hallwood Group	Hallwood Financial	34.33	28	MOM
2012	NTS Realty Holdings LP	Investor group	38.22	346	MOM
2011	Venoco Inc	Investor group	49.68	1,413	MOM
2011	Wesco Financial Corp.	Berkshire Hathaway	19.9	227	MOM
2010	Bancinsurance Corp.	Investor group	25.83	54	MOM
2010	CNX Gas Corp.	CONSOL Energy	16.7	5,833	MOM tender condition

controlling shareholders acquiring the shares that they did not currently own.

There are several things to note. First, even before the 2013 MFW opinion that promised BJR scrutiny in cases in which a controller committed to an ISC and MOM approval, MOM provisions were fairly common.[40] Second, based on a review of public sources (newspaper, web, Securities Exchange Commission (SEC) filings), in none of these cases is there evidence that an active shareholder acquired a significant block and then sought to use the threat of blocking MOM approval to negotiate a higher price.[41] Third, although transactions encountered opposition in a number of cases, and sometimes resulted in price increases, the opposition was not led by active shareholders. Sometimes, the decisive factor was rejection by the board's financial advisor, as in 2014 when Great American Insurance Group withdrew its $30 per share tender offer to acquire the remaining 48.3 percent of National Interstate Corp after an Ohio court indicated that it would enjoin it.[42] Great American returned in 2016 and succeeded in acquiring the remaining shares at $32 per share in a negotiated transaction.[43] In other cases, representative litigation, initiated by entrepreneurial lawyers rather than by large shareholders, played a role, as with the 2012 NTS Realty Holdings buyout proposal when litigation held up the deal and ultimately resulted in raising the consideration from $7.50 per unit to around $9.25 per unit;[44] similarly, in the 2010 CNX Gas Corp transaction (which resulted in a widely read Delaware Chancery opinion),[45] the litigation was ultimately settled with the deal going forward.[46]

B The Dell MBO

The 2012–13 battle between the Michael Dell/Silver Lake buyout group and the Southeastern Asset Management/Icahn group would seem to be

[40] Accord: Fernan Restrepo & Guhan Subramanian, *The Effect of Delaware Doctrine on Freezeout Structure & Outcomes: Evidence on the Unified Approach*, 5 HARV. BUS. L. REV. 205, 218 (2015).

[41] It is, of course, possible that there were private discussions and settlements.

[42] National Interstate Oct. 11, 2016 Definitive Proxy at 17.

[43] Id.

[44] https://globenewswire.com/news-release/2014/02/25/613299/10070047/en/NTS-Realty-Holdings-Limited-Partnership-Announces-Execution-of-Going-Private-Merger-Agreement.html.

[45] In re CNX Gas Corp., 4 A.3d 397 (Del. Ch. 2010).

[46] www.law360.com/articles/440178/consol-strikes-43m-deal-with-cnx-.

the perfect opportunity for large, well-incentivized shareholders to use a MOM approval condition to bargain for better terms.[47] The fact that the Dell MBO went through with only a trivial increase in price, despite a low-ball offer and high-profile, well-publicized opposition, should raise some questions about the value of MOM.

During the first half of 2012, Dell stock traded in the range of $11.75 to $18.15 per share. In the summer of 2012, at a time when Dell shares were trading for around $12 per share,[48] Southeastern Asset Management, an actively managed mutual fund with about $20 billion under management and 146.5 million Dell shares (about 8.6 percent), suggested to Michael Dell that it would make sense to take Dell private, and that Southeastern would be interested in partnering with him to do so. Evidently intrigued by the idea, Mr. Dell started talking with others, including Silver Lake Partners, a private equity firm with about $39 billion under management. By August, the process had begun to get serious. Mr. Dell, while continuing to talk with Silver Lake, continued discussions with another PE firm ("Sponsor A"), and informed Dell's lead director that he was interested in exploring an MBO. In response, the board formed a special committee that quickly hired lawyers (Debevoise) and bankers (JPMorgan).

In October 2012, Silver Lake and Sponsor A both submitted preliminary nonbinding proposals. By December, Sponsor A had dropped out and the Special Committee invited another firm, Sponsor B, to participate. Sponsor B came close to submitting a proposal but ultimately decided not to.

In January 2013, things began to heat up. On January 16, when the stock was trading at $13.05 per share, Silver Lake submitted a nonbinding proposal offering $12.90 per share. In response, the Special Committee expressed pessimism and indicated that it would support a $13.75 offer. On January 20, Silver Lake, when the stock had dropped to $12.72, offered $13.50, an offer that was promptly rejected by the Special Committee. On January 24, Silver Lake raised its offer to $13.60 which it claimed was its "final and best offer."

On January 29, Southeastern informed the Special Committee that it would oppose any merger in $14–$15 range, unless large stockholders were given the opportunity to roll over a portion of their equity. Other

[47] The Dell MBO is not included in Table 5.2 because Michael Dell did not own a controlling position.

[48] Dell historical stock prices: http://i.dell.com/sites/doccontent/corporate/secure/en/Documents/dell-closing-costs.pdf.

major shareholders likewise opposed the deal, preferring to remain invested in the company and benefiting from Michael Dell's ideas for improving the company.[49]

Around the same time, the Dell Special Committee prepared a draft merger agreement including a MOM approval condition, fully aware of the risk of strategic voting. As reported in the Dell proxy:

> The Special Committee discussed the risk that requiring that the merger agreement be adopted by holders of a majority of the outstanding shares of Common Stock entitled to vote thereon not held by Mr. Dell, certain parties related to him and members of management, might incentivize some market participants to seek to disrupt the proposed transaction in order to generate short-term gain.

Within days, on February 4, a deal was struck with Silver Lake at $13.65 (plus the regular quarterly dividend) and a forty-five-day "go shop" period.[50] Shortly thereafter, Blackstone indicated an interest in making an offer. At the end of the month, Icahn Enterprises entered the picture and asked for confidential information, having begun buying shares in early February 2013.[51] On March 5, Icahn indicated that he was a substantial shareholder, proposed a leveraged recapitalization as an alternative to the Silver Lake financed MBO and threatened a proxy contest. On March 22, Blackstone submitted a nonbinding proposal at $14.25. Around this same time, Icahn indicated that he owned 80 million shares and claimed support from Southeastern and T. Rowe Price.[52] By May, Blackstone dropped out, spooked by Dell's declining sales.

The battle then heated up. Icahn and Southeastern nominated directors and, at the end of May, both Dell and Icahn/Southeastern filed proxy statements. By the middle of June, Icahn and Southeastern had filed a 13D indicating that Icahn had purchased around half of

[49] In addition to Southeastern, other major shareholders who publicly opposed the MBO included: T. Rowe Price (4.1%); Yacktman (0.9%); Pzena (0.8%). Telis Demos, David Benoit & Ben Worthen, T. Rowe *Price Opposes Dell Buyout*, WSJ 2/12/2013, www.wsj.com/articles/SB10001424127887324880504578300090035992424.

[50] During this period, the stock traded below this price, indicating that the market did not expect a topping bid.

[51] *Icahn/Southeastern Preliminary Proxy Statement*, 8/16/13, www.sec.gov/Archives/edgar/data/807985/000113379613000175/k353023_prec14a.htm.

[52] This is an early example of the emerging tendency of actively managed mutual funds teaming up with activist hedge funds. Alexandra Stevenson, *Money Managers Take Off the Gloves in Dealing With Companies*, NEW YORK TIMES (April 25, 2017), www.nytimes.com/2017/04/25/business/dealbook/money-managers-take-off-the-gloves-in-dealing-with-companies.html?emc=eta1&_r=0.

Southeastern's shares, giving each approximately 4.1 percent of the shares.

With the shareholders' meeting scheduled for July 18, Dell's proxy solicitors told the Special Committee that it was likely that the majority of outstanding disinterested shares condition would not be satisfied. This was because of the opposition of the large holders like Southeastern and T. Rowe Price, combined with the stale record date which, given the turnover in the stock, meant that many of the shares were no longer owned by the record owner and thus were less likely to be voted.

In response, the Special Committee postponed the meeting to July 24. On August 2, an agreement between the special committee and the Silver Lake group was reached in which the price was raised from $13.65 plus the normal quarterly dividend to $13.75 plus a slightly larger $0.13 dividend in exchange for changing the approval condition to a majority of (non-buyer) shares voted (instead of outstanding). The shareholders' meeting was set for September 12 with an August 13 record date. The effect of the September meeting date and the new record date was to enfranchise shareholders who had bought after the first record date, many of whom were merger arbitrageurs who wanted the deal to close, and to provide time to solicit additional proxies. The Delaware Chancery Court denied Icahn's motion to enjoin the change in the date of the meeting and record date and the change of the approval condition from a "majority of outstanding disinterested shares" to a "majority of disinterested shares voted."[53]

By September 12, in the absence of any binding offer from a third party, 57 percent of the outstanding disinterested shares (70 percent of the disinterested shares voted) had been voted for the deal, thereby approving the buyout. By the end of October, Icahn withdrew his appraisal petition and sold all his shares, exiting with a small profit. In the subsequent appraisal action, the Delaware Chancery Court found that the fair value of Dell shares on the day the merger closed was $17.62, around 27 percent higher than the $13.88 deal price.[54]

What can we learn from this story? First, as recounted in Dell's proxy statement – which because of substantial monetary liability for misstatements and omissions is a credible and comprehensive account – all the

[53] *High River Limited Partnership* v. *Dell Inc.*, Civil Action No. 8762-CS, August 16, 2013 transcript opinion.

[54] In *re Appraisal of Dell*, 2016 Del. Ch. LEXIS 81 (Del. Ch. May 31, 2016), reversed and remanded sub nom. *Dell Inc.*, v. *Magnetar Global*, 2017 Del. LEXIS 518 (Del. Dec. 14, 2017).

negotiations that took place were between the special committee and the potential bidders. Apparently, there were no price negotiations with either Icahn or Southeastern.

Second, why were Southeastern and Icahn seemingly so ineffective? Why were they unable to block the deal through the MOM approval condition? First, they were not willing or perhaps able to buy enough shares to block the merger themselves. Second, in the absence of a topping bid, they apparently could not convince enough of the other shareholders that they would be better off without the deal than with it. Indeed, it was not clear what the Southeastern/Icahn exit plan would have been had they succeeded in blocking the deal. Here we see the Achilles heel of the hedge fund blocking strategy: How will they profit if, instead of reaching an agreement on a higher price, they actually go ahead and defeat the deal? Icahn, as noted above, did not even stick around for the appraisal action. Without a credible path to profit from blocking the deal, a hedge fund will not be able to bargain effectively on its own behalf or on behalf of the disinterested shareholders. Third, as time went by, more and more shares were acquired by merger arbitrageurs who, although they preferred a higher price to a lower price, also strongly preferred the proposed deal to no deal. Thus, moving the shareholders' meeting and resetting the record date had the effect of enfranchising shareholders who were overwhelmingly in favor of approval.

Icahn and Southeastern's strategy seems to have been a combination of bluffing and seeking to put Dell in play by criticizing the deal price. Whether their criticism had any effect is hard to tell, given the amount of information that was available to prospective bidders and the minimal premium over pre-bid market price. That said, threatening to block the deal as a way of encouraging competing bids was a perfectly sensible and traditional hedge fund strategy. That it did not work here is some evidence of the difficulties in bidding against an inside management group and the caution many investors felt about Dell's business prospects. "Catching a falling knife" is a difficult task to complete safely.

There are two clear lessons from Dell. First, there was no practical way, given inside information, for Icahn or Southeastern to negotiate for their support before the deal was announced. Second, once the deal was struck, it was very hard to convince other shareholders that they would be better off voting the deal down, especially the merger arbitrageurs who bought on the expectation of deal completion.

C *The Oracle/NetSuite Merger*

T. Rowe Price's objection to the Oracle merger with NetSuite provides a contrasting case.[55] Oracle, with a market capitalization of around $183 billion, was founded by Larry Ellison who continues to hold about 28 percent of its stock. NetSuite was founded by Zach Nelson, a former Oracle employee who ran its marketing operations during the 1990s, and was funded by Ellison. At the time of the merger, Ellison owned 40 percent of NetSuite's shares. Because Ellison was a large shareholder of both Oracle and NetSuite, the merger presented an indirect conflict of interest.

During 2014–15, NetSuite's share price fluctuated between $69.48 and $120.77. During the first two quarters of 2016, it traded in the range of $51.75 to $85.56 (a market cap of around $6 billion). In April and May, 2016, the Oracle board determined that Oracle should acquire NetSuite. Recognizing Ellison's conflicts, Oracle established an ISC. At the end of May, Oracle presented an initial offer to NetSuite of $100 per share, subject to ISCA and a majority of non-Ellison shares. NetSuite, at that point, also established an independent committee which countered, on June 6, with a demand for $125 per share, and inquired whether Ellison would commit to voting or tendering his shares into a superior third-party proposal. Oracle responded by telling NetSuite that Ellison had recused himself from the process and that, if interested, they should ask Ellison directly. Apparently, that was not done. Between June 7 and July 12, negotiations continued intermittently and additional information was provided. On July 13, Oracle raised its offer to $109 which it termed its "best and final offer."

Finally, on July 28, Oracle and NetSuite agreed to merge at $109 per share in a tender offer pursuant to Section 251(h) and conditional on a majority of the non-Ellison shares tendering. The number of shares required for the deal to be approved was 20.4 million.

T. Rowe Price, a leading "long only" actively managed mutual fund, had held shares in NetSuite for several years. In February 2015, it held 7.8 million shares (around 10.2 percent).[56] By February 2016, it had increased its holdings to 10.4 million shares, around 12.9 percent and more than half of the shares needed to block the deal.[57] The other large shareholders were Capital World Investors with 7.4 million shares

[55] The Oracle/NetSuite merger does not appear in Table 5.2 because it is not a going-private transaction, even though it presents very similar issues.

[56] NetSuite 2015 Proxy; T. Rowe Price 13G as of 2/10/2015.

[57] NetSuite 2016 Proxy; T. Rowe Price 13G as of 2/10/2016.

(around 9.3 percent) and Brown Advisory with 3.8 million shares (around 4.7 percent).

T. Rowe Price is a classic active manager with a 3 to 5-year view of the stock. It had no interest in selling although, at some price, it obviously would sell. Brown Advisory, the former money management arm of Alex. Brown & Company, had a very low profile and also liked its investment.

Shortly after the deal was announced, T. Rowe Price announced its opposition, demanded $133 per share, and indicated that it would not tender.[58] In a September 6, 2016, letter to the NetSuite board, reiterating points made in an earlier meeting, ten T. Rowe Price portfolio managers from the various funds that held NetSuite shares summarized their view that NetSuite should not be sold at $109 per share.[59]

Beyond this short and summary objection, there is no evidence that T. Rowe Price took any steps to discourage other shareholders from tendering. Brown Advisory kept an even lower profile and did not publicly disclose its intentions. Oracle maintained its position that $109 per share was its best and final offer.

NetSuite's "information agent," Innisfree, worked hard to encourage NetSuite shareholders to tender. They repeatedly contacted the top 100 institutional holders (those with 15,000 shares and above), and contacted every retail holder with 100 shares or more.[60]

The outcome was too close to call. With the tender offer closing at 5 pm on November 4, 2016, Innisfree did not know until the very end whether the non-Ellison tender condition had been satisfied. As of 11 am that morning, only 23.9 percent had tendered. By noon, 3 pm, 30.7 percent had tendered, with 23 percent of the shares coming in between 3 pm and 5 pm. In the end, the deal closed with 21.8 million unaffiliated shares (53.21 percent) tendering, a margin of 1.4 million shares.

What is puzzling is why, with T. Rowe Price's 10.4 million shares opposed, and an additional 11.2 million shares in the hands of just two shareholders, T. Rowe Price could not block the deal or negotiate an increase in the price. From what I have been told, T. Rowe Price was

[58] www.wsj.com/articles/t-rowe-price-to-oppose-oracles-deal-to-acquire-netsuite-1473263627.

[59] www.sec.gov/Archives/edgar/data/1117106/000110465916143385/a16-18031_1ex99d1.htm.

[60] Index funds posed a particular challenge. Index funds typically do not tender into tender offers, even when the deal is structured pursuant to Section 251(h) and will quickly close if enough shareholders tender, because doing so increases tracking error (as the company continues to exist for a period of time). As a result, as the funds did not oppose the merger, the information agent spent substantial time seeking to convince the index funds that tendering could well be necessary in order for the deal to close.

largely passive, as they were in the Dell buyout which they also opposed. They had their view; they expressed it publicly; and then did nothing. Unlike Icahn or Southeastern in Dell, they were not looking for a quick exit. On the contrary, they apparently loved the investment and were hoping to stay invested indefinitely. What they most wanted was for the deal to be rejected, not for a topping bid to emerge (which, with Ellison's 40 percent stake, was highly unlikely). With the majority of the non-Ellison shares tender condition, T. Rowe Price, with a few other large holders, seemingly had the ability to block the deal, yet did very little.

Oracle/NetSuite raises the question whether even a large shareholder who, unlike hedge fund activists, would be happy to remain in the company for the long term will be able successfully to push for a higher price or to convince fellow shareholders to block an unacceptable deal.

D Cablevision

In both of the earlier subsections, active shareholders failed to extract significantly better terms or to stop the controlling shareholder transaction from going forward. In this section, I consider what happens when active shareholders have more success.[61]

In a rare but high profile "victory," shareholders resisted the Dolan family's 2006–07 efforts to take Cablevision private. The Dolans controlled Cablevision through their ownership of 87 percent of the company's high voting (ten votes per share) class B stock, giving them close to 65 percent of the total votes.[62] In October 2006, they offered $27 per share, an offer widely opposed by shareholders. In January, 2007, they raised the offer to $30 per share, an offer that was rejected by the ISC. Eventually, after negotiations with the ISC, they raised the offer to $36.26 per share, conditioned on approval of a majority of the outstanding non-Dolan class A and class B shares, an offer that was recommended by the special committee. GAMCO (8.5 percent), T. Rowe Price (5.3 percent), ClearBridge (13.6 percent) and Marathon Asset Management (5 percent) all opposed the merger, arguing that the company was worth at least $50 per share and apparently were concerned that the

[61] Here I rely on a dataset put together by Kobi Kastiel for his very interesting article, *Against All Odds: Hedge Fund Activism in Controlled Companies*, 2016 COLUM. BUS. L. REV. 60 (2016). I am very grateful to him for sharing his data.

[62] Peter Grant & Dennis Berman, *Cablevision Spurns Dolans' Bid*, WALL ST. J., January 17, 2007 at A4.

Dolans would turn around and resell the company to Time Warner for a much higher price.[63] The deal was voted down.[64]

The Dolan/Cablevision soap opera continued for many more years, seeming to develop into something of a grudge match. In the wake of the 2007 rejection of the $36.26 going private transaction, the stock dropped to around $26 per share.[65] In subsequent years, there were various discussions of how to raise the stock price and both AMC Networks and MSG (holding, among other assets, Madison Square Gardens, the Knicks and Radio City Music Hall) were spun off to shareholders (and, by one account, worth around $16 per share). Ultimately, in September 2015, the French cable firm Altice bought Cablevision for $34.90 per share.[66]

How did shareholders do by rejecting the 2007 buyout offer? Although the price paid by Altice was considered high, the earlier spinoffs make it difficult to determine whether, in retrospect, shareholders benefited by rejecting the 2007 buyout offer. There are a variety of ways to think about it. Overall, shareholders did well investing in Cablevision under the Dolans: from 1995, when the Dolans took over Cablevision, until the sale to Altice, the shareholders' total return was around 654 percent (compared to the S & P 500's return of about 211 percent during the same period).[67] Focusing on the 2007–15 period, the $36.26 per share buyout price from 2007 invested in the S & P 500 would have been worth $45.68 at the time of the 2015 sale to Altice (without reinvesting dividends) and $54.39 (had dividends been reinvested).[68] If the spinoff pieces were worth around $16 per share, as some have estimated, then the total consideration was around $50 per share ($34 plus $16), which was about what some shareholders claimed the company was worth in 2007 when the buyout bid was rejected.

[63] Peter Grant, *Cablevision Offer Meets New Opposition*, WALL ST. J., October 15, 2007 at C5; Peter Grant & Tom Lauricella, *Cablevision Deal Meets More Opposition*, WALL ST. J., October 17, 2007 at A3.

[64] Peter Grant, *Cablevision Holders Reject Buyout*, WALL ST. J., October 25, 2007 at A3.

[65] Dana Cimilluca, *Are Cablevision's Dolans Smiling?*. WALL ST. J., December 7, 2007 at C3.

[66] Shalini Ramachandran, *Cable TV's Dolan Clan Ready to Cash Out*, WALL ST. J., September 18, 2015 at B1.

[67] Michael de la Merced, *How Cablevision Shareholders Have Fared*, NEW YORK TIMES (September 19, 2015), www.nytimes.com/2015/09/19/business/dealbook/how-cablevision-shareholders-have-fared.html.

[68] https://dqydj.com/sp-500-return-calculator/.

Cablevision thus stands as a warning to active shareholders that, even if they succeed in blocking a deal, it may be a tough way to make money.

E The European Contrast

In contrast to Delaware's reliance on the "veto" strategy of MOM approval, the EU's Takeover Directive relies on an alternative strategy that conditions mandatory freeze-outs on achieving a very high level (a minimum of 90 percent) of share ownership (usually through a tender offer).[69] In France, for example, the only way to go private is for the controlling shareholder to acquire a minimum of 95 percent of the shares, typically through a public buyout offer.[70] In Sweden, the controlling shareholder must acquire 90 percent. Once that threshold is achieved, the controlling shareholder can mandatorily acquire the remaining shares.

This high threshold creates two sorts of problems. First, it can be very difficult to achieve 90 percent or 95 percent when the shareholders are dispersed. Shareholders who ignore an offer can prevent the offeror from reaching the critical threshold, leading to a variety of strategies to increase participation.[71]

More relevant for our purposes is that a 90 percent or 95 percent threshold is vulnerable to strategic investment, almost inviting "interlopers" to buy a blocking position and then to demand a premium to complete the transaction. This has occurred numerous times over the last fifteen years in France[72] and elsewhere.[73]

In recent years, Elliott has been a particularly active "interloper." Two examples from Sweden are illustrative. In EQT's 2016 bid for IFS, Elliott acquired a 13 percent position and then refused to tender, thereby blocking

[69] Directive 2004/25/EC of the European Parliament and of the Council on Takeover Bids, art. 15, 2004 O.J. (L 142) 12, 21. For a comprehensive discussion of the different rules adopted in the EU, *see* Marco Ventoruzzo, *Freeze-Outs: Transcontinental Analysis and Reform Proposals*, 50 VA. J. INT'L L. 841 (2010); Commission Staff Working Document, Report on the Implementation of the Directive on Takeover Bids, SEC (2007) 268 (Brussels, 21.02.2007), available at http://ec.europa.eu/internal_market/company/docs/takeoverbids/2007-02-report_en.pdf.

[70] Alain Pietrancosta, "Going Private Transactions" in France, RTDF N° 4 – 2013 / N° 1 – 2014 u COLLOQUE.

[71] Id at 81.

[72] Id at 82–83.

[73] Flemming Emil Hansen & Jens Hansegard, *Elliott Complicates DuPont's Danisco Bid*, WALL ST. J. (May 9, 2011), www.wsj.com/articles/SB10001424052748703864204576312510940382854; *see also* www.thestreet.com/story/14343155/1/elliotts-paul-singer-the-800-pound-gorilla-of-activism.html.

the squeeze-out until EQT ultimately bought them out at a premium after the six month "best price" period had lapsed.[74] Similarly, when GE bid for Swedish camera maker Arcam in October 2016, Elliott acquired a 10 percent stake that blocked the transaction until it could negotiate better terms.[75]

As I discuss below, the success of this strategy in Europe raises some very important issues.

V Lessons from the Case Studies

What does this recent experience tell us about MOM conditions? Are they beneficial? Harmless even if not particularly valuable? An invitation to strategic behavior that should be avoided?

A Majority of the Minority as "Chicken Soup"?

One view of MOM conditions is that, like chicken soup, they may not help but cannot hurt. The US case studies show that active shareholders become involved in MOM approval contexts without doing much good but without messing things up. In Dell and Oracle/NetSuite, the active shareholders opposed the transaction at issue on the grounds that the price was too low, but were not able to block the deal or to renegotiate it. Ultimately, the other shareholders, some of whom may have initially been opposed, acquiesced.

By contrast, in Cablevision, the shareholders blocked what they took to be a lowball going private transaction. In the immediate aftermath, the stock price dropped significantly. Thereafter, the company spun off two noncable divisions and ultimately, after eight years, was sold. As discussed above it is unclear whether and to what extent the shareholders benefited by blocking the buyout.

Based on this small number of observations, MOM approval, when added to a special committee, does not seem to empower noncontrolling shareholders in any significant way. On the other hand, it also does not seem to have caused any significant harm. This finding may cast light on a question raised by Restrepo & Subramanhiam (2015) as to why MOM

[74] www.eqtpartners.com/news/Press-Releases/2016/eqt-vii-increases-its-shareholding-to-above-90-percent-in-ifs-and-prepares-for-compulsory-squeeze-out/ (SEK 396.73 per share, a premium of 9.4% over the SEK 362.50 paid other shareholders).

[75] www.reuters.com/article/us-ge-3dprinting-sweden/ge-raises-stake-in-swedens-arcam-by-buying-shares-from-hedge-funds-idUSKBN1EL0NC.

conditions were reasonably common even before M & F provided a potentially significant doctrinal benefit. "Conversations with practitioners pre-Cox suggest that MOM conditions were often inserted as part of a settlement with plaintiffs, allowing the plaintiffs' attorneys to argue for a 'substantial benefit' to the plaintiff class that would then justify an attorneys' fee award."[76] The *absence* of any detectable use of MOM provisions to block transactions or even to negotiate better terms suggests a further refinement: defendants may *agree* to MOM provisions because they are not giving up very much. If true, this would raise questions about attorneys' claim that a MOM in a settlement confers substantial benefit to the class.

By contrast, the European rule that requires the controlling shareholder to secure 90–95 percent of the shares in order to squeeze out the minority *does* seem to invite and reward strategic behavior. The success of this strategy has two important implications. First, the ability of a shareholder or a small group of shareholders to acquire a blocking position, without convincing a larger group of shareholders to oppose a freeze-out, reveals a vulnerability to hold-outs that should make policy makers rethink the use of such high thresholds. Second, this points to an important distinction: voluntary MOM versus mandatory MOM. Voluntary MOM is far less susceptible to strategic behavior because a controlling shareholder need not use it.[77]

More important for our purposes, the European examples cast a shadow on the complacent view that the threat of strategic intervention is not credible, given the lack of an immediate exit option. Elliott and the others who have pursued a similar strategy demonstrate that some shareholders are willing to acquire a blocking position despite the risk of being stuck in a company with limited exit options. Consider, for example, Elliott's purchase of a 10.01 percent blocking position to oppose Canon's 2015 bid for Axis AB.[78] When Canon refused to raise its price, Elliott took advantage of a provision under Swedish law that allows a 10 percent shareholder to demand that a minority auditor and special examiner be appointed.[79] Although the examiner ultimately concluded in

[76] Restrepo and Subramanian, *supra* note 40, at 218.

[77] We do not yet have any cases determining what happens if a controlling shareholder backs out of a commitment to use MOM as part of the M & F procedure.

[78] www.reuters.com/article/us-axis-elliot/elliott-management-ups-axis-stake-complicating-canon-bid-idUSKBN0MR0M420150331.

[79] www.reuters.com/article/axis-canon/hedge-fund-elliott-to-bring-in-special-examiner-at-canons-axis-idUSL5N0Z20Q720150616.

its March 2017 report that the board had largely behaved properly, Elliott clearly demonstrated its ability to inflict pain.[80] The two sides remain deadlocked. Elliott's successful engagements, and its willingness to take a long view, suggest that investors with sufficient funds and a thick enough skin can protect themselves sufficiently, and cause enough pain for the controlling shareholder, that a threat by the controlling shareholder *not* to buy out the remaining shares may not be credible.[81]

B Can Majority of the Minority Be Counted On?

With this (limited and anecdotal) evidence, how much weight ought to be given to MOM approval? Controlling shareholder freeze-outs, management buyouts and conflicted mergers present significant conflicts of interest. It is unsurprising that corporate law typically imposes special conditions and/or enhanced scrutiny on such transactions. As we have seen, Delaware law closely scrutinizes such transactions and encourages the use of "cleansing" devices. Most recently, the Delaware Supreme Court, in *M & F Worldwide*, seemingly believed so firmly in the efficacy of cleansing devices as to relieve courts of the need to scrutinize these sorts of conflict transactions for substantive fairness.

There are two aspects to this question. First, does MOM approval add appreciably to ISCA such that, as in Delaware, the standard of review should shift to a substantially less probing scrutiny? Second, can MOM approval *alone* be sufficient, even without ISCA, as is the case in the United Kingdom?[82]

On the one hand, the votes at Dell, Oracle/NetSuite and Cablevision suggest that MOM is not pointless or useless. In Dell, the buyout group agreed with the special committee to adjourn the meeting in exchange for a small increase in the final dividend because it worried that the deal would not close otherwise. At Oracle/NetSuite, the outcome was sufficiently close that had T. Rowe Price made more of an effort to lobby fellow investors, it might well have come out the other way. At Cablevision, shareholders were

[80] Westmark Anjou, *Special examination of Axis AB* (29 March 2017), www.axis.com/files/sales/Granskningsrapport_Axis_AB_den_29_mars_2017_eng.pdf.

[81] Here, Elliott relied upon a provision of Swedish law, but it is still relevant because most corporate law systems provide opportunities for well-financed, motivated minority shareholders to "cause pain" for controlling shareholders, although the precise channel will vary.

[82] Paul Davies and Sarah Worthington, Gower Principles of Modern Company Law (10th ed. 2016) at 19–2.

able to block the transaction. I have not been able to find any examples in the United States of the MOM condition being exploited by opportunistic shareholders.

On the other hand, this same experience teaches that adding MOM to ISCA may not add much beyond ISCA alone, and thus should not fill us with the sort of confidence some courts give it, either in setting the standard of review or in evaluating whether a settlement that adds a MOM condition provided shareholders with a substantial benefit. As Guhan Subramaniam has recently reminded us with regard to management buyouts, there are numerous challenges to leveling the playing field: Information asymmetries between management and outsiders; Incumbent management can be essential; Management has financial incentives to discourage topping bids; and, in post-signing market checks, third parties face a "ticking clock." Despite the challenges faced by special committees, one has the sense that, with judicial review of the disinterest and effectiveness of special committees, these days they largely do a reasonably good job, given the limitations.[83] With very few examples of shareholders using MOM conditions to reject deals, it is hard to evaluate the extent to which MOM approval does or should stiffen the spine of special committees.

There is not the same depth of experience with a "majority of the minority" condition. Only recently has it become clear that use of the MOM condition in conjunction with a special committee can result in the substantial benefits of shifting the standard of review to the deferential BJR standard.

While the experience at Cablevision teaches us that sometimes shareholders will reject the recommendation of even an effective special committee, the experience at Dell and Oracle/NetSuite should temper any high hopes one might have had for MOM approval. Even large noncontrolling shareholders do not negotiate prior to an offer. Post-offer, there is no evidence of robust negotiation, and there is no mechanism by which they could do so. The strictures of Rule 10b-5 and Regulation FD discourage issuers from sharing any nonpublic information with outside shareholders, especially regarding the terms of a merger.

[83] For a review of the cases in which the duties of special committees in buyouts were developed, *see* Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 U.C.L.A. L. Rev. 1009 (1997). The best explanation for their apparent concern for their performance is that the directors on those committees seek to fulfill their duty to the noncontrolling shareholders and care about their reputations.

Even highly engaged shareholders like Icahn do not seem to be any more effective in negotiating. Although they have the financial wherewithal to get involved, and can threaten and try to bluff, ultimately the threat to block a transaction is not credible because the other shareholders are unlikely to support the activist in the absence of a topping bid. Moreover, without a viable exit strategy if an activist succeeds in blocking a deal, few activists will seek a blocking position. It is apparently just too risky, given the potential rewards.

At the same time, the success of active shareholders in blocking freeze-outs in Europe suggests that a different legal rule, more stubborn shareholders, or higher potential returns, might lead to different outcomes.[84] Moreover, the European experience in which investors take blocking positions, despite the risk of being locked into the company with no ready exit option, shows that a determined minority shareholder may be able to inflict pain on the controlling shareholder, just as the controlling shareholder can inflict pain on the minority.

Active shareholders like T. Rowe Price at NetSuite would seem to stand in quite a different position. Its goal was, in fact, to stop the merger and to remain investors in NetSuite. Moreover, it had a huge position that took it a long way toward the goal, given the MOM approval condition. The fact that T. Rowe did so little to coordinate with other shareholders suggests that there may be a serious incentive problem. Remaining invested in NetSuite, while valuable, was apparently not valuable enough to push it to take the typical steps that activist hedge funds take, namely, hire a proxy solicitor and a public relations firm to urge other shareholders not to vote or tender. That is interesting and a bit surprising.

VI Implications for Judicial Role

Assume that my case studies are more or less representative of how MOM approval works in the United States. What are the implications for judicial role? As we noted earlier, MOM excites strong emotions, with some thinking it a major protection for shareholders while others thinking it at best useless and most likely bad. The cases studies suggest to me that neither view is correct.

Can we count on active shareholders to use MOM to bargain on behalf of noncontrolling shareholders or to police special committees? Is MOM

[84] Jen Wieczner, *Inside Elliott Management: How Paul Singer's Hedge Fund Always Wins*, Fortune Magazine (December 7, 2017), http://fortune.com/2017/12/07/elliott-management-hedge-fund-paul-singer/.

sufficiently robust to justify additional deference over and above the deference given to effective ISCs?

The case studies do not provide one with much confidence in the robustness of the "cleansing" device. While I could not find any clear cases in which MOM did any harm, I also could not find any clear examples of it doing much good. The record hardly provides much of a basis for thinking that MOM approval renders Delaware Chancery's traditional role in valuation in "entire fairness" and appraisal cases unnecessary.

The principal implication of this for Delaware is that the enthusiasm for the cleansing effect of MOM approval in *M & F Worldwide*, based on the evidence available, is perhaps premature. If *M & F Worldwide* is applied broadly, we may regret losing Chancery's traditional role as a court of equity that closely scrutinizes conflict of interest transactions under the "entire fairness" standard or a substitute.

But Delaware Chancery's equity origins and intuitions run deep and one should not underestimate the flexibility of equity to respond to opportunistic behavior. Current doctrine, including *M & F Worldwide*, leaves numerous openings for Chancery to intervene in appropriate cases. As noted above, under Delaware law, ISC approval shifts the burden of proof or the standard of review if, but only if, the committee is disinterested, empowered and effective. All three conditions provide openings for fact specific equitable intervention. How disinterested was the committee? To be empowered, must the committee have the ability to say "no"? What power does it need in order to be able to say "no"? Is a commitment not to consummate a deal in the absence of ISCA sufficient? Or must the committee have the power to adopt a poison pill? And, if so, under what circumstances may it do so? Must it do so? In terms of "effectiveness," the "famous" footnote 14 in *M & F Worldwide* suggests that review of the fairness of the price can be part of the evaluation of a committee's effectiveness. For the MOM prong, there are other openings for judicial review. What does it mean for MOM to be "unwaivable"? What counts as full disclosure when there are severe conflicts of interest? Who counts as "disinterested" in the MOM vote? When is a MOM vote "uncoerced"? For example, do excessive deal protection measures, or too short a "go shop" period, render a vote "coerced"?[85]

[85] The early post-MFW case of In *re Dole Foods*, 2015 Del. Ch. LEXIS 223 (Del. Ch. Aug. 27, 2015), provides a nice example. Although the controlling shareholder purported to follow the MFW procedure, the court found that he undermined it at every step. Following "the common law nostrum, fraus omnia corrumpit – fraud vitiates everything," VC Laster found the controlling shareholder liable for $148 million.

From my perspective, preserving Chancery's historic role in scrutinizing substantive fairness in conflict of interest transactions is both necessary and good, given the conflicts of interest. But a number of contributions to this volume – prominently those of Professor Pacces and Professor Licht – are very hostile to substantive review of RPT by courts under any circumstances and argue that courts should never do so.[86] For Professor Pacces, "courts cannot get RPT just right because they cannot second-guess business judgment." Professor Pacces comes to this conclusion through an interesting route: it cannot be the case, he argues, that RPT are ever justified when there is an available (and unconflicted) market transaction; therefore, in the idiosyncratic and match specific transactions in which it can be justified, the market benchmark will be useless.

This hostility is overdrawn. First, specialized judges can, with experience, become tolerably good at valuation. The statutory right to appraisal under Delaware law forces Chancery Court judges to learn the basics of valuation and, as discussed by Hamermesh and Wachter, they generally do a decent job of it.[87] Moreover, even if, as Professor Pacces argues, an RPT should be motivated by some match-specific surplus not available in a third-party transaction, the arms' length price still provides an important benchmark: the terms offered the firm cannot be worse than the closest available arms' length transaction.

Second, as a practical matter, and without regard to whether a court is specialized or whether a corporate law provides for appraisal, courts *cannot avoid* some version of the substantive "entire fairness" standard. The *only* question is whether it will be part of the liability case or the damages case. As discussed above, Delaware's basic standard for conflict of interest transactions, whether between directors and the firm or controlling shareholders and the firm, is "entire fairness." Within that analysis, "fairness of price" is determined with reference to third-party market standards. But suppose, as both Paccess and Licht argue, a system adopted a purely procedural approach to RPT in which a transaction is valid if but only if it is approved in a specified way.[88]

[86] Pacces, *Procedural and Substantive Review of Related Party Transactions: The Case for Non-Controlling Shareholder-Dependent Directors* (Chapter 7); Licht, *Be Careful What You Wish For: How Progress Engendered Regression in Related Party Transaction Regulation in Israel* (Chapter 16).

[87] *See, e.g.*, Lawrence A. Hamermesh & Michael L. Wachter, *Rationalizing Appraisal Standards in Compulsory Buyouts*, 50 B. C. L. Rev. 1021 (2009).

[88] Prof. Pacces proposes that RPT transactions be approved by independent directors elected directly and exclusively by noncontrolling shareholders.

This avoids any substantive review when the procedure is appropriately followed, but what happens in those cases in which the procedure is *not* followed?

This procedural "failure" can be for a variety of reasons: perhaps the transaction was not submitted to the right body; or perhaps that body was not appropriately independent; or perhaps disclosure was not adequate. What happens then? In the vast majority of transactions that cannot literally be undone (and even in some of them), some sort of valuation exercise will be necessary and will almost necessarily be with regard to third-party market benchmarks. Consider, e.g., a sale of property to the firm or a purchase of property from the firm that does not satisfy the required procedure. When the transaction cannot be unwound – that is, when literal rescission is not possible – then the court will award "rescissory damages" which, at least in Delaware, will be calculated with reference to market benchmarks. Or consider a parent subsidiary freeze-out transaction that does not follow the prescribed procedure but closes anyway. The failure to follow prescribed procedures would constitute a breach with damages inevitably calculated with reference to third-party market benchmarks.

Third, the US case studies provide some basis for thinking that Professor Pacces's concerns that hedge funds will use MOM opportunistically are overdrawn. To be sure, when the approval threshold is set at 90–95 percent, there are examples of hedge funds acquiring blocking positions and using those positions to extract additional payments. But this strategy seems to be linked to precisely the purely procedural approach of requiring that the controlling shareholder reach 90–95 percent. Interestingly, while Elliott Management has successfully acquired blocking positions in Europe, it has not pursued the parallel strategy in the United States, although it is very active in corporate governance.

On the other hand, the US cases suggest that strategic investments will be less likely (and less successful) when active investors need to convince other noncontrolling shareholders to support them. As noted above, once Dell shares moved into the hands of arbitrageurs, the ability of Icahn to threaten the transaction was diminished. Moreover, the credibility of any blocking attempt will depend on a plausible exit strategy. What does the hedge fund do when management refuses? Veto the transaction? And then what? Grudge matches, like in Cablevision, may be satisfying but typically are not very profitable. Indeed, to the extent that there is no plausible exit strategy, shareholders who vote against a transaction reassuringly share proportionally in the costs or benefits of a rejection.

VII Conclusion

Case-by-case equity adjudication is messy and time consuming. For related party transactions, it requires that judges engage in valuation, an area typically not covered in law school or in judges' subsequent training. Doing so under the heading of "Entire Fairness" can result in weeks long trials, the cost of which can be large. In turn, the high cost of adjudication may provide an incentive to file cases in an effort to extract a settlement pretrial.

In response, efforts have been made to "solve" these problems. One of the strategies has been to push for the adoption of a good process on the theory that good process often leads to good substantive outcomes and courts are better at evaluating process than substance. Approval by a majority of the noncontrolling shareholders is an appealing process innovation and has been widely adopted.

But does it live up to the hopes of its advocates? This review of the U.S. experience with majority of the minority approval of conflicted transactions should give its supporters some pause. While it rarely seems to do much harm, it likewise does not seem to do much good.