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Control and Its Discontents

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Abstract

A series of recent Delaware decisions highlights the Delaware courts' growing skepticism toward corporate actions in controlled companies. We analyze these decisions, noting their application to what we term "new" control situations and the per se application of fiduciary duties and entire fairness to controllers. We contend that this application contradicts both the theoretical and economic justifications for limiting the fiduciary duties of controllers, particularly when they undertake actions in their capacity as shareholders. We argue that, outside the context of freeze-outs and similar transactions, strict scrutiny is economically unnecessary and controlling shareholders acting in their capacity as shareholders should not be considered fiduciaries. Instead, we propose that Delaware defer to the market forces and structural safeguards already in place. To address the risk of board domination, we propose that where a controller has plausibly distorted the board process, the decision be subject to intermediate scrutiny. To further strengthen the incentives of directors to resist such domination, we propose the continued application of the duty of loyalty and a greater focus on the actions of dominated directors who favor the interests of a controller over those of the corporation.

Keywords: Corporations, controlled companies, fiduciary duties, shareholders, shareholder domination, Delaware courts, market forces, corporate law, economic corporate control, corporate governance

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ABSTRACT

A series of recent Delaware decisions highlights the Delaware courts' growing skepticism toward corporate actions in controlled companies. We analyze these decisions, noting their application to what we term "new" control situations and the per se application of fiduciary duties and entire fairness to controllers. We contend that this application contradicts both the theoretical and economic justifications for limiting the fiduciary duties of controllers, particularly when they undertake actions in their capacity as shareholders. We argue that, outside the context of freeze-outs and similar transactions, strict scrutiny is economically unnecessary and controlling shareholders acting in their capacity as shareholders should not be considered fiduciaries. Instead, we propose that Delaware defer to the market forces and structural safeguards already in place. To address the risk of board domination, we propose that where a controller has plausibly distorted the board process, the decision be subject to intermediate scrutiny. To further strengthen the incentives of directors to resist such domination, we propose the continued application of the duty of loyalty and a greater focus on the actions of dominated directors who favor the interests of a controller over those of the corporation.

Introduction

In *Richard J. Tornetta et al. v. Elon Musk et al.*,[1] the Delaware Chancery Court invalidated a $55.8 billion pay package granted to Elon Musk by the Tesla board and approved by the Tesla shareholders. The landmark decision

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[1] 310 A.3d 430 (Del. Ch. 2024).

rested upon a fundamental principle: Musk controlled Tesla. Musk's pay package was therefore subject to scrutiny under the "entire fairness" doctrine. Having determined the appropriate standard of review, the court held that the package failed under such scrutiny, and that Tesla's attempts to implement procedural protections for the decision were insufficient—the board approval and shareholder vote were defective. The flaws were fatal, and the court rescinded the entire $55.8 billion pay plan.

Musk, the court determined, was a controlling shareholder despite the fact that he owned only 21.9% of Tesla's voting stock. In so holding, the court recognized the novelty of its ruling, stating that it had determined "to 'boldly go where no man has gone before,' or at least where no Delaware court has tread."[2] The basis for this holding was the court's conclusion that Musk's stock ownership, coupled with his influence on the board itself and with respect to the pay package, sufficed to constitute control.[3]

Tornetta was cabined by an equally world-changing set of decisions. A few months before *Tornetta*, the Delaware Chancery Court in *In re Sears Hometown and Outlet Stores, Inc. Stockholder Litigation,*[4] appeared to extend the context in which a controlling shareholder would be subject to fiduciary duties to actions taken through the exercise of its shareholder voting rights. Then, just a few months after *Tornetta*, the Delaware Supreme Court issued its decision in *In Re Match Group, Inc*., holding that the entire fairness standard of review applied to all corporate decisions in which a controlling shareholder stood "on both sides of a transaction with the controlled corporation and received a non-ratable benefit."[5] To replace this heightened standard of review with the deference of the business judgment rule, a controlling shareholder must adhere to the special cleansing procedure previously recognized in the *MFW* case.[6] The *MFW* procedure which was initially applied in the freeze-out context and, at least historically, was rarely utilized, includes "approval by a well-functioning independent committee and the affirmative vote of the fully informed and uncoerced minority stockholders."[7] The court added that, for a board committee to meet the *MFW* standard, all members of the committee (rather than simply a majority) must be independent of the controlling shareholder.

[2] *Id.* at 446.
[3] *Id.* at 502 ("This unique suite of allegations makes it undeniable that, with respect to the Grant, Musk controlled Tesla.").
[4] 309 A.3d 474 (Del. Ch. 2024).
[5] *In re* Match Group, Inc. Derivative Litig., 315 A.3d 446 (Del. 2024).
[6] Kahn v. M & F Worldwide Corp., 88 A.3d 635 (Del. 2014).
[7] *Match*, 2024 WL 1449815, at *25. The *MFW* court further explained that these procedural protections must be in place "ab initio." *See MFW*, 88 A.3d at 646; *see also* Flood v. Synutra Int'l, Inc., 195 A.3d 754, 761–62 (Del. 2018) (discussing "ab initio" requirement).

Together, the *Tornetta, Sears Hometown,* and *Match* decisions highlight Delaware courts' growing skepticism toward corporate actions in controlled companies. These decisions have wide-ranging implications. They portend that, going forward, courts will apply entire fairness to a wide range of transactions as well as an arguably more expansive set of controlling shareholders. At the same time, the fact-specific analysis in the decisions suggests that the *MFW* procedures, although required in more cases to avoid entire fairness review, will be less readily available to accomplish that objective. In combination, these decisions and several others reflect an evolving approach to control that we believe extends well beyond the traditional application of fiduciary duties to shareholders —an approach that was, as we explain, focused primarily on majority shareholder freeze-outs and similar transactions.[8] This view of control which enables courts to subject shareholder behavior to the close scrutiny of entire fairness review is, as we show, problematic from both a theoretical and judicial perspective.

Critical to our analysis is the fundamental principle that shareholders do not, and we argue should not, owe fiduciary duties to the corporation and their fellow shareholders when they act in their capacity as shareholders.[9] We ground this principle in the historical underpinnings of controlling shareholder fiduciary duty articulated over 75 years ago in the Delaware

[8] For purposes of this article, similar transactions include freeze-outs accomplished through either a tender offer or a merger. They also include transactions in which a controlling shareholder sells a substantial asset to the corporation, purchases a substantial asset from the corporation, or engages in a merger between the corporation and another entity under its control. *See, e.g.*, *In re* Tesla Motors Stockholder Litig., 298 A.3d 667 (Del. June 6, 2023) (treating Tesla's acquisition of Solar City as a conflicted transaction and applying entire fairness standard). In such cases, as in a freeze-out, the controlling shareholder is on both sides of the transaction. In the *Tremont* line of cases, for example, plaintiff challenged as self-dealing a stock purchase from a company controlled by the same controllers as the purchasing company. Kahn v. Tremont Corp., 694 A.2d 422, 428 (Del. 1997). The Delaware Supreme Court held that entire fairness was applicable because, as with a freeze-out, the controlling shareholder was on both sides of the transaction. *Id.* We further note that, as a law professor's amicus brief in *Match* observed, controllers can structure transactions in a variety of ways to evade a limit that focuses narrowly on freeze-out transactions. *See* Amicus Curiae Brief of Academics in Support of Appellants, *In re* Match Group, Inc., Deriv. Litig., C.A. No. 2020-0505-MTZ (Del. 2023). Accordingly, when we use the term "freeze-out" in this article, we intend it to encompass transactions in which the controller is on both sides—a usage that includes technical freeze-outs and other transactions that are economically equivalent. *See id.* at 10–11.

[9] Shareholders have the power to vote, to sue, and to sell their shares. Those are individual actions rather than actions by the corporation. *See, e.g.,* Randall S. Thomas & Patrick C. Tricker, *Contested Director Elections and Management Proposals: A Review of the Empirical Literature*, 70 OKLA. L. REV. 9, 11 (2017) ("[T]hey can sell their shares, vote them where allowed, or sue the company and its management to enforce its officers and directors' fiduciary duties.").

Supreme Court's *Ringling Bros.* decision.[10] The rationale for this principle is that individual shareholder action is not taken on behalf of the corporation and is subject to the existing structural mechanisms of corporate governance— the actions of the board of directors and the unaffiliated shareholders—which play a critical role in converting "shareholder action" into "corporate action." These governance mechanisms have been shown to work imperfectly in cases involving majority shareholder freeze-outs warranting the additional oversight of entire fairness. But the rationale for heightened review for controlling shareholder actions beyond that context has been under-theorized.

Two components of the Delaware courts' recent jurisprudence thus warrant particular analysis. The first is the expanded definition of what it means to be a controlling shareholder. As the *Tornetta* court acknowledged, its treatment of Musk as a controlling shareholder was novel.[11] The parameters by which the court reached its conclusion, however, logically extend to a host of other situations involving shareholders with far less than 50% voting power and who exercise control through soft measures such as a position as a super-star CEO or with respect only to a particular transaction. We term these situations "new" control and explore their potential scope. The significance of the expansion is that controlling shareholder status, broadly construed by the *Tornetta* case, is the trigger for the courts' imposition of fiduciary duties and the potential application of entire fairness scrutiny. This expansion is significant because it occurs at the same time that corporate participants are showing an increased desire to confer control rights on individual shareholders.[12]

The second component that warrants analysis is the *Sears Hometown* decision's application of fiduciary principles to a shareholder acting in his capacity as a shareholder and the *Match* court's conclusion that entire fairness analysis applies to any transaction in which a controlling shareholder receives a non-ratable benefit. Together with the expanded

[10] *See* Ringling Bros.-Barnum & Bailey Combined Shows, Inc. v. Ringling, 53 A.2d 441, 447 (Del. 1947) ("Generally speaking, a shareholder may exercise wide liberality of judgment in the matter of voting, and it is not objectionable that his motives may be for personal profit, or determined by whims or caprice, so long as he violates no duty owed his fellow shareholders.").

[11] *Tornetta*, 310 A.3d at 446 ("This decision dares to 'boldly go where no man has gone before,' or at least where no Delaware court has tread." (citing Star Trek: The Original Series (Paramount Pictures 1968)).

[12] *See, e.g.*, Ric Marshall & Jonathan Ponder, *Ownership and Control 2022, Global Equities Concentration on the Rise*, MSCI (July 11, 2022), https://www.icgn.org/sites/default/files/2022-11/Ownership%20and%20Control%202022_%20Global%20Equities%20Concentration%20on%20the%20Rise.pdf (documenting increased ownership concentration in global equity markets, including a substantial increase in the number of controlled companies).

definition of control, these decisions support significant judicial oversight of controlling shareholder transactions. We challenge this approach and its assumption that all controller transactions are inherently and equally coercive[13] as in tension with the fundamental structure of corporate law, which places legal authority for corporate action in the corporation's officers and directors and relies on entire fairness as a way of disciplining the use of fiduciary authority. The expansive application of entire fairness works particular mischief in cases involving the capacity of a shareholder to exert influence on corporate transactions, to avail itself of statutory governance rights, or to block decisions that it opposes. Given the market's seeming acceptance of the view that control mechanisms can provide value, the courts' current approach is problematic in that it increases the cost and uncertainty associated with the exercise of those mechanisms.[14] Absent a clear indication that the traditional approach to control is deficient, we question the justification for change.

Our analysis leads to three implications. We first explain the inherent subjectivity in the expanded concept of what we term "new" control. We agree that shareholders can exercise power through a variety of mechanisms, but we question whether the exercise of that power invariably does or should serve as a trigger for treating that shareholder as a fiduciary and applying entire fairness. Our analysis questions the assumption that the exercise of shareholder power, particularly in "new" control situations, is somehow inherently coercive, illegitimate, or corrupting—an assumption upon which the current approach appears to be premised. This assumption is of particular concern in that the corporate form imposes structural limits on the ability of any shareholder to exercise corporate power, including the statutory authority of the board.[15] We further observe that the true impact of shareholder power depends on a variety of factors, including the extent of a shareholder's voting rights, the structural features of the corporation, the

[13] Although that characterization may be factually accurate, it fails to recognize that the degree and nature of such control varies. Moreover, we urge caution articulating potentially broad-based fiduciary principles on the basis of actions taken by individual and potentially distinctive corporate personalities.

[14] We note that the presence of controlling shareholders in U.S. companies is more prevalent than commonly supposed. *See, e.g.*, Clifford G. Holderness, *The Myth of Diffuse Ownership in the United States*, 22 REV. FIN. STUD. 1377, 1378 (2009) (presenting statistics on the widespread existence of large blockholders at U.S. public firms). The number of controlling shareholders increases still more if we extend the definition to include shareholders who exercise control by contract as opposed to solely through economic ownership or formal voting rights. *See, e.g.*, Gladriel Shobe & Jarrod Shobe, *The Dual-Class Spectrum*, 39 YALE J. REG. 1343 (2022) (explaining that shareholder agreements can serve as a substitute for dual class voting structures).

[15] These principles are limited by the legislature's adoption of Del. Gen. Corp. L. 122 (18) and its authorization of shareholder agreements that authorize shareholders to exercise traditional board powers. We address this issue in Part III, infra.

characteristics of the corporation's officers and directors, the overall composition of the shareholder base, and the disciplinary effect of the markets in which the corporation operates.

Second, we highlight how the evolving approach to *MFW* has rendered the potential for procedural cleansing uncertain at best and explain why the courts' demanding standard for procedural fairness is in tension with the practicalities of controlled companies. The difficulty in assuring, ex-ante that a process will be sufficiently rigorous to meet the *MFW* standard undercuts the claim that the impact of control creep is limited. Rather, we predict that a growing number of corporate decisions will be subject not just to litigation challenges, but to merits-based scrutiny under an entire fairness standard.

Third, we consider the pragmatic challenges that stem from the courts' analysis. Corporate doctrines like the business judgment rule are premised on the principle that courts are poorly situated to evaluate the merits of corporate decisions. As a result, entire fairness scrutiny has traditionally focused on conflict transactions involving traditional corporate fiduciaries: officers and directors. Courts have been more restrained in applying entire fairness to actions involving controlling shareholders, focusing primarily on old control situations and the transactional context where there is both a material, quantifiable, and disproportionate benefit to the controller and a market-based framework for analyzing the fairness of the transaction price. *Match*'s seeming extension of entire fairness review to all decisions in which a controlling shareholder receives a nonratable benefit undermines that principle. Together, *Match* and *Tornetta* can reasonably be understood to set a difficult standard for demonstrating the entire fairness of a process by which a corporation deemed controlled makes a decision. Similarly, evaluating fair price outside the transactional context—in decisions regarding reincorporation, amendment of the charter, or the setting of CEO pay—potentially brings the courts into treacherous territory.

We therefore call for a reconsideration of the application of fiduciary principles to shareholders. Specifically, we argue that when a shareholder acts in its capacity as a shareholder—even a shareholder with effective voting control—it should owe fiduciary duties only in freeze-outs and similar transactions in which the controller obtains an economic benefit directly at the expense of the minority shareholders, or in instances of outright fraud.[16] We similarly challenge the application of shareholder-level fiduciary principles in cases of "new" control. While we recognize that a shareholder may use soft power to usurp the role of an officer or director, we argue that liability in such a case stems from, and should be limited to,

[16] *See infra* note 8 (discussing what constitute similar transactions).

actions taken in the capacity of a traditional fiduciary.[17] Our more nuanced approach relieves the courts of the difficult task of analyzing entire fairness in situations that are highly fact-specific and subject to longstanding structural and market constraints.[18]

A potential concern with our reliance on existing structural mechanisms is the prospect that a controlling shareholder will dominate traditional fiduciaries—a concern that, as the court recognized in *Tornetta*, may be present in a variety of "new" control contexts. Whether a shareholder possesses soft or hard control, that control, or merely the threat of its use, can corrupt the procedural safeguards of the corporate form. That corruption, we argue, should recognize that control can take various levels of domination and can be addressed not by creating new fiduciaries, but by imposing greater accountability on traditional corporate fiduciaries. We therefore argue for heightened judicial oversight, in the controlling shareholder context, not of shareholders, but of officers and directors.

We offer three suggestions for increasing such accountability. First, where a plaintiff sufficiently alleges both that a controlling shareholder has dominated a board decision and that the decision results in a quantifiable benefit to the controller to the detriment of the minority shareholders, but the transaction is not akin to a freeze-out, we propose that the decision be subject to the one-step cleansing applicable to director and officer conflicted transactions rather than the *MFW* approach.[19] Second, where the decision

[17] A controlling shareholder may hold a position as a director or officer and therefore act in that capacity. A shareholder may also exercise the functions of a traditional fiduciary pursuant to a shareholder agreement. *See infra* note 193 and accompanying text.

[18] As our discussion below explains, although cases evaluating the duties of controlling shareholders involve both public and private companies, our analysis focuses primarily on the public company context for two reasons. First, public companies are subject to the transparency requirements and price discipline of the capital markets, including the likelihood that minority shares trade at a discount that reflects controlled company status. See, e.g., Dieckman v. Regency GP LP, 155 A.3d 358, 367 (Del. Sup. 2017) (observing that, in the publicly-traded partnership context, even when fiduciary duties are waived, investors receive some protection from public disclosures about the entity). Second, both the control relationships and contractual efforts to navigate those relationships in the private company context are often bespoke and less likely to be analyzed in the context of litigation. See generally " Jill E. Fisch, *Stealth Governance: Shareholder Agreements and Private Ordering*, 99 Wash. U. L. Rev. 913, 947-49 (2022) (describing opacity and information costs in private companies). As a result, the potential application of our analysis to private companies is beyond the scope of this article.

[19] We are not the first to advocate a single step cleansing mechanism in controlled transactions. See, e.g., William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Function over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 26 Del. J. Corp. L. 859, 882 (2001) ("The better policy, we think, is to afford business judgment review treatment to self-interested mergers that are approved by either an effective

has not been properly cleansed, we argue for the application of the *Coster* intermediate scrutiny standard.[20] *Coster* would enable the court to examine the reasonableness of the decision as a substantive matter but involve a less demanding inquiry than entire fairness. Third, we argue that where a director, as a result of controlling shareholder domination, acts other than in good faith, the director does and should face potential liability for a breach of the duty of loyalty (which is not subject to exculpation). We argue that such director liability should receive greater focus from both plaintiffs and courts to increase the incentives both for directors to resist controlling shareholder domination and for controlling shareholders to support directors who are sufficiently independent to withstand allegations of domination.[21]

We proceed as follows. In Part I, we document the treatment of controlling shareholders under the principles of what we term "old" control. We show that historically, the courts have found controllers where a shareholder has majority or near-majority voting control. Even in such circumstances, the courts have applied fiduciary duties and entire fairness review sparingly and primarily to transactional events where the controller receives a quantifiable and material benefit to the detriment of the minority shareholders. As a practical matter, the application of this test has largely been limited to the freeze-out paradigm. Part II delineates the expansion of these principles through the series of post-*MFW* cases culminating in *Tornetta, Sears Hometown*, and *Match*. Part III discusses the implications of Delaware's expanded vision of control. We trace the extension of concepts of control beyond share ownership or mathematical voting power—what we term "new" control—explaining how *Tornetta* and its progeny potentially subject a broad range of decision-makers and corporate actions to entire fairness analysis. We identify the consequences of the *Match* decision's approach to *MFW* compliance. And we explore a variety of practical concerns raised by the application of entire fairness to an expanded range of decisions by

independent director committee or by a majority of the minority stockholder vote."). Unlike the three Chancellors, because controlling shareholder freeze-outs present distinctive concerns, we do not advocate replacing the *MFW* procedure with single step cleaning in those transactions").

[20] Coster v. UIP Cos., 300 A.3d 656 (Del. 2023). In *Coster*, the court applied the intermediate scrutiny standard from cases such as *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985) both to board decisions applying defensive measures in response to a takeover threat and to board actions that interfere with shareholder voting rights. Under this intermediate standard, a board's action must be in response to a threat to an important corporate interest and must be both "reasonable in relation to the threat posed and []not preclusive or coercive to the stockholder franchise" *Id.* at 372–73.

[21] We note that these incentives extend beyond those provided by market forces and participants such as institutional investors, proxy advisors and the media. *See* Lawrence A. Hamermesh, Jack Jacobs & Leo Strine, Jr., *Optimizing the World's Leading Corporate Law: A Twenty-Year Retrospective and Look Ahead*, 77 BUS. LAW. 321 (2022) (asserting that such forces will enable independent directors to resist controlling shareholder demands).

controlled companies as well as the tension between the expanded role of controlling shareholders as fiduciaries and the structural features of corporate law. We conclude in Part IV by setting out our proposals to realign the doctrine applicable to controlling shareholders based on our theory of what it means for a shareholder to exercise control in the corporate context as well as the long-recognized economic value inherent in control.

I. Controlling Shareholders in Delaware Corporate Law

a. Control as an Economic Concept

Historically, commentators and corporate participants have understood control as an economic concept for ordering the corporation and directing its endeavors. As one commentator notes "the standard law-and-economics model posits that control of a corporation is a valuable asset independent of either economies of scale or potential monopoly rents."[22]

The theory of economic corporate control recognizes the value of control in and of itself. More specifically, control over a corporation is a definable asset that can be transferred and regulated—a concept with a long academic history. In their book *The Modern Corporation and Private Property*, for example, Adolf A. Berle, Jr. and Gardiner C. Means, describe control as an asset and argue that the asset belongs to the corporation.[23] As a result, they reason that any premium from a sale of corporate control should go to the corporate treasury.[24] In this regard, cases such as *Zetlin v. Hanson Holdings*,[25] which recognize the right of controlling shareholders to transfer their stock at a premium, are grounded in both the recognition that control is an economic asset owned by the controlling shareholder, and that the right to benefit from that control belongs to the shareholder and not the corporation.[26]

[22] Jay B. Kesten, *Managerial Entrenchment and Shareholder Wealth Revisited: Theory and Evidence from a Recessionary Financial Market*, 2010 BYU L. REV. 1609 (2010).
[23] ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 244 (1933).
[24] *Id.* ("[T]he power going with 'control' is an asset which belongs only to the corporation; and that payment for that power, if it goes anywhere, must go into the corporate treasury.").
[25] 397 N.E. 2d 387 (N.Y. 1979).
[26] *See also* Cheff v. Mathes, Del. Supr., 41 Del. Ch. 494, 199 A.2d 548 (1964); Levy v. American Beverage Corp., 265 App. Div. 208, 38 N.Y.S.2d 517 (1st Dep't 1942) ("Control might have lawful advantages. We see no reason why the value of control would not be a lawful property right of the controlling stockholders…"). *See generally* Alfred Hill, *The Sale of Controlling Shares*, 70 HARV. L. REV. 986 (1957) (setting forth authority that control is a value accruing to the controller).

Berle and Means' assertion that the value of control belongs to the corporation has been rejected.[27] Modern courts and commentators instead regard the controlling shareholder as entitled to treat control as a private asset and defend the economic efficiency of doing so. Henry Manne, for example, argued both that it was economically efficient to enable the owner of a controlling block to receive a premium and that regulations that limit that premium or impede efficient transfers of control interfere with the most productive use of the corporation's assets.[28] This reasoning led Manne to criticize takeover defenses on the basis that they diminish the value of control by hindering its transfer and exercise.[29]

Moreover, recognizing and protecting the right of an owner to benefit from control also provides theoretical advantages to minority shareholders. This theory, within visions of new control, was explored by Zohar Goshen and Assaf Hamdani.[30] In a recent article, they explain that control permits entrepreneurs to pursue business strategies that they believe will produce above-market returns by securing the ability to implement their vision in a manner they see fit. The entrepreneur, they argue, "values control because it protects her against the possibility of subsequent midstream investor doubt and objections regarding either the entrepreneur's vision or her abilities."[31] The authors postulate that control itself is not an "unalloyed evil."[32] Instead, control—particularly "new" control—"creates value for controlling and minority shareholders alike."[33] In this regard, "[c]orporate law should secure minority shareholders' rights to a pro-rata share of the corporate pie, while preserving the controller's freedom to pursue her idiosyncratic vision to maximize the corporate pie."[34] In essence, the work of Goshen and Hamdani,

[27] The primary case to take this approach was Perlman v. Feldmann, 219 F.2d 173, 178 (2d Cir. 1955) ("[W]hen a sale [of control] necessarily results in a sacrifice of this element of corporate good will and consequent unusual profit to the fiduciary who has caused the sacrifice, he should account for his gains."). Despite support among some academics, the rule in *Perlman* has not been followed. *See* William D. Andrews, *The Stockholder's Right to Equal Opportunity in the Sale of Shares*, 78 HARV. L. REV. 505 (1965); Victor Brudney, *Equal Treatment of Shareholders in Corporate Distributions and Reorganizations*, 71 CAL. L. REV. 1072 (1983).

[28] Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POLIT. ECON 110 (1965).

[29] *Id.*; *see also* Frank Easterbrook & Daniel Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1173–74 (1981) (explaining the importance of management passivity in response to a takeover so that economic resources can be directed to their highest valued use).

[30] Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L. J. 560 (2016).

[31] *Id.* at 565 (emphasis omitted).

[32] *Id.* at 560.

[33] *Id.*

[34] *Id.* at 595–96.

as well as others, treats economic control as an asset in the new control paradigm that can also benefit minority shareholders.[35]

The theory of economic control and its value thus recognizes that the existence of a majority stockholder does not present an inherent corporate governance problem. Indeed, the finance literature has observed that the presence of a large blockholder can enhance the value of the firm in that the block holder has the power and incentive to control managerial agency costs.[36] Ron Gilson and Alan Schwartz have similarly argued that majority shareholders can provide efficient monitoring of management, and allowing controllers to obtain private benefits of control creates an incentive for them to engage in such monitoring.[37] Moreover, the majority shareholder's economic stake is likely to align its interests with respect to operational decisions with those of the minority shareholders.[38] As Albert Choi observes. concentrated ownership can enhance long-term firm value even in circumstances in which a controlling shareholder is able to extract private benefits of control.[39]

Nonetheless, the presence of control creates opportunities for private expropriatary gain by the controller. An extensive literature explores the risks of tunneling or other diversion of corporate assets to the controller.[40] In other words, control can be an economic benefit, but it can also provide undue and inordinate gains to the controller at the expense of other stockholders.

Corporate law and market forces (as well as regulation) attempt to balance the benefits of control with efforts to contain its dark side. Ronald Gilson, for example, explains that shareholder control reflects a potential trade-off and that "a controlling shareholder may police the management of public

[35] *Id.* at 596–97; *see also* Byung Hyun Ahn, Jill Fisch, Panos N. Patatoukas & Steven Davidoff Solomon, *Synthetic Governance*, 2021 COLUM BUS. L. REV. 476 (documenting benefits to minority shareholders from dual class shares with sunset provisions).
[36] *See, e.g.*, Ronald J. Gilson & Jeffrey N. Gordon, *Doctrines and Markets: Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785, 786 (2003) ("The presence of a controlling shareholder reduces the managerial agency problem, but at the cost of the private benefits agency problem. Non-controlling shareholders will prefer the presence of a controlling shareholder so long as the benefits from reduction in managerial agency costs are greater than the costs of private benefits of control.").
[37] Ronald J. Gilson & Alan Schwartz, *Corporate Control and Credible Commitment*, 43 INT'L REV. L. ECON. 119, 122–23 (2015).
[38] *Id.*
[39] Albert H. Choi, *Concentrated Ownership and Long-Term Shareholder Value*, 8 HARV. BUS. L. REV. 53 (2018).
[40] *See* Yong Lim & Geeyoung Min, *Competition and Corporate Governance: Teaming Up to Police Tunneling*, 36 NW J. INT'L L. & BUS. 267, 269 (2016) (describing tunneling as "a well-known ailment in the corporate governance pathology").

corporations better than the standard panoply of market-oriented techniques employed when shareholdings are widely held."[41] One reason is that "[b]ecause she holds a large equity stake, a controlling shareholder is more likely to have the incentive either to monitor managers effectively or to manage the company itself and, because of proximity and lower information costs, may be able to catch problems earlier."[42] At the same time, however, Gilson observes that controlling shareholders can receive their own private pecuniary gains by appropriating corporate assets.

Gilson observes that both law and market forces play a strong role in monitoring controlling shareholders. He observes that "[t]he empirical evidence supports the proposition that minority shareholders are not uniquely disadvantaged in an efficient controlling shareholder system. Good law keeps diversion of pecuniary private benefits of control low and, in a reasonably efficient stock market, the costs of these payments for focused monitoring, as well as the risk that the talent of future generations of managers will regress to the mean, will be priced."[43] Thus, the benefits of controlling shareholders are greatest in jurisdictions with both strong law and efficient markets—these collectively serve to monitor and discipline controlling shareholders. In the next subsection, we further address the important interrelationship between legal rules and effective market discipline in regulating controlling shareholders.

b. Controlling Shareholders and Fiduciary Duties

The idea that control is an asset that can provide benefits but also be misused has informed notions of control in fiduciary and corporate law. More specifically, since the nineteenth century, corporate law has imposed obligations on those who exercise control over the corporation, recognizing explicitly and implicitly the value of this control and the implication of legal restrictions. In the United States, this fiduciary and related law has been the primary means of regulating controlling shareholders.[44]

Fiduciary duties in corporate law apply, for the most part, to actions by a corporation's officers and directors. The reason for this is that officers and

[41] Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV. 1641, 1651 (2006).
[42] *Id.* at 1651.
[43] *Id.* at 1667.
[44] *But see* Section 13(d) of the Securities Exchange Act, 15 U.S.C. § 78m(d), which requires anyone acquiring 5% of the voting power of an issuer to disclose its ownership position and various other information. Congress adopted § 13(d) to "alert the marketplace to every large, rapid aggregation or accumulation of securities, regardless of technique employed, which might represent a potential shift in corporate control." GAF Corp. v. Milstein, 453 F.2d 709, 717 (2d Cir. 1971), *cert. denied*, 406 U.S. 910 (1972).

directors are classic fiduciaries—they exercise control over decisions that are made with "other people's money."[45] Under the common law, transactions between the corporation and such fiduciaries were inherently void or voidable at the option of the corporation. Delaware adopted Section 144 of the Delaware General Corporate Law to modify this rule and to provide procedural protections that would exempt conflict-of-interest transactions from voidability.[46] Subsequent case law interpreted this statute to nonetheless require that a transaction be entirely fair[47] but developed procedural mechanisms—specifically independent board approval or an informed shareholder vote—that would cleanse a transaction involving a conflicted officer or director from entire fairness review and enable a court to apply the deferential business judgment rule to a lawsuit challenging such a transaction.[48]

Controlling shareholders differ from corporate officers and directors in two ways. First, they do not, as shareholders, have the right to act for the corporation or make decisions on its behalf. Second, shareholders are principals, not agents, which gives them the right to act in accordance with their individual objectives rather than those of the corporation.[49] As a result, Delaware and other courts historically distinguished between shareholders and management. They have held, as a general matter, that shareholders are not fiduciaries and do not owe duties to the corporation.[50] Even controlling

[45] LOUIS BRANDEIS, OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT (1914). As Gordon Smith explains, "The role of fiduciary law is to regulate relationships where one party (the fiduciary) exercises discretionary authority over the resources or practical interests of another party (the beneficiary)." D. Gordon Smith, Delaware's Corporate Fiduciary Law Canon, working paper at 7 (on file with authors).

[46] 8 Del. C. § 141. *See* Marciano v. Nakash, 535 A.2d 400, 403 (Del. 1987) (explaining that the 1967 adoption of the statute "significantly ameliorated . . . [t]he principle of per se voidability for interested transactions").

[47] *See, e.g.*, Fliegler v. Lawrence, 361 A.2d 218 (Del. 1976) (adopting a two-tiered analysis in which Section 144 was applied along with an analysis of intrinsic fairness).

[48] *See, e.g.*, *In re* Wheelabrator Technologies S'holders Litig., 663 A.2d 1194, 1203 (Del. Ch. 1995) ("Approval by fully informed, disinterested shareholders pursuant to § 144(a)(2) invokes 'the business judgment rule and limits judicial review to issues of gift or waste with the burden of proof upon the party attacking the transaction.'" (citing Marciano v. Nakash, Del. Supr., 535 A.2d 400, 405 n.3 (1987))).

[49] Mary Siegel, *The Erosion of the Law of Controlling Shareholders*, 24 DEL. J. CORP. L. 27, 34 (1999) ("[B]ecause shareholders can act in their own self-interest, courts should expect shareholders to assume fiduciary responsibilities only when they exercise power not as shareholders but as managers, negotiating or dictating both sides of a transaction.").

[50] *See, e.g.*, Voigt v. Metcalf, 2020 Del. Ch. LEXIS 55, *27–28 (Del. Ch. 2020) ("A stockholder that does not control the corporation is not a fiduciary and cannot be held liable for breaching non-existent duties.") (citing Basho Techs. Holdco B, LLC v. Georgetown Basho Inv'rs, LLC, 2018 Del. Ch. LEXIS 222, 2018 WL 3326693, at *25 (Del. Ch. July 6, 2018), *aff'd sub nom*. Davenport v. Basho Techs. Holdco B, LLC, 221 A.3d 100 (Del. 2019)).

shareholders owe fiduciary duties to the corporation and other shareholders only in limited circumstances.[51] Historically and absent those circumstances, courts have largely held that controlling shareholders are not subject to fiduciary duties and are legally entitled to act in their own best interests and accrue the benefits of control.[52]

The Delaware Supreme Court famously delineated this principle in the 1940s in *Ringling Bros.-Barnum & Bailey Combined Shows v. Ringling*,[53] In *Ringling Brothers*, the court upheld a trust agreement among shareholders to vote and control the corporation. The court premised its decision on the wide berth given to stockholders to exercise the shareholder franchise with impunity as well as the ability to separate the vote from the other ownership attributes of stock. The court stated that "[g]enerally speaking, a shareholder may exercise wide liberality of judgment in the matter of voting, and it is not objectionable that his motives may be for personal profit, or determined by whims or caprice, so long as he violates no duty owed his fellow shareholders."[54] *Ringling Brothers* thus represented a recognition of

[51] Delaware courts have not been explicit in the basis for this position. In some cases, the courts have held that while a controlling stockholder has fiduciary duties, entire fairness did not apply. In other cases, the courts have rejected the premise that a controlling shareholder is not a fiduciary in the context of a decision that does not involve obtaining a benefit at the expense of the minority. In this article we refer to the imposition of fiduciary duties, as more recent decisions have done, as triggering entire fairness review.

[52] *See, e.g.*, Jeffrey N. Gordon, *Systematic Stewardship*, 47 J. CORP. L. 627, 666–67 (2022) ("[E]ven for a controlling shareholder, there are no shareholder duties, except in frank self-dealing."); *see also* Adolf Berle, Jr., *"Control" In Corporate Law*, 58 COLUM L. REV. 1212 (1958). Berle explored the current state of the law of controller liability and theorized that "[t]he control-function wherever and however held in the corporation is a responsible, not an irresponsible function. It must be used for the benefit and advantage of the corporation, and, where used to benefit holders of control (for example, electing one of them to a salaried office in the corporation or contracting with interests allied to the control-holders), it must not damage the corporation or be unfair or inequitable to it." *Id.* at 1225.

[53] 53 A.2d 441, 447 (Del. 1947). This issue was not novel in Delaware and had been previously addressed in Heil v. Standard Gas & Elec. Co., 151 A. 303, 304 (Del. Ch. 1930). ("[S]tockholders have the right to exercise wide liberality of judgment in the matter of voting and may admit personal profit or even whims and caprice into the motives which determine their choice, so long as no advantage is obtained at the expense of their fellow stockholders.").

[54] *Id.* at 622; *see also* Bershad v. Curtiss Wright Corp, 535 A.2d 840, 845 (1987) ("Stockholders in Delaware corporations have a right to control and vote their shares in their own interest. They are limited only by any fiduciary duty owed to other stockholders. It is not objectionable that their motives may be for personal profit, or determined by whim or caprice, so long as they violate no duty owed other shareholders."). In *Ringling Brothers* the court also stated that a shareholder was free to vote "so long as he violates no duty owed his fellow shareholders." Id. at 623. The court then without explanation cited Heil v. Standard G. & E. Co., 151 A. 303 (Del. Ch. 1930), a case which involved whether a shareholder outside the voting context had reaped a "peculiar benefit" from the transaction at issue. Although the

shareholders' rights to vote in their self-interest, even controlling shareholders—a principle still recognized by Delaware courts.[55]

In *Bershad v. Curtiss-Wright Corp.*,[56] decided forty years after *Ringling Brothers*, the Delaware Supreme Court reiterated that when a majority shareholder acts in its capacity as a shareholder, it is not subject to fiduciary duties and extended this principle to the sale context. In *Bershad*, the court held that "a stockholder is under no duty to sell its holdings in a corporation" even if it is a "majority shareholder."[57] This was true even if the sale would "profit the minority."[58] Applying that rule, the justices rejected a stockholder's claim that a controller breached its duties by engaging in a squeeze-out rather than exploring a sale of the company to a third party. Thus, the controlling shareholders had no obligation to sell in such a situation and were not subject to any fiduciary duty to the other shareholders or corporation, including *Revlon* duties.[59]

Similarly, the Delaware courts have held that controlling stockholders exercising their right to block shareholder action are not subject to fiduciary review. In *Frantz Mfg. Co. v. EAC Industries*,[60] decided a few years before *Bershad*, the Delaware Supreme Court upheld a controlling shareholder's adoption by written consent of a bylaw that required director unanimity in order to protect its interests.[61] The court specifically held that although it would review the transaction for its equitable nature (a review that did not speak of entire fairness), the controller was justified in its "attempt to avoid its disenfranchisement as a majority shareholder."[62]

court in Heil found no such benefit, the language formed the basis for imposing entire fairness on controllers in a wide array of cases involving a "unique benefit." See infra discussion at Part [IV].

[55] *See* Tanzer v. Int'l Gen. Indus., Inc., 379 A.2d 1121, 1124 (Del. 1977) ("[F]or more than fifty years our Courts have held, consistent with the general law on the subject, that a stockholder in a Delaware corporation has a right to vote his shares in his own interest, including the expectation of personal profit, limited, of course, by any duty he owes to other stockholders.").

[56] *Bershad*, 535 A.2d 840 (1987). *Bershad* also included the language from *Ringling* that while controlling shareholders are free to vote their shares they are "are limited only by any fiduciary duty owed to other stockholders." Id. at 845. Again, the fiduciary duties the court was referring to were unspecified.

[57] *Id.* at 845.

[58] *Id.*

[59] *Id.* at 842 (citing Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986)).

[60] 1985 Del. LEXIS 598 (Del. 1985).

[61] *Id.*

[62] *Id.* at *17.

Then-Vice Chancellor Strine expounded on the scope of *Frantz* in *Hollinger Intl. Inc. v. Black*.[63] In *Hollinger*, a controlling shareholder had adopted bylaw amendments dissolving a special committee of the board and preventing it from approving a sale. The Vice Chancellor upheld the statutory authority of the controlling shareholder to engage in this behavior but struck down the bylaw on equitable grounds (again, without applying entire fairness). Specifically, Vice Chancellor Strine stated that "it is no small thing to strike down bylaw amendments adopted by a controlling stockholder…."[64] Vice Chancellor Strine nonetheless found that action was required "because those amendments complete a course of contractual and fiduciary improprieties" and that "Inc.'s written consent was the culmination of Black's efforts on his (and Inc.'s) behalf to end-run the Strategic Process he had agreed to lead and support."[65]

These precedents show that Delaware law has historically provided a wide berth to shareholders, including controlling shareholders, to exercise their rights as shareholders without being subject to fiduciary duties and the application of entire fairness review. Concededly, cases like *Frantz* and *Hollinger* acknowledged that controlling shareholder transactions can be subject to attack on equitable grounds. Importantly, however, the rationale for such an attack was interference with the board process and not a standalone fiduciary duty owed by the controlling shareholder or application of entire fairness to the controller's actions absent specific domination and a benefit to the controller itself.

In addition, the traditional controlling shareholder cases largely relied on objective measures of control.[66] Indeed, early cases used the terminology of "majority stockholder" rather than "controlling shareholder" and focused on situations in which a shareholder owned a majority or near majority of the corporation's voting stock.[67] To be fair, courts extended the concept of a majority shareholder not merely to those shareholders that held mathematical control—that is, more than 50%—but also to those that owned a substantial percentage of stock and exercised effective control.[68] As the Delaware Supreme Court explained in *Kahn v. Lynch*,[69] "a shareholder owes a

[63] 844 A.2d 1022 (Del Ch. 2004).
[64] *Id.* at 1081.
[65] *Id.*
[66] In contrast, Adolf Berle recognized the flexible nature of control. In 1958 he defined control as "the capacity to choose directors" and "[a]s a corollary, it carries capacity to influence the board of directors and possibly to dominate it." *See* Berle, Jr., *supra* note 52, at 1212.
[67] Kahn v. Lynch Communication Sys., 638 A.2d 1110, 1113 (Del. 1994).
[68] *See, e.g.*, Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977); Tanzer v. International Gen. Indus., Inc., 379 A.2d 1121 (Del. 1977).
[69] *Kahn*, 638 A.2d 1110.

fiduciary duty only if it owns a majority interest in or exercises control over the business affairs of the corporation."[70]

Subsequent cases expanded on *Kahn* to recognize that a large shareholder could exercise control without holding an absolute majority of the corporation's shares,[71] but they generally applied the fiduciary duties associated with majority shareholder status only to such shareholders if they exercised actual control of corporate conduct in the specific transaction under scrutiny.[72] As Larry Hamermesh, Jack Jacobs and Leo Strine, Jr. explain, "Under Delaware law, it was historically difficult to establish that a stockholder having less than majority ownership was a controlling stockholder."[73]

c. Fiduciary Duties and Freeze-Outs

Cases in which a controlling shareholder obtains a pecuniary benefit directly from or at the expense of the minority shareholders constitute a long-standing exception to the principle that fiduciary duties do not apply to a controlling stockholder. The prototypical case for the imposition of such duties is when a controlling shareholder initiates a transaction to freeze out the minority shareholders. It also includes similar transactions, such as when the majority shareholder sells an asset to the corporation or purchases an asset from the corporation.[74] Analogous reasoning extends to the situations such as when a controller knowingly sells to a looter or is grossly negligent in allowing such a sale.[75] As detailed below, Delaware has historically taken a nuanced approach to this exception, recognizing both the confined fiduciary duties applicable to shareholders and the value inherent in allowing majority shareholders to enjoy benefits associated with their controlling ownership.

[70] *Id.* at 1114 (quoting Ivanhoe Partners v. Newmont Mining Corp., Del. Supr., 535 A.2d 1334, 1344 (1987) (emphasis omitted)).
[71] Courts recognized that not all shareholders vote and that, as a result, a large block minority block will, as a practical matter, often be sufficient. As the court explained in *Cysive*, however, that block must be sufficient that the controller's vote is likely to be sufficient "without having to attract much, if any, support from public stockholders." *In re* Cysive, Inc. S'holders Litig., 836 A.2d 531, 552 (Del. Ch. 2003).
[72] *See* Gilbert v. El Paso Company, Del. Ch., 490 A.2d 1050, 1055 (1984) ("[A] shareholder who owns less than 50% of a corporation's outstanding stocks does not, without more, become a controlling shareholder of that corporation, with a concomitant fiduciary status.").
[73] Hamermesh, et al., *supra* note 21.
[74] *See, e.g.*, Kahn v. Tremont Corp., 694 A.2d 422, 424 (Del. 1997) (applying fiduciary duties to controlled company's purchase of stock owned by the controlling shareholder).
[75] *See* Harris v. Carter, 582 A.2d 222, 236 (Del. Ch. 1990).

Delaware set out the context in which controlling shareholders would be treated as fiduciaries in *Sinclair Oil v. Levien*.[76] In *Sinclair Oil*, decided in 1971, the parent corporation was accused of using its control to cause its subsidiary to pay dividends, preventing the further development of the subsidiary and providing the parent corporation, which needed liquidity, with cash. The court held that although the parent corporation owed a fiduciary duty to the minority shareholders when dealing with its subsidiary, its actions in the case at bar need not be analyzed under entire fairness because the dividends in question were paid ratably to all shareholders:

> A parent does indeed owe a fiduciary duty to its subsidiary when there are parent-subsidiary dealings. However, this alone will not evoke the intrinsic fairness standard. This standard will be applied only when the fiduciary duty is accompanied by self-dealing—the situation when a parent is on both sides of a transaction with its subsidiary. Self-dealing occurs when the parent, by virtue of its domination of the subsidiary, causes the subsidiary to act in such a way that the parent receives something from the subsidiary to the exclusion of, and detriment to, the minority stockholders of the subsidiary.[77]

Accordingly, the court held that the appropriate standard of review was the business judgment rule. To be sure, the court recognized that a parent-subsidiary transaction could be subject to entire fairness where there was something provided to the "exclusion of, and detriment to" the minority stockholders. However, the court also noted that such a benefit would have to be attributable to the "domination of the subsidiary." In other words, the application of fiduciary duties and entire fairness required two elements—first, a transaction between the company and the controller to the detriment of the minority, and second, domination of the company by the controller in the transaction itself. Outside of this context, the shareholder, when acting in a shareholder capacity, was not subject to such fiduciary duties.

In *Puma v. Marriott*,[78] decided shortly after *Sinclair Oil*, the court similarly upheld a transaction between the Marriott Corporation (Marriott) and the Marriott Group—members of the Marriott family who collectively owned 46% of Marriott's stock.[79] The tranaction was negotiated and approved by a majority of independent Marriott directors and approved by the shareholders. Although Marriott's process arguably met the standard of entire fairness, the court expressly declined to apply that standard,

[76] 280 A.2d 717 (Del. 1971).
[77] *Id.* at 720.
[78] 283 A.2d 693 (Del. Ch. 1971).
[79] *Id.* at 693.

concluding instead that because the plaintiff had not shown that the Marriott family dominated the independent directors (and therefore was not a controller), the applicable standard of review was the business judgment rule.

Similarly, in *Nixon v. Blackwell*,[80] a case decided over twenty years after *Sinclair Oil*, the court concluded that fair treatment of the minority shareholders did not require that they receive the same benefits as the majority.[81] In that case, minority shareholders sued the directors of a closely held corporation, asserting that a failure to pay them dividends was a denial of "liquidity" and a breach of fiduciary duty. The Delaware Supreme Court held that there was no fiduciary rule that granted the minority shareholders in a close corporation the right to "equal treatment." Instead, the analysis was that elaborated in *Sinclair*—entire fairness applied when there was a benefit to the controlling shareholder in a transaction to the exclusion of, and detriment to, the minority stockholders where domination existed.

Thus, although historically controlling shareholders were not subject to general fiduciary duties, early cases recognized that under confined circumstances, a controlling shareholder could be subject to fiduciary duties resulting in entire fairness review.[82] These circumstances aligned with the law and economics literature of the time, which called for limited fiduciary duties for controlling shareholders with exceptions when a controller obtained a pecuniary benefit by taking undue advantage of a corporation or minority shareholders.[83] As a result, the early case law on controlling

[80] 626 A.2d 1366 (Del. 1993).
[81] *Id*. ("The Class B stock was given no voting rights because those stockholders were not intended to have a direct voice in the management and operation of the Corporation. They were simply passive investors—entitled to be treated fairly but not necessarily to be treated equally.").
[82] *See, e.g.*, Canal Cap. Corp. v. French, 1992 WL 159008, at *5–6 (Del. Ch. July 2, 1992) (applying business judgment to a services agreement with controlling stockholder after independent board approval); *see also* Getty Oil Co. v. Skelly Oil Co., 267 A.2d 883, 887 (Del. 1970) (applying business judgment to disputed transaction involving controlling stockholder where domination not found).
[83] See Allied Chem. & Dye Corp. v. Steel & Tube Co. of Am., 120 A. 486, 491 (1923) (holding that "if the majority stockholders so use their power to advantage themselves at the expense of the minority, their conduct in that regard will be denounced as fraudulent and the minority may obtain appropriate relief therefrom upon application to a court of equity. But the general language by which this rule is stated is not to be given its widest possible application. For it is not true that every personal advantage which the majority secures is to be regarded as vitiating in character. An examination of the cases to which special attention is directed by the complainants in this connection will disclose that the personal advantage accruing to the majority is in some way derived from, or intimately associated with, the corporate assets themselves."). See also Frank H. Easterbrook & Daniel R. Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698 (1982); John C. Coffee, *Transfers of*

shareholder fiduciary duties and the application of entire fairness as a general matter arose primarily in the context of freeze-outs.[84]

We theorize that transactions in which the majority shareholder froze out the minority shareholders and became the sole owner of the corporation should be viewed as different and inherently coercive for two reasons.[85] First, unlike operational decisions, in freeze-outs, the majority shareholder's interests directly oppose those of the minority shareholders—every dollar the majority shareholder gains is a dollar lost by the minority shareholders.[86] Second, a freeze-out is an end game situation in that after the freeze-out, the minority shareholders will no longer be investors in the company. Accordingly, any economic value from the freeze-out (such as the majority shareholder's ability to reduce managerial agency costs or other cost savings) inures exclusively to the benefit of the majority shareholder absent statutory protections such as dissenters' rights.[87]

In line with this theoreticcal approach, Delaware historically applied this heightened standard of review to transactions in which the purchase or counterparty was, at the time of the transaction, a majority or near-majority shareholder. As the Delaware Supreme Court explained in *Citron v. Fairchild Camera and Instrument Corp.*,[88] "[u]nder Delaware law, until the conclusion of the tender offer, Schlumberger owed no fiduciary duty of

Control and the Quest for Efficiency: Can Delaware Law Encourage Efficient Transactions, While Chilling Inefficient Ones?, 21 DEL. J. CORP. L. 359 (1996); Robert W. Hamilton, *Private Sale of Control Transactions: Where We Stand Today*, 36 CASE W. RSRV. L. REV. 248 (1986); Thomas L. Hazen, *The Sale of Corporate Control: Towards a Three-Tiered Approach*, 4 J. CORP. L. 263 (1978); Saul X. Levmore, *A Primer on the Sale of Corporate Control*, 65 TEX. L. REV. 1061 (1987).

[84] *See, e.g.*, Weinberger v. UOP, 457 A.2d 701 (Del. 1983) (holding that majority shareholder's cash out merger must satisfy standards of fair price and fair process).

[85] *See, e.g.*, Kahn v. Tremont Corp., 1996 Del. Ch. LEXIS 40, 1996 WL 145452, at *7 ((a controlling shareholder transaction "of course is the context in which the greatest risk of undetectable bias may be present."). A second prominent line of cases outside Delaware identified distinctive concerns posed by a controlling shareholder in a close corporation. These cases developed the "doctrine of oppression" to respond to abusive actions by controlling shareholders and subjected such actions to greater judicial scrutiny. Although various states adopted the doctrine of oppression or similar standards to scrutinize this conduct, Delaware rejected the idea of special rules for oppression type actions outside a statutory close corporation. *See* Nixon v. Blackwell, 626 A.2d 1366, 1381 (Del. 1993). Again, these cases, which arose in the 1970s, defined control as greater than 50% ownership of the corporation. Significantly, however, oppression was a more rigorous standard than entire fairness, and could not be established through evidence of mere self-dealing by a controlling shareholder.

[86] *See, e.g.*, John C. Coates IV, *Fair Value as an Avoidable Rule of Corporate Law: Minority Discounts in Conflict Transactions*, 147 U. PA. L. REV. 1251, 1314 (1999) ("[T]he net effect of a freeze-out is to transfer value from minority shareholders to fiduciaries.").

[87] *Id.*

[88] 569 A.2d 53 (Del. 1989).

candor to Fairchild's stockholders."[89] The Delaware Supreme Court reiterated this point in *Corwin v. KKR*,[90] in which it rejected the argument that KKR was a controlling shareholder of KKR Financial Holdings where, despite plaintiff's allegations of control, "KKR owned less than 1% of Financial Holdings's stock, had no right to appoint any directors, and had no contractual right to veto any board action."[91]

The courts' focus on freeze-outs was in large part in line with the theoretical prospect of domination and the end-stage nature of the transaction.[92] As then Vice-Chancellor Strine explained, the prospect of coercion both undermined the board's potential independence and potentially compromised the significance of minority shareholder approval.[93] Even in freeze-outs, the cases involved both the controlling shareholder's explicit domination of the company and board as well as actions that appeared to bypass or interfere with the corporation's authorized decision-making process.[94] This view was reinforced in the case of *Glassman v. Unocal, Inc*.,[95] where the court held that a short-form statutory merger pursuant to Section 253 of the DGCL was subject to business judgment review as opposed to entire fairness due to the statutory structure of the DGCL as well as the lack of a board or minority shareholder role in such a transaction.

Beyond the freeze-out context, and again in line with our theoretical justification, Delaware courts historically limited the application of entire fairness in corporations with controlling shareholders. Vice Chancellor Parsons explained the state of play in 2014 in *In re Crimson Exploration Inc. Stockholder Litigation.*[96] He stated that Delaware courts did not apply "[e]ntire fairness . . . solely because a company has a controlling stockholder." Instead, he explained that cases in which fiduciary duties applied and hence the standard of entire fairness is employed fall into "one of two categories: (a) transactions where the controller stands on both sides; and (b) transactions where the controller competes with the common stockholders for consideration."[97] He further observed that "the case law has

[89] *Id.* at 70.
[90] Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304 (Del. 2015).
[91] *Id.* at 306.
[92] As we explain below, courts also have a benchmark when evaluating the fairness of freeze-outs by comparing the value minority shareholders would have obtain in an arms-length third party transaction.
[93] *In re* Cox Commc'ns, Inc. S'holders Litig., 879 A.2d 604, 619 (Del. Ch. 2005).
[94] Moreover, at least initially, Delaware courts seemed to limit application of this doctrine to mergers and not tender offers. *See* Solomon v. Pathe Commc'ns Corp., 672 A.2d 35, 39–40 (Del. 1996).
[95] 777 A.2d 242 (Del. 2001).
[96] No. CIV.A. 8541-VCP, 2014 WL 5449419 (Del. Ch. Oct. 24, 2014).
[97] *Id.* at *12.

recognized only a few situations where, despite the stockholders receiving the same consideration, the controller nonetheless receives a unique benefit, and the court applies entire fairness: (a) the controller eliminates something bad for it and good for the minority, as in the elimination of the derivative claim in *Primedia*; or (b) all parties suffer a sub-optimal sale price, but the controller still benefits because it receives cash to satisfy an idiosyncratic liquidity problem, as in infoGROUP."[98] Thus, outside these confined areas, controlling shareholders were not deemed fiduciaries, including in transactions where they exercised their statutorily authorized power as shareholders.

II. Extending Controlling Shareholder Fiduciary Duties

As described in Part I, until recently, the application of fiduciary duties and entire fairness principles to controlling shareholder actions focused largely on the freeze-out context.[99] In Delaware, the extent to which other transactions would be subject to entire fairness review remained an open question at best and, if extended, appeared to require the controlling shareholder to dominate the board process as well as a quantifiable benefit to the controller to the detriment of the minority. Outside these transactions, the courts had generally ruled that transactions involving controlling shareholders were not subject to entire fairness review. As we delineate below, however, in the last decade a series of cases have changed this approach both by applying fiduciary duties and entire fairness review to a broader range of corporate decisions and by expanding the concept of a controlling shareholder.

A. Fiduciary Duties for Controlling Shareholders

We believe a turning point occurred in *In re EZCORP Inc*.[100] Plaintiff brought suit challenging three advisory services agreements which, he alleged, were a means for EZCORP's controlling shareholder, Phillip Ean Cohen, to extract a non-ratable benefit from EZCORP. Cohen controlled EZCORP through a dual class voting structure in which his class B shares, although representing only 5% of EZCORP's outstanding equity, gave Cohen 100% of EZCORP's voting power.

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[98] *Id.* at *20.

[99] In *EZCORP*., Vice Chancellor Laster disputed this proposition citing a number of cases which applied entire fairness outside the freeze-out context. *EZCORP*, 2016 WL 301245, at *13-*15. We acknowledge the holdings of these cases but question the extent to which they stand for the general proposition that entire fairness applies, as a per se matter, to transactions with a controlling shareholder. We therefore view EZCORP as taking a doctrinal step beyond the cases it cites.

[100] No. CV 9962-VCL, 2016 WL 301245 (Del Ch. Jan. 25, 2016).

Plaintiff attempted to hold Cohen liable for aiding and abetting a breach of fiduciary duty by EZCORP's directors, apparently because Cohen was not acting on behalf of EZCORP with respect to the advisory agreements. Vice Chancellor Laster rejected this theory but instead reasoned that, as a controlling shareholder, Cohen owed fiduciary duties to EZCORP. Consequently, he held that the plaintiff had a direct claim against Cohen for breaching those duties. In so doing, the Vice Chancellor relied upon federal precedent, stating:

> An ultimate human controller who engages directly or indirectly in an interested transaction with a corporation is potentially liable for breach of duty, even if other corporate actors made the formal decision on behalf of the corporation, and even if the controller participated in the transaction through intervening entities.[101]

The Vice Chancellor took a broad view of control—looking at "who wields control in substance."[102] He then considered amd rejected the proposition that controlling shareholders only owe fiduciary duties to the corporation in freeze-out transactions, concluding instead that such duties are owed in any transaction in which a controller extracts a non-ratable benefit regardless of whether domination was evident in the transaction itself.[103] Although the court acknowledged some ambiguity in how courts had applied the demand requirement in the context of such transactions, it concluded that demand could not be excused given the prospect of controlling shareholder domination.[104] The court cited facts tending to indicate the potential for such domination, noting that Cohen had attempted to influence EZCORP's nominally independent directors both by inviting them to serve on the boards of EZCORP's affiliates and by firing those directors if they displeased him.[105] Having concluded that Cohen could be liable for breaching his fiduciary duties, the court then determined that the applicable standard of review was entire fairness, and compliance with the *MFW* procedure was required for the case to be resolved through a motion to dismiss.

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[101] *Id.* at *9.
[102] *Id.* at *28 ("Delaware corporate decisions consistently have looked to who wields control in substance and have imposed the risk of fiduciary liability on that person.").
[103] *Id.* at *36 ("The entire fairness framework clearly governs squeeze-out mergers, but Delaware courts also have applied it more broadly to transactions in which a controller extracts a non-ratable benefit.").
[104] *Id.* at *93 ("if the omnipresent specter is enough to excuse demand, then excusal would follow more readily when directors must confront a dominant stockholder who will continue in control of the entity and enjoys both the hard and soft power to engage in potentially blatant, but more likely subtle acts of retribution."). The court acknowledged that "the choice between Aronson and other precedents is something only the Delaware Supreme Court can resolve." *Id.* at *94.
[105] *Id*. at *14, *21.

The defendants in *EZCORP* sought interlocutory appeal, claiming that the decision raised a novel and material issue concerning the appropriate standard of review for controller transactions. In one of two applications, the defendants wrote that "[t]he Supreme Court has never had an opportunity to decide how the holdings in the MFW decisions would apply outside of the controlling stockholder merger context. This case presents that opportunity, and along with it the opportunity to harmonize under one unified framework what this Court has identified as 'considerable tension' between lines of Court of Chancery and Supreme Court authority."[106] Both the Chancery Court and the Supreme Court denied the two motions for interlocutory appeal. At the same time, Cohen challenged the Chancery Court's decision on the basis that, by recognizing a direct claim against Cohen that had not been asserted in the complaint, it misapplied the applicable pleading standards. The trial court subsequently issued a memorandum opinion stating that "There are no claims currently pending against Cohen or Madison Park."[107] The case settled before the issues could be fully resolved.[108]

Subsequently, several other Delaware decisions, relying in part on EZCORP, concluded both that entire fairness review was triggered by a conflicted controlling shareholder transaction outside the freeze-out context and that such review could only be avoided by compliance with the *MFW*

[106] *Id.*

[107] *In re* Ezcorp Inc. Consulting Agreement Derivative Litig., No. 9962-VCL, 2016 WL 727771 (Del. Ch. Feb. 23, 2016).

[108] Dave Simpson, *EZCorp. Investors Seek OK For $6.45M Del. Suit Settlement*, LAW360 (Mar. 5, 2018), https://www.law360.com/articles/1018598/ezcorp-investors-seek-ok-for-6-45m-del-suit-settlement. The arguments in the *Match* case involved supplemental briefing on the place of EZCORP within Delaware jurisprudence. In *Match*, the appellants argued that "*Ezcorp* also ignored the decisions making clear that *Lynch*'s inherent coercion concept was confined to squeeze-outs." *See* Supplemental Opening Brief of the IAC Defendants at 27, *Match*, 2024 WL 1449815. They also argued that:

> In like vein, *Ezcorp* cited, but gave no weight to the decisions of then-Vice Chancellor Berger in *Canal*, Chancellor Chandler in *Tyson*, and Vice Chancellor Noble in *Dolan*, finding that each had somehow failed to appreciate that the concept of inherent coercion rendered the traditional approach to controller conflict transactions improper. Ezcorp gave more respectful treatment to this Court's *Aronson* decision, but ultimately determined not to follow it—finding it to have been an improvident departure from the general concept of inherent coercion, and incompatible with the MFW creep that *Ezcorp* created." *Id.* at 27–28.

procedures.[109] For example, In *IRA Trust FBO Bobbie Ahmed v. Crane*,[110] Chancellor Bouchard, ruling two years after *EZCORP*, found that a reclassification implemented through a charter amendment required application of the entire fairness standard and that, to avoid entire fairness review, the *MFW* framework was required.[111] The majority control shareholder NRG had proposed "that Yield undertake a recapitalization where Class A stockholders would be issued one share of a new class of non-voting common stock for each Class A share they held. NRG intended for Yield to use the non-voting common stock as currency to acquire assets in the future."[112] According to the opinion, this action was undertaken at the behest of NRG to perpetuate NRG's voting control. The court held that the transaction implicated controlling shareholder fiduciary duties and entire fairness review even though it involved a pro rata distribution of the non-voting stock, explaining that "NRG received a uniquely valuable or 'non-ratable' benefit in connection with the Reclassification that was not shared with the Company's other stockholders, namely the ability to perpetuate its majority control over Yield."[113] The court further cited *EZCORP* for the proposition that "numerous types of transactions involving controlling stockholders outside the context of a merger or acquisition that have triggered entire fairness review."[114]

The court went on to conclude that it could "see no principled basis on which to conclude that the dual protections in the MFW framework should apply to squeeze-out mergers but not to other forms of controller transactions."[115] Because the transaction had been conditioned on and approved by a majority of the minority of shareholders and by a special committee of directors complying with DGCL 144, however, the court found that the requirements of *MFW* had been met and dismissed the complaint.[116]

In addition to relying on *EZCORP*, Chancellor Bouchard cited a decision by Vice Chancellor Slights in *In re Martha Stewart Living Omnimedia, Inc.*

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[109] *See* Alex Lindsey, Note, *Expanding MFW: Delaware Law Should Offer a Business Judgment Rule Safe Harbor for all Conflicted Controller Transactions*, 29 FORDHAM J. CORP. & FIN. L. 339, 356–57 (describing three categories of "MFW-creep"); *see also* IRA Trust FBO Bobbie Ahmed v. Crane, 2017 Del. Ch. LEXIS 869 (Del. Ch. Dec. 11, 2017) (identifying several types of conflicted controller transactions that trigger entire fairness analysis).

[110] IRA Tr. Bobbie Ahmed v. Crane (NRG Yield), C.A. No. 12742-CB, 2017 WL 6335912 (Del. Ch. Dec. 11, 2017).

[111] *Id*.

[112] *Id.* at 1.

[113] *Id.* at *18–19.

[114] *Id.* at *18.

[115] *NRG Yield*, 2017 WL 6335912, at *12.

[116] *Id.* at *1.

Stockholder Litig.[117] In that decision, plaintiffs challenged a merger of Martha Stewart Living with a third-party corporation in which they asserted a breach of fiduciary duty claim against Martha Stewart herself, claiming that "she leveraged her position as controller to secure greater consideration for herself than was paid to the other stockholders."[118] The court acknowledged that prior cases had not addressed whether the *MFW* framework applied to a transaction in which, unlike a freeze-out, a controlling shareholder is a seller only.[119] While the court held that *MFW* would apply in the situation where "it is well-pled that the controller, as seller, engaged in a conflicted transaction by wrongfully diverting to herself merger consideration that otherwise would have been paid to all stockholders,"[120] it held that the allegations were not well-pled and that in any event the *MFW* standard was met.

Similarly, in *Palkon v. Maffei (TripAdvisor)*,[121] Vice Chancellor Laster concluded that entire fairness applied to TripAdvisor's decision to move its state of incorporation from Delaware to Nevada. Plaintiffs alleged that the reincorporation was an effort by the controlling shareholder, Greg Maffei, and the defendant directors to secure the greater litigation protection afforded to corporate fiduciaries by Nevada law.[122] The court agreed.

> The reduction in the unaffiliated stockholders' litigation rights inures to the benefit of the stockholder controller and the directors. That means the conversion confers a non-ratable benefit on the stockholder controller and the directors, triggering entire fairness.[123]

Notably, the case appeared to expand the scope of unique benefit beyond quantifiable economic consideration, holding that the "unique benefit" was protection from litigation for the controlling shareholder and a reduction in the litigation rights of the minority shareholders.[124] Going forward, under the

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[117] No. CV 11202-VCS, 2017 WL 3568089 (Del. Ch. Aug. 18, 2017).
[118] *Id.* at *4.
[119] *Id.* The court explicitly stated that "I also disagree with Stewart that the risks and incentives differ significantly as between two-sided controller transactions and one-sided controller transactions where the controller is alleged to have competed with the minority for consideration." *Id.* at *48.
[120] *Id.* at *18.
[121] *TripAdvisor*, 311 A.3d 255 (Del. Ch. 2024)
[122] *Id.* at 261.
[123] *Id.*
[124] The decision appears to leave open the scope of the benefit to the controller necessary to trigger entire fairness. Historically cases viewed this issue as one in which the controller receives a "benefit" and there is an "expense" to the minority. However, *Trip Advisor* opens the door to arguments any controller benefit triggers entire fairness review whether or not

rule of *TripAdvisor*, any transaction in which the controller obtained a benefit (quantifiable or otherwise) would be subject to entire fairness review unless the tranaction applied the *MFW* cleansing mechanisms.[125]

Perhaps the most significant application of controlling shareholder fiduciary duties took place in *Sears Hometown*, decided a month before *TripAdvisor*.[126] *Sears Hometown* involved the controlling shareholder of Sears, Eddie Lampert. When the board of Sears endorsed a plan to liquidate the business, Lampert, who believed that the plan would destroy value, voted to implement measures to block the liquidation plan, including electing new directors and enacting bylaws that would make the adoption of the liquidation plan more difficult. Although plaintiffs did not allege that Lampert dominated the board or received a nonratable benefit, the court nonetheless interpreted the cases we discuss in Part I to hold that Lampert owed a fiduciary duty to the minority shareholders in connection with the exercise of his voting power as a shareholder. Moreover, the court explained that this fiduciary duty included both a duty of loyalty and a duty of care on a modified basis. As the court explained, "when exercising voting power affirmatively to change the status quo, a controlling stockholder owes a fiduciary duty of loyalty which requires that the controller not intentionally harm the corporation or its minority stockholders, plus a fiduciary duty of care that requires that the controller not harm the corporation or its minority stockholders through grossly negligent action."[127] Accordingly, the court applied heightened scrutiny (although not entire fairness) to Lampert's exercise of his voting rights but concluded that Lampert acted reasonably and found no breach of fiduciary duty.

These cases—culminating in *Sears Hometown*—broaden the scope of corporate transactions in which courts have applied fiduciary principles to scrutinize the role of a controlling shareholder.[128] Significantly, the use of fiduciary principles goes beyond the direct holdings of *Frantz* and *Hollinger* which, although applying equitable scrutiny to controller actions, did not hold that those actions were fiduciary in nature such that entire fairness applied. Critically, we believe that the application of fiduciary principles is in theoretical tension with prior Delaware precedent, which recognized that

there is any detriment to the minority. We believe this issue is likely to be litigated heavily in coming years.

[125] The implications of *TripAdvisor* are uncertain at the time of the writing of this Article, as the case is still pending and, in a rare move, the Delaware Supreme Court granted the defendants' motion for an interlocutory appeal. Maffei v. Palkon, No. 125,2024 (Del. Mar. 21, 2024).

[126] *Sears Hometown*, 309 A.3d 474 (Del. Ch. 2024).

[127] *Id.* at 512.

[128] Other recent cases include *Berteau v. Glazek*, No. CV 2020-0873-PAF, 2021 WL 2711678, at *12–15 (Del. Ch. June 30, 2021) and *Knight v. Miller*, No. CV 2021-0581-SG, 2022 WL 1233370, at *10 (Del. Ch. Apr. 27, 2022).

a controller can act selfishly in its individual capacity, including by obtaining a premium for sale of its shares that is not paid to a minority.[129] Thus, *Sears Hometown* marks the dam breaking—the application of fiduciary duties to controlling shareholders when they exercise their individual shareholder rights.[130]

The foregoing series of decisions reflected a marked trend in the Delaware courts, though it was initially confined to the Chancery. Notably, several of these decisions were made at a preliminary stage in the litigation and did not actually find a breach of fiduciary duty.

The Delaware Supreme Court validated this trend in the spring of 2024 in the *Match* case.[131] After requesting supplemental briefing on the question of whether entire fairness analysis applies to transactions outside the merger context and can only be cleansed through use of the MFW procedures,[132] the court confirmed that when a controller was involved, the application of entire fairness review was not limited to freeze-outs or similar transactions. Citing its decisions in the *Lynch* and *Tremont* line of cases, the court explained:

> Even in non-freeze out transactions . . . [t]he underlying factors which raise the specter of impropriety can never be completely eradicated and still require careful judicial scrutiny. This policy reflects the reality that in a transaction such as the one considered in this appeal, the controlling shareholder will continue to dominate the company regardless of the outcome of the transaction. The risk is thus created that those who pass upon the propriety of the transaction might perceive that disapproval may result in retaliation by the controlling shareholder.[133]

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[129] *See* Cheff v. Mathes, 199 A.2d 548, 555 (Del. 1964) ("[I]t is elementary that a holder of a substantial number of shares would expect to receive the control premium as part of his selling price."); Mendel v. Carroll, 651 A.2d 297, 305 (1994) ("The law has acknowledged, albeit in a guarded and complex way, the legitimacy of the acceptance by controlling shareholders of a control premium.").

[130] *See* Hamermesh, et al., *supra* note 21. While it is not clear from the decision itself, *Sears Hometown* implies that these fiduciary duties apply to any exercise of a controller's voting control even if there is no disagreement with the board. However, as one practitioner has noted to us, there is little reason to subject the controller's actions to heightened scrutiny if they are consistent with board decisions that are protected by the business judgment rule such as the implementation of governance changes or operational decisions.

[131] *Match*, 2024 WL 1449815.

[132] Michael D. Blanchard, Jody C. Barillare & Brian Loughnane, *Delaware Reconsiders the Scope of the MFW Doctrine in Match.com Case*, MORGAN LEWIS LAWFLASH (Dec. 13, 2023), https://www.morganlewis.com/pubs/2023/12/delaware-reconsiders-scope-of-the-mfw-doctrine-in-matchcom-case.

[133] *Match*, 2024 WL 1449815, at *29 (citing Kahn v. Tremont Corp., 694 A.2d 422, 428 (Del. 1997)).

The court further explained that, in all such transactions, the defendant was required to satisfy *MFW*'s requirements "to change the standard of review to business judgment."[134] The court stated that MFW was applicable outside the freeze-out context because it "[could not] find any statement in MFW that distances our law in any transactional setting from the inherent coercion described in *Lynch*."[135]

In *Match*, the non-ratable benefit was the result of a spin-off transaction. The court neither analzyed whether such benefit was at the expense of the minority or if there was domination in the transaction itself.The court did however acknowledge that entire fairness review would not apply when "the controlling stockholders received the same benefit as other stockholders."[136] The court also rejected defendants' claims that market mechanisms were sufficient in this context, citing *Lynch* and *Tremont*. [137]

Appellants heatedly disputed this seeming extension of *Lynch* and *Tremont* to all controller transactions, arguing in supplemental briefing that the inherent coercion view of *Tremont* was contradicted by other Delaware precedents (discussed in Part I of this Article). Further, they argued that this view would have been opposed by Chancellor Allen, the lower court judge, in *Tremont* itself, citing an influential article co-authored by Chancellor Allen after his decision in Tremont I in which he argued for providing "full cleansing effect" to a controller squeeze-out conditioned on approval by a majority of the minority stockholders or approval by independent directors.[138]

The *Match* further rejected the proposition that where the independence of a majority of committee members was sufficient to meet the requirements of *MFW*. Notably, the court so held even in the absence of allegations that the controlling shareholder dominated the committee. Because the court found one of the three committee members was not independent, it

[134] *Id.* at *38.
[135] *Id.* at *14.
[136] *Id.* at *13.
[137] *Id.* at *15.
[138] *See* Supplemental Opening Brief of the IAC Defendants at 30, *Match*, 2024 WL 1449815 (citing William T. Allen et al*., Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, 1306-09 & 1306 n.75 (2001)). The article further explained why real-world market evidence exposed inherent coercion as an untenable concept and demonstrated that the traditional approach's deference to decisions made by independent directors and disinterested stockholders is wise policy.

concluded that Match had failed to satisfy the *MFW* standard, and entire fairness review was required.[139]

In sum, the current state of play is heavy judicial scrutiny of decisions by corporations with a controlling shareholder. A controlling shareholder may be viewed as owing fiduciary duties to the corporation even when acting solely in its capacity as a shareholder. Decisions in which the shareholder has received a non-ratable benefit (even decisions in which that benefit does not come at the expense of the minority shareholders and is non-quantifiable) will be subject to entire fairness review absent compliance with the *MFW* procedures. Further, the courts have made *MFW* compliance more difficult by imposing a demanding standard of independence for the special committee.[140] Most importantly, as we discuss in the next section, the potential universe of corporations with a controlling shareholder has arguably expanded.

B. Extending Who is a Controller

At the same time as Delaware courts applied fiduciary duties and entire fairness to a broader range of transactions, they extended the concept of a controlling shareholder to encompass elements of what we term "new" control. To be sure, the increased use of dual class structures created a new category of controlling shareholders who did not hold a majority economic interest. [141] Dual class has the potential to reduce the beneficial features of

[139] The Chancery Court held that it was only necessary that a majority of the committee be independent and found that it was. *Match*, 2024 WL 1449815, at *18. Both courts agreed, however, that one of the committee members was not independent because of his "longstanding business affiliations" with the controlling shareholder. *Id.*

[140] We note that the courts' analysis of director independence in the context of *MFW* appears to be more demanding than that applied in the demand context, although a full analysis of this issue is beyond the scope of this Article. See, e.g., United Food & Commer. Workers Union v. Zuckerberg, 262 A.3d 1034 (Del. 2020) (considering and rejecting challenges to directors' independence at Facebook despite controlling shareholder Mark Zuckerberg's power to elect the board).

[141] Dual class structures are designed to provide a shareholder with voting control despite a lack of majority economic interest. As such, dual class structures present distinctive risks of opportunistic behavior. At the same time, market practices suggest that investors voluntarily invest in companies with dual class structures and perceive some benefits to doing so. *See, e.g.*, Ahn, et al., *supra* note 35. The ability to exercise control through high vote stock means that a controlling shareholder influences a variety of corporate decisions—from election of directors to adopting bylaws—solely in its capacity as a shareholder. Dual class also involves, in some cases, particularized governance issues such as equal treatment provisions and sunset extensions. *See, e.g.*, Caley Petrucci, *Equal Treatment Agreements: Theory, Evidence and Policy*, 40 YALE J. REG. 620 (2023) (discussing equal treatment provisions); David J. Berger, Jill E. Fisch & Steven Davidoff Solomon, *Extending Dual Class Stock: A Proposal,* 25 THEORETICAL INQUIRIES IN LAW 23 (2024) (discussing sunset

controlling shareholdership because a disparity between voting and economic rights heightens the risk of controller self-dealing.[142] Nonetheless, Delaware doctrine can easily accommodate the proposition that control should be premised on a shareholder's voting power rather than economic ownership. As a result, the courts have readily characterized such shareholders as controlling without extensive analysis.[143]

The broader extension of fiduciary duties to shareholders holding significantly lower stakes came hesitantly. In the *Solar City* litigation,[144] plaintiffs argued that Elon Musk, who, at the time, owned 22.1% of Tesla's stock, should be treated as a controlling shareholder.[145] Addressing the issue in the context of a motion to dismiss, Vice Chancellor Slights concluded that the complaint had alleged sufficient facts to make it "reasonably conceivable" that Musk was a controlling shareholder. The court stated that, although Musk's ownership stake was "relatively low," it explained that "there is no absolute percentage of voting power that is required in order for there to be a finding that a controlling stockholder exists."[146]

In agreeing with the proposition that a 22.1% interest could be sufficient to render Musk a controlling shareholder, the court cited a number of earlier decisions in which plaintiffs alleged that shareholders with similar size blocks should be treated as controlling shareholders.[147] Notably, although courts in some of these cases accepted those allegations at the motion to dismiss stage, the decisions did not ultimately resolve the issue.[148] Thus, in a 2016 decision, the court in *PNB Holding*,[149] concluded that, where a group of officers and directors collectively held 33.5% of the company's stock, they should not be treated as a controlling group. As the court explained, "[f]or starters, even taken together, the directors and officers of PNB did not control a majority of the company's voting power."[150] In addition, although

extensions). The extent to which a high vote shareholder's power is a bargained-for feature of dual class or warrants heightened judicial scrutiny raises distinctive questions, some of which extend beyond the scope of this Article.

[142] *See, e.g*., Lucian A. Bebchuk & Kobi Kastiel, *The Perils of Small-Minority Controllers*, 107 GEO. L.J. 1453, 1465 (2019) (discussing how dual class structures enable shareholders to exercise control despite owning "a small minority of the company's equity").

[143] *See, e.g*., *EZCORP*, 2016 WL 301245.

[144] *In re* Tesla Motors, Inc. S'holder Litig., No. CV 12711-VCS, 2018 WL 1560293 (Del. Ch. Mar. 28, 2018).

[145] *Id.* at *19.

[146] *Id.* at *33 (quoting *In re* PNB Holding Co. S'holders Litig., No. CIV.A. 28-N, 2006 WL 2403999, at *9 (Del. Ch. Aug. 18, 2006); *In re* Zhongpin Inc. Stockholders Litig., No. CV 7393-VCN, 2014 WL 6735457, at *6 (Del. Ch. Nov. 26, 2014)).

[147] *See id*. at *33 n. 220.

[148] *See also* Larkin v. Shah, No. CV 10918-VCS, 2016 WL 4485447, at *2 (Del. Ch. Aug. 25, 2016) (finding 23.1% minority stockholder was not a controlling stockholder).

[149] *PNB Holding*, No. CIV.A. 28-N, 2006 WL 2403999 (Del. Ch. Aug. 18, 2006).

[150] *Id.* at *9.

recognizing that the law allowed a court "to impose fiduciary obligations on stockholders who, although lacking a clear majority, have such formidable voting and managerial power that they, as a practical matter, are no differently situated than if they had majority voting control, [that] test is not an easy one to satisfy and stockholders with very potent clout have been deemed, in thoughtful decisions, to fall short of the mark."[151]

Similarly, after reviewing a range of cases involving allegations that a minority blockholder should be treated as controlling, the court in 2014 in *Crimson Explorations* explained that "the scatter-plot nature of the holdings highlights the importance and fact-intensive nature of the actual control factor."[152] The court then explained that prior cases required a plaintiff to show actual domination by a large blockholder for the court to accept the categorization as a controlling shareholder.[153] The court noted that "[a]bsent a significant showing [of domination] such as was made in these prior cases, the courts have been reluctant to apply the label of controlling stockholder—potentially triggering fiduciary duties—to large, but minority, blockholders."[154] And in *Skye Mineral Investors*,[155] the court, again at the motion to dismiss stage, accepted the premise that defendants could be controlling shareholders on the basis of being non-majority shareholders with blocking rights.[156] As the court explained, however, although mere blocking rights would not likely be sufficient to support an allegation of control, the plaintiffs alleged that the blocking rights both gave defendants "the unilateral power to shut SMP down—full stop" and that the defendants actually exercised those rights.[157]

In *Solar City*, Vice Chancellor Slights concluded that the issue "whether a large blockholder is so powerful as to have obtained the status of a 'controlling stockholder' is intensely factual [and] it is a difficult [question] to resolve on the pleadings."[158] The court noted that plaintiffs identified several factors in addition to Musk's stock ownership, including (1) Musk's ability to influence the stockholder vote to effect significant change at Tesla, including the removal of Board members; (2) Musk's influence over the Board as Tesla's visionary, CEO, and Chairman of the Board; (3) Musk's strong connections with members of the Tesla Board and the fact that a majority of the Tesla Board was "interested," as that term is defined in our

[151] *Id*.
[152] *In re* Crimson Exploration Inc. Stockholder Litig., 2014 Del. Ch. LEXIS 213, *34 (2014).
[153] *Id.* at *39.
[154] *Id.* at *39–40.
[155] Skye Mineral Investors, LLC v. DXS Capital (U.S.) Limited, 2020 Del. Ch. LEXIS 72.
[156] *Id.*
[157] *Id.* at *61-62.
[158] *In re* Tesla Motors, Inc. S'holder Litig., 2018 Del. Ch. LEXIS 102, at *13.

law, in the Acquisition; and (4) Tesla's and Musk's acknowledgment of Musk's control in its public filings.[159] It concluded that these allegations were sufficient to survive a motion to dismiss. Ultimately, the court never resolved the question of whether Musk was a controlling shareholder at trial, deciding instead that the transaction was entirely fair.[160]

Like *Solar City*, *Tornetta* involved allegations against Elon Musk in his capacity as controlling shareholder of Tesla. In *Tornetta*, the plaintiff-shareholder class challenged Musk's enormous $55.8 billion pay package. This package had been approved by the purportedly non-independent directors as well as by stockholders. Additionally, it was based on Musk increasing the value of Tesla by $600 billion in order to receive the full package.

Chancellor McCormick began by observing that Musk's status as a controlling shareholder had been *raised* but not decided, in the *Solar City* litigation.[161] The Chancellor then concluded that it was now appropriate to decide the issue—she remarked that "[t]his question of whether Musk controls Tesla has thus proven evasive. It is as good a time as any to run it to ground."[162]

The Chancellor explained that the analysis of control was pragmatic and required a plaintiff to show that a controlling shareholder was similarly situated to one that had majority voting control. She then explained that this inquiry required an analysis of whether a stockholder could exercise what she termed "effective control" based on factors that include: (1) ownership of a "significant equity stake" (albeit less than a majority), (2) the right to "designate directors" (albeit less than a majority), (3) "decisional rules in governing documents that enhance the power of a minority stockholder or board-level position," and (4) the ability to "exercise outsized influence in the board room, such as through high-status roles like CEO, Chairman, or founder."[163]

Chancellor McCormick also distinguished between general control and transactional control, reasoning that control could be operational in a specific transaction.[164] She stated:

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[159] *Id.* at *13.
[160] *In re* Tesla Motors, Inc. Stockholder Litig. 2022 Del. Ch. LEXIS 94 (2022), *aff'd In re* Tesla Motors Stockholder Litig., 2023 Del. LEXIS 178 (Del., June 6, 2023).
[161] *Tornetta*, 310 A.3d at 501.
[162] *Id.* at 502.
[163] *Id.* at 500.
[164] The concept of transaction-specific control, which suggests that the decision of whether a shareholder controls a corporation may vary depending on the transaction at issue appears to

> To establish transaction-specific control, a plaintiff must show that the stockholder "exercise[d] actual control over the board of directors during the course of a particular transaction[.]" This analysis often focuses on relationships "with key managers or advisors who play a critical role in presenting options, providing information, and making recommendations[.]" It can also address "the exercise of contractual rights to channel the corporation into a particular outcome by blocking or restricting other paths," and "commercial relationships," although those factors are less relevant here. Ultimately, "[i]t is impossible to identify or foresee all of the possible sources of influence that could contribute to a finding of actual control over a particular decision."[165]

The Chancellor noted that this was a fact-specific inquiry, stating: "[b]oth general control and transaction-specific control call for a holistic evaluation of sources of influence."[166]

In conducting this holistic evaluation, the *Tornetta* opinion drew heavily on the concept of a "Superstar CEO."[167] The court explained that "CEO superstardom is relevant to controller status because the belief in the CEO's singular importance shifts the balance of power between management, the board, and the stockholders."[168] Based on a comprehensive analysis of Mr. Musk's ties, the court found he had transactional control, stating:

> The collection of features characterizing Musk's relationship with Tesla and its directors gave him enormous influence over Tesla. In

have its origins in In re Western Nat'l Corp. Shareholders Litig., 2000 Del. Ch. LEXIS 82 , *70 ("a significant stockholder that does not, as a general matter, exercise actual control over the investee's business and affairs or over the investee's board of directors but does, in fact, exercise actual control over the board of directors during the course of a particular transaction, can assume fiduciary duties for purposes of that transaction"). See Elizabeth Pollman and Lori Will (working paper forthcoming in Journal of Corporation Law, authors will supply a draft in a later round of edits). Rather than recognizing the existence of transaction-specific control, however, the decision rejected the proposition that a 46% shareholder had transaction-specific or general control based solely on its voting power Similarly, the court refused to apply fiduciary principles to American General's exercise of that power. As the court explained, "American General's exercise of its statutory rights as a stockholder to oppose a merger with U.S. Life is of no legal consequence." Id. at *29.

[165] *Tornetta*, 310 A.3d at 500.

[166] *Id.*

[167] The court cited a law review article, Assaf Hamdani & Kobi Kastiel, *Superstar CEOs and Corporate Law*, 100 WASH. U. L. REV. 1353, 1400 (2023), which developed the concept of a Superstar CEO to explain why such CEOs enjoy substantial influence over corporate decisions but warned that "turning the elusive notion of a superstar CEO into a legal test for control will be costly."

[168] *Tornetta*, 310 A.3d. at 507.

> addition to his 21.9% equity stake, Musk was the paradigmatic "Superstar CEO," who held some of the most influential corporate positions (CEO, Chair, and founder), enjoyed thick ties with the directors tasked with negotiating on behalf of Tesla, and dominated the process that led to board approval of his compensation plan. At least as to this transaction, Musk controlled Tesla.[169]

Chancellor McCormick then found that Tesla had not satisfied *MFW* because (1) the compensation package was not approved by truly disinterested directors, and (2) the shareholder vote was not fully informed. As a result, the Chancellor held that she was required to apply entire fairness review to Musk's compensation package. With respect to the process, the court gave great weight to the fact that, in her words, the option grant was not the product of arms-length negotiations. Drawing from the freeze-out cases, the court stated that "[t]he lack of arm's-length negotiations can overshadow positive aspects of a process."[170] Fair process in a conflicted merger, however, is designed to replicate the negotiations that would take place between independent third parties. In contrast, no negotiation of CEO pay can fairly be described as an arms-length process, especially when it involves an incumbent CEO.[171]

The court also stressed the sheer magnitude of the compensation package.[172] As the court explained:

> There is no absolute limit on the magnitude of a compensation grant that could be considered fair. But "[p]rocess can infect price." And "where the pricing terms of a transaction that is the product of an unfair process cannot be justified by reference to reliable markets or by comparison to substantial and dependable precedent transactions, the burden of persuading the court of the fairness of the terms will be exceptionally difficult."[173]

Because the court held that the defendants failed to satisfy their burden of showing that the compensation package was entirely fair, she ordered that

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[169] *Id.* at 446.
[170] *Id.* at 529–30.
[171] *See generally* LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION 23–44 (2004).
[172] This aspect of the court's decision somewhat resembled the Supreme Court's decision in Rogers v. Hill, 289 U.S. 582 (1933) in which it invalidated the compensation package of executives at the American Tobacco Co. *See id.* at 591 (reasoning that even a stockholder vote cannot "be used to justify payments of sums as salaries so large as in substance and effect to amount to spoliation or waste of corporate property").
[173] *Tornetta*, 310 A.3d at 533 (citations omitted).

the package be rescinded entirely.[174] Courts and commentators have observed, however, that for a judge to determine when an executive pay package is reasonable is a fraught endeavor, and prior judicial skepticism of pay packages based on their size has been short-lived.[175]

Thus *Tornetta* represents yet another milestone in applying controlling shareholder status, after a full trial, to someone holding far less than a near-majority of voting power. The opinion's analysis further suggests that its principles could be used to impose fiduciary duties on a wide array of individuals with limited stockholdings and whose potential influence over a corporation is not based on their voting power.[176] Indeed, as we discuss in the next Part, the expansion of controlling shareholder status to those who exercise power over a corporation—what might be termed "soft control"—can similarly be extended even to those who own no stock at all.

Thus, we identify a series of decisions that, over time, mark a sea change in Delaware doctrine on the fiduciary obligations of controlling shareholders, the standard applicable to controllers who engage in actions vis-à-vis the corporation, and the concept of control itself. Together, they mark an expansion with significant implications not just for what is now termed a controlling shareholder but also for companies and corporate transactions generally. We discuss these implications in the next Part.

III. The Implications of the Current Approach

In this Section we analyze key implications of the current Delaware approach. The full scope of the current Delaware approach has yet to be judicially fleshed out, at least in terms of its implementation. Moreover, practitioners are still adjusting to the impact of these recent decisions, and

[174] *Id.* at 544 ("The court orders rescission of the Grant as a remedy for Defendants' fiduciary breaches."). Notably, the plaintiffs had only requested recission as a damages remedy.

[175] *See, e.g.*, Harwell Wells, *"No Man Can be Worth $1,000,000 a Year": The Fight Over Executive Compensation in 1930s America*, 44 U. RICH. L. REV. 689, 730 (2010) (describing judicial retreat from the approach taken in *Rogers v. Hill* and explaining that this retreat can be explained, in part, by "judges' growing doubts about their ability to determine what constituted reasonable compensation"); Omari Scott Simmons, *Taking the Blue Pill: The Imponderable Impact of Executive Compensation Reform*, 62 SMU L. Rev. 299, 339–40 (2009) ("The epic Disney litigation reflects this judicial reluctance to second guess executive compensation despite significant board dysfunction.").

[176] We acknowledge that the extent to which other courts will base a finding of control on similar facts is unclear. In Sciannella v. Astrazeneca UK, Ltd., et al., C.A. No. 2023-0125 (Del. Ch. July 2, 2024), Vice Chancellor Fioravanti concluded that AstraZeneca was not a controlling shareholder of Viela despite the fact that AstraZeneca owned 26.72% of Viela stock, possessed various blocking rights, had placed its former executives in all five top positions at Viela, had successfully obtained board representation, and had relationships with other Viela directors.

we expect the practices involving the use of *MFW* procedures, for example, will continue to evolve. Nonetheless, we believe that the implications we outline below are substantial.

A. The Line-Drawing Question

Tornetta reflects a trend by the courts to treat those who exercise influence over corporate decisions as controlling shareholders even when they hold far less than a majority of the corporation's voting power. *Sears Homeland* intensifies the impact of this approach by extending the application of fiduciary principles (albeit at a reduced level) even when a shareholder is acting solely in its shareholder role. The resulting judicial scrutiny of a range of corporate decisions is in tension with the traditional deference of the business judgment rule.

Our reading of the history suggets that the traditional determination of whether someone was a controlling shareholder was both objective and binary. It was objective in the sense that it required a shareholder to control a majority or near-majority of voting power. It was binary in the sense that a shareholder either *was* or was *not* a controlling shareholder rather than being considered a controlling shareholder for some purposes and not others.[177] As detailed in subpart C below, these doctrinal features are critically important in that they affect the ability of corporations to plan their decisions and to determine ex-ante the procedural requirements that apply.

Tornetta and the cases on which it relies shift the analysis from voting control to domination, soft power, or even the capacity to influence. They also suggest that control can be context or transaction-specific, meaning that a shareholder's status depends on the amount of influence that it can or does exert in a specific situation. We term this approach "new control" to capture the types of control that do not depend on majority or near-majority stock ownership.

Tornetta offers an example of one type of soft control: the possession of a substantial minority block, which by itself would not give a shareholder the power to dictate voting outcomes, coupled with other types of soft power. As the *Tornetta* court explained, soft power can come from the shareholder's other roles in the company such as founder, CEO, or Chairman. Other courts

[177] *See, e.g.*, Siegel, *supra* note 49, at 38–39 ("Once a court determines that a minority shareholder is a controlling shareholder, the courts have not differentiated between those that control because they are minority shareholders who have dominated the transaction and those who control because they own a majority of stock. …. The courts either have not recognized or have not found the distinctions significant between being a majority shareholder and being a dominating minority shareholder.").

have been even more expansive. Vice Chancellor Laster, for example, stated in *Voigt v. Metcalf*:

> Examples [of the sorts of influence that could lead to a finding of actual control] include, but are not limited to, (i) relationships with particular directors, (ii) relationships with key managers or advisors, (iii) the exercise of contractual rights to channel the corporation into a particular outcome, and (iv) the existence of commercial relationships that provide the defendant with leverage over the corporation, such as status as a key customer or supplier.[178]

In contrast, as discussed above, older cases required both that a shareholder hold a majority or near-majority of the corporation's voting power, and that the shareholder dominate the corporate decision-making process to treat that shareholder as a fiduciary.[179] Domination continues to play a role in the "new" control cases, but courts vary in the extent to which they require actual domination. In *Oracle*, which involved a challenge to Oracle's acquisition of Netsuite, for example, plaintiffs alleged that Larry Ellison was a controller shareholder of Oracle.[180] At the time, Ellison owned 30% of Oracle's stock, which constituted the largest block. He was Oracle's founder and former CEO and, at the time of the acquisition, was a director and Chief Technology Officer. According to the *Oracle* court, "[a] plaintiff must show that the alleged controlling stockholder *in actuality* dominated the corporate conduct, either generally or with respect to the transaction in question, to hold the stockholder to duties as a fiduciary."[181] Because the court concluded that Ellison had not dominated the transaction, it held that entire fairness was not warranted.

Oracle's requirement of actual domination appears to be the exception, however. More recent cases have taken a different approach, relying heavily on a shareholder's potential ability to influence corporate decisions—so-called inherent coercion—rather than allegations of actual domination.[182] As Vice Chancellor Laster explained in *Voigt*, for example, one means of pleading the requisite degree of control is to show that "as a practical matter,

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[178] *Metcalf*, 2020 Del. Ch. LEXIS 55, at *32.
[179] *See, e.g.*, *Kahn,* 638 A.2d at 1114 ("For a dominating relationship to exist in the absence of controlling stock ownership, a plaintiff must allege domination by a minority shareholder though actual control of corporation conduct.").
[180] *In re* Oracle Corp. Derivative Litig., 2023 Del. Ch. LEXIS 114 (Del. Ch. May 12, 2023)
[181] *Id.* at *46.
[182] But see Stephen M. Sciannella v. Astrazeneca UK Ltd., et al. [Viela Bio], C.A. No. 2023-0125-PAF, memo. op. (Del. Ch. July 8, 2024), 43-33 (holding that, where plaintiff alleges that a minority blockholder is a controlling shareholder, plaintiff's allegations of domination must involve actual rather than potential control).

possesses a combination of stock voting power and managerial authority that enables him to control the corporation if he so wishes."[183]

Part of the difference in approach may be the stage of the litigation. Delaware courts may require a lesser showing at the motion to dismiss stage. As a practical matter, however, denial of the motion to dismiss has tremendous implications in terms of the ongoing cost and burden of litigation. It is unsatisfying to accept a vague standard even at this stage with the implication that the question of whether the defendant exercised sufficient control can be sorted out later. Moreover, if actual domination is a requirement for a blockholder to be treated as a controlling shareholder, the plaintiff should be required to assert sufficient facts establishing such domination, and an inference that potential influence is sufficient to infer domination is problematic.[184]

A perhaps better explanation for the courts' expansive approach to control is the expanding protection of directors and officers from liability in connection with these transactions. DGCL section 102(b)(7) allows corporations to exculpate directors, and now officers, from liability for decisions that do not involve a breach of the duty of loyalty or a lack of good faith.[185] *Cornerstone* authorizes courts to dismiss exculpated directors at the pleading stage.[186] Even when directors or officers allegedly act pursuant to a conflict of interest, their liability can be cleansed through a single step of an independent board committee or minority shareholder approval. As a result, minority shareholders alleging misconduct increasingly seek to impose liability on so-called controlling shareholders. Indeed, perhaps recognizing the potential expansion of control concepts implicated by their pleadings, plaintiffs in several of the foregoing cases alleged that shareholders were liable not directly for a fiduciary breach but on the basis that they aided and abetted the board's breach of fiduciary duty.[187]

Moreover, the courts' reasoning conceivably extends the breadth of new control further. If controller status is based on influence, it is unclear why even a nominal shareholding is necessary. To be sure, in *Corwin*, the Delaware Supreme Court held that ownership of less than 1% of a company's

[183] *Metcalf*, 2020 Del. Ch. LEXIS 55, at *32. (citing *In re* Cysive, Inc. S'holders Litig., 836 A.2d 531, 553 (Del. Ch. 2003)). Compare

[184] *See* Puma v. Marriott, 283 A.2d 693, 693 (Del. Ch. 1971) (granting motion to dismiss where complaint failed to allege that the Marriott family, which owned 46% of the stock, dominated the independent directors).

[185] Del. Code Ann. tit. 8, § 102(b)(7) (2024).

[186] *In re* Cornerstone Therapeutics Inc., Stockholder Litig., 115 A.3d 1173, 1187 (Del. 2015) ([W]hen the plaintiffs have pled no facts to support an inference that any of the independent directors breached their duty of loyalty, fidelity to the purpose of Section 102(b)(7) requires dismissal of the complaint against those directors.").

[187] We discuss this point further at n. 258 and accompanying text.

stock, coupled with financial and contractual influence, was insufficient to make the defendant a controlling shareholder and thereby subject the transaction at issue to entire fairness analysis. [188] As a practical matter, however, corporate participants can exercise soft power over corporate decisions through a variety of mechanisms other than shareownership.

One example, drawing upon the analysis in *Tornetta*, would involve premising control on status as a Superstar CEO alone.[189] As noted above, corporate law currently treats officers, even powerful ones, differently from controlling shareholders.[190] Officers can be protected through exculpatory charter provisions pursuant to DGCL section 102(b)(7), and officer conflicts can be cleansed through just a shareholder vote. Indeed, the historical antecedents of distinctive treatment for controlling shareholders are premised on the position that the potential influence of a controlling shareholder is somehow different. But if controlling shareholder status and the associated fiduciary duties are based partly on a shareholder's position as an officer, the distinction breaks down.

It would also be plausible to conclude that a defendant has sufficient influence over corporate actions solely on the basis of contractual rights.[191] Contracts can provide parties with control over a corporation in several ways. Minority shareholders can agree to act collectively by voting their shares pursuant to a voting agreement.[192] Shareholders (and nonshareholders as well) can enter into contracts that afford them rights that would typically require a majority of voting power, such as the right to appoint or remove director candidates or the right to veto governance changes such as an amendment of the bylaws. These shareholder agreements have become increasingly prevalent in large private-equity-backed or venture-capital-funded private companies but are also common in publicly-traded

[188] Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 306–07 (Del. 2015).
[189] *See, e.g.*, Assaf Hamdani & Kobi Kastiel*, Superstar CEOs and Corporate Law*, 100 Wash. U. L. Rev. 1353, 1367 (2023) (arguing that a Superstar CEO's influence is not based on his stock ownership).
[190] *See MFW*, 88 A3d at 648–49 (explaining traditional reluctance to defer to process protections of independent board and shareholder approval in controlling shareholder mergers).
[191] See, e.g., In re Pattern Energy Grp. Inc. S'holders Litig., No. CV 2020-0357-MTZ, 2021 WL 1812674, at * 1 (Del. Ch. May 6, 2021) ("Recognizing that neither the investor nor the supplier owned Company stock, I leave open the possibility that the plaintiff may establish the investor, supplier, and management stockholders formed a control group, given the investor's consent right and other pervasive sources of soft power over the Company and its sales process.")
[192] *See* Hamermesh, et al., *supra* note 21, at 38–39 (discussing judicial analysis of whether such arrangements should result in a group of shareholders being treated as a control group).

companies.[193] Finally, shareholder agreements can authorize signatories to exercise powers typically exercised by the board, such as the power to propose or veto operational decisions, to select officers, or to determine executive compensation.[194]

Notably, to the extent that contractual rights can provide signatories with equal or greater control over corporate decisions than majority shareholders, it is unclear why controlling shareholder status requires any stockholdings at all. Indeed, the plaintiffs in *Skye Mineral* asserted claims against defendants who held no shares in the company.[195] Although the court rejected the proposition that they exercised actual control, it did not hold that stock ownership was required for someone to be a controller.[196] Moreover, with the passage of Del. Gen. Corp. L. § 122(18), there may be a significant expansion of agreements that confer control rights upon parties that do not hold majority voting power.[197]

New control could also extend to other types of shareholder influence. A number of Chancery Court decisions have referenced DGCL Section 203 – Delaware's anti-takeover statute -- and its 20% threshold as a possible determinant of control.[198] Activist investors despite typically owning less than 10% of the issuer's stock, are often successful in pressuring issuers to make decisions that are favorable to the activist. The determination that an

[193] *See* Jill E. Fisch, *Stealth Governance: Shareholder Agreements and Private Ordering*, 99 WASH. U. L. REV. 913 (2021); Gabriel Rauterberg*, The Separation of Voting and Control: The Role of Contract in Corporate Governance*, 38 YALE J. REG. 1124 (2021); Shobe & Shobe, *supra* note 14.

[194] *See, e.g.*, W. Palm Beach Firefighters' Pension Fund v. Moelis & Co., 311 A.3d 809 (Del. Ch. 2024) (discussing and invalidating several such provisions); Del. Gen. Corp. L. §122(18) (explicitly authorizing shareholder agreements that grant shareholders the power to exercise what would otherwise be within the board's statutory authority under Del. Gen. Corp. L. §141(a).

[195] Skye Mineral Investors, LLC v. DXS Capital (U.S.) Limited, 2020 Del. Ch. LEXIS 72.

[196] *See id.* at *62 ("Noronha, Michael Riady, Stephen Riady, and LCR owned no SMP units, appointed none of SMP's Board members and held no contractual blocking rights.").

[197] 8 Del. C. § 122(18). Significantly, the statute does not require the recipient of contractual control rights to be a current shareholder.

[198] *See* Tornetta, 310 A.3d at 503; 8 Del. C. § 203(c)(4) ("[a] person who is the owner of 20% or more of the outstanding voting stock of any corporation, partnership, unincorporated association or other entity shall be presumed to have control of such entity, in the absence of proof by a preponderance of the evidence to the contrary"). Vice Chancellor Travis Laster has also publicly argued that Section 203 is an appropriate reference point for definition of control in the fiduciary context. See *Travis Laster, Wondering About "Control"? The General Assembly Already Defined It*, LinkedIn, (Feb. 24, 2024), ("People have been talking about "control" for decades, and particularly since MFW and Corwin made "control" a bigger deal. When someone asks me about "control," I have good news. The General Assembly already defined it.That definition appears in Section 203 of the DGCL, and it has two parts. . . ."), available at https://www.linkedin.com/pulse/wondering-control-general-assembly-already-defined-travis-laster-4czme/.

investor with even a 5% stake has the potential to affect control is the basis for the requirement that investors acquiring such a stake publicly disclose their holdings pursuant to SEC rule 13D.[199] Engine No. 1, for example, ran a successful proxy contest in which it was able to secure board representation at Exxon—representation that the activist promised to use to cut Exxon's investment in oil and gas projects.[200] This influence led Professors Anabtawi and Stout to argue that activists should be treated as controlling shareholders and subject to fiduciary duties.[201] Although concededly, an activist cannot succeed in a proxy contest unless it obtains the support of other shareholders,[202] as Professor Haan has documented, a substantial majority of activist campaigns result in settlements between the activist shareholder and the issuer.[203] In those settlements, the issuer may agree to provide the activist with board representation and to make other changes. Importantly, these settlements are not subject to approval by the other shareholders, and they typically give the activist ongoing nonratable benefits.[204]

Even non-activist shareholders could fall within the broad definition of controllers. Today, most shares of publicly-traded companies are held by institutional investors, and a relatively small number of those investors dominate.[205] These institutions can exercise a considerable degree of

[199] Similarly, the potential that the acquisition of non-majority block holdings can influence control has led corporations to adopt poison pills with increasingly low triggers. *See, e.g., The Williams Companies Stockholders Litig*., 2021 WL 754593, at *1 (Del. Ch., Feb. 26, 2021) (analyzing a poison pill with a 5% trigger threshold); Ofer Eldar, Tanja Kirmse & Michael D. Wittry, *The Rise of Anti-Activist Poison Pills* 2 (ECGI, Finance Working Paper No. 869/2023, Jan. 2023) ("poison pills in the last decade have substantially lower ownership triggers").

[200] *See* Anna Christie, *The Agency Costs of Sustainable Capitalism*, 55 U.C. DAVIS L. REV. 875, 924-–25 (2021) (describing Engine No. 1's proxy campaign). According to Exxon, efforts to change the nature of its business in this way are contrary to the interests of other shareholders. *See, e.g.*, Complaint, Exxon Mobil Corp. v. Arjuna Capital LLC (N. D. Tex. Jan. 21, 2024) (Case No. 4:24-cv-00069-O).

[201] Iman Anabtawi & Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255, 1260 (2008).

[202] Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863 (2013).

[203] Sarah C. Haan, *Shareholder Proposal Settlements and the Private Ordering of Public Elections*, 126 YALE L.J. 262 (2016).

[204] *See* discussion of Theodore B. Miller, Jr., et al. v. P. Robert Bartolo, et al., C.A. No. 2024-0176-JTL in Jim Woolery, *From Moelis to Miller: How to Settle with Activists*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE (Mar. 26, 2024), https://corpgov.law.harvard.edu/2024/03/26/from-moelis-to-miller-how-to-settle-with-activists/.

[205] *See, e.g*., Jill Fisch, Assaf Hamdani & Steven Davidoff Solomon, *The New Titans of Wall Street: A Theoretical Framework for Passive Investors*, 168 U. PA. L. REV. 17, 19–20 (2019) (describing the emerging role of the "Big Three" asset managers, BlackRock, Vanguard and State Street); Merritt B. Fox & Menesh S. Patel, *Common Ownership: Do Managers Really*

influence over issuer policies.[206] Institutional investor voting has been highly influential in causing issuers to adopt a variety of governance reforms and has extended to more controversial topics, including climate change and DEI initiatives. One paper, for example, finds that the largest institutional investors had a significant impact on the number of women serving on corporate boards.[207] Significantly, issuers can often exercise this influence through behind-the-scenes engagement, which is less transparent than voting.[208] Some commentators argue that, because of the substantial influence of institutional investors, their voting and engagement on these issues should subject them to fiduciary duties.[209] Relatedly, Exxon sued two of its institutional investors for filing a shareholder proposal, which, according to Exxon, sought to change Exxon's business model at the expense of shareholder value.[210] Although the complaint did not assert fiduciary duty claims, such claims would appear viable under an expansive concept of control.

The analogy to controllers extends further. In the Tesla-Solar City merger, a number of large instituitonal investors were invested in both Tesla and Solar City. As a result, in voting their Tesla shares (to approve the merger), their voting preferences were influenced by the impact of the merger on their Solar City investments. In litigation challenging the merger, plaintiffs argued that this conflict of interest should cause the court to disregard those votes.[211] Because non-controlling shareholders are permitted to act in accordance with

Compete Less?, 39 YALE J. ON REG. 136 (2022) ("Three management companies alone--Vanguard, BlackRock, and State Street (the 'Big Three')—manage funds holding in aggregate approximately 21% of the shares of a typical S&P 500 firm.").

[206] The potential influence of large institutional investors has spawned an extensive "common ownership" literature. *See, e.g.*, Kenneth Khoo*, Transaction Costs in Common Ownership*, 25 U. PA. J. BUS. L. 209, 262 (2023) (discussing how engagement can facilitate anticompetitive behavior).

[207] Todd A. Gormley, Vishal K. Gupta, David A. Matsa, Sandra C. Mortal & Lukai Yang, *The Big Three and Board Gender Diversity: The Effectiveness of Shareholder Voice* 38 (Eur. Corp. Governance Inst., Working Paper No. 714, 2023), J. FIN. ECON. (forthcoming) https://ssrn.com/abstract=3724653.

[208] *See, e.g.,* Jill Fisch & Jeff Schwartz, *Corporate Democracy and the Intermediary Voting Dilemma,* 102 TEX. L. REV. 1, 4 (2023) ("[V]oting is merely the tip of the iceberg; direct engagement with issuers is a key component of [institutional investors'] stewardship efforts.").

[209] *See, e.g.*, Marlo Oaks & Todd Russ, *A Historic Breach of Fiduciary Duty*, WALL ST. J. (May 15, 2023), https://www.wsj.com/articles/a-historic-breach-of-fiduciary-duty-shareholder-proposals-proxy-adivsory-climate-43baa5ba (arguing that "institutional investors must vote for what is in the best financial interest of shareholders"). Such duties would be in addition to those owed by institutional money managers to their own investors.

[210] Complaint, *supra* note 200.

[211] *In re* Tesla Motors, Inc. Stockholder Litigation, 2018 WL 1560293 (Del. Ch. March 28, 2018). The court did not have occasion to address this argument.

their own self-interest, the argument would, in effect, have extended the legal principles applicable to controllers to these shareholders.

The use of "new" control is superficially appealing in that it offers a more nuanced and pragmatic evaluation of a shareholder's potential influence over corporate decisions. At the same time, as these examples show, it has the potential to expand the scope of controlling shareholders far beyond traditional limits and, as a result, to extend entire fairness review to an increasing number of corporate decisions. One potential response to these concerns is that corporations can mitigate them by adhering to the procedural protections set out in *MFW*. In this next subpart, we demonstrate why this solution is problematic.

B. Application of *MFW* in Controlled Companies

The courts' willingness to expand the application of the entire fairness analysis appears to be based, in part, on the premise that corporations can always adhere to the *MFW* procedures and, by so doing, return the standard of review to business judgment rule. If a corporation does so, it will be able to have the lawsuit dismissed and avoid the fact-intensive analysis of fair process and fair price. We argue in this subpart, however, that the promise of transactional certainty through *MFW* compliance is overstated.

MFW requires that for a corporate decision to receive business judgment review, that decision must be conditioned, up front on approval, by a disinterested independent committee that fulfills its duty of care and an uncoerced informed vote by a majority of the minority shareholders.[212] Yet compliance with *MFW* is more complex than it initially appears. Uncertainty about whether a court will determine that a corporation has complied adequately and applied the safe harbor likely explains the failure of many corporations to use *MFW*, presumably anticipating that an attempt at compliance will not meaningfully reduce their litigation risk.[213]

[212] Olenik v. Lodzinski, 208 A.3d 704, 715 (Del. 2019). Some commentary has described *MFW* as imposing six requirements. *See, e.g.*, Christopher B. Chuff, Joanna J. Cline & Matthew M. Greenberg, *MFW Pitfalls: Bypassing the Special Committee and Pursuing Detrimental Alternatives*, HARV. L. SCH. FORUM ON CORP. GOV. (June 30, 2020), https://corpgov.law.harvard.edu/2020/06/30/mfw-pitfalls-bypassing-the-special-committee-and-pursuing-detrimental-alternatives/.

[213] *See, e.g.*, Meredith Kotler, Ethan Klingsberg & Marques Tracy, *Maybe Entire Fairness Review Isn't So Bad After All: Lessons from BGC Partners and Other Recent Controlling Shareholder Transactions*, FRESHFIELDS (Sept. 9, 2022), https://blog.freshfields.us/post/102hwqh/maybe-entire-fairness-review-isnt-so-bad-after-all-lessons-from-bgc-partners-a ("While the business judgment rule undoubtedly remains appealing to many controlling stockholders, there may be reasons why some may choose not to go down the MFW path and instead embrace entire fairness review."). In addition to

Consider first the requirement that the *MFW* procedures be established ab initio. The courts have repeatedly held that if the defendants engage in substantial economic negotiations prior to conditioning a transaction on *MFW* compliance, the transaction will not receive the benefit of the safe harbor.[214] For a freeze-out transaction, establishing the start of the negotiations is relatively straightforward, but determining the start of other corporate decisions is more difficult. Similarly, it is often unclear at the outset whether a particular decision will result in a controller receiving a nonratable benefit. A third party, for example, may seek to purchase a corporation and, in the course of the negotiations, determine to provide the controller with different consideration, an ongoing consulting agreement, or some other type of benefit. Finally, to the extent that a court applies a context-specific concept of soft control to a shareholder that holds substantially less than majority voting power, the transaction-specific factors relevant to the assessment of control may not even have occurred at the time that the corporation must decide whether to commit to an MFW process.

Second, *Match* provides that a transaction will not receive the protection of MFW unless the entire special committee is independent.[215] Director independence (like controlling shareholder status) is a complex and fact-dependent analysis. Even if a corporation attempts to create an independent committee, subsequent judicial review may determine that one or more directors is not sufficiently independent. Indeed, *Tornetta* offers an example of a high level of judicial scrutiny, which, at least for some of the challenged directors, broke new ground in identifying factors that could constitute conflicts. To be sure, even a director's expectation of future rewards may create a disabling conflict.[216] Yet a discerning standard of independence is likely to generate widespread ex post facto litigation about director independence in almost every controller case. Indeed, while the court in the *Trade Desk*[217] case found this hurdle met, it still resulted in substantial and costly litigation. Nor is this a problem that can necessarily be solved by bringing in a single director or new directors, particularly if Delaware takes

uncertainty about whether the safe harbor will be available, corporations may wish to retain greater flexibility in negotiating or fear the uncertainty of a majority of the minority vote. *Id.*

[214] *See, e.g.,* Olenik v. Lodzinski, 208 A.3d 704 (Del. 2019); Flood v. Synutra International, Inc. 195 A.3d 754 (Del. 2018).

[215] Notably this reflects a change from prior law. *See* City Pension Fund for Firefighters and Police Officers v. Trade Desk, Inc., 2022 Del. Ch. LEXIS 183, *29–30 (Del. Ch. 2022) (rejecting plaintiff's challenge to the independence of the special committee where plaintiff did not "meaningfully challenge" the independence of two of the three committee members).

[216] Da Lin, *Beyond Beholden*, 44 IOWA J. CORP. L. 515 (2019).

[217] City Pension Fund for Firefighters and Police Officers v. Trade Desk, Inc., 2022 Del. Ch. LEXIS 183 (Del. Ch. 2022).

an expansive view of independence.[218] Indeed, there are reasons to question whether any director at a controlled company can be considered truly independent.[219] And a court's finding of even one conflict on a committee sufficiently taints the process and prevents the application of *MFW*.

The informed shareholder vote raises similar concerns. Corporate law commentators are well familiar with plaintiffs' willingness to challenge virtually any corporate disclosure as inadequate,[220] and there is no reason to believe that the disclosures in connection with the *MFW* shareholder vote will be immune from those challenges. As with director independence, however, the assessment of whether a disclosure is adequate frequently involves a close call, to the degree that the Chancery court and the Delaware Supreme Court regularly disagree on this point. The fact-specific nature of the inquiry heightens the difficulty of ensuring that the required disclosures are sufficient to withstand a litigation challenge.

This concern is illustrated by the post-*Match* decision in *City of Sarasota Firefighters' Pension Fund v. Inovalon Holdings, Inc.*[221] In *Inovalon*, the CEO and founder Dunleavy controlled the company through high vote dual class stock. Nordic Capital, a private equity firm, proposed a buy-out of Inovalon, but due to financing needs, it required a roll-over of $700 million of Dunleavey's shareholdings. The Inovalon board agreed to the transaction and the shareholders of Inovalon (including the minority shareholders voting separately) approved the buy-out.

Plaintiffs sued claiming that entire fairness applied to the transaction since Dunleavy was a controlling shareholder. In response, the defendants claimed compliance with *MFW* procedures. The Chancery Court agreed and dismissed the case.[222] The Delaware Supreme Court reversed en banc. The basis of the Court's ruling was Inovalon's failure to make full disclosure in

[218] *See* Elizabeth Pollman, *Strengthening Special Committees*, 9 U.C. DAVIS BUS. L.J. 137 (2009) (arguing special committees should consist of more than one member); Jared A. Ellias, Ehud Kamar & Kobi Kastiel, *The Rise of Bankruptcy Directors*, 95 S. CAL. L. REV. 1083, 1087, 1128 (2022) (observing that independent directors may suffer from an auditioning bias because their positions are short term and they depend on a small world of clientele for repeat business).

[219] *See, e.g.,* Giovanni Strampelli, *How to Enhance Directors' Independence at Controlled Companies,* 44 IOWA J. CORP. L. 103 (2018).

[220] *See, e.g.,* Jill E. Fisch, Sean J. Griffith & Steven Davidoff Solomon, *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform,* 93 TEXAS L. REV. 557, 558 & n.4, 559 (2015) (describing the ubiquity of challenges to the adequacy of merger disclosures and arguing that, although the challenges frequently result in corrective disclosures, those disclosure do not provide meaningful value to shareholders).

[221] 2024 Del. LEXIS 151.

[222] *Id.*

connection with the shareholder vote.[223] Specifically, the Court found that in three cases, the proxy statement failed to disclose certain potential conflicts by Innovalon's investment bankers. The Court remanded for further proceedings, which presumably will include an entire fairness review.[224]

Inovalon demonstrates the effect of the current approach.[225] Historically, a rollover of the nature described above would not even be subject to entire fairness analysis. Indeed, in the MBO context, this type of transaction has been repeatedly held to be a transaction subject to DGCL §144, with the roll-over itself arguably subject to the old *Sinclair* standard at best and otherwise within the strictures of the free sale doctrine for controlling shareholders. Moreover, *Inovalon* was not a freeze-out, but rather a transaction where the buyer – in order to obtain financing from the controlling shareholder – was requiring a rollover to enable the transaction to move forward. [226] The transaction was negotiated on an arms-length basis with independent directors and approved by the majority of the minority shareholders. To be sure, there is the potential here for soft control to come into play, but the use of dual procedural mechanisms mitigated against a finding of domination which, in any event, the court did not require. Nonetheless, these type of rollovers are now within the per se entire fairness ambit unless the company strictly complies with *MFW*.

C. Entire Fairness and Transactional Uncertainty

Ambiguity in the definition of controlling shareholder, in the types of transactions that will be subject to entire fairness analysis, and on the ability of a corporation to rely on compliance with *MFW* create tranactional uncertainty. The courts' willingness to subject decisions at controlled corporations to heightened scrutiny imposes an effective tax on operating as a controlled company. These costs are particularly great when a controlled company engages in a transaction that provides a controller with an ascertainable benefit. The rationale for the control premium is that a controller will likely be able to engage in such transactions, and transactions that benefit both the controller and the minority shareholders are socially desirable; yet going forward, such transactions will invariably face costly litigation challenges.

[223] Plaintiff originally alleged that the proxy was materially deficient in six ways. *Id.* at *28. The trial court carefully considered and rejected each allegation. *Id.* at *28–32. The Supreme Court disagreed with some, but not all, of the trial court's analysis. *Id*. at *36–64.
[224] *Id.*
[225] In contrast, a Delaware Chancery Court opinion recently dismissed a claim of breach of fiduciary duties under *Corwin*, highlighting the uncertain application of this doctrine. *See In re* Anaplan, Inc. S'holders Litig., 2024 WL 3086013 (Del Ch. June 24, 2024).
[226] Steven Davidoff Solomon & Matt D. Cain, *Form Over Substance? Management Buy-Outs and the Value of Corporate Process*, 36 DEL. J. CORP. L. 849 (2011).

The law provides no ready way to evaluate the fairness of transactions that provide positive yet differential benefits to both the controller and minority shareholders.[227] In the limited context of freeze-outs and similar transactions, courts can rely on well-developed tools for evaluating the fairness of transaction price, specifically the price shareholders would have obtained through an arms-length third-party transaction. Even those tools often deteriorate into a battle of the experts. In contrast, as the *Tornetta* decision illustrates, courts and commentators have struggled for decades with the question of how to determine whether an executive compensation package is fair.[228] Corporations and courts have debated how to measure fairness in the context of a third-party buyout in which a controlling shareholder receives higher consideration for its shares than the minority shareholders.[229] *TripAdvisor* involves an unprecedented effort to measure the impact of a company's decision to reincorporate in Nevada on minority shareholders. As we have observed in other work, similar problems plague other decisions, such as decisions to extend a sunset provision for a dual class voting structure.[230]

These concerns provide reasons to question further the move toward greater judicial scrutiny of controlled company decisions. We note that heightened judicial oversight over controlling shareholder transactions is in tension with Delaware's general deference to corporate decisions, deference premised on the fact that judges are poorly-suited to evaluate the reasonableness of such decisions. An unwillingness to countenance judicial second-guessing of corporate decisions was the original basis for the business judgment rule. Outside the controlling shareholder context, this deference has only increased in recent years. The implementation of exculpation provisions, for example, has resulted in an absence of judicial scrutiny for director and officer misconduct unless that misconduct involves self-dealing or rises to the level of bad faith. Similarly the Delaware Supreme Court has implemented a broad policy of allowing shareholder approval to substitute for judicial review even under the reasonableness standard of *Coster.*[231]

[227] Indeed, the question of whether a controlling shareholder has received a differential benefit is often itself unclear. *See, e.g*., Petrucci, *supra* note 141, at 644–46 (discussing various cases involving challenges to differential treatment of controlling shareholder).
[228] *See* Rogers v. Guaranty Trust Co., 288 U.S. 123 (1933).
[229] *See, e.g., In re* Delphi Financial Group Shareholder Litigation, 2012 Del. Ch. LEXIS 45 (Del. Ch.) (challenging differential consideration negotiated by controlling shareholder in third-party buyout); Petrucci, *supra* note 141.
[230] Berger, et al., *supra* note 141.
[231] *Corwin*, 125 A.3d 304.

We also note that controlling shareholders operate within a broader corporate structure. Decisions at controlled companies are made by boards of directors that exercise broad discretion pursuant to DGCL § 141 (a) and are subject to fiduciary duties to the corporation and its minority shareholders regardless of who elects them. The power of shareholders, even controlling shareholders to participate in corporate decisions, is starkly limited by Delaware law. Although a controlling shareholder may ultimately have the power to replace existing directors who fail to follow its wishes, a change in composition does not alter the fiduciary principles to which all directors are subject. The approach also ignores the role that even minority shareholders can play in these situations – institutional investors and proxy advisors have regularly shown their ability to influence board decisions even in controlled companies and controller transactions.

Controlled companies are also subject to market discipline. To the extent that controlling shareholders destroy corporate value or engage in excessive self-dealing, the market for the shares of controlled companies will reflect those risks. The existence of a minority discount reflects the possibility that a controlling shareholder will behave, to a degree opportunistically.[232] Mminority shareholders appear willing to bear the cost of a controlling shareholder and, in some cases, may benefit from that presence.[233] Contrary to the implicit assumption in recent cases that controlling shareholders are likely to engage in excessive self-dealing, the market appears to reflect a trend toward greater acceptance of controlling shareholders and an increasing number of arrangements designed to facilitate that control. This acceptance is evidenced through things like the expanded market acceptance of dual class structures,[234] extensive use of shareholder agreements affording control rights outside the dual class context,[235] and the consistent willingness of shareholders to approve transactions that provide differential value to controlling shareholders.[236]

Perhaps most importantly, controlling shareholder power is unlikely to persist if it fails to create value for minority shareholders. As Hamdani and Kastiel observe, the power of a Superstar CEO is "limited in scope and

[232] *See, e.g.,* Adam C. Pritchard, *Tender Offers by Controlling Shareholders: The Specter of Coercion and Fair Price*, 1 BERKELEY BUS. L.J. 83 ("It does not take a zealous faith in the efficient capital market hypothesis to see that the risks of appropriation by the controlling shareholder will lead investors to discount the value of shares in a company that has a dominant shareholder.").

[233] When a court then limits the ability of the controller to exercise control, it is denying the controller its bargained-for right.

[234] Jill E. Fisch & Steven Davidoff Solomon, Dual Class Stock, OXFORD HANDBOOK OF CORPORATE LAW & GOVERNANCE (Jeffrey N. Gordon & Wolf-Georg Ringe, eds., forthcoming 2024), https://ssrn.com/abstract=4436331.

[235] Rauterberg, *supra* note 193; Shobe & Shobe, *supra* note 14.

[236] Petrucci, *supra* note 141 (analyzing data on equal treatment charter provisions).

duration" and only likely to persist as long as investors believe that the CEO is creating extraordinary value.[237] "The board is more likely to challenge such CEOs if they lose their star aura or if the expected harm from self-dealing exceeds the surplus generated by their unique contribution to company value."[238] Similarly, an activist shareholder cannot obtain board representation without the support of other shareholders, and those same shareholders, as well as other directors, constrain the ability of the activist to use that representation to influence corporate decisions.[239] Even if institutional investors had sufficient voting power at their portfolio companies to sacrifice firm-specific economic value in favor of broad-based societal objectives, their ability to do so is constrained by the market power of their beneficiaries. At the same time, as Elizabeth Pollman and Yifat Aran have demonstrated, market forces are often a viable match for structural power, and even a founder-CEO or a shareholder with "old control" may find himself ousted if he is no longer serving the corporation effectively[240] In earlier work, Kastiel shows that controlled companies can also be the subject of successful shareholder activism.[241] He finds that "although controlled companies are more insulated from activism than widely held companies, they are not fully immune to it."[242] He further "documents a non-negligible number of shareholder engagements with controlled firms."[243]

We have thus outlined a series of significant implications that appear at odds with the fundamental market approach of Delaware law to controlling shareholders. Recent cases are also likely to force the Delaware courts into a substantial use of judicial resources, both implementing the current approach as well as defining its scope and limitations. In the next subsection, we argue for a new approach to this issue based on a firmer theoretical approach to both controlling shareholders and fiduciaries.

IV. A New Approach to Controlling Shareholder Duties

A. When is a Controlling Shareholder a Fiduciary?

[237] Hamdani & Kastiel, *supra* note 189.
[238] *Id.*
[239] *See, e.g.,* Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48 (Del. Ch. 2011).
[240] Yifat Aran & Elizabeth Pollman, *Ousted* in THEORETICAL INQUIRIES IN LAW, 231 (2024).
[241] Kobi Kastiel, *Against All Odds: Hedge Fund Activism in Controlled Companies*, 2016 Colum. Bus. L. Rev. 61.
[242] *Id*. at 67.
[243] *Id.* Recent work by Chun Zhou, Wei Zhang and Dan W. Puchniak provides similar evidence that the amount of successful shareholder activism at controlled companies in China is non-trivial. Chun Zhou, Wei Zhang & Dan W. Puchniak, The Overlooked Reality of Shareholder Activism in China: Defying Western Expectations. June 6, 2024, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4853552.

Although we believe that imposing fiduciary duties and entire fairness on controlling shareholders in the context of freezeouts continues to be appropriate, we argue that subjecting transactions outside the traditional freeze-out context to entire fairness review is antithetical to the theoretical rationale for fiduciary duties in the first instance.[244] Fiduciary duties are ex-ante default rules imposed in order to guide conduct that cannot otherwise be bargained for.[245] They suffice to serve as rules that can be enforced by the court when market breakdowns occur but are not intended to deprive a party of a benefit that was freely bargained for. Moreover, they should only be imposed if the benefits of judicial oversight outweigh the costs, including the costs of the litigation necessary to subject transactions to judicial scrutiny.

At the same time, the value of judicial oversight must be weighed against the structural and market forces that constrain controlling shareholder opportunism outside the freeze-out context. Transactions like the reincorporation at issue in *TripAdvisor*, for example, require approval both by the board of directors and by the shareholders. Accordingly, Maffei, acting on his own, could not cause the corporation to act. A similar analysis applied in *Trade Desk*,[246] when the controlling shareholder sought to amend the charter to implement a sunset extenson. Thus the structure of Delaware law already provides gatekeepers to protect against abuse.[247] Similarly, a corporation is subject to the discipline of the capital markets, as well as the softer pressure imposed by creditors, employees, and the media, and evidence shows that these tools can be effective in addressing minority shareholder harm even in cases in which a controlling shareholder exercises hard control.[248]

[244] See D. Gordon Smith, The Critical Resource Theory of Fiduciary Duty, 55 VAND. L. REV. 1399, 1402 (2002) ("fiduciary relationships form when one party (the 'fiduciary') acts on behalf of another party (the 'beneficiary') while exercising discretion with respect to a critical resource belonging to the beneficiary").

[245] See also Smith, *supra* note 45 at 7 ("Fiduciary law is distinct from contract law and classic tort law.").

[246] City Pension Fund for Firefighters and Police Officers v. Trade Desk, Inc., 2022 Del. Ch. LEXIS 183 (Del. Ch. 2022).

[247] While one could argue that these features also apply in freeze-outs, the difference is that a freeze-out is an end-stage transaction in which existing shareholders lose their potential sway. Similarly, freeze-outs more closely reflect a zero-sum game in which the value received by the controlling shareholder comes at the direct expense of the minority. Finally, courts evaluating the fairness of the price in a freeze-out are engaged in a quantitative assessment with an established basis in law and theory and in which they can access market-based tools and comparable transactions. In contrast, the nature and even the existence of harm to minority shareholders in non-freeze-out cases requires a more qualitative and arguably speculative determination.

[248] Aran & Pollman, *supra* note 240. *See also* Yifat Aran, Brian Broughman & Elizabeth Pollman, Executive Turnover at Dual-Class Firms (working paper) (documenting effectiveness of market pressures in removing executives at controlled companies).

Moreover, imposing fiduciary duties in these circumstances lacks – for the reasons we outline – a recognition of the value of control. The current trend toward heightened judicial oversight of decisions by controlled companies imposes substantial and additional costs on such control in terms of the ability of the controller to reap documented intangible and tangible benefits from control which may produce additional benefits to minority shareholders and the corporation itself. We also believe that it interferes with the value of control embedded within the DGCL and cases such as *Ringling Bros*. and *Bershad,* which recognize this value of control and the ability of shareholders to exercise that control through statutory rights.[249]

As a result, we argue that fiduciary duties limited to those cases in which the prospect for coercion is highest and when these countervailing factors are absent. Within this framework, we note the particular incongruity of imposing heightened duties on a controlling shareholder, acting solely in its capacity as a traditional shareholder.[250] Such actions include nominating directors and voting on director elections and shareholder proposals, and also amending the bylaws. They include a controlling shareholder using its voting power to block actions that require shareholder approval such as a charter amendment or merger, even when the shareholder does so in a manner that is contrary to the preferences of other shareholders.

Current doctrine is most problematic in these cases because it creates a direct conflict between a shareholder's economic right to act out of self-interest and the potential that self-interested action will be contrary to the best interests of the corporation or other shareholders. The challenge is increased by the fact that normal corporate governance procedures such as board action and minority shareholder approval are not available as checks on the controlling shareholder's actions.

The court in *Sears Hometown* sought to balance these considerations by subjecting the shareholder's actions to intermediate scrutiny. We argue against this approach based both on the principles underlying fiduciary duties and the framework of the Delaware corporate law. In an action for breach of such duties, controlling shareholders are not be protected from the risks of hindsight bias and excessive litigation through traditional legal protections such as the business judgment rule and exculpation. Most problematically, a duty of loyalty analysis is inapposite with respect to actions in which the shareholder is acting out to further an individual

[249] Deborah A. DeMott, *Organizational Incentives to Care About the Law*, 1997 L. & CONTEMP. PROBS. 39 (1997) (discussing the role of fiduciary duties and the incentives embedded within these duties).

[250] We do not include in the context a shareholder who exercises board authority pursuant to a shareholder agreement. Under those circumstances, the shareholder is acting as a traditional fiduciary and should be analyzed as such.

economic interest. Such a shareholder is, by definition, engaged in self-dealing.[251] The critical point is that when a shareholder acts in its capacity as a shareholder, it is not acting on someone else's behalf as would a fiduciary but rather exercising economic interests as a principal that it has obtained through market-based transactions.[252]

The line between a shareholder acting in a traditional shareholder capacity and exercising broader control over corporate operations can, of course, be hard to discern. As noted above, shareholder agreements may give shareholders the authority to exercise traditional board powers, and we argue that, where they do so, such shareholders should be treated as fiduciaries. Shareholders may, in addition, exercise more limited contractual rights, such as blocking rights, that potentially impact the interests of minority shareholders.[253] Such rights are particularly common in the private company context. We argue that the abuse of such contractual rights can be policed through the implied covenant of good faith and fair dealing, such that the additional imposition of fiduciary duties is unnecessary.[254]

We acknowledge that shareholders often act in multiple roles in which they also serve as officers or directors – traditional fiduciaries. We do not intend our proposal to apply to shareholders when they act in their capacity as such. Indeed, *Sears Hometown* recognized the fact that a shareholder also acts as an officer or director reduces the need to impose separate fiduciary

[251] *See, e.g.*, Zipora Cohen, *Fiduciary Duties of Controlling Shareholders: A Comparative View*, 12 U. Pa. J. Int'l Bus. L. 379, 394 (1991) (explaining that directors take "into account solely the interests of the company [while controlling shareholders] act to further their own interests, as owners of the company's capital").

[252] We note that although the courts have expanded the treatment of controlling shareholders as fiduciaries, they have paid relatively less attention to the question of what obligations such fiduciary status would entail. As Zipora Cohen observes, the fact that someone is a fiduciary does not necessarily address the scope of their fiduciary obligations. *See id.*; *see also* Ernest Lim, *The Government Controlling Shareholder as a Fiduciary: Implications for Climate Change Management and Litigation*, 35 Eur. Bus. L. Rev. (2024) (exploring the fiduciary obligations of the government when it is a controlling shareholder).

[253] The classic example is Basho Techs. Holdco B, LLC v. Georgetown Basho Inv'rs, LLC, 2018 Del. Ch. LEXIS 222, *65, in which the court held that a shareholder exercised control by virtue of, inter alia, the exercise of its contractual rights to "maneuver[] the Company into a position of maximum financial distress"

[254] See, e.g., See, e.g., Dieckman v. Regency GP LP, 155 A.3d 358, 367 (Del. Sup. 2017). See also Franklin A. Gevurtz, Corporate Rulers and Their Councils: Are Directors Becket or Cromwell When Dealing With Controlling Shareholders?, __ U. Pa. J. Bus. L. __ (forthcoming), https://ssrn.com/abstract=4613022 (observing that the "abuse of a contractual advantage to gain more than originally bargained for" can potentially be addressed through the implied covenant of good faith and fair dealing).

obligations on actions taken in the capacity of shareholder.[255] For example, Chancellor McCormack could have characterized Tesla's approval of Musk's compensation package as a conflicted officer transaction and invalidated that transaction on the basis neither the board's approval nor the shareholder vote was sufficiently independent, without the need to examine whether Musk was a controlling shareholder.[256] Similarly, although it would have been more difficult, the court could have determined that the conflicted board members were not acting in good faith when they approved the package.[257] Either shows that the Delaware courts already have tools to address the possibility of controlling shareholder domination without expanding the scope of controller fiduciary duties.

In a similar vein, we also note that Delaware has recognized the availability of a claim against nonfiduciaries for aiding and abetting a breach of fidcuiary duty. In addition, a defendant may be liable for aiding and abetting, even where the traditional fiduciary is subject to exculpation.[258] To the extent that a shareholder impedes the board's decisionmaking process or defrauds the directors, aiding and abetting offers a basis for imposing liability that does not require characterizing the shareholder's role as fiduciary in nature.

We also note that, without holding a formal board position, a shareholder who participates in board meetings and actively influences the other directors may constitute a de facto or shadow director and, as such, incur fiduciary obligations to the corporation.[259] Such cases are beyond the scope of our analysis, although we note that in the UK, courts have recognized that

[255] *See, e.g.*, Paula J. Dalley, *The Misguided Doctrine of Stockholder Fiduciary Duties,* 33 Hof. L. Rev. 175, 212 (2004) ("As directors and officers, [controlling shareholders] will be subject to the usual fiduciary duties in acting on behalf of the corporation.").

[256] This potential did not crystalize in *Tornetta* as the Plaintiff class voluntarily dismissed their claims against the director defendants. Stipulation and [Proposed] Order Governing Decertification of Class, Dismissal with Prejudice of Direct Claims, and Schedule and Terms For Plaintiff s Motion For Leave to File Verified Amended Derivative Complaint, Oct. 27, 2021. In addition, because the plaintiff sought recission rather than money damages, DGCL 102(b)(7) would not have presented an impediment to the court providing the requested relief.

[257] *See, e.g.*, *In re* Tyson Foods, Inc. Consol. S'holder Litig., 919 A.2d 563, 593 (Del. Ch. 2007) (holding that complaint adequately alleged that members of Tyson's compensation committee acted disloyally and in bad faith in approving stock option grant).

[258] See, e.g., RBC Capital Mkts., LLC v. Jervis, 129 A.3d 816, 865 (Del. 2015) (rejecting defendant's argument that imposing such liability "would create an anomalous imbalance of responsibilities where a non-fiduciary may be held liable for an unintentional violation of a fiduciary duty by a fiduciary").

[259] *See, e.g.*, *In re* Ionica Plc, 241 B.R. 829, 839 (USBC SDNY 1999) (explaining that, under UK law, "A 'shadow director' is 'a person in accordance with whose directions or instructions the directors of the company are accustomed to act,' other than those rendering professional advice.").

the mere fact that someone serves as a shadow director will not subject them to the same fiduciary obligations as a de jure director.[260]

B. Strengthening the Guardrails at Controlled Companies

By acknowledging that controlling shareholders, in most instances, should not be held to fiduciary duties, we do not want to minimize the problem of domination and inherent coercion. Indeed, the central concern about transactions at controlled companies is the risk that controlling shareholder domination will taint the corporate decision-making process. This taint can arise in several ways. First, a controlling shareholder can use its voting power to nominate and elect loyal directors who are inclined to favor the controlling shareholder's interests. Second, a shareholder can use its power to remove and replace directors whom it views as insufficiently responsive to its concerns. Third, a shareholder can take or threaten to take other actions, such as amending the bylaws, making a tender offer, or selling stock. To the extent that directors have other business relationships or employment positions with the controlling shareholder, the shareholder can also threaten to end those relationships.Courts have recognized that this domination can lead directors to fail to adhere to proper procedures in evaluating corporate decisions or to give undue weight to the interests of the controlling shareholder, even when those interests are adverse to the interests of other shareholders and the corporation.[261] Even in freeze-out cases in which a controlled company forms a special committee to negotiate the transaction, courts have questioned the ability of such committee to function independently. As then Vice-Chancellor Strine explained, "the men and women who populate the committees are rarely individuals 'whose own financial futures depend importantly on getting the best price and, history shows, [they] are sometimes timid, inept, or . . . , well, let's just say worse.'"[262]

As a result, there are reasons to question the extent to which some boards at controlled companies have acted with sufficient independence. At the end of the day, however, corporate law operates under a framework of board primacy. Directors, not shareholders, are responsible for addressing unfairness in corporate actions. The solution, then, is to buttress the board's ability to act independently, rather than imposing fiduciary duties on shareholders that prevent them from acting out of self-interest. We note that

[260] *See, e.g.*, Ultraframe UK Ltd v. Fielding [2005] EWHC 1638.
[261] *See, e.g.*, Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face*, 30 DEL. J. CORP. L. 673, 678 (2005) (there is "an obvious fear that even putatively independent directors may owe or feel a more-than-wholesome allegiance to the interests of the controller, rather than to the corporation and its public stockholders.").
[262] *In re* Cox Commc'ns, Inc. S'holders Litig., 879 A.2d 604, 619 (Del. Ch. 2005) (Strine, V.C.).

judicial oversight of board decisions incorporates longstanding doctrines such as the obligation of directors to become informed, the virtue of relying on the collective decision-making process of a board, and the protection of directors against excessive litigation through the balance struck by features such as the business judgment rule, D&O insurance, and exculpatory charter provisions. Focusing on the board allows the courts to apply the longstanding presumption of regularity to most decisions at controlled companies without triggering the more onerous entire fairness scrutiny. Focusing on the board's role relieves the courts of the difficult task of determining when a shareholder exercises sufficient control to trigger entire fairness.

As with our analysis of controlling shareholder liability, we do not propose to change the legal standard applicable to controlling sharheolder freezeouts, in which we believe entire fairness remains the appropriate standard of review. We argue that the solution to concerns of domination in non-freezeout cases is to strengthen the ability of the board to act independently of controlling shareholder influence. We offer three suggestions for doing so.[263] First, where a plaintiff sufficiently alleges both that a controlling shareholder has dominated a board decision and that the decision results in a quantifiable benefit to the controller to the detriment of the minority shareholders, we propose that the decision be subject to the one-step cleansing applicable to director and officer conflicted transactions rather than the *MFW* approach. That is, we propose that the fully-informed approval of either the disinterested directors or disinterested shareholders cleanse the transaction, subjecting it to the business judgment rule rather than entire fairness scrutiny. We believe that this approval, together with market mechanisms and the board-level fiduciary duties (enhanced as we discuss further below), is sufficient to remove the taint of domination without the additional costs of the full *MFW* process. We note that our proposal would require the plaintiff to allege actual rather than potential domination. As such, and because the procedural burden is substantially less, our proposal substantially reduces the complexity of determining who is a controlling shareholder. Because many new control cases rely on the potential that sources of soft power will enable the shareholder to influence the board, this requirement is likely to reduce significantly instances in which a shareholder's claim is based on new control.[264]

[263] We also agree that in cases of shareholder action by a majority controller, there is also the potential for continuing equitable review of such transactions under the doctrine of *Frantz.*

[264] We do not address in this article the application of *MFW* to freeze-outs. However, we do note that there is also academic literature addressing this issue and the limits of *MFW*. *See* Itai Fiegenbaum, *The Geography of MFW-Land*, DEL. J. CORP. L. (forthcoming), available at SSRN: https://ssrn.com/abstract=2850900

Second, where a plaintiff sufficiently alleges domination and the decision has not been properly cleansed through the aforementioned single-step process, or where the court determines that the cleansing is procedurally deficient, we propose that the court review the decision under the enhanced scrutiny standard[265] from *Unocal* and *Coste*r as applied in *Sears Hometown*.[266] As in those cases, enhanced scrutiny offers a mechanism by which a court can review decisions in which a board's actions are not necessarily presumptively valid but under a reasonableness standard that is more deferential than entire fairness. Notably, because this standard is more deferential than entire fairness, it reduces the stakes of failing to comply with the *MFW* procedures, potentially reducing what threatens to become highly burdensome collateral litigation over issues such as the independence of the special committee or the adequacy of the diclosure to shareholders. In addition, the more deferential standard relieves the courts of the difficult task of determining whether decisions such as reincorporation or compensation are entirely fair in the absence of meaningful quantitative benchmarks for fairness.

Moreover, the courts developed the enhanced scrutiny standard in *Unocal* and *Revlon* precisely for the purpose of guarding against soft conflicts that might compromise the ability of a board to operate independently.[267] More specifically, in the cases of *Unocal* and *Revlon* the court was addressing the "omnipresent specter that the board . . . is serving its own interests"[268] where actual misconduct is not apparent. In such circumstances, intermediate scrutiny serves to provide a judicial check on the possibility that control can be used to for nonobvious self-dealing. Thus our extension of that approach to other soft conflicts is historically grounded.

In applying intermediate scrutiny, we propose a similar test to that laid out in *Coster*. The plaintiff, we argue, should have the initial burden of colorable allegations that the board was dominated by a controlling shareholder in the challenged decision. If the plaintiff meets that burden, the board must first establish that it "in good faith, after a reasonable investigation, to achieve a

[265] We draw from the court's discussion of enhanced scrutiny in *Sears Hometown*, 2024 Del. Ch. LEXIS 12 (2024).
[266] *See supra* note 20 and accompanying text.
[267] *See, e.g.*, *Unocal*, 493 A.2d at 954 (observing that enhanced scrutiny is appropriate "[b]ecause of the omnipresent specter that a board may be acting primarily in its own interests"); Revlon v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 184 (Del. 1986) ("when a board ends an intense bidding contest on an insubstantial basis, and where a significant by-product of that action is to protect the directors against a perceived threat of personal liability for consequences stemming from the adoption of previous defensive measures, the action cannot withstand the enhanced scrutiny which Unocal requires of director conduct.").
[268] *Revlon*, 506 A.2dat 180 (citing *Unocal*, 493 A.2d at 954).

legitimate objective."[269] Second, the board must establish that its actions constituted a reasonable means for accomplishing that objective. As in the *Coster* context, a reasonableness standard means that the court does not simply defer to the board's judgment, as it would under the business judgment rule, but instead evaluates whether that judgment falls within a range of reasonableness.[270] We observe that this level of judicial scrutiny enables the board to operate as a meaningful check on director domination as well as to "smoke out mere pretextual justifications for improperly motivated decisions."[271] Moreover, because intermediate scrutiny only applies if plaintiffs sufficiently allege domination, our proposal provides an incentive for controlling shareholders to support directors who are sufficiently independent to withstand allegations of domination.

Third, although, under existing law, directors of controlled companies who, as a result of controlling shareholder domination, act in furtherance of the controlling shareholder's interests rather than those of the corporation act in bad faith,[272] we believe courts and plaintiffs have been insufficiently demanding of such directors. If directors act in bad faith, their conduct subjects them to liability for money damages, and they are not subject to exculpation. As with the *Caremark* line of cases, we reason that the risk of monetary liability is necessary to provide director incentives to act independently and, as with the *Caremark* decision, we encourage courts to remind directors of controlled companies of this exposure.[273]

V. Conclusion

We explore the evolving concept of control in corporate law and its implications for fiduciary duties in companies with controlling shareholders.

[269] *Sears Hometown*, 2024 Del. Ch. LEXIS 12, *81.

[270] Importantly, reasonableness is a far less demanding standard than entire fairness. We also recognize that this proposal represents a partial overruling of *Sinclair Oil* in its oversight of "European tunnelling", the diversion of assets from the company to the controller. However, we believe that a reasonableness standard is more workable than entire fairness, particularly in light of today's more professional boards which are better able to monitor these issues than at the time *Sinclair Oil* was decided. In this regard, *Coster* still preserves a role for judicial oversight in what we believe is a more workable manner.

[271] *In re* Dollar Thrifty S'holder Litig., 14 A.3d 573, 598 (Del. Ch. 2010).

[272] Under *Stone v. Ritter*, bad faith encompasses actions "where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation." 911 A.2d 362, 369 (Del. 2006).

[273] Recent decisions of the Delaware courts underscore the timeliness of our proposal. *See* Firefighters' Pension System of City of Kansas City v. Foundation Building Materials, Inc., 2024 WL 2795026 (Del. Ch. May 31, 2024) (denying a motion to dismiss and finding a claim stated for non-exculpated breach of fiduciary duties because "it is reasonably conceivable that the [special] committee members consciously disregarded their duties and deferred to" a controlling shareholder).

We describe both the situations in which courts have treated someone as a controlling shareholder, and the situations in which controlling shareholder status triggers entire fairness review have expanded from the traditional cases involving freeze-outs by majority shareholders. We develop the implications of this expansion and show the tension in reconciling it with shareholders' economic rights.

We propose an alternative to the current approach. Rather than imposing *per se* fiduciary obligations upon shareholders acting in their capacity as shareholders, we argue that the law instead should subject board action at controlled companies to greater scrutiny. In particular, we suggest an intermediate standard of review for board decisions, coupled with the meaningful prospect of liability for directors who succumb to shareholder domination in approving a transaction benefitting a controller.

Ultimately, we believe that the approach we outline above is attentive to both the economic benefits and detriments of control and consistent with the concept in Delaware that control in and of itself does not create trust-like fiduciary duties. It is also consistent with the carefully calibrated governance of corporations under Delaware law and in the public capital markets which imposes strict judicial scrutiny only when there is clear evidence of market failure. Ultimately, our proposal provides bright-line transactional rules for corporate planners, which can be reflected in corporate governance procedures and the market prices of public companies.

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