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A Course Correction for Controlling Shareholder Transactions

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Abstract: This paper critically examines the evolving legal standards applied by Delaware courts to controlling shareholder transactions, highlighting the increasing constraints faced by controlling shareholders. Delaware courts increasingly exhibit a reflexive suspicion of transactions involving a controlling shareholder. The court has operationalized that skepticism by notably broadening the definition of who qualifies as a controlling shareholder. In particular, the courts are increasingly willing to hold that shareholders who own less than a majority of the corporation's voting power nevertheless possess control. Taken to its logical extreme, this trend easily could result in someone being deemed a controller even in the absence of stock ownership.

The court's growing skepticism of controlling shareholders is further reflected in its tightening of the standards governing the conduct of controlling shareholders. In doing so, the court has expanded the range of conflicted transactions necessitating cleansing and heightened the rigor with which cleansing standards are applied, particularly regarding the criteria for independent directors.

This article contends that Delaware courts need a course correction. They have pushed the law governing controlling shareholders far beyond legitimate policing into unnecessary and unwise overregulation. This has prompted a backlash in which controllers threaten to reincorporate outside of Delaware, following Elon Musk's example of moving Tesla to Texas.

The article proposes four course corrections, pursuant to which the courts: (1) should narrow the definition of controller; (2) should not attempt to sort out in which cases controllers owe fiduciary duties to the minority from those in which they do not, but instead hold that a controller always owes fiduciary duties to the minority; (3) narrow the class of cases under which entire fairness is the standard of review by adopting a reinvigorated Sinclair Oil threshold test under which entire fairness is triggered only when the controller receives a benefit at the expense of and to the exclusion of the minority; and (4) improve the regime for cleansing transactions in which entire fairness applies. These changes will reduce costs and encourage beneficial investment, while also enhancing Delaware's position as the state of choice for incorporation. Accordingly, if the courts fail to adopt them, the Delaware legislature should consider doing so by statute.

Keywords: corporate law, corporate governance, corporate control, majority shareholders, controlling shareholders, controllers, fiduciary duty

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A Course Correction for Controlling Shareholder Transactions

Stephen M. Bainbridge[*]

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[*] William D. Warren Distinguished Professor of Law, UCLA School of Law. I thank a group of prominent practitioners with whom I conducted off-the-record interviews. In this article, I have honored their requests for anonymity so they could speak candidly about trends in Delaware law and the Delaware courts.

I. Introduction

Agency costs are widely said to be the central problem of corporate governance.[1] The most familiar corporate version of the principal-agent problem arises out of the separation of ownership and control characteristic of most public corporations. Shareholders have an ownership-like claim on corporate assets and earnings, but lack control of the company. As a result, shareholders lack both the ability and the incentive to closely monitor management, which gives managers the opportunity to extract private benefits at the expense of the shareholders.[2] Accordingly, shareholders *qua* shareholders owe no fiduciary duties to either the corporate entity or their fellow shareholders.[3]

Things change when a controlling shareholder enters the mix.[4] A controlling shareholder is the proverbial "800-pound gorilla" in both the boardroom and in the

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[1] See, e.g., Merritt B. Fox, Gatekeeper Failures: Why Important, What to Do, 106 Mich. L. Rev. 1089, 1093 (2008) ("There has been a growing consensus among commentators over the last few decades that the principal corporate governance problem for the U.S.-style dispersed shareholder corporation is minimizing the 'agency costs of management.'"); Andrei Shleifer & Robert W. Vishny, A Survey of Corporate Governance, 52 J. Fin. 737 (1997) (stating that the principal-agent problem is the central problem of corporate governance). As I have observed elsewhere, however, agency costs standing alone provide an inadequate account of corporate governance. The task of minimizing agency costs must be balanced by that of respecting the authority of the board of directors. See, e.g., Stephen M. Bainbridge, A Tribute to Michael P. Dooley, 98 Va. L. Rev. 1430, 1432 (2012).

[2] See Jeremy McClane, Corporate Non-Governance, 44 Del. J. Corp. L. 1, 12 (2020) (noting that the "shareholders' ability to constrain management is sometimes limited by collective action problems—the reality that numerous dispersed shareholders do not have the incentive to coordinate and monitor management").

[3] See, e.g., Borden v. Guthrie, 260 N.Y.S.2d 769, 774 (N.Y. App. Div. 1st Dept. 1965), aff'd, 215 N.E.2d 511 (N.Y. 1966) ("The general rule is that a stockholder has a legal right to vote and dispose of his stock as his self-interest dictates.");. Hunt v. Data Mgt. Resources, Inc., 985 P.2d 730, 732 (Kan. App. 1999) ("The law does not impose a strict fiduciary duty on a shareholder to act in the best interests of the corporation; a shareholder is free to act in his or her own self-interest."); In re Shoe-Town, Inc. Stockholders Litig., No. C.A. 9483, 1990 WL 13475, at *6 (Del. Ch. Feb. 12, 1990) (holding that "a minority shareholder does not owe a fiduciary duty for that reason alone").

[4] Individual small shareholders lack meaningful ability to constrain managerial agency costs. See Elisabeth de Fontenay, Individual Autonomy in Corporate Law, 8 Harv. Bus. L. Rev. 183, 214–15 (2018) (discussing limits on small shareholders' power to constrain agency costs). In contrast, a controlling shareholder has both the incentive to police management agency costs and the ability to sanction managers who slack or self-deal. See Ronald J. Gilson & Jeffrey N. Gordon, Controlling Controlling Shareholders, 152 U. Pa. L. Rev. 785, 786–89 (2003) (arguing that, given effective legal limits, "the presence of a

shareholder meeting.[5] Absent cumulative voting, a controlling shareholder typically will have the power to elect the board of directors, which gives it considerable influence in the boardroom.[6] As for the shareholder meeting, a controlling shareholder typically will be able to veto any matters requiring shareholder approval.[7]

The controlling shareholder thus solves one agency problem (at least partially), while creating a second. On the one hand, unlike dispersed small block shareholders, controlling shareholders have both the ability and the incentive to monitor management and discipline managers who self-deal, shirk, or are simply unlucky.[8] In addition to policing management, the controlling shareholder can use its position to effect win-win transactions whose rising tide lifts all shareholder boats.[9] On the other hand, controlling shareholders also have both the incentive and the ability to extract private benefits from the controlled entity to the detriment of minority shareholders.[10]

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controlling shareholder benefits the non-controlling shareholders because the reduction in managerial agency costs will exceed the level of private benefits").

[5] In re Pure Resources, Inc., Shareholders Litig., 808 A.2d 421, 436 (Del. Ch. 2002).

[6] See François Belot & Timothée Waxin, Mandatory Employee Board Representation: Good News for Family Firms?, 71 Intl. Rev. L. & Econ. 1, 1 n.2 (2022) (stating that "cumulative voting on director election is widely recognized as a rule that weakens controlling shareholders' power and, thus, enhances minority shareholder protection").

[7] See Gaia Balp, Activist Shareholders at De Facto Controlled Companies, 13 Brook. J. Corp. Fin. & Com. L. 341, 364 (2019) (noting that "voting outcomes at the shareholders' general meeting will obviously, and necessarily, coincide with the controlling shareholder's vote, irrespective of any diverging votes by cohesive minorities.").

[8] See Simone M. Sepe, Corporate Agency Problems and Dequity Contracts, 36 J. Corp. L. 113, 133 (2010) ("According to conventional wisdom, the presence of controlling shareholders can reduce the risk of managerial moral hazard for shareholders as a whole because controllers are better able to monitor management.").

[9] See Belén Villalonga & Raphael Amit, Family Control of Firms and Industries, 39 Fin. Mgmt. 863, 865 (2010) (explaining that "controlling shareholders, such as families, may use their private funds to 'prop up' (i.e., provide temporary support) to financially troubled firms, thereby benefiting minority shareholders in those companies").

[10] See id. (noting that "controllers can profit from their influence over the board to induce extraction of private benefits that dissipate minority value"); see generally See Itai Fiegenbaum, The Geography of *MFW*-Land, 41 Del. J. Corp. L. 763, 771 (2017) (explaining that controlling shareholders may engage in "asset tunneling, cash flow tunneling, and equity tunneling"); Gilson & Gordon, supra note 4, at 786 (arguing that "a controlling shareholder may extract private benefits of control in one of three ways: by

To mitigate this risk, Delaware courts have steadily expanded the definition of who qualifies as a "controlling shareholder" and imposed rigorous "entire fairness" standards on transactions involving controllers.[11] This article argues that Delaware's approach, while well-intentioned, has become overly restrictive, stifling beneficial transactions and increasing legal uncertainty. A recalibration is needed—one that respects the agency cost concerns associated with controllers but tempers judicial scrutiny to foster investment and reduce litigation.

Delaware corporate law governing controller transactions opts not for prohibitions but rather for policing, as it does in other situations where there is similar potential for self-dealing.[12] After all, "having a 'conflict of interest' is not something one is 'guilty of'; it is simply a state of affairs."[13] The fact that a controlling shareholder could engage in self-dealing does not mean that it will do so.[14]

Corporate law polices controlling shareholders by subjecting them to unique legal treatment in three important respects.[15] First, controlling shareholders owe fiduciary duties to the corporation and its minority shareholders.[16] One sometimes

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taking a disproportionate amount of the corporation's ongoing earnings, by freezing out the minority, or by selling control").

[11] See infra notes 30-35 and accompanying text.

[12] See Julian Velasco, The Diminishing Duty of Loyalty, 75 Wash. & Lee L. Rev. 1035, 1040 (2018) ("Conflicted transactions are not strictly prohibited; instead, they are regulated.").

[13] Committee on Corporate Laws, Changes in the Model Business Corporation Act—Amendments Pertaining to Directors' Conflicting Interest Transactions, 44 BUS.LAW. 1307, 1309 (1989).

[14] See id. (stating that "while the history of mankind is replete with acts of selfishness, we have all also witnessed countless acts taken by persons contrary to their personal self-interest").

[15] Ann M. Lipton, The Three Faces of Control, 77 Bus. Law. 801, 803 (2022).

[16] Id. In contrast, a minority shareholder is free to vote or otherwise act as their own self-interest dictates. See Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 958 (Del. 1985) ("Nothing precludes Mesa, as a stockholder, from acting in its own self-interest."); see also Hunt v. Data Mgt. Resources, Inc., 985 P.2d 730, 732 (Kan. App. 1999) ("The law does not impose a strict fiduciary duty on a shareholder to act in the best interests of the corporation; a shareholder is free to act in his or her own self-interest.").

Delaware law has rejected the proposition that controlling shareholder duties in close corporations should differ from those in public corporations,. See Nixon v. Blackwell, 626 A.2d 1366, 1381 (Del. 1993) (declining to create "a special judicially-created rule for minority investors" in close corporations). The caselaw discussed herein primarily involves public corporations and the analysis focuses on the concerns of such corporations and their

sees suggestions that controlling shareholders owe such duties only in connection with freezeout mergers and similar transactions typically involving ownership claims, but that is not the law.[17]

> A director is a fiduciary. So is a dominant or controlling stockholder or group of stockholders. Their powers are powers in trust. Their dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation is challenged the burden is on the director or stockholder not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein.[18]

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investors. Some commentators contend that Delaware law in this area must take into account the interests of "smaller investors who hold minority stakes in privately held Delaware corporations." Brief for Academics as Amici Curiae in Support of Appellants, In re Match Group, Inc. Derivative Litig. at 21, 315 A.3d 446 (Del. 2024). This article acknowledges that view, but focuses on the public corporations that are the focus of the caselaw and policy debate.

[17] See, e.g., Iman Anabtawi & Lynn Stout, Fiduciary Duties for Activist Shareholders, 60 Stan. L. Rev. 1255, 1269 (2008) (claiming that "courts have tended to find even controlling shareholders subject to fiduciary duties primarily in two limited business situations: corporate 'freeze-outs' and closely held corporations"); Henry T. C. Hu & Bernard Black, Equity and Debt Decoupling and Empty Voting II: Importance and Extensions, 156 U. Pa. L. Rev. 625, 703 (2008) (suggesting that courts "created a limited fiduciary duty of controlling shareholders in a freezeout"). In fact, however, courts long have held controlling shareholders to the exacting entire fairness standard in enterprise as well as ownership claims. See, e.g., Sinclair Oil Corp. v. Levien, 280 A.2d 717, 723 (Del. 1971) (applying entire fairness where parent caused one subsidiary to breach its contract with another and prevent the latter from seeking legal relief).

Dean Bayless Manning is credited with developing the distinction between enterprise claims, which involve operational decisions such as choosing between product lines, and ownership claim transactions, which directly impact the shareholders' ownership rights. See, e.g., Mary Siegel, The Erosion of the Law of Controlling Shareholders, 24 Del. J. Corp. L. 27, 43–75 (1999). Transactions such as mergers, stock splits, redemptions, tender offers, and the like fall into the latter category. Id. Professors Gilson and Gordon use a different taxonomy, which contrasts "business and strategic decisions of the corporation" with "the controlling shareholder's direct dealings with the controlled corporation." Gilson & Gordon, supra note 4, at 790. They contend that Delaware law treats the former as matters of business judgment and the latter as self-dealing. Id. at 790-91.

[18] Pepper v. Litton, 308 U.S. 295, 306 (1939). In cases involving the duty of loyalty, Delaware courts have variously referred to the standard of review as fairness, entire fairness, or intrinsic fairness. The terms are synonymous and often used interchangeably. See, e.g., Tanzer v. Intl. Gen. Industries, Inc., 402 A.2d 382, 386 (Del. Ch. 1979) ("The words 'entire fairness' are synonymous with the words 'intrinsic fairness.'"). They are used as such herein.

Second, conflicted controlling shareholder transactions are subject to a more demanding cleansing regime than are transactions involving conflicted directors or officers.[19] Third, shareholder litigation challenging certain conflicted controlling shareholder transactions is treated as a direct rather than a derivative action, thereby avoiding the procedural obstacles associated with the latter.[20]

The trouble with a policing-based regime is that aggressive policing can vex those being policed. Unlike street criminals, controlling shareholders are uniquely positioned to decide what laws to which they will be subject and who will judge them. Their power to do so rests on their ability to influence the controlled entity's choice of its state of incorporation.

Recent trends in Delaware caselaw have severely vexed many controlling shareholders and those who advise them. The most prominent example, of course, is Tesla CEO Elon Musk. After his $50 billion-plus compensation plan was struck down by the Delaware Chancery Court,[21] Musk fired off a now notorious social media post recommending that one should "[n]ever incorporate your company in the state of Delaware."[22] Tesla subsequently reincorporated in Texas.[23]

A less well known but even more vociferous example is Phil Shawe, the CEO of TransPerfect. Shawe has been a frequent critic of what he calls "Delaware's legal cabal." [24] In 2018, Shawe successfully pushed to relocate TransPerfect from Delaware to Nevada.[25] He continues his anti-Delaware campaign, however. In

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[19] See infra Part IV.A. (discussing Delaware cleansing law).

[20] Lipton, supra note 15, at 803.

[21] See Tornetta v. Musk, 310 A.3d 430 (Del. Ch. 2024).

[22] Elon Musk (@elonmusk), X (Jan. 30, 2024) https://x.com/elonmusk/status/1752455348106166598.

[23] See Tesla, Inc., https://en.wikipedia.org/w/index.php?title=Tesla,_Inc.&oldid=1252525571 (last visited Nov. 7, 2024).)

[24] See, e.g., Phil Shawe (@PhilShawe), X (Feb. 4, 2024), https://twitter.com/PhilShawe/status/1754160915979653141; see also Karl Baker, Longtime Delaware Courts Attacker TransPerfect Found in Contempt, Faces Fines of $30K a Day, DelawareOnline.com (Oct. 18, 2019) (describing "Shawe's unprecedented resentment over Delaware's court-ordered sale of his profitable New York translation company), https://www.delawareonline.com/story/money/business/2019/10/18/transperfect-found-contempt-delaware-court-faces-fines-30-k-day/4011754002/.

[25] Press Release, TransPerfect Moves State of Incorporation from Delaware to Nevada (Aug. 15, 2018), https://www.transperfect.com/about/press/transperfect-moves-state-incorporation-delaware-nevada.

2024, for example, Shawe financed a $2 million attack ad campaign criticizing the Delaware judiciary and bar.[26]

Off-the-record interviews with prominent transaction lawyers and corporate law litigators on both the plaintiff and defense side confirmed that such concerns are increasingly widespread. As a prominent Delaware-based practitioner asked me, if "you're advising a controlled Silicon Valley company preparing for an IPO, why would you advise them to go public in Delaware? You'd be exposing your client to rent seeking."[27] A leading Delaware-based plaintiff's lawyer quipped that "Elon-wannabe CEOs may follow" him out of state.[28] A New York-based corporate law partner opined that the recent changes in the law governing conflicted controller transactions is the key motivation for reincorporating out of Delaware and therefore predicted that most firms that leave Delaware will be controlled.[29]

According to the lawyers I interviewed, the principal problem is a series of recent cases in which the Chancery Court exhibited a "reflexive suspicion" of transactions involving a controlling shareholder.[30] The court has operationalized

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[26] Lydia Moynihan, Blame Delaware: CEO Defends Elon Musk, Takes Out $2M Ad Campaign Hit on "Anti-Business" State, N.Y. Post, Apr. 8. 2024, https://nypost.com/2024/04/08/business/ceo-takes-out-2m-ad-campaign-hit-on-anti-business-delaware/.

[27] Off-the-Record Interview with Delaware corporate lawyer (May 9, 2024).

[28] Off-the-Record Interview with Delaware trial lawyer (May 9, 2024).

[29] Off-the-Record Interview with New York corporate lawyer (May 7, 2024). The argument that controlled Delaware corporations may seek to exit Delaware finds indirect support in recent empirical studies. A study by Steven Davidoff Solomon of five reincorporations out of Delaware by controlled companies with a market capitalization of $200 million or more, for example, concluded that there was no negative premium associated with the proposal to reincorporate. The Trade Desk, Inc., Special Meeting of Stockholders Preliminary Proxy Statement (Schedule 14A) (2024). A study by Edward Fox found "that controlled Delaware firms are on average worth 4.9% less than similarly situated firms incorporated elsewhere." Edward Fox, Is There a Delaware Effect for Controlled Firms?, U. Pa. J. Bus. L. 23, 40 (2020).

[30] See, e.g., Tornetta v. Musk, 250 A.3d 793, 812 (Del. Ch. 2019) (acknowledging "the Court's reflexive suspicion of Musk's coercive influence over the outcome"); see also Jill E. Fisch & Steven Davidoff Solomon, Control and its Discontents, ___ U. Pa. L. Rev. ___, 103 (2024) (noting the "Delaware courts' growing skepticism toward corporate actions in controlled companies"). It might be more accurate to say that these developments are being driven not by the whole court but by Chancellor McCormick and Vice Chancellor Laster, who have heard many of the pertinent cases. See, e.g., W. Palm Beach Firefighters' Pension Fund v. Moelis & Co., 311 A.3d 809 (Del. Ch. 2024) (Laster, V.C.); Palkon v. Maffei, 311

that skepticism by notably broadening the definition of who qualifies as a controlling shareholder. We also see this broadening in the court's increasing willingness to hold that shareholders who own less than a majority of the corporation's voting power nevertheless possess control.[31] We see it in suggestions that one can possess control even in the absence of stock ownership.[32] We even see it in the court's terminology, as when the court uses the term "controller" rather than "controlling shareholder."[33]

The court's growing skepticism of controlling shareholders is further reflected in its tightening of the standards governing the conduct of controlling shareholders.[34] In doing so, the court has expanded the range of conflicted transactions necessitating cleansing and heightened the rigor with which cleansing standards are applied, particularly regarding the criteria for independent directors.[35]

This article contends that Delaware courts need a course correction. They have pushed the law governing controlling shareholders far beyond legitimate policing into unnecessary and unwise overregulation. Part II addresses the recent broadening

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A.3d 255 (Del. Ch. 2024) (Laster, V.C.), cert. denied, No. 2023-0449-JTL, 2024 WL 1211688 (Del. Ch. Mar. 21, 2024); Tornetta v. Musk, 310 A.3d 430 (Del. Ch. 2024) (McCormick, Ch.); In re Sears Hometown and Outlet Stores, Inc. Stockholder Litig., 309 A.3d 474 (Del. Ch. 2024) (Laster, V.C.). McCormick and Laster were identified by two of the lawyers with whom I conducted off-the-record interviews as being the most hostile members of the court to controlling shareholders and as driving the developments in this area. Off-the-Record Interview with New York-based Corporate Lawyer (May 7, 2024); Off-the-Record Interview with Delaware-based Corporate Lawyer (May 9, 2024).

[31] See Fisch & Solomon, supra note 30, at 134 ("*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.").

[32] See id. at 138-39 (discussing this possibility).

[33] See, e.g., Tornetta v. Musk, 310 A.3d 430, 498 (Del. Ch. 2024) ("When a controller displaces or neutralizes a board's power to direct corporate action, then the controller assumes fiduciary obligations."); In re Sears Hometown and Outlet Stores, Inc. Stockholder Litig., 309 A.3d 474, 504 (Del. Ch. 2024) ("The plaintiffs contend that Lampert breached his fiduciary duties as a controller by engaging in the Controller Intervention.").

[34] Mike Leonard, Crackdown on Corporate Insiders Collides With New Era of Control, Bloomberg L. (Apr. 23, 2024) (arguing that, in cases "involving Tesla Inc., TripAdvisor Inc., Moelis & Co., and Sears Hometown and Outlet Stores Inc.," the court has "sought to tighten the standards for conduct by controlling stockholders"), https://news.bloomberglaw.com/esg/crackdown-on-corporate-insiders-collides-with-new-era-of-control.

[35] Off-the-Record Interview with Delaware Academic (May 9, 2024).

of who constitutes a controller, contending that that trend has had serious costs. Part III turns to the process of distinguishing between routine transactions between a corporation and its controlling shareholder and those transactions sufficiently conflicted so as to require cleansing. It contends that Delaware law is heading towards treating virtually all controller transactions as suspect. Finally, Part IV addresses cleansing of controlling shareholder transactions, arguing that recent trends have made it unnecessarily difficult for such transactions to be cleansed. Taken together, my proposal thus is that Delaware courts: (1) should narrow the definition of controller; (2) should not attempt to sort out in which cases controllers owe fiduciary duties to the minority from those in which they do not, but instead hold that a controller always owes fiduciary duties to the minority;[36] (3) narrow the class of cases under which entire fairness is the standard of review by adopting a

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[36] An alternative interpretation of Delaware law has been suggested by Delaware Vice Chancellor Travis Laster, who argues that the case law reflects an action versus no action distinction, under which fiduciary duties do not apply when a controller acts to preserve the status quo, such as by voting against a proposed transaction, but do apply when the controller alters the status quo, as by voting to approve a proposed transaction. Travis Laster, Stockholder Votes, Linkedin.com (Feb. 19, 2024), https://www.linkedin.com/pulse/dispatch-from-tampa-sears-mundane-stockholder-votes-travis-laster-0mcle/. Even if we accept that as an accurate statement of Delaware law, however, Laster rightly acknowledges that it is not a tenable distinction.

Laster offers an example in which a controlling shareholder is committing fraud—ala Bernie Madoff—with the assistance of the firm's current outside auditor. Id. If the controller votes to retain the auditor, thereby preserving the status quo, under Laster's interpretation of the law, fiduciary duties will not apply. Id. Accordingly, Laster proposes an alternative regime that "would start by applying the business judgment rule, then assess whether the plaintiff had alleged facts sufficient to rebut one of its presumptions, which the auditor vote might well satisfy." Id.

Laster also suggests that there may be cases in which the appropriate standard of review would be enhanced scrutiny, as where "the controller is acting unilaterally to remove an incumbent director and fill the vacancy with someone else." Laster, supra. In such a case, the controller is "interven[ing] in the domain generally reserved for board action, warranting enhanced scrutiny." Id. The proposal strikes me as problematic for two reasons. First, hinging the standard of review on whether the shareholder is using the vote strikes at the heart of the controller's right of selfish ownership. The right to vote in one's own self-interest is a core element of ownership. See Gilbert v. Perlman, No. CV 2018-0453-SG, 2020 WL 2062285, at *1 (Del. Ch. Apr. 29, 2020) ("Corporate controllers . . . may vote their stock, and take other actions with respect to the entity, in their own self-interest free of fiduciary strictures, so long as they do not employ the corporate machinery itself."). Second, Laster's test introduces considerable uncertainty by conditioning the standard of review on the extent to which the controlling shareholder intrudes on the board's sphere of action. See Laster, supra ("If the intervention seemed more significant and designed to invade the board's domain, then I would be inclined to apply enhanced scrutiny.").

reinvigorated *Sinclair Oil*[37] threshold test under which entire fairness is triggered only when the controller receives a benefit at the expense of and to the exclusion of the minority; and (4) improve the regime for cleansing transactions in which entire fairness applies. These changes will reduce costs and encourage beneficial investment, while also enhancing Delaware's position as the state of choice for incorporation. Accordingly, if the courts fail to adopt them, the Delaware legislature should consider doing so by statute.

II. Defining Controlling Shareholders

Before we can conclude that a shareholder owes fiduciary duties to the corporation or its other shareholders, we must first determine whether that shareholder controls the corporation. Absent a showing of control, there is no fiduciary obligation and the shareholder is free to act entirely in their own self-interest.[38] Once such a showing has been made, however, a fiduciary relationship between the controlling shareholder and the minority arises.[39]

A. The Historical Approach

Under Delaware law, a shareholder is deemed to have control if the shareholder owns a majority of the voting power of the corporation.[40] Indeed, it long was

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[37] Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. 1971).

[38] See Donald C. Langevoort, Who is an Insider?—Controlling shareholders, Insider Trading Regulation, Enforcement and Prevention § 3:4 (2024) ("A noncontrolling shareholder . . . is not deemed to be a fiduciary unless he took on some additional role that itself could be treated as fiduciary . . ..").

[39] See Ivanhoe Partners v. Newmont Min. Corp., 535 A.2d 1334, 1344 (Del. 1987) ("Under Delaware law a shareholder owes a fiduciary duty only if it owns a majority interest in or exercises control over the business affairs of the corporation.").

[40] See, e.g., Solomon v. Armstrong, 747 A.2d 1098, 1116 n. 53 (Del.Ch.1999) ("Under Delaware law, the notion of a 'controlling' stockholder includes both de jure control and de facto control."). Note that the question is not whether the shareholder owns a majority of the economic interest in the corporation, but rather a majority of the voting power in the corporation. Hence, for example, Mark Zuckerberg controls Meta Platforms, Inc., because Meta has two classes of stock of voting stock. McRitchie v. Zuckerberg, 315 A.3d 518, 529 (Del. Ch. 2024). Class A is publicly traded and carries one vote per share. Id. Class B is held solely by insiders and carries ten votes per share. Id. Zuckerberg's Class B holdings are sufficient to give him majority voting power even though his shares represent less than 14% of the company's equity. Id.

A group of shareholders acting collectively can be deemed to possess control. See Sheldon v. Pinto Tech. Ventures, L.P., 220 A.3d 245, 251 (Del. 2019) (explaining that "our law recognizes that multiple stockholders together can constitute a control group exercising

Delaware law that "a shareholder who owns less than 50% of a corporation's outstanding stock does not, without more, become a controlling shareholder of that corporation, with a concomitant fiduciary status."[41] The requisite something more was evidence of actual control of corporate conduct:[42]

> [A] stockholder that owns less than half of a corporation's shares will generally not be deemed to be a controlling stockholder, with concomitant fiduciary responsibilities. For a stockholder that owns less than a numerical majority of a corporation's voting shares to be deemed a controlling stockholder for purposes of imposing fiduciary obligations, the plaintiff must establish the actual exercise of control over the corporation's conduct by that otherwise minority stockholder.[43]

Proving sufficient actual control over the corporation to satisfy that requirement historically was difficult.[44] The task was eased somewhat, however, as courts held that it was not necessary to provide evidence of control over day-to-day operations,

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majority or effective control, with each member subject to the fiduciary duties of a controller").

> To demonstrate that a group of stockholders exercises "control" collectively, the [plaintiff] must establish that they are "connected in some legally significant way"—such as "by contract, common ownership, agreement, or other arrangement-to work together toward a shared goal." To show a "legally significant" connection, [plaintiff] must allege that there was more than a "mere concurrence of self-interest among certain stockholders." Rather, "there must be some indication of an actual agreement," although it need not be formal or written.

Id. at 251-52 (footnotes omitted).

[41] Gilbert v. El Paso Co., 490 A.2d 1050, 1055 (Del. Ch. 1984), aff'd, 575 A.2d 1131 (Del. 1990).

[42] See, e.g., Emerald Partners v. Berlin, 726 A.2d 1215, 1221 n. 8 (Del.1999) (holding that "a shareholder who owns less than 50% of a corporation's outstanding stock, without some additional allegation of domination through actual control of corporation conduct, is not a "controlling stockholder" for fiduciary duty purposes"); Kahn v. Lynch Commc'n Sys., 638 A.2d 1110, 1114 (Del. 1994) ("For a dominating relationship to exist in the absence of controlling stock ownership, a plaintiff must allege domination by a minority shareholder through actual control of corporation conduct.").

[43] Weinstein Enterprises, Inc. v. Orloff, 870 A.2d 499, 507 (Del. 2005).

[44] See Lawrence A. Hamermesh, Jack B. Jacobs, & Leo E. Strine, Jr., Optimizing the World's Leading Corporate Law: A Twenty-Year Retrospective and Look Ahead, 77 Bus. Law. 321, 345 (2022) ("Under Delaware law, it was historically difficult to establish that a stockholder having less than majority ownership was a controlling stockholder.").

but rather evidence of control with respect to the specific transaction being challenged.[45]

B. Defining Control Down

Recent cases have expanded the definition of control by reducing the level of stock ownership needed for actual control to be inferred and by emphasizing control mechanisms other than voting power. These trends have made it much more likely that holders of substantially less than a majority of the corporation's voting power will be deemed to possess control. As we shall see in the next section, that has had important costs.

In the absence of majority voting power, the historical standard required proof of "actual domination and control."[46] In the 1988 *Sea-Land* decision, for example, allegations of "significant 'leverage,' (i.e., a superior bargaining position)" because the alleged controlling shareholder owned 39.5% of the corporation's stock were not enough because "'leverage' is not actual domination and control."[47] A 2000 Chancery Court decision thus held that a shareholder owning 46% of the stock but contractually limited to electing a quarter of the board was not a controlling shareholder.[48] As recently as 2013, then Chancellor Leo Strine held in *Morton's Restaurant Group* that, "under our law, a minority blockholder is not considered to be a controlling stockholder unless it exercises 'such formidable voting and managerial power that [it], as a practical matter, [is] no differently situated than if [it] had majority voting control.'"[49]

The actual domination standard, however, has been under pressure since at least the Delaware Supreme Court's 1994 decision in *Kahn v. Lynch Commun. Sys.,*

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[45] See Williamson v. Cox Commc'ns, Inc., No. CIV.A. 1663-N, 2006 WL 1586375, at *4 (Del. Ch. June 5, 2006) ("It is not necessary, however, for plaintiff to plead actual control by Cox and Comcast over the day-to-day operations of At Home. Plaintiff can survive the motion to dismiss by alleging actual control with regard to the particular transaction that is being challenged.").

[46] In re Sea-Land Corp. Shareholders Litig., No. CIV.A. 8453, 1988 WL 49126, at *3 (Del. Ch. May 13, 1988). See also Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 70 (Del. 1989) (requiring a showing of "domination by a minority shareholder through actual control of corporation conduct"); In re Morton's Rest. Group, Inc. Shareholders Litig., 74 A.3d 656, 664–65 (Del. Ch. 2013) (holding that "the Complaint must contain well-pled facts showing that the minority stockholder 'exercised actual domination and control over ... [the] directors.'").

[47] *Sea-Land*, 1988 WL 49126, at *3.

[48] In re W. Nat'l Corp. S'holders Litig., No. 15927, 2000 WL 710192, at *6 (Del. Ch. May 22, 2000).

[49] *Morton's Rest. Group*, 74 A.3d at 665.

Inc.[50] In *Kahn*, the Delaware Supreme Court explained that application of the entire fairness standard of review to freezeout mergers was necessary because of the inherently coercive nature of the transaction.[51] Over time, this concern about inherent coercion moved upstream from the standard of review into the definition of control itself.[52] Recent decisions thus have relied "heavily on a shareholder's potential ability to influence corporate decisions—so-called inherent coercion—rather than allegations of actual domination."[53] Under this standard, which originated in the 2003 *In re Cysive* decision by then Vice Chancellor Strine,[54] actual domination is not required. Indeed, even evidence of actual control over the transaction being challenged is not required.[55] Instead, it suffices if the shareholder "possesses a combination of stock voting power and managerial authority" as would enable the shareholder "to control the corporation, *if he so wishes*."[56]

Chancellor Strine later acknowledged that *In re Cysive* was "perhaps, [Chancery's] most aggressive finding that a minority blockholder was a controlling stockholder,"[57] which may have motivated his 2013 *Morton's Restaurant Group* decision reemphasizing actual control.[58] In a subsequent coauthored law review article, moreover, Strine asserted that *In re Cysive*'s "reasoning remained deeply

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[50] 638 A.2d 1110 (Del. 1994).

[51] See id. at 1117 ("Even where no coercion is intended, shareholders voting on a parent subsidiary merger might perceive that their disapproval could risk retaliation of some kind by the controlling stockholder.").

[52] See Hamermesh et al., supra note 44, at 345-46 (arguing that "the revival of *Lynch*'s inherent coercion theory has created pressure to expand the definition of controlling stockholder to reach persons having far less than a voting majority, but are either critically important to the company or associated with other stockholders as a group").

[53] Fisch & Solomon, supra note 30, at 136.

[54] See In re Cysive, Inc. Shareholders Litig., 836 A.2d 531, 553 (Del. Ch. 2003) (setting out standard).

[55] R. Montgomery Donaldson, Inside Funding Rounds in Venture-Backed Companies: The Perils of "Effective Control", 43 Del. J. Corp. L. 419, 431 (2019) (arguing that "the Vice Chancellor acknowledged the absence of any actual control exercised in connection with the board process giving rise to the transaction itself").

[56] *In re Cysive*, at 553 (emphasis supplied). Professor Siegel criticizes the court's equation of controllers who have majority voting power and those who control despite holding less than a majority of the voting power. See infra notes 281-283 and accompanying text.

[57] In re Morton's Rest. Group, Inc. Shareholders Litig., 74 A.3d 656, 665 (Del. Ch. 2013).

[58] See supra text accompanying note 49.

tied to voting, not just managerial power."[59] Yet, Strine's apparent pull back did not reverse the Court's overall movement, as subsequent Chancery decisions continue to cite not just *In re Cysive* in general but also its "if he so wishes" standard in particular as good law.[60] Hence, as Vice Chancellor Slights observed, it is now likely that even "more 'aggressive' examples can be found in our post-*Cysive* case law . . .."[61] Accordingly, it seems fair to conclude that at least some current members of the Chancery Court are not as wedded to the voting control standard as were their predecessors.[62]

This shift away from emphasizing voting control is highlighted by Chancellor McCormick's decision in *Tornetta v. Musk*, in which she embraced an academic proposal to treat "superstar CEOs" as controllers.[63] In doing so, McCormick acknowledged deciding "to 'boldly go where no man has gone before,' or at least where no Delaware court has tread."[64] Yet, she contended 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. When directors believe a CEO is uniquely critical to the corporation's mission, even independent actors are likely to be unduly deferential. They believe that "letting the CEO go would be harmful to the company and that alienating the CEO might have a similar effect." They "doubt their own judgment and hesitate to question the decisions of their superstar CEO." They view CEO self-dealing as the trade-off for the CEO's value. In essence, Superstar CEO status creates a "distortion field" that interferes with board oversight. As discussed later in this analysis, the distortion field can weaken mechanisms

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[59] Hamermesh et al., supra note 44, at 345.

[60] See, e.g., Tornetta v. Musk, 310 A.3d 430, 500 (Del. Ch. 2024); Sciannella v. AstraZeneca UK Ltd., No. 2023-0125-PAF, 2024 WL 3327765, at *16 (Del. Ch. July 8, 2024); Delman v. GigAcquisitions3, LLC, 288 A.3d 692, 716 (Del. Ch. 2023); Voigt v. Metcalf, No. CV 2018-0828-JTL, 2020 WL 614999, at *11 (Del. Ch. Feb. 10, 2020).

[61] In re Rouse Properties, Inc., No. CV 12194-VCS, 2018 WL 1226015, at *19 n.163 (Del. Ch. Mar. 9, 2018).

[62] See Note, Controller Confusion: Realigning Controlling Stockholders and Controlled Boards, 133 Harv. L. Rev. 1706, 1713 (2020) (arguing that, "particularly in the past few years, the Delaware Court of Chancery has eroded the importance it once placed on the individual having a 'formidable' or 'significant" voting power'").

[63] See Tornetta v. Musk, 310 A.3d 430, 507 (Del. Ch. 2024), citing Assaf Hamdani & Kobi Kastiel, Superstar CEOs and Corporate Law, 100 Wash. U. L. Rev. 1353 (2023).

[64] *Tornetta*, 310 A.3d at 446.

> by which stockholders hold fiduciaries accountable, a risk that becomes more severe when the Superstar CEO owns a large block of shares.[65]

Notice how McCormick implicitly shifts the inquiry from whether the alleged controller possesses de facto voting control to whether the controller's presence in the transaction is inherently coercive.[66] To be sure, she retains a passing reference to "a large block of shares," but the emphasis is on managerial rather than voting power. In other words, she adopted precisely the sort of leverage-focused inquiry that *Sea-Land* rejected.[67] As such, a logical extension of the superstar CEO concept is that one can be a controller based on that status alone.[68]

We also see a deemphasis on voting control in recent decisions involving so-called soft control. In *Voigt v. Metcalf*,[69] for example, Vice Chancellor Laster opined that control could be based on factors such as "the exercise of contractual rights to channel the corporation into a particular outcome" or "the existence of commercial relationships that provide the defendant with leverage over the corporation, such as status as a key customer or supplier."[70] There was a similar emphasis on control through contract rights and similar forms of soft power in *W. Palm Beach Firefighters' Pension Fund v. Moelis & Co*.[71] *Moelis* involved an agreement between the corporation and four of its shareholders—including the founder, CEO, and chairman of the board—requiring the board to obtain the prior written consent of the shareholders before taking any of 18 specified actions, which collectively amounted to "virtually everything the Board can do."[72] The agreement also gave the four shareholders the right to select a majority of the board of

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[65] Id. at 507.

[66] See Fisch & Solomon, supra note 30, at 135 ("*Tornetta* and the cases on which it relies shift the analysis from voting control to domination, soft power, or even the capacity to influence.").

[67] See supra text accompanying note 47 (discussing *Sea-Land*'s rejection of leverage as the basis for finding control).

[68] Fisch & Solomon, supra note 30, at 137. Professors Hamdani and Kastiel, who brought forward the superstar CEO concept McCormick adopted in *Tornetta* emphasized "that significant share ownership is not a necessary condition of superstar status." Hamdani & Kastiel, supra note 63, at 1376.

[69] Voigt v. Metcalf, No. CV 2018-0828-JTL, 2020 WL 614999 (Del. Ch. Feb. 10, 2020).

[70] Id. at *12. Note how the previously rejected idea of leverage sufficing thus even more explicitly crept into *Voigt* than in *Tornetta*.

[71] 311 A.3d 809 (Del. Ch. 2024).

[72] Id. at 818.

directors.[73] The board was obliged to nominate the shareholders' candidates, to recommend that the other shareholders vote to approve their election, and use reasonable efforts to ensure their election.[74] Similar requirements applied to board committees.[75] Vice Chancellor Laster concluded that multiple provisions of the agreement were facially invalid, as they unduly intruded on the board's statutory right to control the business and affairs of the corporation.[76]

The *Moelis* decision was legislatively reversed by the adoption of new Delaware General Corporation Law § 122(18), which specifically authorizes such provisions.[77] Yet, the opinion presumably remains relevant to the determination of whether such now validated agreements make the shareholders in question controllers. Laster pointed out that the agreement was intended to ensure that the shareholders' delegates "control the board."[78] As a result of the agreements, the directors were obliged to keep CEO Moelis in control at the board-level.[79] Indeed, the very purpose of the stockholder agreement was to allocate control rights to Moelis.[80] It would be a short step to concluding that Moelis wielded control solely because of those agreements rather than by stock ownership. As with the superstar CEO concept, a logical extension of the soft control approach thus is that one could be deemed a controller without owning any stock at all.[81]

C. The Case for a Course Correction

The broadening definition of controller poses a number of concerns. It has increased legal uncertainty. It exposes shareholders with small holdings to fiduciary liability without clear rules about when and how they are considered controllers. This will likely result in increased litigation as parties contest whether a particular shareholder's influence qualifies as "control." The cost of this litigation—both in

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[73] Id.

[74] Id.

[75] Id.

[76] See id. at 821 (summarizing the court's holdings on various provisions of the agreement).

[77] Del. Code Ann., tit. 8, § 122(18) (2025).

[78] *Moelis*, 311 A.3d at 818.

[79] Id. at 819.

[80] Id. at 864.

[81] Fisch & Solomon, supra note 30, at 138. Indeed, contending that the distinction between voting and soft power should not matter, Professor Ann Lipton advocates just such an extension. Lipton, supra note 15, at 806–07 (arguing that "there is no reason that stock ownership, specifically, should be required at all").

time and resources—will place additional burdens on companies and shareholders alike, distracting from the core goals of wealth creation and business operation.

1. Legal Uncertainty and Increased Litigation

Providing certainty and predictability is an essential function of corporate law, as it serves several important policy functions.[82] Businesses rely on clear and stable legal rules to make long-term decisions about investments, contracts, and risk management. Predictable legal outcomes allow corporations to make those decisions with confidence that they can allocate resources efficiently without the constant fear of unexpected legal consequences.[83]

Certainty in corporate law helps reduce litigation by providing clear guidelines on frequently litigated issues like corporate governance, contracts, and fiduciary duties. When legal standards are ambiguous, companies are more likely to end up in court to resolve disputes.[84] Predictable laws make law compliance simpler and less costly, while also encouraging early resolution of disputes through settlement.

Certainty and predictability promote investment. Investors prefer jurisdictions with predictable and stable legal frameworks, because such frameworks help ensure that investors understand the rules that protect their investments.[85] Relatedly, investors will perceive certainty and predictability as promoting the rule of law,

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[82] See Harff v. Kerkorian, 324 A.2d 215, 220 (Del. Ch. 1974), aff'd in part, rev'd in part, 347 A.2d 133 (Del. 1975) ("It is obviously important that the Delaware corporate law have stability and predictability."). The extent to which Delaware law actually provides determinate legal rules has been the subject of some debate. See, e.g., William J. Carney & George B. Shepherd, The Mystery of Delaware Law's Continuing Success, 2009 U. Ill. L. Rev. 1, 17 (2009) (claiming that Delaware law is sufficiently indeterminate that it causes "delayed transactions and increased litigation costs"); Mohsen Manesh, Delaware and the Market for LLC Law: A Theory of Contractibility and Legal Indeterminacy, 52 B.C. L. Rev. 189, 223 (2011) ("Delaware corporate law is highly indeterminate.").

[83] See Eliakim v. State, 884 So. 2d 57, 65 (Fla. 4th Dist. App. 2004) (Farmer, C.J., dissenting) ("There are many things about the law that should be determinate and thus predictable, so that people may order their affairs and make decisions about the commitments of families and businesses and their resources.").

[84] See Edward Greene & Olivia Schmid, Duty-Free Insider Trading?, 2013 Colum. Bus. L. Rev. 369, 424 (2013) (arguing that "ambiguity and uncertainty" in the law leads to "more litigation").

[85] See Peter A. Gourevitch, The Politics of Corporate Governance Regulation, 112 Yale L.J. 1829, 1848 (2003) ("Investors, managers, workers, and other individuals making decisions prefer some degree of predictability; without it, economies operate at a lower level.").

reducing the risk of arbitrary or unequal treatment.[86] This contributes to a fairer marketplace where decisions are based on clear legal standards rather than ad hoc interpretations, thereby encouraging capital inflow and market growth.

Despite the desirability of certainty and predictability as a key part of the Delaware brand, the current Delaware caselaw definition of control fails miserably on that score. Indeed, it is not even clear what the exact definition of control is under Delaware law. On the one hand, you have the line of cases citing *In re Cyvise*'s "if he so wishes" standard.[87] On the other hand, you also still have cases citing the "actual domination" standard.[88]

There is also uncertainty as to whether the determination of a minority shareholder's control status depends on the procedural posture of the case. Many of the reported controlling shareholder opinions were issued at the motion to dismiss stage rather than after trial, leaving open the possibility that Delaware courts are applying a more lenient standard at the motion stage than they would after a full factual record is developed.[89] Yet, as Fisch and Solomon observe in an important new contribution to the literature on controlling shareholders, such a dichotomy actually increases litigation costs because more cases survive the motion to dismiss stage.[90] Even though most controlling shareholder cases likely settle before final post-trial judgment,[91] surviving a motion to dismiss undoubtedly raises

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[86] See Rohit Sachdev, Comparing the Legal Foundations of Foreign Direct Investment in India and China: Law and the Rule of Law in the Indian Foreign Direct Investment Context, 2006 Colum. Bus. L. Rev. 167, 182 (2006) (positing that "rules of 'principled predictability' or 'fair certainty'" are an element of the rule of law).

[87] See supra notes 60-61 and accompanying text (discussing line of cases).

[88] See, e.g., Sciannella v. AstraZeneca UK Ltd., No. 2023-0125-PAF, 2024 WL 3327765, at *19 (Del. Ch. July 8, 2024) (holding that "conclusory allegations do not support a reasonable inference that AstraZeneca 'exercised actual domination and control'"); Lockton v. Rogers, No. CV 2021-0058-SG, 2022 WL 604011, at *14 (Del. Ch. Mar. 1, 2022) (holding that "the Amended Complaint must plead facts 'showing that the minority stockholder 'exercised actual domination and control over ... [the] directors'").

[89] See Fisch & Solomon, supra note 30, at 136 ("Delaware courts may require a lesser showing at the motion to dismiss stage.").

[90] See id. (noting that "denial of the motion to dismiss has tremendous implications in terms of the ongoing cost and burden of litigation").

[91] See Elizabeth DiSciullo, Seeking Disclosure: A Review of the Delaware Court of Chancery's Recent Disclosure-Only Settlement Proceedings, 29 Geo. J. Leg. Ethics 947 (2016) (noting that "one study found that nearly seventy percent of shareholder suits ultimately settle"); David L. Finger, Litigating Corporate and Commercial Cases in Delaware, 41 Litig. 36, 40 (Spring 2015) ("In Delaware, as everywhere, most cases settle.").

the settlement value of such cases.[92] Surviving a motion to dismiss also raises discovery costs and increases "the substantial reputational risks to the company, management, and the board that attend litigation highlighting poor corporate governance practices."[93]

A third source of uncertainty arises because, regardless of the precise standard being invoked, the caselaw increasingly incorporates a multitude of factors. In *Tornetta,* for example, Chancellor McCormick identified four broad categories of factors relevant to the inquiry into the minority shareholder's control over the enterprise: "ownership of a significant equity stake (albeit less than a majority)"; "the right to designate directors (albeit less than a majority)"; "decisional rules in governing documents that enhance the power of a minority stockholder or board-level position"; and "the ability to exercise outsized influence in the board room, such as through high-status roles like CEO, Chairman, or founder."[94] As for the alternative inquiry into whether the minority shareholder wielded transaction-specific control, McCormick identified factors including: relationships "with key managers or advisors who play a critical role in presenting options, providing information, and making recommendations"; "the exercise of contractual rights to channel the corporation into a particular outcome by blocking or restricting other paths"; and "commercial relationships."[95]

Unhelpfully, she concluded that "[b]oth general control and transaction-specific control call for a holistic evaluation of sources of influence."[96] As she blithely acknowledged, it is thus now "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."[97] The resulting difficulty for transactional lawyers trying to advise their clients went unremarked, let alone lamented.

Uncertainty and ambiguity are particularly problematic under the superstar CEO approach. Professors Hamdani and Kastiel, who McCormick credited with bringing forward the superstar CEO concept, fail to provide clear guidance as to what makes a CEO a superstar. Instead, they merely posit that superstar CEOs are "individuals who directors, investors, and markets believe make a unique

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92 Leo E. Strine, Jr., Minutes Are Worth the Minutes: Good Documentation Practices Improve Board Deliberations and Reduce Regulatory and Litigation Risk, 29 Fordham J. Corp. & Fin. L. 561, 570 (2024) (noting that "cases that pass the motion to dismiss stage typically have seven figure settlement value").

93 Id.

94 Tornetta v. Musk, 310 A.3d 430, 500 (Del. Ch. 2024).

95 Id.

96 Id.

97 Id.

contribution to company value," while opining "the precise factors that could make certain individuals uniquely valuable are less important."[98] They acknowledge that this approach could lead to "vague standards" that "create uncertainty and encourage litigation."[99] Hence, even though whether a specific individual qualifies as a superstar CEO is precisely the sort of question clients are likely to ask, there are no clear answers.

2. Chilling Investment and Shareholder Participation

In addition to introducing considerable uncertainty into the law, the plethora of factors courts now take into consideration in making the controller determination, the growing breadth of the minority shareholder test hoovers up an increasingly wide variety of actors.[100] Just as a vague law may chill speech,[101] vague fiduciary duty standards may discourage risk taking. In the former case, vagueness is undesirable because it can chill protected speech.[102] In the latter case, uncertainty may discourage investment in controlled companies.

As Lipton observes, moreover, this trend is in direct conflict with current practices in the startup market.[103] Broadening the definition of a controlling

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[98] Hamdani & Kastiel, supra note 63, at 1367-68. As Hamermesh, Jacobs, and Strine observe, "the Superstar CEO designation lacks definitional precision." Hamermesh et al., supra note 44, at 346.

[99] Hamdani & Kastiel, supra note 63, at 1400-02.

[100] Lipton, supra note 15, at 802 ("The most notable feature of the test for minority control is its elasticity: It includes so many factors and considerations that it allows for a great variety of actors to be designated as controllers.").

[101] See Citizens United v. Fed. Election Commn., 558 U.S. 310, 324 (2010) ("Prolix laws chill speech for the same reason that vague laws chill speech: People 'of common intelligence must necessarily guess at [the law's] meaning and differ as to its application.'").

[102] F.C.C. v. Fox TV Stations, Inc., 567 U.S. 239, 253–54 (2012) (holding that "rigorous adherence to" the vagueness doctrine "is necessary to ensure that ambiguity does not chill protected speech").

[103] Lipton explains:

> Today, startup businesses remain private for longer periods of time than in the past, typically conducting multiple rounds of financing from a variety of investors, including venture capital funds, sovereign wealth funds, family offices, and even traditional mutual funds. These different investors are often granted individualized rights, such as designated board seats and the ability to block various corporate actions. The result is that corporate control rights are increasingly allocated in unique and idiosyncratic ways, making a simple "50%" metric inadequate to assess controlling shareholder status. And these complex control arrangements have

shareholder to include those with small ownership stakes could deter investors from acquiring even modest stakes in companies. The widening standard will oblige market participants, especially those who acquire shares for financial rather than managerial purposes, to navigate a complex web of potential liabilities. In turn, investors may be less willing to invest if they fear they will be saddled with the legal responsibilities of a fiduciary—including the strict fairness standard of review—despite holding only a small percentage of shares. This could reduce overall market participation and stifle capital formation, particularly for companies that depend on investment from various minority shareholders. Such risk aversion could harm market liquidity and reduce the efficiency of capital allocation in the broader economy.

3. Disincentive for Entrepreneurial and Strategic Shareholders

Proponents of investor activism should be particularly concerned by the risk that holders of relatively small blocks could be deemed to wield control. According to such commentators, professional investors with small stakes play vital roles in corporate oversight by exerting constructive influence, offering strategic guidance, or serving as a check on management.[104] If such shareholders are burdened with fiduciary responsibilities typically reserved for true controllers, they may be disincentivized from actively engaging with the company. If the proponents of investor activism are correct, this could lead to weaker oversight of corporate management and a reduction in the entrepreneurial dynamism that often accompanies active shareholder involvement.

> begun migrating to public companies. Recent initial public offerings have involved dual, triple, and even quadruple class stock structures, often granting several insiders high-vote shares that shift or sunset over time. Even in companies with single-class structures, shareholder agreements may replicate the special rights that have become common among preferred stockholders in private corporations . . ..

Id. at 803.

[104] Michael C. Jensen, The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems, 48 J. Fin. 831, 867 (1993) (contending that activist investors are an effective means of reinvigorating board oversight). I have been more skeptical of the purported promise of shareholder activism. See, e.g., Stephen M. Bainbridge, Shareholder Activism in the Obama Era, in Perspectives on Corporate Governance 217 (F. Scott Kieff & Troy A. Paredes eds., 2010) (questioning both the efficacy and desirability of shareholder activism).

4. Undermining Corporate Governance Structures

In corporate governance, directors and officers have the legal authority and responsibility to manage the company's affairs.[105] If shareholders, especially those with minor holdings, are categorized as "controlling," it risks undermining the established roles of these corporate fiduciaries. Courts could end up scrutinizing normal shareholder activities—such as voting or voicing opinions about corporate policy—as potential breaches of fiduciary duty. This would blur the distinction between shareholders and management, making corporate governance less effective by distorting the allocation of responsibility.

In doing so, an expansive definition of control that encompasses factors relating to managerial powers is inconsistent with the scheme created by the Delaware legislature. The DGCL provides a number of statutory protections for directors and officers that have not been extended to controlling shareholders. Directors who rely in good faith on reports and information from officers and certain outsiders are "fully protected."[106] Directors and officers may be exculpated for breaches of the duty of care.[107] Directors and officers are entitled to indemnification.[108] Director and officer conflicts of interest are subject to a single step cleansing process.[109] All of these statutory protections will be eviscerated if an officer or director's "superstar" status means they can be treated as a controller despite owning a modest amount of stock (if any). As such, that ought to be a decision for the legislature rather than the courts.

5. Asking the Wrong Questions

In many ways, current Delaware law asks the wrong questions. Consider, for example, the question of superstar CEOs. Whether one qualifies as a controller under that standard is going to matter a great deal to high profile Silicon Valley CEOs. Yet, even if one can distinguish between a CEO who is merely valuable to the company and a superstar CEO who is exceptionally valuable to it, a debatable proposition, the distinction does not speak to the real issue. The question is not whether one is valuable, after all, but whether one controls. To take the paradigmatic case, the fact that "Musk was so talented and visionary that the

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[105] Del. Code Ann., tit. 8, § 141(a) (2025) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation.").

[106] Del. Code Ann., tit. 8, § 141(e) (2025).

[107] Del. Code Ann., tit. 8, § 102(b)(7) (2025).

[108] Del. Code Ann., tit. 8, § 145 (2025).

[109] Del. Code Ann., tit. 8, § 144(a) (2025).

company could not succeed without him," may have given him leverage, but did "not rationally imply that he was a controlling stockholder."[110]

We see the courts similarly asking the wrong questions with respect to soft control. The mere existence of such control rights should not be dispositive, of course, because Delaware law purportedly requires evidence of actual control.[111] In *Voigt*, Vice Chancellor Laster opined that those rights are nevertheless relevant, because "the exercise of contractual rights to channel the corporation into a particular outcome" is evidence of the requisite actual control.[112] As Hamermesh, Jacobs, and Strine point out, however, such rights often "reflect garden variety commercial dealings."[113]

D. A Course Correction

There is a widely shared view that a course correction is necessary. Former Delaware Chief Justice Leo Strine opined that recent cases have posed doctrinal questions requiring clarification, "such as what constitutes control and who is a controller under Delaware's entire fairness doctrine."[114] In a client memo, Dechert LLP identified increasing concerns "about the caselaw of conflicted controller transactions," including "uncertainty as to who is a controller . . ..."[115] Although uncertainty as to that issue is a widely shared concern, a prominent Delaware practitioner told me that the problem is not just uncertainty.[116] Instead, that practitioner believes the substance of the law is a problem, as the law is evolving to be unnecessarily restrictive on controllers.[117] The question then is what direction should a new course take?

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[110] Hamermesh et al., supra note 44, at 346.

[111] Voigt v. Metcalf, No. CV 2018-0828-JTL, 2020 WL 614999, at *11 (Del. Ch. Feb. 10, 2020).

[112] Id. at *12.

[113] Hamermesh et al., supra note 44, at 348.

[114] Rose Krebs, Delaware's Corp. Law Dominance A Hot Topic At Tulane Conference, Law360.com (Mar. 7, 2024), https://www.law360.com/articles/1811403/del-s-corp-law-dominance-a-hot-topic-at-tulane-conference.

[115] In Long-Awaited Match Decision, Delaware Supreme Court Expands MFW Requirements in Conflicted Controller Transactions, Dechert.com (Apr. 24, 2024), https://www.dechert.com/knowledge/onpoint/2024/4/in-long-awaited-match-decision—delaware-supreme-court-expands-m.html.

[116] Off-the-Record Interview with Delaware Practitioner (May 9, 2024).

[117] Id.

The preceding section's analysis of the current standard's defects suggests several basic guiding principles. First, the definition should be based on actual domination and control. Leverage, other forms of bargaining inequalities, the ability to exercise control if one so wishes, and so on should not be factors in the analysis. Second, the definition should not be so all encompassing as to capture those who wield power mainly by virtues of their position as an officer or director. Third, truly substantial stock ownership should be required. Finally, the standard should provide as much clarity, certainty, and predictability as possible.

A brightline statutory definition of control is probably undesirable, as it likely would be both over- and under-inclusive. At the margins, however, the Delaware legislature could provide useful clarifications. In particular, the legislature could amend new DGCL § 122(18) to provide that the contractual provisions authorized therein do not create or imply any fiduciary relationship. As we saw, there is considerable risk that courts will treat such provisions as granting their holder controller status,[118] which such an amendment would prevent.

The legislature could also adopt a provision that a person is not considered a controlling shareholder solely by reason of holding a position as an officer, director, or employee of the corporation. This would prevent the courts from extending the definition to capture officers and directors who do not own stock or whose influence comes mainly from their status as an officer or director rather than through stock ownership. In turn, this should send a message of legislative disapproval for treating superstar CEOs as controllers. Instead, it would leave such superstars to the law governing directors and officers.[119]

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[118] See supra note 70 and accompanying text.

[119] Another option would be for the legislature to adopt a statutory definition of controlling shareholder. The Delaware business combination statute, for example, defines "interested stockholder," albeit solely for purposes of that provision and subject to various provisos, as "any person (other than the corporation and any direct or indirect majority-owned subsidiary of the corporation) that (i) is the owner of 15% or more of the outstanding voting stock of the corporation, or (ii) is an affiliate or associate of the corporation and was the owner of 15% or more of the outstanding voting stock of the corporation at any time within the 3-year period immediately prior to the date on which it is sought to be determined whether such person is an interested stockholder, and the affiliates and associates of such person." Del. Code. Ann., tit. 8, § 203(c)(5). Obviously, however, a 15 percent threshold would be far too overinclusive. The business combination statute, after all, was intended to prevent an interested stockholder from gaining full control over the corporation's assets without complying with the statutory requirements. See Fred Axley & Roberta Blum Andrew, Control Share Statutes, 8 N. Ill. U.L. Rev. 237, 241 (1988) (discussing purpose of business combination statutes).

The American Law Institute's Principles of Corporate Governance proposed a presumption that the holder of 25 percent or more of the corporation's voting power was a

As for judicial reform, a useful analogy the core judicial definition is suggested by *Essex Universal Corp. v. Yates*.[120] Yates owned a substantial block of Republic Pictures Corporation stock, which he agreed to sell at a premium to market to Essex Universal Corporation.[121] As part of the deal, Yates promised to call a special board meeting at which a majority of the incumbent directors would resign and be replaced by Essex nominees.[122] When the price of Republic stock rose to above the agreed premium, Yates tried to renege on the deal by claiming that the delivery of an Essex dominated board was legally impermissible.

On the one hand, New York law generally allowed controlling shareholders to sell their shares at a premium without incurring liability to the minority.[123] On the other hand, New York law prohibited naked sales of corporate office—i.e., those "accompanied by no stock or insufficient stock to carry voting control."[124] Chief Judge Lumbard reconciled those principles by opining that "if Essex had been contracting to purchase a majority of the stock of Republic, it would have been entirely proper for the contract to contain the provision for immediate replacement of directors."[125] On these facts, however, Essex was obtaining 28.3 percent of the stock.[126] Where the purchaser acquired less than a majority of the voting stock, as here, Lumbard thought the simultaneous stock sale and transfer of board control would be permissible if the purchaser "was contracting to acquire what in reality would be equivalent to ownership of a majority of stock, i.e., if it would as a practical certainty have been guaranteed of the stock voting power to choose a majority of the directors . . . in due course, there is no reason why the contract should not similarly be legal."[127]

I propose that Delaware courts adopt a slightly modified version of the *Yates* standard as the test for determining whether a shareholder possesses control

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controlling shareholder. Am. L. Inst., Prin. Corp. Gov. § 1.10(b) (1994). The difficulty with such an approach is that it does not eliminate the need to litigate whether the alleged controller in fact exercise control "over the management or policies of the corporation." See id. cmt (explaining how the presumption may be rebutted). It simply shifts the burden of proof to the alleged controller.

[120] 305 F.2d 572 (2d Cir. 1962).

[121] See id. at 573 (summarizing terms of the deal).

[122] See id. at 574 (quoting relevant provision of sale agreement).

[123] Id. at 576.

[124] Id. at 575.

[125] Id. at 579.

[126] Id.

[127] Id.

sufficient to trigger fiduciary duties. Where the shareholder owns a majority of the voting power, it should be deemed a controlling shareholder. Where the shareholder owns less than a majority of the voting power, there should be a presumption that the shareholder does not exercise control. This presumption should be rebuttable solely by a showing that the shareholder's stock holdings are the equivalent of majority control. This could be shown by evidence that the shareholder owns sufficient stock so as to be practically certain of being able to elect a majority of the board of directors.[128]

Typically, about 80 percent of shares are voted at an annual meeting.[129] Assuming plurality, non-cumulative voting, a shareholder who owns 40 percent of the voting power should be practically certain of electing the board. Of course, evidence that shareholders at a particular company tend to turn out at higher or lower rates would change the number of shares necessary for the holder to meet the practical certainty standard.

Note that the proposal focuses on control over the corporation rather than control with respect to the particular transaction in question. First, a frequently cited justification for imposing fiduciary duties on a controller is the controller's ability to retaliate against the minority shareholders by using its control over the board of directors to impose "some onerous and oppressive policy."[130] Likewise, Delaware courts have argued that a controller should bear fiduciary duties because of the risk that directors may "perceive that disapproval may result in retaliation by the

[128] My proposal is thus somewhat more restrictive than that of Hamermesh, Jacobs, and Strine, who "propose limiting the concept of 'controlling stockholder' to the situation where a stockholder's voting power gives it at least negative power over the company's future, in the sense of acting as a practical impediment to any change of control." Hamermesh et al., supra note 44, at 326.

[129] See Alon Brav et al., Retail Shareholder Participation in the Proxy Process: Monitoring, Engagement, and Voting 51 (ECGI, Working Paper No. 637/2019, 2019) (reporting data on shareholder voting on management sponsored proposals), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3387659.

[130] In re W. Nat. Corp. Shareholders Litig., No. 15927, 2000 WL 710192, at *26 (Del. Ch. May 22, 2000) (noting that "the absence of a controlling shareholder removes the prospect of retaliation"). See also Citron v. E.I. Du Pont de Nemours & Co., 584 A.2d 490, 502 (Del. Ch. 1990) (noting that "shareholders voting on a parent subsidiary merger might perceive that their disapproval could risk retaliation of some kind by the controlling stockholder"); Franklin A. Gevurtz, The Shareholder Approval Conundrum, 60 B.C. L. Rev. 1831, 1875 (2019) (stating that "the explanation Delaware courts have given for not invoking the business judgment rule upon approval of a transaction with a controlling shareholder by a majority of the minority shareholders focused on the fear of retaliation").

controlling shareholder."[131] In either case, a controller who possesses ongoing power over the corporation likely is in a stronger position to retaliate than a shareholder who only exercises control with respect to a particular transaction.

A second consideration militating against imposing fiduciary duties on a transaction-by-transaction basis is that it inevitably will be even more uncertain than assessing whether a shareholder possesses ongoing control over the enterprise. Questions going to issues such as a shareholder's relationships with key managers or contractual rights are going to be much more subjective than how many shares the alleged controller owns. A related concern is that such factors go to matters such as soft control, leverage, and influence rather than actual control and domination.

It may be argued that a practical certainty test will be underinclusive, especially if it does not include cases of control over a particular transaction. Yet, it is important to remember that a controlling shareholder's power is limited by the statutory restrictions on shareholder rights. In public corporations, shareholders have extremely limited powers to initiate corporate action.[132] Instead, corporate powers are exercised by the board of directors and the managers to whom the board delegates authority.[133] The board of directors, of course, is "a legally accountable fiduciary obliged by law to advance the interests of the corporation and its shareholders."[134] As such, a board of directors who rubberstamps the wishes of a shareholder—controlling or not—can face liability for breach of fiduciary duty.[135] Courts concerned that some cases involving a controller may fall through the cracks absent an expansive definition of control should address that concern by focusing

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[131] In re Viacom Inc. Stockholders Litig., No. CV 2019-0948-JRS, 2020 WL 7711128, at *24 (Del. Ch. Dec. 29, 2020).

[132] See Fisch & Solomon, supra note 30, at 146 ("The power of shareholders, even controlling shareholders to participate in corporate decisions, is starkly limited by Delaware law."); Theodore N. Mirvis, Paul K. Rowe, & William Savitt, Bebchuk's "Case for Increasing Shareholder Power": An Opposition, 120 Harv. L. Rev. F. 43, 44 (2007) ("In the context of charter amendments and certain extraordinary corporate events, shareholders are asked to react to board recommendations, but have very limited power to initiate corporate action.").

[133] See Mirvis et al., supra note 132, at 44 ("Significant corporate action (including the 'rules of the road' and 'game ending' decisions at issue in Bebchuk's proposed reforms) may be undertaken under existing law only with the informed and deliberate assent of the board of directors . . ..").

[134] Id.

[135] See, e.g., Edelman v. Fruehauf Corp., 798 F.2d 882, 886 (6th Cir. 1986) (holding that directors breached their fiduciary duty by simply "rubber stamping" a management buyout proposal).

on the duties of directors' of controlled companies rather than increasingly vague efforts to identify controllers.[136]

To be sure, a practical certainty test consists of a standard rather than a brightline rule. Inevitably, standards provide less certainty than rules. The practical certainty test nevertheless has important advantages over the current morass. First, while it acknowledges that control can exist even when the controller owns less than a majority of the voting power,[137] it refocuses the analysis on the traditional tie between voting power and control.[138] By doing so, it eliminates the risk of conflating conflicts of interest involving directors and officers with those involving controlling shareholders. It also eliminates the risk that mere exercise of contractual rights would trigger fiduciary obligations. Second, it is consistent with the line of cases requiring not just some stock ownership but sufficient control as to constitute actual domination.[139] Third, the presumption that a minority shareholder does not have control would restore the historical difficulty plaintiffs had in establishing the

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[136] Although an article by prominent Delaware commentators Larry Hamermesh, Jack Jacobs, and Leo Strine expressed considerable concern about the trends in Delaware law towards expanding the definition of controller, they did not offer a direct response. Instead, they suggested that Delaware courts observe existing doctrinal safeguards. See Hamermesh et al., supra note 44, at 348 ("The courts should heed doctrinal guardrails against overuse of this 'soft power' concept . . .."). Hamermesh, Jacobs, and Strine also suggested addressing the problem not by changing the definition of control but rather by changing the rules governing cleansing of conflicted controller transactions. They believe limiting *MFW* cleansing to freezeout mergers, while allowing other conflicted controller transactions to be cleansed by an independent committee decision, "will reduce the unhelpful pressures by plaintiffs to characterize as 'controlling stockholders' defendants who have far less than majority ownership and unaffiliated defendants as a 'situational control bloc.'" Id. at 379. One problem with their proposal is that there are good arguments for extending *MFW* cleansing to all conflicted controller transactions (as defined in the next Part). See infra notes 298-301 and accompanying text. Another problem is that it would require the Delaware Supreme Court to reverse its recent *Match* decision, which seems unlikely. See infra note 301 and accompanying text. Finally, it depends on the plaintiffs' bar to perform as expected, which seems overly optimistic.

[137] See In re Cysive, Inc. S'holders Litig., 836 A.2d 531, 552 (Del. Ch. 2003) (noting that a sub-50 percent shareholder whose block is large enough to prevail "without having to attract much, if any, support from public stockholders" can be deemed to have de facto control").

[138] See supra note 59 and accompanying text (discussing caselaw whose "reasoning remained deeply tied to voting").

[139] See supra note 46-49 and accompanying text (discussing actual domination standard).

requisite control.[140] Fourth, by focusing on control rather than leverage or influence, it asks the right questions. Finally, by substantially limiting the focus of the inquiry and eliminating extraneous factors, it should provide greater certainty and predictability than the current standard.

III. Identifying Conflicted Controller Transactions

Determining that one person stands in a fiduciary relation towards another only begins the analysis. Because not all fiduciary relationships impose identical obligations, one must go on to determine precisely what obligations are associated with the relationship in question.[141] Finally, one must determine what standards of review apply when courts are asked to determine whether those obligations have been violated.

Delaware law recognizes three standards of review for assessing the actions of corporate fiduciaries.[142] The business judgment rule is invoked where the decision makers are disinterested, independent, and fully informed.[143] Entire fairness is the standard applied to conflicted interest transactions.[144] The intermediate enhanced

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[140] See supra note 44 and accompanying text (noting the historical difficulty).

[141] As Justice Felix Frankfurter famously observed:

> We reject a lax view of fiduciary obligations and insist upon their scrupulous observance. But to say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?

Securities and Exch. Comm'n v. Chenery Corp., 318 U.S. 80, 85–86 (1943) (citations omitted).

[142] See Reis v. Hazelett Strip–Casting Corp., 28 A.3d 442, 457 (Del.Ch.2011) ("Delaware has three tiers of review for evaluating director decision-making: the business judgment rule, enhanced scrutiny, and entire fairness.").

[143] See, e.g., Litt v. Wycoff, No. CIV.A. 19083-NC, 2003 WL 1794724, at *6 (Del. Ch. Mar. 28, 2003) (noting that "employee compensation decisions made by a fully informed, disinterested, and independent board of directors are usually entitled to the protection of the business judgment rule"); see generally Edward P. Welch, et al., Mergers & Acquisitions Deal Litigation Under Delaware Corporation Law § 4.02[A][2] (2014) ("When a decision is made by a majority of well-informed, disinterested, and independent directors, that decision is generally protected by the deferential business judgment rule.").

[144] See Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983) (holding that the entire fairness standard is triggered when financial conflicts of interest are involved); see also In re Crimson Expl. Inc. Stockholder Litig., No. CIV.A. 8541-VCP, 2014 WL 5449419, at *12 (Del. Ch. Oct. 24, 2014) ("Entire fairness is not triggered solely because a company has a controlling stockholder. The controller also must engage in a conflicted

scrutiny standard applies mainly in change of control situations and requires directors to prove they acted reasonably.[145]

Enhanced scrutiny is typically invoked in connection with board resistance to an unsolicited takeover bid and board decisions triggering a sale of control of the corporation.[146] As such, it can be set aside as not pertinent to our analysis. Instead, the choice when it comes to controlling shareholder duties is between the business judgment rule and the entire fairness standard.

More than three decades ago, then-Vice Chancellor Jack Jacobs observed that "[t]he precise circumstances that will trigger the 'entire fairness' standard of review have not been consistently articulated in the Delaware cases."[147] The same could be said today, but the problem has been compounded by a steady expansion of the types of controller transactions triggering entire fairness review. Accordingly, there is considerable uncertainty as to what controller transactions trigger the exacting entire fairness standard and thus require cleansing.[148]

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transaction."). As discussed below, this exacting standard can be relaxed if the transaction is properly cleansed. See infra Part IV.A.

[145] See Paramount Commun. Inc. v. QVC Network Inc., 637 A.2d 34, 45 (Del. 1994) ("The key features of an enhanced scrutiny test are: (a) a judicial determination regarding the adequacy of the decisionmaking process employed by the directors, including the information on which the directors based their decision; and (b) a judicial examination of the reasonableness of the directors' action in light of the circumstances then existing. The directors have the burden of proving that they were adequately informed and acted reasonably.").

[146] See id. at 42 (explaining that the situations in which enhanced scrutiny is applicable include "(1) the approval of a transaction resulting in a sale of control, and (2) the adoption of defensive measures in response to a threat to corporate control").

[147] Citron v. E.I. Du Pont de Nemours & Co., 584 A.2d 490, 500 n.13 (Del. Ch. 1990).

[148] Dechert, supra note 115 (noting uncertainty as to "what constitutes a conflicted controller transaction requiring each of the *MFW* procedures to restore the protections of the business judgment rule").

Vice Chancellor Travis Laster has argued that the duty of loyalty owed by controlling shareholders differs in important ways from those of directors and officers. J. Travis Laster, The Distinctive Fiduciary Duties That Stockholder Controllers Owe (May 30, 2024), https://ssrn.com/abstract=4960206. According to Laster, there are two principal factual settings in which a controller's duty of loyalty comes into play: (1) when a controller enters into transactions in which it has a personal interest and (2) when exercising its individual shareholder rights. Id. at 2. Laster then divides the rights pertinent to the second setting into governance, economic, and litigation categories. Id. at 31. Unlike the case of officers and directors, when transacting with the corporation the controller has no duty to affirmatively benefit the corporation or the minority. Id. at 33. Instead, controller

A. Business Judgment Versus Entire Fairness: Why it Matters

Although the choice between the business judgment rule and entire fairness review is not automatically dispositive,[149] there is no doubt that the latter is a much more demanding standard under which defendants rarely prevail.[150] When the business judgment rule is applicable, the court will not review the merits of the challenged decision, which thereby insulates the decision makers from liability.[151] When entire fairness is the standard of review, the burden of proof is on the defendant to prove that the transaction is fair.[152] Fairness in this context has two components: fair dealing and fair price.[153] The former goes to the process by which

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transactions falling into the first setting are subject to a version of the entire fairness test under which the controller may not harm the corporation or the minority. Id. at 36. As for cases falling into the second fact pattern, the law applicable when a controller exercises litigation rights is not well developed. Where the controller exercises its governance rights (as by voting), the controller's duties are determined by whether the controller acts to preserve or change the status quo. Id. at 50. Only in the latter case is the controller's duty of loyalty triggered. Id. That duty is satisfied if the controller refrains from knowingly or intentionally harming the corporation or the minority. Id. The law governing the exercise of a controller's economic rights largely tracks that governing the exercise of voting rights. Id. at 55-56. My proposed course correction does not adopt this model, which I believe is needlessly complex. The use of a single threshold test in all factual situations avoids the need to parse specific cases with an eye for placing them in a multi-category taxonomy.

[149] See Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1163 (Del. 1995) (noting that requiring "the board of directors to show entire fairness does not create liability per se"); see generally Reza Dibadj, Networks of Fairness Review in Corporate Law, 45 San Diego L. Rev. 1, 22 (2008) ("While the conventional wisdom might suggest that standards of review are typically outcome determinative, the empirical research suggests the fairness standard is not …."); Julian Velasco, A Defense of the Corporate Law Duty of Care, 40 J. Corp. L. 647, 689 (2015) (collecting cases where defendants prevailed under entire fairness and noting that "the entire fairness test is no longer considered outcome-determinative").

[150] See In re Tesla Motors, Inc. Stockholder Litig., No. CV 12711-VCS, 2022 WL 1237185, at *48 (Del. Ch. Apr. 27, 2022) (noting that "defense verdicts after an entire fairness review of fiduciary conduct are not commonplace"), aff'd sub nom. In re Tesla Motors, Inc. Stockholder Litig., 298 A.3d 667 (Del. 2023).

[151] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180 n.10 (Del. 1986) (describing effect of the business judgment rule).

[152] See Kahn v. Lynch Commun. Sys., Inc., 638 A.2d 1110, 1115 (Del. 1994) ("A controlling or dominating shareholder standing on both sides of a transaction, as in a parent-subsidiary context, bears the burden of proving its entire fairness.").

[153] See *Kahn*, 638 A.2d at 1115 (quoting Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983)). Delaware courts use the terms entire fairness, intrinsic fairness, and fairness interchangeably. See, e.g., Tanzer v. Intl. Gen. Industries, Inc., 402 A.2d 382, 386 (Del.

the transaction was proposed, approved, and consummated.[154] The latter goes to the economics of the transaction.[155] The review is not neatly bifurcated; rather, all aspects of the transaction must be considered together.[156] Fairness review also entails "close scrutiny by the court" of the defendants' actions, a degree "of scrutiny that is inappropriate when the business judgment rule's presumption attaches to a decision."[157] Given the rigor with which the fairness standard is applied, it is not surprising that routine application of entire fairness invites "some of the more unscrupulous and entrepreneurial members of the plaintiffs' bar to file hastily crafted complaints in an effort to secure settlements that offer no discernible advantage to the remaining stockholders."[158]

In several contexts, the potentially outcome determinative nature of the choice between the business judgment rule and the entire fairness standard has prompted the Delaware courts to develop preliminary screening mechanisms for deciding which standard to apply to particular factual settings.[159] It likely was that very concern, for example, which motivated the Delaware Supreme Court to create the enhanced scrutiny test in the takeover context.[160] Although reasonableness

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Ch. 1979) ("The words 'entire fairness' are synonymous with the words 'intrinsic fairness.'").

[154] See *Kahn*, 638 A.2d at 1115 (quoting *Weinberger* to the effect that fair dealing "embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained").

[155] Id.

[156] Id.

[157] Harbor Fin. Partners v. Huizenga, 751 A.2d 879, 901 (Del. Ch. 1999). The Delaware Supreme Court has described the business judgment rule as "a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

[158] Fiegenbaum, supra note 10, at 780.

[159] In comparing these two standards, the Delaware Chancery Court has observed that "because the effect of the proper invocation of the business judgment rule is so powerful and the standard of entire fairness so exacting, the determination of the appropriate standard of judicial review frequently is determinative of the outcome of derivative litigation." AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 111 (Del. Ch. 1986). In addition, *AC Acquisitions* was quoted with approval by the Delaware Supreme Court in Mills Acq. Co. v. Macmillan, Inc., 559 A.2d 1261, 1279 (Del. 1989).

[160] *AC Acquisitions*, 519 A.2d at 111 ("Perhaps for that reason, the Delaware Supreme Court recognized . . . that where a board takes action designed to defeat a threatened change

eventually became the ball game, the enhanced scrutiny test originally functioned as a mechanism for deciding on a case-by-case basis for deciding whether the business judgment rule or entire fairness standard applied to corporate takeover defenses.[161]

A different screening text inquiry is used in derivative litigation to like effect and for the same reason.[162] The cause of action underlying any derivative lawsuit brought by a shareholder on behalf of the corporation is one that belongs not to the shareholder but to the corporation.[163] Equity early recognized, however, that in certain cases—especially those in which the cause of action lies against the board of directors or senior management—shareholders should be allowed to "to step into the corporation's shoes and to seek in its right the restitution [they] could not demand in [their] own name."[164] When a shareholder brings a derivative suit, however, the shareholder inherently infringes on the authority of the board of directors.[165] The decision to sue or not sue, after all, is of a kind with all the other business decisions that corporate law assigns to the board rather than to the shareholders.[166] In order to balance these competing interests, equity developed the

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in control of the company, a more flexible, intermediate form of judicial review is appropriate.").

[161] See Stephen M. Bainbridge, Unocal at 20: Director Primacy in Corporate Takeovers, 31 Del. J. Corp. L. 769, 800 (2006) (explaining original function of the enhanced scrutiny standard).

[162] Professor Mary Siegel has pointed out that a similar threshold inquiry is used in the derivative suit context, in which the "Zapata two-step" standard is used to determine whether a corporation can obtain dismissal of a suit as to which the plaintiff has successfully pled that demand would be futile. See Siegel, supra note 17, at 28-29 (discussing *Zapata* standard).

[163] See Louisiana Mun. Police Employees' Ret. System v. Pyott, 46 A.3d 313, 330 (Del. Ch. 2012) (noting "the legal truism that the underlying claim in a derivative action belongs to the corporation"), rev'd on other grounds, 74 A.3d 612 (Del. 2013); MAXXAM, Inc./Federated Dev. Shareholders Litig., In re, 698 A.2d 949, 956 (Del. Ch. 1996) ("A derivative claim belongs to the corporation, not to the shareholder plaintiff who brings the action.").

[164] Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541, 548 (1949).

[165] Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984), overruled by Brehm v. Eisner, 746 A.2d 244 (Del. 2000) ("By its very nature the derivative action impinges on the managerial freedom of directors."); Marx v. Akers, 666 N.E.2d 1034, 1037 (N.Y. 1996) ("By their very nature, shareholder derivative actions infringe upon the managerial discretion of corporate boards.").

[166] Auerbach v. Bennett, 393 N.E.2d 994, 1000 (N.Y. 1979) ("As with other questions of corporate policy and management, the decision whether and to what extent to explore

demand requirement.[167] Unless demand is excused as being futile, the shareholder must make a written demand on the board prior to filing suit, which "must identify the alleged wrongdoers, describe the factual basis of the wrongful acts and the harm caused to the corporation, and request remedial relief."[168]

As the law evolved, the demand requirement became the pivot on which the entire process revolved. If demand is required, the board has an opportunity to review the claim and decide whether the corporation should bring suit. If the board decides that the corporation should do so, the suit goes forward with no further shareholder involvement. If the board rejects the demand, that decision "is entitled to the presumption of the business judgment rule unless the stockholder can allege facts with particularity creating a reasonable doubt that the board is entitled to the benefit of the presumption."[169] This requires the plaintiff to allege particularized facts demonstrating that the decision was not a product of a valid business judgment.[170] If demand is excused, however, the shareholder may go forward with lawsuit under the shareholder's control.[171]

Because shareholder-plaintiffs face considerable difficulty prevailing in wrongful demand cases, the demand excusal decision can have almost outcome determinative effects.[172] The basic question a court faces when deciding on demand excusal thus is whether it trusts the board to make a good faith and independent decision untainted by self-interest or domination by interested parties.[173] In *United*

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and prosecute such claims lies within the judgment and control of the corporation's board of directors.").

[167] *Marx*, 666 N.E.2d at 1037 (discussing the role of the demand requirement).

[168] Allison v. General Motors Corp., 604 F.Supp. 1106, 1117 (D. Del.), aff'd mem., 782 F.2d 1026 (3d Cir.1985).

[169] Grimes v. Donald, 673 A.2d 1207, 1219 (Del. 1996).

[170] Zucker v. Hassell, No. CV 11625-VCG, 2016 WL 7011351, at *7 (Del. Ch. Nov. 30, 2016), aff'd, 165 A.3d 288 (Del. 2017).

[171] The board may regain control of a demand excused case through the use of a special litigation committee (SLC). See Zapata Corp. v. Maldonado, 430 A.2d 779, 786 (Del. 1981) (validating the use of SLCs).

[172] See Robin Alexander, Director Independence and the Impact of Business and Personal Relationships, 92 Denv. U.L. Rev. Online 63, 77 (2015) (noting that because of differing rules on discovery between demand required and demand excused cases, the "distinction may be outcome-determinative"); Christine Hurt, The Undercivilization of Corporate Law, 33 J. Corp. L. 361, 384 (2008) (noting that "a 'wrongful refusal' case [is] difficult to win").

[173] See Aronson v. Lewis, 473 A.2d 805, 814 (Del. 1984) (explaining that the demand futility standard is intended to determine whether "directors are under an influence which

Food and Com. Workers Union and Participating Food Indus. Employers Tri-State Pension Fund v. Zuckerberg,[174] the Delaware Supreme Court thus adopted a three-pronged test to determine whether the board is "able to bring their impartial business judgment to bear on a litigation demand."[175]

The demand excusal standard thus functions in the derivative litigation context very much like the enhanced scrutiny standard does in the takeover context. Both stand at a fork in the road. The choice of which path to follow often will be outcome determinative. Rather than assuming that boards can always be trusted or can never be trusted to make takeover or derivative suit decisions, the law created threshold inquiries to decide upon which path the case should proceed.

B. *Sinclair Oil*: An Initial Screen for Controlling Shareholder Litigation

A similar concern as to the outcome determinative nature of the choice between the business judgment rule and the fairness doctrine likely drove the Delaware Supreme Court's decision in *Sinclair Oil Corp. v. Levien*.[176] Sinclair Oil owned 97 percent of the stock of a subsidiary, the Sinclair Venezuelan Oil Company (Sinven), with the remaining 3 percent being held by minority shareholders.[177] A minority shareholder challenged three transactions between Sinclair Oil and Sinven: (1) payment of large cash dividends by Sinven; (2) Sinclair Oil's use of other (wholly-owned) subsidiaries to develop oil fields located outside of Venezuela; and (3) Sinclair Oil's actions with respect to a contract between Sinven and another Sinclair Oil subsidiary.[178]

The Delaware Supreme Court rejected arguments that a single standard should govern all controller transactions.[179] Instead, the choice needed to be made on a

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sterilizes their discretion, [such that] they cannot be considered proper persons to conduct litigation on behalf of the corporation"); Craig W. Palm & Mark A. Kearney, A Primer on the Basics of Directors' Duties in Delaware: The Rules of the Game (Part I), 40 Vill. L. Rev. 1297, 1337 (1995) (explaining that, "in demand excused cases, the courts review whether the board can make an unbiased business judgment with respect to the litigation").

[174] 262 A.3d 1034 (Del. 2021).

[175] Id. at 1059.

[176] 280 A.2d 717 (Del. 1971).

[177] Id. at 719.

[178] See id. (summarizing claims).

[179] See Siegel, supra note 17, at 30–31 (noting that "the Delaware Supreme Court initially questioned the correctness of both plaintiff's demand for a fairness review and defendant's demand for the business judgment rule").

case-by-case basis. As such, the court rejected the idea that all transactions between a controller and the controlled company triggered fairness review.[180]

Under *Sinclair Oil*, fairness review is triggered:

> When the situation involves a parent and a subsidiary, with the parent controlling the transaction and fixing the terms, the test of intrinsic fairness, with its resulting shifting of the burden of proof, is applied. The basic situation for the application of the rule is the one in which the parent has received a benefit to the exclusion and at the expense of the subsidiary. . . .
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> 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.[181]

In the absence of such self-dealing, however, the appropriate standard is the business judgment rule.[182] By adopting this threshold test for choosing the standard of review appropriate to the case at bar, *Sinclair Oil* thus alleviated the risk that routinely applying one standard or the other would be outcome determinative with no regard to the merits of the case.[183]

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[180] See Steven M. Haas, Toward A Controlling Shareholder Safe Harbor, 90 Va. L. Rev. 2245, 2255 (2004) ("*Sinclair Oil* was significant 'because the court refused to require all parent-subsidiary transactions' to be reviewed under the entire fairness rule.").

[181] Id. at 720 (citations omitted). The opinion uses the terms parent and subsidiary rather than controller and controlled entity, which was appropriate on the facts, but there is nothing in the opinion suggesting an intent to limit the standard to parent-subsidiary cases. See, e.g., Trans World Airlines, Inc v. Summa Corp, No. 1607, 1985 WL 11544, at *2 (Del. Ch. Mar. 12, 1985) (discussing "the ruling in *Sinclair Oil Corporation v. Levien*, supra, which required the controlling shareholder to demonstrate that its conduct was not a cause of the losses suffered by minority shareholders").

[182] *Sinclair Oil*, 280 A.2d at 722. I suggest below that the test is not solely whether a controller stands on both sides of the transaction, but rather whether the controller thereby obtains a benefit at the expense of and to the exclusion of the minority. Put another way, the trigger for entire fairness review is that controller benefited at the expense of and to the exclusion of the minority. See infra notes 264-269 and accompanying text.

[183] Professor Mary Siegel has advanced an alternative explanation for *Sinclair Oil*, which argues the court was attempting to balance preventing self-dealing by controllers with judicial economy:

Under the *Sinclair Oil* threshold inquiry, it is not enough that the controlling shareholder is a party to the transaction. The controlling shareholder must have received a benefit that is both at the expense of and to the exclusion of the minority shareholders. This is made clear by the *Sinclair Oil* court's treatment of the minority's objection to the subsidiary's dividend policy. Sinven (the subsidiary) had adopted at Sinclair Oil's behest a policy of paying out the maximum lawful dividend. This benefited Sinclair Oil but did not constitute self-dealing by Sinclair Oil because the minority received their pro rata share of the dividend and, accordingly, Sinclair received nothing from Sinven to the exclusion of its minority stockholders.[184]

It also is not enough that the controlling shareholder get a benefit or even that the benefit is not shared with the minority. The controlling shareholder must get a benefit not only that excludes the minority but comes at their expense. This is made clear by the court's treatment of the minority's complaint that Sinclair Oil had denied Sinven opportunities to develop oil properties outside of Venezuela. "From 1960 to 1966 Sinclair purchased or developed oil fields in Alaska, Canada, Paraguay, and other places around the world. The plaintiff contends that these were all opportunities which could have been taken by Sinven."[185] But the court rejected that claim: "Sinclair usurped no business opportunity belonging to Sinven. Since Sinclair received nothing from Sinven to the exclusion of and detriment to Sinven's minority stockholders, there was no self-dealing."[186] As such, there must be both exclusion and detriment for entire fairness to be applied.

C. Subsequent Evolution

In the immediate post-*Sinclair Oil* period, two distinct lines of cases emerged. In the first, "the Delaware courts were willing to do some careful scrutiny and

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> While the court did not give its reasons for developing a threshold test before selecting one of the bipolar tests, one suspects that the court's reasoning was premised on a combination of two factors: first, the high degree of deference accorded under the business judgment rule seems disturbingly insufficient in light of the control any parent exerts over its subsidiary through stock ownership and the usual overlap in directors; and second, recognition that many corporations have subsidiaries and transact business with these controlled corporations. . . . As a result, if control were sufficient to invoke the fairness test, courts would be extremely busy reviewing the fairness of a multitude of transactions.

Siegel, supra note 17, at 30.

[184] *Sinclair Oil*, 280 A.2d at 722.

[185] Id.

[186] Id.

analysis in the threshold test before selecting the ultimate standard of review."[187] In the second line of cases, which initially tended to involve so-called ownership claims, courts ignored *Sinclair Oil* and simply applied fairness review without any threshold inquiry.[188] Over time, cases involving enterprise claims began taking the same approach.[189]

A third line of cases eventually emerged, however, in which the court invoked *Sinclair Oil* but omitted the detriment prong of the *Sinclair Oil* threshold test.[190] In recent years, this third line has become a common approach to controller transactions in the Chancery Court. In *In re Tilray, Inc. Reorg. Litig*.,[191] for example, the defendants not only argued that *Sinclair Oil* required not just a showing that the transaction involve a benefit to the controlling shareholder from which the minority were excluded and came at their expense, but that the two were causally linked.[192] Chancellor McCormick observed that multiple decisions of her court implicitly rejected that argument, explaining that "entire fairness

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[187] Siegel, supra note 17, at 51.

[188] Id. at 52-53. Citron v. E.I. Du Pont de Nemours & Co., 584 A.2d 490 (Del. Ch. 1990), is something of an oddball in this period. In it, then-Vice Chancellor Jack Jacobs interpreted *Sinclair Oil* as holding that "the plaintiff must demonstrate that the parent corporation stood on both sides of the transaction and have dictated its terms." Id. at 500 n.13. It is true that the *Sinclair Oil* decision stated that where "the parent control[s] the transaction and fix[es] the terms, the test of intrinsic fairness, with its resulting shifting of the burden of proof, is applied." Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971). But the court also went on to state that "[t]he basic situation for the application of the rule is the one in which the parent has received a benefit to the exclusion and at the expense of the subsidiary." Id. Jacobs ignored that statement of the rule. Instead, he focused on the former and held that post-*Sinclair Oil* case law taught that "all that is required" to invoke entire fairness "is that the parent corporation have stood on both sides of the transaction." Id. The cases he cited, however, were all ownership claim cases involving freezeout mergers. Bershad v. Curtiss–Wright Corp., 535 A.2d 840 (Del. 1987); Rosenblatt v. Getty Oil Co., 493 A.2d 929 (Del. 1985); Weinberger v. UOP, Inc., 457 A.2d 708 (Del. 1983); Sterling v. Mayflower Hotel Corp., 93 A.2d 107 (Del. 1952). As Professor Siegel points out, in such cases the controller by definition is getting a benefit at the expense of the minority. Siegel, supra note 17, at 56.

[189] Siegel, supra note 17, at 59-60. Yet another line of cases "utilized *Sinclair* as a basis for evaluating the fair dealing prong of entire fairness, rather than as a threshold strainer as it had been designed." Id. at 60.

[190] Id. at 66.

[191] No. CV 2020-0137-KSJM, 2021 WL 2199123 (Del. Ch. June 1, 2021).

[192] Id. at 13 ("Defendants reduce this holding to a three-part test, arguing that 'self-dealing requires three elements: (1) an exclusive benefit to the fiduciary (2) that causes (3) a detriment to the minority stockholders.'").

presumptively applies *whenever* a controller extracts a non-ratable or unique benefit."[193] This rule is necessitated by the retributive powers of a controller, which call into question the ability of independent directors and shareholders to truly exercise free judgment.[194] Accordingly, those powers seemingly create a presumption that a non-ratable benefit to the controller comes at the expense of the minority.[195]

In recent years, the Delaware courts—especially the Delaware Chancery Court—have essentially abandoned the *Sinclair Oil* threshold inquiry.[196] To be sure, it still appears to be the case that fairness review "is not triggered solely because a company has a controlling stockholder."[197] But fairness review is no longer limited to cases in which the controller received a benefit at the expense of and to the exclusion of the minority. Instead, fairness review applies whenever the controller stands on both sides of the transaction.[198] Entire fairness also will be

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[193] Id. at *14 (emphasis in original). Hamermesh, Jacobs, and Strine explain that:

> Non-ratable benefits come in many varieties: severance benefits for management, officer or director positions in the surviving corporation, different liquidity desires even in a pro rata transaction, a higher price for a class of stock with admittedly far greater value because of its voting control, an opportunity to acquire an equity interest in the acquiring company, and elimination of potential derivative claims, to name just a few.

Hamermesh et al., supra note 44, at 349.

[194] *Tilray,* 2021 WL 2199123 at *14.

[195] See id. ("To the extent that Sinclair requires that a plaintiff plead the existence of a detriment to minority stockholders to give rise to entire fairness review, the power dynamics in negotiations between a controller and its controlled corporation render a detriment reasonably conceivable.").

[196] Haas, supra note 180, at 2257 ("*Sinclair Oil* has essentially disappeared; it seems to live in dividend and tax cases rather than serve as an overarching principle of controlling shareholder law.").

[197] Lacey on behalf of S. Copper Corp. v. Mota-Velasco, No. CV 2019-0312-SG, 2021 WL 508982, *9 (Del. Ch. Feb. 11, 2021).

[198] In re Viacom Inc. Stockholders Litig., No. CV 2019-0948-JRS, 2020 WL 7711128, at *11 (Del. Ch. Dec. 29, 2020), as corrected (Dec. 30, 2020) (explaining that fairness applies, *inter alia*, when "a controller engages in a 'conflicted transaction, [such as] when . . . 'the controller stands on both sides'").

invoked whenever the controller receives a unique or non-ratable benefit.[199] This is so even when that benefit does not come at the expense of the minority.[200]

D. A Course Correction

I propose that the Delaware courts embrace a reinvigorated *Sinclair Oil* standard as the initial step in all cases involving challenges to conduct by a controlling shareholder. Whether the transaction involves a freezeout merger, a sale of the controller's shares, compensation to the controller in its capacity as a director or officer of the controlled entity, or any other form of potential conflict of interest, entire fairness should be invoked only if the controller has received a benefit at the expense of and to the exclusion of the minority.[201] Otherwise, the business judgment rule applies.

My proposal helps explain many classic cases to which *Sinclair Oil* has not traditionally applied, while also providing a more coherent framework for their analysis. Consider, for example, sales of control. As discussed below, the law recognizes that control is a valuable asset as to which the controller has a legitimate property right.[202] In turn, the power to dispose of an asset is a core element of

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[199] See, e.g., In re Crimson Expl. Inc. Stockholder Litig., No. CIV.A. 8541-VCP, 2014 WL 5449419, at *13 (Del. Ch. Oct. 24, 2014) (holding that entire fairness applies when the controller extracts from a transaction "something uniquely valuable to the controller, even if the controller nominally receives the same consideration as all other stockholders"); In re Ezcorp Inc. Consulting Agreement Derivative Litig., No. CV 9962-VCL, 2016 WL 301245 (Del. Ch. Jan. 25, 2016) (holding that "the entire fairness framework governs any transaction between a controller and the controlled corporation in which the controller receives a non-ratable benefit").

[200] As the Third Circuit opined:

> The District Court relied upon *Sinclair Oil Corp*. for the proposition that "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." However, we do not read *Sinclair Oil Corp.* to hold that a breach of fiduciary duty can never occur under Delaware corporate law without a detriment to the beneficiary.

Cantor v. Perelman, 414 F.3d 430, 435 n.3 (3d Cir. 2005).

[201] This test should apply regardless of whether the plaintiff's complaint raises enterprise or ownership claims. As we have seen, there is a line of Delaware cases under which *Sinclair Oil* is applicable to enterprise claims but not ownership claims. See supra note 188 and accompanying text. As I discuss in Part III.F. infra, at the very least my proposal should apply to freezeout transactions by minority controllers.

[202] See infra note 234 and accompanying text.

ownership.[203] The law thus generally should permit a controller to sell its shares freely, which is the general rule.[204] Because the purchaser is incentivized to increase the value of its newly acquired shares and the minority shareholders will share pro rata in any post-sale gains in the stock's value, minority shareholders will often benefit from sales of control.[205] In any case, one of the risks incident to owning a minority interest in a corporation is that the controller may exercise its ownership rights by deciding to sell its control block without consulting the minority. Under my proposal, the business judgment rule would apply because the controller has received a benefit from which the minority has been excluded but that does not come at the expense of the minority. Accordingly, as under current law, liability would not result.

The cases setting out the general rule, however, typically go on to identify a number of exceptions, such as a sale under circumstances indicating that the purchasers intend to loot or mismanage the corporation, the sale involves fraud or misuse of confidential information, the sale amounts to a wrongful appropriation of corporate assets that properly belong to the corporation, or the sale includes a premium for the sale of office.[206] Under my proposal, such cases would trigger entire fairness review, because the benefit the controller receives now comes both to the exclusion of and at the expense of the minority.

Refusals to sell present another useful example. In the canonical *Mendel v. Carroll* decision, the control group proposed a freezeout merger at $25.75 per

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[203] See Laurence C. Becker, Property Rights—Philosophic Foundations 18 (1977) (arguing that rights of ownership include, *inter alia*, the right to transfer ownership)/

[204] For statements of the general rule, see Treadway Companies, Inc. v. Care Corp., 638 F.2d 357, 375 (2d Cir.1980); Clagett v. Hutchison, 583 F.2d 1259, 1262 (4th Cir.1978); Zetlin v. Hanson Holdings, Inc., 397 N.E.2d 387, 388 (N.Y.1979); Tryon v. Smith, 229 P.2d 251, 254 (Or.1951); Glass v. Glass, 321 S.E.2d 69, 74 (Va.1984).

[205] See Gilson & Gordon, supra note 4, at 795 ("So long as the legal rules governing private benefits of control from operations do not allow all of the synergy to be captured by the controlling shareholder, the non-controlling shareholders will participate in the value increase resulting from the sale of control.").

[206] See Zetlin v. Hanson Holdings, Inc., 397 N.E.2d 387 (N.Y. 1979) ("Recognizing that those who invest the capital necessary to acquire a dominant position in the ownership of a corporation have the right of controlling that corporation, it has long been settled law that, absent looting of corporate assets, conversion of a corporate opportunity, fraud or other acts of bad faith, a controlling stockholder is free to sell, and a purchaser is free to buy, that controlling interest at a premium price."); see also Mendel v. Carroll, 651 A.2d 297, 305 (Del. Ch. 1994) ("A number of liability creating doctrines have been applied which have the effect of creating risks to the controlling shareholder who attempts to realize a control premium. These doctrines include negligence, . . . sale of corporate office, . . . and sale of corporate opportunity . . ..").

share.[207] A third party offeror then proposed acquiring the company at $28.[208] The control group withdrew its offer and announced that it had no interest in selling its shares, thereby precluding the third party offer from going forward.[209] Even if one believes the control group's decision was to the detriment of the minority, the control group is not receiving a benefit from which the minority was excluded. The control group already had control.[210] They got nothing new by virtue of the refusal to sell. Under my proposal, the business judgment rule would apply and, as in the actual case, liability would not result.

As a final example, consider cases in which the controller conducts a sale of the entire company, as in *McMullin v. Beran*.[211] Atlantic Richfield Company ("ARCO") was the majority shareholder (at 80%) of ARCO Chemical Company ("Chemical").[212] In the spring of 1998, ARCO received an unsolicited inquiry from Lyondell Petrochemical Company ("Lyondell"), in which Lyondell expressed interest in acquiring Chemical.[213] ARCO notified Chemical's board, which authorized ARCO to explore a sale of Chemical.[214] Negotiations between ARCO and Lyondell eventually culminated in a $57.75 cash tender offer for any and all Chemical shares, to be followed by a cleanup freezeout merger at the same price.[215] Chemical's board approved the deal, which a Merrill Lynch fairness opinion had blessed.[216] Minority shareholders sued, alleging that Chemical's board made an uninformed decision, that the Chemical board was beholden to ARCO and approved the deal because ARCO needed quick cash, that Chemical's board improperly delegated the responsibility to conduct negotiations to ARCO, and that the tender offer document failed to disclose material facts. The Chancery Court dismissed for failure to state a claim. The Supreme Court reversed, emphasizing that Chemical's directors were in ARCO's pocket.[217] Chemical's directors hastily approved a deal for ARCO's benefit, without determining whether it was a good

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[207] Id. at 298.

[208] Id.

[209] Id.

[210] See id. at 305 (explaining that the control group "already had" control).

[211] 765 A.2d 910 (Del. 2000).

[212] Id. at 914.

[213] Id. at 915.

[214] Id.

[215] Id. at 916.

[216] Id.

[217] See id. at 923 (describing ARCO's influence over Chemical's board).

deal for the minority.[218] But, on the other hand, what could Chemical's board do under the circumstances? The court opined that Chemical's directors had a duty to maximize shareholder wealth, even though a majority shareholder was present, but also acknowledged that the majority shareholder's presence precludes the board from affirmatively seeking alternative deals opposed by the majority.[219]

The court thus gave short shrift to the very real problem facing the independent board members. Any deal supported by ARCO will pass a shareholder vote and any deal opposed by ARCO will fail such a vote. In theory, if the independent directors concluded the ARCO favored deal was a bad one, they have several options, none of which are likely to prove palatable in the real world. The independent directors could vote against the deal, but ARCO and its favored bidder could end run the board by structuring the deal as a tender offer or stock acquisition. The independent board members could contact the minority shareholders to encourage the minority shareholders to exercise their appraisal rights in the event of a freeze-out merger, but the ineffectiveness of the appraisal remedy leaves one skeptical of the merits of that option. At the extreme, the board could authorize Chemical to issue enough stock to dilute ARCO's holdings to the point at which they no longer have control. Once ARCO no longer had control, an alternative deal could go forward. As a doctrinal matter, however, such measures rarely will be required of a board faced with a controlling shareholder.[220]

The McMullin plaintiff focused on claims against Chemical's board of directors,[221] which are beyond the scope of this article. If the plaintiff had pursued claims against ARCO, however, under my proposal this would have been an easy case. The sole benefit ARCO received was that timing and terms of the sale assisted ARCO to meet immediate need for cash.[222] Yet, no one disputed that ARCO was

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[218] See id. at 922 (discussing timing of the offer).

[219] See id. at 919 ("Given ARCO's majority shareholder 80% voting power, under the circumstances of this case, the Chemical Directors did not have the ability to act on an informed basis to secure the best value reasonably available for all shareholders in any alternative to the third-party transaction with Lyondell that ARCO had negotiated.").

[220] See Mendel v. Carroll, 651 A.2d 297, 306 (Del. Ch. 1994) (holding that the board's duty to the minority shareholders "may authorize the board to take extraordinary steps to protect the minority from plain overreaching, it does not authorize the board to deploy corporate power *against* the majority stockholders, in the absence of a threatened serious breach of fiduciary duty by the controlling stock"; emphasis in original).

[221] See *McMullin*, 765 A.2d at 921 (summarizing plaintiff's claim).

[222] See id. ("McMullin's Amended Complaint alleges that ARCO initiated and timed the Transaction to benefit itself because ARCO needed cash to fund the $3.3 billion cash acquisition of Union Texas Petroleum Holdings . . ..").

entitled to sell its control block at a premium.[223] ARCO nevertheless structured the deal so as to take the minority along at the same price. The *McMullin* transaction thus closely resembles the dividend claim in *Sinclair Oil*. Chemical's minority shareholders received their pro rata share of the purchase price, just as Sinven's minority received their pro rata share of the dividends. The fact that Sinven's board approved the largest legally permissible dividends to satisfy "Sinclair's need for cash" did not justify a finding of self-dealing.[224] ARCO's need for cash thus likewise should not have been enough to trigger entire fairness review. If my proposal had been applied, ARCO would not have been held liable, which was the right outcome.

E. Policy Justifications

This section sets out the policy justifications for the proposal offered in the previous section.

1. Rights of selfish ownership

Analysis must begin with the basic proposition that controlling shareholders differ from other types of corporate fiduciaries. Corporate directors and officers are classic examples of fiduciaries, comparable to other textbook fiduciary relationships, such as those between attorney and client, executor and heir, guardian and ward, principal and agent, and trustee and trust beneficiary.[225] As with other examples of fiduciary relationships, all of these examples involve discretionary authority and dependency.[226] It is not merely that the fiduciary exercises discretionary powers that may impact the beneficiary, but that the beneficiary has justifiably reposed trust and confidence in the fiduciary.[227] Put another way, there

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[223] See *McMullin*, 765 A.2d at 920 ("McMullin does not dispute ARCO's right to sell its own 80% interest in Chemical for whatever consideration might have been acceptable to it, whether for cash or stock or a mixture of cash and stock.").

[224] Sinclair Oil Corp. v. Levien, 280 A.2d 717, 721 (Del. 1971).

[225] See U.S. v. Chestman, 947 F.2d 551, 568 (2d Cir. 1991) (listing "hornbook fiduciary relations").

[226] Id. at 569.

[227] See Musalli Factory For Gold & Jewelry v. JPMorgan Chase Bank, N.A., 261 F.R.D. 13, 26 (S.D.N.Y. 2009), aff'd sub nom. Musalli Factory for Gold & Jewelry Co. v. JPMorgan Chase Bank, N.A., 382 Fed. Appx. 107 (2d Cir. 2010) (noting that claims of fiduciary status typically involve "a question of fact: whether someone reposed trust and confidence in another who thereby gains a resulting superiority or influence"). Professor Lipton proposes treating controlling shareholders as fiduciaries when they "exercise discretionary control over assets that properly belong to the remaining shareholders."

must be reliance on the beneficiary's part and de facto control and dominance on the part of the fiduciary.[228] The former is not merely vulnerable to the latter's actions, but also relies on the latter to serve the beneficiary's interests. Hence, as Judge Cardozo famously explained, fiduciaries are held to "the punctilio of an honor the most sensitive."[229] As such, a fiduciary is obliged to put the interests of their beneficiary ahead of their own.[230]

None of this is true of the controlling shareholder—minority shareholder relationship. Granted, the controller wields discretionary voting power that could be used adversely to the interests of the minority, but the minority does not repose trust and confidence in the controller, as illustrated by the proposition that controlling shareholders are generally entitled to vote their shares in their own self-interest.[231] The minority does not rely on the controller to put the minority's interests ahead of the controller's own interests, as illustrated by the proposition that controlling shareholders need not sacrifice their financial interests for the benefit of the minority.[232] As Steven Haas thus observed, imposing director or officer-like fiduciary "duties upon controlling shareholders does not logically follow from their application to other firm agents. After all, shareholders are property owners, not employed agents of the firm."[233]

Lipton, supra note 15, at 806. The difficulty is that that approach omits the requirement of justifiably reposed trust and confidence.

[228] See U.S. v. Margiotta, 688 F.2d 108, 125 (2d Cir. 1982) (explaining that "the concepts of reliance, and de facto control and dominance . . . are at the heart of the fiduciary relationship").

[229] Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928).

[230] See TVI Corp. v. Gallagher, No. CV 7798-VCP, 2013 WL 5809271, at *14 (Del. Ch. Oct. 28, 2013) ("The duty of loyalty is a corporate fiduciary's duty scrupulously to put the interests of the corporation and its shareholders before his or her own.").

[231] See, e.g., Thorpe by Castleman v. CERBCO, Inc., 676 A.2d 436, 444 (Del. 1996) (noting that "the Eriksons were entitled to pursue their own interests in voting their shares").

[232] See, e.g., Bershad v. Curtiss-Wright Corp., 535 A.2d 840, 844-845 (Del. 1987) (holding that a shareholder is under no duty to sell its holdings in corporation even if it is a majority shareholder, merely because the sale would profit the minority); Mendel v. Carroll, 651 A.2d 297, 306 (Del. Ch. 1994) ("No part of their duty as controlling shareholders requires them to sell their interest"); Jedwab v. MGM Grand Hotels, Inc., 509 A.2d 584, 598 (Del. Ch. 1986) (holding that the law "does not, absent a showing of culpability, require that directors or controlling shareholders sacrifice their own financial interest in the enterprise for the sake of the corporation or its minority shareholders").

[233] Haas, supra note 180, at 2276-77.

Unlike other fiduciaries, controlling shareholders thus "have certain rights to what has been termed 'selfish ownership' in the corporation which should be balanced against the concept of their fiduciary obligation to the minority."[234] These rights of selfish ownership follow from the fact that, in most cases, the majority will have made a larger investment, by which it effectively purchased the right to control. In addition, the minority shareholders presumably knew a controlling block existed when they bought into the firm.[235] The minority shareholders therefore assumed the risk that the controller would reap some non-ratable benefits.

This is especially true in the parent-subsidiary corporation context. Parents and subsidiaries routinely engage in perfectly ordinary transactions from which the parent may get some non-ratable benefit.[236] As long as that benefit does not come at the minority's expense however, the minority has no grounds for complaint. Hence, for example, a controlling shareholder should not have to satisfy entire fairness when it consolidates its tax return with that of a subsidiary simply because the controller thereby obtains tax benefits.[237]

A focus on the controller's rights of selfish ownership also helps explain why the law should not focus on the controller's motives. Professor Seigel criticized *Sinclair Oil*'s holding on dividends, on grounds that the court failed to give weight to plaintiff's argument that the dividend payment had improper selfish motives.[238] If we agree that the controller has rights of selfish ownership, however, than motives become irrelevant. The pertinent question is not whether the controller had

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[234] Wilkes v. Springside Nursing Home, Inc., 353 N.E.2d 657, 663 (Mass. 1976). Delaware law thus has long recognized that a controller's status as such is a property right that the controller can protect. See, e.g., Tanzer v. Intl. Gen. Industries, Inc., 379 A.2d 1121, 1123 (Del. 1977) (stating that "we are well aware that a majority stockholder has its rights, too"), overruled on other grounds, Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

[235] See Fisch & Solomon, supra note 30, at 146 (noting that "the risk that a controlling shareholder will behave, to a degree opportunistically, is reflected in the price that minority shareholders pay for their shares"); J. A. C. Hetherington, Defining the Scope of Controlling Shareholders' Fiduciary Responsibilities, 22 Wake Forest L. Rev. 9, 24 (1987) (noting that "buyers of shares in publicly traded, majority controlled firms can and presumably do, reduce their exposure to the risk of managerial or majority abuses by holding diversified portfolios").

[236] See Siegel, supra note 17, at 72 (noting that "a parent corporation that has ongoing business dealings with its partially-owned subsidiary may frequently engage in routine transactions").

[237] Hamermesh et al., supra note 44, at 350 ("Controllers should not have to pay rents to the minority to, for example, conduct business in a tax efficient manner.").

[238] Siegel, supra note 17, at 76.

a self-interest in the decision, but rather whether the controller's selfish motivation caused it to usurp a private benefit to the minority's detriment. So long as the minority gets its fair share, the controller's rationale should be irrelevant.

Finally, assuming controllers have rights of selfish ownership, judicial review of controller actions poses the same concerns that motivate the business judgment rule. As Professor Seigel noted, "one reason for the development of the business judgment rule is that courts do not want to and are not equipped to analyze business transactions."[239] Yet, as she pointed out, many transactions between a controller and the controlled company involve "basic business decisions."[240] Hence, the need for a threshold inquiry, such as *Sinclair Oil*.[241]

2. A Hypothetical Bargain

Once we concede that control is a valuable property right, some degree of inequality inevitably follows. If it were feasible to ensure that all shareholders equally benefited from control, the theoretical value of control would be nil.[242] Consequently, no shareholder would find it worthwhile to acquire a controlling interest.[243] Such a rule would minimize the motivation for outsiders to buy in and replace management, thereby significantly diminishing the primary managerial control mechanism's effectiveness.[244]

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[239] Siegel, supra note 17, at 30 n.17 (1999). As I have noted elsewhere, this is not a complete explanation for the business judgment rule. Stephen M. Bainbridge, The Business Judgment Rule As Abstention Doctrine, 57 Vand. L. Rev. 83, 117-24 (2004)

[240] Id. at 30.

[241] See id. at 31 (citing judicial "disinclination to review the fairness of a large number of transactions" as one likely explanation for *Sinclair Oil*).

[242] Hetherington, supra note 235, at 17.

[243] Id.

[244] Id. Easterbrook and Fischel explain:

> Corporate control transactions can reduce agency costs if better managers obtain control of the firm's assets or if they alter the incentive structure facing existing managers. . . .
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> . . . To illustrate, suppose that the owner of a control bloc of shares finds that his perquisites or the other amenities of his position are worth $10. A prospective acquiror of control concludes that, by eliminating these perquisites and other amenities, he could produce a gain of $15. The shareholders in the company benefit if the acquiror pays a premium of $11 to the owner of the controlling bloc, ousts the current managers, and makes the contemplated improvements. The net gains of $4 inure to each investor according to his holdings, and although the acquiror obtains the largest portion because he holds the largest bloc, no one is left out. If

Because the availability of such a mechanism benefits not just the controller but also the minority, we would expect a *Sinclair Oil*-like hypothetical bargain to emerge. Obviously, when viewed ex post, majority shareholders would favor rules that benefit them, while minority shareholders would prefer equal sharing rules.[245] But when viewed ex ante from behind the veil of ignorance, all investors would prefer a rule under which majority shareholders are not legally obliged to share all gains with minority shareholders but minority shareholders are safeguarded from majority shareholders directly exploiting them.[246] Controllers prefer such a regime because it encourages minority investment, reducing capital costs, and thereby generating more wealth for the controller, while minority shareholders accept that the majority can take a larger share (as long as it's not at their direct expense, like in the Sinclair Oil case) because it fosters a market for corporate control that enhances governance.[247] Put another way, we would expect to see a hypothetical bargain that allows controllers to take non-ratable gains, provided the minority is not left worse off as a result,[248] which is precisely what a reinvigorated *Sinclair Oil* threshold standard would achieve.

3. The Role of Market Constraints

Investors would prefer a reinvigorated *Sinclair Oil* threshold standard at least in part because much controller self-dealing is deterred by market constraints.

> the owner of the control bloc must share the $11 premium with all of the existing shareholders, however, the deal collapses. The owner will not part with his bloc for less than a $10 premium. A sharing requirement would make the deal unprofitable to him, and the other investors would lose the prospective gain from the installation of better managers.

Frank H. Easterbrook & Daniel R. Fischel, Corporate Control Transactions, 91 Yale L.J. 698, 705 & 709-710 (1982)

[245] M. Todd Henderson, Mining Manne's Vein, 12 J.L. Econ. & Policy 339, 348 (2016). On the role of the hypothetical bargain methodology in making corporate law, see Stephen M. Bainbridge, Director Primacy: The Means and Ends of Corporate Governance, 97 Nw. U.L. Rev. 547, 577-79 (2003).

[246] Henderson, supra note 245, at 348.

[247] Id. See also Hetherington, supra note 235, at 24 (noting that "the control group in a publicly traded firm is to some extent restrained in exploiting its controlling position by the risk of an outside takeover if it holds less than a majority of the shares").

[248] See Easterbrook & Fischel, supra note 244, at 715 ("Investors' welfare is maximized by a legal rule that permits unequal division of gains from corporate control changes, subject to the constraint that no investor be made worse off by the transaction"); see also Fisch & Solomon, supra note 30, at 147 ("The increase in IPO companies with dual class stock suggests that minority shareholders are willing to bear the cost of a controlling shareholder and, in some cases, may benefit from the presence of that controlling.").

Among these are independent directors, activist hedge funds, institutional investors, proxy advisors, and various other market forces that effectively limit the power of controllers.[249] As suggested by Justice Brandeis' famous aphorism that sunlight is the best disinfectant and electric light the best police officer,[250] disclosure obligations and media scrutiny also can play a key role in constraining controller behavior.[251] In addition, as noted, institutional investors have proven willing to engage with controllers and to use their voting power to oppose lopsided transactions, which should be especially effective as against minority controllers.[252] Although the Delaware courts are skeptical of the efficaciousness of independent directors in controlled corporations,[253] such directors in fact do also help constrain controller overreaching.[254]

In sum, controllers who overreach face significant adverse consequences. The market value of their stock will fall, reflecting investor perception that the controller is liable to engage in self-dealing.[255] Conversely, controllers who use their control in ways that benefit minority shareholders will be rewarded with higher share values.[256] My proposal recognizes these incentives.

4. Cleansing is not Enough

My proposal for a reinvigorated *Sinclair Oil* threshold test might be criticized on grounds that it will result in controllers reaping non-ratable benefits without

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[249] Hamermesh et. al., supra note 44, at 341.

[250] Louis D. Brandeis, What Publicity Can Do, Harper's Weekly, Dec. 20, 1913, at 10, https://www.sechistorical.org/collection/papers/1910/1913_12_20_What_Publicity_Ca.pdf ("Sunlight is said to be the best of disinfectants; electric light the most efficient policeman.").

[251] See Hetherington, supra note 235, at 24 ("Even a majority control group may be to some extent constrained in exploiting its position by reporting requirements and the attendant risk of litigation.").

[252] See Hamermesh et. al., supra note 44, at 341 (noting that institutional investors have "shown themselves willing to criticize companies—including those with controlling stockholders—and to dissent at the ballot box").

[253] See infra notes 304-306 and accompanying text.

[254] See Hamermesh et. al., supra note 44, at 341

[255] See Fisch & Solomon, supra note 30, at 146-47 ("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.").

[256] See Hetherington, supra note 235, at 24 ("Any control group in such a firm has an incentive to adopt policies which cause its stock to perform well in the market if it is considering selling its own stock or raising additional capital.").

either judicial review or the protections required by the cleansing rules discussed in the next Part. As we shall see, Delaware courts have offered controllers options by which to cleanse conflicted transactions and obtain a less demanding standard of review. If the transaction is conditioned on approval by either a special committee of independent directors or the majority of the minority shareholders, the burden of proof shifts from the defendant to the plaintiff who must not show that the transaction was unfair to the corporation.[257] If the transaction is properly conditioned on approval by both a special committee of independent directors and the majority of the minority shareholders, the burden of proof shifts to the plaintiff to rebut the business judgment rule.[258] Some may argue that all transactions from which a controller receives a non-ratable benefit should be subject to cleansing under that regime.

Allowing cleansing of conflicted controller transactions is not an optimal solution, however. Satisfying the conditions raises the transaction costs of effecting a controller transaction.[259] There is considerable litigation over whether the transactions were properly conditioned and the requisite approvals properly obtained.[260] The legitimate ownership interests of controlling shareholders are infringed. And it remains the case that some beneficial transactions may be deterred.

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[257] Kahn v. Lynch Commun. Sys., Inc., 638 A.2d 1110, 1117 (Del. 1994).

[258] See In re MFW S'holders Litig., 67 A.3d 496, 524–25 (Del. Ch. 2013), aff'd, Kahn v. M&F Worldwide Corp., 88 A.3d 635 (Del. 2014) (holding the business judgment rule is the "correct standard of review for mergers between a controlling stockholder and its subsidiary, when the merger is conditioned on the approval of both an independent, adequately empowered special committee that fulfills its duty of care, and the uncoerced, informed vote of a majority of the minority stockholders").

[259] See Fiegenbaum, supra note 10, at 769 (explaining that "higher transaction costs and the risk of being forced to run a judicial gauntlet could just as easily dissuade the corporation from advancing value-enhancing transactions").

[260] See Edward B. Micheletti, Jenness E. Parker, & Bonnie W. David, Developments in Delaware Corporation Law, 36 No. 17 Westlaw Journal Corporate Officers and Directors Liability 02 (2021) (noting that, in light of numerous post-*MFW* cases, "we expect stockholder plaintiffs to continue to closely scrutinize controller transactions, push the envelope on the level of stockholdings that constitute control and seek ways to prevent *MFW* from applying in order to avoid dismissal at the pleading stage").

F. An Exception for Freezeout Mergers?

In a freezeout merger or similar squeeze-out transaction, the controlling shareholder standards on both sides of the transaction.[261] In a typical transaction, on one side of the transaction is a shell corporation wholly owned by the controller.[262] On the other side is the controlled entity.[263] The question thus arises as to whether a reinvigorated *Sinclair Oil* standard should trigger solely because the controlling shareholder has a conflict of interest by being on both sides of the transaction.

To be sure, there is language in the *Sinclair Oil* decision suggesting that being on both sides of the transaction is the general trigger with obtaining a benefit at the expense of and to the exclusion of the minority being merely the typical case.[264] As has been aptly observed, however, "[c]ontrary to much popular usage, having a 'conflict of interest' is not something one is 'guilty of'; it is simply a state of affairs."[265] There is no certainty that the conflicted party will necessarily engage in self-dealing. Indeed, as we have just seen, controlling shareholders have ex ante incentives to refrain from self-dealing. As Professor Adam Pritchard observes, "minority shareholders generally did not acquire their minority status by accident. They invested in a public offering by a controlling shareholder, in which case the risk of 'unfair' expropriation was incorporated into the price that they paid for their shares."[266] Even though a freezeout merger is a classic final period transaction, because controlling shareholders care about the controlled corporation's cost of capital, they have ex ante incentives to refrain from self-dealing.[267]

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[261] See Rosenblatt v. Getty Oil Co., 493 A.2d 929, 937 (Del. 1985) ("Getty, as majority shareholder of Skelly, stood on both sides of this transaction . . ..").

[262] See Guhan Subramanian, Fixing Freezeouts, 115 Yale L.J. 2, 9 (2005) (explaining that "the controlling shareholder establishes a wholly owned corporation").

[263] See id. (noting that "the target board (typically dominated by the controller) approves the merger; and the shareholders of the target (again, dominated by the controller) approve the transaction").

[264] See supra text accompanying note 181.

[265] Comm. on Corporate Laws, Changes in the Model Business Corporation Act—Amendments Pertaining to Directors' Conflicting Interest Transactions, 44 Bus. Law. 1307, 1309 (1989)

[266] A.C. Pritchard, Tender Offers by Controlling Shareholders: The Specter of Coercion and Fair Price, 1 Berkeley Bus. L.J. 83, 103 (2004).

[267] See Henderson, supra note 245, at 343 ("Majority or controlling shareholders have incentives to offer minority shareholders protections against expropriation, since doing so would reduce the risks for them and therefore lower the cost of capital.").

In addition, it is not necessarily the case that all freezeout mergers generate benefits for the controller that come at the expense of the minority; to the contrary, some are win-win scenarios.[268] Given the virtually dispositive nature of fairness review and the litigation and reputational risks thus associated with transactions triggering it, however, automatically applying entire fairness review to all freezeout transactions likely deters some transactions that produce gains for all.[269] In other words, not all freezeout transactions are solely about pie division; some are about expanding the size of the pie for all. As such, the reinvigorated *Sinclair Oil* standard should focus on whether the controller received a benefit at the expense of and to the exclusion of the minority, rather than simply asking whether the controller stood on both sides of the transaction.

As we have seen, of course, the Delaware Supreme Court justifies entire fairness review in the freezeout setting not only on conflicted interest grounds, but also because squeeze-out transactions are inherently coercive.[270] On close

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[268] See Thomas W. Maddi, Nodak Bancorporation v. Clarke and Lewis v. Clark: Squeezing Out "Squeeze-Out" Mergers Under the National Bank Act, 51 Wash. & Lee L. Rev. 763, 774 (1994) (observing that, "given the often divergent investment interests of the majority and minority shareholders, a squeeze-out merger effected at a fair or premium price may benefit both groups").

[269] See Subramanian, supra note 262, at 23 (noting that "entire fairness review for all freezeouts may deter some value-creating transactions").

[270] See supra text accompanying note 51. Other concerns have also been identified. For example, it is argued that "the controlling shareholder may use insider information to time the freezeout at a point when the stock price is depressed below intrinsic value." Benjamin Klein, The Right Solution to the Wrong Problem: The Status of Controlling Shareholders After in Re John Q. Hammons Hotels Inc., 120 Yale L.J. 1251, 1258 (2011). This assumes, of course, that the controller has the power to ram the transaction through both the board and the other shareholders at a moment of its own choosing. It also ignores the potential liability the controller would face for insider trading. See Victor Brudney & Marvin A. Chirelstein, A Restatement of Corporate Freezeouts, 87 Yale L.J. 1354, 1365-70 (1978) (arguing that freezeouts can be viewed as an extreme form of insider trading). Second, it is argued that "the controlling shareholder may wield its influence over the corporation to drive down the value of shares by, for example, putting off potentially profitable projects or even engaging in negative net present value projects." Klein, supra, at 1258. But this argument assumes that the controller is willing to risk harm to its own financial interests. It also assumes that the board of directors would be unable to check such misconduct, even though the board of directors has a fiduciary duty to protect the interests of the minority. See Natasha G. Menell, The Copperweld Question: Drawing the Line Between Corporate Family and Cartel, 101 Cornell L. Rev. 467, 496 (2016) (observing that "the board of directors has fiduciary duties running to minority shareholders that require them to resist parental control and to direct the subsidiary in competition with the parent if this would best serve the subsidiary's interests").

examination, however, the inherent coercion argument proves unpersuasive. In the first instance, the coercion justification for invoking entire fairness cannot be constrained to freezeout transactions. Instead, it potentially justifies automatically applying entire fairness to all controller transactions. In *Tornetta v. Musk*, for example, Vice Chancellor Slights observed that the risk of coercion is just as present when a conflicted controller enters into a compensation arrangement as when it proposes a freezeout merger:

> Indeed, in the CEO compensation context, the minority knows full well the CEO is staying with the company whether *vel non* his compensation plan is approved. As our Supreme Court observed in Tremont II:
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> > [I]n a transaction such as the one considered . . . 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.
>
> These words apply with equal force to the compensation setting.[271]

Extending the inherent coercion argument—and thus entire fairness review—to all controller transactions compounds the risk that some—perhaps many—beneficial transactions will be deterred. As Professor Seigel thus aptly observed, "monitoring all controlling-shareholder transactions by entire fairness is overkill."[272]

At the very least, expansive application of the inherent coercion rationale will increase the number of controller transactions requiring cleansing, which Hamermesh, Jacobs, and Strine argue "will not generate systemic value for diversified stockholders. Instead, it is more likely to result in excessive transaction costs, increased D&O insurance costs, and contrived settlements designed only to avoid the costs of discovery and justify the attorneys' fee that motivates most corporate representative suits."[273]

A further problem with such an expansive approach to the problem is that it is inconsistent with the generally board-centric nature of Delaware corporate law. A freezeout transaction typically requires board approval.[274] Even a majority

[271] Tornetta v. Musk, 250 A.3d 793, 809 (Del. Ch. 2019).

[272] Seigel, supra note 17, at 74.

[273] Hamermesh et al., supra note 44, at 344.

[274] See Fisch & Solomon, supra note 30, at 146 ("Decisions at controlled companies are made by boards of directors, which exercise broad discretion pursuant to DGCL § 141(a) . . ..").

shareholder cannot effect most freezeout transactions without such approval.[275] To be sure, in this context, the Delaware courts assume that directors—even independent directors—are subject to inherent coercion because of the controller's domineering presence."[276] But directors of a controlled corporation owe fiduciary duties to the minority, which at times may require them to take action to prevent the controller from oppressing the minority, even to the point of issuing stock so as to dilute the controller's voting power.[277] Although a controlling shareholder may have the power to remove directors who attempt to do so, such "a change in composition does not alter the fiduciary principles to which all directors are subject."[278]

Applying *Sinclair Oil* to all freezeout transactions may strike courts as a bridge too far, despite the weakness of the arguments against doing so, given the long entrenched caselaw applying it at least to freezeouts effected by a majority shareholder. In fairness, it may well be the case that freezeout transactions by a majority shareholder are simply so fraught with the potential for self-dealing as to justify automatic application of entire fairness review. In that context, after all, we are dealing with a final period transaction, which inherently increases the risk of self-dealing.[279] We are also dealing with a shareholder who by definition has the

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[275] See id. ("The power of shareholders, even controlling shareholders to participate in corporate decisions, is starkly limited by Delaware law.").

[276] Lonergan v. EPE Holdings, LLC, 5 A.3d 1008, 1023 (Del. Ch. 2010).

[277] See, e.g., Mendel v. Carroll, 651 A.2d 297, 306 (Del. Ch. 1994) ("I continue to hold open the possibility that a situation might arise in which a board could, consistently with its fiduciary duties, issue a dilutive option in order to protect the corporation or its minority shareholders from exploitation by a controlling shareholder who was in the process or threatening to violate his fiduciary duties to the corporation . . .."); see also Hollinger Int'l, Inc. v. Black (Hollinger I), 844 A.2d 1022, 1088 (Del. Ch.2004) (approving board's deployment of rights plan to prevent controlling stockholder from selling block of shares to third party), aff'd, 872 A.2d 559 (Del.2005); Phillips v. Insituform of N.A., Inc., No. CIV.A. 9173, 1987 WL 16285, at *7 (Del. Ch. Aug. 27, 1987) (holding that Delaware law "teaches that the powers of the board to deal with perceived threats to the corporation extend, in special circumstances, to threats posed by shareholders themselves and a board may, in such circumstances, take action to protect the corporation even if such action discriminates against and injures the shareholder or class of shareholders that poses a special threat").

[278] Fisch & Solomon, supra note 30, at 146.

[279] See Haas, supra note 180, at 2301 ("The final-period transaction is characterized by a fall-out of the previously existing constraints that police a controlling shareholder's conduct in going-concern business transactions.").

power to elect the entire board and to approve the transaction even if all the other shareholders vote to the contrary.

Accordingly, it may make sense to carve out a special rule under which freezeout transactions involving a majority controller are reviewed for fairness without requiring a showing that the controller benefitted at the expense of and to the exclusion of the minority. Indeed, there is precedent for carving out just such an exception. As former Delaware Chief Justice Leo Strine points out, for example, the *Lynch* decision itself was initially viewed by many "a special rule for going private transactions involving controlling stockholders."[280]

When we turn to freezeouts effected by a minority controller, however, the inherent coercion rationale rests on a false premise. A controller's ability to retaliate against directors and minority shareholders who oppose the controller's proposal depends on the controller possessing "continuous control."[281] Controllers who own less than a majority of the stock may be able to control specific transactions, but may lack the sort of continuous control necessary to coerce minority shareholders with respect to other transactions.[282] In addition, "the market may be an effective monitor of some of these transactions; not only will the controlling shareholder's stock lose proportionate value from an irrational, retaliatory transaction but, if the controlling shareholder were also only a minority shareholder, an interested bidder might surface to buy stock at depressed prices."[283] A carveout for such transactions is thus not justified.

IV. Cleansing Conflicted Controller Transactions

If a conflicted controller transaction is subject to review under the entire fairness standard, the law allows that transaction to be cleansed via approvals by disinterested and independent directors and/or shareholders. In recent years, however, meeting the conditions required for cleansing has become more difficult.[284] As noted above, this difficulty has been an important driver of the

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[280] Strine, supra note 92, at 509.

[281] Siegel, supra note 17, at 41-42.

[282] Id.

[283] Id. at 42. Hamermesh, Jacobs, and Strine observe that "*Lynch*'s inherent coercion doctrine rested on the premise that a controller could bypass a special committee, make a going private tender offer, and escape ultimate fairness review." Hamermesh et al., supra note 44, at 343. The same would be true for a minority shareholder. As Adam Pritchard notes, however, empirical evidence suggests that "minority shareholders are not readily buffaloed into accepting a lowball offer." Pritchard, supra note 266, at 101.

[284] Stockholder Agreements, Controller Transactions & Non-Compete Covenants, GinsonDunn.com (Jun. 18, 2024) (noting a "trend of MFW conditions becoming more difficult to meet"), https://www.gibsondunn.com/wp-

debate over the desirability of Delaware incorporation.[285] A course correction is thus needed here as well.

A. The Law of Cleansing

If the plaintiff alleges sufficient facts to trigger entire fairness review, the controller bears the burden of proving that the challenged transaction is fair.[286] Under *Kahn v. Lynch Commun. Sys., Inc.,*[287] however, if a conflicted controller transaction is approved either by a committee of independent directors or by an informed vote of a majority of the disinterested shareholders, the standard of review remains entire fairness.[288] But the burden of proof shifts from the defendant to the plaintiff.[289]

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content/uploads/2024/06/WebcastSlides-Stockholder-Agreements-Controller-Transactions-and-Non-Compete-Covenants-18-JUN-2024.pdf.

[285] See supra notes 34-35 and accompanying text.

[286] See, e.g., Weinberger v. UOP, Inc., 457 A.2d 701, 703 (Del. 1983) (holding that "even though the ultimate burden of proof is on the majority shareholder to show by a preponderance of the evidence that the transaction is fair, it is first the burden of the plaintiff attacking the merger to demonstrate some basis for invoking the fairness obligation").

[287] 638 A.2d 1110 (Del. 1994).

[288] See id. at 1117; see also In re Cysive, Inc. S'holders Litig., 836 A.2d 531, 548 (Del. Ch. 2003 (holding that *Lynch* gives "defendants the benefits of a burden shift if either one of the devices is employed"). Although *Kahn* purported to offer transaction planners alternative cleansing approaches, in practice approval by an independent board committee proved preferable because it was less costly and less risky. See Hamermesh et al., supra note 44, at 332 (discussing the "disincentive" to use shareholder approval as a cleansing device).

If the independent board committee route is chosen, the burden will shift only if the controller did not dictate the transaction's terms and the independent committee had "real bargaining power" such that it could negotiate with the controller on an arms-length basis. *Lynch*, 638 A.2d at 1117. The committee must be "truly independent" and "fully informed." Id. at 1120.

[289] See *Lynch*, 638 A.2d at 1117 (holding that "approval of the transaction by an independent committee of directors or an informed majority of minority shareholders shifts the burden of proof on the issue of fairness from the controlling or dominating shareholder to the challenging shareholder-plaintiff").

In *Kahn v. M & F Worldwide Corp.*,[290] the Delaware court held that the transaction could be even more thoroughly cleansed if it were approved by both the independent directors and the disinterested shareholders:

> [I]n controller buyouts, the business judgment standard of review will be applied if and only if: (i) the controller conditions the procession of the transaction on the approval of both a Special Committee and a majority of the minority stockholders; (ii) the Special Committee is independent; (iii) the Special Committee is empowered to freely select its own advisors and to say no definitively; (iv) the Special Committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority.[291]

The controller must ensure that the *MFW* conditions are in place before any substantive negotiations over the economic terms of the transaction begin.[292]

If those protections are in place from the outset, the business judgment rule becomes the standard of review with the burden of proof on the plaintiff.[293] Under that standard, the court will refrain from reviewing the merits of the transaction unless the plaintiff can show waste. Any further judicial review of the transaction takes place under a version of the business judgment rule applies under which the only remaining claim is one for waste.[294] This potential waste claim is more theoretical than real, because to state a claim for waste the terms of the transaction must be so extreme that no rational person acting in good faith could have thought the transaction was fair.[295] In the *MFW* context, however, one only reaches the waste issue after two groups of presumably rational people have approved the transaction; i.e., the special committee of independent directors and disinterested shareholders holding sufficient shares to represent a majority of the minority. If it is "logically difficult to conceptualize how a plaintiff can ultimately prove a waste or gift claim in the face of a decision by fully informed, uncoerced, independent

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[290] 88 A.3d 635 (Del. 2014).

[291] Id. at 645

[292] Olenik v. Lodzinski, 208 A.3d 704, 716 (Del. 2019).

[293] *MFW*, 88 A.3d at 644.

[294] In re Books-A-Million, Inc. S'holders Litig., 2016 WL 5874974, at *1 (Del. Ch. Oct. 10, 2016), aff'd, 164 A.3d 56 (Del. 2017) (TABLE). Hamermesh, Jacobs, and Strine propose eliminating what they refer to as this vestigial waste claim "where fully informed, disinterested stockholders have voted to approve the transaction." Hamermesh et al., supra note 44, at 361-62. They point out that if those with the most money at stake have approved the transaction, there is no logical basis for treating it as waste. Id. at 361.

[295] See In re McDonald's Corp. Stockholder Derivative Litig., 291 A.3d 652, 693 (Del. Ch. 2023) ("A transaction constitutes waste when it is so one-sided that no rational person acting in good faith could approve it.").

stockholders to ratify the transaction,"[296] it becomes even more so when the transaction also has been approved by the independent directors.[297] The vestigial waste claim thus easily could be eliminated without much loss of protection for minority shareholders.

MFW was decided in the context of a freezeout merger. As we have seen, some courts and commentators believe such transactions are uniquely problematic.[298] In *MFW*'s wake, however, there was a steady series of Chancery Court decisions extending *MFW* to other categories of conflicted controller transactions.[299] Although this so-called "*MFW* creep" has prominent critics, including former Delaware Chief Justice Leo Strine and former Justice Jack Jacobs,[300] the Delaware Supreme Court has confirmed that *MFW*'s protections are available with respect to all conflicted controller transactions.[301]

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[296] Harbor Fin. Partners v. Huizenga, 751 A.2d 879, 901 (Del. Ch. 1999).

[297] As the late Chancellor William Allen observed:

> [T]he waste theory represents a theoretical exception to the statement very rarely encountered in the world of real transactions. There surely are cases of fraud; of unfair self-dealing and, much more rarely negligence. But rarest of all-and indeed, like Nessie, possibly non-existent-would be the case of disinterested business people making non-fraudulent deals (non-negligently) that meet the legal standard of waste!

Steiner v. Meyerson, No. CIV. A. 13139, 1995 WL 441999, at *5 (Del. Ch. July 19, 1995)

[298] See supra Part III.F.

[299] See, e.g., In re Match Grp. Derivative Litig., No. 2020-0505-MTZ, 2022 WL 3970159, at *15 (Del. Ch. Sept. 1, 2022) (applying *MFW* to a corporate spin-off), rev'd in part on other grounds, 315 A.3d 446 (Del. 2024); Tornetta v. Musk, 250 A.3d 793, 800 (Del. Ch. 2019) (applying *MFW* to excessive executive compensation claims against a controlling shareholder); In re Martha Stewart Living Omnimedia, Inc. S'holder Litig., Consol. C.A. No. 11202-VCS, 2017 WL 3568089, at *2 (Del. Ch. Aug. 18, 2017) (applying *MFW* to a transaction in which a merger with a third party in which the controller allegedly extracted disparate consideration); IRA Tr. FBO Bobbie Ahmed v. Crane, Consol. C.A. No. 12742-CB, 2017 WL 7053964, at *9 (Del. Ch. Dec. 11, 2017) (applying *MFW* to a stock reclassification); see generally Alex Lindsey, Expanding MFW: Delaware Law Should Offer a Business Judgment Rule Safe Harbor for All Conflicted Controller Transactions, 29 Fordham J. Corp. & Fin. L. 339, 379 (2023) ("Many Chancery Court decisions have endorsed the MFW factors as effective in contexts other than squeeze out mergers . . ..").

[300] See Hamermesh et al., supra note 44, at 336-44 (describing and critiquing *MFW* creep through a series of Chancery Court decisions); see also Fiegenbaum, supra note 10, at 788-96 (criticizing extensive application of *MFW*).

[301] In re Match Group, Inc. Derivative Litig., 315 A.3d 446, 462–63 (Del. 2024).

Extending *MFW* to all conflicted controller transactions should be far less controversial if my proposed course corrections are adopted. Entire fairness review would only be even potentially in play if the defendant shareholder has voting power that is the functional equivalent of majority control, which alleviates concerns about overbreadth as to the definition of controller. Entire fairness review would only be invoked if the controller received gains coming at the expense of and to the exclusion of the minority, which alleviates concerns about overbreadth as to the definition of conflicted controller transactions.

B. The Need for a Course Correction

The independent director requirement is the principal area of concern with respect to cleansing under *MFW*.[302] In an off-the record interview, a New York-based corporate law partner observed that uncertainty about the definition of independence is a major concern among those voicing skepticism about the direction of MFW's progeny.[303] The same partner noted a growing impression that certain Delaware Chancery Court judges have developed a skeptical attitude towards independence of directors of Silicon Valley firms.[304] Similar sentiments were expressed by both a prominent Delaware academic and a leading Delaware practitioner.[305] In a blog post, Professor Ann Lipton likewise speculated that these developments may "hit Silicon Valley companies particularly hard, because of the chumminess of the tech world, and it's not surprising that once independence is questioned, the tone of the opinions is going to come off as skeptical, in a manner that defendants do not like."[306] Their observations are supported by recent law firm

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[302] As the Delaware Supreme Court has explained, independence is a contextual inquiry, which asks whether some is "independent from whom and independent for what purpose?" Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart, 845 A.2d 1040, 1050 (Del. 2004). The questions herein are whether directors are independent from a controller for purposes of *MFW* cleansing. No claim is made as to the utility if the proposed standard in other contexts.

[303] Off-the-Record interview (May 7, 2024).

[304] Id.

[305] Off-the-Record Interview with Delaware Academic (May 9, 2024) (stating that distrust of ostensibly independent directors has led to enhanced judicial scrutiny); Off-the-Record Interview with Delaware Practitioner (May 9, 2024) (arguing that the changing definition of independence is making it harder to satisfy *MFW*).

[306] Ann Lipton, The Delaware Contretemps Continues, Bus. L. Prof. Blog (Apr. 26, 2024), https://lawprofessors.typepad.com/business_law/2024/04/the-delaware-contretemps-continues.html.

commentary confirming that uncertainty in this area is a matter of growing concern.[307]

This concern is problematic because determining whether a director is independent of the controller is a critical aspect of litigating conflicted controller transactions. As we have seen, approval of a transaction by a special committee comprised solely of independent directors flips the burden of proof on fairness from the defendant to the plaintiff.[308] In addition, approval by such a committee is a key element of the *MFW* defense.[309] Finally, whether a majority of the board is independent of the controller is one of the factors used in determining whether the plaintiff will be excused from making demand prior to filing a derivative challenging the transaction.[310]

Under Delaware law, director independence is now a highly factual inquiry conducted on a case-by-case basis.[311] The core question is "whether the director's decision is based on the corporate merits of the subject before the board, rather than extraneous considerations or influences."[312] Put another way, the inquiry is "whether, applying a subjective standard, those ties [between the director and the

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[307] See, e.g., Dechert, supra note 115 (noting "the continuously evolving caselaw around what social and professional relationships will call into question a director's independence"); Wilson Sonsini, Delaware's Status as the Favored Corporate Home: Reflections and Considerations (Apr. 23, 2024), https://www.wsgr.com/en/insights/delawares-status-as-the-favored-corporate-home-reflections-and-considerations.html (noting "the uncertainty that can exist in assessing board independence in some scenarios, along with the frequent occurrence that the independence of excellent board members is a close judgment call").

[308] See supra note 286 and accompanying text.

[309] See supra notes 290-292 and accompanying text.

[310] See United Food and Com. Workers Union and Participating Food Indus. Employers Tri-State Pension Fund v. Zuckerberg, 262 A.3d 1034, 1058 (Del. 2021) (stating that one factor in determining whether demand should be excused is "whether the director lacks independence from someone who received a material personal benefit from the alleged misconduct that is the subject of the litigation demand or who would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand").

[311] See Teamsters Union 25 Health Services & Ins. Plan v. Baiera, 119 A.3d 44, 61 (Del. Ch. 2015) ("Delaware law does not contain bright-line tests for determining independence but instead engages in a case-by-case fact specific inquiry . . ..").

[312] Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart, 845 A.2d 1040, 1049 (Del. 2004).

defendant] were *material*, in the sense that the alleged ties could have affected the impartiality of the individual director."[313]

Relevant ties include material economic relationships between the director and the defendant, such as the controller's ability to terminate the director's employment or to deny the director other material financial benefits.[314] A material familial relationship can also suffice.[315] Finally, close personal relationships can satisfy this requirement.[316]

Historically, Delaware courts focused on the first two factors.[317] The certainty and predictability provided by that focus is, at best, debatable. To be sure, one prominent scholar argued that the cases provided a fair degree of certainty and predictability, although even that scholar acknowledges that a materiality standard is inherently ambiguous.[318] Other commentators are less charitable, however, characterizing the case law as ambiguous and uncertain.[319]

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[313] Kahn v. M & F Worldwide Corp., 88 A.3d 635, 649 (Del. 2014) (emphasis in the original).

[314] See, e.g., Rales v. Blasband, 634 A.2d 927, 937 (Del. 1993) ("Because of their alleged substantial financial interest in maintaining their employment positions, there is a reasonable doubt that these two directors are able to consider impartially an action that is contrary to the interests of the Rales brothers."); Zimmerman v. Braddock, No. CIV.A. 18473-NC, 2005 WL 2266566, at *9 (Del. Ch. Sept. 8, 2005) (holding that "the Court must consider what material benefits (or detriments) the majority shareholder can bestow (or impose) upon each of the directors, other than, as a general matter, the majority shareholder's capacity to deny them their continuing status as directors"), rev'd on other grounds, 906 A.2d 776 (Del. 2006).

[315] See, e.g., Telxon Corp. v. Meyerson, 802 A.2d 257, 264 (Del. 2002)) ("A controlled director is one who is dominated by another party, whether through close personal or familial relationship or through force of will.").

[316] See infra notes 320-328 and accompanying text.

[317] See Mohsen Manesh, Indeterminacy and Self-Enforcement: A Defense of Delaware's Approach to Director Independence in Derivative Litigation, 6 J. Bus. & Sec. L. 177, 186 (2006) ("Delaware law has given corporate boards and corporate lawyers clear guidance with respect to material economic and familial relationships: such relationships compromise a director's independence."); Note, supra note 62, at 1727 ("While historically Delaware's analysis of lack of independence was narrow—focusing on familial or financial ties with a director—recently the courts have indicated an increased willingness to consider social and business ties as part of the director independence inquiry.").

[318] See Manesh, supra note 317, at 186-87 (discussing Delaware guidance as to the financial and familial aspects of director independence).

[319] See, e.g., Victor Brudney, The Independent Director—Heavenly City or Potemkin Village?, 95 Harv. L. Rev. 597, 598–99 (1982) ("The concept, however, does not carry a

As for the third factor, Delaware courts had long paid at least lip service to the proposition that personal relationships could call a director's independence into question.[320] On the other hand, however, it long was a basic proposition of Delaware law that even long standing personal ties could not overcome the presumption of independence afforded directors.[321] Personal relationships were not viewed as disabling as, for example, familial ties.[322]

All of that began to change with then-Vice Chancellor Leo Strine's *Oracle* decision.[323] In assessing the independence of two members of a special litigation committee, Strine emphasized that "*Homo sapiens* is not merely *homo economicus*."[324] In addition to financial or familial considerations, a director could also be biased by "motives like love, friendship, and collegiality."[325] Strine went on to write many of the now leading Delaware precedents on director

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clear meaning for many of its proponents or the same meaning for all its proponents."); Harvey Gelb, Corporate Governance Guidelines—A Delaware Response, 1 Wyo. L. Rev. 523, 540 (2001) (describing the Delaware Supreme Court as adopting a "somewhat indefinite test" "without much specificity").

[320] See, e.g., Orman v. Cullman, 794 A.2d 5, 27 n.55 (Del. Ch. 2002) ("Although mere recitation of the fact of past business or personal relationships will not make the Court automatically question the independence of a challenged director, it may be possible to plead additional facts concerning the length, nature or extent of those previous relationships that would put in issue that director's ability to objectively consider the challenged transaction.").

[321] See, e.g., In re Walt Disney Co. Derivative Litig., 731 A.2d 342, 355 (Del. Ch. 1998), aff'd in part, rev'd in part and remanded sub nom. Brehm v. Eisner, 746 A.2d 244 (Del. 2000) (explaining that CEO Michael Eisner's "long-standing personal and business ties to Ovitz cannot overcome the presumption of independence that all directors, including Eisner, are afforded"); Green v. Phillips, No. CIV. A. 14436, 1996 WL 342093, at *5 (Del. Ch. June 19, 1996) (holding that "the directors' longstanding personal and business ties" were "insufficient to overcome the directors' presumption of independence"); see generally Brudney, supra note 319, at 613 ("No definition of independence yet offered precludes an independent director from being a social friend of, or a member of the same clubs, associations, or charitable efforts as, the persons whose compensation or self-dealing transaction he is asked to assess.").

[322] See, e.g., Chaffin v. GNI Group, Inc., No. CIV. A. 16211-NC, 1999 WL 721569, at *5 (Del. Ch. Sept. 3, 1999) (distinguishing personal relationships from the "filial" relationship in the case at bar).

[323] In re Oracle Corp. Derivative Litig., 824 A.2d 917 (Del. Ch. 2003).

[324] Id. at 938.

[325] Id.

independence.[326] In his subsequent capacity as Chief Justice, he was able to firmly establish the proposition that close personal relationships could be just as bias inducing as family or economic ties.[327] As a result, courts must now undertake "a contextual examination of the materiality of the entire panoply of human relationships that may compromise a person's objectivity,"[328] which is hardly a well-defined or closely constrained set of considerations.

The result has been a considerable loss of certainty and predictability.[329] As former Chief Justice Strine himself acknowledged, the inquiry is "admittedly imprecise,"[330] which is a telling admission coming from the jurist who kicked off the process of broadening the director independence inquiry. Yet, Delaware "caselaw around what social and professional relationships will call into question a director's independence" continues to grow less rather than more certain.[331]

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[326] See Randy J. Holland, Delaware Independent Directors A Judicial Contextual Evolution, 24 U. Pa. J. Bus. L. 781, 783–84 (2022) ("Many of the seminal Delaware decisions involving director independence were written by former Chief Justice Strine when he was on the Delaware Supreme Court and the Court of Chancery.").

[327] See Marchand v. Barnhill, 212 A.3d 805, 820 (Del. 2019) (holding that "our law has recognized that deep and longstanding friendships are meaningful to human beings and that any realistic consideration of the question of independence must give weight to these important relationships and their natural effect on the ability of the parties to act impartially toward each other"); Sandys v. Pincus, 152 A.3d 124, 130 (Del. 2016) (holding that for purposes of a motion to dismiss coownership of an airplane "is suggestive of the type of very close personal relationship that, like family ties, one would expect to heavily influence a human's ability to exercise impartial judgment").

[328] Holland, supra note 326, at 790.

[329] See McClane & Nili, supra note 343. at 958 ("Subsequent decisions in Delaware and elsewhere have taken an inconsistent approach regarding networks; at times, courts have treated far more intimate ties than those in *Oracle* as unproblematic for director independence, while more attenuated ties have raised doubts.").

To be sure, case law gives indications of both a ceiling and a floor. In an opinion from his days as Chancellor, Strine drew a distinction between a friendship in which "the parties had served as each other's maids of honor, had been each other's college roommates, shared a beach house with their families each summer for a decade, and are as thick as blood relations," and one in which the parties who occasionally "dinner over the years, go to some of the same parties and gatherings annually, and call themselves 'friends.'" In re MFW S'holders Litig., 67 A.3d 496, 509 n.37 (Del. Ch. 2013), aff'd sub nom. Kahn v. M & F Worldwide Corp., 88 A.3d 635 (Del. 2014). What we lack is guidance as to where the line falls in the middle.

[330] Sandys v. Pincus, 152 A.3d 124, 128 (Del. 2016).

[331] Dechert, supra note 115.

The indeterminacy of post-*Oracle* analysis is nicely illustrated by Strine's Supreme Court opinion in *Sandys v. Pincus*.[332] The case involved a demand futility inquiry in the context of a motion to dismiss a derivative suit against the company's former CEO and controlling shareholder.[333] Plaintiff alleged *inter alia* that director Ellen Siminoff was not independent of defendant Mark Pincus, pointing to the fact that the Siminoff and Pincus families co-owned a private plane and claiming albeit without support that they were close friends.[334] Citing *Beam* for the proposition that allegations of a mere personal friendship or an outside business relationship did not suffice, the Chancery Court held that "allegations concerning co-ownership of an asset and friendship do not reveal a sufficiently deep personal connection to Pincus so as to raise a reasonable doubt about Siminoff's independence from Pincus."[335]

On appeal, Chief Justice Strine wrote for a majority reversing the Chancery Court. In doing so, Chief Justice Strine not only rebuked the plaintiff for inadequately using the tools available to develop the requisite particularized factual allegations, but also criticized the plaintiff for failing to "focus on the most likely inference from the co-ownership of the private airplane between Pincus and Siminoff—which is not that the private airplane was a business venture—but that it signaled an extremely close, personal bond between Pincus and Siminoff, and between their families."[336] In contrast, Strine focused precisely on that inference. Albeit without citing support for the inferences he drew, Strine opined that:

> Co-ownership of a private plane involves a partnership in a personal asset that is not only very expensive, but that also requires close cooperation in use, which is suggestive of detailed planning indicative of a continuing, close personal friendship. In fact, it is suggestive of the type of very close personal relationship that, like family ties, one would expect to heavily influence a human's ability to exercise impartial judgment. As we noted recently, although a plaintiff has a pleading stage burden that is elevated in the demand excusal context, that standard does not require a plaintiff to plead a detailed calendar of social interaction to prove that directors have a very substantial personal relationship rendering them unable to act independently of each other.[337]

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[332] 152 A.3d 124 (Del. 2016).

[333] Id. at 127.

[334] Sandys v. Pincus, No. CV 9512-CB, 2016 WL 769999, at *8 (Del. Ch. Feb. 29, 2016), rev'd, 152 A.3d 124 (Del. 2016).

[335] Id. at *8.

[336] Sandys, 152 A.2d at 130.

[337] Id.

Granting that the procedural posture of the case required the court to draw all reasonable inferences in favor of the plaintiff,[338] the unsupported inference that co-ownership of a small plane is indicative of a bias-inducing friendship seems dubious, at best. In dissent, Justice Karen Valihura took up that question. She pointed out that the plane in question was a small one rather than a corporate jet.[339] She further observed that plaintiff's allegations suggested nothing more than a business relationship, lacking any factual allegations of an intimate personal relationship.[340] To be sure, she conceded that it might "be reasonable to infer some kind of collaborative relationship given the nature of the asset," but she nevertheless did not believe that the allegations indicated a lack of independence.[341]

Although they applied the same standards, the 6 Delaware jurists who ruled on the case in the two courts split 4-2 on whether Siminoff was independent of Pincus. In the Supreme Court. both the majority and the dissent emphasized the factual specificity of the inquiry and both viewed the case as a close call.[342] It is hard to imagine a case better illustrating that "Delaware decisions regarding independence are characterized by a lack of consistency."[343] Yet, as long as Delaware relies on fact-specific materiality-based standards, inconsistent results will be inevitable.[344]

The increasing indeterminacy of Delaware law in this area may be linked to the growing judicial skepticism of director independence,[345] reflecting concern that even nominally independent directors may feel pressure to comply with a controller's wishes, lest they lose their directorships.[346] Because rules tend to be

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[338] See id. at 129 (noting that "we are bound to draw all reasonable inferences from those facts in the plaintiff's favor").

[339] Id. at 137.

[340] Id. at 138.

[341] Id.

[342] Nathan P. Emeritz, Independence Issues in the Entrepreneurial Ecosystem, 2017 Bus. L. Today 1, 1 (May 2017).

[343] Gregory H. Shill, The Independent Board As Shield, 77 Wash. & Lee L. Rev. 1811, 1833 (2020). As Professors McClane and Nili note, "[t]here is little analytical guidance to say why owing one's job to another entity does not make one beholden to that entity but sharing a private plane with another does." Jeremy McClane & Yaron Nili, Social Corporate Governance, 89 Geo. Wash. L. Rev. 932, 959 (2021).

[344] See Manesh, supra note 317, at 195 ("Given that different judges will find different facts material, indeterminacy will abound.").

[345] On the growth of judicial skepticism about the efficaciousness of director independence, see supra notes 304-306 and accompanying text.

[346] See In re Pure Resources, Inc., Shareholders Litig., 808 A.2d 421, 436 (Del. Ch. 2002) (arguing that the Delaware Supreme Court views "the controlling stockholder as the

either under- or over-inclusive (or both),[347] judicial skepticism of director independence and the resulting desire to capture any bias inducing relationships leads to the use of standards rather than rules.[348] The choice of a standard rather than a rule inherently leads to uncertainty. In turn, the multiplicity of circumstances in which a skeptical jurist might find a relationship to be bias inducing will drive standards even more towards uncertainty.[349]

As a result, the course correction should move the dial back towards a brightline rule rather than the current vague multi-factor standard. To be sure, citing the inherently under- and/or over-inclusive nature of rules, proponents of current Delaware law will object that moving to a more determinate rule will result in trade-offs they regard as undesirable. In *Oracle,* for example, Strine contended that "[b]y taking into account all circumstances, the Delaware approach undoubtedly results in some level of indeterminacy, but with the compensating benefit that independence determinations are tailored to the precise situation at issue."[350] Increasingly, however, it seems that the cost-benefit analysis is trending in favor of

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800–pound gorilla whose urgent hunger for the rest of the bananas is likely to frighten less powerful primates like putatively independent directors who might well have been hand-picked by the gorilla (and who at the very least owed their seats on the board to his support"); Note, supra note 62, at 1726 n.102 ("Some scholars argue that even independent directors may have incentives to follow a controlling stockholder's wishes or otherwise lack adequate incentives to protect other investors."); Ann M. Lipton, After *Corwin*: Down the Controlling Shareholder Rabbit Hole, 72 Vand. L. Rev. 1977, 1983 (2019) (arguing that Delaware caselaw suggests that "even independent directors may fear the wrath of controlling stockholders, such that their approval could not be assumed to be freely bestowed"); 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) (suggesting that "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.").

[347] See MindGames, Inc. v. W. Pub. Co., Inc., 218 F.3d 652, 657 (7th Cir. 2000) ("Rules have the advantage of being definite and of limiting factual inquiry but the disadvantage of being inflexible, even arbitrary, and thus overinclusive, or of being underinclusive and thus opening up loopholes (or of being both over- and underinclusive!).").

[348] See James W. Colliton, Standards, Rules and the Decline of the Courts in the Law of Taxation, 99 Dick. L. Rev. 265, 273 (1995) (noting that "standards are preferable when the law covers widely varying factual situations").

[349] See J. Haskell Murray, The Social Enterprise Law Market, 75 Md. L. Rev. 541, 588 (2016) ("Legal indeterminacy creates uncertainty stemming from broad standards that provide for significant judicial discretion.").

[350] In re Oracle Corp. Derivative Litig., 824 A.2d 917, 941 (Del. Ch. 2003).

certainty rather than fine tuning. Clearer and simpler standards would eliminate the seemingly inconsistent outcomes we observe under the current system. They would provide greater clarity, permitting greater certainty and predictability.[351] They would reduce administrative costs by easing the work of litigants and courts.[352]

C. Assumptions About Independent Directors Underlying the Proposed Course Correction

At the outset, it should be recognized that the risk of controllers effectively firing directors who oppose them is overstated. Granted, controllers—especially as that concept is defined in Part I of this article—have the power to remove independent directors who frustrate the controller's ambitions, controllers must "be sensitive to the prospect that replacing independent directors who said no to a conflict transaction with ones who would do their bidding would impair their ability to raise debt and other capital."[353] Perhaps as a result, the controller's power to control the outcome of director elections has never been deemed enough standing alone to deem a director non-independent.[354]

Unlike the judicial skepticism about the efficaciousness of director independence, the proposed course correction is premised on the assumption that independent directors provide a meaningful constraint on controllers. There has long been empirical evidence that independent directors cause a reduction in agency costs that exceeds the costs of having outsiders on the board.[355] Increasingly, independent directors maintain their board positions even in controlled companies

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[351] Jonathan Weinberg, Broadcasting and Speech, 81 Cal. L. Rev. 1101, 1169 (1993) (explaining that "the great advantage of rules (as opposed to standards) in conventional thought is that rules are said to increase certainty, predictability, . . . and decrease arbitrariness and the possibility of biased enforcement").

[352] See id. (including among the advantages of rules is that they provide "ease of administration in law application").

[353] See Hamermesh et. al., supra note 44, at 341.

[354] See, e.g., McElrath v. Kalanick, 224 A.3d 982, 996 (Del. 2020) (holding that the controller's "ability to appoint and remove" a director was an "insufficient basis for challenging [that director's] independence"); Stroud v. Milliken Enters., Inc., 585 A.2d 1306, 1307 (Del.Ch.1988) (holding that a majority shareholder's ability to nominate or elect directors is not sufficient to raise a reasonable doubt about a director's independence).

[355] See Stephen M. Bainbridge, Independent Directors and the ALI Corporate Governance Project, 61 Geo. Wash. L. Rev. 1034, 1062 (1993) (recounting empirical studies on the corporate governance benefits of independent directors); Hamermesh et. al., supra note 44, at 341 ("When *Function Over Form* was published, independent directors had already shown themselves capable of standing up to corporate managers, and CEO tenure had been declining as a result.").

by keeping influential institutional investors happy, because those "investors have a powerful voice and no fear of controlling stockholders . . .."[356] In addition to dealing with pressure from activist hedge funds and other institutional investors, controlling shareholders must consider that replacing independent directors who stand up to them with more compliant ones will have significant reputational costs that may raise their cost of capital in both the debt and equity markets.[357]

This assumption is particularly true in the *MFW* context. MFW's requirement of dual protections reflects that they are "complements and not substitutes."[358] *MFW*'s dual-protection framework ensures that the controller cannot bypass the special committee by engaging directly with the minority shareholders, nor can the controller sidestep the minority shareholders by dealing directly with the special committee.[359] This mutual oversight restricts the controller's ability to exploit either group.[360]

The point is not that director independence is a panacea. The point is simply that—at least in this context—director independence likely acts as an important constraint on controlling shareholders. As a result, the current excessively strict scrutiny of director independence is unwarranted.

D. A Course Correction

If either the Delaware legislature or courts were minded to address these concerns, a number of plausible fixes are available. We begin with possible legislative fixes. One option, for example, is to align Delaware law with the pertinent stock exchange listing standards. Although the effort to increase director independence has a long history,[361] it accelerated in the post-dot.com bubble era and then again following the subprime mortgage crisis when the Sarbanes-Oxley and Dodd-Frank acts "appointed independent directors as the capitalist cavalry and

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[356] Hamermesh et. al., supra note 44, at 341.

[357] Id. (noting that "even controllers had to be sensitive to the prospect that replacing independent directors who said no to a conflict transaction with ones who would do their bidding would impair their ability to raise debt and other capital").

[358] In re Cox Commc'ns, Inc. Shareholders Litig., 879 A.2d 604, 619 (Del. Ch. 2005).

[359] Iman Anabtawi, The Limits of Shareholder Ratification 47 (September 19, 2023), https://ssrn.com/abstract=4576584.

[360] Id.

[361] See Jeffrey N. Gordon, The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices, 59 Stan. L. Rev. 1465, 1477 (2007) (describing the legal and market drivers of director independence in the period 1950-2005).

charged them with riding to the system's rescue."[362] In particular, Sarbanes-Oxley required publicly traded companies to have an audit committee of the board comprised exclusively of independent directors and mandated that stock exchanges adopt listing standards requiring listed companies to have a majority of independent directors.[363] Subsequently, Dodd-Frank required that public corporations have compensation board committee comprised exclusively of independent directors.[364] In addition to adopting listing standards complying with these statutory requirements, the exchanges also adopted rules requiring that public corporations have a nominating committee comprised exclusively of independent directors.[365]

At the core of the new listing standards are rules for determining whether directors are independent. NYSE Listed Company Manual § 303A.02(b) lays out five bright-line tests for director independence.[366] These focus on such issues as whether the company employs the director or immediate family member of a director, pays the director or an immediate family member more than $120,000 in compensation, or other specified affiliations.[367] In addition, there is a backstop requirement that the board determine whether the director has any other material relationship with the corporation.[368]

There is precedent for such a legislative approach. Delaware courts acknowledge that the legislature "may limit or bar the application of judge-made

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[362] Stephen M. Bainbridge, Corporate Governance after the Financial Crisis 78 (1st ed. 2012).

[363] See Yaron Nili, The "New Insiders": Rethinking Independent Directors' Tenure, 68 Hastings L.J. 97, 109 (2016) (describing Sarbanes-Oxley requirements).

[364] See Regina F. Burch, Financial Regulatory Reform Post-Financial Crisis: Unintended Consequences for Small Businesses, 115 Penn St. L. Rev. 409, 437 (2010) (describing compensation committee

[365] See Michael E. Murphy, The Nominating Process for Corporate Boards of Directors: A Decision-Making Analysis, 5 Berkeley Bus. L.J. 131, 148 (2008) ("NYSE rules now require the nominating committee to be composed entirely of independent directors. The NASDAQ Exchange adopted a rule with much the same effect, though it contains exceptions of minor significance.").

[366] NYSE, Listed Company Manual § 303A.02(b) (2024). The NYSE Listed Company Manual exempts controlled companies—defined as those "of which more than 50% of the voting power for the election of directors is held by an individual, a group or another company—from the requirement to have a majority of independent directors and the requirements to have independent compensation and nominating committees. Id., § 303A.00.

[367] Id., § 303A.02(b).

[368] Id., § 303A.02(a)(i).

common law."[369] Pertinent examples abound in the DGCL. Sections 112 and 113, for example, were adopted in response to the Delaware Supreme Court's decision in *CA, Inc. v. AFSCME Employees Pension Plan*.[370] Sections 102(f) and 115 were adopted in response to a Delaware Supreme Court decision invalidating fee-shifting bylaws.[371] In response to Smith v. Van Gorkom,[372] the legislature adopted § 102(b)(7) authorizing articles of incorporation to include exculpation clauses.[373] Of course, the potential benefits of following suit with respect to director independence would be eviscerated if the legislation included a backstop provision such as that provided by NYSE listing standard § 303A.02(a)(i). Such a provision would create a hole through which the Delaware courts could drive a truck carrying all the existing common law baggage.

In lieu of adopting an outcome determinative bright-line definition, the Delaware legislature could create a bright-line presumption. In other words, Delaware law could provide that a director meeting a set of tests based on the NYSE listing standards is presumptively independent.[374] It is not clear that doing so would be an effective solution, however, because the law already provides—outside the context of an SLC motion to dismiss derivative lawsuit—a presumption of director independence.[375] As we have seen, that presumption has failed to ensure determinacy.[376]

Still other presumptions could be imagined. Todd Henderson and I have proposed amending Delaware corporate law to allow entities we called board

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[369] Smith v. Guest, 16 A.3d 920, 927 (Del. 2011).

[370] Catherine G. Dearlove & A. Jacob Werrett, Proxy Access by Private Ordering: A Review of the 2012 and 2013 Proxy Seasons, 69 Bus. Law. 155, 163 (2013).

[371] David Skeel, The Bylaw Puzzle in Delaware Corporate Law, 72 Bus. Law. 1, 10 (2017)

[372] 488 A.2d 858 (Del. 1985).

[373] Comment, Ariel Beverly, The Battle over Corporate Bylaws, 50 Loy. L.A. L. Rev. 847, 855 (2017).

[374] An alternative list of bright-line tests was proposed by the Council of Institutional Investors in an amicus brief in Brehm v. Eisner, 746 A.2d 244 (Del. 2000). See Gelb, supra note 319, 558 (describing brief). As Leo Strine noted, the brief is significant because "it represents the view of a group of powerful investors who hold significant equity portions in America's largest public corporations." Leo Strine, Derivative Impact? Some Early Reflections on the Corporation Law Implications of the Enron Debacle, 57 Bus. Law. 1371, 1402 (2002).

[375] See supra note 321 and accompanying text.

[376] See supra notes 329-344 and accompanying text.

service providers to serve as a corporation's board.[377] We proposed that the shareholders approve the selection of the board service provider, just as they elect directors currently.[378] If our proposal were to be adopted, it could be coupled with a presumption that a shareholder approved board service provider is independent. If the corporation has a controller, such a presumption could be premised on approval by a majority of the minority shareholders.

Turning to possible judicial solutions, it seems improbable that the Delaware courts would adopt the NYSE listing standards as the common law definition of director independence. Granted, then Chancellor Strine opined in *MFW* that stock exchange listed standards are a useful resource for courts analyzing a director's independence, because the standards "were influenced by experience in Delaware and other states and were the subject of intensive study by expert parties."[379] As Chancellor Bouchard subsequently pointed out, however, Delaware common law rejects bright line rules for director independence in favor of its current fact-specific standard.[380] This rejection is of a piece with Delaware common law generally. In multiple contexts, the Delaware courts have "expressed a preference for fact-

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[377] See Stephen M. Bainbridge & M. Todd Henderson, Outsourcing the Board: How Board Service Providers Can Improve Corporate Governance 87-103 (2018) (setting out proposal).

[378] See id. at 93-97 (describing selection and election of a board service provider).

[379] In re MFW Shareholders Litig., 67 A.3d 496, 510 (Del. Ch. 2013), aff'd sub nom. Kahn v. M & F Worldwide Corp., 88 A.3d 635 (Del. 2014).

[380] See Teamsters Union 25 Health Services & Ins. Plan v. Baiera, 119 A.3d 44, 61 (Del. Ch. 2015) ("Unlike the NYSE Rules, Delaware law does not contain bright-line tests for determining independence but instead engages in a case-by-case fact specific inquiry based on well-pled factual allegations."); see generally Mark J. Loewenstein, The Quiet Transformation of Corporate Law, 57 SMU L. Rev. 353, 375 (2004) ("One irony of *Oracle*, in light of the recent stock exchange rules, is that the Delaware court seems to be moving toward a more flexible meaning of independence while the stock exchanges have opted for a more precise definition based on financial relationships."); Usha Rodrigues, The Fetishization of Independence, 33 J. Corp. L. 447, 466 (2008) ("In Delaware, unlike under SOX, the NYSE, or NASDAQ, one cannot determine independence or interest ex ante. One must instead ask: 'Independent for what purpose? Independence from whom?'").

specific inquiry over the employment of firm, bright-line rules."[381] At the same time, however, Delaware case law is replete with presumptions.[382]

Ronald Gilson and Reinier Kraakman proposed creating a class of professional directors who would serve on a portfolio of boards as their full-time job.[383] These professionals would know their portfolio companies better because they would be able to devote more time to following those companies, and they would be more dependent on institutional shareholders for their position.[384] They recommended the use of a central clearinghouse to take care of the logistics of helping institutional shareholders select professional directors to serve on their companies' boards.[385] If their proposal were implemented, a court could presume such directors are independent.

Alternatively, Delaware courts could assume that directors chosen and certified as independent by an independent nominating committee are independent.

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[381] Park Employees' and Ret. Bd. Employees' Annuity and Benefit Fund of Chicago v. Smith, No. CV 11000-VCG, 2016 WL 3223395, at *10 (Del. Ch. May 31, 2016), aff'd sub nom. Park Employees' and Ret. Bd. Employees' Annuity and Benefit Fund of Chicago on behalf of BioScrip, Inc. v. Smith, 175 A.3d 621 (Del. 2017). Professor Usha Rodrigues goes so far as to assert "that articulating a simple, non-contextual definition of Delaware's independence is impossible." Rodrigues, supra note 380, at 484.

For a defense of Delaware's indeterminate standard and critique of a bright-line rules-based approach, see Manesh, supra note 317, at 197-201. Manesh contended that an indeterminate standard will encourage boards to self-police by choosing only directors who lack any professional, social, or financial ties, id. at 198, although he admitted that that claim could not be proven empirically. Id. at 199. Even if the claim were true, moreover, it is not self-evidently true it is desirable for boards to consist exclusively of members multiple degrees of separation away from one another. Professors McClane and Nili argued that having board members who are part of larger networks of directors offers multiple benefits. McClane & Nili, supra note 343, at 953-54. Networks "facilitate the transfer of best practices and knowledge." Id. at 854. They provide "access to capital, strong networks for potential hiring or corporate partnerships, and access to personal relationships for mentoring or other networking opportunities." Id. They "have even been found to perform better in terms of adhering to certain environmental policies . . .." Id.

[382] See William M. Lafferty, Towards A Relaxed Summary Judgment Standard for the Delaware Court of Chancery: A New Weapon Against "Strike" Suits, 15 Del. J. Corp. L. 921, 928 (1990) ("Delaware law contains strong presumptions that favor corporate management and places heightened burdens on plaintiffs that attack corporate decision making.").

[383] Ronald J. Gilson & Reinier Kraakman, Reinventing the Outside Director: An Agenda for Institutional Investors, 43 Stan. L. Rev. 863 (1991).

[384] See id. at 885-86 (describing advantages of the proposed professional directors).

[385] Id. at 887.

Although it did not create such a presumption, the Delaware Supreme Court suggested in *Beam* that "whether the board used a nominating committee to select directors and maintained a separation between the director-selection process and management" is pertinent to the analysis of a director's independence.[386] Going further to create such a presumption would be supported by the evidence that independent nominating committees are positively correlated with firm performance, presumably because they select independent directors who are more effective at monitoring the CEO and top management.[387]

One difficulty with any of these proposed presumptions is that they likely would not provide much additional certainty and predictability over current law if they can be rebutted by the sort of evidence allowed under the current post-*Oracle* regime. What is needed is a presumption that is extremely difficult to rebut. I propose a standard under which if reasonable and informed businesspeople might disagree about the director's independence—i.e., if the issue is a close call, as was the case in *Sandys*[388]—the court should not overturn the presumption of independence.[389]

V. Conclusion

Current Delaware law faces challenges in balancing the rights of controllers and the protections needed for minority shareholders, especially in light of the evolving interpretations of director independence and fiduciary duty. This paper highlights the pressing need for clearer, more predictable guidelines to address conflicts of interest, particularly regarding conflicted controller transactions and the inherent coercion doctrine. Additionally, it calls for a refined standard that better delineates

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[386] Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart, 845 A.2d 1040, 1056 (Del. 2004).

[387] Steven A. Ramirez, The Special Interest Race to CEO Primacy and the End of Corporate Governance Law, 32 Del. J. Corp. L. 345, 377 (2007). Conversely, however, Professor Lisa Fairfax argues that "notwithstanding the creation of independent nominating committees, evidence reveals that CEOs continue to influence the director-nomination process through informal consultations and recommendations of directorial candidates." Lisa M. Fairfax, The Uneasy Case for the Inside Director, 96 IOWA L. REV. 127, 159 (2010).

[388] See supra text accompanying note 342.

[389] This proposed standard is based on the definition of waste. See *Zapata*, 658 A.2d at 183 ("If reasonable, informed minds might disagree on the question, then in order to preserve the wide domain over which knowledgeable business judgment may safely act, a reviewing court will not attempt to itself evaluate the wisdom of the bargain or the adequacy of the consideration.").

the circumstances warranting entire fairness review, thus mitigating the risk of deterring beneficial transactions.

By proposing a reevaluation of the entire fairness standard application and advocating for clearer definitions of control and independence, this paper contributes to the discourse on corporate governance. The suggested adjustments, such as a reinvigorated threshold test for applying entire fairness, aim to foster a governance environment where both controllers and minority shareholders can coexist with reduced litigation risks and a heightened focus on transparency and fairness. The proposed reforms hold promise for enhancing legal certainty, ultimately strengthening Delaware's position as a leading jurisdiction for corporate law.