GOING PRIVATE AT THE INTERSECTION OF THE MARKET AND THE LAW

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INTRODUCTION

TERMINOLOGY & OVERVIEW

A variety of corporate acquisition transactions are loosely described as "going private" transactions.[1] In the ones at issue in this Article, which are commonly described as "freezeouts," the public stockholders sell their shares en masse to a controlling stockholder at their company (a "controller.)" The controller can be either a person or another company (a parent corporation);[2] and the acquisition occurs most commonly through the vehicle of a merger or tender offer, and often a combination of both.

From the perspective of equity, what is distinctive about freezeouts is that the controller's formal and informal power over the target company's board gives the controller the ability to manipulate the transaction, to its financial advantage.[3] Most importantly, in whatever form they are structured, freezeouts allow controllers to inhibit corporate directors from furthering or even adequately protecting the minority stockholders' welfare in these transactions.[4] In effect, freezeouts provide controllers an opportunity to combine their market power with their legal authority and influence influence over the target board so that they operate at both the "buy" and the "sell" sides of these transactions. In recognition of this fact, and the attendant vulnerability of minority investors in this context, freezeouts are considered classic self-dealing transactions as defined within corporate fiduciary law.[5]

Corporate law affords controllers considerable discretion to pursue their self-interest -- for example in voting their shares as they choose.[6] However, once their power over the board is implicated, as it is in freezeouts, controllers owe fiduciary duties to the minority stockholders at their company.[7] In cash out mergers, equity defines controllers' obligations to the minority in terms of a duty of "fairness;"[8] in freezeouts based on tender offers, the case law describes controllers as owing a duty to avoid coercion and misrepresentation.[9] In both structural forms, therefore, freezeouts raise basic questions about the definition and significance of fairness and investors' freedom of choice within corporate fiduciary law, as it has developed in this context.[10] Moreover, because fiduciary doctrine develops through the adjudication of private suits, freezeouts provide an intriguing context to examine a question at the forefront of contemporary corporate law reform: that is, civil litigation's contribution to supporting (or undermining) strong acquisitions and capital markets.[11]

The substance and efficacy of the fiduciary doctrine governing freezeouts is of signal importance because corporate fiduciary law, and preeminently *Delaware's* fiduciary law,[12] rather than other areas of law or regulation, most fundamentally defines the scope of controllers' entitlements and duties to minority investors in freezeouts.[13] And yet Delaware's freezeout doctrine is presently in disarray. As stated above, the case law imposes exacting standards on controllers in cash out mergers and more minimal constraints if the controller's deal is structured as a tender offer freezeout (that is, a combined tender offer and short form merger).[14] The two strands in the case law reflect different substantive definitions of the "fair price" controllers must pay to acquire the public, “minority” shares,[15] and different views about whether the courts should actively oversee controllers’ conduct in freezeouts. These doctrinal differences have evolved, furthermore, without adequate attention to whether controllers have genuinely different capacities for overreaching in these two settings.[16]

Ironically, the substantially different levels of equitable protection afforded minority investors in cash out mergers and tender offer freezeouts has promoted controllers’ capacity for overreaching, to minority investors’ detriment. Because different equitable standards attach to the different formats, controllers have been able to profit from a kind of “structural arbitrage.” (Since controllers initiate freezeouts, they have authority to select their format.) In selecting, switching, even mixing and matching the different legal formats for freezeouts, controllers are able to exploit the complexity and uncertainty in the law governing freezeouts to the disadvantage of minority shareholders. This is one important feature of the present disarray in the doctrine governing freezeouts. Because freezeout transactions are occurring at a significant rate,[17] and because they raise important questions about fiduciary law’s influence on high stakes acquisitions activity,[18] the disarray in freezeout law merits attention and better resolution.

THE DISARRAY IN FREEZEOUT DOCTRINE

Delaware's Chancery Court has become aware of the shortcomings in its freezeout doctrine and in a recent trilogy of opinions has proposed sweeping reform. These recent decisions are *In re Cox Communications*, [19] *In re Cysive*[20] and *In re Pure Resources.*[21] (Notably, each of these monumental opinions was authored by Vice-Chancellor Leo Strine, Jr.[22]) In these decisions, the Chancery Court is proposing to unify the two bodies of case law governing freezeouts.[23] In furtherance of this goal, the Chancery Court is proposing, also, that the deferential “business judgment rule”[24] standard of review should apply in a stockholder suit against a freezeout. Consistent with this proposal, the rigorous entire fairness standard would apply only if and after the controller’s freezeout offer was rejected by either the independent directors or holders of the outstanding minority stock, and the controller nevertheless proceeded to consummate the freezeout.[25] (These proposals are referred to collectively herein as the “*Cox* Reforms”). As enunciated in *Cox*, a duty of fairness would apply in the freezeout only if and when a controller proceeded with the transaction over the disapproval of either the independent directors or a majority of the minority shares.

In *Cox,* the Chancery Court contends that such combined independent director and disinterested shareholder assent (“Dual Ratification”) is adequate evidence of arm's-length dealings and, hence, the freezeout's fairness. The *Cox* opinion contends that so long as there's been Dual Ratification, allowing equitable review of the freezeout’s fairness upon a shareholder complaint is a waste of resources.[26] Hence, if *Cox* and the other recent freezeout cases are respected as authoritative, and validated by the Supreme Court ultimately, going private doctrine will be "going private."[27] If the business judgment rule becomes the presumptive standard of review, freezeouts will be subject to less frequent and less vigorous judicial oversight; most stockholder complaints in freezeouts would be dismissed on the pleadings.

This Article devotes careful attention to the reasoning in *Cox*, *Cysive* and *Pure* because these decisions are likely to shape the future development of freezeout doctrine.[28] These recent Chancery Court opinions present their reforms to freezeout doctrine as empirically-sound, pragmatic measures designed to reduce litigation, benefit minority investors and strengthen the capital markets generally. *Cox* contends, furthermore, that eliminating judicial review for fairness where there's been Dual Ratification will make going private doctrine more logical, clear and consistent with corporate law's fundamental tenets – especially its deference towards decisions by disinterested directors.[29] Parts II and III of this Article explain why several of these claims are contestable, if not erroneous.

At this juncture it's important to note that the reforms also coincide with a broader, popular policy orientation that disfavors class action suits, including suits by stockholders.[30] Specifically, the *Cox* Reforms evidence the contemporary distaste for stockholder suits against business,[31] and the popular mistrust of the lawyers who bring them.[32] Accordingly, a full treatment of the *Cox* Reforms requires some discussion of these broader, institutional issues.[33] Congress' concern over meritless stockholder claims and "litigation agency costs"[34] was dramatically evidenced by its enactment of *The Private Securities Litigation Reform Act of 1995* ("PSLRA"), which imposed substantial procedural hurdles to plaintiffs' prevailing in securities class actions.[35] In the name of preventing savvy plaintiffs' lawyers from pursuing class actions in state court and thereby circumventing the procedural checks established by the PLSRA, Congress enacted *The Securities Litigation Uniform Standards Act of 1998* ("SLUSA") shortly thereafter.[36] Even in enacting the sweeping corporate governance reforms in *The Sarbanes Oxley Act* ("SOX"), Congress eschewed anything that would promote stockholder class actions.[37] In sum, *Cox's* jaundiced view of the plaintiffs' bar and its skeptical view of investor class actions[38] fits into the broad swath of contemporary law reform and public policy in which markets are portrayed as naturally "free" and requiring minimal judicial intervention or other regulatory support.[39]

Mirroring federal limits on stockholder class-actions, state corporate law imposes substantial limits on shareholder derivative suits.[40] Although Congress saved fiduciary claims for misrepresentation from being preempted by SLUSA,[41] many corporate legal academicians view shareholder litigation as a deadweight cost for firms and the economy.** From this perspective, corporate fiduciary law should operate essentially as a normative force, and only in the rarest instances involve the imposition of real sanctions.[42] Again, a principal rationale for this view is that shareholders can largely fend for themselves in markets, and without recourse to the courts -- for example through diversification and the exercise of collective opposition.[43] Over the past two decades, this viewpoint has been influential in corporate legal scholarship and in certain strands of the case law. Indeed, *Cox* fervently contends that in freezeouts, the "piece-work" of judicial review is rarely worth the cost.[44]

This Article rejects the view that equitable actions in freezeouts are essentially exogenous burdens on an acquisitions market that would otherwise be self sustaining, wealth-maximizing and socially salutary. Instead, it espouses a more affirmative, symbiotic view of the relationship between corporate fiduciary principles and acquisition markets. In this view, a robust equitable tradition is constitutive of a well-functioning "M&A" market – it instantiates the range of legitimate possibilities and expectations that collectively shape deal making. In this mode, the seminal mergers and acquisitions cases prescribe steps that buyers and sellers (and their advisers) should take to accommodate both the parties' legitimate pursuit of financial self-interest, as well as other social welfare objectives, including longer-term wealth maximization.[45] Indeed, in recommending the employment of special committees and independent legal and financial advisers, and other "steps" that deal principals and planners should take, judges adjudicating freezeouts and other acquisition transactions have taken on the status of "transactional choreographers."[46] In prescribing various safeguards and procedures to be followed in high stakes M&A deals, the equity courts have sought to promote "fairness," "candor," "consent" and "independent" decision making in order to foster the integrity of the free market framework.[47] Equitable constructions such as special committees of independent directors,[48] and their employment of independent financial and legal advisers[49] are highly influential in determining the standards courts will apply in reviewing a disputed M&A transaction; they therefore warrant scrutiny in deals where conflicts of interest are rife and the stakes are high, as they are in freezeouts.[50] Accordingly, "minimalist," deferential, business judgment review has not been the norm in freezeouts or the broader M&A jurisprudence.[51]

As interpreted herein, the transactional choreography for freezeouts reflects different judicial responses to three interrelated problems. These are (i) the scope of controllers' obligation to pay no less than a legally determined "fair price," (ii) the public stockholders' capacity either to consent to or reject the freezeout offer and (iii) the potential for controllers to coerce the target directors and the public investors into agreeing to a bad deal. As elaborated in the analysis that follows, in order to encourage controllers and other deal principals to adhere to the transactional choreography for freezeouts, the courts have promised them more favorable treatment as defendants if they follow the established equitable prescriptions and the transaction nevertheless becomes subject to litigation.

Most significantly in freezeouts, the courts have encouraged controllers to submit their cash out mergers to a vote of the target's independent directors or public stockholders. To encourage controllers to condition their freezeouts on receipt of such disinterested approval, the courts have provided that so long as the deal receives either form of approval, the plaintiffs cannot recover unless *they* prove the freezeout's unfairness. This is exceptional because defendants ordinarily have the burden of proof in self-dealing cases.[52] The recent cases, and *Cox* in particular, rightly endorse unifying the doctrine governing freezeouts so the law will become more authoritative and coherent. However, *Cox* endorses too relaxed an approach to controllers' capacity for overreaching and too easy a faith that private bargaining will lead to fair outcomes for minority investors in freezeouts.

This Article proposes, instead, that the Entire Fairness standard should govern freezeouts in both formats, with one exception. In addition, defendants should be able to obtain the beneficial burden shift only upon receiving approval of both the independent directors and a majority of the disinterested stockholders. The proposed exception is that deferential, business judgment rule review should apply only where a controller has allowed the target's independent directors to conduct an auction or market check to ascertain the company's going concern value, and the controller has agreed to be a seller if an offer emerges that is superior to its own. But the business judgment rule should only apply in this circumstance -- only where there's been an auction or market check should a freezeout enjoy a *presumption* of fairness in a stockholder suit.

Publicly listed companies should not have any difficulty establishing a Committee of independent directors to conduct such an auction or market check. Changes to stock exchange and NASD listing standards inspired by SOX mandate that even where there's a controller that owns a majority of the stock there will still be at least three independent directors on the board to oversee such an auction or market check.[53] And in companies where there's a de facto controller – that is, one who dominates voting but does not own the shares constituting voting control – a majority of the full board must meet the new listing standards' criteria for independence.[54] (Where the distinction is relevant these are described as "True Majority Controllers" and "De Facto Controllers," respectively.)[55] On this basis, there shouldn't be any structural impediments to establishing a Special Committee of at least three independent directors to conduct an auction or market check of the controller's bid.[56] Delaware's freezeout doctrine should reflect these federally inspired changes to board independence requirements.

In addition, in contrast to *Cox's* endorsement of the business judgment rule for freezeouts, *Revlon* is the more obvious fallback standard.[57] Indeed, where the freezeout offer comes from a De Facto Controller, "*Revlon* duties" would presently apply to the target directors' response to the offer, and mandate they withhold their consent until they had canvassed the market to ensure the freezeout offered "the best price reasonably available."[58] And even in a freezeout offer from a True Majority Holder, the directors' duty of care would require them at least to canvass the market to ascertain if there are better alternatives to the controller's bid.

This Article proceeds as follows. Part I outlines the doctrinal framework for freezeouts established by the landmark cases of *Weinberger v UOP, Kahn v Lynch* and *Solomon v Pathe*. Part II focuses on tender offer freezeouts, providing a critical analysis of the doctrine from *Solomon* to *Pure* to *Cox.* This Part II specifically focuses on the new equitable conditions *Pure* and *Cox* endorse for tender offer freezeouts to receive deferential review under the business judgment rule in a suit. Part III analyzes the equitable standards applied in cash out mergers. It focuses on *Cysive's* and *Cox's* claims about the negative byproducts arising from the Entire Fairness standard, as well as their arguments in favor of applying the business judgment rule in suits over freezeouts. Part IV takes a deeper look at the implications of applying business judgment rule deference to freezeouts, especially as it would eliminate a fair price duty in controllers' offers. Part V presents the Article's suggested reforms for freezeout doctrine, consistent with the proposals briefly described above.

I. THE TWENTIETH CENTURY LEGAL FRAMEWORK FOR FREEZEOUTS

A. *Weinburger's* Entire Fairness Standard

The Delaware merger statute, like most, provides for cash out mergers by the vote of a majority of the directors on the board and a majority of the outstanding voting stock.[59] On this basis, the minority shareholders' voting rights afford them no authority to stop a merger proposed by a controller, since the controller has the votes constituting the necessary shareholder approval.[60] Just as importantly, the controller has the votes necessary to control the outcome of director elections, as well as the votes necessary to remove directors from the board. In most instances the controller can accomplish the removal of directors "without cause" virtually at any time.[61]

As suggested above, it is the controller's power over the board that makes cash out mergers classic self-dealing transactions. If the board could operate with genuine independence from the controller in a freezeout, then functionally speaking the controller would only be on the "buy side" of the transaction. Instead, since the controller can remove directors who oppose its plans, the controller is able both to manipulate the terms of the sale and profit as a purchaser from so doing. Fiduciary law mandates that the directors owe duties of care and loyalty to all the shareholders equally, notwithstanding the controller's power and influence over the board, but once a controller is present the directors are in a difficult, inherently conflicted situation. Despite their fiduciary duties, if they act in ways that conflict with the controller's desires, they are likely to find themselves off the board.

Whether and under what circumstances controllers could use mergers to eliminate minority stockholders from the corporation has always been a controversial matter within corporate law.[62] Prior to *Weinberger,* equity had imposed a "business purpose requirement" on cash out mergers as a way to limit controllers' pursuit of their private, self-interest.[63] *Weinberger* rejected the business purpose requirement (which was considered so subjective as to be useless), and endorsed a different set of equitable criteria to rein in controllers' use of cash out mergers to pursue their self-interest.[64] In *Weinberger v UOP* the Supreme Court held that "Entire Fairness" would henceforth be the governing standard for controllers' conduct in these transactions.[65] As the measure of "fair price," the Entire Fairness standard requires controllers to pay the public stockholders no less than their pro rata share of the company valued as a going concern. And because fair price is a range, rather than an easily observable or finite sum, *Weinberger* also requires controllers to demonstrate the fairness of the proceedings in the cash out merger.[66] Importantly, despite the controller's formal power to compel the transaction, *Weinberger* placed heavy emphasis on their equitable obligation to allow independent directors to negotiate on behalf of the minority investors in establishing the price or other basic terms of the deal.[67] Thus, under *Weinberger,* vigorous judicial review for fair dealings and fair price – that is, "Entire Fairness" – was validated as the standard applicable to controllers' conduct in cash out mergers.[68]

In addition, beyond providing a benchmark for liability, *Weinburger's* admonitions have influenced controllers' planning in cash out mergers (consistent with the concept of transactional choreography described in the Introduction).[69] For example, in furtherance of the fair dealing requirement, the Court encouraged controllers to establish special committees of independent directors to represent the public stockholders' interests in the negotiations -- as a method of simulating arms'-length dealings. In so doing *Weinburger* established what is still the formative transactional choreography for cash out mergers.[70] *Weinburger* also encouraged what is now the accepted practice of having outside, independent financial and legal experts advise Special Committees representing public investors.[71] And *Weinburger* laid heavy emphasis on controllers' duty of candor,[72] and thus encouraged controllers to facilitate the flow of accurate information among the parties during the negotiations.

Yet, because Entire Fairness imposes demands on controllers and courts, it at times becomes controversial. This is evident in the recent freezeout cases, but was true also earlier in the evolution of freezeout doctrine.[73] In particular, in the early 1990's a split evolved in the Chancery Court over whether approval of cash out mergers by independent directors was a sufficient indicia of fairness so that the courts should afford deferential review to the transaction, consistent with applying the business judgment rule.[74]

B. ***Kahn v Lynch*** and the Problem of Coercion in Cash Out Mergers

In 1994 the Supreme Court resolved this question in the negative in *Kahn v Lynch*.[75] *Lynch* held that *Weinberger* intended independent director approval to operate merely as "evidence" of fair dealings, rather than disposative proof of fairness. As described by the Supreme Court in *Lynch*, this concept has come to be known as "inherent coercion." The working concept is that even the independent directors on the target's board and also the disinterested, public minority shareholders may be cowed into approving a suboptimal freezeout offer out of fear that the controller could take even more aggressive actions in its private self-interest if they blocked the freezeout. [76] ("Coercion," as defined therein, refers to being disabled from considering the merits of an offer on account of threats or conditions exogenous to the proposed transaction.) *Lynch* affirms that this inherent form of coercion undermines the Court's ability to presume the legitimacy of the consents to the freezeout, and that it operates even if the controller hasn't expressly signaled an intention to "retaliate" (financially speaking), if its desired transaction is thwarted. Accordingly, in *Lynch* the Supreme Court held that in stockholder complaints against cash out mergers, controllers would bear the burden of demonstrating the deal's fairness. Thus, *Lynch* refused to give either the independent directors' or minority investors' consent the full "exonerating" effect it would otherwise have in self-dealing transactions of lesser financial magnitude, or where no controller was present.

Nevertheless, to furnish some incentive for controllers to submit their cash out mergers to the independent directors or the public stockholders for their approval (or rejection), *Lynch* held that either form of ratification would provide controllers a beneficial shift in the burden of proof. Instead of the usual situation in the adjudication of self dealing transactions (where the defendant must demonstrate the inherent fairness of the challenged deal), *Lynch* provides that where a cash out merger has received approval by either the independent directors or majority of the public shares, the *plaintiffs must show the freezeout was unfair* in order to obtain a recovery. (Because *Lynch* validates and expands upon the criteria elaborated in *Weinberger*, their fiduciary mandates are referred to collectively herein as the "*Lynch* doctrine.")

In sum, in light of controllers' significant power advantages, and their duties as fiduciaries, the Supreme Court has imposed substantial equitable safeguards on controllers' cash out mergers. It has given force to these safeguards by allowing aggrieved minority shareholders to sue in equity if they allege a genuine claim of unfairness in a cash out merger, and it has limited the usual effect of disinterested ratification in providing for dismissal of plaintiffs' complaints on the pleadings.

C. Controllers' Tender Offers and the Issue of Consent

The statutory and equitable standards relevant to controllers' tender offer freezeouts present a fundamentally different picture than those relevant to controllers' cash out mergers.

In taking account of these differences it is important to note the very different history behind cash out mergers and tender offer freezeouts. Although cash out mergers were not expressly validated in Delaware until 1967, as part of the comprehensive statutory modernization that occurred then (and elsewhere around this time),[77] they had already been occurring for decades. As described above, in the early years, equity endorsed tremendous "protectionism" against cash out mergers in the interest of minority investors.**

In contrast, tender offers are a far more recent phenomenon, with a very different legal complexion. The Williams Act, which governs tender offers in Exchange-Act listed securities, was enacted only in 1968.[78] Tender offers, as they are presently understood, were uncommon prior to that time. The Williams Act imposes certain elementary, procedural safeguards against unfairness in tender offers – including pro-ration,[79] minimum timing,[80] withdrawal[81]and "best price" requirements.[82] However, the principal focus of federal law is ensuring the completeness of the offeror's disclosures and prohibiting fraud therein.[83] Furthermore, although the SEC's tender offer rules require the target's directors to state their views regarding the merits of the tender offer, the board may satisfy this obligation by declaring it is unable to reach a conclusion about the offer's merits.[84] In a similar vein, the cases interpreting the Act and the rules follows a principle of neutrality in respect to bidders and targets. The SEC's Rule13e-3 mandates an additional layer of disclosure for going private transactions (in both structural forms, in fact but once again the focus is on ensuring the ability of the offerees to make informed judgments, rather than on promoting the substantive fairness of controllers' offers.[85] There is no form of "merit" regulation in the federal tender offer scheme, in relation to controllers' offers or otherwise; nor do the federal cases (or other federal regulations) provide a role for target directors in negotiating on the public stockholders' behalf.

The states' approach to controllers' tender offers mirrors the federal approach in assuming a posture of relative "neutrality." Consistent with the fact that the bidder's offer to purchase is made directly to security holders, there is no statutory requirement in corporate law that directors must consent in order for a tender offer to proceed. At a formal level, the omission of a board approval requirement reflects the fact that the company, as a legal entity, survives any change in ownership effectuated by a tender offer.[86] That is, no corporate-level act or transaction occurs in a tender offer, formally speaking, and this has influenced the case law's approach to tender offer freezeouts.

Although director approval is not required under the state statutes, directors' fiduciary duties encompass discretionary authority to oppose "outside" (non-controller's) hostile bid. Equity has afforded target directors authority to employ a variety of defensive tactics to inhibit third party tender offers the directors regard as inadequate or coercive.[87] Functionally speaking, this defensive, equitable authority is effectively a "reverse, partial, implied" board approval condition as applied to hostile tender offers. Crucially, however, a parallel grant of defensive authority has not been recognized by equity in relation to directors of a controlled company – although this provocative logical inconsistency was noted by the Chancery Court in its decision in *Pure*.[88]

In sum, the federal regulation of controllers' tender offers has not preempted state regulation of these transactions, but it appears to have influenced equity to adopt an uncharacteristically laissez faire posture towards controllers' tender offer freezeouts, as compared both to controllers' cash out mergers and third parties' hostile tender offers. In the absence of misrepresentation, or other forms of overt, objectively defined forms of coercion, controllers can bypass the target directors and make their offer to purchase directly to the target's minority stockholders, without concern that the Courts or the independent directors will intervene on the minority investors' behalf.[89] This approach was validated in 1996 in *Solomon v Pathe Communications*

("*Solomon*").[90] In *Solomon* the Supreme Court held that absent an affirmative showing of fraud or coercion, equity would not intervene to protect minority shareholders' welfare in controllers' tender offers.

Until recently, controllers rarely relied on tender offers as a primary vehicle for going private transactions. For one thing, it is impossible to consummate a freezeout exclusively through a tender offer, because there will always be some "holdout" stockholders who choose not to or simply fail to tender their shares. In order for a tender offer to become a full fledged freezeout, controllers typically execute a "short form merger" after the tender offer is consummated. Delaware's section 253 provides that a controller may execute such a short form merger unilaterally and almost instantaneously if it has acquired 90% or more of the outstanding voting stock of the target company.[91] No agreement or negotiation with the target directors or outstanding stockholders is required to effectuate a short form merger. When this fact is combined with the fact that no negotiation or agreement with a Special Committee, the full board or the target stockholders themselves is required for controllers to go forward with tender offers, it becomes evident that controllers can effectuate these freezeouts more rapidly and with lower transaction costs than they can cash out mergers.[92]

The final piece of "good news" for controllers' seeking to engage in tender offer freezeouts was delivered by the Delaware Supreme Court in 2001 in *In re Glassman*.[93] Although the Court did not address tender offer freezeouts per se, in *Glassman* the Court held that equity would not apply any fiduciary criteria to short form mergers. Because controllers use short form mergers, commonly, to consummate their tender offer freezeouts, this was interpreted as a "green light" for these transactions.

Equity's less protective stance towards minority investors in tender offer freezeouts would seem to make them the preferred route for controllers planning on going private. And since the *Glassman* decision, the relative number of tender offer freezeouts compared to cash out mergers has increased, as predicted. Commentators assumed that controllers would nearly always prefer tender offer freezeouts to cash out mergers, since the former are likely to involve lower transaction costs and even less opportunity for litigation. However, the most recent empirical evidence suggests that the shift to tender offer freezeouts has not been as pronounced as commentators expected.[94] The more traditional cash out merger route is still more prevalent,[95] as exemplified, in fact, by the going private transaction in *Cox*. The most logical explanation for this is that controllers starting with a relatively lower stock holdings would perceive a tender offer freezeout as involving greater risk of nonconsummation, because of the 90% ownership requirement attendant to completing the short form merger.[96]

D. Different Approaches to a Legal "Fair Price" Duty

The inconsistency between the fiduciary standards endorsed in *Lynch* and *Solomon* has invited bidders to employ sharply different tactics, even to offer proportionally different premiums depending on which structure is employed for the freezeout.[97] More specifically, there are three bodies of law that define public stockholders' financial entitlements in freezeouts – the law governing appraisals, the law governing cash out mergers and the law governing tender offer freezeouts. Because controllers have the opportunity to select among freezeout structures, they shape their deals to take advantage of the different legal requirements, especially the differences regarding "fair price" that pertain to different structures.

The appraisal statutes can be read as the legislatures' acknowledgment that they'd afforded controllers a legal power analogous to eminent domain in the cash out merger provisions.[98] From this perspective, appraisal rights can be construed as the legislatures' attempt to rectify the power imbalance they created in favor of controllers. The appraisal statutes afford public investors subject to a cash out merger the right to go to court to obtain the legally determined measure of the fair price of their shares – that is, the cash value of their stake in the company measured as a going concern. In their affirmation of going concern value as the legal measure of the fair price minority stockholders are entitled to, appraisal rights are unambiguous.

In practice, however, appraisal's efficacy is compromised by the existence of various statutory caveats and practical impediments.[99] These hurdles inhibit public investors' ability to rely on appraisal rights to obtain the full value of their shares in cash out mergers. For example, there is only a short time period in which investors can commence appraisal proceedings. The plaintiff-stockholders must await the final conclusion of the appraisal proceedings to receive any financial recovery – and they do so in a situation where they must decline any of the merger consideration. There are limits tied to the form of consideration offered by the controller – appraisal is unavailable, normally, where the merger consideration is widely traded stock. And appraisal is unavailable to public investors who sell to a controller in a tender offer. In addition, the statutes don't create a mechanism for investors to bring appraisals as class-actions, so that the legal costs of appraisal are prohibitive in most cases for ordinary (non-institutional) investors. In addition, because the quantitative methods for calculating going concern value are highly complex, the public investors' receipt of an ultimate recovery is always speculative.[100] In sum, despite the formal clarity of the promise of going concern value as part of appraisal rights, the risks and impediments attaching thereto have sent mixed signals about the value that minorities can obtain -- and thus the price that controllers should offer to pay -- in cash out mergers.

In assessing *Weinburger's* implications for minority investors' ability to demand a fair price in a freezeout, Professors Gilson and Gordon have described the cause of action arising there under as a class-based, equitable equivalent of an appraisal action.[101] Indeed, both the equitable cause of action and appraisal actions incorporate going concern value as the legal measure of fair price in cash out mergers. In a sense, then, the *Lynch* doctrine represents equity's judgment (among other things) that appraisal's promise of going concern value is excessively constrained by statutory caveats and practical impediments, as described above. Under the *Lynch* doctrine, minority shareholders' equitable fair price claims in cash out mergers have not been circumscribed in the way actions for appraisal are.[102]

And yet the standards defining minority investors' ability to obtain a fair price in tender offer freezeouts present a wholly different. Based on the assumption that the public investors can freely choose whether or not to tender to a controller, the Supreme Court in *Solomon* declined to impose a fair price duty on controllers' tender offers. *Solomon* rejected the fair price duty expressly and without equivocation. And *Solomon* did so, furthermore despite the fact that an earlier decision of the Supreme Court, *Lynch v Vickers' Energy*, had endorsed going concern value as the benchmark for damages where controllers had engaged in fraud or coercion in a tender offer.[103] The different approaches to minority investors' financial entitlements in *Vickers Energy* and *Solomon* reflects *Solomon's* assumption that the public stockholders are free to decide whether or not to tender, absent misconduct by the controller. In effect, both the cash out merger and the tender offer freezeout doctrines place great emphasis on minority investors' freedom of choice in setting the legal standards for price. But the *Lynch* doctrine imposes a fair price duty on controllers going forward -- assuming coercion operates and limits minority investors' free choice. In the alternative, *Solomon* forbears imposing a fair price duty on controllers' tender offers, presuming coercion is normally absent and investors can make a free choice about the freezeout.

To summarize, each of these three bodies of law reflects a distinct approach to defining "fair price" and affording public investors a legal means to obtaining it in a freezeout. Equity has endorsed a fair price duty (as going concern value) in controllers' cash out mergers, but not in controllers' tender offers. In tender offers, the law provides that "fair price" will be whatever the public stockholders accept in tendering to the controller, so long as there's been no affirmative showing of express misconduct on its part. And while both appraisal actions and equitable causes of action under the Entire Fairness standard validate controller's duty to pay a "fair price" (as going concern value), the practical utility of appraisal actions has been compromised by myriad limitations and practical impediments.

E. Controllers Benefit from Structural Arbitrage

Unlike other major corporate transactions, it is the controller rather than the board that will initiate a freezeout offer. As part of this authority, the controller will have discretion over the selection of the formal structure for the freezeout. Although other structural alternatives are available,[104] in most cases controllers select between cash out mergers and tender offer freezeouts, as described above. The different statutory and equitable standards applicable to these different structures (and especially the differences pertaining to the fair price duty, as described above) have become apparent to controllers considering a freezeout, especially since they cannot go forward in complex M&A transactions like freezeouts without expert legal counsel.[105]

A further crucial feature of controllers' power to select the freezeout's structure is that they are not wed entirely to either choice. That is, controllers "mix and match" mergers and tender offer structures in going private deals to their advantage. For example, in negotiating a cash out merger agreement with the representatives of the target, the controller will frequently provide that it can launch a "clean up" tender offer after the agreement is signed (and prior to the shareholder vote thereon). The advantage of such a tender offer is that it may lessen the controller's total financial exposure in the freezeout, because stockholders who tender surrender their right to bring an appraisal action. The merger agreement will also commonly afford the controller discretion to abandon the ordinary cash out merger, which requires a shareholder vote (and thus the solicitation of proxies in compliance with federal law) in favor consummating the freezeout through a short form merger if it obtains the minimum 90% target stock ownership threshold. By switching to the short form merger, the controller can avoid a shareholder vote, and thus the solicitation of proxies in compliance with federal laws and regulations. Switching to a clean up tender offer and short form merger – even after there is a signed, negotiated cash out merger agreement, may help the controller to reduce its transaction costs overall.

Importantly, however, under the case law as it stands, so long as there is a merger agreement signed by the controller and the target, as the controller goes forward in the freezeout, the minority shareholders are protected by the Entire Fairness standard. That is, even if the controller abandons the long form merger and consummates the transaction through the short form merger (after a successful tender offer), *Lynch's* Entire Fairness standard will apply to the process, and not the more lenient standards applied under *Solomon*.

If the *Cox* Reforms become authoritative, however, controllers would not be governed by the Entire Fairness standard as they negotiate the process of a freezeout, at least until the independent directors or the majority of the public investors officially disapproved of the transaction. (A duty to pay no less than going concern value, under the *Lynch* doctrine, would apply as a measure of damages if controllers were found, after the fact, to have engaged in coercion or other forms of unfairness.) But under the *Cox* Reforms, until the freezeout was officially rejected by either the independent directors or a majority of the public shares, controllers would not be negotiating in the presence of a fair price duty or a duty of fair dealings. The representatives of the minority stockholders would not have the leverage they have presently where controllers negotiate under a duty of Entire Fairness.

The dual track approach to the regulation of freezeouts in different formats has allowed the courts to play close attention to the different structural dynamics that apply in different transactional contexts. This context-sensitive approach has been beneficial in many areas of law, consistent with the notion of transactional choreography developed herein. Indeed, the various corporate actors and the markets have been able to adjust their expectations to the risks attendant to different deal contexts as equity has refined the pertinent transactional choreography.

However, as the Chancery Court has recognized in *Pure* and *Cox*, it's most probable that the differences in the structural dynamics between controllers' tender offer freezeouts and cash out mergers are more superficial than substantive, more formal rather than practical and concrete. The different bodies of case law have therefore done more to obscure this similarity than to illuminate it, so that the parties could respond thereto. In addition, if the differences are more apparent than real, then the courts are expending an unwarranted amount of resources maintaining the two bodies of case law for freezeouts.

But there is an even more problematic feature of the dual track case law for freezeouts: this is that it has not truly done justice to the complex patterns through which controllers execute freezeouts. In reality, controllers can tailor make, mix and match and change deal structures in mid-stream. This degree of power and discretion affords controllers the ability to arbitrage the advantages of the different structures in their interests. Furthermore, this is the kind of legal complexity and uncertainty that would appear difficult for the markets to price, and thus it's reasonable to believe that minority investors are coping with some measure of market failure in relation to the trading price of their shares and that they may be overpaying for their securities. Furthermore, if the price of minority shares was systematically downgraded to take into account the maximum degree of potential overreaching by controller, this would make it difficult for companies where there were controllers to raise capital in the public markets at reasonable prices.

The remainder of this Article lays out the case for judicial reform intended to unify freezeout doctrine consistent with the Entire Fairness standard. One of the features that makes this unification more feasible, from a legal process perspective, is the fact that the tender offer freezeout case law is not as legally coherent, not as conceptually sound, as are other areas of Delaware's corporate fiduciary law.

II. THE EQUITABLE STANDARDS FOR TENDER OFFER FREEZEOUTS

In *Pure* and then *Cox*, Chancellor Strine departs from the established tradition of laissez faire towards controllers' tender offer freezeouts. These are the first decisions in the tender offer freezeout case law to take stock of the bias that had developed in controllers' favor. They are also the first decisions fully exploring this case law's relationship both to the standards applied to controllers in cash out mergers and to target directors in defending against hostile tender offer bids. As *Pure* and *Cox* suggest, the conceptual framework underlying the tender offer freezeout case law does not hold up well in this comparison.

A. *Solomon's* Approach to Controllers' Tender Offers

For the past ten years, *Solomon* has been respected as the landmark opinion governing controllers' duties in tender offers. This is surprising in several respects. First, most simply, the opinion is only an affirmance (by Delaware's Supreme Court) of the Chancery Court's grant of the defendant's motion to dismiss. Thus, the issues of fiduciary duty addressed in the case did not receive the full airing of a trial.

Second, even more powerfully, *Solomon's* discussion of controllers' fiduciary duties in tender offers is very limited. Most of the opinion focuses on the pleading standards applicable in shareholder class actions, as a general matter. The Court analyzes when stockholder complaints in class actions may be dismissed for failure to state a claim. The plaintiffs in the appeal argued that the Chancery Court had erroneously applied a heightened pleading standard, but the Supreme Court disagreed and ruled against them.[106] Importantly, *Solomon's* lengthy discussion of pleading standards does not add any refinement or precision on the matter of how they apply in controllers' tender offers.

Thirdly, although the case is treated as authoritative precedent regarding *controllers'* duties in tender offers, the plaintiffs' complaint alleged breaches of fiduciary duty on the part of the target's *directors*. The complaint alleged that the target directors had breached the duty of care and fair dealings they owed the minority investors, on account of their passivity in response to the controller's offer.[107] Although it goes to the heart of the plaintiffs' complaints, Solomon devotes very little discussion or analysis to the directors' conduct in the controller's tender offer.

Adding to the strangeness of the opinion's stature in going private doctrine, the transaction under scrutiny did not actually involve a going private transaction, precisely speaking. The controller, Credit Lyonnais Bank, was conducting the tender offer for the small slice of public equity while it was simultaneously foreclosing on an 89.5% interest in the stock it held as a creditor.[108] On the day the tender offer was announced, the controller also initiated a public auction for the stock subject to the pledge.

Even the small section of *Solomon* that does discuss the fiduciary duties of target directors responding to controllers' tender offers is problematic. After reciting the breach of care and fair dealings allegations against the target directors, the opinion makes a leap of logic. It observes that *controllers* don't have a duty of fair dealings or duty to pay any particular "fair" price in a tender offer. But this is a non sequitur, analytically speaking. Whether the target directors breached their duty of diligence in responding (or failing to afford an adequate response) to the controller's tender offer is not logically dependent on the nature of the controller's duties. [109] Indeed, the target directors' duty to be active advocates for the minority investors would appear to be most crucial precisely where the controller's duties were minimal.

Solomon's conclusion that controllers are not under a fiduciary duty to offer a fair price is also puzzling. The opinion seems to imply that the matter is resolved by precedent. The Court cites *Lynch v. Vickers Energy*, a Delaware Supreme Court decision from 1976,[110] as well as *Weinberger* for the principle. But this is very odd since *Weinberger* says nothing at all about whether a fair price duty exists in controllers' tender offers. In *Weinberger* the Supreme Court validated the fair price duty in relation to controllers' cash out mergers; the Court was silent about the role of equity (and thus the application of a fair price duty) in other going private structures. Nor is the *Vickers' Energy* opinion cited in *Solomon* truly germane.[111] On the subject of price, *Vickers' Energy* states merely that it "... cannot be one which would induce the acceptance of an unconscionable bid by an unwary stockholder at a price below the market." This seems to be, essentially, a prohibition on coercion by controllers in cash out mergers; and where the opinion goes on to state that the price cannot be "otherwise unreasonable under the facts and circumstances" this hardly affirms the absence of a fair price duty in controllers' tender offers. Indeed, to the contrary, this language from *Vickers Energy* suggests that controllers must offer at least a "reasonable" price for the minority shares.[112] In any event, *Vickers Energy* certainly does not affirm the absence of a fair price duty in controllers' tender offers. *Solomon* thus cites *Vickers Energy* and *Weinberger* too broadly, if not inappropriately. Instead of taking the principle that controllers do not have a fair price duty in their tender offers from these opinions, it seems that the Supreme Court in *Solomon* arrived at this conclusion largely on its own.

Strangely, despite these stunning shortcomings in its legal analysis, *Solomon* has been respected as the principal authority governing controllers' tender offers. Perhaps this largely reflects the brief elapse of time since the case was decided. More concretely, since the Solomon opinion issued only in 1996, the Supreme Court has not had an occasion since then to enunciate rules for controllers or target directors in tender offer freezeouts. Given the idiosyncrasies in *Solomon*, when the Supreme Court does have this opportunity, it should feel confident in electing to chart a new course for tender offer freezeouts, including endorsing the application of the Entire Fairness standard in these transactions.

B. *In re Glassman* – No Fiduciary Requirements in Short Form Mergers

As described earlier, in tender offer freezeouts, controllers usually employ a short form merger to eliminate the remaining equity investors who failed to tender (assuming the controller reached the 90% ownership threshold). Through the end of the twentieth century, there was uncertainty regarding whether equity would apply the Entire Fairness standard in short form mergers, as it does in regular ("long-form") cash out mergers. For decades, the Supreme Court's *Schnell v Chris Craft* opinion was understood to allow equity's imposition of fiduciary mandates over and above any express statutory requirements applicable in a corporate act or transaction.[113] *Schnell* has frequently been held to be relevant in settings where the power of the board has been employed to the detriment of some or all of the stockholders.[114] This suggested that although the short form merger statutes allowed controllers to circumvent the target board entirely, this tactic might prove unacceptable to equity, on account of its negative implications for minority shareholders' interests. Thus, consistent with *Schnell*, there had been considerable lingering uncertainty about the nature of the fiduciary duties and requirements that attached to controllers and target directors' conduct in short form mergers.

Adding to the uncertainty, in *Kahn v Lynch* the Supreme Court had stated that Entire Fairness was the "exclusive" standard of review for parent companies' cash out mergers of subsidiary companies – that it, the Court made no distinction between long form and short form mergers in *Lynch*.[115] Because of cash out mergers' crucial importance in tender offer freezeouts, the issue of whether and what form of fiduciary obligations applied in short form mergers was a hotly contested issue when it came before the Supreme Court in 2001.[116] In that year, in *In re Glassman* the Supreme Court affirmed the Chancery Court's ruling that no fiduciary criteria would be applied by equity in short form mergers.[117] Reviewing the opinion, it is apparent that the Supreme Court did not consider the question simple or the answer self evident, since it reviewed five decades of equitable decision-making in cash out mergers prior to enunciating its holding. But in *Glassman* the Supreme Court finally held that equity would not imply an fiduciary criteria in short form mergers, seemingly on account of the Court's impression that the legislature had intended for equity to abstain from so doing. The *Glassman* opinion suggests that the Court felt precluded from applying fiduciary criteria to short form mergers on account the Delaware Legislature's express validation of controllers' power to effectuate these transactions unilaterally – that is, without target board or target shareholder consent.[118] The court held that the legislature had in effect preempted equity's authority to impose a fair dealings requirement in short form mergers.

Although *Glassman* is interpreted as resolving that the Entire Fairness standard is inapplicable in short form mergers, it's important to note that the decision leaves open the potential for the equity holders eliminated through the short form merger to pursue claims of misrepresentation, "fraud" or illegality therein. Specifically, in reiterating that the equitable action for misrepresentation applies to controllers even in short form mergers, *Glassman* validates the fiduciary duty of "complete candor" endorsed in *Vickers Energy* and its progeny.[119] Nevertheless, *Glassman* has been accepted as resolving that equity should have a limited role in overseeing short form mergers.[120]

But *Glassman's* relevance to tender offer freezeouts is a actually a separate question. The distinction arises from the fact that *Glassman* did not involve the Supreme Court in reviewing a premeditated, combined tender offer and short form merger of the kind that became more common after the decision itself. Indeed, the *Glassman* decision nowhere states or even implies that the Supreme Court considered the impact of its decision for controllers planning tender offer freezeouts (as these involve short form mergers). Because controllers had rarely combined tender offers and short form mergers as a structure for going private, *Glassman's* relevance to future freezeouts may not have been apparent to the Supreme Court at the time of its decision..[121] Furthermore, as was true in relation to *Solomon*, in the years since *Glassman* was decided, the Supreme Court has not had the opportunity to revisit the equitable standards pertinent to short form mergers in tender offer freezeouts, per se. Therefore, once again, should the Supreme Court wish to endorse Entire Fairness as the norm for tender offer freezeouts, it can do so without significantly disturbing the existing legal precedents.

C. *In re Siliconix* – A True Tender Offer Freezeout

1. The *Siliconix* Facts

In *Siliconix* the Chancery Court had the opportunity to review a full fledged tender offer freezeout – that is, a going private deal self consciously structured as a combined tender offer and short form merger.[122] Siliconix Incorporated was a NASDAQ listed technology company that had suffered through the market correction that occurred in the early months of 2000.[123] At the time of the buyout, its stock price and performance in the product markets were showing signs of a rebound, but Siliconix's price was not far advanced from its historic low. The controller, Vishay Intertechnology Inc. was closely aligned to Siliconix's product line and owned 80% of Siliconix's stock. It was clearly seeking to take advantage of what it apparently feared was a fleeting market opportunity to acquire the minority stock at a favorable price, as evidenced by the records amassed by the Court. In February of 2001, without prior notice to Siliconix or its minority investors, the controller announced a proposed cash tender offer for all of Siliconix's shares.[124] As part of its offer, it declared its probable intention to effectuate a back end short form merger (at the same, tender offer price) but it reserved discretion to decline to do so. The controller's disclosures to the minority investors informed them that Siliconix would probably be delisted from the NASDAQ at the conclusion of the tender offer. The controller was somewhat equivocal in stating its reasons for effectuating the tender offer freezeout. Even more problematically, the controller's disclosures failed to enunciate the basis for the price it was offering to the minority.

The controller appears to have done the minimum necessary to claim "good faith" compliance with the prevailing transactional choreography for freezeouts. It declared a desire to negotiate with a Special Committee of target directors, but the Committee it negotiated with was clearly biased in its favor, and intentionally so. It was composed of two directors, each of whom had substantial connections to the controller. One of the Committee directors had been the controller's lawyer until shortly before the transaction. The other Special Committee director "had been active in providing banking services to Vishay" in prior years. In addition, both of these directors "were friends of Vishay management," including, specifically, the controller's chief negotiator in the tender offer freezeout. The lawyer-director had been appointed to the target's board and Special Committee at the express suggestion of this individual who would be "negotiating" on the controller's behalf with him. (The controller was also allowed by the Committee to vet its selection of "independent" financial advisers.) There was evidence that the Committee directors would receive a "special fee" if the freezeout was consummated; and there was no question that the Committee's financial advisor's fee was contingent on the closing of the freezeout. Finally, the Committee was cautioned that "Vishay could not be compelled to sell its stake in Siliconix" (and could thus block third party offers) and that it could also "commence a unilateral offer at any time."

In its favor, the controller agreed to a majority of the minority shares minimum tender condition, which gave the minority investors some limited capacity to thwart the freezeout if they viewed it as genuinely unfair and were able to act in concert. However the minority investors' ability to arrive at a considered evaluation of the controller's price was hindered by several factors (in addition to the arguably conflicted nature of the Committee). As stated previously, the controller did not enunciate the rationale underlying its offering price or the circumstances of its buyout proposal. The Committee did not obtain, indeed appears not to have attempted to obtain a fairness opinion from its financial adviser in the transaction. And the Committee itself failed to provide any guidance to the public equity holders by taking an official stance of "neutrality" in the Schedule 14D-9.

With respect to the merits of the price, the opinion seems to indicate that the controller lowered its final offer in comparison to its opening bid. The controller set its opening cash bid at a 10% premium to the then market trading price of Siliconix stock. (This offering price was, however, still twenty percent below the average trading price of the stock in the six months previous to the bid.) The value actually being offered to the public equity holders became more difficult to evaluate once the controller switched from cash to stock consideration. Furthermore, the opinion states that in setting the conversion ratio for the exchange offer, the controller made no allowance for a premium to the Siliconix public equity holders. In addition, the switch to stock, and the finalization of terms for the freezeout were effectuated unilaterally by the controller without notice to the Committee.

2. The Standards for Coercion and Valid Disclosure

The minority stockholders in *Siliconix* were seeking a preliminary injunction to stop the controller's exchange offer. This made it somewhat more difficult for them to recover, in light of the higher standards that apply to the grant of an injunction. Apart from this matter, however, the *Siliconix* Court appears to have applied a heightened standard to *Solomon's* prohibition on coercion by controllers. The Court reviewed the facts, instead, for coercion it would deem "actual" or "serious" or "substantial" – implicitly accepting that some "normal" amount of coercion was ordinary and to be tolerated by the courts and public investors. Thus, although it refers to *Solomon* as authoritative precedent on this matter, in *Siliconix* the Chancery Court appears to have upped the ante in evaluating what forms of coercion by controllers would merit the Court's intervention.

As described above, there were many features of the *Siliconix* freezeout that would appear to have been coercive in their intention or in their effect or both. These include the conflicted Committee, the tainted process of selecting the financial adviser, the question of the Committee's and financial advisers' incentives being skewed by contingent fee arrangements, the failure of the Committee to obtain a fairness opinion, the controller's silence regarding crucial features of the transaction, the controller's equivocation about whether it would consummate the short form merger (which would determine whether appraisal rights would exist), and the threat implicit in the discussion about delisting. In fairness to the Chancery Court, *Solomon* had provided no justiciable contours to the definition of coercion that it validated as being of central importance. Nevertheless, the tender offer freezeout in *Siliconix* doesn't look like a close case. Rather, the Court appears to have ignored the avalanche of worrisome facts relating to the controller's and target directors' conduct, as being inadequately coercive to merit equitable relief.

In addition, rather than inquiring whether the controller had satisfied its duty of complete candor, consistent with *Lynch v Vickers Energy* and its progeny,[125] in *Siliconix* the Court parsed through the many questionable aspects of the controller's disclosures inquiring whether the *plaintiff* minority stockholders had proven the existence of *material misrepresentations* therein. The difference between a standard of "acceptable" disclosure (disclosure that eschews material omissions and falsehoods) and "entirely candid" disclosure -- as required by equity in controller's tender offers pursuant to the Supreme Court's holding in *Lynch v Vickers Energy,* is thus an important and well established one. But in *Siliconix* the Chancery Court appears to have ignored the distinction; and it applied the more lenient standard, to the advantage of the defendant-controller.

In sum, although the Court went to great lengths to describe conduct by the controller that it appears to have regarded as problematic, it also appears to have gone out of its way to conclude that this conduct was not actionable under the prevailing equitable standards. In so ruling the Chancery Court appears to have been particularly impressed by the controller's acceptance of a majority of the minority minimum tender condition -- which the Court took as evidence that the minority investors could stop the freezeout if they were sufficiently displeased. But viewing the number of worrisome aspects of the controller's bid revealed in the *Siliconix* opinion, in conjunction with the case's holding, minority investors and counselors would have to wonder if Courts would ever find coercion sufficiently "actual" for the Courts to intervene in their favor.

3. The Standards for Target Directors in Tender Offer Freezeouts

Indeed, as was true in *Solomon*, in *Siliconix* the Court appears somewhat confused about the intermingling of the fiduciary standards applicable to controllers and those applicable to target directors in freezeouts. In *Solomon,* the Court deflected the latter question by validating that controllers do not have a fair price duty in a tender offer (as previously discussed). In *Siliconix,* the Court faced the issue of the target directors' fiduciary duties more squarely; indeed the opinion gives more lengthy consideration to the target directors' duties than it does to the *controller's* duties, interestingly.

As part of the discussion of the target directors' duties, the *Siliconix* Court noted that the state statutes do not afford directors an explicit role in tender offers. (This fact is noted, subsequently in *Pure* as well.) In *Siliconix* the Court interpreted this silence as leaving less room for equity to impose fiduciary duties on target directors in controllers' tender offers. The Court also reasoned that because no sale of corporate property is involved in a tender offer, as opposed to a sale of the stockholders' property, the authority of the board is less immediately implicated in tender offers than in other transactions – most significantly, cash out mergers. (This question is also revisited in *Pure*). Perhaps the Court's impression in *Siliconix* was that the target directors had little choice other than to take the passive approach that they did, so that finding them liable under fiduciary law would simply be unfair. In any case, the inconsistency between the *Siliconix* Court's recitation of the facts (where it expresses substantial dissatisfaction with the parties' conduct) and its conclusion to exonerate the target directors is striking.

4. The Comparison with Target Directors' Conduct in a Recent Cash Out Merger

The greatest hurdle to the Court's exonerating the target directors and denying the plaintiffs' requested injunction, however, appears to have been the recent decision by the Delaware Supreme Court in *McMullin v Beran*. *McMullin* involved a sale of a controlled company through a cash out merger with a third party – the controller had arranged the deal so that the subsidiary's public shareholders would take cash as consideration in the merger. Consistent with the wishes of the controller, the directors of the target (the subsidiary) abdicated their role in the merger negotiations in favor of allowing the controller (the parent company) to pursue the transaction and decide its terms. The parent company was interested only in selling the subsidiary for cash. The Court held that in limiting the financial alternatives affecting the minority investors of the subsidiary in this fashion, the controller had benefited itself to the disadvantage of the minority investors. Furthermore, most relevantly, the Supreme Court held that the target directors in the cash out merger process had breached their fiduciary duties by abdicating their role as advocates for and advisers to the minority investors. *McMullin* held that the target directors could not merely leave it up to the minority investors to decide whether or not to go along with the transaction proposed by the controller. The crucial issue for the Court in Siliconix, therefore, was whether the cash out merger structure mandated a different result, on the issue of the target directors' duties, than would a tender offer freezeout.

The parallels between the situation of the minority investors in the *McMullin* merger and the tender offer freezeout before them in *Siliconix* were palpable to the Chancery Court, and they are discussed at length in the opinion. The opinion states that the public investors' need for guidance in these two contexts appears equivalent. It also states that the financial effects for the public investors in both transactional settings were largely analogous. They were each faced with taking the consideration approved by the controller or holding out in the hope of getting better value in an appraisal. In *Siliconix* the Court went so far as to refer to the different equitable standards applicable to cash out mergers and controllers' tender offers as an "anomaly." And the *Siliconix* Court, although it denied the injunction in the end, affirmed that target directors have fiduciary duties to the public investors in controllers' tender offers.

However (as was true in *Solomon*), in *Siliconix* the Court appears to have been unready to give affirmative content to the target directors' fiduciary obligations in the face of controllers' tender offers. In *Siliconix* the Court expressed the view that it would have to endorse "a new approach to assessing the conduct of directors of a tender target" if it were to rule in the plaintiffs' favor. Although this would arguably not be correct, in *Siliconix* the Court said that it would have to overrule cases such as *Solomon* in order to validate an active defensive role for the target directors. It's apparent in *Siliconix* that the Chancery Court was not then prepared to make such a bold move. Hence, no injunction issued against the tender offer freezeout, and the legal bias in favor of controllers in tender offer freezeouts persisted, indeed acquired greater momentum.

D. *Pure* -- New, Affirmative Protections Against Coercion

Pure was decided by the Chancery Court in October, 2002 – only fourteen months after *Siliconix*. It's apparent from the tenor of the *Pure* opinion that the Court had become increasingly sensitized to the strongly pro-controller bias that had grown up in the case law governing controllers' tender offers.[126] *Pure* is also the first occasion in which the Chancery Court expressly examined, at length, the combined effect of *Glassman's* holding that no equitable criteria apply in short form mergers and *Solomon's* relaxed attitude towards controllers' capacity for coercion in tender offers. Against this backdrop, *Pure* charts the beginnings of a more minority-protective posture towards controllers' tender offers.[127] In the *Pure* opinion, the Court appears intent on raising the level of protection afforded public equity holders by enunciating further fiduciary safeguards applicable controllers' offers. But it is also apparent that the Court is seeking to accomplish this objective in a way that will avoid providing minority stockholders greater room to sue controllers.

1. The Factual Setting of Unocal's Bid for Pure Resources

In *Pure* the minority shareholders sued for a preliminary injunction to stop the tender/exchange offer by Unocal Corporation, the controller of Pure Resources, Inc. Unocal was a True Majority Controller; it owned 65% of Pure's stock and thus possessed the votes required unilaterally to control the composition of Pure's board, to approve a cash out merger if the tender offer failed, and to block third party offers for Pure if any appeared. In fact, Unocal had declared its unwillingness to participate in a sale to a third party if one surfaced in the course of the freezeout negotiations.

Like Vishay in *Pure*, and Unocal agreed to abide by a majority-of-the-minority shares minimum tender condition, but Unocal (the controller in Pure) was more straightforward in committing to the short form merger (which would trigger appraisal rights on the minorities' behalf). There was also a big distinction in the quality of the Special Committees. At Pure Unocal negotiated with a Special Committee consisting of two non-management directors unaffiliated with the controller or its senior managers. It was given full discretion to select its own financial and legal advisers, and it availed itself of this freedom. On the whole, Pure's Special Committee appears to have been far more effective in advocating for the public investors than were the Committees in *Solomon* and *Siliconix.*[128]

Most dramatically, Pure's independent directors sought affirmation from the controller of their authority to pursue financial and transactional alternatives to Unocal's offer. But was where the controller drew the line: it denied the Special Committee's authority to do so. And it appears that this is where the Committee's defensive efforts ended. The Committee directors did nothing further to seek alternatives to the controller's tender offer freezeout or to thwart the buyout. But they were not wholly cowed: in the Schedule 4D-9 they refused to recommend in favor of the public's tendering to the controller.

In *Pure* the Court ultimately ruled in favor of granting the plaintiffs the requested preliminary injunction, in contrast to *Solomon* and *Siliconix*. The Chancery Court found curable defects in the structure of the majority-of-the-minority tender condition and the controller's disclosures.[129] The controller cured these defects and was able to proceed to consummate the freezeout (at a slightly higher price than originally contemplated).

2. Structural Coercion Benefiting Controllers in Tender Offers

In *Pure* the Court engaged in a detailed analysis of the several strands of fiduciary doctrine relevant to freezeouts. Based on the changes it endorses, it is apparent that the Court found the tender offer case law unsatisfactory. Specifically, *Pure* compares the underlying principles and assumptions in the *Solomon* line of cases to the *Lynch* doctrine (which applies to controllers' cash out mergers) and *Unocal* and its progeny (which apply to third parties' tender offers). In comparison to these bodies of fiduciary law, Pure ruled that case law proceeding from *Solomon* was too lax in its fiduciary mandates and thus excessively biased in favor of controllers. For instance, in comparing *Solomon's* influence in deals to the fair price duty pertaining to controllers in cash out mergers under *Lynch*, *Pure* observes that the *Solomon* tradition has provided minority investors only enough leverage to stop grossly unfair bids and not "merely inadequate" ones.

In *Pure* the Court begins by noting the litigants' disagreement about the applicable standard of review. The plaintiff claimed it was Entire Fairness, consistent with *Lynch*; the defendants—who ultimately succeed in their argument -- claimed it was the more deferential fiduciary standards contemplated by *Solomon*. The opinion explains that the selection of the standard of review has been dictated by formal structure: essentially, it's *Lynch* for cash out mergers and *Solomon* (in combination, now, with *Glassman*) for tender offer freezeouts. (In this regard, consistent with the earlier discussion, the Court misses the "patchwork quilt" dimension of freezeouts where controllers incorporate tender offers into cash out mergers and short form mergers into tender offer freezeouts.)

But rather than merely accepting this duality in the case law, in *Pure* the Court ambitiously explores whether it's been efficacious (and for whom). And it also considers whether the doctrines should be unified consistent with the higher fiduciary standards of *Lynch* or the more lower standards of *Solomon*. In the end, in *Pure,* the Chancery Court attempts to split the difference.

In considering the rationale and merits of the *Lynch* doctrine, *Pure* notes that doctrine's concern for "inherent coercion."[130] The opinion acknowledges that tender offer freezeouts don't conform to the classic structural paradigm of self dealing transactions, because the controller does not visibly operate through the board on the "sell" side of the transaction.[131] Instead, in a tender offer the controller speaks to the minority investors directly as a potential purchaser. The departure from the ordinary., paradigmatic self-dealing structure is deemed relatively unimportant by the Court, which finds that the controller has many other possibilities for profiting from the structural dynamics that operate in its favor in tender offers. For example, as in the tender offer in *Pure* itself, the controller can use its access to the target's board and senior management to obtain nonpublic information that it can use to its advantage in planning and negotiating the bid. In terms of timing, there is always the danger that the controller will take advantage of a short term dip in the public stock's trading price to buyout the minority at temporarily depressed prices.[132] And the controller's superior organizational clout is assured in light of the public investors being dispersed geographically and, potentially, in regard to their particular investment objectives.

Even if there are a substantial percentage of institutional investors within the public equity holders, these institutions only individually possess a small fraction of the company's outstanding stock. As the recent financial scandals illustrated, institutional investors' capacity to self-protect is impaired by a variety of institutional and organizational costs and conflicts. will each possess a very small percentage of the entity's overall outstanding stock. Certainly, compared to action taken by the controller, the action taken by the institutional investors is far more costly, less swift and less cohesive. And they will have to act through intermediaries, which will add to their proportionately higher transaction costs.[133] *Pure* also observes that controllers cannot compel the minority's elimination as they can through a cash out merger. But once again the Court finds a mitigating factor that argues in favor of equal protection in the tender offer context. That is, shareholders who vote "no" in a cash out merger may still accept the merger consideration if the deal succeeds; they would be swept along with the majority of the minority unless they elect appraisal. In comparison, shareholders who do not tender are likely to be left in a worsened situation if the offer closes, they would not have an "after the fact" opportunity to elect the tender offer consideration and no appraisal rights apply. In this respect, tender offer freezeouts impose more "coercive" pressure than to cash out mergers, where Lynch applies higher fiduciary safeguards as a reflection of this concern. In addition, in *Pure* the

Court acknowledges that the combined effect of *Solomon* and *Glassman* means that aggrieved stockholders will have little opportunity to present a claim of unfairness in equity, since most claims would be dismissed upon the controller's motion. And *Pure* concludes that inherent coercion would operate with equal force in tender offers – that there's no basis for minority investors to have less to fear from thwarting a tender offer freezeout than a cash out merger.[134] For the above reasons, in *Pure* the Court concludes that the difference between the protective approach embodies in the *Lynch* doctrine and the laissez faire approach embodies by *Solomon* are unwarranted. Indeed, *Pure* opines that they represents a "potential incoherence" in Delaware law. The Court observes that tender offer freezeouts even appear to be "the more dangerous form of going private deal" [135]

Pure next compares the fiduciary mandates affecting target directors in controllers' offers and those affecting target directors facing third parties' bids under *Unocal.* That is, in attempting to make sense of the relative absence of equitable protections in controllers' tender offers, *Pure* asks whether Delaware's general focus on activist boards is simply irrelevant in the tender offer context – whether tender offers represent a distinct doctrinal "space" where target directors' fiduciary duties are simply inapplicable. But this potentiality is flatly contradicted by the *Unocal* line of cases which afford target directors substantial defensive authority against third parties' unsolicited tender offers.[136] Once again, the *Solomon* line of cases are dismaying because controllers' tender offers would appear to represent "the more dangerous" kind of tender offer in comparison to outsiders' unsolicited bids.

The Court's dissatisfaction with the *Solomon* line of cases' implications for controllers' duties naturally leads it to question whether this case law should be folded into the *Lynch* doctrine. This result would seem warranted, since *Pure* concluded that minority investors face equivalent dangers of coercion and unfairness both freezeout structures. However, at this point in the analysis, logical or doctrinal analysis and precedent have run out as a basis for decision-making.

The Chancery Court therefore turns to an analysis of the policies underlying these bodies of equitable doctrine. It openly espouses the view that the objective of fiduciary doctrine in the corporate area is to reinforce the strength of the capital markets and the creation of financial wealth.[137] The opinion queries whether this objective is better advanced by endorsing robust fiduciary safeguards (which inspire investors to trust), or more porous ones that put a damper on suits and stimulate transactions that might otherwise have been discouraged by the fear of litigation. In *Pure* the Court concludes that *Lynch* is too "rigid" and has inspired too much fruitless litigation. *Pure* claims that this as a valid rationale for refusing to endorse the *Lynch* doctrine for controllers' tender offer freezeouts. Instead of recommending that Lynch be extended to controllers' tender offers, *Pure* endorses four new equitable criteria for determining whether a controller has exerted impermissible coercion in a tender offer freezeout. In regard to the "potential doctrinal incoherence" arising from there being two different levels of scrutiny addressed to freezeouts, *Pure* suggests that the problem should be resolved by "easing" *Lynch* – bringing it into line with this more "flexible" variation on the *Solomon* approach.

3. New Pre-Conditions for Business Judgment Deference

As previously described, *Solomon* had affirmed that in the absence of the plaintiff demonstrating affirmative coercive conduct by the controller, its tender offer would be *presumed* voluntary – and the minority investors would be regarded as capable of making a free choice whether or not to tender. *Pure* upends this presumption. After observing that coercive pressures inhere in the structural and organizational dynamics of controllers' tender offers, *Pure* endorses four objective tests for determining whether the controller has exploited or, alternatively, minimized these coercive pressures.

First, *Pure* provides that controllers must have refrained from making any express threats about taking retributive action if the tender offer freezeout is thwarted.[138]

Second, *Pure* endorses the kind of majority of the minority minimum tender condition that was present in the tender offers in *Solomon, Siliconix* and in *Pure* itself. The rationale for this, obviously, is to enhance the public stockholders' capacity to thwart an unsatisfactory tender offer if they act in concert.

Third, in order to limit the pressure to tender arising from fear of being left worse off on account of other investors tendering (the classic "prisoner's dilemma"), *Pure* provides that controllers must commit to do a short form merger if they obtain the shares necessary. This would ensure that the holdouts from the tender offer at least are afforded the option of taking the merger consideration, and would more often have appraisal rights. On this basis, *Pure* attempts to lessen the pressure to tender into bids perceived as inadequate.[139]

Finally, in order to counter the controller's superior informational status, *Pure* provides that controllers must allow independent directors on a Special Committee the time, freedom and access to independent advisers they require to arrive at an informed recommendation to guide the minority investors' decision making.

Pure contends that only where controllers have adhered to these standards, will they have ensured that the public stockholders can make a free choice in deciding whether or not to tender into the freezeout. Thus, *Pure* contends that only in this case should courts presume that the controller's tender offer is voluntary. *Pure* is a landmark case in its reversal of the presumption about voluntariness in controllers' tender offers, so that controllers have to do something for their deals to meet this expectation. Nevertheless, its proposals are ambiguous and incomplete in important respects.

4. Critical Analysis

First, it is important to observe that even where controllers allow for a nonwaivable, majority-of-the-minority approval condition, this doesn't make the controller's consolidation of power through the tender offer "voluntary" for the shareholders who do not tender. Once the controller appears intent on closing the offer, the shareholders cannot preserve the status quo. Rather, those who tender must live with the value conferred by the controller. As for the shareholders who elected not to tender, their shares are likely to be less liquid and less valuable upon the success of the controller's tender offer. In this sense the concept of "voluntary" tender offers is equivocal.

Pure provides for a minimum tender condition of a majority of the minority shares. But this can only be partially equated to the minority shares consent provision that operates within the *Lynch* doctrine. This is because there are dynamics within tender offers that favor tendering. Chancellor Jacobs makes this point in his opinion in *Emerging Communications*.[140] As stated above, controllers' timing, informational and organizational advantages are exacerbated in tender offers. Because no proxies must be circulated or votes returned and tabulated, tender offers usually proceed on a more accelerated time frame than do cash out mergers. And brokers' financial incentives may generate pressure for investors to tender to the controller. Furthermore, as *Pure* observes, shareholders who vote "no" in a merger have the opportunity to benefit from taking the deal consideration if the transaction closes – but shareholders who do not tender have no credible alternatives to the (now even more depressed) market price. For these reasons, the forces operating to effectuate tenders by at least a majority of the outstanding public shares represent a distinct phenomenon, noncomparable to shareholder voting. And, in any event, under the *Lynch* doctrine, the (voting) consents by a majority of the public shares have been efficacious only to shift the burden of proof; *Pure* would tie the "easier to obtain" minority shareholder tenders to the adoption of the more defendant-friendly "business judgment" standard of review. This is an example of *Pure's* attempt to establish a middle ground between *Lynch's* rigor in favor of minority's and *Solomon's* laissez faire in favor of controllers. But it appears incorrect to interpret *Pure* as establishing a true middle ground (even accepting that a middle ground was satisfactory).

Pure's "90%-short form merger" provision is less efficacious for minority investors than it might first appear. *Pure* provides that coercion operates (and will be presumed) where a controller fails to commit to liquidate the non-tendering "stub" investors through a short form merger (at the same price as the tender offer) if it obtains the shares necessary to do so. Read squarely, however, this provision would allow controllers to creep up close but remain just below the 90% level and avoid the application of Pure's provision. Controllers could effectuate the final purchases to obtain the 90% share ownership requisite for the cash out merger at a later date and potentially at a lower price than was offered in the tender offer.[141] In effect, this kind of minute, tactical calculation is "fair game" for controllers in a world where equity has eschewed a fair dealings requirement in favor of more manipulable objective requirements. Of course, where the controller's commitment to effectuate the short form merger is indefinite, this generates substantial pressure on the public investors to tender into the controller's offer.[142] This is, in fact, the basic problem identified but not resolved by *Pure*'s "90% provision." In a world where *Pure's* "90% provision" applies, controllers would simply avoid committing to a 90% minimum tender, going forward and so the minority investors facing the tender offer would never be assured the "back end" short form merger would materialize. Therefore, a "cost" attendant to holding would be the possibility of finding oneself in a delisted state of financial "limbo." This is a particularly scary kind of limbo since under *Glassman*, no equitable fair price or fair dealings requirements apply even if the short form merger eventually occurs.

But the most problematic feature of *Pure's* responses to controllers' capacity for overreaching in tender offer freezeouts (as a result of the coercive pressures inherent therein) is revealed in what the opinion declines to do. In *Pure* the Court afforded no separate significance to the Special Committee's disapproval of the controller's offer in the Schedule 14D-9. Consistent with *Solomon*, in *Pure* the Court focused on the conduct of the controller and generally eschews attributing separate significance to the actions or inactions of the independent directors in regard to defending the minority investors' interests. (Even more significantly, as in earlier decisions, the Court declined to validate independent directors' defensive authority in responding to controllers' offers. And it did so expressly in *Pure*, since the Special Committee sought such authority.[143]) But even sticking with the Committee's more limited role in opining about the offer, the Court declined to shape the standard of review to take account of a Special Committee's disapproval of the controller's tender offer. By declining to give the Committee's opinion about the offer independent significance in affecting the standard of review, the Court denied that the Special Committee's disapproval mandated a judicial presumption that the offer was unsatisfactory. In effect, *Pure's* criteria for controllers' tender offer freezeouts endorses a legal standard that expressly disregards the judgment of disinterested, independent directors charged with acting in the best interests of the public investors. This is a remarkable omission from a Court that has expressly embraced the concept that the judgment of independent directors is of paramount importance in the construction of corporate law. And for this reason, as described hereinafter, *Cox* recants this feature of *Pure's* Special Committee provision.

E. *Cox* Adds Another (Ambiguous) Committee-Related Safeguard

Cox expands upon the four equitable requirements for deferential review in tender offer freezeouts enunciated in *Pure*. In particular, *Cox* proposes that where a Committee has disapproved of the controller's offer, and the controller proceeds with the buyout in any event, the transaction should not be presumed voluntary. If *Cox's* proposed reform are accepted, then in this circumstance the controller would have to prove the deal's inherent fairness in a suit.[144] In this proposed reform, the Chancery Court recants the part of *Pure* that gave no weight to a Special Committee's disapproval of the controller's offer.

Before continuing with the analysis of *Cox's* proposal relating to a Special Committee's published opinion of the transaction (the *Cox* "Committee Opinion Provision"), the discussion below surveys the capital market and legal developments in this period that would have influenced the Court to give greater weight to the judgment of independent directors in freezeouts.

1. Legal and Capital Market Developments Immediately Preceding *Cox*

Pure was decided in October 2002, only a few months after the enactment of SOX. The *Cox* opinion issued in June 2005 in a period in which the reforms instigated by SOX were being assimilated into the system of corporate governance at both the national and the state level.

In the period around *Sox's* enactment and thereafter, the rate of going private transactions accelerated. Some commentators attribute this increased going private activity to the greater regulatory costs associated with *Sox*.[145] It is equally plausible, however, that the relative stagnation in the capital markets that produced discounted stock market prices, as well as the ready availability of financing for going private deals, influenced this trend. In addition, many of these controlling shareholders seeking to go private had only recently taken their firms public during the heyday of high stock market valuations in the 1990s. This phenomenon of controllers "going public high" and turning around shortly thereafter to "go private low" -- when "regular," outside investors were often coping with substantial investment losses – suggested the kind of insider opportunism that the Delaware Courts have tried to discourage and remedy. The Delaware Courts' sensitivity to insider self dealing by corporate fiduciaries would have been accentuated, also, by the series of major corporate looting, excess compensation and fraudulent accounting scandals that came to light in this period – that is the period immediately after *Pure* and prior to *Cox.*

In this same period there was continued emphasis on corporate governance reform at the national level, most saliently through SEC and SRO rule making.[146] These reforms particularly highlighted the salutary effects of promoting the service of genuinely independent directors on corporate boards. In its proposed reforms for freezeouts in both structures, *Cox* analogously validates reliance on independent directors' decision making in freezeouts, as a basis for deferential review.

Also in this period, Vice Chancellor Strine (who authored *Pure* and *Cox*) became familiar with the data presented in the Harvard Law School working paper mentioned earlier. This data emphasized the salutary role of Special Committees in garnering enhanced premiums on behalf of minorities in cash out mergers.[147] Finally, *Cox* cites an influential law review article on freezeouts authored by Professors Gilson and Gordon which had gently criticized *Pure* for not further endorsing the authority of Special Committees in promoting minorities' interests in freezeouts.[148] These contemporaneous legal reforms and sources of influence would have shaped the Chancery Court's renewed emphasis on the role of independent directors in freezeouts.

However, in this same period, certain opinions from the Chancery Court expressed extreme frustration with the demands of deciding valuation-related cases of the kind involved in Entire Fairness cases. And although Professors Gilson and Gordon had criticized the *Solomon* line of cases' bias in favor of controllers, other influential law review articles published in this period objected to Delaware's fiduciary standards as favoring, promoting and prolonging meritless shareholder suits.[149] As stated in the Introduction, many of these complaints about class action suits in freezeouts echoed the complaints which had been directed at federal securities class actions prior to the enactment of the PSLRA. This gave these claims and criticisms increased traction.

In sum, at the same time that it affirms target directors' fiduciary duties and their crucial role in freezeouts, *Cox* loudly echoes these complaints about Delaware law promoting excessive stockholder litigation. By the time it was called upon to rule in *Cox*, the Chancery Court was (i) concerned about the accumulated inconsistencies in its freezeout doctrine and the bias in favor of controllers in the *Solomon* line of cases, (ii) impressed by the argument in favor of giving independent directors greater authority in freezeouts and (iii) alert to the dangers of corporate legal doctrine facilitating stockholder suits. Cox attempts to reconcile these different concerns and impulses in its proposed reforms to freezeout doctrine. This, in part, explains why its Committee Opinion Provision for tender offer freezeouts is ambiguous and internally inconsistent.

3. Ambiguities in *Cox's* Special Committee Provision

a. What Does *Cox's* Special Committee Recommendation Require?

As was true in relation to *Pure's* Committee provision, it would be easy to confuse or exaggerate what *Cox*'s Committee Opinion Provision says and does. First (again like *Pure*), *Cox* does not provide that controllers have a fiduciary duty to establish a Special Committee at the target to represent the minority investors in a tender offer freezeout. Rather, like *Pure*, *Cox* merely assumes that a Special Committee will be formed as a matter of "best" practice.[150] (It's not clear how far a controller can go in thwarting the establishment of a Special Committee in a tender offer freezeout without this being coercive; the bright line, objective standards in *Pure* and *Cox* do not address the issue.) Taking this a step further, as in *Pure*, *Cox* declines to validate a fiduciary duty on the part of target independent directors to block a controller's suboptimal bid or pursue alternatives in the market. Cox's Committee Opinion Provision is intended to affect only the applicable standard of review as it relates to the controller's obligations to the minority.

Second, the *Cox* opinion actually includes two very different versions of the Committee Opinion Provision. In the early part of the opinion, the Court provides for deferential review in a tender offer freezeout if the Special Committee has not disapproved of the controller's tender offer. Towards the conclusion of the opinion, in contrast, *Cox* calls for deferential review where the Committee has approved of the controller's offer. The latter (required approval) provision is much more restrictive than the disapproval provision. Because Committee's can elect neutrality in the 14D-9, and will have a great incentive to do so after *Cox*, these alternatives are not mirror images of one another.[151]

b. Cox's Committee Opinion Provision as Applied Tactically in Negotiations

In relation to how Cox's Committee Opinion Provision is likely to operate in practice, controllers will surely threaten to rescind their offer if the Committee disapproves.[152] This threat will have some bite since the Committee's disapproval, under Cox, would mandate that the controller prove the freezeout's Entire Fairness in a suit. The controller's threat to rescind will put great pressure on Committees not to disapprove of controllers' freezeout offers. In addition, even if Cox's proposed reforms are all accepted, the Controller can tell the Committee directors that they have no duty to defend the minority investors' interests in the tender offer freezeout. The Controller will remind the Committee, again accurately, that equity has always emphasized minority investors' capacity to make their own choices regarding whether to sell to a controller in a tender offer. And the Controller will remind the Committee that there is no legal fair price requirement in this setting. Each of the above factors will weigh in favor of the Committee assuming a stance of neutrality, in the "worst" case. For all these reasons, Cox's Committee Opinion provision is a very loose, foreseeably ineffective safeguard.[153]

c. *Cox's* Committee Recommendation Provision in Broader Context

It's not accidental, then, that the *Co* opinion does not present the Committee Opinion Provision for controllers' tender offers as a significant, additional protection for minority investors. In this regard, the tenor of *Pure* is very different from *Cox*. The Chancery Court in *Pure* expresses considerable concern about controllers' capacity for coercion in tender offer freezeouts. This concern is expressed minimally, if at all, in *Cox*. In *Cox*, the Committee Opinion provision comes into the discussion, effectively, as an aside. (*Cox* involved a cash out merger and thus the discussion of what standards should apply in controllers' tender offer freezeouts was in essence gratuitous therein). It appears in the Court's discussion of its proposed reforms for freezeouts as a byproduct of the plan to unify the two bodies of case law. *Cox's* Committee Opinion Provision is intended to complement the reform proposals envisioned in *Pure*, but the objective of protecting minority investors is not first and foremost on the Court's agenda in *Cox*. The *Cox* opinion's principal preoccupation appears to be creating a unified doctrinal framework for freezeouts that will provide some support for minority investors in their negotiations with controllers while minimizing stockholder litigation in freezeouts.

F. Summary – Residual Ambiguity in the Standards for Tender Offer Freezeouts

As the above discussion demonstrates, the Supreme Court has considerable leeway to depart from the existing and proposed doctrinal framework and chart a new course for controllers' tender offer freezeouts. The existing legal standards for tender offer freezeouts, as described above, are thinly rooted in precedent, ambiguous and disconnected with the broader outlines of Delaware's transactional choreography for M&A deals involving conflicted corporate fiduciaries. They fail to do justice to protecting the interests of minority investors in these deals. In particular, the largely passive role accepted for directors in tender offer freezeouts is inconsistent with the active role equity envisions for independent directors in third party tender offers. This inconsistency exposes the infirmity in Delaware's tender offer freezeout doctrine.

Cox's attempt to reform the tender offer freezeout case law founders as it runs up against the Chancery Court's larger objectives of unifying freezeout doctrine and minimizing stockholder litigation. Equity's commitment to protecting public investors' interests in freezeouts is undermined in the process. As outlined in Part V, the better course to "easing" *Lynch* is endorsing Entire Fairness for both freezeout structures, and allowing deferential review upon a bona fide auction or market check only.

III. *CYSIVE'S* AND *COX'S* CRITIQUES OF ENTIRE FAIRNESS REVIEW

This Part III analyzes the deficiencies in the *Lynch* doctrine that are discussed in the Chancery Court's opinion in *Cysive* and *Cox*; it demonstrates that these criticisms are largely exaggerated. Neither *Cysive* nor *Cox* present persuasive reasons for the Supreme Court to endorse a departure from the Entire Fairness standard in cash out mergers. Indeed, the benefits of applying Entire Fairness, which are also described hereinafter, suggest that it should be applied to tender offer freezeouts as well.

A. *Cysive's* Critique of Entire Fairness Review

1. Overview of the Opinion and Cash Out Merger in *Cysive*

Cysive exaggerates several problems it attributes to the *Lynch* doctrine and the Entire Fairness standard.[154] To illustrate *Cysive's* hyperbole, this section reviews the Court's reasoning as it applies to the transaction disputed by the parties. As demonstrated herein, in *Cysive* the Court could have resolved the dispute through a motion to dismiss or motion for summary judgment, had the defendant so desired. It could have done so, moreover, without departing the fundamental tenets of the *Lynch* doctrine.

The *Cysive* opinion recites the findings of the Chancery Court in a disputed cash out merger after a full trial on the merits. Mr. Nelson Carbonell, the controller of Cysive, Inc. was seeking to acquire the remaining public equity of Cysive through a cash out merger. Cysive had become financially distressed as a result of technology market changes and a failed business reorganization plan.[155] Cysive's board – both the independent and management directors, agreed that fundamental change was required if Cysive was to avoid a liquidation. Accordingly, the controller, the board and a financial advisory firm all searched for an outside buyer. No credible offers were received, however. Although the search for a third party buyer was ongoing, Carbonell offered to acquire the outstanding public equity. His proposal contemplated a premium over the public equity's trading price and Cysive's liquidation value.[156] Carbonell's plans were being impeded by the minority investors' request for a preliminary injunction against the freezeout; for this reason he sought an expedited, full trial to resolve all the outstanding issues and finalize his financing.

2. *Cysive* on *Lynch's* Inefficiency

As was true in *Pure,* the Cysive opinion begins by noting the parties' disagreement over the applicable standard of review. The parties' disagreement was based on different views about whether Carbonell fit the definition of being a "controller" for purposes of the *Lynch* doctrine. The plaintiffs, of course, argued that he was, so that Entire Fairness was the appropriate standard of review.

In *Cysive* the Court proposes that the answer was not self-evident on account of the fact that Carbonell owned approximately 40% of the shares, liberally construed, and thus did not possess outright voting control. However, in addition, he was an active executive, indeed Cysive's CEO, as well as its founder. Combining his stock ownership with his actual, hands-on managerial authority, it was clear that Carbonell had the kind of power of importance to a Court's application of the *Lynch* doctrine – that is, the power to coerce or compel a freezeout if he so choose. On this basis, the Court ruled that Entire Fairness applied in the trial.[157] *Cysive* reflects an expansive approach to the scope of the Entire Fairness standard, but not a truly unorthodox one.

Far more unusual is *Cysive's* statement that determining whether a controller is present (which will determine the standard of review) is a matter of such complexity under *Lynch* that it cannot be resolved on the pleadings (that is prior to a full trial or at least extensive discovery in anticipation of a full trial).[158] The Chancery Court also states, in *Cysive,* that this is true also of the burden of proof – that it cannot be resolved on the pleadings.[159] More broadly, *Cysive* states that the *Lynch* doctrine inevitably "entangles" the Court's analysis of threshold questions with matters pertinent to the resolution of the merits of the case.

On this basis, the Chancery Court in *Cysive* contends that the *Lynch* doctrine is fatally flawed; that it generates gross inefficiencies. As stated by the Court: "our law has so entangled the standard of review determination with the ultimate decision on the merits that the two inquiries are inseparable." The opinion contends that the parties to the dispute, facing this conundrum, have declined to make duplicative presentations of the facts of their case – that is, to do so in motions and again at trial. Instead, *Cysive* states, they have been forced to elect the paradoxical but pragmatic approach of awaiting the conclusion of a full trial in order to learn what standard of review applied and who possessed the burden of proof.

As support for this observation, *Cysive* points to the fact that neither party in the case requested that the standard of review or burden shift issue be resolved pre-trial. But in doing so the Court failed to note that the procedural posture of the case was highly unusual because the defendant did not seek an expedited resolution of the claims. Again, it was the controller himself who sought a full trial in order to resolve the outstanding claims and accelerate his ability to obtain financing. For this reason, *Cysive* hardly stands as a model of *Lynch's* dysfunctionality.

3. The Importance of Who Has the Burden of Persuasion

At the same time that *Cysive* complains that *Lynch* makes consideration of the burden of proof issue inseparable from consideration of the merits of the case, it also contends that the allocation of the burden of proof between the parties is of trivial importance. According to the Court, the "practical effect of the *Lynch* doctrine's burden shift is slight." If the allocation of the burden of proof were indeed of trivial importance, then the Court's antipathy towards *Lynch* would be more comprehensible. However, it's very unclear that there is widespread agreement that the allocation of the burden of proof is a trivial matter.[160] In *Cysive*, the Court expresses the view that "shifting the burden of persuasion under a preponderance standard is not a major move, if one assumes, as I do, that the outcome of very few cases hinges on what happens if the evidence is in equipoise."[161] In stark contrast to this view, in a recently published retrospective of Delaware Supreme Court decisions, former Chief Justice Norman Veasey writes that "... burdens and standards of review are often outcome determinative."[162] And more broadly, a fundamental tenet of corporate fiduciary loyalty doctrine is that once self-dealing has been established, the defendant has the burden of demonstrating the challenged transaction's fairness.[163]

As a matter of actual litigation practice, furthermore, *Cysive's* presumption that Courts objectively weigh each individual fact in isolation and then proceed to "total" the results to see who has won seems unrealistically formalistic. It isn't even apparent that this is what the equity courts are supposed to do; it certainly seems inconsistent with the more intuitive analysis of the overall complexion of the facts that is equity's hallmark. It seems more realistic that the Court's background, starting assumption about the burden of proof, and standard of review, shapes the Court's analysis overall. On this bases these determinations would be highly important to the case.

4. The Entanglement Criticism against *Lynch*

It isn't clear in Cysive that the Court could not legitimately have resolved that Carbonell was a controller based on the pleadings. The Court possessed clear information about his stock holdings, as well as his role in management. On this basis it had the information to resolve that Carbonell was a controller as a matter of law.

This should have constituted adequate evidence to resolve that the Entire Fairness standard applied.

There was also undisputed evidence that the directors on the Special Committee conformed to the accepted legal standard of being "independent." There was similarly dependable evidence demonstrating that they actively and effectively negotiated with the controller and sought market alternatives to his freezeout proposal at the same time. The Court had evidence that the independent directors met twenty one times, contacted thirty-seven potential buyers and hired two different, reputable, unaffiliated ("independent") financial advisers to do valuation analyses of the company. In addition, the Committee several times negotiated down the controller's requested termination fee, refused his preliminary bids and denied his request to cut off third party offerors. Once this kind of objective evidence exists, the Courts should be able to resolve whether there is prima facie evidence of fair dealings in order to assign the burden of proof in *Lynch* cases. Indeed, the market check in Cysive is a nearly textbook example of prima facie evidence of fair dealings and represents precisely the scenario where this Article proposes that Courts should presume the freezeout's fairness and refrain from investigating the merits of the complaint in a stockholder suit.

In regard to the general validity of the entanglement critique,[164] it seems unreasonable to assume that the *Lynch* doctrine is far more complex than other bodies of civil law. The bite of the entanglement critique comes from *Cysive* representing *Lynch* as an outlier in this regard. But there are many areas of civil law in which the Courts engage in substantial pretrial hearings to resolve preliminary questions such as the appropriate standard of review, the allocation of the burden of persuasion and the relevance of affirmative defenses.[165] These determinations would often require the parties to litigate pretrial motions and, thus, necessitate some duplication in their presentation of the facts of their case. And yet in other contexts, this has not given rise to widespread criticisms of the law as being grossly inefficient. In the alternative, it is reasonable to assume that by progressing through a suit in foreseeable increments (that is hearings, motions, etc.) the parties can gradually take stock of whether they are better off continuing to litigate or deciding to settle or drop their claims.[166] Assuming the operation of reasonable limits on attorneys' fees, there would not seem to be anything grossly inefficient or abusive about this process.

Cysive states that "few defendants have sought a pre-trial hearing to determine who bears the burden of persuasion on fairness." This is a broad, empirical generalization, of course. But it isn't clear what the evidence for this generalization is, beyond the *Cysive* case itself. The Court does not cite other decisions where there's been a full trial prior to an adjudication of the burden shift and standard of review issues.

To bolster its legal conclusion about *Lynch's* "entanglement" problem, *Cysive* cites a recent Supreme Court decision, *Krasner v Moffett.* Quoting from *Krasner*, *Cysive* states: "[r]ecently the Supreme Court expressly held that defendants could not meet their burden to prove a valid special committee process at the pleading stage and that a full factual record had to be developed." The language from *Krasner* cited by the Court is ambiguous. As presented in the opinion, it almost seems like the Supreme Court in Krasner resolved, as a matter of law, that it is impossible to resolve whether a Special Committee's approval passes muster on the pleadings. But this conclusion is tenable only if the language from *Krasner* is read out of context. Interpreting the statement in context, it is clear that the Supreme Court did not intend to make such a generalization. Thus, *Krasner* does not provide support for *Cysive's* claim that *Lynch* forces full trials on account of entangling threshold questions with the substance of the merits of the case. doctrine. It therefore seems that *Cysive* is at least premature in its conclusion that *Lynch* has distorted the system of equitable adjudication by forcing full trials in states of absurd uncertainty or forcing grossly inefficient, duplicative presentations of the same evidence in a disputed freezeout.[167]

6. Pleadings Requirements under *Lynch*

Cysive presents another provocative, contestable assertion about freezeout doctrine – one that becomes critical to *Cox*'s criticism of *Lynch*. In *Cysive* the Court contends that plaintiffs can always go forward with a full trial so long as they "produce evidence creating a genuine dispute of fact regarding the economic unfairness of the transaction." The controversiality of the statement depends on how one interprets what constitutes a "genuine dispute of fact" regarding economic fairness. It is hard to argue with the idea that plaintiffs should be allowed to go forward where they present a *genuine* issue of economic unfairness.

At other times, however, *Cysive* contends that plaintiffs can always present enough of a claim of economic unfairness in order to proceed to a full trial because economic fairness is always contestable. But it simply isn't clear that the Court would allow a complaint to go forward under *Lynch* on the basis of any allegation of financial unfairness. Neither *Weinberger* nor *Lynch* provide for this.

And separate from the pleading issue, where financial fairness is the sole claim alleged by the plaintiff, it isn't entirely clear that an equitable action would be available under *Lynch*. The point has never been squarely addressed by the case law. *Weinberger* expressly held that a plaintiff was required to demonstrate some basis for invoking the fairness obligation – and as the Court did so it was addressing the subject of *unfair dealings*. The Courts have never precisely addressed whether a claim can go forward in equity where there is no credible claim of unfair dealing, but merely a dispute about valuation.[168]

B. *Cox's* Arguments Against Entire Fairness

1. The Cash Out Merger in *Cox*

The cash out merger in *Cox* exemplifies many features of modern freezeouts. The *Cox* family proposed a buyout of the public shares in Cox Communications, Inc., a

Delaware company in the broadband communications business. The company's public equity was traded on the New York Stock Exchange at the time the family announced its freezeout proposal. The controlling family had previously taken the company public and then private and then public again, consistent with its interests.[169] As stated in the opinion: "At various times, the Family has found it convenient to take Cox public, in order to raise money from the public capital markets. At other times, the Family has found it preferable to run Cox as a private company." At the time the family announced the recent freezeout bid, in the fall of 2004, it held 74% of the voting power and had representatives filling a majority of the board's seats, including the Chairmanship. The family was thus unequivocally a controlling shareholder as defined under the *Lynch* doctrine.

The family's initial $32 bid represented a 14% premium over the average trading price of Cox's listed shares (measured over the previous thirty days); the final price agreed to by the Special Committee and the minority shareholder plaintiffs counsel was $34.75. In the minority's interest, the family had agreed to consummate the freezeout only if it reached agreement with the Special Committee over final merger terms and if the Committee obtained a fairness opinion from its financial advisor. Less favorably for the minority, the family announced that it was unwilling to allow a market check or sale of the company, which would have tested its bid against going concern value.[170] This limited the Special Committee's ability to evaluate the real merits of the controller's offer, of course.

Consistent with the established transactional choreography for cash out mergers, the Special Committee was aided by independent legal advisers (Fried, Frank) and financial advisers (Goldman Sachs). Once the controller and Special Committee arrived at final terms, the merger was also ratified by the full board, on behalf of the company. After the merger agreement had been signed, the Cox family initiated a tender offer for the minority's shares, consistent with minimizing the potential costs of appraisal proceedings.[171] After it owned in excess of 90% of the company's shares, the family completed the freezeout through a short form merger.[172] The Stipulation of Settlement reflecting the final $34.75 price per share had been ratified as reasonable by the Chancery Court a month earlier.

2. The Goal of Reshaping Freezeout Doctrine

Coming two years after *Cysive, Cox* deepens and expands the Chancery Court's vitriolic criticisms of the *Lynch* doctrine.

In *Cox* the Chancery Court was called upon to resolve an objection to the plaintiffs' attorneys' fee request in the settlement of a cash out merger governed by *Lynch*. From the outset it's apparent that the Court is ill-disposed towards the plaintiffs' lawyers, who it describes disparagingly, on several occasions, as having filed "premature, hastily-drafted makeweight complaints." Notionally, the Court's survey of the several strands of equitable doctrine pertinent to going private serves as background to its determination over whether or not to approve the fee – but it becomes apparent almost immediately that there are broad law reform objectives at stake in *Cox*.

Cox surveys what it describes as the general characteristics of suits and settlements in cash out mergers announced as negotiable deals. In particular, it attests to a pervasive pattern of contemporaneous, triangular negotiations between controllers and Special Committees and controllers and attorneys representing the public stockholders. At one point *Cox* does observe that its criticisms of the "perverse incentives" generated by Entire Fairness review are relevant almost exclusively to cash out mergers announced as negotiable offers. That is, the opinion indicates that an entirely different pattern of suits and settlements applies when freezeouts are announced after the freezeout's crucial terms have been set. However, this caveat is most frequently overlooked in course of *Cox's* vituperation about forced settlements and unearned attorneys' fees under *Lynch*.

However, if *Cox* is correct that the routine payment of "forced" settlements and plaintiffs' lawyers' fees accost controllers in cash out mergers announced as negotiable offers, it's unclear why controllers wouldn't be able to bypass these costs and problems. Consistent with *Cox's* description of the problem, controllers could do so simply by waiting to announce their deals publicly until they'd reached an agreement in principle with the Special Committee. This would appear to represent an optimal, private solution to the litigation agency costs that are *Cox's* chief complaint against *Lynch.*

It's hard to avoid the conclusion that *Cox's* attention goes elsewhere because "self-help" by controllers won't effectuate doctrinal reform. It won't unify the case law for both freezeout structures and establish the business judgment rule as a routine bar to most stockholder claims in freezeouts. Nor will private solutions by controllers solidify Delaware's position at the forefront of corporate governance reform while signaling Delaware's support for the popular opposition to class action suits. This is to say that like *Cysive*, the *Cox* opinion reflects a sweeping ambition to effectuate law reform for freezeouts.[173]

Nevertheless, to its credit, in *Cox* the Chancery Court had an unusual opportunity, procedurally speaking. Despite equity's tradition of deciding only the case before it,[174] because the fee dispute involved the Court in reviewing a settlement of a class action, the Court had substantial leeway to enunciate its vision for reforming freezeout doctrine.

Cox's Committee Opinion Provision for tender offer freezeouts was discussed earlier. This Part of the Article focuses on *Cox's* criticism of the Entire Fairness standard (which has applied only to cash out mergers to date).

3. *Lynch* & Dismissals on the Pleadings

One of *Cox's* most frequent criticisms of *Lynch* is that it prevents even vacuous unfairness claims in freezeouts from being resolved in an expeditious manner – that is, on motions to dismiss ("Nondismissability"). *Cox* is adamant about this. It states, for example, "Unlike any other transaction one can imagine ... it was impossible after *Lynch* to structure a merger with a controlling stockholder in a way that permitted the defendants to obtain a dismissal of the case on the pleadings." In addition, for emphasis, *Cox* describes a hypothetical cash out merger in which a controller offered a 25% premium to the market price and allowed for every conceivable procedural protection for the public investors, only to have its motion for a dismissal denied. The Court states that Nondismissability is inevitable under *Lynch* because "financial fairness is always a debatable issue."[175] *Cox* contends that contends that even "premature, hastily-drafted, makeweight" complaint go forward and operate, in effect, as a tax on controllers' freezeout bids. The opinion explains that because complaints under *Lynch* are Nondismissable, controllers settle them rather than pay the additional cost of defending against further protracted litigation. The deplorable result of this abusive litigation, *Cox* contends, is that it chills some controllers from ever proposing a freezeout bid. According to *Cox*, the *Lynch* doctrine has "deterred the procession of [freezeout] offers that provide valuable liquidity to minority stockholders and efficiency for the economy in general."

Cox also describes how plaintiffs' attorney's fee incentives favor their settling early. According to the opinion, the plaintiffs' lawyers can score a quick, low risk fee by settling at the same improved price endorsed by the Special Committee. The plaintiffs' lawyers defend their decision to settle on the rationale that some premium is better than none[176] – even if it isn't close to going concern value. On a sense, it's difficult to fault the plaintiffs' lawyers' because they are not under a fiduciary duty to obtain going concern value for their minority investors – as are controllers. In sum, it's apparent that the Court believes that the *Lynch* doctrine is undermining the creation of value in the acquisitions market and distorting the integrity of the litigation system.

But the doctrinal basis for the belief in Nondismissability is not as clear; *Cox* never explains it in detail.[177] Perhaps, as a variation of the entanglement concept in *Cysive*, the Court in *Cox* is assuming that the issues relating to fair price and fair process under the *Lynch* doctrine are too complex and fact-intensive to be resolvable pretrial. In that case, the same objections to this line of reasoning discussed earlier in relation to "entanglement" in *Cysive* apply here.

Or, perhaps the Court interprets the *Lynch* doctrine as mandating, as a matter of law, that any allegation of unfairness can go forward. However, nothing in the doctrine – in *Weinberger* or *Lynch* or related cases suggests that plaintiffs are relieved of demonstrating a genuine issue of triable fact. To the contrary, *Weinberger* expressly endorses the principle that a plaintiff must make an initial showing of unfairness to proceed. What is palpable, however, from the opinion's harangue against Lynch is that it is frustrated by the demands of resolving valuation-related suits, like those that arise under the Entire Fairness standard in freezeouts.[178] This burden isn't going away if *Lynch* is dismantled, however, since the Chancery Court also hears appraisal actions. And the Court's frustration with not being able to get valuation "perfect" shouldn't become a rationale for minimal judicial oversight without the Court being satisfied that the minority investors were put in a position meaningfully to bargain with the controller. And even the Entire Fairness standard, as it has operated, has not given target independent directors to unleash real market forces in the process, for the minority's benefit.[179]

It's also troubling that the *Cox* opinion never entertains the possibility that controllers settle Entire Fairness claims because they obtain a genuine, net financial benefit from so doing. The benefits for controllers of settling early in state cases come more fully into view in light of the holding in *Matsushita Electric Industrial Co., Ltd v Epstein*.[180] In *Matsushita*, the United States Supreme Court affirmed that the settlement of claims in state court can also bar the future litigation of federal disclosure claims, so long as the claims would relate to the same overall transaction.[181] Settlements and plaintiffs' attorneys' fees paid by controllers in federal securities law claims tend to be significantly larger than those in Entire Fairness claims under *Lynch*, [182] so that controllers would have a significant financial incentive to preempt the potential for litigation in federal court. In addition, the approvals of independent directors and minority shareholders are irrelevant to defendants' ability to obtain a dismissal of disclosure claims under the federal securities laws, as are charter exculpation clauses. Finally, indemnification agreements are considered unenforceable under the securities laws as contrary to public policy. In sum, in light of *Matsushita*, it's entirely plausible that controllers enjoy a net financial benefit from offering lower prices, anticipating suits and reaching a comprehensive settlements in state court that will bar future federal claims against the freezeout.

There is a further paradox in *Cox's* description of Nondismissability under *Lynch*. *Cox* maintains that claims under *Revlon* are not uncommonly dismissed on the pleadings, but *Lynch* claims cannot ever be.[183] Even allowing for some hyperbole, the disparity is difficult to comprehend at the level of doctrine. Under *Revlon*, in a stockholder suit the Court is called upon to ascertain if the directors exerted their maximum best efforts to obtain the highest price reasonably available for the public stockholders.[184] The doctrine further complicates matters by providing that there is no one blueprint for determining how directors should act to obtain the best price for the company in a sale. Thus, stockholder claims under *Revlon* seem to involve a similar mixture of substantive, economic issues ("best price reasonable available") and process based safeguards ("best efforts," "good faith") as do *Lynch* claims. So it's difficult to distinguish a doctrinal basis for why *Revlon* claims would be dismissable on the pleadings, but *Lynch* claims "would not ever be."

Rather than what is inherently at stake in the two doctrines, the salient difference seems to be that *Revlon* claims are typically brought against target company independent directors individually, whereas controllers under *Lynch* are most commonly parent companies or other corporate entities. Although there are frequently independent directors who are named in Entire Fairness suits in freezeouts, they almost always manage to avoid the imposition of direct, personal liability.[185]

Delaware's fiduciary law evidences a deep reluctance to find independent directors liable for breach of duty.[186] If *Revlon* claims are commonly dismissed and *Lynch* claims less so, as *Cox* indicates,[187] this may say very little about the merits of complaints under *Lynch* and the incidence of overreaching by controllers, but a great deal about Delaware's concern for attracting and retaining nonmanagement directors on corporate boards. Read in this way, the disparity would not indicate any shortcoming in the *Lynch* doctrine.

4. Reasonable Attorneys' Fees under *Lynch*

The *Cox* opinion goes to great lengths in describing how Lynch forces controllers to pay unearned, excessive fees to plaintiffs' lawyers.[188] Indeed, *Cox* states that the "incentive system that *Lynch* created for plaintiffs' lawyers is its most problematic feature." *Cox* disparages the conduct of plaintiffs' lawyers in freezeouts under *Lynch* on the whole; it represents suits filed in these cases as being, essentially, an expression of plaintiffs' lawyers' venality."[189]

However, logically speaking, if the principle problem the Court attributes to the *Lynch* doctrine is that it encourages the payment of excessive or unearned attorneys' fees, the Chancery Court has ample judicial authority and practical means to remedy the situation directly. Certainly it can do so without overhauling equity's approach to going private transactions, moreover. Indeed, because the Chancery Court is already required to review all settlements in class actions to inhibit abuse,[190] it should not be difficult at all for the Court to adjust the relevant fee doctrine (which is not governed by the *Lynch* doctrine) to limit the fees paid by controllers to plaintiffs' lawyers.[191]

In regard to the specifics of the fee doctrine applicable to *Lynch* claims, *Cox* notes that the Courts have discretion, in reviewing plaintiffs' lawyers' fee requests in Entire Fairness claims, to apply either the *Chyrsler v Dann* standards[192] or the more traditional "*Sugarland*" standards. In *Cox*, the Chancery Court validates the more conservative *Sugarland* standards, as being appropriate for freezeouts.[193] The opinion states that "complaints challenging fully negotiable, all cash, all shares merger proposals by controlling stockholders are not meritorious when filed under the *Chrysler v. Dann* standard." It continues to act to limit abusive fees by ruling that "no risk premium should be awarded in fee applications in cases [...] when a plaintiff suing on a proposal settles at the same level as the special committee. Even further, if a controller and a special committee ignore a prematurely filed suit and conclude merger terms, there should be no presumed entitlement to a fee by the plaintiffs." Thus, in *Cox*, the Court robustly employs its equitable authority to adjust the doctrinal standards for fees. In so doing it limited the incentives for plaintiffs' lawyers to file claims in freezeouts.[194]

In effect, by endorsing the *Sugarland* standards for fee awards in cash out mergers, *Cox* extends the transactional choreography for freezeouts to encompass the plaintiffs' lawyers. After *Cox*, plaintiffs' lawyers can anticipate that if they file claims in cases where the cash out merger is announced as a negotiable offer, they will not receive a risk premium but merely a reasonable hourly wage. More disappointingly, they must risk receiving no fee at all if the Special Committee and the controller elect to "ignore" their suit and are able to conclude terms for the freezeout. In regard to the fee request in *Cox*, the Court determined substantially to reduce the fee award requested by the plaintiffs' lawyers. It did so, moreover, although the controller's fee to the plaintiffs' lawyers did not reduce the award to the plaintiff stockholders in the settlement of claims in the freezeout. In ruling to approve an award of only $1.275 million to the plaintiffs' lawyers (instead of the $4.95 million dollar fee the controller had agreed to)[195] the *Cox* opinion provides a dramatic example of the Court's competence to rein in "excessive" plaintiffs' attorneys' fees in freezeouts.

Cox's suggestion that the *Lynch* doctrine is defective because plaintiffs can systematically obtain outrageous fees by exploiting it is also undercut by the existing empirical data about fee awards in these cases. Evidence presented in a 2004 Article by Professors Thomas & Thompson indicates that plaintiffs' attorneys receive monetary awards in only one third of the freezeout claims filed under *Lynch*.[196] Thus, in two thirds of the cases the fee awards to the plaintiffs' lawyers are either "nominal" or nonexistent. The study also indicates that these fees conformed to criteria of reasonableness both when they are assessed on an hourly and a percentage of recovery basis.[197] Furthermore, Thomas and Thompson's article indicates that fees in *Lynch* litigation are substantially smaller than those paid to plaintiffs' counsel in the settlement of federal securities class actions (as measured on both of the bases described above)[198] At one point the *Cox* decision itself notes that plaintiffs' lawyers in claims under *Lynch* have reined in their fee requests to a moderate size.[199] In sum, while *Cox* cites the lawyers' fee problem as the gravamen of its complaint against *Lynch*, the problem does not appear to be a very serious one, but rather one that the Chancery Court can address directly without fundamentally changing the doctrine governing freezeout transactions.

5. *Lynch* Benefits Public Stockholders

As an extension of its views about fee opportunism in freezeouts, *Cox* suggests that the filing of claims under *Lynch* adds little if any value to what Special Committees would obtain from controllers in bilateral negotiations – that is, without the filing of the claims.[200]

a. Evidence of the Value of *Lynch* Filings

It seems that the views espoused by Professors Weiss and White -- who have written extensively about the abuses of meritless class action suits and who also served as the objectors in the *Cox* litigation -- were influential in influencing the Court's conclusion that Entire Fairness claims are largely vacuous and subversive of investors' best interests.[201] This negative view of filings under *Lynch* is undercut, however, by the empirical data and analysis presented to the Court by Harvard Law School Professor Guhan Subramanian. [202] Subramanian's data supports the conclusion that Entire Fairness standard has afforded independent directors on Special Committees greater leverage to obtain enhanced premiums from controllers in cash out mergers. Indeed, in an affidavit submitted to the Court, Subramanian concluded, to the expressed frustration of the Court, that greater premiums were obtained in cash out merger negotiations where claims had been filed under *Lynch* than in cash out merger negotiations where no claims had been filed.

But the Court discounts the data and analysis presented by Professor Subramanian. Although it goes to great lengths to do so, the Court essentially dismisses the credibility of the data indicating that higher premiums are realized in cash out mergers where Entire Fairness claims have been filed. Instead, to the extent that it acknowledges that relatively greater premiums are realized in cash out mergers (where the Entire Fairness applies) than tender offer freezouts (where it does not), the Court surmises that the result is attributable to the superior bargaining stature of Special Committees in comparison with disaggregated stockholders in negotiating with controllers. Most importantly, the Court appears to go out of it way to minimize the role played by law and emphasize the role played by nonlegal, organizational factors in affecting bargaining outcomes between the parties in these deals.

b. A Concession that *Lynch* Affords Special Committees Bargaining Leverage

Except, in fact, at one point in an attenuated invective against the evidence that the Entire Fairness standard has increased the size of premiums paid to minority stockholders, *Cox* suddenly, momentarily, concedes the point – albeit begrudgingly. The opinion states that *Lynch* might "charitably" be understood to provide “special committee members with additional clout that they wield to get good results, and that gives lawyers for controllers leverage to get their clients to pay a higher price to ensure deal closure and the utmost reduction of litigation." But in the overall arc of *Cox’s* invective against the *Lynch* doctrine, this begrudging acknowledgment of the doctrine’s efficacy in promoting public stockholders’ welfare simply doesn’t gain any traction at all.

And yet from the data reported in Professor Subramanian’s Harvard Working Paper the point seems irrefutable: the “early” filing of *Lynch* claims in cash out mergers promotes Special Committees' negotiating leverage with controllers and incites the latter to pay higher premiums than they do, on average, in deals where Entire Fairness does not apply. The filings of complaints in these cash out mergers allows Special Committees representing the public investors a legal basis to claim, with credible force, that the controller has an enforceable, fiduciary duty to pay no less than the full going concern value attributable to the public’s stock. With the *Lynch* filings in the background, the Special Committee can assert that if the controller does not act in accordance with this fair price duty, and its duty of fair dealings, the public investors will vindicate their rights in court – indeed, in suits that have already commenced.

c. The Simultaneous-Settlement Phenomenon

In dismissing *Lynch*'s importance as leverage for Special Committees negotiating with controllers, furthermore, *Cox* many times points out that plaintiffs' lawyers commonly settle their claims in cash out mergers on the same terms and at the same time as do Special Committees negotiating on the minorities' behalf.[203] *Cox* contends that once the controller's agents in the negotiation communicate to the plaintiffs' lawyers that they have reached final terms with the Special Committee, the plaintiffs' lawyers immediately "cave" and settle their Entire Fairness suit on the same terms as has the Special Committee. *Cox* seizes upon this "simultaneity-of-settlement" phenomenon as proof of the vacuous, nonmeritorious nature of filings under *Lynch*.[204] As further proof of this, *Cox* states that these *Lynch* claims do not involve any actual "litigation conflict."

Over and over *Cox* points to the simultaneous-settlement phenomenon and the absence of "real litigation conflict" as proof of the wasteful, defective nature of the *Lynch* doctrine. But viewing the matter in perspective, it isn't at all obvious that the simultaneous-settlement phenomenon compels a conclusion that the filings are nonmeritorious, in essence, gratuitous. It would seem to prove, only, that in the triangular "game of chicken" played between controllers and Special Committees and controllers and minority shareholders' attorneys in cash out merger negotiations the plaintiffs' lawyers typically defer to the independent directors about when "enough is enough."

d. "Early" Filings Aren't Necessarily Abusive

Furthermore, the fact that the filings are made by the plaintiffs' lawyers while the cash out mergers are still represented as "negotiable" offers also doesn't prove that the filings are specious or abusive. It would indicate, only, that at the time the plaintiffs file their complaints, it isn't yet clear which freezeout offers would eventually be at or near fair value and in conformity with the requirements of fair dealings. In fact, it's more reasonable to presume that where controllers announce freezeouts as "negotiable" offers, they do so at the lowest credible price – far below going concern value – in anticipation that they may be forced to negotiate some price increase. From this perspective, claims of unfair price in negotiable cash out mergers are probably all legitimate when filed.

And to the extent that *Cox* emphasizes that "no actual litigation conflict" occurs in these suits,[205] rather than furnishing further evidence of *Lynch's* dysfunctionality, this would seem to demonstrate that these cases don't consume a disproportionate amount of judicial resources. Furthermore, the "early" filing of *Lynch* claims in cash out mergers allows the plaintiffs' lawyers time, early on, to sort out who will act as lead plaintiff and lead counsel. This might prove especially important if the freezeout's timing were suddenly to accelerate -- for example, if the controller determined to proceed unilaterally to effectuate the merger or switched to a tender offer freezeout.

e. Fiduciary Claims Against Target Directors in *Lynch* Filings

Further evidence of the efficacy of "early" filings under *Lynch* can be surmised from the fact that the Special Committee directors will probably be named individually in filings claiming unfairness under the *Lynch* doctrine. This is likely to promote the caliber of these directors' efforts on behalf of the public investors. Although *Lynch* itself would not be a basis for holding them liable, [206] the Special Committee directors have a duty of care to inform themselves of all information reasonably available to them prior to accepting the controller's freezeout bid. This duty is illustrated by the landmark case of *Smith v Van Gorkom* (in relation to a third party merger)[207] and the recent decision in *McMullin v Beran* (in relation to a merger of a controlled entity with a third party where there was overreaching by the controller).[208] These cases affirm that in a cash out merger, the target directors have no ability to remain neutral and allow the stockholders to decide for themselves whether to approve the transaction. To do so, according to these decisions, would violate the directors' statutory and fiduciary duties in cash out mergers.

The evidence presented in Professor Subramanian's Harvard Study supports this phenomenon. It confirms that Special Committees that have represented minority investors in freezeouts structured as tender offers -- which are governed by the *Solomon* standards and thus present less opportunity for the Special Committee directors to be named in freezeout filings as individual defendants -- have not obtained the same positive price increases from controllers than have independent directors on Special Committees negotiating in the shadow of *Lynch*. Subramanian's evidence doesn't prove that directors are more vigorous advocates for minority investors where there is a suit for breach of duty pending against them – this concept is supported mostly by common sense. But Professor Subramanian's evidence is entirely consistent with this common sense intuition.

f. The Utility of Discovery for Public Investors

Finally, it's possible that the discovery process associated with claims under *Lynch* also serves to promote the best interests of the public investors in freezeouts. *Cox* represents shareholder plaintiffs' legal power to go forward with discovery as being merely a form of extortion. As represented in *Cox*, the prospective costs of discovery exert significant pressure on controllers to settle even nonmeritorious cases. But the discovery process may in fact be the public stockholders' form of due diligence in respect to the value of their firm. In this sense it may further the process of arms'- length dealings that *Weinberger* declared should operate for the benefit of minority investors in cash out mergers.

To elaborate, in the context of an acquisition offer, even the seller will have a need to conduct extensive due diligence (which would be the equivalent of the discovery process, outside of litigation) in order to evaluate the merits of a bid. This was graphically illustrated in the sale-through-merger analyzed in the landmark *Smith* *v Van Gorkom* case -- where the directors failed to undertake the kind of intensive analysis of their firm that would have furnished an informed basis for their approving the sale of the company. Moreover, in freezeouts it is ideally independent directors who will negotiate on the minority's behalf with the controller. But the independent directors are at a significant informational disability in comparison with the controller. In addition, consistent with *Lynch's* concern about inherent coercion, the target's independent directors may be reluctant to, or even hindered from obtaining the full range of company-specific information that would be intrinsic to a fully informed analysis of it value. The independent directors on the Special Committee might reasonably fear that such a comprehensive and time consuming due diligence analysis of their own firm would provoke the controller and encourage it to deploy its various tactical advantages to the public stockholders' detriment.

In sum, the plaintiffs' discovery requests may operate as a surrogate for the kind of due diligence that would ordinarily properly be conducted by the board of the seller in a third party merger. On this basis, *Cox's* unqualifiedly negative view of plaintiffs' lawyers' discovery requests, as being nothing more than a form of extortion, appears too biased in favor of controllers.

6. Reducing Litigation through the Business Judgment Rule

a. The Purported Problem and the Plan

As indicated above, one of *Cox's* principal criticisms of *Lynch* is that it has promoted fruitless litigation – litigation that has deterred wealth-enhancing freezeouts. Accordingly, a crucial objective of *Cox's* proposals is to reduce the incidence of shareholder suits in freezeouts, in order to encourage more deals and increase shareholder wealth.[209] Implicit in *Cox* is the belief that litigation would be reduced, and the economy enhanced, if the business judgment rule was the normal standard of review for freezeouts.[210] Once the business judgment rule applies in corporate suits, the Court will not investigate the underlying merits of the transaction.[211] *Cox* proposes that the public stockholders' welfare will be protected adequately by Dual Ratification, so that judicial review of the substance of a freezeout is inefficient, wasteful and institutionally suspect.[212]

Cox is probably correct to presume that once controllers understand that obtaining Dual Ratification will confer the protection of the business judgment presumption on their freezeouts, in the event of litigation, they are likely to seek Dual Ratification in almost all instances. If one accepts *Lynch's* belief in the operation of inherent coercion (as this Article does), then controllers are likely to obtain Dual Ratification in almost all cases when they seek it. This means that the business judgment rule will almost always apply to claims brought in freezeouts, and will block judicial inquiry into the fairness of these transactions.[213]

If reducing litigation were an absolute good in itself, *Cox's* program of law reform would be an astonishingly impressive one. Indeed, as stated in the introduction, there are schools of thought and public policy relevant to corporate law that endorse the imposition of severe limits on private civil suits. However, Delaware's equitable tradition has historically embodied a far more modulated approach to balancing the potentially abusive aspects of shareholder litigation with the enforcement of other-regarding duties on corporate fiduciaries, in the interest of public stockholders. In order to promote the reasonableness of trust on the part of public investors, and the long term financial welfare that it supports, fiduciary litigation imports some of the values associated with the public law into the corporate context. Within corporate legal doctrine, this value has competed with the objective of reducing litigation overall. *Cox* would make the latter value of primary importance, and thus upend the fiduciary tradition in relation to controllers' self dealing transactions.

b. Reducing Litigation at the Cost of Ignoring Tainted Consents

Even on their own terms, it's not apparent that the *Cox* Reforms will successfully reduce stockholder suits against freezeouts.

First of all, as described in Part III, *Cox* actually increased the equitable safeguards that controllers must adhere to in order for their tender offer freezeouts to receive deferential treatment in equity. It did so, moreover, by imposing conditions which are not obvious in what they require – Cox's two versions of the Committee Opinion Provision being only the most salient of these.[214] Given the procedural importance that *Cox* attributes to the Special Committee's recommendation, this ambiguity will inspire litigation, as will the intersection/intermingling of the four or five equitable criteria enunciated by *Pure* and *Cox* as applied in particular tender offer freezeouts, in combination.

Furthermore, the Dual Ratification requirement proposed by *Cox* will be (and as explained below should be) susceptible to litigation. In *Cysive* the Court argued that it was essentially impossible to verify the validity of disinterested informed consent on the pleadings. If this complaint against *Lynch* was valid, then with after the *Cox* Reforms the Court will need to be involved in scrutinizing the quality of the consents that constitute Dual Ratification upon a shareholder's complaint. If this complaint against *Lynch* was invalid, then the argument against Entire Fairness review loses even more of its force.

Finally, if it is impossible for the Court to verify the quality of Dual Ratification that is a predicate to deferential review without some reasonable judicial inquiry, but the Court do not devote attention to the matter or too easily presume the regularity of the consent that trigger judicial abstention from an inquiry into the merits, then controllers' capacity for overreaching in freezeouts will have become nearly unlimited as a result of the *Cox* Reforms. The standards for going private will have "gone private" – to the great advantage of the more powerful parties in these deals – that is, controllers. But if the Court is conscientious in taking the Cox Reforms' Dual Ratification requirement seriously, then it will have to analyze whether there has been dual, disinterested informed ratification by both independent directors and a majority of the public stockholders prior to applying deferential review. In this regard, effectively, the *Cox* Reforms would recapitulate a variation on *Lynch* fair dealings requirement. Complaints that alleged a genuine issue of fact showing unfair dealings in relation to either form of consent would go forward in equity. Under the Cox Reforms, once Dual Ratification was established, claims that instead primarily alleged unfair price would be split off, to be brought as appraisals if the litigants could sort out the process and avoid the "rabbit holes." But even sorting out which complaints were of which type would involve litigation. In conclusion, the plan to reduce stockholder litigation through the *Cox* Reforms seems unrealistic and misguided.

c. Factoring in Suits Against Target Directors

At one point in the opinion, *Cox* suggests that its proposals are not radical because plaintiffs can still sue the target directors on the Special Committee if they believe there is unfairness in the freezeout. In the words of the opinion: "[p]laintiffs who believe that a special committee breached its fiduciary duties in agreeing to a merger would continue to have the practical ability to press a claim; they would just have to allege particularized facts demonstrating a breach of fiduciary duty." The Court's suggestion about suing the target directors personally is easy to miss because it is quite brief, and because its substance is surprising, given the broader context of corporate fiduciary law.

As described earlier, corporate fiduciary law has always resisted expanding the personal financial liability of independent directors. The rationale for this restraint is that independent directors serve a crucial function in contributing to reasoned, unbiased corporate decision making and would be discouraged from so doing if they were subject to significant liability exposure. Also influential has been the idea that qualified independent directors are uncommon and that that they are not fully compensated for their service as independent directors. Substantial personal liability exposure has always been rejected by equity on grounds that it would make recruiting and retaining talented independent directors on corporate boards far more difficult. Consistent with the above, *Cox's* assertion that aggrieved stockholders would have recourse against the target's independent directors even if its proposed reforms were accepted is truly surprising, if not inexplicable. And Cox's suggestion is more puzzling because if public stockholders can go forward in a suit against a freezeout merely by suing target directors instead of the controller, then *Cox* will not have accomplished its expressed intention of reducing shareholder suits or "litigation agency costs" in significant measure.

d. Factoring In Increased Appraisals

If equitable actions against controllers were significantly limited by the application of the business judgment rule, furthermore, it seems likely that there would be an attendant increase in appraisal actions.[215] Since *Lynch* was decided, the equitable cause of action for unfairness it established has been more attractive than appraisal actions. But this would change if the *Cox* Reforms became binding.[216] Many suits that would have challenged fair price in equity would go forward as appraisal actions. Indeed, like equitable actions for fair price under *Lynch*, appraisal actions come before the Chancery Court. Thus, even if fair price claims could not go forward as equitable actions under *Lynch*, the Chancery Court's docket of valuation cases might be reduced very little, if at all. Hence, even accepting *Cox's* contention that a certain number of freezeout bids have been deterred by the threat of litigation, controllers would be unlikely to conclude that the threat of litigation was substantially diminished even if the *Cox* Reforms are accepted as binding.

In addition, if the equitable action for fair price were effectively eliminated, as would be the case if Dual Ratification became prevalent under the *Cox* Reforms, it is likely that there would be increased calls for reforming the appraisal statutes to enhance their practicability. It's entirely probable that Delaware's legislature has been able to resist calls to modernize the appraisal statutes because the equitable cause of action under *Lynch* has been efficacious. But if the equitable cause of action under *Lynch* was substantially circumscribed, as *Cox* proposes, it's foreseeable that calls to reform the statutory appraisal process would intensify and prove successful. Additionally, because both appraisal actions and Entire Fairness claims employ going concern value as the measure of fair price, controllers would not enjoy any overall financial savings from the transformation of equitable claims against freezeouts into appraisal actions. This is further reason that even if *Cox's* proposals are accepted, they are unlikely to effect an overall reduction in the incidence of shareholder litigation against freezeouts, and thus unlikely to promote wealth enhancing transactions that would otherwise have been deterred by the threat of suit.

e. Slowing the Development of the Transactional Choreography for Freezeouts

There is a further, "hidden" cost implied in the objective of reducing equitable actions in freezeouts. If the Chancery Court takes a more "hands-off" approach to freezeouts (especially if it fails to scrutinize the quality of the consents constituting Dual Ratification) this will limit the development of the transactional choreography for going private deals. In this transactional choreography, the Court has had the opportunity to survey innovative transactions, as well as creative proposals from commentators, to develop an authoritative body of best practices for freezeouts and other M&A deals. This is not the type of innovation that is well suited to legislation. Rather, it reflects what is most advantageous about the common law process (as reflected in what Delaware's Chancellors do in equity). Were the transactional choreography for freezeouts to atrophy, established market power and entrenched positional advantage would systematically favor controllers and disadvantage the public investors in freezeout transactions, and more broadly. These negative effects should be considered by the other courts, and especially Delaware's Supreme Court, when they review *Cox's* calculations about the benefits to be achieved from reducing stockholder suits in freezeouts.

7. Empirical Claims Against Entire Fairness

Cox makes a variety of broad empirical claims about why the Entire Fairness standard has become superfluous and the concept of inherent coercion outmoded.

a. Independent Directors' New Ability to Say "No"?

In *Cox* the Chancery Court claims that experience has demonstrated that the concept of inherent coercion is erroneous or out-moded because "by now" we see that both independent directors and public stockholders are able to say "no" to freezeouts that are less than fair.[217] *Cox* cites a transaction or two to support this assertion, but it does not cite broad based empirical data for supporting independent directors' and public investors' "no" votes in freezeouts. In fact, it isn't clear that such evidence exists. It's not clear whether there are statistical accounts of controllers dropping their bids on account of actual or anticipated resistance from independent directors or minority investors. Of course, it would be difficult to get an accurate count the bids that disintegrate. But there wouldn't appear to be a substantial number of cash out mergers in which controllers have proceeded notwithstanding the disapproval of the independent directors or minority investors (as evidenced by the Court's failure to cite them at least). Hence, as an empirical matter it is highly contestable that there is widespread evidence of independent directors' and public investors' capacity to thwart unfair freezeouts.

However, although it isn't based on counting freezeout transactions or disapprovals, there is a growing body of academic research that would reinforce the idea that independent directors and minority investors have a limited capacity to withstand the kinds of pressure and coercion exerted by controllers. Research in social and group psychology and "behavioral finance" reinforces the belief that controllers are capable of wielding great social and professional and organizational clout to sway even "independent" directors and minority investors to say "yes" to their proposals. The insights developed in this literature are increasingly respected in corporate law and entering mainstream corporate and securities law scholarship (and even corporate legal decisions).[218] This research reinforces the basic insight that gave rise to *Lynch's* insistence on review for Entire Fairness. That is, it suggests the continued validity of the inherent coercion concept.

In addition, the widespread corporate wrongdoing that has come to light in recent years undercuts the reasonableness of putting blind faith in the ability of independent directors to limit self dealing on the part of powerful corporate insiders.[219] The new independence criteria adopted by the exchanges and the NASD as part of their listing standards should promote independent directors' capacity for impartial, objective decision-making, and independent directors' capacity for opposing, finding and putting a stop to insiders' self-dealing. But no one expects that these changes will be transformative, certainly with respect to the power exerted by controlling stockholders.[220] Without greater support from equity, independent directors will continue to inhabit a "conflicted space" in the corporate governance world once a controller is present.

b. Institutional Investors' New Ability to Say "No"?

Cox implies that the increased proportion of institutional investors within the class of public stockholders subject to freezeouts serves to protect the public investor class in these transactions, as a whole. But because it's widely acknowledged that no single institutional investor owns more than a tiny percentage of the stock of a publicly listed company, Cox is not suggesting that any individual institutional investor's "no" vote could stop the controller. Indeed, many institutional investors would need to coordinate their voting in opposition to a freezeout in order to derail a controller's bid. Even all the institutional investors added together in a public company with a controller present might not constitute a majority of the minority shares – so that the institutions, banding together, could block Dual Ratification. And it's also notable that different types of institutions have different investment objectives and would have different investment histories in the company subject to the freezeout. This would hinder the institutional investors' capacity to act in concert to block a controller.

Corporate legal professors used to be more optimistic about institutional investors' capacity to coordinate in their actions in their common interest. But over time it became apparent that institutional conflicts of interest, professional norms, transaction costs associated with collective action (chiefly free rider problems) and forms of risk aversion have hindered institutional investors from taking a strong stand against management in most instances. These disabilities would also apply in freezeouts, and promote controllers' ability to sway a majority of the minority stockholders to endorse a merely adequate bid. The limits that hinder institutional investors from serving effective advocates for public stockholders' interests is illustrated also by the losses they suffered, alongside regular retail investors in the recent financial accounting and self dealing scandals. Providing for a vote of a majority of the minority in a freezeout is a credible supplement to the safeguard of independent director consent. But the limits and disabilities that affect institutional investors choices and capacity for coordination mandate in favor of limiting their authority to block judicial review for fairness.

c. Diversification

As further evidence that Entire Fairness review can be eliminated without adding to the jeopardy of public investors in freezeouts, *Cox* points to their power to diversify their investment capital in the markets.[221] However, if the equitable protections for freezeouts provide for judicial abstention (on account of the application of the business judgment rule) upon Dual Ratification, then controllers may succeed in consummating freezeouts that involve coercion and overreaching in a large number and broad spectrum of companies. The increased availability of funding for going private would contribute to this. Once there was any enhanced possibility of a controlling stockholder appearing on the scene, the price of the public equity would be discounted substantially to reflect the controller's potential for self-dealing. This could affect a large number and broad spectrum of companies, so that diversification would be of limited efficacy as a safeguard.

But in its reference to diversification, *Cox's* appears to be claiming, more precisely, that losses public investors suffer in freezeouts are offset by the gains they enjoy in other freezeouts as part of a controlling shareholder group. However, it isn't clear that the same class of investors are likely to appear at both sides of freezeout transactions, even over "the long run." For example, the minimum capital contribution rules in most private equity funds would preclude many "ordinary" investors from being included as part of a controlling shareholder group at company, through an investment therein. Furthermore, it isn't clear that investors are as interested in or as successful at diversifying their capital as commentators would like them to be. Once again, the losses suffered by employee shareholders in recent corporate scandals are evidence of this. And there are transaction costs attendant to diversifying (either directors or through a fund) that might alter *Cox's* calculation about whether diversified stockholders' gains and losses in freezeouts are likely to offset one another.

Finally, if overreaching by controllers represents a subversion of the system of corporate governance,[222] then fiduciary law should provide some reasonable recourse. This is part of the work done by the *Lynch* doctrine's insistence on review for Entire Fairness. Seen from this perspective, it's unseemly for the courts to propose that investors should seek to benefit from overreaching along with a controller in order to offset the instances where they suffer losses because of overreaching by controllers.

d. Better Information Flow

Another practical argument *Cox* makes against the Entire Fairness standard is that modern technology has enabled greater and faster information flows. This argument appears twice, although it isn't well spelled out in the opinion.

It's possible that *Cox* is alluding to institutional investors' capacity to communicate more quickly and inexpensively with one another on account of improved information flows – that this supports endorsing Dual Ratification as adequate protection in freezeouts. However, just because institutional investors can transmit information among each other with relative ease and speed, does not mean that they can arrive at decisions about what to do in a freezeout with ease or speed.

It's also possible that *Cox* is suggesting that controllers will have less room to engage in propaganda or even misrepresentation on account of improved information flows. But if this is the improved information flows argument, it isn't a strong basis for "easing" *Lynch*. The technological ability to transmit more corporate data and to do it faster doesn't correlate with whether the information is accurate or useful to investors. Research in behavioral finance further supports the view that there is a meaningful gap between companies' disclosure and transmission of information to investors and how and when that information is digested by investors and the public markets. Complex corporate information of the kind that would be relevant to a freezeout proposal appears to be "lumpy." It isn't neatly incorporated into investors' decision-making, so that improved information technology would equate with quicker, smarter decisions.

In addition, for corporate data to be useful, it has to be not only accurate but also transparent – that is, presented in a format that lends itself to comparison with other firms' disclosures, Better information technology is of limited efficacy in promoting accurate and usefully transparent disclosure – this facet of disclosure has been supported by laws and regulations more than technology. If *Lynch* is diluted, especially if the Courts become inattentive to the quality of the disclosures underlying Dual Ratification, this will loosen the structure supporting accurate, transparent corporate disclosure. Lynch provides public investors to bring claims of misrepresentation in freezeouts as part of the Entire Fairness (fair dealings) requirement. Better information flows are not an argument for loosening legal safeguards. Instead, better information flows will only benefit investors if the law supports the accuracy and transparency of disclosure, including controllers' disclosure in freezeouts.[223]

8. More Legal Arguments for Junking Entire Fairness

a. The Analogy to *Aronson*

At several points, *Cox* notes that the judgment of independent directors is respected where they elect to terminate a shareholder's derivate action.[224] *Cox* expresses dismay over the difference between the deference afforded independent directors in their choice to terminate a derivative suit and the limited deference afforded Special Committees in freezeouts, under the *Lynch* doctrine. To support the contention that independent directors' consent should go far in preventing the courts from scrutinizing the merits of the freezeout, *Cox* specifically points to the Supreme Court's decision in *Aronson v Lewis*. In *Aronson* the Supreme Court affirmed the propriety of independent directors' termination of a stockholder suit challenging the board's award of a special compensation package to the company's former CEO and controlling stockholder. Most pertinently, the Court held that notwithstanding the controller's voting rights and potential influence over the board, the decision of the independent directors to terminate the derivative suit would not be respected by the Court. Indeed, *Cox* is correct that equity is applying a different standard under *Aronson* and *Lynch*.

But *Cox* fails to note a simple but profound factual distinction between the two contexts. While both doctrines relate to judicial treatment of self dealing transactions by controlling stockholders, in suits where *Aronson* is relevant the financial stakes for the public stockholders are not as high as they are in freezeouts. *Aronson* is applied to derivative suits involving "ordinary" self-dealing transactions,[225] whereas freezeout transaction are a financial "endgame" for the public shareholders. Equity has traditionally taken account of the financial magnitude of the disputed transaction in the application of fiduciary standards, including the weight and significance to be afforded disinterested approvals of the disputed transaction. For example, for many years there was controversy surrounding the question of whether independent directors or minority investors could ever "ratify" breaches of loyalty, so that the business judgment rule would apply.[226] In essence, for many years the Courts applied an analog of Entire Fairness in all instances of self dealing by corporate fiduciaries – not just controlling stockholders. Ratification by disinterested parties was effective only to shift the burden of proof. As in *Lynch*, it would not work to reinstitute deferential review.

Another example of the context-specific application of fiduciary duties is provided by the Courts' interpretation of the duty of care. Where the financial magnitude of the transaction is higher, greater diligence, a more thorough-going duty of inquiry has been expected of directors approving a transaction. This was visible in *Smith v Van Gorkom*, where the Court applied a relatively heightened version of fiduciary care on the directors charged with authority to approve or decline the sale of the company through a merger with a third party. The *Revlon* standard is also similar – given the financial consequences of a change of control transaction, the directors are not automatically entitled to the usual deference of the business judgment rule. Instead, they have to earn it through conduct that attests to their effort to get the "best price reasonably available." These cases and doctrines are closer to the *Lynch* doctrine than is *Aronson* – consistent with the heightened financial magnitude of the transactions involved..[227] For this reason *Cox's* frequent references to the inconsistency between *Lynch* and *Aronson* are misplaced; they misses the underlying factual distinctions that warrant greater judicial scrutiny in freezeouts.

b. Applying the Business Judgment Rule in Freezeouts Would Be A Big Change

Cox frequently makes light of the implications of the changes it proposes – suggesting that it intends only to *"ease"* Lynch. Near the opening of the opinion, *Cox* describes its proposals a "reforming and extending *Lynch* in modest but important ways."[228] Nevertheless, the proposal to allow Dual Ratification to forestall judicial inquiry into the merits of the transaction would be a major doctrinal change.

Nevertheless, there are points in *Cox* where the Court is ambiguous about the proposed effect of Dual Ratification. At one point the Court states that with Dual Ratification, the complaint would be dismissed unless: 1) the plaintiffs plead particularized facts that the special committee was not independent or was not effective because of its own breach of fiduciary duty or wrongdoing by the controller (e.g. fraud on the committee); or 2) the approval of the minority stockholders was tainted by misdisclosure, or actual or structural coercion." As discussed above, Cox is proposing that the Court must validate the legitimacy of the consent constituting Dual Ratification if a genuine issue fairness has been stated in relation thereto. But this would, in substance, allow many claims for unfair dealings to go forward.[229] Read this way, Cox would not allow the usual scope of judicial deference associated with the business judgment rule. A more traditional application of the business judgment rule would limit the Court's role in scrutinizing the consent and consent process constituting Dual Ratification. But as stated previously, this would involve a level of laissez faire towards freezeouts that would represent a radical change.

c. Sales Through Mergers with Third Parties and Cash Out Mergers by Controllers Are Fundamentally Different

At several instances the *Cox* opinion presses the analogy between cash out mergers involving controllers (where there has been Dual Ratification) and mergers with third parties. *Cox* correctly describes how mergers with third parties require consent of the board and a majority of the shareholders at the target corporation. After noting this, *Cox* describes how Dual Ratification would involve the same kind of protective consent process that characterizes cash out mergers with third parties. The argument continues with the contention that because the business judgment rule is the "normal" standard for mergers with third parties, the business judgment rule should apply to cash out mergers with controllers where both forms of consent were obtained.

The first problem with this analogy is that it ignores the inherent coercion concept that is the cornerstone of the *Lynch* doctrine. Towards the end of the *Cox* opinion, the Court directly expresses its view that inherent coercion is an exaggerated and outmoded idea. Nevertheless, to accept the validity of the comparison between cash out mergers with third parties and cash out mergers with controllers, the inherent coercion problem must be disregarded.

The analogy between cash out mergers with third parties and cash out mergers with controllers misses an even more salient distinction that increases the risks of unfairness in the latter context. In the third party merger setting, before approving the transaction, the target directors must inform themselves of "all information reasonably available to them," to satisfy their duty of care. To do so they normally obtain extensive valuation data. As part of this, or as a further step in evaluating the merits of the merger proposal before them, the independent directors will almost always canvass the market for third party offers. The *Cox* Reforms do not provide the target directors authority to pursue an auction or market check in a freezeout. And yet they still argue in favor of giving full fledged effect to Dual Ratification, as if it were the same as the approvals obtained in third party merger, and allowing them to trigger deferential judicial review. In sum, the differences between the approval process in third parties' merger offers and controllers' mergers offers calls for different rather than common legal treatment.

d. An Apocryphal Intellectual History of the *Lynch* Doctrine

As part of its argument for rejecting *Lynch's* validity, *Cox* presents a strange, seemingly apocryphal account of the origin of the inherent coercion concept. *Cox* states that *Lynch's* refusal to give deference to the business judgment of independent directors (in controllers' cash out mergers) was linked to equity's rejection of the business purpose requirement (for controllers' cash out mergers). In the words of the Court: "*Lynch's* decision on this score seemed to turn on a vestigial concept from a discarded body of case law; namely, that because there no longer needed to be a 'business purpose' for a merger with a controlling stockholder, it was somehow not a 'business judgment' for independent directors to conclude that a merger was in the best interests of the minority stockholders." The Court is correct that this would be a strange conflation of ideas, an "odd and unsatisfying rationale"[230] for a court's refusing to defer to the decision making of independent directors. And *Cox* is correct that *Weinberger* both overruled the 'business purpose' requirement for cash out mergers and provided that independent directors' consent to a freezeout would serve merely as evidence but not proof of its fairness.[231] But neither *Weinberger* nor the decisions following it ever implicitly or explicitly linked these two ideas – that is, the abandonment of the business purpose requirement for controllers' cash out mergers and the limited deference afforded independent directors' approvals in controllers' cash out mergers. *Cox* is correct that these ideas don't fit together, but it isn't correct that they were supposed to, or that the fact that they do not undermines *Lynch's* validity.

This portion of *Cox's* reasoning does hit upon an important insight however -- specifically a further important distinction between freezeouts and mergers with third parties. The distinction is not developed in *Cox*, which, instead, focuses on the parallels between the two types of transactions. The difference is that controllers initiate freezeout proposals and they have discretion, within the law, to do so in their private interest. There is no requirement, even under the Entire Fairness standard, that the public stockholders obtain a benefit from the freezeout. The fair price prong of the Entire Fairness standard merely requires that the public stockholders be paid the full value of the stock they surrender in the freezeout transaction. The directors at the target will be expected to approve the freezeout transaction so long as the public stockholders are not left worse off by it (that is, so long as they receive their pro rata share of the company's going concern value). Again, the Entire Fairness standard allows the controller to profit from the freezeout so long as the public stockholders receive full value for the stock they surrender (willingly or not).

The deference afforded the board under the business judgment rule rests on the idea that the board initiates fundamental corporate transactions, not the shareholders. Under corporate law, the board has authority to approve transactions that will benefit all the stockholders equally (or at least leave no shareholders worse off than others). Arguing that controllers' deals should be afforded business judgment rule deference therefore involves a kind of "category" mistake or "institutional" confusion, because the controller is not under a duty to benefit all the stockholders equally, even under *Lynch*. And under the Cox Reforms, the controller would not even operate under a duty of fairness in going forward with the transaction (at least until either the independent directors of shareholders disapproved of the transaction). From this perspective, the argument for affording the freezeout "business judgment" deference rests on a profound mistake.

e. Has the Supreme Court Already Precluded Deferential Review If *Both* Forms of Approval Are Obtained?

Cox asserts that its reforms address an unsettled, open question of law. That is, it contends that in *Weinberger* and *Lynch* the Court only held that Entire Fairness would apply if there was either disinterested director or disinterested (minority) stockholder consent to the freezeout. *Cox* is correct that neither decision expressly precluded deferential judicial review for cash out mergers which had received both forms of approval.[232] That possibility was simply not addressed explicitly by either opinion. From this silence *Cox* extrapolates that the issue is unsettled. From this perspective, the *Cox* Reforms would not overrule *Lynch*, but clarify its limits. The relevant question is therefore whether *Weinberger* or *Lynch implicitly* reject deferential review for a freezeout where both forms of consent had been obtained.

Cox extrapolates that the deficiencies of one form of approval are made up for by the strengths of the other. It describes how independent directors are more organized negotiators than are disaggregated public stockholders. It then explains that because directors' choices and personal interests may not align perfectly with the stockholders' own, providing for approval by a majority of the minority shares is a check on the integrity of the directors' conduct in the freezeout.[233] But this logic (as before) makes sense only if one disbelieves in inherent coercion.

The better "collective action," bargaining situation of the independent directors on the Special Committee does not free them from feeling compelled to approve an inadequate offer out of fear that the controller would act even more aggressively in its self interest if its preferred deal were derailed. And precisely the same kind of structural coercion infects the minority shareholder consent process. *Cox's* reasoning in relation to Dual Ratification is something like "two halves make a whole." But if one accepts the logic of inherent coercion, the two approvals are not complementary to one another. Rather they each suffer from the same, profound infirmity; so combining them wouldn't resolve the problem.

C. Using Rhetoric to Undermine the Inherent Coercion Concept

The *Cox* opinion represents the most comprehensive contemporary treatment of the law governing going private transactions. It is the work of a brilliant, ambitious and prolific Delaware Judge active in many of the most contentious and high profile contemporary contests for corporate control. The *Cox* decision is likely to exert a substantial influence on the development of judicial thinking about freezeouts. This will be true whether it's proposed reforms are adopted in full, in part or hardly at all. For this reason, it's important to evaluate all the arguments presented in the opinion – both those which are presented explicitly and those which are presented implicitly through the use of colorful language and other forms of rhetoric. Much of this rhetoric is employed to discredit the inherent coercion concept. Before proceeding to analyze the various forms of rhetoric artily employed in *Cox*, the concept of inherent coercion is further explored immediately below.

1. The Inherent Coercion Concept, In General

At various points in the *Cox* opinion it becomes clear that the Court has implicitly rejected the inherent coercion concept. To reiterate, the inherent coercion concept posits that because controllers can withhold dividends while still enjoying the private benefits of control, and can at will switch to a nonnegotiated cash out merger at a lower price, for instance, the independent directors and public stockholders are inhibited from evaluating the merit of the freezeout offer on its own terms. They may consent to the freezeout only because they fear worse from the controller.

The *Cox* opinion does not discuss the broader relevance or importance of the inherent coercion concept.[234] Implicit in *Lynch* is the notion that equity should not stand by while public stockholders are fooled or cowed into surrendering their stock-as-property. In mandating vigorous judicial oversight in this context, *Lynch* suggests that there is something more at stake in freezeouts than ordinary private, commercial dealings. That is, the *Lynch* doctrine takes into account that controllers' power is partly legal in nature, partly enabled by the legal framework of corporate governance. In this sense, the law cannot legitimately leave the "private" parties to work out their bargain. Because legal structures and forms of legal authority cannot be separated from financial dealings in complex M&A transactions like freezeouts, *Lynch's* commitment to the Entire Fairness standard imports a variation of "due process" into the freezeout setting. This due process analog is expressed through equity's transactional choreography for freezeouts, as it informs the planning and execution of these deals, as well as their adjudication in equity. Consistent with this idea, controllers cannot seize the public stockholders' stock-as-property without complying with minimum conditions of fairness.

The inherent coercion concept may also reflect concern that unfairness in freezeouts reduces allocative efficiency overall. Much of the force of the contract law paradigm in corporate governance arises from the idea that in the absence of fraud, private parties will only agree to transactions that are beneficial. (One party may benefit more than the other, but absent fraud, in truly voluntary transactions, neither party should be worse off.) However, if the consent is not truly voluntary, as may be the case in a freezeout even where Dual Ratification has been obtained, overall wealth may not be increased by the transaction. The controller's gains may essentially reflect the public stockholders' losses.

Of course, private values and public values eventually converge. This has become more obvious recently as countries attempting to transition to market economies founder in the absence of sound cultural, social and legal institutions that would inhibit corruption and other forms of abuse. A strong civil society framework, including a dependable legal system, is an economic resource; where these institutions do not exist, all forms of social transacting become more risky, including financial transacting. If equity's robust commitment to fairness in freezeouts were substantially diluted, this would vastly increase the risk associated with being a minority investors and eventually make it impossibly costly for companies with controllers to raise public equity. Controllers would come to be seen as private raiders.

Cox makes certain empirical arguments against inherent coercion, as reviewed above. But the appeals to the capacity of Special Committees and public shareholders to act competently in their self interest and the salutary effect of improved information flows are not entirely convincing in themselves. They are claims but not proofs that inherent coercion is misguided and out-moded. In addition to these empirical rationales, therefore, *Cox* uses several powerful rhetorical devices to undermine the seriousness and validity of the inherent coercion concept.

2. Parody (Funny But Disturbing)

One example of this is *Cox's* use of parody. *Cox* describes the operation of inherent coercion by comparing it to a contest for control between larger and smaller apes. In particular, *Cox* describes gorillas and chimpanzees sparring over bananas – the idea being that the chimpanzees know that resistance is futile. As described in *Cox*: "Facing the proverbial 800 pound gorilla who wants the rest of the bananas for himself, chimpanzees like independent directors and disinterested stockholders could not be expected to make sure that the gorilla paid a fair price."[235] This story about the apes appears as an explanation of inherent coercion early in the *Cox* opinion. It is presented as an illustration of how those who believe in inherent coercion perceive it to work and how it became the rationale for heightened legal protections. But as an explanation or illustration, the story about the apes and bananas is jarring – a parable that is ambiguously savage or comic, but clearly outside of the usual discourse of corporate legal analysis.[236]

It's possible that Cox's monkey story is presented merely as a trivial illustration of the power imbalance in freezeouts. But to a careful reader, Cox's comparison between inherent coercion and the story of battling apes suggests that the inherent coercion concept fails to take account of the parties' higher capacity for reasoned decision making and peaceful dispute resolution. In addition, *Cox's* story suggests that the concept of inherent coercion mistakenly analogizes controlling shareholders to brutish gorillas. *Cox's* story implies that by endorsing the operation of inherent coercion, rather than acknowledging that controlling shareholders are entitled to the outcomes they achieve in freezeouts, *Lynch* presumes that controllers win these favorable outcomes through force. By telling the story of inherent coercion and the genesis of the *Lynch* doctrine through the parable of contending primates, *Cox* is suggesting, in effect, that the Courts should realize that independent directors and public stockholders are not monkeys, and controllers not brutish gorillas. The jarring reference to gorillas and chimpanzees in *Cox* is intended to point out the fundamental error in *Lynch's* conceptual structure. *Cox* uses the irony implicit in analogizing investors and directors to primates to make a point – that these are intelligent commercial actors who do not need extraordinary legal protections.

Cox's parodic narrative about apes and bananas also deflates the seriousness of the concept of inherent coercion and the doctrine governing freezeouts. The implication of the monkey story is that Courts are mistakenly preoccupied with issues of fair process and truth in freezeouts, when what is at stake, metaphorically speaking, is nothing more serious than the division of a bunch of bananas.

Another instance of *Cox's* use of colorful language to suggest the absurdity of the *Lynch* doctrine and its byproducts appears in the opinion's description of the triangular negotiation process that occurs in cash out mergers. *Cox* describes the "ritualistic" negotiation process as "almost invariably resulting in the simultaneous bliss of the three parties – the plaintiffs' lawyers, the special committee, and the controlling stockholders."[237] The opinion ups the ante in describing the settlement of claims in freezeouts governed by the *Lynch* doctrine as involving "a jurisprudential triumph of an odd form of tantra."[238] The references to "bliss" and "tantra" are shocking in this context, and there's every reason to think they are intended to be. They suggest that the *Lynch* doctrine is unreasonable and excessive; that it has caused the rule of law to spin out of control. As represented by *Cox*, *Lynch* has given rise to a bizarre kind of legal decadence, a surfeit of legal proceedings that is orgiastic in its effect.[239] In its references to "bliss" and "tantra" *Cox* implies that if lawyers and law professors and judges are still thinking that the *Lynch* doctrine and the Entire Fairness standard are really about ensuring fairness, they have "missed the party."

3. Inherent Coercion – a Suspect 'Sociological' Inference

A further example of *Cox's* deft use of rhetoric to undermine and marginalize the *Lynch* doctrine is where the Court refers to the inherent coercion concept as a "sociological inference." By associating the inherent coercion with sociology, rather than law, *Cox* is implying, again, that it is illogical and non-essential. *Lynch* and the inherent coercion concept are the product of "soft science," rather than legal doctrine. Until recently, sociology has been disparaged by corporate law professors, and other academics in the "hard" sciences. In developing depth outside of the law, corporate legal academics have largely been inspired by economics, as a frame of reference for analyzing corporate governance and market dynamics. Traditionally, the working assumptions have been that law is logical, economics scientific and sociology at best conjecture. Good law should not be based on conjecture. So by associating the inherent coercion concept with sociology, *Cox* is implying that it cannot be a basis for good law.

4. A Pointed Rhetorical Question

Cox also uses a very pointed rhetorical question to undermine the inherent coercion concept. Rhetorical questions are not real questions of course; they are masked declarations of absolute certainty. In contrast to real questions, rhetorical questions end discussion, by implying that there can be only one intelligent answer. In this mode, *Cox* asserts, “If both the independent directors and the disinterested stockholders are given the ability to say no and do not, ought we not presumptively assume that the transaction was fair?” Read in context, where this rhetorical question is surrounded by other criticisms of the inherent coercion concept and the *Lynch* doctrine, the answer is obvious. We are supposed to think: “Yes! Of course! The consents should resolve the matter and preclude harassing litigation!” Like all rhetorical questions, this one suggests that it would be foolish to think otherwise – in this instance, not to agree that the heightened protections afforded by the *Lynch* doctrine are unnecessary and wasteful.

However, examining this rhetorical question closely, it becomes evident that it has assumed away the heart of problem – that is, the operation of inherent coercion in undermining the parties’ capacity for free choice. Cox’s rhetorical question states that both the independent directors and the disinterested stockholders “are given the ability to say no and do not.” The inherent coercion concept denies that the independent directors and public stockholders are given a genuine opportunity to say no. In essence, *Cox’s* rhetorical question is tautological – it assumes the answer (free choice) to the question it poses (fairness). In merely assuming the answer to the all-important questions of choice and fairness, rather than truly addressing the situation of independent directors’ and public stockholders’ limited capacity for choice (and how the law should respond to the problem), *Cox’s* rhetorical question exposes its inherent limits as a form of legal argument.

5. Corporate Law as Commercial Law

In another brief, highly suggestive statement, *Cox* makes a claim about the true nature or scope of corporate law -- and thus its appropriate concerns. *Cox* states: “This is corporate law, after all, a species of commercial law having to do with stockholders ...” Again, the statement is very brief – but it communicates a great deal. It’s brevity is part of what makes the claim about the inherent boundaries and limits of corporate law highly persuasive. Commercial law relates the buying and selling of goods, it focuses on transactions rather than institutions. Commercial law assumes that parties seek to maximize profit in each exchange, and they commit to exchange (in the absence of fraud) only when doing so is mutually beneficial. In contrast, the basic unit of corporate law is institutional rather than transactional. Corporate law focuses on institutions -- companies themselves, and then the institutions of power within them, such as the board of directors, rather than individual, basically bilateral transactions. Corporate law’s “value added” is this broader institutional dimension that addresses the structures, justifications and limits of decisional authority. Describing corporate law as a “species” of commercial law obscures, in effect rejects corporate law’s broader concern for institutions and the ways they mediate commercial power. By adopting the language of biological taxonomy (a “species” fits into a larger “genus”), *Cox* is implicitly asserting that commercial law is corporate law's natural place in the order of things -- that it cannot be otherwise.

6. Creating Urgency through Hyperbole

The *Cox* opinion is also rife with hyperbolic language that creates a sense of urgency around the project of limiting review for Entire Fairness. The opinion's use of heightened language suggests that the Entire Fairness standard is destructive to the economy and the corporate legal system. There are many examples of this throughout the *Cox* opinion.

For example, *Lynch* is described as having generated "perverse incentives" for both defense and plaintiffs' counsel that "cast doubt on the integrity of the representative litigation process." Cox describes the *Lynch* doctrine as having made it "impossible" for controlling stockholders, even the most-well meaning ones, "ever" to structure a going private deal "in any fashion" that would avoid a suit for Entire Fairness.[240] Instead, these suits are "unavoidable" under the *Lynch* doctrine.[241] *Cox* explains that this is because the plaintiffs' claims "always" have settlement value irrespective of their merit.[242] These examples illustrate *Cox's* use of superlatives and other heightened adjectives that are intended to communicate the urgency and validity of the law reform plan it proposes.

Furthermore, at the same time that Cox exaggerates the urgency of eliminating the Entire Fairness standard, it minimizes the effects that largely eliminating review for Entire Fairness would have on minority investors.[243] This is evident at many points in the *Cox* opinion. For example, early on *Cox* contends that: "Delaware law would improve the protections it offers to minority stockholders and the integrity of the representative litigation process by reforming and extending Lynch in modest but important ways. The reform would be to invoke the business judgment rule standard of review when a going private merger with a controlling stockholder was effected using a process that mirrored both elements of an arms-length merger..."[244] Indeed, *Cox* proposes that the switch to the business judgment rule upon Dual Ratification would actually improve the protections afforded minority investors, rather than minimize them.

7. Damning with Faint Praise

Cox includes an example of the rhetorical device of "damning with faint praise." The opinion describes *Lynch* as "a well-motivated" decision. In the approximately one hundred pages that make up the Cox decision, this is the only complimentary thing said about the Lynch doctrine. Of course, by stating that the doctrine was "intended" to do good, *Cox* is affirming that it has proven dysfunctional -- that it has not worked to benefit investors or the legal system.

D. Non-Obvious "Side-Effects" of Minority Shareholder Approvals

There is a further troubling feature to *Cox's* Dual Ratification proposal. *Cox* proposes that Dual Ratification (which includes approval by a majority of the disinterested shares) should "trigger" judicial deference towards the freezeout – that the private approvals go far enough in ensuring the transaction's fairness and the protection of the public stockholders' rights therein. *Cox* also notes, correctly, that as applied, Dual Ratification would mean adding the stockholder approval, since controllers presently, in general, obtain only disinterested director approval prior to going forward with a cash out merger. Thus, *Cox* describes the addition of the minority shareholder vote as an additional protection, an additional financial safeguard in the public investors' interest.[245]

But it's also likely that where there is approval by a majority of the outstanding public stock, that this may limit the stockholders' financial recourse against the target directors if they were sued for breach of fiduciary duty on account of their conduct in the freezeout. This is an outgrowth of equity's interpretation of the statutory provisions relating to ratification of self dealing transactions under Section 144 of the Delaware Code. This case law provides (as described in *Cox* itself) that informed ratification by disinterested directors or stockholders can exonerate breaches of duty on the part of corporate fiduciaries who have profited from the transaction.[246] The approvals, in effect, can "cure" the fiduciary breach – they can exonerate the fiduciaries from financial liability for their fiduciary breaches. As applied in the freezeout context, in particular, the disinterested (public) shareholders' approval could exonerate the target directors' breaches of fiduciary duty.[247] Such an exculpatory vote can be given broad effect – it could cover both the directors on the target's Special Committee and those on the full board.[248] *Cox* advocates in favor of the public stockholders' approval in freezeouts as an additional safeguard in the favor, but their approval could also hinder their ability to receive a recovery in a breach of fiduciary duty suit – even if their claims were meritorious. Consistent with the Cox Reforms, the disinterested, informed vote of the minority stockholders could protect the target directors more than protects the public investors themselves.[249]

IV. SWITCHING TO THE BUSINESS JUDGMENT RULE

A. The Disappearance of a Fair Price Duty in Freezeouts

1. Recapping the Fair Price Construct

The *Lynch* doctrine mandates that minority shareholders have a legal right to be paid their proportionate interest in the firm's going concern value in a cash out merger. Going concern value, rather than market value, has been the operative legal standard and measure of fair price for these transactions (as described in Part I).[250] Minority shares often trade at a discount to their stake in the firm's full, going concern value. This discount in the market trading price, in part, reflects the expectation of self dealing by the controller.[251] The *Lynch* doctrine's fair price duty backs out this "self-dealing" discount affecting the market trading price, consistent with the idea that equity should not permit a fiduciary to obtain a financial benefit from its self-dealing.

The *Solomon* line of cases dealing with tender offer freezeouts, in contrast, has eschewed imposing a fair price duty on controllers. This is not because these cases are less disapproving of self-dealing by controllers. Rather, as *Pure* observed, they simply failed to address the inherently coercive structural dynamics that operate to benefit controllers in tender offers. Presuming the absence of these coercive structural dynamics, equity reasonably declined to impose a fair price duty on controllers therein. However, once the coercive structural dynamics of tender offer freezeouts come into view, as *Pure* made clear, the basis for equity's declining to impose a fair price duty in tender offer freezeouts falls away.

2. *Cox's* Implicit Elimination of a Fair Price Duty in Freezeouts

To unify freezeout doctrine, *Cox* would have to resolve the inconsistency in between the presence of a fair price duty in cash out mergers and its absence in tender offer freezeouts. Furthermore, there wouldn't appear to be any middle ground. Controllers either will or will not have a duty to offer a legally determined fair price when they announce, negotiate and close their freezeout deals.

Perhaps because the matter is so controversial, the *Cox* opinion does not address the fair price issue head on. It never explicitly rejects the propriety of the fair price duty that has operated in the *Lynch* doctrine. Nor does *Cox* recant *Pure's* affirmation that coercive pressures inhere in controllers' tender offers. Indeed, *Cox*'s rejection of the fair price duty is nowhere expressed in the opinion. A hint of *Cox's* rejection of a fair price duty comes through where the opinion describes "good" prices as ones incorporating a premium to market value. *Cox* states that minority investors are "doing more than passably well" because they are receiving premiums to market value in both forms of freezeout.[252] *Cox's* rejection of a fair price duty is also apparent where the opinion enumerates the causes of action that would still be viable under its proposed reforms, and it says nothing about a cause of action for unfair price or inadequate value.

Mostly, the erasure of the fair price duty implicitly arises from the new, Dual Ratification proviso *Cox* endorses for freezeouts in both formats.[253] That is, *Cox* proposes that with Dual Ratification the business judgment rule should apply. As stated therein: "The reform would be to invoke the business judgment rule standard of review when a going private merger with a controlling stockholder was effected using a process that mirrored both elements of an arms-length merger: 1) approval by disinterested directors; and 2) approval by disinterested stockholders."[254] That is, Cox would make the Entire Fairness standard apply in a freezeout only if either form of consent were withheld. *In effect, the fair price duty would apply only where the controller goes forward with the freezeout after the negotiations have broken down* (that is, either form of consent was conclusively withheld from the transaction).

Unless and until either form of ratification were withheld, the fair price duty (and even the fair dealing duty, presumptively) would be inapplicable.[255]

3. Entire Fairness Only After Negotiations Have Broken Down

Crucially, *Cox* never proposes that Entire Fairness (and thus a legal fair price duty) should apply *unless* there is Dual Ratification. Instead, Cox provides that Entire Fairness would apply if the controller does not obtained Dual Ratification but goes ahead with the freezeout in any event. For example, Cox states that "the protections of *Pure Resources* should be supplemented by subjecting the controlling stockholder to the entire fairness standard if a special committee recommended that the minority not tender."[256] The difference is not merely semantic. Rather, forestalling the application of Entire Fairness until either form of consent has been denied would crucially affect the freezeout negotiations by altering their starting point.[257]

Under the *Cox* Reforms, a controller would approach the negotiations relieved of the burden of offering a legally determined fair price. Accordingly, in the course of the negotiations, the Special Committee has no legal basis to demand going concern value from the controller – the legal fair price duty does not apply at this point. Under the *Lynch* doctrine, consistent with controllers' duty to pay a legally set fair price, Special Committees had a duty to refuse a bid that offered less than the legally set fair price (going concern value). And where the independent directors concluded the freezeout offered less than going concern value to the public investors, and rejected it on this basis, they could point to the clear standard in the law as a basis for doing so. The law gave the Committee leverage to bargain with the controller and leverage to explain their conduct to the public investors. In the alternative, if the *Cox* Reforms are accepted, Special Committees won't be able to demand at least going concern value from controllers. Nor will they be able to defend a decision to reject a freezeout offer by explaining that it was less than the legal standard of fair price – because equity will have taken away the public investors' legal claim to receive at least going concern value in a freezeout. (Again, the Entire Fairness standard would apply only after the independent directors or public stockholders have rejected the bid – which, in most cases, will mean that the controller will withdraw the proposal.)

Once market value becomes the benchmark of fair price, a premium to market value makes almost any offer a "good" offer. A Special Committee's refusal to approve a freezeout bid offering a premium to market value would appear foolhardy, irrational, potentially self-serving. In sum, by changing the applicable legal standard so that a fair price duty applies only if and after the independent directors or majority of the minority shares officially disapprove of the freezeout, the *Cox* Reforms alter the starting point for freezeout negotiations. Under the *Cox* Reforms, controllers would not be obligated to offer and pay at least going concern value – that requirement would "kick in" only if the offer were rejected. Because *Cox* implicitly validates market price as the starting point for the negotiations over price, it would foreseeably alter, profoundly, the price at which the negotiations end.

The elimination of the fair price duty for controllers' offers is rendered more consequential, furthermore, by equity's failure to endorse Special Committees' power to go to the market to pursue financial alternatives to the controller's offer. *Cox* not only allows for deferential review of a freezeout, and hence the elimination of a fair price duty, where Dual Ratification is obtained – it also affirms this lesser level of equitable protection without affording Special Committees the power to test the controller's bid in the market. Under the *Cox* Reforms, Special Committees would be negotiating with controllers in freezeouts in the absence of both strong legal protections and bona fide market alternatives. This is not a situation that presents a strong rationale for presuming the fairness of the transaction and barring a stockholder's claim from going forward.

B. Dual Ratification Doesn't Substitute for a Fair Price Duty

Instead of "owning" its rejection of a legal fair price duty, Cox highlights the efficacy of the Dual Ratification requirement in effectuating good outcomes in freezeouts. *Cox* proposes that the Dual Ratification proviso allows for arms'-length dealings between the parties. As described earlier, *Cox* analogizes cash out mergers with Dual Ratification to arms'-length mergers with third parties. And *Cox* suggests that its Dual Ratification proposal fulfills *Weinburger's* promise of arms-length dealings in the public stockholders' interest. *Cox* might claim that Dual Ratification would be sufficient leverage so that minority investors would receive a premium over the market price, but it isn't reasonable to believe that Dual Ratification, in the absence of a fair price duty, would push premiums into the high range of fairness, consistent with going concern value. This is because once the fair price requirement is attenuated, public investors are largely captives to the discounted market price in the presence of a controller. The controller stands as a bulwark against the public investors' ability to benefit from the market for corporate control. As described earlier, the analogy to cash out mergers with third parties is inappropriate in a situation where the target directors are hindered from seeking market alternatives, as they typically are by controllers. *Cysive* was exceptional in this sense.

Cox describes the Dual Ratification proviso as if it is a proxy, a true equivalent of a fair price duty, but this is misleading. This could be true, potentially, if the parties were of roughly equivalent stature in their bargaining leverage and had full access to market alternatives. *Cox's* proviso that both forms of consent should be required in order to forestall equitable review for fairness is intended to minimize controllers' potential for coercion, and it may do so. But Lynch's Entire Fairness encompasses both a fair price and a fair duty standard and eliminating the latter necessarily changes the situation dramatically. Minority stockholders' ability to bargain with a controller (either directly or through a Special Committee) would be affected fundamentally by withdrawing the background fair price duty. (Making it apply only if the Special Committee or minority investors have declined the controller's offer is the equivalent of withdrawing it for most purposes.) Once the fair price duty is withdrawn consistent with the *Cox* Reforms, then the controller is bargaining against the market price, rather than full, going concern value. The potentially greater safeguard of requiring Dual Ratification (both forms of consent) doesn't come close to making up for the cancellation of the substantive fair price duty.

C. Business Judgment Deference Is Not the Norm in High Stakes M&A Deals

1. Simplicity Is Not an Unqualified Virtue in Law

At many points the *Cox* opinion appeals to what it contends is the relatively pervasive application of the business judgment in corporate law. This is one of the rationales for its disapproving of Lynch's Entire Fairness standard for freezeouts. For example, in its frequent references to the *Aronson* decision, Cox rightly notes that corporate law commonly defers to the disinterested judgment of corporate boards in determining the course of corporate affairs in the best interests of the company and all the stockholders.[258]

Cox defends its proposed reforms on the rationale that adopting the business judgment rule for freezeouts (that receive Dual Ratification) would synchronize this body of law with the broader architecture of corporate law. Cox endeavors to unify both bodies of case law for freezeouts. Moreover, this project of unification is pursued as a mode of simplifying the law. Indeed, in Cox, the project of streamlining and simplifying the law (indeed, reducing the intrusion of law into corporate affairs) is endorsed as being a virtue in itself.

Of course, in many areas of law and experience, simplicity has its virtues. But the measure of the law, as Chancellor Strine himself has written, must be its function rather than its form. The crucial question for equity has to be not merely whether the law is straightforward and simple but whether it is adequate to do justice to the situation. In reforming freezeout doctrine, equity must ask whether the proposed standards do justice to the circumstances of the parties and the forms of legitimate and illegitimate power being exercised therein. If the two transactional forms for freezeouts involve substantially similar power dynamics, then a substantially similar doctrinal framework is warranted. But that doesn't resolve that the distinct features of this case law should be collapsed into the business judgment rule.

2. Heightened Scrutiny in Corporate Sales and Change of Control Transactions

Cox is correct about the overall deference that corporate law shows to the disinterested, informed judgment of corporate boards. But what *Cox* deemphasizes, in fact ignores, in calling for the adoption of the business judgment rule in freezeouts is the fact that the Delaware Courts have developed a richly complex body of equitable doctrines for high stakes mergers and acquisitions. These heightened standards take account of the operation of a variety of forms of conflicts of interest, as well as the financial magnitude of these transactions. Equity has taken account of these context-specific "reasons for concern" and balanced them against the value of deferring to the decision making of disinterested boards. This is part of the essence of the concept of transactional choreography developed herein.

There are many examples of this context-specific approach -- these heightened standards for M&A transactions within corporate fiduciary law. For example, in the context of reviewing a board's decision to sell the company through a merger in *Smith v Van Gorkom*, on account of the financial magnitude of the transaction (from the perspective of the selling stockholders), even though there was no conflict of interests impairing the board's judgment, the Supreme Court applied what has been recognized as a heightened duty of care.[259] Under the line of case law established by *Unocal v Mesa* Petroleum, the Court allows that incumbent directors discretion to defend the corporation from threats (including coercive and inadequate tender offers).[260] But at the same time equity enforces limits on the scope of the directors' defensive authority in this context. Under the *Blasius* standard, in light of the signal importance of stockholders' voting rights within corporate law, fiduciary law requires the board to demonstrate a compelling justification for interfering with the stockholder franchise. And under *Revlon*, corporate directors are under a duty to ensure they are getting the best price reasonably available in the stockholders' interest prior to approving a sale or break up of the company.

Freezeout transactions, in either format, are more closely analogous to these high stakes acquisition transactions than they are to ordinary corporate transactions that are handled with deference by the Courts in a stockholder challenge, consistent with business judgment rule. *Cox's* claim, in effect, that the business judgment rule should apply in freezeouts because it "usually does" is off the mark. It ignores controllers' significant capacity for overreaching and the implications for corporate law of allowing them to do so. It also ignores the broad and rich tradition of heightened equitable safeguards in high stakes mergers and acquisitions transactions. Perhaps most troublingly, the *Cox* Reforms envision a decreased role for equity – that is lesser equitable safeguards – without allowing for a wider scope in which market forces could operate. They would allow the application of the business judgment rule, based on the rhetoric of arms'-length dealings, without allowing target directors to unleash market forces to test the controllers' bid. Without the latter, the promise of arms'-length dealings is suspect and the reduction in legal safeguards unjustified. Under the reforms proposed in *Cox*, public investors in freezeouts are left in a kind of limbo between the market and the law. Neither one is properly available to serve their interests.

V. TWENTY-FIRST CENTURY STANDARDS FOR FREEZEOUTS

A. Unifying Freezeout Doctrine

Part I of this Article described the two doctrinal traditions governing freezeouts. It described the relaxed standards applied to tender offer freezeouts and the rigorous standards applied to controllers' cash out mergers. As the *Pure* opinion notes, there are a variety of forces pressuring stockholders to sell in tender offer freezeouts. The pressures and disabilities that affect public investors in tender offer freezeouts undermine their capacity to consider the merits of the controller's freezeout offer in its own right. In this sense, tender offer freezeouts meet the *Lynch* doctrine's standard for being coercive – which would suggest that *Lynch's* protections should apply in tender offer freezeouts as well.

In addition, as *Pure* also observes, the problem of inherent coercion that presents itself in cash out mergers is relevant to minority stockholders' choices in tender offer freezeouts. There is no reason that public investors would be less susceptible to inherent coercion on account of the freezeout being based primarily on a tender offer instead of a cash out merger. In addition, the fact that the law has not affirmed target directors' fiduciary authority to defend public investors against controllers' tender offers, while it affirms their duties to defend stockholders from third parties' tender offers, exposes the weak underpinnings of the tender offer freezeout line of cases. Most fundamentally, by declining to impose either an Entire Fairness requirement or an affirmative duty on target directors to protect minority investors' interests through an auction or market check, equity has left public stockholders in limbo in tender offer freezeouts. Law reform in this area of freezeout doctrine is therefore crucial to minority investors' welfare.

The different approaches to whether controllers' offers are subject to a fair price requirement in tender offer freezeouts and cash out mergers has further undermined public stockholders' interests in going private deals. This problem has been compounded by the erratic availability of appraisal rights. Given the comparability of minority investors' vulnerability in the two freezeout formats, the argument for adopting a unified doctrinal structure for freezeouts is a strong one.

In sum, *Cox* rightly takes a strong stand in favor of unifying the jurisprudential standards for freezeouts. However, *Cox* is less convincing in advocating that unification should occur under the framework of deferential review, as conventionally associated with the application of the business judgment rule.

B. Entire Fairness for Cash Out Mergers and Tender Offer Freezeouts

The tender offer freezeout case law is not nearly as sound or as well established as is the *Lynch* doctrine and the Entire Fairness standard. The best approach for equity would be to unify freezeout doctrine under the framework of *Lynch's* Entire Fairness, as described below.

Part II of this Article described the weaknesses in the tender offer freezeout case law, specifically, its underestimation of controllers' exercise of coercive power therein. In the two Supreme Court decisions of relevance, *Solomon* and *Glassman*, neither one explicitly considered a freezeout transaction. In addition, *Solomon* held that no fair price duty applies in controllers' tender offers without presenting substantial legal analysis to support its conclusion, or even relevant legal precedent.

Glassman addressed only a short form merger by a controller, without considering the opinion's implications for freezeouts. Furthermore, the Entire Fairness standard is presently applied in freezeouts that end with short form mergers, so long as they begin with long form, cash out mergers -- and no one has suggested that this approach is inconsistent with *Glassman* or the will of the Delaware Legislature. That is, once short form mergers become incorporated into complex, multi-segmented freezeout deals, they take on a complexion different from the short form considered in *Glassman*.

A careful reading of *Siliconix* clearly reveals that the Chancery Court was troubled by the exercise of coercive power by the controller in the tender offer freezeout disputed therein. However, the Court appears to have felt it would be on uncertain legal footing in granting the preliminary injunction requested by the minority investors. In *Siliconix* the Chancery Court invoked formalistic differences between the structure of cash out mergers and tender offer freezeouts, and equity's treatment of controllers and independent directors' duties in these different contexts. It used these differences as a basis to retreat from a robust application of its equitable authority in the minority investors' interests.

The *Pure* decision is both more comprehensive and more bold in its approach to addressing coercion in tender offer freezeouts. It affirms that coercive pressures inhere in these transactions to the pervasive advantage of controllers. But *Pure's* concern for protecting public investors in tender offer freezeouts founders as it encounters the Court's other major preoccupation – reducing the incidence of stockholder suits in freezeouts. In essence, in *Pure* the Chancery Court tries to accommodate both concerns -- to afford public investors somewhat greater equitable protection against coercion in tender offer freezeouts, while limiting stockholders' opportunity to sue on a claim of unfairness in a freezeout. But ultimately, in *Pure*, the concern for limiting stockholder suits in freezeouts takes precedence. (This is even more graphically evident in *Cox*.)

But *Pure* gets it right that public investors face similar jeopardy in tender offer freezeouts as they do in cash out mergers, and it is unfortunate that the Court's boldness did not result in its validating Entire Fairness as the applicable equitable standard for all forms of freezeouts. As *Pure* noted, the problem of inherent coercion applies equally in both settings. Shareholders' collective action disabilities apply in both settings, as do information asymmetries that favor controllers. (Consistent with this analysis, *Pure* appears to come close to endorsing Entire Fairness as the rule for freezeouts.) The *Pure* opinion also noted the disturbing doctrinal inconsistency inherent in directors having a fiduciary duty to defend against third parties' inadequate tender offers, but not controllers' inadequate tender offer freezeouts.

Pure failed to resolve this inconsistency, however, as does *Cox*. That is, there is no explanation in the case law for target directors having lesser defensive authority in tender offer freezeouts than in relation to third parties' hostile bids. It would seem that equity has declined to afford target directors facing a controller's tender offer such affirmative, fiduciary defensive authority because it would inevitably give rise to a messy institutional conflict.[261] That is, if equity required target directors' to take affirmative actions to defend public stockholders facing a controller's inadequate tender offer, controllers would inevitably object and take action to remove or at least fail to reappoint these directors.[262]

In any event, leaving aside the concern over encouraging stockholder suits and institutional conflicts between target directors' and controllers' authority, the compromised situation of public investors facing controllers' tender offers suggests that heightened equitable protections are warranted in both forms of freezeout. The Chancery Court in *Pure* and then *Cox* endorses a set of objective, bright line safeguards and tests for ensuring that coercion has not compelled a result in a controller's tender offer. But the better approach would be to endorse a duty of Entire Fairness consistent with Lynch (which comprehends both a duty of fair dealings and fair price). This would have allowed equity to fill out the substance of the appropriate equitable safeguards for controllers' tender offers over time. This approach has worked effectively in cash out mergers, consistent with the concept of transactional choreography elaborated herein. As applied in cash out mergers, *Lynch's* Entire Fairness standard has encouraged the establishment of Special Committees and their hiring of independent financial and legal advisers in the minority investors' interest.

As described in Part III, the concern over excessive litigation reaches a fever pitch in the *Cox* decision and becomes the basis for an all out assault on the inherent coercion concept that is the cornerstone of *Lynch*. But many of *Cox's* criticism of the *Lynch* doctrine are exaggerated, as described in Part III. They can be resolved without abandoning equity's commitment to reviewing freezeouts for Entire Fairness. In addition, *Cox* underestimates the benefit of applying Entire Fairness in freezeouts. In particular, the Courts have discretion to adjust the fee doctrine pertinent to plaintiffs' attorneys' awards in Entire Fairness litigation. In addition, it is unreasonable to believe that the Courts are unable to develop workable standards for dismissing *Lynch* claims on the pleadings where they fail to state a genuine claim of unfairness. Nothing in the *Lynch* doctrine relieves plaintiffs from the requirement of demonstrating a genuine issue of unfairness in a freezeout in order to go forward with a suit. A mere declaration of financial fairness has not and should not be enough to force a full trial in equity.

Perhaps most importantly, the fair price duty inherent in the Entire Fairness standard has afforded Special Committees substantial leverage in negotiating with controllers. This leverage has limited controllers' capacity to buyout minority investors at less than fair value. In addition, the improved operation of information technology and the increased presence of institutional investors are inadequate proxies for the Entire Fairness standard. Better information flows and the presence of institutional investors are complements to the fair price duty that should apply in negotiations with controllers, not substitutes for it. As a self-help strategy, moreover, diversification is costly and, in any case, may not work to protect public investors if controllers are given broad latitude to act opportunistically in freezeouts. Moreover, telling public investors that they can make up their losses in freezeout by becoming part of an opportunistic controlling shareholder group is unrealistic and unseemly.

Given equity's longstanding commitment to the principle that corporate insiders should not profit from their self-dealing to the disadvantage of their company or the other, minority stockholders, the fair price duty applied to controllers under *Lynch* should be retained and expanded, also, to tender offer freezeouts. In addition, in contrast to *Cox's* proposed doctrinal framework for freezeouts, Dual Ratification cannot work as an effective safeguard to protect public investors from unfairness once it is unhinged from controllers' duty to pay a fair price (or target directors' authority to seek market alternatives). For this reason, the *Cox* Reforms should not replace the Entire Fairness standard. The ability of target directors to negotiate with controllers at arms' length is affected not only by the availability of information and unbiased advisers, but also by minorities legal entitlements to receive a fair price for what controllers can take from them through a freezeout. Though *Cox* obscures the difference, a legal entitlement to receive fair value if negotiations have broken down is not the same as a legal entitlement to receive fair value that informs negotiations. In order for minority investors to obtain the benefit of the full value of their shares from negotiations, controllers have to be under a duty to offer a fair price in these negotiations.

C. The Questionable Objective of Reducing Stockholder Claims in Freezeouts

The proposal to abandon Entire Fairness for the purpose of reducing stockholder litigation is suspect. Reducing stockholder claims in freezeouts is not an unqualified good. Reducing stockholder claims at the cost of allowing an increased scope for overreaching by controllers would not be a good result. A downward cycle of unaddressed self-dealing by corporate insiders eventually harms the capital raising process and investors broadly. Despite *Cox's* rhetoric, the operation of inherent coercion has not been disprove, nor is it less serious a problem than it was when *Weinberger* and *Lynch* were decided. Indeed, modern financial theory suggests that capital markets thrive where minority investors' interests are protected by the legal system, not where they are disregarded.

Furthermore, the business judgment rule does not make sense in application to controllers' freezeout offers. Controllers initiate freezeouts – rather than disinterested corporate boards of directors. Because equity has not given target directors full authority to pursue market alternatives to the controller's bid, the target directors' approvals in a freezeout cannot be equated to the full, unfettered decision-making in other corporate contexts. In addition, the business judgment rule is not applied without limit in the review of corporate change of control and other sale transactions. *Revlon* duties require the board to take affirmative actions to obtain the best price reasonably available in a change of control or corporate sale transaction – business judgment deference is not the rule in this setting. Even where a board approves a merger with a third party that does not involve a change of control, the Courts have applied a heightened fiduciary duty of care in reviewing these directors' conduct, for example. Given this tradition of heightened review in high stakes mergers and acquisitions deals, the superior organizational and legal powers of controllers in freezeouts and the collective action and informational disabilities that affect minority investors therein, the business judgment rule should not apply to these transactions.

D. The Exception: Deferential Review Upon an Auction or Market Check

The *Cox* Reforms fail to take account of the fact that under the law as it presently stands, *Revlon* duties "to obtain the best price reasonably available" would apply to target directors in a freezeout proposed by a De Facto Controller. The freezeout by the De Facto Controller would involve a change in voting control of the type of concern in *Revlon* and its progeny.[263] Although the case law under *Revlon* affirms that there is no single blueprint for directors to obtain the best price available in a sale of the company, it does affirm that independent directors would ordinarily conduct an auction or at least a market check before approving closing a deal.[264] Truly independent directors in freezeouts should have a similar instinct, and similar freedom and authority. Target directors facing a controller's freezeout bid, in either format, should have authority to go to the market to seek alternatives to the controller's proposal. Where they do not do so, this casts doubt on their independence and suggests that presuming the fairness of the freezeout would be a mistake.

In addition, if the controller wishes to avoid the Entire Fairness standard, potentially, in a dispute over the freezeout, it should agree to be a seller as well as a buyer. That is, if the controller would not agree to sell its stock for the same price it offers to the minority, there is little basis to assume the offer is at full, fair value. Controllers could still go forward with the freezeout under this regime, even if they refused to allow the target directors to conduct an auction or market check and even if they refused to sell their shares. But in these instances, equity should not afford the controller's transaction a presumption of fairness so that deferential review would apply. If equity is not willing to embrace affirmative fiduciary duties mandating that directors test a controller's bid through an auction or market check prior to approving it, it should at least decline to afford controllers' freezeouts deferential review where no market check or auction has occurred. Without the latter, the controller's freezeout has not been tested by the market, and hence it should be tested by the standard of Entire Fairness in a stockholder suit. The case law under *Revlon* and *Van Gorkom* would seem to require no less.

The recent changes to the listing standards for public company boards ensure a greater presence of independent directors and more objective standards for ascertaining directors' independence.[265] Where there is a Special Committee that undertakes a market check or auction of the company's full value, prior to approving a controller's freezeout bid, and then determines that the controller's bid offers the superior value, then there is a reasonable basis for a court to defer to the independent directors' judgment and assume that the minority investors' interests have been protected as part of the transaction.

In addition, prior to affording controllers the beneficial burden shift allowed under *Lynch*, controllers should have to obtain Dual Ratification, consistent with that envisioned in *Cox*. As *Cox* rightly contends, the two forms of consent – that of disinterested directors and minority shareholders – complement one another. They are not adequate indicia of fairness individually. The argument for affording controllers the beneficial burden shift where they bypass either the disinterested directors or the minority investors is not strong. In addition, the improved information flows described in *Cox* should make it relatively easy and inexpensive for controllers to present their proposals for both forms of consent. Where controllers obtain both forms of consent, as envisioned by *Lynch*, the plaintiffs should have the burden of demonstrating the unfairness of the freezeout in order to obtain a recovery in equity.

CONCLUSION

Corporate law is often analogized to contract law. The Delaware Chancery Court's proposed reforms to freezeout doctrine would take this analogy further, embedding it into the transactional choreography for going private. The metaphor of contract is appealing where the parties are relatively equally situated, informed, clear about their entitlements and capable of recourse if there is fraud. There are powerful reasons to believe that this does not describe the situation of minority investors in a freezeout transaction.

The Courts should apply the Entire Fairness standard in freezeouts, irrespective of their structure. Equity should continue to have a meaningful role in reviewing freezeouts when a stockholder presents a genuine claim of unfairness, as it has in cash out mergers for generations. The costs of unchecked overreaching by controllers are incalculable – they are clearly greater than the Delaware Chancery Court's recent trilogy of freezeout cases contemplate.

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[1] Corporate law does not use "going private transaction" or "freezeout" as a precise term of art; instead, these terms have meant different things in different contexts. This Article uses the term only to connote transactions in which controlling shareholders effectuate the buyout of the public stock, whether based on a tender offer and short form merger or a (long form) cash out merger. (On this basis the usage "controllers' cash out mergers" is generally avoided as being redundant. Freezeouts are a subset of the broader management or leveraged buyout phenomenon which is once again (as in the mid to late 1980s) achieving great prominence in the acquisitions markets. See Andrew Ross Sorkin, *HCA Buyout Highlights Era of Going Private*, A1, July 25, 2006.

[2] A controlling stockholder can be a natural person or a legal entity. In many instances controllers are parent companies of a subsidiary. In this context the stockholders in the buyout are the public investors at the subsidiary company. For purposes of linguistic convenience, the impersonal pronoun "it" is used when referring to a controlling stockholder generically. For further discussion of the definition see footnote _- below and accompanying text [discussing control through straight stock ownership versus control through participation in management]

[3] The point is not commonly observed.

[4] In tender offer freezeouts, this inhibition proceeds from equity's failure to grant target directors authority to defend the public investors against the bid. In cash out mergers, the inhibition arises from controllers' capacity cow even independent directors with the threat that they will seek financial retribution against the public investors if the directors don't agree to the deal.

[5] For a comprehensive analysis of the common forms of illicit self dealing that present themselves to controllers, see Gilson & Gordon, *Controlling Controlling Shareholders* 152 U. Pa. L. Rev. __ . Self-dealing in corporate property is the classic problem addressed within corporate fiduciary law, under the rubric of the duty of loyalty. See e.g. *Pepper v. Litton*, 308 U.S. 295 (1939*); Globe Woolen v Utica Gas & Electric Co.* 121 NE 378 (NY 1918)(Cardozo J*); Bayer v Beran* (NY, 194_); See Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, Duke L.J. (1988): 879, 910–11; Victor Brudney, *Contract and Fiduciary Duty in Corporate Law*, Corporate Practice Commentator 39 (1998).

[6] See, e.g., *Thorpe v. Cerbco*, 676 A.2d 436 (Del. 1996).

[7] Like all fiduciary law, corporate fiduciary law aims to reduce the abuse of power. While self dealing in corporate property is a central concern of corporate fiduciary law (especially the duty of loyalty), it is not the only concern. For the relevance of corporate fiduciary law to directors' disclosure of corporate information see Faith Stevelman Kahn, *Transparency and Accountability, Rethinking Fiduciary Law's Relevance to Corporate Disclosure*, 34 Ga. L. Rev. 505 (2000); for fiduciary law's relevance to the practice and disclosure of corporate contributions to nonprofit organizations see Faith Stevelman Kahn, *Pandora's Box: Managerial Discretion and the Problem of Corporate Philanthropy*, 44 UCLA L. Rev. 579 (1997). For the argument that broad social and moral values inhabit corporate fiduciary law, although they vary in nature and intensity over time, see Faith Stevelman Kahn, *Bombing Markets, Subverting the Rule of Law:, Enron, Financial Fraud and September 11, 2001*, 76 Tul. L. Rev. 1579 (2002).

[8] *Weinburger v. UOP*, 457 A2d 701 (Del. 1983).

[9] *Solomon v Pathe*

[10] There is no more contentious a subject in private law, and especially corporate fiduciary law, than the definition of fairness and the appropriate role of the courts in enforcing it. For a notable, law-and-economics inspired account of the issue, see LOUIS KAPLOW AND STEVEN SHAVELL, FAIRNESS VERSUS WELFARE, HARVARD UNIVERSITY PRESS (2002). For a strong argument that the law and economics movement has misrepresented the discipline of economics by over-extending its utility and been used in corporate law to overshadow the operation of other crucial values, see Martha C. Nussman, *Flawed Foundations: The Philosophical Critique of a (Particular Type of) Economics*, 64 U. Chi. L. Rev. 1197 (1998).

[11] There is increasing evidence in the empirical literature that there is a link between strong securities markets and protections for minority investors. See e.g. Michael S. Weisbach and William A Reese, Jr. P*rotection of Minority Shareholder Interests, Cross Listings in the United States and Subsequent Equity Offerings*, Journal of Financial Economics (2002); Bernard Black, *The Legal and Institutional Preconditions for Strong Securities Markets*, 48 UCLA L. Rev. 781 (2001); James Cox, *Making Securities Fraud Class Actions Virtuous*, 39 Ariz. L. Rev. 497 (1997).

[12] For this reason, references to "The Supreme Court" herein denote the *Delaware* Supreme Court, unless otherwise stated. The preeminence of Delaware law in influencing both corporate conduct and the other fifty states' corporate laws is widely acknowledged. For discussion as it pertains to freezeouts, see e.g. Guhan Subramanian, *Post-Siliconix Freeze-Outs, Theory, Evidence and Policy*, Harvard Law and Economics Discussion Paper No. 472; and see also, Robert Daines, *Does Delaware Corporate Law Increase Firm Value? ...* In addition, approximately 60% of the Fortune 500 are incorporated in Delaware and thus governed by its fiduciary dictates.

[13] This is to say that the fiduciary standards governing controllers' duties in freezeouts are a subset of the duty of loyalty.

[14] All references to cash out mergers herein are long form and thus "negotiated" mergers under Delaware Corporate Code, Section 251, unless specified otherwise. Where we intend to refer to a short form merger, as governed by Section 253 of the Delaware Corporate Code, the text so indicates.

[15] See infra, footnote __ and accompanying text. Freezeout doctrine does not generally distinguish between controllers' obligations to the "dominated" shares, whether they constitute are a true minority of the outstanding voting shares or slightly more -- so that they are technically a majority. In most instances these are both described as the "public stock" or "public stockholders" herein for convenience.

[16] Going private deals can also be accomplished through sales of substantially all assets and charter amendments effectuating stock splits. But these are quite rare, comparatively.

[17] As a result of the anticipated higher costs to public companies from increased regulation under Sarbanes Oxley, the prevalence of private equity in the form of professionalized funds and relatively depressed public market prices, there has been an increased incidence in going private deals in the last several years. Andrew Ross Sorkin, *HCA Buyout Highlights Era of Going Private*, NYT, July 25, 2006, A1.

[18] As in prior decades, the present stagnation in stock market prices is causing the rate of leveraged buyouts, management buyouts and freezeouts by controllers to accelerate. As it does so, the public outcry over perceived

overreaching by insiders is also escalating. See e.g. Ben Epstein, *On Buyouts: There Ought To Be A Law*, NYT, September 3, 2006.

[19] *In re Cox Communications, Inc. S'holder Litig.*, 2005 Del Ch Lexis 79 (June 6, 2005) (Strine, V.C.) .

[20] *In re Cysive, Inc. S'holders Litig.*, 836 A.2d 531 (Del Ch. 2003) (Strine, V.C.).

[21] *In re Pure Resources S'holders Litig.*, 808 A.2d 421 (Del. Ch. 2002) (Strine, V.C.)

[22] Biographical data for Vice Chancellor Strine and information about the Delaware Chancery Court is available at www.court.delaware.gov. References to "equity" herein denote the tradition of common law-like adjudication conducted by Delaware's equity courts.

[23] As scholars have noted, even if one embraces the merits of a unified approach in freezeout doctrine, this does not resolve what the governing standard should be. For a review of different scholarly proposals and the argument for convergence (in the presence of Dual Ratification) around the business judgment rule standard, see Guhan Subramanian, *Fixing Freezeouts*, 115 Yale L. J. 2 (2005).

[24] The business judgment rule is a protean concept in corporate law. As a standard of review in litigation it reflects the statutory principle that the business affairs of the company should be run by or under the direction of the corporate board, consistent with the corporation codes. In this sense, it operates as a legal presumption in favor of the board's judgment. Once the business judgment rule applies, the Court will not evaluate the substance of the board's decision or judgment without the plaintiff showing some extraordinary irregularity. That is, where the business judgment rule presumptively applies, a plaintiff can go forward with a claim only if it can show deception, illegality, (truly) gross negligence, material financial conflicts of interest or a compelling social or professional affiliation that renders a director "beholden." [Cite to recent Disney case about executive compensation granted to M. Ovitz; affirmed by the S. Ct] As discussed in Part V, there is a fundamental illogic in applying the business judgment rule in freezeouts, since the transactions are initiated by the controlling shareholder and not the board. Furthermore, equity does not afford the independent directors on the board authority to explore market alternatives to the controller's offer – so that even if they approve of the controllers' bid, the directors' "business judgment" has been profoundly constrained in the freezeout setting in most instances.

[25] The proposal reflects that advocated by Prof. Subramanian. See Fixing Freezeouts 115 Yale L. J. 2 (2005).

[26] See Part III and the discussion of Cox in particular. ["... Lynch has generated perverse incentives for both defense and plaintiffs' counsel that cast doubt on the integrity of the representative litigation process." At 119. "In this corner of our law, a relatively modest alteration of Lynch would do much to ensure this type of integrity, while continuing to provide important, and I would argue, enhanced, protections for minority stockholders. That alteration would permit the invocation of the business judgment rule for a going private merger that involved procedural protections that mirrored what is contemplated in an arms' length merger under '251..." At 121. "If both the independent directors and the disinterested stockholders are given the ability to say no and do not, ought we not presumptively assume that the transaction was fair?" At 132.]

[27] The Article's title is intended to allude to the fact that 1) going private deals involve both market and legal structures – there is no avoiding the crucial role of law in these deals; and 2) if the assault on the Entire Fairness standard in freezeouts is successful, and independent directors are not allowed to test the controller's bid through an auction or market check, then minority investors will be left in limbo -- without adequate legal protections or market forces on their side. Within the academic literature there's been increased emphasis on the ability of commercial communities to govern themselves through private, extra-legal rules and norms. See, e.g. Lisa Bernstein ....; Gillian Hadfield .... The regulation accomplished through stock exchange listing requirements is an interesting popular example. In addition, the absence of "governmental" or other "quasi-legal" regulation in cyber worlds has allowed for (virtual) experiments testing the limits of the capacity for economic development in an unregulated environment. See, *State of Play* Conference, NYLS, fall 2005 (Faith Stevelman Kahn, Moderator, Virtual Economies in Cyberworlds, Panel I) (Available through the Web)

[28] On his law blog, Professor Larry E. Ribstein refers the *Cox* opinion as a "classic-to-be;" describing it as "so interesting for so many reasons." See http://busmovie.typepad.com/ideoblog. A writer for The Financial Times referred to Vice Chancellor Strine as Delaware's "Wunderkind of US Corporate Law." *Financial Times* __.

[29] *Cox* at 130 – 131 "In this way, the alteration [of the standard of review to embrace deferential review] brings this area of our law into harmony with the rest of Delaware corporate law that gives substantial deference to decisions made by disinterested, independent directors and approved by disinterested, non-coerced stockholders. That deference is consistent with the central notion of our law, which respects business judgments made by impartial directors and approved by uncomplicated stockholders."

[30] This policy orientation was evidenced, most recently, in Congress' enactment of *the Class Action Fairness Act of 2005*, which is intended to make it easier for consumer class actions to be moved out of state court and into a federal court, with the objective of curtailing plaintiffs' lawyers' forum shopping to maximize jury awards. The Act also sets limits on the total portion of a jury award that can go to the plaintiffs' lawyers. The Act was signed into law by President Bush on February 18, 2005.

[31] The proper scope of private litigation and its effect on the economy are, of course, huge issues in contemporary American law and public policy. For example, see Manhattan Institute for Policy Research, Trial Lawyers, Inc, A Report on the Lawsuit Industry in America, 2003; and cf THOMAS F. BURKE, LAWYERS, LAWSUITS AND LEGAL RIGHTS, THE BATTLE OVER LITIGATION IN AMERICAN SOCIETY (Univ. Ca. Press (2002). James D. Cox, *The Social Meaning of Shareholder Suits*, 65 Brooklyn L. Rev. 3 (1999) (The 8th Annual Pomerantz Lecture).

[32] For academic discussion of the criticisms of the plaintiffs' bar, see, e.g., Anita Berntstein, *The Enterprise of Liability*, Emory Public Law Research Paper No. 06-15; 69 Valparaiso Univ. L. Rev. 27 (2004); Lawrence E. Mitchell, *Gentleman's Agreement, The Anti-Semitic Origins of Restrictions on Stockholder Litigation*, Working Paper (2004).; Marc Galanter ___________.

[33] For an important modern treatment of the comparative institutional advantages of legislatures, courts and markets, see NEIL KOMESAR, IMPERFECT ALTERNATIVES (199_).

[34] Robert Thomas and Randall Thomas, *The New Look of Acquisition Oriented Shareholder Class Actions*, __ Vand. L. Rev. __ (2004).

[35] Private Securities Litigation Reform Act of 1995, Pub. L. No. 104 – 67, 109 Stat. 737 (codified as amended in sections 15 U.S.C.).

[36] *Securities Litigation Uniform Standards Act of 1998,* Pub. L. No. 105-353, 112 Stat. 3227 (codified as amended in sections 15 U.S.C.). See e.g. Merill *Lynch, Pierce, Fenner & Smith, Inc., v Dabit,* No. 04-1371 (U.S. Mar. 21, 2006), in which the U.S. Supreme Court held that SLUSA bars class actions brought under state law by persons claiming to have been misled into holding securities, as opposed to purchasing or selling them.. For a thoughtful critical analysis of the effects of preemption see Richard W. Painter, *Responding to a False Alarm: Federal Preemption of State Securities Fraud Causes of Action*, 84 Cornell L. Rev. 1 – 108 (1998).

[37] Sarbanes Oxley Act of 2002, Pub. L. No. 107 – 204, 116 Statt 745. The exception is that SOX restored the statute of limitations for securities class actions involving fraud to two years from learning of the fraud or five years from the time it was committed – it had been one and five. Otherwise, SOX expands the scope of potential criminal fines and penalties (and adds a new criminal cause of action for fraud): and it imposes federal mandates on corporate boards and committees – but it does not support the expansion of private causes of action by investors.

[38] This negative view of the plaintiffs' bar was reinforced in the summer of 2006 when the famous plaintiffs' class action firm, Milberg, Weiss, Bershad & Shulman was indicted for making large secret payments to persons who agreed to become plaintiffs in lucrative class-action securities lawsuits.

[39] In this mode, the "cost" of unfair laws is prices by investors who simply pay less for their shares. See e.g. A.C. Pritchard, Tender *Offers by Controlling Shareholders: The Specter of Coercion and Fair Price,* 1 Berkeley Bus. L. J. 83 (2004).

[40] DEBORAH DEMOTT, SHAREHOLDER DERIVATIVE ACTIONS: LAW AND PRACTICE (1999). See also Thomas & Thompson, [Derivative Litigation] Vanderbilt Law Review (2004)

[41] This is the so called "Delaware carve-out" in SLUSA. If Congress had not made this special provision, then suits against controllers for misrepresentation in freezeouts would not be litigable in equity.

[42] By the late '90s, corporate legal scholars became fluent in the "law and norms" literature; as incorporated into corporate law, this school of thought was employed as a way to argue that legal standards – or at least the enforcement of legal standards – was often unnecessary to the promotion of efficiency or the best resolution of conflicts. In this tradition, see, e.g., Edward Rock [& Wachter], *Saints and Sinners...* ; see also, Lisa Bernstein ...; Cass Sunstein ... .

[43] *Cox* makes this point expressly, see final pages.

[44] Vice Chancellor Strine is a highly respected participant in corporate legal symposia and academic debates, and he appears to be partial to this viewpoint – at least this is what the freezeout cases highlighted herein, as well as other influential decisions and law revivew articles he has authored and co-authored See e.g. *Harbor Finance Partners v Huizenga*, 751 A2d 879 (Del Ch. 1999) Strine, V.C.) ("Although I recognize that our law has long afforded plaintiffs the vestigial right to prove that a transaction that a majority of fully informed, uncoerced independent stockholders approved by a non-unanimous vote was wasteful, I question the utility of this 'equitable safety valve.'"); Hollinger v Black [...] ; Allen, Jacobs & Strine, Jr., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 26 Del. J. Corp. L. 859 (2001); Leo E. Strine, Jr., *If Corporate Action is Lawful, Presumably There Are Circumstances in Which it is Equitable To Take That Action: The Implicit Corollary to the Rule of Schnell v. Chris-Craft*, 60 Bus. Law. 877 – 906 (2005. See e.g. and Leo E. Strine, Jr., *The Inescapable Empirical Foundations of the Common Law of Corporations*, 27 Del. J. Corp. L 499 (2002).

[45] For a innovative discussion of these conflicting impulses within Delaware's M&A case law, see William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 Cardozo L. Rev. 261 (1992.

[46] The term and concept are my own.

[47] Add citation to procedural justice literature in social science journals, Tom Tyler et alia.

[48] See, e.g., *In re Oracle* Decision – V.C. Strine (Examining professor-directors' affiliation with Stanford University in light of University's receipt of large gifts from defendant in order to resolve the director "independence" question).

[49] For discussion of investment bankers' obtaining a contingent upon a freezeout's consummation and the Court's implicit discomfort with this practice, see, e.g., *Siliconix* at __.

[50] In particular, in high stakes M&A deals -- and certainly in the presence of a controlling shareholder, we regard the presence of multi-layered, potentially antagonistic interests and affiliations as being common, rather than exceptional *See. e.g., Barbarians at the Bedside; How Wall Street Firms Plan to Profit in HCA Hospitals; Juggling Many Roles in Buyout*, WSJ, C1 (Tuesday, July 25, 2006).

[51] See Part IV herein.

[52] This burden shift issue is discussed below in relation to the Supreme Court's decision in *Kahn v Lynch*

[53] The one proviso is that the shares must still be publicly traded. Cite to NYSE and NASD new standards for independent directors on Audit Committees.

[54] Cite to NYSE and NASD new independence criteria for independent directors, adopted Fall 2003; and SOX requirement that board contain a majority of independent directors.

[55] Delaware law has applied equivalent equitable safeguards to shareholders owning a majority of the outstanding voting stock and shareholders possessing a lesser stake but still de facto power to dictate governance and operational outcomes. Hence we refer to both as "controllers." See e.g. *Ivanhoe Partners v Newmont Mining Corp.,* 535, A2d 1334, 1344 (Del. 1987) (requiring for the imposition of fiduciary duties on a large stockholder "domination through actual control of corporate conduct"). For commentary and further support for more differentiation between de jure and de facto controlling shareholders in the future evolution of the doctrine, see Mary Siegel, *The Erosion of the Law of Controlling Shareholders*, 24 Del. J.Corp. L. 27 (1999).

[56] In light of the federally-initiated changes to listed companies' boards, going private deals by de facto controllers do not pose the usual risks of abuse, at least not to the same degree. Because the listing standards will require the company to have a majority of independent directors on the board, the controller's capacity to control the board's decision making is limited. The controller could still, by definition, force the incumbent directors off the board, but would be compelled to replace them with other directors meeting the new, more exacting standards of independence.

[57] *Revlon Inc. v MacAndrews and Forbes Holdings, Inc*., 506 A2d 173 (Del. Supr. 1985)

[58] Id at __.

[59] 8 Del. C. § 251

[60] Equity has never fully resolved the deep normative issues posed by the statutes' obviating the public stockholders' right to refuse being cashed out; but the obvious (but not completely satisfactory) response is the Entire Fairness standard.

[61] The Delaware statute provides for removal without cause, with certain limitations (staggered board or cumulative voting provisions) which the controller might be able to overcome. See 8 Del. C. 141(_). In some measure the new listing standards will circumscribe controllers' discretion in replacing the directors formally or informally forced off the board. If they were part of the cohort of independent directors (which must constitute a majority of the board), the vacancy created by their departure will need to be filled by directors meeting the listing standards' criteria of independence.

[62] *Elliott J. Weiss, Balancing Interests in Cash Out Mergers: The Promise of Weinburger v UOP, Inc.*, 8 Del. J. Corp. L 1 (1983) (discussing cycles in judicial treatment of cash out mergers from the 1920's up to We*inburger*).

[63] Singer v Magnavox, __ A2d __.

[64] As late as the late 1970's transactions in which minority shareholders were eliminated at the "mere" desire of the majority shareholders were highly controversial and presumptively wrongful – even if not "fraudulent" as defined under the anti-fraud provisions of the federal securities laws. See e.g. *Kellogg v. Georgia Pacific Paper Co.*, 227 F. Supp. 719 (1964); *Marshel v. Concord Fabrics Inc*., 533 F.2d 1277 (1976); *Santa Fe Industries v Green*, 430 U.S. 462 (1977).

[65] *Weinburger* resolved many questions of law but it also left many crucial questions unanswered, including questions pertaining to the definition of Entire Fairness. The relevant language in the opinion is as follows: "The concept of fairness has two basic aspects: fair dealing and fair price. The former 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 stockholders were obtained. The latter aspect of fairness relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock .... However, the test for fairness is not a bifurcated one as between fair dealings and price. All aspects of the issue must be examined as a whole since the question is one of entire fairness." *Weinburger* at __. The second appeal in *Kahn v Lynch* made apparent that Entire Fairness does not mean "perfect" fairness. *Kahn v Lynch*, __ A2d __ (1996) (holding that despite problems pertaining to the Special Committee ratification process, the shareholders were benefited in the cash out merger so that it would be deemed fair).

[66] On the precept that fair price is a range rather than a singular value, review for "entire fairness" has encompassed not only the financial terms of the controller's offer for the minority's stake, but also the circumstances (such as timing) and process in which negotiations over the freezeout are conducted – "fair dealings," as well as "fair price." See e.g. *Cinerama v. Technicolor*, 663 A2d 1134, 1153 (Del. Ch. 1994) aff'd, 663 A2d 1156 (Del. 1995) ("Thus in assessing overall (or entire) fairness in this instance the court must consider the process itself that the board followed, the quality of the result it achieved and the quality of the disclosures made to the shareholders to allow them to exercise such choice as the circumstances could provide.").

[67] In most instances, the independent directors' disapproval could not stop the transaction from going forward, in itself, because the independent directors would not constitute a majority of the board.

[68] The Entire Fairness standard was first adopted in the landmark case of Sterling v Mayflower, [cite] but the case did not involve a cash out merger per se, but rather a parent-subsidiary merger where the subsidiary's public investors took stock in the parent.

[69] The distinction is of more than formal, academic interest. Cox argues for radically circumscribing plaintiffs' capacity to obtain judicial review under the Entire Fairness standard. As it argues in favor of limiting this form of shareholder litigation, the opinion fails to address that this would also diminish the efficacy of the Entire Fairness standard as a prospective, prescriptive guide for controllers in setting the procedures and terms of their deals (will diminish the efficacy of Entire Fairness as a standard of conduct). For discussion of corporate fiduciary law in regard to this duality, see Melvin A. Eisenberg, *Standards of Conduct and Standards of Review in Corporate Law ...*

[70] See *Weinburg*er, footnote 7 at 709. For the most current empirical work on the presence and operation of special committees of independent directors in the representation of minority investors' interests in freezeouts, see Guhan Subramanian, *Post-Siliconix Freeze-Outs: Theory and Evidence,* Harvard Law and Economics Discussion Paper No. 472 (May 2005) (the "Harvard Study").

[71] The Court was very critical of the rushed job done by the target company's financial adviser, as well as their questionable independence from the controller. *Weinburger* _ A.2d at __ (1983). For discussion of reading equitable decisions as lessons for lawyers about mistakes not to make, see Lawrence Lederman & Jay A. Levenson, *Dealing with the Limits of Vision: The Planning Process and the Education of Lawyers*, 62 NYU L. Rev. 404 (1987).

[72] On the facts therein, representatives of the parent company on the subsidiary's board used their insider status to obtain confidential information about the subsidiary that they did not share with the public stockholders or their representatives in the course of the negotiations. This information was incorporated into a "Feasibility Study" which stated that the controller could pay considerably more than it had offered the minority and still profit from the transaction. The Court held that if the controller elected not to share this information (consistent with the duty of candor that applies in a fiduciary relationship) then it was compelled fully to empower some agency to negotiate on the minority investors' behalf. _ A.2d at __.

[73] See *In re Trans World Airlines, Inc. S'holders Litig*., 1988 WL 111271, at *7 (Del. Ch. 1988)(advocating the business judgment rule should apply to cash out mergers where approval was obtained from a board with a majority of independent directors, a Special Committee or a majority of the minority stock); cf *Citron v. E.I. DuPont de Nemours & Co.* , 584 A.2d 490 , 499-502 (endorsing Entire Fairness review on the basis of what has come to be called 'inherent coercion.').

[74] As discussed infra, it's something of a misnomer to describe deferential review in freezeouts as the "business judgment rule" because the concept alludes to the principle that the business and affairs of the corporation are to be administered under the discretion of the board of directors. The inconsistency stems from the fact that controllers, and not corporate boards, initiate freezeout proposals and to date, even under the Entire Fairness standard, boards have only limited authority to shut these deals down where they appear prejudicial to the minority's best interests.

[75] 638 A2d 1110 (Del. 1994).

[76] The concept of inherent coercion was first enunciated in Delaware in *Citron v. E.I. DuPont de Nemours & Co.* , 584 A.2d 490, 499-502 (Del. Ch.1990).

[77] Provide citation to 1967 amendment to Delaware's cash out merger statute. See Weiss' Weinburger article for help/citation.

[78] The Williams Act added the Securities Exchange Act Section 13(d), and Sections 14(d)-(f) ___ Pub. L. No....

[79] Under SEC Rule 14d-8, when a tender offer is for less than all the securities of a class, the bidder must purchase tendered securities pro rata, according to the number of securities tendered by each security holder at any time during the period of the tender offer. This requirement is designed to limit the time pressure security holders would otherwise feel to tender into the offer.

[80] SEC Rule 14e-1(a) requires a tender offer to remain open a minimum of 20 business days; this time period may be extended, but not shortened. This too is designed to decrease unreasonable pressure to tender quickly.

[81] Tendering security holders can generally change their mind at any time during the tender offer period, as provided by SEC Rule 14d-7.

[82] Section 14(d) requires that if the bidder increases the tender offer price even after shares have been tendered, even shares already tendered must receive the improved price.

[83] Section 14(d) makes it unlawful to make a tender offer for an Exchange-Act registered equity security unless, with limited exception, at the time such offer is commenced the offeror has published or given to security holders certain filings, including a Tender Offer Statement on Schedule TO. Section 14(e) is the antifraud provision applicable to tender offers.

[84] See SEC Rule 14e-2.

[85] The additional disclosure called for by SEC Rule 13e-3 applies to going private deals irrespective of whether they are structured as cash out mergers (where proxies or information statements are nevertheless required to be filed) or tender offer freezeouts (where tender offer filings must be made). The bidder must file, update and finalize a Schedule 13E-3 with the SEC.

[86] The comparability of changes of control transactions effected through mergers and tender offers is evidenced by the fact that where third parties such as lenders require consents to such a transactions, the provisions are drafted to apply to both forms of transactions.

[87] See discussion of *Unocal v Mesa Petroleum* at footnote _and accompanying text. As a further inhibition on third parties' hostile tender offers, during the 1980s many state legislatures enacted "control share" or "fair price" provisions in their corporation codes. These statutes, including Delaware's Section 203, may complicate a controller's plan to go private through a tender offer to some degree.

[88] See footnote __ and accompanying text.

[89] See the discussion below in *Pure* and *Cox*, where the Chancery Court proposes to alter this extreme posture of laissez faire.

[90] *Solomon v Pathe Communications Corp.* 672 A.2d 35 (Del. 1996).

[91] Cite to 8 Del. C § 253.

[92] Although that is required in Delaware is a simple filing of a Certificate of Dissolution with the Office of the Secretary of State.

[93] *In re Glassman* __ A.2d __ (2001). See also *Erickson v Centennial Beauregard Cellular, LLC* 2003 WL1878583 (Del. Ch. April 11, 2003) (affirming that courts will refrain from applying equitable principles to short form mergers).

[94] Guhan Subramanian, *Post-Siliconix Freezeouts: Theory and Evidence,* Harvard Law and Economics Discussion Paper, May 2005.

[95] Id.

[96] Id.

[97] The empirical data documenting the receipt of higher premiums (over the pre-announcement, market trading price for the minority shares) is presented in Guhan Subramanian, *Post-Siliconix Freezeouts: Theory and Evidence,* Harvard Law and Economics Discussion Paper, May 2005. Although he contends that the difference is minimal, Even Vice Chancellor Strine acknowledges that freezeouts governed by *Lynch's* Entire Fairness requirement have resulted in statistically higher premiums than freezeouts governed by the Solomon's standards, as in Siliconix. See Cox.... ;

[98] 8 Del. C. § 262.

[99] For discussion of the need to modernize the appraisal statutes, see Randall S. Thomas, *Revising the Delaware Appraisal Statute*, 3 Delaware L Rev 1 (2000).

[100] See Chen, Yee & Yoo, *Did Adoption of Forward Looking Valuation Methods Improve Valuation Accuracy in Litigation?* Journal of Accounting, Auditing and Finance (Forthcoming); Lawrence A. Hamermesh and Michael Wachter, *The Fair Value of Cornfields in Delaware Appraisal Law*, 31 J. Corp. L. 119 (2005).

[101] Ronald Gilson and Jeffrey N. Gordon, *Controlling Controlling Stockholders*, 152 U. Penn. L. Rev. 785 (2003).

[102] See Robert B. Thompson, *Exit, Liquidity & Majority Rule, Appraisal's Role in Corporate Law* 84 Geo. L. J. 1 – 60 (1995) (Arguing that until there is substantial reform in the Delaware Appraisal action it would be a mistake to circumscribe the equitable cause of action for Entire Fairness.).

[103] *Lynch v Vickers Energy Corp*., 429 A.2d 497 (Del Supr. 1981) (Vickers II).

[104] reverse stock split by charter amendment with fractional interests paid out as cash; liquidation (sale of assets) followed by dissolution

[105] Note Guhan Subramanian's hypothesis about tender offer freezeouts being relatively more attractive to controllers who had retained legal counsel with considerable experience in these more specialized transactions.

[106] Interestingly, it appears that the Chancery Court, as in Cox, was concerned about the filing of frivolous claims and forcing of unearned settlements in shareholder class actions; thus, the Chancery Court stated that "the propensity for frivolous litigation in shareholder, class action suits requires the application of the pleading test under Rule 12 with special care." *Solomon v Pathe Communications Corp*. 1995 Del. Ch. LEXIS 46; Del Ch., C.A. No. 12, 563 Allen, C. (April 21, 1995). Notably, the Chancery Court's decision in Pathe came in the same year that Congress enacted the PLSRA which raised pleading standards for investor class actions under federal

securities laws in response to concerns over excessive and frivolous suits. The Supreme Court ruled in Solomon that the notice pleading remained the standard for shareholder class actions in Delaware, which standard was not as rigorous, the court indicated, as that applied to evaluate whether pre-suit demand has been excused in a stockholder derivative suit filed pursuant to Chancery Rule 23.1 *S v P*, 672 A2d at 39.

[107] It seems that the plaintiffs were clever in their complaint. Their claim that the directors owed them a duty of fair dealing was unusual – perhaps more advantageous to them than merely claiming a lack of diligence (as a duty of care breach) or a material, financial conflict of interest, which was unsupported by the facts. In effect, they tried to assert that the directors had a duty to be proactive, vigorous advocates for the minority, consistent with something like a Revlon duty – although Revlon hadn't (hasn't) been applied in this context.

[108] Given the factual circumstances noted in the opinion, it's likely that the bank's tender offer was intended to push its ownership over the 90% threshold, so that it would be able to obtain a higher price in the sale of Pathe's stock by conveying to a third party the right to execute a short form merger – but this, like other important features of the case, is not discussed in the Supreme Court's opinion.

[109] This becomes even clearer when the doctrine governing directors' duties in third parties' offers is analyzed. In its landmark *Unocal* decision, in 1985, the Supreme Court validated target directors' duties to defend corporation and the shareholders from coercive or otherwise unsatisfactory tender offer bids. This duty exists irrespective of the fact that third parties have no duty to pay a "fair" price in a tender offer, of course. (In fact, the defensive duty would seem crucial expressly in the situation where the offeror was not under a fair price constraint.) *Unocal v Mesa Petroleum*, _ A2d __ (1985).

[110] *Lynch v Vickers Energy, Inc*. __ A2d __ (1976) (Holding that a duty of complete candor applies in tender offers by controllers); cf [*Lynch v Vickers Energy, Inc*., __ A2d __ (1978) (Holding that a broader measure of damages applies in a fiduciary suit where misrepresentation by controllers has been demonstrated than would be available in an appraisal action.).

[111] The measure of fair price is the central question in the second Vickers Energy appeal but as applied to damages, ex post, where coercion, misrepresentation or other wrongdoing by a controller has been proven.

[112] To complicate the matter further, there is a second appeal in the *Vickers Energy* litigation that is not cited by the Court, that is indirectly relevant to the issue at hand. In that appeal, the Supreme Court held that going concern value, or even a higher measures of damages, is the appropriate standard for an award to minority investors where a controller is found to have engaged in fraud or coercion in tendering for the public stock. Obviously, the Court's determination that going concern value (at minimum) is the appropriate measure of damages, after the fact, when misconduct is proven, is not precisely the same as establishing going concern value as a duty that governs controllers in making tender offers for minorities' shares. But given that *Solomon* cites the first appeal in the *Vickers Energy* litigation for the proposition that controllers do not have any obligation to pay a particular or "fair" price in a tender offer, this feature of the second appeal is startling. And it's apparent that in both appeals in *Vickers Energy* the Supreme Court was sending a stern message to controllers about their duties in tendering for the minority's shares.

[113] *Schnell v Chris Craft Industries, Inc*. 285 A2d 437 (1971)

[114] See, e.g. *Blasius v Atlas Industries, Inc*. Del. Ch Ct 199_ (Allen).

[115] Cite to opinion

[116] From one perspective, *Glassman's* limited view of the room for equitable safeguards in short form mergers seems inevitable -- courts are not entitled to contravene the will of the legislature. The problem is that even in this situation, *Schnell* held out the possibility that equity would come to the defense of the public, minority investors in these transactions, where overreaching by controllers is a clear possibility. Perhaps on this basis, the Supreme Court went out of its way to note that in many cases, if they believed that controllers had seized their stock on the cheap, the holdout stockholders could pursue appraisal proceedings.

[117] *In re Unocal*, supra note ___.

[118] On the merits, *Glassman* represents an intriguing departure from the rationale operating in both *Lynch* and *Solomon*. Again, the former presumes coercion and the absence of genuine consent and thus imposes a fair price duty on controllers. *Solomon* presumes the absence of coercion and stockholders' capacity for genuine choice, and thus eschews a fair price duty. But in *Glassman* the Supreme Court observes target directors' and shareholders' inability to stop the freezeout and still does not apply a fair price obligation. This is a notable inconsistency. Given the Courts' frequent reference to the idea that something can be legal (conforming to statute) but not equitable (and hence unlawful), the Supreme Court's conclusion that it was "preempted" from applying fiduciary requirements in short form mergers is not a self evident one. Given that the Supreme Court in *Glassman* several times alludes to the potential availability of appraisal rights, it's possible that the Court was basically relying on appraisal as a pragmatic resolution to controllers' capacity for overreaching in short form mergers. But there is no question the Court would have been conscious about the shortcomings and limits applicable to appraisal, and indeed the broader financial damages remedy available in fiduciary suits proving wrongdoing by controllers.

[119] The notion is that because the ultra-minority has a choice between taking the merger consideration and electing appraisal, the directors of the controlled entity owe the minority a duty to facilitate their capacity to make

an informed choice.) The notion is that because the ultra-minority has a choice between taking the merger consideration and electing appraisal, the directors of the controlled entity owe the minority a duty to facilitate their capacity to make an informed choice.) *Glassman* expressly notes this duty of complete candor as it applies to controllers in short form cash out mergers (and other freezeouts), citing the recent, influential opinion in *Malone v Brincat*, for example, as authority.

[120] For discussion of the interesting, residual ambiguity in the opinion, see Mark I. Steinberg, *Short Form Mergers in Delaware*, 27 Del J. Corp L 489 (200[2]).

[121] For discussion of a rare exception, that is an "early" tender offer based going private deal, see Peter Letsou, *The Dilemma That Should Never Have Been...[*Business Lawyer, forthcoming, 2005]

[122] In fact, the controller remained somewhat indecisive or ambiguous about its intention to complete the second step, short form merger. The effect of this, however, was to make the target stockholders' decision to refuse to tender more perilous, since appraisal rights would not be triggered without the short form merger's occurrence. *Siliconix* at *2.

[123] *Siliconix* at *2 and *4 – 5.

[124] Id at *4.

[125] See *Lynch v Vickers Energy* 383 A.2d 278 (1978) *Malone v. Brincat*, 722 A.2d 5 (Del. 1998); *Loudon v Archer-Daniels-Midland* Co., 700 A.2d 135 (Del 1997); *Arnold v. Society of Savings Bancorp, Inc*., 650 A.2d 1270 (Del. 1994);. For an analysis of the evolution of Delaware's fiduciary disclosure doctrine, see Lawrence Hamermesh, *Calling Off the* Lynch *Mob: The Corporate Director's Fiduciary Disclosure Duty,* 49 Vand. L. Rev. 1087 (1996); and for further commentary see Faith Stevelman Kahn, *Transparency and Accountability: Rethinking Delaware Fiduciary Law's Relevance to Corporate Disclosure,* 34 Ga. L. Rev. 505 (2000); Jennifer O'Hare, *Director Communications and the Uneasy Relationship Between the Fiduciary Duty of Disclosure and the Anti-Fraud Provisions of the Federal Securities Laws*, 70 U. Cinn. L. Rev. 475 (2002).

[126] This bias had also been highlighted, after *Siliconix*, by the Chancery Court's opinion in *In re Aquila,* decided very shortly thereafter. *In re Aquila Inc. S'holders Litig*. 805 A. 2d 184 (Del Ch. 2002).

[127] In *Pure* the Court attempts to incorporate more shareholder protective equitable safeguards into business judgment review. As illustrated in Part VI, this Article the Entire Fairness standard is a more appropriate foundation for protecting public shareholders in tender offer freezeouts.

[128] The Special Committee in Aquila provides the most glaring instance of nonfeasance. *In re Aquila Inc*. 2002 Del. Ch. Lexis 5 (Del. Ch. Jan. 3, 2002).

[129] In the end, subsequent to the issuance of the Chancery Court's opinion, Unocal remedied the minority consent and disclosure problems identified therein and concluded its freezeout without having suffered inordinate delay.

[130] Again, "inherent coercion" refers to the ability of controllers to subvert the ability of even independent directors and public stockholders to reject a freezeout offer they view as inadequate out of fear of financial retribution. See supra footnote __ and accompanying text.

[131] This appears to be the foundational myth that distinguishes *Solomon* and *Pure*, but the fallacy that the controller remains "aloof" from the sell side is revealed as such once it's clear that the target board is inhibited from taking defensive action against the controller's bid or pursuing alternative bids in the market.

[132] In *Pure* itself, Unocal had been in discussions with Pure for over a year, and then launched a "surprise" tender offer.

[133] By this we mean minority investors' willingness to tender into an unsatisfactory bid in order to avoid being left in a worsened position because their cohort tender on account of the same anxiety. This is the classic use of the term in the tender offer context, as it has applied in the doctrine analyzing the propriety of target directors' defenses.

[134] In particular, if the controller was thwarted by the public investors' failure to tender, the controller could still proceed with a unilateral cash out merger at a lower price, or withhold dividends, or engage in other, less salient self dealing transactions detrimental to the minority. In particular, if the controller was thwarted by the public investors' failure to tender, the controller could still proceed with a unilateral cash out merger at a lower price, or withhold dividends, or engage in other, less salient self dealing transactions detrimental to the minority.

[135] *Cox: "*...because the majority stockholder-offeror has access to inside information, and the offer requires disaggregated stockholders to decide whether to tender quickly, pressured by the risk of being squeezed out in a short-form merger at a different price later or being left as part of a much smaller public minority."

[136] The disparity is more strange for the fact that third parties' offers, where the equitable protections are higher, would appear to present less opportunity for overreaching than controllers' offers do.

[137] This is a claim that is at once self-evident and noncontroversial and packed with unstated assumptions and conclusions. ...

[138] *Pure* at 445, note __ supra.

[139] *Pure* does not explicitly require the controller to impose a 90% non-waivable condition to closing the tender offer, but practitioners read it as such. Ordinarily, the controller would not proceed to close the tender offer

or otherwise restructure the freezeout if it failed to reach 90%. In addition, in some cases Delaware's Section 203 would apply and block the consummation of the freezeout by merger for three years. Nevertheless, leaving the controller with the choice to close and leave the stub of the minority shareholders in possession of shares of a company that will probably delist, is coercive. For a decision in which the Court asserted that it would not approve a waivable 90% condition, see *Next Level Comm v. Motorola*, 2003 WL 549083 (Del Ch Feb. 25, 2003) ("Thus, if the tender offer is consummated, Motorola will have the unilateral exercisable power ... to effectuate the short form merger and will do so. At footnote 71.)

[140] *In re Emerging Communications,* Co., 2004 Del Ch. Lexis 2004.

[141] Verify whether this can be done through private stock purchases without compliance with the Williams Act. In *Rabkin v Olin* the Controller waited in this way, but this was held to violate the duty of fair dealings that applies under *Lynch*. A plan that contemplates a future acquisition of the sliver required to acquire the shares necessary to consummate the short form merger involves some risk for the controller – but imposes substantially more risk on the shareholders in the tender offer who might be inclined not to tender.

[142] Again, *Pure* merely admonishes controllers that they must commit to effectuate the clean up, short form merger at the tender offer price *if* they obtain the 90% ownership threshold. It's up to controllers to determine whether to attempt to get at least or more than 90% (rather than just under that level). Indeed, in *Pure*, although Unocal imposed a 90% ownership requirement on its obligation to close the tender offer, it retained the right to waive this condition and close the tender offer at less than the 90% level necessary to do an immediate short form merger.

[143] Reading between the lines it is apparent that the Court was sensitive to the limits it had implicitly validated – that is, the limits it allowed on independent directors' authority to promote the public's investors' best interests. Interestingly, previously in *Siliconix*, the Court had simply assumed that it could not affirm target directors' authority to employ defensive devices once a controller was present. Presumably, in *Siliconix* and *Pure*, the Chancery Court assumed that the controllers would simply replace the directors who attempted to exercise their office in opposition to the controllers' wishes. However, in adopting this approach -- that is, in attempting to avoid an express "institutional conflict" by affirming target directors' authority and duty take actions that controllers would foreseeably disapprove of – these cases cast doubt on the legitimacy of the concept of independent directors in this setting. On this basis, applying the Entire Fairness standard to controllers' deals would seem even more compelling.

[144] That is, consistent with Vickers Energy again, in a suit the controller would have to prove it's inherent fairness in order to avoid having to pay damages to the minority investors.

[145] See NYT *Op-Ed* by Maurice Greenburg, [End of August] 2006. The former Chairman of AIG, attributed the recent trend towards delisting and going private to increased regulatory costs and cautioned that increased regulation can harm investors. (Mr. Greenburg's embattled relationship to regulators, however, may be influencing his views on the matter.)

[146] See e.g. Mark J. Roe, *Delaware's Competition*, Harvard Law and Economics Discussion Paper No. 432; William W. Bratton [2004/UCLA paper] (arguing that progressive-leaning federal corporate governance reforms threatened to overshadow Delaware's historic preeminence in the field).

[147] Vice Chancellor Strine's intensive familiarity with the Harvard Study is graphically evidenced in *Cox*, where he takes issue with certain features of the Study's conclusions relevant to the importance of litigation in benefiting minority investors in freezeouts. In particular, the findings emphasized the enhanced financial benefits enjoyed by public investors who had been represented by Special Committees in *cash out merger negotiations*, that is where they'd had the benefit of Lynch's leverage. But it also suggested that controllers increasingly endorsed the use of Special Committees in tender offer freezeouts as well

[148] Gilson and Gordon, *Controlling Controlling Shareholders*, 152 U. Penn. L. Rev. (2002).

[149] See e.g., Elliott Weiss and Lawrence White, *File Early, Then Free-Ride: How Delaware (Mis)Shapes Shareholder Class Actions*, 57 Vand. L. Rev. 1797 (2004). But see also Robert B. Thompson & Randall S. Thomas, *The New Look of Shareholder Litigation: Acquisition Oriented – Class Actions*, 57 Vand. L. Rev. 133 (2004) (hereinafter, *"The New Look of Litigation*");

[150] To clarify, the new listing standards impose requirements about the proportionate representation of independent directors on boards and the exclusive service of independent directors on auditing and compensation and nominating committees in most instances. However, they do not require that only independent directors serve on Special Committees involved in freezeouts and they do not require the establishment of a Special Committee in a freezeout.

[151] The picture is complicated by the fact that Cox presents a different version of the Committee approval/nondisapproval provision at the end of the opinion, one hundred pages later and with no further explanation of its terms. At that point, the presumption is flipped. Cox proposes that Entire Fairness would not apply in situations where the reforms proposed by Pure are observed and, additionally, "the tender offer was recommended by an independent special committee..." at 129.

[152] For one thing the controller can switch to a cash out merger under Lynch, bypass the independent directors entirely, and still obtain the beneficial burden shift if a majority of the minority shares approve, under the current Lynch doctrine.

[153] If *Cox* had taken a definite position on the fair price in controllers' tender offers question, it would have found itself in the midst of the doctrinal morass bearing on fair price in tender offers described in Part I. In doing so, moreover, the Chancery Court might well provoke a direct confrontation with the Supreme Court's holding in *Solomon* (which held, most relevantly, that in the absence of exceptionally bad conduct, controllers have no duty to offer any set, legally determined "fair price" in a tender offer). In such a direct confrontation, the other law reforms advocated in *Pure* and *Cox* might also have been censured and rejected by the Supreme Court.

[154] *Cysive* at 48, note 1 supra ("These realities suggest that the Lynch doctrine, if it is to be perpetuated, could be usefully simplified.").

[155] It had intended to switch from being fundamentally a services provider to a technology product developer, but its timing was unfortunate.

[156] Because the company's public stock price was severely depressed, the public investors had taken substantial losses. In contrast, Carbonell had garnered approximately $60 million in the company's IPO. *Cysive* 4 – 15, note 1 supra.

[157] Id at 55 – 58.

[158] To clarify, the Court would normally avail itself only of information in the complaints in deciding motions to dismiss, but the expansive documentary evidence can be analyzed by the Court consistent with defendants' motions for summary judgment. The kind of objective information we describe about the criteria of director independence and activism would be reflected in the controller's federal securities law disclosures. Especially with the new, more structured and objectified standards for independence defined by the NYSE, NASD and AmEx, the way should be cleared to resolve the validity of director ratification without discovery most often.

[159] As discussed in this Article's Introduction, the allocation of the burden of proof under *Lynch* depends on whether there's been informed, disinterested approval by the target's directors (or, less commonly, the minority shareholders).

[160] See *e.g.* Stephen M. Bainbridge, Mergers and Acquisitions at 211 ("As is often the case, the party bearing the burden of proof on a given dispute lost.") ; and see, also, Tamar Frankel, *Presumptions and Burdens of Proof as Tools for Legal Stability and Change*, 17 Harv. J.L. & Pub. Pol'y 759 (1994).

[161] Cox at [45]. His opinion about the triviality of the burden shift issue is seconded by Professors Gilson and Gordon in their important law review article on freezeouts.

[162] E Norman Veasey, *What Happened in Delaware Corporate Law and Governance from 1992 to 2004, A Retrospective on Some Key Developments*, 153 U. Pa. L. Rev. 1399, 1435 (2005).

[163] *Pepper v Litton; Bayer v Beran; Globe Woolen*... passim

[164] The "entanglement" critique in *Cysive* is that to determine the standard or review and which party bears the burden of proof, the Court must delve into the merits of the claim.

[165] The adjudication of employment discrimination, comes to mind, as well as proportionate liability under tort.

[166] To be sure, this assumption depends on there being coherent, enforceable limits on plaintiffs' attorneys' fees – which does not seem too difficult to ensure. See discussion below ...

[167] Legal scholarship appears only recently to be catching up to the "broad brush" fact that Delaware's equity courts are hearing substantially more acquisition oriented shareholder class actions than traditional derivative ones. For the most recent data on this, see *The New Look of Shareholder Litigation*, note __ supra.

[168] To clarify, it's true that in *Rabkin v. Philip Hunt Chemical Co., Inc.* (decided two years after *Weinburger*) the Supreme Court held that once there is "a *credible claim of unfair dealings*" appraisal would not be the exclusive remedy; but the converse has not been tested. Neither *Weinburger*, nor *Lynch* nor *Rabkin* held that an equitable action can go forward in a cash out merger merely on an allegation of unfair price. Clearly none of these cases suggest that a full trial must be held upon an allegation of unfair price. And once matters of unfair dealings are off the table, competing valuation analyses would seem to be susceptible, frequently, to resolution through summary judgment. Thus, once again, it appears that *Cysive* is exaggerating *Lynch's* dysfunctionality.

[169] [Find reference]

[170] The family was quoted as saying that "it would not sell its Cox shares or support a sale of Cox to a third party." [p12op]

[171] This is a very common practice and one that controllers will anticipate in the merger agreement ordinarily. Because tendering shareholders surrender their appraisal rights, the tender offer serves to cap the controller's financial exposure to appraisals. Importantly, once there is a merger agreement between the controller and the representatives for the company/public stockholders, the Lynch doctrine will apply rather than the more relaxed approach dictated by Solomon. This remains true even if the deal is consummated through a short form merger once the controller has obtained 90% of the shares. By going the cash out merger route, the controller obtains

greater certainty about being able to consummate the freezeout, and once the independent directors sign off, at least the plaintiff have the burden of proof if Entire Fairness litigation ensues.

[172] Cox at 26

[173] This is a hallmark of Vice Chancellor Strine's decisions, one he isn't shy about. To his great credit, he allows no sacred cows in corporate governance doctrine, doesn't hide his agenda and doesn't shrink from addressing criticism. For commentary on Vice Chancellor Strine's style of deciding cases, see John Gapper, *Capitalist Punishment*, The Financial Times, January 29, 2005 (describing Strine as the "Wunderkind of US corporate Law").

[174] Justice Veasey enunciates this as a crucial feature of equitable adjudication as practiced by the Delaware Courts. [Cite to his retrospective on Delaware Corporate Law]. Nevertheless, sweeping, controversial opinions in the approval of settlements are something of a tradition in Delaware. Perhaps most notoriously, see, e.g., the elaboration of directors' duty of oversight in Chancellor Allen's approval of a settlement in a shareholders' derivative suit in *In re Caremark Int'l Deriv. Litig.* 698 A2d 959 (1996).

[175] at 5, *49

[176] *56-57, *88

[177] Cf *Solomon v Pathe's* discussion of pleading standards in stockholders' class actions. In that case the Court had no difficulty dismissing a complaint against the target directors for breach of fiduciary duty.

[178] See data in Thomas/Thompson article. This data suggests that claims under Lynch do indeed make up a significant proportion of the Chancery Court's docket of corporate cases. However, this may say as much about the ease with which other fiduciary cases are dismissed than it does about the intractability of the *Lynch* doctrine.

[179] It's apparent that the Court is in sympathy with the claims made by the objectors, Weiss and White. As the Court notes, the authors' complaints about stockholder class actions under state law are effectively the mirror image of criticisms they made earlier about investor class actions under the securities laws. They appear to have a pretty patent ideological bias for this reason. ...

[180] 516 U.S. 367 (1996) (Thomas).

[181] See *Epstein v MCA* (*Matsushita II*), 126 F.3rd 1235 (9th Cir. 1997); and see also, William T. Allen, *Finality of Judgments in Class Actions: A Comment on Epstein v MCA, Inc.*, 73 N.Y.U. L. Rev. 1149 (1998).

[182]

[183] at *50, *90

[184] Cite to *Revlon*

[185] See *Weinburger*, *Cysive*, Cox ...

[186] The most famous and notorious exception in the acquisitions area is in Smith v Van Gorkom. As relevant to freezeouts, however, see Justice Jacobs' decision in In re Emerging Communications. Nevertheless, reading the facts closely the independent directors in that transaction used extraordinarily bad judgment, to put it mildly.

[187] The disparity in dismissal rates is validated (but no explanation provided) by Professors' Thomas and Thompson's article: The New Look of Shareholder Litigation in Delaware... 2004.

[188] This is the consequence of Nondismissability, of course, from controllers' perspective – as it gives rise to the shortfall in controllers' wealth-producing freezeout bids.

[189] The opinion even employs colorful metaphors to ridicule the plaintiffs' lawyers conduct in the *Cox* transaction – for example it describes the process of their selecting lead counsel as resembling a "food fight." Cox at 15. As an aside, it's difficult to believe that controller's lawyers are less concerned about their fees and status among their peers than are the plaintiffs' lawyers, but it's easy to imagine that their battles over status and fees are less visible.

[190] See Del Rule __ requiring the Court to validate settlements in class actions.

[191] Add discussion of fee doctrine as per *Cox*.

[192] *Chrysler v Dann* governs the payment of fees where the plaintiffs' suit has become moot on account of voluntary action by the defendant. See *Cox* __. The Court substantially reduced the requested fee notwithstanding that there was no contention by the objectors that the settlement was reduced by the amount of the fee the controller agreed to pay to the plaintiffs' lawyers; that is, the objectors could not allege they were harmed by the agreement to pay the full fee.

[193] Under *Sugarland* the Court may consider: " .... " Cox __.

[194] Discuss potential over inclusiveness in Court's fee ruling.

[195] Cox __ . [end of the opinion]

[196]

[197] Thompson and Thomas, The New Look of Shareholder Litigation, note __ supra.

[198] Id at __.

[199] See *Cox* at **57 – 58. "In seeking fees in these cases, the plaintiffs' lawyers have been pragmatic. Recognizing that they, at best, can claim "shared credit" with the special committee, the plaintiffs' lawyers have tempered their fee requests and have asked for relatively small percentage of the "benefit" – i.e., the difference between the price of the controller's opening bid and the final merger price agreed to by the special committee. But, at the same time, the rewards they reap are substantial..."

[200] Without *Lynch* as leverage, *Cox* contends, minority shareholders are still protected because (i) they are often diversified investors who may own stock in the bidder as well as the minority investor shares; (ii) they can vote no in the face of disadvantageous deals, especially since the greater presence of institutional investors assists in the process of informed decision making; and (iii) they can still sue the target directors for breach of duty and also for appraisal, in many circumstances.

[201] Weiss & White, *File Early.. Then....*

[202] *Cox* cites the objectors' view that "litigation of this kind is of no material benefit to minority stockholders," but it doesn't present their evidence for this assertion, and thus this evidence never comes under criticism. In comparison, in disparaging the evidence presented by the plaintiffs' expert, rather than merely disagreeing with its meticulous legal and quantitative analysis, *Cox* describes him as having thrown his data together "in a bucket," which "skews the analysis from the start."

[203] According to Cox, in fact, this is universally the case.

[204] see Cox at *54, for example.

[205] see *Cox* at *84

[206] Formally speaking, the *Lynch* doctrine pertains to controllers' duties and not the target directors. The latter would be governed by distinct doctrines and duties. But the claims against the target directors would be appended to the claims against the controller under the Entire Fairness standard.

[207] *Smith v Van Gorkom* __ A2d __ (1985).

[208] *McMullin v Beran*, 765 A.2d 910 (Del. Supr. 2000)

[209] Most graphically, where the controller does not seek or does not obtain Dual Ratification.

[210] As described earlier, where the business judgment rule applies, it blocks judicial inquiry into the merits of the act or transaction that is the subject of the claim. See supra footnote __.

[211] Cite the quotation from *Caremark* to this effect. That once BJR applied, no matter how mistaken or wrong a decision appears in retrospect, the Courts will not overturn it to afford a remedy in a suit.

[212] To recapitulate, according to *Cox*, because *Lynch* has made claims nondismissable on the pleadings, it has invited self-interested plaintiffs' lawyers to file nonmeritorious claims in cash out mergers, which has clogged the Chancery Court's dockets and damaged the integrity of the system of representative shareholder litigation under Delaware law. This same pathology, according to *Cox*, reduces controllers' enthusiasm for proposing freezeout deals that would otherwise have created wealth and liquidity for public investors.

[213] In relation to the requirement of fair dealings, moreover, it's possible that the *Cox* Reforms will encourage the Courts, consistent with the business judgment rule, to adopt a less than vigorous approach to monitoring the integrity of the processes underlying Dual Ratification. In any event, if plaintiffs go forward and file claims in freezeouts, notwithstanding the deals' having received Dual Ratification, their claims will almost certainly be dismissed upon the controller's motion. This is what is intended by the *Cox* Reforms. Many plaintiffs, realizing this, will be discouraged from filing a complaint altogether, even if they believe there were irregularities in the consent or disclosure process in the freezeout. And, as reviewed previously, *Cox* has endorsed the imposition of sweeping limits on plaintiffs' attorneys' fees in freezeouts, so that these lawyers will have vastly reduced financial incentives for proceeding with unfairness claims in freezeouts. Much of the "action" will revolve around whether the Court exercises vigor in scrutinizing the underlying legitimacy of the consents. If it does not, equitable oversight in freezeouts, and in effect, equitable claims in freezeouts will be drastically reduced.

[214] As described previously, late in *Cox* it's described as an "approval" condition, whereas earlier in the opinion, it appears as a "nondisapproval" condition to deferential review in a tender offer freezeout.

[215] As the Thomas/Thompson data indicates, appraisals are presently used infrequently as a form of recourse by aggrieved stockholders in cash out mergers.

[216] If the Dual Ratification in a particular freezeout were respected, this would bar an equitable inquiry into fair price. As the discussion above indicates, it's not clear how difficult it would be to force a judicial inquiry into the quality of the independent directors' judgment about the freezeout.

[217] "By now, experience has proven that special committees and independent board majorities are willing to say no to controllers. Experience has also shown that disinterested stockholders, given a non-coercive choice, will reject low ball tender offers by controllers." Cox at *132.

[218] In *re Oracle*, for example. And in securities law, see the "behavioral" work of Donald C. Langevoort ("A Behavioral Explanation for ...")

[219] Jeffrey Gordon makes the point in his piece *on Enron's Implications for Corporate Governance* (2002).

[220] For example, there really is no ready solution to the problem of independent director compensation. The basic problem is that if independent directors are not well compensated, they may not be incentivized to devote substantial time and attention to critical corporate decisions; but if they are well compensated by the company, then they may cling to their office when the shareholders need an impartial judgment about whether the company should be sold, for example. The intractable nature of the (independent) director compensation problem is well noted in the corporate legal academic literature.

[221] Cox at *132.

[222] That is, in controller's power to undercut the board's fiduciary duties to act in the interest of all the stockholders equally, specifically.

[223] The recent, major, widespread financial reporting scandals also support the argument that the law should not move in the direction of loosening oversight over corporate disclosures under the Entire Fairness standard. forms.

[224] Where stockholders bring derivative actions against "ordinary" self-dealing transactions (not involving controllers), they must first "demand" that the company itself pursue the claim. However, Special Committees of independent directors may elect to terminate the derivative suit, so that the plaintiff-stockholders cannot proceed. In certain cases where the apparent conflict of interest is too great or the transaction approved appears egregious in nature or its effects on the company, equity will provide for the demand requirement to be "excused." *Aronson*.

[225] Furthermore, the self-dealing transaction would already have passed muster with a majority of independent directors or disinterested stockholders, that is prior to its occurrence.

[226] *Fleigler v Lawrence, Agau v USAC.*

[227] This line of reasoning is continued below in Part V, Section _ which describes how the business judgment deference has not been the norm in high stakes M&A deals.

[228] The extension described is the Dual Ratification part of the *Cox* Reforms, since under *Lynch* either form of ratification would operate to shift the burden of proof.

[229] What the list of claims that could still go forward does clearly omit, however, is a reference to a fair price challenge. Indeed, as discussed below in Part V, *Cox* implicitly overrules a duty of fair price for controllers' freezeouts. This is a major shift in equity's treatment of cash out mergers, of course, and one which would foreseeably have a major impact on the negotiation process between controllers and the public stockholders' representatives. On this basis it's difficult to agree with the Court's observation in *Cox* that the switch to the business judgment rule for freezeouts (upon Dual Ratification) "would not diminish the integrity-enforcing potential of litigation in any material way *Cox* at *125 The opinion continues, thereafter, " Plaintiffs who believed that a special committee breached its fiduciary duties in agreeing to a merger would continue to have the practical ability to press a claim; they would just have to allege particularized facts demonstrating a breach of fiduciary duty." As mentioned earlier in the text, the suggestion to sue the target directors personally does not make this section of the opinion clearer.

[230] *Cox* at __

[231] *Weinburge*r at __

[232] Although it is an undeniable reality that *Lynch* stated that any merger with a controlling stockholder, however structured, was subject to entire fairness review, it would be unfair not to make explicit another reality. No defendant in *Lynch* and defendant since, has argued that the use of an independent special committee and a Minority Approval Condition sufficiently alleviated any implicit coercion as to justify invocation of the business judgment rule. For this reason, it is important not to assume that the Supreme Court has already rejected this more precisely focused contention. at *42.

[233] For a variety of obvious reasons (e.g. informational asymmetries, the possibility that the outside directors might be more independent in appearance than in substance, or might lack the savvy to effectively counter the controller), the integrity-enforcing utility of a Minority Approval Condition seems hard to dispute. at *47 -48.

[234] This is an interesting omission and suggests the Court's overzealousness to be rid of the *Lynch* doctrine and to reduce stockholder litigation.

[235] *Cox* at *40

[236] Writing about the difference between Comedy and Tragedy, Aristotle stated that the former was the more serious genre. ARISTOTLE, THE POETICS.

[237] *Cox* at __. It's quite revealing that the only important class of actors left out of the bliss described in the opinion are the public stockholders – while the controlling stockholders are described as getting their share.

[238] Tantra are understood in the West primarily in relationship to exotic sexual practices, although as part of Hinduism they have a broader and richer meaning. A pungent use of sexually charged rhetoric also appears in the Court's reference to the one of the law firms vying for lead counsel position. The Court states, "That firm is no ingenue to the lead counsel sweepstakes." *14

[239] This is evident also where *Cox* opinion describes the plaintiffs' different counsel as having a "food fight" over who would be lead counsel. See *Cox* at *15.

[240] *Cox* at *119

[241] *Cox* at *40.

[242] *Cox* at *56.

[243] See also *Pure* at __ (where the Court proposes "easing" *Lynch*).

[244] *Cox* at *7. Importantly, in this passage, as elsewhere, *Cox* fails to note that a crucial ingredient of an arms-length merger, conducted properly, is that prior to consenting to the transaction, it would have been subjected to an auction or market check or some other form of valuation that would have measured the offer in hand against offers that would be attainable in the market.

[245] *Cox* at 44 – 49, note __ supra.

[246] Although the transaction did not involve a freezeout or controlling stockholder, the effect of disinterested ratification in curing a fiduciary breach was illustrated recently in the Chancery Court's decision in *Harbor Partners v Huizenga*. The opinion was authored by Vice Chancellor Strine; which makes drives home the idea that he would be cognizant of this secondary effect of shareholder ratification in freezeouts.

[247] For a decision where the court found informed, uncoerced minority shareholder ratification precluded a finding of liability against defendant directors, and granted summary judgment on that basis, see *Orman v Cullman*, 2004 Del Ch Lexis 150; and see also *Harbor Partners v Huizenga*, 751 A2d 879, 900-901 (Del Ch. 1999) for discussion of the exculpatory effect of disinterested shareholder ratification in a duty of loyalty claim, outside of a freezeout. There is controversy regarding whether shareholder ratification can expunge a duty of loyalty claim against controllers in a freezeout. Shareholder ratification of directors' fiduciary breaches is frequently invalidated on the basis of it being inadequately informed; see e.g. *Smith v Van Gorkom*, 488 A.2d 858 (Del. 1985) (invalidating shareholder ratification of directors' duty of care breach as inadequately informed). For discussion and citation to precedent, See *In re JCC Holdings Co. Inc Shareholders Litigation*, 843 A2d 713 (2003) (holding that plaintiff minority shareholders' voting in favor of or accepting consideration in a merger effectuated by a controlling stockholder does not bar them, on the basis of acquiescence, or any other related doctrine of waiver, from challenging the fairness of the merger in an equitable action. p. 722-723).

[248] See *Orman v Cullman; Harbor Partners v Huizenga; Emerging Comms.*

[249] See *Harbor Partners v Huizenga; Orman v Cullman; Lewis v Vogelstein...*

[250] After the stock market bubble and financial analyst and investment banking scandals of the late 1990s, it is harder for even die hard law and economics aficionados to claim that the capital markets accurately price the value of companies, consistent with the efficient capital market hypothesis. But even prior to the scandals there was mounting evidence that markets were "noisy" signals about value.

[251] There are a variety of financial reasons why market values at times sink below asset valuations, as appears to be occurring at present. The last time this phenomenon was widespread was in the mid to late 1980s, when (leveraged) buyouts also became numerous.

[252] In *Smith v Van Gorkom* for instance, a premium to the market price was acknowledged to be indeterminate in itself, absent an analysis of the "inherent" or "fair value" of the company to be sold -- measured as a going concern under modern financial valuation methods.

[253] See e.g. Cox at *9 – 10. ("Because Pure Resources already requires the equivalent of an informed, uncoerced majority of the minority vote condition, for a controller to avoid entire fairness review, the additional step of triggering review for fairness when controller proceeded against the views of the special committee would bring together both lines of our going-private jurisprudence in a sensible manner, *providing stockholders with substantial procedural guarantees* of fairness that work in tandem while minimizing the role filing of makeweight cases." (*sic*) (emphasis added).

[254] *Cox* at *7

[255] See e.g. *Cox* at *8 (" Therefore, when a merger with a controlling stockholder was 1) negotiated and approved by a special committee of independent directors; and 2) conditioned on an affirmative vote of a majority of the minority stockholders, the business judgment standard of review should presumptively apply, and any plaintiff ought to have to plead particularized facts that, if true, support an inference that, despite a facially fair process, the merger was tainted by wrongdoing. This reform to *Lynch* would not permit a controller to obtain business judgment protection merely by using a special committee or a majority of the minority vote; in that case, Lynch in its current form would still govern. To invoke the business judgment rule standard of review, the controller would have to replicate fully both elements of the arms-length merger process.")

[256] *Cox* at *8

[257] There are several passages in the *Cox* opinion where the Court describes its proposed doctrinal framework. In several of these *Cox* states that the business judgment rule should presumptively apply where there has been dual ratification. At no point does it state that Entire Fairness should apply *until* there is Dual Ratification. The language, instead, provides for the Entire Fairness standard where a controller fails to obtain Dual Ratification – which controllers will foreseeably seek in almost all instances.

[258] "Reform of our common law in this manner also honors our law's traditions, by respecting the informed bj of idint'd dirs and stockh" *Cox* at *10

[259] *Smith v Van Gorkom*

[260] *Unocal v Mesa Petroleum.*

[261] An analogous messy institutional conflict is presently playing itself out in the scope of shareholder adopted bylaws and boards' power to limit shareholders' authority in using them to direct corporate affairs. [See Hamermesh article.] The SEC stepped into a messy institutional conflict in suggesting that stockholders should have more room to nominate directors in the management proxy statement. The proposal was eventually dropped on account of the ragingly negative response from businesses, notwithstanding that it was truly a very cautious one that would have affected the composition of boards only incrementally. See Proposed SEC Rule 14a-11 (Proposed fall 2004).

[262] It's notable however, that controllers' power to influence and determine who will remain and be reelected to the board is diminishing as a result of rules and regulations promulgated in the wake of SOX. Nominating Committees must be staffed exclusively by independent directors, as a result of the recent listing standards' amendments. And the same rules will mandate that even if a controller were able to force an independent director off the board, he or she would have to be replaced, in most cases, with another person meeting the objective criteria of independence applied by the NYSE, NASD or Amex, as relevant. In addition, the very common presence of staggered boards in public companies makes it harder for controllers to remove directors without cause – as this is inconsistent with most statutory requirements relating thereto.

[263] See Paramount v QVC in particular.

[264] In a closed auction the seller announces to the marketplace that it is inviting prospective acquirers to submit sealed offers. Prior to this, the company, with the assistance of its investment banker, will have prepared an offering memorandum and invited the bidders to conduct a limited due diligence review. The bidders will also generally be given a sample acquisition agreement which they can respond to. After it receives the bids, the seller may negotiate with the parties and may conduct a further round of bidding if it so desires. A pre-agreement market check is, in effect, an informal auction where the "prospecting" for potential acquirers is conducted more discretely. A post-agreement market check confers on the seller the benefit of having at least one deal/sale price in hand; in a freezeout, this would presumably be an agreement with the controller. As is the case with auctions, with market checks, in order to proceed, third party offerors must become informed of the opportunity to make a bid, must have access to the information required for them to make a reasonably informed bid, must have time to consider their offer and arrange for financing, for example, and must not be precluded by lock ups and other "entrenching" devices that would legally preclude their offer or make it unreasonably costly in comparison to the initial offer.

The downside of a post-agreement market check for the selling company (the target in a freezeout) is that it may be more difficult to structure the sale so that third parties are given a genuine opportunity to make alternative offers, as compared to the auction or pre-agreement market check scenario. Controllers are likely to demand termination fees as well as, potentially, no-shop provisions or other kinds of legal and financial "first mover" advantages in coming to terms with the independent committee. Directors have been afforded discretion to confer these benefits on initial offerors (again, the controller in a freezeout most probably) where they adjudge this the best way to maximize the price or value in the sale. Although controllers are in an advantageous position to coerce highly advantageous termination fees or lock up arrangements from committees, Delaware's courts have considerable expertise (arising from the adjudication of cases under *Revlon* and its progeny) in adjudging the line between reasonable benefits conferred to obtain an advantageous deal for the shareholders and "auction ending," value reducing preferences to favored bidders.

[265] In November 2003 the SEC approved sweeping amendments to the corporate governance listing standards of the NYSE and the NASD. The changes focus especially on the composition, structure and precise functions of corporate boards and committees of directors in companies with publicly listed shares. These new standards are intended, especially, to promote service by directors free of prejudicial financial conflicts of interest and compromising social affiliations, as these might impair the directors' capacity for impartiality in judging corporate affairs. Both the NYSE and NASD standards mandate that a majority of the entire board be comprised of directors meeting the new heightened criteria of independence, and the NYSE standards require establishment of audit, compensation and nominating/governance committees comprised exclusively of independent directors. The NASD also imposes independence criteria for committees, but the requirements are somewhat looser. As they related to potential freezeout transactions, the standards have different implications for companies with a large block, de facto controlling shareholders and companies with a majority shareholder ("controlled companies"). In the large block holder case, the full complement of majority of independent directors and independent committee requirements apply. For controlled companies, however, the requirements are truncated so that only the audit committee-independent director requirements apply. In this case of controlled companies, the standards mandate that no less than three directors must meet the independence criteria pertinent to audit committee membership. In sum, in companies with a large block holder, there shouldn't be any difficulty in assembling a committee of independent directors to represent the minority shareholders. And even in listed companies with a majority shareholder, there will reliably be a minimum of three independent directors who could serve as an independent negotiating committee on the minority's behalf. The listing standards' board related reforms are highly comprehensive. In addition to the director independence and committee requirements, many other provisions support the systematic, professional and meaningfully substantive (rather than reactive, passive or formalistic) functioning of corporate boards and their accountability to shareholders. These requirements include a mandate of separate, executive sessions of independent directors, the adoption of company-specific governance standards and codes of ethics, written committee charters and annual performance evaluations for committees and directors, and enhanced disclosure to shareholders regarding all of these. See SEC Release Nos. 48745 (File No. SR-NYSE-2002-33)(Nov. 4, 2003); NYSE Listed Company Manual §§303A.01 and 303.A.05; NASD Manual

§4350(c). See Rule Change and Amendment No. 1. thereto by The New York Stock Exchange, Inc. Relating to Corporate Governance, 68 Fed. Reg. 19,052 (proposed April 11, 2003).