EXPLORING THE STANDARD OF REVIEW OF TRANSACTIONS WITH CONTROLLING SHAREHOLDERS AFTER *IN RE MFW SHAREHOLDERS LITIGATION* (DECIDED MAY 29TH, 2013)

MIRIAM BITTON & ODELIA MINNES

I. INTRODUCTION

In re MFW Shareholders Litigation[1] established a standard for the examination of transactions where a controlling shareholder offers to purchase the rest of the company's shares in a going-private merger.[2] According to the court's opinion, under certain conditions this transaction would be examined through the lens of the business judgment rule (BJR) as opposed to the entire fairness review, which normally applies to such transactions.[3] This judgment reflects a more lenient approach by the court towards going-private mergers with a controlling shareholder.[4] As such, it is worth a closer examination.

This Article will begin with a review of the *MFW* case, followed by a review of the judicial history prior to this decision. Then it will try to analyze, albeit partially, some of the reasons for why this judgment is timely and

[1] *In re* MFW S'holders Litig., 67 A.3d 496 (Del. Ch. 2013).
[2] *See id.*
[3] *Id.* at 536.
[4] *Id.*

reasonable considering changes that occurred in the last decades. It will also address some of the courts' reasoning and its persuasiveness.

II. THE CASE

MacAndrews & Forbes is a holding company, owned entirely by Ronald Perelman, which holds 43% of the shares of M&F Worldwide (MFW).[5] MacAndrews & Forbes offered to purchase the rest of MFW's shares (57%) in a going-private merger with a purchase price of $24/share[6], reflecting a 47% premium over the closing price before the offer was made.[7] The offer made by MacAndrews & Forbes had two preliminary conditions.[8] According to their offer, they would not proceed with the transaction unless it was approved by an independent special committee *and* by a vote of the minority shareholders.[9] Accordingly, a committee was formed and selected its legal and financial advisors.[10] Over the course of three months, the committee met eight times and negotiated with MacAndrews & Forbes, eventually leading the latter party to raise its offer by $1, to $25/share.[11] Consequently, the offer was approved by 65% of minority shareholders.[12]

The shareholders, who alleged that the merger was unfair, sued MacAndrews & Forbes, Perelman, and MFW's directors.'.[13] At first, the plaintiffs requested a preliminary injunction hearing prior to the merger vote, a motion that was eventually dropped and replaced by the seeking of post-closing damages as a remedy for breach of the directors' fiduciary duty.[14] The plaintiffs claimed the transaction should be subject to the entire fairness review, according to which the court would examine the substantial fairness of the transaction.[15] The defendants asserted, however, that due to the specific procedures set by the controlling shareholder in this case, the applicable standard should be the

---

[5] *Id.* at 499.

[6] *Id.*

[7] *Id.* at 519.

[8] *Id.* at 499.

[9] *Id.* Or more accurately: an approval by the majority of the shareholders unaffiliated with the controlling shareholder. *Id.*

[10] *Id.*

[11] *Id.*

[12] *Id.*

[13] *Id.*

[14] *Id.*

[15] *Id.* at 502. The fairness of the bargain is examined on both levels: fair dealing (or: procedure) and fair price (or: substance). Kahn v. Lynch Commc'n Sys., 638 A.2d 1110, 1115 (Del. 1994) (quoting Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1981)).

business judgment rule.[16] This rule does not allow the court to inquire regarding the transaction's substance but rather allows the court to disapprove the merger only if terms are "so disparate that no rational person acting in good faith could have thought the merger was fair to the minority."[17] In other words, only under extreme circumstances would the court interfere with the decision made.[18]

The court decided in favor of the defendants, allowing for the application of the BJR even in cases of going-private mergers led by a controlling shareholder, as long as these two preliminary conditions were completely and soundly followed.[19] The court emphasized that the independent committee must be comprised of directors who qualify as independent according to the law.[20] As to the majority of the minority shareholders, the vote cannot be tainted either by disclosure violation or coercion.[21] After analyzing whether these requirements were fulfilled in the current case and declaring that the Supreme Court has not yet answered the question at hand, the court decided that in this case the BJR standard of review applied.[22]

The court referred to the case of *Kahn v. Lynch*,[23] where it was decided that if *either one* of the requirements was met, the burden of proof under the entire fairness standard would shift from the defendant to the plaintiff.[24] The *Kahn* case was quite groundbreaking as it established an easement in the burden of proof in circumstances where the defendant presumably had managed to prove the fairness of the bargain through the precautions undertaken before the transaction was approved.[25] Indeed, the standard applied was still the entire fairness standard, i.e. the stricter one, but there was a noticeable easement as to what was expected from the defendant once she proved that one of the requirements was fulfilled.[26] The court in the *MFW* case emphasized that the *Kahn* ruling did not give an answer to the current case, in which both requirements were fulfilled, hence the need for a judgment in the matter.[27]

Furthermore, the court stated that its holding was compatible with

---

[16] *See id.* at 500.
[17] *Id.*
[18] *See id.*
[19] *Id.* at 502.
[20] *Id.*
[21] *Id.*
[22] *Id.*
[23] Kahn v. Lynch Commc'n Sys., 638 A.2d 1110, 1117 (Del. 1994).
[24] *See MFW*, 67 A.3d at 500.
[25] *Kahn*, 638 A.2d at 1117.
[26] *Id.*
[27] *MFW*, 67 A.3d at 500.

Delaware tradition.[28] Under Delaware law, it is accepted that when decisions are deferred to disinterested directors and/or to shareholders whose money is at stake the results are better than if courts, which are not business experts, make the decisions.[29] The MFW transaction implements both structures.[30] In the first stage, it gives the power to negotiate and vote to an unbiased, independent committee of directors.[31] In the second stage, minority shareholders are given the option of approval (or disapproval).[32] According to the court, the BJR is compatible with the perception which views reliance on a decision made by the affected parties rather than that of the court as a preferable approach, as long as the structure of the transaction is not contaminated by misinformation or conflict of interests.[33]

The court emphasized that the most important benefit deriving from this holding is that it will incentivize controlling shareholders to opt for a transactional structure that will protect the rights and interests of the minority shareholders.[34] The appointed committee will bargain for the minority and will get the best price available, or else will disapprove the transaction.[35] Independent directors, as the court stressed, are presumed to be motivated to do their duty diligently.[36] They have a self-protective interest that induces them to act in a manner that will preserve their reputation.[37] This will be particularly true when the committee is followed by a vote of the minority shareholders.[38] Knowing in advance that the shareholders could reject their recommendation,, the special committee will have a strong incentive to negotiate a deal that will be approved.[39] Similarly, this will be the incentive of the controlling shareholder herself.[40] After committing to these two stages in the transaction, the controlling shareholder will undoubtedly make a true effort to reach a compromise because otherwise she will not be able to purchase the shares at all.[41] This is due to the fundamental advantage the structure here presents: even

[28] *Id.* at 526.

[29] *Id.*

[30] *Id.* at 499.

[31] *Id.*

[32] *Id.*

[33] *Id.* at 526.

[34] *Id.* at 528.

[35] *Id.* at 529–30.

[36] *Id.* at 528.

[37] *See id.* at 528–29 (citing Beam *ex rel.* Martha Stewart Living Omnimedia, Inc. v. Stewart, 845 A.2d 1040, 1048 (Del. 2004)).

[38] *Id.* at 529.

[39] *Id.* at 530.

[40] *Id.* at 532.

[41] *Id.*

if the committee approves a deal, the minority shareholders still have an opportunity to reject it based on full information and without coercion.[42]

Twenty years passed between *Kahn* and the *MFW* case.[43] Several major crises have occurred, both global ones[44] as well as relatively smaller ones,[45] forcing the law in general and corporate law in particular to adjust and figure out ways to deal with the dynamics of the market.[46] The easement of the defendants' burden reflected in the *MFW* case calls for explanation.

Scholars have previously suggested that there should be a different level of scrutiny based on the actions taken prior to a transaction's approval.[47] The court in *MFW* finally took the extra step toward lessened judicial scrutiny and put more trust in the judgment of directors and shareholders, albeit under certain conditions.[48] The next section reviews cases leading up to MFW to provide an understanding of how far the court went to promote its final approach concerning the transaction in question and whether this approach actually corresponds with earlier decisions..

III. HISTORY OF JUDICIAL REVIEW

It is important to examine the history of the judicial review of transactions involving controlling shareholders in order to understand the true impact of the *MFW* case. The holding discusses most of these precedential cases discussed below, some more in depth than others.[49] Tracing the judgments made in these types of transactions thus far helps put the *MFW* case in the right perspective: whether it reflects a single, isolated judgment or continues a pattern of decisions by the Delaware court.

The first case of importance is the *Weinberger*[50] case. In this case, which

---

[42] *Id.*

[43] *Id.* at 500.

[44] *See* David A. Skeel, Jr., *Governance in the Ruins*, 122 HARV. L. REV. 696 (2008) (book review). Notably, the financial crisis (otherwise known as the subprime crisis) of 2007–2008 has changed the game for many actors in the market. *See id.* Prof. Skeel suggested the subprime crisis started when two Bear Stearns hedge funds failed in the summer of 2007. *See id.* at 734.

[45] *See* Dan Ackman, *WorldCom, Tyco, Enron—R.I.P.* FORBES, July 1, 2002. An example of such major events could be the Enron-led fiasco followed by multiple financial scandals and bankruptcies such as those of Worldcom, Xerox, Tyco, and more. These were in turn followed by the enactment of the Sarbanes-Oxley Act of 2002, Pub. L. No. 107–204, 116 Stat. 745 (or in its formal name: the Public Company Accounting Reform and Investor Protection Act of 2002).

[46] Skeel, *supra* note 44.

[47] *See*, *e.g.*, Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785, 839–40 (2003).

[48] *See MFW*, 67 A.3d at 499, 502–03.

[49] *Id.* at 520–36.

[50] Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983)), *aff'd*, 497 A.2d 792 (Del. 1985).

involved a freeze out merger transaction with a controlling shareholder, the court examined the aspect of negotiations.[51] It determined that since no measures were taken to provide for arm's length negotiating, the appropriate standard of review was entire fairness.[52] The court did note that

> the result here could have been entirely different.†.†. . [p]articularly in a parent-subsidiary context, a showing that the action taken was as though each of the contending parties had in fact exerted its bargaining power against the other at arm's length is strong evidence that the transaction meets the test of fairness.[53]

The holding implies that if certain procedural protections indicating true arm's length bargaining were used, the transaction might not be subject to the same level of review.[54] It is debatable whether the *Weinberger* court intended the arm's length procedures to eliminate the requirement for entire fairness and default to BJR, or whether the intent was to retain entire fairness and simply shift the burden to the plaintiffs.

Shortly after *Weinberger*, the court decided *Kahn v. Lynch*,[55] which became a leading holding in this area of law. The court determined that in negotiated freeze out mergers the standard of review is entire fairness, but if one of two procedural protections was used, that would indicate arm's length negotiations and the burden of proof would shift to the plaintiffs.[56] The two criteria noted by the court were: (1) approval of the transaction by an independent special committee or (2) approval of the transaction by the majority of minority stockholders.[57] One issue with the *Lynch* decision is that it created a situation in which controlling shareholders were very vulnerable to strike suits with no valid claim backing them[58] since each case "has [a] settlement value, not necessarily because of its merits but because it cannot be dismissed."[59]

Solomon v. Pathe Communications Corp.[60] demonstrated how parties adapt to previous rulings and how the market attempts to deal with them.[61] The case in *Solomon* involved a new method of conducting freeze out transactions,

---

[51] *Id.* at 710–12.

[52] *Id.* at 710–11.

[53] *Id.* at 715 n.7.

[54] *Id.* at 710–11, 715 n.7.

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

[56] *Id.* at 1117.

[57] *Id.*

[58] *See generally* Jeffrey J. Clark, Kahn v. Lynch Communication Systems, Inc.*: A Major Step Toward Clarifying the Role of Independent Committees*, 20 DEL. J. CORP. L. 564 (1995).

[59] *In re* Cox Commc'ns, Inc. S'holder Litig., 879 A.2d 604 (Del. Ch. 2005).

[60] Solomon v. Pathe Commc'ns Corp., 672 A.2d 35 (Del. 1996).

[61] *See generally* Solomon v. Pathe Communications Corp., 20 DEL. J. CORP. L. 1123 (1995).

aimed at avoiding the demanding entire fairness review.[62] It drew a distinction between freeze out mergers and two-step tender offers in which a tender offer is initiated by a buyer to acquire a majority of the shares and then a back-end or short-form merger freezes out remaining stockholders.[63] The Delaware Supreme Court held that as long as there was no coercion, it is a completely voluntary transaction between separate parties and is not a case of self-dealing.[64] As such, it is not subject to the entire fairness review.[65] *In re Siliconix Inc. Shareholder Litigation*[66] relied on the logic reflected in *Solomon* when it held that "as long as the tender offer is pursued properly, the free choice of the minority shareholders to reject the tender offer provides sufficient protection," and therefore, entire fairness need not be applied.[67] As long as there is no element of coercion or disclosure violations, BJR is sufficient.[68] *Glassman v. Unocal Exploration Corp.* held that the short-form merger that constitutes the back end of a two-step tender offer freeze-out is also not subject to entire fairness.[69] In 2002, *In re Aquila Inc*.,[70] upheld the standard of review set by *Siliconix* and used BJR to review a two-step tender offer.[71]

Though the court explained its reasoning for distinguishing between classical freeze-out mergers and two-step tender offers, the disparity between the two transactions was still considered troubling and was therefore reconsidered in *In re Pure Resources Shareholder Litigation*.[72] Though it did not overturn BJR as the standard of review for tender offers, it added a number of requirements designed to protect minority shareholders and make the protections in the two types of transactions more similar.[73] The court held that in order to not be considered coercive, (1) the tender offer must be subject to a non-waivable majority of the minority tender condition; (2) the controlling stockholder promises to consummate a prompt short-form merger at the same price if he obtains more than 90% of the shares and; (3) the controlling

---

[62] *Id.*

[63] *Id.*

[64] *Id.* at 40 (noting that "in the absence of coercion or disclosure violations, the adequacy of the price in a voluntary tender offer cannot be an issue").

[65] *Id.*

[66] *In re* Siliconix, Inc. S'holders Litig., No. CIV. A. 18700, 2001 WL 716787, at *6 (Del. Ch. Jun. 21, 2001).

[67] *Id.*

[68] *Id.*

[69] Glassman v. Unocal Exploration Corp. 777 A.2d 242, 247–48 (Del. 2001).

[70] *In re* Aquila Inc. S'holders Litig., 805 A.2d 184 (Del. Ch. 2002).

[71] *Id.* at 190.

[72] *In re* Pure Resources, Inc., S'holders Litig., 808 A.2d 421 (Del. Ch. 2002).

[73] *Id.* at 445.

stockholder has made no retributive threats.[74] If the conditions were not met, the transaction would be considered coercive and would be subject to entire fairness review.[75] The judgment seems to tighten the courts' scrutiny in order to prevent controlling stockholders from taking advantage of minority shareholders through the use of the two-stage method. While the court acknowledged the irrelevancy of applying a stricter standard of review when the transaction is neither self-dealing nor coercive, it aimed at forming tighter criteria to determine when these conditions apply.[76]

In *Pure Resources*, Vice Chancellor Strine attempted to create a more unified standard by raising the level of protections to minority shareholders in tender offers.[77] In *Cox Communications*,[78] he suggested revising the requirements in a merger and easing the level of scrutiny.[79] The case concerned a merger proposal that was conditioned on the approval of a special committee of independent directors as well as approval by a majority of minority stockholders.[80] The issue was over previously agreed upon attorney's fees, which the court slashed significantly ($1.274M rather than $4.95M).[81] The reasoning was that, as mentioned above, *Lynch* makes it impossible to structure a transaction so that it would not be subject to a complaint.[82] Therefore, it is nearly always worthwhile to settle.[83] Vice Chancellor Strine proposed a reform in which the *Lynch* decision would be extended so that in a case where *both* procedural protections are used (an independent special committee and majority of minority approval), the standard of review would be BJR.[84] This is the first instance of the approach later taken by the court in MFW.[85] This proposal would also make the standard for freeze-out mergers more in line with the standard for tender offers.[86]

---

[74] *Id.*

[75] *Id.* at 424.

[76] *Id*. at 444.

[77] *See id.* at 421–53.

[78] *In re* Cox Commc'ns, Inc. S'holder Litig., 879 A.2d 604 (Del. Ch. 1994).

[79] *Id.* at 615.

[80] *Id.* at 605.

[81] *Id.*

[82] *Id.* at 619.

[83] *Id.*at 605

[84] *Id.* at 606.

[85] *See*, Leonardo Pinta, *The U.S. and Italy: Controlling Shareholders' Fiduciary Duties in Freeze Out Mergers and Tender Offers*, 7 N.Y.U. J. L. & BUS. 931, 947 (2011) (referring to Vice Chancellor Strine's proposal as a "new solution").

[86] Indeed, unifying the two standards is one of the stated goals of the decision. See *Id.*at 607 ("To provide even greater coherence to our law, the equitable standards governing going-private transactions with controlling stockholders could be sensibly unified through an extension of this reformed *Lynch* standard.")

The more lenient "unified" approach suggested in *Cox Communications* was accepted by Vice Chancellor Laster in *In re CNX Gas Corporation*.[87] He ruled that though the case was a one-step merger and not a tender offer, if both conditions were met, it could be tried by BJR.[88] In the particular circumstances of the case, the independent special committee did not recommend in favor of the transaction and so entire fairness did apply.[89] Similarly, *In re John Q. Hammons Hotels Inc. Shareholder Litigation*[90] held that the *Lynch* standard would not necessarily apply to the merger but rather, "the use of sufficient procedural protections for the minority stockholders *could have* resulted in application of the business judgment standard of review in this case".[91] As in the *CNX Gas Corporation* case, the procedures actually used were insufficient.[92] In addition to the fact that the vote by the minority stockholders was waivable, it was only a majority of minority stockholders voting, and not the majority of minority stockholders.[93] Therefore, entire fairness applied.[94] *Frank v. Elgamal*[95] reaffirmed *John Q. Hammons Hotels*.[96] It concerned a merger in which entire fairness was applied only because the adequate procedural protections were not in place (it was not conditioned on a non-waivable vote of the majority of the minority of stockholders).[97] The assumption is that if it had been, it would have been tried under BJR.[98]

Even with the additional conditions required by the court in *Pure Resources* in an attempt to unify the standard, the issue of the bifurcated standard is the subject of much academic debate. The foremost question is whether there is a valid reason to employ the different standards in the different types of freeze-out transactions. Assuming that there is not, the question becomes which is the most appropriate standard to apply? Pritchard argues in favor of the *Solomon/Siliconix* standard and argues that because of the differing natures of the transactions, the bifurcation is legitimate.[99] He considers the protections in tender offers to be sufficient and claims that BJR should be

[87] *In re* CNX Gas Corp. S'holder Litig., 4 A3d 397, 400 (Del. Ch. 2010).

[88] *Id.* at 400.

[89] *Id.* at 416.

[90] *In re* John Q. Hammons Hotels Inc. S'holder Litig., No. 758–CC, at 3 (Del. Ch. 2009).

[91] *Id.*

[92] *Id.* at 2

[93] *Id.* at 29.

[94] *Id.*

[95] Frank v. Elgamal, No. 6120-VCN, at 1 (Del.Ch. 2012).

[96] *Id.*

[97] *Id.* at 1–11.

[98] *Id.*

[99] Adam C. Pritchard, *Tender Offers by Controlling Shareholders: The Specter of Coercion and Fair Price*, 1 BERKELEY BUS. L.J. 83, 110 (2004)

used.[100] Letsou and Haas,[101] Levy[102], and Resnick[103] argue that there is no cause for distinguishing between the transactions, and the entire fairness standard should be applied uniformly.[104] Support for this approach comes from a 2007 study that found that minority shareholders received lower cumulative abnormal returns (CARs) in tender offers than in mergers.[105] The study attributes the differences to the differing standards of review and argues that they should be more uniform.[106] In an article by Chancellors Allen, Strine, and Jacob, the opposite was suggested.[107] They argue that in today's economic environment, BJR should be used even in a merger transaction if a procedural safeguard, such as an independent special committee is in place.[108] Gilson and Gordon also suggested this approach.[109]

In re MFW Shareholders Litigation was the first time that the standard suggested in *Cox Communications* was applied.[110] Though it was a case of a merger, since both procedural protections were met, – there was approval by both an independent special committee and by the majority of the minority of stockholders – the standard of review applied was BJR.[111] The *MFW* case is thus groundbreaking, as it finally implements a more lenient standard of the review for merger transactions where the controlling shareholder is the purchaser.[112] At the same time, it follows opinions put forth in previous cases and, for the first time, gives them practical ramifications.[113]

It seems that what the courts tried to establish in their holdings is that some form of review is necessary in transactions where there is a reasonable concern of self-dealing and its complications. Where the review is done,

---

[100] *Id.*

[101] Peter V. Letsou & Steven M. Haas, *The Dilemma That Should Never Have Been: Minority Freeze Outs in Delaware*, 61 BUS. LAW. 25 (2005).

[102] Ely R. Levy, *Freeze-Out Transactions the Pure Way: Reconciling Judicial Asymmetry Between Tender Offers and Negotiated Mergers*, 106 W. VA. L. REV. 305 (2004).

[103] Brian M. Resnick, *Recent Delaware Decisions May Prove to be "Entirely Unfair" to Minority Shareholders in Parent Merger with Partially Owned Subsidiary*, 2003 COLUM. BUS. L. REV. 253 (2003).

[104] *See* sources cited *supra* notes 92–94.

[105] Guhan Subramanian, *Post-Siliconix Freeze-Outs: Theory and Evidence*, 36 J. LEGAL STUD. 1 (2007).

[106] *Id.*

[107] William T. Allen, Jack B. Jacobs & Leo E. Strine Jr., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287 (2001).

[108] *Id.*

[109] *See* Gilson & Gordon, *supra* note 45.

[110] *In re* MFW S'holders Litig., 67 A.3d 496 (Del. Ch. 2013).

[111] *Id.*

[112] *Id.*

[113] *Id.* at 524.

thoroughly and honestly, *ex ante*—by appointing an independent, qualified committee, and giving the minority shareholders a chance to vote with full knowledge—there is no need for a thorough review *ex post*. The court's consideration is required primarily where there is a reason to suspect it is the only one who has the ability to be fair and objective. If others, who are more acquainted with the company's business and more allied with the minority shareholders' interests, can take this role, the role of the court is accordingly minimized. Thus, one might say that, in fact, the court does not choose a more lenient approach in the *MFW* case, but rather considers the review done *ex ante* by insiders within the transaction's structure specified to be just as strict as what the court would have done *ex post*.

The next section will focus on some of the specific arguments which may support the courts' decision, some raised by the court itself and one which was not raised by the court, but could be noted as one that reinforces the holding. We would like to examine them, albeit briefly, as they reflect a view which takes into account what appears to be changes in the reality, whether legal, economic, or market-wise. These arguments all support the notion that it is possible to rely on minority shareholders' discretion. First, it will deal with the relationship between the new holding and one of the most important legal enactments of the last century: the Sarbanes-Oxley Act of 2002 and will show how these two relate to each other.

IV. HOW REALITY CHANGES SUPPORT THE *MFW* CASE

A. MFW *& Sarbanes-Oxley: A Balancing Game?*

The parallel between Sarbanes-Oxley and MFW was not suggested by the court, but nonetheless could have played a role in the growing tendency to relieve some of the burdens lying on a controlling stockholder when trying to approve a transaction with minority stockholders. In many respects, it is possible to view the Sarbanes-Oxley Act of 2002 (SOX), which tightened the rules applied to corporations and management, as something that effectively (even if not directly, as will be explained below) led to the new Delaware holding.[114] This Act sets forth stricter requirements regarding disclosure and corporate governance.[115] The purpose of the Act was, in fact, to rebuild the confidence of investors in the capital market, primarily through broader

[114] *See*, Robert Charles Clark, *Corporate Governance Changes in the Wake of the Sarbanes-Oxley Act: A Morality Tale for Policymakers Too*, 22 GA. ST. L. REV. 251 (2005), for another view, which connects between Delaware's judicial opinions and SOX.

[115] *See*, for example, Title I – Public Company Accounting Oversight Board (Sec. 101-109) and Title IV – Enhanced Financial Disclosures (Sec. 401-409)

financial reporting duties.[116] Assuming that SOX was able to achieve its goals, or at least the majority of them, the shift of the court from entire fairness review to the BJR seems logical. The SOX Act was meant to encourage firms to invest more in internal controls and, as a result, to enhance transparency, reliability and accountability for investors and the public as a whole.[117] Several studies since its enactment have claimed that though high costs were associated with the Act, benefits were also demonstrated.[118]

As in the transaction structure promoted by the court, SOX relates in some form to both sides of the equation. On the one hand, it deals with problems in firms' corporate governance that affect confidence in independent committees.[119] On the other hand, it mandates broader disclosure standards, requirements that correspond to the second stage of the transaction in which minority stockholders are given the right to decide their own fates.[120]

Furthermore, it is relatively easy to predict that obligations mandated[121] by

---

[116] The stated purpose of the Act is "To protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes." *See also* John C. Coates IV, *The Goals and Promise of the Sarbanes-Oxley Act*, 21 J. ECON. PERS. 91 (2007) (arguing that the Act should bring net long-term benefits driven from raising the resources spent on auditing); *see also Speech by SEC Commissioner: The Sarbanes-Oxley Act of 2002: Goals, Content, and Status of Implementation*, INT. FIN. L. REV., Mar. 2003, *available at* http://www.sec.gov/news/speech/spch032503psa.htm.

[117] *Id.*

[118] *See, e.g.*, Aigbe Akhigbe & Anna D. Martin, *Valuation Impact of Sarbanes-Oxley: Evidence from Disclosure and Governance Within the Financial Services Industry*, 30 J. BANK. & FIN. 989 (2006), *available at* http://www.sciencedirect.com/science/article/pii/S0378426605002293# (finding that the wealth effects of firms viewed as non-compliant with SOX are significantly lower than firms viewed as compliant); Pankaj K. Jain & Zabihollah Rezaee, *The Sarbanes-Oxley Act of 2002 and Capital-Market Behavior: Early Evidence*, 23 CONTEMP. ACCT. RES. 629 (2006), *available at* http://onlinelibrary.wiley.com/doi/10.1506/2GWA-MBPJ-L35D-C4K6/abstract (claiming that the Act induced benefits which significantly outweigh its imposed compliance costs); Gerald J. Lobo & Jian Zhou, *Did Conservatism in Financial Reporting Increase after the Sarbanes-Oxley Act? Initial Evidence*, 20 ACCT. HORIZONS 57 (2006), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=859624 (showing empirical evidence according to which the SOX as well as SEC regulations resulting from it have supposedly altered managerial discretionary reporting behavior towards a more conservative one); Christian Leuz, *Was the Sarbanes-Oxley Act of 2002 Really this Costly? A Discussion of Evidence from Event Returns and Going-Private Decisions*, 44 J. ACCT. & ECON. 146 (2007), *available at* http://www.sciencedirect.com/science/article/pii/S0165410107000444#. For a broad analysis of SOX after 10 years of its enactment, see John C. Coates IV & Suraj Srinivasan, *SOX after Ten Years: A Multidisciplinary Review* (October 21, 2013), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2343108 (reviewing and assessing research findings from 120 papers in accounting, finance and law regarding SOX and concluding that on balance, research on the Act's net social welfare is inconclusive).

[119] See Titles I-III of The SOX Act

[120] See Title IV of The SOX Act

[121] Some scholars expressed the view that SOX should not be mandatory at all, but rather optional, as the legislation was ill conceived as an emergency legislation and is not efficient. *See* Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521 (2005).

the Act and other related legislation entail additional costs on corporations compared to the previous legal structure.[122] It is possible to view *MFW*'s approach as a way to waive some of the financial burdens companies now have. The SOX Act is considered by many as one of the most important pieces of legislation in the U.S. since the 1930s.[123] In both instances, it seems that what the law (or court) actually said was that as long as companies or controlling shareholders manage to supply the knowledge necessary and in essence, to act fairly *ex ante*, their actions will be more protected *ex post*.[124]

To be sure, SOX and the decision presented in the *MFW* case do not target the exact same conduct. Whereas SOX, in general, targets behavior of companies and their relevant gatekeepers,[125] the *MFW* case relates to the conduct of *controlling shareholders*. That said, upon closer inspection, both deal, for the most part, with public companies and both bear costs on the market and on these companies.[126] It appears that a need for some sort of a balance may arise. Stricter corporate governance requirements supposedly lead to greater efficiency within the firm.[127] If that is the case, easing up in certain circumstances where there appears to be no real concern as to the method of conduct by the company and its insiders seems logical, even necessary. For example, research shows that post-SOX boards of directors are larger and more independent. [128] They also tend to be more professionally led than before and cost more as a result.[129] Given that there are more substantive reasons to rely on

---

[122] *See* Ivy Xiying Zhang, *Economic Consequences of the Sarbanes-Oxley Act of 2002*, 44 J. ACCT. & ECON. 74 (2007), *available at* http://rfs.oxfordjournals.org/content/22/8/3287.full.pdf+html.

[123] *See, e.g.*, Haidan Li, Morton Pincus & Sonja Olhoft Rego, *Sarbanes-Oxley Act of 2002 and Earnings Management*, 51 J. L. & ECON. 111, 111 (2008), *available at* http://www.journals.uchicago.edu/doi/pdf/10.1086/588597.

[124] *See*, Alex Barden, *US Corporate Law Reform Post-Enron: A Significant Imposition on Private Ordering of Corporate Governance*, 5 J. CORP. L. STUD. 167, 188 (2005) ("The *ex ante* rules of Sarbanes-Oxley provide (generally) clear guidance as to what conduct is permissible. Compliance with these bright-line conditions indicate eradicates the possibility of further liability.").

[125] The Act aimed "[t]o protect investors by improving the accuracy and reliability of corporate disclosures". *See*, Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745.

[126] It seems that there is a difference between the ability of large public companies to comply with SOX and small ones. Whereas the former can retain the costs associated with the Act, for the latter the Act sets heavy burdens. *See*, *e.g.*, Ginger Carroll, *Thinking Small: Adjusting Regulatory Burdens Incurred by Small Public Companies Seeking to Comply with the Sarbanes-Oxley Act*, 58 ALA. L. REV. 443 (2006); Oleg Rezzy, *Sarbanes-Oxley: Progressive Punishment of Regressive Victimization*, 44 HOUS. L. REV. 95 (2007).

[127] *See* Leora F. Klapper & Inessa Love, *Corporate Governance, Investor Protection, and Performance in Emerging Markets*, 10 J. CORP. FIN. 703 (2004).

[128] *See* James S. Linck, Jeffry M. Netter & Tina Yang, *The Effects and Unintended Consequences of the Sarbanes-Oxley Act on the Supply and Demand of Directors*, 22 REV. FIN. STUD. 3287 (2009),

[129] *Id.*, (suggesting that SOX had a dramatic impact on corporate boards and the costs thereof).

corporate directors, in a going-private transaction where independent directors are given the right to negotiate for minority shareholders, relying on them does not seem to be so out of line. When corporate governance appears to be heading in the right direction, it will inevitably impact other areas within the law that depend on it including the ones referred to here.

SOX aims at enhancing outside monitoring over the firm through independent or outside directors.[130] As such, it is possible to claim that on many occasions it reduces the need for the thorough review offered by the entire fairness review. Indeed, and as noted above, the *MFW* case focuses on a transaction between a controlling shareholder and the company's minority stockholders, as distinct from the somewhat routine corporate conduct set by SOX.[131] However, the company's directors play a role in the going-private or merger transaction as well.[132] If SOX positively impacted directors' behavior and corporate governance, there is reason to believe the court can trust these directors' advice and judgment more.[133] SOX reduced agency problem concerns between management or other gatekeepers and shareholders.[134] By creating a less biased, more neutral corporate arena, SOX may ultimately lead to laxer court scrutiny at certain key points in a company's life.

The second major aspect in which SOX greatly impacted corporate life and behavior is even more closely linked to the somewhat less meticulous approach adopted in the *MFW* case. SOX targeted companies' disclosure practices as well as their accuracy.[135] In order to sustain the faith of investors and the public in the market, more information should be provided, supposedly

---

[130] *Id.* at 3316. The SOX Act and SEC regulations followed by it mandates, for example, require a majority of independent directors on boards as well as session without insiders and set a stricter definition of independence. *Id.* at 3292.

[131] See s*upra,* note 125

[132] On the role of directors in going private transactions *see, e.g*., Kimble Charles Cannon, *Augmenting the Duties of Directors to Protect Minority Shareholders in the Context of Going-Private Transactions: The Case for Obligating Directors to Express a Valuation Opinion in Unilateral Tender Offers after Siliconix, Aquila and Pure Resources*, 2003 COLUM. BUS. L. REV. 191, Part IV (2003); Lawrence A. Hamermesh, *Premiums in Stock-for-Stock Mergers and Some Consequences in the Law of Director Fiduciary Duties*, 152 U. PA. L. REV. 881 (2003).

[133] For a view which finds a connection between the misapplication of SOX requirements regarding corporate governance and problems with self-dealing transactions, see *Pereira v. Cogan*, 294 B.R. 449 (S.D.N.Y. 2003) *vacated and remanded sub nom. Pereira v. Farace*, 413 F.3d 330 (2d Cir. 2005) (applying SOX requirements on a private company based on this reasoning).

[134] The goal of SOX was to restore investors' confidence in the market through the enforcement of corporate and professional's accountability. *See* J. Brent Wilkins, *The Sarbanes-Oxley Act of 2002: The Ripple Effect of Restoring Shareholder Confidence*, 29 S. ILL. U. L.J. 339, 339-340 (2005);

[135] The SOX Act § 302 requires CEOs and CFOs to certify the accuracy of financial reports or be subject to criminal prosecution. *See also* Brian Kim, *Sarbanes-Oxley Act*, 40 HARV. J. ON LEGIS. 235 (2005)

with better quality and standards.[136] What the average stockholder knows, or should know, has improved since the enactment of SOX.[137] Relying on that knowledge is, therefore, next in line. The more information is provided during the course of the business, the safer it is to assume that stockholders and investors are able to decide for themselves knowingly and with broader understanding.[138] The purpose of disclosure is to enable participants in the market to decide for themselves if, where and how to invest.[139] The decision regarding a merger offer, albeit more complicated, must also be made based on the information provided.[140] The mechanism provided in MFW combines two factors, each of which independently enables reliance on stockholders.

The next part will examine an argument mentioned only briefly by the court, but one that nonetheless may be viewed as central to relying on minority shareholders' discretion instead of that of the court.

B. The Role of Institutional Investors

The structure of the transaction as approved by the court also corresponds with major changes that occurred in the last few decades in the market of publicly traded companies. The court, in the *MFW* case, mentions institutional investors as a component that makes it easier for minority investors to form a blocking position.[141] According to the court, these investors' holdings have grown in the last decades, making it easier than before for minority investors to create a blocking position.[142] The court does not elaborate on the role and

[136] The SOX Act requires that top management establish, maintain and evaluate the internal control over financial reporting. Sarbanes-Oxley Act, 15 U.S.C. §§ 7241, 7262 (2002). Firms have to disclose every material weakness, which is described as "as a deficiency, or combination of deficiencies, in ICFR such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis by the company's ICFR". (Securities Act Release No. 33-8809, June 20, 2007, available at http://www.sec.gov/rules/final/2007/33-8809.pdf)

[137] *See, e.g.*, Lawrence A. Gordon, et al., *The Impact of Sarbanes-Oxley Act on the Corporate Disclosures of Information Security Activities*, 25 J. ACC. & PUB. POL'Y 503 (2006); *see also* Gus De Franco, Yuyan Guan & Hai Lu, *The Wealth Change and Redistribution Effects of Sarbanes-Oxley Internal Control Disclosures* (2005), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=706701 (claiming that small investors benefit more from the disclosure standards imposed by SOX than large investors).

[138] *See*, *e.g.*, Takeover Bids: Hearing on H.R. 14475, S.510 Before the Subcom. on Commerce and Finance of the House Com. On Interstate and Foreign Commerce, 90th Cong., 2d sess. 54 (1968) (where Chairman Cohen stresses the importance of informed decision-making made by shareholders of a target corporation in a merger).

[139] John C. Coffee, Jr., *Market Failure and the Economic Case for A Mandatory Disclosure System*, 70 VA. L. REV. 717 (1984).

[140] *See supra* note 138.

[141] *See In re* MFW S'holders Litig., 67 A.3d 496, 530 (Del. Ch. 2013).

[142] *Id.*

impact of institutional investors, but it should be noted as a factor that is worth investigation.[143]

Institutional investors' shares in public companies have risen dramatically in the last few decades.[144] Corporate governance is inevitably affected by these changes and, so, is the interaction between different shareholders of the companies.[145] The United States capital markets have traditionally been described as diversified, or widely held.[146] This feature highlights the need to create mechanisms for the moderation of the agency problem between shareholders and management. Going-private mergers, such as the one in the center of the *MFW* case, are somewhat different because the focus is on agency problems between majority and minority shareholders. In other respects there is a close connection between these two issues. Many of the problems arising are connected to the fact that there are no strong shareholders who can protect the interests of the minority.

Since institutional investors' power and ability to impact companies has grown, it is easier and more justifiable to depend on the minority shareholders' vote.[147] This case essentially shifts the right to review the transaction and decide whether it is fair from the court (through the entire fairness standard) to the minority shareholders themselves.[148] The court, supposedly, is less concerned with agency problems arising between the controlling shareholder and minority shareholders than it used to be.[149] The growing impact of

---

[143] *See generally id.* at 486–536.

[144] *See* Philippe Aghion, John Van Reenen & Luigi Zingales, *Innovation and Institutional Ownership*, figure 1 (working paper, 2008), *available at* http://scholar.harvard.edu/files/aghion/files/innovation_and_institutional_ownership.pdf (demonstrating a rise from below 10% of institutional investors' holdings of public companies in the 1950s to about 60% of their share in companies in the mid-2000s, as based on the Federal Reserve Board reports); Eric Gonnard, Eun Jung Kim & Isabelle Ynesta, *Recent Trends in Institutional Investors Statistics*, 95 FIN. MARKET TRENDS (OECD, 2008), *available at* http://www.oecd.org/finance/financial-markets/42143444.pdf (showing a global rise in the share of institutional investors when the U.S. has the lion's share of around 50% of the market). The huge rate of investment by this type of investor is also reflected in the actual money invested by them, which is growing every year. *Id.*

[145] OECD (2011), *The Role of Institutional Investors in Promoting Good Corporate Governance*, Corporate Governance, OECD Publishing., *available at* http://www.oecd.org/daf/ca/49081553.pdf.

[146] This has been the perception since the seminal work of Berle and Means, who pointed to one of the United States capital markets' feature, namely the separation of ownership and control deriving from the fact the ownership is widely held. *See* ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (2009).

[147] *See In re* MFW S'holders Litig., 67 A.3d 496, 530 (Del. Ch. 2013) at 530.

[148] *Id.*

[149] Institutional investors may play a positive role with mitigating the agency problem between shareholders and management. *See* Jay C. Hartzell & Laura T. Starks, *Institutional Investors and Executive Compensation*, 58 J. FIN. 2351 (2003); s*ee also* Parthiban David, Rahul Kochhar & Edward Levitas, *The Effect of Institutional Investors on the Level and Mix of CEO Compensation*, 41

institutional investors in the last few decades makes this transfer both logical and efficient.[150] Institutional investors are presumably more sophisticated than the average public shareholder. They have better means and capabilities of understanding complex transactions and their potential impact on corporations.[151] Additionally, they have much more to lose and, therefore, a greater incentive to be involved in the company, particularly at crucial junctures.[152]

Institutional investors can be viewed as a balancing force against that of the controlling shareholder.[153] The issue of rational apathy does not apply to them as much as it applies to minority investors.[154] In short, institutional investors have the tools that enable them to review corporate decisions and enough resources, both human and financial, to analyze data and derive more effective conclusions from it. This, combined with the fact they have good reasons to be involved in the company, as large assets may be at stake, may lead to the view that they could be the right agents to stand against majority shareholders when needed. The changes in the last decade in corporate governance of public corporations make way for changes in the examination of transactions within the company. It is important to note that this does not mean scrutiny by the court is no longer needed in these cases, just that a shift in the court's focus might be required. For example, instead of analyzing the controlling shareholder's conduct, the court may need to examine more thoroughly the role of institutional investors in the company and their actions in transactions where their votes are crucial.

The next section will relate to another argument proffered by the court, again without much emphasis or elaboration. This argument also reflects the fact that the court is aware and takes into account major changes that occurred in the last decades and implements them in its judgments.

ACAD. MGMT. J. 200 (1988); Clair E. Crutchley, et al., *Agency Problems and the Simultaneity of Financial Decision Making: The Role of Institutional Ownership*, 8 INT'L REV. FIN. ANALYSIS 177 (1999).

[150] *See, e.g.*, Chenchuramaiah, T. Bathala, Kenneth P. Moon & Ramesh P. Rao, *Managerial Ownership, Debt Policy, and the Impact of Institutional Holdings: An Agency Perspective*, 23 FIN. MGMT. 39 (1994) (showing a negative correlation between institutional investors' holdings and the use of debt and managerial stock ownership in the firm).

[151] David, *supra,* at 201

[152] *Id.*

[153] *See* Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811 (1992) (supporting the enhancement of institutional investors' voice, as opposed to control, in the public corporations).

[154] *Id.*at 822.

C. The Internet as a Source of Information

Interestingly, in support of its judgment in the *MFW* case, the court focused on the growing impact of the Internet.[155] The court referred to the Internet as a mechanism that enables stockholders to become more knowledgeable, and hence more powerful as they are more able to obtain and process information about the firm and the market.[156] By accepting BJR as the leading standard, the court acknowledges the preference for a well-informed, non-coercive vote by shareholders (and directors) over the court's judgment.[157] The court uses the expansion of the Internet—a growing, public source of information—as the basis for its notion that majority shareholders are more knowledgeable nowadays, making their judgment more trustworthy to the court.[158]

This is a rather unique argument. On the one hand, it is impossible to overestimate the availability of information today, both in terms of the ease and comfort with which it can be obtained as well as the scope of the information available. Shareholders today do not have to wait for the company to deliver information to them. They are able to gather it by themselves, perhaps even more quickly than before, sometimes even without trying to do so given the fact that information in the Internet is often "viral" and spreads rapidly. Considering these features of the Internet, it makes a lot of sense to rely on the ability of shareholders in the 21st century to make decisions regarding their own assets. The assumption that they are better informed is quite grounded.

However, there is another side to this story. Is it possible to view the Internet as a complicating force? The heavy flow of information may result in investors' inability to differentiate between important and insignificant data.[159] How much is the unsophisticated minority shareholder actually able to understand, even under the assumption that all the information is within arm's reach?[160] There is such thing as too much information or information overload.[161] When shareholders receive a lot of information over time it is hard

---

[155] *See generally In re* MFW S'holders Litig., 67 A.3d 496, 496 (Del. Ch. 2013).

[156] *See id.*at 530.

[157] *Id.* at 533.

[158] *Id.*

[159] Some research has been conducted regarding different types of individuals' capacity for understanding information. *See, e.g.*, Jungae Yang & Maria Elizabeth Grabe, *Knowledge Acquisition Gaps: A Comparison of Print Versus Online News Sources*, 13 NEW MEDIA & SOC'Y 1211 (2011) (showing differences in some groups in relation to their understanding of information gathered online versus by reading a newspaper).

[160] *See id.*

[161] Similar problems arise with regards to medical information in the Internet. *See* William M. Silberg, George D. Lundberg & Robert A. Musacchio, *Assessing, Controlling, and Assuring the*

to distinguish between the important, relevant bits of information and those that have practically no effect on the business itself.[162]

In addition, the Internet provides an arena in which it is much easier to affect, and perhaps even manipulate, the information available to the parties involved.[163] Different players in the market might use the Internet to influence investors in one way or the other.[164] Public shareholders do not necessarily have the capacity to distinguish between different types of information, how much is really accurate, and what conclusions should be derived.[165] Frequently, information revealed makes a lot of noise and draws a lot of public attention but that does not necessarily correlate to its importance and economic impact.[166] Deciding which factors are worth considering and which are not is something that is not easy even for professional investors, and is certainly not easy for public stockholders, who are mostly laymen.[167]

This does not suggest that taking into account the greater availability and ease of information nowadays is not appropriate. Rather, it merely points at the complex impact the flow (or overflow) of information may have on parties.[168] That said, considering it an essential part of how markets function today seems important and timely.

V. SUMMARY

The *MFW* case finally established a legal framework that gives more security and certainty to parties engaging in a transaction whose structure is deemed adequate.[169] It is crucial for the court to emphasize that this does not actually represent a deviation from the existing law but rather a continuation of

---

Quality of Medical Information on the Internet, 277 J. AM. MED. ASSOC'N 1244 (1997).

[162] Troy A. Paredes,*Blinded by the Light: Information Overload and Its Consequences for Securities Regulation*, 81 Wash. U. L. Q. 417 (2003). *See also* Sarah Lynch, *SEC Chief Concerned Investors Face 'Information Overload',* Reiuters, Oct. 15, 2013 available at: http://www.reuters.com/article/2013/10/15/us-sec-white-publicreporting-idUSBRE99E0DK20131015.

[163] *Compare* Chrysanthos Dellarocas, *Strategic Manipulation of Internet Opinion Forums: Implications for Consumers and Firms*, 52 MANAGEMENT SCIENCE 1577 (2006) (analyzing firms' tempted to manipulate consumer perception by posting in internet opinion forums anonymous messages).

[164] *Id.*'

[165] Pardes, s*upra* note 162.

[166] *Id.*

[167] *Compare* Timothy D. Wilson & Jonathan W. Schooler, *Thinking Too Much: Introspection Can Reduce the Quality of Preferences and Decisions*, 60 J. PERS. & SOC. PSYCH. 181 (showing through an empirical study that analyzing reasons can focus people's attention on non-optimal criteria).

[168] Yang & Grabe, *supra* note 124.

[169] *In re* MFW S'holders Litig., 67 A.3d 496, 496 (Del. Ch. 2013).

it. This can be attributed to the perception that in a sense of stability in financial markets is essential.[170] In this case, the review of preceding cases shows that the claim that the court is not deviating from the precedent is also accurate, as the opinion was already made prior to the *MFW* case.[171] This case is nevertheless a focal point as it took the extra step towards acknowledging that even transactions with controlling shareholders could be made 'right' and that when done in such a way, the court will give the controlling shareholder the benefit of the doubt.[172]

This holding also more accurately reflects changes that occurred in the last few decades (and appear to be gaining more force lately). Although the court does not relate much to the economic effects of this judgment, it will supposedly reduce costs associated with self-dealing transactions, while simultaneously reducing the risks for minority shareholders by encouraging controlling shareholders to make sure the transactions are structured fairly *ex ante*.

[170] *See* Joseph E. Stiglitz, *Capital Market Liberalization, Economic Growth, and Instability*, 28 WORLD DEVELOPMENT 1075, Part 3 (2000).

[171] Indeed, it was first suggested in *In re* Cox Commc'ns, Inc. S'holder Litig., 879 A.2d 604 (Del. Ch. 1994).

[172] *In re* MFW S'holders Litig., 67 A.3d 496, 496 (Del. Ch. 2013).