Shareholder Divorce Court

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I. INTRODUCTION 297
II. MANAGING AUTHORITY WITHIN THE CORPORATE FORM 298
A. Directors and Wealth Maximization 299
B. Shareholders and Wealth Maximization 302
III. THE DISRUPTIVE RISE OF THE INSTITUTIONAL SHAREHOLDER 308
A. Consolidation and Conflict in the Shareholder Base 308
B. From Shareholder Fiction to Shareholder Reality 313
1. The Traditional Role of Wealth Maximization in the M&A Context 314
2. The Paradigm Shift of M&F *and* Corwin 317
C. With Great Power Does Not Come Great Responsibility 320
D. More Money, More Problems 324
IV. GROUNDS FOR DIVORCE: SEGMENTING THE SHAREHOLDER BASE 326
A. Decentralized Mutual Fund Voting 327
B. Dissenter-Only Fiduciary Lawsuits 328
C. Appraisal: The Original Solution to Shareholder Heterogeneity 330
1. The Right of Appraisal 331
2. Reforming Appraisal for the Modern Market 335
a. Deal Price and "Going Concern" Value 335
b. Expanding Appraisal's Availability 339
c. Simplifying Appraisal Procedures 342
V. CONCLUSION 345

I. INTRODUCTION

Corporate law is designed to address conflicts of interests among stockholders and managers. For decades, the law operated on the assumption that stockholders all have the same interest—wealth maximization—and imposed upon managers a duty to advance that interest. In fact, stockholder interests were never quite so clear cut: for example,

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stockholder-debtholders might have also wished to protect their loans, while stockholder-employees might have also wished to protect their jobs. Nonetheless, the system managed to elide these messy realities. Stockholders themselves had minimal input into the corporate decision-making process, because votes were rare and accomplished little; meanwhile, judicial deference to managerial decision-making created a space for directors to balance stockholders' competing interests. As practiced, then, in extreme circumstances, the duty of wealth maximization was strictly enforced; at other times, it functioned as a polite fiction, papering over real differences among corporate constituents.

In recent years, however, the landscape has changed. Stockholders have grown larger and more powerful, exacerbating their conflicts with each other. At the same time, courts have begun to acknowledge that strict adherence to a legal requirement of wealth maximization may have deleterious economic effects. As a result, the law has evolved; courts have demonstrated less appetite for enforcing a legal norm of wealth maximization when the majority of the shareholder base would tolerate departure from that mandate. The situation has left minority stockholders less protected against exploitation by the majority.

The shifts are particularly visible when it comes to mergers and acquisitions, where courts have long recognized that directors face special conflicts not present in other kinds of transactions. In earlier years, courts scrutinized directors' actions in the context of a merger to ensure they negotiated with sufficient vigor to obtain the best deal possible under the circumstances. Today, however, courts generally assume that shareholders can perform this task and treat a shareholder vote in favor of a transaction as the final word on its adequacy. Yet, due to the increasing consolidation of the shareholder base, powerful investors may be as conflicted as directors, and may therefore have no interest in driving a hard bargain. In this scenario, minority shareholders are left without an effective advocate for their interests, and may be coerced into suboptimal transactions.

This Article proposes that corporate law respond to shareholders' irreconcilable differences with limited rights of "divorce," in the form of a reconfiguration of the right of appraisal. Appraisal allows a stockholder to surrender her shares in exchange for their fair value. The appraisal right, in other words, forces the majority stockholders to buy off dissenters before changing the corporation's strategy. Though in recent years, appraisal has been championed mainly as a deterrent against exploitative transactions, it can also be used as a mechanism for price discrimination, to allow satisfaction of divergent shareholder preferences. In this state of affairs, the stockholder vote serves a sorting function, to allow investors to signal their preferences and be treated accordingly. To be effective for this purpose, however, certain aspects of appraisal should be changed, including expanding its availability, and adjusting how damages are calculated.

In Part II, I discuss the traditional balance of power and responsibility within the corporate form. In Part III, I describe the disruptions caused by the rise of institutional shareholders. In Part IV, I discuss how shareholders can "divorce" so that their separate interests may be effectively vindicated.

II. MANAGING AUTHORITY WITHIN THE CORPORATE FORM

In a corporation, investors supply capital that is managed by others. Because this separation of ownership and control—between those who provide capital and those who dictate its use—creates varying opportunities for exploitation and unfairness, corporate law regulates these relationships. In the traditional account, this regulation takes the form of

legal constraints on managers' actions, and architectural constraints on the actions of shareholders. In fact, as described below, the arrangement is more nuanced.

A. Directors and Wealth Maximization

Within a corporation, shareholders, as equity investors, elect directors, and directors in turn are endowed with responsibility for managing the corporation.[1] Directors have near complete discretion to make corporate decisions as they see fit, subject only to certain minimal procedural requirements.[2] For the largest sorts of decisions—mergers, liquidations, amendments to the charter—directors must obtain shareholder approval before they can act, but directors maintain the sole right to propose such actions in the first instance.[3]

Directors' expansive discretion creates the potential for abuse. In the worst cases, directors may use their control over corporate assets to self-deal, contracting with the corporation on preferred terms. In less extreme circumstances, they may direct corporate business in suboptimal ways to satisfy their personal priorities. Alternatively, they may simply shirk their obligations of oversight, causing the corporation to incur excessive costs and to forego profitable opportunities. Any of these possibilities would concern potential investors, and dissuade them from entrusting directors with their capital.

To reassure investors that their capital will not be squandered, state law imposes fiduciary responsibilities on corporate directors that temper their authority.[4] Directors thus have expansive powers of control, but are bound to use that power in accord with certain legal principles. As the Delaware Supreme Court put it, "inequitable action does not become permissible simply because it is legally possible."[5]

That said, if directors are to be controlled via legal oversight, the state must specify the duties it chooses to impose. Yet surprisingly, the precise nature of these obligations remains subject to dispute.[6] Certainly, directors must take proper care in their decision-making processes by informing themselves about the matters on which they act.[7] They also must be loyal, in the sense that they must not use their positions to enrich themselves personally, and must advance the best interests of the corporation.[8] Less clear, however, is

1. DEL. CODE ANN. tit. 8, §141 (2016); MODEL BUS. CORP. ACT § 8.01 (AM. BAR ASS'N 2016).

2. *See,* e.g., DEL. CODE ANN. tit. 8, §141(c)(2–4), (f), (i–j) (2016).

3. Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 846–47 (2005).

4. *See, e.g.*, Robert B. Thompson, *Exit, Liquidity, and Majority Rule: Appraisal's Role in Corporate Law*, 84 GEO. L.J. 1, 7 (1995); James D. Cox, *Corporate Law and the Limits of Private Ordering*, 93 WASH. U. L. REV. 257, 264 (2015); FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 90–91 (1991) (explaining how states impose fiduciary responsibilities).

5. Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971).

6. David G. Yosifon, *The Law of Corporate Purpose*, 10 BERKELEY BUS. L.J. 181, 183 (2013) ("The confusion in the literature on corporate purpose is . . . embarrassing.").

7. Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

8. *See, e.g.*, *In re* Novell, Inc. S'holder Litig., No. 6032-VCN, 2013 WL 322560 (Del. Ch. Jan. 3, 2013); DiRienzo v. Lichtenstein, No. 7094-VCP, 2013 WL 5503034 (Del. Ch. Sept. 30, 2013). Some states have adopted constituency statutes that permit directors to consider other stakeholders (such as employees and the surrounding community) when making decisions, although there is some debate as to whether these statutes should be interpreted to mean that directors may only consider such constituencies insofar as doing so benefits the stockholders. Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 737–38 (2005). Because of its prominence, Delaware sets a standard that other jurisdictions often follow, *see* William

how the "best interests of the corporation" should be defined.

Most modern theories of the corporation subscribe to what is known as "shareholder primacy," i.e., the notion that directors have, or should have, a commitment to manage the corporation in a manner that benefits the shareholders.[9] Yet the concept of shareholder primacy is not monolithic; it encompasses two sharply divergent views of the precise nature of directors' legal obligations.[10]

The first is simply wealth maximization: the primary duty of directors is to ensure that the corporation earns the highest possible profits, and thus offers shareholders the highest possible return on their investment.[11] Commenters in this camp recognize that some shareholders may have other preferences, but assume that at least their sole common ground is a desire to increase corporate wealth, and therefore, it is to that end that managers should direct their energies.[12] The central paradox of this view is that it permits shareholders to vote even for wealth-reducing actions if they so choose, but also holds that directors may not allow those interests to guide their behavior.[13] The tension is often resolved by insisting that shareholders' power within the corporate form be minimized; that way, directors can devote their attention to the project of wealth maximization without the distractions of actual shareholder demands.[14] For this reason, skeptics have derided wealth maximization as advocating for "fictional shareholders" :[15] since very few shareholders would prefer the pursuit of wealth maximization to the exclusion of all other interests—as described in more detail below,[16] all shareholders likely have some other priorities, even if they differ as to which priorities those are—in its purest form, a duty of wealth maximization requires directorial fealty to a set of desires that may not be possessed by any actual shareholder.

The second approach defines shareholder primacy to mean that directors must honor

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B. Chandler III & Anthony A. Rickey, *Manufacturing Mystery: A Response to Professors Carney and Shepherd's "The Mystery of Delaware Law's Continuing Success,"* 2009 U. ILL. L. REV. 95, 113 (2009); therefore, this Article mainly focuses on Delaware though it discusses other jurisdictions as indicated.

9. There are other views that do not place shareholders as primary: for example, according to stakeholder theory, the primary responsibility of directors is to moderate between various corporate constituencies, including shareholders, employees, and creditors. *See, e.g.*, Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 320–22 (1999).

10. Jennifer Taub, *Able But Not Willing: The Failure of Mutual Fund Advisers to Advocate for Shareholders' Rights*, 34 J. CORP. L. 843, 879–80 (2009); *see generally* Paul Weitzel & Zachariah J. Rodgers, *Broad Shareholder Value and the Inevitable Role of Conscience*, 12 N.Y.U. J.L. & BUS. 35 (2015).

11. *See, e.g.*, Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 103 (2004).

12. *See, e.g.*, Roberta Romano, *Metapolitics and Corporate Law Reform*, 36 STAN. L. REV. 923, 961 (1984); Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395, 405 (1983).

13. Myron T. Steele, former Chief Justice, Delaware Supreme Court, Continuity and Change in Delaware Corporate Law Jurisprudence, The Albert A. DeStefano Lecture on Corporate, Securities, and Financial Law at the Fordham Corporate Law Center, *in* 20 FORDHAM J. CORP. & FIN. L. 352, 360–62 (2015).

14. Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 572 (2003); Leo E. Strine, Jr., *Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America*, 119 HARV. L. REV. 1759, 1763 (2006) [hereinafter Strine, *Toward a True Corporate Republic*].

15. Daniel J.H. Greenwood, *Fictional Shareholders: For Whom Are Corporate Managers Trustees, Revisited*, 69 S. CAL. L. REV. 1021, 1026 (1996); *see also* Grant M. Hayden & Matthew T. Bodie, *One Share, One Vote and the False Promise of Shareholder Homogeneity*, 30 CARDOZO L. REV. 445, 500 (2008) (pointing out that shareholders do not share uniform preferences for wealth maximization).

16. *See infra* Part III.

the actual wishes of the shareholder base, typically by granting shareholders greater power within the corporate form.[17] Advocates of this view seek greater shareholder control over such matters as nomination of directors, executive compensation, and corporate political spending.[18] Doing so, however, fails to resolve the problem that shareholders may, in fact, want different things, and therefore risks permitting the majority to exploit the minority.[19] These concerns are generally answered with the argument that unless a shareholder has a controlling stake, the shareholder will not be able to influence corporate operations without the cooperation of other shareholders,[20] which necessarily minimizes the chance for exploitation. As discussed below, however, the prevalence of diversified institutional shareholders—on which the movement for greater shareholder power is often predicated[21]—is itself the very fact that undermines this assumption.

Until recently, these tensions could be elided via the business judgment rule.[22] That principle, which largely insulates directors' day-to-day decision-making from judicial review absent evidence of self-dealing or criminality,[23] has usually rendered it unnecessary for courts to specify the exact nature of directors' duties to the corporation. Market forces are deemed to exert the greatest pull on director behavior, and these may be assumed to favor shareholder wealth maximization,[24] or director obedience,[25] as the observer prefers.[26]

That said, when it comes to mergers and acquisitions, courts scrutinize director actions more closely,[27] and it is in that context that a more precise articulation of directors' legal

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17. Weitzel & Rodgers, *supra* note 10, at 43–44; Hayden & Bodie, *supra* note 15, at 503; Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J.L. FIN. & ACCT. 247, 248 (2017).

18. *See, e.g.*, Hart & Zingales, *supra* note 17, at 270–71; Bebchuk, *supra* note 3, at 865–74; Lucian A. Bebchuk & Robert J. Jackson, Jr., *Corporate Political Speech: Who Decides?*, 124 HARV. L. REV. 83, 98–101 (2010); Lisa M. Fairfax, *Mandating Board-Shareholder Engagement?*, 2013 U. ILL. L. REV. 821, 824–30 (2013); Carol Goforth, *Proxy Reform as a Means of Increasing Shareholder Participation in Corporate Governance: Too Little, But Not Too Late*, 43 AM. U. L. REV. 379, 448–53 (1994).

19. Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 575–77 (2006).

20. Bebchuk, *supra* note 3, at 883–84; Stewart J. Schwab & Randall S. Thomas, *Realigning Corporate Governance: Shareholder Activism by Labor Unions*, 96 MICH. L. REV. 1018, 1020 (1998).

21. Bebchuk, *supra* note 3, at 883–84; Goforth, *supra* note 18, at 403–04; Edward S. Adams, *Bridging the Gap Between Ownership and Control*, 34 J. CORP. L. 409, 424–25 (2009); Bernard Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 608 (1990).

22. This is why, despite a century of corporate doctrine, there are still arguments about to whom directors' duties are owed—and the case law has not generated clear answers. *See generally* Joan MacLeod Heminway, *Shareholder Wealth Maximization as a Function of Statutes, Decisional Law, and Organic Documents*, 74 WASH. & LEE L. REV. 939 (2017).

23. D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 309–10 (1998); Elhauge, *supra* note 8, at 746. Although theoretically directors might also be liable for grossly negligent behavior, corporations can—and usually do—opt out of that kind of liability. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (2015).

24. William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653, 658–59 (2010).

25. Marcel Kahan & Edward Rock, *Embattled CEOs*, 88 TEX. L. REV. 987, 1037–40 (2010); Weitzel & Rodgers, *supra* note 10, at 55; Larry E. Ribstein, *Accountability and Responsibility in Corporate Governance*, 81 NOTRE DAME L. REV. 1431, 1433–34, 1447–49 (2006).

26. In only a small handful of cases do courts directly state that directors' duties are to maximize wealth; most articles discussing the common law evidence on this point follow a standard pattern. *See* Heminway, *supra* note 22, at 950–51 (describing how law review articles typically summarize the precedents).

27. *See infra* Part III.

duties can be found.[28] Courts have held that directors seeking a sale of the company must work to obtain the highest possible price for the stockholders,[29] and they are permitted to favor long-term wealth accumulation strategies over short-term ones that would benefit shareholders who expect a quick payout,[30] so at least in that respect, directors may favor one group of shareholder preferences over another. The merger case law suggests that directors' duties are not to favor shareholder preferences, but instead to favor shareholder wealth maximization.[31]

However, the merger cases do not fully resolve the issue from a descriptive (let alone normative) point of view, because until very recently, they rested on certain assumptions described more fully below, namely, that corporate shareholders are inexpert, rationally passive, and incapable of generating informed preferences.[32] Without actual shareholders to guide them, it was relatively easy for courts to declare—especially in the context of a sale of the company—that "[s]tockholders generally are presumed to have an incentive to seek the highest price for their shares."[33]

B. Shareholders and Wealth Maximization

In the above account, investors' capital is protected from exploitative directors by legal obligations that constrain their behavior. When it comes to the actions of other shareholders, however, the standard maxim is that shareholders have no obligation to exercise their votes with any degree of care, or to use them to advance any particular purpose. Instead, they may vote, or not, as they choose, for their own idiosyncratic reasons, or for no reason at all.[34] Unlike directors, they are not required to use their votes to protect

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28. *E.g.*, Elhauge, *supra* note 8, at 849; Yosifon, *supra* note 6, at 199–200.

29. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986).

30. Paramount Commc'n, Inc. v. Time, Inc., 571 A.2d 1140, 1155 (Del. 1989).

31. *In re* Trados, Inc. S'holder Litig., 73 A.3d 17, 38 (Del. Ch. 2013) ("Stockholders may have idiosyncratic reasons for preferring decisions that misallocate capital. Directors . . . need not cater to stockholder whim."); *In re* Lear Corp. S'holder Litig., 967 A.2d 640, 655 (Del. Ch. 2008) ("Directors are not thermometers, existing to register the ever-changing sentiments of stockholders . . . . [D]irectors may take good faith actions that they believe will benefit stockholders, even if they realize that the stockholders do not agree with them."); Paramount Commc'n, Inc. v. Time, Inc., 571 A.2d 1140, 1153 (Del. 1989) (holding that directors may maintain takeover defenses even in the face of contrary shareholder preferences).

32. Jack B. Jacobs, former Justice, Delaware Supreme Court, Does the New Corporate Shareholder Profile Call for a New Corporate Law Paradigm?, The Eugene P. and Delia S. Murphy Conference on Corporate Law (May 8, 2012), *in* 18 FORDHAM J. CORP. & FIN. L. 19 (2012).

33. *In re* Crimson Exploration Inc. Stockholder Litig., Civil Action No. 8541-VCP, 2014 WL 5449419, at *17 (Del. Ch. Oct. 24, 2014); *see generally* Paul H. Edelman & Randall S. Thomas, *The Theory and Practice of Corporate Voting at U.S. Public Companies*, *in* RESEARCH HANDBOOK OF SHAREHOLDER POWER 459 (Jennifer Hill & Randall Thomas eds., 2015) ("On some of these issues, such as a vote on accepting a merger, where the sole issue is the adequacy of an offer, we would expect that shareholders will have similar preferences, so long as they have not engaged in empty voting."); *see also* Lyman Johnson, *Pluralism in Corporate Form: Corporate Law and Benefit Corps.*, 25 REGENT U. L. REV. 269, 286 (2013) (arguing that wealth maximization is the norm in the context of the merger if not necessarily elsewhere).

34. Hewlett v. Hewlett-Packard Co., No. Civ. A. 19513-NC, 2002 WL 549137, at *11 (Del. Ch. Apr. 8, 2002) ("Shareholders are free to do whatever they want with their votes, including selling them to the highest bidder."); Ringling Bros.-Barnum & Bailey Combined Shows, Inc. v. Ringling, 53 A.2d 441, 447 (Del. 1947) ("Generally speaking, a shareholder may exercise wide liberality of judgment in the matter of voting, and it is not objectionable that his motives may be for personal profit, or determined by whims or caprice . . . . The ownership of voting stock imposes no legal duty to vote at all."); Anabtawi, *supra* note 19, at 564 n.8 (observing that non-controlling shareholders are "free to act opportunistically"). Some shareholders, such as pension funds or mutual

any specific interests.

In theory, this might represent its own kind of threat: a majority of stockholders, whether due to malice or neglect, could vote for wealth-reducing actions that endanger the investment of the minority. In a close corporation, shareholders might know and trust each other,[35] but in a public corporation, investors are likely to be cautious before putting their fate in the hands of an anonymous, fluid set of co-owners whose preferences cannot be ascertained.

Here too, the regulatory framework offers protection, but with respect to shareholders, it comes in the architecture of the corporate form itself: there is very little that shareholders are actually permitted to do.[36] They may vote for directors, they may vote to confirm or reject certain actions proposed by directors (mergers, charter amendments, and so forth), they may pass bylaws within certain defined subjects (which corporate directors may have the power to repeal or amend at will), and under some circumstances they may be able to call special meetings.[37] But they have no ability to make day-to-day business decisions or otherwise control director actions, except through the power to select the directors themselves. As a result, when shareholders are numerous and dispersed—as is the case for widely traded public corporations—shareholder power is neutralized. Collective action problems prevent shareholders from coordinating to select directors or oversee their behavior; thus, existing directors dominate the nomination process and perpetuate their own control over the company.

The ostensible justification for this design is that shareholders with relatively small stakes have neither sufficient knowledge, nor sufficient incentives, to contribute positively to corporate governance.[38] But that rationale is only part of the story, because shareholder dispersion is itself carefully cultivated. At the federal level, the regulatory framework discourages investors from accumulating large positions in particular companies.[39] Meanwhile, state law grants corporate directors expansive ability to design "poison pills" that further penalize shareholders who accumulate large positions.[40] These measures help maintain shareholders' subordination, so that power can be concentrated in the hands of corporate directors whose actions are more easily made subject to state control.[41]

Given this arrangement, many have explored why shareholders have the right to vote at all. If they are uninformed and inexpert, and if, as a result, their governance powers are sharply circumscribed, there remains an open question as to whether, and when, the

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funds, may hold their shares for others' benefit; these shareholders are obligated to vote in the beneficiaries' interests, Jill E. Fisch, *Standing Voting Instructions: Empowering the Excluded Retail Investor*, 102 MINN. L. REV. 11, 20–21 (2017), but they have no duty to the issuing corporation.

35. Douglas K. Moll, *Shareholder Oppression and "Fair Value": Of Discounts, Dates, and Dastardly Deeds in the Close Corporation*, 54 DUKE L.J. 293, 300 (2004) (noting that "close corporation investors are often linked by family or other personal relationships that result in a familiarity among the participants").

36. Ann M. Lipton, *Manufactured Consent: The Problem of Arbitration Clauses in Corporate Charters and Bylaws*, 104 GEO. L.J. 583, 606–08 (2016).

37. *Id.* For a discussion of corporate directors' potential ability to repeal or amend shareholder bylaws, see *id.* at 608 n.152.

38. *Id.* at 608–10.

39. *See generally* Mark J. Roe, *Political Elements in the Creation of a Mutual Fund Industry*, 139 U. PA. L. REV. 1469 (1991); Black, *supra* note 21.

40. *See, e.g.*, Third Point LLC v. Ruprecht, C.A. No. 9469-UCP, 2014 WL 1922029 (Del. Ch. May 2, 2014); Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985).

41. LARRY E. RIBSTEIN, THE RISE OF THE UNCORPORATION 66 (2010).

shareholder vote has any value.[42]

In general, most theorists argue that voting serves two basic functions. First, it operates to minimize agency costs, by allowing shareholders to discipline unfaithful directors and, in extreme circumstances, to facilitate a change in control.[43] Second, it allows dispersed shareholders to aggregate their information and collectively reach an accurate determination as to the corporation's best course of action, which directors can then use to inform their own decision-making.[44] Both functions are rooted in the expectation of wealth maximization, namely, that all shareholders act to maximize firm value and therefore proceed from a uniform set of preferences.[45] Indeed, some have argued that the entire rationale for permitting a vote breaks down if this condition is not met; shareholders' votes cannot improve directors' decision-making if they are not directed toward the same goals.[46]

The assumed shareholder preference for wealth maximization ordinarily operates as an underlying axiom of corporate law. In certain situations, however, it translates to a legal duty imposed on shareholders. Perhaps the most significant of these is the shareholder primacy norm itself. As initially conceived, shareholder primacy was developed not as a mechanism for constraining directors' actions, but as a mechanism for constraining shareholders.[47] In the days when most corporations were small and closely held, it was common for the majority shareholders to install themselves as corporate directors and officers and, in those roles, direct various perquisites to themselves.[48] Courts responded with the duty of shareholder primacy, which, in its original incarnation, meant that corporate directors must act for the benefit of all shareholders equally, rather than favor certain shareholders over others by way of catering to their private interests. At a time when corporate directors were also shareholders (or very closely allied with them), shareholder primacy was, in effect, a mechanism for imposing duties on shareholders indirectly, by addressing them in their managerial roles. But as corporations grew larger and the

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42. Easterbrook & Fischel, *supra* note 12, at 397–98, 402; Robert B. Thompson & Paul H. Edelman, *Corporate Voting*, 62 VAND. L. REV. 129, 129–32 (2009).

43. Bebchuk, *supra* note 3, at 892; Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601, 610 (2006); Matteo Gatti, *Reconsidering the Merger Process: Approval Patterns, Timeline, and Shareholders' Role*, 69 HASTINGS L.J. 835, 847 n.45 (2018); Bernard Black & Reinier Kraakman, *Delaware's Takeover Law: The Uncertain Search for Hidden Value*, 96 NW. U. L. REV. 521, 559 (2002); Thompson & Edelman, *supra* note 42, at 141.

44. Thompson & Edelman, *supra* note 42, at 152; Zohar Goshen, *Voting (Insincerely) in Corporate Law*, 2 THEORETICAL INQUIRIES L. 815, 817–18 (2001).

45. Thompson & Edelman, *supra* note 42, at 149; Zohar Goshen, *The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality*, 91 CAL. L. REV. 393, 400 (2003); Easterbrook & Fischel, *supra* note 12, at 405 ("It is well known, however, that when voters hold dissimilar preferences it is not possible to aggregate their preferences into a consistent system of choices.").

46. Andrzej Rapaczynski, *Impact Investing as a Form of Lobbying and Its Corporate-Governance Effects*, 11 CAPITALISM & SOC'Y 1, 6 (2016) ("That investors in a company, unlike the consumers of its products, have essentially *identical* interests is a very important *systemic presupposition* of American corporate law."); Shaun Martin & Frank Partnoy, *Encumbered Shares*, 2005 U. ILL. L. REV. 775, 788 (2005) ("Homogeneity of preferences is a key assumption in the law and economics model of corporate voting.").

47. Smith, *supra* note 23, at 279.

48. *Id.* at 305–06; J. MARK RAMSEYER, RAMSEYER'S CORPORATE LAW STORIES: RAMSEYER'S THE STORY OF RINGLING BROS. V. RINGLING: NEPOTISM AND CYCLING AT THE CIRCUS 135, 156–57 (2009); Douglas K. Moll, *Shareholder Oppression in Close Corporations: The Unanswered Question of Perspective*, 53 VAND. L. REV. 749, 757–58 (2000) (close corporations are often controlled by majority shareholders who may "siphon[] off . . . corporate earnings through high compensation").

separation of ownership and control became more acute, the shareholder primacy norm ceased to operate on shareholders directly, and thus became inadequate to resolve internecine battles between shareholders with divergent preferences.

Today, under certain conditions, other doctrines perform that work. One such condition concerns those shareholders who are able to overcome the architectural limitations on their ability to influence corporate policy. When that occurs, the law provides that these controlling shareholders—defined as those with a sufficient equity stake to dictate the corporation's actions[49]—become subject to fiduciary duties akin to those of directors. Specifically, they may not force the corporation to advance their private interests at the expense of the corporation as a whole. For example, a controlling shareholder is prohibited from purchasing assets from the corporation at a discounted price or causing the corporation to buy assets from the controller at an inflated price.[50] Such actions are forbidden because they would advance the controller's private interests while diminishing the wealth of the corporate entity and its remaining stockholders. The controlling shareholder's conflict—between its wealth outside of its status as a shareholder, and its wealth in its capacity as a shareholder—justifies regulation of how it exercises its power.[51] Controllers are free, however, to cause the corporation to take actions that benefit themselves as shareholders because (assuming that such benefits are shared proportionally with the minority) there is no conflict, and wealth is maximized for all shareholders.[52]

A similar type of shareholder conflict occurs when an interested person buys a shareholder's vote. Vote-buying is defined as a "voting agreement supported by consideration personal to the stockholder, whereby the stockholder . . . votes as directed by the offeror."[53] A stockholder who sells her vote is conflicted: she may believe voting one way will increase the value of the corporate equity generally (and thus her shares proportionately), but voting with the offeror will allow her to profit personally, even if it diminishes the value of her shares. It is because of this conflict that vote-buying transactions are subject to judicial scrutiny[54]: they "creat[e] a misalignment between the voting interest and the economic interest of [the] shares."[55] A "bought" vote, according to

49. Controlling stockholders are usually those that own shares representing at least 50% of the corporate voting power, but courts may determine that a stockholder exercises actual power over corporate decision making even at lower thresholds. *See, e.g.*, Kahn v. Lynch Commc'n Sys., 638 A.2d 1110 (Del. 1994) (43.3% stake sufficient to confer controlling status); *In re* Cysive, Inc. S'holders Litig., 836 A.2d 531 (Del. Ch. 2003) (35% stake sufficient to confer controlling status).

50. *See, e.g.*, *In re* S. Peru Copper Corp. S'holder Derivative Litig., 52 A.3d 761 (Del. Ch. 2011); *In re* EZCORP, Inc. Consulting Agreement Derivative Litig., C.A. No. 9962-VCL, 2016 WL 301245, at *22–23 (Del. Ch. Jan. 25, 2016).

51. *EZCORP*, C.A. No. 9962-VCL, 2016 WL 301245, at *2–3 (discussing the incentives of controlling shareholders).

52. Sinclair Oil Corp. v. Levien, 280 A.2d 717, 721 (Del. 1971). In small closely-held firms, the doctrine of "minority oppression" also fills the same space as the original conception of shareholder primacy, see Smith, *supra* note 23, at 310–13. However, it is not recognized in Delaware. *See* Nixon v. Blackwell, 626 A.2d 1366, 1377 (Del. 1993).

53. Flaa v. Montano, No. 9146-VCG, 2014 WL 2212019, at *7 (Del. Ch. May 29, 2014) (quoting Schreiber v. Carney, 447 A.2d 17, 23 (Del. Ch. 1982) (internal quotations omitted).

54. Use of corporate resources, rather than personal resources, to purchase the vote, presents a different—and more severe—problem. *See generally* Hewlett v. Hewlett-Packard Co., No. Civ. A. 19513-NC, 2002 WL 549137 (Del. Ch. Apr. 8 2002).

55. *Flaa*, 2014 WL 2212019, at *8 (quoting Crown EMAK Partners, LLC v. Kurz, 992 A.2d 377, 388 (Del. 2010)).

the Delaware Supreme Court, becomes illegitimate when it does not "reflect rational, economic self-interest arguably common to all shareholders."[56]

Thus, the vote-buying cases add more nuance to the regime governing shareholder voting: even though minority shareholders are not obligated to cast their vote to achieve any particular result, they are granted votes in the first place in the expectation that they will use them to "express[] their collective view as to whether a particular course of action serves the corporate goal of stockholder wealth maximization."[57] In other words, shareholders may vote for any reason because they are presumed to seek corporate wealth maximization merely by virtue of their economic stake.[58]

Commenters have argued that there is something asynchronous about imposing duties directly on shareholders; they claim that the legal regime would be more coherent if shareholders remained free to vote as they please, with obligations imposed only on corporate directors to resist wealth-reducing directives from conflicted shareholders.[59] The rule is less incongruous, however, when viewed as a mechanism for policing the underlying assumption of uniform interests that justifies the shareholder vote: When the salience of shareholders' divergent preferences becomes impossible to ignore (and is blatant enough to be feasible to police), the law steps in to cabin shareholders' discretion.

But although the law only officially constrains conflicted shareholder action in these two contexts—controlling shareholders, and vote buying—all shareholders also exist in their capacity as non-shareholders, and as such, are likely to maintain private interests that conflict with the interests of the corporation as a whole. The vote buying cases, and the controlling shareholder cases, merely represent unusually clear examples.

Many shareholders, for example, may hold corporate debt, and thus are less likely to favor risk-taking; others may be corporate employees, and thus favor higher wages[60]; some may be customers, and thus favor lower prices;[61] some may be members of the surrounding community, and thus favor local employment.[62] Differential tax effects of corporate action

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56. *Crown EMAK*, 992 A.2d at 388 (quoting *In re* IXC Commc'ns, Inc. S'holders Litig., No. C.A. 17324 1999 WL 1009174, at *8 (Del.Ch. Oct. 27, 1999)).

57. *Crown EMAK*, 992 A.2d at 388 (internal citation omitted).

58. Kurz v. Holbrook, 989 A.2d 140, 180 (Del. Ch. 2010), *aff'd in part rev'd in part sub nom. by Crown EMAK*, 992 A.2d, at 377 ("[S]tockholders can choose freely whether and how to vote, and may do so for any reason . . . The premise underlying that freedom is the alignment of economic interests and voting rights."). Interestingly, in the earliest days of the modern corporation, Adolf Berle argued that even dispersed stockholders would, under appropriate circumstances, be bound by duties of good faith when voting on corporate action. As he put it, "a majority composed of scattered shareholders, not actuated by a unifying interest, nevertheless must not so exercise its power as to 'confiscate' the rights of the minority, nor so as to oppress them unreasonably." A.A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1068–69 (1931).

59. Paula J. Dalley, *The Misguided Doctrine of Stockholder Fiduciary Duties*, 33 HOFSTRA L. REV. 175, 176, 211–18 (2004); *see also* Lyman Johnson, *Unsettledness in Delaware Corporate Law: Business Judgment Rule, Corporate Purpose*, 38 DEL. J. CORP. L. 405, 422 (2013).

60. In one infamous example, the public pension fund CalPERS withheld support for a Safeway director apparently out of opposition to his hardline stance when bargaining with the Safeway union workers. *See* Anabtawi, *supra* note 19, at 590.

61. Joseph Farrell, *Owner-Consumers and Efficiency*, 19 ECONS. LETTERS 303, 305 (1985).

62. Hayden & Bodie, *supra* note 15, at 490–91; *see also* Lawrence Summers, *Funds that Shake Capitalist Logic*, FIN. TIMES (July 29, 2007), https://www.ft.com/content/bb8f50b8-3dcc-11dc-8f6a-0000779fd2ac (discussing sovereign wealth funds: "The logic of the capitalist system depends on shareholders causing companies to act so as to maximise the value of their shares. It is far from obvious that this will over time be the only motivation of governments as shareholders.").

may also influence shareholder preferences.[63]

One species of conflict—deemed "empty voting" or "encumbered shares"—may exist when shareholders have purchased options or entered into other contracts that cancel out their economic interest in the corporation in which they vote; in some cases, to the point where they profit more when the corporation's stock does poorly than when it does well.[64] Empty voting may represent an extreme end of a spectrum of conflict,[65] but the broader point is that conflicts between shareholders' equity investments, and their private interests, are pervasive.[66]

Due to these conflicts, shareholders may be injured in their private capacities by corporate actions even as they profit in their capacity as shareholders, or vice versa. These differences go beyond mere factual disagreements as to which corporate opportunities are likely to yield the most wealth;[67] they even go beyond disagreements as to the time horizon on which corporate goals are to be achieved.[68] Instead, these are differences regarding the external effects of corporate behavior, namely, its effects on other kinds of interests possessed by shareholders. In other words, shareholders' power within the corporate governance structure—and their relative freedom to act—is predicated on the assumption that they will vote to increase the value of the corporate equity, even though, on any given issue, this is likely not true for at least some segment of the shareholder base.

Thus, there remains a central, unresolved tension at the heart of the corporate design: directors are (nominally) selected by shareholders and tasked with advancing shareholders' desire for wealth maximization, but shareholders themselves may not share that goal. At the same time, the shareholder franchise is justified by their (presumed) preference for wealth maximization, but they are also kept subordinate and powerless, because they may not favor wealth maximization.[69] The tension is perhaps most visible in Frank Easterbrook and Daniel Fischel's germinal article on corporate voting.[70] In that piece, they both justified the shareholder vote on the ground that equity investors have homogeneous preferences for wealth maximization, and simultaneously assumed that shareholders are

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63. *See* Omri Marian, *Is All Corporate Tax Planning Good for Shareholders?*, 52 U.C. DAVIS L. REV. (forthcoming 2018); *see also* Greg Roumeliotis & Jessica Toonkel, *Comcast's All-Cash Bid Could Pit Murdoch Against Fox Shareholders*, REUTERS (May 15, 2018), https://www.reuters.com/article/us-fox-m-a-comcast-murdoch/comcasts-all-cash-bid-could-pit-murdoch-against-fox-shareholders-idUSKCN1IG1CH (pointing out that in a bidding war between Disney and Comcast for Fox assets, Rupert Murdoch—Fox's controlling shareholder—may prefer Disney's bid because of the implications for his tax liability).

64. Henry T.C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811, 814 (2006); Martin & Partnoy, *supra* note 46, at 789.

65. Frank Partnoy, *U.S. Hedge Fund Activism*, *in* RESEARCH HANDBOOK ON SHAREHOLDER POWER 99, 105–06 (Randall Thomas & Jennifer Hill eds., 2015). For this reason, those scholars who have argued that empty voting represents a unique problem that challenges the justification for the shareholder vote, *see e.g.*, Thompson & Edelman, *supra* note 42, at 154, are misguided; empty voting is more properly conceived as part of a continuum of private interests that temper shareholders' desire for wealth maximization at a particular firm.

66. Anabtawi, *supra* note 19, at 578–93; Hayden & Bodie, *supra* note 15, at 477–91.

67. *See* Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 Harv. L. Rev. 1735, 1745 (2006).

68. Many commentators have observed that the interests of long-term and short-term shareholders may conflict, although this is only an issue if one assumes that markets are not perfectly efficient (and thus do not perfectly price the company's long-term prospects). *See, e.g.*, Anabtawi, *supra* note 19, at 581; James J. Park, *Reassessing the Distinction Between Corporate and Securities Law*, 64 UCLA L. REV. 116, 173 (2017); *see also* Bebchuk, *supra* note 3, at 884 (arguing that long term prospects will be reflected in current stock prices).

69. *See supra* Part II.A.

70. *See generally* Easterbrook & Fischel, *supra* note 12.

diversified—which is the very fact that undermines shareholder homogeneity.[71]

III. THE DISRUPTIVE RISE OF THE INSTITUTIONAL SHAREHOLDER

The tensions at the heart of corporate law have been forced into the open by a tectonic shift in the nature of the shareholder base. Whereas once most securities were held by ordinary persons—retail investors—today, it is institutional investors, such as pension funds, insurance companies, hedge funds, and mutual funds, who dominate the market. Institutional investors' size and sophistication puts significant strain on the doctrinal axiom that shareholders are too inexpert, or do not have sufficient incentives, to meaningfully contribute to corporate governance.[72] The law has therefore shifted away from judicial enforcement of a fictionalized wealth-maximization norm, and toward accommodation of actual shareholder preferences. In doing so, however, the legal system has failed to contend with the reality of conflicts among shareholders themselves.

A. Consolidation and Conflict in the Shareholder Base

The federal policies that kept shareholders in public corporations fractured and dispersed have gradually been eroded, and with their demise has come the rise of the institutional shareholder. Securities regulations have been relaxed to permit formation of large funds that are able to take influential positions in public companies;[73] meanwhile, federal policies have encouraged the use of 401(k) plans that facilitate the growth of giant mutual funds.[74] In 1950, institutional investors owned 7% or 8% of public equities; today, that figure is closer to 70-80%.[75]

These investors are not controllers in the traditional sense, but unlike retail investors, they direct large pools of capital and thus hold sizable stakes in the companies in which they invest. For example, in 2005, on any given day, the Fidelity mutual fund family was the largest shareholder of 10% of corporate America.[76] Today, when all of its funds are considered, BlackRock controls 5% blocks of more than half of United States publicly listed companies, and Vanguard has 5% blocks in over 40% of them.[77] The three largest passive mutual fund companies—BlackRock, Vanguard, and State Street—taken together, hold the largest block of stock in 40% of all United States listed companies, and 88% of the S&P 500.[78]

71. *See id.* at 401, 405–06.

72. Steele, *supra* note 13, at 361–62; Jacobs, *supra* note 32, at 25.

73. Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 HASTINGS L.J. 445, 467–68 (2017).

74. Anne Tucker, *Retirement Revolution: Unmitigated Risks in the Defined Contribution Society*, 51 HOUS. L. REV. 153, 164–65 (2013).

75. Amy Westbrook & David A. Westbrook, *Unicorns, Guardians, and the Concentration of the U.S. Equity Markets*, 96 NEB. L. REV. 688, 729 (2018). Different companies may have a greater or lesser number of retail shareholders: for example, only 12% of investors in companies in the S&P 500 index are retail shareholders, but the P&G shareholder base is 40% retail. David Benoit, *P&G vs. Nelson Peltz: The Most-Expensive Shareholder War Ever*, WALL STREET J. (Oct. 6, 2017), https://www.wsj.com/articles/p-g-vs-nelson-peltz-the-most-expensive-shareholder-war-ever-1507327243.

76. Westbrook & Westbrook, *supra* note 75, at 733.

77. Jan Fichtner et al., *Hidden Power of the Big Three? Passive Index Funds, Re-concentration of Corporate Ownership and New Financial Risk*, 19 BUS. & POL. 298 (2017).

78. *Id.* at 313.

Large shareholders have taken an increasingly aggressive approach to corporate governance. Some obtain significant stakes with the intention of forcing changes at the target company,[79] but more commonly, large shareholders engage privately with corporate management in order to better understand the company and communicate their views on strategy and governance.[80] When private discussions fail, they may either vote to oust directors or vote in favor of governance changes that give shareholders a greater voice more generally, such as proxy access or board declassification. Significantly, though large asset managers hold their shares across multiple funds, they often coordinate their governance and engagement policies so that the funds speak with a single voice, amplifying their power.[81]

The remarkable growth of institutional ownership has led to increasing—and increasingly visible—conflicts between investor preferences in their shareholder and non-shareholder capacities. For example, the dominance of institutional investors has led to increasing cross-ownership across firms. In 1985, the five largest shareholders of any given S&P 500 firm would hold 17% of that firm, and 2% of another randomly selected firm in the index. By 2005, the five largest shareholders of a given S&P 500 firm held 26%, and 10% of another randomly selected index firm.[82] As a result, "most institutional investors in S&P 500 firms do not want corporate managers to narrowly maximize the value of their own firm. Instead, investors would see their portfolio values maximized if managers internalized a large percentage of any externalities imposed on other index firms."[83] Or, as one set of researchers put it, ownership of the S&P 500 has become so concentrated that "in a hypothetical conflict between two S&P 500 firms in 2005, 15% of the equity in either firm would on average be held by institutional investors that prefer the other side to win."[84]

Researchers have begun to demonstrate the real-world effects that flow from this concentration of ownership. One study found that investors who hold stakes in competing firms are more likely to vote for corporate governance measures, such as board declassification, that are opposed by management.[85] The authors theorize that poor governance within an industry creates a "race to the bottom" that attracts officer candidates who welcome weak monitoring. When investors hold shares in multiple similar companies, they have an incentive to shore up governance uniformly across their portfolio and disrupt the competition for weak oversight.[86]

One of the most well-publicized—and controversial—findings has been that cross-

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79. Leo E. Strine, Jr., *Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L.J. 1870, 1886 (2017) [hereinafter Strine, *Who Bleeds*].

80. Fichtner et al., *supra* note 77, at 318; Matthew J. Mallow & Jasmin Sethi, *Engagement: The Missing Middle in the Bebchuk-Strine Debate*, 12 N.Y.U. J. L. & BUS. 385, 392–94 (2016); Sarah Krouse et al., *Meet the New Corporate Power Brokers: Passive Investors*, WALL STREET J. (Oct. 25, 2016 10:41 AM), https://www.wsj.com/articles/the-new-corporate-power-brokers-passive-investors-1477320101.

81. Ann M. Lipton, *Family Loyalty: Mutual Fund Voting and Fiduciary Obligation*, 19 TRANSACTIONS: TENN. J. BUS. L. 175, 177 (2017).

82. Jarrad Harford et al., *Institutional Cross-Holdings and Their Effect on Acquisition Decisions*, 99 J. FIN. ECON. 27, 36 (2011).

83. *Id.* at 37.

84. *Id.* at 36.

85. Jie He et al., *Internalizing Governance Externalities: The Role of Institutional Cross-Ownership*, J. FIN. ECON. (forthcoming 2018) (manuscript at 1–2), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2940227.

86. *Id.*

ownership within an industry decreases consumer price competition, raising the spectre of antitrust violations.[87] In a similar vein, another study found that firms in the same industry are more likely to collaborate on projects like joint ventures and strategic alliances when they have cross-holders.[88] Although some skeptics dispute the robustness of the evidence of anticompetitive effects, even they agree there is cause for concern.[89] Researchers have also found that when investors have stakes in multiple companies operating within the same industry, compensation packages for corporate executives provide fewer incentives for them to engage in vigorous competition with peer firms.[90] Another study of the syndicated loan market found that firms with a common institutional blockholder are more likely to strike a deal with each other.[91]

Diversified holdings can have particularly distorting effects in the area of mergers and acquisitions. Contrary to the doctrinal assumption that stockholders seek to maximize the

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87. *See* José Azar et al., Ultimate Ownership and Bank Competition 2 (July 24, 2016) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2710252; José Azar et al., *Anti-Competitive Effects of Common Ownership*, 73 J. Fin. 1513, 1555 (2018); Einer Elhauge, *Horizontal Shareholding*, 129 HARV. L. REV. 1267, 1268 (2016); Eric A. Posner et al., *A Proposal to Limit the Anti-Competitive Power of Institutional Investors*, 81 ANTITRUST L.J. 669, 696 (2017).; Germán Gutiérrez & Thomas Philippon, *Investment-less Growth: An Empirical Investigation* 18 (NBER, Working Paper No. 22897, 2017), http://www.nber.org/papers/w22897 (finding that common ownership is associated with less investment activity by the firm); Jin Xie & Joseph Gerakos, Institutional Cross-Holdings and Generic Entry in the Pharmaceutical Industry 22 (May 10, 2018) (unpublished manuscript), http://abfer.org/media/abfer-events-2018/annual-conference/accounting/AC18P5001_Institutional_Cross-holdings_and_Generic_Entry.pdf (finding that brand-name drug manufacturers are more likely to settle disputes with generic manufacturers to keep generic drugs off the market when the firms have overlapping shareholders). One set of researchers conclude that overlapping ownership affects competitive behavior, but without causing harmful externalities. Brian L. Connelly et al., *Something in Common: Competitive Dissimilarity and Performance of Rivals with Common Shareholders*, ACAD. MGMT. J. (2018), http://amj.aom.org/content/early/2018/03/22/amj.2017.0515. Companies with common owners may also be more likely to voluntarily disclose information to the market, apparently because they are less concerned about conferring a competitive advantage on rivals. *See* Andrea Pawliczek & A. Nicole Skinner, Common Ownership and Voluntary Disclosure 8 (June 8, 2018) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3002075.

88. Jie He & Jiekun Huang, *Product Market Competition in a World of Cross Ownership: Evidence from Institutional Blockholdings*, 30 REV. FIN. STUD. 2674, 2676 (2017).

89. Daniel P. O'Brien & Keith Waehrer, *The Competitive Effects of Common Ownership: We Know Less Than We Think*, 81 Antitrust L.J. 729, 730 (2017); Edward B. Rock & Daniel L. Rubinfeld, *Antitrust for Institutional Investors*, 82 Antitrust L.J. 221, 223 (2018); Patrick J. Dennis et al., Common Ownership Does Not Have Anti-Competitive Effects in the Airline Industry 2 (Feb. 5, 2018) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3063465; COMM. ON CAP. MKTS. REG., *Common Ownership and Antitrust Concerns*, (Nov. 15, 2017), https://www.capmktsreg.org/2017/11/15/common-ownership-and-antitrust-concerns/. *But see* Thomas A. Lambert & Michael E. Sykuta, *The Case for Doing Nothing About Institutional Investors' Common Ownership of Small Stakes in Competing Firms* 2 (U. of Mo. Sch. of L. Legal Studies Research Paper, Working Paper No. 2018-21, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3173787 (disputing the empirical evidence and arguing that any anticompetitive effects are slight compared to the harms that would be caused by corrective measures); C. Scott Hemphill & Marcel Kahan, *The Strategies of Anticompetitive Common Ownership* 9 (NYU L. & Econ. Research Paper Series, Working Paper No. 18-29, 2018) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3210373.

90. *See generally* Miguel Anton et al., *Common Ownership, Competition, and Top Management Incentives* (ECGI Working Paper No. 511, 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2802332.

91. *See generally* Gjergji Cici et al., *Cross-Company Effects of Common Ownership: Dealings Between Borrowers and Lenders With a Common Blockholder* (Eur. Corp. Governance Inst., Working Paper No. 511, 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2705856.

price paid for their shares,[92] stockholder interests vary based on their other investments. For example, when a target company is weak and its debt is risky, a merger may shore up the value of the target's bonds. As a result, one study found that investors who own both stock and debt of the target—especially risky targets—are more likely to favor a merger, and to accept a lower premium for their shares.[93] The same study concluded that when investors with debt and equity hold large stakes in a target, deals will be consummated at lower premiums.[94]

Researchers have also studied investor preferences when they hold stock in both the acquirer and the target. Because these investors stand on both sides of the deal, they are hedged; any expenses paid by the acquirer benefit them in their capacity as a holder of target stock. Studies have therefore found that shareholder overlap influences merger activity and the effect of the merger on the constituent companies, though the precise effects vary. For example, cross-holders may be more likely to vote in favor of value-reducing acquisitions on the buyer side, presumably because they will obtain a premium for their target shares.[95] Cross-holdings are also associated with negative acquirer-side returns when a merger is announced, suggesting that cross-holders promote or support value-reducing acquisitions.[96] At the same time, researchers focused on premiums rather than returns have found that the effects of cross-holding run in the opposite direction: if shareholders hold stock in both the acquirer and the target, takeover premiums are likely to be lower.[97] Cross-ownership also makes a merger between two peer firms more likely.[98] The implication is that shareholders of the acquirer are willing to accept less compensation for their target shares, in the expectation that they will share in the acquirer's gains.

There is anecdotal evidence that corporate boards are well aware of the diverse holdings of institutional investors, and take those cross-holdings into account when negotiating deals. For example, recently Anheuser-Busch InBev NV acquired SABMiller PLC. Financial advisors to the deal were confident SABMiller's shareholders would vote to accept Anheuser-Busch's buyout offer because many of the largest shareholders—including BlackRock and State Street—also held stakes in Anheuser-Busch.[99] When Jos A. Bank made an unsolicited takeover offer for Men's Wearhouse, it cited the shareholder overlap between the two companies as a reason for Men's Wearhouse investors to favor

92. *See supra* Part II.B.

93. *See generally*, Andriy Bodnaruk & Marco Rossi, *Dual Ownership, Returns, and Voting in Mergers*, 120 J. FIN. ECON. 58 (2016).

94. *Id.* at 59.

95. Gregor Matvos & Michael Ostrovsky, *Cross-Ownership, Returns, and Voting in Mergers*, 89 J. FIN. ECON. 391, 392 (2008). Though a later study concluded that cross-owners did not hold sufficient stakes in both firms to plausibly influence their voting patterns, Harford et al., *supra* note 82, at 27, the original finding remains unchallenged. *See* Martin C. Schmalz, *Common-Ownership Concentration and Corporate Conduct*, 10 ANN. REV. FIN. ECON. (forthcoming Dec. 2018) (manuscript at 16, n.12).

96. *See* Maria L. Goranova et al., *Owners on Both Sides of the Deal: Mergers and Acquisitions and Overlapping Institutional Ownership*, 31 STRATEGIC MGMT. J. 1114, 1123 (2010); *see also* Robert G. Hansen & John R. Lott, Jr., *Externalities and Corporate Objectives in a World with Diversified Shareholder/Consumers*, 31 J. FIN. & QUANTITATIVE ANALYTICS 43, 65 (1996) (finding acquirer returns are lower when there is significant cross-holding between acquirer and target).

97. Chris Brooks et al., *Institutional Cross-Ownership and Corporate Strategy: The Case of Mergers and Acquisitions*, 48 J. CORP. FIN. 187, 189 (2018).

98. Harford et al., *supra* note 82, at 36.

99. Eyk Henning & Tripp Mickle, *Hedge Funds Complicate SABMiller Vote*, WALL STREET J. (Sept. 20, 2016), https://www.wsj.com/articles/hedge-funds-complicate-sabmiller-vote-1474390913.

the deal.[100] A few years ago, Air Products & Chemicals launched a failed hostile bid for the Airgas company.[101] Once the dust settled, Air Products approached Airgas again, arguing that due to the extensive overlap among their shareholders, Airgas's shareholders were likely to accept a new, revised deal.[102] Airgas, fearing pressure to undersell the company, sought a different acquirer instead.

The recent acquisition of SolarCity by Tesla Motors presents an example that runs in the other direction. Both companies were chaired by Elon Musk, and they shared several board members. Musk served as CEO of Tesla, while his cousin served as CEO of SolarCity.[103] Given the structural conflicts, the acquisition was widely viewed as an effort by Musk to shore up the faltering SolarCity at Tesla's expense.[104] Nonetheless, because the companies shared several large shareholders—including Blackrock, Vanguard, and Fidelity—it was widely (and correctly) anticipated that Tesla's shareholders would vote to approve the deal.[105] Indeed, Tesla's financial advisor highlighted the shareholder overlap when discussing the deal with Tesla's board.[106]

At this point, overlapping shareholders is a sufficiently significant aspect of merger practice to warrant discussion in the Takeover Law and Practice guide published for clients by the law firm of Wachtell Lipton. According to the guide, when an acquirer decides whether to make an unsolicited bid for a target, "[a] thorough understanding of the target's shareholder base is also critical. For example, overlapping shareholders may be important

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100. Alex Gavrish, *Jos. A Bank and Men's Wearhouse Leave Investors Puzzled*, VALUEWALK (Jan. 2, 2014), http://www.valuewalk.com/2014/01/jos-bank-mens-wearhouse-leave-investors-puzzled/. Later, a significant shareholder of both companies threw its support behind a competing bid by Men's Wearhouse to take over Jos. A. Bank, characterized by observers as a significant stumbling block to Jos. A. Bank's offer. Dana Cimilluca, *Eminence Capital Backs Men's Wearhouse Bid For Jos. A. Bank*, WALL STREET J. (Jan. 13, 2014), https://www.wsj.com/articles/eminence-capital-backs-men8217s-wearhouse-bid-for-jos-a-bank-1389630447.

101. Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 55–56 (Del. Ch. 2011).

102. Leslie Picker, *Why Airgas Was Finally Sold, for $10 Billion Instead of $5 Billion*, N.Y. TIMES: DEALBOOK (Sept. 5, 2016), https://www.nytimes.com/2016/09/06/business/dealbook/why-airgas-was-finally-sold-for-10-billion-instead-of-5-billion.html.

103. Steven Davidoff Solomon, *Silicon Valley Style Puts Gloss on Tesla's Bid for SolarCity*, N.Y. TIMES: DEALBOOK (Nov. 8, 2016), https://www.nytimes.com/2016/11/09/business/dealbook/silicon-valley-style-puts-gloss-on-teslas-bid-for-solarcity.html.

104. Claudia Assis, *Tesla-SolarCity Deal 'Veiled Bail-Out,' Glass Lewis Says*, MARKETWATCH (Nov. 4, 2016), https://www.marketwatch.com/story/glass-lewis-proxy-service-tesla-solarcity-deal-veiled-bail-out-2016-11-04.

105. Solomon, *supra* note 103; David Welch & Dana Hull, *The Real Reason Investors Are Backing the Tesla-SolarCity Deal*, BLOOMBERG (Sept. 20, 2016), https://www.bloomberg.com/news/articles/2016-09-19/musk-s-tesla-city-vision-has-backing-where-it-counts-the-most. Technically, Tesla shareholders were voting on a stock issuance necessary to complete the deal. *See infra* Part IV.C. A similar type of shareholder conflict existed when Bank of America acquired Merrill Lynch. Merrill Lynch had been experiencing severe mortgage-related losses, and many Bank of America shareholders viewed the acquisition as a Merrill Lynch bailout. Nonetheless, Bank of America shareholders voted to approve the deal, arguably because a significant percentage were also invested in Merrill. *See* Maria Goranova & Lori Verstegen Ryan, *Shareholder Empowerment: An Introduction*, *in* SHAREHOLDER EMPOWERMENT (Maria Goranova and Lori Verstegen Ryan eds., 2015); *see also* Goranova et al., *supra* note 96, at 1117 (contending that the same incentives were at work in the merger between HP and Compaq).

106. *See* Plaintiffs' Answering Brief in Opposition to Defendant's Motion to Dismiss the Second Amended Complaint, at 35 n.11, *In re Tesla Motors Stockholder Litig.*, C.A. No. 12711–VCS (Del. Ch. July 20, 2017); Defendants' Reply Brief, at 18 n.14, *In re* Tesla Motors Stockholder Litig., C.A. No. 12711-VCS (Del. Ch. Aug. 17, 2017), at 18 n.14.

proponents of a transaction . . ."[107] Shareholder overlap can be critical to how deals are designed from inception: the Dow/DuPont merger, for example, was structured around the significant shareholder overlap, in the expectation that cross-ownership would allow the combined entity to spin off into separate companies without an associated tax burden.[108]

The phenomenon of empty voting has generated a great deal of scholarly attention because it presents a danger that hedge funds might vote for inefficient transactions in order to profit from offsetting investments.[109] It is unclear how common that phenomenon is likely to be,[110] but if it occurs, it represents an intentional manipulation of the voting process. Today's conflicts, however, represent a pervasive, baseline characteristic of the market, and they are growing.[111]

B. From Shareholder Fiction to Shareholder Reality

Because institutional shareholders have both the incentives and the resources to express informed opinions about corporate governance, the typical justifications for minimizing shareholder power within the corporate form no longer hold, or at least do not hold as strongly. The legal regime has therefore begun to shift to accommodate the new reality. Under federal law, for example, shareholder power has been dramatically enhanced. Regulations have been amended to grant shareholders greater access to the corporate proxy, to limit the circumstances in which brokers can vote on shareholders' behalf in the absence of voting instructions, and to loosen restrictions on communications among shareholders.[112]

That said, the increasing influence of institutions has not been viewed as entirely benign. In true "be careful what you wish for" turnabout, many commenters—including the current Chief Justice of the Delaware Supreme Court[113]—have expressed alarm over

107. DAVID A. KATZ & THEODORE N. MIRVIS, WACHTELL, LIPTON, ROSEN & KATZ, TAKEOVER LAW AND PRACTICE 123 (2017). Unsurprisingly, activist investor Carl Icahn recently withdrew a challenge to a merger between Cigna and Express Scripts, in part because significant shareholder overlap between the two companies made it unlikely he would find many allies. *See* Cara Lombardo, *Icahn Backs Down on Cigna-Express Scripts Deal*, WALL STREET J. (Aug. 13, 2018), https://www.wsj.com/articles/icahn-backs-down-on-cigna-express-scripts-deal-1534207697.

108. Kevin Allison, *The Tax Acrobatics in the Dow-DuPont Deal*, N.Y. TIMES: DEALBOOK (Dec. 15, 2015), https://www.nytimes.com/2015/12/16/business/dealbook/the-tax-acrobatics-in-the-dow-dupont-deal.html. A study of institutional shareholders in the United Kingdom found that cross-holders "can dominate the institutional influencing and decision-making process before, during and after the merger. This overlapping group of core stakeholders for both companies A and B has the strongest pre bid influence on the thinking of the predator . . . They become the focus for intensive private and public corporate communications during the merger as both parties seek to gain their support." John Holland, *Influence and Intervention by Financial Institutions in Their Investee Companies*, 6 CORP. GOVERNANCE 249, 259 (1998).

109. *E.g.*, Hu & Black, *supra* note at 64, at 819; Martin & Partnoy, *supra* note at 46, at 789.

110. Partnoy, *supra* note 65, at 99, 107; Henry T.C. Hu & Bernard Black, *Equity and Debt Decoupling and Empty Voting II: Importance and Extensions*, 156 U. PA. L. REV. 625, 652, 659 (2008).

111. Robert Thompson and Paul Edelman hypothesize that these conflicts are of little concern because institutions are not likely to be systematically biased in their investments; as a result, in the merger context, shareholders who are hedged in one direction will balance those who are hedged in another direction, leaving the vote relatively undistorted. Thompson & Edelman, *supra* note 42, at 155. In fact, the evidence suggests that crossholdings doaffect merger votes and deal pricing, perhaps due to the new dominance of a handful of extremely large financial conglomerates.

112. Ann M. Lipton, *Reviving Reliance*, 86 FORDHAM L. REV. 91, 103 (2017).

113. Strine, *Who Bleeds*, *supra* note 79, at 1871–74.

the (perceived) pressure for wealth maximization (typically in the form of immediate returns) that institutional investors apply to their portfolio companies. Commenters have blamed institutions' purported focus on profit and indifference to risk (due to diversification) for everything from diminished R&D spending[114] to the financial crisis.[115] The recent decline in new public offerings has also been attributed, in part, to the overwhelming investor scrutiny associated with public markets.[116]

As a result, at the state level, where corporate law is generated more by judicial decision-making than by statutory design, the response has been less to grant shareholders more power within the corporate form than for courts to remove themselves from corporate disputes.[117] This retrenchment has something of a Rorschach quality: on the one hand, it is trumpeted as a signal of confidence in the ability of institutional shareholders to protect themselves without the need for judicial second-guessing. In practical effect, however, it loosens directors' legal obligations vis-à-vis shareholders. The renewed freedom granted to directors functionally empowers them with the flexibility they had in an earlier era to—once again—mediate among constituencies and even deviate from the wealth maximization norm without openly admitting as much. The difficulty, however, is that to retreat from wealth maximization is to ignore the very real conflicts among the shareholder base that the wealth maximization norm was originally intended to resolve. This development is mainly visible in the realm of mergers and acquisitions, though theoretically it can be applied in other contexts.

1. The Traditional Role of Wealth Maximization in the M&A Context

As described above, directors are vested with responsibility for overseeing corporate operations, and are obligated to act both loyally and with due care. So long as they comport with these obligations, their decisions are virtually unreviewable by a court; if they fail to meet them, however—for example, by causing the corporation to engage in a self-dealing transaction—and a stockholder later challenges the action as the product of a breach of fiduciary duty, a reviewing court will closely scrutinize their behavior to ensure that it was entirely fair to stockholders.[118] If the directors are deemed to have violated their duties, they (and anyone who aided and abetted the breach) may be liable for monetary damages.[119] Necessarily, by the time a dispute reaches this stage, courts will focus on whether directors acted to maximize the wealth of the firm and, thus, returns to stockholders.[120]

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114. John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545, 573–77 (2016).

115. Bratton & Wachter, *supra* note at 24, at 658–59.

116. de Fontenay, *supra* note 73, at 462.

117. There are some exceptions; Delaware recently amended its corporate code to allow for the possibility of shareholder proxy access, and to allow for procedures for reimbursement of proxy solicitation expenses by dissidents. *See* DEL. CODE ANN. tit. 8, §§ 112, 113 (2009). Yet much of the response has come in the form of changes to the common law.

118. Fliegler v. Lawrence, 361 A.2d 218, 224 (Del. 1976).

119. Most corporate charters today contain provisions that insulate directors from monetary liability for breaches of the duty of care, but directors may still be liable for damages in connection with violations of the duty of loyalty. Those who aid and abet a director's breach of the duty of care may themselves incur damages liability. *See generally* RBC Capital Mkts., LLC v. Jervis, 129 A.3d 816 (Del. 2015).

120. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986).

Directors can avoid this type of review by fully disclosing all relevant information and seeking the approval of the disinterested stockholders. For example, when directors set their own salaries (plainly an interested transaction) it is common to submit the proposed compensation package to a shareholder vote, so as to insulate it from subsequent challenge.[121] Until recently, however, it was not clear whether a shareholder vote could cleanse directorial breaches of duty in the context of selling a company, where directors' actions are scrutinized more closely.[122]

In most friendly merger situations, the target's board either presents a plan of merger for the target shareholders' vote,[123] or the acquirer makes a tender offer for the target's shares in hopes of acquiring a sufficient stake to render a formal vote unnecessary, and the target's board recommends that shareholders accept the offer.[124] In either case, if a sufficient number of target shareholders agree to the deal—either by voting in favor, or by tendering—the merger is completed, and all target shareholders (regardless of whether they favored the deal) receive merger consideration in exchange for their shares.

It is well known that target boards of directors may have conflicting incentives when negotiating these arrangements; for example, they (or their advisors, or the corporate officers) may wish to maintain relationships with the acquirer, or expect a large bonus upon the consummation of a deal.[125] As a result, there is a particular danger that they will agree to a merger price that undervalues the target. To protect shareholders against this possibility, Delaware courts apply a heightened form of scrutiny to directors' efforts to secure a sale of the company[126] and have suggested that—while there are no specific blueprints for conducting a sales process—certain procedures may be preferable to others. These include soliciting multiple bidders and conducting negotiations through independent directors rather than interested management.[127] With these and other standards for director conduct in hand, shareholders of target corporations frequently file class action lawsuits alleging that the target board breached its fiduciary duties by approving a merger without a sufficiently vigorous negotiation process.[128] Thus, in recent years, it has been common for transactions of this sort to receive some kind of judicial review to ensure that directors live up to their fiduciary obligations to try to obtain the highest possible price for target shareholders.

For a long time, there was some doubt as to how far a shareholder vote could go to cleanse director actions in these situations.[129] One concern was that, when target

121. For examples of such votes, see Seinfeld v. Slager, No. 6462-VCG, 2012 WL 2501105 (Del. Ch. June 29, 2012); Calma v. Templeton, C.A. No. 9579-CB, 2015 WL 1951930 (Del. Ch. Apr. 30, 2015).

122. J. Travis Laster, *The Effect of Stockholder Approval on Enhanced Scrutiny*, 40 WM. MITCHELL L. REV. 1443 (2014) [hereinafter Laster, *The Effect of Stockholder Approval*]; Iman Anabtawi, *The Twilight of Enhanced Scrutiny in Delaware M&A Jurisprudence*, 43 DEL. J. CORP. L. (forthcoming 2019) (manuscript at 25).

123. DEL. CODE ANN. tit. 8, § 251 (2018).

124. *Id.* §§ 251(h), 253.

125. *See* J. Travis Laster, Revlon *is a Standard of Review: Why It's True and What It Means*, 19 FORDHAM J. CORP. & FIN. L. 5, 11–17 (2013).

126. *Id.*

127. *Id.* at 20; J. Travis Laster, *Changing Attitudes: The Stark Results of Thirty Years of Evolution in Delaware M&A Litigation*, *in* RESEARCH HANDBOOK ON REPRESENTATIVE SHAREHOLDER LITIGATION (forthcoming 2018) [hereinafter Laster, *Changing Attitudes*], https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2982603.

128. Matthew D. Cain et al., *The Shifting Tides of Merger Litigation*, 71 VAND. L. REV. 603, 612 (2018).

129. Laster, *The Effect of Stockholder Approval*, *supra* note 122, at 1444–45.

shareholders are presented with a premium-generating deal—even if it is not the very best deal possible—they may feel they have little choice but to accept it, precisely because they have no way of negotiating directly with the acquirer themselves.[130] Additionally, it was unclear whether, as a matter of formal doctrine, shareholder votes that were necessary to complete a transaction should also be treated as having ratified management conduct.[131] As a result, even in the face of an approving shareholder vote, courts signaled their willingness to continue to closely analyze mergers to ensure that target shareholders were protected.[132]

One particular area where courts have expressed concern about shareholder coercion is in the context of controlling shareholder buyouts. An offer by a controlling shareholder to purchase the minority's stake can carry with it an implicit threat of retaliation if the offer is refused.[133] Thus, courts examined such offers to ensure that they were "entirely fair" to the minority stockholders. If the controlling shareholder conditioned the deal on approval by the majority of the disinterested stockholders—or if it set up a special board committee of independent directors and permitted them to negotiate freely on the minority's behalf—the controlling shareholder could shift the burden of proof from itself to any plaintiff challenging the deal, but either way, courts scrutinized such mergers closely.[134]

This regime has always had its flaws. First, it attracted frivolous litigation that did not materially benefit shareholders.[135] Second, a growing number of commenters—including the Delaware courts, and its judges—have expressed concern that prices paid for target companies have become too high.[136] As a result, destructive deals damage the acquiring company and externalize harms to other stakeholders like creditors and employees in the form of bankruptcies and layoffs.[137]

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130. *See, e.g.*, *In re* El Paso Corp. S'holder Litig., 41 A.3d 432 (Del. Ch. 2012) ("The negotiation process and deal dance present ample opportunities for insiders to forge deals that, while 'good' for stockholders, are not 'as good' as they could have been, and then to put the stockholders to a Hobson's choice."). The Delaware Supreme Court also suggested that pathologies in merger negotiations could substantively coerce shareholders into accepting a bad bargain, undercutting the argument that a yes vote should be read as approval of the directors' conduct. *In re* Santa Fe Pacific Corp. S'holder Litig., 669 A.2d 59 (Del. 1995).

131. *See* Gantler v. Stephens, 965 A.2d 695, 713 (Del. 2009); *see also* Laster, *The Effect of Stockholder Approval*, *supra* note 122, at 1445.

132. For example, in *In re* El Paso Corp., 41 A.3d at 452, the court refused to enjoin a merger despite evidence of fiduciary breaches in the course of the negotiations, but recognized the possibility of damages relief after closing. After shareholders voted in favor of the merger, litigation proceeded and ultimately settled for $110 million. *See generally* Joel Edan Friedlander, *Vindicating the Duty of Loyalty: Using Data Points of Successful Stockholder Litigations as a Tool for Reform*, 72 BUS. LAW. 623 (2017).

133. Larkin v. Shah, C.A. No. 10918-VCS, 2016 WL 4485447, at *9 (Del. Ch. Aug. 25, 2016).

134. Kahn v. Lynch Commc'n Sys., 638 A.2d 1110 (Del. 1994); Kahn v. M&F Worldwide, 88 A.3d 635 (Del. 2014); Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

135. *See generally* Jill E. Fisch et al., *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 TEX. L. REV. 557 (2015).

136. *See* DFC Glob. Corp. v. Muirfield Value Partners, L.P., 172 A.3d 346, 371 (Del. 2017) ("[T]here is a rich literature noting that the buyers in public company acquisitions are more likely to come out a loser than the sellers, as competitive pressures often have resulted in buyers paying prices that are not justified by their ability to generate a positive return on the high costs of acquisition and of integration."); Strine, *Who Bleeds*, *supra* note 79, at 1946; Afra Afsharipour & J. Travis Laster, *Enhanced Scrutiny on the Buy-Side*, 53 GA. L. REV. (forthcoming 2019); David Dayen, *The Cause and Consequences of the Retail Apocalypse*, NEW REPUBLIC (Nov. 14, 2017).

137. Strine, *Who Bleeds*, *supra* note 79, at 1946; Afra Afsharipour, *Reevaluating Shareholder Voting Rights in M&A Transactions*, 70 OKLA. L. REV. 127, 128 (2017) [hereinafter Afsharipour, *Reevaluating*].

It is perhaps unsurprising, then, that in the past few years Delaware has relaxed its scrutiny of mergers, placing greater emphasis on the cleansing effect of a shareholder vote, and evincing less concern that shareholders may feel pressured to accept a deal they do not fully endorse.

2. The Paradigm Shift of M&F *and* Corwin

The Delaware Supreme Court took its first step in this direction in 2014, when it revised the standards of review for controlling shareholder mergers in *Kahn v. M&F Worldwide*.[138] The court held that if the controlling shareholder both conditions the merger on the favorable vote of a majority of the disinterested stockholders, and allows an independent committee of directors to negotiate the deal on the minority's behalf, and if there are no retributive threats or other overly coercive tactics, then the transaction will be evaluated like any other arm's length merger.[139] Although the Supreme Court has not decided the issue yet, Chancery decisions have converged on applying similar standards to controlling shareholder tender offers.[140]

A year later, the Delaware Supreme Court decided *Corwin v. KKR Financial Holdings*,[141] and confirmed that—outside the controlling shareholder context, where M&F applies—so long as shareholders receive full information prior to their vote, acceptance of a deal acts as ratification of the directors' conduct. The court reasoned that judges should not "second-guess the judgment of a disinterested stockholder majority that determines that a transaction . . . is in their best interests." As a result, under *Corwin*, no matter how inadequate the negotiation process, shareholders are deemed to accept it by voting to accept the deal. The *Corwin* framework has also been extended to two-step tender offers; i.e., so long as a majority of the target shareholders tendered their shares upon full disclosure of the negotiation process, they are deemed to have ratified any directorial breaches of duty that may have occurred in striking the deal.[142]

Corwin thus represents a new direction in merger litigation, one that reduces directors' legal obligations to, as a practical matter, full disclosure. Almost anything else is presumed to have been addressed via market mechanisms.[143] To the extent directors' duties have atrophied to mere formalities—their actions are required to initiate a merger, but the substantive judgment required of them is no longer legally enforceable—it represents a sea change in the legal framework governing mergers.[144]

The ostensible rationale behind these shifts in standards of review (occasionally stated

138. Kahn v. M&F Worldwide, 88 A.3d 635, 644 (Del. 2014).

139. *Id.*

140. *See In re* CNX Gas Corp. S'holders Litig., 4 A.3d 397 (Del. Ch. 2010).

141. Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 314 (Del. 2015).

142. *In re* Volcano Corp. Stockholder Litig., 143 A.3d 727, 743–47 (Del. Ch. 2016), *aff'd* 156 A.3d 697 (Del. 2017).

143. To be sure, a vote may not be deemed cleansing even with full disclosure if it was structurally coercive, see Sciabacucchi v. Liberty Broadband Corp., C.A. No. 11418-VCG, 2017 WL 2352152, at *2 (Del. Ch. May 31, 2017), and there may remain questions about *what*, precisely, shareholders voted to cleanse, see *In re* Massey Energy Co. Derivative & Class Action Litig., 160 A.3d 484, 508 (Del. Ch. 2017).

144. Just a few years ago, Marcel Kahan and Edward Rock described the directors' "duty to take a position on a merger" as "one of the hooks on which the structure of fiduciary duties is hung." Marcel Kahan & Edward Rock, *How to Prevent Hard Cases from Making Bad Law: Bear Stearns, Delaware, and the Strategic Use of Comity*, 58 EMORY L J. 713, 722 (2009).

explicitly, other times left as subtext) is that today's shareholder base is more sophisticated and powerful than the dispersed shareholder base of a previous era.[145] Institutional, diversified shareholders are assumed to be capable of protecting their interests without the interference of the judiciary,[146] despite their inability to negotiate deal terms directly. Similar to the voting theorists,[147] Delaware portrays these shareholders as able to assimilate and aggregate information to reach an accurate determination as to a transaction's fairness and desirability (or, at least a more accurate determination than could be expected of a court).[148] As a result, their choice to sell their shares on terms they deem favorable will not be disturbed.[149]

In practical effect, however, these decisions alleviate the legal pressure on boards to maximize wealth. As corporate architecture becomes less capable of cabining shareholder

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145. *In re* Netsmart Techs. S'holder Litig., 924 A.2d 171, 209–10 (Del. Ch. 2007) ("If [stockholders] are confident that the company's prospects are sound and that a search for a strategic buyer or higher-paying financial buyers will bear fruit, they can vote no and take the risk of being wrong . . . [t]he disinterested Netsmart stockholders are well-positioned to carry the day, and most of them are institutional investors."); *In re* Cox Commc'ns, Inc. S'holders Litig., 879 A.2d 604, 619 (Del. Ch. 2005) ("With increasingly active institutional investors and easier information flows, stockholders have never been better positioned to make a judgment as to whether a special committee has done its job."); *In re* Pure Res., Inc., S'holders Litig., 808 A.2d 421, 432 (Del. Ch. 2002) ("The discovery record also reveals that a great deal of the Pure stock held by the public is in the hands of institutional investors."); *In re* IXC Commc'ns, No. C.A. 17324, C.A. 17334, 1999 WL 1009174 (Del. Ch. Oct. 27, 1999) (rejecting vote buying allegations in part because institutional investors made up a large part of the shareholder base); *In re* MFW S'holders Litig., 67 A.3d 496, 503 (Del. Ch. 2013) ("Stockholders, especially institutional investors who dominate market holdings, regularly vote against management on many issues, and do not hesitate to sue, or to speak up. Thus, when such stockholders are given a free opportunity to vote no on a merger negotiated by a special committee, and a majority of them choose to support the merger, it promises more cost than benefit to investors generally in terms of the impact on the overall cost of capital to have a standard of review other than the business judgment rule."); Jacobs, *supra* note 32, at 25; Laster, *Changing Attitudes*, *supra* note 127; Steven Davidoff Solomon & Randall S. Thomas, *The Rise and Fall of Delaware's Takeover Standards*, *in* THE CORPORATE CONTRACT IN CHANGING TIMES (Steven Davidoff Solomon et al. eds., forthcoming 2019).

146. *Cox*, 879 A.2d at 647 ("This is corporate law, after all, a species of commercial law involving stockholders (increasingly of the institutional investor variety) who would be well-positioned to protect themselves through diversification."); *Pure Res.*, 808 A.2d at 444 ("Corporate law should not be designed on the assumption that diversified investors are infirm but instead should give great deference to transactions approved by them voluntarily and knowledgeably.").

147. *See supra* Part II.B.

148. Corwin v. KKR Fin. Holdings, 125 A.3d 304, 314 n.28 (Del. 2015) ("In this day and age in which investors also have access to an abundance of information about corporate transactions from sources other than boards of directors, it seems presumptuous and paternalistic to assume that the court knows better in a particular instance than a fully informed corporate electorate with real money riding on the corporation's performance."); *Netsmart*, 924 A.2d at 209–10 ("With full information, Netsmart stockholders can decide for themselves whether to accept or reject the Insight deal. If they are confident that the company's prospects are sound and that a search for a strategic buyer or higher-paying financial buyers will bear fruit, they can vote no and take the risk of being wrong. If they would prefer the bird in hand, they can vote yes and accept Insight's cash. Because directors and officers control less than 15% of the vote on the most generous estimate, the disinterested Netsmart stockholders are well-positioned to carry the day, and most of them are institutional investors."); *Cox*, 879 A.2d at 619 ("With increasingly active institutional investors and easier information flows, stockholders have never been better positioned to make a judgment as to whether a special committee has done its job."); *Pure Res.*, 808 A.2d at 444 ("Adherence to [relaxed review standards] as a general matter . . . is advisable in view of the increased activism of institutional investors and the greater information flows available to them.").

149. Delaware has also become less willing to selectively invalidate portions of deal agreements that are deemed to have been reached in violation of directors' breach of duty. *See generally* Laster, *Changing Attitudes*, *supra* note 127.

power, Delaware has reinvigorated the power of directors to act without judicial oversight,[150] at least so long as they seek a sanitizing shareholder vote.[151] Since shareholders necessarily can only express a blunt preference for or against a proposed transaction,[152] the relaxation of legal obligations leaves directors with more flexibility to satisfy a range of preferences, within the boundaries of what shareholders will tolerate.

Nor is the shift necessarily limited to target shareholders in a merger. Certainly, shareholder votes have long had a cleansing effect,[153] but *Corwin* appears to represent, for lack of a better term, a mood in favor of a new vigor in allowing shareholders to choose for themselves whether to ratify director action.[154] It also appears that M&F may be extended to other kinds of deals with controlling shareholders, outside the merger context.[155]

These moves, however, challenge the vitality of the wealth maximization norm. If the law merely requires that shareholders be given an opportunity to make their own determinations, then—due to shareholders' varying private interests—it raises the spectre that corporate action will be approved even when it does not maximize wealth at a particular company.[156] By elevating real shareholder preferences over fictionalized ones, the duty of wealth maximization, enforced by courts, gives way to a broader degree of directorial discretion, limited only by what the market will bear. The new standards, in sum, acknowledge the presence of powerful non-controlling shareholders, but fail to make allowance for how the priorities of these shareholders may differ from those of the smaller, less diversified, and less influential segment of the shareholder base.

The new disjunction has led to some awkward attempts to square the circle. For example, Chief Justice Strine has endorsed the view that directors' fundamental obligation is to enhance shareholder wealth[157] and has fiercely advocated for a reduction in shareholder power to avoid having the corporate purpose hijacked from that goal.[158] At the same time, he has observed that most capital is invested in the hope that corporations will preserve employee jobs and contribute to the surrounding community, so as to benefit their human investors in both their shareholder and their non-shareholder capacities.[159] To

150. In recent years, there have been other forms of pushback against the growth of shareholder power. These include the resurgent popularity of dual-class share structures, and the tendency of companies to remain private for prolonged periods. *See* de Fontenay, *supra* note 73, at 462.

151. Shareholders almost always vote to approve transactions presented to them, but this fact should not be taken to mean that the vote does not represent a real limitation on director behavior. Directors, aware of the preferences of their shareholder base, present them with deals that they are likely to approve. *See* Afsharipour, *Reevaluating*, *supra* note 137, at 148; Matteo Gatti, *Reconsidering the Merger Process: Approval Patterns, Timeline, and Shareholders' Role*, 69 HASTINGS L.J. 835, 840 (2018).

152. *In re* Cox Commc'ns, Inc. S'holders Litig., 879 A.2d 604, 619 (Del. Ch. 2005).

153. *See supra* notes 137–43 and accompanying text; *see generally* Harbor Finance Partners v. Huizenga, 751 A.2d 879 (Del. Ch. 1999).

154. *See generally In re* Massey Energy Co. Derivative & Class Action Litig., 160 A.3d 484 (Del. Ch. 2017).

155. *In re* EZCORP, Inc. Consulting Agreement Derivative Litig., No. 9962-VCL, 2016 WL 301245, at *11–12 (Del. Ch. Jan. 25, 2016); IRA Trust FBO Bobbie Ahmed v. Crane, Consolidated C.A. No. 12742-CB, 2017 WL 7053964, at *10 (Del. Ch. Dec. 11, 2017).

156. And that directors will seek votes when they can be assured that otherwise dilutive transactions are favored by conflicted shareholders.

157. *See* Leo E. Strine, Jr., *Our Continuing Struggle with the Idea that For-Profit Corporations Seek Profit*, 47 WAKE FOREST L. REV. 135, 149–51 (2012).

158. Strine, *Toward a True Corporate Republic*, *supra* note 14, at 1765.

159. Strine, *Who Bleeds*, *supra* note 79, at 1882–83.

ensure directors are free to effectuate that goal, he recommends that shareholder power be diminished.[160] He is also one of the most vigorous champions of the notion that today's shareholders are too sophisticated to require the protection of the judiciary.[161] His main argument, then, is that directors must have more power and discretion—though his arguments for why this is so vacillate between leaving directors free to pursue wealth maximization, and leaving them free to avoid it.

There have been other displays of discomfort with the new regime. For example, when a group of Tesla shareholders filed a lawsuit challenging Tesla's acquisition of SolarCity, the Delaware Chancery court—faced with a transaction that was, by all available evidence, not wealth-maximizing—avoided *Corwin*'s application by declaring that Elon Musk was a controlling stockholder, subjecting the deal to the more exacting standards of *Kahn v. M&F* (which it had not met).[162] Because Musk held only 22% of Tesla's voting power, such a conclusion surely stretched the boundaries of what it means to be a controller, perhaps heralding that courts chafing at *Corwin*'s constraints will find new ways to evade it.

C. With Great Power Does Not Come Great Responsibility

Judicial reliance on the institutional shareholder base is a double-edged sword. It allows courts to take a hands-off approach to directors' management choices, but—because Delaware has not yet abandoned wealth maximization as the basis for legitimate corporate action—it ensnares courts in second-order disputes around shareholder heterogeneity.

The dilemma actually has its seeds in the controlling shareholder problem, i.e., one of the few areas where Delaware has openly recognized—and imposed heightened duties on—shareholders who act to advance private interests.[163] Corporate transactions are subject to additional scrutiny when the controller receives private benefits,[164] but that rule further requires courts to determine what, precisely, counts as a benefit. When a controlling shareholder receives different consideration in the context of a merger, that benefit is treated as a conflict giving rise to heightened scrutiny[165] (absent the protections of *Kahn v. M&F Worldwide*), but Delaware courts have waffled on the question whether controllers of a target company should be treated as conflicted when they receive the same merger consideration as other shareholders.[166] In particular, the case law is mixed as to whether a controller's need for liquidity—a desire that may be common to many shareholders—creates a materially distinct set of incentives.[167]

That problem has carried over to the context of shareholder ratification. As described above, shareholder voting is treated as ratifying because of the trust courts place in shareholders' ability to gauge the advisability of corporate action—a faith that, in turn,

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160. *Id.* at 1964–68.

161. *See, e.g.*, *In re* Pure Res., Inc., S'holders Litig., 808 A.2d 421 (Del. Ch. 2002); *In re* Cox Commc'ns, Inc. S'holders Litig., 879 A.2d 604 (Del. Ch. 2005); *In re* MFW S'holders Litig., 67 A.3d 496 (Del. Ch. 2013).

162. *In re* Tesla Motors S'holder Litig., No. 12711-VCS, 2018 WL 1560293, at *12. (Del. Ch. Mar. 8, 2018).

163. *See supra* Part II.B.

164. *See Id.*

165. *In re* John Q. Hammons Hotels Inc. S'holder Litig., Civil Action No. 758-CC, 2009 WL 3165613, at *1 (Del.Ch. 2009).

166. Friedlander, *supra* note at 132, at 652–53; *see also* Larkin v. Shah, C.A. No. 10918-VCS, 2016 WL 4485447, at *9 (Del. Ch. Aug. 25, 2016).

167. *Id.*

rests on the assumption that stockholders share the same goal of wealth maximization.[168] But in the face of the obvious reality that some stockholders have conflicting interests—and the absence of any legal duty imposed on shareholders to vote solely in the interests of the firm—the *Corwin* line of cases holds only votes by "the disinterested equity owners" have a cleansing effect on director action.[169] This limitation requires courts to determine which shareholders count as "disinterested." Thus far, Delaware has treated shareholders as interested when they appear to be motivated by private interests other than wealth maximization.[170] The inquiry itself, however, is a fool's errand: there is no such thing as a shareholder without private interests, and the growth of institutional investing has made that fact impossible to ignore.

The problem presented itself most clearly in *In re CNX Gas Corporation*.[171] Consol, a publicly traded company, also owned a majority stake in CNX Gas, and sought to buy out the public shareholders via tender offer. The largest such shareholder was T. Rowe Price, which owned over 6% of CNX Gas across various mutual funds that it administered. One of those funds also owned over 6% of Consol's stock. T. Rowe Price funds also held a significant amount of Consol debt. As a result, the controller negotiated with T. Rowe Price directly, and secured its agreement to a deal price (on behalf of all of its funds) before proposing a tender offer to the minority stockholders generally.

Now, had T. Rowe Price been a controlling shareholder of CNX Gas with equivalent or significant stakes in Consol, there would have been no question that its position on both sides of the deal created a conflict. But T. Rowe was not a controlling stockholder; it simply had a large minority position. Nonetheless, when the terms of the deal were challenged by the other minority stockholders, the Delaware Chancery court concluded that because T. Rowe Price owned stock and debt in Consol as well as stock in CNX Gas, it was not disinterested. As a CNX Gas stockholder, T. Rowe Price wanted to receive the highest possible price for its shares, but as a Consol stockholder and debtholder, it wanted Consol to pay a lower price. T. Rowe Price's roughly equal holdings in CNX Gas and Consol left it "fully hedged and indifferent to the allocation of value between CONSOL and CNX Gas."[172] Thus, in determining whether the deal had been approved by a majority of the minority, T. Rowe Price's tender would not be counted.

Significantly, in reaching this conclusion, the court invoked the vote buying cases, emphasizing that stockholder voting is premised on the notion that shareholders seek wealth maximization. T. Rowe Price's incentives to favor Consol over CNX Gas left it with materially different interests than those of the remaining CNX Gas shareholders. Thus, the *CNX* court took the reasoning of the vote-buying cases to their logical conclusion: even absent vote-buying per se, stockholders who vote to advance interests other than corporate wealth maximization are conflicted in a manner that undermines the legitimacy of their votes.

The issue has also arisen in a handful of other cases. In each instance, the court allowed for the possibility that a non-controlling shareholder's investments beyond the

168. *See supra* Part II.B.

169. Corwin v. KKR Fin. Holdings, 125 A.3d 304, 312 (Del. 2015).

170. Harbor Finance Partners v. Huizenga, 751 A.2d 879, 900 (Del. Ch. 1999) ("[O]nly the votes of those stockholders with no economic incentive to approve a wasteful transaction count" for the purpose of cleansing a transaction).

171. *In re* CNX Gas Corp., 4 A.3d 397, 399 (Del. Ch. 2010).

172. *Id.*

company's common stock—be it loans,[173] options,[174] or shares in a corporate acquirer[175]— raised the possibility that the shareholder would not vote for corporate wealth maximization, and therefore was not disinterested. Strikingly, the types of conflicts under consideration were, for the most part, fairly pedestrian. As described above, because of the increasing concentration of stock ownership among institutional investors, it is common for "significant" shareholders to hold stakes in both target and acquirer—indeed, the existence of cross-ownership makes an acquisition more likely.[176] It is also common for investors to simultaneously hold stock and debt in a single company, which further distorts their incentives.[177] And the general practice of buying derivatives in advance of a merger—and potentially voting with conflicted or distorted incentives as a result—has long been documented.[178] These types of conflicts are likely to arise in any merger or, indeed, any shareholder vote.

Although—unsurprisingly—these disputes have been considered in the context of large shareholders whose votes were potentially outcome-determinative, courts have not attempted to discern how much stock is enough to raise the question, nor is it clear that only the conflicts of significant shareholders must be considered. Indeed, the whole problem originates from the fact that only controlling shareholders—defined as shareholders who exercise actual control over corporate conduct[179]—have duties to the corporation; there is no formal standard for applying special scrutiny for shareholders with holdings below that threshold.[180]

To be sure, where courts have engaged the issue, the conflicted shareholders did not merely passively hold their competing investments; the shareholders had, to various degrees, negotiated with, had direct contact with, or had managerial/directorial positions with the acquirer. The CNX court highlighted this fact, holding that:

> [N]othing about this case requires that Delaware courts conduct generalized inquiries into "the extent of institutional stockholders' other investments" or "their true motivations for tendering."

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173. *In re* Zale Corp. Stockholders Litig., Consolidated C.A. No. 9388-VCP, 2015 WL 5853693, at *9 (Del. Ch. Oct. 1, 2015) (concluding that large shareholder's loan to the company was not sufficiently large to create divergent incentives).

174. *In re* Pure Res., Inc., S'holders Litig., 808 A.2d 421, 426 (Del. Ch. 2002) (finding that put agreements held by the target's management created "materially different incentives for the holders than if they were simply holders of Pure common stock").

175. Glob. GT LP v. Golden Telecom, Inc., 993 A.2d 497 (Del. Ch. 2010), *aff'd* 11 A.3d 214 (Del. 2010) (target shareholders' stock in acquiring company made the deal more akin to a controlling shareholder buyout than an arm's length merger).

176. Brooks et al., *supra* note 97; Harford et al., *supra* note 82, at 4.

177. Bodnaruk & Rossi, *supra* note 93, at 59.

178. Christopher Holt, *Merger Arbitrage With Options: Eye-Popping Returns, But Not for the Faint of Heart*, SEEKING ALPHA (Oct. 26, 2010, 7:21 AM), https://seekingalpha.com/article/232253-merger-arbitrage-with-options-eye-popping-returns-but-not-for-the-faint-of-heart; Martin & Partnoy, *supra* note 46, at 810 ("Particularly in share exchange mergers, arbitrageurs buy millions of shares of the target corporation and sell short shares of the acquirer corporation (a practice known as 'risk arbitrage') to capture price disparities between merger-related shares.").

179. Weinstein Enters. v. Orloff, 870 A.2d 499, 507 (Del. 2005).

180. Federal law imposes certain mandatory obligations on shareholders at particular thresholds of ownership. *See, e.g.*, 15 U.S.C. §§ 78p, 78m (2015). Some states also set a threshold of stock ownership for determining whether a transaction is "interested" for appraisal purposes. *See, e.g.*, MODEL BUS. CORP. ACT §13.01 (AM. BAR ASS'N 2010). But these rules are quite limited and do not trigger fiduciary duties.

> It was neither the plaintiffs nor this Court that put the focus on T. Rowe Price and its cross-ownership. It was CONSOL who elected to pre-negotiate the terms of the Tender Offer with T. Rowe Price, a third-party non-fiduciary, rather than negotiating with the Special Committee.
>
> This case also is not the result of, nor should it be read to encourage, generalized fishing expeditions into stockholder motives.[181]

But even if the existence, or absence, of direct negotiation was a coherent principle for identifying a conflicted stockholder (a doubtful proposition on its face), it is increasingly common for institutional investors to engage with corporate management on a regular basis,[182] and even for management or proxy solicitors to discuss deals with large institutions.[183] Thus, in the mine-run of cases, it is likely there will have been some contact that could call an investor's impartiality into question.[184]

In sum, the same sophistication and diversification that justifies increasing reliance on the shareholder vote also gives rise to conflicts that make the shareholder vote an imperfect measure of the advisability of a proposed action across all equity holders. Delaware courts are trapped in an ouroboros: even if it were possible to tease out all of the myriad conflicts these entities face (a likely impossible task), to do so would leave the smallest, and least sophisticated, shareholders to approve deals, which would undermine the basis for relying on their votes to avoid judicial scrutiny in the first place.

More of these cases are likely to follow. For example, as described above, Tesla approved the acquisition of SolarCity in part on the strength of a conflicted shareholder vote. Tesla stockholders filed a lawsuit against Tesla's board, arguing, among other things, that their conflicts were not cleansed because cross-holders are not "disinterested" for *Corwin* purposes.[185] For now, the Chancery court has decided to resolve the case on alternative grounds,[186] but the issue is bound to recur. Moreover, mergers are often approved by the deciding votes of corporate insiders, and Delaware has not generated any standard for determining whether and to what extent their votes should be treated as

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181. *In re* CNX Gas Corp., 4 A.3d 397, 416–17 (Del. Ch. 2010).

182. William B. Chandler, III, *On the Instructiveness of Insiders, Independents and Institutional Investors*, 67 U. CIN. L. REV. 1083, 1088–91 (1999); Fichtner et al., *supra* note 77, at 307, 318 ("A recent survey found that 63 percent of very large institutional investors have engaged in direct discussions with management over the past five years, and 45 % had had private discussions with a company's board outside of management presence . . . From mid-2014 to mid-2015, BlackRock has performed over 1,500 private 'engagements' with companies held in their portfolio, 670 in the Americas and about 850 in the rest of the world—Vanguard had over 800 company engagements."); Mallow & Sethi, *supra* note 80, at 394–95.

183. *See, e.g.*, Davidoff Solomon, *supra* note 103; Vikas Shukla, *Dell Buyout Deal Enters Fierce Lobbying Phase*, VALUEWALK (May 29, 2013), https://www.valuewalk.com/2013/05/dell-buyout-deal/; Goranova et al., *supra* note 96, at 1117 (stating that large investors "become the focus for intensive private and public corporate communications during the merger as both parties seek to gain their support"); Edward B. Rock, *MOM Approval in a World of Active Shareholders* (NYU L. Econ. Research, Working Paper No. 18–02, 2018) (describing efforts by management's proxy solicitors to encourage shareholders to tender into an offer).

184. Significantly, in Larkin v. Shaw, C.A. No. 10918-VCS, 2016 WL 4485447, at *33 (Del. Ch. Aug. 25, 2016), the court made clear that when determining whether a shareholder is not disinterested for *Corwin* purposes, the inquiry is whether the shareholder had material interests that differed from other shareholders, *not* whether the shareholder had management access or even a controlling position.

185. *In re* Tesla Motors Stockholder Litig., C.A. No. 12711-VCS, 2018 WL 1560293, at *12 (Del. Ch. Mar. 28, 2018).

186. *Id.*

interested.[187]

One could imagine, of course, a variety of bright-line rules that would define "interest" for *Corwin* purposes while being generally administrable by courts. For example, outside the controlling shareholder context, courts might consider only conflicts experienced by shareholders possessing unique, nonpublic investment interests or inside information. In this formulation, investors might be treated as conflicted when they purchase stock in a private sale, extend private corporate loans, or hold bespoke options, while investments in publicly-traded securities would not be treated as disabling. The rationale for such a rule would be that all investors might equally avail themselves of public opportunities, and therefore no investors are disadvantaged. But leaving aside complex questions about what counts as public—what about widely traded securities or loan offerings that are only made available to sophisticated investors?[188]—such a rule would only sweep the problem under the rug, rather than address the reality of pervasive, and pedestrian, conflicts born of the fact that large investors can accumulate positions in publicly-traded stock and bonds that smaller investors cannot hope to imitate.

D. More Money, More Problems

Corwin is a solution to a particular set of problems. Courts grew concerned that they had been overzealous in enforcing wealth maximization duties, resulting in nuisance lawsuits and ill-advised deals. The solution was to assume that judicial oversight of directors' conduct was no longer necessary.[189] But *Corwin* creates a new set of difficulties, by tying corporate action to the consent of shareholders who act to advance their private interests. The less diversified shareholders, whose interests do not align with those of the largest institutions, are left without an advocate for their interests, and therefore may be trapped in suboptimal transactions.[190] These shareholders may include smaller institutions that have adopted active trading strategies, and they are also likely to be retail investors, who continue to hold roughly 30% of corporate equity. Directors' obligations to maximize wealth go unenforced under *Corwin* and *M&F*, but there is no guarantee that the large investors, whose approval is substituted for that of directors, will operate on the same priorities.

In this state of affairs, conflicted shareholders may exert a significant influence on corporate behavior. In some scenarios, they may induce deals that are beneficial overall, but allocate wealth differently than they otherwise would have (for example, with a lower purchase price so that gains of a merger are captured on the acquisition side rather than the target side).[191] The remaining shareholders will then lose out on gains that otherwise would

187. Gatti, *supra* note 43, at 879–80; Matteo Gatti, *It's My Stock and I'll Vote If I Want to: Conflicted Voting by Shareholders in (Hostile) M&A Deals*, 47 U. MEM. L. REV. 181, 222–23 (2016).

188. Such instruments are common. *See generally* William K. Sjostrom, Jr., *The Birth of Rule 144A Equity Offerings*, 56 UCLA L. REV. 409, 443 (2008) (describing rule 144A offerings); Sung Eun (Summer) Kim, *Managing Regulatory Blindspots: A Case Study of Leveraged Loans*, 32 YALE J. ON REG. 89, 98 (2015) (addressing leveraged loan offerings).

189. *See generally*, Laster, *Changing Attitudes*, *supra* note 127; Solomon & Thomas, *supra* note 145, at 8; James D. Cox & Randall S. Thomas, *Corporate Darwinism: Disciplining Managers in a World With Weak Shareholder Litigation*, 95 N.C. L. REV. 19, 31–32 (2016).

190. Goranova et al., *supra* note 96, at 1117.

191. *See* Marcel Kahan & Edward Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1057 (2007) (recognizing that institutional cross-holders may be indifferent as to how

have been allocated to them in the absence of conflict. Even more dysfunctional scenarios may also exist, such as where the losses to minority shareholders exceed the private gains to conflicted shareholders.[192] This may occur when an acquirer overpays for a target, or a company is sold at a discounted price to shore up the trading price of its debt, or to an acquirer that will not make the best use of its assets.[193] These deals may not simply reallocate wealth from one set of shareholders to another set, but may actually reduce wealth overall. In these scenarios, rather than minimizing agency costs, the shareholder vote amplifies the very conflicts that the vote was intended to constrain.[194] And any informational signal communicated by a vote is muddled; it cannot improve directors' decision-making because it cannot be trusted to communicate new factual information directed towards a uniform goal.[195]

To be sure, these conflicts may in fact efficiently mitigate frictions. When debtholders are also stockholders, they may reduce the agency costs of debt by deterring overly-risky firm behavior.[196] Shareholders who own stock in both an acquirer and target may encourage a more efficient allocation of merger gains between the two.[197] But there is no guarantee of these salutary effects; meanwhile, value-seeking investors are forced to bear the risk that their wealth will be appropriated by other shareholders, which will then have to be accounted for in ex ante pricing determinations.[198] In extremes, then, *Corwin* and its progeny represent a further step toward discouraging the undiversified, active investing on which the market relies to maintain its accuracy and efficiency.

Significantly, the problem is not confined to publicly-traded entities, though it may be most obvious in that context. Today's "private" corporations may have substantial numbers of employee-shareholders, for example, as well as potentially-conflicted institutional investors such as venture capital and mutual funds.[199] These shareholders may

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wealth is allocated in a transaction); Thompson & Edelman, *supra* note 42, at 154–55.

192. William J. Carney, *Fundamental Corporate Changes, Minority Shareholders, and Business Purpose*, 5 AM. B. FOUND. RES. J. 69, 132 (1980); Lynn Stout, *Are Takeover Premiums Really Premiums? Market Price, Fair Value, and Corporate Law*, 99 YALE L. J. 1235, 1273 (1990).

193. Martin & Partnoy, *supra* note 46, at 810 (arguing that shareholders with hedged or conflicting investments may distort the market for corporate control, encourage corporations to embark upon value-reducing projects, or support takeover defenses that entrench management).

194. Thompson & Edelman, *supra* note 42, at 154–55.

195. *Id.*; *see also* Goshen, *supra* note 45, at 400.

196. Bodnaruk & Rossi, *supra* note 93, at 60; Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 333–39 (1976).

197. Brooks et al., *supra* note 97 (finding that mergers between firms with high cross-ownership have higher post-announcement returns and superior post-merger performance). Others are less sanguine, and conclude that overlapping ownership may induce acquirers to overpay for target firms, to the detriment of the acquiring firm. *See* Goranova et al., *supra* note 96, at 1117.

198. John C. Coffee, Jr., *Transfers of Control and the Quest for Efficiency: Can Delaware Law Encourage Efficient Transactions While Chilling Inefficient Ones?*, 21 DEL. J. CORP. L. 359, 370 (1996) ("To the extent that the law permits uncompensated wealth transfers, the law creates unproductive uncertainty and leaves the minority's property rights inadequately defined."); Martin & Partnoy, *supra* note 46, at 801 ("If shareholders believe such activity might take place, they will be less willing to purchase such stocks, resulting in a higher cost of capital overall and a less efficient market."); *see* Lucian Arye Bebchuk, *The Sole Owner Standard for Takeover Policy*, 17 J. LEGAL STUD. 197 (1988) (arguing that target shareholders must be permitted to share in acquisitions gains to incentivize their initial investment in the target); Sam Glasscock III, *Ruminations on Appraisal*, 25 DEL. LAW. Summer2017, at 9 (explaining that if minority stockholders anticipate they will be exploited, they will invest less ex ante, which ultimately damages capital markets).

199. Katie Benner, *When a Unicorn Start-Up Stumbles, Its Employees Get Hurt*, N.Y. TIMES (Dec. 27, 2015),

be counting on a buyout —often by a public entity—to monetize their investment.[200] Even when a public corporation is bought out by a private equity fund, conflicts among investors may be present—from the incentives faced by holders of target debt as well as equity, to the interests of institutional investors who may be invested in either the private equity fund itself, or its publicly-traded parent.

IV. GROUNDS FOR DIVORCE: SEGMENTING THE SHAREHOLDER BASE

It is likely impossible to put the *Corwin* genie back in the bottle. Even if courts were to discover a new appetite for vigorous second-guessing of managerial decision-making, *Corwin*'s fundamental rationale—that the majority of shareholders should be permitted to accept transactions that they find beneficial, without being chained to a small number of holdouts—has a normative appeal. Nor is there a feasible mechanism for conducting a more nuanced analysis of shareholder conflicts, if only because *Corwin* itself is predicated on the sophistication of diversified—and thus conflicted—shareholders. In other words, the consolidation and institutionalization of the shareholder base has eroded the distinctions between conflict and non-conflict transactions. Or, perhaps more accurately, the reality of shareholder conflict has reached a level where it can no longer be papered over doctrinally. Shareholders are too concentrated, and their conflicts too public, to turn a blind eye to their incentives.

These conflicts undermine, in some accounts, the justification for permitting shareholders a vote in the first place.[201] As a result, recent years have witnessed a surge of arguments in favor of limiting shareholders' voting rights, often via dual-class share structures that provide high votes to certain insiders, or even no votes to public shareholders.[202] These proposals are rooted in the argument that shareholders' varying preferences constitute a type of cost that drags on the firm, and that voting rights may be appropriately tailored to compensate.[203]

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https://www.nytimes.com/2015/12/27/technology/when-a-unicorn-start-up-stumbles-its-employees-get-hurt.html; *see also* Robert Bartlett & Eric Talley, *Law and Corporate Governance*, *in* THE HANDBOOK OF CORP. GOVERNANCE (Benjamin Hermalin et al. eds., 2017) (noting that venture capitalists often have financial ties to the public companies that acquire the private company startups that the venture capitalists finance); Ronald W. Masulis & Rajarishi Nahata, *Venture Capital Conflicts of Interest: Evidence from Acquisitions of Venture-Backed Firms*, 46 J. FIN. & QUANTITATIVE ANALYSIS 395 (2011); Paul A. Gompers & Yuhai Xuan, *Bridge Building in Venture Capital-Backed Acquisitions* (Am. Fin. Ass'n S.F. Meetings Paper 2009), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1102504. Venture capitalists' conflicts can lead to lower target premiums, *see* Masulis & Nahata, *supra*, and increase the likelihood that the acquisition will be financed with equity, *see* Gompers & Xuan, *supra*. These findings mirror similar findings regarding public company mergers with institutional cross-holders. Brooks et al., *supra* note 97 (concluding that such mergers are accomplished at a lower premium, and are more likely to be financed with equity).

200. Telis Demos & Corrie Driebusch, *Forget Going Public, U.S. Compaines Want To Get Bought*, WALL STREET J., Nov. 29, 2015, 5:33 AM), https://www.wsj.com/articles/forget-going-public-u-s-companies-want-to-get-bought-1448793190.

201. Martin & Partnoy, *supra* note 46, at 792; *see also* Rapaczynski, *supra* note 46.

202. *See generally* Zohar Goshen & Richard Squire, *Principal Costs: A New Theory of Corporate Law and Governance*, 117 COLUM. L. REV. 767 (2017); Dorothy Lund, *Nonvoting Shares and Efficient Corporate Governance*, 71 STAN. L. REV. (forthcoming 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3028173.

203. It has been argued that shareholder fiduciary duties should be expanded beyond the current controlling shareholder standard to encompass shareholders who cast deciding votes in contested disputes. Iman Anabtawi & Lynn A. Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255 (2008). But it is difficult to

The disenfranchisement of shareholders raises significant legal questions regarding the vitality of *Corwin* and even the business judgment rule, both of which assume there exists a set of shareholders who exercise their voting rights to express approval or disapproval of management action, thereby rendering judicial interference unnecessary.[204] But more fundamentally, the characterization of shareholder preferences as "costs" in the first place necessarily carries with it the assumption that firms exist to maximize individual firm wealth, even when doing so is suboptimal for those who hold a majority of the equity. Advocates of this view assume that shareholders would prefer to tie themselves to the mast of wealth maximization rather than incur the frictions that result from squabbling about it ex post, even if in some circumstances they may "win" individual battles.[205] This, of course, brings us back to where we began: it is not obvious that such a model accurately describes investors' motivations. Leaving aside the obvious point that the ultimate human beneficiaries of these investments may have a greater financial interest in their jobs and communities (and thus do not prefer wealth maximization as a fundamental goal),[206] modern institutional investors are so diversified that they, in a sense, "own[] the economy" and therefore may legitimately oppose some wealth maximizing behavior that includes destructive externalities.[207]

If the law has moved in favor of accommodating shareholder preferences over shareholder wealth maximization, then, the solution may be to fully commit to that position rather than try to mask the conflicts by requiring that all shareholders receive similar treatment. Instead, when shareholders suffer from irreconcilable differences, they may be entitled to "divorce": accommodations of differently-situated shareholders to ensure that they are fairly compensated.

A. Decentralized Mutual Fund Voting

One potential avenue for reform is to examine the problem from the shareholder side. The diversified investors on whose sophistication *Corwin* rests are frequently mutual fund companies, who own large swaths of corporate America across the various funds they control.[208] Because these companies often centralize their voting decisions and governance engagement across all of the funds they advise,[209] all funds in a single family may vote as a block, rendering their preferences particularly powerful.[210]

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see how such a rule could be implemented; in close disputes, many shareholders would be the "deciding" vote, and when several blocks vote in favor of a course of action, they all might be.

204. *In re* Massey Energy Derivative & Class Action Litig., No. 02-3924, 2011 WL 2176479, at *113 (Del. Ch. May 31, 2011) ("The primary protection for stockholders against incompetent management is selecting new directors."); Brehm v. Eisner, 746 A.2d 244, 256 (Del. 2000).

205. Goshen & Squire, *supra* note 202, at 818.

206. *See, e.g.*, DAVID WEBBER, THE RISE OF THE WORKING-CLASS SHAREHOLDER 181–201 (2018); Strine, *Who Bleeds*, *supra* note 79, at 1877–79.

207. JAMES P. HAWLEY & ANDREW T. WILLIAMS, THE RISE OF FIDUCIARY CAPITALISM 21 (2000).

208. INV. CO. INST., 2017 INVESTMENT COMPANY FACT BOOK ii (2017) (showing that investment companies owned 31% of US corporate equities in 2016).

209. Lipton, *supra* note 81, at 187–89. There is also evidence that they share information and trading strategies. *See generally* Jun Kyung Auh & Jennie Bai, *Cross-Asset Information Synergy in Mutual Fund Families* (Georgetown McDonough Sch. of Bus. Research paper No. 3163135, 2018) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3163135.

210. Fund families may vary in how much individual fund managers are permitted to make their own voting decisions. *See, e.g.*, Anders Melin, *Trillion-Dollar Investors Don't Mind Billion-Dollar CEO Awards*,

One side-effect of governance centralization, however, is that it elides the distinct interests of the individual funds. For example, as described above, mutual fund companies that sponsor both bond funds and equity funds may use their voting power on the equity side to increase value on the bond side.[211] Alternatively, in an acquisition, one fund may own shares in the acquirer while another owns shares in the target, placing the funds on opposite sides of a deal; by centralizing voting decisions, the interests of both are compromised. This, in fact, is what transpired in the *CNX* case, described above: one of T. Rowe Price's funds was invested in both the acquirer and the target, while other funds were invested in the target alone. Despite the funds' conflicting interests, T. Rowe Price negotiated for a deal price on behalf of all of its funds, as though they were all part of a single portfolio.[212]

As I have detailed elsewhere, mutual fund companies' practice of centralizing voting decisions may violate their fiduciary duties to each individual fund.[213] It is blackletter law that an agent may not use the assets of the principal to benefit a third party;[214] by the same logic, an investment adviser may not vote shares of one fund in a manner designed to benefit other funds.[215] If mutual funds' fiduciary duties were more rigorously enforced, at least some problems described above might be mitigated: funds would be less likely to vote as a block, and shareholder votes would represent a more variable set of interests. But such a transformation would not be a complete solution to the problem of conflicted shareholders, if only because many funds—as well as other institutional investors—are themselves diversified, and any fiduciary voting shares on behalf of those institutions would properly consider the effect on the portfolio as a whole.

B. Dissenter-Only Fiduciary Lawsuits

Another potential solution would be to recognize that a shareholder vote in favor of a transaction can only insulate the transaction from lawsuits by those shareholders, akin to a form of estoppel; other shareholders, who rejected the transaction, would still be permitted to bring claims alleging that directors violated their fiduciary duties of wealth maximization. In such a regime, directors would presumably recognize that the more controversial the proposed deal—and the more that it rests on a slight majority of conflicted shareholders to close—the more they risk a subsequent lawsuit by an aggrieved minority. The possibility of a lawsuit would therefore offset the pressure of the majority.[216]

Such a regime might have some advantages. Today, fiduciary duty lawsuits by target

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BLOOMBERG NEWS (Sept. 11, 2018), https://www.bloomberg.com/news/articles/2018-09-11/trillion-dollar-investors-don-t-mind-billion-dollar-ceo-awards.

211. *See supra* Part III.B.2.

212. *In re* CNX Gas Corp., 4 A.3d 397 (Del. Ch. 2010).

213. Lipton, *supra* note 81, at 192–97.

214. RESTATEMENT (THIRD) OF AGENCY § 8.05 (AM. LAW INST. 2006).

215. Lipton, *supra* note 81, at 193–94.

216. Dissenter lawsuits would not be viable in the context of controlling shareholder transactions evaluated under *M&F*, because *M&F* already permits a showing of negotiating defects to neutralize the ratifying effect of a shareholder vote. For non-controlling shareholder deals evaluated under *Corwin*, however, there is no similar problem. Leaving aside the issue of the effect of a shareholder vote, plaintiffs would only be able to survive a motion to dismiss or for summary judgment upon a showing of some defects in the negotiating process that rendered the transaction suspect. In a controlling shareholder buyout, by contrast, the existence of such defects already undermines the effect of a shareholder vote, making an additional dissenter cause of action unnecessary.

shareholders have an unsavory reputation, largely due to the practice of disclosure-only settlements. Lawyers indiscriminately file class action lawsuits on behalf of all of the target's shareholders prior to a scheduled vote, alleging only that corporate disclosures regarding the merits of the deal are insufficient.[217] They then settle the case for worthless additional disclosures and claim attorneys' fees from the corporation itself, predicated on the fiction that they conferred a benefit on the entity as a whole.[218] *Corwin* was at least a partial reaction to these nuisance lawsuits,[219] and Delaware courts have recently struggled to dissuade attorneys from filing cases with the intention of settling for meaningless disclosures and a fee.[220] If a cause of action was available only to the dissenting target stockholders in deals otherwise immune from challenge under *Corwin*, many of these pathologies would be eliminated. Disclosure, by hypothesis, would be irrelevant, because if the company had concealed critical facts, the shareholder vote would be invalidated, and *Corwin* immunity would be unavailable.[221] Thus, the only basis for a settlement—and a fee award—would be meaningful pecuniary relief to the class.

To fully correct for the influence of conflicted shareholders, however, we would also want to ensure that a cause of action is available to acquirer side shareholders. As described above, though it might be more common that conflicted shareholders of the target vote to accept a deal at an artificially low price, there might be situations—as the Tesla shareholders are alleging in connection with the SolarCity merger—where conflicted shareholders of the acquirer vote to approve an unfavorable acquisition. In this scenario, minority stockholders are left holding shares of the acquirer with a diminished value.[222]

Usually, when shareholders of an existing corporation claim that directors took actions that caused the company harm, their only recourse is a derivative lawsuit. A derivative lawsuit is, technically, a lawsuit brought on behalf of the corporate entity itself, alleging that the directors violated their fiduciary duties to the entity. The shareholder is permitted to stand in the shoes of the entity to press the claim, but damages are paid to the corporation rather than to its shareholders directly.[223] As a result, there is no way that a derivative lawsuit could be tailored only to include dissenting stockholders; all stockholders' fortunes would rise and fall together.[224] Thus, if we want to allow only dissenters to be able to bring claims for *Corwin*-insulated deals, we must relax current distinctions between direct actions (filed by stockholders to vindicate their own rights) and

217. Fisch et al., *supra* note 135, at 562; *see generally* Sean Griffith, *Correcting Corporate Benefit: How to Fix Shareholder Litigation by Shifting the Doctrine on Fees*, 56 B.C. L. REV. 1 (2015).

218. Fisch et al., *supra* note 135, at 560–62; Griffith, *supra* note 217, at 2

219. Friedlander, *supra* note 132, at 642–44.

220. *In re* Trulia, Inc. Stockholder Litig., 129 A.3d 884, 891–92 (Del. Ch. 2016).

221. Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304 (Del. 2015); *In re* Saba Software, Inc. Stockholder Litig., C.A. No. 10697-VCS, 2017 WL 1201108 (Del. Ch. Apr. 11, 2017).

222. As described above and below, though acquisitions can be structured without the need for an acquirer-side vote on the acquisition itself, very often corporations need a shareholder vote to issue additional shares that will be used as merger consideration. If there is an obvious conflict among the directors, or if there is a conflicted controlling stockholder, the corporation may also seek a shareholder vote as a cleansing mechanism. This is what happened with the Tesla merger; shareholders voted on whether to issue additional shares, and the issuance was conditioned on approval by disinterested stockholders, which Tesla management defined to mean unconnected to management.

223. Griffith, *supra* note 217, at 8.

224. Moreover, any stockholders who sold their shares prior to the damages award—and thus would not share in gains to the corporation—would receive no remedy at all.

derivative actions. We might, for example, permit the dissenters to bring direct actions for the diminished value of their shares as a result of the acquisition; alternatively, we could maintain the action's derivative status, but allow a pro rata flow-through remedy that is available only to dissenting stockholders.[225]

But even if it were possible to iron out the administrative kinks inherent in such a solution,[226] there remains a broader theoretical problem, namely, the extent to which directors' actions in this context should be treated as violations of fiduciary duty at all. As described above, the exact nature of these duties is hotly contested. To the extent directors are, in fact, required to seek wealth maximization, it may be appropriate to permit claims against them when they fail to live up to those obligations, but the recent shift in standards of review suggests something else, namely, that directors' duties should be defined to require something akin to effectuating the will of the shareholder base. And if that is, in fact, directors' fundamental obligation, a more satisfying solution would be to have "damages" come not from directors based on a theory of fault, but from the corporation itself based on a theory of harm to the dissenters. Which brings us to the realm of appraisal.

C. Appraisal: The Original Solution to Shareholder Heterogeneity

Corporate law has long sought to manage the problem of conflicts among shareholders for the simple reason that, absent some assurances that their capital will not be siphoned away for the private benefits of the majority, minority shareholders will be reluctant to invest.[227] In the earliest corporations, the problem of shareholder heterogeneity was addressed in two ways. The first, as described above, was the duty of shareholder primacy. That duty operated on directors rather than shareholders, but nonetheless resolved heterogeneity problems at a time when there was far less separation between those roles. The second mechanism for addressing shareholder heterogeneity was the right of appraisal.

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225. Some courts have permitted flow-through remedies in derivative actions when an award to the entity would reward wrongdoers. *See, e.g.*, Bangor Punta Operations, Inc. v. Bangor & Aroostock R.R. Co., 417 U.S. 703, 718 n.15 (1974); *In re* Mercury Interactive Corp. Derivative Litig., 487 F. Supp. 2d 1132, 1137 (N.D. Cal. 2007); *cf.* Northstar Fin. Advisors Inc. v. Schwab Invs., 779 F.3d 1036, 1059–60 (9th Cir. 2015).

226. For example, even if dissenters alone could bring claims for breach of fiduciary duty, there would be a risk that a broader nuisance lawsuit might be filed seeking a disclosure-only settlement—or even a minor adjustment to deal protections in advance of the vote—that would purport to release all related fiduciary-duty litigation. *See* Griffith, *supra* note 217, at 49. Such a maneuver by competing plaintiffs and their attorneys could bar subsequent lawsuits by dissenters before they even got off the ground. Corporate defendants would therefore be incented to encourage the nuisance litigation in the first place—and the sweetheart release that follows—in order to forestall more serious lawsuits by dissenting stockholders after the vote. *Cf.* C.N.V. Krishnan et al., *The Impact on Shareholder Value of Top Defense Counsel in Mergers and Acquisitions Litigation*, 45 J. CORP. FIN. 480 (2017) (describing how top litigation counsel can take advantage of the fact that more problematic deals attract multiple lawsuits to strategically settle with a favored firm in a manner that minimizes deal disruption). Thus, courts would have to be especially vigilant in limiting the scope of litigation releases, and stockholders who anticipate dissenting from a deal might need to object to preclusive settlements.

227. John Armour et al., *Agency Problems and Legal Strategies*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 37 (2d ed. 2009) ("legal constraints on the ability of controlling shareholders to expropriate minority shareholders should increase the price at which shares can be sold to non-controlling shareholders, hence reducing the cost of outside equity capital").

1. The Right of Appraisal

Appraisal permits shareholders to surrender their stock to the corporation in exchange for its judicially-determined "fair value" in response to certain corporate fundamental changes. States famously vary as to the types of transactions that qualify,[228] and the procedural hoops through which shareholders must jump to perfect their rights,[229] but all states agree that at least some mergers give rise to appraisal rights.[230] The price that shareholders receive for their stock is usually calculated based on the corporation's value at the time just prior to the transaction giving rise to the right;[231] thus, appraisal grants shareholders a method for exiting a corporation without suffering the effects of value-reducing corporate action. Though there has been substantial debate about the usefulness—if any—of the appraisal right today,[232] originally it was another mechanism for addressing heterogeneity problems.

In their earliest incarnations, corporations were viewed as the product of a contractual agreement among shareholders to accomplish specific purposes. A corporation might be established solely to operate a bridge, a road, or a railroad, with the precise toll, route, and other characteristics delineated in the charter itself.[233] Actions taken outside of these narrow limits were deemed "ultra vires," and voidable at the option of any shareholder.[234] Because corporate activity was so tightly defined from the outset, it could be reasonably assumed that all shareholders had consented to actions that followed; the constraints protected shareholders by ensuring they could choose precisely how their capital would be invested.[235] Heterogeneity was addressed by giving specific notice to shareholders of potential corporate action before they made their investment.

Eventually these limitations grew unworkable. Rapid expansions in technology, energy, and commerce necessitated that corporations be granted more flexibility in their operations.[236] Allowing small groups of "holdout" shareholders to impede profitable change was untenable.[237] The law thus developed mechanisms to loosen and eventually eliminate unanimity requirements. Among other things, courts invented various judicial fictions to allow corporations to engage in stock-for-stock mergers without the technical label of merger; when dissenting shareholders sued to challenge these transactions, they

228. Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 226 (1962); Mary Siegel, *Back to the Future: Appraisal Rights in the Twenty-First Century*, 32 HARV. J. ON LEGIS. 79, 81–83 (1995).

229. Siegel, *supra* note 228, at 81.

230. *Id.* at 80.

231. DEL. CODE ANN. tit. 8, § 262(h) (2010).

232. Daniel R. Fischel, *The Appraisal Remedy in Corporate Law*, 8 AM. B. FOUND. RES. J. 875, 876 (1983);; Hideki Kanda & Saul Levmore, *The Appraisal Remedy and the Goals of Corporate Law*, 32 UCLA L. Rev. 429, 430–32 (1985); Charles R. Korsmo & Minor Myers, *The Structure of Stockholder Litigation: When Do the Merits Matter?*, 75 OHIO ST. L.J. 829, 861 (2014) [hereinafter Korsmo & Myers, *The Structure of Shareholder Litigation*];; Manning, *supra* note 228, at 233–34, 243–44; Siegel, *supra* note 228, at 85; Randall S. Thomas, *Revising the Delaware Appraisal Statute*, 3 DEL. L. REV. 1, 1 (2000); Thompson, *supra* note 4, at 26–28.

233. Carney, *supra* note 192, at 83.

234. Kent Greenfield, *Ultra Vires Lives! A Stakeholder Analysis of Corporate Illegality (With Notes on How Corporate Law Could Reinforce International Norms)*, 87 VA. L. REV. 1279, 1302 (2001).

235. *Id.* at 1304–05.

236. Carney, *supra* note 192, at 79–81; Frederick Tung, *Before Competition: Origins of the Internal Affairs Doctrine*, 32 J. CORP. L. 33, 58 (2006).

237. Carney, *supra* note 192, at 79; Manning, *supra* note 228, at 249.

were awarded cash for their shares as compensation.[238] Before long, legislatures codified the practice of permitting shareholders to seek the fair value of their shares in lieu of merger consideration, giving rise to the modern right of appraisal.[239] Appraisal, then, became a substitute mechanism for addressing the problem of shareholder heterogeneity. Eventually state legislatures expanded the remedy beyond mergers to encompass, to varying degrees, certain charter amendments, asset sales, and share exchanges.[240]

Yet as corporate law continued to evolve, appraisal atrophied to the point of insignificance.[241] Directors' duties of shareholder primacy were transplanted from private companies to public ones,[242] and the presumed common goal of wealth maximization papered over the problem of heterogeneous preferences.[243] Regulated securities markets provided shareholders with an alternative mechanism of exit when businesses adopted strategies with which they disagreed.[244] And appraisal's cumbersome procedural requirements[245] made it an unattractive remedy in all but the most extreme circumstances.

In recent years, scholars have debated what purposes appraisal does—or should—serve in the modern era. For a time, appraisal was viewed as a mechanism to provide liquidity when there exists no public market for the corporation's shares, and for protecting against exploitation by conflicted managers or controlling shareholders.[246] As a result, many states (and the Model Business Corporation Act), do not allow appraisal for non-conflict transactions involving publicly traded stock (what is known as the "market out" exception to appraisal).[247] Recognizing that conflicts can involve non-controlling shareholders, some states have created bright-line rules that define conflict transactions to include shareholders that cross certain thresholds of voting power.[248]

Delaware's appraisal statute is both more and less generous than many other states'. Delaware, unusually, only allows appraisals for mergers: even transactions that functionally are the equivalent of mergers, but technically are structured as other kinds of combinations (such as asset sales), are excluded.[249] However, Delaware does allow even holders of publicly traded target stock to seek appraisal, if at least some portion of the merger consideration is paid in cash.[250] Because so many public companies are incorporated in Delaware, in recent years, certain investors have been able to engage in a

238. Siegel, *supra* note 228, at 86–89.

239. *Id.* at 89.

240. Albert Choi & Eric Talley, *Appraising the "Merger Price" Appraisal Rule*, 35 J.L. ECON. & ORG. (forthcoming 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2888420.

241. Korsmo & Myers, *The Structure of Shareholder Litigation*, *supra* note 232, at 834–35.

242. Smith, *supra* note 23, at 279.

243. Hayden & Bodie, *supra* note 15, at 490–91; Greenfield, *supra* note 234, at 1306.

244. Thompson, *supra* note 4, at 4.

245. Siegel, *supra* note 228, at 84, 111.

246. *Id.* at 110; Fischel, *supra* note 232, at 876–77; Thomas, *supra* note 232, at 16; Thompson, *supra* note 4, at 18–19, 26–27.

247. *See, e.g.*, MICH. COMP. LAWS 450.1762(2)(a) (1997); MODEL BUS. CORP. ACT §13.02(b) (AM. BAR ASS'N 2010).

248. *See, e.g.*, MODEL BUS. CORP. ACT § 13.01(5) (AM. BAR ASS'N 2010) (defining an interested shareholder for appraisal purposes as one who controls 20% of the voting power).

249. Thompson, *supra* note 4, at 10–11.

250. DEL. CODE ANN. tit. 8, § 262(b)(2) (2010); Louisiana Mun. Police Ret. Sys. v. Crawford, 918 A.2d 1172, 1192 (Del. Ch. 2007). Holders of publicly-traded stock are also permitted appraisal regardless of the form of consideration when the merger is forced through without a shareholder vote by a controlling shareholder who holds in excess of 90% of the voting power of the merged company. *See* DEL. CODE ANN. tit. 8, §262(b) (2010).

practice known as "appraisal arbitrage." These investors—typically sophisticated hedge funds—buy public shares of a company about to engage in an appraisal-eligible transaction, and file appraisal claims after the deal is consummated.[251] Due in large part to appraisal arbitrage, appraisal has recently enjoyed a renaissance after being declared all but dead.[252]

The prevalence of appraisal arbitrage has led to recognition of a new purpose for appraisal: that of a disciplining force that deters unfaithful managers—beholden either to their own conflicting interests, or demands of controlling shareholders—from underselling the target company.[253] To its champions, appraisal is preferable to the traditional mechanism for deterring directorial misbehavior—the lawsuit for violation of fiduciary duty—because it is less vulnerable to the abuses described above.[254] Specifically, unlike a class action, where all shareholders are deemed to be members of the class unless they affirmatively opt-out, appraisal actions are "opt-in," in the sense that each aggrieved shareholder must individually notify the corporation of her intention to seek appraisal. Additionally, any attorneys' fees are paid by the dissenting shareholders (often on contingency arrangements, so that fees are calculated as a percentage of amounts obtained above the merger price); this too is unlike many fiduciary class actions, where fees are paid out of the corporate coffers.[255] Finally, appraisal requires dissenting stockholders to take a real economic risk because the judicially-determined "fair value" of the shares might come in below the merger price, in which case stockholders will receive less than they would have absent their dissent. As Charles Korsmo and Minor Myers conclude, these features eliminate many of the pathologies of the class action that incentivize attorneys to file "strike suits" that settle for nuisance value.[256]

It is a legitimate question whether appraisal should, in fact, serve this function. If the procedural mechanics of fiduciary litigation create agency costs between litigants and their counsel, presumably, the most appropriate response is to repair those procedures—as Professors Korsmo and Myers recognize.[257] Appraisal by its very nature is not designed to determine whether a breach of fiduciary duty has occurred, and therefore may be inadequate both to identify such breaches, and to articulate appropriate standards going forward. Its role as a backup to fiduciary litigation arises mainly because no other solution to the problems inherent in fiduciary litigation has been identified, which has prompted courts and legislatures to gradually limit fiduciary litigation's scope (a process *Corwin* has hastened).

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251. Charles R. Korsmo & Minor Myers, *Appraisal Arbitrage and the Future of Public Company M&A*, 92 WASH. U. L. REV. 1551 (2015) [hereinafter Korsmo & Myers, *Appraisal Arbitrage*].

252. *Id.* at 1553.

253. *Id.* at 1555–56; Choi & Talley, *supra* note 240, at 4; Fischel, *supra* note 232, at 880; *see generally* Richard A. Booth, *The Real Problem with Appraisal Arbitrage*, 72 BUS. LAW. 325 (2017).

254. Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 248, at 1588; Korsmo & Myers, *The Structure of Shareholder Litigation*, *supra* note 232, at 832–36.

255. Korsmo & Myers, *The Structure of Shareholder Litigation*, *supra* note 232, at 867; Griffith, *supra* note 217, at 2.

256. Korsmo & Myers, *The Structure of Stockholder Litigation*, *supra* note 232, at 890–91. Other scholars have observed that appraisal lawsuits are typically only filed for deals that have hallmarks suggesting mispricing or exploitation. *See, e.g.*, Choi & Talley, *supra* note 240, at 9; Wei Jiang et al., *Appraisal: Shareholder Remedy or Litigation Arbitrage?*, 59 J. L. & ECON. 697, 700 (2016). *But see* Cox & Thomas, *supra* note 189, at 38 (citing evidence that there are nuisance appraisal suits).

257. Korsmo & Myers, *The Structure of Stockholder Litigation*, *supra* note 232, at 890–94.

But in addition to its function as a deterrent against managerial disloyalty and slack, appraisal today can be modified to serve its original purpose: it can allow the corporation to accommodate the preferences of differently-situated shareholders. Some shareholders may be perfectly willing to accept a suboptimal price for their shares, in the expectation that they will benefit from the transaction through alternative investments. Other shareholders, who do not share those gains, will want to be paid a higher price up front. Appraisal provides a mechanism for satisfying the entire shareholder base.

Peter Letsou, analyzing common features of appraisal statutes, similarly concludes that the remedy was designed to address differing preferences among shareholders, specifically with respect to risk tolerance.[258] He argues that when a corporation dramatically alters its risk/reward profile, shareholders will value the change differently. By forcing the majority to pay for the losses experienced by the dissenters, appraisal ensures that corporation will only pursue opportunities when the gains to the majority exceed the losses to the minority.[259] However, he ruled out the possibility of using appraisal to accommodate preferences beyond risk tolerance—such as preferences regarding wealth maximization—because, in his view, a lawsuit for breach of fiduciary duty can accomplish the same result.[260]

Today, however, the landscape has changed. Given restrictions on fiduciary lawsuits, coupled with the increasing consolidation of the shareholder base, appraisal may be an appropriate mechanism of addressing investors' different preferences concerning wealth maximization as well. Shareholders may vote to induce the corporation to pursue opportunities that do not maximize returns—presumably because they will benefit in their non-shareholder capacities—but they will, in effect, pay other shareholders for the privilege. If the transaction is overall beneficial, it will be completed, and varying shareholder preferences will be accommodated; however, transactions that merely transfer wealth or that are wealth-destroying will be discouraged. In fact, Delaware courts—apparently recognizing that appraisal may provide a solution to the box in which they have put themselves—have begun to advocate for it in precisely these terms. For example, in *In re Merge Healthcare*, the court applied *Corwin* to reject certain merger-related fiduciary claims, while explaining:

> Where a majority of the disinterested ownership of the corporate asset approves the transaction, in a manner both uncoerced and informed, the agent/principal conflict with directors is ameliorated, and the need for judicial oversight of the agents is reduced concomitantly. Of course, another agency relationship, the majority dragging along the minority, remains; however, because the interests of the unaffiliated stockholders tend to be aligned, that relationship is less problematic, and is addressed statutorily via appraisal.[261]

Notably, under this scheme, the shareholder vote (or tender) would serve a different

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258. Peter V. Letsou, *The Role of Appraisal in Corporate Law*, 39 B.C. L. REV. 1121, 1123 (1998).

259. *Id.* at 1140–42.

260. *Id.* at 1171.

261. *In re* Merge Healthcare, Consolidated C.A. No. 11388-VC6, 2017 WL 395981 (Del. Ch. Jan. 30, 2017). *See also In re* Netsmart Tech. Inc. S'holder Litig., 924 A.2d 171, 209 (Del. Ch. 2007) (refusing to enjoin a merger vote despite a flawed sales process because "Netsmart stockholders can decide for themselves whether to accept or reject the Insight deal . . . In refusing to grant a broader injunction, I am also cognizant of the availability of appraisal rights.").

purpose than one traditionally offered by scholars. Rather than aggregating information to allow shareholders to collectively and accurately decide the corporation's most profitable course of operation,[262] voting would take on a sorting function, so that shareholders can individually indicate how they would prefer to dispose of their own investment.

To conceptualize appraisal in this manner is to recognize that the simple distinction between interested and non-interested transactions—often used as a basis for different approaches to appraisal[263]—is no longer tenable. Nor is appraisal in this context necessarily intended to deter managers from favoring the preferences of some shareholders above others; if they can do so while also providing fair value to the dissenters, the transaction will proceed. Notably, this vision of appraisal turns one criticism of the procedure into a feature rather than a bug: appraisal skeptics have argued that companies may set aside funds to pay off objecting stockholders that might otherwise have been included as merger consideration.[264] However, if one envisions appraisal as a form of price discrimination, this practice is entirely appropriate.

2. Reforming Appraisal for the Modern Market

Because appraisal allows shareholders to separate their fates, it presents a reasonable opportunity for addressing the problem of conflicting shareholder preferences. That said, as currently constituted, appraisal's cumbersome procedures make it unattractive to many of the shareholders who might benefit, and it is entirely unavailable in many situations where it is needed. Below are some potential avenues for reform.

a. Deal Price and "Going Concern" Value

An appraisal proceeding requires the judge to determine the "fair value" of the corporation's shares.[265] Delaware's appraisal statute dictates that the court must consider "all relevant factors" when making this determination, "exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation."[266] However, if appraisal is to serve as a form of price discrimination among shareholders, value should be redefined to include merger-related gains.

262. *See* Thompson & Edelman, *supra* note 42, at 149; *see also* Zohar Goshen, *Voting (Insincerely) in Corporate Law*, 2 THEORETICAL INQUIRIES LAW 815, 817–18 (2001).

263. MODEL BUS. CORP. ACT § 13.02(b)(4) (AM. BAR ASS'N 2010); Thomas, *supra* note 232, at 16–17; Fischel, *supra* note 232, at 883–84; Thompson & Edelman, *supra* note 42, at 11.

264. Jay B. Kesten, *The Uncertain Case for Appraisal Arbitrage*, 52 WAKE FOREST L. REV. 89, 92 (2017). It is unclear whether, as a factual matter, appraisal's availability incentivizes acquirers to withhold merger consideration that would otherwise go to target shareholders; studies have found that the stronger the appraisal remedy, the higher the merger premiums. *See* Audra L. Boone et al., *Merger Negotiations in the Shadow of Judicial Appraisal* (Indiana Legal Studies Research Paper No. 381); Scott Callahan et al., *Appraisal Arbitrage and Shareholder Value*, 3 J. L. FIN & ACCT'G 147 (2018).

265. *In re* Appraisal of Petsmart, Consolidated C.A. No. 10782-VCS, 2017 WL 2303599, at *1 (Del. Ch. May 26, 2017).

266. DEL. CODE ANN. tit. 8, § 262. Other statutes may make reference to customary valuation techniques as measured prior to triggering transaction. *See, e.g.*, MODEL BUS. CORP. ACT § 13.01(4) (AM. BAR ASS'N 2010) ("'Fair value' means the value of the corporation's shares determined: (i) immediately before the effectiveness of the corporate action to which the shareholder objects; (ii) using customary and current valuation concepts and techniques generally employed for similar businesses in the context of the transaction requiring appraisal."). Some states permit dissenters to share in merger-related gains, *see, e.g.*, *In re* Cawley v. SCM Corp., 530 N.E.2d 1264, 1267 (N.Y. 1988), though due to Delaware's dominance, they exert less influence.

Under current law, "fair value" for appraisal purposes is an awkward creature, openly conceded to be a "jurisprudential, rather than purely economic, construct."[267] The central difficulty is that most acquirers pay a premium for their targets above the market price, especially when the stock is widely traded and there exists no controlling shareholder. If one assumes that open and developed markets efficiently price stocks at their true value, the premium is likely to represent the fact that stock aggregated into a single controlling block, without the need to cater to a minority shareholder base, is more valuable than dispersed stock, for a variety of reasons (including synergies from the combination of complementary businesses, elimination of the transaction costs of dealing with minority shareholders, reduction of agency costs associated with a lack of control, and the benefits a controlling shareholder can extract when implementing new business plans).[268] All of these increases in value are, in some sense, the result of the acquisition itself; a strict application of the statutory mandate to "exclu[de] . . . any element of value arising from the . . . merger" would also exclude these gains and (at least for publicly traded stock) simply grant dissenting shareholders the stock's pre-transaction market price, which would nullify the remedy in most instances.[269]

For many years, Delaware elided the issue by defining "fair value" for appraisal purposes as "the value of the company as a going concern, rather than its value to a third party as an acquisition."[270] This "going concern" value was described as something other than the "actual real world economic value of the petitioners' shares"[271]; instead, courts were instructed to consider a variety of factors, which might include, but not be limited to, a consideration of the stock market price as well as the acquisition price.[272] The flexibility afforded by this judicially-constructed measure of fair value allowed courts to depart from market pricing when they believed it appropriate to do so.[273]

That said, in a pair of recent decisions, the Delaware Supreme Court shifted away from this Delphic formulation of "fair value." In *DFC Glob. Corp. v. Muirfield Value Partners, LP*[274] and *Dell Inc. v. Magnetar Global Event Driven Masterfund Ltd*.[275] the

267. DFC Glob. Corp. v. Muirfield Value Partners, L.P., 172 A.3d 346, 367 (Del. 2017).

268. *See* Lawrence A. Hamermesh & Michael L. Wachter, *The Short and Puzzling Life of the "Implicit Minority Discount" in Delaware Appraisal Law*, 156 U. Pa. L. Rev. 1, 30–38 (2007).

269. *In re* Appraisal of Petsmart, Consolidated C.A. No. 10782-VCS, 2017 WL 2303599, at *1 (Del. Ch. May 26, 2017).

270. *Id.*

271. Finkelstein v. Liberty Dig., Inc., No. Civ.A. 19598, 2005 WL 1074364, *12 (Del. Ch. Apr. 25, 2005). At least one theoretical justification for this distinction is that acquisitions are conducted between willing buyers and sellers; an appraisal action, by definition, is brought by an *unwilling* seller who has been involuntarily deprived of her economic interest Inc in the company. *See* Booth, *supra* note 253, at 341; Chicago Corp. v. Munds, 172 A. 452, 455 (Del. Ch. 1934) ("When a merger proposal is put through with which he chooses to dissociate himself, he is forced out of his investment and compelled to abandon his association with a business of which he was a part owner.").

272. *In re* Appraisal of Dell Inc., C.A. No. 9322-VCL, 2016 WL 3186538 at *24–25 (Del. Ch. May 31, 2016).

273. Courts might, for example, conclude that certain information was not incorporated into market price, Cede & Co. v. Technicolor, 542 A.2d 1182, 1187 n.8 (Del. 1988), that the acquirer was able to exploit preexisting corporate opportunities, Merion Capital LP v. BMC Software, C.A. No. 8900-VCG, 2015 WL 6164771 (Del. Ch. Oct. 15, 2015), or that there was a change in circumstances between the setting of the deal price and the date of the merger's consummation, *Dell Inc.*, 2016 WL 3030909.

274. DFC Glob. Corp. v. Muirfield Value Partners, LP, 172 A.3d 346 (Del. 2017).

275. Dell Inc. v. Magnetar Glob. Event Masterfund, Ltd., 177 A.3d 1 (Del. 2017).

court held that the best evidence of value comes from terms agreed upon between informed, motivated sellers and buyers.[276] This pronouncement carried with it two somewhat conflicting implications: first, that when the stock trades efficiently, market price is the best evidence of fair value;[277] and second, with respect to merger prices specifically, that "the best evidence of fair value [is] the deal price" itself, so long as the target company engages in vigorous negotiations with potential acquirers, free from the taint of self-dealing.[278]

The full implications of *DFC* and *Dell* are still being hashed out. The emphasis on deal price suggests that if the target company engaged in robust negotiations, dissenters are unlikely to receive an award above that resulting merger price in a subsequent appraisal action. More ominously for the practice of appraisal arbitrage, at least one decision has interpreted *DFC* and *Dell* to mean that most deal prices reflect both the target's value and gains attributable to the merger itself, and that therefore in the mine-run of cases, the pre-merger value of the stock should be appraised solely at pre-announcement market value.[279] Should the Delaware Supreme Court adopt this reasoning, it would severely curtail the incidence of appraisal arbitrage, as the best a dissenter could hope for would be an award somewhere between market price and deal price. Appraisal actions would then likely be limited to private companies, or public companies where there is strong evidence that the market pricing was inaccurate, perhaps because of nonpublic information about the target. We might begin to see, then, that for publicly-traded targets, *Corwin* is simply replicated, with even the appraisal remedy conditioned on the existence of inadequate disclosures.

In any event, whatever the impact of DFC and Dell, the analysis of this Article suggests that an entirely different approach to valuation should be adopted. If companies are choosing less-than-wealth-maximizing transactions to please a segment of their shareholder base, the practice of excluding merger-related gains from the appraisal valuation should be abandoned. Instead, courts should award whatever premium a typical bidder might have been expected to pay, including, if it is common practice, some share of the gains the bidder might have expected to achieve as a result of the merger itself.[280] The proper analysis might exclude synergistic values that are unique to the combination of a particular buyer and target on the theory that the combination itself is the product of the exact conflict to which the dissenting shareholder objects,[281] but include other types of

276. *DFC*, 172 A.3d at 369; *Dell*, 177 A.3d at 24–27, 35.

277. *DFC*, 172 A.3d at 369–70; *Dell*, 177 A.3d at 25.

278. *DFC*, 172 A.3d at 349; *see also Dell*, 177 A.3d at 30 (given evidence of robust negotiations, "Dell's deal price has heavy, if not overriding, probative value"). Despite these pronouncements, the Delaware Supreme Court stopped short of holding that the deal price is presumptively fair value for appraisal purposes. *DFC*, 172 A.3d at 364; *Dell*, 177 A.3d at 21–22.

279. *See* Verition Partners Master Fund, Ltd. v. Aruba Networks, Inc., C.A. No. 11448-VCL, 2018 WL 922139 (Del. Ch. Feb. 15, 2018). Significantly, in neither *DFC* nor *Dell* did the defendant company argue that the deal price included value due solely to the merger, a point which the *DFC* decision emphasized. *DFC*, 172 A.3d at 367.

280. Notably, such a change in valuation would be consistent with the text of Delaware's appraisal statute; Delaware courts have observed that the strict exclusion of all merger-related gains is a common law interpretation rather than legislative command. *See DFC*, 172 A.3d at, 368; *Merion Capital LP*, No. 8900-VCG, 2015 WL 6164771, at *16 (Del. Ch. Oct. 21, 2015).

281. As described above, conflicts among shareholders may make it more likely that two particular companies will merge in the first place, *see supra* Part III.A; therefore, if a dissenter objects to a deal, it may be appropriate to exclude her from the benefits that are specific to that combination. That said, to truly compensate dissenters for the opportunity costs of a better deal, it might even be reasonable to permit stockholders to share in

merger-related gains that would ordinarily be shared with a target firm, such as those associated with reduced agency costs (recognizing, as the DFC court colorfully put it, stockholders are not entitled to "the highest possible price that a company might have sold for had Warren Buffett negotiated for it on his best day and the Lenape who sold Manhattan on their worst"[282]). The reason for the shift would be to ensure that majority shareholders do not leech value that might otherwise have been allocated to minority shareholders if they had an effective advocate for their interests.[283] If we consider that the acquirer might have paid a higher price but for the conflicts experienced by shareholders, or that a different buyer might have offered a richer premium, then the harm experienced by the minority shareholders is the opportunity cost of a better deal, and the appraised value should reflect that fact.[284] Such calculations would be complex, but not impossible; private equity buyouts, which often do not include synergistic gains, might prove a helpful reference point.[285] Additionally, though it is not the common practice today, litigants could seek discovery from third parties who expressed interest in, but ultimately were not able to consummate, a deal, which would also allow for a more accurate determination of the corporation's arm's-length value.

The chief drawback of this proposal might be that the inclusion of merger-related gains in valuation could encourage meritless litigation: if the deal price is close to the "floor" of any award arbitrageurs expect to receive, they may be willing to roll the dice on appraisal claims regardless of the likelihood of success.[286] But, to the extent this is a real possibility,[287] there are a number of options to address it. Appraisal actions could be

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synergies, if they would do so in an arm's length transaction. It is generally assumed that in most mergers, synergies tend to be allocated to target shareholders, particularly if there are multiple bidders, *see* Lawrence A. Hamermesh & Michael L. Wachter, *The Fair Value of Cornfields in Delaware Appraisal Law*, 31 J. CORP. L. 119, 143 (2005) [hereinafter Hamermesh & Wachter, *Fair Value*]; Lawrence A. Hamermesh & Michael L. Wachter, *Finding the Right Balance in Appraisal Litigation: Deal Price, Deal Process, and Synergies* (U. Penn. Inst. for L. and Econ. Research Paper No. 18-01, 2018). https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3086797, but—due to the conflicts described in this article—that may be changing to allocate more synergies to acquirers. *Cf.* G. Alexandridis et al., *Value Creation from M&As: New Evidence*, 45 J. CORP. FIN. 632 (2017); Brooks et al., *supra* note 97.

282. DFC Global Corp. v. Muirfield Value Partners, LP, 172 A.3d 346, 370 (Del. 2017).

283. Presumably, this highly fact-specific analysis would also take into account whether there were or could have been any other potential bidders, whether the existing acquirer might have been willing to pay a higher price, and so forth. To be sure, any inquiry into hypothetical third party bidders carries with it the potential for error. *See* Hamermesh & Wachter, *Fair Value*, *supra* note 281, at 136.

284. Once again, this is a common proposal for dealing with conflict transactions, such as when a controlling shareholder involuntarily forces out the minority. *See* 2 PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 7.22 (AM. L. INST. 2008) ("If the transaction giving rise to appraisal [involves controlling shareholders or a management buyout], the court generally should give substantial weight to the highest realistic price that a willing, able, and fully informed buyer would pay for the corporation as an entirety. In determining what such a buyer would pay, the court may include a proportionate share of any gain reasonably to be expected to result from the combination, unless special circumstances would make such an allocation unreasonable."); Thompson, *supra* note 4, at 35–38.

285. Concededly, there is a circularity to this proposal. The more conflicts pervade the merger process, the fewer "clean" deals that will be available to serve as a basis for comparison. Moreover, if traders begin to expect that conflicts will negatively affect their investment, that fact will be reflected in market prices, rendering market price —and premiums above market price—a less informative measure, as well.

286. Hamermesh & Wachter, *Finding the Right Balance*, *supra* note 281. If synergies are excluded from appraisal awards, as proposed, the deal price would not represent a floor in strategic mergers, but could represent a floor—or close to it—in financial ones.

287. These concerns may be overstated; the transaction costs inherent in appraisal arbitrage, including

modified to place the burden of proof on the plaintiff to establish that the deal price itself was inadequate. This would be a departure from current law, in which neither party has the burden of proof and instead the court is simply directed to make its own determination as to the corporation's value.[288] Alternatively, a limited "loser pays" rule could be adopted, making the petitioners responsible for some share of the defendants' costs if the award is less than or equivalent to the deal price. Such a rule would perhaps be more practical than loser pays rules in other contexts, because payments would not need to be collected from the petitioners; instead, the costs could be deducted from whatever amount the court awards petitioners for their shares.

b. Expanding Appraisal's Availability

Appraisal imposes transaction costs on corporations, shareholders, and courts, and more fundamentally, constrains managers' discretion by requiring the corporation maintain sufficient liquidity to pay off dissenting shareholders.[289] For these reasons, the appraisal right must be limited to the most important and serious corporate transactions, as is currently the law.[290] That said, although the most obvious situation where a minority of shareholders risk being dragged along by a majority vote is on the target side of a merger, there are other scenarios where we may wish to protect shareholders against the wealth-reducing preferences of a conflicted majority.

For the purpose of accommodating heterogeneity in the absence of a single controlling shareholder, it makes the most sense to make appraisal available for transactions that require shareholder votes or actions (such as tender) for their consummation.[291] Certainly, there are myriad corporate transactions that can be influenced by shareholder preferences even in the absence of a shareholder vote, but transactions that require a shareholder vote (or consent, or tender) not only present the most immediate danger, but are also the ones that *Corwin* and similar decisions insulate from subsequent judicial review. They are also likely to be significant enough to justify the extreme remedy of appraisal.[292]

Additionally, not all transactions are likely to give rise to conflicts between investors in their shareholder and non-shareholder capacities that are pervasive enough to affect the vote outcome, likely to be value-reducing, and likely to create a class of injured shareholders. For example, votes for particular corporate directors (rather than specific corporate actions), or bylaws that change governance rules (such as destaggering a board), may later lead to value-reducing transactions, but are not votes for such transactions in and of themselves. It is useful in this regard to draw upon the concept of loss-causation in the context of federal securities actions brought for false proxy statements under Section 14.

attorneys' fees, may impose their own kind of discipline. Moreover, costs inhere in the fact that arbitrageurs would have to wait until the conclusion of trial to receive consideration for their shares, though some have argued that the relatively high interest rates available in appraisal litigation over-incentivize meritless claims. *See, e.g.*, Jay B. Kesten, *The Uncertain Case for Appraisal Arbitrage*, 52 WAKE FOREST L. REV. 89 (2017).

288. *In re* Appraisal of Dole Food Co., 114 A.3d 541, 549–50 (Del. Ch. 2014).

289. Manning, *supra* note 228, at 234.

290. Thompson, *supra* note 4, at 9.

291. In this context, "require" means that there has been some corporate precommitment not to engage in the action absent shareholder consent. This could occur because of a commitment in the proposal itself, charter or bylaw provisions, common law or statutory law, or even stock exchange rules.

292. Under this conception, appraisal should not be available for precatory/nonbinding votes, such as say on pay or recommendations that directors adopt a bylaw.

Courts have held that in order to bring a damages claim, shareholders must have directly voted on the loss-inducing action.[293] A similar principle should be applied when determining which corporate actions should be subject to appraisal.

With these ground rules in hand, we can sketch out a rough list of transactions that should be subject to appraisal for the purpose of addressing heterogeneity. Most are similar to those already subject to appraisal in most states: target shareholders in mergers, target shareholders in share exchanges, and shareholders of corporations that sell all or most of their assets.[294] Appraisal might appropriately be available for other corporate actions that require shareholder votes, such as the creation and issuances of new classes of stock, reverse stock splits (especially if they involuntarily cash out some stockholders), and reincorporations in other jurisdictions —all of which are also issues on which shareholders' private interests might result in differing preferences.

Critically, however, if appraisal is to address the differing preferences of shareholders, it should not be subject to a "market out." That is, appraisal should remain available even if the stock being surrendered, or the consideration received, is publicly traded, and even if the shareholder receives cash. The market out exception may make sense if appraisal exists to provide liquidity or to address varying risk preferences,[295] but it is unhelpful when the concern is that large investors may vote for value-reducing transactions. Once a deal is proposed (or approved), publicly-traded stock will reflect the reduction in value; the minority shareholder's ability to quickly exit her investment does not compensate for the loss.[296] And the fact that shareholders may receive publicly traded shares or cash in exchange for their investment provides no assurance that the consideration received is equivalent to what they surrendered. In fact, one study found that the presence of overlapping shareholders makes it more likely that an acquisition will use stock-based consideration;[297] because these are the acquisitions that pose a particular danger of conflicts among shareholders, it is especially important that the appraisal remedy be made available.

Given the changes in the corporate landscape, it would also be appropriate to expand the appraisal remedy to buy-side shareholders for corporate acquisitions large enough to require a shareholder vote. Due to conflicts described above, the ordinary mechanisms that might constrain acquirer-side overreaching, such as market pricing, are unlikely to function.[298] If minority buy-side shareholders have the option of appraisal in the event of potentially dilutive acquisitions—where value is gauged before the acquisition, rather than after—then majority shareholders will only favor transactions that are ultimately accretive as measured across all shareholders, and less-diversified shareholders will be less vulnerable to exploitation by the majority.[299]

293. *See* Gen. Elec. Co. v. Cathcart, 980 F.2d 927, 933 (3d Cir. 1992).

294. Delaware currently limits appraisal rights to statutory mergers; other states, however, provide for appraisal rights in a broader range of transactions. *See* Siegel, *supra* note 228, at 91 n.52.

295. Letsou, *supra* note 258, at 1144–48; Siegel, *supra* note 228, at 125.

296. *See* Charles Korsmo & Minor Myers, *Reforming Modern Appraisal Litigation*, 41 DEL. J. CORP. L. 279, 332–33 (2017).

297. Brooks et al., *supra* note 97, at 201.

298. Robert Thompson and Paul Edelman argue market constraints make appraisal unnecessary for most going concerns. *See* Thompson & Edelman, *supra* note 42, at 141. However, due to *Corwin* and the fact that—by hypothesis—large shareholders (who may be passive holders and thus unlikely to sell as an indication of displeasure) approve of the deal, it is not as clear these constraints are as strong as they once were.

299. Some states already permit buy-side shareholders to seek appraisal. *See* Steven H. Schulman & Alan

Under current law, acquisition decisions are not usually presented directly to buy-side shareholders for their vote. However, due to the complex interplay between state law requirements and—for publicly traded companies—the stock exchange listing rules, when acquirers issue substantial amount of stock to complete a deal, they often must seek shareholder approval, if not on the acquisition itself, then at least on the share issuance, or an authorizing charter amendment.[300] Thus, appraisal rights should generally be made available whenever a shareholder vote is required to effectuate the transaction.[301]

To be sure, permitting appraisal in this circumstance might require special accommodations. For example, to avoid heads-I-win-tails-you-lose situations, petitioners should be required to escrow their shares before bringing an action, with limits on their ability to drop the litigation should the market price rise.[302] Fair value in this instance would be calculated without reference to any new opportunities that arose after the triggering transaction. So constrained, buy-side appraisal actions would likely be rare events, but the option could be valuable in appropriate circumstances.

This Article is not the first to suggest that buy-side shareholders be permitted to exit the company in advance of a disfavored acquisition. Afra Afsharipour has in fact made a

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Schenk, *Shareholders' Voting and Appraisal Rights in Corporate Acquisition Transactions*, 38 BUS. LAW. 1529, 1533 n.15 (1983).

300. Under many state laws, if the acquirer issues a certain number of shares to effectuate the merger—Delaware sets the figure at 20%—a shareholder vote is required, and appraisal may become available. DEL. CODE ANN. tit. 8, §§251(f), 262 (2010). These state law requirements are easily evaded by structuring the transaction as a triangular merger, Thompson, *supra* note 4, at 10, yet publicly-traded corporations cannot avoid the vote entirely, because the major stock exchanges, while not providing for appraisal rights, require that shareholders be permitted to vote for 20% share issuances. N.Y.S.E. LISTED COMPANY MANUAL § 312.03(c) (2015); NASDAQ EQUITY RULES § 5635 (2017). Additionally, if the acquisition requires a charter amendment to increase the number of authorized shares, that too will require a shareholder vote, without necessarily triggering appraisal rights. Some states may allow appraisal for an upside-down merger, where the nominal acquirer issues so many shares that the nominal target is, in fact, functionally obtaining control. Thompson, *supra* note 4, at 18 n.72. The major stock exchanges require a shareholder vote for these transactions as well. N.Y.S.E. LISTED COMPANY MANUAL § 312.03(d) (2015); NASDAQ EQUITY RULES § 5635 (2017).

301. This reasoning further suggests that appraisal should be made available more generally for any share issuance that requires approval of existing shareholders (i.e., a large share issuance under exchange listing rules, or a charter amendment to increase the number of authorized shares). Currently, some states permit appraisal when charter amendments alter the rights of existing shares. *See, e.g.*, ARIZ. REV. STAT. ANN. § 10-1302 (2018); 805 ILL. COMP. STAT. 5/11.65 (2018). Although exchange-listed companies are prohibited from creating new stock that disparately reduces the voting power of existing shares, N.Y.S.E. LISTED COMPANY MANUAL § 313.00 (2015); NASDAQ EQUITY RULES § 5640 (2017), recently there has been a trend towards companies attempting to create classes of "no vote" shares that permit founding shareholders to maintain their control of the corporation. *See* Steven Davidoff Solomon, *New Share Class Gives Google Founders Tighter Control*, N.Y. TIMES (Apr. 13, 2012), https://dealbook.nytimes.com/2012/04/13/new-share-class-gives-google-founders-tighter-control/; Tom Hals, *Zuckerberg Nixes New Facebook Share Class After Shareholder Lawsuit*, REUTERS (Sept. 22, 2017), https://www.reuters.com/article/us-facebook-stock-trial/zuckerberg-nixes-new-facebook-share-class-after-shareholder-lawsuit-idUSKCN1BX2PA. It is easy to see how these transactions could give rise to factions among existing shareholders; even if amendment is conditioned on majority-of-the-minority approval, certain shareholders—such as employees—might be more comfortable with continuity of control relative to other shareholders. Of course, it might be counterintuitive to drain the company of capital precisely when it is seeking to raise more, but that simply means that the company would have to find new investors willing to replace the old ones.

302. Although it would be unusual, it is possible that litigants on both the target and acquirer side would bring appraisal actions for the same deal. Such a result should be welcomed, as it would present a greater opportunity for the court to hear competing viewpoints.

similar proposal, recommending that acquirer-side shareholders be entitled to purchase a put option from the company (which, like appraisal, requires the company to repurchase the shares at their pre-merger value, but avoids the need for judicial involvement).[303] Her proposal is aimed less at conflicted shareholders than general managerial disloyalty; as a result, she does not tie the put to a shareholder vote and she recommends that the put be capped at 20% of the shareholder base. Put options necessarily function differently than appraisal—among other things, they only work for public company acquirers, and present different risks for shareholders and different opportunities for arbitrage—but the more general point is that the legal system should more seriously consider ways for dissenting shareholders to avoid losses associated with certain types of transactions.

c. Simplifying Appraisal Procedures

The byzantine procedure for seeking appraisal represents the biggest stumbling block to its effectiveness as a mechanism for addressing shareholder conflicts. As described above, in general, it is less diversified shareholders who are most likely to need the remedy, and these are disproportionately likely to be retail shareholders, or smaller institutions. The more difficult appraisal procedures are to navigate, the more they will exclude the very persons who need them the most.[304] At the same time, certain aspects of appraisal—including its opt-in character and the financial risks it imposes on petitioners—may make it less subject to abuse than other forms of stockholder litigation. Therefore, any reformation of appraisal procedure must strike a balance between accessibility and discouraging frivolous claims.[305]

As currently constituted, appraisal operates in a manner akin to an opt-in class action. The fair value determination is made in a single court proceeding, with fees and expenses shared by all dissenting stockholders.[306] Assuming actions can be led by a small number of sophisticated investors who are equipped to manage the claim, the main barriers to participation by other stockholders are the procedural complexities associated with exercising the appraisal right, the need to ensure that stockholders are equipped to make an informed decision about seeking appraisal, and the delays in payment associated with an appraisal action. All of these aspects of the appraisal remedy can be reformed.

Under Delaware law, shareholders may be entitled to appraisal if a merger occurs as a result of a shareholder vote, or if a merger occurs without a vote because the acquirer obtained sufficient shares to make the vote unnecessary (often as a result of a prior tender

303. Afra Afsharipour, *A Shareholders' Put Option: Counteracting the Acquirer Overpayment Problem*, 96 MINN. L. REV. 1018, 1025–26 (2012).

304. *See* Korsmo & Myers, *Appraisal Arbitrage*, *supra* note 251, at 1600–01; George S. Geis, *An Appraisal Puzzle*, 105 NW. U. L. REV. 1635, 1656 n.132 (2011). The practice of appraisal arbitrage may also benefit smaller stockholders even if they do not directly take part in an appraisal proceeding, if the purchases of arbitrageurs push up the price of the stock until it reaches something approaching the risk-adjusted expected value of the claim.

305. Certainly, a reconsideration of appraisal procedure is warranted if for no other reason than Delaware's recent retrenchment from fiduciary litigation. As Randall Thomas argued, "appraisal must provide shareholders with adequate protections if they are to be asked to forgo other remedies." Thomas, *supra* note 232, at 20. After *Corwin* and *M&F*, Delaware may not have formally made appraisal the exclusive remedy for potentially unfair mergers, but it has dramatically restricted other avenues of redress; it is appropriate that appraisal procedures be concomitantly relaxed.

306. *In re* Appraisal of Shell, No. 8080, 1992 WL 321250, at *1169–71 (Del. Ch. Oct. 30, 1992); Raynor v. LTV Aerospace Corp., 317 A.2d 43, 47 (Del. Ch. 1974).

offer).[307] In the former circumstance, shareholders must be notified of their right of appraisal at least 20 days before the shareholder vote on the triggering transaction. In the latter, the offeror will typically notify shareholders of the appraisal right at the time of the tender offer. The shareholder must then notify the corporation in advance of the vote, or the closing of the tender offer, of her intention to seek appraisal. The shareholder must not vote in favor of the transaction (or must not tender her shares). Once the transaction is consummated, any stockholder who has perfected her rights has 120 days to file a petition in court seeking judicial determination of the fair value of her stock. After the petition is filed, the corporation supplies the court with the names of all appraisal-eligible stockholders, and the court notifies the stockholders of the date and time of the appraisal hearing. A stockholder who is not a named party to the court proceeding may, within 60 days of the triggering transaction, drop the appraisal demand and receive the merger consideration; after that, any settlements of an appraisal demand require either court approval or the approval of the corporation.[308]

Certain aspects of these procedures must be maintained. For example, it is necessary that stockholders notify the corporation in advance, and refrain from voting in favor of the merger; the corporation must have a sense of how many appraisal petitions to expect in order to decide whether the transaction is worth completing,[309] and to allow appraisal after a "yes" vote invites manipulation. That said, notifications to shareholders regarding their appraisal rights could be made easier for novices to digest. Current law requires that corporations inform shareholders of their appraisal rights and provide a copy of the relevant appraisal statute,[310] and the SEC has certain "plain English" requirements for public companies,[311] but notifying materials are still drafted in a manner that attorneys, much less laypersons, might find impenetrable. Happily, there is an alternative model: in the class action context, notices must be "clear[] and concise[]" and be drafted with "plain, easily understood language."[312] There is no reason why similar standards should not apply to appraisal notices, with special emphasis placed both on the risks of appraisal, and on the ability of shareholders to opt-in to lawsuits filed by others. Notably, in advance of the recent management buyout of the Dell Corporation, Carl Icahn publicly campaigned for shareholders to seek appraisal by distributing just such a plain (some might say blunt) English letter to stockholders laying out their options.[313] Permitting shareholders to submit appraisal demands electronically (perhaps in a check-the-box format), and providing them with easy instructions—and internet links—for changing their merger votes or

307. DEL. CODE ANN tit. 8, §262 (2010).

308. Because of the quasi-class nature of the claim, stockholders who file appraisal petitions in court (and thus represent the interests of other stockholders) may not settle their claims without notice to the non-appearing dissenters. *See* Raynor v. LTV Aerospace Corp., 317 A.2d 43, 47 (Del. Ch. 1974); Mannix v. PlasmaNet, C.A. No. 10502-CB, 2015 WL 4455032, at *4 (Del. Ch. July 21, 2015).

309. It is common for mergers today to contain "appraisal blow" provisions that cancel the deal if too many shareholders indicate they plan to seek appraisal. *See In re* Books-A-Million, Inc. Stockholders Litig., C.A. No. 11343-VCL, 2016 WL 5874974, at *5 (Del. Ch. Oct. 10, 2016).

310. DEL. CODE ANN tit. 8, §262 (2010).

311. 17 C.F.R. § 229.1001 (2012).

312. FED. R. CIV. P. 23(c)(2) (2009); *see generally* Todd B. Hilsee et al., *Do You Really Want Me to Know My Rights? The Ethics Behind Due Process in Class Action Notice Is More Than Just Plain Language: A Desire to Actually Inform*, 18 GEO. J. LEGAL ETHICS 1359 (2005).

313. Icahn Partners Master Fund LP, Amendment to Schedule 13D (July 11, 2013), https://www.sec.gov/Archives/edgar/data/826083/000092846413000169/dellsch13damd7071113.htm.

withdrawing tendered shares would also facilitate compliance with the appraisal requirements.

Though many shareholders may feel ill-equipped to determine whether appraisal is appropriate entirely on their own, they may be comfortable joining an action filed by a more sophisticated investor. This is, in fact, something like the model for federal securities class action litigation, which encourages large institutions to take the lead, on the theory that they will better represent the class.[314] Appraisal procedures could be modified, then, to make it easier for investors to choose appraisal when they can tag along in another action. For example, corporations could be required to disclose information about the total amount of stock for which appraisal demands have been filed in advance of the shareholder vote, which would both help shareholders determine whether their concerns about a transaction have merit and help shareholders who favor the deal properly assess its potential costs.

Additionally, if an appraisal petition is filed in court, all non-named dissenters should be immediately notified, and given basic information about the claim and the named plaintiff, with rights to withdraw and receive the merger consideration at their option (thus allowing them to decide whether they want to have their interests represented by the existing litigant). If no action is filed, dissenters should automatically receive the merger consideration.[315]

Stockholders also find appraisal litigation challenging because they must hold on to their shares throughout the proceeding which, like any trial, may take a great deal of time to resolve. During that time, the investor may not receive any merger consideration, and may not receive dividends or vote on any further corporate matters. Though at the conclusion of litigation the investor receives the judicially-determined value plus interest at 5% above the Federal Reserve discount rate,[316] some investors may find that the delay imposes a hardship. Delaware recently gave companies the option to prepay a portion of the consideration if they choose to do so (and thus avoid paying interest on that amount),[317] but it is not clear how many companies take advantage of that option.[318]

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314. *In re* Cendant Corp. Litig., 264 F.3d 201, 261–62 (3d Cir. 2001).

315. Currently, corporations may include such provisions voluntarily in their merger agreement. *See, e.g.*, Dell, Inc., Schedule 14A, (May 30, 2013), https://www.sec.gov/Archives/edgar/data/826083/000119312513242115/d505470ddefm14a.htm ("If any stockholder who demands appraisal of shares . . . fails to perfect, successfully withdraws or loses such holder's right to appraisal, such stockholder's shares of Common Stock will be deemed to have been converted . . . into the right to receive the merger consideration . . . . A stockholder will fail to perfect, or effectively lose, the stockholder's right to appraisal if no petition for appraisal is filed within 120 days after the effective time of the merger.").

316. DEL. CODE ANN. tit. 8 §262(h) (2010).

317. *Id.*

318. Some companies may withhold consideration despite the prepayment option because they treat it as a loan with favorable terms, or because they do not want to supply petitioners with the means to finance the litigation. *See* Kesten, *supra* note 264, at 132–33. At the same time, there have been concerns that the interest rate is set too high, which encourages nuisance petitions—an argument that is countered with the claim that appraisal arbitrageurs are unlikely to find the rate attractive. Booth, *supra* note 253, at 339–40; *see generally* Charles Korsmo & Minor Myers, *Interest in Appraisal*, 42 J. CORP. L. 109 (2016). However, that debate plays out for sophisticated investors, there is a risk that retail shareholders might desire the interest rate and seek appraisal on that basis alone. Therefore, companies should have the option to prepay shareholders selectively—thus avoiding financing arbitrageurs, while dissuading retail shareholders from appraising for interest—an option that does not appear to be permissible under the current statute. Notably, the Model Business Corporations Act provides a model: it requires the corporation pay the corporation's estimate of fair value to dissenters *unless* they are

The payment delay is a challenge to address. Corporations could simply be required to pay the merger consideration up front, but it is unclear what should happen if the judicially-determined fair value comes in below that amount. In theory, the corporation should be entitled to claw it back, but that, too, would presumably impose a hardship on some investors. A compromise, then, would be to require companies to pay a portion of the merger consideration immediately (with the option of paying more to avoid interest), on the theory that doing so would ease petitioners' burdens without creating a risk of a need for clawbacks. For example, companies might be required to pay the uncontested portion of the merger consideration,[319] or—at minimum—half of the merger consideration. Though there is a chance (slim, but not impossible[320]) that a judicially-determined fair value would fall below that figure, it is unlikely enough to be worth the risk.[321]

In sum, unnecessary procedural complexity can be eliminated from the appraisal action while maintaining appraisal's essential character. If accomplished with a view toward facilitating shareholders' ability to follow the lead of more informed investors when deciding whether to seek appraisal, the remedy could once again become a realistic option for resolving shareholder conflicts.

V. CONCLUSION

Modern corporate law was built on a foundational myth: that of the homogeneity of shareholder preference. The myth was relatively easy to maintain in the days when public company shareholders were dispersed and held small stakes; however, in a world of large institutions invested in wide swaths of corporate America, the reality of heterogeneity must be confronted more directly. To continue to require that directors adhere to the fictional preference of wealth maximization not only forces upon (some) shareholders less-than-optimal choices, but also is impossible to enforce given the power that institutional shareholders possess. A better solution, then, is to permit shareholders to part ways under appropriate circumstances.

That said, it should be noted that corporate law in Delaware—and, indeed, the United States—is rooted in a general preference for flexibility and privately-ordered arrangements. If that approach were to be reconsidered, other options might be available. For example, the United Kingdom has long had to grapple with its own version of the conflicted shareholder problem. There, institutional shareholders came to dominate the landscape much earlier than in the United States,[322] in part, apparently, because there were fewer

arbitrageurs. MODEL BUS. CORP. ACT §§ 13.24, 13.25 (AM. BAR ASS'N 2010).

319. This is what the MBCA requires, though the company has the option of not paying arbitrageurs. MODEL BUS. CORP. ACT §§ 13.24, 13.25 (AM. BAR ASS'N 2010).

320. ACP Master, Ltd., v. Sprint Corp., C.A. No. 9092-VCL, 2017 WL 3421142 (Del. Ch. Aug. 8, 2017).

321. Finally, under current law, it is unclear whether shareholders who seek to coordinate an appraisal action with a single attorney would be treated under federal law as a group required to file disclosures on Schedule 13D. *See* 17 C.F.R. § 240.13d-1 (2012). The prospect of this kind of premature disclosure may deter meritorious appraisal actions, particularly if it forces the petitioners—who may be individually considering strategic alternatives to appraisal—to reveal plans not otherwise subject to disclosure. Because Schedule 13D itself was intended to force disclosure of plans to influence corporate activity—not plans for shareholders to separate from the entity—the SEC should make clear that a group formed solely for the purposes of appraisal is not subject to 13D requirements.

322. Dan Awrey et al., *Resolving the Crisis in U.S. Merger Regulation: A Transatlantic Alternative to the Perpetual Litigation Machine*, 35 YALE J. REG. 1, 26 (2018).

regulatory initiatives favoring shareholder atomization.[323] Corporate power is distributed accordingly, with shareholders granted much more expansive rights to approve or reject proposed corporate actions than is the norm in this country.[324] To protect minority shareholders against oppression by the majority, the U.K. has adopted three basic mandatory mechanisms.

First, rather than allow corporations to choose their own voting thresholds, the U.K. imposes certain supermajority voting requirements for extraordinary transactions.[325] These perhaps echo of the unanimity requirements, described in Part IV, above, that were the dominant mechanism for addressing shareholder heterogeneity in earlier eras when shareholding was more concentrated.

Second, the U.K. polices shareholder intentions in a manner alien to United States jurisprudence. A vote by the majority is only permitted to bind the minority if "exercised . . . bona fide for the benefit of the company as a whole,"[326] a standard that has been interpreted to mean that shareholders must act reasonably and in good faith to advance the company's interests.[327] Because the actual intentions of shareholders may be impossible to determine, courts instead evaluate whether the action is "so oppressive as to cast suspicion on the honesty of the persons responsible for it, or so extravagant that no reasonable man could really consider it for the benefit of the company," an inquiry that has been likened to review of a jury verdict.[328]

Third, U.K. law explicitly addresses the problem of shareholder conflict in the context of "schemes of arrangement"—the U.K. equivalent of an acquisition by way of a shareholder vote. All such schemes must be submitted to judicial review before they can be finalized.[329] If the court concludes that "those [shareholders] voting in favor . . . have done so with a special interest to promote which differs from the interest of the ordinary independent and objective shareholder, then the vote . . . is not to be given effect . . ."[330] During this inquiry, courts are explicitly empowered to consider whether shareholders favoring the transaction hold other investments, including cross-holdings in the acquirer, that swayed their vote.[331]

The U.K. system thus balances greater shareholder control with greater state monitoring, which is the opposite of the direction in which Delaware law has trended. Still, should American shareholders continue to increase their power vis-a-vis managers, Delaware's approach may need to be revisited. At present, however, a retooled appraisal action may be sufficient to protect all shareholders, while allowing Delaware to maintain its hands-off approach to reviewing corporate decision-making.

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323. John Armour & David A. Skeel, Jr., *Who Writes the Rules for Hostile Takeovers, and Why?—The Peculiar Divergence of U.S. and U.K. Takeover Regulation*, 95 GEO. L.J. 1727, 1764 (2007).

324. Awrey, *supra* note 322, at 30–31. In the context of mergers, shareholders have a number of mandatory rights not present in the United States, including certain rights to force a sale of their shares to a controlling stockholder. *See* Jennifer Payne, *Schemes of Arrangement, Takeovers and Minority Shareholder Protection*, 11 J. CORP. L. STUD. 67, 83 (2011).

325. *See* Payne, *supra* note 324, at 77–79.

326. Allen v. Gold Reefs of West Africa Ltd [1900] 1 Ch 656.

327. Citco Banking Corp NV v. Pusser's Ltd [2007] UKPC 13 (PC).

328. F.G. Rixon, *Competing Interests and Conflicting Principles: An Examination of the Power of Alteration of Articles of Association*, 49 MOD. L. REV. 446, 458 (1986).

329. Payne, *supra* note 324, at 94.

330. Re BTR plc [2000] 1 BCLC 740, 747; *see also* Payne, *supra* note 324, at 94.

331. Re BTR, at 748.