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## CONTROLLER CONFUSION: REALIGNING CONTROLLING STOCKHOLDERS AND CONTROLLED BOARDS

Corporate law has long been concerned with issues of control. In few matters is this concern as salient as Delaware's<sup>1</sup> heightened standards of judicial review for matters involving two related concepts: a board of directors that is not independent (a "controlled board") and a stockholder with substantial stock and control (a "controlling stockholder"). While control pervades both circumstances, the analytical processes, implications, and outcomes remain distinct.

Regarding the first matter, directors owe a duty of loyalty to the corporation and its stockholders, which requires that a director act in good faith and in the best interest of the corporation and stockholders, rather than in the director's own interests or the interests of someone who the director is beholden to, controlled by, or otherwise dependent on.<sup>2</sup> Because certain contexts may incentivize a director to breach this duty — for example, a change in corporate control or policy that threatens the director's position, or a transaction involving a conflict of interest — a court may apply heightened scrutiny, including the exacting "entire fairness review."<sup>3</sup> One rationale for heightened review that Delaware courts can, and do, rely on is whether there is a controlled board — either by a third party or the directors' self-interest.

Another factor that can lead courts to apply enhanced judicial review is the presence of controlling stockholders — stockholders who hold the

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<sup>1</sup> Because Delaware is a leading domicile for corporations and "generally considered to have the most well-developed body of [corporate] law," this Note will focus on controlling stockholders under Delaware law. Scott V. Simpson & Katherine Brody, *The Evolving Role of Special Committees in M&A Transactions: Seeking Business Judgment Rule Protection in the Context of Controlling Shareholder Transactions and Other Corporate Transactions Involving Conflicts of Interest*, 69 BUS. LAW. 1117, 1118 n.2 (2014); see also *About the Division of Corporations*, DEL. DIVISION CORPS., <http://www.corp.delaware.gov/aboutagency> [<https://perma.cc/GUH2-CXJ5>] (stating that over 1,000,000 business entities and 66% of the Fortune 500 "have chosen Delaware as their legal home").

<sup>2</sup> See *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1345 (Del. 1987) ("[D]irectors must eschew any conflict between duty and self-interest."); *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939); see also DEL. CODE ANN. tit. 8, § 102(b)(7) (West 2019).

<sup>3</sup> See, e.g., *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983) ("The requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts."); *N.J. Carpenters Pension Fund v. infoGROUP, Inc.*, No. Civ.A 5334, 2011 WL 4825888, at \*8, \*11 (Del. Ch. Oct. 6, 2011) (applying entire fairness review to a transaction when a majority of the board lacked independence from an interested party); *In re Tyson Foods, Inc. Consol. S'holder Litig.*, 919 A.2d 563, 596 (Del. Ch. 2007) ("As the majority of the Tyson board can be considered interested at all relevant times, transactions not sterilized by independent review receive no protection from the business judgment rule, and plaintiffs must only allege that the transactions were in some way unfair to shift the burden upon the defendants to prove their entire fairness.").

majority of a company's vote<sup>4</sup> or exercise effective control over the company while holding a sufficient and often substantial nonmajority vote.<sup>5</sup> Such substantial voting power may render the other stockholder votes "mere formalities."<sup>6</sup> Because stockholder approval is required for "many of the most fundamental corporate changes" — including election of directors, amendments to certificates of incorporation, mergers, consolidations, sales of all or substantially all of a corporation's assets, and dissolutions — a stockholder with substantial voting power has tremendous influence.<sup>7</sup> Largely because of this influence, a controlling stockholder owes fiduciary duties much like a director, and courts often apply heightened scrutiny to transactions involving a controlling stockholder.<sup>8</sup>

Controller confusion — conflating minority controlling stockholders with controlled boards — underlies an ongoing doctrinal shift in Delaware law. While there is no bright-line rule for determining whether a minority stockholder is a controlling stockholder, the courts have historically emphasized the importance of significant voting power in evaluating controlling stockholder status. Yet, in recent years, a proliferation of Delaware cases has muddled the inquiry, de-emphasizing substantiality of share ownership and holding that stockholders with as little as 15% ownership and no effective voting power are controlling stockholders despite the presence of a controlled board.<sup>9</sup> This Note grapples with the doctrinal implications of conflating control doctrines, arguing that the courts should require control by virtue of stock ownership for controlling stockholder status and rely on the dependent board analysis when stock ownership is divorced from control.

This Note will proceed in three parts. Part I provides an overview of the controlling stockholder doctrine, including the rationale, fiduciary duties, and standards of review. Part II details the underlying case law,

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<sup>4</sup> *E.g.*, *Weinstein Enters., Inc. v. Orloff*, 870 A.2d 499, 507 (Del. 2005) ("[C]ontrol exists when a stockholder owns, directly or indirectly, more than half of a corporation's voting power."). While courts typically frame majority holders as controlling stockholders, it is possible for even a majority holder not to be a controlling stockholder if that individual does not exercise control over a particular matter or the board. *See, e.g.*, *Williams v. Geier*, 671 A.2d 1368, 1378 & n.22 (Del. 1996) (holding that a majority stockholder was not in control).

<sup>5</sup> *See, e.g.*, *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304, 307 (Del. 2015) (en banc). Controlling stockholders dominate the modern corporate landscape. *See* HOLGER SPAMANN, CORPORATIONS § 2, <https://opencasebook.org/casebooks/79342-corporations> [<https://perma.cc/4JJ7-PXYJ>] (noting that most corporations have a controlling stockholder); Jens Dammann, *The Controlling Shareholder's General Duty of Care: A Dogma that Should Be Abandoned*, 2015 U. ILL. L. REV. 479, 483; Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV. 1641, 1645–50 (2006).

<sup>6</sup> *Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 42 (Del. 1994).

<sup>7</sup> *Id.*; *see* DEL. CODE ANN. tit. 8, §§ 211, 242, 251–258, 263, 271, 275 (West 2020); *Weinstein Enters.*, 870 A.2d at 507.

<sup>8</sup> *See* *Pepper v. Litton*, 308 U.S. 295, 306 (1939).

<sup>9</sup> *See* *FrontFour Capital Grp. LLC v. Taube*, C.A. No. 2019-0100, 2019 WL 1313408, at \*21 (Del. Ch. Mar. 22, 2019).

noting the court's recent inconsistent application of the controlling stockholder inquiry and conflation of controlling stockholder status with controlled boards. This Part discusses the implications of the doctrinal shift, emphasizing the resulting uncertainty and inefficiency, and noting the increased likelihood of entire fairness review. Part III advances a doctrinal proposal, arguing that by redefining controlling stockholders to require control by virtue of stock ownership and modifying the board independence analysis to fill any enforcement gaps, courts can clarify a murky field, more logically align stockholder protections with controlled boards, and more adequately protect the company and its stockholders.

## I. AN OVERVIEW OF CONTROLLING STOCKHOLDER DOCTRINE

### A. *Defining and Justifying Controlling Stockholder Status*

Under Delaware law, a controlling stockholder is a stockholder who either (1) controls a majority of the company's voting power<sup>10</sup> or (2) exercises "a combination of potent voting power and management control such that the stockholder could be deemed to have effective control of the board without actually owning a majority of stock."<sup>11</sup> Typically the stockholder must have "actual domination and control" over the company, either generally or regarding the transaction at issue.<sup>12</sup> While the control element of this test is a fact-intensive inquiry that cannot be established by voting power alone, the courts are less clear on the requisite threshold — or indeed if there is a requisite threshold — of voting

<sup>10</sup> *E.g.*, *Weinstein Enters.*, 870 A.2d at 507.

<sup>11</sup> *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304, 307 (Del. 2015) (en banc) (footnote omitted). Unaffiliated stockholders may constitute a controlling stockholder group, regardless of whether or not they would individually constitute a controlling stockholder, if the stockholders execute an agreement that gives them voting power, demonstrate a history of cooperation and coordination, or are connected in another "legally significant way." *E.g.*, *Dubroff v. Wren Holdings, LLC*, C.A. Nos. 3940, 6017, 2011 WL 5137175, at \*7 (Del. Ch. Oct. 28, 2011) (quoting *Dubroff v. Wren Holdings, LLC*, C.A. No. 3940, 2009 WL 1478697, at \*3 (Del. Ch. May 22, 2009)); *see also Thorpe ex rel. Castleman v. CERBCO, Inc.*, 676 A.2d 436, 438 (Del. 1996); *In re Hansen Med., Inc. Stockholder Litig.*, C.A. No. 12316, 2018 WL 3025525, at \*8 (Del. Ch. June 18, 2018); *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 25–26 (Del. Ch. 2010).

<sup>12</sup> *In re Sea-Land Corp. S'holders Litig.*, Civ. A. No. 8453, 1988 WL 49126, at \*3 (Del. Ch. May 13, 1988); *see also, e.g.*, *Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1113–14 (Del. 1994); *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1344 (Del. 1987); *In re Tesla Motors, Inc. Stockholder Litig.*, C.A. No. 12711, 2018 WL 1560293, at \*13 (Del. Ch. Mar. 28, 2018) (stating that a controlling stockholder's domination and control may be "with respect to the challenged transaction" or "the board generally"); *In re Rouse Props., Inc.*, C.A. No. 12194, 2018 WL 1226015, at \*12 (Del. Ch. Mar. 9, 2018) (noting that control may be inferred); *Superior Vision Servs., Inc. v. ReliaStar Life Ins. Co.*, No. Civ.A. 1668-N, 2006 WL 2521426, at \*4 (Del. Ch. Aug. 25, 2006).

power.<sup>13</sup> Nevertheless, courts frequently indicate that some substantial degree of voting power is necessary.<sup>14</sup>

Courts distinguish controlling stockholders from noncontrolling stockholders primarily because controlling stockholders may have idiosyncratic goals beyond maximizing company returns and the ability to act in self-interest to achieve these goals, often to the detriment of noncontrolling stockholders.<sup>15</sup> Three categories of conflicted behavior may be particularly noteworthy: (1) a transfer-pricing scheme in which the controlling stockholder uses artificially inflated or deflated prices to shift value from one company to another while capturing the difference; (2) a company issuance of new shares to the controlling stockholder or to an entity owned by the controlling stockholder at low prices; and (3) asset stripping, wherein the controlling stockholder sells the company's assets to another company owned by the controlling stockholder at a low price, or the opposite, in which the controlling stockholder forces the company to buy from another company owned by the stockholder at an inflated price.<sup>16</sup> Because a controlling stockholder's "power is difficult to check,"<sup>17</sup> directors may fear the loss of their board seats or other benefits if they do not comply with the controlling stockholder's wishes.<sup>18</sup> Thus, the controlling stockholder's substantial voting power, and the ability that power brings to influence company and board actions, is a primary rationale underlying the controlling stockholder doctrine.

### B. Implications of Controlling Stockholder Status

When a controlling stockholder is involved in a transaction, there are two primary consequences: imposition of fiduciary duties and en-

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<sup>13</sup> See, e.g., *Kahn*, 638 A.2d at 1114–15; *Citron v. Fairchild Camera & Instrument Corp.*, 569 A.2d 53, 70 (Del. 1989); see also Grant M. Hayden & Matthew T. Bodie, *One Share, One Vote and the False Promise of Shareholder Homogeneity*, 30 CARDOZO L. REV. 445, 474 n.128 (2008).

<sup>14</sup> See, e.g., *In re Crimson Expl. Inc. Stockholder Litig.*, Civil Action No 8541, 2014 WL 5449419, at \*10 (Del. Ch. Oct. 24, 2014).

<sup>15</sup> See Yu-Hsin Lin, *Controlling Controlling-Minority Shareholders: Corporate Governance and Leveraged Corporate Control*, 2017 COLUM. BUS. L. REV. 453, 483; Ann M. Lipton, *After Corwin: Down the Controlling Shareholder Rabbit Hole*, 72 VAND. L. REV. 1977, 1979 (2019).

<sup>16</sup> See SPAMANN, *supra* note 5, § 2.2.1. See generally Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785, 786–87 (2003) (noting the primary ways a controlling stockholder may extract private benefits).

<sup>17</sup> Daniel Wilson, *Desirable Resistance: Kahn v. M&F Worldwide and the Fight for the Business Judgment Rule in Going-Private Mergers*, 17 U. PA. J. BUS. L. 643, 643 (2015).

<sup>18</sup> Lipton, *supra* note 15, at 1981–82; see Lucian A. Bebchuk & Assaf Hamdani, *Independent Directors and Controlling Shareholders*, 165 U. PA. L. REV. 1271, 1274 (2017); see also Leo E. Strine, Jr., *The Inescapably Empirical Foundation of the Common Law of Corporations*, 27 DEL. J. CORP. L. 499, 509 (2002) (analogizing controlling stockholders to "an 800-pound gorilla [that] wants the rest of the bananas" and independent directors to "little chimpanzees" who "cannot be expected to stand in the way"); cf. *In re Pure Res., Inc., S'holders Litig.*, 808 A.2d 421, 436 (Del. Ch. 2002) (similar).

hanced transaction scrutiny. Under Delaware law, stockholders typically do not owe fiduciary duties.<sup>19</sup> However, because a controlling stockholder effectively controls the company,<sup>20</sup> a controlling stockholder assumes fiduciary duties similar to those of a director on the board.<sup>21</sup> The most notable of the fiduciary duties imposed on controlling stockholders is the duty of loyalty. A duty of loyalty requires a controlling stockholder act in the best interests of the company and its stockholders, not in the controlling stockholder's self-interest to the detriment of the company or other stockholders.<sup>22</sup> A controlling stockholder may also owe fiduciary duties of disclosure and care.<sup>23</sup> *Lynch v. Vickers Energy Corp.*<sup>24</sup> is the primary duty of disclosure case, wherein the court found that a controlling stockholder violated the duty to disclose material facts by not revealing asset value estimates despite initiating a tender offer for a price that undervalued the assets.<sup>25</sup> In general, the duty of care is the duty to make informed business decisions,<sup>26</sup> although this duty may be tenuous at best when compared to the duty of loyalty.<sup>27</sup>

Additionally, transactions involving controlling stockholders are generally subject to entire fairness, Delaware's most onerous standard of review, rather than the default business judgment rule. When the business judgment rule applies, courts generally presume that directors act in the best interest of the corporation and will not second-guess the judgment of the board.<sup>28</sup> Because of this deference, "dismissal is typically

<sup>19</sup> See Lipton, *supra* note 15, at 2004-05; see also *S. Pac. Co. v. Bogert*, 250 U.S. 483, 487-88 (1919) (noting that the majority occupies a fiduciary relation when it exercises control).

<sup>20</sup> See *supra* notes 4-8 and accompanying text.

<sup>21</sup> Dammann, *supra* note 5, at 481-82; see also *Zahn v. Transamerica Corp.*, 162 F.2d 36, 42-43 (3d Cir. 1947) (finding a controlling stockholder's fiduciary status "unmistakable," *id.* at 42); *Citron v. Fairchild Camera & Instrument Corp.*, 569 A.2d 53, 70 (Del. 1989); *Aronson v. Lewis*, 473 A.2d 805, 815 (Del. 1984) ("There must be coupled with the allegation of control such facts as would demonstrate that through personal or other relationships the directors are beholden to the controlling person."); *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 719-23 (Del. 1971).

<sup>22</sup> See SPAMANN, *supra* note 5, at § 2.2.1.

<sup>23</sup> *Cinerama, Inc. v. Technicolor, Inc.*, Civ. A. No. 8358, 1991 WL 111134 (Del. Ch. June 24, 1991), *aff'd in part, rev'd in part on other grounds sub nom. Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345 (Del. 1993); Dammann, *supra* note 5, at 480.

<sup>24</sup> 383 A.2d 278 (Del. 1977).

<sup>25</sup> *Id.* at 279, 282.

<sup>26</sup> See *Smith v. Van Gorkom*, 488 A.2d 858, 873 (Del. 1985).

<sup>27</sup> See Dammann, *supra* note 5, at 496 (noting that while courts "have explicitly recognized a general duty of care," there has not been "a single case in which a controlling [stock]holder was actually found liable for a mere violation of his general duty of care"); see also *Abraham v. Emerson Radio Corp.*, 901 A.2d 751, 759 (Del. Ch. 2006) ("I am dubious that our common law of corporations should recognize a duty of care-based claim against a controlling stockholder . . ."). Some scholars argue that this duty of care is a mere "doctrinal misstep." Dammann, *supra* note 5, at 481 (arguing that courts should reject a general duty of care because controlling stockholders have "strong financial incentives to make informed decisions in the best interest of their corporations").

<sup>28</sup> See *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984); *Zapata Corp. v. Maldonado*, 430 A.2d 779, 782 (Del. 1981); Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*,

the result.”<sup>29</sup> In contrast, entire fairness review is an exacting standard, requiring fair price (economic and financial considerations) and fair dealing (timing, structure, negotiations, disclosures, processes, and consents).<sup>30</sup> Under entire fairness review, a court that would otherwise defer to the business judgment of the board could instead find a transaction lacking in fair price or fair dealing, and thus void the transaction entirely.<sup>31</sup> Granted, it is possible to shift the burden of proving entire fairness from the defendant to the plaintiff if a transaction is subject to the approval of an effective special committee of independent directors or the approval of the noncontrolling stockholders in a fully informed, uncoerced vote.<sup>32</sup> Furthermore, when a transaction is subject to both conditions *ab initio* the court may review the transaction under the business judgment rule.<sup>33</sup> Nevertheless, absent such protections a conflicted controlling stockholder brings heightened transaction scrutiny that can be outcome determinative.<sup>34</sup>

A controlling stockholder’s existence also implicates the company’s ability to cleanse a director’s breach of fiduciary duty. While ordinarily courts review interested transactions under entire fairness, corporations may avoid this onerous review if a board properly cleanses the transaction.<sup>35</sup> In *Corwin v. KKR Financial Holdings*,<sup>36</sup> the Delaware Supreme Court held that, unless a controlling stockholder is involved, the disinterested stockholders can “cleanse” a director’s breach of fiduciary duty, which generally results in a more deferential standard of review.<sup>37</sup> As scholars note, such deference “potentially insulates a great variety of . . . transactions that would otherwise merit closer judicial scrutiny.”<sup>38</sup> Accordingly, *Corwin*, in conjunction with other Delaware case law, “has

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57 VAND. L. REV. 83, 88–89 (2004); *cf.* DEL. CODE ANN. tit. 8, § 141(a) (West 2020) (“The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . .”).

<sup>29</sup> Singh v. Attenborough, 137 A.3d 151, 152 (Del. 2016).

<sup>30</sup> Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983).

<sup>31</sup> See Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1279–80 (Del. 1988).

<sup>32</sup> Kahn v. M & F Worldwide Corp., 88 A.3d 635, 642 (Del. 2014).

<sup>33</sup> *Id.* at 644; see also Flood v. Synutra Int’l, Inc., 195 A.3d 754, 762 (Del. 2018) (en banc) (finding that *ab initio* means “before any substantive economic negotiations”); Recent Case, Flood v. Synutra International, Inc., 195 A.3d 754 (Del. 2018), 132 HARV. L. REV. 2386 (2019) (critiquing the court’s threshold in *Synutra* as vague and contrary to the holding of the case).

<sup>34</sup> See AC Acquisitions v. Anderson, Clayton & Co., 519 A.2d 103, 111 (Del. Ch. 1986) (“Because the effect of the proper invocation of the business judgment rule is so powerful and the standard of entire fairness so exacting, the determination of the appropriate standard of judicial review frequently is determinative of the outcome . . .”).

<sup>35</sup> Lipton, *supra* note 15, at 1981.

<sup>36</sup> 125 A.3d 304 (Del. 2015) (en banc).

<sup>37</sup> See *id.* at 311–13.

<sup>38</sup> Lipton, *supra* note 15, at 1984.

widened the gulf between transactions that involve a controlling shareholder and those that do not.”<sup>39</sup> Thus, controlling stockholder status remains significant, both for the individual in acquiring fiduciary duties and for the board that may find its decisions subject to heightened scrutiny and difficult to cleanse.

## II. EVALUATING CONTROLLING STOCKHOLDER STATUS

As Delaware has developed its controlling stockholder doctrine, it has produced pronounced analytical inconsistencies and varied treatment of the significance of substantial stock ownership. The courts have traditionally referred to the amount of stock required for controlling stockholder status as substantial. Yet, in a line of recent decisions, the courts have de-emphasized the substantiality requirement or declined to engage in an analysis of substantiality at all, without explicitly acknowledging an intent to alter the controlling stockholder doctrine. The result is an increasing state of uncertainty with far-reaching implications.

### A. *Cysive and Its Progeny*

Guidance for controlling stockholder doctrine can largely be traced back to *In re Cysive, Inc. Shareholders Litigation*,<sup>40</sup> in which the Court of Chancery held that a 35% stockholder was a controlling stockholder, and emphasized that “[i]n practical terms, [the stockholder held] a large enough block of stock to be the dominant force in any contested . . . election.”<sup>41</sup> The court noted that “a 100% turn-out is unlikely,”<sup>42</sup> and that the controlling stockholder’s voting power must be significant enough to make that stockholder dominant even “without having to attract much, if any, support from public stockholders.”<sup>43</sup> Over the next decade, the court would repeatedly recognize this decision as perhaps “its most aggressive finding” of a minority controlling stockholder.<sup>44</sup>

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<sup>39</sup> *Id.* at 1986–87 (discussing *C&J Energy Servs., Inc. v. City of Miami Gen. Emps.’ and Sanitation Emps.’ Ret. Trust*, 107 A.3d 1049 (Del. 2014) and *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635 (Del. 2014)).

<sup>40</sup> 836 A.2d 531 (Del. Ch. 2003).

<sup>41</sup> *Id.* at 551–52; *see id.* at 535, 551–52.

<sup>42</sup> *Id.* at 552 n.30. In part because not all stockholders will engage in each vote, majority ownership is not necessary to control a company through electing the board, particularly when one group holds a large block of stock and the remaining stock is “widely scattered.” *Gottesman v. Gen. Motors Corp.*, 279 F. Supp. 361, 368 (S.D.N.Y. 1967) (“This is called practical or working control.”); *see Kahn v. Lynch Commc’n Sys., Inc.*, 638 A.2d 1110, 1114–15 (Del. 1994). Furthermore, employees who receive stock as part of their compensation may be particularly inclined to support a controlling stockholder as a familiar party, favoring stability and consistency in governance.

<sup>43</sup> *In re Cysive*, 836 A.2d at 552.

<sup>44</sup> *In re Morton’s Rest. Grp., Inc. S’holders Litig.*, 74 A.3d 656, 665 (Del. Ch. 2013); *see Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304, 307 & n.8 (Del. 2015) (en banc).

Following *Cysive*, the Delaware courts have continued to emphasize that substantial voting power is necessary for controlling stockholder status. Over the following years, the Delaware Court of Chancery frequently underscored the importance of the controlling stockholder's voting power, describing the necessary amount as "significant" in nature.<sup>45</sup> On multiple occasions the court stressed the need for minority stockholders to "have such formidable voting and managerial power that they, as a practical matter, are no differently situated than if they had majority voting control."<sup>46</sup> The Delaware Supreme Court has also addressed minority controlling stockholders' voting power, most recently holding that "the Court of Chancery, consistent with the instructions of this Court, looked for a combination of potent voting power and management control such that the stockholder could be deemed to have effective control of the board without actually owning a majority of stock."<sup>47</sup> Given this backdrop, it is reasonable to infer that courts, practitioners, and transaction planners relied on the necessity of some substantial degree of stock ownership to qualify a stockholder as a controlling stockholder.

### B. Recent Developments Shifting the Focus

Yet, particularly in the past few years, the Delaware Court of Chancery has eroded the importance it once placed on the individual having a "formidable" or "significant" voting power.<sup>48</sup> This series of recent cases conflates controlling stockholder status with controlled boards or declines to engage in the controlling stockholder analysis at all. In these decisions ownership seems merely incidental, and the ability to control or dominate the board is not by virtue of the shares one holds, but rather through external factors independent from stockholder status. While there may be a valid inquiry into whether ownership as low as 15% is substantial enough to trigger controlling stockholder status, in these cases the court failed to engage in a meaningful analysis and may have unnecessarily relied on controlling stockholder status when other less controversial circumstances warranted entire fairness review. The recent case *In re Tesla Motors, Inc. Stockholder Litigation*<sup>49</sup> provides one illustrative example of the difficulty of navigating the line

<sup>45</sup> *Superior Vision Servs., Inc. v. ReliaStar Life Ins. Co.*, No. Civ.A. 1668-N, 2006 WL 2521426, at \*4 (Del. Ch. Aug. 25, 2006).

<sup>46</sup> *In re PNB Holding Co. S'holders Litig.*, No. Civ.A. 28-N, 2006 WL 2403999, at \*9 (Del. Ch. Aug. 18, 2006); see, e.g., *In re Rouse Props., Inc.*, C.A. No. 12194, 2018 WL 1226015, at \*11 (Del. Ch. Mar. 9, 2018); *Morton's*, 74 A.3d at 664-65.

<sup>47</sup> *Corwin*, 125 A.3d at 307 (footnote omitted).

<sup>48</sup> While the court has not explicitly indicated an intent to change the controlling stockholder doctrine and depart from *Cysive* as an "aggressive" finding, the increasing complexity of transactions may be partly to blame. See Lipton, *supra* note 15, at 1980.

<sup>49</sup> C.A. No. 12711, 2018 WL 1560293 (Del. Ch. Mar. 28, 2018).

between controlling-stockholder transactions and control-related transactions more generally.

In 2018, Tesla stockholders challenged Tesla's acquisition of SolarCity.<sup>50</sup> Elon Musk served as the head of both companies, and several Tesla directors had relationships with SolarCity.<sup>51</sup> Because the transaction was conditioned on the affirmative vote of the majority of Tesla's disinterested stockholders, *Corwin*, which applies only absent a controlling stockholder, would ordinarily "cleanse" the transaction and result in the deferential business judgment rule.<sup>52</sup> Perhaps in an effort to circumvent such deferential review, the court ultimately held that, despite CEO Musk holding only 22% of Tesla's outstanding voting power, "it is reasonably conceivable that Musk, as a controlling stockholder, controlled the Tesla Board in connection with the [a]cquisition."<sup>53</sup> Musk's status as a controlling stockholder precluded *Corwin*, and because the transaction was not conditioned on the additional protection of an independent special committee, the transaction was thus subject to entire fairness review.<sup>54</sup>

While the court acknowledged that Musk's ownership stake was "relatively low," it rejected the defendants' argument that the difference between Musk's 22% stake and actual voting control was too great for Musk to constitute a controlling stockholder.<sup>55</sup> Instead, the court held that the focus is "on the *de facto* power of a significant (but less than majority) shareholder, which, when coupled with other factors, gives that shareholder the ability to dominate the corporate decision-making process."<sup>56</sup> The court chose to focus on control elements that are divorced from voting power, including Musk's influence within the company, which could enable him to dominate the board's decisionmaking and gather stockholder support, and the lack of independence of the other directors.<sup>57</sup> As examples, the court noted Musk's role in designing

<sup>50</sup> See *id.* at \*1.

<sup>51</sup> See *id.* at \*2-4, \*17.

<sup>52</sup> See *id.* at \*1 & n.1. For a discussion of structural coercion and whether *Corwin* would indeed apply in such cases, see *infra* notes 115-20 and accompanying text.

<sup>53</sup> *In re Tesla*, 2018 WL 1560293, at \*1 (emphasis added); see *id.* at \*2. This case would not be the first to consider controlling stockholder status at a low percentage of stock ownership. See, e.g., *In re Zhongpin Inc. Stockholders Litig.*, C.A. No. 7393, 2014 WL 6735457, at \*7-9 (Del. Ch. Nov. 26, 2014), *rev'd on other grounds sub nom. In re Cornerstone Therapeutics Inc., Stockholder Litig.*, 115 A.3d 1173 (Del. 2015).

<sup>54</sup> *In re Tesla*, 2018 WL 1560293, at \*12. In controlling stockholder transactions, generally the transaction must be conditioned on both the affirmative vote of the disinterested stockholders and an independent special committee to shift the standard of review to the business judgment rule. See *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635, 645 (Del. 2014).

<sup>55</sup> *In re Tesla*, 2018 WL 1560293, at \*14 (quoting Defendants' Opening Brief in Support of Motion to Dismiss the Second Amended Complaint at 15, *In re Tesla*, C.A. No. 12711); see also *id.* at \*19-20 (denying the defendants' motion to dismiss on this reasoning).

<sup>56</sup> *Id.* at \*14 (emphasis omitted) (quoting *Superior Vision Servs., Inc. v. ReliaStar Life Ins. Co.*, No. Civ.A. 1668-N, 2006 WL 2521426, at \*4 (Del. Ch. Aug. 25, 2006)).

<sup>57</sup> See *id.* at \*15-19.

all Tesla products, and his significant and active recruiting of executives and engineers, raising capital for Tesla, and bringing investors to the company.<sup>58</sup> The court also found noteworthy Tesla's SEC filing, which stated that Tesla is "highly dependent on the services of Elon Musk."<sup>59</sup> Yet these are elements that are separable from stock ownership. If Musk were to sell all his stock, he would still hold the same de facto control as an executive and the face of the company. Accordingly, the key issue in *Tesla* seems to be a board that is not truly independent — a controlled board — not necessarily a controlling *stockholder*. But *Tesla* is only one of several recent examples of the court disregarding substantiality of shares, de-emphasizing the importance of a causal relationship between stock and control, and conflating controlling stockholder doctrine with problematic behavior.

In another 2018 case, this time involving Oracle's acquisition of NetSuite, the court appeared to assume — without explicitly stating — that Larry Ellison, a 28% stockholder, was a controlling stockholder of Oracle due substantially to his influence and the deference shown to him.<sup>60</sup> The facts of *In re Oracle Corp. Derivative Litigation*<sup>61</sup> are similar to those of *Tesla*. Ellison was a cofounder and executive of Oracle, and cofounder and 45% owner of NetSuite.<sup>62</sup> The court focused on elements divorced from stock ownership such as directors' business affiliations, "lucrative" director fees that would be at risk if directors sued Ellison, statements from directors about Ellison's control of the directors and organization, and other factors that indicated a lack of director independence.<sup>63</sup> Even though the court based its decision on the lack of impartiality of the majority of the Oracle's board,<sup>64</sup> the court's passing assumption that Ellison was a controlling stockholder — without any analysis of controlling stockholder status — remains problematic. *Oracle* would not be the last decision to state that a minority stockholder is a controlling stockholder without considering substantiality of voting power.<sup>65</sup>

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<sup>58</sup> *Id.* at \*2, \*5.

<sup>59</sup> *Id.* at \*2 (quoting Second Amended Verified Class Action and Derivative Complaint at 7, *In re Tesla*, C.A. No. 12711).

<sup>60</sup> See *In re Oracle Corp. Derivative Litig.*, C.A. No. 2017-0337, 2018 WL 1381331, at \*16 (Del. Ch. Mar. 19, 2018).

<sup>61</sup> C.A. No. 2017-0337, 2018 WL 1381331.

<sup>62</sup> *Id.* at \*2, \*4.

<sup>63</sup> *Id.* at \*17; see *id.* at \*17–19.

<sup>64</sup> *Id.* at \*16.

<sup>65</sup> See, e.g., *Basho Techs. Holdco B, LLC v. Georgetown Basho Inv'rs, LLC*, C.A. No. 11802, 2018 WL 3326693, at \*25–35 (Del. Ch. July 6, 2018) (assuming controlling stockholder status without stating the voting power of the alleged controlling stockholder). Like its predecessors, *Basho* reflects the court conflating other elements, such as unfair wielding of contractual rights, with controlling stockholder status. See *id.* at \*29–31.

Most recently, in *FrontFour Capital Group LLC v. Taube*<sup>66</sup> the Delaware Court of Chancery held that two brothers were controlling stockholders despite jointly owning less than 15% of the company.<sup>67</sup> Even more noteworthy, the alleged controlling stockholders were subject to “echo voting” requirements, which mandated that they vote their shares proportionately with the other stockholders.<sup>68</sup> Yet the court did not address whether the stockholders held substantial stock, or discuss the impact of echo voting restrictions, despite existing precedent emphasizing that restrictions on stockholder power are noteworthy factors in determining controlling stockholder status.<sup>69</sup>

These cases, culminating with *FrontFour*, take the court to the precarious edge of what constitutes a “significant” but nonmajority stockholder or whether significance even matters in the inquiry. By conflating control-related behavior with controlling stockholder status and assuming controlling stockholder status without engaging in substantive analysis, the court has unnecessarily expanded the definition of controlling stockholder.<sup>70</sup> If the court is concerned about problematic behavior, it often has other vehicles, including lack of board independence, inadequate disclosures, or insufficient ratification, to achieve a more stringent review.<sup>71</sup>

### III. RAMIFICATIONS OF THE DOCTRINAL SHIFT

This doctrinal ambiguity lends itself to problematic overapplication of entire fairness review that falls short of protecting stockholders from control-ridden transactions. As a result of this shifting doctrine, transaction planners and investors face heightened uncertainty that discourages substantial investment, skews bargaining power, and obfuscates changes in control. Stockholders and transaction planners can mitigate

<sup>66</sup> C.A. No. 2019-0100, 2019 WL 1313408 (Del. Ch. Mar. 22, 2019).

<sup>67</sup> *Id.* at \*5 & n.31, \*21–22. One could argue that the corporate structures, which included management corporations, were so closely related that practically speaking the alleged controlling stockholders “owned” more than 15% of the company, *see id.* at \*5 n.30. However, the court did not explicitly rely on such reasoning. *Id.* at \*21–22.

<sup>68</sup> *See id.* at \*21 (mentioning echo voting, for the first and only time, merely in passing). Echo voting, also known as shadow voting or mirror voting, is when certain votes are cast proportionately to reflect the other votes. *Mirror Voting*, FARLEX FIN. DICTIONARY, <https://financial-dictionary.thefreedictionary.com/Mirror+voting> [<https://perma.cc/ZZJ2-SHY2>].

<sup>69</sup> *See, e.g.,* *Sciabacucchi v. Liberty Broadband Corp.*, C.A. No. 11418, 2017 WL 2352152, at \*17–18 (Del. Ch. May 31, 2017) (discussing an agreement preventing the 26% stockholder from acquiring over 35%, designating more than 40% of the directors, or soliciting proxies or contests).

<sup>70</sup> This conflation of bad behavior with controlling stockholder status is not universal, however. *See, e.g., id.* at \*3–4, \*7, \*17, \*20–23 (distinguishing controlling stockholder status from board independence). It is possible that recent decisions like *Tesla* and *Oracle* are simply exceptional cases, involving highly entangled founders and CEOs, and particularly deferential boards.

<sup>71</sup> *See* DEL. CODE ANN. tit. 8, § 144(a) (West 2020); *Williams v. Geier*, 671 A.2d 1368, 1382–83 (Del. 1996) (noting that approval can be structurally coerced); *infra* section IV.B, pp. 1725–27.

these harms, but the ability to bring a derailed doctrine back on track ultimately lies with the courts.

*A. Entire Fairness Review and Stockholder Protections*

Doctrinal ambiguity in conjunction with the diminishing importance of stockholder voting power may problematically enable control alone to carry the burden in warranting entire fairness review in controlling stockholder transactions. As one scholar notes, “if control were sufficient to invoke the fairness test, courts would be extremely busy reviewing the fairness of a multitude of transactions” and “basic business decisions.”<sup>72</sup> Expansion of entire fairness review is contrary to recognition of the democratic process by which stockholders elect the board to run the company, makes it more difficult to attract qualified company directors, and discourages beneficial risk-taking in corporate management. Given the onerous nature of entire fairness, it is both inefficient and costly.<sup>73</sup> Additionally, courts and scholars have long recognized that boards are better equipped to analyze business transactions.<sup>74</sup> The courts have repeatedly noted that this policy rationale underlies the business judgment rule and the courts’ reluctance to second-guess the judgment of the board.<sup>75</sup> And the decision to apply entire fairness rather than the business judgment rule can also be outcome determinative.<sup>76</sup>

Additionally, some scholars have argued that reliance on controlling stockholder status (rather than director status) may actually impose slightly different fiduciary duties, which is problematic because not all

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<sup>72</sup> Mary Siegel, *The Erosion of the Law of Controlling Shareholders*, 24 DEL. J. CORP. L. 27, 30 (1999); see *id.* at 31 n.18 (noting “the extremely vague and open-ended nature of the fairness standard” (quoting MICHAEL P. DOOLEY, FUNDAMENTALS OF CORPORATION LAW 610 (1995))).

<sup>73</sup> *Id.* at 72.

<sup>74</sup> See *Beard v. Elster*, 160 A.2d 731, 738 (Del. 1960) (“[W]e are precluded from substituting our uninformed opinion for that of experienced business managers of a corporation . . . .”); *Reading Co. v. Trailer Train Co.*, No. 7422, 1984 WL 8212, at \*4 (Del. Ch. Mar. 15, 1984) (“[C]ourts should be loathe to interfere with the internal management of corporations or to interfere with their business decisions unless statutory or case law indicates they have overstepped their bounds.”).

<sup>75</sup> See, e.g., *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304, 306 (Del. 2015) (en banc) (“For sound policy reasons, Delaware corporate law has long been reluctant to second-guess the judgment of a disinterested stockholder majority . . . .”); *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) (“The business judgment rule is an acknowledgment of the managerial prerogatives of Delaware directors under Section 141(a).”); *id.* at 811 (“A cardinal precept of the General Corporation Law of the State of Delaware is that directors . . . manage the business and affairs of the corporation.”); *Gries Sports Enters., Inc. v. Cleveland Browns Football Co.*, 496 N.E.2d 959, 963 (Ohio 1986) (explaining the presumption that the board is “better equipped than the courts to make business judgments”); *id.* at 964 (noting that the directors’ judgment “will be respected by the courts”). The General Corporation Law of Delaware states that “[t]he business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided.” DEL. CODE ANN. tit. 8, § 141(a).

<sup>76</sup> See *supra* p. 1712; see also *Nixon v. Blackwell*, 626 A.2d 1366, 1376 (Del. 1993).

fiduciary duties are created equal. In part because the threat that controlling stockholders pose is distinct from that posed by directors, “Delaware courts have long acknowledged that the duty of loyalty imposed on controlling shareholders is a very different constraint from the duty of loyalty imposed on corporate directors.”<sup>77</sup> For example, courts impose “more stringent” requirements on transactions involving controlling stockholders than those involving only corporate directors,<sup>78</sup> requiring that the transaction be conditioned on approval by an independent, special committee *and* a majority of the minority stockholders to receive the business judgment rule.<sup>79</sup> To the extent that the fiduciary duties differ between controlling stockholders and directors, reliance on controlling stockholder status rather than director status may result in differing obligations owed to the stockholders.

Furthermore, by relying on controlling stockholder doctrine in lieu of developing other control-related doctrine, the court may fall short in protecting stockholders by leaving open the risk that an individual exerting control over the stockholders, board, or transaction (a “controller”) with little or no stock will nevertheless exercise problematic behavior that a court may be unable to adequately scrutinize. Practically speaking, unless the court reaches a determination that an individual is a controlling stockholder or that the board was dependent, a controller is largely free to exert control.<sup>80</sup> This gap in protection from controllers means that companies and stockholders may be at risk from precisely those who lack strong financial incentives to behave in their interests.<sup>81</sup>

### B. Investor and Transaction Planner Uncertainty

With heightened uncertainty and the risk of ownership as low as 15% constituting controlling stockholder status, a reasonable investor may be incentivized to invest at a lower level. Breaching a fiduciary duty can result in serious consequences, including heightened standards

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<sup>77</sup> Dammann, *supra* note 5, at 504 (citing *Cinerama, Inc. v. Technicolor, Inc.*, Civ. A. No. 8358, 1991 WL 111134, at \*19 (Del. Ch. June 24, 1991), *aff’d in part, rev’d in part on other grounds sub nom. Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345 (Del. 1993)).

<sup>78</sup> *Id.* at 505 (noting that, absent a controlling stockholder, “independent director approval and shareholder approval are *alternative* ways of shielding the transactions”).

<sup>79</sup> *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635, 644 (Del. 2014).

<sup>80</sup> Colloquially, “controller” is sometimes used as shorthand for “controlling stockholder.” Other times, a “controller” is simply an individual exercising control over another or over the board. Generally, the courts impose duties and heightened scrutiny on the former but not the latter. This linguistic ambiguity may contribute to doctrinal uncertainty under existing law. For the purposes of this Note, “controller” refers more broadly to an individual (stockholder or nonstockholder) exerting control over the company, board, or challenged transaction.

<sup>81</sup> See Dammann, *supra* note 5, at 504–05 (relying on the assumption that, largely because of the economic interests given substantial stock ownership, controlling stockholders have financial incentives that reduce the need for a general duty of care).

of review, altered transaction outcomes, and monetary liability.<sup>82</sup> Given the severity of these consequences, it is reasonable for strategic investors to carefully consider the risk of acquiring controlling stockholder status. But with these latest rulings, investors previously relying on stock ownership to provide a guideline for controlling stockholder status will need to rethink their prior investments and exercise greater caution in investing going forward to minimize the risk of obtaining such status.

The uncertainty also skews bargaining power by pressuring transaction planners to unnecessarily include conditions that benefit one side. Companies have long since illustrated their reluctance to seek minority stockholder approvals absent the incentive of a more deferential standard of review, given “the leverage such a vote bestows.”<sup>83</sup> Originally, under *Kahn v. Lynch Communication Systems, Inc.*,<sup>84</sup> the Delaware Supreme Court permitted shifting the burden of proof for controlling stockholder transactions if the transaction was approved by either “an independent committee of directors *or* an informed majority of minority shareholders.”<sup>85</sup> When left with this choice, companies remained reluctant to seek minority stockholder approval,<sup>86</sup> and thus the court would later add the incentive of a more deferential standard of review when both conditions were included.<sup>87</sup> If a transaction does not involve a controlling stockholder, then transaction planners are unlikely to condition the transaction on minority approval, while when a transaction does involve a controlling stockholder, planners often include such approval conditions to receive more deferential review. Thus, when faced with heightened uncertainty on whether a transaction involves a controlling stockholder, risk-averse transaction planners seeking business judgment review will likely be incentivized to include both conditions,<sup>88</sup>

<sup>82</sup> See, e.g., DEL. CODE ANN. tit. 8, § 102(b)(7) (West 2020); *Basho Techs. Holdco B, LLC v. Georgetown Basho Inv'rs, LLC*, C.A. No. 11802, 2018 WL 3326693, at \*22 (Del. Ch. July 6, 2018) (“A claim for breach of fiduciary duty is an equitable tort.”).

<sup>83</sup> Robert S. Reder, *Chancery Court Again Grants Early Dismissal of Litigation Challenging Control Stockholder-Led Buyout*, 72 VAND. L. REV. EN BANC 11, 12 (2018); see also Guhan Subramanian, *Fixing Freezeouts*, 115 YALE L.J. 2, 11, 16–17 (2005).

<sup>84</sup> 638 A.2d 1110 (Del. 1994).

<sup>85</sup> *Id.* at 1117 (emphasis added); see Wilson, *supra* note 17, at 655–56.

<sup>86</sup> Subramanian, *supra* note 83, at 16–17 (noting that, because of the option, “controllers have no further incentive to provide a [majority-of-the-minority] condition”).

<sup>87</sup> See *In re MFW S'holders Litig.*, 67 A.3d 496, 535 (Del. Ch. 2013); Lyman Johnson, *Unsettledness in Delaware Corporate Law: Business Judgment Rule, Corporate Purpose*, 38 DEL. J. CORP. L. 405, 410–23 (2013). Shortly after, the court would affirm these conditions as part of a multifactor test. See *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635, 645 (Del. 2014).

<sup>88</sup> However, Delaware law encourages protection of minority stockholders, and courts could view such actions as simply new best practices. See *Kahn*, 88 A.3d at 643 (“[T]he common law equitable rule that best protects minority investors is one that encourages controlling stockholders to accord the minority both procedural protections.”); *cf.* *Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd*, 177 A.3d 1, 37 (Del. 2017) (endorsing certain techniques partly because they encourage best practices). One could argue, though, that if the court is concerned with protecting

despite the resulting leverage inequities, even when the transaction may be subject to business judgment review absent the approvals.

Transaction planners also face greater uncertainty in assessing whether a transaction results in a change of control, an event that both is priced into a transaction and influences whether transaction planners continue to pursue a transaction at all. A controlling stockholder's involvement in a company, such as when a merger results in a corporation having a controlling stockholder, can constitute a "change of control" or "sale of control."<sup>89</sup> In this context, directors are "charged with getting the best price for the stockholders at a sale of the company."<sup>90</sup> Furthermore, many contractual agreements, such as employment contracts for executives, may also include a change-of-control provision granting third parties the right to receive payments or terminate the agreement in the event of a change in control.<sup>91</sup> Debt instruments may also contain "poison puts" that allow debtholders to sell their bonds back to the issuing corporation at a predetermined price in the event of a change of control.<sup>92</sup> Even if these contracts and instruments define change of control, the gulf between contractual definitions and the courts' interpretation more broadly may widen. These consequences — from director obligations to potential loss of lucrative contracts — are just a few of the reasons why uncertainty in controlling stockholder doctrine is problematic for transaction planners.

Until the courts revise the doctrinal inquiry for controlling stockholders, transaction planners should carefully evaluate whether a minority stockholder with even an insubstantial voting stake could be at risk for controlling stockholder status. Stockholders can take several actions to reduce the risk of being designated a controlling stockholder: (1) minimize share ownership and exercise great caution if holding over 15%; (2) avoid involvement with the company's board, management, or

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minority stockholders, it should not rely on a murky doctrine that provides enhanced protections only to transactions involving risk-averse transaction planners and stockholders exerting control.

<sup>89</sup> See, e.g., *Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 46 (Del. 1994) (finding a change in control when a corporation had no controlling stockholder pre-merger but would have a controlling stockholder post-merger); *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182–85 (Del. 1986) (noting that a merger resulting in a corporation having a controlling stockholder could constitute a change of control subject to enhanced judicial review); James D. Cox & Randall S. Thomas, *Delaware's Retreat: Exploring Developing Fissures and Tectonic Shifts in Delaware Corporate Law*, 42 DEL. J. CORP. L. 323, 331–33 (2018).

<sup>90</sup> *Revlon*, 506 A.2d at 182.

<sup>91</sup> Courts have nearly universally held that such agreements are both enforceable and consistent with directors' fiduciary duties absent a conflict of interest, and thus usually view change-of-control provisions under the business judgment rule. See, e.g., *In re Walt Disney Co. Derivative Litig.*, 731 A.2d 342, 366–69 (Del. Ch. 1998), *aff'd in part, rev'd in part sub nom. Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

<sup>92</sup> See, e.g., *San Antonio Fire & Police Pension Fund v. Amylin Pharm., Inc.*, 983 A.2d 304, 310, 319 (Del. Ch.), *aff'd*, 981 A.2d 1173 (Del. 2009).

day-to-day operations;<sup>93</sup> and (3) limit ability to control the company or transaction, such as by self-disabling through a stockholder agreement<sup>94</sup> and not leveraging contractual rights to coerce the board.<sup>95</sup> Despite these suggestions, the burden of bringing clarity to this muddled doctrine lies with the Delaware courts, not the stockholders and transaction planners.

#### IV. A DOCTRINAL PROPOSAL

It would defy rationality to argue that Elon Musk did not control Tesla, or that Larry Ellison did not control Oracle. Yet such control need not equate to controlling stockholder status. There is a key linguistic and substantive inquiry in the controlling stockholder doctrine: the importance of the stockholder. The Delaware Supreme Court should clarify its analysis to hold that a controlling stockholder must, substantially due to their stock ownership, exercise sufficient control over the board or company either in general or regarding the contested transaction.<sup>96</sup> While this inquiry is a fact-intensive one, the courts may find guidance in assessing substantiality under existing case law and using rebuttable presumptions. Voting power of over 40%, assuming such power is the largest of any holder or group of holders, would invoke a

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<sup>93</sup> See Lipton, *supra* note 15, at 1991 (“[P]ersons who control the day-to-day functioning of the corporation are in a position to retaliate against the company should their desires be thwarted, and if directors believe they must bow to their wishes to avoid that result, those persons, too, could be deemed controlling stockholders.”). For example, stockholders should avoid explicitly or implicitly threatening the independent directors, such as with the loss of a board seat. See *id.*; see also Kahn v. Lynch Commc’n Sys., Inc., 638 A.2d 1110, 1114–15 (Del. 1994); *In re Tesla Motors, Inc. Stockholder Litig.*, C.A. No. 12711, 2018 WL 1560293, at \*16 & n.242 (Del. Ch. Mar. 28, 2018); *In re Zhongpin Inc. Stockholders Litig.*, C.A. No. 7393, 2014 WL 6735457, at \*9 (Del. Ch. Nov. 26), *rev’d on other grounds sub nom. In re Cornerstone Therapeutics Inc., Stockholder Litig.*, 115 A.3d 1173 (Del. 2014); *In re Pure Res., Inc., S’holders Litig.*, 808 A.2d 421, 436 (Del. Ch. 2002). The absence of control over day-to-day management may weigh against controlling stockholder status. See, e.g., *In re Rouse Props., Inc.*, C.A. No. 12194, 2018 WL 1226015, at \*19–20 (Del. Ch. Mar. 9, 2018); *In re W. Nat’l Corp. S’holders Litig.*, No. 15927, 2000 WL 710192, at \*6 (Del. Ch. May 22, 2000). Stockholders should also avoid threatening the corporation’s well-being in a manner that forces directors to acquiesce to protect the corporation. See *Basho Techs. Holdco B, LLC v. Georgetown Basho Inv’rs, LLC*, C.A. No. 11802, 2018 WL 3326693, at \*29–30 (Del. Ch. July 6, 2018) (threatening to limit financing access); *Reis v. Hazelett Strip-Casting Corp.*, 28 A.3d 442, 465 (Del. Ch. 2011) (threatening to block dividends to minority stockholders). See generally Lipton, *supra* note 15, at 1992 (critiquing tests that look to the likelihood of retaliation against the company as having “the ironic effect of designating those shareholders with the *least* amount of voting power as controllers”).

<sup>94</sup> See, e.g., *In re Rouse*, 2018 WL 1226015, at \*18–20; *In re W. Nat’l Corp.*, 2000 WL 710192, at \*6; Lipton, *supra* note 15, at 1990 n.73.

<sup>95</sup> *Superior Vision Servs., Inc. v. ReliaStar Life Ins. Co.*, No. Civ.A. 1668-N, 2006 WL 2521426, at \*5 (Del. Ch. Aug. 25, 2006); Lipton, *supra* note 15, at 1991.

<sup>96</sup> See Siegel, *supra* note 72, at 72 (“[A] majority shareholder might well cede control over a particular transaction in order to avoid the burdens that attend to being a controlling shareholder.”).

presumption of control by virtue of substantial stock and thus controlling stockholder status, while voting power below 25% would invoke a presumption of insufficient stock to provide control.<sup>97</sup>

### A. Rationale

This proposal's focus on substantiality of stock and a degree of causality between stock and control harkens back to the central justification underlying control-related doctrines — the importance of protecting the stockholders — by emphasizing the difference between a controlling stockholder and a controller more broadly. Prior Delaware case law has highlighted the necessity of control by virtue of stock for controlling stockholder status, noting that “when a shareholder, who *achieves power through the ownership of stock*, exercises that power by directing the actions of the corporation, he assumes the duties of care and loyalty of a director of the corporation.”<sup>98</sup> Yet, when control is divorced from ownership, the role of the stockholder is divorced from the problematic conduct, weakening the connection to the control-by-stock justification underlying the controlling stockholder doctrine and blurring the distinction between a controlling stockholder and a controlled board.

This proposal does more than simply bring the controlling stockholder inquiry in line with the doctrinal justifications and the substantiality of stock emphasized in *Cysive*. By focusing on a connection between significant stock ownership and control, and relying on other doctrines to address control separable from stock ownership, the proposal also better protects stockholders from controllers; if the courts wish to regulate transactions involving an individual exercising control (a “controller”), then a controlling *stockholder* analysis will fall short. Generally, the more equity an individual owns, the greater the incentive

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<sup>97</sup> Indeed, despite the indeterminacy of the meaning of *controlling stockholder*, existing guidelines leverage similar presumptions when defining *control*. See, e.g., DEL. CODE ANN. tit. 8, § 203(c)(4) (West 2020). Alternatively, courts and transaction planners may wish to explore whether there is an average percentage ownership necessary to win a proxy fight or other similar measures the courts could assess for whether nonmajority voting power is sufficient. This proposal's use of rebuttable presumption percentages is not meant to create a dispositive numerical cut-off. Rather, these numbers are meant to provide a helpful rule of thumb and ensure courts are carefully considering stock ownership in a controlling stockholder inquiry. Whether the doctrinal proposal framed here is advanced as a rule or a standard, the underlying conceptual emphasis on control by virtue of stock remains unchanged. While the discussion of rules versus standards is beyond the scope of this Note, it is a robust area of debate in scholarship more broadly. See, e.g., Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 560, 622 (1992).

<sup>98</sup> *Cinerama, Inc. v. Technicolor, Inc.*, Civ. A. No. 8358, 1991 WL 111134, at \*19 (Del. Ch. June 24, 1991) (emphasis added), *aff'd in part, rev'd in part on other grounds sub nom. Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345 (Del. 1993). The courts would continue to rely on this language in subsequent decisions. See, e.g., *Pfeffer v. Redstone*, 965 A.2d 676, 691 n.52 (Del. 2009); *Ford v. VMware, Inc.*, C.A. No. 11714, 2017 WL 1684089, at \*21 (Del. Ch. May 2, 2017); *HITE Hedge LP v. El Paso Corp.*, C.A. No. 7117, 2012 WL 4788658, at \*3 n.28 (Del. Ch. Oct. 9, 2012).

that individual has to preserve company value. Conversely, the lower the equity stake one has, the less the incentive to protect company value and the greater the incentive to advance private interests to the detriment of the company.<sup>99</sup> By focusing on controlling stockholder status rather than the controlled board, the courts may be impeding their ability to protect companies and stockholders from control by bad actors who would not fall within the controlling stockholder doctrine because of insufficient stock ownership. This could leave open the risk that individuals with little incentive to benefit the company — precisely those the court should be most concerned with regulating — will act in self-interest and still benefit from the deferential business judgment rule. If Elon Musk sold all of his stock prior to the transaction in *Tesla*, he would no longer be a stockholder, let alone a controlling stockholder. While one can make a good-faith argument that, even under *Corwin*, the transaction warranted heightened scrutiny,<sup>100</sup> the court's willingness to rely on such reasoning is far from settled. Until the court establishes a pathway to heightened review absent a controlling stockholder's presence, the court may find itself unable to scrutinize even the most control-ridden transactions.

Perhaps the most compelling justification for broadly imposing controlling stockholder duties without requiring control by virtue of substantial stock is the inability of the courts to otherwise review problematic transactions. However, such an argument conflates problematic behavior with a stockholder's ability to control; the prime threat is not the controlling stockholder so much as the controller, irrespective of stock ownership, that interferes with the independence of the board.<sup>101</sup> Given transactions fraught with control over the board, the court has looked to controlling stockholder doctrine as a means of increasing scrutiny, despite the existence of a better alternative for more stringent review irrespective of stock ownership: board dependence.

Courts generally review a transaction under entire fairness when a majority of directors are personally interested in a board's decision, not independent from an interested individual, or otherwise dominated by someone who is interested.<sup>102</sup> A director's duty of loyalty also includes

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<sup>99</sup> See Lucian A. Bebchuk & Kobi Kastiel, *The Perils of Small-Minority Controllers*, 107 GEO. L.J. 1453, 1465 (2019) (noting that a "large equity stake in the controlled company provides powerful financial incentives to maximize company value"); *cf. id.* at 1465–66.

<sup>100</sup> See *infra* notes 113–20 and accompanying text.

<sup>101</sup> In some decisions the Delaware courts do distinguish between controlling stockholders and controlled boards. See, e.g., *In re KKR Fin. Holdings LLC S'holder Litig.*, 101 A.3d 980, 995–96 (Del. Ch. 2014) (considering the inquiries separately).

<sup>102</sup> See, e.g., *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1341 (Del. 1987); *In re PNB Holding Co. S'holders Litig.*, No. Civ.A. 28-N, 2006 WL 2403999, at \*12 (Del. Ch. Aug. 18, 2006); *AC Acquisitions Corp. v. Anderson, Clayton & Co.*, 519 A.2d 103, 111 (Del. Ch. 1986); see also DEL. CODE ANN. tit. 8, § 144(a) (West 2020). Some scholars argue that even independent directors may have incentives to follow a controlling stockholder's wishes or otherwise lack adequate incentives to protect other investors. See Bebchuk & Hamdani, *supra* note 18, at 1284.

within it a duty of good faith, which a director violates when intentionally acting “with a purpose other than that of advancing the best interests of the corporation” or when “demonstrating a conscious disregard for [the director’s] duties.”<sup>103</sup> One could challenge *Tesla*, *Oracle*, and the like as falling within these types of breaches of director fiduciary duties.

Furthermore, there are safeguards in place to limit the business judgment rule under *Corwin* even absent a controlling stockholder. Under *Corwin*, the vote of the disinterested stockholders cannot be coerced.<sup>104</sup> Applying this principle, *Sciabacucchi v. Liberty Broadband Corp.*<sup>105</sup> held that, despite the lack of a controlling stockholder, *Corwin* did not apply because the disinterested stockholders’ vote was coerced.<sup>106</sup> In finding coercion, the court emphasized that two substantially unrelated items — a favorable acquisition and a dilutive share issuance to a 26% stockholder — were bundled into a single resolution submitted for stockholder vote.<sup>107</sup> The Delaware Court of Chancery would later expand on several ways in which a stockholder vote may be coerced.<sup>108</sup> Cases such as these illustrate that a controlling stockholder’s involvement is not necessary to decline to apply deferential review under *Corwin*.

Additionally, even if the courts find the board independence inquiry lacking, the proper remedy is not an expansion of controlling stockholder doctrine, but rather a revision to the board independence inquiry<sup>109</sup> or a shift to a *controller* inquiry that applies regardless of stock ownership. Thus, through redefining controlling stockholder status to require control by virtue of stock ownership and adapting alternative doctrines to fill any enforcement gaps, the courts can both clarify a murky field and better align stockholder protections with the fact-

<sup>103</sup> *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 67 (Del. 2006) (quoting *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 755 (Del. Ch. 2005)).

<sup>104</sup> See *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304, 311–13 (Del. 2015) (en banc); Cox & Thomas, *supra* note 89, at 339–40.

<sup>105</sup> C.A. No. 11418, 2017 WL 2352152 (Del. Ch. May 31, 2017).

<sup>106</sup> See *id.* at \*4 (“The result of this determination — that there is no controller but that *Corwin* does not apply due to structural coercion — simply means that the business judgment rule is not imposed via ratification under *Corwin*.”).

<sup>107</sup> See *id.*; Cox & Thomas, *supra* note 89, at 340 & n.98.

<sup>108</sup> See *In re Rouse Props., Inc.*, C.A. No. 12194, 2018 WL 1226015, at \*21 (Del. Ch. Mar. 9, 2018) (discussing inherent, structural, and situational coercion).

<sup>109</sup> While historically Delaware’s analysis of lack of independence was narrow — focusing on familial or financial ties with a director — recently the courts have indicated an increased willingness to consider social and business ties as part of the director independence inquiry. See, e.g., *Marchand v. Barnhill*, 212 A.3d 805, 820 (Del. 2019); *Sandys v. Pincus*, 152 A.3d 124, 126 (Del. 2016); *Del. Cty. Emps. Ret. Fund v. Sanchez*, 124 A.3d 1017, 1022–24 (Del. 2015); *In re Oracle Corp. Derivative Litig.*, No. 2017-0337, 2018 WL 1381331, at \*15 (Del. Ch. Mar. 19, 2018) (emphasizing that directors can be sufficiently affected by professional or personal friendships that exceed familial closeness and loyalty). This shift may better reflect the relationships that influence behavior and give an individual control over the board of a company.

specific and control-related threat: often that of the controlled board rather than the controlling stockholder.

*B. An Application to Recent Cases*

Recall that in *Tesla*, despite other stockholders owning 78% of the company, the court held that Musk was a controlling stockholder.<sup>110</sup> Even more noteworthy, Musk's control, including his senior positions, extensive recruiting, and status as the face of Tesla, was independent of stock ownership.<sup>111</sup> Under the proposed doctrinal inquiry, it is unlikely that Musk, as a holder of less than 25% of the company's stock, had sufficient control by virtue of that stock to receive a controlling stockholder designation.<sup>112</sup> Does Musk's failure to meet the elements necessary for controlling stockholder status mean that the court is unable to review Tesla's acquisition of SolarCity under entire fairness? Certainly not.

The court itself concluded that "it is reasonably conceivable that a majority of the five Board members who voted to approve the Offer and Acquisition (Musk and Gracias recused themselves) were interested in the Acquisition or not independent of Musk."<sup>113</sup> While ordinarily a dependent board warrants entire fairness review, under *Corwin* the approval by a majority of the other stockholders could enable review under the business judgment rule absent a controlling stockholder.<sup>114</sup> One could argue that the court would have been compelled to apply *Corwin* and defer to the business judgment of the board even in a control-filled transaction unless it found that Musk was a controlling stockholder. Yet there are two primary challenges to this argument: that *Corwin* is inadequate and that coercion precludes its application. While the adequacy of *Corwin* is a debated issue beyond the scope of this Note,<sup>115</sup> even when

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<sup>110</sup> See *In re Tesla Motors Stockholder Litig.*, C.A. No. 12711, 2018 WL 1560293, at \*2 (Del. Ch. Mar. 28, 2018).

<sup>111</sup> See *id.* at \*16.

<sup>112</sup> As mentioned, the 25% guideline is, however, a rebuttable presumption. One could argue that, given the composition of Tesla's stockholders at that point in time, 25% was sufficient ownership to control the board. If that were the case, then the court could hold that Musk was a controlling stockholder. While the outcome would then be similar to the actual holding of *Tesla*, the court would need to *explicitly* engage with the relationship between ownership and control to rebut the presumptive threshold.

<sup>113</sup> *In re Tesla*, 2018 WL 1560293, at \*17. The court found it noteworthy that several Tesla directors had relationships with SolarCity and that Musk had numerous opportunities to influence the board's consideration of the transaction. See *id.* at \*2, \*5-7, \*17-22. SolarCity's board may have also been conflicted. Nancy Pfund, a member of the SolarCity board and one of two members on the SolarCity special committee that negotiated and approved the transaction, "is a close friend of Musk's and has said that '[h]e's always been a master of the universe in my mind.'" *Id.* at \*3 (alteration in original) (quoting Second Amended Verified Class Action and Derivative Complaint, *supra* note 59, at 13).

<sup>114</sup> See *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304, 308 (Del. 2015) (en banc).

<sup>115</sup> Given the discussion in this Note, one challenge to *Corwin* that may be particularly obvious is that if controlling stockholders are so problematic, then so too are controllers, and thus *Corwin*

relying on *Corwin* in its current form, the *Tesla* court could both decline to find a controlling stockholder and refuse to apply *Corwin*. Indeed, the court did just that in *Sciabacucchi*, noting that “despite the lack of a controller . . . it [is] reasonably conceivable that the vote of the disinterested stockholders in this matter was structurally coerced . . . [and therefore] fails to cleanse the transactions here under *Corwin*.”<sup>116</sup> Existing precedent, including *Sciabacucchi*, “make[s] clear that a coerced vote is one in which the stockholders conceivably vote for a [transaction] for reasons other than [its] underlying merits.”<sup>117</sup> While the coercion element of *Corwin* remains largely untested in the Delaware courts,<sup>118</sup> Musk’s tremendous influence and the facts surrounding *Tesla* — including that Tesla’s own co-underwriter Goldman Sachs “publicly stated that SolarCity was the ‘worst positioned’ company in the solar energy sector for capitalizing on future growth in the industry”<sup>119</sup> — seem to suggest that votes in favor may have been coerced.<sup>120</sup>

*Oracle* represents a simpler case. Ellison’s stock ownership of 28% falls below the presumptive controlling stockholder threshold but above the presumptive noncontrolling stockholder threshold.<sup>121</sup> Because the facts of the case seem to indicate that his control was not by virtue of stock ownership but rather due to other factors such as his roles as co-founder and CEO, under the doctrinal proposal he would likely not be a controlling stockholder.<sup>122</sup> However, while the *Oracle* court appears to have assumed that Ellison was a controlling stockholder, it did not explicitly reach that holding. Instead, the court relied on lack of board independence as a vehicle for combatting the controlled board, noting that “a majority of Oracle’s twelve-person board could not impartially consider a demand.”<sup>123</sup> Accordingly, the substantive outcome of the

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should be narrowed to apply only to transactions that do not involve a controller or controlling stockholder. The disparate treatment of controlling stockholders and controllers generally is an active area of legal scholarship. See, e.g., Lipton, *supra* note 15, at 2007 (arguing that courts should focus on mechanisms of self-help available to noncontrolling stockholders).

<sup>116</sup> C.A. No. 11418, 2017 WL 2352152, at \*20 (Del. Ch. May 31, 2017).

<sup>117</sup> Brandon Mordue, *The Revlon Divergence: Evolution of Judicial Review of Merger Litigation*, 12 VA. L. & BUS. REV. 531, 572 (2018).

<sup>118</sup> See *id.* at 586.

<sup>119</sup> *In re Tesla Motors, Inc. Stockholder Litig.*, C.A. No. 12711, 2018 WL 1560293, at \*7 (Del. Ch. Mar. 28, 2018).

<sup>120</sup> See *id.* at \*2, \*6–7.

<sup>121</sup> See *In re Oracle Corp. Derivative Litig.*, C.A. No. 2017-0337, 2018 WL 1381331, at \*16 (Del. Ch. Mar. 19, 2018).

<sup>122</sup> See *id.* at \*3–4.

<sup>123</sup> *Id.* at \*16. The court noted that a key inquiry in the independence analysis is whether “a director’s decision is based on the corporate merits . . . rather than extraneous considerations or influences.” *Id.* at \*15 (quoting *Aronson v. Lewis*, 473 A.2d 805, 816 (Del. 1984)). Indeed, the court emphasized that a lack of director independence may be established by alleging that a director is influenced by another party in a manner that undermines that director’s ability to evaluate based on the merits. *Id.* The court explained that “professional or personal friendships, which may border

case — demand excuse — would remain unchanged while Ellison’s underlying status as a controlling stockholder would be altered.

Applying the doctrinal proposal to *FrontFour* is likewise relatively straightforward: at less than 15% ownership, the alleged controlling stockholders were well below the presumptive 25% threshold.<sup>124</sup> Furthermore, given that they were subject to echo voting requirements, their effective independent voting power was 0%.<sup>125</sup> Perhaps obviously given the low percentage ownership and contractual restrictions, the alleged controlling stockholders’ control was divorced from their stock ownership.<sup>126</sup> Much like *Tesla*, the transaction in *FrontFour* was approved by the stockholders, and while one could raise similar coercion arguments, there is another, simpler rationale for declining to apply *Corwin*. *Corwin* applies only where there is a *fully informed vote* of disinterested stockholders, and in *FrontFour* the court expressly held that the defendants failed to adequately disclose material information to the stockholders.<sup>127</sup> Thus, the court did not need to reach a decision on controlling stockholder status to review the transaction under entire fairness because *Corwin* would not apply regardless.

#### CONCLUSION

When it comes to control-related transactions, it is the analysis and not simply the standard of review that matters. Controlling stockholder status may bring fiduciary duties and outcome-determinative implications. Such a status should not be imputed to a stockholder merely in passing, particularly when such a stockholder possesses mere fractions of the full voting power and holds control independently from stock ownership. A desire to protect vulnerable stockholders from control-ridden transactions need not rely on muddling the controlling stockholder inquiry. While recent Delaware case law has further obscured controlling stockholder doctrine, courts can return to their roots from *Cysive* while also considering what distinguishes controlling stockholders from controllers: control substantially by virtue of the stock itself.

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on or even exceed familial loyalty and closeness,” may be sufficient. *Id.* (quoting *Beam v. Stewart*, 845 A.2d 1040, 1050 (Del. 2004)).

<sup>124</sup> See *FrontFour Capital Grp. LLC v. Taube*, C.A. No. 2019-0100, 2019 WL 1313408, at \*21 (Del. Ch. Mar. 22, 2019).

<sup>125</sup> *Id.* at \*5 n.31, \*21.

<sup>126</sup> *Id.* at \*21–24 (emphasizing extensive phone contact and “personal adoration,” *id.* at 24, of the alleged controlling stockholders).

<sup>127</sup> *Id.* at \*29. The court noted that the proxy filing created the misleading impression that the special committee process was effective, and emphasized that the defendants failed to disclose certain expressions of interest, standstill agreements, and third-party proposals to stockholders. *Id.* at \*28–30. In other cases, the Delaware courts have referred to mistaken beliefs or ignorance surrounding a stockholder vote as “situational coercion.” *In re Rouse Props., Inc.*, C.A. No. 12194, 2018 WL 1226015, at \*21 (Del. Ch. Mar. 9, 2018).