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When a Minority Stockholder Has Truly "Outsized Influence," Its Self-Interested Transaction May Be Subject to Entire Fairness Notwithstanding a Special Committee Process--

And Other Points from Controller Decisions Issued in 1Q 2018--Rouse, Tesla, Oracle, NEA

We have discussed in recent Fried Frank M&A/PE Briefings the dramatic transformation in Delaware law since about 2014—with a trend toward clearer paths to more certain judicial outcomes. This has been accompanied by a continued contraction of the grounds on which directors may have legal liability in connection with their decisions relating to M&A matters. Thus, under the seminal *Corwin* decision, cases not involving a conflicted controller are routinely dismissed at the pleading stage of litigation if the stockholders have approved the transaction in a fully informed and uncoerced vote. Where a conflicted controller is involved, however, *Corwin* does not apply—and the courts continue to conduct a highly contextual analysis, and (unless the prerequisites for application of *MFW* are satisfied, as discussed below) to apply the "entire fairness" standard of review, the most rigorous standard applicable to target board responsibilities (requiring that both the price and the process be fair).

When a *controller* is self-interested in a transaction—that is, the transaction is between the company and the controller or is between the company and a third party but the controller has an interest in it that differs from that of the other stockholders—the board's independent judgment as to whether the transaction is in the best interests of the company and the other stockholders is viewed as inherently affected (and potentially undermined) due to the ability of a controller to remove the directors and elect new ones. When a *minority stockholder* with significant influence is self-interested in a proposed transaction, the issue is whether the stockholder, notwithstanding its non-majority equity stake, is a controller with respect to the transaction—that is, at the pleading stage of litigation challenging the transaction, whether it is reasonably conceivable that the stockholder had and exercised a degree of influence over the board that compromised the board's independence when it considered the transaction.

The issue whether a minority stockholder may be a controller with respect to a transaction will be relevant to the stockholder, the board, and any third party participating in the transaction. The question often arises in the context of a transaction proposed by a founder or a private equity sponsor which owns a significant percentage of the company's stock, may have designated a large portion of the board, may have additional relationships with the company or its directors.

Where a minority stockholder is involved in a transaction with or by the company, the risk of its being considered by the court to be a controller will be on a continuum based on (a) the extent of its influence over the board (generally and with respect to the specific board decision) and (b) the extent of the process, if any, put into place to separate the stockholder from the board's consideration of the transaction (for example, recusal of the stockholder's board designees from the board's discussions and vote, a special committee with independent advisors, a fairness opinion, and/or a vote of the unaffiliated stockholders). The recent decisions highlight the impact that a minority stockholder's having what the court referred to as truly "outsized influence" (on the order of 22% stockholder Elon Musk at Tesla or 28% stockholder Larry Ellison at Oracle) can have. *Rouse* underscores that a minority stockholder *without* truly "outsized influence" (such as 33% stockholder Brookfield Management Co. at Rouse) generally will not be deemed to be a controller, particularly when a special committee process was in place and the stockholder recused itself from the board's consideration of the stockholder's self-interested transaction. *Tesla* reflects that a minority stockholder *with* "outsized influence" may be deemed to be a controller with respect to his self-interested transaction when there was *no* special committee process in place and he did *not* separate himself from the board's consideration of the transaction. *Oracle* reflects that a minority stockholder with "outsized influence" may be deemed to be a controller with respect to his self-interested transaction *notwithstanding* that there *was* a special committee process in place and he recused himself from the board's consideration of the transaction.

However, importantly, because, in *Oracle*, the court viewed Ellison as likely having acted stealthfully to control the special committee process (through the co-CEO of the company who was his "chief lieutenant" and extremely deferential to him), it remains an open question whether, in a case involving a stockholder with "outsized influence," where a typical special committee process is in place and the stockholder actually recuses himself, the court would find that the stockholder was not a controller—or whether, to accomplish that result, additional, extraordinary steps would have to be taken with respect to the process in order to "disable" the stockholder's "outsized influence" (as discussed further below). It bears emphasis that, in most cases involving a minority stockholder, the stockholder, even if influential, does not have the type of "outsized influence" the court addressed in *Tesla* and *Oracle* and there is no doubt that, in such cases, a state-of-the-art special committee process will meaningfully reduce the litigation risk.

The 2018 Decisions—Key Points

- **Absent truly "outsized influence" of a minority stockholder, in most cases, the court will not deem a minority stockholder to be a controller**. In *Tesla* and *Oracle*, the court found that a minority stockholder (a 22% stockholder and a 28% stockholder, respectively) may have been a controller. In recent years, there have been only three other decisions in which the court found that a minority stockholder may have been a controller—*Cysive* (2003) (35% stockholder), *Zhongpin* (2014) (17% stockholder) and *Calesa* (2016) (26% stockholder). In all five of these cases, the court emphasized the stockholder's truly unusual extraordinary level of influence—through the stockholder's other critical roles at the company (such as founder, CEO and/or Chairman), the stockholder's indispensability to the company, and the stockholder's history of dominating board decisions. The level of influence in these situations was viewed by the court, as a practical matter, as no less than a majority stockholder (with the ability to remove and elect directors) would have.

- ***Oracle* indicates that, in determining controller status, the court may emphasize the real-world practicalities of the stockholder's influence—and, *if the stockholder has truly "outsized influence,"* the board process may not overcome a view of the stockholder as a controller.** As discussed below, in *Oracle*, the court did not view the special committee process and Larry Ellison's recusal from consideration of his proposed transaction as disabling Ellison's "outsized influence" with respect to the transaction. Based on the alleged facts, Oracle's co-CEO, who was on the board and was the lead negotiator with respect to the transaction, appeared to be working (likely at the direction of Ellison, according to the court) to ensure both that the transaction was effected and that it was effected on Ellison's desired terms. It is uncertain whether the special committee process and Ellison's recusal would have been viewed by the court as sufficient to render Ellison a non-controller if the co-CEO had *not* been an "agent" for his influence and if a majority of the directors and special committee had been viewed by the court as independent. However, in the rare situation in which a stockholder may have such "outsized influence" that the court may view the board as likely to want to fulfill the stockholder's objectives even without the stockholder having to do or say anything, to avoid entire fairness review, the stockholder may have to take affirmative steps beyond the usual special committee process to effectively "disable" the reality and perception of the outsized influence. What additional steps could be taken to accomplish this result would depend on the specific facts and circumstances. For example, if the stockholder's proposed transaction involves a sale of the company and the stockholder owns a significant amount of stock, a commitment to cooperate with and sell into any alternative transaction approved by the board should be effective. In all cases, satisfying the *MFW* prerequisites (which includes subjecting the transaction to the approval of the unaffiliated stockholders in a fully informed and uncoerced vote) should be effective.

- **There is no certain formula as to a process that would prevent the court from viewing a minority stockholder as a controller.** *Rouse* reflects a predictable outcome—the court found that a 33% stockholder was *not* a controller where it did *not* have "outsized influence"; its representatives fully recused themselves; it did not attempt to influence the board; it did not have a history of dominating the board; and there was a special committee process (with independent advisors and a fairness opinion). In *Tesla*, the 22% stockholder *was* viewed as a controller—he *did* have outsized influence and a history of dominating board decisions; there was no special committee process; he selected the board's independent advisors; he did not recuse himself from the board's consideration of the transaction and in fact himself led the board's discussions; and there were possible infirmities in the fairness opinion process.

  In *Oracle*, the 28% stockholder *was* deemed to be a controller due to his "outsized influence"—notwithstanding that he had recused himself from the board's consideration of the transaction and that there was a special committee with independent advisors, the committee obtained a fairness opinion, and the stockholder did not overtly attempt to influence the board. The court emphasized Larry Ellison's "outsized influence" over the company as a general matter; his history of ousting directors and executives who would not support his agenda; the non-independence of a majority of the board (and a majority of the special committee) due to ties to Ellison combined with the potential of the loss of their very lucrative director seats (with director fees of about $500,000 annually paid to each) if he were to stop supporting them; and, perhaps most critically, the overly deferential approach that Oracle's co-CEO-director (who was the lead negotiator for the transaction) had toward Ellison and that she had "pushed" for the transaction (including in disregard of the board's specific instructions to her with respect to when to discuss price during the negotiations and by "feeding" projections to the committee which made the deal price look more attractive).

We note that, in the *Dell* case (2017), the 16% minority stockholder, Michael Dell, who arguably had "outsized influence" in ways similar to Ellison and Musk, *was not* viewed by the court as a controller with respect to the MBO that he proposed. Notably, Michael Dell took very significant steps to separate himself from the board's consideration of the transaction—including not only a typical special committee process with independent advisors and a fairness opinion, but also his active participation in extensive due diligence by other parties potentially interested in making a competing bid for the company and his expressed willingness to sell his shares into any superior deal. Moreover, there was some question whether his influence truly *was* "outsized" given that some parties contacted during the process had explained that they did not view him as indispensable to the company and the court's conclusion that the lack of competing bids was not due to the presence of a bid by a controller but a belief in the market generally that, with or without Michael Dell, the troubled company could not achieve a turnaround.

- **What is "outsized influence"?** There is no mechanical formula for determining whether a minority stockholder may have what the court referred to in *Oracle* as "outsized influence." Clearly, most minority stockholders do <u>not</u> have outsized influence. The concept has been limited to those rare situations where a minority stockholder is so influential that he or she effectively "controls the board" notwithstanding an inability (based solely on equity ownership) to effect the removal and election of directors. That level of influence may arise through a combination of factors, including: a level of stock ownership closer to 50%; key roles at the company (such as founder, CEO and/or Chairman; longtime past CEO or Chairman; or significant creditor); being indispensable to the company for other reasons (such as being the "face" of the company, its "visionary," or the architect or implementer of its critical products or plans); a dominating personality and approach (including the expression of threats or a history of retribution); a general reputation for "calling the shots" at the company or being the central point of authority on all matters; a history of being effective at ousting directors or executives who were not supportive; and/or wielding significant influence within the industry generally.
- **A controller can act self-interestedly in his or her capacity as a stockholder, but cannot use the corporate power (directly as a director or manager, or indirectly by dominating other directors) to benefit his or her self at the expense of the other stockholders.** In *NEA*, where a venture capital firm was a *majority* stockholder, there was no issue as to its status as a controller. The court found a reasonable inference of a breach of the duty of loyalty by both the controller-director and the conflicted board, based on their approval of a transaction, allegedly at an unfairly low price and for the purpose of incentivizing the buyer to acquire and invest in the controller's other portfolio companies.

The 2018 Decisions—Summary

Rouse. In *Rouse Properties, Inc. Fiduciary Litigation* (Mar. 9, 2018), Vice Chancellor Slights found, at the pleading stage, that it was not reasonably conceivable that Brookfield, a 33.5% stockholder, was a controller with respect to the take-private transaction that it had proposed. As noted above, Brookfield's board representatives recused themselves entirely from the board's process; the board formed a special committee which engaged independent advisors of its choosing and obtained a fairness opinion; Brookfield did not attempt to influence the board or to coerce the stockholder vote; and it did not have a history of dominating the board's decisions. The court emphasized that a minority stockholder "is not considered to be a controlling stockholder unless it exercises such formidable voting and managerial power that, as a practical matter, it is no differently situated than if it had majority voting control." The power "must be so potent that independent directors cannot freely exercise their judgment, fearing retribution from the controlling minority blockholder." Establishing such power is "not easy"—requiring the pleading of facts supporting a reasonable inference that the minority stockholder either (i) actually dominated and controlled the board or special committee with respect to the challenged transaction (*i.e.*, exerted its power "in the boardroom") or (ii) actually dominated and controlled a majority of the board generally (*i.e.*, its power "loomed" by virtue of the board's awareness of its ability to make changes at the board level or "to push other coercive levers should [it] be displeased" with the board's decision-making).

Tesla. In *Tesla Motors, Inc. Litigation* (Mar. 28, 2018), Vice Chancellor Slights found a reasonable pleading-stage inference of control by Elon Musk, who was a 22.1% stockholder (and CEO, Chair, "visionary" of, and often spokesperson for, the company), with respect to Musk's proposal that the company acquire, at an alleged unfairly high price, SolarCity, Inc., a troubled company that he controlled. The court emphasized Musk's voting influence as a stockholder (as a two-thirds vote was required for major transactions, so his stake represented close to a block on major actions); his being "the face" of the company and providing the "vision for the Company's success"; his raising capital for and public awareness of the company; his having infused $100 million of his own capital into the company "to keep it afloat"; his history of having effected the ouster of executives and directors who displeased him; and his domination of the board process relating to the acquisition—all against the backdrop of his "extraordinary influence" within the company generally, board-level conflicts that diminished the board's resistance to his influence, and the company's and his own public acknowledgments of his outsized influence at the company. The court observed that, in addition, the board engaged in "no formal process," such as forming a special committee. Moreover, Musk himself, as the CEO, engaged the board's legal counsel and financial advisor—notwithstanding his and the board's "obvious conflicts." Furthermore, the board's first meeting with the financial advisor was during the meeting at which the board approved the transaction; although the financial advisor's presentation included a review of other potential acquisitions in the same industry as SolarCity, the board considered only the SolarCity acquisition; and, after receiving revised projections from the target company's management, the financial advisor did not rerun its DCF analysis although the SolarCity advisor's DCF based on the new projections yielded a result below the deal price. (Musk has requested permission to file an interlocutory appeal to the Delaware Supreme Court, arguing that the decision introduces uncertainty into the controlling stockholder doctrine by holding that a stockholder may be a controller when his stake is far below majority control, he made no retributive threats, and he did not vote on the transaction.)

Oracle. In *Oracle Corporation Deriv. Litigation* (Mar. 19, 2018), although the issue whether Larry Ellison, who was a 28% stockholder (as well as the founder, former longtime CEO, and still Chairman), had controller status was not directly ruled on, Vice Chancellor Glasscock appeared to view Ellison as the equivalent of a controller in connection with Ellison's proposal that Oracle acquire NetSuite, Inc., a company that he controlled. The opinion focused on whether demand should be excused—which it was, based on the court's finding that there was reasonable doubt that a majority of the board would be capable of bringing its business judgment to bear given Ellison's influence over them. Notably, in contrast to Musk in *Tesla*, Ellison had ostensibly "fully recused" himself from the board's consideration of the transaction. Further, the board had formed a special committee with independent advisors, met twenty times, considered alternatives, "negotiated seriously" the terms of the transaction, and obtained a fairness opinion. However, notwithstanding the process, the court focused on Ellison's general domination of the company and the board, which led the court to view a majority of the board (and of the special committee) to be non-independent by virtue of the directors' various relationships with Ellison in combination with

Ellison's history of ousting executives and directors who would not support his agenda and the implicit threat of the loss of the directors' seats (which were unusually lucrative, with director fees of about $500,000 annually for each director) and in some cases management positions (which carried enormous compensation of roughly $40 million annually for each person). Perhaps most critically, the court focused on the general extremely deferential approach of Oracle's co-CEO-director toward Ellison, her extraordinary compensation, and her role in "pushing" the transaction on his desired terms, including her engaging in "secret price negotiations" against the committee's instructions and "feeding" projections to the committee that made the deal price look more attractive (which, the court inferred, may have been done under Ellison's direction). All of this occurred in the context of longstanding and numerous public statements by Ellison, the company and others that emphasized Ellison's outsized importance to and influence at the company. The court also observed that, over the past several years, Ellison and the co-CEO each were paid roughly $45 million annual compensation notwithstanding that the company had "failed" say-on-pay votes over several years.

NEA. *Carr v. New Enterprise Associates Inc.* (Mar. 26, 2018) involved a *majority* stockholder and therefore no uncertainty that entire fairness would apply (*i.e.*, a different type of situation than in *Rouse*, *Tesla* and *Oracle*, where there was a *minority* stockholder and the issue was whether entire fairness should apply because the stockholder had such "outsized influence" that the stockholder was the equivalent of a majority-stockholder controller). *NEA* reaffirms the essential principle that a controller, when it is not acting in its capacity as a stockholder, cannot use the company for its own self-interest at the expense of the other stockholders. In the context of a motion to dismiss, Chancellor Bouchard found that it was reasonably conceivable that the venture capital firm that was the majority stockholder of American Cardiac Therapeutics, Inc., and the company's conflicted board, had breached their duty of loyalty to the company's stockholders by approving a sale to a third party of a warrant that provided an option to acquire the company, allegedly, at an unfairly low price in order to incentivize the buyer to also acquire and invest in the controller's other portfolio companies. The court, applying the entire fairness standard, found that the alleged facts supported a reasonable inference that neither the price nor the process relating to the option were fair. As to price, the court noted that the sale price under the option was far below the price implied for the company by a stock offering that was effected three months earlier. As to the process, the court observed that the board likely was not independent due to ties to the VC firm and its affiliates, had not engaged in "any formal process" to consider the transaction (not even engaging a financial advisor) and had not pursued an alternative facially superior offer that the company had received while considering the sale of the option. The controller's engaging in "a form of portfolio optimization"—that is, "prioritiz[ing] its fund's overall rate of return over maximizing value for [the company]'s shareholders"—is "precisely the kind of behavior that controllers may not engage in under Delaware law," the court wrote.

Key Principles Relating to Controller Status

The general principles that have been established by the Delaware courts relating to control are as follows:

- **A majority stockholder generally is a controller.** A more than 50% stockholder almost always will be deemed to be a controller—absent circumstances, such as contractual or other restrictions on the voting of its shares, which indicate that the stockholder does not have the ability to appoint, elect or remove a majority of directors or to block or bring about action by the board. Of course, as discussed, a controller may seek to "disable" its control with respect to any given transaction (for example, by being separated from the board's consideration of the transaction and agreeing to fully support any alternative transaction approved by the board or subjecting the transaction to a fully informed and uncoerced vote of the unaffiliated stockholders).

- **A minority stockholder generally is *not* a controller.** There has been a high bar to establishing that a less-than-50% stockholder is a controller. The most critical part of the inquiry is whether the person (or group) has *"actual control" over the* <u>*board*</u> (rather than solely operational or managerial control). In other words, whether through equity ownership, contract or other rights, personality or status (for example, as a founder), and/or as a practical matter for any reason, can the person appoint, elect or remove a majority of the directors, block or bring about action by the board, or have a dominating influence over the board's decision-making? Generally, to be deemed a controller with respect to a given board decision, (a) the person must have, directly or indirectly, actually exercised control with respect to the specific decision (*i.e.*, the person dominated the directors in the board room) or (b) the person must *generally* exercise control over a majority of the board (*i.e.*, the person's control "looms over" the board).

- **When a stockholder is conflicted.** A stockholder is clearly self-interested in its own transactions with the company (such as where the stockholder acquires the portion of the company that it does not already own or the company acquires another company controlled by the stockholder). A stockholder may also be self-interested in transactions between the company and a *third party* in which the stockholder will obtain additional or different consideration or a "unique benefit" (such as receiving a higher price per share; being offered the opportunity to obtain a significant continuing stake in the buyer through a "rollover" of shares; or receiving a material benefit that is not shared ratably with the other stockholders). The essential inquiry is whether the stockholder's interests are aligned with the other stockholders' interests (in maximizing the price to be obtained for the company's shares if a sale of the company, or minimizing the price to be paid if an acquisition by the company). It is well established that a stockholder is not deemed to be a controller by reason of "casual" or nonmaterial business or personal ties with directors or by the stockholder merely having designated or elected directors. A private equity sponsor's desire for liquidity, standing alone, has been found *not* to compromise its identity of interest with the other stockholders in maximizing the price on a sale of the company—except where the liquidity need is so acute as to indicate that the PE firm likely would accept less than full value for its shares. "Side deals" that a controller obtains in connection with a transaction between the company and a third party will not render the controller conflicted if they are not material. Materiality means that the benefits were so significant in the context of the controller's economic circumstances as to have made it improbable that the controller could perform his or her fiduciary duties to the stockholders without being influenced by an overriding personal interest. Side benefits also would not render a controller conflicted if they only in effect replicated arrangements that were in place prior to the transaction.

- **Conflicted controller transactions will be subject to the "entire fairness" standard of review (unless *MFW* applies).** A challenged conflicted controller transaction will be reviewed under the stringent entire fairness standard, which is satisfied only if both the price and the process were fair. The controller bears the burden of proving fairness; however, if the transaction was approved by *either* a committee of independent directors *or* the unaffiliated stockholders, the burden shifts to the plaintiffs to prove unfairness. If a conflicted controller merger, from the outset, is subject to the conditions of approval by *both* a special committee of independent directors (that is fully authorized and functions effectively) *and* a majority of the unaffiliated stockholders (in a fully informed and uncoerced vote), then, under *MFW*, entire fairness would not apply and the deferential business judgment standard would apply instead. We note that a controller may decide to not seek to satisfy the *MFW* prerequisites—often, due to the uncertainty that the minority stockholder approval requirement could create (including as a result of the opportunity it could present to third parties to buy shares to create leverage with respect to the transaction).

- **Controllers can act in their own self-interest when acting in their capacity as shareholders but cannot use "the corporate power" in their self-interest.** To the extent that a controller is acting in its capacity as a stockholder, it has the right to act in its own self-interest. Thus, for example, a controller does not violate any fiduciary duty by proposing a transaction and not being willing to sell its shares in or otherwise cooperate with an alternative superior transaction. The court has indicated that, where a controller has the ability to block an alternative transaction, a board need not seek to produce alternatives that it has no leverage to effect—but generally the board still should consider what a third party might be willing to pay and should attempt to negotiate with the controller (recognizing that the board has the leverage of "just saying no" to the controller's transaction). A controlling stockholder is prohibited from exercising "*corporate* power" (either formally as a director or manager, or informally through control over the officers and directors) so as to benefit itself at the expense of the corporation and the other stockholders.

- **The "entire fairness" standard of review also will apply if a majority of the directors are not independent and disinterested with respect to the transaction.** Independence means that a director's decision will be based on the corporate merits of the transaction rather than other interests or influences. A director lacks independence if he or she is "beholden" to the interested party or interested director, or is under that person's influence to such an extent that (in the court's words) the director's "discretion is sterilized." The issue of independence may also be focused on independence from management; and the payment of very large director fees or annual compensation to an employee-director may undermine independence. The inquiry depends on an examination of each director's interest in the transaction or in the counterparty, as well as the relationships among the parties (such as board or management positions the director may hold at the counterparty or its affiliates, which implicate conflicted loyalties or dependence on financial benefits; close or longstanding personal or business relationships that could result in conflicted loyalties or compromised judgment; or any other relationship or circumstance that could indicate control of or undue influence over the director such that the director likely would feel beholden to the person). The following do not, *standing alone*, render a director not independent (but could be considered as one fact in combination with others that indicate non-independence): casual personal or business ties; any ties that are not material to the director from a financial point of view; having been designated to the board by an interested party; an expectation of serving on an acquiror's board post-transaction; or owning a non-material interest in a target company being acquired.

Practice Points

- **A minority stockholder involved in a self-interested transaction should weigh the advantages of taking steps to mitigate the litigation risk of being deemed a controller against the possible disadvantages (including with respect to deal certainty).** A stockholder should keep this weighing in mind when deciding to what extent (if any) to be involved in the board's consideration of the transaction and whether to propose that a special committee be formed and independent advisors engaged. As discussed, there is limited certainty as to the minimum steps required in any given case to achieve non-controller status. In general, the greater the stockholder's direct or indirect actual or perceived influence, the greater the steps that would be required for reducing the risk. As highlighted by *Oracle*, and discussed above, where the stockholder has truly "outsized influence," it is possible that a process may only be sufficient to avoid controller status if it includes steps that go beyond the typical process so that the stockholder's influence is effectively reduced. What steps would be effective would depend on the facts and circumstances. In any case, however, certain typical process steps may meaningfully reduce the litigation risk without significantly reducing the likelihood of effecting a transaction.

- **A third party considering a transaction involving a minority stockholder who may be conflicted should, before structuring or proposing the transaction, consider the likelihood and possible impact of the minority stockholder's being deemed a controller.** When a party considers proposing or participating in a transaction with a company in which an influential stockholder may be conflicted, the party should do due diligence to establish, to the extent possible, whether the stockholder is likely to be deemed to be a controller in the event that the transaction is challenged (and, therefore, that the transaction would be subject to entire fairness review unless it is structured to comply with the *MFW* prerequisites). The party should research publicly available information and should ask questions of the stockholder (and possibly others) relating to the stockholder's role and influence. It is to be noted that it may be difficult to reach a certain conclusion as to the true extent of the stockholder's influence (as all of the information that would be available in the context of a litigation challenging the transaction may not be revealed). However, at least a preliminary assessment of the litigation risk should be made and taken into account when deciding whether to propose and how to structure the transaction.

- **Process points.** While, as discussed, there is no precise formula that will ensure that a process will be deemed sufficient for rendering a stockholder a non-controller or for satisfying the entire fairness test, the following should enhance the effectiveness of the process for these purposes: The special committee being comprised of independent directors and having at least two members; the committee hiring its own independent legal and financial advisors (rather than, as in *Tesla*, the interested stockholder, who was also the CEO, selecting the board's advisors); any ties between the advisors and the interested stockholder being disclosed to, and carefully reviewed by, the board; the financial advisor not being compensated wholly on a contingent basis; all relevant information, including the company's current financial information and projections, being available to the independent directors; the independent directors being authorized not only to evaluate and negotiate the transaction but also to consider alternatives and to just say no; the stockholder not being involved in the board's deliberations or in the negotiations (if with a third party), and whether through participation in board meetings or informally through conversations with directors.

- **Consider the "independence" of director designees.** When designating a director, a stockholder should consider the extent to which the director would be likely to be considered by a court to be independent and disinterested in transactions in which the stockholder is self-interested. A stockholder generally will not be considered to be a controller if the stockholder does not have majority equity ownership and a majority of the directors are considered by the court to be "independent" of the stockholder. A stockholder generally has substantial leeway in designating directors who will be considered to be independent and disinterested, as the court typically has defined these concepts broadly. It is well established that designation of a director by a stockholder does not, standing alone, render the director non-independent or interested. *Oracle* implicitly raises (but does not answer) the issue whether a director *can* be independent of a stockholder who has "outsized influence" when the stockholder has a history of ousting directors who displease him, and particularly when the directors receive unusually high director fees or other compensation.

- **Benefits of including "independent" director(s) on the board.** Even if a stockholder designates a majority of directors who are not independent (which, as noted, would be a negative factor in the evaluation of whether the stockholder would be a controller), there will still be an advantage to the stockholder in designating one or more independent directors so that there is the option of satisfying the *MFW* prerequisites or at least increasing the chances of meeting the entire fairness test (both substantively and through a shift of the burden of proof as discussed above). While one independent director technically could comprise a special committee, the court has been more skeptical of a committee where (as the court has put it) "a single member works free of the oversight provided by at least one colleague."

- **Consider limiting public statements about control and independence.** When the court evaluates whether a minority stockholder may have "outsized influence" such that the stockholder could be considered to be a controller, the court often cites public statements made by the stockholder or the company relating to the extent of the stockholder's influence. Accordingly, statements relating to the stockholder's control, influence, indispensability and the like should be made in the company's public filings or otherwise only after careful consideration and review by legal counsel and an understanding of the legal requirements and possible risks. In many cases, legal conclusions (for example, relating to a stockholder's "control") may not be legally required and should not be drawn. With respect to the disclosure relating to a proposed transaction, a stockholder's or director's interest in the transaction should be described but, again, subject to legal requirements, a legal conclusion should not be drawn (for example, that the stockholder's interest is "different from" the other stockholders' interests, or that a director is "not independent").

- **Caution with respect to board presentations and emails.** Although not a feature of the cases discussed in this Briefing, it bears continued emphasis that, when directors or stockholders write emails, or management or bankers prepare board presentations, they should be vigilant in not casually making references to or characterizations about directors' independence or a stockholder's influence, as these could be taken out of context or given more attention than appropriate in a determination of independence or control. Moreover, while designation or election of a director by a stockholder does not *by itself* render the director non-independent, a director and its designating-stockholder should be mindful that communications between them may be used to determine whether the director was beholden to or otherwise influenced by the stockholder (generally or with respect to a specific board decision).

- **Abstentions are not an absolute shield where the director or stockholder was closely involved.** In *Tesla*, Musk's abstention from voting on his self-interested transaction was not sufficient to shield him from being deemed a controller given his outsized influence and his extensive involvement in the board's consideration of the transaction. In *Oracle*, the court held that the plaintiff's complaint supported a reasonable inference of breach of the duty of loyalty by Ellison and Oracle's co-CEO-director and reaffirmed that a corporate fiduciary who abstains from a vote on a transaction "may nevertheless face liability" if he or she had "close involvement" with the negotiation and approval of the transaction and the transaction's alleged unfairness may have been based in large part on that involvement.

- **Delaying announcement of favorable financial results until after announcement of a deal was held not to result in the stockholder vote having been "coerced."** In *Rouse*, the plaintiff alleged that, in response to the offer by Brookfield, the board delayed disclosure of Rouse's favorable financial results until after announcement of the deal. The court rejected the contention that, based on the timing, the stockholder vote was coerced—because the financial information was released before the stockholder vote, so the stockholders had the information when they voted.

- **The court suggested that non-independence of directors (even without a reasonable inference of their breach of the duty of loyalty) might prevent their dismissal at the pleading stage under *Cornerstone*.** In *Oracle*, the court found that the facts alleged did *not* support a reasonable inference that the directors (other than Ellison and the co-CEO) had breached the duty of loyalty. However, the court raised the question (and has sought supplemental briefing from the parties as to) whether, under *Cornerstone*, the directors' possible non-independence (due to their substantial ties to Ellison), standing alone, would prevent their dismissal from the case at the pleading stage.

- **Banker conflicts and compensation must be carefully considered.** (i) In *Rouse*, the court rejected the plaintiffs' contention that disclosure of the conflict of the seller's financial advisor was inadequate. The company disclosed that the banker had in the past provided, and might in the future provide, "investment banking, commercial banking and other financial services to [the buyer, Brookfield] for which it has received and may receive compensation." While the precise nature of the services or the exact amount of the compensation was not disclosed, there was disclosure of the aggregate fees paid to the advisor from 2014 through 2016. Further, the proxy statement disclosed that the committee considered this information before engaging the advisor and had determined that the potential conflicts were "not material in the context of the proposed transaction or expected to impair the banker's ability to perform financial advisory services for the Committee." The court concluded: "With this information in hand, stockholders had more than enough information to evaluate [the advisor's] fitness to serve as the Committee's financial advisor." (ii) In *Oracle*, the committee's banker was to be paid $17 million if the transaction closed and $1 million if it did not. While the court reaffirmed the "pitfalls" of contingent fee arrangements, it rejected the plaintiffs' contention that the fee arrangement indicated bad faith by the directors. Critical to the court's conclusion was that the record reflected that the directors had carefully considered the advantages and disadvantages of the contingent aspect of the fee arrangement and had specific reasons for concluding that it was in the company's interest.

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