Fall 2013 Update For
BUSINESS ASSOCIATIONS
Agency, Partnerships, LLCs, and Corporations
Eighth Edition

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Chapter 1. Agency

Section 1. Who is An Agent?

On page 13, insert the following new question to follow existing questions following Cargill:

6. What is the likely effect of decisions like Cargill on the behavior of major creditors? In addressing this question consider the effect on other, minor creditors, like the farmers who sold grain to Warren, as well as major creditors such as Cargill, Inc.
Chapter 2. Partnership

Section 1. What is a Partnership? And Who Are the Partners?

On page 88, delete the existing question 6 following Martin v. Peyton and replace it with the following new version:

6. Like A. Gay Jenison Farms Co. v. Cargill, Inc. (Chapter 1, § 1, supra), Martin v. Peyton raises the question whether a lender had become so entangled with its borrower as to become responsible for the borrower’s debts to others. Although the legal theories differed (agency versus partnership), the same basic principles are at stake. The two cases, of course, reached different results. What distinguishes the relationship between PPF and K. N. & K. from that between Cargill and Warren so as to justify the differing outcomes? Or, was one of the cases incorrectly decided?
Section 5.A. Dissolution

Insert the following on page 148 after the problems

Giles v. Giles Land Company
279 P.3d 139 (Kan. App. 2012)

Kelly Giles (Kelly), a general partner in a family farming partnership, filed suit against the partnership and his partners, arguing that he had not been provided access to partnership books and records. The remaining members of the partnership then filed a counterclaim requesting that Kelly be dissocated from the partnership. The trial court held that Kelly was not denied access to the partnership books and records. Kelly does not appeal from this decision. Moreover, the trial court held that Kelly should be dissociated from the partnership. Kelly, however, contends that the trial court's ruling regarding his dissociation from the partnership was improper. We disagree. Accordingly, we affirm.

The dispute in this case centers on a family owned and operated limited partnership, Giles Land Company, L.P. (partnership). On one side is the plaintiff, Kelly, the second youngest of seven children in the Giles family. On the other side are the defendants: the partnership; Norman Lee Giles and Dolores Giles, the mother and father of the seven children involved; and Kelly's six siblings: Norman Roger Giles (Roger), Lorie Giles Horacek, Trudy Giles Giard, Audry Giles Gates, Jody Giles Peintner, and Julie Giles Cox.

Kelly appeals from the trial court's judgment granting the counterclaim filed by the defendants, which included Norman and Dolores Giles along with their six other children, seeking the dissociation of Kelly from the partnership, under K.S.A. 56a–601 [UPA (1997) § 601]. The trial court also denied Kelly's claim that the defendants had failed to provide him full access to the partnership records, but Kelly does not appeal that judgment.

The record reveals the following facts. The partnership was formed in the mid–1990's. One-half of the assets in the partnership came from a trust held for the benefit of the children of Norman and Dolores, and the other half of the assets came from Norman. Over the years, Norman and Dolores transferred interests in the partnership to their children. The ownership in the partnership is as follows:

<table>
<thead>
<tr>
<th></th>
<th>General Partnership Interest</th>
<th>Limited Partnership Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>Norman Lee Giles</td>
<td>4.634500</td>
<td>03.3357145</td>
</tr>
<tr>
<td>Dolores N. Giles</td>
<td>4.634500</td>
<td>03.3357145</td>
</tr>
<tr>
<td>Trudy Giles Giard</td>
<td>12.857143</td>
<td></td>
</tr>
<tr>
<td>Norman Roger Giles</td>
<td>.243667</td>
<td>12.857143</td>
</tr>
<tr>
<td>Audry Giles Gates</td>
<td>12.857143</td>
<td></td>
</tr>
<tr>
<td>Jody Giles Peintner</td>
<td>12.857143</td>
<td></td>
</tr>
</tbody>
</table>
Lorie Giles Horacek .243666 12.857143
Kelly K. Giles .243667 06.185714
Julie Giles Cox 12.857143

Totals: 10.00% 90.00%

The general partnership interests held by Roger, Lorie, and Kelly were gifted to them by their parents.

The partnership owns both ranchland and farmland. This partnership [Giles Land Company] is not the only Giles family business; there is also Giles Ranch Company and H.G. Land and Cattle Company. In 1999, Kelly was a partner in the Giles Ranch Company, but he became so overwhelmed with the debt he had incurred in the operations of the ranch company that he insisted that he be bought out of the ranch company and relieved of all debt. The other partners managed to buy out Kelly's interest in the ranch company. At the time of the lawsuit, Kelly only had an ownership interest in the partnership at issue, *i.e.*, Giles Land Company.

On March 26, 2007, the partnership held a meeting to discuss converting the partnership into a limited liability company. Kelly was unable to attend the meeting, but he later received a letter explaining the family's interest in converting the partnership to a limited liability company. Kelly did not sign the articles of organization for the proposed conversion and instead had his attorney request production of all of the partnership's books and records for his review. Kelly was not satisfied with the records that the partnership had provided, so he filed suit asking the court to force the partnership to turn over all of the documents he was requesting. In response, the defendants filed an answer and a counterclaim seeking to dissociate Kelly from the partnership.

After a 2–day trial, the trial court determined that the partnership had properly complied with the document requests. The trial court also held that Kelly should be dissociated from the partnership under K.S.A. 56a–601(e)(3) [UPA (1997) § 601(5)(iii)] or, in the alternative, K.S.A. 56a–601(e)(1) [UPA (1997) § 601(5)(i)]. The trial court found that due to Kelly's threats and the total distrust between Kelly and his family, it was not practicable to carry on the business of the partnership so long as Kelly was a partner.

*Did the Trial Court Err in Finding that Kelly Should Be Dissociated from the Partnership?*

On appeal, Kelly argues that the trial court erred in finding that he should be dissociated from the partnership under K.S.A. 56a–601(e)(3) or, alternatively, K.S.A. 56a–601(e)(1). …

K.S.A. 56a–601 states the following:

A partner is dissociated from a partnership upon the occurrence of any of the following events:

....

(e) on application by the partnership or another partner, the partner's expulsion by judicial determination because:
The partner engaged in wrongful conduct that adversely and materially affected the partnership business;

....

(3) the partner engaged in conduct relating to the partnership business which makes it not reasonably practicable to carry on the business in partnership with the partner.”

The trial court relied primarily on K.S.A. 56a–601(e)(3) to dissociate Kelly; therefore, the record must demonstrate that (1) Kelly engaged in conduct relating to the partnership business and (2) such conduct makes it not reasonably practicable to carry on the business in partnership with Kelly. See K.S.A. 56a–601(e)(3).

Kansas' partnership statutes were … changed on the enactment of the Kansas Revised Uniform Partnership Act in 1998. These changes brought about the concept of dissociation, which previously did not formally exist in our law. … The statutory dissociation language in K.S.A. 56a–601(e) is very similar to the dissolution provisions set out in K.S.A. 56a–801(e). The comment to § 601 of the UPA, which is the source of K.S.A. 56a–601(e), confirms that the dissociation provisions were based on the preexisting grounds for dissolution under the UPA. … Consequently, caselaw addressing the analogous UPA dissolution provisions is probative in analyzing the defendants' dissociation claim.

Kelly first contends that there is no evidence that he engaged in conduct relating to the partnership business. Kelly argues that the trial court erroneously relied on evidence that he had threatened his family members and that the familial relationship was broken. Kelly maintains that this evidence is not related to the partnership business and, therefore, it was not relevant.

Before we address Kelly's argument as to the trial court's use of this evidence in concluding that dissociation was proper, it is helpful to our review to set out some of the trial court's findings. …

First, the trial court found that Kelly did not trust the other general partners and that he did not trust some of his sisters who are limited partners in the partnership. The trial court also found that the general partners as well as all of the other partners did not trust Kelly.

The trial court further found that the relationship between Kelly and the other family members was irremediably broken. In reaching that conclusion, the trial court focused on a meeting between the partners in 2006. Kelly turned to each of the general partners and said that they would each die, in turn, and that he would be the last man standing and that he would then get to control the partnership. Although Kelly testified that this was not a threat and that he was simply trying to explain the right of survivorship, the trial court believed the testimony of the rest of the family that it was taken as a threat. The trial court also relied on evidence that Kelly had said that “paybacks are hell” and that he intended to get even with his partners. The trial court also found this to be a threat. Another fact that the trial court relied on in finding that the family relationship was irreparably broken was that it was impossible for any of the family members to communicate with Kelly regarding the partnership. Each family member testified that he or she believed that it was in the best interest of the partnership to not have Kelly remain a partner.

In finding that Kelly should no longer be a partner, the trial court stated:
This court finds that the testimony of the counterclaimants regarding the plans of Kelly Giles to take over Giles Land Company, L.P., [the partnership], predicting the deaths of the other General Partners, the statement of Kelly Giles that 'paybacks are hell’ and that he would get even, is credible. The Court finds that Kelly Giles’ version of events as something close to the magnanimous savior of the family lacked credibility. The Court finds that Kelly Giles was not amenable to land acquisitions or working with the family .... The Court further finds that given the lack of trust between Kelly Giles and his siblings who are General Partners, the partnership cannot operate in a meaningful fashion, and certainly cannot operate as intended, as a family business where there is cooperation, as long as Kelly Giles is a partner in [the partnership].

... Additionally, to support its argument that the trial court correctly applied K.S.A. 56a–601(e)(3), the defendants direct this court to consider Brennan v. Brennan Associates, 293 Conn. 60, 977 A. 2d 107 (2009). ... The Brennan court held that “an irreparable deterioration of a relationship between partners is a valid basis to order dissolution, and, therefore, is a valid basis for the alternative remedy of dissociation.” 293 Conn. at 81, 977 A. 2d 107.

Here, like in Brennan, Kelly argues that the evidence that the trial court relied on was not related to the partnership business. Reviewing the record as a whole, it is clear that the trial court found the evidence to be related to the partnership business because this was a family partnership and all of the alleged disputes were between family members in that partnership. It is also telling that both of the parents and all of the other siblings joined in this lawsuit seeking Kelly's dissociation. Clearly, the relationship between Kelly and his family was broken, and although Kelly attempted to argue that their personal issues were not interfering with the partnership, the trial court did not find his testimony to be credible.

In light of the animosity that Kelly harbors toward his partners and his distrust of them (which distrust is mutual), it is clear that Kelly can no longer do business with his partners and vice-versa. Indeed, the partnership has reached an impasse regarding important business because of a lack of communication between Kelly and his partners. The evidence indicated that most communications with Kelly had to be conducted through his attorney. Moreover, Kelly's statement predicting the deaths of his general partners, his statement that “paybacks are hell,” and his statement that he would get even showed a naked ambition on his part to control the partnership, contrary to the interests of the other partners.

... Alternative Theory for Dissociation

The trial court also found that there was enough evidence to dissociate Kelly under K.S.A. 56a–601(e)(1). ...

Under this alternative theory of dissociation, the record must demonstrate (1) that Kelly engaged in wrongful conduct and (2) that the wrongful conduct adversely and materially affected the partnership business. ...

Kelly first argues that he did not engage in wrongful conduct towards his parents, Norman and Dolores... Additionally, Kelly argues that even if his conduct was wrongful, it did not adversely or materially affect the partnership business. Kelly contends the record shows that
the partnership continued to operate as it always had and that the partners failed to show how his conduct materially or adversely affected the business of the partnership.

…

Kelly had created a situation where the partnership could no longer carry on its business to the mutual advantage of the other partners. For example, Lorie testified that Kelly would berate and belittle Norman in an attempt to make Norman do what Kelly wanted. There was also testimony given by John Horacek, Lorie’s husband, that in a phone conversation between Kelly and Norman, Kelly yelled and cursed at his father and his father was in tears by the end of the conversation. Norman further testified that it would be better for everyone if Kelly were no longer in the partnership because it was clear that Kelly did not agree with what the other partners were wanting to do with the future of the partnership. Norman testified: “ ‘Cause I think the route we’re on now, Judge, if we continue on this, and we don’t—we’re just at a standstill on what we plan to do.” There was also evidence that Kelly had frustrated the partnership’s opportunities to purchase more land. …

Because this is a family partnership, the evidence of Kelly making threats or berating his parents to get them to give him what he wants qualifies as wrongful conduct. None of the partners were able to interact or communicate with Kelly. Additionally, Norman clearly testified that the partnership was at a standstill because of the disputes between Kelly and the rest of the partners. This is evidence that Kelly was materially or adversely affecting the partnership. Moreover, this evidence is clearly enough to support dissolution based on the caselaw listed earlier; therefore, it is also sufficient for dissociation. Based on this evidence, we determine that the trial court properly held that Kelly could also be dissociated under K.S.A. 56a–601(e)(1).

Affirmed.

NOTE AND QUESTION

Under UPA (1997) § 603, when a partner ceases to be associated with the firm, one of two things can happen. In most cases, per Article 7, the nondissociating partners usually may continue the partnership by buying out the dissociating partner’s interest. Section 701 explains, in pertinent part, that:

(a) If a partner is dissociated from a partnership without resulting in a dissolution and winding up of the partnership business under Section 801, the partnership shall cause the dissociated partner’s interest in the partnership to be purchased for a buyout price determined pursuant to subsection (b).

(b) The buyout price of a dissociated partner’s interest is the amount that would have been distributable to the dissociating partner under Section 807(b) if, on the date of dissociation, the assets of the partnership were sold at a price equal to the greater of the liquidation value or the value based on a sale of the entire business as a going concern without the dissociated partner and the partnership were wound up as of that date. Interest must be paid from the date of dissociation to the date of payment.

In some cases, however, per Article 8, the partners may--and in some cases, must--go forward with a dissolution and winding up of the business. Section 801 explains that:

A partnership is dissolved, and its business must be wound up, only upon the occurrence of any of the following events:
(1) in a partnership at will, the partnership’s having notice from a partner, other than a partner who is dissociated under Section 601(2) through (10), of that partner’s express will to withdraw as a partner, or on a later date specified by the partner;

(2) in a partnership for a definite term or particular undertaking:

   (i) within 90 days after a partner’s dissociation by death or otherwise under Section 601(6) through (10) or wrongful dissociation under Section 602(b), the express will of at least half of the remaining partners to wind up the partnership business, for which purpose a partner’s rightful dissociation pursuant to Section 602(b)(2)(i) constitutes the expression of that partner's will to wind up the partnership business;

   (ii) the express will of all of the partners to wind up the partnership business; or

   (iii) the expiration of the term or the completion of the undertaking;

(3) an event agreed to in the partnership agreement resulting in the winding up of the partnership business;

(4) an event that makes it unlawful for all or substantially all of the business of the partnership to be continued, but a cure of illegality within 90 days after notice to the partnership of the event is effective retroactively to the date of the event for purposes of this section;

(5) on application by a partner, a judicial determination that:

   (i) the economic purpose of the partnership is likely to be unreasonably frustrated;

   (ii) another partner has engaged in conduct relating to the partnership business which makes it not reasonably practicable to carry on the business in partnership with that partner; or

   (iii) it is not otherwise reasonably practicable to carry on the partnership business in conformity with the partnership agreement; or

(6) on application by a transferee of a partner’s transferable interest, a judicial determination that it is equitable to wind up the partnership business:

   (i) after the expiration of the term or completion of the undertaking, if the partnership was for a definite term or particular undertaking at the time of the transfer or entry of the charging order that gave rise to the transfer; or

   (ii) at any time, if the partnership was a partnership at will at the time of the transfer or entry of the charging order that gave rise to the transfer.

On the facts of this case, is either the partnership or Kelly entitled to a dissolution under § 801?
ANALYSIS

1. What did UPA (1997) achieve by adding the possibility of dissociation found in § 601?

2. How did Kelly’s actions “materially affect[] the partnership business” or “make[] it not reasonably practicable to carry on the business in partnership with the partner”?

3. What advice might you have offered Kelly about whether to appeal the judgment of the trial court?

4. Was Kelly’s conduct more or less reprehensible than that of defendant Cohen in Owen v. Cohen, supra, of defendant John Lewis in Collins v. Lewis, supra? Regardless of what you conclude on that question, would the plaintiff in either of those cases have been entitled to a dissolution under the principles applied in Giles?
Chapter 3. The Nature of the Corporation

Section 1. Promoters and the Corporate Entity

On page 175, insert the following the Planning Problem

Introduction

In most states, incorporating a business is an astonishingly simple process. Articles of incorporation meeting certain minimal statutory requirements are drafted. One or more incorporators sign the articles and deliver them to the state of incorporation’s secretary of state’s office, along with a check for any applicable fees or taxes. The secretary of state retains the original articles and returns a copy to the incorporator with a receipt for the fee. Unless the articles provide to the contrary, the corporation comes into existence at the moment the secretary of state’s office accepts the articles for filing.

Modern articles of incorporation usually are bare-bones documents, containing little more than the statutorily mandated terms. Model Business Corporation Act (MBCA)§ 2.02(a), for example, requires the articles to contain only four items:

- **Name.** A corporation’s name may not be the same or confusingly similar to that of another corporation incorporated or qualified to do business in the state of incorporation. The name must also include some word or abbreviation indicating that the business is incorporated, such as corporation, company, “Inc.” or the like.

- **Authorized shares.** The articles must state the maximum number of shares the corporation is authorized to issue.

- **Registered agent.** The articles must state the name of the corporation’s registered agent and the address of its registered office. The registered office must be located within the state of incorporation. The registered agent receives service of process when the corporation is sued.

- **Incorporators.** The articles must state the name and address of each incorporator.

Under MBCA § 2.02(b), the articles of incorporation also may contain a host of optional provisions. Some of these options alternatively may be included in the bylaws, but many must be included in the articles of incorporation in order to be effective. Some of the more common and important optional provisions include:

- **Statement of purpose.** The articles may state the nature of the corporation’s business or the purposes for which it was formed.¹

- **Classes and series of shares.** Corporate stock may be separated into multiple classes and series. If the corporation wishes to do so, the articles must identify the different classes and state the number of shares of each class the corporation is authorized to issue. Where one or more classes of shares have certain preferential rights over other classes, those rights must be spelled out in this part of the articles.

- **Director and officer indemnification and liability limitation.** We will see many situations throughout this text in which directors or officers of a corporation may be held liable for

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¹ A number of states, prominently including Delaware, still require that the articles contain a statement of corporate purpose. It is sufficient, however, to state that “the purpose of the corporation is to engage in any lawful act or activity . . . .” DGCL § 102(a)(3).
misconduct. Most corporate statutes now permit the articles to include provisions limiting the scope of a director’s liability and/or permitting indemnification of directors.

The articles of incorporation may be amended at any time. A three-step process is normally involved. First, the board of directors must recommend the amendment to the shareholders. Second, the shareholders must approve the amendment. Finally, the amendment must be filed with the secretary of state’s office.

Bylaws are the rules a corporation adopts to govern its internal affairs. Bylaws tend to be far more detailed than the articles of incorporation, for three reasons: (1) bylaws need not be filed with the state government, which means they are not part of any public record; (2) bylaws are more easily amended than articles of incorporation (see below); and (3) officers and directors tend to be more familiar with bylaws than with the articles, which makes them a ready repository of organizational rules. In the event of a conflict between a bylaw and the articles, the latter controls.

The bylaws typically deal with such matters as number and qualifications of directors, board vacancies, board committees, quorum and notice requirement for shareholder and board meetings, procedures for calling special shareholder and board meetings, any special voting procedures, any limits on the transferability of shares, and titles and duties of the corporation’s officers.

**Boilermakers Local 154 Retirement Fund v. Chevron Corporation**

--- A.3d ----, 2013 WL 3191981 (Del.Ch.2013)

I. Introduction

The board of Chevron, the oil and gas major, has adopted a bylaw providing that litigation relating to Chevron's internal affairs should be conducted in Delaware, the state where Chevron is incorporated and whose substantive law Chevron's stockholders know governs the corporation's internal affairs. The board of the logistics company FedEx, which is also incorporated in Delaware and whose internal affairs are also therefore governed by Delaware law, has adopted a similar bylaw providing that the forum for litigation related to FedEx's internal affairs should be the Delaware Court of Chancery. …

The plaintiffs, stockholders in Chevron and FedEx, have sued the boards for adopting these “forum selection bylaws.” The plaintiffs' complaints are nearly identical and were filed only a few days apart by clients of the same law firm. In Count I, the plaintiffs claim that the bylaws are statutorily invalid because they are beyond the board's authority under the Delaware General Corporation Law (“DGCL”). In Count IV, the plaintiffs allege that the bylaws are contractually invalid, … because they were unilaterally adopted by the Chevron and FedEx boards using their power to make bylaws. ... The plaintiffs have also claimed that the boards of Chevron and FedEx breached their fiduciary duties in adopting the bylaws.
II. Background And Procedural Posture

A. The Chevron And FedEx Forum Selection Bylaws

Critical to the resolution of this motion is an understanding of who has the power to adopt, amend, and repeal the bylaws, and what subjects the bylaws may address under the DGCL. 8 Del. C. § 109(a) identifies who has the power to adopt, amend, and repeal the bylaws:

[T]he power to adopt, amend or repeal bylaws shall be in the stockholders entitled to vote.... Notwithstanding the foregoing, any corporation may, in its certificate of incorporation, confer the power to adopt, amend or repeal bylaws upon the directors.... The fact that such power has been so conferred upon the directors ... shall not divest the stockholders ... of the power, nor limit their power to adopt, amend or repeal bylaws.

8 Del. C. § 109(b) states the subject matter the bylaws may address:

The bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees.

Both Chevron's and FedEx's certificates of incorporation conferred on the boards the power to adopt bylaws under 8 Del. C. § 109(a). Thus, all investors who bought stock in the corporations whose forum selection bylaws are at stake knew that (i) the DGCL allows for bylaws to address the subjects identified in 8 Del. C. § 109(b), (ii) the DGCL permits the certificate of incorporation to contain a provision allowing directors to adopt bylaws unilaterally, and (iii) the certificates of incorporation of Chevron and FedEx contained a provision conferring this power on the boards.

Acting consistent with the power conferred to the board in Chevron's certificate of incorporation, the board amended the bylaws and adopted a forum selection bylaw … that provided:

Unless the Corporation consents in writing to the selection of an alternative forum, the Court of Chancery of the State of Delaware shall be the sole and exclusive forum for (i) any derivative action or proceeding brought on behalf of the Corporation, (ii) any action asserting a claim of breach of a fiduciary duty owed by any director, officer or other employee of the Corporation to the Corporation or the Corporation's stockholders, (iii) any action asserting a claim arising pursuant to any provision of the Delaware General Corporation Law, or (iv) any action asserting a claim governed by the internal affairs doctrine. Any person or entity purchasing or otherwise acquiring any interest in shares of capital stock of the Corporation shall be deemed to have notice of and consented to the provisions of this [bylaw].

Several months later, on March 14, 2011, the board of FedEx, a Delaware corporation headquartered in Tennessee, adopted a forum selection bylaw identical to Chevron's. Like Chevron, FedEx's board had been authorized by the certificate of incorporation to adopt bylaws without a stockholder vote, and the FedEx board adopted the bylaw unilaterally.

Chevron's board amended its bylaw on March 28, 2012 to provide that suits could be filed in any state or federal court in Delaware with jurisdiction over the subject matter and the
parties. The amended bylaw also provides that the bylaw would not apply unless the court in Delaware had personal jurisdiction over all the parties that were “indispensable” to the action.

In their briefing, the boards of Chevron and FedEx state that … these bylaws are not intended to regulate *what* suits may be brought against the corporations, only *where* internal governance suits may be brought.

**B. The Defendant Boards Have Identified Multiforum Litigation Over Single Corporate Transactions Or Decisions As The Reason Why They Adopted The Bylaws**

The Chevron and FedEx boards say that they have adopted forum selection bylaws in response to corporations being subject to litigation over a single transaction or a board decision in more than one forum simultaneously, so-called “multiforum litigation.” The defendants' opening brief … describes how, for jurisdictional purposes, a corporation is a citizen both of the state where it is incorporated and of the state where it has its principal place of business. Because a corporation need not be, and frequently is not, headquartered in the state where it is incorporated, a corporation may be subject to personal jurisdiction as a defendant in a suit involving corporate governance matters in two states. … Furthermore, both state and federal courts may have jurisdiction over the claims against the corporation. The result is that any act that the corporation or its directors undertake may be challenged in various forums within those states simultaneously. The boards of Chevron and FedEx argue that multiforum litigation, when it is brought by dispersed stockholders in different forums, directly or derivatively, to challenge a single corporate action, imposes high costs on the corporations and hurts investors by causing needless costs that are ultimately born by stockholders, and that these costs are not justified by rational benefits for stockholders from multiforum filings.

…

**C. The Plaintiffs Challenge The Forum Selection Bylaws**

… [B]ecause Chevron and FedEx had made persuasive arguments that addressing the facial challenges to the bylaws would avoid unnecessary costs or delay, … the court consolidated their cases to resolve those common and narrow questions of law: (i) whether the forum selection bylaws are facially invalid under the DGCL (Count I); and (ii) whether the board-adopted forum selection bylaws are facially invalid as a matter of contract law (Count IV). …

**III. The Standard Of Review**

The standard of review on this motion is important in framing this consolidated motion. … [T]his motion is only concerned with the facial statutory and contractual validity of the bylaws, and the motion is expressly not concerned with how the bylaws might be applied in any future, real-world situation. The plaintiffs’ proposed standard, by contrast, is based on a case in which this court resolved an actual, live controversy over whether a bylaw could be applied to the real human events underlying that case.

… [T]he plaintiffs’ burden on this motion challenging the facial statutory and contractual validity of the bylaws is a difficult one: they must show that the bylaws cannot operate lawfully
or equitably under any circumstances. So, the plaintiffs must show that the bylaws do not address proper subject matters of bylaws as defined by the DGCL in 8 Del. C. § 109(b), and can never operate consistently with law. …

IV. Legal Analysis

A. The Board–Adopted Forum Selection Bylaws Are Statutorily Valid

... First, … the court must determine whether the adoption of the forum selection bylaws was beyond the board's authority in the sense that they do not address a proper subject matter under 8 Del. C. § 109(b), which provides that:

The bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees.

…

1. The Forum Selection Bylaws Regulate A Proper Subject Matter Under 8 Del. C. § 109(b)

… As a matter of easy linguistics, the forum selection bylaws address the “rights” of the stockholders, because they regulate where stockholders can exercise their right to bring certain internal affairs claims against the corporation and its directors and officers. They also plainly relate to the conduct of the corporation by channeling internal affairs cases into the courts of the state of incorporation, providing for the opportunity to have internal affairs cases resolved authoritatively by our Supreme Court if any party wishes to take an appeal. …

Perhaps recognizing the weakness of any argument that the forum selection bylaws fall outside the plain language of 8 Del. C. § 109(b), the plaintiffs try to argue that judicial gloss put on the language of the statute renders the bylaws facially invalid. The plaintiffs contend that the bylaws … attempt to regulate an “external” matter, as opposed to, an “internal” matter of corporate governance. The plaintiffs attempt to support this argument with a claim that traditionally there have only been three appropriate subject matters of bylaws: stockholder meetings, the board of directors and its committees, and officerships.

But even if one assumes that judicial statements could limit the plain statutory words in the way the plaintiffs claim (which is dubious), the judicial decisions do not aid the plaintiffs. The plaintiffs take a cramped view of the proper subject matter of bylaws. The bylaws of Delaware corporations have a “procedural, process-oriented nature.” It is doubtless true that our courts have said that bylaws typically do not contain substantive mandates, but direct how the corporation, the board, and its stockholders may take certain actions. 8 Del. C. § 109(b) has long been understood to allow the corporation to set “self-imposed rules and regulations [that are] deemed expedient for its convenient functioning.” The forum selection bylaws here fit this description. They are process-oriented, because they regulate where stockholders may file suit,

not whether the stockholder may file suit or the kind of remedy that the stockholder may obtain on behalf of herself or the corporation. The bylaws also clearly address cases of the kind that address “the business of the corporation, the conduct of its affairs, and ... the rights or powers of its stockholders, directors, officers or employees,” because they govern where internal affairs cases governed by state corporate law may be heard. These are the kind of claims most central to the relationship between those who manage the corporation and the corporation's stockholders.

By contrast, the bylaws would be regulating external matters if the board adopted a bylaw that purported to bind a plaintiff, even a stockholder plaintiff, who sought to bring a tort claim against the company based on a personal injury she suffered that occurred on the company's premises or a contract claim based on a commercial contract with the corporation. The reason why those kinds of bylaws would be beyond the statutory language of 8 Del. C. § 109(b) is obvious: the bylaws would not deal with the rights and powers of the plaintiff-stockholder as a stockholder. ...

Nor is it novel for bylaws to regulate how stockholders may exercise their rights as stockholders. For example, an advance notice bylaw "requires stockholders wishing to make nominations or proposals at a corporation's annual meeting to give notice of their intention in advance of so doing." Like such bylaws, which help organize what could otherwise be a chaotic stockholder meeting, the forum selection bylaws are designed to bring order to what the boards of Chevron and FedEx say they perceive to be a chaotic filing of duplicative and inefficient derivative and corporate suits against the directors and the corporations.

The plaintiffs’ argument, then, reduces to the claim that the bylaws do not speak to a “traditional” subject matter, and should be ruled invalid for that reason alone. For starters, the factual premise of this argument is not convincing. … But in any case, the Supreme Court long ago rejected the position that board action should be invalidated or enjoined simply because it involves a novel use of statutory authority. In Moran v. Household International in 1985, … the court reiterated that “our corporate law is not static. It must grow and develop in response to, indeed in anticipation of, evolving concepts and needs. Merely because the General Corporation Law is silent as to a specific matter does not mean that it is prohibited.”

2. The Board–Adopted Bylaws Are Not Contractually Invalid As Forum Selection Clauses Because They Were Adopted Unilaterally By The Board

Despite the contractual nature of the stockholders' relationship with the corporation under our law, the plaintiffs argue, in Count IV of their complaints, that the forum selection bylaws by their nature are different and cannot be adopted by the board unilaterally. The plaintiffs' argument is grounded in the contention that a board-adopted forum selection bylaw cannot be a contractual forum selection clause because the stockholders do not vote in advance of its adoption to approve it. The plaintiffs acknowledge that contractual forum selection clauses are

“prima facie valid” under The Bremen v. Zapata Off–Shore Co. and Ingres Corp. v. CA, Inc., and that they are presumptively enforceable. But, the plaintiffs say, the forum selection bylaws are contractually invalid in this case, because they were adopted by a board, rather than by Chevron's and FedEx’s dispersed stockholders. The plaintiffs argue that this method of adopting a forum selection clause is invalid as a matter of contract law, because it does not require the assent of the stockholders who will be affected by it. Thus, in the plaintiffs' view, there are two types of bylaws: (i) contractually binding bylaws that are adopted by stockholders; (ii) non-contractually binding bylaws that are adopted by boards using their statutory authority conferred by the certificate of incorporation.

In an unbroken line of decisions dating back several generations, our Supreme Court has made clear that the bylaws constitute a binding part of the contract between a Delaware corporation and its stockholders. Stockholders are on notice that, as to those subjects that are subject of regulation by bylaw under 8 Del. C. § 109(b), the board itself may act unilaterally to adopt bylaws addressing those subjects. Such a change by the board is not extra-contractual simply because the board acts unilaterally; rather it is the kind of change that the overarching statutory and contractual regime the stockholders buy into explicitly allows the board to make on its own. In other words, the Chevron and FedEx stockholders have assented to a contractual framework established by the DGCL and the certificates of incorporation that explicitly recognizes that stockholders will be bound by bylaws adopted unilaterally by their boards. Under that clear contractual framework, the stockholders assent to not having to assent to board-adopted bylaws. The plaintiffs' argument that stockholders must approve a forum selection bylaw for it to be contractually binding is an interpretation that contradicts the plain terms of the contractual framework chosen by stockholders who buy stock in Chevron and FedEx. …

Even so, the statutory regime provides protections for the stockholders, through the indefeasible right of the stockholders to adopt and amend bylaws themselves. “[B]y its terms Section 109(a) vests in the shareholders a power to adopt, amend or repeal bylaws that is legally sacrosanct, i.e., the power cannot be non-consensually eliminated or limited by anyone other than the legislature itself.” Thus, even though a board may, as is the case here, be granted authority to adopt bylaws, stockholders can check that authority by repealing board-adopted bylaws. And, of course, because the DGCL gives stockholders an annual opportunity to elect directors, stockholders have a potent tool to discipline boards who refuse to accede to a stockholder vote repealing a forum selection clause. Thus, a corporation's bylaws are part of an inherently flexible contract between the stockholders and the corporation under which the stockholders have powerful rights they can use to protect themselves if they do not want board-adopted forum selection bylaws to be part of the contract between themselves and the corporation.

V. Conclusion

For these reasons, the court finds that the challenged bylaws are statutorily valid under 8 Del. C. § 109(b), and are contractually valid and enforceable as forum selection clauses. Judgment is entered for the defendants dismissing Counts I and IV of the plaintiffs' complaints against Chevron and FedEx, with prejudice. IT IS SO ORDERED.

ANALYSIS

1. In a portion of the opinion we have omitted, the court explains that “neither the wisdom of the Chevron and FedEx boards in adopting the forum selection bylaws to address the prevalence of multiforum litigation, or in proceeding by way of a bylaw, rather than proposing an amendment to the certificate of incorporation, are proper matters for this court to address.” Are forum selection provisions wise? And, if so, is it wise to adopt them in the bylaws rather than the articles of incorporation?

2. The court emphasized that the plaintiffs had made a facial challenge to the bylaws and, accordingly, the possibility that the bylaws might operate inequitably under some circumstances was not before the court. In what circumstances, if any, might a forum selection bylaw operate inequitably?

3. The court noted that “contractual nature of the stockholders' relationship with the corporation under our law.” What does it mean to say that that relationship is contractual in nature?
Chapter 5. The Duties of Officers, Directors, and Other Insiders

Section 3.C. Derivative Aspects

Introductory Note

Cases involving alleged oversight failures almost never reach the merits of the claims. Instead, in the vast majority of cases, the plaintiff files a derivative suit without making demand on the board of directors, in response to which the defendants move to dismiss the suit for failure to comply with Delaware Rule of Civil Procedure 23.1’s demand requirement. The case is thus joined on the issue of whether demand was excused as futile. The following case illustrates how the Caremark standards fit into the demand excused context, explains the special rules on demand futility applicable to oversight cases, and provides an opportunity to review both oversight and demand futility.

In re China Agritech, Inc. Shareholder Derivative Litigation
2013 WL 2181514 (Del.Ch. 2013)

China Agritech, Inc. ... purportedly operates a fertilizer manufacturing business in China. According to lead plaintiff Albert Rish, China Agritech is a fraud that serves only to enrich its co-founders, defendants Yu Chang and Xiao Rong Teng. Rish has sued derivatively to recover damages resulting from (i) the Company's purchase of stock from a corporation owned by Chang and Teng, (ii) the suspected misuse of $23 million raised by the Company in a secondary offering, (iii) the mismanagement that occurred during a remarkable twenty-four month period that witnessed the terminations of two outside auditing firms and the resignations of six outside directors and two senior officers, and (iv) the Company's failure to make any federal securities filings since November 2010 and concomitant delisting by NASDAQ. …

The defendants have moved to dismiss pursuant to Rule 23.1, contending that the complaint fails to plead that demand was made on the board or would have been futile. ...

I. FACTUAL BACKGROUND

...

A. China Agritech

According to its public filings, China Agritech is a Delaware corporation that develops, manufactures, and markets environmentally friendly fertilizer products in the People's Republic of China. The Company accessed the domestic securities markets in February 2005 through a reverse merger with an inactive corporation that had retained its NASDAQ listing.* “[U]sing a defunct Delaware corporation that happens to retain a public listing to evade the regulatory

* [Eds.: When two or more corporations merge, only one of the constituent corporations survives. In a forward merger, which is by far the more common type, the acquiring company survives. In a reverse merger, by contrast, the acquired corporation is the one that survives. In such a merger, the newly formed entity retains all the rights of the surviving company, including its listing on a US stock exchange. By using this technique, a corporation thus can go public on US capital markets without the delay and expense of an initial public offering (IPO).]
regime established by the federal securities laws is contrary to Delaware public policy.”

Defendant Chang founded China Agritech. Chang has served as the Company's President, Chief Executive Officer, Secretary, and Chairman of the board since February 2005. He owns approximately 55% of China Agritech's outstanding common stock, holding 34.1% directly and another 20.8% beneficially through China Tailong Group Limited. By virtue of his stock ownership and positions with the Company, Chang controls China Agritech.

Defendant Teng co-founded China Agritech. Teng has served as a director of the Company since June 2005. From February 3, 2005 until March 13, 2009, she served as the Company's Chief Operating Officer. She owns 1.68% of the Company's common stock directly.

B. Problems With Internal Controls

In its [annual] Form 10–K for the year ending December 31, 2007, filed with the SEC on March 28, 2008, the Company disclosed that it “did not have in place the financial controls and procedures required to comply with U.S. financial reporting standards.” …

In an effort to correct its control problems, the Company hired new executives and expanded its board. On October 22, 2008, defendant Yau–Sing Tang (“Y.Tang”) joined China Agritech as its CFO and controller. On that same date, defendants Gene Michael Bennett, Lun Zhang Dai, and Hai Ling Zhang (“H.Zhang”) became directors. The board then established an Audit Committee, a Compensation Committee, and a Nominating and Governance Committee (the “Governance Committee”), each populated with the new outside directors. Beginning with its Form 10–K for the year ending December 31, 2008, filed with the SEC on March 28, 2009, China Agritech disclosed that its internal controls and procedures were effective as of December 31, 2008.

C. The Yinlong Transaction

On February 12, 2009, Yinlong Industrial Co., Ltd. (“Yinlong”) sold China Agritech the remaining 10% equity interest in China Agritech's otherwise 90% owned subsidiary, Pacific Dragon Fertilizers Co. Ltd. (“Pacific Dragon”). Chang and Teng owned 85% and 15%, respectively, of Yinlong's shares, making the deal an interested transaction. …

China Agritech acquired the Pacific Dragon shares through a wholly owned subsidiary, China Tailong Holdings Company Ltd. (“Tailong”). China Agritech agreed to pay Yinlong $7,980,000 for the shares, with all but $1 million coming in the form of an interest-free promissory note from Tailong to Yinlong. The transaction closed on May 15, 2009. On the day of the closing, the parties entered into a supplemental purchase agreement. The supplemental purchase agreement amended the “settlement of the purchase consideration” to a cash payment of $1 million and the issuance of 1,745,000 restricted shares of China Agritech common stock. …

Chang, Teng, Dai, Bennett, and H. Zhang comprised the board at the time of the Yinlong Transaction. Dai, Bennett, and H. Zhang comprised both the Audit Committee and the Governance Committee.
In March 2009, defendant Ming Gang Zhu became China Agritech's Chief Operating Officer, taking over from Teng. In December 2009, defendant Zheng Wang joined the board as a designee of a fund that invested in the Company. Because of her affiliation, the board did not consider her to be an independent director. …

In early January 2010, Charles Law became an outside director. He joined the Governance Committee and the Compensation Committee.

D. The $23 Million Offering

In April 2010, China Agritech announced a public offering of 1,243,000 shares of common stock, plus an underwriter's option on an additional 186,450 shares, which the underwriter exercised (the “Offering”). The stated purpose of the Offering was to finance the construction of distribution centers for China Agritech's fertilizer products. The Offering raised total gross proceeds of $23 million. According to the Complaint, the funds have not been used to construct distribution centers or for any other discernible business purpose, suggesting either that the funds have been misused or that the stated purpose was false. At the time of the Offering, Chang, Teng, Dai, Bennett, H. Zhang, Law, and Wang comprised the board.

E. The Material Weaknesses Return

In its [quarterly] Form 10–Q dated August 16, 2010, China Agritech disclosed that material weaknesses had again undermined its disclosure controls and procedures. … The material weaknesses necessitated making adjustments to the Company's reported results for first quarter 2010.

In its Form 10–Q dated November 10, 2010, the Company claimed to have fixed its internal controls problem: “[M]anagement enhanced the supervision and review of the financial reporting process” and deemed that the “remediation steps correct[ed] the material weaknesses” previously identified. The November 2010 Form 10–Q was the last time that China Agritech made a federally mandated securities filing. …

On November 13, 2010, three days after claiming that the material weaknesses were solved, the Company fired its outside auditor, Crowe Horwath LLP. The Audit Committee approved the termination. Dai, Bennett, and H. Zhang comprised the Audit Committee.

F. The Company Hires Ernst & Young.

Effective as of November 13, 2010, the Company hired Ernst & Young Hua Ming (“Ernst & Young”) as its new outside auditor…

On December 15, 2010, Ernst & Young provided a letter to the Audit Committee describing matters which, if not appropriately addressed, could result in audit adjustments, significant deficiencies or material weaknesses, and delays in the filing of the Company's Form 10–K for 2010. Company management claimed to have addressed the issues, but Ernst & Young did not agree.
G. The McGee Report

While Ernst & Young was raising issues with Company management, Lucas McGee was investigating China Agritec. McGee is a self-described “consultant and private investor with more than ten years of business and finance experience throughout Asia, including China, Hong Kong and Vietnam.” On February 3, 2011, McGee posted a report titled “China Agritech: A Scam” (the “McGee Report”) on the investor website www.seekingalpha.com. McGee disclosed that he held a short position in the Company's stock and stood to profit from a decline in the Company's common stock price.

The McGee Report identified a series of alleged problems with the Company's business, including:

- Factories are idle: After visiting [China Agritech's] reported manufacturing facilities ... we found virtually no manufacturing underway. The single exception was the facility in Pinggu County on the outskirts of Beijing, where the plant was not in operation on the Friday when we visited but local people told us that it has sporadically produced some liquid fertilizer over the last year. Plants in Bengbu, Anhui (supposedly the largest), Harbin, and Xinjiang were completely shuttered.
- Harbin plant for sale: The Harbin facility—supposedly a major manufacturing facility for the $100 million revenue business—whose name has never been officially changed in government documentation from “Pacific Dragon,” had a sign hanging on the gates last summer reading “this factory is for sale.”
- No contract with Sinochem: A January [China Agritech] announcement states: “In May 2010, the Company signed a renewed contract supplying organic liquid compound fertilizers to Sinochem, China's largest fertilizer distributor.” ... But a manager with Sinochem told us that Sinochem has no contract with [China Agritech] and in fact has never bought or sold organic liquid fertilizers....
- [China Agritech] not permitted to make granular fertilizer: [China Agritech] claims that most of its sales volume now derives from granular compound fertilizers. But government officials familiar with the [China Agritech] operation say that [China Agritech] has not received a license to manufacture granular compound fertilizer and does not sell any.
- Unable to buy the product: Although the [C]ompany has announced 21 regional distribution centers, we have not been able to locate any. ...
- Fictional Revenue: [W]e have received an analysis of audited [China Agritech] revenues reported to the Chinese government for the year 2009 In its [third quarter 2010 10–Q], [China Agritech] claims that it has 100,000 metric tons of production capacity in Anhui, 50,000 metric tons in Harbin, and 50,000 tons in Xinjiang. But a total value of ... $3,000 in plant and equipment in Xinjiang would be insufficient to support 50,000 tons of production capacity. Indeed, when we visited the site of the Xinjiang plant, we found little more than a warehouse, shared with two other companies and demonstrating no activity.
- Our early attempts to find the Xinjiang factory were unsuccessful.... [A]fter searching the area and asking county officials, we were able to discover a factory bearing [China Agritech's] name along with the names of two other companies [at a different location than the registered address] ....The facility, however, is idle and we were told by local people that there is no production activity there.
• In Anhui, which [China Agritech] calls its principal production facility ... [w]e visited and found a small plant on a rutted road outside Bengbu, completely deserted.

• The Beijing plant is larger, but plant staff said in our presence that the facility was idle. The [C]ompany would not allow us in, but we drove around the plant and saw a few people on site washing clothes but no evidence of production. Local government officials said that [China Agritech] had not been able to obtain a production license for granular fertilizer and that it produced a very small volume of liquid fertilizer.

• No distribution centers: In May 2010, [China Agritech] issued over 1.4 million new shares, raising just under $19 million for the construction of distribution centers. But we have not been able to find evidence that any distribution centers were actually built.

• Mysterious suppliers: The companies that [China Agritech] lists in its corporate materials as suppliers of raw materials ... cannot be found in any directory under possible Chinese names that would correspond to the transliterated names or under the alphabetic names.

• Financial anomalies:

  …

  3. The Xinjiang company reports zero fixed assets, meaning that it owns no equipment for production....

  4. The Beijing facility has licensed registered capital of $20 million, but by the end of 2009 had received 88 million RMB, so only more than half of the legally required amount. But despite the missing capital, half of the registered capital was still sitting in the account in cash in 2009, indicating that the company had not purchased much, if any, equipment. ...

McGee concluded that China Agritech “is not a currently functioning business that is manufacturing products. Instead it is, in our view, simply a vehicle for transferring shareholder wealth from outside investors into the pockets of the founders and inside management.” …

On February 4, 2011, the day after the McGee Report issued, the Company posted a press release on its website denying the allegations. On February 10, the Company issued a second press release in the form of an open letter from Chang to “Fellow Shareholders and Potential Investors” in which he contested key elements of the McGee Report. …

On February 10, 2011, Law resigned from the board. The remaining directors appointed X. Zhang to fill his seat.

H. The Company Fires Ernst & Young.

On March 8, 2011, Ernst & Young met with the Audit Committee to discuss potential violations of law, including the United States securities laws. The issues identified by Ernst & Young included goods delivery notes that appeared to be modified after the fact; time sheets and related data for the Harbin facility that appeared to be destroyed; material purchases apparently made without supporting official tax invoice or with duplicative official tax invoice; a tax notice
from the Harbin City tax bureau that appeared to be falsified; and what appeared to be material undisclosed related party transactions. Ernst & Young expressed concern about whether the firm could continue to rely on management's representations. ... Ernst & Young asked the Audit Committee to take “timely and appropriate action.”

On March 10, 2011, the board formed a Special Investigation Committee (the “Special Committee”) to investigate Ernst & Young's allegations. The original members of the Special Committee were Wang, Dai, Bennett, and H. Zhang. Because Dai, Bennett, and H. Zhang were members of the Audit Committee, they faced the awkward task of investigating, evaluating, and passing on the propriety of their own actions as members of the Audit Committee. Wang was the only member of the Special Committee who did not face the prospect of investigating her own actions, but she was also a director whom the board did not regard as independent.

On March 12, 2011, Company management drafted a press release stating that the Special Committee had been formed and explaining that the action was taken due to allegations “made by third parties” with respect to the Company and certain issues “identified in connection with the performance of the Company's year end audit.” When the actual press release was issued, it omitted the phrase “identified in connection with the performance of the Company's year end audit.” Ernst & Young immediately advised Company counsel that the deletion of the reference to audit issues was a material omission. Ernst & Young stated that it would resign if a corrective press release was not issued. No correction was made.

On March 14, 2011, Chang informed Ernst & Young that the Audit Committee had terminated its engagement. Ernst & Young had no prior notice regarding its potential termination and had no reason to believe its termination was under consideration before the dispute over the press release. …

On March 15, 2011, Ernst & Young sent the Company a letter detailing its concerns about its termination and the accuracy of the Company's purported reasons. The letter noted that it was being sent to fulfill Ernst & Young's obligations “under Section 10A(b)(2) of the Securities Exchange Act of 1934,” which requires an independent auditor to report directly to a company's board of directors if it believes an (i) “illegal act” has occurred that materially affects the issuer's financial statements and (ii) that management had not, either independently or as required by the board, yet taken “timely and appropriate remedial action.”

Wang, the chair of the Special Committee, resigned from the board on March 15, 2011. She “was a Special Committee member only for one day.” Def. Op. Br. at 38 n. 14. The other members of the Special Committee continued to serve. Bennett, the Chair of the Audit Committee, took over as Chair of the Special Committee.

On April 25, 2011, the remaining directors appointed defendant Kai Wai Sim to fill Wang's seat. On the same day, Bennett resigned from both the Audit Committee and Special Committee, although for the time being he remained a member of the board. …

In April 2011, NASDAQ notified the Company that it would be delisted “based on public interest concerns and the Company's failure to file its 2010 form 10–K on time.” …

On May 27, 2011, the Company announced that Zhu, the Company's COO, had resigned. …
J. The Special Committee's “Findings”

On December 1, 2011, the Company issued a press release announcing that the Special Committee had completed its investigation. The Company noted that “[t]he investigation was subject to certain limitations,” including that “[Ernst & Young] did not cooperate with the investigation....” It is not clear what other limitations, if any, existed.

Without providing any details or explanation, the Company reported that according to the Special Committee, all was well:

[T]he [Special] Committee concluded that the investigation appropriately addressed all material issues raised by [Ernst & Young], the circumstances of [Ernst & Young]'s termination, and the allegations in [the McGee Report]. With specific regard to [the McGee Report], the [Special] Committee concluded that the allegations were either factually incorrect or that there were reasonable explanations as to their non-materiality. …

K. The Parade Of Resignations

On January 6, 2012, Rish filed this lawsuit. At the time, defendants Chang, Teng, Dai, Sim, Bennett, H. Zhang, and X. Zhang comprised the board (the “Demand Board”). Sim, Dai, H. Zhang, and X. Zhang served on the Special Committee, and Sim, H. Zhang, and X. Zhang served on the Audit Committee. [Shortly thereafter, Sim, Y. Tang, H. Zhang, X. Zhang, and Bennett resigned from the board.] …

The resignations left Chang, Teng, and Dai as the only members of the board. To recapitulate, Chang and Teng are the Company's co-founders. Chang controls a mathematical majority of China Agritech's outstanding voting power, and he is the Company's President, CEO, Secretary, and Chairman of the Board. …

II. LEGAL ANALYSIS

…

A. Rule 23.1

When a corporation suffers harm, the board of directors is the institutional actor legally empowered under Delaware law to determine what, if any, remedial action the corporation should take, including pursuing litigation against the individuals involved. “A cardinal precept of the General Corporation Law of the State of Delaware is that directors, rather than shareholders, manage the business and affairs of the corporation.” Aronson v. Lewis, 473 A.2d 805, 811 (Del.1984). …

In a derivative suit, a stockholder seeks to displace the board's authority over a litigation asset and assert the corporation's claim. Aronson, 473 A.2d at 811....

Because directors are empowered to manage, or direct the management of, the business and affairs of the corporation, the right of a stockholder to prosecute a derivative suit is limited to situations where the stockholder has demanded that the directors pursue the corporate claim and
they have wrongfully refused to do so or where demand is excused because the directors are incapable of making an impartial decision regarding such litigation.

Rish concedes that he did not make a litigation demand on the Demand Board, and the Company opposes his efforts to pursue litigation. Consequently, for Rish to obtain authority to move forward on behalf of China Agritech, his Complaint must “allege with particularity ... the reasons ... for not making the effort [to make a litigation demand],” and this Court must determine based on those allegations that “demand is excused because the directors are incapable of making an impartial decision regarding whether to institute such litigation.” Stone v.. Ritter, 911 A.2d 362, 367 (Del.2006)....

The Delaware Supreme Court has established two tests for determining whether the allegations of a complaint sufficiently plead demand futility. In Aronson, the seminal demand-futility decision, the Delaware Supreme Court crafted a specific two-part test that applies when a derivative plaintiff challenges an earlier board decision made by the same directors who remain in office at the time suit is filed. The Court of Chancery “must decide whether, under the particularized facts alleged, a reasonable doubt is created that: (1) the directors are disinterested and independent and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment.” [Aronson, 473 A.2d at 814.] The first of the two inquiries examines “the independence and disinterestedness of the directors” with respect to the decision that the derivative action would challenge. Id. * … If the underlying transaction was approved by a disinterested and independent board majority, then the court moves to the second inquiry: whether the plaintiff “has alleged facts with particularity which, if taken as true, support a reasonable doubt that the challenged transaction was the product of a valid exercise of business judgment.” Id. at 815. A plaintiff might allege sufficiently, for example, that the directors were grossly negligent in approving the transaction.

... 

In [Rales v. Blasband, 634 A.2d 927 (Del.1993)], the Delaware Supreme Court confronted a board whose members had not participated in the underlying decision that the derivative action would challenge, and therefore “the test enunciated in [Aronson ] ... [was] not implicated.” [Id.] at 930. In response, the Delaware Supreme Court framed a second and more comprehensive demand futility standard that asks “whether or not the particularized factual allegations of a derivative stockholder complaint create a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand.” Id. at 934. The Delaware Supreme Court envisioned that the Rales test would be used in three principal scenarios: (1) where a business decision was made by the board of a company, but a majority of the directors making the decision have been replaced; (2) where the subject of the derivative suit is not a business decision of the board; and (3) where ... the decision being challenged was made by the board of a different corporation.

* [Eds.: Later in the opinon, the Vice Chancellor stated that: “A director is deemed ‘interested’ if he ’has received, or is entitled to receive, a personal financial benefit from the challenged transaction which is not equally shared by the stockholders.’ Pogostin v. Rice, 480 A.2d 619, 624 (Del.1984).”]
A director cannot consider a litigation demand under *Rales* if the director is interested in the alleged wrongdoing, not independent, or would face a “substantial likelihood” of liability if suit were filed. *Rales*, 634 A.2d at 936 (internal quotation marks omitted). To show that a director faces a “substantial risk of liability,” a plaintiff does not have to demonstrate a reasonable probability of success on the claim. In *Rales*, the Delaware Supreme Court rejected such a requirement as “unduly onerous.” Id. at 935. The plaintiff need only “make a threshold showing, through the allegation of particularized facts, that their claims have some merit.” Id. at 934. …

The *Aronson* and *Rales* have been described as complementary versions of the same inquiry. This case illustrates that reality. The fundamental question presented by the defendant's Rule 23.1 motion is whether the Demand Board could have validly considered a litigation demand. The Complaint challenges at least three events that involved actual decisions: the Yinlong Transaction, the terminations of the outside auditors, and the Special Committee's determination to take no action. Five of the seven members of the Demand Board were directors at the time those decisions were made. Because less than “a majority of the directors making the decision have been replaced,” *Rales*, 634 A.2d at 935, *Aronson* provides the demand futility standard for the five participating directors. *Rales* would provide the standard for the two remaining directors, but because the *Aronson* analysis establishes demand futility, I do not reach the *Rales* aspect. …

The litigation also alleges a systematic lack of oversight at China Agritech. That challenge does not involve an actual board decision, so *Rales* governs.* …

The board of a Delaware corporation has a fiduciary obligation to adopt internal information and reporting systems that are “reasonably designed to provide to senior management and to the board itself timely, accurate information sufficient to allow management and the board, each within its scope, to reach informed judgments concerning both the corporation's compliance with law and its business performance.” In re Caremark Int'l Inc. Deriv. Litig., 698 A.2d 959, 970 (Del. Ch.1996). If a corporation suffers losses proximately caused by fraud or illegal conduct, and if the directors failed “to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists,” then there is a sufficient connection between the occurrence of the illegal conduct and board level action or conscious inaction to support liability. Id. “[I]mposition of liability requires a showing that the directors knew that they were not discharging their fiduciary obligations.” *Stone*, 911 A.2d at 370.

The burden on a plaintiff who seeks to establish liability under a failure-to-monitor theory “is quite high.” *Caremark*, 698 A.2d at 971.

Generally where a claim of directorial liability for corporate loss is predicated upon ignorance of liability creating activities within the corporation, as in Graham [v. Allis–Chalmers Manufacturing Co., 188 A.2d 125 (Del.1963) ] or in [the Caremark case itself], ... only a sustained or systematic failure of the board to exercise oversight—such as an

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* [Eds.: Recall that earlier in the decision the court had explained that *Rales* applies “where the subject of the derivative suit is not a business decision of the board.” When plaintiff alleges a Caremark violation by the board for failing its oversight duties, by definition there has been no business decision and the second *Rales* prong is applicable.]
utter failure to attempt to assure a reasonable information and reporting system exists—will establish the lack of good faith that is a necessary condition to liability.

Id. “Concretely, this latter allegation might take the form of facts that show the company entirely lacked an audit committee or other important supervisory structures, or that a formally constituted audit committee failed to meet.” [David B.] Shaev [Profit Sharing Account v. Armstrong], 2006 WL 391931, at *5 [(Del. Ch. Feb. 13, 2006)]. (footnote omitted)…

The allegations of the Complaint support a reasonable inference that China Agritech had a “formally constituted audit committee [that] failed to meet.” Shaev, 2006 WL 391931, at *5. In response to the Section 220 Demand, China Agritech did not produce any Audit Committee meeting minutes for 2009 or 2010. The Company's proxy statement filed on July 22, 2010 similarly implies that the Audit Committee did not meet during 2009, although it did take action by written consent on three occasions.

During 2009 and 2010, the Company engaged in the Yinlong Transaction, conducted the Offering, disclosed a material weakness in its disclosure controls and procedures, claimed to have fixed the problem, terminated Crowe Horwath as its outside auditor, hired Ernst & Young as its new outside auditor, and named Dai's daughter as head of China Agritech's internal audit department. Yet there is no documentary evidence that the Audit Committee ever held a single meeting during this two year period. …

Discrepancies in the Company's public filings with governmental agencies reinforce the inference of an Audit Committee that existed in name only. During its time as a publicly listed entity in the United States, the federal securities laws mandated that the Company make periodic filings with the SEC. Regulatory requirements in China mandated that the Company make periodic filings with the State Administration for Industry and Commerce (“SAIC”). The Complaint alleges that in four of five years that the Company reported large profits in its filings with the SEC, the Company reported net losses to the SAIC. In the fifth year, the Company reported a large profit in its filings with the SEC, and one-fifth of that profit to the SAIC.

…

Taken together, the factual allegations of the Complaint support a reasonable inference that the members of the Audit Committee acted in bad faith in the sense that they consciously disregarded their duties. Unlike the parade of hastily filed Caremark complaints that Delaware courts have dismissed, and like those rare Caremark complaints that prior decisions have found adequate, the Complaint supports these allegations with references to books and records ..., and with inferences that this Court can reasonably draw from the absence of books and records that the Company could be expected to produce.

Because of their service on the Audit Committee, Dai, Bennett, and H. Zhang face a substantial risk of liability for knowingly disregarding their duty of oversight. These directors could not validly consider a litigation demand concerning the problems that occurred on their watch. Dai also could not validly consider a litigation demand for the additional reason that his daughter, Lingxiao Dai, served as Vice President of Finance from May 1, 2009 until November 19, 2010, and as head of the internal audit department thereafter. A director lacks independence when “the director is unable to base his or her decisions on the corporate merits of the issue before the board.” Litt v. Wycoff, 2003 WL 1794724, at *3 (Del. Ch. Mar. 28, 2003). A meaningful investigation into or litigation regarding China Agritech's lack of internal controls,
financial reporting deficiencies, and potential violations of law would necessitate an investigation into Dai's daughter and could lead to a finding of wrongdoing against her. Close family relationships, like the parent-child relationship, create a reasonable doubt as to the independence of a director. … Dai also cannot consider a demand that would place Chang or Teng at risk because his daughter's primary employment depends on the good wishes of the Company's controlling stockholders. …

Lastly, Chang could not validly consider a demand because he would face a substantial risk of liability in connection with the events of the 2009 through 2010 period. Chang was the Company's Chairman, CEO, and controlling stockholder. The disputes between the Company and Crowe Horwath and Ernst & Young pitted Chang and his management team against the outside auditors. Ernst & Young pointed the finger directly at Chang and his management team by advising the Audit Committee that it did not believe it could rely on management's statements. Ernst & Young also contended that it was senior management that made a materially misleading disclosure regarding Ernst & Young's termination.

Chang, Dai, Bennett, and H. Zhang comprise a majority of the Demand Board. Demand is therefore futile under Rales for purposes of the Caremark claim, rendering it unnecessary to consider the other three directors.

…

C. Section 102(b)(7)*

The defendants argue that the Complaint should be dismissed because it does not assert a claim for which the defendants could be held liable in light of the exculpatory provision in China Agritech's certificate of incorporation. Because the Complaint pleads claims that implicate the duty of loyalty, including its embedded requirement of good faith, the defendants cannot invoke the exculpatory provision as a defense at this stage.

The Complaint challenges the Yinlong Transaction, an interested transaction with a controlling stockholder where entire fairness provides the presumptive standard of review. When the entire fairness standard of review applies, “the inherently interested nature of those transactions” renders the claims “inextricably intertwined with issues of loyalty.” Emerald P'rs v. Berlin, 787 A.2d 85, 93 (Del.2001). Chang and Teng benefitted directly from the Yinlong Transaction, and Dai, Bennett, and H. Zhang approved it. Given the standard of review, I cannot dismiss these defendants.

The balance of the Complaint states claims that raise questions about whether the directors acted in good faith. A Section 102(b)(7) provision “can exculpate directors from monetary liability for a breach of the duty of care, but not for conduct that is not in good faith or a breach of the duty of loyalty.” Stone, 911 A.2d at 367. The standard for Caremark liability parallels the standard for imposing liability when directors failed to act in good faith. See Stephen M. Bainbridge et al., The Convergence of Good Faith and Oversight, 55 UCLA L.Rev. 559 (2008) (discussing the re-interpretation of Caremark as a good faith case and the potential liability risks to directors that result).

A failure to act in good faith may be shown, for instance, [1] where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the

* [Eds.: See supra Chapter 5, § 1.]
corporation, [2] where the fiduciary acts with the intent to violate applicable positive law, or [3] where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties. There may be other examples of bad faith yet to be proven or alleged, but these three are the most salient.

In re Walt Disney Co. Deriv. Litig, 906 A.2d 27, 67 (Del.2006) (quoting In re Walt Disney Co. Deriv. Litig, 907 A.2d 693, 755–56 (Del. Ch.2005), aff'd, 906 A.2d 27 (Del.2006). … The ruling that the Complaint states an oversight claim against the defendants prevents them from invoking the Company's exculpatory provision at the pleading stage.

…

ANALYSIS

1. In this opinion, the court was resolving the defendant's motion to dismiss for failure to make demand. As the court noted in a portion we omitted, at that stage of the case, "plaintiffs receive the benefit of all reasonable inferences." If the case goes to trial, however, the court will be obliged to make credibility determinations. Is there any reason to be skeptical of elements of the plaintiff's evidence such as the McGee Report?

2. Although the Vice Chancellor stated that the Aronson and Rales tests are “complementary versions of the same inquiry,” the opinion also quotes Delaware Supreme Court precedents indicating that Aronson is not “implicated” where Rales applies and vice-versa. What are the differences between the Aronson and Rales standards and why did the Delaware Supreme Court create the latter standard to govern the specified cases?

3. In Rich v. Chong, 2013 WL 1914520 (Del. Ch. 2013), the Delaware Chancery Court faced a case, similar to China Agritech, involving a Chinese corporation—Fuqi International, Inc.—that had accessed the US capital markets via a reverse merger into a US shell company listed on NASDAQ. In 2009, Fuqi announced that it would be unable to file its quarterly and annual SEC disclosure statements due to “certain errors related to the accounting of the Company’s inventory and cost of sales.” In 2010, Fuqi disclosed that the SEC had begun an investigation of Fuqi’s failures to file SEC reports on a timely basis and other potential violations. Thereafter, Fuqi disclosed accounting errors, internal control failures, and other management problems.

Plaintiff Rich brought a derivative suit alleging that Fuqi’s board of directors had violated its Caremark duties. The court explained that:

One way a plaintiff may successfully plead a Caremark claim is to plead facts showing that a corporation had no internal controls in place. Fuqi had some sort of compliance system in place. For example, it had an Audit Committee and submitted financial statements to the SEC in 2009. However, accepting the Plaintiff’s allegations as true, the mechanisms Fuqi had in place appear to have been woefully inadequate. In its press releases, Fuqi has detailed its extensive problems with internal controls. … These disclosures lead me to believe that Fuqi had no meaningful controls in place. The board of directors may have had regular meetings, and an Audit Committee may have existed, but there does not seem to have been any regulation of the company’s operations in China.
Id. at *13 (footnotes omitted) (emphasis supplied). Did China Agritech likewise have no meaningful controls in place, such that a Caremark case could be successfully pled?

The Rich court further explained that:

As the Supreme Court held in Stone v. Ritter, if the directors have implemented a system of controls, a finding of liability is predicated on the directors’ having “consciously failed to monitor or oversee [the system’s] operations thus disabling themselves from being informed of risks or problems requiring their attention.” One way that the plaintiff may plead such a conscious failure to monitor is to identify “red flags,” obvious and problematic occurrences, that support an inference that the Fuqi directors knew that there were material weaknesses in Fuqi’s internal controls and failed to correct such weaknesses. …

First, Fuqi was a preexisting Chinese company that gained access to the U.S. capital markets through the Reverse Merger. Thus, Fuqi’s directors were aware that there may be challenges in bringing Fuqi’s internal controls into harmony with the U.S. securities reporting systems. Notwithstanding that fact, according to the Complaint, the directors did nothing to ensure that its reporting mechanisms were accurate. Second, the board knew that it had problems with its accounting and inventory processes by March 2010 at the latest, because it announced that the 2009 financial statements would need restatement at that time. In the same press release, Fuqi also acknowledged the likelihood of material weaknesses in its internal controls. Third, Fuqi received a letter from NASDAQ in April 2010 warning Fuqi that it would face delisting if Fuqi did not bring its reporting requirements up to date with the SEC.

It seems reasonable to infer that, because of these “red flags,” the directors knew that there were deficiencies in Fuqi’s internal controls.

Id. at *14 (footnotes omitted). Are there comparable red flags in China Agritech that would permit one to draw the same inference in that case?

4. If the directors in either China Agritech or Rich were aware that their company’s internal controls were inadequate, have they failed to act in the face of a known duty such that they can be deemed to have acted in bad faith?

5. As to at least one of the transactions, namely the related party transaction between China Agritech and directors Chang and Teng, it appears that not all the directors were personally interested in the transaction. Can such directors nevertheless be held liable under Caremark even if they were not complicit in the underlying transaction?

6. As the China Agritech court indicates, Caremark claims are not excusable under § 102(b)(7) clauses. Why not? Should they be excusable?

7. In cases like these, in which a corporation with the vast bulk of its operations in a foreign country becomes a US corporation via a reverse merger with a US shell corporation, and appoints US residents to the board of directors, what should those directors do to ensure that they comply with their duties as set forth in Stone v. Ritter, supra, and Francis v. United Jersey Bank, supra? Would you have been willing to serve as a director of China Agritech? What do you suppose motivates people to serve on the boards of such corporations?
In re MFW Shareholders Litigation
--- A.3d ----, 2013 WL 2436341 (Del. Ch. 2013)

I. Introduction

This case presents a novel question of law. Here, MacAndrews & Forbes—a holding company whose equity is solely owned by defendant Ronald Perelman—owned 43% of M & F Worldwide (“MFW”). MacAndrews & Forbes offered to purchase the rest of the corporation's equity in a going private merger for $24 per share. But upfront, MacAndrews & Forbes said it would not proceed with any going private transaction that was not approved: (i) by an independent special committee; and (ii) by a vote of a majority of the stockholders unaffiliated with the controlling stockholder (who, for simplicity's sake, are termed the “minority”). A special committee was formed, which picked its own legal and financial advisors. The committee met eight times during the course of three months and negotiated with MacAndrews & Forbes, eventually getting it to raise its bid by $1 per share, to $25 per share. The merger was then approved by an affirmative vote of the majority of the minority MFW stockholders, with 65% of them approving the merger.

MacAndrews & Forbes, Perelman, and the other directors of MFW were, of course, sued by stockholders alleging that the merger was unfair. …

The defendants have moved for summary judgment as to that claim. … Because, the defendants say, the merger was conditioned up front on two key procedural protections that, together, replicate an arm's-length merger—the employment of an active, unconflicted negotiating agent free to turn down the transaction and a requirement that any transaction negotiated by that agent be approved by the disinterested stockholders—they contend that the judicial standard of review should be the business judgment rule. …

… Almost twenty years ago, in Kahn v. Lynch, our Supreme Court held that the approval by either a special committee or the majority of the noncontrolling stockholders of a merger with a buying controlling stockholder would shift the burden of proof under the entire fairness standard from the defendant to the plaintiff.2 Although Lynch did not involve a merger conditioned by a controlling stockholder on both procedural protections, statements in the decision could be, and were, read as suggesting that a controlling stockholder who consented to both procedural protections for the minority would receive no extra legal credit for doing so, and that regardless of employing both procedural protections, the merger would be subject to review under the entire fairness standard.

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2 Kahn v. Lynch Commc'n Sys. (Lynch I), 638 A.2d 1110, 1117 (Del.1994).
Uncertainty about the answer to a question that had not been put to our Supreme Court thus left controllers with an incentive system all of us who were adolescents (or are now parents or grandparents of adolescents) can understand. Assume you have a teenager with math and English assignments due Monday morning. If you tell the teenager that she can go to the movies Saturday night if she completes her math or English homework Saturday morning, she is unlikely to do both assignments Saturday morning. She is likely to do only that which is necessary to get to go to the movies—i.e., complete one of the assignments—leaving her parents and siblings to endure her stressful last-minute scramble to finish the other Sunday night.

For controlling stockholders who knew that they would get a burden shift if they did one of the procedural protections, but who did not know if they would get any additional benefit for taking the certain business risk of assenting to an additional and potent procedural protection for the minority stockholders, the incentive to use both procedural devices and thus replicate the key elements of the arm's-length merger process was therefore minimal to downright discouraging.

III. The Procedural Devices Used To Protect The Minority Are Entitled To Cleansing Effect Under Delaware's Traditional Approach To The Business Judgment Rule

A. MacAndrews & Forbes Proposes To Take MFW Private

MFW is a holding company incorporated in Delaware. ... The MFW board had thirteen members. The members were Ron Perelman, Barry Schwartz, William Bevins, Bruce Slovin, Charles Dawson, Stephen Taub, John Keane, Theo Folz, Philip Beekman, Martha Byorum, Viet Dinh, Paul Meister, and Carl Webb. Perelman, Schwartz, and Bevins had roles at both MFW and MacAndrews & Forbes. Perelman was the Chairman of MFW, and the Chairman and CEO of MacAndrews & Forbes; Schwartz was the President and CEO of MFW, and the Vice Chairman and Chief Administrative Officer of MacAndrews & Forbes; and Bevins was a Vice President at MacAndrews & Forbes.

In May 2011, Perelman began to explore the possibility of taking MFW private. At that time, MFW’s stock price traded in the $20 to $24 range. MacAndrews & Forbes engaged the bank Moelis & Company to advise it. Moelis ... valued MFW at between $10 and $32 a share.

On June 10, 2011, MFW’s shares closed on the New York Stock Exchange at $16.96. The next business day, June 13, 2011, Schwartz sent a proposal to the MFW board to buy the remaining shares for $24 in cash. The proposal stated, in relevant part:

The proposed transaction would be subject to the approval of the Board of Directors of the Company [i.e., MFW] and the negotiation and execution of mutually acceptable definitive transaction documents. It is our expectation that the Board of Directors will appoint a special committee of independent directors to consider our proposal and make a recommendation to the Board of Directors. We will not move forward with the transaction unless it is approved by such a special committee. In addition, the transaction will be subject to a non-waivable condition requiring the approval of a majority of the shares of the Company not owned by M & F or its affiliates. ...
... In considering this proposal, you should know that in our capacity as a stockholder of the Company we are interested only in acquiring the shares of the Company not already owned by us and that in such capacity we have no interest in selling any of the shares owned by us in the Company nor would we expect, in our capacity as a stockholder, to vote in favor of any alternative sale, merger or similar transaction involving the Company. If the special committee does not recommend or the public stockholders of the Company do not approve the proposed transaction, such determination would not adversely affect our future relationship with the Company and we would intend to remain as a long-term stockholder.

... 

B. The MFW Board Forms A Special Committee Of Independent Directors To Consider The Offer

The MFW board met the following day to consider the proposal. At the meeting, Schwartz presented the offer on behalf of MacAndrews & Forbes. Schwartz and Bevins, as the two directors present who were also on the MacAndrews & Forbes board, then recused themselves from the meeting, as did Dawson … who had previously expressed support for the offer. The independent directors then invited counsel from Willkie Farr & Gallagher, which had recently represented a special committee of MFW's independent directors in relation to a potential acquisition of a subsidiary of MacAndrews & Forbes, to join the meeting. The independent directors decided to form a special committee, and resolved further that:

[T]he Special Committee is empowered to: (i) make such investigation of the Proposal as the Special Committee deems appropriate; (ii) evaluate the terms of the Proposal; (iii) negotiate with Holdings [i.e., MacAndrews & Forbes] and its representatives any element of the Proposal; (iv) negotiate the terms of any definitive agreement with respect to the Proposal (it being understood that the execution thereof shall be subject to the approval of the Board); (v) report to the Board its recommendations and conclusions with respect to the Proposal, including a determination and recommendation as to whether the Proposal is fair and in the best interests of the stockholders of the Company other than Holdings and its affiliates and should be approved by the Board; and (vi) determine to elect not to pursue the Proposal.

... [T]he Board shall not approve the Proposal without a prior favorable recommendation of the Special Committee.

... [T]he Special Committee [is] empowered to retain and employ legal counsel, a financial advisor, and such other agents as the Special Committee shall deem necessary or desirable in connection with these matters.

The special committee consisted of Byorum, Dinh, Meister (the chair), … and Webb. … Besides hiring Willkie Farr as its legal advisor, the special committee engaged Evercore Partners as its financial advisor.

...
D. The Independence Of The Special Committee

... Although the plaintiffs concede the independence of the special committee's chairman (Meister), they challenge the independence of each of the other three members, contending that various business and social ties between these members and MacAndrews & Forbes render them beholden to MacAndrews & Forbes and its controller Perelman, or at least create a permissible inference that that is so, thus defeating a key premise of the defendants' summary judgment motion.

... Under Delaware law, there is a presumption that directors are independent. To show that a director is not independent, a plaintiff must demonstrate that the director is “beholden” to the controlling party “or so under [the controller's] influence that [the director's] discretion would be sterilized.” Our law is clear that mere allegations that directors are friendly with, travel in the same social circles, or have past business relationships with the proponent of a transaction or the person they are investigating, are not enough to rebut the presumption of independence. Rather, the Supreme Court has made clear that a plaintiff seeking to show that a director was not independent must meet a materiality standard, under which the court must conclude that the director in question's material ties to the person whose proposal or actions she is evaluating are sufficiently substantial that she cannot objectively fulfill her fiduciary duties. ... Our Supreme Court has rejected the suggestion that the correct standard for materiality is a “reasonable person” standard; rather, it is necessary to look to the financial circumstances of the director in question to determine materiality.

Before examining each director the plaintiffs challenge as lacking independence, it is useful to point out some overarching problems with the plaintiffs' arguments. Despite receiving the chance for extensive discovery, the plaintiffs have done nothing, as shall be seen, to compare the actual economic circumstances of the directors they challenge to the ties the plaintiffs contend affect their impartiality. In other words, the plaintiffs have ignored a key teaching of our Supreme Court, requiring a showing that a specific director's independence is compromised by factors material to her. As to each of the specific directors the plaintiffs challenge, the plaintiffs fail to proffer any real evidence of their economic circumstances. Furthermore, MFW was a New York Stock Exchange-listed company. Although the fact that directors qualify as independent under the NYSE rules does not mean that they are necessarily independent under our law in particular circumstances, the NYSE rules governing director independence were influenced by experience in Delaware and other states and were the subject of intensive study by expert parties. They cover many of the key factors that tend to bear on independence, including whether things like consulting fees rise to a level where they compromise a director's independence, and they are a useful source for this court to consider when assessing an argument that a director lacks independence. Here, ... the plaintiffs fail to argue that any of the members of the special committee did not meet the specific, detailed independence requirements of the NYSE.

...
1. Byorum

Director Byorum is a vice president and co-head of the international group at Stephens, an investment bank. She was a director of MFW from 2007, and served on the audit committee. As was mentioned, the plaintiffs do nothing to illustrate the actual economic circumstances of Byorum, other than say she has worked in finance. Thus, the plaintiffs do nothing to show that there is a triable issue of fact that any of the factors they focus on were material to Byorum based on her actual economic circumstances.

The plaintiffs allege, in a cursory way, that Byorum has a personal relationship with Perelman, and that she had a business relationship with him while she worked at Citibank in the nineties. …

Taken together, these allegations and the record facts on which they are based do not create a triable issue of fact regarding Byorum's independence. …

2. Dinh

The plaintiffs next challenge the independence of Dinh, who was a member of MFW's Nominating and Corporate Governance Committees. Dinh is a professor at the Georgetown University Law Center and a cofounder of Bancroft, a Washington D.C. law firm. …

Dinh's firm, Bancroft, has advised MacAndrews & Forbes and Scientific Games since 2009, and it is undisputed that Bancroft received approximately $200,000 in fees in total from these two companies between 2009 and 2011. The plaintiffs have also alleged that Dinh had a close personal and business relationship with Schwartz. Schwartz sits on the Board of Visitors of the Georgetown University Law Center, where Dinh is a tenured professor, and Schwartz requested that Dinh join the board of another Perelman corporation, Revlon, in 2012.

But these allegations do not create any issue of fact as to Dinh's independence. … [T]he plaintiffs have not put forth any evidence that tends to show that the $200,000 fee paid to Dinh's firm was material to Dinh personally, given his roles at both Georgetown and Bancroft. The fees paid to Bancroft are … a fraction of what would need to be paid for Dinh no longer to be considered an independent director under the New York Stock Exchange rules, and would not fund Bancroft's total costs for employing a junior associate for a year. Nor have the plaintiffs offered any evidence that might show that this payment was material in any way to Dinh, given his personal economic circumstances.

Furthermore, Dinh's relationship with Schwartz does not cast his independence into doubt. Dinh was a tenured professor long before he knew Schwartz. And there is no evidence that Dinh has any role at Georgetown in raising funds from alumni or other possible donors, or any other evidence suggesting that the terms or conditions of Dinh's employment at Georgetown could be affected in any way by his recommendation on the merger.64 Likewise, the fact that Dinh was

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64 If Dinh were the Dean, that fact would be contextually important. Likewise, if Dinh were the head of a distinct organization within the law school (e.g., a center for corporate governance or for the study of some subject in which he has an interest) that sought funds from alumni such as Schwartz, that context would be important to consider in applying the Supreme Court's materiality test. But even then, that relationship would have to be contextually material. See In re Oracle Corp. Deriv. Litig., 824 A.2d 917, 930 & n. 21 (Del. Ch.2003) (discussing cases in which
offered a directorship on the board of Revlon, another Perelman company, after he served on the MFW special committee does not create a genuine issue of fact regarding his independence.

3. Webb

Finally, the plaintiffs challenge the independence of Webb, who was a member of MFW's audit committee. Webb was, at the time of the MFW transaction, a banking executive. The plaintiffs allege that Webb has known Perelman since at least 1988, when Perelman invested in failed thrifts with the banker Gerald J. Ford, and that Webb was President and Chief Operating Officer of their investment vehicles. According to the plaintiffs, Webb and Perelman both made a “significant” amount of money in turning around the thrifts, which they sold to Citigroup for $5 billion in 2002. …

The profit that Webb realized from coinvesting with Perelman nine years before the transaction at issue in this case does not call into question his independence. In fact, it tends to strengthen the argument that Webb is independent, because his current relationship with Perelman would likely be economically inconsequential to him. …

For all these reasons, therefore, the MFW special committee was, as a matter of law, comprised entirely of independent directors.

E. There Is No Dispute Of Fact That The MFW Special Committee Satisfied Its Duty Of Care

The plaintiffs do not make any attempt to show that the MFW special committee failed to meet its duty of care, in the sense of making an informed decision regarding the terms on which it would be advantageous for the minority stockholders to sell their shares to MacAndrews & Forbes. …

… [After extensive review of MFW’s financial data and other information,] the special committee rejected the $24 proposal, and countered at $30 a share. MacAndrews & Forbes was disappointed by this counteroffer. On September 9, 2011, MacAndrews & Forbes rejected the special committee's $30 counteroffer, and reiterated its $24 offer. Meister informed Schwartz that he would not recommend the $24 to the special committee. Schwartz then obtained approval from Perelman to make a “best and final” offer of $25 a share. At their eighth, and final, meeting, on September 10, 2011, Evercore opined that the price was fair, and the special committee unanimously decided to accept the offer.

The MFW board then discussed the offer. Perelman, Schwartz, and Bevins, the three directors affiliated with MacAndrews & Forbes, and Dawson and Taub, the CEOs of HCHC and Mafco, recused themselves. The remaining eight directors voted unanimously to recommend the offer to the stockholders.

… The record is clear that the special committee met frequently and was presented with a rich body of financial information relevant to whether and at what price a going private transaction was advisable, and thus there is no triable issue of fact as to its satisfaction of its duty of care. Because the special committee was comprised entirely of independent directors, there is

this court has decided the independence of directors with fundraising responsibilities at universities).
no basis to infer that they did not attempt in good faith to obtain the most favorable price they could secure for the minority or believe they had done so.

F. A Fully Informed, Uncoerced Majority Of The Minority Votes To Support The Merger

On November 18, 2011, the stockholders were provided with a proxy statement containing the history of the merger and recommending that they vote in favor of the transaction. ...

When the votes were counted on December 21, 2011, stockholders representing 65% of the shares not owned by MacAndrews & Forbes voted to accept the offer. …

Under settled authority, the uncoerced, fully informed vote of disinterested stockholders is entitled to substantial weight under our law. Traditionally, such a vote on a third-party merger would, in itself, be sufficient to invoke the business judgment standard of review. In the controlling stockholder merger context, it is settled that an uncoerced, informed majority-of-the-minority vote, without any other procedural protection, is itself sufficient to shift the burden of persuasion to the plaintiff under the entire fairness standard.

Here, therefore, it is clear that as a matter of law, the majority-of-the-minority vote condition qualifies as a cleansing device under traditional Delaware corporate law principles. … [T]he plaintiffs themselves do not dispute that that majority-of-the-minority vote was fully informed and uncoerced, because they fail to allege any failure of disclosure or any act of coercion.

As to the special committee, the court … finds, as a matter of law, that there is no issue that the special committee was sufficiently empowered to hire its own advisors, inform itself, negotiate, and to definitively say no. ...

These conditions are sufficient, under a traditional approach, to be effective in influencing the intensity of review, and as to a conflict transaction not involving a controlling stockholder, to invoke the business judgment rule standard of review.

The court gives the committee such effect here. In doing so, the court eschews determining that the special committee was “effective” in a more colloquial sense. Although prior cases can potentially be read as requiring an assessment of whether a special committee was effective in the sense of being substantively good at its appointed task, such a precondition is fundamentally inconsistent with the application of the business judgment rule standard of review. For a court to determine whether a special committee was effective in obtaining a good economic outcome involves the sort of second-guessing that the business judgment rule precludes. When a committee is structurally independent, has a sufficient mandate and cannot be bypassed, and fulfills its duty of care, it should be given standard-shifting effect. …

G. There Is No Triable Issue Of Fact That The Merger Was A Transaction That A Rational Person Could Believe Was Favorable To MFW's Minority Stockholders

If the business judgment rule standard of review applies, the claims against the defendants must be dismissed unless no rational person could have believed that the merger was favorable to
MFW's minority stockholders.\textsuperscript{107} ... The merger was effected at a 47\% premium to the closing price before MacAndrews & Forbes's offer. A financial advisor for the special committee found that the price was fair in light of various analyses, including a DCF analysis, which mirrors the valuation standard applicable in an appraisal case. MFW's businesses faced long-term challenges. After disclosure of the material facts, 65\% of the minority stockholders decided for themselves that the price was favorable.

The plaintiffs' argument that many of these stockholders were arbitrageurs who had bought from longer-term stockholders and whose views should be discounted has a fundamental logical problem. The fact that long-term MFW stockholders sold at a price that was substantially higher than the market price when MacAndrews & Forbes made its offer but less than $25 per share merger price does not suggest that the price was one that long-term stockholders viewed as unfavorable. Rather, it suggests the opposite. The value of most stocks is highly debatable. What is not debatable here is that a rational mind could have believed the merger price fair, and that is what is relevant under the business judgment rule, which precludes judicial second-guessing when that is the case.

IV. The Supreme Court Has Never Had A Chance To Answer The Question The Defendants Now Pose And Therefore It Remains Open For Consideration

The next issue the court must determine is whether the question that the defendants pose has already been answered in a binding way by our Supreme Court. The defendants accurately argue … that the Supreme Court has never been asked to consider whether the business judgment rule applies if a controlling stockholder conditions the merger upfront on approval by an adequately empowered independent committee that acts with due care, and on the informed, uncoerced approval of a majority of the minority stockholders. To their credit, the plaintiffs admit that the defendants are correct in their argument that the Supreme Court has never been asked this question and that none of its prior decisions hinged on this question.

But the plaintiffs, also accurately, note that there are broad statements in certain Supreme Court decisions that, if read literally and as binding holdings of law, say that the entire fairness standard applies to any merger with a controlling stockholder, regardless of the circumstances. In particular, the plaintiffs rely on language from the Supreme Court's decision in \textit{Lynch}, which, they say, requires this court to review the MFW transaction under the entire fairness standard: “A controlling or dominating shareholder standing on both sides of a transaction, as in a parent-subsidiary context, bears the burden of proving its entire fairness.” …

… The transaction that gave rise to the \textit{Lynch} case was a merger between a parent corporation, Alcatel, and the subsidiary that it controlled, Lynch. Alcatel owned 43\% of Lynch, E.g., In re Walt Disney Co. Deriv. Litig., 906 A.2d 27, 74 (Del.2006) (“[W]here business judgment presumptions are applicable, the board's decision will be upheld unless it cannot be ‘attributed to any rational business purpose.’” (quoting Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del.1971))); Brehm v. Eisner, 746 A.2d 244, 264 (Del.2000) (“We do not even decide if [directors' decisions] are reasonable in this context.” (emphasis added)); see generally Stephen Bainbridge, The Business Judgment Rule as Abstention Doctrine, 57 Vand. L.Rev. 83 (2004) [hereinafter Bainbridge, Abstention Doctrine ].
and sought to obtain the rest of Lynch through a cash-out merger. And Lynch created a special committee to negotiate with Alcatel. But that is the critical point where the similarity ends.

In this case, MacAndrews & Forbes made two promises that were not made in Lynch. MacAndrews & Forbes said it would not proceed with any transaction unless the special committee approved it, and that it would subject any merger to a majority-of-the-minority vote condition. In Lynch, the conduct was of a very different and more troubling nature, in terms of the effectiveness of the special committee and the ability of the minority stockholders to protect themselves. Instead of committing not to bypass the special committee, Alcatel threatened to proceed with a hostile tender offer at a lower price if the special committee did not recommend the transaction to the board. The special committee, which the Supreme Court perceived to be itself coerced by this threat, recommended the offer and signed up a merger agreement, and the stockholders voted in favor of the transaction. A stockholder objected to the price paid, and brought an action for breach of fiduciary duty. The question of the equitable standard of review of the transaction was raised on appeal, and the Supreme Court stated: “Entire fairness remains the proper focus of judicial analysis in examining an interested merger, irrespective of whether the burden of proof remains upon or is shifted away from the controlling or dominating shareholder, because the unchanging nature of the underlying ‘interested’ transaction requires careful scrutiny.”123 This language, the plaintiffs say, dictates the standard of review to be applied to this case.

But, as indicated, the situation in Lynch was very different from the transaction in this case. … In this case, … there is no dispute that the special committee did have the power to say no to the transaction. And, unlike in Lynch, the transaction in this case was conditioned upfront on the approval of both the special committee and the majority of the noncontrolling stockholders; in Lynch, by contrast, the transaction was conditioned on neither.

Moreover, as the defendants point out, … the Supreme Court was only asked to determine what the standard of review was when a merger was approved by a special committee, not by a special committee and a non-waivable majority-of-the-minority vote. Thus, the defendants accurately point out that the binding holding of Lynch is narrower and consists in this key statement from the decision: “[E]ven when an interested cash-out merger transaction receives the informed approval of a majority of minority stockholders or an independent committee of disinterested directors, an entire fairness analysis is the only proper standard of judicial review.”125 The plaintiffs might wish the disciplined use of “or” by our Supreme Court was inadvertent, but this court does not believe that was the case. …

V. The Business Judgment Rule Governs And Summary Judgment Is Granted

This case thus presents, for the first time, the question of what should be the correct standard of review for mergers between a controlling stockholder and its subsidiary, when the merger is conditioned on the approval of both an independent, adequately empowered special committee

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123 Lynch I, 638 A.2d at 1116.
125 Id. at 1117 (emphasis added) ….
that fulfills its duty of care, and the uncoerced, informed vote of a majority of the minority stockholders.

...

After considering [the parties’] arguments, the court concludes that the rule of equitable common law that best protects minority investors is one that encourages controlling stockholders to accord the minority this potent combination of procedural protections.

There are several reasons for this conclusion. The court begins with a Delaware tradition. Under Delaware law, it has long been thought beneficial to investors for courts, which are not experts in business, to defer to the disinterested decisions of directors, who are expert, and stockholders, whose money is at stake.147 Thus, when no fiduciary has a personal self-interest adverse to that of the company and its other stockholders, the fiduciary is well-informed, and there is no statutory requirement for a vote, the business judgment rule standard of review applies and precludes judicial second-guessing so long as the board’s decision “can be attributed to any rational business purpose.”148 Outside the controlling stockholder merger context, it has long been the law that even when a transaction is an interested one but not requiring a stockholder vote, Delaware law has invoked the protections of the business judgment rule when the transaction was approved by disinterested directors acting with due care.

...

But tradition should admittedly not persist if it lacks current value. If providing an incentive for a disinterested bargaining agent and a disinterested approval vote are of no utility to minority investors, it would not make sense to shape a rule that encourages their use.

But even the plaintiffs here admit that this transactional structure is the optimal one for minority stockholders. They just claim that there is some magical way to have it spread that involves no cost. That is not so, however. Absent doing something that is in fact inconsistent with binding precedent—requiring controlling stockholders to use both protections in order to get any credit under the entire fairness standard—there is no way to create an incentive for the use of both protections other than to give controllers who grant both protections to the minority the benefit of business judgment rule review.

A choice about our common law of corporations must therefore be made, and the court is persuaded that what is optimal for the protection of stockholders and the creation of wealth through the corporate form is adopting a form of the rule the defendants advocate. By giving controlling stockholders the opportunity to have a going private transaction reviewed under the

147 E.g., Trenwick Am. Litig. Trust v. Ernst & Young, L.L.P., 906 A.2d 168, 205 (Del. Ch.2006), aff’d, 931 A.2d 438 (Del.2007) (TABLE) (describing the business judgment rule as being designed to “provid[e] directors with sufficient insulation so that they can seek to create wealth through the good faith pursuit of business strategies that involve a risk of failure”); Gagliardi v. TriFoods Int'l, Inc., 683 A.2d 1049, 1052 (Del. Ch.1996) (“[The business judgment rule] protects shareholder investment interests against the uneconomic consequences that the presence of judicial second-guessing risk would have on director action and shareholder wealth in a number of ways.”); Bainbridge, Abstention Doctrine, at 110 (describing part of the role of the business judgment rule as “encouraging optimal risk taking”).

148 Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del.1971) …
business judgment rule, a strong incentive is created to give minority stockholders much broader access to the transactional structure that is most likely to effectively protect their interests. In fact, this incentive may make this structure the common one, which would be highly beneficial to minority stockholders. That structure, it is important to note, is critically different than a structure that uses only one of the procedural protections. The “or” structure does not replicate the protections of a third-party merger under the DGCL approval process, because it only requires that one, and not both, of the statutory requirements of director and stockholder approval be accomplished by impartial decisionmakers. The “both” structure, by contrast, replicates the arm's-length merger steps of the DGCL by “requir[ing] two independent approvals, which it is fair to say serve independent integrity-enforcing functions.”156

When these two protections are established up-front, a potent tool to extract good value for the minority is established. From inception, the controlling stockholder knows that it cannot bypass the special committee's ability to say no. And, the controlling stockholder knows it cannot dangle a majority-of-the-minority vote before the special committee late in the process as a deal-closer rather than having to make a price move. From inception, the controller has had to accept that any deal agreed to by the special committee will also have to be supported by a majority of the minority stockholders. That understanding also affects the incentives of the special committee in an important way. The special committee will understand that those for whom it is bargaining will get a chance to express whether they think the special committee did a good or poor job. Although it is possible that there are independent directors who have little regard for their duties or for being perceived by their company's stockholders (and the larger network of institutional investors) as being effective at protecting public stockholders, the court thinks they are likely to be exceptional, and certainly our Supreme Court's jurisprudence does not embrace such a skeptical view. The Supreme Court has held that independent directors are presumed to be motivated to do their duty with fidelity, like most other people, and has also observed that directors have a more self-protective interest in retaining their reputations as faithful, diligent fiduciaries. The requirement that a majority of the minority approve the special committee's recommendation enhances both motivations, because most directors will want to procure a deal that their minority stockholders think is a favorable one, and virtually all will not want to suffer the reputational embarrassment of repudiation at the ballot box. That is especially so in a market where many independent directors serve on several boards, and where institutional investors and their voting advisors, such as ISS and Glass Lewis, have computer-aided memory banks available to remind them of the past record of directors when considering whether to vote for them or withhold votes at annual meetings of companies on whose boards they serve.

… [Of course,] the court is aware that even impartial directors acting in good faith and with due care can sometimes come out with an outcome that minority investors themselves do not find favorable. Conditioning the going private transaction's consummation on a majority-of-the-minority vote deals with this problem in two important and distinct ways. The first was just described. …

But the second is equally important. If … the special committee approves a transaction that the minority investors do not like, the minority investors get to vote it down, on a full information base and without coercion. … Market developments … have made it far easier, not harder, for stockholders to protect themselves. With the development of the internet, there is

156 In re Cox Commc'ns, Inc. S'holders Litig., 879 A.2d 604, 618 (Del. Ch.2005).
more public information than ever about various commentators', analysts', institutional investors', journalists' and others' views about the wisdom of transactions. Likewise, the internet facilitates campaigns to defeat management recommendations. Not only that, institutional investor holdings have only grown since 1994, making it easier for a blocking position of minority investors to be assembled. Perhaps most important, it is difficult to look at the past generation of experience and conclude that stockholders are reluctant to express positions contrary to those espoused by company management. Stockholders have been effective in using their voting rights to adopt precatory proposals that have resulted in a sharp increase in so-called majority voting policies and a sharp decrease in structural takeover defenses. Stockholders have mounted more proxy fights, and, as important, wielded the threat of a proxy fight or a “withhold vote” campaign to secure changes in both corporate policies and the composition of corporate boards. Stockholders have voted against mergers they did not find favorable, or forced increases in price. Nor has timidity characterized stockholder behavior in companies with large blockholders or even majority stockholders; such companies still face stockholder activism in various forms, and are frequently the subject of lawsuits if stockholders suspect wrongdoing.

[Accordingly,] there seems to be little basis to doubt the fairness-assuring effectiveness of an upfront majority-of-the-minority vote condition when that condition is combined, as it was here, by a promise that the controller would not proceed with a transaction without both the approval of the special committee and the approval of a majority of the minority. …

…

Of course, as with any choice in making common law, there are costs. The loss from invoking the business judgment rule standard of review is whatever residual value it provides to minority investors to have the potential for a judicial review of fairness even in cases where a going private transaction has been conditioned upfront on the approval of a special committee comprised of independent directors with the absolute authority to say no and a majority-of-the-minority vote, that special committee has met its duty of care and negotiated and approved a deal, and the deal is approved by the minority stockholders on fair disclosures and without coercion. The difficulty for the plaintiffs is that what evidence exists suggests that the systemic benefits of the possibility of such review in cases like this are slim to non-existent. Indeed, the evidence that the possibility of such review provides real benefits to stockholders even in cases where a special committee is the only procedural protection is very slim at best, and there is a good case to be made that it is negative overall. The lack of demonstrable benefit is contrasted with the clear evidence of costs, because, absent the ability of defendants to bring an effective motion to dismiss, every case has settlement value, not for merits reasons, but because the cost of paying an attorneys’ fee to settle litigation and obtain a release without having to pay the minority stockholders in excess of the price agreed to by the special committee exceeds the cost in terms of dollars and time consumed of going through the discovery process under a standard of review in which a substantive review of financial fairness is supposedly inescapable. This incentive structure has therefore resulted in frequent payouts of attorneys' fees but without anything close to a corresponding record of settlements or litigation results where the minority

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176 See In re Cox Commc'ns, Inc., S'holders Litig., 879 A.2d 604, 626–34 (Del. Ch.2005) (explaining that the empirical evidence offered in that case and later published in Subramanian, Post–Siliconix tended to show that the bargaining power of the special committee is what drives the consideration paid in going private transactions, not the standard of judicial review).
stockholders got more than the special committee had already secured. In fact, it is easier to find a case where a special committee got more than the price at which plaintiffs were willing to settle than it is to find the opposite. And it is unavoidable that it is investors themselves who are injured if the litigation system does not function with a rational benefit-to-cost ratio. Ultimately, litigation costs are borne by investors in the form of higher D & O insurance fees and other costs of capital to issuers that reduce the return to diversified investors. If those costs are not justified in a particular context by larger benefits, stockholders are hurt, not aided. Relatedly and as important, if no credit is given for the use of both procedural protections in tandem, minority investors will be denied access to the transactional structure that gives them the most power to protect themselves. Without any clear benefit to controllers for the clear costs of agreeing upfront to a majority-of-the-minority condition—a condition that controllers know creates uncertainty for their ability to consummate a deal and that puts pressure on them to put more money on the table—those conditions are now much less common than special committees, and when used are often done as part of a late stage deal-closing exercise in lieu of price moves. Under an approach where the business judgment rule standard is available if a controller uses a majority-of-the-minority condition upfront, minority investors will have an incentive for this potent fairness protection to become the market standard and to be able more consistently to protect themselves in the most cost-effective way, at the ballot box.

... 

When all these factors are considered, the court believes that the approach most consistent with Delaware's corporate law tradition is the one best for investors in Delaware corporations, which is the application of the business judgment rule. That approach will provide a strong incentive for the wide employment of a transactional structure highly beneficial to minority investors, a benefit that seems to far exceed any cost to investors, given the conditions a controller must meet in order to qualify for business judgment rule protection. Obviously, rational minds can disagree about this question, and our Supreme Court will be able to bring its own judgment to bear if the plaintiffs appeal. But, this court determines that on the conditions employed in connection with MacAndrews & Forbes's acquisition by merger of MFW, the business judgment rule applies and summary judgment is therefore entered for the defendants on all counts. IT IS SO ORDERED.

ANALYSIS

1. If the Special Committee had rejected the offer, would Perelman have been precluded from making a tender offer? Forever? Why was it important to the court that Perelman had indicated that he would not follow a rejection of his offer with a tender offer? How would such a strategy coerce shareholders?

2. How meaningful is the shareholder right to vote on the offer? What is the role of institutional holders and arbitrageurs?

3. Just how independent was Byorum? The court dismisses as trivial the fact that she was friends with Perelman. Do you agree?

4. The court notes that the price of $24 was almost a 50% premium over the most recent closing price at the time, $16.96. (Accurately, it was 42%; the price of $25 was a 47% premium.) But that closing price was on June 10, 2011. In May the range of prices had been $20-24. And as
recently as April 29, the price had been $25.09; and on April 1 it was $26.25. And on Jan. 8, 2010, the price had been $42.25. So why was the price of $16.96 the court’s focal point?

5. Why might a controlling shareholder decide not to structure the acquisition so as to gain the benefit of the business judgment rule?