Decoupling and Motivation: Re-Calibrating Standards of Fiduciary Review, Rethinking ‘Disinterested’ Shareholder Decisions, and Deconstructing ‘De SPACs’

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At the heart of corporate governance are fundamental doctrines that limit court scrutiny of fiduciary and stockholder decisions: the business judgment rule limits scrutiny of informed director decisions and, as with Corwin cleansing, informed voting by “disinterested” shareholders is accorded substantial deference. Only when, for example, the motivations of a director or controlling shareholder are sufficiently suspect would either the “entire fairness” or “enhanced scrutiny” standards of review apply. How to assess such motivations, however, is underdeveloped in the case law.

This Article addresses this task in three areas, relying partly on a methodology for assessing a person’s overall economic motivation flowing from the person’s financial stakes in or directly relating to the corporation. The methodology, from the analytical framework for “decoupling” (e.g., “empty voting”) introduced in 2006 deconstructs the person’s “overall economic interest” in a company’s shares (“host shares”) from such stakes by considering the net effect of the person’s: (a) host shares; (b) “coupled assets;” and (c) “related non-host assets.” A shareholder such as one the framework refers to as an “empty voter with a negative overall economic interest” in host has incentives that are opposite to an “empty voter with a positive overall economic interest” in host shares, and both have incentives different from an “empty voter with a zero overall economic interest” in host shares.

Re-Calibration of Standards of Court Deference to Fiduciary Decisions

First, the Article offers a re-calibration of standards of judicial review of fiduciary decisions when a fiduciary has financial stakes on both sides of the challenged transaction. Dubious outcomes flow from the traditional approach to choosing from the triad of the business judgment rule, enhanced scrutiny, and entire fairness.
We show, for example, how courts use entire fairness in circumstances not meriting such review, such as where a controller’s percentage ownership stakes in the corporation and a counterparty are identical. We illustrate this by, among other things, considering the 2022 Tesla-SolarCity merger case, in which Elon Musk was allegedly the controlling shareholder in both firms, and the 2020 CBS-Viacom merger case, in which Shari Redstone was the controlling shareholder in both.

In fact, there is no general reason why a transaction supported by a controller with a zero or positive “overall economic interest” in host shares should be subjected to the same strict level of judicial review as a transaction supported by a controller with a materially negative overall economic interest. With a zero or positive overall economic interest, the controller is at worst indifferent to, and perhaps strongly inclined to favor, the welfare of the host’s stockholders. We offer a systematic approach that methodically maps the triad of zero, materially positive, and materially negative “overall economic interest” in host shares to the triad of standards of review.

**Rethinking Court Deference to “Disinterested” Shareholder Decisions**

Second, the Article strikes at core elements of shareholder decision-making in public companies. Here, deference issues can arise in a variety of contexts: “majority of minority” votes in controller conflict transactions, “majority of minority” tender conditions in controller tender offers, and so-called Corwin cleansing to relieve boards of directors from being subject to entire fairness analysis or enhanced scrutiny.

We show the need for a wholesale rethinking of such court deference to “disinterested” shareholder decisions and that this rethinking cannot occur independent of the grand debate over the purpose of the corporation. The need for such rethinking stems largely from the now overwhelmingly institutional ownership of public companies combined with the prevalence of new financial stake patterns and new organizational voting dynamics at institutions.

As to new financial stake patterns, related non-host asset issues (e.g., increased index investing in conjunction with increased asset manager size) and coupled asset issues (e.g., holdings of certain cash-settled equity swaps) will often result in institutional investors having a zero or negative “overall economic interest” in host shares. We show this by, among other things, looking at “related non-host assets” of large asset managers not mentioned in the 2010 CNX case (Vanguard, BlackRock, and State Street would not have been deemed disinterested, for more compelling reasons than those the court found applicable to T. Rowe Price), and by offering broader evidence. (Note that the foregoing effects are independent of the usual cost/lack of payoff reasons why index funds are less motivated to be active in corporate governance.)

Indeed, rigid application of existing law would disqualify large asset managers from being considered “disinterested” shareholders with surprising, likely undesirable, frequency. We propose
steps to improve the integrity of shareholder voting while mitigating that undesirable prospect. We also propose a general method for determining when an institutional investor’s overall economic interest should be deemed “material.”

As to new organizational voting dynamics, both conceptual challenges and practical difficulties arise. The bedrock premise for court deference to “disinterested” shareholders is that such shareholders are motivated to make decisions in ways that enhance the value of their shares. The debate over ESG and shareholder primacy poses a fundamental dilemma. Some of the debate participants call for the subjugation of the interests of shareholders and urge institutional investors to act accordingly. If institutional investors heed calls to consider non-share price-directed goals, this conceptual basis for deference is brought into question. Other new organizational voting dynamics, such as “pass-through voting” and heterogeneity among asset managers as to respecting voting preferences of their individual portfolio managers raise mechanical complexities in calculating overall economic interest.

In short, the very idea of a “disinterested” shareholder is increasingly a convenient myth.

Decoupling and De-SPACing: Idiosyncratic Stakes in a Single Entity

Third, this Article addresses a novel and especially challenging context for assessing motivation: the “de-SPACing” of special purpose acquisition companies (SPACs). The 2023 Delman case takes the welcome step of analyzing deference to shareholder “cleansing” by relying in part on certain aspects of the decoupling framework. This Article shows how full deployment of the framework’s deconstruction methodology, however, could not only provide more comprehensive guidance as to shareholder cleansing but also provide guidance in selecting the proper standard of review of fiduciary decisions. Systematically considering different patterns of host share, coupled asset, and related non-host asset holdings suggests that the motivations of the public shareholders voting in de-SPAC transactions are more heterogeneous than conventionally understood.

Conclusion

The decoupling framework and its deconstruction methodology offer a fresh perspective on how courts can more systematically and comprehensively assess the motivations of fiduciaries and shareholders flowing from their financial stakes. Applying that perspective, especially in view of transformative changes in institutional investor ownership, the nature of financial stakes, and the organizational voting dynamics of their holders exposes fundamental, yet largely unrecognized, limitations to longstanding corporate jurisprudence while simultaneously offering guidance for shoring up the integrity of that jurisprudence.

The complete article is available here.