

DELAWARE CORPORATE FIDUCIARY DUTIES, ERISA FIDUCIARY DUTIES, AND IRS TRANSFER PRICING RULES: A COOPERATIVE APPROACH TO SELF-DEALING

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I. INTRODUCTION

In many cases, both minority shareholders of controlled companies¹ and taxing authorities have a stake in the prices controlled companies set in their dealings with related parties.² This Comment examines three distinct areas of the law that potentially apply to instances where a controlled company deals with related parties: corporate fiduciary duty in state laws, fiduciary duty law under ERISA,³ and the IRS transfer pricing rules under section 482 of the Internal Revenue Code. After examining the potentially applicable law, this Comment suggests ways in which the laws might evolve to best serve majority shareholders, minority shareholders, and taxing authorities.

State fiduciary duty laws operate to prevent a controlling shareholder from engaging in the types of self-dealing transactions that would unfairly erode minority shareholder value.⁴ When the minority shareholder is a retirement fund subject to ERISA,⁵ not only does the controlling

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1. In this Comment, the term “controlled companies” refers to companies with a shareholder who has a sufficient ownership stake to effectively control operations of the company, regardless of the wishes of minority shareholders. Often this controlling shareholder is a parent company.

2. The term “related parties” refers to other companies owned by the same ownership that owns the company in question.

3. Employee Retirement Income Security Act of 1974, 29 U.S.C. §§ 1001-1461 (2006).

4. *See, e.g.*, DEL. CODE ANN. tit. 8, § 144 (2006) (setting out rules that protect shareholders from corporate transactions in which directors have a financial interest).

5. Retirement plans are often minority shareholders in controlled companies. This was the case in *Ford Motor of Can. v. Ont. Mun. Employees Ret. Bd.*, 41 B.L.R. (3d) 74 (2004), discussed *infra* in section II of this Comment.

shareholder have a duty to refrain from improper self-dealing, but ERISA imposes a duty of prudence⁶ on the person or persons charged with overseeing the fund.⁷ This duty imposed by ERISA presumably means the plan fiduciary is responsible for ensuring that the majority shareholder does not engage in self-dealing that erodes the value of the plan. Finally, in the tax arena, the so-called “transfer pricing” regulations under section 482 of the Internal Revenue Code⁸ are designed to prevent controlled groups of companies from improperly shifting income in order to reduce the group’s federal income tax burden.

In the situation at issue in this Comment, these three bodies of law share a central concern: how can the law prevent the improper shifting of income out of a controlled company? As we will see, U.S. tax law⁹ and state fiduciary duty laws¹⁰ deal with this issue very differently, and the ERISA rules are vague and not instructive. This Comment will discuss and compare state fiduciary duty law, ERISA fiduciary duty law, and tax law approaches to dealing with improper transactions of controlled companies.

6. 29 U.S.C. § 1104(a)(1)(B) (2006).

7. In certain cases, including the prototype case described immediately below, pension funds and other employee stock ownership plans own stock amounting to a substantial minority interest in a company that is otherwise controlled. In such cases, the controlling shareholder, often the employer, may, as in the prototype below, be able to illegally enrich itself at the expense of the pension fund or plan’s interest. Even though these “transfer pricing” issues may seem obscure to the average pension fiduciary, and indeed to the labor lawyer, the fiduciary in charge of monitoring the pension fund or plan’s interest must be extremely diligent about monitoring such issues. As the prototype demonstrates, the dollar amounts at stake can be extremely large.

8. Treas. Reg. § 1.482 (as amended in 2004) [hereinafter section 482 regulations].

9. Nearly all industrialized countries have well developed transfer pricing rules. See *generally* INTERNATIONAL TRANSFER PRICING 2002/2003 (PricewaterhouseCoopers ed., 2003) (describing the transfer pricing rules for countries from around the world). Most countries have adopted a transfer pricing regime based on the model developed by the Organisation for Economic Cooperation and Development. See TRANSFER PRICING GUIDELINES FOR MULTINATIONAL ENTERPRISES AND TAX ADMINISTRATIONS (Organization for Economic Cooperation and Development ed., 2001) [hereinafter OECD GUIDELINES]. The U.S. transfer pricing rules, as set out in the section 482 regulations, are similar in substance to the OECD GUIDELINES in that both are based on the “arm’s length standard” of inter-company pricing, as discussed further in this Comment. See Treas. Reg. § 1.482-1(b) (describing the arm’s length standard). The scope of this Comment will be limited to discussion of the U.S. rules, although the analysis applies to any transfer pricing regime based on the arm’s length standard.

10. In the United States, a corporation’s internal affairs are governed by state law. See MELVIN ARON EISENBERG, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS 101 (8th ed. 2000). Most of the issues discussed in this Comment are issues faced by large multinational corporations. As of 1996, fifty-six percent of all U.S. corporations listed on major stock exchanges, and sixty-two percent of the corporations listed on the New York Stock Exchange, were incorporated in Delaware. *Id.* Delaware fiduciary duty law is also fairly well-developed with regard to the issue of the fiduciary duty of loyalty. For these reasons, the discussion in this Comment will involve Delaware corporate law.

Most importantly, this Comment will discuss how each area of law might be altered in order to improve its efficacy, fairness, and administrative ease.

II. BACKGROUND

A. *Relevant Fact Pattern: The Ford Motor Case*

Before describing the contours of the law, it is helpful to understand the typical fact pattern to which the analysis in this Comment applies. To date, there have been no published state court decisions in the United States that could serve as an explanatory tool.¹¹ A Canadian case¹² (hereinafter “*Ford Motor*”) between Ford Motor Company of Canada and one of its largest minority shareholders, the Ontario Municipal Employees Retirement Board, provides a good illustration of how corporate fiduciary duty law, ERISA fiduciary duty law, and tax law must address the same substantive issue.¹³

1. Squeeze-Out Merger

Ford Motor Company (hereinafter “Ford”) was incorporated in the United States in 1903, and Ford Canada was incorporated as a separate company in Canada in 1904.¹⁴ Up until 1995, a portion of Ford Canada’s shares were publicly owned, although Ford always owned enough shares to be a controlling shareholder.¹⁵ Over the years, Ford increased its ownership in Ford Canada to nearly ninety percent,¹⁶ allowing Ford to effectuate a “squeeze-out” of the remaining shareholders of Ford Canada.¹⁷ The squeeze-out would make Ford Canada a 100 percent subsidiary of Ford

11. One case, decided under New York law, comes close. See *Lewis v. S.L. & E., Inc.*, 629 F.2d 764 (2d Cir. 1980) (deciding issues related to the valuation of a company where shareholders claimed that the company would be worth more if transfer prices with a related company had been proper.) *Lewis*, however, is not a proper teaching prototype for this Comment, as it does not involve international transactions that would be of interest for the tax law component of this Comment, nor is the minority shareholder in the case a retirement plan subject to ERISA.

12. *Ford Motor of Can. v. Ont. Mun. Employees Ret. Bd.*, 41 B.L.R. (3d) 74 (2004).

13. *Ford Motor* is not the only case involving a conflict between a U.S. parent company and the shareholders of a Canadian subsidiary. See *Taylor v. LSI Logic Co.*, 715 A.2d 837 (Del. 1998) (discussing a case where Canadian minority shareholders complained that the U.S. parent company’s transfer pricing policies depressed the value of their shares for a U.S. buyout; the case was dismissed on procedural grounds).

14. *Ford Motor of Can.*, 41 B.L.R. (3d) at para. 3.

15. *Id.* at paras. 3-4.

16. *Id.* at para. 3.

17. *Id.* at para. 7.

by having Ford purchase all outstanding shares of Ford Canada that were publicly owned.¹⁸

Because Ford owned more than ninety percent of Ford Canada's outstanding shares, minority shareholders' approval was not required for the transaction.¹⁹ While minority shareholders could not prevent the transaction from going forward, they did have a statutory appraisal remedy to ensure that Ford paid adequate consideration for the shares.²⁰

2. Valuation of Ford Canada's Shares

Before effectuating the transaction, the interested parties engaged experts to assist them in valuing the shares held by the minority shareholders. Ford Canada put in place a special committee of the Board of Directors,²¹ made up of board members other than Ford nominees, to manage the valuation process on behalf of the minority shareholders and to offer advice on whether to accept Ford's offer or contest it.²² Ford originally offered \$150 per share,²³ and ultimately increased its offer to \$185 per share.²⁴ Based on its valuation experts' advice, the special committee recommended that the minority shareholders accept this offer.²⁵ Experts hired by OMERS, however, arrived at a value per share of \$624.50.²⁶ How could there have been such a large discrepancy?

Ford's valuation of the shares was primarily based on a discounted cash flow methodology that analyzed Ford Canada's future revenue streams.²⁷ Ford Canada had a history of losses, and future projections of the company had to take this into account. From 1985 to 1995, Ford Canada had a cumulative operating loss of \$497 million.²⁸ This obviously depressed the value of Ford Canada's shares.

18. *Id.*

19. *Id.* at para. 20.

20. *Ford Motor of Can.*, 41 B.L.R. (3d) at para. 19. The Canadian squeeze-out merger scheme is, with respect to the details described above, identical to the Delaware squeeze-out merger scheme. See DEL. CODE ANN. tit. 8, § 253 (2006) (providing for a similar squeeze-out scenario when a corporation that is incorporated in Delaware owns ninety percent or more of another corporation).

21. Although not explicitly stated in the facts of the case, it can be assumed for the purposes of using this case as a prototype that Ford controlled the Ford Canada Board of Directors and therefore had effective control over the management of Ford Canada.

22. *Ford Motor of Can.*, 41 B.L.R. (3d) at para. 25.

23. The dollar amounts mentioned in this portion of the discussion are in Canadian dollars.

24. *Ford Motor of Can.*, 41 B.L.R. (3d) at para. 25.

25. *Id.*

26. *Id.* at para. 22.

27. *Id.* at para. 200.

28. *Id.* at para. 76.

3. Ford Canada's Transfer Pricing with Ford

In common business parlance, when companies within controlled corporate groups have business dealings with each other, the prices charged for the property or services are referred to as “transfer prices”. Since a transfer price, once paid, shifts monies from one company to another, it will, like any item of revenue or expense, affect on a company's profitability. The more a company transacts with related parties, the more transfer pricing affects the company's profitability. This effect is important because, unlike most revenues and expenses, transfer prices are not determined by the market. Whereas most prices are negotiated at arm's length by parties who have divergent interests—that is, the seller wants a high price while the buyer wants a low price—transfer prices are usually set by the top management of a group of controlled companies. Transfer prices are not negotiated.

Returning to the *Ford Motor* prototype, both Ford Canada and Ford undertook three main activities: manufacturing, assembly, and vehicle sales of completed cars to Ford dealers.²⁹ For each activity, operations of the two companies were coordinated to maximize overall group efficiency.³⁰

Ford Canada and Ford had significant transactions with each other. Both companies would buy manufactured components from the other to use in assembling cars, and both companies would buy fully assembled cars from the other to resell to dealers in their respective domestic markets.³¹ In all cases, Ford set the transfer pricing policies for these inter-company sales without negotiating with Ford Canada.³² The transfer prices were based on formulas that had been in place since 1965.³³

The bankers that Ford Canada's minority shareholders hired believed that the transfer pricing formulas put in place by Ford management were unfair to Ford Canada. The bankers believed that if the transfer prices had been fair to Ford Canada—that is, if the prices were what unaffiliated parties would have negotiated at arm's length—Ford Canada would have been financially better off, and the company's shares would be worth more. Specifically, if the transfer prices had been and would continue to be fair, the minority shareholders' bankers believed the Ford Canada shares would

29. See *Id* at paras. 48-56 (describing the three functional divisions within Ford and Ford Canada).

30. *Ford Motor of Can.*, 41 B.L.R. (3d) at paras. 48-56.

31. See *id.* at para. 51 (describing Ford and Ford Canada's integration of their manufacturing and assembly operations).

32. See *id.* at para. 66 (stating that Ford Canada was “bound to accept the . . . prices set by Ford”).

33. *Id.* at para. 45.

be worth \$642 per share, not \$130 per share.³⁴

4. Lessons of the *Ford Motor* Prototype

The primary lesson of the prototype is that if transfer prices among members of a controlled group are unfair, or not as they would be in an arm's length transaction, minority shareholders of an individual company within the group will see the value of their shares depressed.³⁵

The minority shareholders of Ford Canada are not the only group with an interest in seeing that Ford and Ford Canada get their transfer pricing policies right. If Ford Canada had earned more income due to more favorable transfer prices, it would have paid more in income tax to the Canada Revenue Agency (hereinafter "CRA").³⁶ Therefore, the CRA has an incentive to ensure that Ford Canada has transfer pricing policies that meet its standards of acceptability.

While the *Ford Motor* prototype ended up in court as a result of a merger, the facts of the case would have presented problems for the minority shareholders even if there had not been one. Although the transfer pricing policy between Ford and Ford Canada had been in place since 1965, it was not until thirty years later that Ford Canada's shareholders finally complained about it.

If the transfer pricing policies were improperly set in favor of Ford, then Ford Canada's profits had been artificially low for thirty years, costing Ford Canada's shareholders millions, or perhaps billions, in lost share appreciation and dividends. Even if there had not been a merger, Ford Canada's minority shareholders would have had reason to protest that the company's day-to-day transfer pricing arrangements constituted unfair oppression of their rights, and that Ford Canada's majority shareholder, Ford, was engaging in illegal self-dealing.³⁷

The focus of this Comment is on transfer pricing issues rather than merger issues. Therefore, the following discussion and analysis will center on: first, how state and ERISA fiduciary duty laws currently operate to

34. *Id.* at paras. 22, 25.

35. Of course, if transfer prices are improper but favorable to the minority shareholder, the value of the minority shareholders' interest will be artificially high. This was not the case in the *Ford Motor* prototype, and is unlikely to be the case if the controlling parent acts in its best interests. This type of situation could occur if the company in which minority shareholders hold an interest was domiciled in a low-tax jurisdiction, in which case it could be in all parties' best interests to artificially shift income to this company.

36. The CRA is the Canadian analogue of the IRS in the United States.

37. In fact, Ford Canada's minority shareholders did make this claim in court, requesting that the court award the minority shareholders damages for "oppression" between 1985 and 1995. *Ford Motor of Can.*, 41 B.L.R. (3d) at para. 26. Again, the application of Canadian law to this claim is beyond the scope of this Comment.

ensure that controlling shareholders do not damage minority shareholders' interests through transfer pricing; and second, how tax law functions differently to prevent the same types of manipulative transfer pricing schemes. After discussing the relevant law, the focus of the analysis will turn to how state fiduciary duty law, ERISA fiduciary duty law, and tax law might be improved.

III. DISCUSSION

A. *State Fiduciary Duty Laws*

This section will discuss how the current law deals with the shareholder issues created by the transfer pricing problem discussed in the Ford Canada prototype. For the reasons previously discussed,³⁸ this discussion will center on Delaware corporate law.

1. What Is A Controlling Shareholder?

Under Delaware law, a shareholder becomes a controlling shareholder with concomitant fiduciary obligations "only if it owns a majority interest in or *exercises control* over the business affairs of the corporation."³⁹ Thus, a relevant threshold question in this discussion is whether or not a shareholder has sufficient power to influence transfer prices.⁴⁰ If a shareholder lacks the power to influence the company's pricing policy, no duty attaches. As illustrated by the quotation above, Delaware law recognizes that a shareholder's power is not necessarily linked to ownership, and attaches fiduciary duties to any shareholder with the ability to exercise control over the company.⁴¹ Returning to the *Ford Motor* prototype, Ford met both prongs of the Delaware controlling shareholder test: Ford owned over fifty percent of Ford Canada and exercised control

38. See *supra* note 10 (explaining the significance of Delaware corporate law in the United States).

39. Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1113-14 (Del. 1994) (citing Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1344 (Del. 1987)) (emphasis in original).

40. The question of what constitutes the power to control the affairs of a corporation is a complex inquiry in itself, and is beyond the scope of this Comment.

41. This approach is not unique to Delaware law. Section 1.10 of PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS (American Law Institute ed. 1994) also defines a controlling shareholder as one who "(1) [o]wns . . . more than fifty percent of the . . . corporation; or (2) [o]therwise exercises a controlling influence over the management or policies of the corporation . . . by virtue of the person's position as a shareholder."

over the company.

2. Delaware Standards of Review

Delaware courts have developed different common law standards to apply in different types of fiduciary duty cases. The two most common standards, and the most relevant for this analysis, are the business judgment rule and the entire fairness standard. Before discussing which standard would apply in the prototypical transfer pricing case, it is useful to discuss how each standard operates.

a. The business judgment rule

Delaware corporations law is founded on “the fundamental principle . . . that the business and affairs of a Delaware corporation are managed by . . . its board of directors.”⁴² Since the board of directors runs the corporation, the Delaware courts should not be a forum for second-guessing the judgment of a board of directors, as long as the board’s decision is procedurally correct. That is, as long as a board “acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company . . . that judgment will be respected by the courts.”⁴³ The Delaware courts will not hold a director liable for an informed, good faith business decision absent gross negligence.⁴⁴ The business judgment rule is a legal presumption that a decision by a board is valid if proper procedures were followed. Even if the results show that it was clearly foolish, the decision will be respected by the courts.

b. Entire fairness

Compared to the business judgment rule, entire fairness is a much more difficult standard for defendants in shareholder suits, as there is no presumption that the defendant’s conduct was the result of a valid business judgment. Instead, in cases judged under the entire fairness standard, the court looks with an impartial eye to examine whether or not a transaction meets the court’s standard for “fairness.”

The Delaware courts have specifically defined fairness as having “two basic aspects: fair dealing and fair price. [Fair dealing] embraces questions of when the transaction was timed, how it was initiated,

42. *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985). This principle is codified in DEL. CODE ANN. tit. 8, § 141(a) (2005).

43. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

44. *Id.*

structured, negotiated, [and] disclosed to the directors”⁴⁵ Thus, similar to analyses under the business judgment rule, the focus in this prong of the fairness standard is on procedure rather than substance.

In contrast, the fair price aspect “relates to the economic and financial considerations of the [transaction]”⁴⁶ The Delaware courts, after hearing expert testimony, render judgment about what the fair price in a transaction should have been. Even though the Delaware courts have identified the entire fairness test as consisting of two distinct concepts, the court in *Weinberger* noted that “the test for fairness is not a bifurcated one as between fair dealing and price. All aspects of the issue must be examined as a whole since the question is one of entire fairness.”⁴⁷

c. *Which standard would apply in transfer pricing cases?*⁴⁸

Which standard the Delaware courts apply depends on the specific claim. If the *Ford Motor* prototype had been controlled by Delaware law, the minority shareholders of Ford Canada could have made a claim against Ford for self-dealing. According to the Delaware courts, “[s]elf-dealing occurs when the parent, by virtue of its domination of the subsidiary, causes the subsidiary to act in such a way that the parent receives something from the subsidiary to the . . . detriment to[] the minority stockholders of the subsidiary.”⁴⁹ This description fits transfer pricing cases perfectly. In the prototype, Ford, by virtue of its control over Ford Canada, caused Ford Canada to agree to an intercompany pricing scheme that benefited Ford, to the detriment to the minority shareholders of Ford Canada.

The Delaware courts have made clear which standard applies in cases of self-dealing involving a controlling shareholder. The policy of the Delaware courts is that “when a controlling shareholder stands on both sides of [a] transaction the conduct of the parties will be viewed under the more exacting standard of *entire fairness* as opposed to the more deferential business judgment [rule] standard.”⁵⁰

Thus, in the *Ford Motor* prototype, if Ford Canada’s minority shareholders had brought suit under Delaware law, not only would the defendants not have received the benefit of the business judgment rule

45. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983).

46. *Id.*

47. *Id.*

48. The business judgment rule and the entire fairness standard are used in a wide range of cases under Delaware law. The following discussion is limited to the types of transactions at issue in this Comment unless otherwise noted.

49. *Sinclair Oil Co. v. Levien*, 280 A.2d 717, 720 (Del. 1971).

50. *Kahn v. Tremont Co.*, 694 A.2d 422, 428 (Del. 1997) (citing *Kahn v. Lynch Communication Sys.* 638 A.2d 1110, 1116 (Del. 1994)) (emphasis added).

(which would have resulted in a presumption of fair transfer prices), but they would have had the burden of proving that the transaction was fair to the minority shareholders. Applying the entire fairness standard in cases of self-dealing has its analogue in Delaware corporate statutes.⁵¹

d. Standard shifting and burden shifting

In certain circumstances, a shareholder⁵² engaging in self-dealing can improve his chances of prevailing in Delaware courts by undertaking procedural safeguards to protect against self-dealing that would be unfair to minority shareholders. The Delaware courts are more lenient toward defendants who undertake such safeguards, especially: (1) having a committee of disinterested directors⁵³ approve a transaction; or (2) having disinterested shareholders⁵⁴ approve a transaction.⁵⁵ The logic is that “[i]f . . . independent stockholders [or directors] have approved the transaction, they have . . . made the decision that the transaction is ‘a fair exchange.’ As such, it is difficult to see the utility of . . . litigation”⁵⁶

Therefore, if a transaction involving self-dealing is approved by disinterested shareholders or independent directors, the court is more inclined to respect the decision and less likely to substitute its own judgment. The way this works procedurally is that, if disinterested shareholder or independent director approval is obtained, the court may change the standard of review it uses to judge a shareholder lawsuit, and

51. See DEL. CODE ANN. tit. 8, § 144(a)(3) (stating that “[n]o contract or transaction . . . between a corporation and any other corporation . . . in which 1 or more of its directors . . . have a financial interest, shall be void or voidable . . . if . . . [t]he contract or transaction is fair as to the corporation”).

52. The discussion will continue to refer to shareholders who engage in self-dealing, rather than directors who engage in self-dealing. However, the situation would likely involve a shareholder who is also a director, or who has a director representing his or her (or its, if the shareholder is a corporation) interests. Since, under Delaware law, a corporation is controlled by its board of directors, it is through representatives on the board of directors that a shareholder would be able to exert his or her interests and possibly engage in self-dealing.

53. In the *Ford Motor* prototype, this would be any director not controlled or appointed by Ford. Whether a director is controlled by a majority shareholder could be a very difficult, fact-intensive determination. See, e.g., *Harbor Fin. Partners v. Huizenga*, 751 A.2d 879, 886 (Del. Ch. 1999) (discussing whether a director’s relationship to a large shareholder impairs his ability to impartially make decisions in the best interests of the company). Analysis of whether a director is independent or not is beyond the scope of this Comment.

54. In the *Ford Motor* prototype, this would be any shareholder, such as OMERS, not Ford or anyone connected to Ford.

55. This procedural shift has its analogue in DEL. CODE ANN. tit. 8, § 144(a)(2)-(3) (2005), which states that a transaction shall not be void or voidable if an independent board committee or independent shareholders approve a transaction with respect to which there has been full and proper disclosure.

56. *Harbor Fin. Partners*, 751 A.2d at 901.

may also shift the burden from the defendant to the plaintiff.

In any claim of improper self-dealing, regardless of whether or not it involves a majority shareholder, the defendant originally bears the burden of showing that the transaction in question meets the entire fairness standard.⁵⁷ However, if the defendant shows that shareholders or independent directors approved the transaction, the burden shifts back to the plaintiff. Whether or not the standard of review changes depends on whether or not the defendant is connected with a controlling shareholder.

In cases where the defendant accused of improper self-dealing is *not* a controlling shareholder, or is not connected with a controlling shareholder, the standard of review shifts along with the burden. As for the types of cases in which this happens, Delaware law seems to be in a state of flux. In one subset of self-dealing cases, in which executives and board members have determined their own compensation, “informed, uncoerced, disinterested shareholder ratification of a transaction in which corporate directors have a material conflict of interest has the effect of protecting the transaction from [entire fairness] judicial review”⁵⁸

In ordinary self-dealing cases, as described in the *Ford Motor* prototype, Delaware law used to offer plaintiffs who had gained shareholder or independent director approval a burden shift from entire fairness to the business judgment rule. This, however, recently changed when the Delaware Supreme Court announced that

[it had], since . . . *Rosenberg*⁵⁹ [was] decided, more fully developed the standard by which it should judge a board’s actions when it engages in a transaction with one or more of its own directors. At the time former Vice Chancellor Berger decided *Rosenberg*, our Courts held that an interested board was required to show the entire fairness of a transaction unless the transaction was entitled to a safe harbor [because of shareholder or independent director approval], in which case the board would receive the protection of the business judgment rule It is now clear that even if a board [obtains independent director or shareholder approval], the board is not entitled to receive the protection of the business judgment rule. [Obtaining approval] merely shifts the burden to the plaintiffs to demonstrate that the

57. See *Kahn v. Lynch Commc’n Sys. Inc.*, 638 A.2d 1110, 1115 (Del. 1994) (stating that a controlling shareholder engaging in a self-dealing transaction has the burden to show that the transaction meets the entire fairness standard); *Cooke v. Oolie*, No. CIV. A. 11134, 1997 WL 367034, at *8 (Del. Ch. 1997) (stating that board members engaging in self-dealing in a company without a controlling shareholder have the burden to show that a transaction meets the entire fairness standard).

58. *Lewis v. Vogelstein*, 699 A.2d 327, 336 (Del. Ch. 1997) (citations omitted). In *Vogelstein*, the standard shifted from entire fairness to waste, which is even more deferential to defendants than the business judgment rule.

59. *Rosenberg v. Oolie*, CIV. A. No. 11, 134, 1989 WL 122084 (Del. Ch. 1989).

transaction was unfair.⁶⁰

This is a change with respect to how the court evaluates standard self-dealing transactions in companies without a controlling shareholder. Even with approval by disinterested shareholders or directors, entire fairness still applies with only a burden shift.

As discussed above, the same standard applies for transactions involving a controlling shareholder. Like the revised rule concerning non-controlling shareholders, “[a]n approval of [a] transaction by an independent committee of directors or an informed majority of minority shareholders shifts the burden of proof on the issue of fairness from the controlling or dominating shareholder to the challenging shareholder-plaintiff.”⁶¹

B. *IRS Transfer Pricing Rules*

Transfer pricing has been of utmost importance to taxing authorities around the world. One reason for this is the massive dollar amounts that are at stake.⁶² Another is that transfer pricing is viewed as a soft target, where there is no absolute “right” answer as to what transfer prices should be. Because of this, taxpayers may be more likely to settle disputes with the IRS, rather than risk large adjustments and penalties.⁶³

Conceptually, it is relatively simple for a large taxpayer to use transfer pricing for tax avoidance purposes. If a taxpayer is a member of a controlled group of companies operating in many countries around the world, the taxpayer’s central management need only adjust its internal prices for goods, services or intangible property in a way that boosts taxable income in low tax jurisdictions⁶⁴ and lowers taxable income in high tax jurisdictions.⁶⁵

The Internal Revenue Code (hereinafter “the Code”) has only one section specifically dedicated to transfer pricing: section 482.⁶⁶ While the

60. *Cooke*, No. CIV. A. 11134, 1997 WL 367034, at *9.

61. *Kahn*, 638 A.2d at 1117 (citing *Rosenblatt v. Getty Oil*, 493 A.2d 929, 937-938 (Del. 1985)).

62. See, e.g., *Glaxo Fights \$2.7 Billion in Deficiencies, Seeks \$1 Billion Refund for Discrimination*, Daily Tax Rep. (BNA) G-4 (April 9, 2004) (describing the IRS’ \$2.7 billion tax deficiency assessed against GlaxoSmithKline related to transfer pricing).

63. INTERNATIONAL TRANSFER PRICING 2002/2003 (PricewaterhouseCoopers ed., 2003) at 1.

64. Or no tax jurisdictions, such as so-called “tax haven” jurisdictions.

65. Or, provide something of value without reporting any inter-company charge at all. This is especially an issue in the case of services.

66. 26 U.S.C. § 482 (2006) is less than one-half of one page long, and states in relevant part: “In any case of two or more . . . businesses . . . owned or controlled directly or indirectly by the same interests, the Secretary may . . . allocate gross income . . . among such . . . businesses, if he determines that such . . . allocation is necessary in order to prevent

Code gives the IRS a broad grant of authority, the regulations to section 482 of the Code provide much more detailed rules. In fact, the section 482 regulations currently number over fifty pages.⁶⁷

1. The Section 482 Regulations

a. *The arm's length standard*

Since 1934, the arm's length standard has been the standard used by the IRS to evaluate the appropriateness of a taxpayer's transfer prices.⁶⁸ According to the section 482 regulations, "[a] controlled transaction meets the arm's length standard if the results of the transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances."⁶⁹

b. *Pricing methods under the section 482 regulations*

It is difficult to measure what "results . . . would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances."⁷⁰ The section 482 regulations specify a number of methods available to a taxpayer to estimate what an arm's length price should be for the taxpayer's inter-company transaction.⁷¹

The methods described in sections 1.482-3 and 1.482-4 take different approaches to determining appropriate transfer prices. Some determine transfer prices very directly. For example, the comparable uncontrolled price method "evaluates whether the amount charged in a controlled transaction is arm's length by reference to the amount charged in a comparable uncontrolled transaction."⁷² Simply put, a controlled transaction is deemed to be arm's length if unrelated parties engage in similar transactions at similar price levels. Many transactions, however,

evasion of taxes"

67. See INCOME TAX REGULATIONS (CCH ed. 2004) (setting out rules for the application of the arm's length standard).

68. INTERNATIONAL TRANSFER PRICING 2002/2003 (PricewaterhouseCoopers ed. 2003) at 105.

69. Treas. Reg. § 1.482-1(b)(1) (as amended in 2003).

70. *Id.*

71. See Treas. Reg. § 1.482-3 (as amended in 1995) (describing methods to determine transfer prices in connection with a transfer of tangible property, including the "comparable uncontrolled price method," the "resale price method," and the "cost-plus method"); Treas. Reg. § 1.482-4 (1994) (describing methods of determining taxable income in connection with a transfer of intangible property, including the "comparable uncontrolled transaction" method).

72. Treas. Reg. § 1.482-3(b)(1) (as amended in 1995).

involve unique products, product volumes, or economic terms and cannot be measured against transactions between unrelated parties.⁷³

Other methods specifically described in the section 482 regulations, such as the comparable profits method, require substantially less comparability.⁷⁴ Rather than examining the prices charged between unrelated companies at the transactional level, the comparable profits method looks to what independent companies earn at an operating profit level, and uses those profitability levels to measure what a controlled company should earn.⁷⁵ For instance, if independent marketing services companies generally earn profits equal to ten percent of their sales, a controlled subsidiary that performs marketing services solely for its parent company should set its transfer prices to earn a profit equal to ten percent of its sales.

Although the section 482 regulations specifically list methods taxpayers can use to determine and document their transfer prices,⁷⁶ taxpayers are not limited to these specified methods. Taxpayers or IRS auditors can use a method not specified in the section 482 regulations if it is the best method available.⁷⁷

c. The best method rule

When it comes to choosing among the many specified or unspecified methods that are available, the section 482 regulations state that the “best method” must be used.⁷⁸ The best method is the one that, “under the facts and circumstances, provides the most reliable measure of an arm’s length result.”⁷⁹

73. See Treas. Reg. § 1.482-3(b)(2)(ii)(A) (as amended in 1995) (acknowledging that “because even minor differences in contractual terms or economic conditions could materially affect the amount charged in uncontrolled transactions, comparability under the comparable uncontrolled price method depends on close similarity with respect to these factors”).

74. INTERNATIONAL TRANSFER PRICING 2002/2003, *supra* note 9, at 2.

75. Treas. Reg. § 1.482-5 (2004).

76. Treas. Reg. §§ 1.482-3 (as amended in 1995), 1.482-4 (1994).

77. See Treas. Reg. § 1.482-1(c) (as amended in 2003) (discussing the use and determination of the “best method”). The best method rule is discussed in Section III(B)(1)(c) of this Comment, *infra*.

78. Treas. Reg. § 1.482-1(c)(1) (as amended in 2003).

79. *Id.*

2. Documentation Requirements

The purpose of section 482 of the Code, and of the related regulations, “is to ensure that taxpayers clearly reflect income attributable to controlled transactions, and to prevent the avoidance of taxes with respect to such transactions.”⁸⁰ Since, as discussed above, manipulating transfer prices allows a company to avoid massive amounts of taxes, the IRS only provides penalty safe harbors to taxpayers who prepare and file, contemporaneous with their tax returns, documentation that their transfer prices meet the arm’s length standard.⁸¹ The IRS is becoming increasingly strict about this documentation requirement, and is imposing penalties for non-compliance.⁸²

C. ERISA Duty of Prudence

In a situation like the *Ford Motor* prototype, there is an important distinction between ERISA rules on the one hand and state fiduciary duty and IRS rules on the other. State fiduciary duty and IRS rules specifically prohibit the types of transactions discussed in the prototype, whereas ERISA rules merely charge the person or persons in charge of the pension fund with monitoring the fund. Therefore, unlike state fiduciary duty and IRS rules, ERISA rules have no bearing on the actions of the controlling shareholder or management of the company. ERISA rules require the plan fiduciary to prevent harmful self-dealing not because it is illegal, but merely because it is detrimental to the plan. The contours of ERISA fiduciary law are discussed below.

1. The Meaning of “Prudence”

ERISA section 404(a)(1)(B) requires any person in charge of plan administration to act “with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.”⁸³ Experts have argued that “familiar

80. Treas Reg. § 1.482-1(a)(1) (as amended in 2003).

81. 26 U.S.C. § 6662(e)(3)(B)(i)(II) (2006).

82. See *Langdon Reveals Compliance Initiative; Examiners Told to Emphasize Documentation*, Daily Tax Rep. (BNA) G-1 (Feb. 10, 2003) (describing IRS division Commissioner Larry Langdon’s direction to examiners to more actively enforce the thirty-day deadline for providing transfer pricing documentation).

83. 29 U.S.C. § 1104(a)(1)(B) (2006).

with such matters” means that the standard is really a “prudent expert” standard, and not a “prudent man” standard.⁸⁴ Commentators believe that

it will be some time before the courts provide a clear picture of the new prudence standard. In the meantime, the Department of Labor [has stated that the] . . . inquiries [a fiduciary must make] concerning a certain investment are limited to those aspects which the fiduciary knows or should know are relevant to the particular investment in question.⁸⁵

Thus, applying these standards, would a pension manager in charge of managing the pension’s minority stake in a controlled company be responsible for monitoring transfer pricing issues? Given that in the *Ford Motor* case, the courts found that transfer pricing had cost Ford Canada hundreds of millions in foregone profits, it seems that transfer pricing should be deemed “relevant to the particular investment in question.”⁸⁶

Finally, it should be noted that this issue is too big to be ignored by a plan fiduciary in this situation. Under ERISA, the plan can sue to recover from the fiduciary an amount equal to the pension plan’s loss.⁸⁷

IV. ANALYSIS

The purpose of this analysis is to examine how IRS transfer pricing rules, ERISA fiduciary duty rules, and the Delaware fiduciary duty rules apply in a case like the *Ford Motor* prototype, as well as to discuss how application of each set of rules would benefit from a cooperative approach to satisfying all three sets of rules. While the transactions between Ford and Ford Canada were in fact subject to IRS transfer pricing rules, this analysis needs to assume that the relationship between Ford Canada and its shareholders was governed by Delaware law,⁸⁸ and that OMERS was subject to ERISA.⁸⁹

84. JEFFREY D. MAMORSKY, *EMPLOYEE BENEFITS LAW: ERISA AND BEYOND*, at 12-17 (1981).

85. *Id.* at 12-18.

86. *Id.* A separate issue would be whether in the *Ford Motor* case the plan fiduciary would be found not to have acted according to the standard of care required in the situation (were the plan a U.S. plan covered by ERISA). It seems that the fiduciary could say that he or she relied on the accounts reports for Ford Canada. Whether such an argument would prevail is unclear. The final analysis in this Comment describes a means of avoiding this issue entirely.

87. 29 U.S.C. §§ 1109 and 1132 (1999).

88. Since Ford Canada is a Canadian corporation, it is not governed by Delaware law.

89. As a Canadian pension plan, OMERS is not subject to ERISA.

A. Referencing the Protections of Delaware Law to Document Transfer Prices

With respect to transfer prices between the United States and foreign-related companies, the IRS transfer pricing rules mandate that the prices reflect what would be charged between parties operating at arm's length. While a method like the comparable uncontrolled price method provides an accurate and direct method of determining transfer prices, it is often impossible to use such a direct method.

For instance, in the *Ford Motor* prototype, Ford Canada and Ford only sold vehicle components and completed vehicles to each other or other members of the controlled Ford group. There was no market price to which to refer, because there was no public market for these items nor anything even remotely similar. The problem of the lack of comparable transactions becomes even more acute when addressing a transfer pricing issue related to intellectual property, which is very often unique and impossible to ascribe a market price. Therefore, the comparable uncontrolled price method, which provides such direct results, is unavailable.

Among the remaining specified methods in the section 482 regulations, there are more subjective ones, such as the comparable profits method. As defined in the section 482 regulations, the comparable profits methods is designed to find a *range* of acceptable profitability, not a pinpointed "correct" answer.⁹⁰ Therefore, due to its indirect nature, such analysis will be unlikely to reproduce exactly what would have happened at arm's length.

B. The Minority Shareholder as an Arm's Length Party

With respect to transfer pricing transactions, the minority shareholder of a controlled company is, in many ways, like an arm's length party. Just as an arm's length party would seek the best possible price for itself, the minority shareholder wants to see the company in which it has an interest get the best price possible when dealing with its parent company. As described above, the parent company has an opposing interest.

The minority shareholder also has some power in the transaction. While an arm's length party can walk away from a deal it does not like, the minority shareholder finds power in its access to the courts. If a minority shareholder feels that the transfer price in a transaction is unfair, he can seek a judicial remedy. As a party to a self-dealing transaction, the

90. See Treas. Reg. § 1.482-5(b)(3) (as amended in 2004) (describing how to calculate an arm's length range of profitability using the comparable profits method.)

majority shareholder will have the burden of showing that the transaction was entirely fair.

The power of the minority shareholder is unequal to that of an arm's length party. The majority shareholder can still put in place a transfer pricing scheme without the consent of the minority shareholder, but the minority shareholder's ability to get a judicial remedy is powerful.⁹¹

C. *The Existence of a Minority Shareholder as Transfer Pricing Documentation*

Because, as discussed above, a minority shareholder has some attributes similar to an arm's length party, a controlled company with a minority shareholder might argue that it should be able to refer to this relationship when it prepares its required transfer pricing documentation.⁹² If a company like Ford Canada prepared its transfer pricing documentation by stating that its transfer prices with Ford must be arm's length, or else Ford Canada's minority shareholders would seek judicial remedy, then it seems like this might qualify as the "best method" to "provide the most reliable measure of an arm's length result."⁹³

There are two readily apparent pitfalls to using this approach. The first issue is that the IRS seems to have already addressed and rejected this approach in Chief Counsel Advisory⁹⁴ 200408030.⁹⁵ In CCA 200408030, "[t]axpayers claim[ed] that their compliance with state law standards of fairness for the minority shareholders in valuing the [e]xchange is tantamount to dealing at arm's length."⁹⁶ In a response that was short and lacking in rationale, the IRS stated:

We have no basis, other than Taxpayers' unsupported claims, to believe that [the terms of the transaction] satisf[y] the arm's length standard. Moreover, we have no reason to believe that compliance with state laws satisfies the arm's length standard.

91. The minority shareholder's remedy is, however, substantially more costly. In a world where all transaction costs are known, the parent company might be tempted to exploit the minority shareholder up to the point where it would be less expensive for the minority shareholder to accept the exploitation, rather than litigate the issue. The cost of litigation is not figured into this Comment's analysis, but would likely have to be considered by a taxing authority when analyzing why a minority shareholder did not take action against a transfer pricing transaction.

92. As required by 26 U.S.C. § 6662(e)(3)(B)(i)(II) (2006).

93. The "best method" language is from Treas. Reg. 1.482-1(c)(1) (as amended in 2003).

94. Chief Counsel Advisories may not be used or cited as precedent. 26 U.S.C. § 6110(k)(3) (2006).

95. I.R.S. CCA 200408030, 2004 WL 319073, at *1 (IRS CCA 2003) [hereinafter CCA 200408030].

96. *Id.* at *5.

As stated above, we do not see the relevance of state law fiduciary duties to the application of section 482 and the regulations thereunder, which constitute a separate and distinct system for measuring and determining arm's length prices.⁹⁷

The IRS' argument is unpersuasive. The "distinct system"⁹⁸ the IRS has in place for "measuring and determining arm's length prices"⁹⁹ is based on the arm's length standard, which should "be applied in every case."¹⁰⁰ If minority shareholders have opposing interests to the controlling shareholder in a transaction and have sufficient power to attack the transaction under state law, their failure to attack is a strong indication that they approve of the transaction. If minority and majority shareholders have opposing interests, but both approve of the transaction, this should be sufficient to demonstrate that the transaction meets the arm's length standard.

The second pitfall of using failure to sue as documentation of arm's length prices is that the IRS could simply refer to the *Ford Motor* case as an example of why failure to sue does not necessarily mean that transfer prices were fair. Even though Ford Canada's minority shareholders had opposing interests to the majority shareholder, as well as the power to judicially attack unfair transfer prices,¹⁰¹ they did not do so. The minority shareholders of Ford Canada, most notably OMERS, the retirement fund, had a substantial financial interest in monitoring Ford Canada's transfer pricing with Ford, but, inexplicably, they did not.

Ford Canada's minority shareholders did not act to remedy the oppressive transfer pricing policy that Ford had kept in place *for thirty years*, finally taking action only when they were forced to value their shares due to the merger. The IRS is justified in not relying on minority shareholders to act as watchdogs of a transfer pricing policy if the shareholders do not actually monitor it.

The final section of this Comment addresses how state fiduciary duty law could encourage the involvement of minority shareholders in formulating transfer prices. If minority shareholders were more involved, this would achieve two things: it would (1) discourage derivative lawsuits, as minority shareholders could voice their concerns early on, therefore providing a "standard shift" that would benefit the defendants in court; (2) allow companies to point to the active approval of minority shareholders, rather than mere failure to object, as proof that their inter-company transfer pricing meets the arm's length standard; and (3) allow ERISA fiduciaries to

97. *Id.*

98. *Id.*

99. *Id.*

100. Treas. Reg. § 1.482-1(b)(1) (as amended in 2003).

101. Ford Canada's minority shareholders have this power under Canadian law.

satisfy their legal obligation of prudence.

D. Using a "Standard Shift" as a Means Of Encouraging Minority Shareholder Involvement

If minority shareholders were more involved in the process of negotiating major transfer pricing policies,¹⁰² it would, as stated above, discourage derivative lawsuits and possibly ease companies' transfer pricing documentation burdens. Delaware law could encourage minority shareholder involvement, or rather encourage majority shareholders to *seek* minority shareholder input, by granting a "standard shift" to majority shareholders who had sought and gained minority shareholder approval of a transfer pricing policy. That is, if the majority shareholder were ever sued for improper self-dealing as a result of a transfer pricing policy, and the majority shareholder had previously received minority shareholder approval, the court would judge the case under the business judgment rule, not entire fairness.

This suggestion is not far-fetched. As previously stated, Delaware courts grant standard shifts from entire fairness to the business judgment rule in other situations where minority shareholder approval is obtained, such as executive compensation cases and merger cases. Why do the Delaware courts not currently grant the standard shift in self-dealing cases where minority shareholder or independent director approval has been obtained?

Delaware courts have expressly addressed this issue, stating:

[e]ntire fairness remains applicable even when an independent committee¹⁰³ is utilized because the underlying factors which raise the specter of impropriety can never be completely eradicated and still require careful judicial scrutiny.¹⁰⁴ This policy reflects the reality that in a transaction [involving self-dealing and a controlling shareholder], the controlling shareholder will continue to dominate the company regardless of the outcome of the transaction.¹⁰⁵ The risk is thus created that those who pass upon the propriety of the transaction might perceive that disapproval may result in retaliation by the

102. Either directly more involved, or more involved through directors specifically informed about their interests.

103. Although not explicit in Delaware case law, approval by a disinterested committee of Directors is generally treated as equivalent to approval by independent shareholders.

104. Kahn v. Tremont, 694 A.2d 422, 428 (Del. 1997) (citing Weinberger v. UOP, 457 A.2d 701, 710 (Del. 1983)).

105. *Id.* at 428, *construed in* Citron v. E.I. Du Pont de Nemours & Co., 584 A.2d 490, 502 (Del. Ch. 1990).

controlling shareholder.¹⁰⁶ Consequently, even when the transaction is negotiated by a special committee of independent directors, ‘no court could be certain whether the transaction fully approximate[d] what truly independent parties would have achieved in an *arm’s length* negotiation.’¹⁰⁷

The court’s concerns are valid. Majority shareholders do wield power. A better solution, however, would be to make a more searching inquiry of the procedural validity of the independent director/minority shareholder approval process, rather than simply denying the majority shareholder the benefit of the business judgment rule. Only when, in its review of the independent director/minority shareholder approval process, the court senses impropriety or influence, should the court insist on the entire fairness standard. Otherwise, the court should allow the majority shareholder defendant the benefit of the business judgment rule.

While the approach advocated above may seem to favor a majority shareholder by granting deferential review, it also favors the *minority* shareholder because the majority shareholder has a substantial incentive to gain the minority shareholders’ approval. Knowing that a court would review a transaction under the business judgment rule is a large advantage due to the difficulty a plaintiff would have in overcoming it in court.

Companies and majority shareholders realize this, and, where a standard shift is available, they actively seek minority shareholder participation even though it is not required.¹⁰⁸ Therefore, allowing a majority shareholder the benefit of a standard shift when minority shareholder approval is obtained gives the majority shareholder incentive to actively consult the minority shareholder. This phenomenon is beneficial. It would have prevented the thirty years of shareholder oppression in the *Ford Motor* prototype, and once potential plaintiffs realize the majority shareholder has earned the protection of the business judgment rule, they will be discouraged from commencing lawsuits.

More relevant to this Comment, this situation will also have the effect of giving controlled companies more ability to claim that minority shareholder approval is evidence that the company’s transfer prices are at arm’s length. Without affirmative approval of a scheme, a company can only point to its lack of minority shareholder disapproval as evidence of the minority shareholder’s consent. As we saw in the *Ford Motor* prototype, lack of disapproval does not necessarily mean consent.

With affirmative minority shareholder approval, the IRS would have a

106. *Id.*

107. *Id.* (citing *Citron*, 584 A.2d at 502) (emphasis added).

108. *See* *Lewis v. Vogelstein*, 699 A.2d 327, 330 (Del. Ch. 1997) (noting that “shareholder approval was not required for the authorization of this transaction and was sought only for its effect on the standard of judicial review”).

much more difficult time making the claim that they “have no reason to believe that compliance with state laws satisfies the arm’s length standard.”¹⁰⁹ When the minority shareholder has characteristics of an arm’s length party; that is, opposing interests, and its consent to a transfer pricing scheme is actively given, there is no reason not to believe that a transaction does not meet the arm’s length standard. Therefore, this approval by a party with opposing interests to the majority shareholder should qualify as the “best method” to demonstrate the arm’s length nature of a transaction under the section 482 regulations.¹¹⁰

E. Satisfying ERISA Duties by Approving Transfer Prices

If the persons in charge of a pension fund that owned a minority stake in a controlled company were allowed to approve transfer prices, they almost certainly could not be accused of breaching their ERISA duties with respect to this issue. This Comment notes in Section III, *supra*, that pension fund fiduciaries have a duty to inquire about issues “relevant” to any given investment. This Comment claims that transfer prices, which can have a huge financial impact on a company, are therefore “relevant”.

By negotiating transfer prices with majority shareholders, pension fund managers should be able to satisfy their ERISA duties with respect to this “relevant” inquiry. Thus, the conclusion is, simply, that if Delaware fiduciary duty laws and IRS transfer pricing rules can encourage majority shareholders to negotiate transfer prices with minority shareholders, fiduciaries of pension funds that hold minority interests also win, as they are able to fulfill an ERISA-imposed duty.

V. CONCLUSION

The section 482 regulations and Delaware fiduciary duty law both contain provisions to ensure that when a U.S. subsidiary with a foreign majority owner engages in a transaction with its foreign parent, the prices charged or paid by the foreign parent are fair. ERISA requires that when a minority shareholder is a pension, the pension fiduciary must monitor the fairness of these prices. This Comment argues that the fairness and ease of compliance with all three bodies of law would be enhanced with two changes.

First, in transfer pricing cases, the Delaware courts should change their standard of review once minority shareholders’ active approval is obtained. Majority shareholders who seek out and gain minority

109. CCA 200408030 at *5.

110. The “best method” rule, described above, is set out in Treas. Reg. § 1.482-1(c)(1) (as amended in 2003).

shareholder approval should be afforded the protection of the business judgment rule. This would discourage lawsuits by plaintiffs who would realize the futility of pursuing legal action, and would also encourage majority shareholders to mind the needs and rights of minority shareholders. If minority shareholders were consulted, pension fund managers should be able to satisfy their ERISA duties with respect to transfer pricing.

As for the IRS and the section 482 regulations, the IRS should accept that once minority shareholders approve a transfer pricing scheme, this approval, in most cases, should be sufficient to demonstrate the arm's length nature of the transactions. As long as minority shareholders and majority shareholders have opposing interests with respect to the transfer pricing scheme and there is no evidence of undue influence on the minority shareholder, minority shareholder approval should be sufficient evidence that parties operating at arm's length approve of the transaction.