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## Control Transaction Governance: Collective Action and Asymmetric Information Problems and Ex post Policing

*Kenju Watanabe\**

*Abstract: Why, when and how should control transactions be policed ex post and by a judiciary? This article is the first to 1) articulate the doctrinal prerequisites for effective ex post judicial policing of fiduciaries in control transactions, and 2) theoretically unify two seemingly distinct approaches to police control transactions: the ex post judicial policing in the United States and the ex ante policing by the Takeover Panel in the United Kingdom. Shareholder collective action and asymmetric information problems, and the extent of gatekeeping by fiduciaries together determine the mode of third-party interventions, such as those by judiciaries and the Takeover Panel, in control transactions. The Article's analysis yields normative conclusions about how judiciaries in the United States, including Delaware's, should fine-tune gatekeeping by corporate fiduciaries in control transactions. It predicts that multijurisdictional shareholder litigation that seeks anticipatory adjudication will produce negative consequences. Further, it gives policy makers outside of the United States the theoretical foundations for crafting third-party interventions in both types of control transactions, i.e., third-party acquisitions of control and controller freeze-outs, that are optimal for their own jurisdictions.*

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TABLE OF CONTENTS

I. Introduction .....	49
II. Twin Problems, Dilemmas, <i>Ex Post</i> Judicial Intervention, and Attendant Complications.....	51
A. Governance Dilemmas .....	52
1. Acquisition of Companies with Wholly Dispersed Shareholders.....	52
2. Acquisition of Minority Shares by Controllers.....	54
B. Governance Dilemmas Intensified .....	54
1. Acquisition of Companies with Wholly Dispersed Shareholders.....	55
2. Acquisition of Minority Shares by Controllers.....	55
C. U.S. Model to Solve Governance Dilemmas.....	57
D. <i>Ex Post</i> Judicial Policing: Amplified Needs and Difficulties.....	63
1. Preexisting Problems Amplified and <i>Ex post</i> Judicial Policing Becoming Both More Crucial and More Challenging .....	63
2. Gatekeeping Activities Make Policing More Challenging ...	64
3. Acquisition of Companies with Dispersed Shareholders: Directors Acting as Gatekeepers .....	64
4. Acquisition of Minority Shares by Controllers: Controllers Acting as Gatekeepers.....	66
III. <i>Ex Post</i> Judicial Policing of Gatekeepers: Twin Problems and Possible Solutions .....	66
A. Twin Problems re Initiation and Prosecution of Lawsuits .....	67
1. Twin Problems .....	67
(a) Collective Action Problems .....	67
(b) Asymmetric Information Problems .....	68
2. Solutions .....	69
(a) Solutions to Collective Action Problems.....	69
(b) Solutions to Asymmetric Information Problems .....	71
B. Twin Problems re <i>Ex Post</i> Restorative Relief to Undo a Shareholder Collective Decision or Transaction .....	71
1. Twin Problems .....	71
2. Solutions .....	73
C. Inadequacy and Inefficiency of <i>Ex Post</i> Damage Relief .....	73
1. Inadequacy and Inefficiency .....	73
(a) Adequacy of <i>Ex Post</i> Damage Relief .....	73
(i) Directors as Gatekeepers .....	73

(ii) Controllers as Gatekeepers .....	75
(b) Efficiency of <i>Ex Post</i> Damage Relief.....	75
(i) Directors as Gatekeepers .....	75
(ii) Controllers as Gatekeepers .....	78
2. Solutions .....	79
D. Summary .....	81
IV. United States .....	82
A. Delaware.....	82
1. Strategies to Reduce the Twin Problems of Initiation and Prosecution of Lawsuits .....	82
(a) Collective Action Problems re Initiation and Prosecution of Lawsuits.....	82
(i) Class Actions .....	82
(ii) Costs of Lawsuits.....	85
(iii) Anticipatory Relief .....	87
(b) Asymmetric Information Problems re Initiation and Prosecution of Lawsuits.....	88
(i) Fact-finding.....	88
(ii) Burden of Proof .....	90
2. Strategies to Avoid Ex Post Restorative Relief to Undo a Shareholder Collective Decision or Transaction.....	91
(a) Anticipatory Relief .....	92
(i) Interlocutory Injunctions.....	93
(ii) Permanent Injunctions .....	97
(b) Speed .....	97
(c) Expertise and Flexibility.....	100
(i) Chancery Court.....	100
(ii) Supreme Court.....	102
B. Other States .....	103
1. Strategies to Reduce the Twin Problems of Initiation and Prosecution of Lawsuits .....	103
(a) Collective Action Problems re Initiation and Prosecution of Lawsuits.....	103
(b) Asymmetric Information Problems re Initiation and Prosecution of Lawsuits.....	104
2. Strategies to Avoid Ex post Restorative Relief to Undo a Shareholder Collective Decision or Transaction.....	104
(a) Anticipatory Adjudication .....	104
(b) Speed .....	105
(c) Expertise and Flexibility.....	105
C. Summary.....	106

V. Non-US Jurisdictions .....	106
A. Introduction .....	106
B. Japan .....	107
1. Background .....	107
(a) Landscape .....	107
(b) Basic Legal Framework for Control Transactions .....	110
(i) Tender Offer .....	110
(ii) Freeze-outs.....	113
2. Strategies to Reduce the Twin Problems of Initiation and Prosecution of Lawsuits .....	115
(a) Collective Action Problems re: Initiation and Prosecution of Lawsuits.....	115
(i) Class Actions .....	115
(ii) Costs of Lawsuits.....	117
(iii) Anticipatory Relief .....	118
(b) Asymmetric Information Problems re Initiation and Prosecution of Lawsuits.....	118
(i) Fact-finding in Regular Proceedings .....	119
(ii) Fact Finding in Provisional Injunctions.....	122
(iii) Allocation of Burden of Proof .....	124
3. Strategies to Avoid Ex Post Restorative Relief to Undo a Shareholder Collective Decision or Transaction.....	125
(a) Anticipatory Relief .....	126
(i) Permanent Injunctions .....	126
(ii) Provisional Injunctions .....	129
(b) Speed .....	130
(c) Expertise and Flexibility .....	131
(i) Courts.....	131
(ii) Weak Specialization .....	133
C. Other Non-US Jurisdictions.....	134
D. Summary .....	135
VI. Intensity of Gatekeeping and <i>Ex Post</i> Judicial and <i>Ex Ante</i> Nonjudicial Policing.....	137
A. United States .....	137
B. Non-US Jurisdictions.....	139
VII. Conclusion.....	141

## I. INTRODUCTION

Why, when, and how should control transactions be policed *ex post* and by a judiciary? Collective action and asymmetric information problems and related agency problems often frustrate efficiency enhancing control transactions and encourage efficiency destroying control transactions. These happen particularly at the companies that have already been plagued with the problems. There is no pure internal mechanism to correct these and a third party intervention is due. It can be done *ex post* or *ex ante*.

This paper identifies normative prerequisites that a judiciary must meet to effectively police *ex post* fiduciaries in acquisitions of companies<sup>1</sup> with dispersed shareholders and in freeze-outs of dispersed minority shareholders, both in cash (together “control transactions”). Collective action problems (CAPs) and asymmetric information problems (AIPs)—together twin problems (TPs)—resulting from shareholder dispersion<sup>2</sup> determine the prerequisites. The less empowered corporate fiduciaries are to gatekeep control transactions for dispersed shareholders, the less the normative strength of the prerequisites is. Delaware’s judiciary, while it meets the prerequisites better than any other judiciaries and is the best in the United States, should examine if its judicial standards give excessive gatekeeping powers to the fiduciaries relative to its ability to address TPs relating to shareholder lawsuits against the fiduciaries in control transactions and thus less than optimal. Non-Delaware judiciaries, generally less capable of addressing the TPs, should examine if they should follow Delaware’s judicial standards. It predicts that multijurisdictional shareholder litigation that seeks anticipatory adjudication will produce negative consequences. Jurisdictions outside the United States may opt to limit the fiduciaries’ gatekeeping roles and abandon the *ex post* judicial policing if their judiciaries do not satisfy the normative prerequisites and resort to *ex ante* policing.

Part II first shows that the TPs and related agency problems create unique governance dilemmas in relation to both types of control transactions. This is especially true when TPs and related agency problems preexist and induce control transactions as a solution. The dilemmas call for a special governance regime for control transactions. In the United States, federal tender offer and proxy solicitation rules partially address the dilemmas. Boards and controllers assume the roles of further addressing the TPs

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<sup>1</sup> In this paper, generally “corporation” and “company” are used interchangeably.

<sup>2</sup> The nature and extent of the TPs depend on the shareholder base, which changes over time. In the United States, there has been a reconcentration of share ownership. See Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 864, 865 (2013). This reconcentration, however, is in “intermediary institutions,” which are still “rationally reticent” and fail to “act like . . . ‘real’ owners.” *Id.* at 867, 888. If so, the discussion in this paper should remain largely intact.

in respective types of control transactions for dispersed shareholders. By default, the task of policing the corporate fiduciaries falls upon judiciaries. However, judicial policing takes place after the fiduciaries' gatekeeping actions. This creates two related complications. First, the TPs tend to worsen and gain momentum before the judicial intervention and make the intervention both more crucial and challenging. Second, the TPs and related agency problems assume a different dimension of modalities if the fiduciaries gatekeep control transactions for dispersed shareholders and make judiciaries' policing of the conduct of the fiduciaries even more crucial and challenging.

Part III identifies normative prerequisites for effective judicial policing. Ownership dispersion has "Powerful and Pervasive Effects" on "M&A" litigation.<sup>3</sup> TPs do not go away and again challenge the judiciaries at the initiation and prosecution stage of the lawsuits (Stage I). Control transactions involving companies with preexisting TPs are disproportionately represented among control transactions that require judicial policing. It is crucially important to have solutions to the TPs at Stage I.<sup>4</sup> In most instances, judicial relief is rendered following fiduciary actions. The TPs also challenge the judiciaries at the stage of implementing the *ex post* relief (Stage II): restorative remedies are often superior to damage remedies, but the TPs make restorative remedies impractical.<sup>5</sup> Possible solutions are explored to satisfy the normative prerequisites.

Part IV examines the solutions the Delaware judiciary uses. Delaware has a robust discovery system to solve AIPs and an opt-out class action system with fee calculation and shifting mechanisms to solve CAPs, each relating to Stage I. The availability of anticipatory adjudication combined with the judiciary's speed, expertise, and flexibility allows it to take advantage of a window of time between decisions by fiduciaries on control transactions and shareholder actions on the transactions. Thus, the Delaware judiciary satisfies the Stage II prerequisites. Moreover, in the context of anticipatory adjudication—Delaware's oft-criticized "indeterminacy"—is less of a problem and can even be beneficial. First, generally decisions are rendered *ex post* fiduciaries' decisions but *ex ante* irreparable damages, and the fiduciaries are not subject to financial liabilities. Second, "indeterminacy" prevents opportunistic activities. Part IV then reveals that discovery and class action are generally available in the United States to solve TPs at Stage I. Non-Delaware judiciaries can render anticipatory relief. Unlike Delaware's judiciary, however, the non-Delaware judiciaries typically lack the flexibility

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<sup>3</sup> John C. Coates IV, *The Powerful and Pervasive Effects of Ownership on M&A* (Harv. Law Sch. John M. Olin Ctr. for Law, Econ., and Bus., Discussion Paper No. 669, 2010), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1544500](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1544500).

<sup>4</sup> Hereinafter, the prerequisites necessary to solve the TPs at Stage I the "Stage I prerequisites."

<sup>5</sup> Hereinafter, the prerequisites necessary to solve the TPs at Stage II the "Stage II prerequisites," and together with the Stage I prerequisites, the "prerequisites."

and expertise necessary to meet the Stage II prerequisites.

Part V examines whether judicial systems in non-U.S. jurisdictions have strategies, tools, and attributes to meet the prerequisites. Japan will be used to illustrate possible difficulties for non-U.S. jurisdictions to meet the prerequisites. Discovery and opt-out class actions are uniquely American institutions. Thus, many non-U.S. judiciaries lack key tools to meet the Stage I prerequisites. These non-U.S. judiciaries at a minimum need to explore whether they have alternative tools to satisfy the Stage I prerequisites. They should not let judiciaries assume, by default or not, the policing role unless they are shown to be capable of playing that role. Non-U.S. judiciaries may engage in anticipatory adjudication. However, no other major judiciary appears to have the speed, expertise, and flexibility of the Delaware judiciary.

The penultimate Part VI observes the relationship between the intensity of gatekeeping by fiduciaries and the required capability of judiciaries to police the fiduciaries. The less empowered corporate fiduciaries are to gatekeep control transactions for dispersed shareholders, the less crucial and demanding judiciaries' policing roles become, and the less the normative strength of the prerequisites becomes. This should mean that, under the modified regime, the disadvantages of non-Delaware judiciaries in the United States should become smaller. Non-Delaware jurisdictions in the United States should consider cutting back the fiduciaries' gatekeeping role to level the playing field and to reduce the risk of errors in anticipatory adjudications. While it is the best, the Delaware judiciary is not perfect and is unable to completely eliminate the TPs relating to the lawsuits and the agency problems of the corporate fiduciaries. The more capable it is, the more gatekeeping power it should be able to give to the fiduciaries and vice versa. It seems beneficial to examine whether the judicial standards the Delaware judiciary uses to police the fiduciaries are optimal. Internationally, the removal of the gatekeeping role makes *ex ante* policing possible, and expert nonjudicial organs could become credible substitutes.

Finally, Part VII, based on the findings in the preceding parts, suggests possible approaches for judicial and nonjudicial interventions in control transactions.

## II. TWIN PROBLEMS, DILEMMAS, *EX POST* JUDICIAL INTERVENTION, AND ATTENDANT COMPLICATIONS

The sole or single owner standard theory has been implicitly or explicitly accepted to establish rules to enhance efficient acquisitions and discourage inefficient acquisitions.<sup>6</sup> “The single-owner standard holds that an effi-

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<sup>6</sup> See, e.g., Alan Schwartz, *The Fairness of Tender Offer Prices in Utilitarian Theory*, 17 J. LEGAL



cient sale is one that a willing buyer and seller would make were both parties free from coercion.”<sup>7</sup> The sole owner does not suffer from CAPs and suffers far less from AIPs or is well informed.<sup>8</sup> Thus, under the sole owner standard, CAPs and AIPs (together twin problems or TPs), in relation to cash acquisitions of control, exist as “problems”: they tend to induce inefficient acquisitions, and thus it is desirable to eliminate or lessen them. Similarly, the TPs of minority shareholders, if the minority shareholders are given a strong say—such as a veto in freeze-outs—may unduly frustrate efficiency-enhancing freeze-outs and induce inefficient freeze-outs.<sup>9</sup> How do TPs adversely affect control transactions, and how should we address those problems?

### A. Governance Dilemmas

#### 1. Acquisition of Companies with Wholly Dispersed Shareholders

Once a discussion for a potential control transaction is initiated, the TPs tend to intensify. The control transactions raise complex business, financial, and legal issues that will exacerbate the TPs. The composition of

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STUD. 165, 166–67 (1988).

<sup>7</sup> *Id.* at 166. The theory’s first academic proponent was presumably Lucian Bebchuk. *See, e.g.*, Lucian Arye Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 HARV. L. REV. 1693, 1743–44 (1985) [hereinafter Bebchuk, *Toward Undistorted Choice*]; Lucian Arye Bebchuk, *The Sole Owner Standard for Takeover Policy*, 17 J. LEGAL. STUD. 197, 221–28 (1988) [hereinafter Bebchuk, *The Sole Owner Standard*]; Lucian Arye Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 923, 981–88 (2002) [hereinafter Bebchuk, *The Case Against Board Veto*]. Under the market standard theory, “any offer above the target’s prebid market price should succeed.” Schwartz, *supra* note 6, at 165. For the details of the market standard theory, see, for example, Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target’s Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981); Frank H. Easterbrook & Daniel R. Fischel, *Auctions and Sunk Costs in Tender Offers*, 35 STAN. L. REV. 1 (1982).

<sup>8</sup> Dispersed selling shareholders tend to be less informed than buyers. The academic proponents of the sole owner standard appear to have focused more on the CAPs and far less on the AIPs. This, however, does not mean that AIPs are irrelevant to the efficiency. *See, e.g.*, Bebchuk, *Toward Undistorted Choice*, *supra* note 7, at 1772 (“[A] mistaken estimate [of the independent target’s value] might of course lead to an inefficient outcome.”). A sole owner as well as dispersed shareholders might suffer from AIPs. Typically, however, the sole owner’s AIPs are infinitely far less than those of dispersed shareholders. Moreover, the sole owner’s AIPs can be fixed quite easily and quickly when, for example, the owner delves into the records of the company and has one-on-one discussions with the management. This is not the case for the dispersed shareholders. But for their possible actual or potential conflict of interest, the company’s management is best equipped to address the AIPs. However, in their view it is difficult to eliminate the downside effects of the conflicts. *See, e.g., id.* at 1772–73; Bebchuk, *The Case Against Board Veto*, *supra* note 7, at 999–1004; John Armour & David A. Skeel, Jr., *Who Writes the Rules for Hostile Takeovers, and Why?—The Peculiar Divergences of U.S. and U.K. Takeover Regulation*, 95 GEO. L.J. 1727, 1741 n.53 (2007).

<sup>9</sup> *See, e.g.*, Ronald J. Gilson & Jeffrey Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785, 804 n.73 (2003) [hereinafter Gilson & Gordon, *Controlling Controlling*].

the shareholders becomes fluid as well, which may worsen the TPs, in particular the CAPs. Naturally, actual and potential third-party participants in the control transactions are tempted to exploit the TPs. The problems persist through shareholder decisions, if any, on such potential control transactions.

Corporate directors work for shareholders' collective interests and are capable of solving the TPs.<sup>10</sup> However, corporate directors suffer from agency problems.<sup>11</sup> At the precise moment when they could be most helpful to shareholders in relation to control transactions, directors—particularly nonindependent directors—have strong personal interests in the outcome of such discussions that are not aligned with those of the shareholders, and they may be tempted to act selfishly at the expense of the shareholders' welfare.<sup>12</sup> The TPs have already made it difficult for shareholders to monitor the directors, which could further exacerbate the director agency problems. Thus, the more the shareholders need help from the directors, the less helpful the directors might possibly become.<sup>13</sup> Unless a solution is found to neutralize these related problems, they could stifle or skew the market for corporate control and diminish efficiency-enhancing functions of control transactions.<sup>14</sup> A targeted scheme might be helpful to solve the dilemma.<sup>15</sup>

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<sup>10</sup> Directors may have other constituents to look after.

<sup>11</sup> As to the term "agency problems," see John Armour et al., *Agency Problems and Legal Strategies*, in *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* ch. 2, § 2.1 (Reinier Kraakman et al. eds., 2d ed. 2009) [hereinafter Armour et al., *Agency Problems and Legal Strategies*] ("[A]n agency problem—in the most general sense of the term—arises whenever the welfare of one party, termed the 'principal', depends upon actions taken by another party, termed the 'agent.'"). See also Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 309–10 (1976).

<sup>12</sup> See, e.g., Fernando Gomez & Maria Isabel Saez, *The Enforcement of Management Passivity Duty in Take-over Law: Class Action or Government Action?*, in *THE LAW AND ECONOMICS OF CLASS ACTIONS IN EUROPE* 261, 267 (Jüden G. Backhaus et al. eds., 2012).

<sup>13</sup> See, e.g., Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 84 VAND. L. REV. 83, 104–08 (2004); Armour et al., *Agency Problems and Legal Strategies*, *supra* note 11, § 2.2.1 (describing interactions between CAPs and agency problems); ALESSO M. PACCES, *RETHINKING CORPORATE GOVERNANCE: THE LAW AND ECONOMICS OF CONTROL POWERS* §§ 1.1.1, 1.1.2.2 (2012) (stating that AIPs make it possible for corporate agents to cheat and difficult for shareholders to monitor the agents).

<sup>14</sup> Once the directors assume gatekeeping functions, these problems may intensify. See *infra* Part II.D.2.

<sup>15</sup> See, e.g., Bernard Black & Reinier Kraakman, *Delaware's Takeover Law: The Uncertain Search for Hidden Value*, 96 NW. U. L. REV. 521, 559 (2002) [hereinafter Black & Kraakman, *Delaware's Takeover Law*] ("[H]ostile takeover bids are a relatively recent arrival, which the corporate statutes leave unaddressed."). The lack of any independent institution that can credibly intervene may lead to laws that heavily restrict the control transactions. See also Bernard Black & Reinier Kraakman, *A Self-Enforcing Model of Corporate Law*, 109 HARV. L. REV. 1911, 1930 (1996) [hereinafter Black & Kraakman, *A Self-Enforcing Model*] ("A prohibitive code simply bars many kinds of corporate behavior that are open to abuse, such as self-dealing transactions and cash-out mergers.").

## 2. Acquisition of Minority Shares by Controllers

Under certain circumstances, controllers may find it efficient to completely own the companies.<sup>16</sup> Company laws, however, may allow the minority shareholders a say, including a veto power, in connection with the freeze-outs<sup>17</sup> necessary to effect 100% ownership. In such cases, the TPs of the minority shareholders may prevent the controllers from having effective negotiations with the minority shareholders. The controllers, of course, may try to exploit the TPs. Thus, unless a solution is put in place, the TPs of the minority shareholders may let efficiency-decreasing freeze-outs move forward or prevent efficiency-enhancing freeze-outs from going forward.<sup>18</sup> Again, a targeted scheme might be helpful to solve the dilemma.<sup>19</sup>

### B. Governance Dilemmas Intensified

Preexisting CAPs and AIPs may induce control transactions. This is because the control transactions could remove the TPs and improve the val-

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<sup>16</sup> For various reasons to allow freeze-outs, see, for example, John C. Coates IV, “Fair Value” as an Avoidable Rule of Corporate Law: Minority Discounts in Conflict Transactions, 147 U. PA. L. REV. 1251, 1327–29 (1999) [hereinafter Coates, *Minority Discounts*]; FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 113, 134 (1991) [hereinafter EASTERBROOK & FISCHEL, THE ECONOMIC STRUCTURE]; Benjamin Hermalin & Alan Schwartz, *Buyouts in Large Companies*, 25 J. LEGAL STUD. 351, 352 (1996); Guhan Subramanian, *Post-Siliconix Freeze-outs: Theory and Evidence*, 36 J. LEGAL STUD. 1, 2 (2007) [hereinafter Subramanian, *Post-Siliconix Freeze-outs*]. Cf. Fernan Restrepo, *Do Freezeouts Affect the Performance of the Controlling Shareholder? An Empirical Analysis 2* (Rock Ctr. for Corp. Governance at Stanford, Working Paper No. 184, 2014) (“[W]hether or not freezeouts are efficiency generating transactions is a question that cannot be responded at the level of theory.”), <http://ssrn.com/abstract=2418846>; Victor Brudney & Marvin A. Chirelstein, *A Restatement of Corporate Freezeouts*, 87 YALE L.J. 1354, 1365–70 (1978) (proposing a flat prohibition of pure freeze-outs due to the minimal benefits relative to the great risks they engender). For unique incentives controllers may have in the United Kingdom and Japan, see *infra* Part V.B.1.b.i.

<sup>17</sup> The term is used to denote controller freeze-outs generally. The term “freeze-out” is used differently in the European Union. For the meaning of freeze-outs in the EU, see Directive 2004/25, of the European Parliament and of the Council of 21 April 2004 on Takeover Bids, 2004 O.J. (L 142) 12 (EC) art. 15 [hereinafter EU Takeover Directive]; Companies Act, 2006, c. 3, § 979 (U.K.).

<sup>18</sup> Of course a free rider problem may also prevent efficiency-enhancing freeze-outs. See, e.g., Lucian Arye Bebchuk, *Efficient and Inefficient Sales of Corporate Control*, 109 Q.J. ECON. 957, 983 (1994) (hereinafter Bebchuk, *Efficient and Inefficient Sales*). However, when the minority shareholders are not dispersed and do not have TPs, the importance of the free rider issue may be small, since, not having TPs, the minority shareholders are able and incentivized to make contributions commensurate with their aggregate ownership percentage relative to the controller’s ownership percentage.

<sup>19</sup> See *supra* note 15. Typically, minority shareholders do not have powers to oust controllers. See, e.g., Paul Davies & Klaus Hopt, *Control Transactions*, in THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH ch. 8, § 8.3.2 (Reinier Kraakman et al., 2d ed. 2009) [hereinafter Davies & Hopt, *Control Transactions*] (stating that there is not much company law can do if the controllers are unwilling to relinquish their position). As to Delaware, see *Bershad v. Curtiss-Wright Corp.*, 535 A.2d 840, 845 (Del. 1987) (“Clearly, a stockholder is under no duty to sell its holdings in a corporation, even if it is a majority shareholder, merely because the sale would profit the minority.”).

ues of the issuing companies. Thus, attempted control transactions involve a disproportionately large number of companies with shareholders or minority shareholders with preexisting TPs. However, TPs themselves, combined with other factors, may hamper the control transactions that are otherwise efficiency enhancing. It is important to find an effective solution.

### 1. Acquisition of Companies with Wholly Dispersed Shareholders

Assume that there is a public company with dispersed shareholders suffering from acute TPs. Assume further that the relevant corporation law gives the shareholders a say with respect to certain business decisions. Due to their TPs, the shareholders might have blocked efficiency-enhancing transactions. The TPs might also have hampered shareholders' ability to elect qualified persons as directors. The TPs might have frustrated the shareholders' ability to monitor agents and might have allowed them to "act opportunistically, skimping on the quality of [their] performance, or even diverting to [themselves] what was promised to the principal."<sup>20</sup> There will be those who believe that they are able to remove or significantly reduce the TPs and agency problems by becoming sole owners. If so, they might value the company more highly than the company's market capitalization and want to explore the purchase of the company at a price higher than the prevailing market price but lower than the value they would be able to achieve after the ownership change.<sup>21</sup> Such attempts are potentially efficiency enhancing.<sup>22</sup> In these situations, however, the TPs and the related agency problems<sup>23</sup> may magnify in the deal phases and hamper the transactions that would remove the inefficiency attributable to the preexisting problems.

### 2. Acquisition of Minority Shares by Controllers

Controllers are tempted to exploit minority shareholders. To protect minority shareholders, some jurisdictions may enact less enabling laws embedding procedural safeguards in shareholder approval requirements, such

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<sup>20</sup> Armour et al., *Agency Problems and Legal Strategies*, *supra* note 11, § 2.1 (footnote omitted).

<sup>21</sup> See, e.g., Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965); EASTERBROOK & FISCHEL, *THE ECONOMIC STRUCTURE*, *supra* note 16, at 112–17; Armour et al., *Agency Problems and Legal Strategies*, *supra* note 11, § 2.2.1.

<sup>22</sup> See, e.g., Eli Ofek, *Efficiency Gains in Unsuccessful Management Buyouts*, 49 J. FIN. 637 (1994); Gomez & Saez, *supra* note 12, at 264. Cf. Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV. 1641, 1651 (2006) (indicating that takeovers are responsive only to certain kinds of governance problems and appropriate only for very large problems), <http://law.stanford.edu/wp-content/uploads/sites/default/files/publication/257565/doc/slpublic/Controlling-Shareholders.pdf>. Of course, the buy side may suffer from its own agency costs.

<sup>23</sup> See, e.g., EASTERBROOK & FISCHEL, *THE ECONOMIC STRUCTURE*, *supra* note 16, at 162.

as a supermajority voting requirement, a majority of the minority voting requirement, a prohibition of super voting shares, and a mandatory shareholder equality principle.<sup>24</sup> In particular, related party transactions may be subject to strict procedural requirements. Due to their TPs, however, the minority shareholders with the minority protections might unnecessarily veto<sup>25</sup> the controllers' proposals or otherwise restrict the controllers' ability to manage the companies efficiently. For example, the minorities might block related party transactions that should benefit both.<sup>26</sup> In addition, they might unduly restrict private benefits to the controllers commensurate with the benefits of the governance and other benefits they provide or the costs the controllers incur.<sup>27</sup> Freeze-outs can remove minority shareholders' TPs and related "passive agency problems"<sup>28</sup> and achieve economic efficiency.<sup>29</sup> In these situations, however, the TPs in the deal phases may be correspondingly greater. If the minority shareholders are also given a say in the freeze-out process, there could be a significant risk for the minority shareholders' passive agency problems to magnify and block or otherwise skew efficiency-enhancing freeze-outs.

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<sup>24</sup> See generally, Luca Enriques et al., *The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies*, in *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* ch. 4, §§ 4.1.2–4.1.4 (Reinier Kraakman et al., 2d ed. 2009) [hereinafter Enriques et al., *The Basic Governance Structure: Minority Shareholders*]; Black & Kraakman, *A Self-Enforcing Model*, *supra* note 15, at 1958–60. As to rules in Delaware, see, for example, Gilson & Gordon, *Controlling Controlling*, *supra* note 9, at 789–93. For a brief description of rules in the United States, the United Kingdom, Germany, Italy, and Canada, see Zohar Goshen, *The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality*, 91 CAL. L. REV. 393, 426–37 (2003). These protective measures may not be only for companies with dispersed minority shareholders. However, dispersed minority shareholders have a stronger need for the protective measures.

<sup>25</sup> This power is strong if a supermajority or a majority of the minority voting requirement is in place with respect to certain corporate transactions. See, e.g., Goshen, *supra* note 24, at 402 (discussing possible adverse effects of a majority of the minority requirement).

<sup>26</sup> See, e.g., *id.* at 400.

<sup>27</sup> As to the validity of some level of controllers' private benefits, see generally Ronald J. Gilson & Alan Schwartz, *Corporate Control and Credible Commitments* 3 (Columbia Law and Econ. Research Paper No. 436, Stanford Law and Econ. Olin Research Paper No. 438, Yale Law and Econ. Research Paper No. 461, Eur. Corp. Governance Inst. Law Working Paper No. 216, 2014), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2182781](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2182781); Gilson, *supra* note 22, at 1652 (describing controllers' costs of monitoring, liquidity, and nondiversification). If the controllers are undercompensated for their governance role, minority shareholders are at least partially "free riding." For the ranges of private benefits in the United Kingdom, the United States, Japan, Germany, Italy, and France, see, for example, Enriques et al., *The Basic Governance Structure: Minority Shareholders*, *supra* note 24, § 4.3.2.1.

<sup>28</sup> See, e.g., Armour et al., *Agency Problems and Legal Strategies*, *supra* note 11, § 2.1.

<sup>29</sup> Hermalin & Schwartz, *supra* note 16, at 358–359; EASTERBROOK & FISCHER, *THE ECONOMIC STRUCTURE*, *supra* note 16, at 113 (giving examples of possible efficiency gains that may be achieved through controllers' minority freeze-outs). See also Coates, *Minority Discounts*, *supra* note 16, at 1327–29.

### C. U.S. Model to Solve Governance Dilemmas

Globally, at present, there are two principal approaches to solve the control transaction dilemmas. Under the Takeover Code in the United Kingdom,<sup>30</sup> the Takeover Panel assumes the role of a third-party institution to solve or lessen the dilemmas and polices control transactions *ex ante*.<sup>31</sup> The most salient features of the Takeover Code are a no-frustrating action rule and a mandatory bid rule (U.K. MBR).<sup>32</sup> “[T]he ‘no frustration’ rule . . . operates so as to put the shareholders in the driving seat as far as decision-making on the offer is concerned.”<sup>33</sup> However, the U.K. MBR simultaneously requires holders of 30% or more of the shares of a company to launch a general offer for the remaining shares at the best price paid for shares during the preceding twelve months. The U.K. MBR minimizes shareholder CAPs (collective action problems) and coercive effects that would otherwise result by assuring treatment of the shareholders left after the bidder’s establishment of control (i.e., 30% ownership) over the target no less favorable than the treatment of any of the shareholders of the target when the bidder is in the process of accumulating the control position.<sup>34</sup> Under the Takeover Code regime, a scheme of arrangement to effect a control transaction requires approval by a majority in number of shareholders representing in the aggregate 75% in the value of the shares of each class of shareholders present and voting as well as *ex ante* court sanction.<sup>35</sup> The approach taken by the Takeover Code is one that is less concerned with TPs of dispersed shareholders and more concerned with agency problems of corporate fiduciaries or less confident in the ability to address the agency problems *ex*

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<sup>30</sup> THE PANEL ON TAKEOVERS AND MERGERS, THE TAKEOVER CODE (11th ed. 2013), <http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/code.pdf> [hereinafter THE TAKEOVER CODE].

<sup>31</sup> See Davies & Hopt, *Control Transactions*, *supra* note 19, § 8.2.2.

<sup>32</sup> THE TAKEOVER CODE, *supra* note 30, r. 9, at F1, r. 21.1, at I16. See discussion *supra* Part V.B.1.b.i. (referring to the U.K. MBR in discussing Japanese tender offer rules).

<sup>33</sup> Davies & Hopt, *Control Transactions*, *supra* note 19, § 8.2.3.1. Note that the code does not prohibit prebid frustrating actions. This “exemption” apparently does not create any serious issue in the United Kingdom. See Armour & Skeel, *supra* note 8, at 1736.

<sup>34</sup> See, e.g., Davies & Hopt, *Control Transactions*, *supra* note 19, § 8.2.5.3, -4; PAUL L. DAVIES & SARAH WORTHINGTON, GOWER & DAVIES PRINCIPLES OF MODERN COMPANY LAW ¶ 28–46 (9th ed. 2012). This does not mean that the U.K. MBR addresses all structural coercion. See *infra* note 48. To the extent that off-market purchases without a tender offer are restricted, unsolicited bidders are less likely to establish large toehold stakes quickly. Thus, companies have more time to adopt defense measures. For various strategies for crafting tender offer regulations, see Davies & Hopt, *Control Transactions*, *supra* note 19, § 8.2.5.3.

<sup>35</sup> Companies Act, 2006, c. 3, § 899 (U.K.). See also THE TAKEOVER CODE, *supra* note 30, app. 7.1. For protection of minority shareholders in a scheme of arrangement, see, for example, Jennifer Payne, *Minority Shareholder Protection in Takeovers: A UK Perspective*, 8 EUR. CO. & FIN. L. REV. 145, 152–58 (2011).

*post*.<sup>36</sup> The EU Takeover Directive used the approach of the Takeover Code as a prototype model. However, significant exceptions to such approach were created in the EU Takeover Directive. For example, it permits EU member countries to opt out of the no-frustration rule.<sup>37</sup> Variations of the approach under the Takeover Code have also been proposed.<sup>38</sup>

The other approach to address the control transaction dilemmas is one that prevails in the United States. In the United States, two principal governance regimes regulate control transactions: state corporation law and federal securities law.<sup>39</sup> Unlike the approach under the Takeover Code, combined, they represent an approach that is concerned more with the TPs of dispersed shareholders and less with the agency problems of gatekeeping corporate boards or controllers, as the case may be, or that has more confidence in the ability to police the agents *ex post*.

Corporation laws in the United States generally follow an enabling model,<sup>40</sup> and a cash merger, including one in which a controller freezes out minority shareholders, can be effected through a simple majority vote.<sup>41</sup> Boards of directors propose mergers to shareholders.<sup>42</sup> Direct purchases of shares are possible without any involvement of the board of the issuer company. The Securities Exchange Act of 1934 has tender offer rules<sup>43</sup> and proxy rules.<sup>44</sup> These rules focus primarily on the information and time necessary or helpful for shareholders to decide whether to tender or how to vote their shares. Going private rules<sup>45</sup> focus on disclosure. The tender offer rules focus on protections against “Saturday night special” bids or “blitzkrieg tactics”<sup>46</sup> and prescribe certain substantive rules as well.<sup>47</sup> Thus, these

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<sup>36</sup> For a comparison of the U.S. approach and the U.K. approach with a focus on situations in which there are no controllers, see Armour & Skeel, *supra* note 8, at 1733–45 (with respect to corporate managers as agents); Davies & Hopt, *Control Transactions*, *supra* note 19, § 8.2.1.

<sup>37</sup> EU Takeover Directive, *supra* note 17, art. 12, para. 1. See also Luca Enriques et al., *The Case for an Unbiased Takeover Law (with an Application to the European Union)*, 4 HARV. BUS. L. REV. 85 (2014) (proposing a model that allows an entity-level choice for EU countries).

<sup>38</sup> See, e.g., Bebchuk, *Toward Undistorted Choice*, *supra* note 7, at 1796–1801.

<sup>39</sup> Hereinafter the model that prevails in the United States will be referred to as the U.S. model.

<sup>40</sup> An enabling model is contrasted with a prohibitive model. See, e.g., Black & Kraakman, *A Self-Enforcing Model*, *supra* note 15, at 1930.

<sup>41</sup> See, e.g., DEL. CODE ANN. tit. 8, § 251 (2014).

<sup>42</sup> See, e.g., § 251(b). In the case of short-form mergers, no shareholder approval of subsidiary corporations is required. § 253.

<sup>43</sup> These provisions were added by the Williams Act, Pub. L. No. 90-439, 82 Stat. 454 (1968) (codified as amended at 15 U.S.C. §§ 78m(d), n(d)–(f) (2012); 17 C.F.R. §§ 240.14-d1 to 14d-103 (2014)).

<sup>44</sup> 15 U.S.C. § 78n(a) (2012); 17 C.F.R. §§ 240.14a-1 to 14b-2 (2014).

<sup>45</sup> See 17 C.F.R. § 240.13e-3 (2008).

<sup>46</sup> See, e.g., Armour & Skeel, *supra* note 8, at 1734, 1755.

<sup>47</sup> For example, the best price rule is in place. 17 C.F.R. § 240.14d-10(a)(2) (2006). If shares exceeding the maximum limit are tendered in response to a partial bid, the bidder is subject to a proration requirement. 17 C.F.R. 240.14d-8 (2011).

rules address the TPs described in Parts II.A. and II.B. above or issues the TPs present. The rules, however, do not address the TPs comprehensively. For example, unlike the U.K. MBR of the Takeover Code, the rules do not focus on CAPs stemming from structural coercion of two-tier tender offers or cascading tender offers.<sup>48</sup> Further, unlike the U.K. rules, the Securities Exchange Act rules—including the act’s going private rules—do not tighten the corporate law rules regarding freeze-outs.

The roles to fill the gap and further reduce or remove issues arising out of the TPs fall on the directors or the controllers as fiduciaries.<sup>49</sup> Unlike the Takeover Code, the tender offer rules do not have a no-frustrating action rule. Corporation laws do not contain an outright prohibition of the boards’ use of a defense measure. While it is not completely settled if “substantive coercion” should be recognized as a cognizable threat,<sup>50</sup> Delaware generally let directors gatekeep control transactions on behalf of shareholders.<sup>51</sup>

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<sup>48</sup> For structural coercion, see, for example, Bebchuk, *Toward Undistorted Choice*, *supra* note 7; Bebchuk, *The Sole Owner Standard*, *supra* note 7; Ronald J. Gilson & Reinier Kraakman, *Delaware’s Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review*, 44 BUS. LAW. 259, 259 (1989). There may be residual CAPs that the U.K. MBR does not address. See, e.g., Bebchuk, *Toward Undistorted Choice*, *supra* note 7, at 1737–38. Depending on the procedural requirements for freeze-outs, varying degrees of structural coercion also exist in the context of freeze-outs. For discussions concerning Delaware corporations, see, for example, *In re Pure Resources, Inc., S’holders Litig.*, 808 A.2d 421 (Del. Ch. 2002); see also A. C. Pritchard, *Tender Offers by Controlling Shareholders: The Specter of Coercion and Fair Price*, 1 BERKELEY BUS. L.J. 83, 101–03 (2004); Gilson & Gordon, *Controlling Controlling*, *supra* note 9; Guhan Subramanian, *Fixing Freezeouts*, 115 YALE L.J. 2 (2005).

<sup>49</sup> As to the relationships of the two regimes, see, for example, Armour & Skeel, *supra* note 8 (describing the history of the emergence of this dual control); Marcel Kahan & Edward Rock, *Symbiotic Federalism and the Structure of Corporate Law*, 58 VAND. L. REV. 1573, 1578 (2005) [hereinafter Kahan & Rock, *Symbiotic Federalism*] (arguing that “the relation between federal law and Delaware law is symbiotic, rather than competitive”).

<sup>50</sup> See, e.g., *Air Products and Chemicals, Inc. v. Airgas, Inc.*, 16 A.3d 48 (Del. Ch. 2011); Guhan Subramanian, *Bargaining in the Shadow of Takeover Defenses*, 1113 YALE L.J. 621 (2003) [hereinafter Subramanian, *Bargaining*]; Black & Kraakman, *Delaware’s Takeover Law*, *supra* note 15, at 561–63; Enriques et al., *The Case for an Unbiased Takeover Law*, *supra* note 37, at 10 n.24. For the concept of “substantive coercion,” see *infra* note 73. Further, there is a renewed debate as to the extent of federal preemption of poison pills. See Lucian A. Bebchuk & Robert J. Jackson, Jr., *Toward a Constitutional Review of the Poison Pill*, 114 COLUM. L. REV. 1549 (2014); Marty Lipton et al., *A Response to Bebchuk and Jackson’s Toward a Constitutional Review of the Poison Pill*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Mar. 13, 2014), <http://blogs.law.harvard.edu/corpgov/2014/03/13/a-response-to-bebchuk-and-jacksons-toward-a-constitutional-review-of-the-poison-pill/>; Lucian A. Bebchuk & Robert A. Jackson, Jr., *Toward a Constitutional Review of the Poison Pill: A Reply to Wachtell Lipton*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Mar. 17, 2014), <https://blogs.law.harvard.edu/corpgov/2014/03/17/toward-a-constitutional-review-of-the-poison-pill-a-reply-to-wachtell-lipton/#more-61373>.

<sup>51</sup> One may call this decision-making approach a joint decision-making strategy. See, e.g., Davies & Hopt, *Control Transactions*, *supra* note 19, § 8.2.3.1. However, we should note that shareholders have a chance to join the joint decision making with respect only to potential transactions that are presented to them.



Boards are also generally recognized as gatekeepers of control transactions in other states.<sup>52</sup> Similarly, if they own a sufficient number of shares, controllers—at their initiation—are empowered to unilaterally freeze out minority shareholders.<sup>53</sup> They may choose to craft ad hoc Gatekeeping and other governance measures that address the TPs and related agency problems.<sup>54</sup> Judiciaries confronting shareholder lawsuits<sup>55</sup> police the Gatekeepers *ex post* relative to their decisions using as a nexus “fiduciary duty,” a state law concept.<sup>56</sup> This is how the governance dilemmas presented in control transactions are addressed in the United States.<sup>57</sup>

In the United States, the Delaware judiciary has played a dominant role and has been known for its relative superiority in resolving shareholder lawsuits against Gatekeepers. “65.6 percent of all Fortune 500 companies are incorporated in Delaware, up from 58 percent in 2000. . . . And almost 89 percent of U.S. based Initial Public Offerings in 2014 chose Delaware as their corporate home . . . .”<sup>58</sup> And Delaware law governs when shareholders

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<sup>52</sup> As to defense measures in states other than Delaware, see generally Michal Barzuza, *The State of State Antitakeover Law*, 95 VA. L. REV. 1973 (2009).

<sup>53</sup> Hereinafter these roles of the boards and controllers will be Gatekeeping, and directors and controllers playing such roles will be Gatekeepers. Any capitalized derivatives words shall be construed accordingly. Stephen M. Bainbridge used the terms in the same manner. See Stephen M. Bainbridge, *Unocal at 20: Director Primacy in Corporate Takeovers*, 31 DEL. J. CORP. L. 769 (2006). Note, however, that “[t]he term has been widely used to refer to the outside professionals who serve the board or investors.” John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301 (2004).

<sup>54</sup> See *In re MFW S’holders Litig.*, 67 A.3d 496, 503, 525 (Del. Ch. 2013) (making the same point), *aff’d* by Kahn v. M & F Worldwide Corp., 88 A.3d 635 (Del. 2014). See also Davies & Hopt, *Control Transactions*, *supra* note 19, §§ 8.1.2.4, 8.2.3.1.

<sup>55</sup> Kahan & Rock, *Symbiotic Federalism*, *supra* note 49, at 1604–07; Elliott J. Weiss & Lawrence J. White, *File Early, Then Free Ride: How Delaware Law (Mis)Shapes Shareholder Class Actions*, 57 VAND. L. REV. 1797, 1798 (2004). Confidential arbitration before the Chancery Court has been held unconstitutional. *Del. Coal. for Open Gov’t, Inc. v. Strine*, 733 F.3d 510 (3d Cir. 2013), *cert. denied*, 134 U.S. 1551 (2014). For a comparison of the level of private enforcement in the United States with that in the United Kingdom, see John Armour et al., *Private Enforcement of Corporate Law: A Comparative Empirical Analysis of the UK and the US*, 6 J. EMPIRICAL LEGAL STUD. 687 (2009).

<sup>56</sup> To borrow a phrase from an article by Norman Veasey, former Chief Justice of the Delaware Supreme Court, the state law side of the U.S. model “rests on a two-fold trust in the judiciary, and in the board of directors.” Norman Veasey, *Law and Fact in Judicial Review of Corporate Transactions*, 10 U. MIAMI BUS. L. REV. 1, 3 (2002). There are state antitakeover statutes that have the effect of reducing structural coercion. Delaware’s antitakeover statute is of a different type. See DEL. CODE ANN. tit. 8, § 203(c) (2014).

<sup>57</sup> See *supra* Parts II.A., II.B. This approach can be said to allocate “the real authority to a court.” Enriques et al., *The Case for Unbiased Takeover Law*, *supra* note 37, at 4. As this paper will show, however, such a court may prove to be a paper tiger.

<sup>58</sup> DEL. DEP’T OF STATE, DIV. OF CORP., 2014 ANNUAL REPORT (2015), [https://corp.delaware.gov/Corporations\\_2014%20Annual%20Report.pdf](https://corp.delaware.gov/Corporations_2014%20Annual%20Report.pdf). Most of such corporations, however, are headquartered outside Delaware. The percentage seems to favorably compare with those reported in the *New York Times* in 1969. See Comment, *Law for Sale: A Study of the Delaware Corporation Law of 1967*, 117 U. PA. L. REV. 861, 891 (1969) (stating, based on the *New York Times*, Jan. 12,

of a Delaware corporation can sue directors or controlling shareholders alleging their violations of fiduciary duties, including those relating to control transactions.<sup>59</sup> This does not mean that the Delaware judiciary has a monopoly over such disputes.<sup>60</sup> In fact, plaintiffs often choose to litigate in federal or non-Delaware state courts.<sup>61</sup> However, this should not indicate that the quality or effectiveness of the judicial proceedings in that state is in decline,<sup>62</sup> and the Delaware judiciary is still dominating cases involving corporate control transactions involving public Delaware companies.<sup>63</sup>

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1969, that “one third of the companies listed on the New York Stock Exchange and almost half of the nation’s one hundred largest industrial concerns” are Delaware corporations).

<sup>59</sup> See, e.g., *Edgar v. MITE Corp.*, 457 U.S. 624, 645 (1982); see also, e.g., Jack B. Jacobs, *The Reach of State Corporate Law beyond State Borders: Reflections upon Federalism*, 84 N.Y.U. L. REV. 1149, 1159–60 (2009) (describing the internal affairs doctrine).

<sup>60</sup> John Armour et al., *Delaware’s Balancing Act*, 87 IND. L.J. 1345, 1351–53 (2012) [hereinafter Armour et al., *Delaware’s Balancing Act*]; Brian JM Quinn, *Shareholder Lawsuits, Status Quo Bias, and Adoption of the Exclusive Forum Provision*, 45 U.C. DAVIS L. REV. 137, 155–56 (2011) [hereinafter Quinn, *Shareholder Lawsuits*] (stating that since the vast majority of publicly held Delaware corporations’ headquarters are in states other than Delaware, they “generally have sufficient contracts for personal jurisdiction before at least two courts, allowing plaintiffs to bring suits out of Delaware”). Delaware’s judiciary has jurisdiction over directors of Delaware corporations. DEL. CODE ANN. tit. 10, § 3114(a) (2014).

<sup>61</sup> See, e.g., John Armour et al., *Is Delaware Losing Its Cases?*, 9 J. EMPIRICAL LEGAL STUD. 605, 609–10 (2012) [hereinafter Armour et al., *Is Delaware Losing Its Cases?*]. For statistical information, see OLGA KOUMRIAN, *SHAREHOLDER LITIGATION INVOLVING ACQUISITIONS OF PUBLIC COMPANIES 3* (2015), <https://www.cornerstone.com/GetAttachment/897c61ef-bfde-46e6-a2b8-5f94906c6ee2/Shareholder-Litigation-Involving-Acquisitions-2014-Review.pdf>.

<sup>62</sup> For possible reasons for the decline in the recent past, see, for example, Armour et al., *Delaware’s Balancing Act*, *supra* note 60, at 1380. See also Armour et al., *Is Delaware Losing Its Cases?*, *supra* note 61, at 651 (an empirical study suggesting relationships between Delaware’s tough stance on fees and its diminished deference to the first to file advantage, on the one hand, and the filing of lawsuits with courts outside Delaware, on the other). The suggested reasons seem to suggest that “plaintiffs’ counsel seeks to avoid Delaware’s recent turn towards more aggressive policing of agency costs in acquisition related shareholder litigation, as well as to improve their relative position in the competition for fees.” Quinn, *Shareholder Lawsuits*, *supra* note 60, at 139. In fact, the shift away from Delaware might have been attributable in part to the relative inexperience of non-Delaware courts to apply Delaware law. See, e.g., *id.* at 155 (suggesting the creation of possible settlement value if a judge in a non-Delaware court is unfamiliar with Delaware law and fails to dismiss weak claims).

<sup>63</sup> Under a recent Delaware Chancery Court decision, forum selection bylaws designating a court in Delaware as the exclusive forum for litigation relating to internal affairs can be valid. *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013). In a subsequent decision, the court also held that a forum selection bylaw designating courts in the state in which the headquarters of the Delaware corporation reside is valid both facially and as applied. *City of Providence v. First Citizens Bancshares, Inc.*, 99 A.3d 229 (Del. Ch. 2014) (permitting a bylaw change that designated the state in which the corporation’s headquarters is). These bylaw changes, on balance, are more likely to increase the dominance of the Delaware judiciary. In 2015, Delaware amended its corporation law to expressly permit Delaware corporations to have a forum selection clause in the certificate of incorporation or bylaws designating Delaware as the exclusive state in which all internal corporate claims may be brought and to expressly prohibit them from having provisions in the certificate of incorporation or bylaws prohibiting such claims from being brought in Delaware. DEL. CODE ANN. tit. 8, § 115 (2015). This legisla-

When the Securities Exchange Act and Delaware governance law are combined, they are in large measure consistent with the sole owner standard.<sup>64</sup> In Delaware, for example, in *In re Pure Resources, Inc. Shareholders Litigation*, Vice Chancellor Leo Strine Jr. stated:

Delaware law has seen directors as well-positioned to understand the value of the target company, to compensate for the disaggregated nature of stockholders by acting as a negotiating and auctioning proxy for them, and as a bulwark against structural coercion. Relatedly, dispersed stockholders have been viewed as poorly positioned to protect and, yes, sometimes, even to think for themselves.<sup>65</sup>

Are there challenges to implementing the sole owner standard in judicial proceedings?

Control transactions typically are effected in one step—a cash merger or its equivalent—or in two steps—a direct share purchase through a tender offer from shareholders followed by a cash merger or its equivalent cash-out transaction. Regardless of the forms, however, they typically have the following key dates under the U.S. model: (1) the date on which the process for a possible control transaction is initiated (the initiation date), (2) the date on which Gatekeepers decide to or decide not to let the shareholders make a collective decision on the transaction (the Gatekeeper decision date), (3) the date on which shareholders make a collective decision based on the Gatekeepers' decision on the Gatekeeper decision date (the shareholder decision date), and (4) the date on which the control transaction is completed after the shareholders' favorable collective decision on the shareholder decision date (the completion date). As to (3) above, if the relevant transaction is in the form of a one-step acquisition, the shareholders' collective decision is made at a shareholders meeting. If it is in the form of a two-step acquisition, the shareholders' collective decision to approve the transaction may have to be made in two stages. The first stage decision is made by tendering a number of shares enough to meet the minimum tender condition of the relevant tender offer. If the bidder fails to accumulate enough shares to entitle him or her to effect the second step without having shareholder approval, the second stage decision must be made at a shareholders meeting to ap-

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tion appears to overrule the *City of Providence* decision. In 2014, there was a marked increase in the percentage of "M&A litigation" filed in Delaware compared to several preceding years. KOUMRIAN, *supra* note 61, at 3. "This is likely a result of wide spread adoption of forum provisions in corporate bylaws . . ." *Id.*

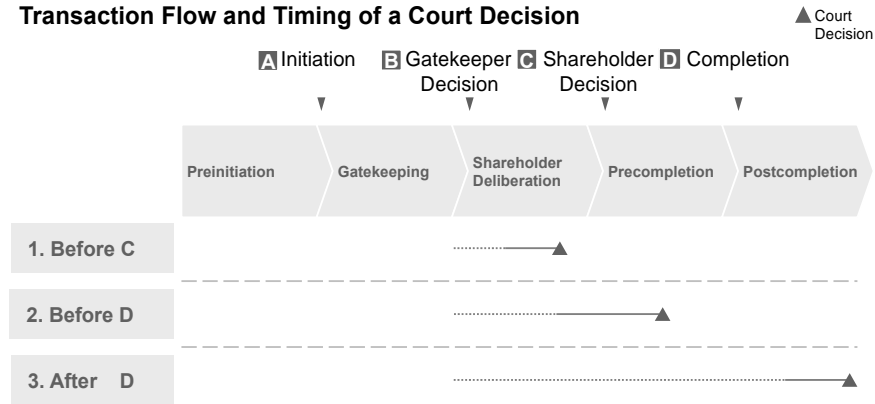
<sup>64</sup> See Schwartz, *supra* note 6. However, commentators have differed significantly as to the utility and risks associated with the use of target directors. For examples of contrasting positions, see Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101, 103 (1979); Bebchuk, *The Case Against Board Veto*, *supra* note 7. See also *supra* note 50.

<sup>65</sup> 808 A.2d 421, 441 (Del. Ch. 2003). See also *In re MFW S'holders Litig.*, 67 A.3d at 503, 525 (making the same point).

prove the second step cash squeeze out. Regardless of the need to have such a shareholders meeting, the acquisition of shares is made in two stages. The five successive phases the key dates create will be referred to as Preinitiation Phase, the Gatekeeping Phase, the Shareholder Deliberation Phase, the Execution Phase, and the Postcompletion Phase.<sup>66</sup> As described below, these phases may have unique TPs and dynamics.

**Chart 1**

**Transaction Flow and Timing of a Court Decision**



A hallmark of the U.S. approach is to let Gatekeepers make initial decisions. This is consistent with the ripeness requirement applicable generally to judiciaries in the United States.<sup>67</sup> Thus, judiciaries intervene in any dispute between the shareholders and the Gatekeepers only on or after the Gatekeeper decision date.

*D. Ex Post Judicial Policing: Amplified Needs and Difficulties*

*1. Preexisting Problems Amplified and Ex post Judicial Policing Becoming Both More Crucial and More Challenging*

As stated,<sup>68</sup> among non-freeze-out control transactions, those involving companies with preexisting TPs and related director agency problems are

<sup>66</sup> See *infra* Chart I.

<sup>67</sup> See, e.g., *Bebchuk v. CA, Inc.*, 902 A.2d 737, 740 (Del. Ch. 2007) (citing 15 JAMES WM. MOORE ET AL., MOORE'S FEDERAL PRACTICE ¶ 101.76[1][a], ¶ 101.76[2] (3d ed. 2006) (denying a request for declaratory judgment confirming the validity of a bylaw change proposed to shareholders stating that the dispute was unripe)).

<sup>68</sup> See *supra* Part II.B.1.

disproportionately represented. As also stated,<sup>69</sup> among freeze-outs, those involving companies with minority shareholders with preexisting TPs are disproportionately represented. The preexisting TPs and agency problems tend to persist and intensify during the Gatekeeping Phase and the Shareholder Deliberation Phase. The buyers are also tempted to exploit the problems. This is likely to mean that among the companies requiring effective *ex post* judicial policing, the companies with the preexisting TPs will be more disproportionately represented. The *ex post* judicial policing must be able to effectively address the TPs at Stage I.<sup>70</sup>

### *2. Gatekeeping Activities Make Policing More Challenging*

Once directors or controllers assume Gatekeeping roles, the TPs and related agency problems take on vastly different modalities. This affects the attributes the judiciaries need to police them effectively.

### *3. Acquisition of Companies with Dispersed Shareholders: Directors Acting as Gatekeepers*

Once directors are given a Gatekeeping role, they can and sometimes must adopt defense measures, and the TPs and related agency problems during deal phases could take on vastly different modalities.<sup>71</sup> First, shareholder AIPs could dramatically worsen during the Gatekeeping Phase and the Shareholder Deliberation Phase. Deal-related communication with existing bidders or proposed or potential bidders will be primarily with the target boards. Negotiations will be delicate and nuanced and often will have elements of a mind game. Many deal points will need to be negotiated. In addition, directors are unable to disclose everything they know. For example, they may have to posture from time to time and to maintain their negotiating leverage, should not show all of their cards during the Shareholder Deliberation Phase. They may have to comply with contractual confidentiality obligations. It is advisable not to disclose information to preserve attorney-client privilege or to maintain its propriety value.<sup>72</sup> Moreover, it may be difficult to communicate certain types of information accurately to the shareholders.<sup>73</sup> Deal negotiations may move quickly. Thus, during these phases

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<sup>69</sup> See *supra* Part II.B.2.

<sup>70</sup> Note that if any preexisting agency problem involves a breach of fiduciary duty, it could also suggest the judiciary's inability to police the agency problem associated with the control transaction.

<sup>71</sup> Cf. *supra* Parts II.A.1., II.B.1.

<sup>72</sup> See, e.g., Dale A. Oesterle, *Target Managers as Negotiating Agents for Target Shareholders in Tender Offers: A Reply to the Passivity Thesis*, 71 CORNELL L. REV. 53, 58 n.19 (1985) ("[M]anagement may have access to valuable information that cannot be made publicly available without destroying its value.").

<sup>73</sup> For example, when they resist unsolicited overtures, boards may argue the existence of a substan-

the information asymmetry between the Gatekeepers and the shareholders will become greater than when the boards are not acting as Gatekeepers.

Second, shareholder CAPs may worsen due to rapid and less predictable developments, increased fluidity of the shareholder bases, asymmetric information, and possible exploitations of the problems by third parties, such as actual and potential bidders. Third, potential agency costs relating to boards' Gatekeeping function become higher. During the Gatekeeping Phase and the Shareholder Deliberation Phase, there is "the omnipresent specter that a board may be acting primarily in its own interests."<sup>74</sup> Board members perform complex tasks, their discretions are wide, and they often act behind the scenes. This increases the potential agency costs.<sup>75</sup> Note that the conduct the potential conflicts engender include those that might exacerbate the TPs. For example, the directors may be tempted to be less up-front about what they are doing than when they do not act as Gatekeepers. They may choose to time various events to make coordination among shareholders difficult. Control transactions may be induced by the target boards' agency problems.<sup>76</sup> In these situations, unless the targets' directors are completely oblivious to their possible predicaments, they tend to be even more conscious of their job security. If so, the agents have even more acute conflicts of interest<sup>77</sup> and may attempt to block the proposed transactions or curry favor with the bidders, in each case more so than when they do not act as Gatekeepers. Fourth, third parties—including existing, proposed, and potential bidders—may be more strongly tempted to exploit the

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tive coercion, which assumes "an informational disparity between target managers and shareholders." Ronald J. Gilson & Reinier Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 BUS. LAW. 247, 260 (1989). Substantive coercion is "the risk that shareholders will mistakenly accept an underpriced offer because they disbelieve management's representations of intrinsic value." *Id.* at 267. See also Black & Kraakman, *Delaware's Takeover Law*, *supra* note 15, at 523. Noted commentators, however, have argued that the substantive coercion argument does not have an empirical foundation in the modern marketplace in the United States. See, e.g., Subramanian, *Bargaining*, *supra* note 50, at 633–35.

<sup>74</sup> *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985). For final period problems, see, for example, Black & Kraakman, *Delaware's Takeover Law*, *supra* note 15, at 559 (stating that the decisions the directors have to make are "decisions that place . . . directors in a final period problem, where agency costs are likely to be high," and that "[c]ontrol contests and board decisions to reject all bidders raise final period problems similar to those that arise in mergers and sales of all or substantially all assets, and could plausibly call for similar regulatory treatment"); Bebchuk, *The Case Against Board Veto*, *supra* note 7, at 991 (referring to this as "ex post agency costs").

<sup>75</sup> See, e.g., Armour et al., *Agency Problems and Legal Strategies*, *supra* note 11, § 2.1. ("The greater the complexity of the tasks undertaken by the agent, and the greater the discretion the agent must be given, the larger these 'agency costs' are likely to be.")

<sup>76</sup> See *supra* Part II.B.1.

<sup>77</sup> See Gomez & Saez, *supra* note 12, at 284–85. In addition to "conflicted motives," the agents may also suffer from "cognitive biases"; "[u]nderperforming managers can be reluctant to acknowledge mistake, rather explaining bad strategy as market misvaluation." Enriques et al., *The Case for an Unbiased Takeover Law*, *supra* note 37, at 10.

conflicts of interest than when they do not act as Gatekeepers.<sup>78</sup> Finally, these four modalities combine to magnify the risk that the Gatekeepers will engage in “pretextual justifications.”<sup>79</sup>

#### *4. Acquisition of Minority Shares by Controllers: Controllers Acting as Gatekeepers*

In the United States, freeze-outs can be effected in one step or in two steps.<sup>80</sup> If the controllers choose to effect a freeze-out through one-step transactions, as long as they already own the requisite percentage of shares that assures a favorable voting result, voting decisions by minority shareholders do not affect the outcome.<sup>81</sup> In a tender offer by the controllers, minority shareholders can choose not to tender their shares. If, however, the controllers already own the requisite percentage of shares that assures a favorable voting result, the minority shareholders’ decisions as to the tender offers do not affect the outcome. Thus, these are self-dealing transactions in which the controllers have the most acute conflicts of interest but are not subject to an outright prohibition. In the self-dealing context, minority shareholders are generally in riskier positions than the shareholders in control transactions in which board members act as Gatekeepers. All the complications described in Part II.D.2.a. exist in their extreme forms. Robust judicial policing is necessary to protect minority shareholders.

### III. EX POST JUDICIAL POLICING OF GATEKEEPERS: TWIN PROBLEMS AND POSSIBLE SOLUTIONS

As shown, under the U.S. model, judiciaries capable of effectively policing Gatekeepers are crucially important. Are shareholder lawsuits to police Gatekeepers unique? If so, what prerequisites do judicial systems need to meet to effectively police the Gatekeepers?

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<sup>78</sup> See, e.g., Subramanian, *Bargaining*, *supra* note 50, at 664–65.

<sup>79</sup> See, e.g., *In re Topps Co. S’holder Litig.*, 926 A.2d 58, 91 (Del. Ch. 2007) (“The Topps board’s negotiating posture and factual misrepresentations are more redolent of pretext, than of a sincere desire to comply with their *Revlon* duties.”); *In re Dollar Thrifty S’holder Litig.*, 14 A.3d 573, 598 (Del. Ch. 2010) (stating that in situations where heightened scrutiny applies, “the court seeks . . . to . . . smoke out mere pretextual justifications for improperly motivated decisions”). If the directors are permitted to consider the interests of constituents other than the shareholders, they should be able to come up with any number of pretexts that are on the surface not facetious.

<sup>80</sup> See, e.g., DEL. CODE ANN. tit. 8, § 251 (2014); Bainbridge, *supra* note 53, at 20.

<sup>81</sup> However, minority shareholders might vote against the freeze-outs to exercise appraisal rights. See, e.g., DEL. CODE ANN. tit. 8, § 262(a) (2014).

## A. Twin Problems re Initiation and Prosecution of Lawsuits

### 1. *Twin Problems*

For a judiciary to perform the policing function described above,<sup>82</sup> someone has to file and prosecute a lawsuit against the Gatekeepers. However, TPs also plague the initiation and prosecution of shareholder lawsuits. As stated,<sup>83</sup> among the companies requiring effective *ex post* judicial policing, those having preexisting problems tend to be disproportionately represented. The preexisting TPs could be further carried over to the initiation and prosecution of the lawsuits to police the Gatekeepers. Effective mechanisms must exist to solve the TPs.

#### (a) Collective Action Problems

Shareholders may have direct claims<sup>84</sup> against the Gatekeepers. However, they face CAPs. A lawsuit is costly, time consuming, and often unpredictable as to both the process and the outcome. Shareholder lawsuits against Gatekeepers alleging the breach of fiduciary duties are inordinately technical and complex and often are fast moving. Frequently, they have to be filed quickly to preserve the status quo and require quick tactical decisions.<sup>85</sup> It is typically against strongly motivated, well-financed, and well-coordinated defendants.<sup>86</sup> Free riders may emerge. If one conducts a cost-benefit analysis, typically it does not make sense for a small shareholder to file a lawsuit individually and to invest sufficient time and other resources in the lawsuit.<sup>87</sup> A fluid shareholder base exacerbates the CAPs.<sup>88</sup> There-

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<sup>82</sup> See *supra* text accompanying notes 54–57.

<sup>83</sup> See *supra* Part II.B.

<sup>84</sup> Shareholders may be able to derivatively sue corporate fiduciaries to enforce the claims of corporations against the corporate fiduciaries. However, in the context of M&As generally, there are often situations in which the shareholders suffer but the companies do not suffer from the Gatekeepers' misconducts. Thus, in general derivative suits are less important than direct suits. For example, in Delaware derivative suits against fiduciaries involving public company acquisitions represent a minor portion when compared to class actions. See, e.g., Robert B. Thompson & Randall S. Thomas, *The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions*, 57 VAND. L. REV. 133, 167–69 (2004) [hereinafter Thompson & Thomas, *The New Look*]. In addition, there may be restrictive rules relating to filing of derivative suits. As to the hurdles of Delaware's appraisal rights, see Gilson & Gordon, *Controlling Controlling*, *supra* note 9, at 798–99; Subramanian, *Fixing Freezeouts*, *supra* note 48, at 30–31.

<sup>85</sup> See *infra* Part III.C.2.

<sup>86</sup> “[I]t is not necessarily true . . . that parties with greater financial resources are unable to improve their position before a judge by hiring a more skilled or articulate legal advocate.” John Armour et al., *The Evolution of Hostile Takeover Regimes in Developed and Emerging Markets: An Analytical Framework*, 52 HARV. INT’L L.J. 221, 230 (2011) [hereinafter Armour et al., *The Evolution of Hostile Takeover Regimes*] (citation omitted).

<sup>87</sup> There may be shareholders who have large and unique stakes. For example, unsolicited suitors,



fore, unless the judicial system has features or tools to neutralize the CAPs, the expected shareholder-initiated judicial policing will not materialize.

(b) Asymmetric Information Problems

Shareholders also face acute AIPs when they decide whether they should file lawsuits and when they prosecute such lawsuits. The most sensitive and delicate facts crucial to the court's determination on the merits of the shareholders' fiduciary duty claims against Gatekeepers are in the hands (or minds) of the fiduciaries or those on the fiduciaries' side. Shareholders are not necessarily privy to the intricacies of the Gatekeepers' decision-making processes during the Gatekeeping Phase.<sup>89</sup> Of course, extensive disclosures may be made to the public. Such information, however, is typically insufficient to evaluate whether the Gatekeepers have complied with their duties. Moreover, it is difficult for shareholders to know if the disclosure is adequate<sup>90</sup> unless they have access to undisclosed information.<sup>91</sup> In addition, agents may try to finesse their public disclosure to avoid giving any hint of impropriety.<sup>92</sup> In short, shareholder lawsuits are "'outsider-looking-in' litigation"<sup>93</sup> and are plagued by acute AIPs.<sup>94</sup>

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while their shareholding interests are small, have a big stake in the outcome of their challenge against board members. They may want to prosecute their own lawsuits, particularly if they can seek anticipatory relief. For such examples in Delaware, see *infra* note 171 and accompanying text.

<sup>88</sup> See, e.g., Christopher R. Leslie, *The Significance of Silence: Collective Action Problems and Class Action Settlements*, 59 U. FLA. L. REV. 71, 74–77 (2007); Quinn, *Shareholder Lawsuits*, *supra* note 60, at 153; PACCES, *supra* note 13, § 5.5.2.1; Armour & Skeel, *supra* note 8, at 1791.

<sup>89</sup> Ronald J. Gilson et al., *Contracts and Innovation: The Limited Role of Generalist Courts in the Evolution of Novel Contract Forms*, 88 N.Y.U. L. REV. 170, 207 (2013) (“[T]he emphasis is on process rather than detailed rules.”). “[T]he focus is on process rather than on substantive facts.” *Id.* at 208

<sup>90</sup> For example, when the applicability of a substantive judicial standard depends on a shareholder decision made on an informed basis, plaintiff shareholders may have to know facts that have not been disclosed to them. See, e.g., *In re Pure Resources, Inc., S’holders Litig.*, 808 A.2d 421, 450–51 (Del. Ch. 2002) (14D-9’s failure to disclose material information). Absent a means to find such facts that have not been publicly disclosed, such a substantive judicial standard does not work.

<sup>91</sup> See, e.g., Bernard Black, *The Core Institutions That Support Strong Securities Markets*, 55 BUS. LAW. 1565, 1574 (2000) (stating that “[p]roving misdisclosure often requires information that is buried in the company’s records”).

<sup>92</sup> See *id.* at 1588–89, 1601–02.

<sup>93</sup> Jeffrey W. Stempel, *Politics and Sociology in Federal Civil Rulemaking: Errors and Scope*, 52 ALA. L. REV. 529, 610 (2001). Major proxy advisory firms have class action services. See, e.g., *Maximize Recoveries and Meet Fiduciary Responsibilities with Securities Class Action Services*, INST’L S’HOLDER SERVS. INC., <http://www.issgovernance.com/scas>; *Right Claim*, GLASS, LEWIS & CO., LLC, <http://www.glasslewis.com/solutions/right-claim>. However, their roles in shareholder class actions relating to control transactions appear to have been limited.

<sup>94</sup> For impacts of information asymmetry between parties on dispute resolution, see, for example, Keith N. Hylton, *Information, Litigation, and Common Law Evolution*, 8 AM. L. & ECON. REV. 33 (2006); Lucian Arye Bebchuk, *Litigation and Settlement under Imperfect Information*, 15 RAND. J. ECON. 404 (1984).

Since the Gatekeepers' tasks are complex and their discretion is wide, their agency costs can become heavy.<sup>95</sup> Accordingly, the tasks of the judiciary to police the agency problems become complex and intricate. The judiciary will not be able to render decisions with confidence unless it has full factual information. This means in particular that shareholders in the process of litigation need to have a strong means to obtain relevant information, including information in the hands (or minds) of defendants.

## 2. Solutions

### (a) Solutions to Collective Action Problems

Opt-out class actions with an appropriate cost arrangement could greatly reduce CAPs at the initiation and prosecution phase of shareholder lawsuits.<sup>96</sup> John Coffee stated that an opt-out class action "is usually justified as necessary to solve collective action problems that render small claimants rationally apathetic."<sup>97</sup>

While not much attention has been paid to this, restorative and anticipatory relief also helps reduce CAPs with respect to the initiation and prosecution of lawsuits. As will be discussed,<sup>98</sup> however, in most shareholder lawsuits against Gatekeepers restorative relief is not desirable.

Typically, anticipatory relief has direct or indirect effects or impacts that are helpful to all the shareholders and reduce CAPs. For example, if an injunction is issued, other shareholders can receive the immediate benefits of and essentially free ride on the decision. This is true if the particular jurisdiction does not have the concept of issue preclusion (collateral estoppel).<sup>99</sup> If a declaratory judgment is issued in a jurisdiction where issue preclusion is recognized, other shareholders can rely on its precedential value.<sup>100</sup> Even if issue preclusion is not recognized, in most shareholder suits in the context of control transactions "there are questions of law or fact

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<sup>95</sup> See *supra* text accompanying note 75.

<sup>96</sup> See, e.g., Black, *supra* note 91, at 1574, 1601–02 (advocating the use of a class action or similar system to support a strong securities market). Class action is a type of aggregate litigation. For various types of aggregate litigation, see John C. Coffee, Jr., *Litigation Governance: Taking Accountability Seriously*, 110 COLUM. L. REV. 288, 298–304 (2010).

<sup>97</sup> See Coffee, *supra* note 96, at 298.

<sup>98</sup> See *infra* Part III.B.

<sup>99</sup> For the anticipatory effect of issue preclusion, see William M. Landes & Richard A. Posner, *The Economics of Anticipatory Adjudication*, 23 J. LEGAL STUD. 683, 700 (1994) [hereinafter Landes & Posner, *Anticipatory Adjudication*].

<sup>100</sup> As to the preclusive effects of such determinations, see, for example, Samuel R. Bray, *Preventive Adjudication*, 77 U. CHI. L. REV. 1275, 1291–96 (2010). The preclusive effects are generally broad since shareholder suits tend to have common legal or factual issues.

common to the [shareholders].”<sup>101</sup> Thus, unless the defendant thinks the case was erroneously decided and the judgment is timely, the defendant may refrain from taking actions that would cause damages or may take actions to reverse the course of earlier actions to prevent such damage, which benefits other shareholders.<sup>102</sup>

Depending on the allocation or calculation of the costs of class actions, potential plaintiffs could be reluctant to file lawsuits, or they may not have lawyers who are willing to represent them. A contingent fee arrangement is helpful but not enough.<sup>103</sup> First, the plaintiffs want to make sure that if they lose they do not have to pay fees for the defendants’ lawyers.<sup>104</sup> Second, if they win they need to come up with the money to pay the contingent fees to their own lawyers under the American Rule.<sup>105</sup>

There is yet another issue. As expected, in opt-out class actions most typically the lawyers representing the classes drive the process. Nominal plaintiffs possess neither the requisite expertise nor strong incentives or resources to effectively monitor and control their lawyers in such suits. Further, depending on the financial arrangement, the stakes of plaintiffs’ lawyers in the lawsuits may be far greater than those of the named shareholders and are not completely aligned with those of the shareholders in the class.<sup>106</sup> Thus, another agency problem will emerge, but the TPs hamper the ability of the shareholders in the class to monitor the agents. Further, in class actions seeking anticipatory relief, plaintiffs’ lawyers have to make quick decisions on a wider range of issues than in class actions seeking monetary payments only. This could increase the attorney agency costs. Generally, a generalist court less knowledgeable than plaintiff lawyers is not able to effectively control the attorney agency costs. A specialist court can help alleviate the attorney agency costs in class actions against the Gatekeepers.

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<sup>101</sup> FED. R. CIV. P. 23(a)(2).

<sup>102</sup> This is not to suggest that all the shareholders have the same goals. In some situations, they may want to pursue different remedies. *See, e.g., Kingsbridge Capital Group v. Dunkin’ Donuts, Inc.*, 1989 Del. Ch. LEXIS 87, at \*4–5 (Del. Ch. Aug. 7, 1989).

<sup>103</sup> *Cf. Black, supra* note 91, at 1574 (“Contingent fee arrangements are a useful supplement to the class action procedure, but in my judgment not essential.”).

<sup>104</sup> Under the English Rule, losers pay winners’ attorney fees. *See, e.g., Coffee, supra* note 96, at 292 n.8. For the history of the English Rule, see also John F. Vargo, *The American Rule on Attorney Fee Allocation: The Injured Person’s Access to Justice*, 42 AM. U. L. REV. 1567, 1570–71 (1993).

<sup>105</sup> As to the American Rule, see Vargo, *supra* note 104, at 1571. For the history of the American Rule, see *id.* at 1575–78.

<sup>106</sup> As to the agency costs of various players in shareholder lawsuits, see Randall S. Thomas & Robert B. Thompson, *A Theory of Representative Shareholder Suits and Its Application to Multijurisdictional Litigation*, 106 NW. U. L. REV. 1753, 1768–73 (2012). For agency problems in and alternatives to opt-out class action lawsuits in general, see Coffee, *supra* note 96.

(b) Solutions to Asymmetric Information Problems

In an adversarial system, one approach to alleviate shareholder AIPs is to allow the shareholder plaintiffs to demand relevant information from the defendants and third parties. A negative inference can be used to incentivize a party that has asymmetrically more information to produce evidence.<sup>107</sup> Thus, shifting the burden of proof<sup>108</sup> to the Gatekeepers—the parties that have asymmetrically more information—is also likely to reduce the AIPs. The burden shifting could be especially effective when self-dealings are involved.<sup>109</sup> It should have a dramatic effect in jurisdictions where the threshold for the burden of proof is high.<sup>110</sup> In the context of corporate control lawsuits against Gatekeepers, burden shifting is not necessarily unfair: typically in anticipation of shareholder lawsuits they are often in a position to create and maintain records to prepare, defend, and exonerate themselves against meritless lawsuits.

The need for the means to uncover facts in the possession of Gatekeepers or third parties of course exists with respect to facts that plaintiffs have to prove. The same need, however, also exists with respect to facts that the defendants have to prove: the plaintiffs might have to undermine the credibility of the proof the defendants have offered.

B. Twin Problems re *Ex Post* Restorative Relief to Undo a Shareholder Collective Decision or Transaction

1. *Twin Problems*

On the Gatekeeper decision date, Gatekeepers may decide to let share-

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<sup>107</sup> See, e.g., Ronald J. Allen, *How Presumptions Should Be Allocated: Burden of Proof, Uncertainty, and Ambiguity in Modern Legal Discourse*, 17 HARV. J.L. & PUB. POL'Y 627, 632 (1994) (*Res ipsa loquitur* “arose to offset systematic biases that were introduced into litigation as a function of access to evidence,” and it “persists in these post-discovery days because of its added incentive to the full production of information, which is at the heart of modern litigation theory”). See also *id.* at 636 (stating that in a pre-discovery time in the United States, *res ipsa loquitur* was a tool for the court to uncover facts otherwise unavailable); see also Robert Cooter & Bradley J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 6 N.Y.U. L. REV. 1045, 1054–55 (1991) (describing burden shifting in relation to duty of loyalty cases due to AIPs).

<sup>108</sup> In this article, unless otherwise specifically noted, “burden of proof” means the burden of persuasion or risk of nonpersuasion and does not include the duty of producing evidence or the production burden. For explanations of the concept, see Fleming James, Jr., *Burdens of Proof*, 47 VA. L. REV. 51, 51 (1961); Richard A. Posner, *An Economic Approach to the Law of Evidence*, 51 STAN. L. REV. 1477, 1502–07 (1999).

<sup>109</sup> Black, *supra* note 91, at 1588–89. The use of circumstantial evidence should also be permissible. *Id.*

<sup>110</sup> See Kevin M. Clermont & Emily Sherwin, *A Comparative View of Standards of Proof*, 50 AM. J. COMP. L. 243, 248 (2004) (“Any high standard of proof makes burdens of proof critical to outcome.”).

holders consider a proposed control transaction and make a collective decision on it.<sup>111</sup> Gatekeepers' breaches of their fiduciary duties, however, may adversely affect the integrity of the shareholders' collective decision. For example, conflicts of interest might have caused the Gatekeepers to make recommendations to shareholders that they should not have made. The Gatekeepers may have failed to make a fair disclosure to the shareholders. In two-step freeze-outs controllers' tender offers in the first steps might have been coercive.

Typically, however, the TPs will make it costly and time-consuming to undo the shareholder collective decision, repeat the Shareholder Deliberation Phase, and restore integrity to the shareholders' collective decision.<sup>112</sup> This should become clear if one notes that the Shareholder Deliberation Phase is unnecessary in the absence of dispersed shareholders. One will also note that the reversal should be much simpler if shareholders are not dispersed.

Once control transactions are completed and the Postcompletion Phase commences, it is generally even more impractical, disruptive, costly, and time-consuming to restore the status quo ante. There will be related transactions and other important changes simultaneously with or soon after the completion date.<sup>113</sup> These will make the reversal difficult even when the ownership is not dispersed and no TPs exist. The TPs, however, make the reversal particularly difficult.<sup>114</sup> In the case of tender offers, promptly after the tender offer periods, shares and money change hands. In the case of one-step mergers, pursuant to the merger agreements, the transactions are effected and shares change hands in due course. The TPs make the task of reversing the transfer of shares no small task.<sup>115</sup>

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<sup>111</sup> See *supra* Part II.C.

<sup>112</sup> In fact, due to the TPs, collective decisions tend to be formed over a period leading up to the day of reckoning. Thus, any court decision to fix such decision-making processes is somewhat "restorative" even if the court decision is made before the shareholder decision date. In view of this restorative nature, as the shareholder decision date comes close, the court may become increasingly reluctant to disrupt the timing of that date. See Armour et al., *Delaware's Balancing Act*, *supra* note 60, at 1367 (describing a plaintiff's lawyer's complaint that "it was hard to get a preliminary injunction hearing in merger cases until shortly before the shareholder vote, when there was almost no chance the judge would delay the vote").

<sup>113</sup> When financial buyers are involved, simultaneously with the closings, for example, the shares and/or assets of the targets may be pledged to secure the loans the proceeds of which are used to pay the purchase prices.

<sup>114</sup> Cf. Lynch v. Vickers Energy Corp., 429 A.2d 497, 501 (Del. 1981) (indicating a possibility of rescission of the sales of shares pursuant to a tender offer), *overruled in part on other grounds by* Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

<sup>115</sup> Typically, courts do not get into the details of the enormity and complexity of the undoing of completed transactions. See, e.g., Weinberger v. UOP, Inc., 457 A.2d 701, 714 (Del. 1983) (stating in relation to a controller freeze-out merger approved by a majority of the minority shareholder vote based on deficient disclosure that "[s]ince it is apparent that this long completed [freeze-out merger] transac-

No less importantly, at least as to non-freeze-out control transactions,<sup>116</sup> the control transaction opportunities might entirely disappear if courts are to undo the distorted shareholder decisions or transactions approved by such decisions. If so, restorative remedies may create situations worse for the shareholders than when such remedies are not ordered.

## 2. Solutions

We need to explore whether there are adequate alternative remedies. Major alternatives worthy of examination are damage and anticipatory remedies.

### C. Inadequacy and Inefficiency of *Ex Post* Damage Relief

#### 1. Inadequacy and Inefficiency

##### (a) Adequacy of *Ex Post* Damage Relief

###### (i) Directors as Gatekeepers

Damage remedies are often inadequate or inappropriate for breach of fiduciary duties by directors committed in connection with control transactions. “[I]n corporate law [standards of conduct and standards of review] often diverge. The reasons are rooted in policy interests. First, directors must make decisions in an environment of imperfect information. Second, . . . any risk of liability would likely dwarf the incentives for assuming the role.”<sup>117</sup> Therefore a relaxed standard is typically used to judge whether

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tion is too involved to undo, and in view of the Chancellor’s discretion, the award, if any, should be in the form of monetary damages based upon entire fairness standards, i.e., fair dealing and fair price”); *Lynch v. Vickers Energy Corp.*, 429 A.2d 497, 501 (Del. 1981) (stating that rescission of the sales of shares pursuant to a tender offer is not feasible due to a subsequent merger of the target into another company and other changes), *overruled in part on other grounds by* *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983); *Eisenberg v. Chi. Milwaukee Corp.*, 537 A.2d 1051, 1062 (Del. Ch. 1987) (assuming implicitly that a shareholders’ collective decision on a self-tender offer suffering from inadequate disclosure and coerciveness cannot “easily be undone”); *Elster v. Am. Airlines, Inc.*, 128 A.2d 801, 805 (Del. Ch. 1957) (“In cases involving the sale of corporate assets or their merger with those of another corporation, slight delay may in itself lead to the denying of a motion for injunctive relief where such an order would involve a complex undoing of an accomplished corporate act.”); *In re Siliconix Inc., S’holders Litig.*, 2001 Del. Ch. LEXIS 83, at \*66 (Del. Ch. June 19, 2001) (stating that a completed exchange offer is difficult to unwind). For the difficulties in undoing M&A deals involving public targets when there is a contractual breach, see John C. Coates IV, *Managing Disputes Through Contract: Evidence from M&A*, 2 HARV. BUS. L. REV. 295, 311–12 (2012).

<sup>116</sup> As to freeze-outs, no other bidders will surface unless controllers decide to sell their positions.

<sup>117</sup> William T. Allen et al., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, 1296 (2001) [hereinafter Allen et al., *Function Over Form*]

directors made a legally cognizable error in business judgments.<sup>118</sup> To further reduce the risk of liability, statutory exemptions may be created. For example, it may be wise to exculpate directors from claims for damages arising out of a violation of their fiduciary duties unless such a violation constitutes a breach of the duty of loyalty or an act or inaction taken in bad faith.<sup>119</sup>

In addition, damage awards are not adequate to compensate the victims if the directors are unable to satisfy the monetary obligations. Directors may be wealthy but not wealthy enough to pay such damages out of their pockets. Directors' and officers' insurance has exclusions,<sup>120</sup> may be too expensive, or may not cover the full liability. The insurers may become insolvent.<sup>121</sup> The companies may not indemnify directors against the payment of such damages.<sup>122</sup> Therefore, there are situations in which the feasibility and adequacy of nonmonetary relief should be explored.<sup>123</sup>

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(footnote omitted). See also Luca Enriques et al., *The Basic Governance Structure: The Interests of Shareholders as a Class*, in THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH ch. 3, § 3.6.1 (Reinier Kraakman et al., 2d ed. 2009) (text accompanying notes 128–32).

<sup>118</sup> Allen et al., *Function Over Form*, *supra* note 117, at 1296.

<sup>119</sup> See, e.g., DEL. CODE ANN. tit. 8, § 102(b)(7) (2014). As to Japan, see, for example, Kaisha-hō [Companies Act], Law No. 86 of 2005, art. 427 (Japan) (allowing corporations to have preset limits on the amounts of damages payable by nonexecutive directors for breach of fiduciary duties not amounting to gross negligence through provisions in articles of incorporation).

<sup>120</sup> The exclusions may include liabilities arising out of “deliberately fraudulent misconduct” and “transactions resulting in an individual receiving any personal benefit or advantage to which he is not legally entitled.” See, e.g., Tom Baker & Sean J. Griffith, *Predicting Corporate Governance Risk: Evidence from the Directors’ & Officers’ Liability Insurance Market*, 74 U. CHI. L. REV. 487 (2007); Bernard Black et al., *Legal Liability of Directors and Company Officials Part 2: Court Procedures, Indemnification and Insurance, and Administrative and Criminal Liability (Report to The Russian Securities Agency)*, 2008 COLUM. BUS. L. REV. 1, 77–79 (2008) [hereinafter Black et al., *Legal Liability of Directors and Company Officials Part 2*]; Bernard Black et al., *Outside Director Liability*, 58 STAN. L. REV. 1055, 1085–88 (2006).

<sup>121</sup> *Id.* at 1088.

<sup>122</sup> *Id.* at 1093–94. For surveys of directors’ liability, including indemnification, see generally DIRECTORS’ LIABILITY: A WORLDWIDE REVIEW (Alexander Loos ed., 2d ed. 2010); Bernard Black et al., *Legal Liability of Directors and Company Officials Part 1: Substantive Grounds for Liability (Report to the Russian Securities Agency)*, 2007 COLUM. BUS. L. REV. 614 (2007) [hereinafter Black et al., *Legal Liability of Directors and Company Officials Part 1*]; Black et al., *Legal Liability of Directors and Company Officials Part 2*, *supra* note 120.

<sup>123</sup> If anticipatory adjudication is available and rendered against director decisions, those decisions may be subject to reputational sanctions. See, e.g., Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950–2005: Of Shareholders Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1488–90 (2007); Allen et al., *Function over Form*, *supra* note 117, at 451 n.10 (“Directors are reputationally sensitive and likely will try to avoid making decisions that could be enjoined by a court.”). The reputational sanction, however, will be weak if the public is not properly sensitized. See Gomez & Saez, *supra* note 12, at 285–87.

(ii) *Controllers as Gatekeepers*

Controllers may owe fiduciary duties to minority shareholders.<sup>124</sup> Controllers' failures to discharge their fiduciary duties in relation to freeze-outs typically means that the shareholders would have been better off if it had not been for such failures. Unlike directors, however, controllers are more likely to have resources to pay damages from their failures to observe their fiduciary duties in the transactions.

(b) Efficiency of *Ex Post* Damage Relief

(i) *Directors as Gatekeepers*

The efficient breach hypothesis—the claim that “loss-based measures” are superior “because they enable the parties to avoid performance that is more costly than the benefit created”<sup>125</sup> or “court-ordered expectation damages (a liability rule) lead parties to maintain or abandon prior agreements efficiently”<sup>126</sup>—has long been an influential principle.<sup>127</sup> There has been a contractual understanding of fiduciary duties.<sup>128</sup> “[t]he duty of loyalty replaces detailed contractual terms, and courts flesh out the duty of loyalty by prescribing the actions the parties themselves would have preferred if bargaining were cheap and all promises fully enforced. The usual economic assessments of contractual terms and remedies then apply.”<sup>129</sup> There can be instances in which fiduciary duties may be efficiently breached.<sup>130</sup>

Importantly, however, a simple calculation shows that unless self-

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<sup>124</sup> In Delaware controllers owe duties to minority shareholders. See *infra* note 166 and accompanying text. For Japan, under the prevailing view, the answer is no. See *infra* note 417 and accompanying text.

<sup>125</sup> Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425, 441 (1993) [hereinafter Easterbrook & Fischel, *Contract and Fiduciary Duty*].

<sup>126</sup> Richard R.W. Brooks & Warren F. Schwartz, *Legal Uncertainty, Economic Efficiency, and the Preliminary Injunction Doctrine*, 58 STAN. L. REV. 381, 384–85 (2005).

<sup>127</sup> For a short history and development of the hypothesis, see *id.* at 384 n.11. See also Alan Schwartz, *The Myth That Promisees Prefer Supracompensatory Remedies: An Analysis of Contracting for Damage Measures*, 100 YALE L.J. 369 (1990). There has been a recent lively debate as to the validity of the theory. For a short list of critics of the efficient breach hypothesis, see Daniel Markovits & Alan Schwartz, *The Myth of Efficient Breach: New Defenses of the Expectation Interest*, 97 VA. L. REV. 1929, 1940 n.5 (2011).

<sup>128</sup> See, e.g., Easterbrook & Fischel, *Contract and Fiduciary Duty*, *supra* note 125, at 441–44.

<sup>129</sup> *Id.* at 427. See also Cooter & Freedman, *supra* note 107, at 1048–49; John C. Coffee, Jr., *Privatization and Corporate Governance: The Lessons from Securities Market Failure*, 25 J. CORP. L. 1, 28 (1999).

<sup>130</sup> However, damage remedies appropriate for the breaches are not necessarily expectation damages and can be damages short of full restitution damages. See, e.g., Easterbrook & Fischel, *Contract and Fiduciary Duty*, *supra* note 125, at 442–44.



dealing is involved,<sup>131</sup> the efficient breach theory in most instances does not justify directors' breaches of their duty of loyalty. In these situations any surpluses created or losses avoided by the breach are not likely to be sufficient to compensate the shareholders for the losses the breach would cause.<sup>132</sup>

For example, suppose the directors of a company decide to sell the company they serve to one bidder over another bidder. The terms the two bidders proposed are identical except that the second bidder indicates a willingness to offer a price substantially more than the price the first bidder offers. The directors choose the first bidder, since the first bidder has indicated a willingness to keep the incumbent directors after the acquisition. Ordinarily, possible losses to the shareholders substantially exceed any gain the directors realize from the job security the first bidder offers the directors. For the same reason, if directors of a target company deploy or maintain a poison pill to protect their jobs, the economic value of the job security is likely to be substantially outweighed by the shareholders' loss of the opportunity to be bought out by the bidder.<sup>133</sup>

When directors acting as Gatekeepers are in breach of their fiduciary duties, the negotiations with bidders have been skewed. This could lead to less optimal transactions than when the directors discharge their duties in negotiating the deal. This rationale is also applicable to a breach of the duty to disclose.

In the first example above, depending on the circumstance,<sup>134</sup> if the court orders an injunction, it may encourage the directors to renegotiate with the bidder in compliance with their fiduciary duties. In the second example above, in most instances if the court issues an injunction to redeem the poison pill, the directors may be encouraged to negotiate with the hostile bidder and possibly others in a manner consistent with their duties. In many instances timely issued and appropriately crafted remedies resulting from anticipatory adjudications<sup>135</sup> should be more efficient than expectation

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<sup>131</sup> For an example of the definition of self-dealing, see Luca Enriques, *The Law on Company Directors' Self-Dealing: A Comparative Analysis*, 2 INT'L & COMP. L.J. 298, 299 (2000). Management buy-outs (MBOs) are self-dealing transactions. It is easy to conceive situations where Kaldor-Hicks efficiency exists; the buyers' gains will exceed the losses of the target shareholders. See, e.g., ROBERT COOTER & THOMAS ULEN, *LAW & ECONOMICS* 42 (6th ed. 2012).

<sup>132</sup> No Kaldor-Hicks efficiency exists.

<sup>133</sup> This should follow from the following proposition: "[T]he amounts that you need to pay managers to do the right thing are generally small compared to the benefits that doing the right thing creates for shareholders." Marcel Kahan & Edward B. Rock, *How I Learned to Stop Worrying and Love the Pill: Adaptive Responses to Takeover Law*, 69 U. CHI. L. REV. 871, 901 (2002).

<sup>134</sup> Of course, by the time of the decision the second bidder might have lost interest in the target, and there may be no other prospective bidders. In a case like this, it may be disadvantageous to the shareholders if the court issues an injunction.

<sup>135</sup> The terminology is borrowed from Landes & Posner, *Anticipatory Adjudication*, *supra* note 99. While Landes and Posner did not define the term, the concept includes declaratory judgment, temporary

damages even if the directors are fully capable of paying the damages.<sup>136</sup>

In addition, even in self-dealing transactions, such as management buyouts (MBOs), where there could be net surpluses from a breach, there are circumstances beyond the reach of the theory.<sup>137</sup> For example, damages from a failure to observe the duty to disclose are difficult to measure.<sup>138</sup> It may be difficult for a court to reconstruct a likely transaction scenario that would have ensued had there been no violation of fiduciary duties. For example, in discussing whether the irreparable injury requirement for a preliminary injunction is satisfied in a case involving a breach of the *Revlon* duty, the Delaware Chancery Court stated:

No doubt there is the chance to formulate a rational remedy down the line, but that chance involves great cost, time, and, unavoidably, a large degree of imprecision and speculation. After-the-fact inquiries into what might have been had directors tested the market adequately or stockholders been given all the material information necessarily involve reasoned guesswork.<sup>139</sup>

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restraining order, preliminary injunction, and permanent injunction. *Id.* Such adjudication is contrasted with “ex post adjudication.” *Id.* at 685. The concept includes administrative and other types of nonjudicial adjudication. In this paper the term denotes adjudication in a lawsuit against a Gatekeeper relating to his or her adherence to his or her fiduciary duties in performing Gatekeeping activities and of the types Landes and Posner contemplate. The concept therefore is different from the “preventive adjudication” that Samuel Bray used. *See* Bray, *supra* note 100, at 1300 n.100. Bray contrasts the concept with “remedial adjudication” that “correct[s] past harm” and does not include injunction. *Id.* at 1276. Anticipatory adjudication also differs from “restorative adjudication,” which restores the status quo and includes both rescission and mandatory injunction. *See generally, e.g.,* DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY §§ 12.02[c], 12.04[a] (2014). With respect to a typical fiduciary duty lawsuit against Gatekeepers seeking anticipatory adjudication, “the facts bearing on the plaintiff’s entitlement to judgment have already occurred . . . .” Landes & Posner, *Anticipatory Adjudication*, *supra* note 99, at 699. “[C]ases . . . in which the facts bearing on legal entitlement are in existence rather than contingent even though no one has yet been injured . . . .” *Id.*

<sup>136</sup> Anticipatory adjudication may have yet another efficiency gain: there is no need to calculate damages. *See* Landes & Posner, *Anticipatory Adjudication*, *supra* note 99, at 699; William Savitt, *The Genius of the Modern Chancery System*, 2012 COLUM. BUS. L. REV. 570, 583 n.41 (2012). Richard Brooks and Warren Schwartz pointed out certain efficiency gains from preliminary injunctions. *See* Brooks & Schwartz, *supra* note 126, at 384–85. The efficiency gains, however, are those derived in the context of and assume the existence of decisions on the merits after trial and are different from those described here.

<sup>137</sup> *See, e.g.,* Easterbrook & Fischel, *Contract and Fiduciary Duty*, *supra* note 125, at 445.

<sup>138</sup> *See, e.g., In re Anderson*, Clayton S’holders’ Litig., 519 A.2d 669, 676 (Del. Ch. 1986). In the REX II Tokyo High Court decision, the court recognized breach of the duty to disclose but stated that plaintiffs failed to prove damages from the breach. *See infra* note 577.

<sup>139</sup> *In re Netsmart Technologies, Inc. S’holders Litig.*, 924 A.2d 171, 207 (Del. Ch. 2007). *See also* Coates, *supra* note 3, at 17 (pointing out that “damages from broken deals are hard to estimate and prove” as a factor to make the parties to agreements to acquire companies with dispersed shareholders prefer to have specific performance remedies in the agreements); MASAKAZU SHIRAI, YŪKŌTEKIBAISHŪ NO BAMEN NI OKERU TORISHIMARIYAKU NI TAISURU KIRITSU [RULES APPLICABLE TO DIRECTOR

If so, it will be also difficult to calculate damages. Anticipatory corrections, however, should lead to informed shareholder decisions.<sup>140</sup> In instances like this, “[t]ransaction forcing remedies” may be superior.<sup>141</sup> This is particularly true if the dispersed shareholders suffering from the TPs have agents—such as independent directors—who can effectively negotiate for them. Restorative remedies and anticipatory remedies can be contract-forcing remedies.

(ii) *Controllers as Gatekeepers*

In freeze-outs, unless a special self-help mechanism is chosen to be adopted,<sup>142</sup> controllers engage in self-dealing transactions and there can be no real negotiation, and no re-negotiation will be induced. Further, unlike the situations described above,<sup>143</sup> there is a real possibility that the self-dealing transactions in which the controllers breach their duties to the minority shareholders will create net surpluses.<sup>144</sup> Therefore, there is a real likelihood of an efficient breach. In addition, controllers typically have resources to pay the monetary awards after the transactions.<sup>145</sup> Thus, the need for anticipatory adjudication is less than when the Gatekeepers are directors in relation to non-freeze-out control transactions.<sup>146</sup>

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CONDUCTS IN FRIENDLY ACQUISITIONS] 510 n.1765 (2013).

<sup>140</sup> Cf. Jill E. Fisch et al., *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 TEX. L. REV. 557 (2015) (suggesting that Delaware’s disclosure only settlements in relation to mergers have not meaningfully changed shareholder voting).

<sup>141</sup> See, e.g., Easterbrook & Fischel, *Contract and Fiduciary Duty*, *supra* note 125, at 445. See also Edelman v. Freuhauf Corp., 798 F.2d 882 (6th Cir. 1986) (issuing a preliminary injunction (i) enjoining the use of corporate funds and attempts to preempt a bidding contest designed to assist a management group’s defensive MBO and to prevent a third-party hostile bidder from acquiring the company, a Michigan corporation, and (ii) opening a fair auction process). Often, however, damage remedies may still be superior. See, e.g., Easterbrook & Fischel, *Contract and Fiduciary Duty*, *supra* note 125, at 433, 442–43 (regarding management’s self-dealing transactions, including MBOs).

<sup>142</sup> For example, the use of both an independent committee approval and a majority of the minority condition may remove the self-dealing nature. See, e.g., *In re MFW S’holders Litig.*, 67 A.3d 496, 503 (Del. Ch. 2013), *aff’d by Kahn v. M & F Worldwide Corp.*, 88 A.3d 635 (Del. 2014). See also Gilson & Gordon, *Controlling Controlling*, *supra* note 9, at 804 (stating that an independent negotiating committee and a rigorous judicial review serve to ensure that the minority will receive “some portion of the gain that would result from bargaining in a bilateral monopoly”).

<sup>143</sup> See *supra* Part III.C.1.b.i.

<sup>144</sup> See *supra* Parts II.A.2., II.B.2.

<sup>145</sup> See *supra* Part III.C.1.a.ii.

<sup>146</sup> See Easterbrook & Fischel, *Contract and Fiduciary Duty*, *supra* note 125, at 433 (stating that remedies for a majority shareholder’s breach of his or her duty to minority shareholders are usually loss based).

## 2. Solutions

As described above in the context of lawsuits against Gatekeepers, damage relief rendered for breach of fiduciary duties is frequently inadequate or inefficient. This is particularly true when control transactions are not self-dealing transactions. As aforementioned, restorative remedies are often impractical, costly, inadequate, and inefficient. Further, if they are enforced, restorative remedies may cause great harm to third parties who have entered into contracts with the companies.<sup>147</sup>

Anticipatory adjudication rendered during the Shareholder Deliberation Phase will reduce or preempt circumstances in which the court would have no choice other than to award damage relief even if such relief would be inadequate or inefficient.<sup>148</sup> It may induce renegotiations untainted by conduct in breach of fiduciary duties.<sup>149</sup> Further, it may reduce hardships to third-party contractors if restorative relief is rendered.<sup>150</sup>

In anticipatory adjudication rendered in the context of control transactions, predictability is less of a concern since the court expresses its view before decisions of Gatekeepers can have real negative consequences. No irreversible shareholder decisions have been made. Often their breach of fiduciary duties has not yet caused fatal, irreparable damages.<sup>151</sup> Anticipatory adjudication has an added benefit of allowing the court to render decisions tailored to the specific circumstances.<sup>152</sup>

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<sup>147</sup> See, e.g., Paul L. Regan, *Great Expectations? A Contract Law Analysis for Preclusive Corporate Lock-Ups*, 21 CARDOZO L. REV. 1 (1999); Celia R. Taylor, "A Delicate Interplay": *Resolving the Contract and Corporate Law Tension Mergers*, 74 TUL. L. REV. 561 (1999).

<sup>148</sup> The ex post aspect sometimes creates a less-than-ideal situation in which, due to deal dynamics, it is too late for the court to fashion anticipatory relief. See, e.g., *In re El Paso Corp. S'holder Litig.*, 41 A.3d 432, 449–52 (Del. Ch. 2012). See also *supra* note 112.

<sup>149</sup> See *supra* Part III.C.1.b.i

<sup>150</sup> See, e.g., *In re Del Monte Foods S'holders Litig.*, 25 A.3d 813, 842 (Del. Ch. 2011) (indicating the possibility for a contractual right of a third party to prevail over the interests of shareholders once the challenged transaction has been completed and thus an egg has been scrambled). See *infra* text accompanying note 260. See also *supra* note 148.

<sup>151</sup> See, e.g., Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 250–51 (1985); Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1085 (2000) (indicating that an injunction, a form of anticipatory relief, does not require as much predictability as a damage remedy). Ehud Kamar stresses the importance of predictability in business planning and strongly suspects the suboptimality of Delaware's indeterminacy. Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908, 1919–23 (1998). Significantly, however, Kamar failed to recognize that predictability is less important if judicial determination is in the form of anticipatory adjudication. See also Ronald J. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 881–87 (1981) [hereinafter Gilson, *Structural Approach*] (describing possible demerits of specific rules).

<sup>152</sup> See, e.g., Fisch, *supra* note 151, at 1084 ("Corporate law in particular, because of the essentially unlimited range of structural possibilities, may make ex ante specification difficult."); Leo E. Strine, Jr.,

Anticipatory relief, however, has to be timely, and the window available for the adjudication is often narrow.<sup>153</sup> In particular, with respect to control transactions that the Gatekeepers have agreed to let shareholders decide, the adjudication must be made before the shareholders' collective decisions. To reduce TPs relating to the shareholder decisions, the U.S. model gives a minimum window of time leading up to the decisions.<sup>154</sup> In lawsuits seeking anticipatory relief, "time is of the essence," and the court renders decisions "on the fly."<sup>155</sup> Thus, the court that handles lawsuits seeking anticipatory relief must be equipped to move quickly. It may not have time to hold a trial or other formal fact-finding proceedings. Further, anticipatory adjudication generally has greater administrative and error costs.<sup>156</sup> If interlocutory injunctions are erroneously rendered, often due to deal dynamics ultimately attributable to TPs, they are likely to cause irreversible consequences.<sup>157</sup> Delay in the timing of the initiation of the adjudication may increase the ripeness of the matter and reduce such costs. However, that will further shorten the window of time to render the adjudication. In addition, crafting injunctive remedies requires intimate knowledge of deal documents and familiarity with deal dynamics.<sup>158</sup>

Specialized judges help remove or alleviate these potential risks.<sup>159</sup>

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*Delaware's Corporate-Law System: Is Corporate America Buying an Exquisite Jewel or a Diamond in the Rough? A Response to Kahan & Kamar's Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1257, 1275 (2001) ("Complex human behavior rarely lends itself to bright-line rules."). Lack of predictability, however, also creates the need for anticipatory adjudication to avoid dire adverse consequences that might result from corporate fiduciaries' misapplication or misinterpretation of fiduciary duty law.

<sup>153</sup> In the context of a hostile offer, the bidder does not necessarily have a fixed deadline. However, if another bidder surfaces all of a sudden, it becomes necessary for the dispute to be resolved before the shareholder action on the other bid. Further, it is costly for the hostile bidder to maintain the hostile bid for a prolonged period. See, e.g., Lucian Arye Bebchuk et al., *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887, 922–23 (2002) [hereinafter Bebchuk et al., *The Powerful Antitakeover Force of Staggered Boards*].

<sup>154</sup> See *supra* Part II.C.

<sup>155</sup> See, e.g., Ronald J. Gilson, *The Fine Art of Judging: William T. Allen*, 22 DEL. J. CORP. L. 914, 916 (1997) [hereinafter Gilson, *The Fine Art*] ("[T]he Court of Chancery was, *de facto*, the court of first and last resort for many takeover contests and was restructuring corporate law on the fly.").

<sup>156</sup> Landes & Posner, *Anticipatory Adjudication*, *supra* note 99, at 685.

<sup>157</sup> First, a window of time to correct the errors that control transactions can afford to have is too short for the court to render final decisions. Second, the erroneous decisions tend to have immediate and irreversible effects on the deal dynamics of a transaction. See, e.g., WOLFE & PITTENGER, *supra* note 135, § 10.02 (referring to "the powerful and often sweeping effects that such a conclusion and the issuance of an interim injunction can engender").

<sup>158</sup> See, e.g., *In re El Paso Corp. S'holder Litig.*, 41 A.3d 432, 449–52 (Ch. Ct. 2012).

<sup>159</sup> There can be "specialist" judges in courts of general jurisdiction. See Edward K. Cheng, *The Myth of the Generalist Judge*, 61 STAN. L. REV. 519 (2008) (stating that judges are more specialized than popularly understood and discussing the merits and demerits of specialization). See also Rochelle C. Dreyfuss, *Forums of the Future: The Role of Specialized Courts in Resolving Business Disputes*, 61 BROOK. L. REV. 1 (1995).

They are familiar with both typical fact patterns<sup>160</sup> and legal issues, and do not require time to get up to speed.<sup>161</sup> This also helps reduce court administrative costs.<sup>162</sup> It may be difficult to have time to appeal lower court decisions.<sup>163</sup> Thus, it would be desirable if such specialists existed at the level of the court of first instance.

There is yet another factor that would complicate the administration of anticipatory adjudication in shareholder lawsuits against Gatekeepers: such adjudication often must be made in response to class action lawsuits. The judiciary has to address the agency problems of the attorneys representing the classes.<sup>164</sup> Class action lawsuits seeking anticipatory relief present unique agency problems compared to class actions seeking damage relief. This is because the attorneys have to make judgments on wide-ranging issues, including business issues, and negotiate with the Gatekeepers and possibly other parties to craft tailored equitable remedies. Judges handling such lawsuits deal with wide-ranging issues and exercise wider discretion than judges in damage suits. Again, specialist judges are the answer to the need to deal with such agency problems in the fast-moving and complex judicial proceedings.

#### D. Summary

TPs continue to plague control transactions during shareholder lawsuits to resolve agency problems closely related to such TPs. They plague lawsuits at both Stage I and Stage II. Conceptually, it is easy to identify solutions for the TPs at Stage I. As to Stage II, damage relief as an alternative to restorative relief is often inadequate and inappropriate, particularly with respect to lawsuits involving third-party acquisitions. Often anticipatory relief substantially sidesteps the adverse consequences of restorative relief relating to control transactions. It may also induce economically efficient transactions. However, the relief imposes a heavy burden on the judiciary

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<sup>160</sup> This may be important in relation to decisions, such as interlocutory injunctions, that are issued without a full fact-finding proceeding. For example, specialist judges are able to contextualize statements in deposition transcripts. See, e.g., Ronald J. Gilson & Alan Schwartz, *Constraints on Private Benefits of Control: Ex ante Control Mechanisms versus Ex post Transaction Review*, 169 J. INST. & THEORETICAL ECON. 160, 178 (2013) (describing a situation in which a specialist judge does not need a trial to reach an accurate result but an inexpert judge may reach a wrong result even after a trial).

<sup>161</sup> See Landes & Posner, *Anticipatory Adjudication*, *supra* note 99, at 713; Cheng, *supra* note 159, at 548–90.

<sup>162</sup> See Landes & Posner, *Anticipatory Adjudication*, *supra* note 99, at 714. The greater administrative cost may be unavoidable. However, the sizes of the stakes in shareholder class actions against Gatekeepers may warrant the greater cost.

<sup>163</sup> See Gilson, *The Fine Art*, *supra* note 155, at 915–16 (stating that many preliminary injunction cases did not have a chance to reach the Delaware Supreme Court).

<sup>164</sup> See *infra* Part IV.A.1.a.i.

and requires the judiciary to have special attributes.

#### IV. UNITED STATES

##### A. Delaware

##### *1. Strategies to Reduce the Twin Problems of Initiation and Prosecution of Lawsuits*

##### (a) Collective Action Problems re Initiation and Prosecution of Lawsuits

##### *(i) Class Actions*

Under Delaware's judge-made law, directors of Delaware corporations owe fiduciary duties to the company shareholders as well as to the corporations.<sup>165</sup> Similarly, controlling shareholders owe fiduciary duties to corporations and minority shareholders.<sup>166</sup> Shareholders<sup>167</sup> and corporations generally have standing to file direct lawsuits to enforce their rights against the fiduciaries.

In contested acquisitions unsolicited suitors often file lawsuits against the targets' directors to seek anticipatory relief, such as preliminary injunctions.<sup>168</sup> The suitors' standing in such lawsuits is based on their ownership of shares in the target companies. Economically, however, it is not their share ownership that justifies the lawsuits. Rather, their large stakes as hostile suitors economically justifies the lawsuits.<sup>169</sup> In these situations, other

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<sup>165</sup> See, e.g., *Agostino v. Hicks*, 845 A.2d 1110, 1122 n.54 (Del. Ch. 2004).

<sup>166</sup> See, e.g., *Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1113–15 (Del. 1994).

<sup>167</sup> See, e.g., *Braasch v. Goldschmidt*, 199 A.2d 760, 766 (Del. Ch. 1964) (stating that beneficial owners of shares, such as those holding shares under street names, have standing as shareholders). Cf. DEL. CODE ANN. tit. 8, § 219(c) (2014) ("The stock ledger shall be the only evidence as to who are the stockholders entitled by this section to examine the list required by this section or to vote in person or by proxy at any meeting of stockholders"); see also, § 262 (providing that a record holder has an appraisal right). However, shareholders do not have standing to sue for breaches committed before they became shareholders. See, e.g., *Omnicare, Inc. v. NCS Healthcare, Inc.*, 809 A.2d 1163, 1169–70 (Del. Ch. 2002). With respect to derivative suits, this position is codified. DEL. CODE ANN. tit. 8, § 327 (2014).

<sup>168</sup> See *Thompson & Thomas, The New Look*, *supra* note 84, at 169 tbl.2. A significant percentage of the direct individual lawsuits were "by bidders either in hostile transactions or in second bidder situations." *Id.* at 174.

<sup>169</sup> See, e.g., *Omnicare, Inc.*, 809 A.2d at 1172 (indicating in a decision denying a hostile bidder's standing that bidders' interests as shareholders are often "immaterial"). See also EDWARD WELCH ET AL., *MERGERS & ACQUISITIONS DEAL LITIGATION UNDER DELAWARE CORPORATION LAW* § 3.02[B] (2012) [hereinafter WELCH ET AL., *MERGERS & ACQUISITIONS DEAL LITIGATION*]. The prospects of the monetary and other costs, however, might discourage potential bidders from launching the bids. Note

shareholders will benefit from the lawsuits, particularly if the bidders win anticipatory relief.<sup>170</sup> However, the interests of the unsolicited suitors and the other shareholders may diverge.<sup>171</sup> More importantly, these lucky situations are hard to come by.

Delaware's opt-out class actions,<sup>172</sup> combined with a regime for the calculation of fees for the plaintiffs' attorneys and the allocation of the costs of the lawsuits,<sup>173</sup> greatly alleviate shareholder CAPs in relation to the initiation and maintenance of individual (versus derivative) shareholder lawsuits against corporate fiduciaries.<sup>174</sup> The "decisions are res judicata as to the entire class."<sup>175</sup> The Delaware judiciary is keenly aware of the importance of its opt-out class action regime. For example, the Chancery Court recently stated that "[t]he class action mechanism originated in equity practice and is particularly important to the substantive law of corporations as a mechanism to address collective action problems."<sup>176</sup>

The expert court monitors the agents for the classes. Class representatives must be those who will fairly and adequately protect the class interests<sup>177</sup> and owe fiduciary duties to the class.<sup>178</sup> The selection of counsel at the outset of the lawsuits is one of the most important tasks of the court with which the lawsuits are filed.<sup>179</sup> In selecting lead counsel, "the weight

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that other potential bidders might be able to free ride on the first bidders' efforts.

<sup>170</sup> See *supra* Part III.A.2.a. Class action lawsuits may also be filed. When bidders file lawsuits, however, class action plaintiffs tend to take a backseat to the bidders. See also Thompson & Thomas, *The New Look*, *supra* note 84, at 139–40.

<sup>171</sup> See, e.g., *Kingsbridge Capital Group v. Dunkin' Donuts, Inc.*, 1989 Del. Ch. LEXIS 87, at \*4–5 (Del. Ch. Aug. 7, 1989); *Black & Decker Corp. v. American Standard, Inc.*, 682 F. Supp. 772, 778 (D. Del. 1988).

<sup>172</sup> Del. Ch. Ct. R. 23(a). The court rules governing class actions in Delaware are "modeled substantially upon Rule 23 of the Federal Rules of Civil Procedure." WOLFE & PITTENGER, *supra* note 135, § 9.03[a] (citing *Prezant v. De Angelis*, 636 A.2d 9154, 920 (Del. 1994)). For the limitation of the opt-out right, see, for example, *In re Phila. Stock Exch., Inc.*, 945 A.2d 1123 (Del. 2008) (stating that opt out as of right is available only from a class certified by Court of Chancery Rule 23(b)(3)). In European jurisdictions, "opt-in" class actions seem to predominate. See, e.g., *Coffee*, *supra* note 96, at 301, and authorities cited therein.

<sup>173</sup> See *infra* Part IV.A.1.a.ii.

<sup>174</sup> The Delaware General Corporation Law does not authorize a class appraisal proceeding. See DEL. CODE ANN. tit. 8, § 262(a)–(d) (2014).

<sup>175</sup> See, e.g., *Dieter v. Prime Computer, Inc.*, 681 A.2d 1068, 1073 (Del. Ch. 1996).

<sup>176</sup> *In re Celera Corp. S'holder Litig.*, 2012 WL 1020471, at \*1 (Del. Ch. Mar. 23, 2012), *aff'd in part and rev'd in part, remanded by BVF Partners L.P. v. New Orleans Emps. Ret. Sys. (In re Celera Corp. S'holder Litig.)*, 59 A.3d 418 (Del. 2012). See also *In re Cox Commc'ns, Inc. S'holders Litig.*, 879 A.2d 604, 643 (Del. Ch. 2005) (stressing the importance of maintaining the integrity of a representative suit).

<sup>177</sup> Del. Ch. Ct. R. 23(a)(4).

<sup>178</sup> See, e.g., *Barbieri v. Swing-N-Slide Corp.*, 1996 Del. Ch. LEXIS 46, at \*15–16 (Del. Ch. May 7, 1996).

<sup>179</sup> Del. Ch. Ct. R. 23(a)(4). See also Savitt, *supra* note 136, at 578–81.



given to the size of a plaintiffs' holding . . . comes into play when a plaintiff owns a sufficient stake to provide an economic incentive to monitor counsel and play a meaningful role in conducting the case."<sup>180</sup>

It is also necessary for the court to monitor such representatives and lawyers on an ongoing basis to avoid or minimize the litigation agency costs.<sup>181</sup> Thus, "[a] trial court has a continuing duty in a class action case to scrutinize the class attorney to see that he or she is adequately protecting the interests of the class."<sup>182</sup> A court "must throughout the proceedings, stringently apply the requirement of adequate representation . . ."<sup>183</sup> Thus, for example, the court may order changes to the lead counsel positions.<sup>184</sup> Settlements of class action lawsuits are also subject to court approval.<sup>185</sup>

An equally potent and "cost efficient" mechanism to control the litigation agency costs (and align the interests of the plaintiffs' lawyers)<sup>186</sup> is the court's ability to award or adjust legal fees to the plaintiffs' lawyers.<sup>187</sup> Further, recently the Delaware judiciary crafted a judicial standard that would reduce "settlement value" from certain types of lawsuits.<sup>188</sup>

In Delaware, notwithstanding the race to the bottom problem that might have been created by the prevalence of multijurisdictional lawsuits,<sup>189</sup>

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<sup>180</sup> *In re Revlon, Inc. S'holders Litig.*, 990 A.2d 940, 955 (Del. 2010). *See also* Del. Ch. Ct. R. 23(a)(4). Other states may still have the first-filer rule, and the divergence in the methods of selecting lead counsel is one reason for the prevalent multistate jurisdictional lawsuits. *See, e.g., Armour et al., Delaware's Balancing Act*, *supra* note 60, at 1373. For an analysis of the impacts of the lead plaintiff provision of the Private Securities Litigation Reform Act, Publ. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.), *see, for example, James D. Cox et al., Does the Plaintiff Matter? An Empirical Analysis of Lead Plaintiffs in Securities Class Actions*, 106 COLUM. L. REV. 1587 (2006).

<sup>181</sup> *See, e.g., WOLFE & PITTENGER*, *supra* note 135, § 9.03[a].

<sup>182</sup> *In re Revlon, Inc. S'holders Litig.*, 990 A.2d at 955 (quoting 4 ALBA CONTE & HERBERT B. NEWBERG, *NEWBERG ON CLASS ACTIONS* § 13:22, at 417 (Thomson West 4th ed. 2002)).

<sup>183</sup> *Guerine v. J & W Inv., Inc.*, 544 F.2d 863, 864 (5th Cir. 1977).

<sup>184</sup> *See, e.g., In re Revlon, Inc. S'holders Litig.*, 990 A.2d at 961-64.

<sup>185</sup> Del. Ch. Ct. R. 23(e). For the importance of this power, *see, for example, Savitt, supra* note 136, at 575.

<sup>186</sup> The award of more than \$304 million to plaintiffs' counsel in the context of a derivative suit resulting in an award of more than \$2 billion is the most notable recent example. *In re S. Peru Copper Corp. S'holder Derivative Litig.*, 30 A.3d 60 (Del. Ch. 2011), *aff'd sub nom. Ams. Mining Corp. v. Theriault*, 51 A.3d 1213 (Del. 2012).

<sup>187</sup> *See, e.g., Quinn, Shareholder Lawsuits, supra* note 60, at 154-55; *Savitt, supra* note 136, at 576-77. For the ability of the court to award legal fees to plaintiffs' lawyers, *see infra* Part IV.A.1.a.ii.

<sup>188</sup> *In re MFW S'holders Litig.*, 67 A.3d 496, 504 (Del. Ch. 2013), *aff'd sub nom. Kahn v. M & F Worldwide Corp.*, 88 A.3d 635 (Del. 2014).

<sup>189</sup> *See* Leo E. Strine, Jr. et al., *Putting Stockholders First, Not the First-Filed Complaint*, 69 BUS. LAW. 1, 14 (2013) [hereinafter Strine et al., *Putting Stockholders First*] ("[T]he prevalence of multi-forum litigation and the inability or unwillingness of courts to limit such litigation can exacerbate . . . 'race to the bottom' type behavior . . ."). Delaware's efforts to control litigation agency costs may encourage certain plaintiffs' lawyers to file in courts outside Delaware. *See Quinn, Shareholder Lawsuits*,

litigation agency costs appear to be constrained at a level not overly excessive relative to the benefits, that is, the reduction of agency costs relating to the Gatekeeper/shareholder relationship.<sup>190</sup> A delicate balancing act by “specialist judges”<sup>191</sup> appears to have prevented the problems from growing out of control.<sup>192</sup>

(ii) *Costs of Lawsuits*

The Chancery Court is entitled to “make such order concerning costs in every case as is agreeable to equity.”<sup>193</sup> In exercising such authority,<sup>194</sup> the court generally allows a prevailing party to recover certain costs from the losing party. Such costs typically “consist of so-called court costs, witness fees, and statutory delineated charges.”<sup>195</sup> In particular cases, the court can deviate from the norm.<sup>196</sup>

As to all the more important attorney fees, however, the court generally defers to the American Rule. Under the rule, each litigant is responsible for the fees of his or her own counsel.<sup>197</sup> Therefore, typically each party bears his or her costs of attorney’s fees.<sup>198</sup> There are certain exceptions to the rule.<sup>199</sup> Under the so-called common fund or substantial (or therapeutic) benefit doctrine, a litigant or a lawyer who creates a common fund or achieves a substantial benefit, as the case may be, is entitled to a reasonable

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*supra* note 60, at 155.

<sup>190</sup> At least it is not typical for acquisition agreements for control transactions to have a clause specifically providing for a price adjustment directly or indirectly linked to the cost of litigation to defend fiduciary duty claims raised in connection with the contemplated transaction. As to the level of legal fees, see *infra* Part IV.A.1.a.ii.

<sup>191</sup> See *infra* Part IV.A.2.c.

<sup>192</sup> See, e.g., Quinn, *Shareholder Lawsuits*, *supra* note 60, at 155.

<sup>193</sup> DEL. CODE ANN. tit. 10, § 5106 (West 2015). This is viewed as a restatement of “the long-existing rule of equity.” WOLFE & PITTENGER, *supra* note 135, § 13.01. See also DEL. CODE ANN. tit. 10, § 6510 (2015) (providing that courts may award costs relating to declaratory judgments “as may seem equitable and just”).

<sup>194</sup> Del. Ch. Ct. R. 54(d).

<sup>195</sup> WOLFE & PITTENGER, *supra* note 135, § 13.02[b] (footnote omitted).

<sup>196</sup> Del. Ch. Ct. R. 54(d).

<sup>197</sup> See, e.g., WOLFE & PITTENGER, *supra* note 135, § 13.03[a] (footnote omitted); WELCH ET AL., *MERGERS & ACQUISITIONS DEAL LITIGATION*, *supra* note 169, § 11.02[A].

<sup>198</sup> See, e.g., *In re SS & C Tech., Inc. S’holders Litig.*, 948 A.2d 1140, 1149 (Del. Ch. 2008); *Chrysler Corp. v. Dann*, 223 A.2d 384, 386 (Del. Ch. 1966).

<sup>199</sup> For the types of exceptions, see, for example, *Arbitrium (Cayman Islands) Handels AG v. Johnston*, 705 A.2d 225, 231 (Del. Ch. 1997), *aff’d*, 720 A.2d 542 (Del. 1998). See also *ATR-Kim Eng Fin. Corp. v. Araneta*, 2006 WL 3783520, at \*22 (Del. Ch. Dec. 21, 2006), *aff’d*, 930 A.2d 928 (Del. 2007); WOLFE & PITTENGER, *supra* note 135, § 13.03[a] (giving a list of exceptions). As to the history of and exceptions to the rule, see *Vargo*, *supra* note 104, at 1570–90.

attorney's fee.<sup>200</sup> The common fund doctrine requires that the fees be paid out of the funds created by the litigant or lawyer.<sup>201</sup> If the created benefits are therapeutic, however, no funds for such payments exist. In the context of a shareholder lawsuit, "because the corporation is the only vehicle through which the costs of obtaining the benefit can be equally shared,"<sup>202</sup> the court may obligate the companies to shoulder the fees.<sup>203</sup>

In the context of shareholder lawsuits against Gatekeepers, the calculation and allocation of attorneys' fees are very important.<sup>204</sup> The foregoing rules regarding attorney fees make named plaintiffs in class actions less concerned with the costs of class action lawsuits.<sup>205</sup> On the other hand, the plaintiffs' attorneys, who work on a contingent fee basis, have a potentially significant upside of being rewarded with lucrative fees.<sup>206</sup> The Delaware judiciary has made conscious efforts to craft a fee structure that gives healthy incentives to plaintiff's lawyers to solve "a collective action problem that might stifle individual stockholders from litigating general breaches of duty"<sup>207</sup> and to seek real benefits in class actions.<sup>208</sup>

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<sup>200</sup> See, e.g., WOLFE & PITTENGER, *supra* note 135, §§ 9.05[a], 13.03[e]. These doctrines also apply in settings other than representative suits. See, e.g., *Tandycrafts, Inc. v. Initio Partners*, 562 A.2d 1162, 1166 (Del. 1988); WOLFE & PITTENGER, *supra* note 135, § 13.03[e].

<sup>201</sup> See Vargo, *supra* note 104, at 1579–83. For an example of fee awards under the common fund doctrine, see *Ams. Mining Corp. v. Theriault*, 51 A.3d 1213, 1253 (Del. 2012).

<sup>202</sup> *Eisenberg v. Chi. Milwaukee Corp.*, 1988 Del. Ch. LEXIS 141, at \*8 (Del. Ch. Oct. 25, 1988) (citing *Sugarland Indus., Inc. v. Thomas*, 420 A.2d 142, 148–49 (Del. 1980)). See also *Mills v. Elec. Auto-Lite Co.*, 396 U.S. 375, 396 (1970).

<sup>203</sup> See, e.g., *In re First Interstate Bancorp Consol. S'holder Litig.*, 756 A.2d 353, 359–60 (Del. Ch. 1999). See also WOLFE & PITTENGER, *supra* note 135, § 9.05[g]; WELCH ET AL., *MERGERS & ACQUISITIONS DEAL LITIGATION*, *supra* note 169, § 5.01[C][6].

<sup>204</sup> See *supra* text accompanying notes 103–105.

<sup>205</sup> Preliminary injunctions are conditioned on the posting of a bond. However, generally the amount has not been prohibitively high. See, e.g., Marc Wolinsky & Ben Schireson, *Deal Litigation Run Amok: Diagnosis and Prescriptions*, 47 REV. SEC. & COMMODITIES REG. 1, 6 (2014).

<sup>206</sup> See Weiss & White, *supra* note 55, at 1830 ("[L]itigating merger-related class actions in Delaware Chancery Court appears to be a lucrative area of practice for the plaintiffs' bar."). See also Strine et al., *Putting Stockholders First*, *supra* note 189, at 15 n.49 ("The data on attorney's fee awards in stockholder representative litigation show that it is not the case that Delaware judges are reluctant to award fees in meritorious cases.").

<sup>207</sup> WELCH ET AL., *MERGERS & ACQUISITIONS DEAL LITIGATION*, *supra* note 170, § 11.02[A][1]. See also *In re Cox Commc'ns S'holders Litig.*, 879 A.2d 604, 642–48 (Del. Ch. 2005); *In re Fuqua Indus., Inc. S'holder Litig.*, 752 A.2d 126, 133 (Del. Ch. 1999) (stating that the cost and fee-shifting mechanisms are used to "economically incentivize" private lawyers). See generally Jason W. Adkins, *A Guide to Predicting the Calculation of Attorneys' Fees Under Delaware Law for Shareholder Lawsuits*, 37 DEL. J. CORP. L. 501 (2012).

<sup>208</sup> *Ams. Mining Corp. v. Theriault*, 51 A.3d 1213, 1255 (Del. 2012). In May 2014, the Delaware Supreme Court, in response to certified questions, rendered a decision stating that a bylaw provision approved by a board to shift attorney fees in intracorporate litigation to losing claimants is not invalid per se. *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 554–560 (Del. 2014). The case involved a Delaware non-stock corporation. However, the holding is also applicable to Delaware stock corpora-

Studies indicate that the fees paid to plaintiffs' lawyers in relation to acquisitions have been modest compared to the transaction values.<sup>209</sup> For example, a study focusing on mergers for the years from 1990 to 2001 in which the target companies were publicly traded Delaware corporations with deal values in excess of \$100 million shows that class action plaintiffs' lawyers in settled lawsuits earned fees per case of 0.19% of the deal value on average, ranging from 0.005% to 1.36%.<sup>210</sup> According to another study, for settlements of lawsuits of deals in 2011, the mean attorneys' fee was \$1.43 million, and the median fee was \$580,000. There appears to be no discernible upward trend from 2005 to 2011.<sup>211</sup> Class action lawsuits involve players other than the plaintiffs' lawyers, such as judges, lawyers for the defendants, witnesses, and people involved in document production in response to discovery requests. The statistical information does not include the costs relating to these additional players. The magnitude of the fees paid to plaintiff's lawyers, however, could be a good indicator of the total costs of lawsuits. If so, the magnitude of the additional costs may not be prohibitively high. At least it does not appear very likely that the prospect of the cost of class action lawsuits will significantly deter efficiency-enhancing transactions.<sup>212</sup>

(iii) *Anticipatory Relief*

As described below,<sup>213</sup> the Chancery Court has the power to render anticipatory relief. Delaware recognizes issue preclusion.<sup>214</sup>

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tions. After much debate, Delaware amended its corporation law, which now prohibits such fee shifting in connection with an internal corporate claim. DEL. CODE ANN. tit. 8, §§ 102(f), 109(f) (2015).

<sup>209</sup> See Subramanian, *Fixing Freezeouts*, *supra* note 48, at 45 (stating that a percentage of litigation costs in effect incurred by controllers is small relative to deal values).

<sup>210</sup> Weiss & White, *supra* note 55, at 1831. These figures can be compared against the fees payable to "investment bankers, lawyers, and accountants in arms-length transaction," ranging from "1.0% to 2.0% of deal value." Subramanian, *Fixing Freezeouts*, *supra* note 48, at 45.

<sup>211</sup> See DAINES & KOUMRIAN, *supra* note 61, at 12, 13 tbl.10 (a study covering 2007–11).

<sup>212</sup> See, e.g., Thompson & Thomas, *The New Look*, *supra* note 84, at 140. With respect to merger freeze-outs, see Subramanian, *Fixing Freezeouts*, *supra* note 48, at 47. In a recent article Charles Korsmo and Minor Myers suggest various proposals to reduce attorney agency costs in shareholder class actions challenging mergers. See Charles R. Korsmo & Minor Myers, *The Structure of Stockholder Litigation: When Do the Merits Matter?*, 75 OHIO ST. L.J. 829 (2014).

<sup>213</sup> See *infra* Part IV.A.2.a.

<sup>214</sup> In Delaware mutuality is no longer required for issue preclusion. See, e.g., *Coca-Cola Co. v. Pepsi-Cola Co.*, 172 A. 260, 264 (Del. 1934).

(b) Asymmetric Information Problems re Initiation and Prosecution  
of Lawsuits

(i) *Fact-finding*

Delaware's discovery system<sup>215</sup> addresses the AIPs during Stage I.<sup>216</sup> Importantly, in the context of lawsuits against Gatekeepers, it allows shareholder plaintiffs to expeditiously delve into and uncover the process of decision making by the Gatekeepers and their advisors, including the documents, e-mail communications, and conversations crucial to their cases.

Subject to certain exceptions, the parties are entitled to obtain discovery regarding any matter, not privileged, which is *relevant* to the subject matter involved in the pending action, including the existence, description, nature, custody, condition and location of any documents, electronically stored information, or tangible things and the identity and location of persons having knowledge of any discoverable matter.<sup>217</sup>

"Relevance" is defined broadly.<sup>218</sup> The parties may seek information that is "inadmissible at the trial if the information sought appears reasonably calculated to lead to the discovery of admissible evidence."<sup>219</sup> In addition, the court does not have jurors.<sup>220</sup> Thus, the judge in charge of the case reviews the results of the discovery directly without first removing inadmissible evidence.

Discovery tools include depositions, interrogatories, production of documents, and requests for admission.<sup>221</sup> In the context of fiduciary duty

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<sup>215</sup> DEL. CH. CT. RS. 26–37. The Chancery Court's discovery rules are "parallel in most respects their counterparts in the Federal Rules of Civil Procedure." WOLFE & PITTINGER, *supra* note 135, § 6.01. Unlike the Federal Rules of Civil Procedure, however, the Chancery Rules do not require the automatic production of initial disclosure. *See* FED. R. CIV. P. 26(a)(1)(A). For the role of discovery in shaping the corporate governance in the United States, see Érica Gorga & Michael Halberstam, *Litigation Discovery and Corporate Governance: The Missing Story About the "Genius of American Corporate Law,"* 63 EMORY L.J. 1384 (2014).

<sup>216</sup> *See supra* Part III.A.1.b. *See also* Veasey, *supra* note 56, at 7 (stating that Delaware corporate jurisprudence has a "fact-intensive aspect").

<sup>217</sup> DEL. CH. CT. R. 26(b)(1) (emphasis added). Thus, "[n]o longer can the time-honored cry of 'fishing expedition' serve to preclude a party from inquiring into the facts underlying his opponent's case." *Hickman v. Taylor*, 329 U.S. 495, 507 (1947) (footnote omitted). *See also* Stephen N. Subrin, *Fishing Expeditions Allowed: The Historical Background of the 1938 Federal Discovery Rules*, 39 B.C. L. REV. 691 (1998). On April 29 of 2015, the Supreme Court of the United States proposed amendments to the Federal Rules of Civil Procedure. The proposed changes are available at [http://www.supremecourt.gov/orders/courtorders/frcv15\(update\)\\_1823.pdf](http://www.supremecourt.gov/orders/courtorders/frcv15(update)_1823.pdf). The changes became effective on December 1, 2015. The proportionality factors in the amended Rule 26(b)(1) explicitly include information asymmetry.

<sup>218</sup> *See, e.g.,* Gorga & Halberstam, *supra* note 215, at 1413–14.

<sup>219</sup> *Id.*

<sup>220</sup> *See infra* note 321 and accompanying text.

<sup>221</sup> DEL. CH. CT. RS. 26–37.

lawsuits relating to control transactions, along with document requests, depositions<sup>222</sup> are typically the most important tool to find out what transpired behind the scenes.<sup>223</sup> Depositions may be taken from third parties as well as from the parties.<sup>224</sup>

Typically, the parties drive the discovery process, including depositions. Therefore:

Neither leave of court nor the presence of a judge or commissioner was required. Both supporting and hostile witnesses could now be deposed, including party opponents and their employees. Parties were required to appear on simple notice. Third parties could be subpoenaed directly without leave of court. Attorneys could directly examine the witnesses.<sup>225</sup>

Notice pleading is generally applicable.<sup>226</sup> Therefore, plaintiffs only need to allege facts sufficient to state a claim for relief to overcome a motion to dismiss.<sup>227</sup> Plaintiffs can pursue discovery only after lawsuits are filed.<sup>228</sup> However, plaintiffs may be able to amend original pleadings after the commencement of the discovery.<sup>229</sup> Therefore, if plaintiffs do not have enough relevant facts or supporting evidence when they commence lawsuits, it should not necessarily lead to a judgment on the pleadings.

Discovery may be expedited.<sup>230</sup> Typically, discovery precedes preliminary injunction hearings.<sup>231</sup> This is important since anticipatory relief is of-

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<sup>222</sup> DEL. CH. CT. RS. 26–31.

<sup>223</sup> See, e.g., WELCH ET AL., MERGERS & ACQUISITIONS DEAL LITIGATION, *supra* note 169, § 8.01[B] (“Document requests and depositions are usually the most frequently used discovery tools in deal litigation.”).

<sup>224</sup> DEL. CH. CT. R. 30(a). See also DEL. CH. CT. R. 45 (subpoena to compel the attendance of witnesses).

<sup>225</sup> Gorga & Halberstam, *supra* note 215, at 1411 (footnotes omitted).

<sup>226</sup> DEL. CH. CT. R. 8(a)(1). The US Supreme Court now uses “plausibility” to decide if a claim survives a motion to dismiss. *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2007); *Ashcroft v. Iqbal*, 556 U.S. 662, 678–79 (2009). However, the Delaware Supreme Court has not abandoned its traditional and less strict “conceivability” standard. See *Central Mortg. v. Morgan Stanley Mortg.*, 27 A.3d 531, 536–37 (Del. 2013).

<sup>227</sup> For summary judgment, see *infra* text accompanying notes 297, 298.

<sup>228</sup> Unlike the rules of some other states, the Delaware Chancery Court Rules omitted Rule 27 of the Federal Rules of Civil Procedure (Deposition to Perpetuate Testimony). See, e.g., JACK H. FRIEDENTHAL et al., CIVIL PROCEDURE 405 (4th ed. 2005).

<sup>229</sup> DEL. CH. CT. R. 15. See, e.g., WOLFE & PITTENGER, *supra* note 135, § 4.07[a]. Cf. *Cede & Co. v. Technicolor, Inc.*, 542 A.2d 1182 (Del. 1988) (involving a claim plaintiffs filed after discovering new facts in an appraisal proceeding).

<sup>230</sup> See *infra* Part IV.A.2.b.

<sup>231</sup> To facilitate efficient discovery before a preliminary injunction hearing, the Chancery Court also issued the Court of Chancery Guidelines for Expedited Discovery in Advance of a Preliminary Injunction Hearing. DEL. CH. CT., COURT OF CHANCERY GUIDELINES FOR EXPEDITED DISCOVERY IN ADVANCE OF A PRELIMINARY INJUNCTION HEARING (2013),

ten the most efficient remedy.<sup>232</sup>

(ii) *Burden of Proof*

Discovery in Delaware, described immediately above, makes AIPs less acute. However, in general, it will take more time and will cost more for the parties who suffer from the AIPs to dig up, uncover, and assemble evidence on a particular issue.<sup>233</sup> The time element is particularly important in the context of anticipatory interlocutory relief.<sup>234</sup> The preponderance of the evidence standard in Delaware makes the possibility of a false negative or Type II error less likely than when a higher standard of proof is used.<sup>235</sup> Burden shifting, however, may still be effectively used to further ameliorate the AIPs and avoid judgments that are false negatives or Type II errors.<sup>236</sup>

Courts can use burden shifting for various reasons.<sup>237</sup> However, the guiding rule for allocating the burden of proof “put[s] it on the party having the readier access to knowledge about the fact in question.”<sup>238</sup> This approach has been generally used in the context of shareholder lawsuits

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<http://courts.state.de.us/chancery/docs/PIDiscoveryGuidelines.pdf>.

<sup>232</sup> See *supra* Parts III.B, III.C.

<sup>233</sup> See Bruce L. Hay & Kathryn E. Spier, *Burdens of Proof in Civil Litigation: An Economic Perspective*, 26 J. LEGAL STUD. 413, 419 (1997).

<sup>234</sup> See *infra* Part IV.A.2.a.i.

<sup>235</sup> See *In re MFW S’holders Litig.*, 67 A.3d 496, 505 (Del. Ch. 2013) (a similar statement), *aff’d* by *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635 (Del. 2014); *In re Cysive, Inc. S’holders Litig.*, 836 A.2d 531, 548 (Del. Ch. 2003) (stating that the effect of burden shifting is “slight” when the standard to be applied is the preponderance standard, since “the outcome of very few cases hinges on what happens if in [*sic*] the evidence is in equipoise”). However, there are also certain areas in which the Delaware Chancery Court has applied higher evidentiary standards, such as a clear and convincing standard. For example, the court requires a plaintiff to show his or her entitlement to specific performance by clear and convincing evidence. See, e.g., *In re IBP S’holders Litig.*, 789 A.2d 14, 52 (Del. Ch. 2001) (noting that New York’s evidentiary standard is a preponderance standard).

<sup>236</sup> See, e.g., Andrew Johnston, *Takeover Regulation: Historical and Theoretical Perspectives on the City Code*, 66 CAMBRIDGE L.J. 422, 441 (2007) (suggesting that in England, to lighten the evidentiary burden of proving an improper purpose of directors when they deploy a defense measure, the common law could have moved to create a rebuttable presumption that “once the board has notice of a bid then actions that make the bid less likely to succeed are for an improper purpose”).

<sup>237</sup> James, *supra* note 108, at 58 (“The allocation is made on the basis of one or more of several variable factors.”).

<sup>238</sup> *Id.* at 60. Similarly:

In determining whether the normal allocation of the burden of proof should be altered, the courts consider the knowledge of the parties concerning the particular fact, the availability of the evidence to the parties . . . .

. . . The court may also consider [in allocating the burden of proof] which party will usually be best situated to carry or meet the burden of proof. The party with greater expertise and access to relevant information should bear the evidentiary burdens of production of evidence and persuasion.

31A C.J.S. *Evidence* § 196 (2014) (footnote omitted).

against corporate fiduciaries involving the duty of loyalty.<sup>239</sup>

In fiduciary duty cases in Delaware, “a great deal of judicial time and energy is devoted to explicating and refining . . . burden-shifting rules.”<sup>240</sup> Fiduciary duty standards may contain context-specific pronouncements relating to the allocation of the burden of proof.<sup>241</sup> The Delaware legislature recognizes the judiciary’s burden-shifting practice in enacting Section 203 of the General Corporation Law, the Delaware General Assembly specifically acknowledged “the case law development of directors’ fiduciary duties of care and loyalty in responding to challenges to control or *the burden of proof with regard to compliance with those duties*.”<sup>242</sup> There is no obvious indication that the Delaware judiciary is deviating from the general practice described in the preceding paragraph.

## 2. Strategies to Avoid Ex Post Restorative Relief to Undo a Shareholder Collective Decision or Transaction

Under the current federal tender offer and proxy rules, we do not see control transactions that are signed and closed simultaneously.<sup>243</sup> As shown below, Delaware’s judiciary has in its arsenal the power to issue various types of anticipatory relief having varying degrees of formality and speed. The judiciary’s speed, expertise, and flexibility—each backed by equity tradition—help it engage in anticipatory adjudication without suffering from excessive administrative or error costs. Conditions for the issuance of anticipatory relief are also largely conducive to efficiency-enhancing resolutions to shareholder disputes with Gatekeepers. The expertise helps manage the attorney agency costs relating to class actions, especially those that may arise in class actions to seek anticipatory relief. Thus, Delaware’s judiciary is equipped to follow the strategy to implement the solutions outlined in Part III.C.2. above. In anticipatory adjudication there is less need for pre-

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<sup>239</sup> See, e.g., Cooter & Freedman, *supra* note 107, at 1053–56 (giving examples of allocating the burden to corporate fiduciaries when they have easier access to relevant information).

<sup>240</sup> CHARLES M. YABLON, *A Theory of Presumptions*, 2 LAW, PROBABILITY, AND RISK 227, 231 (2003). See also Charles M. Yablon, *On the Allocation of Burdens of Proof in Corporate Law: An Essay on Fairness and Fuzzy Sets*, 13 CARDOZO L. REV. 497 (1991).

<sup>241</sup> See, e.g., Allen et al., *Function over Form*, *supra* note 117 (describing various judicial standards with attendant allocations of the burden of proof); Subramanian, *Fixing Freezeouts*, *supra* note 48, at 63 fig.1. (showing the allocation of the burden of proof for each judicial standard applicable to a particular freeze-out scenario).

<sup>242</sup> DEL. CODE ANN. tit. 8, § 203 (synopsis) (reprinted in DAVID A. DREXLER ET AL., *DELAWARE CORPORATION LAW AND PRACTICE* § 23.03) (emphasis added)).

<sup>243</sup> See *supra* Part II.C. In addition, as to transactions of any significant size, premerger notification is also required. See generally 1 LOU R. KLING & EILEEN T. NUGENT, *NEGOTIATED ACQUISITIONS OF COMPANIES, SUBSIDIARIES, AND DIVISIONS* § 5.04, at 5-183 to 5-184.11, § 5.09, at 5-228 to 5-240 (2012) (describing premerger notification rules of U.S. and certain non-U.S. jurisdictions).



dictability.<sup>244</sup> Widely acknowledged indeterminacy,<sup>245</sup> mushiness,<sup>246</sup> or muddiness<sup>247</sup> of the decisions of the Delaware judiciary may be attributable to the judiciary's frequent use of anticipatory relief.<sup>248</sup> Further, notwithstanding the "mushiness" and "muddiness," because of the Chancery Court's exclusive jurisdiction,<sup>249</sup> there is less "indeterminacy" than when multiple courts apply such standards.

(a) Anticipatory Relief

"[T]he Court of Chancery has broad flexibility and discretion with respect to the relief it may award"<sup>250</sup> or has broad discretion to "fashion such relief as the facts of a given case may dictate."<sup>251</sup> In exercising such power, the court issues anticipatory relief, such as declaratory judgments, temporary restraining orders (TROs), preliminary injunctions, and permanent injunctions. Here we will focus on the last three types of remedies.<sup>252</sup> The Court of Chancery, if necessary, compels obedience to its in personam orders using its contempt powers.<sup>253</sup>

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<sup>244</sup> See *supra* Part III.C.2.

<sup>245</sup> Kamar, *supra* note 151, at 1909.

<sup>246</sup> Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1101–03 (1997) (characterizing Delaware's fiduciary duty case law as "mushy").

<sup>247</sup> Fisch, *supra* note 151, at 1083.

<sup>248</sup> *Id.* ("Cases in which a court is considering a request for preliminary relief are apt to appear more indeterminate than cases in which the litigants have developed a complete factual and legal record."). Cf. Kamar, *supra* note 151, at 1939 ("[A] more plausible explanation links the indeterminacy of Delaware law to the influence of the corporate bar, judicial preferences, and a court-centered legal culture.").

<sup>249</sup> See *infra* Part IV.A.2.c.i.

<sup>250</sup> WOLFE & PITTENGER, *supra* note 135, § 12.01[a] (footnote omitted).

<sup>251</sup> Weinberger v. UOP, Inc., 457 A.2d 701, 715 (Del. 1983). See also *Int'l Telecharge, Inc. v. Bemarko, Inc.*, 766 A.2d 437, 439 (Del. 2000); *GPC XLI L.L.C. v. Loral Space & Communs. Consol. Litig.*, 2008 Del. Ch. LEXIS 136, at \*119 (Del. Ch. Sept. 19, 2008) ("Our Supreme Court has emphasized the broad remedial power of this court to address breaches of the duty of loyalty"). See also WOLFE & PITTENGER, *supra* note 135, § 12.01[a] (footnote omitted); Jack B. Jacobs, *The Uneasy Truce Between Law and Equity in Modern Business Enterprise Jurisprudence*, 8 DEL. L. REV. 1, 5–9 (2005) (a transcribed version of the Regent's Lecture that Justice Jack B. Jacobs gave at the University of California, Los Angeles, School of Law on Feb. 3, 2005, in Los Angeles); Myron T. Steele & J.W. Verret, *Delaware's Guidance: Ensuring Equity for the Modern Witenagemot*, 2 VA. L. & BUS. REV. 189, 191–92 (2007).

<sup>252</sup> In some situations shareholders sought declaratory judgments. See, e.g., *Quickturn Design Sys., Inc. v. Shapiro*, 721 A.2d 1281 (Del. 1998) (plaintiff seeking both declaratory and injunctive remedies); *Air Products and Chemicals, Inc. v. Airgas, Inc.*, 16 A.3d 48 (Del. Ch. 2011) (same). For the explicit authority of the court to render declaratory judgments, see DEL. CODE ANN. tit. 10, §§ 6501–13 (2015). See also Del. Ch. Ct. R. 57. Sometimes the threshold issue is whether the claim is ripe: the court does not entertain the request unless the issue is fit for review in a situation where hardship will not result if it withholds its judgment. See, e.g., *Bebchuk v. CA, Inc.*, 902 A.2d 737, 740 (Del. Ch. 2007).

<sup>253</sup> See WOLFE & PITTENGER, *supra* note 135, §§ 12.01, 12.02[b].

(i) *Interlocutory Injunctions*

TROs and preliminary injunctions are interlocutory injunctions. Unlike a TRO, a motion for a preliminary injunction is typically heard after the parties have had an opportunity to take discovery and develop a record.<sup>254</sup> Unlike permanent injunctions, however, preliminary injunctions may be issued without having a full trial. Thus, it takes less time for the court to decide on motions for preliminary injunctions than permanent injunctions.<sup>255</sup>

In the context of control transactions, preliminary injunctions have been the most important tool for shareholders when they challenge Gatekeepers.<sup>256</sup> In a preliminary injunction proceeding, the applicant must show: (i) that there is a reasonable probability of success on the merits, (ii) that he or she will suffer an irreparable injury if such relief does not issue, and (iii) that the balance of the equities favors the issuance of the injunction, that is, that the harm from the injunction will not invite greater harm to the defendants, the public, or other identified interests.<sup>257</sup> These conditions are not mechanically applied, and the court may take into account the strength or weakness of the showing of each element to come to a final resolution.<sup>258</sup>

Both factual and legal issues can affect the likelihood of success. If the issues are factual, however, due to the absence of a full trial, the court seems reluctant to resolve them.<sup>259</sup> This approach helps the court reduce

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<sup>254</sup> See *supra* text accompanying note 231.

<sup>255</sup> See, e.g., *City Capital Assocs. Ltd. P'ship v. Interco Inc.*, 551 A.2d 787 (Del. Ch. 1988) (ordering a redemption of a poison pill; criticized as a "narrow and rigid construction of *Unocal*" and "reject[ed] . . . as not in keeping with a proper *Unocal* analysis" by *Paramount Commc'ns, Inc. v. Time Inc.*, 571 A.2d 1140, 1153 (Del. 1989)).

<sup>256</sup> See, e.g., WELCH ET AL., *MERGERS & ACQUISITIONS DEAL LITIGATIONS*, *supra* note 169, § 10.03[B][2] ("Deal litigation frequently involves a request by the plaintiff for a preliminary injunction preventing the parties to a merger or stock purchase agreement from completing the transaction."); Savitt, *supra* note 136, at 590 n.56 (stating the Chancery Court's "receptivity to preliminary injunction applications").

<sup>257</sup> See, e.g., *In re El Paso Corp. S'holder Litig.*, 41 A.3d 432, 435 (Del. Ch. 2012); *In re Del Monte Foods Co. S'holders Litig.*, 25 A.3d 813, 829–30, 39 (Del. Ch. 2011); *Lennane v. ASK Computer Sys., Inc.*, 1990 WL 154150, at \*6 (Del. Ch. Oct. 11, 1990). The Chancery Court has on occasion formulated the requirement differently and replaced the third element with the following two: "(3) a balance of the harms plaintiffs would suffer in the absence of an injunction against the harms defendant would suffer by the issuance of the injunction; and (4) the public interest." *In re CheckFree Corp. S'holders Litig.*, 2007 WL 3262188, at \*1 (Del. Ch. Nov. 1, 2007). See also *Wayne County Employees' Retirement Sys. v. Corti*, 954 A.2d 319, 329 n.16 (Del. Ch. 2008) (indicating that the modified formulation is in accord with *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 391 (2006)); *WOLFE & PITTENGER*, *supra* note 135, § 10.02[b][5]. The court, however, considers the fourth factor of the four-factor articulation within the third factor of the more common three-factor articulation. See, e.g., *Braunschweiger v. Am. Home Shield Corp.*, 1989 WL 128571, \*5 (Del. Ch. Oct. 26, 1980).

<sup>258</sup> See, e.g., *In re TWA, Inc. S'holders Litig.*, 1988 Del. Ch. LEXIS 139, at \*6–7 (Del. Ch. Oct. 21, 1988).

<sup>259</sup> See, e.g., *In re Digex, Inc. S'holder Litig.*, 789 A.2d 1176, 1188 n.36 (Del. Ch. 2000); *WOLFE &*

false positives or Type I errors in preliminary injunction proceedings.<sup>260</sup>

“Harm is irreparable unless ‘alternative legal redress [is] clearly available and [is] as practical and efficient to the ends of justice and its prompt administration as the remedy in equity.’”<sup>261</sup> If monetary damages are adequate, the requirement is not satisfied. Difficulty in calculating damages, however, may also lead to the inadequacy.<sup>262</sup> Further, if defendants do not have financial resources to pay potential damage awards or are not credit-worthy,<sup>263</sup> or if the law limits damage claims,<sup>264</sup> the adequacy of damage relief is also questionable. When controllers are sued in relation to freeze-outs, however, their ability to pay typically is not an issue.<sup>265</sup> In addition, Section 102(b)(7) does not protect the controllers.<sup>266</sup> In general, this should mean that it is more likely for the court to issue preliminary injunctions when directors are the only defendants than otherwise. Thus, the second requirement is applied generally in a manner to select cases where the use of

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PITTINGER, *supra* note 135, § 10.02[b][2].

<sup>260</sup> Thus, the court tends not to resolve “factual indeterminacy.” For the terminology, see *infra* note 301. For the error costs of anticipatory adjudication, see *supra* note 157. The approach will not reduce false negative decisions. However, the plaintiffs may have opportunities to seek relief after a trial, such as permanent injunctions and damage remedies in later proceedings.

<sup>261</sup> *In re Del Monte Foods Co. S’holders Litig.*, 25 A.3d 813, 838 (Del. Ch. 2011) (internal quotations and citations omitted) (quoting *T. Rowe Price Recovery Fund, L.P. v. Rubin*, 770 A.2d 536, 557 (Del. Ch. 2000)).

<sup>262</sup> See, e.g., *In re Staples, Inc.*, 792 A.2d 934, 960 (Del. Ch. 2001) (“[A]n after-the-fact damages case is not a precise or efficient method by which to remedy disclosure deficiencies.”); see also Savitt, *supra* note 136, at 583. As to the prevalence of disclosure only cases, see, for example, Strine et al., *Putting Stockholders First*, *supra* note 189, at 8–9.

<sup>263</sup> See, e.g., *In re El Paso Corp. S’holder Litig.*, 41 A.3d 432, 448 (Del. Ch. 2012) (stating that a defendant may be wealthy but not likely to be wealthy enough to pay a potential adverse judgment).

<sup>264</sup> See, e.g., *In re Del Monte Foods*, 25 A.3d at 838 (“Exculpation under Section 102(b)(7) can render empty the promise of post closing damages.”) (“For directors who have relied on qualified advisors chosen with reasonable care, Section 141(e) provides another powerful defense.”); see also WOLFE & PITTINGER, *supra* note 135, § 10.02[b][4][ii].

<sup>265</sup> See, e.g., *In re CNX Gas Corp. S’holders Litig.*, 4 A.3d 397, 420 (Del. Ch. 2010) (denying a motion for preliminary injunction, stating, among others things, that “[n]o question has been raised . . . to cast doubt on [the controller’s] solvency or ability to satisfy a damages award”). The availability of appraisal rights may be considered to tip the balance in favor of not granting injunctive relief. See, e.g., *In re Netsmart Tech., Inc. S’holders Litig.*, 924 A.2d 171, 210 (Del. Ch. 2007); *In re Lear Corp. S’holders Litig.*, 926 A.2d 94, 123 (Del. Ch. 2007); *La. Mun. Police Emps.’ Ret. System v. Crawford*, 918 A.2d 1172, 1185 (Del. Ch. 2007); *Koehler v. NetSpend Holdings Inc.*, 2013 WL 2181518, at \*22 (Del. Ch. May 21, 2013); *In re Answers Corp. S’holders Litig.*, 2011 Del. Ch. LEXIS 57, at \*38 n.87 (Del. Ch. Apr. 11, 2011). It, however, does not necessarily preclude the availability of anticipatory relief. See, e.g., *Cede & Co., v. Technicolor, Inc.*, 634 A.2d 345, 367 (Del. 1993); *Rabkin v. Philip A. Hung Chem. Corp.*, 498 A.2d 1099, 1104 (Del. 1985); cf. *Glassman v. Unocal Exploration Corp.*, 777 A.2d 242 (Del. 2001) (stating that absent fraud or misleading or inadequate disclosure, a short-form merger is contested only in an appraisal proceeding). Importantly, the direct and immediate benefits of such rights accrue only to those who have voted against such organic change and take other steps to perfect the rights. As to the hurdles of Delaware’s appraisal rights, see *supra* note 86.

<sup>266</sup> See, e.g., *In re Rural Metro Corp. S’holder Litig.*, 88 A.3d 54 (Del. Ch. 2014).

injunctions may be warranted under the analysis of Part III.C. above.

To satisfy the irreparable injury condition in preliminary injunction proceedings, there must also be a threat of an injury that will occur before a trial and will not be fully remediable by final equitable relief, such as permanent injunctions<sup>267</sup> and rescissions.<sup>268</sup> In Delaware, this determination often translates into a determination whether the final relief can be rendered before a collective action by shareholders on the recommendation by the defendant Gatekeeper. Often, after the shareholder decision date, due to the TPs anticipatory relief also becomes inadequate. Thus, for example, the Chancery Court once stated that a shareholder vote:

[C]an be reversed or . . . declared invalid, the effect of reversing any exercise of ‘the will of the stockholder’, even for their own benefit, is to create an insurmountable obstacle of confusion and antipathy. The Plaintiffs will not be able to achieve the real remedy, i.e., a fair proxy contest with an informed electorate. This disadvantage in waging a later contest substantially tips the “balance of harms” in favor of the Plaintiffs.<sup>269</sup>

This is entirely consistent with Part III.C. above.

Further, the court does not grant a preliminary injunction if the “harm, discounted by its likelihood, is greater than harm to any other person that the granting of the relief would occasion, discounted by its probability of its occurring.”<sup>270</sup> Even if the court decisions are rendered before shareholder decision dates, it is possible that the decisions or conduct of the Gatekeepers have already caused procedural harms that are not easily reversible often due to the twin problems. In such cases, injunctions have restorative effects.<sup>271</sup> The balancing of the equities requirement allows the court to refrain from rendering preliminary injunctions in such situations, which is not inconsistent with Part III.C. above.

Delaware allows mandatory preliminary injunctions. For example, in a contested acquisition, if the target has already adopted a rights plan and the

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<sup>267</sup> See, e.g., *Gradient OC Master, Ltd. v. NBC Universal, Inc.*, 930 A.2d 104, 132 (Del. Ch. 2007); *City Capital Assocs. Ltd. P’ship v. Interco, Inc.*, 551 A.2d 787, 795 (Del. Ch. 1988); see also WOLFE & PITTENGER, *supra* note 135, § 10.02[b][4][i].

<sup>268</sup> Also rescissory damages, i.e., “a ‘money award designed to be as nearly as possible the financial equivalent of rescission.’” *MAXXAM, Inc./Federated Dev. S’holders Litig. v. MAXXAM, Inc.*, 659 A.2d 760, 775 n.15 (Del. Ch. 1995). Sometimes this requirement is considered only implicitly. See, e.g., *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 185 (Del. 1986).

<sup>269</sup> *American Pac. Corp. v. Super Foods, Servs., Inc.*, 1982 WL 8767, at \*326 (Del. Ch. Dec. 6, 1982); see also *Third Point LLC v. Ruprecht*, 2014 WL 1922029, at \*24 (Del. Ch. May 2, 2014) (making a similar statement in a case involving a flawed proxy context for the election of directors).

<sup>270</sup> *Crown Books Corp. v. Bookstop, Inc.*, 1990 WL 26166, at \*731 (Del. Ch. Feb. 28, 1990); *Pitts v. City of Wilmington*, 2009 WL 1204492, at \*4 (Del. Ch. Apr. 27, 2009), *reconsideration denied*, 2009 WL 1515580 (Del. Ch. May 29, 2009).

<sup>271</sup> See *supra* notes 112, 135.

bidder needs to avoid a dilution resulting from the rights plan, the bidder may seek an affirmative injunction requesting that the target board redeem the plan before a trial.<sup>272</sup> In addition, the availability of a mandatory injunction sometimes allows the court to fine-tune its remedy.<sup>273</sup> They are restorative. If the court decisions are rendered before the shareholder decision date, however, they do not reverse shareholder decisions. Therefore, mandatory preliminary injunctions are consistent with Parts III.B. and III.C. above.<sup>274</sup>

“An applicant for a TRO requires the applicant to show a colorable claim, an imminent irreparable harm that will be suffered if the TRO does not issue, and a balance of equities favoring issuance of the TRO.”<sup>275</sup> A motion for a TRO may be due if, from a timing standpoint, the plaintiff is not in a position to go through “discovery, develop a record, and present legal arguments to the court in an orderly, if expedited, fashion,”<sup>276</sup> and TROs generally provide for scheduling for related preliminary injunction proceedings and limit their durations based on such schedules.<sup>277</sup> TROs can be issued through *ex parte* proceedings<sup>278</sup> but are uncommon in the context of control transactions.<sup>279</sup> For the reasons stated above in relation to prelimi-

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<sup>272</sup> See, e.g., *Grand Metropolitan PLC v. Pillsbury Co.*, 558 A.2d 1049 (Del. Ch. 1988); *City Capital Assocs. Ltd. P’ship v. Interco Inc.*, 552 A.2d 787 (Del. Ch. 1988); *Mills Acquisition Co. v. Macmillan, Inc.*, 1988 WL 108332, at \*18–19 (Del. Ch. Oct. 18, 1988), *rev’d on other grounds*, 559 A.2d 1261 (Del. 1989). There are situations where shareholders have time to seek permanent injunctions. See the first two cases cited in *supra* note 252.

<sup>273</sup> For example, when a disclosure claim relating to proxy materials is made, the court may choose to obligate a supplemental disclosure rather than completely enjoin the shareholders meeting to which the proxy materials relate.

<sup>274</sup> Generally, mandatory injunctions need to meet higher thresholds. See, e.g., *Pomilio v. Caserta*, 215 A.2d 924, 925 (Del. 1965) (stating that mandatory injunctions are “issuable only in the exercise of extraordinary judicial caution”); *Steiner v. Simmons*, 111 A.2d 574, 575 (Del. 1955) (stating that a mandatory injunction “will not issue unless the legal right to be protected is clearly established”); *In re El Paso Corp. S’holder Litig.*, 41 A.3d 432, 451 n.61 (Del. Ch. 2012). Mandatory preliminary injunctions, if proved to be wrong, may have irreversible consequences in which the court proceeds even more cautiously. See, e.g., *Kingsbridge Capital Group v. Dunkin’ Donuts, Inc.*, 1989 Del. Ch. LEXIS 87, at \*13 (“a great likelihood of eventual success should a full trial be held”).

<sup>275</sup> WELCH ET AL., *MERGERS & ACQUISITIONS DEAL LITIGATION*, *supra* note 169, § 10.03[A]. “[T]he merit based standard for a TRO is often lower than for a preliminary injunction,” and “the emphasis is on the risk of imminent irreparable harm.” *Id.*

<sup>276</sup> WOLFE & PITTENGER, *supra* note 135, § 10.02[a].

<sup>277</sup> *Id.*; see, e.g., *Robert M. Bass Group, Inc. v. Evans*, 552 A.2d 1227, 1228 (Del. Ch. 1988), *appeal dismissed on the basis of mootness*, 548 A.2d 498 (Del. 1988) (indicating that expedited discovery ensued after the issuance of a TRO).

<sup>278</sup> Del. Ch. Ct. R. 65(b). See Frederick P. Santarelli, *Preliminary Injunctions in Delaware: The Need for a Clearer Standard*, 13 DEL. J. CORP. L. 107 (1988).

<sup>279</sup> WELCH ET AL., *MERGERS & ACQUISITIONS DEAL LITIGATION*, *supra* note 169, § 10.03[B][1][a]. For an exception, see *MacAndrews & Holdings, Inc. v. Revlon, Inc.* 501 A.2d 1239, 1243 (Del. 1986). Further, they cannot last more than ten days unless extended by the court during the original period. Del. Ch. Ct. R. 65(b).

nary injunctions, conditions for TROs are also consistent with Parts III.B. and II.C. above.

(ii) *Permanent Injunctions*

“To obtain injunctive relief, [the applicant] must not only prove ‘actual success on the merits,’ but also ‘irreparable harm’ and that ‘the harm resulting from a failure to issue an injunction outweighs the harm to [the other party] if the court issues the injunction.’”<sup>280</sup> Thus, as indicated in the context of preliminary injunctions,<sup>281</sup> the court may not issue permanent injunctions unless the plaintiffs would suffer irreparable injuries. The primary issue is whether damage remedies would provide full and effective relief,<sup>282</sup> and if not, the irreparable injury requirement is typically met.<sup>283</sup> As to the balancing of the equities requirement,<sup>284</sup> it is an important factor in crafting the relief.<sup>285</sup> These conditions for permanent injunctions are also generally consistent with Parts III.B. and III.C.<sup>286</sup>

(b) Speed

The following long quotation from a 1987 remark by an associate justice of the Delaware Supreme Court vividly illustrates how takeover disputes were brought and resolved in Delaware:

First, let me explain the legal context in which some of the more recent, “celebrated” cases have arisen. The *Unocal* and *Revlon* cases are perfect examples. The court of chancery almost invariably gets the case on short notice, usually in the context of a preliminary injunction to enjoin one side or the other. The injunction is either granted or denied, and immediately—in fact, even before the order is issued—calls come to the supreme court, generally

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<sup>280</sup> *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*, 56 A.3d 1072, 1144 (Del. Ch. 2012) (quoting COPI of *Del., Inc. v. Kelly*, 1996 Del. Ch. LEXIS 136, at \*11 (Del. Ch. Oct. 25, 1996)), *aff’d*, 68 A.3d 1208 (Del. 2012) (as corrected on July 12, 2012). *See also* *Airo Assocs., L.P. v. Hayward*, 2003 Del. Ch. LEXIS 112, at \*24–25 (Del. Ch. Apr. 1, 2003); *cf.* *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 391 (2006).

<sup>281</sup> *See infra* Part IV.A.2.a.i.

<sup>282</sup> *See, e.g., In re Delphi Fin. Grp. S’holder Litig.*, 2012 Del. Ch. LEXIS 45, at \*68–69 (Del. Ch. Mar. 6, 2012); *In re Silicon Inc., S’holders Litig.*, 2001 Del. Ch. LEXIS 83, at \*17 (Del. Ch. June 13, 2001).

<sup>283</sup> *WOLFE & PITTENGER*, *supra* note 135, § 12.02[e].

<sup>284</sup> *Id.* § 12.02[f].

<sup>285</sup> *Id.*; *see also* *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*, 68 A.3d 1208, 1227–28 (Del. 2012) (stating that the Chancery Court crafted the appealed injunctive remedy with relative equities in mind).

<sup>286</sup> Plaintiffs sometimes seek redemption of rights plans. *See supra* note 272 and accompanying text.

from both counsel, saying: “We understand that at four o’clock today the court of chancery is going to release its decision in the XYZ case, and no matter who wins, the loser is going to seek an immediate conference to apply for an interlocutory appeal.” The justice preliminarily responsible for hearing such matters that month gives the parties an appointment at four o’clock, or shortly thereafter. . . . What we do, after the motion justice confers with the court, is to set the case down for briefing and oral argument on a very tight schedule. One brief may be due the next day, the answering brief two days later, and a reply brief a day later, brief oral argument the following day, and a decision announced from the bench either at the conclusion of the oral argument, or the next morning before the stock exchanges open officially.<sup>287</sup>

The foregoing remains valid today.<sup>288</sup> Equally important for shareholders seeking anticipatory adjudication is a credible commitment to timely adjudication. “The State of Delaware’s investment in a Chancery Court and a Supreme Court that can act with the speed and expertise to meet the business community’s needs is an important element of service it provides to its corporate domiciliaries and their stockholders.”<sup>289</sup>

Therefore, “motions for expedited proceedings . . . are available procedural avenues in virtually any suit commenced in the Court of Chancery in which such treatment is shown to be necessary.”<sup>290</sup> The court upon motion<sup>291</sup> ordinarily gives expedited treatment when interlocutory injunctions are sought.<sup>292</sup> Proceedings for permanent relief—which requires a trial un-

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<sup>287</sup> Andrew G. T. Moore, II and Bayless Manning, *State Competition: Panel Response*, 8 CARDOZO L. REV. 779, 780 (1987) (remarks by Andrew G.T. Moore, II) (footnote omitted). See also William H. Rehnquist, *The Prominence of the Delaware Court of Chancery in the State-Federal Joint Venture of Providing Justice*, 48 BUS. LAW. 351, 354 (1992) (“Because the Court of Chancery . . . has no jurisdiction over criminal and tort cases . . . corporate litigation can proceed quickly and effectively. The Delaware Supreme Court, similarly, is poised to act quickly in important corporate cases.”); *Box v. Box*, 697 A.2d 395, 398 (Del. 1997) (citing Chief Justice William H. Rehnquist’s article).

<sup>288</sup> See Black & Kraakman, *A Self-Enforcing Model*, *supra* note 15, at 1914 (stating that [Delaware] judges involved in takeover contests make decisions overnight to ensure that judicial delay does not kill a challenged transaction); Kurt M. Heyman, *Expedited Proceedings in the Delaware Court of Chancery: Things of the Past?*, 23 DEL. J. CORP. L. 145, 145 (1998) (“In that time, the court developed an estimable reputation for its willingness and ability to hear litigants on an expedited basis and to render decisions quickly enough to keep pace with the fast-moving demands of business.”) (footnote omitted).

<sup>289</sup> Leo E. Strine, Jr., “Mediation-Only” Filings in the Delaware Court of Chancery: *Can New Value Be Added by One of America’s Business Courts?*, 53 DUKE L.J. 585, 588 (2003).

<sup>290</sup> WOLFE & PITTENGER, *supra* note 135, § 8.01.

<sup>291</sup> *Id.* A motion for a summary judgment, a TRO, or a preliminary injunction must accompany a motion for an expedited proceeding. Del. Ch. Ct. R. 3(bb)(1).

<sup>292</sup> See, e.g., Savitt, *supra* note 136, at 582–84. If such treatment is granted, various default periods are shortened. Thus, “[e]xpedited cases are unique. The Court gives them priority. Counsel should give them similar priority.” DEL. CH. CT., GUIDELINES TO HELP LAWYERS PRACTICING IN THE COURT OF CHANCERY II.4.e.i., <http://courts.delaware.gov/chancery/docs/CompleteGuidelines2014.pdf> [hereinafter

less a summary judgment can be issued—may also be expedited.<sup>293</sup> When a request for expedited treatment is granted, the parties move on a fast-track basis, know more about the timing of the court events in advance,<sup>294</sup> and if feasible, adjust deal schedules. The court is also ready and willing to move fast if it is legitimately necessary from a deal perspective.<sup>295</sup> Since there is no jury, it does not slow the court.<sup>296</sup> The Chancery Court also has the ability to summarily dispose of a claim when “there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law.”<sup>297</sup> Summary judgment is a method for prompt disposition of actions in which there is no genuine material factual issue, and it may be issued without a trial.<sup>298</sup>

Under certain circumstances, the Delaware Supreme Court also allows expedited appeals<sup>299</sup> in which the case briefing, oral argument, and decision are conducted and rendered in a compressed time frame.<sup>300</sup> To meet the needs of the parties, it is not unusual for the supreme court to announce its decisions promptly after oral argument and issue full-blown written opinions later.<sup>301</sup>

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GUIDELINES TO HELP LAWYERS]. With respect to unusual instances in which the court refused to grant such treatment, see WOLFE & PITTENGER, *supra* note 135, § 10.07.

<sup>293</sup> Obviously, however, due to the heavy costs of such an expedited process imposed on the court as well as the respondents, the court needs to have the power to refuse to entertain such requests: “[T]he court is likely to deny an application for expedition if there is no colorable theory of irreparable harm or if the plaintiffs unreasonably delayed in bringing their companion motion for interim equitable relief.” Heyman, *supra* note 288, at 146. *See also, e.g., In re Blockbuster Entertainment Corp. S’holders’ Litig.*, 1994 WL 89011 (Del. Ch. Mar. 1, 1994) (denying a motion for a scheduling conference due to the plaintiff’s delay in filing a lawsuit despite the party’s awareness of the transaction the party sought to enjoin temporarily). With respect to the use of laches to deny expedition, see WELCH ET AL., *MERGERS & ACQUISITIONS DEAL LITIGATION*, *supra* note 169, § 2.02[C][1]. If the court becomes strict in granting the expedited treatment that plaintiffs’ lawyers request, it could encourage them to file lawsuits elsewhere. *See, e.g., Armour et al., Delaware’s Balancing Act*, *supra* note 61, at 1367.

<sup>294</sup> *See* WOLFE & PITTENGER, *supra* note 135, § 10.07.

<sup>295</sup> The Chancery Court’s uncrowded docket helps it move quickly when necessary. *See infra* text accompanying note 308.

<sup>296</sup> *See infra* text accompanying notes 321–322. In other states, litigants opt out of the use of juries if they are available. *See infra* text accompanying note 350.

<sup>297</sup> Del. Ch. Ct. R. 56(c). *See generally* Samuel Issacharoff & George Loewenstein, *Second Thoughts About Summary Judgment*, 100 *YALE L.J.* 73 (1990).

<sup>298</sup> Summary judgments issue when only “lexical indeterminacy” exists and there is no “fact-based indeterminacy.” For the distinction between “lexical indeterminacy” and “fact-based indeterminacy” and the implications of the distinction, see Bray, *supra* note 100.

<sup>299</sup> Del. Sup. Ct. R. 25(d). *See, e.g., Quickturn Design Sys., Inc. v. Shapiro*, 721 A.2d 1281 (Del. 1998); *Interco Inc. v. City Capital Assocs. L.P.*, 556 A.2d 1070 (Del. 1988).

<sup>300</sup> WELCH ET AL., *MERGERS & ACQUISITIONS DEAL LITIGATION*, *supra* note 169, § 12.07[B].

<sup>301</sup> *See, e.g., Martin Marietta Materials, Inc. v. Vulcan Materials Co.*, 68 A.3d 1208 (Del. 2012) (a formal opinion dated July 10, 2012, and as corrected on July 12, 2012, issued after announcing its decision on May 31, 2012); *Paramount Commc’ns, Inc. v. QVC Network Inc.*, 637 A.2d 828 (Del. 1993) (a short order was issued on Dec. 9, 1993, followed by a full written opinion on Feb. 4, 1994); *Paramount*



The judiciary also has a weapon to encourage shareholders not to sit idle when they have chances to seek anticipatory relief. It can use the equitable doctrine of laches.<sup>302</sup> In expedited proceedings the judiciary gives them priority but also expects counsel to give similar priority.<sup>303</sup>

(c) Expertise and Flexibility

(i) *Chancery Court*

The Delaware Court of Chancery is a court of equity<sup>304</sup> and is a court of limited jurisdiction.<sup>305</sup> No other courts in Delaware handle equity.<sup>306</sup> Under the jurisdictional setup, the court's docket turned out to consist significantly of corporate matters—in particular corporate governance matters relating to public company mergers and acquisitions (M&As)—which makes the court a specialist in the area.<sup>307</sup> The arrangement also contributes to “[a] sufficiently un-crowded docket [that] permits urgent cases to be resolved expeditiously.”<sup>308</sup>

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*Comme'ns, Inc. v. Time Inc.*, 571 A.2d 1140, 1142 (Del. 1990) (a written opinion dated Feb. 26, 1990 and revised Mar. 9, 1990, explaining the rationale for a bench ruling rendered on July 24, 1989, *Literary Partners, L.P. v. Time Inc.*, 565 A.2d 280 (Del. 1989)); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985) (a written opinion dated June 10, 1985, explaining the rationale for an oral ruling rendered on May 17, 1985).

<sup>302</sup> See, e.g., *Ryan v. Lyondell Chem. Co.*, No. 3176-VCN, 2008 WL 2923427, \*21 n.128 (Del. Ch. July 29, 2008) (citing the possible use of the doctrine of laches to bar a claim for monetary damages for a defective disclosure when the shareholder had an ample opportunity to seek an injunctive remedy). For the use of laches to deny a motion for expedition, see *supra* note 293. In expedited proceedings, the judiciary gives them priority but also expects counsel to give similar priority.

<sup>303</sup> See *GUIDELINES TO HELP LAWYERS*, *supra* note 292, at II.4.e.i.

<sup>304</sup> DEL. CODE ANN. tit. 10, § 341 (2014) (“The Court of Chancery shall have jurisdiction to hear and determine all matters and causes in equity.”).

<sup>305</sup> DEL. CODE ANN. tit. 10, § 342 (2014) (“The Court of Chancery shall not have jurisdiction to determine any matter wherein sufficient remedy may be had by common law, or statute, before any other court or jurisdiction of this State.”); *Clark v. Teeven Holding Co.*, 625 A.2d 869, 875 (Del. Ch. 1992) (stating that the court is a general court of equity having “the same jurisdiction as the English High Court of Chancery had in 1776”). Its subject matter jurisdiction was expanded, for example, by the Delaware Business Corporation Act. See, e.g., WOLFE & PITTENGER, *supra* note 135, § 2.02. That the Chancery Court is a court of equity does not necessarily preclude it from awarding damages. For example, claims for damages for violation of equitable rights, such as those based on fiduciary obligations, are within the court's jurisdiction. See *Harman v. Masoneilan Int'l, Inc.*, 442 A.2d 487, 500 (Del. 1982). See also WOLFE & PITTENGER, *supra* note 135, § 12.10[2].

<sup>306</sup> See Dreyfuss, *supra* note 159, at 8. Delaware regards class actions as well as derivative suits equitable in nature. *Id.* at 7.

<sup>307</sup> See *id.* at 5–8. “Delaware's small size and its many corporate charters” contribute to the concentration. Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 85 NW. U. L. REV. 542, 589 (1990).

<sup>308</sup> Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749, 1760 (2006).

The chancellor and four vice chancellors<sup>309</sup> are nominated by the Governor of Delaware and confirmed by the state's Senate for 12-year terms.<sup>310</sup> The nomination and confirmation process focuses on the expertise and competence of the appointees and is generally divorced from party politics.<sup>311</sup> Judges are appointed to the court on "their expertise in Delaware corporate law and cannot help but become even more expert by virtue of their deep and continuous exposure to that law."<sup>312</sup> "[T]he five Delaware Chancery judges frequently compare notes about . . . emerging corporate law issues, which enable[] them to begin mulling over new developments long before a particular dispute arises."<sup>313</sup> These traditions and practices further enhance the quality of and coherence in the adjudications the court makes.<sup>314</sup>

In the 1960s, the court was more deferential to decisions made by fiduciaries in relation to control transactions than it is today.<sup>315</sup> By the mid-1980s, "equitable principles took on an entirely new dimension,"<sup>316</sup> and the court started to assert its abilities and powers related to equity more in adjudicating disputes relating to control transactions.<sup>317</sup> Such tradition remains intact.<sup>318</sup> As a court of equity, the court is less constrained by precedents and the range of available remedies, and it resolves disputes based on the

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<sup>309</sup> DEL. CONST. art. IV, § 2; DEL. CODE ANN. tit. 10, § 307 (2014).

<sup>310</sup> DEL. CONST. art. IV, § 3 (as amended through 1997).

<sup>311</sup> Kahan & Rock, *Symbiotic Federalism*, *supra* note 49, at 1603. *See also* David A. Skeel, Jr., *The Unanimity Norm in Delaware Corporate Law*, 83 VA. L. REV. 127, 133–34 (1997) (in connection with the selection of Delaware Supreme Court Justices).

<sup>312</sup> Savitt, *supra* note 136, at 585.

<sup>313</sup> Armour & Skeel, *supra* note 8, at 1749. *See also* Savitt, *supra* note 136, at 595 ("The judges consult with one another on thorny new matters, further ensuring that each has a substantially complete view of the field.").

<sup>314</sup> *See, e.g.*, Dreyfuss, *supra* note 159, at 16–19. The quality and coherence may be lost if non-Delaware courts render decisions on Delaware corporation law issues. For the recent surge of lawsuits filed with non-Delaware courts, *see supra* note 61.

<sup>315</sup> Jacobs, *supra* note 251, at 6 ("[B]efore the 1970s, corporate law jurisprudence fell closer to the 'law' than the 'equity' side. . . . [T]he 1960s were the tail end of a decades-long era during which courts were far less skeptical about the motivations, and were far more confident of the decisions, of corporate managers and boards than they are today.").

<sup>316</sup> *Id.* at 8.

<sup>317</sup> The court started to favor the equity side in the 1970s, and this trend accelerated in the 1980s. *See id.* at 4–9 (referring to, as examples of cases creating such a shift to the equity side, *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985); *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986); *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988)).

<sup>318</sup> *See generally* Jacobs, *supra* note 251, at 9–15. Recently, a noted M&A litigator made the following observation regarding the Chancery Court's evolving jurisprudence: "[A] system of mergers and acquisition regulation that resembles old-fashioned equitable judging, but which yields special benefits typically obtained only through the operation of modern regulatory agencies." Savitt, *supra* note 136, at 571.

particular facts of the disputes brought before it.<sup>319</sup> The court's broad discretion to fashion remedies allows it to craft prescriptions that are efficiency enhancing under the particular set of facts.<sup>320</sup>

As a court of equity, the Chancery Court has no juries.<sup>321</sup> This assures that the court resolves factual issues quickly, even in situations in which trials need to be held,<sup>322</sup> and without the risk of making errors that may result from having a lay jury.<sup>323</sup>

(ii) *Supreme Court*

Decisions of the Court of Chancery may be appealed directly to the Delaware Supreme Court, and “[i]f needed, appeals from the Court of Chancery are heard by the Delaware Supreme Court quickly and decided promptly after oral argument.”<sup>324</sup>

The Supreme Court justices are, like the judges of the Chancery Court, nominated by the Governor of Delaware and confirmed by the state's senate.<sup>325</sup> As with the nomination and confirmation of Chancery Court judges,<sup>326</sup> the process is largely divorced from party politics and focuses on the expertise and competence of the appointees.<sup>327</sup> “[N]ot all of the Supreme Court's cases are corporate law cases. . . . But the corporate law cases have

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<sup>319</sup> See Steele & Verrett, *supra* note 251, at 191 (“The Delaware Court of Chancery, as an equity court, has wide latitude to craft remedies and mold precedent to fit particular fact patterns in the tradition of the English High Court of Chancery.”). See also William B. Chandler III, *On the Instructiveness of Insiders, Independents, and Institutional Investors*, 67 U. CIN. L. REV. 1083, 1096 (1999); Susan Black, *A New Look at Preliminary Injunctions: Can Principles from the Past Offer Any Guidelines to Decision Makers in the Future?*, 36 ALA. L. REV. 1, 4–5 (1984); Kamar, *supra* note 151, at 1943; Fisch, *supra* note 151, at 1071.

<sup>320</sup> See, e.g., *In re Del Monte Foods Co. S'holders Litig.*, 25 A.3d 814, 818–19 (Del. Ch. 2011) (preliminarily enjoining the board of a target company from holding a stockholder meeting for twenty days to allow a potential topping bid). As to the efficiency-enhancing effects, see Part III.C.2 above.

<sup>321</sup> DEL. CONST. art. IV, § 10; *Park Oil, Inc. v. Getty Ref. & Mktg. Co.*, 407 A.2d 533, 535 (Del. 1979); *Getty Ref. & Mktg. Co. v. Park Oil, Inc.*, 385 A.2d 147, 150 (Del. Ch. 1978).

<sup>322</sup> See, e.g., Fisch, *supra* note 151, at 1077; Stephen J. Massey, *Chancellor Allen's Jurisprudence and the Theory of Corporate Law*, 17 DEL. J. CORP. L. 683, 703–04 (1992) (stating that the absence of a jury enables the court “to respond rapidly to parties' requests”).

<sup>323</sup> See, e.g., Gilson et al., *supra* note 89, at 207 n.105 (“A lay jury as the trier of fact is a significant independent source of potential error in complex commercial cases.”). As a court of equity, the court traditionally does not have the power to award penalties. See, e.g., *Beals v. Washington Int'l, Inc.*, 386 A.2d 1156, 1159 (Del. Ch. 1979) (regarding punitive damages); *WOLFE & PITTINGER*, *supra* note 135, § 2.05.

<sup>324</sup> Kahan & Rock, *Symbiotic Federalism*, *supra* note 49, at 1605.

<sup>325</sup> DEL. CONST. art. IV, § 3.

<sup>326</sup> See *supra* Part IV.A.2.c.i.

<sup>327</sup> Kahan & Rock, *Symbiotic Federalism*, *supra* note 49, at 1603. The Delaware Constitution provides that three of the justices are of “one major political party” and two are of “the other major political party.” DEL. CONST. art. IV, § 3.

an obvious prominence.<sup>328</sup> Since the beginning of 2014, four justices have retired from the court. Out of the four replacements, three are experienced in corporate control matters.<sup>329</sup> The fact that there is only one trial court, and only one appellate review of the trial court decisions contributes further to consistent and speedy resolution of disputes related to control transactions.<sup>330</sup>

## B. Other States

### 1. Strategies to Reduce the Twin Problems of Initiation and Prosecution of Lawsuits

#### (a) Collective Action Problems re Initiation and Prosecution of Lawsuits

Most states recognize opt-out class actions, and as in Delaware,<sup>331</sup> many states have class action systems based on Rule 23 of the Federal Rules of Civil Procedure.<sup>332</sup> Thus, Delaware is not unique in this respect. Neither the common fund doctrine<sup>333</sup> nor the substantial benefit doctrine<sup>334</sup> is unique to Delaware's judiciary.<sup>335</sup> Further, issue preclusion, which can be used to address or ameliorate CAPs in relation to lawsuits against Gatekeepers, is not unique to Delaware either.<sup>336</sup>

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<sup>328</sup> Skeel, *supra* note 311, at 134 n.21. See also Mitchell L. Bach & Lee Applebaum, *A History of the Creation and Jurisdiction of Business Courts in the Last Decade*, 60 BUS. LAW. 216 n.583 (2004) (calling the Delaware Supreme Court "a pre-eminent 'business court'" due to the importance of the corporate cases it deals with and the time the court spends on corporate matters); Dreyfuss, *supra* note 159, at 28–29.

<sup>329</sup> See, e.g., *Markell's Supreme Court, and a Missed Opportunity*, DELAWARELIBERAL.NET (Feb. 24, 2015), <http://www.delawareliberal.net/2015/02/24/markells-supreme-court-and-a-missed-opportunity>; see also Kahan & Rock, *Symbiotic Federalism*, *supra* note 49, at 1602 ("[S]everal of the five supreme court justices . . . are former members of the chancery court.").

<sup>330</sup> See, e.g., Dreyfuss, *supra* note 159, at 28.

<sup>331</sup> See *supra* note 172.

<sup>332</sup> See, e.g., FRIEDENTHAL ET AL., *supra* note 228, at 774; CLASS ACTION & DERIVATIVE SUITS COMM. OF ABA, *THE LAW OF CLASS ACTION: FIFTY-STATE SURVEY 2012–2013* (Elizabeth J. Cabraser & Fabrice N. Vincent eds., 2013).

<sup>333</sup> Ferdinand S. Tinio, *Attorneys' Fees in Class Actions*, 38 A.L.R. 3d 1384, §§ 4[a], 4[b] (1971); *Knebel v. Capital Nat'l Bank in Austin*, 519 S.W.2d 795, 799 (Tex. 1975) (citing 49 A.L.R. 1149, 1150, 1170, 1171; 107 A.L.R. 749) (stating that the doctrine "has been recognized with approval in Texas and elsewhere, particularly in federal jurisdictions"); 20 AM. JUR. 2D *Costs* § 65 (2014).

<sup>334</sup> See, e.g., Tinio, *supra* note 333, § 4[c]; 20 AM. JUR. 2D *Costs* § 67 (2014).

<sup>335</sup> For a compilation of cases relating to attorneys' fees in class actions generally, see Tinio, *supra* note 333; 1 ROBERT L. ROSSI, *ATTORNEYS' FEES* § 7:10 (3d ed. 2013); Adolf Homburger, *State Class Actions and the Federal Rule*, 71 COLUM. L. REV. 609 (1971).

<sup>336</sup> See generally, e.g., 47 AM. JUR. 2D *Judgments* §§ 487–500 (2014). Unlike Delaware, however, some courts still require that both parties to the proceedings be identical. See *id.* § 491.

(b) Asymmetric Information Problems re Initiation and Prosecution  
of Lawsuits

Again, nearly all states have discovery.<sup>337</sup> As in Delaware,<sup>338</sup> many states have discovery regimes based on the Federal Rules of Civil Procedure.<sup>339</sup> Delaware is not known to have standards for the burden of proof that are systemically different from those of other jurisdictions.<sup>340</sup> Further, burden-shifting<sup>341</sup> techniques that can be used to address or ameliorate AIPs in relation to lawsuits against Gatekeepers are not unique to Delaware.<sup>342</sup>

2. *Strategies to Avoid Ex post Restorative Relief to Undo a  
Shareholder Collective Decision or Transaction*

(a) Anticipatory Adjudication

In deciding whether to grant preliminary injunctions, generally, the following are the “four most important factors”:

- (1) the significance of the threat of irreparable harm to plaintiff if the injunction is not granted;
- (2) the state of the balance between this harm and the injury that granting the injunction would inflict on defendant;
- (3) the probability that plaintiff will succeed on the merits; and
- (4) the public interest.<sup>343</sup>

The approach is substantially analogous to that of Delaware.<sup>344</sup> The same is true with respect to both permanent injunctions<sup>345</sup> and TROs.<sup>346</sup>

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<sup>337</sup> See, e.g., FRIEDENTHAL ET AL., *supra* note 228, at 397.

<sup>338</sup> See *supra* note 215.

<sup>339</sup> See, e.g., 23 AM. JUR. 2D *Depositions and Discovery* § 2 (2014).

<sup>340</sup> See generally, 29 AM. JUR. 2D *Evidence* § 173 (2014); 32A C.J.S. *Evidence* §§ 1624, 1627 (2014); RICHARD H. FIELD ET AL., *MATERIALS FOR A BASIC COURSE IN CIVIL PROCEDURES* 1344–32 (10th ed. 2010.)

<sup>341</sup> See generally, e.g., 31A C.J.S. *Evidence* § 203 (2014); 29 AM. JUR. 2D *Evidence* § 175 (2013). See also *supra* text accompanying notes 240–242.

<sup>342</sup> See *supra* text accompanying notes 240–242.

<sup>343</sup> 11A CHARLES ALAN WRIGHT ET AL., *FEDERAL PRACTICE AND PROCEDURE* 122–24 (3d ed. 2013).

<sup>344</sup> See *supra* Part IV.A.2.a. Delaware’s regular formulation does not explicitly mention the fourth requirement. However, when appropriate Delaware takes the fourth requirement into account. See *supra* note 257.

<sup>345</sup> See generally 43A C.J.S. *Injunctions* § 28 (2014). As to Delaware, see *supra* Part IV.A.2.a.ii. With respect to permanent injunctions, the U.S. Supreme Court recently stated that the following are the requirements:

- (1) that [the plaintiff] has suffered an irreparable injury; (2) that remedies available at law, such as monetary damages, are inadequate to compensate for that injury; (3) that, considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warrant-

Declaratory judgments are also available in non-Delaware jurisdictions.<sup>347</sup> Therefore, in non-Delaware jurisdictions in the United States generally, anticipatory adjudication is an available tool to address the TPs or the issues the TPs present.

(b) Speed

It has been observed that courts in states other than Delaware “also move quickly on high profile corporate cases where time is of the essence.”<sup>348</sup> As stated, there has been a significant recent increase in the number of lawsuits filed outside Delaware.<sup>349</sup> Since it is not likely that plaintiffs’ lawyers will file lawsuits with courts they know will not be able to move speedily, the increase also seems to suggest that there are non-Delaware courts that can render decisions quickly. The existence of a jury could slow the judicial proceedings. However, the parties do not appear to have incentives to choose a jury trial.<sup>350</sup>

(c) Expertise and Flexibility

There are a number of specialized business courts.<sup>351</sup> No other judiciary, however, is remotely as specialized as the Delaware judiciary with respect to shareholder lawsuits against corporate fiduciaries of public companies, such as those against Gatekeepers. The number of courts of equity in

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ed; and (4) that the public interest would not be disserved by a permanent injunction. *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 391 (2006). The Delaware Chancery Court noted that the Supreme Court’s formulation is in accord with the Chancery Court’s formulation of requirements for preliminary injunctions. *Wayne Cnty. Emps.’ Ret. Sys. v. Corti*, 954 A.2d 319, 329 (Del. Ch. 2008). For the analyses of the Supreme Court case, see, for example, Mark P. Gergen et al., *The Supreme Court’s Accidental Revolution? The Test for Permanent Injunctions*, 112 COLUM. L. REV. 203 (2012); Rachel M. Janutis, *The Supreme Court’s Unremarkable Decision in eBay Inc. v. MercExchange, L.L.C.*, 14 LEWIS & CLARK L. REV. 597 (2010).

<sup>346</sup> See generally, e.g., 43A C.J.S. *Injunctions* § 31. Unlike Delaware’s, however, this formulation maintains a merit standard almost identical with the one for preliminary injunctions. For Delaware’s formulation, see *supra* note 277.

<sup>347</sup> See generally, e.g., 26 C.J.S. *Declaratory Judgments* § 169 (2014).

<sup>348</sup> Black, *supra* note 307, at 590.

<sup>349</sup> See *supra* text accompanying note 61.

<sup>350</sup> See, e.g., Matthew D. Cain & Steven Davidoff Solomon, *A Great Game: The Dynamics of State Competition and Litigation*, 100 IOWA L. REV. 465, 477 (2015) (“No transaction in our sample is decided by a jury . . .”).

<sup>351</sup> See Bach & Applebaum, *supra* note 328, at 147; Lee Applebaum, *The Steady Growth of Business Courts in National Center for State Courts*, in FUTURE TRENDS IN STATE COURTS 2011 70 (2011), <http://www.ncsc.org/sitecore/content/microsites/future-trends-2011/home/Specialized-Courts-Services/~media/Microsites/Files/Future%20Trends/Author%20PDFs/Applebaum.ashx>. This should not suggest that specialization of judges occurs only in a specialized court. See *supra* note 159.

the United States is small.<sup>352</sup> Further, at the turn of the twentieth century the Chancery Court of Delaware adhered more closely to the English Chancery Court than did those of any other states.<sup>353</sup> Therefore, the Chancery Court of Delaware is almost systemically different from most others in the United States with respect to its ability to handle shareholder lawsuits against Gatekeepers.

### C. Summary

U.S. state judiciaries generally have tools to satisfy the Stage I prerequisites. However, this is not necessarily the case with respect to the Stage II prerequisites. Delaware's judiciary is unique compared to the other state judiciaries in its ability to engage in anticipatory adjudication in relation to shareholder lawsuits against Gatekeepers. In large measure, Delaware's judiciary has strategies, tools, and attributes to implement the solutions to the TPs or the issues they raise at Stage II. The speed, expertise, and flexibility of the Delaware judiciary are particularly crucial for anticipatory adjudication, and the supremacy of Delaware's judiciary in shareholder lawsuits against Gatekeepers has normative foundations. The court's expertise and specialization also makes it most qualified to alleviate attorney agency costs, especially in opt-out class actions seeking anticipatory adjudication. The "indeterminacy" of its judgments in the context of anticipatory adjudication is not as malignant as the term implies and is even benign.

## V. NON-US JURISDICTIONS

### A. Introduction

There is no single perfect solution for the dilemmas identified in Parts II.A. and II.B. that works for all jurisdictions<sup>354</sup> or all companies.<sup>355</sup> Presumably, judiciaries are the default institutions that solve legal disputes in most countries. Therefore, it seems worthwhile to examine whether non-U.S. jurisdictions, as in the United States, have judiciaries equipped to intervene and solve the dilemmas. There appears to be no reason for non-U.S. judiciaries to be spared from the CAPs and the AIPs that plague the judiciaries in the United States. Do they have effective strategies and tools to

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<sup>352</sup> See, e.g., Curtis Alva, *Delaware and the Market for Corporate Charters: History and Agency*, 15 DEL. J. CORP. L. 885, 903 (1990); see also WOLFE & PITTINGER, *supra* note 135, § 1.01.

<sup>353</sup> See William T. Quillen & Michael Hanrahan, *A Short History of the Delaware Court of Chancery, 1772–1992*, 18 DEL. J. CORP. L. 819, 840 (1993).

<sup>354</sup> See, e.g., Black & Kraakman, *A Self-Enforcing Model*, *supra* note 15, at 1952–63 (proposing models for emerging markets).

<sup>355</sup> See, e.g., Enriques et al., *The Case for an Unbiased Takeover Law*, *supra* note 37, at 5 (“[I]ndividual companies should be able to decide ‘who decides.’”).

solve TPs? Japan is a rare jurisdiction that has given directors and controlling shareholders the authority to Gatekeep for dispersed shareholders and, without a designated substitute organ or institution, lets judiciaries police them.<sup>356</sup> Japan's experience will be used to illustrate possible differences between the judiciaries in the United States and elsewhere and to highlight international ramifications of the use of judiciaries to police Gatekeepers.

This section first confirms that Japan basically uses the U.S. model. Part V.B. then examines whether Japan's judiciary satisfies the Stage I prerequisites and the Stage II prerequisites. Part V.C. considers the feasibility of judicial policing in other non-U.S. jurisdictions.

## B. Japan

### 1. Background

#### (a) Landscape

A recent study indicates that Japan's listed companies have dispersed ownership structures. While those structures are not as straightforward as the level of dispersion suggests,<sup>357</sup> the TPs in Japan appear to be no less acute than those in the United Kingdom or the United States. There are also controlled companies with dispersed minority shareholders.<sup>358</sup> The minority shareholders also suffer from the TPs.

The provisions of Japanese Companies Act (JPN Companies Act) are more shareholder-centric than those of the Delaware General Corporation Law.<sup>359</sup> The business and affairs of the companies, however, are managed

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<sup>356</sup> The Enterprise Chamber of the Amsterdam Court of Appeal appears to be another example. *See, e.g.,* J. van Bekkum et al., *Corporate Governance in the Netherlands*, 14.3 ELEC. J. COMP. L. 22 para. 3.2.2. (2010), [www.ejcl.org/143/abs143-17.html](http://www.ejcl.org/143/abs143-17.html).

<sup>357</sup> *See, e.g.,* Julian Franks et al., *The Ownership of Japanese Corporations in the 20th Century* 47 (Eur. Corp. Governance Inst., Fin. Working Paper Series No. 410/2014, 2014), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2397142](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2397142) ("Japan has . . . become more outside in relating to the presence of outside investors but it has not in the Anglo-American sense."); Edward Rock et al., *Fundamental Changes*, in *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* ch. 7, § 3.7 (Reinier Kraakman et al., 2d ed., 2009) (pointing out, for example, the existence of manager-friendly shareholders having business ties with the issuers); Rafael La Porta et al., *Corporate Ownership Around the World*, 54 J. FIN. 471 (1999).

<sup>358</sup> "356 or 15.6% of TSE-listed companies have controlling shareholders. Out of these, 67.7% (10.6% overall) have parent companies, and 32.3% (5.1% overall) have controlling shareholders other than parent companies." TOKYO STOCK EXCHANGE INC., TSE-LISTED COMPANIES WHITE PAPER ON CORPORATE GOVERNANCE 2013 7 (2013), <http://www.tse.or.jp/rules/cg/white-paper/b7gje6000005ob1-att/b7gje6000003ukm8.pdf>.

<sup>359</sup> This is not surprising, since corporation laws in the United States, in particular the Delaware General Corporation Law, are the most board centric among those in Germany, France, Italy, Japan, the United Kingdom, and the United States. *See generally,* Enriques et al., *The Basic Governance Structure:*



by or are under the direction of boards of directors.<sup>360</sup> Most of the major techniques to effect control transactions in Delaware or their functional equivalents now exist in Japan. Controllers can freeze out minority shareholders with a two-thirds supermajority vote.<sup>361</sup> In general, Japanese companies are able to issue or distribute shares or share warrants without specific shareholder approval and without being subject to shareholder preemption rights.<sup>362</sup>

The Japanese tender offer rules and the U.K. Takeover Code have features referred to by similar nomenclatures. As described below, however, Japan regulates control transactions fundamentally differently from how the Takeover Panel does under the Takeover Code. Rather, the combination of the JPN Companies Act and tender offer and proxy rules presents a regime much closer to the U.S. model. As in the United States,<sup>363</sup> in Japan the task of policing Gatekeepers in control transactions falls on the judiciary.<sup>364</sup>

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*The Interests of Shareholders as a Class*, *supra* note 117, § 3.7. In June 2014 the JPN Companies Act was significantly amended. *See* Kaishahō no ichibu wo kaiseisuru hōritsu [Law to Make Partial Amendments to the Companies Act], Law No. 90 of 2014 (Japan). The amendments made the JPN Companies Act slightly less enabling.

<sup>360</sup> Kaisha-hō [Companies Act], Law No. 86 of 2005, art. 362 (Japan). Most Japanese companies listed on the exchanges in Japan have two boards, a board of directors and a board of statutory auditors. Statutory auditors have compliance functions. *Id.* art. 390. It is a common view, however, that they have not effectively performed such functions. *See, e.g.*, KENJIRO EGASHIRA, KABUSHIKIKAISHAHŌ [LAW OF STOCK CORPORATIONS] 511–11 (5th ed. 2015). A small fraction of Japanese public companies have boards of directors only. Law No. 86 of 2005, art. 404 (Japan). For the percentage of the Japanese companies listed on the Tokyo Stock Exchange with boards of directors only, see TOKYO STOCK EXCHANGE INC., *supra* note 358, at 14 (stating that these companies “account for only 2.2% of TSE-listed companies”). After the 2014 JPN Company Act Amendments, Japanese companies are allowed to have “audit committees” in their boards of directors. Law No. 86 of 2005, art. 2, para. 1, item 11-2, art. 326, para. 2, art. 327, para. 1, item 3 (Japan). Either way, for practical purposes these types of boards of directors have functions largely analogous to those of Delaware corporations in relation to control transactions. Unless otherwise stated, however, this paper focuses on the companies with both a board of directors and a board of statutory auditors.

<sup>361</sup> *See infra* Part V.B.1.b.ii.

<sup>362</sup> Law No. 86 of 2005, art. 201, para. 1 (Japan). Due to the 2014 JPN Company Act Amendments, shareholder approval generally is now required when the transaction would create a majority owner of the issuer and shareholders owning 10% or more object to the transaction. *Id.* art. 206, para. 2. *Cf.* TOKYO STOCK EXCHANGE INC., SECURITIES LISTING REGULATIONS 78–79 [http://www.jpx.co.jp/english/rules-participants/rules/regulations/tvdivq000001vyt-att/securities\\_listing\\_regulations\\_20141201.pdf](http://www.jpx.co.jp/english/rules-participants/rules/regulations/tvdivq000001vyt-att/securities_listing_regulations_20141201.pdf) (making the requirement not mandatory).

<sup>363</sup> *See supra* Part II.C.

<sup>364</sup> *See, e.g.*, TOSHIYUKI TAMAI, KAISHAHŌ NO KISEIKANWA NI OKERU SHIHŌ NO YAKUWARI [ROLE OF JUDICIARY AFTER LIBERALIZATION OF CORPORATION LAW] 302–03 (2009) (stating that the Japanese judiciary should play roles similar to the Delaware judiciary). In one respect the JPN Companies Act relies more on the judiciary, since it does not have an antitakeover statute analogous to Section 203 of the Delaware General Corporation Law. *See infra* note 513. “Internationally, corporate law rules are to a large extent publicly enforced.” Kahan & Rock, *Symbiotic Federalism*, *supra* note 49, at 1605. In this respect Japan follows the international norm, and the JPN Companies Act has retained, among others, provisions criminalizing certain director misbehavior. *See, e.g.*, Law No. 86 of 2005, arts. 960 (violation

In the second half of the last decade, the Japanese judiciary showed its willingness to assume such a role by essentially referring to a standard that evokes *Unocal* in determining whether the distribution or issuance of share warrants uses as a defense measure should be enjoined.<sup>365</sup> Transplantation of additional enhanced substantive judicial standards to determine Gatekeepers' compliance with their duties in relation to control transactions has also been discussed.<sup>366</sup> There seems to be a growing shared sense, however, that policing by the Japanese judiciary has been less than optimal. The disenchantments are expressed mainly as proposals either to tweak the current regime or to adopt a regime similar to the U.K. model.<sup>367</sup> The underlying assumption of these views is that in general the Japanese judiciary has operated at suboptimal levels.<sup>368</sup>

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of duties, including fiduciary duties), 964 (false disclosures), 967 (receipt of bribe) (Japan).

<sup>365</sup> For the provisions of the JPN Companies Act that were relied on, see *infra* text accompanying notes 500–504. For chronological developments in the last 10 years, see Curtis J. Milhaupt, *In the Shadow of Delaware? The Rise of Hostile Takeovers in Japan*, 105 COLUM. L. REV. 2171 (2005); Kenichi Osugi, *Transplanting Poison Pills in Foreign Soil*, in TRANSFORMING CORPORATE GOVERNANCE EAST ASIA Part I.2 (Hideki Kanda et al. eds., 2008); Curtis J. Milhaupt, *Bull-Dog Sauce for the Japanese Soul? Courts, Corporations, and Communities—A Comment on Haley's View of Japanese Law*, 8 WASH. U. GLOBAL STUD. L. REV. 345, 348–56 (2009) [hereinafter Milhaupt, *Bull-Dog Sauce*]; Armour et al., *The Evolution of Hostile Takeover Regimes*, *supra* note 86, at 250–57.

<sup>366</sup> For example, in the REX II Tokyo High Court decision, the court acknowledged directors' general duties to make a fair disclosure and to achieve an objectively fair price for shareholders. See *infra* note 571. However, first, the court did not explicitly state that directors owe fiduciary duties directly to shareholders. Second, it is unclear if the duty to achieve a fair price is an obligation analogous to the *Revlon* duty in Delaware. See HIDEFUSA IIDA, *Rekkusu hōrudingusu songaibaishō seikyūjiken kōsai hanketsu no kentō (jō)* [Examination of REX Holdings Damage Suits Tokyo High Court Judgment Part I], 2022 SHŌJI 4, 8–9 (2014); HIDEFUSA IIDA, *Rekkusu hōrudingusu songaibaishō seikyūjiken kōsai hanketsu no kentō (ge)* [Examination of REX Holdings Damage Suits Tokyo High Court Judgment Part II], 2023 SHŌJI 17, 21–23 (2014). See also SHIRAI, *supra* note 139, at 505 (recommending an adoption of the *Revlon* duty). As to the duty to disclose under Delaware law, see, for example, *Arnold v. Soc'y for Sav. Bancorp*, 650 A.2d 1270, 1277 (Del. 1994); as to the *Revlon* duty in Delaware, see *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 185 (Del. 1986). As to controllers' fiduciary duties to minority shareholders, see *infra* text accompanying note 417.

<sup>367</sup> See generally, HIDEFUSA IIDA, *Kōkaikaisuke kisei no kaikaku—Ōshūgata no gimuteki kōkaikaisuke no taishutsuken no kangaekata wo donyūsubeki ka* [Reforming Tender Offer Regulation: Should A Mandatory Bid Rule Used in Europe Be Introduced?], 1933 SHŌJI 14 (2011); WATARU TANAKA, KIGYŌBAISHŪ TO BŌEISAKU [CORPORATE ACQUISITIONS AND DEFENSES] 394–406 (2012).

<sup>368</sup> In 2004 when Japanese lawyers were cooking up Japanese-style pills, Ronald Gilson warned that “it would be a serious mistake to underestimate the weight of” “the burden of assuring the sensible operation of the poison pill.” See Ronald J. Gilson, *The Poison Pill in Japan: The Missing Infrastructure*, 2004 COLUM. BUS. L. REV. 21, 42 (2004). The warning was timely but was not well heeded. There are optimistic views as to the future transformation of the Japanese judiciary as well. See, e.g., SHIRAI, *supra* note 139, at 533–34.

(b) Basic Legal Framework for Control Transactions

Under the JPN Companies Act, one may acquire 100% of another company through a merger<sup>369</sup> or a share exchange<sup>370</sup> using cash as a consideration. Due mostly to the dual entity-level tax of the target or controlled company and the shareholder-level tax applicable in one-step cash acquisitions,<sup>371</sup> cash freeze-outs have been effected through de facto reverse stock splits.<sup>372</sup> Further, in most control transactions—including friendly acquisitions—tender offers precede the de facto reverse stock splits. This could be due in part to a perceived reduction of risks arising from the direct involvement of Gatekeepers in freezing out minority shareholders in the de facto reverse stock splits.<sup>373</sup>

(i) Tender Offer

Japan's tender offer rules, when legislated in 1971, were largely modeled after the Williams Act enacted in the United States in 1968.<sup>374</sup> However, due to significant amendments in 1990 and in the last decade, the rules have diverged in many respects from their U.S. counterpart. The current Japanese rules are highly technical, and it is difficult to see any single coherent policy behind them. As described below, the rules require that certain share purchases be made in the form of a formal (or conventional) tender offer (the JPN MBR) and are often referred to with names identical with or similar to those used to refer to the U.K. MBR, such as “mandatory offer rules”<sup>375</sup> or “mandatory bid rules.”<sup>376</sup>

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<sup>369</sup> Law No. 86 of 2005, art. 2, para. 1, no. 27 (Japan).

<sup>370</sup> *Id.* no. 31.

<sup>371</sup> Hōjinzei hō [Corporation Tax Act], Law No. 34 of 1965, arts. 62, 62-9 (Japan). The entity-level tax is questionable from a tax policy standpoint. The JPN Companies Act does allow forward triangular mergers but does not allow reverse triangular mergers. *See, e.g., id.* art. 749, para. 1 (not requiring that a merger agreement include a provision relating to consideration payable to the surviving companies' shareholders).

<sup>372</sup> The de facto reverse stock split requires at least conceptually successive amendments to the subject company's articles of incorporation followed by a redemption of all the outstanding shares for a new class of stock at a ratio that would cause all the shareholders other than the shareholder who would become the sole owner to notionally receive fractions of the new class of stock payable in cash. *See* Law No. 86 of 2005, art. 108, para. 1, no. 7, art. 111, para. 2, no. 1, art. 171, para. 1, no. 1, item *i*, art. 173, art. 234, para. 1, no. 2 (Japan). After the 2014 JPN Company Act Amendments, it is clear that actual reverse stock splits may be used to squeeze out minority shareholders. *See id.* arts. 182-4, -5 (appraisal rights).

<sup>373</sup> *See infra* text accompanying notes 419–421. This combined with the entity-level tax creates a perverse effect analogous to one that existed at least before the adoption of the unified standard by the Delaware Chancery Court in *In re CNX Gas Corp. S'holder Litig.*, 4 A.3d 397 (Del. Ch. 2010). *See, e.g.,* Subramanian, *Post-Siliconix Freeze-outs*, *supra* note 16.

<sup>374</sup> With respect to the Williams Act, *see supra* Part ILC.

<sup>375</sup> Tomotaka Fujita, *The Takeover Regulation in Japan: Peculiar Developments in the Mandatory*

They generally require a tender offer for anyone to purchase voting shares of a reporting company through any off-market<sup>377</sup> transaction: (i) if, after the purchase, the purchaser would have acquired shares from eleven or more persons during the sixty-one day period ending on the date of the relevant purchase and would own more than 5% of the voting shares of the target company,<sup>378</sup> or (ii) if, after the purchase, the purchaser would have acquired shares from ten or fewer persons during the sixty-one day period ending on the date of the relevant purchase and would own more than one-third of the voting shares of the target company.<sup>379</sup> Further, the following may not be made outside a tender offer: (a) any on-market purchase executed on a non-auction market of an exchange after which the acquiring person would own more than one-third of the voting shares of the target company,<sup>380</sup> and (b) when a person acquires in a three-month period more than 10% of a company's voting shares more than 5% of which consist of shares acquired off market or on a non-auction market of an exchange and, after the acquisitions, owns more than one-third of the shares of the company, the purchases of outstanding shares among such acquisitions.<sup>381</sup> No off-market purchase, however, needs to be made through a tender offer if, after the relevant purchase, the purchaser would not have made off-market purchases from eleven or more persons during the sixty-one day period ending on the date of the relevant purchase, has already owned more than 50% of the target company as of the first of the off-market purchases during the sixty day period, and would own less than two-thirds of the voting shares of

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*Offer Rule*, 3 UT SOFT L. REV. 24, 30 (2011).

<sup>376</sup> Davies & Hopt, *supra* note 19, § 8.2.5.4; Curtis J. Milhaupt & Mark D. West, *Institutional Change and M&A in Japan: Diversity Through Deals*, in GLOBAL MARKETS, DOMESTIC INSTITUTIONS: CORPORATE LAW AND GOVERNANCE IN A NEW ERA OF CROSS-BORDER DEALS 295, 306 (Curtis J. Milhaupt ed., 2003). Hereinafter the Japanese tender offer rules requiring that share purchases be made through tender offers will be the JPN MBR.

<sup>377</sup> For the purposes of the application of the rule described in (i), certain trading through designated alternative trading systems is treated as on-market trading. Kinyūshōhin torihikihō [Financial Instruments and Exchange Act], Law No. 25 of 1948, art. 27-2, para. 1, no. 1 (Japan); Kinyūshōhin torihikihō shikōrei [Financial Instruments and Exchange Act Cabinet Order], Cabinet Order No. 321 of 1965, art. 6-2, para. 2, no. 2, para. 3 (Japan).

<sup>378</sup> Law No. 25 of 1948, art. 27-2, para. 1, no. 1, art. 27-2, para. 1, no. 1 (Japan); Cabinet Order No. 321 of 1965, art. 6-2, para. 3, art. 7 (Japan).

<sup>379</sup> Law No. 25 of 1948, art. 27-2, para. 1, no. 2 (Japan); Cabinet Order No. 321 of 1965, art. 6-2, para. 3 (Japan). However, subject to the exception described in (C) below, no purchases through an alternative trading market may be made if, after the purchase, the purchaser's ownership percentage would exceed 1/3. *See* Law No. 25 of 1948, art. 27-2, para. 1, no. 6 (Japan); Cabinet Order No. 321 of 1965, art. 7, para. 7, no. 1 (Japan).

<sup>380</sup> Law No. 25 of 1948, art. 27-2, para. 1, no. 3 (Japan).

<sup>381</sup> Law No. 25 of 1948, art. 27-2, para. 1, no. 4 (Japan); Cabinet Order No. 321 of 1965, art. 7, paras. 2-4 (Japan).

the target.<sup>382</sup>

Under the tender offer rules, tender offer periods must be at least twenty business days, but unless an exception is applicable, not longer than sixty business days.<sup>383</sup> The offers must be made to all holders and at the same prices.<sup>384</sup> In general, no purchases outside the tender offers may be made during the tender offer periods.<sup>385</sup> Partial tender offers are prohibited when the offerors have the potential to acquire two-thirds or more of the shares through such offers.<sup>386</sup> There is a proration requirement when a partial offer is made.<sup>387</sup>

As indicated, similar nomenclature is used to refer to the JPN MBR and the U.K. MBR. The two, however, call for fundamentally different roles for the boards of the target companies.<sup>388</sup> As stated,<sup>389</sup> the U.K. MBR requires holders of 30% or more of the shares of a company to launch a general offer for the remaining shares at the best price paid for shares during the preceding twelve months. This minimizes shareholder CAPs and coercive effects that would result but for the requirement.

First, the JPN MBR does not prohibit partial offers except in cases where the bidders through the offers would end up owning two-thirds or more of the target shares. Second, while the JPN MBR obligates the offerors to give the same prices to all tendering shareholders,<sup>390</sup> it permits the bidders to pay less than the prices they pay before the commencement of the tender offers. Third, they do not require those who have acquired control to make an offer to buy the remaining shares. The effects of the Japanese tender offer rules are much closer to the combined effects of the Rules on Substantial Acquisition of Shares (or the SARs), abolished in 2006, and

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<sup>382</sup> Law No. 25 of 1948, art. 27-2, para. 1 (proviso) (Japan); Cabinet Order No. 321 of 1965, art. 6-2, para. 1, no. 4 (Japan).

<sup>383</sup> Law No. 25 of 1948, art. 27-2, para. 2 (Japan); Cabinet Order No. 321 of 1965, art. 8, para. 1 (Japan). Therefore, for example, a bidder who has launched a tender offer may have to launch a new tender offer if the Japanese judiciary fails to resolve the bidder's dispute with the target before the initial tender offer period ends.

<sup>384</sup> Law No. 25 of 1948, art. 27-2, para. 3 (Japan); Cabinet Order No. 321 of 1965, art. 8, paras. 2-3 (Japan).

<sup>385</sup> Law No. 25 of 1948, art. 27-5 (Japan).

<sup>386</sup> *Id.* art. 27-2, para. 5; Cabinet Order No. 321 of 1965, art. 8, para. 5, no. 3 (Japan); Hakkōsha igai no mononiyoru kabuken tō no kōkaikaitusuke no kaiji ni kansuru naikakufurei [Prime Minister's Office Ordinance Concerning Disclosure Relating to Third Party Tender Offers for Shares, etc.], Ministry of Fin. Ordinance No. 38 of 1990, art. 5 (Japan).

<sup>387</sup> Law No. 25 of 1948, art. 27-13, para. 5 (Japan). Further, there are rules modeled on Sections 13(d) and 13(g) of the Securities Exchange Act. *Id.* arts. 27-23 to 27-30.

<sup>388</sup> *See, e.g.,* Fujita, *supra* note 375, at 24. The JPN MBR is not the proration version of the equal opportunity rule either. *See* Bebchuk, *Efficient and Inefficient Sales*, *supra* note 18, at 960.

<sup>389</sup> *See supra* Part II.C.

<sup>390</sup> Law No. 25 of 1948, art. 27-2, para. 2 (Japan); Cabinet Order No. 321 of 1965, art. 8, para. 2 (Japan).

Rule 5 of the Takeover Code except that the Japanese rules slow down share accumulations more significantly than the U.K. rules.<sup>391</sup> Therefore, the JPN MBR does not address the coordination/coerciveness issues that the U.K. MBR addresses. For example, the JPN MBR does not prevent a coercive two-step acquisition. Thus, unlike the U.K. MBR, the JPN MBR cannot afford to adopt the no-frustrating action rule. By default, the Japanese judiciary is put in a position to police target boards' Gatekeeping activities.<sup>392</sup>

(ii) *Freeze-outs*

Freeze-out transactions may be used as the second step in noncontrollers' acquisitions of corporate control<sup>393</sup> or as preexisting controllers' minority freeze-out transactions. Under the JPN Companies Act, there are several ways to freeze out minority shareholders for cash, provided either that a two-thirds supermajority vote is obtained at a shareholders' meeting<sup>394</sup> or that the controllers own 90% or more of the company.<sup>395</sup> Due to the same

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<sup>391</sup> See RS 2005/4 Issued on 21 April 2005.

<sup>392</sup> For a prominent example of the use of a poison pill in Japan, see Saikō Saibansho [Sup. Ct.] Aug. 7, 2007, Hei 19 (kyo) no. 30, 61 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 2215 (Japan), <http://www.courts.go.jp/hanrei/pdf/20070927142919.pdf>. The four authorities cited in *supra* note 366 discuss the case. A number of Japanese companies have adopted a variation of a rights plan (or poison pill) in the United States. See, e.g., HIDEKI KANDA, KAISHAHŌ [COMPANY LAW] 162 n.3 (17th ed. 2015) [hereinafter KANDA, COMPANY LAW] (giving rights plans and golden shares as examples of possible defense measures). As of the end of July 2013, approximately 14.5% of Japanese public corporations in Japan had such plans. Mogi Miki & Koji Tani, *Tekitaitekibaishū bōeisaku no dōnyū jyōkyō* [Status of the Adoption of Defense Measures against Hostile Acquisitions; An Analysis After June 2013 Shareholder Meeting Season], 2012 SHŌJI 49, 50 (2013). Authorized shares specified in the issuer's articles of incorporation may not exceed four times as much as the outstanding shares. Kaisha-hō [Companies Act], Law No. 86 of 2005, art. 37, para. 3, art. 113, paras. 3–4, art. 184, para. 2 (Japan). Thus, the dilutive effects of Japanese poison pills are limited. Staggered boards are possible. However, the maximum term of office is two years. *Id.* art. 332. In addition, shareholders can remove board members for no cause at any time at a shareholders meeting. *Id.* art. 341. At the substantive law level, these make Japanese pills weaker than the pills for Delaware corporations. See, e.g., TANAKA, *supra* note 367, at 317–21 (a preprint of an article with Peng Xu) (giving an example where a Japanese company lost to a hostile suitor in a proxy fight despite the use of a pill). As to the strength of poison pills combined with staggered boards, see Bebchuk et al., *The Powerful Antitakeover Force of Staggered Boards*, *supra* note 154; Bebchuk et al., *The Powerful Antitakeover Force of Staggered Boards: Further Findings and a Reply to Symposium Participants*, 55 STAN. L. REV. 885 (2002).

<sup>393</sup> Note that the de facto reverse stock split method described in note 372 does not work unless the acquiring person is already the largest shareholder of the subject company.

<sup>394</sup> See *supra* text accompanying notes 369–371.

<sup>395</sup> Law No. 86 of 2005, art. 784, para. 1 (short-form mergers and share exchanges) (Japan). After the 2014 JPN Company Act Amendments, it is possible for a shareholder owning 90% or more of a company to choose to buy out the remaining shareholders if the company's board consents to the buy-out. *Id.* arts. 179 to 179-10.

Japanese tax that makes one-step cash acquisitions unpopular,<sup>396</sup> however, most freeze-outs have been effected through de facto reverse stock splits.<sup>397</sup>

The controllers, whether they become controllers after the first step of a two-step transaction or are preexisting controllers, are not prohibited from voting their shares if shareholder consent is required.<sup>398</sup> Moreover, if the freeze-out is the second step of a two-step acquisition, there is no statutory requirement that the proceeds payable to the minority on a per share basis should be no less than the price paid in the first step tender offer.<sup>399</sup> Thus, the regime for freeze-outs in Japan is closer to that in the United States, and if there is anyone that can step in to fill the gap and police controllers acting as Gatekeepers in freeze-out transactions, it is the Japanese judiciary.

The JPN MBR economically discourages bidders from establishing control positions short of 100% ownership, because they are unable to subsequently resell the entire controlling positions except in response to a tender offer. The all holders rule, the same price rule, and the proration requirement make it impossible for the controller-resellers to obtain the prices that reflect the control premiums the controlling interests should otherwise command. Rule 5.2(a) of the Takeover Code allows controllers to sell their positions to others outside an offer. However, the U.K. MBR obligates the buyers of such positions to make a general offer. Therefore, as in Japan, those buying from the controllers are unable to pay control premiums exclusively to the controllers. Consequently, the U.K. MBR also economically discourages the establishment of control positions. As indicated, however, unlike the U.K. MBR, in general the JPN MBR does not prevent partial offers. Thus, if bidders wish, it is easy in Japan for the bidders to establish controlling positions owning the percentage of shares desirable for the bidders.<sup>400</sup> If the controllers later wish to resell their interests without sharing the control premiums with the minority shareholders, they may first try to freeze out the minority shareholders at a price reflecting a minority discount and then sell their entire interests to third parties.<sup>401</sup> Thus, there may be a stronger need for the Japanese judiciary to police controllers in freeze-out transactions than in the United States.

## 2. *Strategies to Reduce the Twin Problems of Initiation and*

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<sup>396</sup> See *supra* text accompanying note 371.

<sup>397</sup> See *supra* note 372.

<sup>398</sup> For the possibility of a revocation of the shareholder resolutions, see *infra* text accompanying note 418.

<sup>399</sup> For anticipatory relief that may be available for minority shareholders, see *infra* Part V.B.3.a.i.

<sup>400</sup> As to the percentage of controlled companies listed on the Tokyo Stock Exchange, see *supra* note 358.

<sup>401</sup> Alternatively, the controllers may first sell up to one-third of the controlled company shares at a premium and subsequently sell a portion of the rest in response to a tender offer. The strategy should permit the controllers to partially escape the predicament of the JPN MBR.

*Prosecution of Lawsuits*

(a) Collective Action Problems re: Initiation and Prosecution of  
Lawsuits

The circumstances in which shareholders have direct claims against Gatekeepers are limited. Japan lacks opt-out class actions. Further, the rules and current practices regarding allocation of costs of lawsuits do not help alleviate CAPs. The Japanese Supreme Court also declined to follow a scholarly suggestion<sup>402</sup> to recognize issue preclusion under certain circumstances.<sup>403</sup>

(i) *Class Actions*

Plaintiffs' lawyers seem to use postal mail<sup>404</sup> and Internet sites<sup>405</sup> to attract shareholders willing to join in filing shareholder lawsuits. In December 2013, a class action act was enacted.<sup>406</sup> The act adopts an opt-in system that allows a qualified consumer organization to file lawsuits seeking the enforcement of certain types of monetary claims by individuals against businesses relating to contracts between the individuals and the businesses.<sup>407</sup> At least preliminarily, the act does not seem to have any applicability to shareholder claims against Gatekeepers.<sup>408</sup>

At present the list of recognized shareholder fiduciary duty claims against Gatekeepers is small. There is, however, room for the Japanese judiciary to consider additional types of shareholder fiduciary duty claims.<sup>409</sup> The small size of the list appears to be a reflection of the scarcity of shareholder fiduciary duty lawsuits that—to a significant extent—have resulted

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<sup>402</sup> See, e.g., MAKOKO ITO, MINJI SOSHŌHŌ [CIVIL PROCEDURE LAW] 563–69 (4th ed. 2014).

<sup>403</sup> Saikō Saibansho [Sup. Ct.] July 20, 1956, Shō 29 (o) no. 110, 10 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 965 (Japan). The JPN Companies Act has provisions that expand the binding effects of judgments to rescind or declare void certain corporate actions beyond the immediate parties to the lawsuits. Kaisha-hō [Companies Act], Law No. 86 of 2005, art. 828 (Japan). For example, a court decision to declare a shareholder resolution void has such effects. *Id.*

<sup>404</sup> Shareholders are entitled to inspect share registers. Law No. 86 of 2005, art. 125 (Japan).

<sup>405</sup> See, e.g., Kazunari Otsuka, *Naze nihondewa shōkensoshō ga kappatsuka shina no ka* [Why in Japan Securities Lawsuits Have Not Been Vibrant?], KINYŪZAISEIJIJŌ, June 3, 2013, at 14 (Japan).

<sup>406</sup> Shōhisha no zaisantekihigai no shūdantekina kaifuku no tameno minjitetsuzuki no tokurei ni kansuru hōritsu [Law Relating to Special Civil Procedural Measures for the Collective Recovery of Financial Damages Suffered by Consumers], Law No. 96 of 2013 (Japan). The law, however, has not taken effect yet.

<sup>407</sup> *Id.* art. 3.

<sup>408</sup> Under the traditionally prevailing view, Japanese corporations are not contractual constructs, and there are no contractual relationships between shareholders and directors. See, e.g., EGASHIRA, *supra* note 360, at 56–58.

<sup>409</sup> See *infra* notes 412, 417.



from the procedural deficiencies discussed in this Part V.B.2., which has deprived the Japanese judiciary of the opportunities to exercise “lawmaking and law enforcement powers”<sup>410</sup> and to expand the list of such direct claims.

Directors owe statutory duties of care and loyalty to companies.<sup>411</sup> Under the traditionally prevailing view, they do not owe fiduciary duties directly to shareholders.<sup>412</sup> The growing trend, however, is toward a view that they in fact owe such duties.<sup>413</sup> Anyone, including a shareholder, has a statutory right to directly sue directors for damages if the directors knowingly or grossly negligently breach their duties and as a consequence cause damages to the person.<sup>414</sup> Shareholders may also directly sue directors for damages under a tort theory.<sup>415</sup> Finally, the JPN Companies Act provides specific circumstances in which shareholders may seek to enjoin certain corporate and director actions.<sup>416</sup>

Under the prevailing view, controlling shareholders do not owe fiduciary duties either to the companies or to minority shareholders.<sup>417</sup> If a share-

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<sup>410</sup> Katharina Pistor & Chenggang Xu, *Fiduciary Duties in Transitional Civil Law Jurisdictions: Lessons from the Incompleteness of Law Theory*, in GLOBAL MARKETS, DOMESTIC INSTITUTIONS: CORPORATE LAW AND GOVERNANCE IN A NEW ERA OF CROSS-BORDER DEALS 78, 78 (Curtis J. Milhaupt ed., 2003).

<sup>411</sup> Kaisha-hō [Companies Act], Law No. 86 of 2005, arts. 330 (subjecting directors to the same duties that agents generally owe to their principals), 355 (imposing the duty of loyalty) (Japan). The duty of loyalty provision is a 1950 transplant from the United States. For the historical origin of the duty of loyalty and analysis of how after a long incubation period it started to show signs of life, see Hideki Kanda & Curtis J. Milhaupt, *Re-examining Legal Transplants: The Director's Fiduciary Duty in Japanese Corporate Law*, 51 AM. J. COMP. L. 887, 893–96 (2003). As stated, a recent case recognized directors' duty to disclose. *See infra* note 571.

<sup>412</sup> For various positions on this issue, see Yo Ota & Masahiro Yano, *Taikō-teki baishū teian wo uketa taishōkaisha torishimariyaku ha ikani kōdōsubeki ka: Wagakuni kaishahō to Reburon “gimu” [How Should Target Directors Act When Competing Bids Surface?: Our Company Act and Revlon “Duty”]*, in M&A HŌMU NO SAISENTAN [FRONTIERS OF M&A LAW] 42–46 (Masakazu Iwakura & Yo Ota eds., 2010).

<sup>413</sup> *See, e.g., id.* at 45–46 (listing academic authorities taking this position); TAMAI, *supra* note 364, at 306–09.

<sup>414</sup> Law No. 86 of 2005, art. 429, para. 1 (Japan). *See also* Saikō Saibansho [Sup. Ct.], Nov. 26, 1969, no. 11, 23 Saikō Saibansho Minji Hanreishū [MINSHŪ] 2150; Tōkyō Chihō Saibansho [Tokyo Dist. Ct.] Sep. 29, 2011, Hei 22 (wa) no. 26190, 1375 HANREI TAIMUZU [HANTA] 187 (Japan) (denying directors' liabilities to shareholders under Article 429, paragraph 1, for damages claimed to have been caused by a share exchange). There are conflicting views as to whether directors owe liabilities to shareholders when the shareholders indirectly suffer damages due to damages the company has suffered. *See, e.g.,* EGASHIRA, *supra* note 360, at 504 n.3.

<sup>415</sup> MINPŌ [CIV. C.] arts. 709, 710 (Japan).

<sup>416</sup> *See infra* Part V.B.3.a.i.

<sup>417</sup> *See, e.g.,* EGASHIRA, *supra* note 360, at 432–33, 444–45; Mitsuo Kondo, *Commentaries on Article 355 of the Companies Act*, in KAISHAHŌ KONMENTĀRU [8 COMMENTARIES ON COMPANIES ACT: ORGANS (2)] 57 (Seiichi Ochiai ed., 2009). *Cf.* TAMAI, *supra* note 364, at 309–13. In the REX II Tokyo High Court decision, the court responded to plaintiffs' claims under both Article 429 of the JPN Companies Act and Article 709 of the Japanese Civil Code (a tort claim for damages). *See infra* note 571.

holder resolution to effect a freeze-out is “severely unjust” due to a vote cast by a controller, however, minority shareholders are statutorily authorized to request that a court revoke the resolution.<sup>418</sup> Further, under an increasingly influential view, in such a case the minority shareholders should be able to seek a provisional injunction of the freeze-out transaction.<sup>419</sup> In considering the unjustness of a shareholder resolution to effect a virtual reverse stock split to effect the freeze-out, the court may take into account the availability of appraisal or equivalent rights<sup>420</sup> as a factor against the unjustness.<sup>421</sup> This makes the efficacy of the revocation right less certain.

(ii) *Costs of Lawsuits*

In principle, the loser must reimburse the winner for certain expenses the winner directly incurs and pay the court filing fees and certain expenses the court incurs in relation to court proceedings, such as fees payable to witnesses and postage.<sup>422</sup> On the other hand, attorney fees are generally borne by the respective parties regardless of the outcome.<sup>423</sup> There is no prohibition against contingency fees. These rules are similar to those pre-

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<sup>418</sup> Kaisha-hō [Companies Act], Law No. 86 of 2005, art. 831, para. 1, no. 3 (Japan). See, e.g., EGASHIRA, *supra* note 360, at 365.

<sup>419</sup> See *infra* text accompanying notes 522–523.

<sup>420</sup> As in the case of the appraisal rights in Delaware, such minority shareholders must clear procedural hurdles. See Law No. 86 of 2005, arts. 116, 117, 172 (Japan). It has been suggested that despite these hurdles, due to the lack or weakness of other means to remedy wrongs, appraisal rights have been forced to play a more important role than their counterparts in Delaware. See Tomotaka Fujita, *Shinkaihashō ni okeru kabushikikaitori seikyūken seido* [Appraisal Right Regime under the New Companies Act], in KIGYŌHŌ NO RIRON JŌKAN [1 THEORIES ON BUSINESS LAW] 261, 284 (Etsuro Kuronuma & Tomotaka Fujita eds., 2007). For articles describing procedural hurdles in Delaware, see *supra* note 84. Unlike in Delaware, however, in Japan there is no statutory prohibition against the counting of value arising from the relevant transaction in determining the fair value of shares. See Law No. 86 of 2005, art. 116 (Japan); for Delaware, see DEL. CODE ANN. tit. 8, § 262(f) (2014).

<sup>421</sup> See, e.g., Tōkyō Chihō Saibansho [Tokyo Dist. Ct.] Aug. 24, 1990, Shō 63 (wa) no. 6541, 1331 HANREI JIHŌ [HANJI] 136, *aff'd* Tōkyō Kōtō Saibansho [Tokyo High Ct.] Jan. 1, 1990, Hei 1 (ne) no. 2921, 77 SHIRYŌBAN SHŌJI HŌMU [SHIRYŌBAN SHŌJI HŌMU] 193 (Japan). As to the law on a similar point in Delaware, see *supra* note 266. The author’s gut sense, however, is that Japanese courts weigh the availability against shareholders more heavily than the Delaware judiciary.

<sup>422</sup> MINJI SOSHŌ HŌ [MINSOHŌ] [C. CIV. PRO.] art. 61 (Japan); Minji soshō hiyō tō ni kansuru hōritsu [Act on the Cost etc. of Civil Lawsuits], Law No. 40 of 1971, art. 2 (Japan); Minji hozenhō [Civil Provisional Remedies Act], Law No. 91 of 1989, art. 7 (Japan). As to exceptions to the general rule, see MINJI SOSHŌ HŌ [MINSOHŌ] [C. CIV. PRO.] arts. 62–63 (Japan). As to the costs of lawsuits in general, see ITO, *supra* note 402, at 581–86; TAKAARI HATTORI & DAN FENNO HENDERSON, CIVIL PROCEDURE IN JAPAN §§ 13.01–13.09 (Yasuhei Taniguchi et al. eds., 2nd ed. 2009) [hereinafter HATTORI & HENDERSON, CIVIL PROCEDURE IN JAPAN].

<sup>423</sup> Further, tortfeasors may be obligated to reimburse victims for attorneys’ fees that victims incur in prosecuting their claims in court. Saikō Saibansho [Sup. Ct.] Feb. 27, 1969, Shō 41 (o) no. 280, 23 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 2, 441 (Japan). Note that shareholder lawsuits against corporate fiduciaries may be based on a tort theory. See *supra* text accompanying note 415.

vailing in the United States.<sup>424</sup> There is, however, no general statutory or established case law doctrine in Japan similar to the common fund doctrine or the substantial benefit doctrine in Delaware.<sup>425</sup> As to a shareholder suit to enjoin directors' illegal actions, due to its similarity to a derivative suit, provisions relating to derivative suits<sup>426</sup> may be made applicable by analogy. For example, if shareholders win, they may recover attorneys' fees from the companies.<sup>427</sup> The derivative suit provisions, however, limit the recovery to "an amount that is deemed appropriate,"<sup>428</sup> and courts in Japan have not been as liberal as those in Delaware.<sup>429</sup> Thus, neither shareholders' nor plaintiffs' lawyers see strong economic incentives to file shareholder lawsuits.<sup>430</sup>

(iii) *Anticipatory Relief*

As to the availability of anticipatory relief in Japan, see below Part V.B.3.a.

(b) Asymmetric Information Problems re Initiation and Prosecution of Lawsuits

With respect to civil lawsuits, Japan generally follows an adversarial system<sup>431</sup> as opposed to an inquisitorial system.<sup>432</sup> However, there is no ef-

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<sup>424</sup> See *supra* Parts IV.A.1.a.ii., IV.B.1.a.

<sup>425</sup> For the Delaware law doctrines, see *supra* Part IV.A.1.a.ii.

<sup>426</sup> Kaisha-hō [Companies Act], Law No. 86 of 2005, art. 852, para. 1 (Japan).

<sup>427</sup> See EGASHIRA, *supra* note 360, at 496; KANDA, COMPANY LAW, *supra* note 392, at 273.

<sup>428</sup> Law No. 86 of 2005, art. 852, para. 1 (Japan).

<sup>429</sup> For example, a court granted only \$800,000 (at the exchange rate of US\$1 = yen 100) in a derivative suit in which the company recovered more than \$105 million after six years from the filing to the favorable judgment. Ōsaka Chihō Saibansho [Osaka Dist. Ct.] July 14, 2010, Hei 20 (wa) no. 16888, 2093 HANREI JIHŌ [HANJI] 138 (Japan). This should be contrasted with the example in Delaware described in *supra* note 188.

<sup>430</sup> See, e.g., Otsuka, *supra* note 405, at 11.

<sup>431</sup> See, e.g., MINSOHŌ (C. CIV. PRO.) arts. 159 (effect of a failure to dispute a factual allegation by the opposing party), 179 (effect of an admission of fact) (Japan). See generally ITO, *supra* note 402, at 295–309. With respect to provisional remedies, however, this principle is somewhat tempered. See HIROSHI SEGI, MINJI HOZENHŌ SHINTEIBAN [PROVISIONAL REMEDIES LAW—NEWLY REVISED] ¶ 211 (2014) [hereinafter SEGI, PROVISIONAL REMEDIES].

<sup>432</sup> In appraisal proceedings resulting from minority shareholder freeze-outs, the court is empowered to initiate and conduct factual investigations. Hishō-jiken tetsuzukihō [Noncontentious Cases Procedures Act], Law No. 51 of 2012, arts. 49–53 (Japan). In view of the relatively weak fact-finding tools in shareholder lawsuits, in some cases it could be strategically better for plaintiffs to sue for damages after the conclusion of appraisal proceedings in which the inquisitorial system should not prevail. Note that the damage lawsuits resulting in the REX II Tokyo High Court decision were filed after the REX I Supreme Court determination. See *infra* Part V.D. See also SHIRAI, *supra* note 139, at 513 n.1773 (noting the Tokyo High Court's request in the REX I appraisal proceeding to the target company to disclose a

fective discovery or substantial functional equivalent in Japan. Written interrogatories are mostly dysfunctional.<sup>433</sup> Other main fact-finding tools may involve courts, which do not foster speedy disclosure or discovery of facts.<sup>434</sup> If plaintiffs fail to allege facts sufficient to support their claims, technically the courts may dismiss the claims prior to formal fact-finding before judges.<sup>435</sup> It is even more difficult in provisional injunction settings for shareholders to find facts to support their claims.<sup>436</sup> In addition, courts generally set a high threshold for the burden of proof and have not used burden-shifting flexibly in the context of shareholder lawsuits against Gatekeepers. Therefore, the judiciary system does not adequately address AIPs at Stage I.<sup>437</sup>

(i) *Fact-finding in Regular Proceedings*

The Code of Civil Procedure of Japan provides for written interrogatories.<sup>438</sup> A prospective plaintiff may initiate a mutual exchange of written questions.<sup>439</sup> The prospective defendant—if [s]he has responded to the prospective plaintiff's inquiries—is entitled to send his or her own written inquiry. The parties may use a similar procedure once a lawsuit commences.<sup>440</sup> Surprisingly, however, there is no direct sanction against a recipient's

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valuation report used in connection with the MBO to support a statement that there is willingness among judges to force disclosure of corporate information to shareholder plaintiffs).

<sup>433</sup> See *infra* note 443.

<sup>434</sup> Presumably, a lack of available information in provisional injunction proceedings sometimes makes presiding judges nervous when they render decisions. See, e.g., Masahito Monguchi and Kenjiro Egashira, *Kaishahō no rippō to saiban 8-kikan (2) [Drafting of Company Law and Judging]*, in KAISHAHŌ KONMENTĀRU 8 KIKAN (2) [8 COMMENTARIES ON COMPANIES ACT: ORGANS (2)] (Seiichi Ochiai ed., 2010) [hereinafter Monguchi/Egashira Dialogue]. Judge Monguchi was a carrier judge and spent several years each at the Tokyo District Court and the Tokyo High Court.

<sup>435</sup> See, e.g., Sachio Ota, *Amerikahō ni okeru purīdingu yōkenron no aratana tenkai [New Developments in Pleading Requirements under American Law]*, 19 HIKAKUHŌBUNKA 79, 94–96 (2011); see also ITO, *supra* note 402, at 196–97. MINSOHŌ (C. CIV. PRO.) art. 133, para. 2, no. 2 (Japan); Minji soshō kisoku [Rules of Civil Procedure], Supreme Court Rule No. 5 of 1996, art. 53, para. 1 (Japan).

<sup>436</sup> See, e.g., Norimitsu Arai, *Emu ando ei jidai no minji hozon: Tekitaitekibaishū ni okeru karishobun wo chūshin ni shite [Provisional Remedies in the Era of M&As: Focusing on Provisional Injunctions Relating to Hostile Acquisitions]*, 1317 JURISUTO 221, 224–25 (2006).

<sup>437</sup> See, e.g., Otsuka, *supra* note 405, at 12 (stating that, due to difficulties in assembling facts to prove their cases, securities holders and their lawyers have been hesitant to file lawsuits).

<sup>438</sup> See generally HATTORI & HENDERSON, CIVIL PROCEDURE IN JAPAN, *supra* note 422, §§ 7.08[8][c], 7.08[8][d].

<sup>439</sup> MINSOHŌ (C. CIV. PRO.) arts. 132-2 to 132-3 (Japan). For a general description, see HATTORI & HENDERSON, CIVIL PROCEDURE IN JAPAN, *supra* note 422, § 7.06[8][d]. With respect to the system's legislative background, see, for example, ITO, *supra* note 402, at 312.

<sup>440</sup> MINSOHŌ (C. CIV. PRO.) art. 163 (Japan). The basic concept in this article was inspired by the interrogatories under Rule 33 of the U.S. Federal Rules of Civil Procedure. ITO, *supra* note 402, at 272 n.82.

failure to comply with a request.<sup>441</sup> Due to this and other reasons, these written interrogatory tools are unattractive, and their use has been almost negligible.<sup>442</sup>

Further, the prospective plaintiff who has initiated the mutual exchange of interrogatories and the prospective defendant who has responded to the prospective plaintiff's interrogatories may each request via a court a production of documents constituting evidence clearly necessary for the requestors but difficult for the requestors to obtain.<sup>443</sup> However, the recipient does not have any legal obligation to comply. This strategy relies on the recipient's goodwill and voluntary cooperation, which is encouraged by the court.<sup>444</sup> The use of this tool has been negligible.<sup>445</sup>

The parties may, upon application to the court, seek to take testimonies from experts, witnesses, and other parties to the lawsuit, and seek court orders for document production.<sup>446</sup> Such an application, however, must concretely identify the facts to be proved,<sup>447</sup> which, strictly applied, could present an undue challenge if the plaintiff does not know much about what transpired on the defendant's part.<sup>448</sup> If a witness fails to appear for no justi-

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<sup>441</sup> See *id.* at 273, 314. The lawyer representing the delinquent party, however, may possibly be in violation of his or her ethical duties. *Id.* at 271, 312 n.164.

<sup>442</sup> See, e.g., Yoshiki Yamaura et al., *Shōko dēta shūshū no hōhō to jijitsu nintei* [Means to Collect Evidence/Data and Findings of Fact], 1248 HANTA 5, 12–17 (2007) (transcript of a roundtable discussion held on July 16, 2007; remarks by various participants). For litigators in the United States this may not be a surprise at all, since they know that written interrogatories in the United States have not been very effective. See Gorga & Halberstam, *supra* note 215, at 1410. Attorneys may request that their bar associations send inquiries to various organizations (but not to individuals). Bengoshihō [Lawyers' Law], Law No. 205 of 1949, art. 23-2 (Japan). However, the effects of noncompliance by the recipients are similarly unclear. See, e.g., Nagoya Kōtō Saibansho [Nagoya High Ct.] Feb. 8, 2013, Hei 25 (ne) no. 212, 1430 KIN'YŪ SHŌJI HANREI [KINHAN] 25 (Japan).

<sup>443</sup> MINSOHŌ (C. CIV. PRO.) arts. 132-4 to 132-9 (Japan). Article 23-2 allows lawyers to request that their bar associations seek information from public authorities and other organizations to supply information that relates to matters the lawyers handle. Bengoshihō [Lawyers' Law], Law No. 205 of 1949, art. 23-2 (Japan). However, the consequences of noncompliance with the request are unclear. For its legal effects, see, for example, Ōsaka Kōtō saibansho [Osaka High Court] Jan. 30, 2007, Hei 18 (ne) no. 779, 1962 HANREI JIHŌ [HANJI] 78 (Japan); Nagoya Kōtō Saibansho [Nagoya High Ct.] Feb. 8, 2013, Hei 25 (ne) no. 212, 1430 KIN'YŪ SHŌJI HANREI [KINHAN] 25 (Japan). At least in the context of typical control transactions, its use, if any, seems to have been limited.

<sup>444</sup> See ITO, *supra* note 402, at 315.

<sup>445</sup> SUPREME COURT OF JAPAN, SAIBAN NO JINSOKU-KA NI KAKARU KENSHŌ NI KANSURU HŌKOKUSHO 4-KAI [REPORT ON THE EXAMINATION OF SPEEDIER RESOLUTION OF CASES (4TH)] 27–29 (2012), [http://www.courts.go.jp/about/siryō/hokoku\\_04\\_hokokusyo/index.html](http://www.courts.go.jp/about/siryō/hokoku_04_hokokusyo/index.html); Yamaura et al., *supra* note 442, at 17–19.

<sup>446</sup> See generally ITO, *supra* note 402, at 330–31. The court can deny such requests if the evidence is unnecessary. MINSOHŌ (C. CIV. PRO.) art. 181, para. 1 (Japan). See ITO, *supra* note 402, at 371 n.281.

<sup>447</sup> MINSOHŌ (C. CIV. PRO.) art. 180, para. 1 (Japan); Minji soshō kisoku [Rules of Civil Procedure], Supreme Court Rule No. 5 of 1996, art. 99, para. 1 (Japan). To call a witness, the party must set forth individual and specific inquiries to be addressed. *Id.* art. 107.

<sup>448</sup> See, e.g., MIKIO AKIYAMA ET AL., KONMENTĀRU MINJI SOSHŌHŌ 4 [COMMENTARIES ON CIVIL

liable reason, the court has the power to impose civil fines. The witness may also be subject to criminal fines and detention.<sup>449</sup> However, Japanese courts have rarely imposed such sanctions.<sup>450</sup> In fact, judges discourage parties from calling unwilling witnesses.<sup>451</sup> Witnesses have to testify under oath and are subject to perjury charges.<sup>452</sup> Witnesses are rarely if ever criminally sanctioned for lying,<sup>453</sup> and presumably they are not infrequently untruthful.<sup>454</sup> Further, parties who testify are not subject to the penalty of perjury if they lie under oath.<sup>455</sup>

Parties by motion may ask the court to issue an order to any person to produce specific documents in his or her possession.<sup>456</sup> There are exceptions to the general rule. For example, documents are exempt if they are for the exclusive use of the person to whom the order is directed.<sup>457</sup> The language of the exemption may be broadly interpreted to cover many types of necessary documents in shareholder lawsuits against Gatekeepers.<sup>458</sup> With respect to specifically identifiable documents, the court may not be as restrictive as one might have feared.<sup>459</sup> At any rate, the party who seeks the court order

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PROCEDURE LAW 4] 72–73 (2010).

<sup>449</sup> MINSOHŌ (C. CIV. PRO.) arts. 192–94 (Japan).

<sup>450</sup> See *Watashi wa shōnin to shite yōkyū o mieru koto o kyohi shitai nodesuga, . . .* [I Want to Refuse Request to Appear as a Witness, but . . .], NPO HŌJIN NO HŌTEKI SEKYURITI KURABU [NPO LEGAL SECURITY CLUB] (Feb. 21, 2008), <http://www.hou-nattoku.com/consult/689.php>. In a blog article, one practitioner speculates that such practice is a reflection of the pervasive attitude of judges in Japan that the parties should feel lucky if witnesses willingly show up to assist them. See *Naze shōnin no gimu o mushi shite imasu* [Why Witness Obligation is Neglected Practice of Law], PRACTICE OF LAW (May 3, 2004, 8:42 AM), <http://blog.livedoor.jp/kazsin/archives/504337.html>.

<sup>451</sup> A noted scholar stated that despite the available sanctions, it is difficult to force witnesses to appear against their will. ITO, *supra* note 402, at 386. Further, there is a risk that witnesses who are forced to appear are less likely to give testimony favorable to the parties calling them. If the witnesses lie, it is difficult to prosecute them.

<sup>452</sup> KEIHŌ (PEN. C.) arts. 169, 171 (Japan) (imprisonment for a period of three months to ten years).

<sup>453</sup> *Id.* at 775 (“[E]nforcement of the perjury law is very weak.”). The United States seems to have a similar problem although perhaps to a lesser extent. See Matthew L. Lifflander, *The Economic Truth About Lying*, WALL ST. J. (Mar. 25, 2013), <http://online.wsj.com/article/SB10001424127887324532004578360941582888094.html>.

<sup>454</sup> See, e.g., Yasuhei Taniguchi, *Code of Civil Procedure of Japan*, 45 AM. J. COMP. L. 767, 775 (1997) (“[M]ost witnesses are partisan and not always trustworthy”).

<sup>455</sup> They may, however, be subject to civil fines of not more than yen 100,000 (US\$1,000 at the exchange rate of US\$1 = yen 100). MINSOHŌ (C. CIV. PRO.) art. 209 (Japan).

<sup>456</sup> MINSOHŌ (C. CIV. PRO.) arts. 219, 220, 222–24 (Japan).

<sup>457</sup> *Id.* art. 220, para. 1, no. 4, item (d).

<sup>458</sup> See ITO, *supra* note 402, at 419 n.394. This exemption, however, does not cover documents legally required to be created.

<sup>459</sup> For example, in a recent case involving a derivative suit to recover damages that directors allegedly inflicted on a company, a court ordered the company to produce internal memorandums and documents showing agendas for executive committee meetings relating to the selection of various professionals, including valuation firms and law firms, hired in relation to the examination of a management buyout. Kōbe Chihō Saibansho [Kobe Dist. Ct.] May 8, 2012, Hei 22 (mo) nos. 230, 231, 1398 KIN’YŪ

must provide a description and the gist of the document, and the facts the document seeks to prove.<sup>460</sup> This requirement, however, is often challenging in shareholder lawsuits against Gatekeepers, particularly with respect to documents not legally required to be prepared, such as e-mails. When it is “extremely difficult” to give such a description or gist, then the requirement is relaxed, and it is enough for the petitioner to provide information sufficient for the holder of the document to identify the requested document.<sup>461</sup> In such a case the petitioner must ask the court to request that the holder clarify the description and gist of the document.<sup>462</sup> However, this method of requesting documents has not been very effective.<sup>463</sup>

Under the JPN Companies Act, subject to certain carve outs, a shareholder who owns 3% or more of the voting rights of the outstanding shares for six months or longer is entitled to inspect the accounting books and records of the company.<sup>464</sup> The Act also grants shareholders the right to inspect other specified types of records.<sup>465</sup> Further, in relation to tender offers and proxy fights, there are disclosure requirements. These are all helpful but are not necessarily unedited “raw materials” that reveal facts that actually transpired beyond the view of dispersed shareholders.

*(ii) Fact Finding in Provisional Injunctions*

Parties seeking provisional injunctions must make a “rough showing” (*somei*) of both the existence of a relevant legal relationship to be protected and the need for such provisional injunctions to avoid severe damage or imminent danger.<sup>466</sup> Under this standard, the level of proof required for

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SHŌJI HANREI [KINHAN] 40 (Japan). According to a blog run by the lawyers for the plaintiffs, the determination was later upheld by both the Osaka High Court and the Japanese Supreme Court. Masatoshi Kato, *Sharure bunsho teishutsu meirei saikōsai kettei* [*Supreme Court's Determination on Charle Document Production Order*], KŌBE SOYOKAZE HŌRITSU JIMUSHO KŌSHIKI BLOG (April 18, 2013, 9:34 PM), <http://www.soyokaze.ws/mt/archives/cat2/index.html>.

<sup>460</sup> MINSOHŌ (C. CIV. PRO.) art. 221 (Japan). For the consequences of noncompliance, see *id.* art. 224, para. 1, art. 225, para. 1.

<sup>461</sup> *Id.* art. 222.

<sup>462</sup> If the court issues such request, it does not have any direct means to force the holder to make the clarification. However, the recipient's failure could lead to a deemed admission. See ITO, *supra* note 402, at 410 n.371. Cf. AKIYAMA ET AL., *supra* note 448, at 439–41.

<sup>463</sup> *Id.* at 433.

<sup>464</sup> Kaisha-hō [Companies Act], Law No. 86 of 2005, art. 433 (Japan).

<sup>465</sup> See, e.g., *id.* art. 125, para. 2 (a list of shareholders), art. 371, para. 2 (board minutes), art. 394, para. 2 (minutes of statutory auditor meetings), art. 442, para. 3 (certain accounting documents), art. 782, para. 3 (surviving corporations' merger and other similar agreements), art. 794 (disappearing corporations' merger and other similar agreements). The scope of the accessible documents and records seems narrower than the “books and records” that Section 220 of the Delaware General Corporation Law covers. Further, the carve outs under the JPN Companies Act are wider than those under Section 220 of the Delaware General Corporation Law.

<sup>466</sup> Minji hozenhō [Civil Provisional Remedies Act], Law No. 91 of 1989, arts. 13, 23, para. 2 (Ja-

provisional injunction proceedings is lower than the one required in regular proceedings.<sup>467</sup> However, in general, judges in Japan appear to impose a standard no lower than the preponderance standard in Delaware.<sup>468</sup>

The court procedure for provisional injunctions is informal and abbreviated relative to the procedure required to render definitive judgments, such as permanent injunctions. These characterizations are particularly true with respect to the fact-finding aspect of the procedure.<sup>469</sup> In provisional injunction proceedings, the court confers (*shinjin*), orally or in writing, with the parties.<sup>470</sup> The court may, to clarify the parties' positions on disputed factual matters, hear statements from those who (i) administer affairs for the parties, such as independent contractors or professional advisors, including attorneys, or (ii) assist the parties with respect to the administration of such affairs, such as officers or employees of a company that is a party to the proceedings.<sup>471</sup> The court may seek such statements at the suggestion of an opposing party or let the opposing party directly ask questions.<sup>472</sup>

The parties may submit documentary evidence to the court.<sup>473</sup> In addition, during a face-to-face conference that both parties can attend, the court may hear testimonies from the parties or third parties who have been designated by one of the parties and have agreed to appear.<sup>474</sup> However, testimonies are not made under oath.<sup>475</sup> In addition, the court does not have a legal means to compel testimonies of third parties, and third-party testimonies have been taken only infrequently.<sup>476</sup> The court may at its discretion choose

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<sup>467</sup> See *infra* text accompanying note 483.

<sup>468</sup> See, e.g., SEGI, PROVISIONAL REMEDIES, *supra* note 431, ¶ 245 (stating that under the standard a tentative conviction of the truth is required), ¶¶ 248–52, ¶ 253–2; Ito, *supra* note 402, at 331 (stating that “a substantial level of likelihood” of veracity is required); AKIYAMA ET AL, *supra* note 448, at 132 (a likelihood that permits a tentative conviction). As to the need (*hitsuyōsei*), see SEGI, PROVISIONAL REMEDIES, *supra* note 431, ¶ 253.

<sup>469</sup> In general, however, the court may not issue a provisional injunction without having a face-to-face informal conference that the party against whom the injunction is directed can attend. Law No. 91 of 1989, art. 23, para. 4 (Japan). However, the requirement will be waived if the passage of time necessary to have such a conference or trial would frustrate the purpose of the provisional injunction. *Id.*

<sup>470</sup> Law No. 91 of 1989, art. 7 (incorporating by reference, among others, MINSOHŌ (C. CIV. PRO.), art. 87, para. 2 (Japan)) (Japan).

<sup>471</sup> *Id.* art. 9. Cf. MINSOHŌ (C. CIV. PRO.) art. 151, para. 1, no. 2 (Japan). See SEGI, PROVISIONAL REMEDIES, *supra* note 431, ¶¶ 221, 228–30.

<sup>472</sup> Law No. 91 of 1989, art. 7 (incorporating by reference, among others, MINSOHŌ (C. CIV. PRO.) art. 149, para. 3 (Japan)) (Japan). See SEGI, PROVISIONAL REMEDIES, *supra* note 431, ¶ 231.

<sup>473</sup> See SEGI, PROVISIONAL REMEDIES, *supra* note 431, ¶ 221.

<sup>474</sup> Law No. 91 of 1989, art. 7 (incorporating, among others, MINSOHŌ (C. CIV. PRO.) art. 187 (Japan)) (Japan). Cf. SEGI, PROVISIONAL REMEDIES, *supra* note 431, ¶ 222 (stating the existence of a contrary view).

<sup>475</sup> See SEGI, PROVISIONAL REMEDIES, *supra* note 431, ¶ 221.

<sup>476</sup> See *id.*



to have a formal fact-finding procedure before judges.<sup>477</sup> At such procedure, evidence must be taken pursuant to the formalities generally applicable to the proceeding.<sup>478</sup> It is rare, at best, for a court to hold such a proceeding.<sup>479</sup>

Moreover, the required showing must be made through evidence that can be examined “immediately.”<sup>480</sup> Because of this requirement, in practice, document production orders are not issued in provisional injunction proceedings.<sup>481</sup> It also means that there are no scheduled testimonies.<sup>482</sup>

(iii) *Allocation of Burden of Proof*

In general, Japan’s standard of proof for civil cases is substantially higher than the preponderance standard in Delaware and requires a judge to form a conviction as to the existence of a fact to be proved.<sup>483</sup> Therefore, the information asymmetry between shareholders and Gatekeepers in Japan poses a greater problem than it does in Delaware.<sup>484</sup>

From time to time, Japanese courts have shifted burdens of proof or used presumptions or inferences to impose a persuasion burden on the parties who otherwise do not have that burden even when there are no explicit statutory mandates to do so.<sup>485</sup> For example, in connection with employee dismissal cases, Japanese courts have reversed the usual burden of proof to aid dismissed employees.<sup>486</sup>

However, the importance of burden shifting in lawsuits against Gatekeepers is yet to be widely recognized,<sup>487</sup> and we have not seen flexible

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<sup>477</sup> Law No. 91 of 1989, art. 3 (Japan).

<sup>478</sup> See SEGI, PROVISIONAL REMEDIES, *supra* note 431, ¶ 223.

<sup>479</sup> See, e.g., *id.*

<sup>480</sup> MINSOHŌ (C. CIV. PRO.) art. 87, para. 2 (Japan).

<sup>481</sup> *Id.* art. 188.

<sup>482</sup> See AKIYAMA ET AL., *supra* note 448, at 134.

<sup>483</sup> *Id.*

<sup>484</sup> See ITO, *supra* note 402, at 331–33; Kevin M. Clermont, *Standards of Proof in Japan and the United States*, 37 CORNELL INT’L L.J. 263, 264 (2004); HATTORI & HENDERSON, CIVIL PROCEDURE IN JAPAN, *supra* note 422, § 7.06[9][b] (stating that “the majority of judges appear to require a 70 to 80 percent probability”); AKIYAMA ET AL., *supra* note 448, at 132 (an 80% level of conviction).

<sup>485</sup> It is true that, for example, when directors are involved in specified types of related party transactions without complying with statutorily prescribed ex ante safeguards, the directors’ failure to observe their fiduciary duties are statutorily presumed. Kaisha-hō [Companies Act], Law No. 86 of 2005, art. 356, para. 1, nos. 2–3, art. 365, art. 423, para. 3 (Japan). However, neither MBOs nor freeze-outs necessarily involve such specified types of related party transactions.

<sup>486</sup> See, e.g., HIROSHI ODA, JAPANESE LAW 422 (3d ed. 2009); KOJI SHINDO, MINJISOSHŌHŌ [CIVIL PROCEDURE LAW] 615–20 (5th ed. 2009).

<sup>487</sup> See, e.g., Takeshi Araki, *Flexibility in Japanese Employment Relations and the Role of the Judiciary*, in JAPANESE COMMERCIAL LAW IN AN ERA OF INTERNATIONALIZATION 249, 253–54 (Hiroshi Oda ed., 1994).

<sup>488</sup> More recently, several commentators have advocated burden shifting in relation to shareholder

burden shifting or the use of presumptions in that area.<sup>488</sup> One may speculate that the REX II Tokyo High Court decision,<sup>489</sup> which involves a self-dealing transaction (a controller freeze-out or at least an MBO), might have been decided differently if the burden had been shifted to the defendants.<sup>490</sup>

### 3. Strategies to Avoid Ex Post Restorative Relief to Undo a Shareholder Collective Decision or Transaction

Tender offer and proxy (or its equivalent) rules in Japan create a window of time for the judiciary to render anticipatory relief. Japanese courts can render, among others, provisional injunctions, permanent injunctions,<sup>491</sup> and declaratory judgments.<sup>492</sup> However, Japanese courts are not equity courts, and their power to render injunctive relief outside statutorily authorized circumstances has been limited, and is, at best, of an uncertain scope. Further, the level of the courts' discretion in rendering injunctions appears a lot less than that of the Delaware Chancery Court. They might frustrate the Japanese courts' efforts to decide flexibly and to take full account of the efficiency considerations discussed in Part III.C. above in issuing injunctions. Specialization of judges focusing on disputes relating to control transactions is incomplete and weak. The courts in Japan, in dealing with preliminary injunction proceedings, have been remarkably speedy. However, the speed has been due in part to the absence of any fact-finding mechanisms that are meaningful in the context of shareholder lawsuits against Gatekeepers.<sup>493</sup> Thus, Japan's judiciary has not played catch-up with the role recently thrust

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lawsuits against Gatekeepers. *See, e.g.*, Hidesato Iida, *MBO wo okonau torishimariyaku no gimu to dai-sansha ni taisuru sekinin* [Duties of Directors Participating in MBO and Duties to Third Parties], 1437 JURISUTO 96 (2012) (arguing that in MBOs, directors should owe the burden of proving the fairness of the transactions); Ota & Yano, *supra* note 412, at 87, 88 n.138 (suggesting burden shifting when a competing bid emerges during an MBO).

<sup>488</sup> This does not mean that burden shifting has not happened. *See, e.g.*, KANDA, COMPANY LAW, *supra* note 392, at 151 n.1 (describing a case where the court effectively shifted a burden of persuasion from one party to the other).

<sup>489</sup> *See infra* note 571.

<sup>490</sup> *See, e.g.*, Iida, *supra* note 487, at 99–100 (arguing that burden shifting in the JPN Companies Act applicable to certain types of self-dealings should be applied to MBOs); SHIRAI, *supra* note 139, at 502–03 (arguing that MBOs should be subject to a standard similar to the entire fairness standard in Delaware and that in such situations directors should bear the burden of proving the fairness).

<sup>491</sup> Japanese courts now have a means to compel compliance with injunctive remedies, both permanent and provisional: the courts can impose monetary sanctions. Minji shikkōhō [Civil Execution Act], Law No. 4 of 1979, art. 172 (Japan), Minji hozenhō [Civil Provisional Remedies Act], Law No. 91 of 1989, art. 52, para. 2 (Japan). *See* HIROSHI SEGI, MINJI HOZENHŌ NYŪMON [INTRODUCTION TO THE CIVIL PROVISIONAL REMEDIES ACT] 240–42 (2011) [hereinafter SEGI, INTRODUCTION].

<sup>492</sup> As to the types of remedies Japanese courts may employ, see generally ITO, *supra* note 402, at 158–63.

<sup>493</sup> *See infra* Part V.B.3.b.

on it, and in particular, is not able to expertly render anticipatory relief in the context of shareholder lawsuits against Gatekeepers.

(a) Anticipatory Relief

(i) *Permanent Injunctions*

Several provisions in the JPN Companies Act explicitly allow shareholders to seek injunctive remedies. These provisions can be used to enjoin certain Gatekeeper actions taken in violation of their fiduciary obligations or transactions resulting from or attributable to such Gatekeeper actions. However, at least under the currently prevailing view, these provisions do not cover many situations where injunctive remedies would be available under the Delaware law.<sup>494</sup>

First, any shareholder who has held shares for six months or longer may enjoin directors from taking an action in violation of law if such action might result in *irreparable damages to the corporation*.<sup>495</sup> “Violation of law” includes a violation of the directors’ fiduciary duties.<sup>496</sup> However, the power may be exercised with respect only to director actions that would cause damages to the “corporation,” and such damages must be “irreparable.” But for the two requirements, this right could have been potent ammunition for shareholders to challenge defense measures. There are many instances where director actions taken in relation to control transactions would cause damages to shareholders but not to the corporation. Commentators have proposed various interpretations to temper the limitation.<sup>497</sup> The

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<sup>494</sup> The 2014 JPN Company Act Amendments added several provisions that allow shareholders to seek injunctive relief in relation to certain squeeze out transactions. *Kaisha-hō* [Companies Act], Law No. 86 of 2005, arts. 784–2, 796–2, 805–2 (Japan). However, the injunctions are available only when the transactions fail to comply with the technical requirements of the JPN Companies Act or articles of incorporation. See HIROAKI TAKAGI, YASUSHI KANOKOGI & SABURO SAKAMOTO, HŌSEISHINGIKAI KAISHAHŌ BUKAI DAJYŪYONKAI GIJIRŌKU [MINUTES OF THE FOURTEENTH MEETING OF THE CORPORATE LAW COMMITTEE OF THE COMMITTEE ON THE LEGAL SYSTEM] 32–33 (2011), <http://www.moj.go.jp/content/000081570.pdf>. Thus breach of fiduciary duties does not directly trigger the newly added injunction provisions. For the possible availability of provisional injunctions, see *infra* text accompanying note 526.

<sup>495</sup> Law No. 86 of 2005, art. 360, paras. 1, 3 (Japan).

<sup>496</sup> See EGASHIRA, *supra* note 360, at 495, and cases cited therein. Note that, unlike the derivative suit, to seek damages from directors under Article 847 of the JPN Companies Act the shareholder does not have to first demand that the company enforce its claim against the directors. *Cf. infra* text accompanying note 500.

<sup>497</sup> See, e.g., Masao Yanaga, *Ichijirushiku futōna gappeijōken to sashitome/songaibaishō seikyū* [Extremely Unjust Merger Terms and Injunctions/Damage Suits], in KIGYŌHŌ NO RIRON JŌKAN [I THEORIES ON BUSINESS LAW] 623, 627 n.3, 630–32 (Etsuro Kuronuma & Tomotaka Fujita eds., 2007); HŌSEISHINGIKAI KAISHAHŌ BUKAI DAISANKAI GIJIRŌKU [MINUTES OF THE THIRD MEETING OF THE CORPORATE LAW COMMITTEE OF THE COMMITTEE ON THE LEGAL SYSTEM] 43 (2010) (statement of Wataru Tanaka), <http://www.moj.go.jp/content/000052523.pdf>.

results of such efforts are still uncertain.<sup>498</sup> Further, “irreparable damage” is a threshold higher than “severe damage.”<sup>499</sup>

Second, shareholders may sue the company to seek an injunction against an issuance of shares or stock warrants if the issuance would violate the law or is severely unjust<sup>500</sup> and may have unfavorable consequences for the shareholders.<sup>501</sup> When target companies attempt to issue new shares or share warrants as a defense measure, plaintiffs commonly try to rely on this statutory authority to enjoin the issuances.<sup>502</sup> Further, the provisions to enjoin the issuance of shares or share warrants can be applied to certain analogous transactions. For example, in *Steel Partners Japan Strategic Fund (Offshore), L.P. v. Bull-Dog Sauce Co.*,<sup>503</sup> the Japanese Supreme Court agreed that Article 247 could be applied by analogy to a distribution to shareholders of stock warrants constituting a poison pill.<sup>504</sup>

Third, in the case of a short-form merger or a short-form share exchange,<sup>505</sup> minority shareholders of the controlled corporation, who do not

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<sup>498</sup> The Tokyo District Court, however, recently held that the difference between the actual issue price of equity securities and the issue price that could have been achieved but for directors’ breach of their fiduciary duties constitutes damages to the company. Tōkyō Chihō Saibansho [Tokyo Dist. Ct.] May 10, 2010, Hei 22 (yo) no. 20040, 1343 KIN’YŪ SHŌJI HANREI [KINHAN] 21.

<sup>499</sup> See Masafumi Nakahigashi, *Kigyosaihen wo meguru kaishahōsei no kadai* [Corporate Law Design Issues Relating to Corporate Restructuring], 1437 JURISUTO 17, 20 (2011) (stating the difficulty of satisfying the higher threshold). Statutory auditors have similar rights except that they can seek an injunction against a director action that is violative of the directors’ fiduciary duties and might result in severe damages to the company. Law No. 86 of 2005, art. 385, para. 1, art. 386, para. 1 (Japan).

<sup>500</sup> Under the prevailing view, violation of the law is a violation by the issuing company and does not include a breach of fiduciary duties by directors. However, if the board decides to issue shares or share warrants in violation of the fiduciary duties of the board members, it could constitute an unjust issuance. See, e.g., Wataru Tanaka, *Kakushu sashitomesekiyūken no seishitsu, yōken oyobi kōka* [Nature, Prerequisites and Effects of Various Injunctive Claims], in KAISHASAIBAN NI KAKARU RIRON NO TŌTATSUTEN [FRONTIERS OF THEORIES FOR CORPORATE LAWSUITS] 2, 17–18 (Hiroyuki Kansaku et al. eds., 2014).

<sup>501</sup> Law No. 86 of 2005, art. 210 (as to the issuance of shares), art. 247 (as to the issuance of stock warrants) (Japan).

<sup>502</sup> See, e.g., Tōkyō Kōtō Saibansho [Tokyo High Ct.] March 23, 2005, Hei 17 (ra) no. 429, 1899 HANREI JIHŌ [HANJI] 56; Tōkyō Kōtō Saibansho [Tokyo High Ct.] July 29, 2005, Hei 17 (ra) no. 942, 1909 HANREI JIHŌ [HANJI] 87.

<sup>503</sup> BESSATSU SHŌJI HŌMU HENSHŪBU, 311 BURUDOKKU SŌSU JIKEN NO HŌTEKI KENTŌ: BAISHŪ BŌEISAKU NI KANSURU SAIBAN KEIKA TO IGI KINKYŪ SHUPPAN [311 LEGAL EXAMINATION OF THE BULL-DOG SAUCE CASE: TRIAL COURSE ON ANTI-TAKEOVER MEASURES AND THE SIGNIFICANCE OF EMERGENCY PUBLISHING] 438 (2007). Due to the discriminatory nature of the rights plan deployed in the case, the hostile bidder alleged a violation of the principal of the equality of shareholders. See Law No. 86 of 2005, art. 109, para. 1 (Japan). If there was indeed such a violation, it would have given a separate ground for the injunction. The court, however, rejected the argument.

<sup>504</sup> For the analysis of the case, see Milhaupt, *Bull-Dog Sauce*, *supra* note 365, at 353–56.

<sup>505</sup> Note that these are not popular methods to effect minority freeze-outs. See *supra* text accompanying notes 394–397.

have a chance to vote,<sup>506</sup> can seek to enjoin the transaction when considerations payable to the shareholders are “extremely unjust” and the transaction could result in damages to the shareholders.<sup>507</sup>

Furthermore, if literally interpreted, the foregoing injunction provisions do not authorize an affirmative injunction.<sup>508</sup> Therefore, for example, once a poison pill is adopted and warrants are actually distributed to shareholders, under the literal interpretation the court will not be able to give an order to redeem the warrants.<sup>509</sup> The lack of affirmative injunctions also makes it difficult for shareholders to challenge friendly acquisitions. In Japan, bidders typically launch friendly tender offers without prior agreements with the targets.<sup>510</sup> This could mean that there is no action by the target board for shareholders to stop. Under tender offer rules, targets’ boards are obligated to issue recommendation statements.<sup>511</sup> Shareholders, however, may not have the opportunity to seek a negative injunction against the recommendation statements if they are announced simultaneously with the commencement of tender offers.

In general, the Japanese courts have issued injunctions when there are no specific statutory authorizations in the JPN Companies Act. For example, they have issued injunctions against certain types of interference with ownership rights, environmental rights, intellectual property rights, and privacy rights.<sup>512</sup> However, there are no standard theories behind the court’s practices, and it is quite uncertain in what additional areas the courts will

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<sup>506</sup> Law No. 86 of 2005, art. 784, para. 1, art. 796, para. 1 (Japan).

<sup>507</sup> *Id.* art. 784, para. 2, art. 796, para. 2. Minority shareholders also have a statutory appraisal right. *Id.* art. 785, para. 1, para. 2, no. 2, art. 786, art. 797, para. 1. para. 2, no. 2, art. 798. The holders of shares that are subject to the buyout right described in *supra* note 395 are similarly allowed to seek an injunction of the buyout or a statutory appraisal.

<sup>508</sup> The statutory term *yameru* literally means “stop” or “cease.” Recently, in an antitrust context the Commercial Division of the Tokyo District Court stated that language of similar import does not prevent it from issuing an affirmative injunction. *See* Tōkyō Chihō Saibansho [Tokyo Dist. Ct.] June 19, 2014, Hei 23 (wa) no. 32660, 2232 HANREI JIHŌ [HANJI] 102 (relating to an injunction under Shitekidokusen oyobi kōseitōhiki no kakuho ni kansureu hōritsu [Dokusenkinshihō] [Antimonopoly Act], Law No. 4 of 1947, art. 24 (Japan)).

<sup>509</sup> In Delaware this is not the case. *See supra* text accompanying note 272.

<sup>510</sup> Japan does not have antitakeover provisions similar to Section 203 of the Delaware General Corporation Law. Ironically, the lack of antitakeover provisions magnifies the problem of not having affirmative injunctions to challenge control transactions. If Japan had such provisions, parties to friendly transactions would be encouraged to enter into acquisition agreements, which would give shareholders a chance to seek negative injunctions against the transactions.

<sup>511</sup> Kinyūshōhin torihikihō [Financial Instruments and Exchange Act], Law No. 25 of 1948, art. 27-10, para. 1 (Japan); Hakkōshaigainomono ni yoru kabukentō no kōkaikaisuke no kaiji ni kansuru naikakufurei [Disclosure Rules Relating to Third Party Tender Offers], Law No. 38 of 1971, art. 25, para. 1, no. 3 (Japan).

<sup>512</sup> *See, e.g.,* Yanaga, *supra* note 500, at 632, 638 n.19; Akira Tokutsu, *Minji hozenhō idete kaishahō horobu?* [Will the Emergence of the Provisional Remedies Act Bring about the Demise of the Companies Act?], 82 HÖRITSUJIHŌ 28, 30 (2011).

entertain requests for injunctive remedies.<sup>513</sup> Some scholars are attempting to expand the scope of available permanent injunctions.<sup>514</sup> The results of their attempts are uncertain.

(ii) *Provisional Injunctions*

Under the literal language of the Provisional Remedies Act, a court may issue a provisional injunction if the plaintiff roughly shows a legal relationship to be protected and the need for the provisional injunction<sup>515</sup> in order to avoid severe damage or an imminent danger.<sup>516</sup> Despite the broad language, however, the available scope of provisional injunctions—in relation to control transactions based on a claim under the JPN Companies Act—has been limited and uncertain.

A traditionally prevailing view is that general provisional injunctions should be available to protect a right only in situations where the right is of a nature that entitles the holder of such right to a permanent injunction.<sup>517</sup> As described above,<sup>518</sup> however, the availability of permanent injunctions for shareholders, in relation to control transactions, has been limited or at best uncertain. This could result in a very narrow availability of provisional injunctions in the context of control transactions.

Recently, scholars have attempted to more broadly decouple the availability of provisional injunctions from specific provisions of the JPN Companies Act authorizing permanent injunctions.<sup>519</sup> Despite the traditional view, in some cases Japanese courts have issued provisional injunctions to protect rights granted under the JPN Companies Act even if the Act does not explicitly authorize permanent injunctions to protect the rights.<sup>520</sup> In relying at least in part on such precedents, one academic has suggested that provisional injunctions should be available for rights that would entitle their owners to obtain specific performance.<sup>521</sup> The JPN Companies Act explicitly entitles shareholders to request that a court revoke a severely unjust

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<sup>513</sup> See, e.g., the authorities referenced in Yanaga, *supra* note 497, at 638 n.19. For an extensive analysis of legal theories that analyze civil law cases in Japan, see MUNENORI NEMOTO, SASHITOMESEIKYŪKEN NO RIRON [THEORIES FOR INJUNCTIONS] (2011).

<sup>514</sup> See, e.g., Yanaga, *supra* note 497, at 632–33; SHIRAI, *supra* note 139, at 515–19.

<sup>515</sup> *Karisashitome*; the term can also be translated as “interlocutory injunction.” Delaware has two types of interlocutory remedies, temporary restraining orders and preliminary injunctions. See *supra* Part IV.A.2.a. Japan has *ex parte* and non-*ex parte* proceedings too. See generally HATTORI & HENDERSON, *supra* note 422, §§ 6.1–6.08.

<sup>516</sup> See *supra* text accompanying note 466.

<sup>517</sup> Tokutsu, *supra* note 512, at 31.

<sup>518</sup> See *supra* Part V.B.3.a.i.

<sup>519</sup> See, e.g., Yanaga, *supra* note 497, at 632, 638 n.19; Tokutsu, *supra* note 512, at 30.

<sup>520</sup> See, e.g., Tokutsu, *supra* note 512, at 30, and authorities cited therein.

<sup>521</sup> *Id.* at 31.

shareholder resolution if such a resolution passed owing to a vote by a shareholder especially interested with respect to the resolution.<sup>522</sup> Under the recent scholarly view, to protect the revocation right the minority shareholders should be able to provisionally enjoin a transaction, such as a merger, it is authorized to enjoin as a result of the severely unjust shareholder resolution.<sup>523</sup> However, the ultimate outcome of the scholarly attempt is uncertain.<sup>524</sup> As stated,<sup>525</sup> under the prevailing view, permanent injunctions explicitly sanctioned by the JPN Companies Act do not allow affirmative injunctions. This position, despite the examples of affirmative provisional injunctions in Article 24 of the Provisional Remedies Act,<sup>526</sup> may further inhibit their use in the context of control transactions.

(b) Speed

In general, Japanese courts are not known for speedy handling of cases.<sup>527</sup> Unlike Delaware, no formal expedited proceeding exists in Japan. Based on the author's observation of recent high-profile provisional injunction proceedings relating to control transactions, in general Japanese courts have handled them with amazing speed and without causing undue delays in the execution of control transactions.<sup>528</sup> This is largely due to informal and abbreviated procedures applicable to such proceedings<sup>529</sup> and the courts' keen awareness of the time constraints under which the parties oper-

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<sup>522</sup> See *supra* text accompanying note 418.

<sup>523</sup> Tokutsu, *supra* note 512, at 31. See also Kōfu Chihō Saibansho [Kōfu Dist. Ct.] June 28, 1960, Shō 35 (yo) no. 61, 237 HANREJIHŌ [HANJI] 30 (Japan); EGASHIRA, *supra* note 360, at 366; Yanaga, *supra* note 497, at 634–35.

<sup>524</sup> The JPN Provisional Remedies Act does not require a court to balance equities in determining if provisional remedies should be issued. As to the Delaware requirement, see *supra* Part IV.A.2.a.i. The permanent injunction provisions of the JPN Companies Act do not contain such a requirement either. See *supra* Part V.B.3.a.i. The absence of the specific authorization for the court to consider the equities may tempt it to choose to apply the statutory requirements strictly and discourage robust use of injunctions. However, this concern may be unwarranted. For example, in rejecting a motion in which a petitioner sought a provisional order that prohibits the respondent from holding a shareholders meeting, the Tokyo High Court referred to potential hardships to the respondent if such a motion were granted. Tōkyō Kōtō Saibansho [Tokyo High Ct.] June 28, 2005, Hei 17 (ra) no. 1012, 1911 HANREI JIHŌ [HANJI] 163 (Japan).

<sup>525</sup> See *supra* Part V.B.3.a.i.

<sup>526</sup> Article 24 gives several examples of the types of orders the court may give.

<sup>527</sup> See, e.g., Carl F. Goodman, *Japan's New Civil Procedure Code: Has It Fostered A Rule of Law Dispute Resolution Mechanism?*, 29 BROOK. J. INT'L L. 511, 542–70 (2004); Takeshi Kojima, *Japanese Civil Procedure*, 46 U. KAN. L. REV. 687, 689 (1997). In recognition of the problem, Japan enacted a law designed to encourage speedy resolution of lawsuits. Saiban no jinsokuka ni kansuru hōritsu [Act on the Expediting of Trials], Law No. 107 of 2003 (Japan). MINSOHŌ (C. CIV. PRO.) art. 157 (Japan).

<sup>528</sup> For an example, see *infra* note 535. See also Arai, *supra* note 436, at 226. This does not seem unique to the Japanese courts.

<sup>529</sup> SEGI, INTRODUCTION, *supra* note 491, at 44–45.

ate.<sup>530</sup> For example, as indicated,<sup>531</sup> no formal fact-finding procedures exist, and unless a trial has been held, the court is not required to give comprehensive reasons for its order.<sup>532</sup> However, the courts' use of more robust fact-finding measures to solve AIPs may undermine their ability to render timely decisions.

Defendants in provisional remedy proceedings could have three possible appeal opportunities.<sup>533</sup> One justifiably wonders if the involvement of four separate tribunals—three of which conduct factual inquiries<sup>534</sup>—is warranted.

With respect to regular court proceedings, as one might expect, there is no rule prohibiting the courts and parties from moving expeditiously. Rather, Japanese courts have reserved power to press the parties to move speedily.<sup>535</sup>

### (c) Expertise and Flexibility

#### (i) Courts

The courts of first instance for civil cases are generally district courts located throughout Japan (fifty altogether).<sup>536</sup> The final judgments of the

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<sup>530</sup> Monguchi/Egashira Dialogue, *supra* note 434, at 11–12 (Judge Monguchi's remarks that in rare instances judges in the Commercial Division of the Tokyo District Court may try to get up to speed in anticipation of possible preliminary injunction proceedings with novel issues and the time constraints may become the most pressing issues that judges in the Commercial Division face when they handle such proceedings).

<sup>531</sup> See *supra* Part V.B.2.b.ii.

<sup>532</sup> Minji hozenhō [Civil Provisional Remedies Act], Law No. 91 of 1989, art. 16 (Japan).

<sup>533</sup> See *infra* text accompanying notes 540–543. One example is *Sumitomo Trust & Banking Co., Ltd. v. UFJ Holdings Co.* Saikō Saibansho [Sup. Ct.] Aug. 30, 2004, Hei 16 (kyo) no. 19, 58 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 1763 (Japan), [http://www.courts.go.jp/hanrei/pdf/js\\_20100319120824143614.pdf](http://www.courts.go.jp/hanrei/pdf/js_20100319120824143614.pdf). The plaintiff commenced the provisional injunction proceeding on July 16, 2005 at the Tokyo District Court, which granted the injunction. UFJ made an interlocutory appeal to another panel in the court that affirmed on August 4 the earlier determination of the court. UFJ further appealed the determination to the Tokyo High Court, which on August 11 rescinded the lower court's determination. The Japanese Supreme Court affirmed the Tokyo High Court's determination on August 30.

<sup>534</sup> Minji hozenhō [Civil Provisional Remedies Act], Law No. 91 of 1989, arts. 23, para. 4, 29, 41, para. 4 (Japan).

<sup>535</sup> See generally ITO, *supra* note 402, at 227–37. Anecdotally, delays in court proceedings are often attributable to the habits of judges and lawyers involved in lawsuits. See, e.g., Yamaura et al., *supra* note 442, at 13–14 (speculating that lawyers do not want to have quick resolutions of matters they handle, since quick resolutions mean less stable income). Some habits and traditions that existed before World War II seem to have endured despite the efforts to change them after World War II. See, e.g., ALFRED OPPLER, LEGAL REFORM IN OCCUPIED JAPAN, 130–34 (1979).

<sup>536</sup> Saibanshohō [Court Act], Law No. 59 of 1947, art. 24 (Japan) (district courts have jurisdiction over all matters of first instance unless otherwise provided by law).



district courts are generally appealable to the respective high courts (numbering eight) covering the regions in which the districts courts reside.<sup>537</sup> The high courts' final judgments may be appealed to the Supreme Court of Japan if the judgment involves an error interpreting the Constitution of Japan, or otherwise violates it.<sup>538</sup> The Japanese Supreme Court may decide to entertain an appeal from the high court if the judgment conflicts with Japanese Supreme Court precedents or involves an important interpretive issue.<sup>539</sup>

Decisions of the district courts granting provisional remedies may be appealed to panels of separate judges of the same district courts.<sup>540</sup> The decisions these separate panels and the original decisions of the district courts denying provisional remedies are appealable to the high courts.<sup>541</sup> The high court decisions are further appealable to the Japanese Supreme Court if they involve errors in interpreting the Constitution of Japan or otherwise violate it.<sup>542</sup> Appeals of high court decisions are also possible when the high courts that render the decisions allow the appeals on the basis that the judgments conflict with Japanese Supreme Court precedents or involve important interpretive issues.<sup>543</sup>

The Cabinet nominates the chief judge and appoints associate judges of the Japanese Supreme Court.<sup>544</sup> The Japanese Supreme Court nominates lower court judges.<sup>545</sup> The lower court judges are appointed for ten-year terms that may be renewed.<sup>546</sup> With certain exceptions—in particular several of the current members of the Japanese Supreme Court—judges are mostly career judges.<sup>547</sup> No jurors are present at Japanese civil proceedings.

(ii) *Weak Specialization*

“[H]istorically, common law judges have been more comfortable than

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<sup>537</sup> MINSOHŌ (C. CIV. PRO.) art. 281, para. 1 (Japan).

<sup>538</sup> *Id.* art. 312, paras. 1, 3 (Japan).

<sup>539</sup> *Id.* art. 318 (Japan).

<sup>540</sup> Minji hozenhō [Civil Provisional Remedies Act], Law No. 91 of 1989, art. 26 (Japan). *See, e.g., supra* note 533.

<sup>541</sup> MINSOHŌ (C. CIV. PRO.) art. 328, para. 1 (Japan); Law No. 91 of 1989, art. 41 (Japan).

<sup>542</sup> MINSOHŌ (C. CIV. PRO.) art. 336 (Japan); Saibanshohō [Court Act], Law No. 59 of 1989, art. 7, para. 1, no. 2 (Japan).

<sup>543</sup> MINSOHŌ (C. CIV. PRO.) art. 337 (Japan); Law No. 59 of 1989, art. 7, para. 1, no. 2 (Japan).

<sup>544</sup> NIHONKOKU KENPŌ [KENPŌ] [CONSTITUTION], art. 6, para. 2, art. 79, para. 1 (Japan); Law No. 59 of 1989, art. 39 (Japan). They will retire at age 70. *Id.* ¶5.

<sup>545</sup> NIHONKOKU KENPŌ [KENPŌ] [CONSTITUTION], art. 40, para. 1 (Japan); Law No. 59 of 1989, art. 40, para. 1 (Japan).

<sup>546</sup> NIHONKOKU KENPŌ [KENPŌ] [CONSTITUTION], art. 80, para. 1 (Japan); Law No. 59 of 1989, art. 40, para. 3 (Japan).

<sup>547</sup> *See generally* HATTORI & HENDERSON, CIVIL PROCEDURE IN JAPAN *supra* note 422, § 3.02.

their civil law counterparts in working with open-ended standards,<sup>548</sup> and, anecdotally, Japanese judges prefer not to “interpret” standards. However, they seem to shed such a mind-set when they are put on the spot. Thus, they interpret broadly phrased constitutional<sup>549</sup> and statutory provisions,<sup>550</sup> including the fiduciary duty provisions in the JPN Companies Act.<sup>551</sup> There are certain “judge-made” laws as well.<sup>552</sup> Perhaps Japanese judges are more comfortable interpreting standards than judges in Continental Europe.<sup>553</sup> Thus, in policing Gatekeepers, the judiciary is required to apply amorphous standards, which should not necessarily be fatal.

Due to the heavy concentration of headquarters of public Japanese companies in Tokyo and Osaka, however, lawsuits relating to control transactions tend to be filed with the Tokyo District Court or the Osaka District Court. Based on their respective internal rules, these courts have Commercial Divisions<sup>554</sup> to deal with a high percentage of the disputes relating to control transactions. This specialization, however, is incomplete. First, not all cases are filed with the two district courts. Second, typically judges, including those in the Commercial Divisions, have frequent rotations in the

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<sup>548</sup> Kanda & Milhaupt, *supra* note 411, at 895.

<sup>549</sup> NIHONKOKU KENPŌ [KENPŌ] [CONSTITUTION], art. 81 (Japan).

<sup>550</sup> *See, e.g.*, the Japanese Civil Code: “The exercise of rights and performance of duties must be done with good conscience and sincerity.” MINPŌ (CIV. C.) art. 1, para. 1, no. 1 (Japan). “No abuse of rights is permissible” is another example. *See id.* art. 1, para. 1, no. 2 (Japan).

<sup>551</sup> Kanda and Milhaupt point out Japanese courts’ successful applications of “duty of loyalty” provisions of Article 254–3 of the Commercial Code that were statutorily introduced into company law after World War II and are now in Article 355 of the JPN Companies Act. *See* Kanda & Milhaupt, *supra* note 411, at 895–96.

<sup>552</sup> *See, e.g.*, Shoji Shinoda, *Hanrei ni yoru hō no sōzō* [Creation of Law by Judicial Precedents], in HANREI TO SONO YOMIKATA [JUDICIAL PRECEDENTS AND HOW THEY SHOULD BE READ] 219 (Tsugio Nakano ed., 3d ed. 2009).

<sup>553</sup> There are commentaries possibly justifying the conjecture. *See* NOBUYOSHI TOSHITANI, NIHON NO HŌ WO KANGAERU [REFLECTIONS ON JAPANESE LAW] 27 (2d ed. 2013) (suggesting that Japanese Civil Code provisions are much simpler than those of France and Germany); ATSUSHI OMURA, HŌGEN, KAISHAKU, MINPŌGAKU [SOURCE OF LAW, INTERPRETATION, CIVIL LAW STUDY] 69 (3d ed. 2003) (stating that judgments in Japan in civil cases in many ways look more similar to those in the United States than to those in France).

<sup>554</sup> For the Tokyo District Court, see TOKYO DISTRICT COURT, TOKYŌ CHIHŌ SAIBANSHO OYOBI KAN’NAI KAN’I SAIBANSHO NO HEISEI 25-NENDO NI OKERU SAIBANKAN NO HAICHI, SAIBANJIMU NO BUNPAI OYOBI DAIRI JYUNJO, KAITEI NO HIWARI NARABINI SHIHŌGYŪUSEIJIMU NO DAIRI JYUNJO NI TSUITE NO SADAME [RULES FOR THE TOKYO DISTRICT COURT AND SUMMARY COURTS WITHIN ITS JURISDICTION ON JUDGES’ ASSIGNMENTS, ALLOCATION OF JUDICIAL TASKS AND SUBSTITUTION SEQUENCE, COURT IN SESSIONS, AND SEQUENCE OF JUDICIAL ADMINISTRATION SUBSTITUTION] art. 9, para. 4 (2015) (this document and its prior versions respectively as of April 19, 2012, June 25, 2013 and May 14, 2014 are on file with the author). For the Commercial Division of the Osaka District Court, see Ōsaka chihōsaibansho ōsakakateisaibansho [Summary Court of the Osaka District Court], NIHON NO SAIBANSHO [JAPANESE COURTS], [http://www.courts.go.jp/osaka/saiban/minji4/dai1\\_1/index.html](http://www.courts.go.jp/osaka/saiban/minji4/dai1_1/index.html) (last visited Jan. 23, 2016).

judicial system.<sup>555</sup> Third, not all control transaction cases are assigned internally to the Commercial Divisions. Further, there is no specialization at the high court level.<sup>556</sup>

### C. Other Non-US Jurisdictions

The broad discovery and opt-out class action systems in the United States are uniquely American.<sup>557</sup> Many civil law countries require a higher level of proof than the preponderance of the evidence standard in the United States.<sup>558</sup> The same is true with respect to issue preclusion.<sup>559</sup> “European countries usually adopt the ‘English rule’ . . . [and] the final sum cannot be negotiated in advance by the plaintiff and her lawyer, because it is a cost

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<sup>555</sup> For example, of the thirteen judges and associate judges in the Commercial Division of the Tokyo District Court on April 19, 2012, seven, twelve and all rotated out of the division by June 25, 2013, and April 1, 2014, respectively. For the names of the judges and associate judges in the division on April 19, 2012, June 25, 2013, May 14, 2014 and April 15, 2015, see TOKYO DISTRICT COURT, *supra* note 554, annex 1–2 (on file with the author).

<sup>556</sup> See Arai, *supra* note 436, at 227 (recommending that the Tokyo and Osaka High Courts should have special commercial divisions). Recently, the need to implement measures to enhance the specialization of judges dealing with finance and commercial matters has been discussed at both the agency and the political levels. See, e.g., HŌSEISHINGIKAI KAISHAHŌ BUKAI DAISANKAI GIJIRŌKU [MINUTES OF THE THIRD MEETING OF THE CORPORATE LAW COMMITTEE OF THE COMMITTEE ON THE LEGAL SYSTEM] 11 (2010) (statement of Futoshi Nasuno), <http://www.moj.go.jp/content/000052523.pdf>; CORP. GOVERNANCE COMM., LIBERAL DEMOCRATIC PARTY ECON. RES. COMM., KŌSEINA M&A RŪRU NI KANSURU TEIGEN [PROPOSALS RELATING TO FAIR M&A RULES] 5 (2005), [http://www.jimin.jp/election/results/sen\\_san22/seisaku/2005/pdf/seisaku-006.pdf](http://www.jimin.jp/election/results/sen_san22/seisaku/2005/pdf/seisaku-006.pdf).

<sup>557</sup> With respect to discovery, see, for example, Gorga & Halberstam, *supra* note 215, at 1389–90. With respect to opt-out class actions, see, for example, *id.* at 69; Coffee, *supra* note 96, at 301 n.37 (focusing on European jurisdictions); Samuel Issacharoff & Geoffrey P. Miller, *Will Aggregate Litigation Come to Europe?*, in THE LAW AND ECONOMICS OF CLASS ACTIONS IN EUROPE 37 (Jürgen G. Backhaus et al. eds., 2012); CHRISTOPHER HODGES, THE REFORM OF CLASS AND REPRESENTATIVE ACTIONS IN EUROPEAN LEGAL SYSTEMS (2008); Richard A. Nagareda, *Aggregate Litigation across the Atlantic and the Future of American Exceptionalism*, 62 VAND. L. REV. 1, 19–37 (2009). Moreover, the transplant of discovery and class action systems are “very hard, won’t work very well if attempted, or both.” Black, *supra* note 91, at 1594, 1601–02. See also Guido Ferrarini & Paolo Giudici, *Financial Scandals and the Role of Private Enforcement: The Parmalat Case 4* (Eur. Corp. Governance Inst. Law Working Paper No. 40/2005, 2005), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=730403](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=730403) (indicating “class action and discovery rules” as “US institutions”). Moreover, in some jurisdictions the judiciaries have inquisitorial rather than adversarial systems. See, e.g., Oscar G. Chase, *American “Exceptionalism” and Comparative Procedure*, AM. J. COMP. L. 277, 283–84 (2002). Inquisitorial jurisdictions may require an entirely different approach to solve AIPs (asymmetric information problems) in relation to the Stage I prerequisites.

<sup>558</sup> See, e.g., Clermont & Sherwin, *supra* note 110, at 243 (“In civil-law countries, the standard seems strange to us: a civil claimant must in effect convince the trier of fact that the claimant’s assertions are true.”).

<sup>559</sup> See, e.g., Hiroshi Motomura, *Arbitration and Collateral Estoppel: Using Preclusion to Share Procedural Choices*, 63 TUL. L. REV. 29, 78 (1988); Antonio Gidi, *Class Actions in Brazil: A Model for Civil Law Countries*, 51 AM. J. COMP. L. 311, 384–85 (2003).

that the loser has to face.”<sup>560</sup> Also, the loser pays aspect disincentivizes potential plaintiffs.<sup>561</sup> It appears that the rule applied by courts “ends up chilling lawyers’ activism as [private attorneys general].”<sup>562</sup> Thus, in general, judiciaries in non-U.S. jurisdictions find meeting the Stage I prerequisites difficult.

As to the Stage II prerequisites, injunctions, including interlocutory injunctions, may not be available in lawsuits against fiduciaries as readily, broadly, and flexibly as in the United States.<sup>563</sup> They may not have specialized judiciaries that focus on corporate matters and can move quickly and flexibly.<sup>564</sup> Judges in European countries may be less comfortable applying broad standards than judges in Japan,<sup>565</sup> let alone in the United States.<sup>566</sup> Thus, in general, those judiciaries will also find it difficult to satisfy the Stage II prerequisites.

#### D. Summary

To date there have been few, if any, successful hostile acquisitions under the current JPN Companies Act, which was enacted in 2005.<sup>567</sup> There were a couple of successful legal challenges against defense measures adopted in the middle of the last decade.<sup>568</sup> The defeated defense measures were very primitive. The judges were able to rule on the legality of the measures without looking beyond the four corners of the public disclosures made in relation to the adoption or the use of the measures.<sup>569</sup> Those challenges were not brought by dispersed shareholders. However, advisors on the defense side quickly became more sophisticated and able to create a facade that, on the surface, passes muster under the *Unocal* standard. Soon,

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<sup>560</sup> Ferrarini & Giudici, *supra* note 557, at 49; *see also* Gomez & Saez, *supra* note 12, at 276 n.30 (stating that a contingency fee arrangement “is still formally not acceptable in several Continental European jurisdictions”).

<sup>561</sup> Gomez & Saez, *supra* note 12, at 276 n.30.

<sup>562</sup> *Id.*

<sup>563</sup> For example, Fernando Gomez and Maria Isabel Saez discussed only class action damage suits to enforce the no-frustration rule under the EU Takeover Directive. *See* Gomez & Saez, *supra* note 12. For the no-frustration rule, *see* EU Takeover Directive, *supra* note 17, art. 9. *See also* Wendy A. Kennett, *Enforcement of Judgments in Europe*, 5 EUR. REV. PRIVATE L. 321 (1997).

<sup>564</sup> *See, e.g.*, Black et al., *Legal Liability of Directors and Company Officials Part 1*, *supra* note 120, at 715 (with respect to Russia).

<sup>565</sup> *See supra* note 553.

<sup>566</sup> Judges in civil law countries are generally less experienced in interpreting standards. *See, e.g.*, Simon Johnson et al., *Tunneling*, 90 AM. ECON. REV. 22 (2000); Coffee, *supra* note 129, at 28.

<sup>567</sup> *See* TANAKA, *supra* note 367, at 326, 338.

<sup>568</sup> For examples, *see, for example*, Osugi, *supra* note 365, at 43–49; Milhaupt, *Bull-Dog Sauce*, *supra* note 365, at 348–50.

<sup>569</sup> *See* Arai, *supra* note 436, at 223. They should have met the standards for summary judgments in Delaware. *See supra* text accompanying notes 297, 299.

due primarily to the AIPs relating to lawsuits, hurdles for hostile suitors became exceedingly high. Poor prospects of having a day in court or success in court discourage potential hostile acquisition attempts if the boards of potential target companies resist acquisition attempts in violation of their fiduciary duties. Other shareholders fared worse, since they also had CAPs. With respect to friendly acquisitions, including MBOs and freeze-outs, the narrow scope of available injunctive remedies further discourages shareholders from seeking anticipatory adjudication. They tend to sit idle until transactions are completed and then seek a de facto appraisal proceeding. Damage suits have also been uncommon.

This is illustrated by two legal proceedings relating to a two-step acquisition of REX Holdings Inc. (REX) completed in 2007 by (i) an individual who is a founder, a representative director, and a de facto 29.61% owner (the Founder) and (ii) a private equity fund (the Fund). The initial agreement between the Founder and the Fund contemplated the Founder's post-buyout stake of 3%–5%. However, after a postdiligence negotiation, the buyout price went down significantly, and the Founder's postbuyout stake increased to 33.4%, a figure higher than the prebuyout stake. In relation to the transaction, the buyout group did not implement any notable measures to mitigate the Founder's conflict of interest. Despite the obvious shortcomings, no one sought to enjoin the first step tender offer or the second step freeze-out. Shortly after the completion of the transaction, an appraisal proceeding (the REX I proceeding) commenced, and in 2009 the Japanese Supreme Court confirmed a valuation by the Tokyo High Court that was substantially higher than the price offered in the two-step acquisition.<sup>570</sup> Piggybacking on the successful Japanese Supreme Court appraisal determination, 114 shareholders filed damage lawsuits (the REX II proceeding) against the Founder and certain other former officers of the company alleging the defendants' violated their fiduciary duties in relation to the second step freeze-out transaction. In the damage proceeding, the Tokyo High Court<sup>571</sup> refused to grant any damage awards despite the much higher valuation given in the REX I Supreme Court determination. The case was appealed to the Japanese Supreme Court, which is yet to announce its decision. The chronology of the two related proceedings—particularly the absence of any injunction proceeding—shows that the Japanese judiciary does not have effective strategies and tools to solve the TPs relating to shareholder lawsuits against Gatekeepers.<sup>572</sup>

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<sup>570</sup> Saikō Saibansho [Sup. Ct.] May 29, 2009, Hei 20 (ku) no. 1037/ Hei 20 (kyo) no. 48, 1326 KIN'YŪ SHŌJI HANREI [KINHAN] 35 (Japan). For an analysis of the REX I proceeding, see, for example, Wataru Tanaka, *Going Private and the Role of Courts: A Comparison of Delaware and Japan*, 3 U. TOKYO SOFT L. REV. 12, 16–18 (2011).

<sup>571</sup> Tōkyō Kōtō Saibansho [Tokyo High Ct.] Apr. 17, 2013, Hei 23 (ne) no. 2230, 2190 HANREI JIHŌ [HANJI] 96 [hereinafter REX II Tokyo High Court decision] (appeal pending).

<sup>572</sup> In Delaware a class action damage lawsuit may follow a favorable appraisal decision. See *In re*

It appears that many or most judiciaries elsewhere in the world would not fare any better than the Japanese judiciary in a similar situation.<sup>573</sup> For example, Guido Ferrarini and Paolo Giudici took a dim view of securities damage suits in Continental European countries.<sup>574</sup> However, the TPs at Stage I in shareholder lawsuits against Gatekeepers are more acute than those in securities actions for damages. In addition, in lawsuits against Gatekeepers—unlike securities actions for damage suits—there is often a need for anticipatory relief. Thus, the observation of Ferrarini and Giudici apply more strongly to shareholder lawsuits against Gatekeepers.

## VI. INTENSITY OF GATEKEEPING AND *EX POST* JUDICIAL AND *EX ANTE* NONJUDICIAL POLICING

### A. United States

The *ex post* judicial policing of Gatekeepers is a possible solution to solve dilemmas of control transaction governance.<sup>575</sup> However, *ex post* judicial policing faces its own dilemmas. These dilemmas all relate to the TPs.<sup>576</sup> Delaware's judiciary has been revealed as the best-equipped in the United States to deal with such dilemmas. This does not mean, however, that the Delaware judiciary is perfect<sup>577</sup> and can completely solve or eliminate the dilemmas. The more capable it is, the more Gatekeeping power it should be able to give to Gatekeepers. The more confidence one has in the Delaware judiciary, the more power one is willing to give to boards and vice versa.

There have been heated disagreements on the proper limit of Gatekeepers' roles. However, to a substantial extent, this debate might have

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Orchard Enter., Inc. Stockholder Litig., 88 A.3d 1 (Del. Ch. 2014). However, the factual circumstance is entirely different from that of the REX buyout transaction. The Delaware case involved a controller freeze-out after the controller's failure to sell its position. *See id.* at 12. Therefore it appeared unlikely for a third-party bidder to surface to acquire the company at a price acceptable to the controller. In addition, the controller has the ability to pay damages. A preliminary injunction did not appear to lead to an arms-length negotiation between the controller and a purported independent committee. *See supra* Parts III.C.1.b.ii., III.C.2. Thus it seemed strategically sensible for potential plaintiffs to seek damages from the controller after the completion of the transaction.

<sup>573</sup> The Enterprise Chamber in the Netherlands may be an exception. *See, e.g.*, Jack B. Jacobs, The Role of Specialized Courts in Resolving Corporate Governance Disputes in the United States and in the EU, Paper presented at the OECD Exploratory Meeting on Resolution of Corporate Governance Related Disputes 20–21 (Mar. 20, 2006), <http://www.oecd.org/daf/corporateaffairs/corporategovernanceprinciples/37188750.pdf>.

<sup>574</sup> *See Ferrarini & Giudici, supra* note 557, at 41–56.

<sup>575</sup> *See supra* Part II.C.

<sup>576</sup> *See supra* Part II.D.

<sup>577</sup> *See, e.g.*, William T. Allen, *The Pride and the Hope of Delaware Corporate Law*, 25 DEL. J. CORP. L. 70, 72 (2000).

been a proxy for a debate on the court's capability. Disagreements as to the outer limit of the judiciary's capability could create disagreements as to the proper limit on Gatekeepers' roles. In recent years, despite sharp criticisms by several noted academics,<sup>578</sup> Delaware's judiciary has been reluctant to tighten the Gatekeeping roles of corporate boards.<sup>579</sup> This could mean that the Delaware judiciary thinks more highly of its own overall capabilities than those critics do. It seems worthwhile to examine whether this is indeed the case.

The standards that non-Delaware judiciaries can optimally apply and enforce are different from those the Delaware judiciary can optimally apply and enforce. Thus, if non-Delaware judiciaries transplant and use Delaware standards, there could be too many false negatives and false positives. They should consider cutting back corporate fiduciaries' Gatekeeping roles to make the fiduciaries' tasks less demanding. For example, non-Delaware states might want to limit the use of defense measures—such as poison pills—to those that protect against well-defined structural coercions,<sup>580</sup> given that structural coercion is more objectively identifiable than substantive coercion.<sup>581</sup> The collective interests of shareholders are also more easily identifiable than the interests of all the constituents. The removal of these from what the Gatekeepers are allowed to consider would markedly reduce the need for and the complexity of anticipatory adjudication.<sup>582</sup> This in turn might reduce their competitive disadvantages vis-à-vis Delaware and level the playing field.<sup>583</sup> Shareholders of Delaware corporations may file lawsuits with non-Delaware judiciaries. There is a risk that plaintiff shareholders would file these lawsuits hoping to see many false positive decisions.<sup>584</sup> If true, it seems reasonable for Delaware corporations to adopt forum selection certificates or bylaws.<sup>585</sup>

Michal Barzuza has pointed out that to varying degrees and depending on the anti-takeover statutes under which they operate courts in non-Delaware states use standards less exacting than those that Delaware uses to determine directors' compliance with their fiduciary duties in connection with change in control transactions.<sup>586</sup> Based on this observation, she has suggested federal legislation to obligate all states to use the Delaware judi-

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<sup>578</sup> See, e.g., EASTERBROOK & FISCHER, *THE ECONOMIC STRUCTURE*, *supra* note 16, at 162–211; Bebchuk, *The Case Against Board Veto*, *supra* note 7; Gilson, *Structural Approach*, *supra* note 151.

<sup>579</sup> See the authorities cited in *supra* note 51.

<sup>580</sup> For structural coercion, see the authorities cited in *supra* note 48.

<sup>581</sup> For substantive coercion, see *supra* note 73.

<sup>582</sup> See *supra* Part II.D.2.a.

<sup>583</sup> See Kamar, *supra* note 151, at 1954 (stating that the jurisdictional competition “may not be a race among equals”).

<sup>584</sup> See *supra* text accompanying notes 60–61.

<sup>585</sup> See *supra* note 63.

<sup>586</sup> See Barzuza, *supra* note 52.

cial standards as the minimum for policing the conduct of directors in such transactions.<sup>587</sup> This position, however, mistakenly assumes that “all judiciaries are created equal” and ignores that non-Delaware judiciaries are not necessarily equipped to handle such fine instruments, particularly in the context of anticipatory adjudication. The non-Delaware judges, if they are unsure of how to properly use the fine instruments, may try to hide behind the more-deferential and less-exacting business judgment rule. Rather, Barzua should propose that the non-Delaware states consider cutting back the powers of Gatekeepers.

### B. Non-US Jurisdictions

Shareholder lawsuits against Gatekeepers are unique, and courts, even if they are generally competent, are not necessarily effective in handling such lawsuits.<sup>588</sup> Before any jurisdiction chooses to have Gatekeepers under its corporation law,<sup>589</sup> it needs to make certain that its judiciary is equipped to police Gatekeepers.<sup>590</sup> In view of the potentially large gap existing judiciaries must bridge to satisfy the prerequisites, one choice is to have a specialized court with strategies, tools, and attributes that enable it to satisfy the prerequisites. This adaptation could be the least disruptive to the overall judicial system.<sup>591</sup> Over time this court will develop expertise in the field. The administrative cost of maintaining a judiciary that can meet the prerequisites can also be made minimal.<sup>592</sup>

With respect to directors acting as Gatekeepers, a possible interim measure is to give directors only a limited Gatekeeping role similar to the one suggested for non-Delaware jurisdictions in the United States.<sup>593</sup> An alternative can be judicial adoption of the no-frustration rule under the Takeover Code.<sup>594</sup> Under these approaches, “[t]he impact of management action

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<sup>587</sup> *See id.*

<sup>588</sup> *Cf. Kamar, supra note 151*, at 1954–55 (“It is implausible that courts in [Germany, Britain, and Japan] are inherently less equipped than their American counterparts to handle corporate disputes.”).

<sup>589</sup> Some EU countries have opted out of the no-frustration rule. *See supra note 37* and accompanying text. If the company laws of the relevant jurisdictions give the local companies devices that function as defense measures, those who opt out might unwittingly put their judiciaries on the spot.

<sup>590</sup> For an analysis of transplants of fiduciary duties in civil law countries in Europe, see Pistor & Xu, *supra note 410*.

<sup>591</sup> A small change may speed up a judicial reform that typically does not move quickly. *See, e.g., Jens Dammann & Henry Hansmann, Globalizing Commercial Litigation*, 94 CORNELL L. REV. 1, 9–10 (2008).

<sup>592</sup> This might be the approach the Netherlands took when it established the Enterprise Chamber. *See, e.g., Jacobs, supra note 573*. To resolve disputes relating to freeze-outs, Ronald Gilson and Alan Schwartz suggested the establishment of “an EU-level-specialized commercial court.” Gilson & Schwartz, *supra note 160*, at 179.

<sup>593</sup> *See supra Part VI.A* (third paragraph).

<sup>594</sup> *See supra note 38*. Gilson once suggested this approach. *See Gilson, Structural Approach, supra*



on the opportunity for shareholder decision is a relatively narrow factual question.<sup>595</sup> Due to the objective nature of the prohibitions, the normative force of the Stage I prerequisites should be less.<sup>596</sup> As stated,<sup>597</sup> depending on its capability and attributes, each judiciary has a substantive judicial standard it can use optimally. As its capabilities and attributes improve, it can shift to another standard that allows it to attain a higher optimal equilibrium point.<sup>598</sup> Creative use of existing tools and changes to uncodified traditions—such as allowing for flexible burden shifting and lowering the level of the burden of proof—should also be considered. The Internet might also lessen CAPs at Stage I. These approaches still require the availability of strong and flexible anticipatory adjudication. If controllers act as Gatekeepers, it is essential for the judiciary to meet the Stage I prerequisites.<sup>599</sup>

If a no-frustration rule exists, the TPs—particularly the AIPs—may be fewer in lawsuits to enforce the rule, but they would still need to be resolved. If the judiciaries are far from being able to meet the Stage I prerequisites, therefore, we have to abandon the interim approach and consider an approach in which neither board members nor controllers act as Gatekeepers. That is the approach of the Takeover Code.<sup>600</sup> Under this approach, the Stage I prerequisites become substantially irrelevant, since shareholders do not have to initiate and prosecute proceedings to police the control transactions. This means that the tasks of the boards and the controllers are far more straightforward and simple, and no less importantly, the tasks do not force them to make numerous intricate decisions imbued with strong or outright conflicts of interest.<sup>601</sup> “rules” or “regulations,” rather than “standards,” generally now regulate the conduct of the directors and controllers. Thus, a nonjudicial body, organ, or institution can credibly assume the policing roles that would otherwise fall upon judiciaries. The nonjudicial body’s *ex ante* rule making and enforcement release the judiciary from the problem of implementing restorative relief.<sup>602</sup> Thus, the Stage II prerequi-

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note 151, at 877–79.

<sup>595</sup> See Gilson, *Structural Approach*, *supra* note 151, at 881–82.

<sup>596</sup> It would be necessary for the jurisdiction to have mechanisms similar to the U.K. MBR to prevent structural coercion. See *supra* text accompanying notes 389–391. Under the market standard, such mechanisms are unnecessary. For the market standard, see *supra* note 7.

<sup>597</sup> See *supra* Part V.C.

<sup>598</sup> It may be true that “the effectiveness of judicial review . . . is more important than the details of the legal standard that a country adopts.” Gilson & Schwartz, *supra* note 160, at 164–65. However, as indicated, different substantive rules may require different types of competence from the courts that apply the rules.

<sup>599</sup> In the context of freeze-outs, anticipatory adjudication is less important. See *supra* Part III.C.2.

<sup>600</sup> See *supra* Part II.A. (first paragraph).

<sup>601</sup> See *supra* Part II.D.

<sup>602</sup> At least the review of these decisions can be made “in real time.” Armour & Skeel, *supra* note 8, at 1744.

sites are also irrelevant.<sup>603</sup> This regime, however, would require shareholder protections similar to the U.K. MBR and restrictive freeze-out rules, and these restrictions have anti-efficiency aspects.<sup>604</sup>

## VII. CONCLUSION

Upon reflection, it should become quickly obvious that shareholder CAPs and AIPs of companies with partially or wholly dispersed shareholders generate root issues relating to both the governance of the companies and the policing of their control transactions, including freeze-outs, that are often induced by the governance issues. The *ex post* policing by a judiciary of these control transactions calls for unique judicial attributes. The Delaware judiciary has speed, expertise and flexibility. Those are features doctrinally called for and specially suited to *ex post* policing. That is why it is the best in the business. While less suited to engage in such *ex post* policing than the Delaware judiciary, other judiciaries in the United States in general have the most critical of the procedures and attributes necessary to engage in such policing. However, for example, class action and discovery are uniquely American but are crucial for effective *ex post* judicial policing. There are others features that are unusual outside of the United States. Thus, at least *ex post* judicial policing will not work in many jurisdictions outside of the United States. The scopes of corporate fiduciaries' gatekeeping roles in control transactions, however, have positive relationships with the severity of the twin problems relating to shareholder lawsuits against the fiduciaries and the complexity and difficulty of *ex post* judicial policing.

What do these suggest? To a substantial extent, the ongoing debate as to the scope of board veto power in relation to third party acquisitions could be a disagreement as to the ability of the Delaware judiciary to police board members: "Yes, the Delaware judiciary is very sophisticated and the best, but is it good enough to let directors recognize for example the threat of substantive coercion as a threat under *Unocal*?" Non-Delaware judiciaries should consider applying judicial standards that give fiduciaries less gatekeeping powers than those the Delaware judiciary gives. Multijurisdictional

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<sup>603</sup> Further, judiciaries may be less efficient than the Takeover Panel in enforcing these principals. See, e.g., Armour & Skeel, *supra* note 8, at 1732 ("[T]he United Kingdom's system has *prima facie* advantages in terms of procedure—it seems at once quicker, cheaper, and more certain than a system that relies upon litigation."); Gomez & Saez, *supra* note 12. One remaining question is whether it makes sense, unlike the regime under the Takeover Code, to let controllers remain as Gatekeepers with respect to freeze-outs.

<sup>604</sup> Anti-efficiency aspects of the U.K. MBR, see, for example, Davies & Hopt, *Control Transactions*, *supra* note 19, §§ 8.2.5.4, 8.3.1; PACCES, *supra* note 13, § 7.4.2.2. The same can be said about the stringent freeze-out rule in the United Kingdom. For example, minority shareholders might vote down efficiency enhancing freeze-outs. See *supra* Part II.B.2. As to the allocation of lawmaking and law enforcement powers between judiciaries and agencies, see Pistor & Xu, *supra* note 410, at 13–17.

litigation involving Delaware companies to arbitrate differences in the relevant qualities of the judiciaries are expected to produce adverse consequences.

Non-U.S. judiciaries in jurisdictions that have companies with at least partially-dispersed shareholders—such as certain EU countries and Japan—should keep the gatekeeping roles of corporate fiduciaries significantly below those given to fiduciaries in Delaware if they choose to employ *ex post* judicial policing. As their procedures and attributes become more consistent with the theoretical prerequisites for *ex post* judicial policing, they can choose to use another standard that gives a greater gatekeeping role to attain a higher optimal equilibrium. Depending on the procedures and attributes of their judiciaries, it may be better for non-U.S. jurisdictions to forgo judicial policing and resort to nonjudicial organs or bodies—such as those similar to the Takeover Panel—that promulgate rules to address the twin problems and engage in *ex ante* enforcement.