



# Controlling Non-controlling Shareholders: The Case of Effective Control

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## Controlling Non-controlling Shareholders: The Case of Effective Control

Moran Ofir\*

**Abstract:** One of the most important developments underlying capital markets in recent years is the increase in the influence of activist minority shareholders. In a company without a controlling shareholder, dominant and active shareholders, who hold a low proportion of the company's shares, can influence, and even tip the scales in the decisions made and direct the company's business. As a result, the legal system imposes a fiduciary duty not only on controlling shareholders but also on those with effective control, but alongside the obligation, the absence of a clear and explicit definition of the concepts of effective power and effective control stands out. The article empirically analyzes key court decisions litigated under Delaware law and finds that only two explanatory variables significantly explain court decisions in cases raising the question of effective control. Therefore, the article proposes a test for estimating the effective power borrowed from the field of cooperative game theory. The test is based on the Shapley Value and the Shapley and Shubik's Power Index and presents its application to the decisions made at the shareholders' meetings to estimate the effective power of activist minority shareholders in various decisions. As detailed in the article, this test, simple to operate, examined objectively based on the factual system that existed at the time of making the tested decision and is not limited to specific ownership structures, certain markets, and current times. The adoption of the test is expected to increase the legal certainty regarding the imposition of duties on activist minority shareholders with effective control, thereby reducing the agency costs created as a result of the gap between their formal share in the corporation and their effective power.

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## INTRODUCTION

Institutional investors own up to 80% of the public U.S. capital market. Their portion of the market has grown steadily from 1950 when it was just below 10%.<sup>1</sup> This significant change introduces new conceptions of risks and incentives and requires a re-examination of decision-making process at corporate institutions. An empirical study shows that the average number of institutions with a 1% block in a given security is 11.19, the number of 3% block is 4.33, and of 10% is just 0.90. These numbers demonstrate the institutional investors' preference of limited block share.<sup>2</sup> The fact that, as of today, most minority shareholders are sophisticated investors who take active part in corporations' decision-making process<sup>3</sup> requires adequate adaptation in terms of the legal duties which apply to minority activist shareholders.<sup>4</sup>

The common discussion about shareholders' duties and restrictions is mainly focused on the controlling shareholders of corporates. The accepted definition of this category – controlling shareholders – was identified in the monumental case of *Kahn v. Lynch* by the Delaware Supreme Court of Justice which described circumstances in which a stockholder could be found a controller under Delaware law: where a stockholder owns more than 50% of the voting power; or owns less than 50% but "exercises control" in the business.<sup>5</sup> Indeed, the interpretation of "exercises control" will set the legal boundaries for the minimum ownership which could be enough for one to be considered as a controller.

The problem, though, is that this binary distinction between controller and minority shareholder is missing a category of shareholders which effectively influence company decisions in one way or another, but are not subjected to neither regulation or legal duties. These "minority activist shareholders" do not satisfy the definition of "controlling shareholders" but can gain, in some situations, effective control.

Those minority activist shareholders dominate some of the world largest companies<sup>6</sup> and are mostly institutional investors who are governed by different legal frameworks.<sup>7</sup> They are subject to legal restrictions and regulations due to their special practice – to manage and invest others money.<sup>8</sup> However, these rules aim to

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<sup>1</sup>Alan R. Palmiter, *Staying Public: Institutional Investors in U.S. Capital Markets*, Brooklyn Journal International Law, Vol. 3, 243, 256 (2009).

<sup>2</sup>Amil Dasgupta, Vyacheslav Fos & Zacharias Sautner, *Institutional Investors and Corporate Governance*, European Corporate Governance Institute, Finance Working Paper N° 700/2020, 25-26 (2020).

<sup>3</sup>*Id.* at 13.

<sup>4</sup>Nicole Stracar, *Applying a New Regulatory Framework to Interested Transactions by Minority Shareholders*, 20 U. PENN. J. BUS. L. 993, 1018 (2018).

<sup>5</sup>*Kahn v. Lynch Comm'n Sys. Inc.*, No. 638 A.2d 1110, 1113–14 (Del. 1994).

<sup>6</sup>Lucian A. Bebchuck & Kobi Kastiel, *The Perils of Small-Minority Controllers*, 107 GEO. L.J. 1453 (2019).

<sup>7</sup>Dasgupta et al., *supra* note 2.

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

protect the investors (customers) of the funds and are not applied to the actions of the funds as share block-holders in other publicly traded companies.<sup>9</sup>

In this article, the literature review will present possible legal tools to restrict active minority shareholders in the cases of "effective control", and the case law review will provide an overview of cases in which the judges focus on possible definitions of "active or effective control" and the principal ways to restrict those non-controlling activist shareholders.

In the second part of the paper, I empirically analyse cases litigated under Delaware law which deal with activist minority shareholders. All cases were coded by a list of explanatory variables to test their correlation with the court's decision on whether the activist minority shareholder holds effective control. The result shows inconsistencies in courts' decisions, with only two explanatory variables significantly explaining it. In order to solve the existing inconsistency, the third part of the paper offers a tool based on the Shapley Value and the Shapley and Shubik's Power Index and presents its application to the decisions made at the shareholders' meetings to estimate the effective power of minority shareholders in various decisions. The last part of the paper discusses the proposed tool as well as its policy implications and concludes.

## I – THEORY

The principal-agent problem is an inherent problem in many corporate structures. The literature distinguishes between three different principal-agent problems: between shareholders and managers; between shareholders and creditors; and between controlling and minority shareholders. In companies with a controlling shareholder, the main principal-agent problem is "horizontal" between the controller and minority shareholders. Despite the existence of a homogeneous interest among all shareholders of the company in relation to maximizing the value of the corporation, there is an inherent conflict of interest between the controlling shareholder and the other minority shareholders regarding the aspirations of the former to tunnel value from the corporation at a rate exceeding the sum of his real holdings.

In a dispersed ownership structure, with no controlling shareholder owning a significant share of the corporation, the main principal-agent problem is the "vertical" one between the (decentralized) shareholders and the company's managers. When there is no controlling shareholder – who would own large blocks of shares in a corporation and therefore has a significant economic incentive to

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<sup>9</sup> *Id.* at 6 ("The investment adviser to a mutual fund is a fiduciary that owes the fund a duty of "utmost good faith, and full and fair disclosure. This fiduciary duty extends to all functions undertaken on the fund's behalf, including the voting of proxies relating to the fund's portfolio securities. An investment adviser voting proxies on behalf of a fund, therefore, must do so in a manner consistent with the best interests of the fund and its shareholders.")

effectively monitor the activities of corporate managers – the power of managers increases. Accordingly, there is a concern that managers will act for their own interests, which may deviate from the main interest of the corporation and its shareholders and stakeholders – value and wealth maximization.

Parallel to the increase in the relative power of the company's managers in the context of decentralized ownership, the relative power of dominant minority shareholders who are not controlling shareholders also increases. In a company without a controller, dominant and active minority shareholders, who hold a low proportion of the company's shares, can influence and even tip the scales of decisions. These shareholders who can hold effective power, may, in some cases, influence the corporation and accumulate power in ways similar to controlling shareholders do.

The rational apathy that characterizes most of minority shareholders intensifies the power of those who choose to try and influence the decisions. This contributes to the accumulation of the effective power of the dominant and active minorities and creates a gap between the formal power reflected in the holdings and the effective power expressed in the actual influence on what happens in the corporation.

This gap between the formal power and the effective power of dominant minority shareholders is the subject of this paper. While the question of the liability of those with effective power has been discussed in the past both in literature and case law, a coherent test for estimating the effective power of an activist minority shareholder, which can lead to the conclusion that the relevant obligations should be applied to him, has not yet been proposed. The third part of the paper proposes a tool for determining the effective power of a minority shareholder that can provide legal certainty to the question of the diagnosis of the effective power of dominant minority shareholders.

## II - ACTIVIST MINORITY SHAREHOLDERS - LITERATURE AND CASE LAW REVIEW

In recent years, activist minority shareholders have preoccupied researchers,<sup>10</sup> regulators, and courts. It appears that the change in the nature of minority shareholders in public corporations, reflected in the decline in private investors' holdings and in the increase in the holdings of entities and institutional investors (particularly hedge funds),<sup>11</sup> is the main reason for the breaking of the legal paradigm

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<sup>10</sup>For empirical review of the scope of the phenomena in the US and its consequences: Lucian A. Bebchuck & Kobi Kastiel, *The Perils of Small-Minority Controllers*, 107 GEO. L.J. 1453 (2019).

<sup>11</sup>J.P. Morgan, *The Activist Revolution: Understanding and Navigating a New World of Heightened Investor Scrutiny*, 6 (2015), <https://www.ipmorgan.com/ipmpdf/1320693986586.pdf>

that held that there is no need to impose duties on minority shareholders and the proposed regulatory change in the imposition of such duties in various forms.<sup>12</sup>

In this part of the paper, I will review the literature and the case law on the distinction between controlling shareholders and minority shareholders to whom effective power is attributed to. The literature refers both to the phenomenon of effective power given to minority shareholders, to the principal-agent problem created due to the existence of this effective power, and to the solutions proposed to reduce this principal-agent problem. Most of the literature was written recently and created an extensive public debate about the increase in the power of institutional investors, hedge funds, and large investment companies, and the activist conduct of some of these investors.<sup>13</sup>

## II.A - LITERATURE REVIEW

Activist minority shareholders create a growing concern among corporate governance researchers due to the agency problem which arises from the gap between their equity holdings and their potential influence on material decisions. The severity of this agency problem increases as the gap between their formal and effective power increases. Therefore, researchers have tried, over the years, to offer legal tools which imply fiduciary duties on those minority shareholders to minimize the expected costs created by this specific agency problem.

Anabtawi and Stout offer to imply fiduciary duties (which are not typically implied to non-controlling shareholders under Delaware law)<sup>14</sup> that will address the problem of the "opportunistic shareholder" and restrict minority shareholders from employing activist tactics which are not in the company's favor.<sup>15</sup> They emphasize that the reasons for the lack of regulation imposed on minority shareholders are no longer valid. The original conception was that minority shareholders do not have an economic incentive to influence the company's business decisions and that they share a homogeneous interest with other investors – wealth maximization.<sup>16</sup> But, in fact, institutional investors, which usually own minority stakes in companies, have an economic incentive to act and profit at other shareholders' expense. Thus, their goals are not aligned with other, mostly retail investors and shareholders anymore.

The legal framework for the fiduciary duties' solution offered by Anabtawi and Stout is that all the shareholders:

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<sup>12</sup> Stracar, *supra* note 4.

<sup>13</sup> For expansion about the implications of such change see: Assaf Hamdani & Sharon Hannes, *The Future of Shareholders Activism*, Boston University Law Review, vol 99, p.972, 2019, which focuses on the US corporate market, and see Assaf Hamdani & Sharon Hannes, *Institutional Investors, Activist Funds, and Ownership Structure*, Research Handbook on Comparative Corporate Governance, forthcoming which discuss these trends in the global market.

<sup>14</sup> Ann M. Lipton, *After Corwin: Down the Controlling Shareholder Rabbit Hole*, 72 VAND. L. REV. 1977, 1979 (2019).

<sup>15</sup> Iman Anabtawi & Lynn A. Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255, 1260 (2008).

<sup>16</sup> *Id.* at 1258.

be viewed as owing latent duties to the firm and their fellow shareholders. These latent duties would be triggered whenever a particular shareholder - whether or not it is technically a shareholder capable of controlling the boards' decisions as to all matters - in fact manages to successfully influence the company's actions with regard to a particular issue in which that shareholder has a material, personal economic interest.<sup>17</sup>

This legal solution changes the current legal landscape in two major ways. First, it enables us to imply duties on shareholders when needed. The duties will no longer be "all or nothing" but would be imposed on an ad-hoc basis.<sup>18</sup> Secondly, the researchers suggest modifying of the definition of "control". The current accepted definition is that a shareholder would be considered as a controller only when he has an "effective control" in the general meeting of the company and in its board.<sup>19</sup> Anabtawi and Stout suggest that effective control in a specific subject or decision could be also counted as control which will imply fiduciary duties and restrictions regarding that specific matter.<sup>20</sup> Moreover, they emphasize that "effective control" could be an outcome of other actions, rather than control of the board's decisions. For example, by using public campaigns or persuasive pressure to affect the corporate's business decisions.

To conclude, Anabtawi and Stout would broaden the liability of shareholders in two ways: They suggest that all the shareholders owe latent duties which would be triggered when a shareholder manage to "control" or effect company's action, and they set a new, moderate, definition for such "control".

Stracar suggests different ways to regulate the agency problem which arise due to increasing minority stakes held by institutional investors. Stracar suggests amending section 144 of the Delaware General Corporation Law, which restricts conflict of interest transactions by corporate directors and officers, to add similar restrictions on relevant minority shareholders. The main outcome of such a restriction would be to apply the entire fairness standard of review to this kind of transactions. Stracar opposes the solution suggested by Anabtawi and Stout and argues that applying fiduciary duties to minority shareholders would result in increased litigation since those minority activist shareholders have inherent conflict of interest with publicly held.<sup>21</sup>

Stracar has also indicated that the current approach of 5% as the minimum threshold of shares which considered significant enough to exercise control is not relevant.<sup>22</sup> This is because, there are recent examples which shows that share blocks

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<sup>17</sup> *Id.* at 1295.

<sup>18</sup> Anabtawi & Stout, *supra* note 15 at 1296-1297.

<sup>19</sup> *Ivanhoe Partners v. Newmont Mining Corp.*, No. 535 A.2d 1334 (Del. 1987).

<sup>20</sup> Anabtawi & Stout, *supra* note 15 at 1298.

<sup>21</sup> Nicole Stracar, *Applying a New Regulatory Framework to Interested Transactions by Minority Shareholders*, 20 U. PENN. J. BUS. L. 993. 1023 (2018).

<sup>22</sup> *Id.* at 1019. 5% is consistent with the SEC 13D or 13G disclosure rules. *See* 17 C.F.R. § 240.13(d) – 101 – Schedule 13D.

of less than 5% could be sufficient for activists to affect the company's decisions.<sup>23</sup> Stracar, like Anabtawi and Stout, is interested in wider, more flexible, definition of "control". However, she brings a different solution which should be applied to those who would be considered as controller (under its broader definition).

Varottil, develops the academic discussion regarding applying duties to minority activist shareholders as well. First, he argues that the lack of restrictions applied to active minority shareholders is a worldwide problem and not a specific issue of markets with mostly dispersed shareholding structures (e.g. the U.K and the U.S). He argues that similar restrictions should be imposed on minority shareholders in jurisdictions with concentrated shareholding structures, such as continental Europe and Asia).<sup>24</sup> Second, he differentiates between active and passive institutional investors and offers modified legal restrictions for each group. Like Anabtawi and Stout, he argues that active investors such as hedge and index funds should be subjected to fiduciary duties.

Another possible solution is to require disinterested shareholder votes on issues in which those activist minority shareholders have personal interests. Varottil suggests, somehow an opposite solution, that the passive minority investors including pensions and some mutual funds, who tend to be "too passive", should be required to exercise their participation rights and be more transparent about their voting policy as part of a wider "stewardship code".<sup>25</sup> However, it is unclear whether such stewardship obligations can effectively affect these passive investors and whether they would be enforceable.

Leo E. Strine, Jr., former Chief Justice of the Delaware Supreme Court suggests a solution which would apply regulations and duties (including fiduciary duties) to some minority active shareholders under existing law. Strine argues that:

In the past few years, most activist hedge fund campaigns resulted in the hedge fund gaining at least some degree of representation on the company's board, and in most of these situations, the victory resulted from a settlement.<sup>26</sup>

Strine indicates that settlements which involve board seats for hedge fund managers could prohibit them from exercising practices such as short-swing profit taking and insider trading. The fact that some hedge fund members, such as managers and partners, would be subjected to restrictions and duties as directors, would bring positive outcomes for the corporations.<sup>27</sup>

## II.B - CASE LAW REVIEW

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<sup>23</sup> J.P. Morgan, *supra* note 11.

<sup>24</sup> Umakanth Varottil, "Minority Shareholders' Rights, Powers and Duties: The Market for Corporate Influence", 2-3 NUS Law Working Paper 2020/006, February 2020.

<sup>25</sup> *Id.* at 22-23.

<sup>26</sup> Leo E. Strine Jr., *Who Bleeds When the Wolves Bite: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L. J. 1870, 1903 (2017).

<sup>27</sup> Strine Jr., *supra* note 27 at 1905.



According to the literature, there is a lack of regulation, duties, and restrictions applied to activist non-controlling shareholders. As mentioned above, different scholars suggest different solutions to address this legal void. However, without adequate legal tools, when a judge seeks to restrict a minority shareholder from using his internal influence to profit at other shareholders' expense, he can only do that by considering the shareholder as a controlling shareholder. Therefore, the decisions regarding minority activist shareholders consistently involve the legal question and definition of control.

While there are no explicit conditions for determining whether a dominant minority shareholder is a controller, the courts have historically tended to take the shareholder voting power as an important indicator for board control and de-facto control over the company. For example, in *In re KKR Financial Holdings LLC Shareholder Litigation* the Chancellor, Andre G. Bouchard, indicated that there is a need for minimum threshold of ownership to be considered as a controlling shareholder.<sup>28</sup> In *In re Crimson Expl. Inc. Stockholder Litig* the court emphasized that a minimum threshold of voting power is necessary,<sup>29</sup> and in *In re Cysive, Inc. Shareholders Litigation* Vice-Chancellor Strine held that 35% is "enough block of stock to be the dominant force...".<sup>30</sup>

However, recent rulings suggest that the focus is no longer on "significant equity position"<sup>31</sup> but has shift to other factors which reflect possible control in the company.<sup>32</sup> Among these factors are "managerial supremacy"<sup>33</sup> and a company's public statement about the importance of the relevant minority shareholder regarding its business activities.<sup>34</sup> In *In re Tesla Motors, Inc. Stockholder Litigation*, the court issued a memorandum opinion holding that Elon Musk was a controlling shareholder in Tesla while only owning 22% of Tesla's common stock.<sup>35</sup> In this case, the court inquired into the merger between Tesla and SolarCity in relation to the plaintiffs' claims that Elon Musk breached his fiduciary duties as a controller in Tesla (and a controlling shareholder in SolarCity – the purchased company). In a concurring opinion Vice Chancellor Slight, added that Musk's ability – rather than his exercise of control – is the right way to examine Musk's holding status according to the "inherent coercion" doctrine.<sup>36</sup>

The novel concept of "inherent coercion" in this ruling is that Musk's influence depends neither on his nominal holding nor on his activities. Indeed, he will still be able to exercise his control even if he sells all his shares. His status as a controller is

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<sup>28</sup> *In re KKR Fin. Holdings LLC S'holder Litig.*, 101 A.3d 980, 995 (Del. Ch. 2014).

<sup>29</sup> *In re Crimson Expl. Inc. S'holder Litig.*, C.A No8541, 2014 WL 5449419 (Del. Ch. 2014).

<sup>30</sup> *In re Cysive, Inc. S'holders Litig.*, 836 A.2d 531, 551–52 (Del. Ch. 2003).

<sup>31</sup> *Superior Vision Servs., Inc. v. ReliaStar Life Ins. Co.*, 2006 WL 2521426, at \*4 (Del. Ch. Aug. 25, 2006)

<sup>32</sup> *Cysive, Inc. S'holders Litig.*, *supra* note 31 at 531, 533 ("Holding a minority blockholder is a controller when "as a practical matter, [He] possesses a combination of stock voting power and managerial authority that enables him to control the corporation, if he so wishes").

<sup>33</sup> *Id.* at 552

<sup>34</sup> *In re Zhongpin inc. S'holders Litig.*, 2014 WL 6735457, at \*7 (Del.Ch.Nov.26, 2014).

<sup>35</sup> *In re Tesla Motors, Inc. S'holder Litig.*, 2018 WL 1560293 (Del. Ch. Mar. 28, 2018).

<sup>36</sup> *In re Tesla Motors, Inc.*, 2020 WL 553902, 40-41 (Del. Ch. Feb. 4, 2020).

an outcome of his special position in the company which he cannot evade but must instead exercise in better compliance with the duties and restrictions imposed by it.

In a similar recent decision, Larry Ellison, the co-founder, Executive Chairman and CTO of Oracle Corp was considered as controlling shareholder of the company, even though he owns just 28% of its shares.<sup>37</sup> The reasons were similar to the reasons applied in the Tesla case to Elon Musk and derived in this case from Ellison's position in the company that gained him "inherent coercion".

In the absence of other, directed, legal tools, judges can only restrict those minority activist shareholders by designating them as controllers, even though the threat they pose as shareholders is sometimes different from that posed by the more "classic" controlling shareholder.<sup>38</sup>

Alongside the widespread recognition of the imposition of fiduciary duties on the controlling shareholders of a company<sup>39</sup> which receive prominence in situations of sale of control, courts have not yet fully and explicitly recognized the imposition of similar duties on minority shareholders in companies in which there is a controlling shareholder. However, this legal question has been raised repeatedly in recent years, especially in U.S. courts, with several decisions indicating the beginning of a change in trend. This is reflected in the willingness of courts to recognize the possibility of imposing similar duties on minority shareholders when they have decisive power.

A recent verdict in the Court of Chancery in Delaware in the case of *Skye Mineral Investors*<sup>40</sup> dealt with a "minority cluster" in a private company which resulted in a long and complicated series of actions. This included the company being forced to sell a major asset it owned at a price equal to only 5% of its value. This "minority cluster" included a few shareholders who held very low percentages of the company's equity and were family members who worked together. In carrying out its various moves, the "minority cluster" was assisted by contractual rights granted to it. This included the company requiring its approval to carry out any additional capital raising or taking on a loan by the company. These contractual rights, in fact, gave it decisive power in relation to the company's ability to raise funds, whether through capital or debt.

While it was easy for the court to impose duties on the director appointed on behalf of the "minority cluster" to the board, who worked vigorously to promote the aforementioned moves, it had difficulty in imposing fiduciary duties on the shareholders who formed the "minority cluster". According to the court, there is still no express provision in Delaware, in statute or in case law, according to which minority shareholders have direct fiduciary duties, either towards the company or towards its controlling shareholder, similar to the duties which apply to the

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<sup>37</sup> In re Oracle Corp. Derivative Litig., C.A. No. 2017-0337, 2018 WL 1381331, at \*16 (Del. Ch. Mar. 19, 2018).

<sup>38</sup> Classic means with higher percentage of ownership or with greater influence on the company.

<sup>39</sup> David Kershaw, *Delaware's Fiduciary Imagination: Going-Privates and Lord Eldon's Reprise*, 98 Wash. U. L. Rev. 1669 (2021).

<sup>40</sup> *Skye Mineral Investors, LLC, Plaintiffs, v. DXS Capital (U.S.) Limited and others, Defendants, and Skye Mineral Partners LLC, Nominal Defendant*, C.A. No. 2018-0059-JRS (24.2.2020).

controlling shareholder of the company at the time of the sale of the controlling stake to an external purchaser. However, the court agreed to impose contractual fiduciary duties on some of the shareholders who formed the "minority cluster", which originates from the contractual regulation of their right to block any raising of capital or debt.

About two years earlier, the issue of imposing fiduciary duties on minority shareholders was raised in the *PLX* case<sup>41</sup>. In the same case, an activist investment fund, which was also represented on the board of directors, managed to lead the company, within a short time, to a merger transaction in which the invested company was sold to an external purchaser. This lead was carried out with the vigorous activity of the fund's representative on the board of directors and was motivated by interests of the investment fund that were incompatible with the interests of the company. In examining the liability of the activist investment fund, the court ruled that a minority shareholder is not liable for fiduciary duties to the company or to the rest of its shareholders. Yet, once the activist fund placed a director on its behalf on the board, and used him to promote the merger that led to the sale of the company, in order to promote its personal interests and to remove its holdings in the company, in a way that benefits it and harms the company, hence the directors violated their fiduciary duty towards the company and its other shareholders, while the fund assisted in this and is therefore responsible only for assisting in the breach of fiduciary duty. In this case, too, it can be seen that while it is easy for the court to impose fiduciary duties on the directors, it finds it difficult to impose similar duties on minority shareholders, and in fact recognizes their liability only as an aid to the violation of the directors' liability.

The *Corwin* case<sup>42</sup>, which aroused great interest, dealt with a similar question when it was discussed in the Court of Chancery in Delaware<sup>43</sup>. The question discussed was whether a shareholder holding less than 1% of the company's issued capital could be considered an effective controlling shareholder. Unlike previous decisions that dealt with similar questions, in this case, it was a minority shareholder who holds a particularly low share of the company's value. In this case, it was held that the existence of effective control has not been proven and that a decision on this question requires the court to examine the power and ability of the shareholder who does not hold formal control in the form of a majority in the voting rights in the company, to direct, nonetheless, the business of the corporation. In addition, it was determined that it is difficult to consider a shareholder whose holdings are less than 1% of the total shares in the company, to be able to direct the corporation's business.

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<sup>41</sup> In Re PLX Technology Inc. Stockholders Litigation, consolidated, C.A. No. 9880-VCL (16.10.2018).

<sup>42</sup> *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304 (Del. 2015).

<sup>43</sup> *KKR Financial Holdings*, *supra* note 29.

In another case, the *Basho Techs* case<sup>44</sup>, a high-tech company which had undergone several rounds of investments and needed additional significant funding to continue developing the product was discussed. A minority shareholder in the company, who had contractual veto rights that enabled him to prevent further capital raising, used the veto power to prevent the issuance of additional shares, and thus forced the company to borrow money from him. Concurrently, he influenced the board of directors in making various financial decisions. In court, it was argued that the minority shareholder was in fact a controlling shareholder of the company and in his conduct violated the fiduciary duty he owed to the company. The court ruled that the totality of the circumstances indicates that the minority shareholder had effective control in practice, but in this determination, it noted that it is not possible to define in advance all the ways in which a minority shareholder can influence the company's activities and therefore it is not possible to speak of a clear and closed test for examining the existence of effective control. At the same time, the court listed several examples or indications evidencing effective control:

It is impossible to identify or foresee all of the possible sources of influence that could contribute to a finding of actual control over a particular decision. Examples include, but are not limited, to: (i) relationships with particular directors that compromise their disinterestedness or independence, (ii) relationships with key managers or advisors who play a critical role in presenting options, providing information, and making recommendations, (iii) the exercise of contractual rights to channel the corporation into a particular outcome by blocking or restricting other paths, and (iv) the existence of commercial relationships that provide the defendant with leverage over the corporation, such as status as a key customer or supplier.<sup>45</sup>

Similarly, in the *Voigt* case<sup>46</sup>, which also dealt with a minority shareholder who had contractual veto rights regarding a number of material actions in the company, such as issuing shares, distributing dividends, approving material transactions, changing the company's statute, and providing collateral for loans, it was determined that there is no "magic formula" regarding the proof of effective control and this must be determined on a case-by-case basis<sup>47</sup>. To this end, it was determined that the court must be attentive to the variety of situations that can establish a conclusion regarding effective control and that the aggregate weight of these situations and the various circumstances of the case should be assessed in a "holistic" manner<sup>48</sup>.

The case law confronts the issue of the share of holding in a company with the issue of effective control, but at the same time fails to formulate a uniform and

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<sup>44</sup> *Basho Techs. Holdco B, LLC v. Georgetown Basho Invs., LLC*, 2018 WL 3326693 (Del. Ch. July 6, 2018), *aff'd sub nom.*, *Davenport v. Basho Techs. Holdco B, LLC*, 221 A.3d 100 (Del. 2019).

<sup>45</sup> *Id.* at 66-67.

<sup>46</sup> *Voigt v. Metcalf*, 2020 WL 614999 (Del. Ch. Feb. 10, 2020).

<sup>47</sup> *Voigt*, *supra* note 47 at 23-24.

<sup>48</sup> *Voigt*, *supra* note 47 at 26, footnote 32.

certain test for determining the existence of the latter. These decisions illustrate the necessity of a principled test that will help examine the question of the existence of effective control or decisive power while considering both the share of holdings and the ability to influence decision-making. Even a shareholder with minimal holding may sometimes have decisive power when he is the shareholder who tilts the scales from one decision to another. Nonetheless, not in every situation, the same minority shareholder will constitute a deciding factor in a company's actions and therefore can be attributed decisive power. In the next chapter, I will empirically analyze key court decisions from Delaware courts dealing with the definition of effective control to examine whether specific aspects of each case influence court's decisions.

### III - EMPIRICAL ANALYSIS

In order to analyze the courts' decisions in cases involving activist minority shareholders and dealing with effective control, I coded 39 key decisions litigated under Delaware law between the years 1971-2021. The list of the cases can be found in Appendix 1. Table 1 below, shows the various explanatory variables under consideration and their descriptions:

**Table 1: Explanatory Variables**

| <b>Variable</b>               | <b>Description</b>   |
|-------------------------------|--|
| % Ownership                   | Identifies what percentage of stock or membership units the effective controlling stockholder or member owned at the time of the challenged transaction. It does not include the percentage of stock or membership units that the effective controlling stockholder or member could have owned if he exercised any options, warrants, or conversion rights he may have had. Such rights would be shown in other explanatory variables. |
| % Board Control               | Identifies how many directors lacked independence from the effective controlling stockholder or member.  |
| % Committee Control           | Identifies how many managers, or committee members lacked independence from the effective controlling stockholder or member.   |
| Contractual Rights<br>(dummy) | Shows whether or not the alleged effective controller possessed or exercised contractual rights, such as blocking rights or debt instruments.  |

|   |  |
|---|--|
| Contractual Rights<br>(count)               | Shows how many types of contractual rights, such as blocking rights or debt instruments, that the alleged effective controller possessed or exercised. |
| Veto or Blocking Rights<br>(dummy)          | Shows whether the alleged effective controller possessed or exercised veto or blocking rights.   |
| Rights to Appoint Board<br>Member (dummy)   | Shows whether the alleged effective controller possessed rights to appoint board member(s).  |
| Founder (dummy)                             | Shows whether the alleged effective controller was the founder of the company.   |
| Significant Creditor<br>(dummy)             | Shows whether the alleged effective controller was significant creditor of the company.  |
| Financial Distress<br>(dummy)               | Identifies whether the corporation was in financial distress at the time of the litigation.  |
| Affiliated Officers or<br>Employees (dummy) | Shows whether company's officers were employees of the effective controller or beholden by him.  |
| Affiliated Advisors<br>(dummy)              | Shows whether the alleged effective controller was affiliated with company's advisors.   |

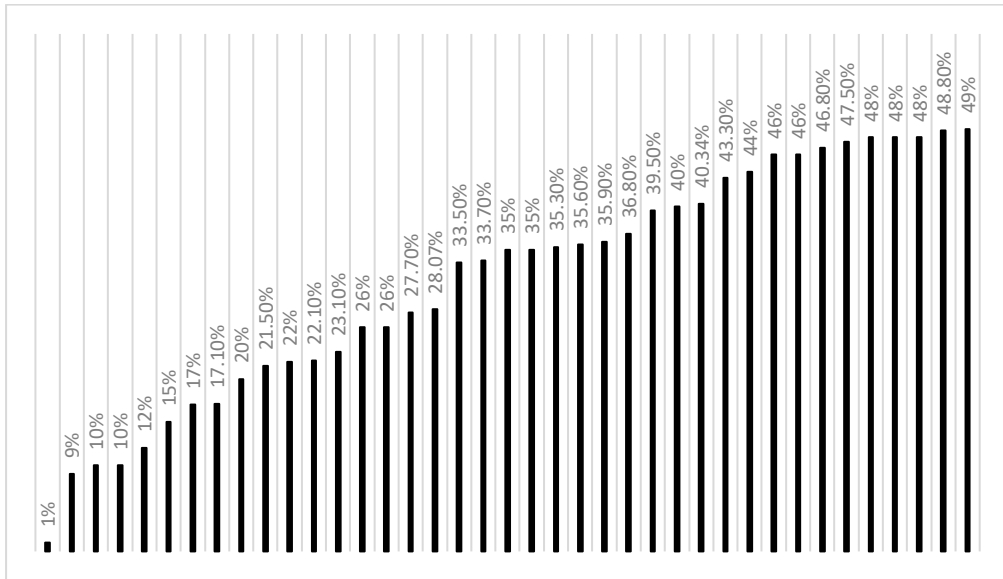
Table 2 below, shows descriptive statistics of the explanatory variables (which are not dummy variables):

**Table 2: Statistics on Explanatory Variables**

| Variable               | Average | Min | Max | Median | SD    |
|------------------------|---------|-----|-----|--------|-------|
| % Ownership            | 31%     | 1%  | 49% | 35%    | 0.135 |
| % Board<br>Control     | 35.8%   | 0%  | 80% | 33%    | 0.208 |
| % Committee<br>Control | 6.2%    | 0%  | 67% | 0%     | 0.167 |

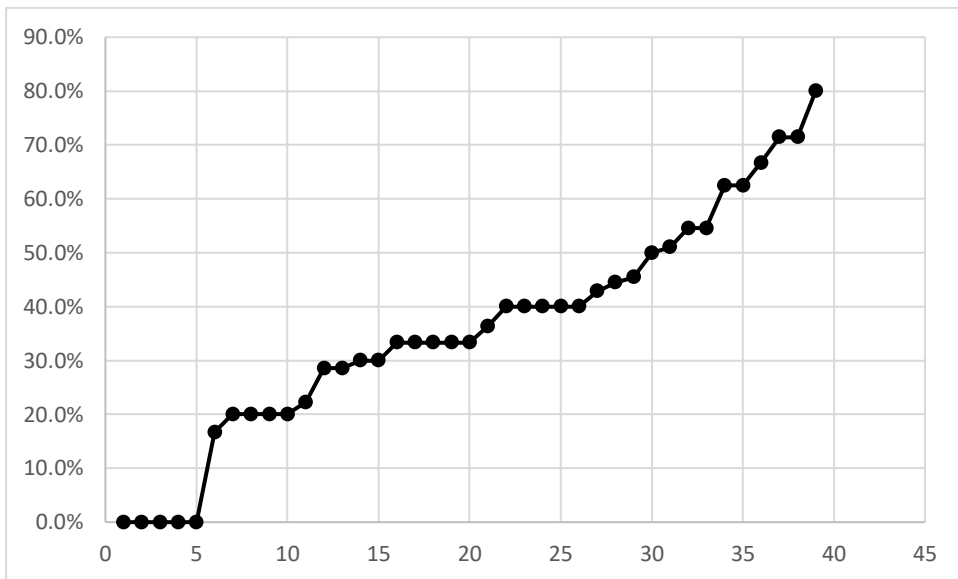
The percentage of stock or membership units the effective controlling stockholder owned in all cases is presented in the following figure:

Figure 1: % Ownership



The percentage of directors that lacked independence from the effective controlling stockholder in all cases is presented in the following figure:

Figure 2: % Board Control



#### IV - ECONOMETRIC ANALYSIS

In order to examine the impact of any single variable on the inclination of the court whether to define the activist minority shareholder as effective controller, an econometric analysis was performed. In the classical regression model, the dependent variable can take any value on the real line. In our case, the dependent variable is a discrete binary outcome of the court decision to see the minority shareholder as an effective controller or not. In other words,  $y$  (the court decision) is a binary variable that takes only two values:  $0$  when the court decides not to define the shareholder as effective controller and  $1$  if the decision define the shareholder as effective controller. The linear probability model (LPM) is simple to estimate and use, but has some drawbacks in dealing with binary dependent variables. LPM's limitations can be overcome by using a binary response model<sup>49</sup>. The binary response model I use is of the form:

$$P(y = 1|x) = G(\beta_0 + \beta_1 x_1 + \dots + \beta_k x_k) = G(\beta_0 + \mathbf{x}\boldsymbol{\beta})$$

Where  $y$  is the court's decision to define the minority shareholder as effective controller and  $\mathbf{x}$  is the full set of explanatory variables.  $G$  is a function taking on values strictly between zero and one for all real numbers  $z$ :

$$0 \leq G(z) \leq 1$$

For the function  $G$ , it is possible to use two nonlinear functions used in the vast majority of applications: logit and probit. In the *logit model*,  $G$  is the logistic function:

$$G(z) = \frac{\exp(z)}{1 + \exp(z)}$$

$G(z)$  is between zero and one for all real numbers  $z$ . This is the cumulative distribution function for a standard logistic random variable.

In the *probit model*,  $G$  is the standard normal cumulative distribution function, which again ensures that the regression equation is strictly between zero and one for all parameter values and for  $X_j$ . In the paper I use the *probit model* for its underlying assumption of normal distribution and provide both linear model results (in Table 3) and probit model results (in Table 4).

I used four different linear models and three different probit models to process the data. Each model controls for a different set of explanatory variables. It is easy

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<sup>49</sup> Wooldridge, Jeffrey M., *Introductory Econometrics: A Modern Approach*, 4<sup>th</sup> Edition, South-Western Cengage Learning, 2009.



to see that the explanatory power of the models (presented as  $R^2$ /pseudo  $R^2$ ) is increasing as I add variable but they are relatively high for all models.

**Table 3: OLS Regression Results**

| <b>Variable</b>                  | <b>(1)</b>          | <b>(2)</b>         | <b>(3)</b>          | <b>(4)</b>          |
|----------------------------------|---------------------|--------------------|---------------------|---------------------|
| % Ownership                      | -0.007<br>(0.600)   | 0.424<br>(0.579)   | -0.036<br>(0.613)   | 0.056<br>(0.608)    |
| % Board Control                  | 1.375***<br>(0.429) | 1.046**<br>(0.351) | 1.373***<br>(0.354) | 1.386***<br>(0.351) |
| % Committee Control              | 0.037<br>(0.397)    | 0.056<br>(0.381)   | -0.007<br>(0.419)   | 0.129<br>(0.413)    |
| Contractual Rights (dummy)       |                     |                    | 0.076<br>(0.196)    |                     |
| Contractual Rights (count)       |                     |                    |                     | -0.122<br>(0.142)   |
| Veto or Blocking Rights          |                     | 0.178<br>(0.178)   |                     |                     |
| Rights to Appoint Board Member   |                     | 0.535*<br>(0.212)  |                     |                     |
| Founder                          | -0.040<br>(0.181)   | 0.001<br>(0.178)   | -0.019<br>(0.191)   | -0.087<br>(0.189)   |
| Significant Creditor             | 0.006<br>(0.230)    | 0.021<br>(0.214)   | -0.046<br>(0.269)   | 0.115<br>(0.264)    |
| Financial Distress               | 0.540*<br>(0.199)   | 0.438*<br>(0.194)  | 0.536*<br>(0.203)   | 0.568**<br>(0.203)  |
| Affiliated Officers or Employees | -0.086<br>(0.201)   | -0.116<br>(0.186)  | -0.072<br>(0.207)   | -0.096<br>(0.202)   |
| Affiliated Advisors              | 0.259<br>(0.186)    | 0.311<br>(0.176)   | 0.240<br>(0.195)    | 0.291<br>(0.191)    |
| Constant                         | -0.135<br>(0.202)   | -0.124<br>(0.187)  | -0.144<br>(0.206)   | -0.127<br>(0.203)   |
| N                                | 39                  | 39                 | 39                  | 39                  |
| $R^2$                            | 0.535               | 0.628              | 0.538               | 0.547               |

\*\*\*Significant at the 1 percent level \*\* Significant at the 5 percent level

\* Significant at the 10 percent level.

**Table 4: Probit Regression Results**

| <b>Variable</b>                  | <b>(1)</b>          | <b>(2)</b>          | <b>(3)</b>          |
|----------------------------------|---------------------|---------------------|---------------------|
| % Ownership                      | -2.012<br>(3.804)   | -2.090<br>(3.822)   | -1.870<br>(4.427)   |
| % Board Control                  | 10.901**<br>(4.808) | 10.770**<br>(4.803) | 13.545**<br>(6.209) |
| % Committee Control              | 0.985<br>(2.228)    | 0.807<br>(2.376)    | 1.572<br>(2.551)    |
| Contractual Rights (dummy)       |                     | 0.220<br>(0.992)    |                     |
| Contractual Rights (count)       |                     |                     | -1.020<br>(0.930)   |
| Founder                          | -0.406<br>(0.896)   | -0.335<br>(0.942)   | -0.943<br>(1.077)   |
| Significant Creditor             | -1.041<br>(1.613)   | -1.168<br>(1.694)   | -0.870<br>(1.896)   |
| Financial Distress               | 5.172*<br>(2.623)   | 5.123*<br>(2.611)   | 6.819*<br>(3.495)   |
| Affiliated Officers or Employees | 0.169<br>(1.068)    | 0.172<br>(1.066)    | 0.274<br>(1.118)    |
| Affiliated Advisors              | 1.980<br>(5.601)    | 1.927<br>(4.767)    | 2.375<br>(38.981)   |
| Constant                         | -3.968<br>(1.691)   | -3.962<br>(1.684)   | -4.623<br>(1.991)   |
| N                                | 39                  | 39                  | 39                  |
| Pseudo R <sup>2</sup>            | 0.572               | 0.573               | 0.602               |

\*\*\*Significant at the 1 percent level \*\* Significant at the 5 percent level  
\*Significant at the 10 percent level.

As Tables 3 and 4 indicate, the results are consistent through all model and regression types. A multi-variable analysis shows that the only statistically significant variables that explain court decisions are the percentage of board control and financial distress of the company (significant at a lower level). Surprisingly, regarding all other explanatory variables as the ownership of the alleged effective controller and different types of contractual rights including veto and blocking rights, there was no statistical evidence supporting their effect on court decisions. This is opposed to the facts that veto rights, for example, can grant the shareholder an effective power and the notion that there should be a positive correlation between ownership and effective power.

Since most of the explanatory variables, that by the theory mentioned in previous sections of the paper should influence court's decisions, were not proved to have statistically significant influence, in the next section of the paper I offer a tool, supported by the theory that can be used by courts to improve decision and to increase certainty and reduce randomness and arbitrariness.

The proposed tool is based on developments in the field of cooperative game theory that has been used in the past to distinguish between formal and effective power in various aspects, for example, on the question of the effective power of various members of the UN Security Council. The tool will build on the Shapley value and the Shapley and Shubik's power index. A simple application of the test can show when an activist minority shareholder is the deciding factor in a particular decision and what is its effective power in relation to the other shareholders of the company at the same time.

## V - SHAPLEY VALUE AND SHAPLEY AND SHUBIK POWER INDEX

The Shapley Value<sup>50</sup>, named after the mathematician Lloyd Shapley, makes it possible to measure the relative power of individuals and coalitions<sup>51</sup> in the framework of voting. The principle underlying the Shapley value is that voting power increases as the frequency at which an individual or coalition becomes a deciding factor, i.e. acquires the ability to tip the scales from one decision to another, increases. Since the voting power may differ from the formal power given to an individual or a coalition considering their relative share in the team, the Shapley value serves as a measure of the power that each actor has in the decision-making process. This application for the Shapley value was developed by Shapley and Shubik<sup>52</sup> and is known as Shapley and Shubik's Power Index. Later, Hart and Mas-Kollel<sup>53</sup> showed that the Shapley value, in fact, measures the marginal contribution of each actor to the decision.

The Shapley value is used for many extensive applications. It was used in the past to measure the relative power of the permanent members of the UN Security Council as opposed to the changing members. It is frequently used after the election results become clearer to estimate the relative power of the various parties, as opposed to the electoral power that emerges from the election results themselves. It has also recently been used to examine the relative power of different family members in managing their family firm<sup>54</sup>. Moreover, the Shapley and Shubik's

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<sup>50</sup> Lloyd S. Shapley, *Notes on the n-Person Game -- II: The Value of an n-Person Game*, Santa Monica, Calif.: RAND Corporation; Roth, Alvin E., ed. (1988). *The Shapley Value: Essays in Honor of Lloyd S. Shapley*. Cambridge: Cambridge University Press; art, Sergiu (1989). "Shapley Value". In Eatwell, J.; Milgate, M.; Newman, P. (eds.). *The New Palgrave: Game Theory*. Norton. pp. 210–216; *Game Theory*, Maschler, Solan & Zamir, chapter 18.

<sup>51</sup> Coalition, in our context, is the group of shareholders that votes in the same manner regarding a certain decision.

<sup>52</sup> Shapley & Shubik, 1954.

<sup>53</sup> Hart & Mas-Kollel, 1989.

<sup>54</sup> Ben-Shahar, Carmeli, Sulganik & Weiss, *The Confluence of Soft and Hard Powers in the Formation of Dominant Coalitions among Shareholders in Family Firms*, Working Paper, 2020.

Power Index was recently used to examine the power of institutional investors in voting at the general shareholders' meeting on the approval of conflict-of-interest transactions after changing the requirement of the disinterested majority at the meeting from one-third to one-half<sup>55</sup>.

To illustrate how the Shapley value works, we can imagine a situation where all shareholders enter the room one by one. Each shareholder who enters the room receives a value equal to his marginal contribution to the group of shareholders that came before him. That is, if 'S' is the group of shareholders who are already in the room before a shareholder 'i' enters, the value for shareholder i will be the difference between the value of the group of shareholders that was in the room including the shareholder i and the value of group S without him. If the order in which the shareholders enter the room is coincidental, and all the different arrangements have the same probability, then the value expectancy for actor i is equal to the average of its value in each of the possible arrangements.

I will demonstrate this with a simple numerical example. Suppose a company has three shareholders: 1, 2, and 3 who hold 25%, 25%, and 50% of the company's shares, respectively. Each of the shareholders, alone, cannot tip the scales in a particular decision and therefore the value of each of the shareholders separately will be 0:

$$V(1) = V(2) = V(3) = 0$$

Due to the ownership structure, even shareholders 1 and 2 together cannot tip the scales in a particular decision, and therefore their value together,  $V(1,2)$  is also 0:

$$V(1,2) = 0$$

On the other hand, shareholders 1 and 3 can tip the scales together, and so can shareholders 2 and 3. Of course, if the three shareholders vote together, then they will tip the scales as well. The value of a coalition tipping the scales in a particular decision will be 1 and therefore:

$$V(1,3) = V(2,3) = V(1,2,3) = 1$$

The following table shows how you can simply calculate a Shapley value for each shareholder in this decision. The left column will show the order in which shareholders "enter the room" in the decision making and the other three columns will show the marginal contribution of each shareholder in each of the arrangements respectively:

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<sup>55</sup> Dressler, Efrat, Voice & Power, *Do Institutional Shareholders Make Use of Their Voting Power?* Journal of Corporate Finance, 65 (2020).

| Order   | Shareholder 1<br>Contribution | Shareholder 2<br>Contribution | Shareholder 3<br>Contribution |
|---------|-------------------------------|-------------------------------|-------------------------------|
| (1,2,3) | $V(1) = 0$                    | $V(1,2) - V(1) = 0$           | $V(1,2,3) - V(1,2) = 1$       |
| (1,3,2) | $V(1) = 0$                    | $V(1,2,3) - V(1,3) = 0$       | $V(1,3) - V(1) = 1$           |
| (2,1,3) | $V(1,2) - V(2) = 0$           | $V(2) = 0$                    | $V(1,2,3) - V(1,2) = 1$       |
| (2,3,1) | $V(1,2,3) - V(2,3) = 0$       | $V(2) = 0$                    | $V(2,3) - V(2) = 1$           |
| (3,1,2) | $V(1,3) - V(3) = 1$           | $V(1,2,3) - V(1,3) = 0$       | $V(3) = 0$                    |
| (3,2,1) | $V(1,2,3) - V(2,3) = 0$       | $V(2,3) - V(3) = 1$           | $V(3) = 0$                    |

For each shareholder, we will consider a kind of weighted average by summing the sum of the marginal contributions and dividing by the number of arrangements. We will accept that the Shapley value of shareholder 1 is  $\frac{1}{6}$ , the Shapley value for shareholder 2 is also  $\frac{1}{6}$ , and finally, the Shapley value for shareholder 3 is  $\frac{2}{3}$ . In other words, the decisive power of shareholder 3 is four times higher than the decisive power of each of the other shareholders, although his formal power is only two times higher than their power.

An order for a particular motion up for a vote can express the intensity of the shareholders' attitude towards the motion – the first one who "enters" is the most ardent supporter, the last who "enters" is the strongest opponent, and among them are the rest of the shareholders in descending order of support. The most ardent supporter and the strongest opponent will try to get the support of the rest of the shareholders. The decision will fall in accordance with the one that manages to recruit more shareholders alongside him.

The Shapley and Shubik power index is a function that corresponds to each simple game its Shapley value<sup>56</sup>. A simple game is a game in which the value of each coalition is either 0 or 1 (as shown in the numerical example). This type of game models the ability to pass a motion given a group of decision-makers. The value of a coalition is equal to 1 if the members of the coalition can take the decision on their own, even if the rest of the players oppose the motion. In this case, this coalition will be called *a winning coalition*. The value of a coalition would be 0 if its members could not impose their opinion on the rest of the decision-makers. In this case, the coalition will be called *a losing coalition*. A simple game would be monotonous if every sub-coalition of a losing coalition is a losing coalition and any coalition that contains a winning coalition also wins.

Most of the group's decision-making mechanisms that are familiar to us are simple and monotonous games. The three typical examples of decision-making mechanisms that meet this definition are: multiplayer games, in which the decision is made if the majority of the decision-makers agree to it; unanimous games, in

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<sup>56</sup> Maschler, Solan & Zamir, at 801, footnote 50.

which the decision is made only if all the decision-makers agree to it; and dictator games, in which there is a single decision-maker who decides whether to accept or reject the decision. The use of the Shapley value and the Shapley and Shubik power index is suitable for each of these decision-making mechanisms, which cover most situations in which we would like to assess the effective power of the decision-makers.

Another concept that is important to define for applying Shapley and Shubik's power index to the shareholders' decision-making process is a *pivot player*. If group of N shareholders makes decisions through votes at a general meeting, then for any order in which the shareholders are arranged (depending on their support for the decision) there is exactly one shareholder whose group of all shareholders before him is a losing coalition, and his joining turns the coalition from a losing to a winning coalition. This is the pivot player. If the pivot player votes in favor of the motion, since all his predecessors in the order support it even more than he does, they will also vote in favor, and therefore the motion will be accepted. If the pivot player votes against, since all subsequent shareholders are even less ardent than him, they will vote against it, and the motion will not be accepted. The pivot player is the actor who tilts the scales in a certain decision and hence his strength.

When all possible arrangements are obtained with equal probabilities, the Shapley and Shubik power index of a particular shareholder is the probability that they will be a pivot player. In the example described in the table above, shareholder 3 is a pivot player in four of the six possible arrangements. Each of shareholders 1 and 2 is a pivot player in only one order. Therefore, the decisive power of shareholders 3 is four times greater than the power of each of shareholders 1 and 2.

Another numerical example of a different set of forces between the company's shareholders can occur in a situation where there are also three shareholders 1, 2, and 3 who hold 45%, 45%, and 10%, respectively. Even in this situation, each of the shareholders, alone, cannot tip the scales in a particular decision and therefore the value V of each of the shareholders separately will be 0:

$$V(1) = V(2) = V(3) = 0$$

But unlike the previous example, each pair of shareholders can tip the scales together and therefore:

$$V(1,3) = V(1,2) = V(2,3) = 1$$

In the table, we will examine the marginal contribution of each shareholder in this example according to the various possible arrangements:

| Order   | Shareholder 1<br>Contribution | Shareholder 2<br>Contribution | Shareholder 3<br>Contribution |
|---------|-------------------------------|-------------------------------|-------------------------------|
| (1,2,3) | $V(1) = 0$                    | $V(1,2) - V(1) = 1$           | $V(1,2,3) - V(1,2) = 0$       |

|         |                         |                         |                         |
|---------|-------------------------|-------------------------|-------------------------|
| (1,3,2) | $V(1) = 0$              | $V(1,2,3) - V(1,3) = 0$ | $V(1,3) - V(1) = 1$     |
| (2,1,3) | $V(1,2) - V(2) = 1$     | $V(2) = 0$              | $V(1,2,3) - V(1,2) = 0$ |
| (2,3,1) | $V(1,2,3) - V(2,3) = 0$ | $V(2) = 0$              | $V(2,3) - V(2) = 1$     |
| (3,1,2) | $V(1,3) - V(3) = 1$     | $V(1,2,3) - V(1,3) = 0$ | $V(3) = 0$              |
| (3,2,1) | $V(1,2,3) - V(2,3) = 0$ | $V(2,3) - V(3) = 1$     | $V(3) = 0$              |

Although there is a significant gap in holdings between shareholders 1 and 2 who each separately hold 45% of the company's shares and shareholder 3 who hold only 10% of the company's shares, the Shapley value of all three shareholders, in this case, is the same and stands on  $\frac{2}{6}$  or  $\frac{1}{3}$ . Therefore, although in this situation these are shareholders whose formal power is different, their effective power is the same, and therefore the scope of the legal duties imposed on them should also be the same.

In addition, it is also possible to implement in the index voting agreements between shareholders and even existing disputes on the other side, so that the index's result will also take those into account. Let's assume in the last example that shareholders 1 and 2 are at odds with each other and vote strategically the opposite of each other, that is, if shareholder 1 votes in favor of a particular motion, shareholder 2 votes against, and vice versa, then the power structure will look different.

Even in this situation, each of the shareholders, alone, cannot tip the scales in a particular decision and therefore the value of each of the shareholders separately will be 0:

$$V(1) = V(2) = V(3) = 0$$

But this time, shareholders 1 and 2 together are unable to make a decision together due to the conflict between them. Therefore:

$$V(1,2) = 0$$

But shareholder 3 can tip the scales each time he joins forces with another of the other two shareholders:

$$V(1,3) = V(2,3) = 1$$

We will also examine the marginal contribution of each shareholder in this example according to the various possible arrangements:

| Order   | Shareholder 1<br>Contribution | Shareholder 2<br>Contribution | Shareholder 3<br>Contribution |
|---------|-------------------------------|-------------------------------|-------------------------------|
| (1,2,3) | $V(1) = 0$                    | $V(1,2) - V(1) = 0$           | $V(1,2,3) - V(1,2) = 1$       |
| (1,3,2) | $V(1) = 0$                    | $V(1,2,3) - V(1,3) = 0$       | $V(1,3) - V(1) = 1$           |
| (2,1,3) | $V(1,2) - V(2) = 0$           | $V(2) = 0$                    | $V(1,2,3) - V(1,2) = 1$       |
| (2,3,1) | $V(1,2,3) - V(2,3) = 0$       | $V(2) = 0$                    | $V(2,3) - V(2) = 1$           |
| (3,1,2) | $V(1,3) - V(3) = 1$           | $V(1,2,3) - V(1,3) = 0$       | $V(3) = 0$                    |
| (3,2,1) | $V(1,2,3) - V(2,3) = 0$       | $V(2,3) - V(3) = 1$           | $V(3) = 0$                    |

In this case, a surprising result obtains. While shareholder 3 has the lowest formal power since he holds only 10% of the company's shares, his effective power is the greatest and in fact, it is four times greater than the power of each of the other two shareholders whom each hold 45% of the company's shares. Since these two shareholders are at odds with each other, shareholder 3 is a "pivot" player who tips the scales in the decisions made at the company's shareholders' meeting in a greater number of cases.

## VI - APPLYING SHAPLEY AND SHUBIK'S POWER INDEX TO EFFECTIVE CONTROL CASES

The main advantage of Shapley and Shubik's power index is its simplicity of application. Although it is an index based on an abstract mathematical theory, applying it to decision-makers in majority-based decisions, in many specific cases does not require much more than simple numerical calculations of the cases in which each of the shareholders constitutes a pivot player for the purpose of a particular decision and the scheme of these situations to all relevant decision-makers. Finally, a comparison is required between the number of cases in which each decision maker constitutes a pivot player, which thereby estimates the decisive power of each and every one of the company's shareholders who come to the vote. There are few accessible online calculators currently available for calculating the Shapley value in which you can enter the share of the holdings of the various shareholders and get the result of the index for their effective power<sup>57</sup>.

It is proposed to use this index as a judicial auxiliary tool that will assist courts that discuss the scope of liability of activist minority shareholders that gain effective power that exceeds their formal one. The use of this test may help with the current arising ambiguity from the attempts of courts around the world to assess the existence of "inherent coercion" or "effective control" based on a diverse set of

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<sup>57</sup> For example, see: <http://shapleyvalue.com/>



circumstances and subjective weighing of this complex, as described in the previous sections.

Alongside the use of the index as a judicial auxiliary tool, it is proposed to enable the existence of a pre-ruling mechanism that will be coordinated by the relevant regulator which shareholders can access before making material decisions at the shareholders' meeting for the purpose of declaring them as ones without decisive power and in accordance with the decision of the regulator. This would clarify the scope of legal duties applicable to them at the time of the decision will be derived. This pre-ruling mechanism should increase legal certainty and reduce litigation on the question of the liability of activist minority shareholders with effective power.

The index is suitable for the use and estimation of the effective power of a minority shareholder both in the existence and absence of a controlling shareholder in the company, and its use will be made in the same manner in these two ownership structures. Therefore, although the proposed use of the index comes from problems arising especially in dispersed ownership structure, its implementation does not depend on the fact that one or another company operates with or without a controller and can be uniformly applied to all ownership structures. Thus, the use of the index is not only suitable for this period but is possible for future use regardless of future trends in the ownership structure in capital markets. In addition, its use is not dependent on a specific market, and it is possible, for the same reason, to use the index in countries that are characterized by different ownership structures.

Another issue that needs to be discussed in this context is when the index will be used. It is possible to think of two relevant times when the parties involved may require an examination of the decisive power. One time will be after the fact when a certain decision will come to the examination of the court. Another possible time will be in real-time, approaching making a decision, when a minority shareholder will want to finance his actions in advance and estimate the scope of liability that is expected to be imposed on him for his influence on accepting or opposing a motion. It is important to note that in both situations, in advance and in retrospect, the application of the index should be the same and in accordance with what was demonstrated in the previous section. For this purpose, there is no importance to the decision made in a particular case, but only to the number of cases in which a particular minority shareholder was a pivot player in the relevant decision. Therefore, there is also no discrepancy between hindsight and prior examination of the existence of decisive power, and any judicial decision made in accordance with it will not be vulnerable and exposed to the effect of the hindsight bias.

Further to this, it should be emphasized that the index does not examine the actual vote in one decision or another, but rather examines the potential decisive power that was in the possession of a shareholder at the time the decision was made. After determining, in accordance with the index, the existence of a decisive power, the court will be able to examine whether this decisive power was exercised within

the provisions of the law and the rulings, and based on this, determine whether a certain duty was violated in the exercise of this decisive power. Of course, if it is decided according to the test that the minority shareholder did not have the decisive power in the relevant decision, the duties that will be imposed on him are the same general duties that apply to every shareholder of the company.

Another clear advantage of the index is that it is an objective index based on a factual situation that applies at the time of decision making at the shareholders' meeting and does not require subjective assessments as required by tests applied in case law and discussed in previous sections, such as the "inherent coercion" test or the "effective control" test. These two tests, which were applied in the past, require a subjective opinion of the courts that is done retroactively while knowing the results of the decision in question and thus allowing the court to cast context-sensitive content in examining the question. The objectivity of the proposed index contributes to legal certainty by allowing the various shareholders to assess in advance, at the time of making the decision, the scope of their liability in accordance with their level of decisive power.

Many situations that have been decided so far in case law, such as those in which a minority shareholder had the decisive power, were situations in which a contractual right was granted to that shareholder. These situations are easy to decide and, of course, do not require the use of any test to estimate the decisive power of a shareholder. The use of Shapley and Shubik's power index is not limited to situations in which a veto right is explicitly assigned to a minority shareholder and is expected to allow the courts to evaluate each of the many and varied situations in which a minority holder has decisive power that does not derive from the existence of a veto right. This will allow the courts to apply fiduciary duties on shareholders uniformly and fully, without discriminating between different techniques that lead to the creation of the decisive power and situations in which it is granted by an explicit contractual right, or it is created through the ownership structure of the company or by existing voting agreements between shareholders. On the other hand, it is important to note that there are many ways of creating decisive power that are not reflected in voting in the meeting<sup>58</sup>. This proposal is to keep these cases examined substantively according to the circumstances of each case as detailed in previous sections of this article.

This article focuses on the duties imposed on shareholders, which distinguish between the scope of liability that applies to controlling shareholders and that which applies to other non-controlling shareholders. However, the use of the index proposed in the article is suitable for any case in which the applicable law distinguishes between dominant and non-dominant shareholders. A prominent case for this is the different way the law deals with conflict-of-interest transactions and establishes a different approval procedure for transactions in which the personal

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<sup>58</sup> For example, see: Fried, Jesse M. & Kamar, Ehud, Alibaba, *A Case Study of Synthetic Control*, Harvard Business Law Review 11, (2021), 279 which demonstrate another ways to create effective power that is greater than the formal power, not through voting in.

matter is tainted by a dominant shareholder as opposed to a non-dominant shareholder. In this case, too, it is possible to use the index and distinguish between different shareholders based on their effective power as opposed to the formal as an alternative to choosing one or another arbitrary holding rate.

Finally, unlike the simple numerical examples given in the article to illustrate how the index is calculated in various holding structures, the reality is more complex and includes a larger number of shareholders who hold the various public companies. The higher the number of different shareholders, the greater the complexity of calculating the index. However, despite the existence of many shareholders in public companies, most of the shareholders do not attend meetings and do not actively participate in voting, a phenomenon known as "rational apathy" which is widely discussed in the literature. Therefore, to simplify the index calculation and correctly represent the decisive power considering the shareholders who come to the meetings and influence the decisions through their voting, it is proposed to calculate the index based on the average of the holdings of shareholders who come to the votes in the years before the calculation. Thus, in the case that an average of 40% of the shareholders attend each general meeting in a particular company, only those shareholders should be considered in the calculation of the index. This proposal will be correct as it is a general meeting whose attendance is similar to the average. In the manner that a particular general meeting attracts a particularly high or low number of shareholders, it will be correct to calculate the index according to the shareholders present at the meeting.

## CONCLUSION

In the absence of controlling shareholders, the power of activist minority shareholders increases. Such shareholders use their power to influence and direct the company's actions. This ownership structure raises a principal-agent problem whereby a minority shareholder influences in his decisions the benefit of the many communities associated with the corporation and as a result, the various laws, impose legal duties on shareholders who have effective control.

This liability exists, but alongside it, the definition of this "effective control" is lacking, and in fact today, the courts are required to decide whether this or that shareholder had effective control without being presented with explicit guidelines that assist in this decision. An empirical analysis, performed in the paper, of 39 key court decisions from Delaware courts shows that in fact very few circumstances influencing court decisions and many other material aspects of the case cannot explain the decision regarding effective control.

Therefore, the article proposes a borrowed test from the field of cooperative game theory that helps to examine the existence of effective power among minority shareholders. This test, as detailed in the article, is simple to operate, and examines

the factual system that existed at the time the decision under consideration was made objectively and is not limited to specific ownership structures, specific markets, and current times.

It is important to note that the proposed tool is based on the effective power of the various shareholders as opposed to their formal power, based on the fact that there may be situations, as demonstrated in the article, in which there will be gaps between formal and effective power and as this gap increases its agency costs increases as well.

Finally, the adoption of the test is expected to increase legal certainty regarding situations in which the fiduciary duty will be exercised on minority shareholders, thereby helping to reduce the agency costs arising from the rise in power of activist minority shareholders and to ensure these shareholders act when the good of the company is at the forefront of them. This move may bring, with time, as more companies move to a decentralized ownership structure, to derive the value of the companies navigated by minority shareholders with effective power.

## **APPENDIX 1- LIST OF DELAWARE COURTS' KEY DECISIONS**

1. *Puma v. Marriott*, 283 A.2d 693 (Del. Ch. 1971).
2. *In re Sea-Land Corp. S'holders Litig.*, 1988 WL 49126 (Del. Ch. May 13, 1988).
3. *Citron v. Steego Corp.*, 1988 WL 94738 (Del. Ch. Sept. 9, 1988).
4. *Siegman v. Tri-Star Pictures, Inc.*, 1989 WL 48746 (Del. Ch. May 5, 1989).
5. *In re Shoe-Town, Inc. S'holders Litig.*, 1990 WL 13475 (Del. Ch. Feb. 12, 1990).
6. *In re Tri-Star Pictures, Inc., Litig.*, 634 A.2d 319 (Del. 1993).
7. *Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110 (Del. 1994).
8. *In re Wheelabrator Techs., Inc. S'holders Litig.*, 663 A.2d 1194 (Del. Ch. 1995).
9. *Emerson Radio Corp. v. Int'l Jensen Inc.*, 1996 WL 483086 (Del. Ch. Aug. 20, 1996).
10. *Harbor Fin. Partners v. Sugarman*, 1997 WL 162175 (Del. Ch. Apr. 3, 1997).
11. *Odyssey Partners, L.P. v. Fleming Companies, Inc.*, 735 A.2d 386 (Del. Ch. 1999).
12. *O'Reilly v. Transworld Healthcare, Inc.*, 745 A.2d 902 (Del. Ch. 1999).
13. *In re W. Nat. Corp. S'holders Litig.*, 2000 WL 710192 (Del. Ch. May 22, 2000).
14. *In re Cysive, Inc. S'holders Litig.*, 836 A.2d 531 (Del. Ch. 2003).
15. *Zimmerman v. Braddock*, 2005 WL 2266566 (Del. Ch. Sept. 8, 2005), *rev'd on other grounds*, 906 A.2d 776 (Del. 2006).
16. *Williamson v. Cox Commc'ns, Inc.*, 2006 WL 1586375 (Del. Ch. June 5, 2006).
17. *Superior Vision Servs., Inc. v. ReliaStar Life Ins. Co.*, 2006 WL 2521426 (Del. Ch. Aug. 25, 2006).
18. *In re Lorai Space & Commc'ns Inc.*, 2008 WL 4293781 (Del. Ch. Sept. 19, 2008).
19. *Hokanson v. Petty*, 2008 WL 5169633 (Del. Ch. Dec. 10, 2008).
20. *In re Morton's Rest. Grp., Inc. S'holders Litig.*, 74 A.3d 656, 658 (Del. Ch. 2013).
21. *In re Primedia, Inc. S'hlders Litig.*, 67 A.3d 455, 477 (Del. Ch. 2013).
22. *Hamilton Partners, L.P. v. Highland Cap. Mgmt., L.P.*, 2014 WL 1813340 (Del. Ch. May 7, 2014).
23. *In re Crimson Expl. Inc. Stockholder Litig.*, 2014 WL 5449419 (Del. Ch. Oct. 24, 2014).
24. *In re KKR Fin. Holdings LLC S'holder Litig.*, 101 A.3d 980 (Del. Ch. 2014), *aff'd sub nom., Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304 (Del. 2015).
25. *In re Sanchez Energy Derivative Litig.*, 2014 WL 6673895 (Del. Ch. Nov. 25, 2014), *rev'd sub nom. on other grounds, Delaware Cty. Emps. Ret. Fund v. Sanchez*, 124 A.3d 1017 (Del. 2015).
26. *In re Zhongpin Inc. Stockholders Litig.*, 2014 WL 6735457 (Del. Ch. Nov. 26, 2014), *rev'd sub nom. on other grounds, In re Cornerstone Therapeutics Inc, S'holder Litig.*, 115 A.3d 1173 (Del. 2015).
27. *Larkin v. Shah*, 2016 WL 4485447 (Del. Ch. Aug. 25, 2016).
28. *In re Rouse Properties, Inc.*, 2018 WL 1226015 (Del. Ch. Mar. 9, 2018).
29. *In re Tesla Motors, Inc. S'holder Litig.*, 2018 WL 1560293 (Del. Ch. Mar. 28, 2018).

30. *Basbo Techs. Holdco B, LLC v. Georgetown Basbo Invs., LLC*, 2018 WL 3326693 (Del. Ch. July 6, 2018), *aff'd sub nom., Davenport v. Basbo Techs. Holdco B, LLC*, 221 A.3d 100 (Del. 2019).
31. *Arkansas Tchr. Ret. Sys. v. Alon USA Energy, Inc.*, 2019 WL 2714331 (Del. Ch. June 28, 2019).
32. *FrontFour Cap. Grp. LLC v. Taube*, 2019 WL 1313408 (Del. Ch. Mar. 11, 2019).
33. *Klein v. Wasserman*, 2019 WL 2296027 (Del. Ch. May 29, 2019).
34. *Reith v. Lichtenstein*, 2019 WL 2714065 (Del. Ch. June 28, 2019).
35. *Genuine Parts Co. v. Essendant Inc.*, 2019 WL 4257160 (Del. Ch. Sept. 9, 2019).
36. *Voigt v. Metcalf*, 2020 WL 614999 (Del. Ch. Feb. 10, 2020).
37. *Skye Min. Invs., LLC v. DXS Cap. (U.S.) Ltd.*, 2020 WL 881544 (Del. Ch. Feb. 24, 2020).
38. *In re Pattern Energy Grp. Inc. S'holders Litig.*, 2021 WL 1812674 (Del. Ch. May 6, 2021).
39. *In re GGP, Inc. S'holder Litig.*, 2021 WL 2102326 (Del. Ch. May 25, 2021).



Appendix 2- Table of Key Decisions Under Delaware Law (source: Troutman Pepper)

| <u>Case Name</u>  | <u>Own %</u> | <u>Board Control</u>   | <u>Committee Control</u>  | <u>Contractual Rights</u>   | <u>Other Commercial Leverage</u>  | <u>Other Indicia/Factors</u>  | <u>Y/N</u> |
|-------------------|--------------|--|---------------------------|---|---|---|------------|
| <i>KKR</i>        | ~1%          | 4/12 (2/12 were insiders of effective controller; another 2/12 conceivably lacked independence from controller). | N/A                       | N/A   | N/A   | <ul style="list-style-type: none"> <li>• Effective controller was the founder of the company.</li> <li>• Company was “completely reliant” upon affiliate of effective controller.</li> <li>• All the company’s officers were employees of the effective controller at the time.</li> <li>• Affiliate of effective controller managed day-to-day business pursuant to a Management Agreement.</li> </ul> | No         |
| <i>Tri-Star I</i> | 9%           | 3/10 of board lacked independence.   | N/A                       | N/A   | N/A   | <ul style="list-style-type: none"> <li>• Effective controller purportedly participated in negotiation on behalf of the seller in the transaction.</li> </ul>  | No         |
| <i>Shoe-Town</i>  | 10%          | 0/10.  | N/A                       | N/A   | N/A   | <ul style="list-style-type: none"> <li>• None</li> </ul>  | No         |
| <i>Pattern</i>    | ~10%         | 2/7 of board.  | 0/4 of special committee. | Effective controllers threatened using consent right to channel company toward particular bidder. This affected the special committee’s decision-making process in connection with the sale. “With these two sources of soft power, [the effective controllers] pervaded the Company’s C-suite, boardroom, and supply chain.” | Company controlled by effective controllers was an “essential part of the Company’s upstream supply chain.” | <ul style="list-style-type: none"> <li>• Effective controllers had a long history with the company’s high-ranking officers, which gave the effective controllers “the ability to exercise outsized influence in the board room or on committees.”</li> </ul>  | Yes        |
| <i>Essendant</i>  | ~12%         | 0/8 of board.  | N/A                       | N/A   | N/A   | <ul style="list-style-type: none"> <li>• Board allegedly caved to the will of effective controller.</li> <li>• Two stockholders with slightly larger holdings.</li> </ul>   | No         |



|  |            |  |   |            |            |  |            |
|--|------------|--|---|------------|------------|--|------------|
| <p><i>Front<br/>Four<br/>Capital</i></p> | <p>15%</p> | <p>5/7 (2 of 7 were effective controllers; 1 of 7 was close friend of controllers; 2 of 7 demonstrated a lack of independence from effective controllers).</p> | <p>2/4 of special committee tasked with evaluating challenged mergers lacked independence from effective controllers.</p> | <p>N/A</p> | <p>N/A</p> | <ul style="list-style-type: none"> <li>• Effective controllers were founders, directors, and officers of company.</li> <li>• Effective controllers owned the majority of the registered investment advisor firms that managed the day-to-day operations of the company.</li> <li>• Effective controllers were to be directors and/or high-ranking officers of the combined company after the merger.</li> <li>• Effective controllers were directors, and/or high-ranking officers of each of the company's transaction counterparties in the challenged mergers.</li> </ul> | <p>Yes</p> |
|--|------------|--|---|------------|------------|--|------------|

| <u>Case Name</u> | <u>Own %</u> | <u>Board Control</u>   | <u>Committee Control</u> | <u>Contractual Rights</u>  | <u>Other Commercial Leverage</u> | <u>Other Indicia/Factors</u>   | <u>Y/N</u> |
|------------------|--------------|--|--------------------------|--|----------------------------------|--|------------|
| <i>Petty</i>     | 17%          | 1/5 of board were appointed by and beholden to effective controller.               | N/A                      | N/A  | N/A                              | <ul style="list-style-type: none"> <li>• Largest single stockholder of the company.</li> <li>• Directors were afforded role in the post-merger company.</li> </ul>   | No         |
| <i>Cox</i>       | 17.1%        | 2/5 of board were appointed by and lacked independence from effective controllers. | N/A                      | Charter provisions gave the effective controllers veto power over all decisions of the board of directors. | N/A                              | <ul style="list-style-type: none"> <li>• The effective controllers were the company's <i>only</i> significant customers and the company depended on their cooperation as customers if it was going to operate profitably.</li> <li>• One larger stockholder. Larger stockholder appointed 3 of 5 board members.</li> </ul> | Yes        |
| <i>Wasserman</i> | 20%          | 1/3 of board.  | N/A                      | N/A  | N/A                              | <ul style="list-style-type: none"> <li>• One larger stockholder. Larger stockholder appointed 2 of 3 board members.</li> </ul>   | No         |

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|                |       |   |     |     |     |  |    |
|----------------|-------|---|-----|-----|-----|--|----|
| <i>Sanchez</i> | 21.5% | 2/5 of board were members of effective control group. | N/A | N/A | N/A | <ul style="list-style-type: none"> <li>• Both members of the effective control group were part of the founding family.</li> <li>• One of the effective members of the control group was the CEO.</li> <li>• One director was long-time friends with a member of the control group (not beholden).</li> <li>• One director was effective to have had existing business relationships with members of control group (not beholden).</li> </ul> | No |
|----------------|-------|---|-----|-----|-----|--|----|

| <u>Case Name</u>    | <u>Own %</u> | <u>Board Control</u>   | <u>Committee Control</u> | <u>Contractual Rights</u> | <u>Other Commercial Leverage</u> | <u>Other Indicia/Factors</u>   | <u>Y/N</u> |
|---------------------|--------------|--|--------------------------|---------------------------|----------------------------------|--|------------|
| <i>Wheelabrator</i> | 22%          | 4/11 of board were beholden to effective controller.   | N/A                      | N/A                       | N/A                              | <ul style="list-style-type: none"> <li>No other indicia of control.</li> </ul>   | No         |
| <i>Tesla</i>        | 22.1%        | 5/7 of board members lacked independence from controller.<br><br>3/5 of board members that voted on the transaction lacked independence from controller. | N/A                      | N/A                       | N/A                              | <ul style="list-style-type: none"> <li>Effective controller was the company's visionary, CEO, founder, Chairman, and largest stockholder.</li> <li>Public filings disclosed effective controllers' outsized influence on the Company and in the boardroom.</li> <li>Effective controller responsible for engaging advisors.</li> </ul>   | Yes        |
| <i>Larkin</i>       | 23.1%        | 3/9 of board were controlled by effective controllers.   | N/A                      | N/A                       | N/A                              | <ul style="list-style-type: none"> <li>2 other members of the board did not lack independence but were granted tax reimbursements by a committee that included directors who lacked independence from the effective controllers.</li> <li>2 other members of the board did not lack independence but were alleged to have been "handpicked by [the] conflicted directors" and given generous stock options.</li> </ul>   | No         |
| <i>Zhongpin</i>     | 26%          | 2/5 of board were effective controller or beholden to effective controller.  | N/A                      | N/A                       | N/A                              | <ul style="list-style-type: none"> <li>The effective controller was founder, CEO, director, and largest stockholder of company.</li> <li>Company "substantially" relied upon effective controller to manage operations.</li> <li>Losing effective controller would constitute a material adverse effect.</li> <li><i>Notably</i>, an effective controller used significant leverage to force the company to accept his proposal. He would not cooperate with any third-party bidder and caused the special committee to reject a superior third party offer</li> </ul> | Yes        |

|               |     |   |     |     |     |  |    |
|---------------|-----|---|-----|-----|-----|--|----|
|               |     |   |     |     |     | <p>because he refused to remain CEO or roll over his shares if third party bid was accepted.</p> <ul style="list-style-type: none"> <li>Initial financial advisor refused to render fairness opinion and terminated its engagement.</li> </ul> |    |
| <i>Jensen</i> | 26% | 1/5 of board was general partner of effective controller. | N/A | N/A | N/A | <ul style="list-style-type: none"> <li>There was one larger stockholder than effective controller.</li> </ul>  | No |

| <u>Case Name</u>             | <u>Own %</u> | <u>Board Control</u>   | <u>Committee Control</u>                                      | <u>Contractual Rights</u>  | <u>Other Commercial Leverage</u> | <u>Other Indicia/Factors</u>   | <u>Y/N</u> |
|------------------------------|--------------|--|---|--|----------------------------------|--|------------|
| <i>Morton's</i>              | 27.7%        | 2/10 of board were insiders of effective controller.   | N/A   | N/A  | N/A                              | <ul style="list-style-type: none"> <li>Effective controller owned 100% of the company before it went public.</li> <li>Effective controller was alleged to be involved in the sale process, including the retention of the company's financial advisor.</li> </ul>  | No         |
| <i>Skye Mineral Partners</i> | 28.07%       | 1/3 of board was an insider of effective controller.   | N/A   | Effective controller allegedly weaponized contractual blocking rights to starve the company of capital, drive it into bankruptcy, and take control of the company through a bankruptcy sale at a discount. | N/A                              | <ul style="list-style-type: none"> <li>Company is financially distressed.</li> <li>Additional observer rights.</li> </ul>  | Yes        |
| <i>Rouse</i>                 | 33.5%        | 3/10 of board members were beholden to effective controller.<br><br>2/10 of the board—had ties to effective controller, but not enough to lack independence. | 2/5 of special committee charged with considering the merger. | N/A  | N/A                              | <ul style="list-style-type: none"> <li>Effective controller proposed the challenged transaction.</li> <li>The Special Committee was comprised of members who were placed on the board by an affiliate of the effective controller.</li> <li>Company disclosed in its Form 10-K that the effective controller was a “substantial stockholder” that “may exert influence over” the company.</li> </ul> | No         |

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|                |       |   |     |     |   |   |    |
|----------------|-------|---|-----|-----|---|---|----|
| <i>Crimson</i> | 33.7% | 3/7 of board were insiders of effective controller. | N/A | N/A | Affiliate of effective controller was a significant creditor. | <ul style="list-style-type: none"> <li>• One other director, who was also the company's CEO, had a prior business relationship with effective controller, but did not lack independence.</li> <li>• Remaining directors were elected to the board after the effective controller invested, but did not lack independence.</li> <li>• CFO was alleged to be handpicked by effective controller.</li> <li>• Other executive officers joined after effective controller invested.</li> <li>• Effective controller neither proposed transactions nor led board discussions of transaction.</li> </ul> | No |
|----------------|-------|---|-----|-----|---|---|----|

| <u>Case Name</u> | <u>Own %</u> | <u>Board Control</u>  | <u>Committee Control</u> | <u>Contractual Rights</u>  | <u>Other Commercial Leverage</u>                                    | <u>Other Indicia/Factors</u>  | <u>Y/N</u> |
|------------------|--------------|---|--------------------------|--|---|---|------------|
| <i>Voigt</i>     | 35%          | 8/12 (4 of 12 were insiders of effective controller; another 4 of 12 conceivably lacked independence from effective controller).                      | N/A                      | The effective controller had contractual veto rights over actions that boards of directors could normally take unilaterally. Effective controller had contractual right to representation on key board committees proportionate to ownership percentage. | N/A   | <ul style="list-style-type: none"> <li>The effective controller had relationships with banker and law firm hired by special committee to evaluate deal.</li> </ul>  | Yes        |
| <i>Cysive</i>    | 35%          | 2/5 (1 was effective controller; 1 was beholden to effective controller).<br><br>1 other affiliated with effective controller ( <i>not</i> beholden). | N/A                      | N/A  | Options to purchase another 0.5% to 1% of additional company stock. | <ul style="list-style-type: none"> <li>Financially distressed company.</li> <li>The controller was the Chairman, director, CEO, largest stockholder, and founder.</li> <li>The controller was company's "inspirational force."</li> <li>The CFO was beholden to the controller.</li> <li>The company employed two of the controller's family members.</li> <li>Management buy-out transaction was proposed by controller, after sale process failed.</li> <li>The special committee negotiated more favorable terms and conducted pre- and post-signing market checks.</li> <li>The Controller did not have any relationship with special committee financial advisor but did confer with financial advisor during sale process and directly reached out to potential bidders.</li> </ul> | Yes        |



| <u>Case Name</u> | <u>Own %</u> | <u>Board Control</u> | <u>Committee Control</u>   | <u>Contractual Rights</u>  | <u>Other Commercial Leverage</u> | <u>Other Indicia/Factors</u>  | <u>Y/N</u> |
|------------------|--------------|----------------------|--|--|----------------------------------|---|------------|
| GGP              | 35.3%        | 3/9 of board.        | 1/3 of nominating and governance committee.<br><br>0/5 of special committee negotiating the transaction. | <ul style="list-style-type: none"> <li>The Standstill agreement prevented effective controller from acquiring more than 45% ownership.</li> <li>Effective controller had the right to nominate three members to the company's board.</li> <li>Contractual provisions in investment agreement required: company to have majority of independent directors under the NYSE Rules; a majority of the Nominating and Governance Committee to be "disinterested directors" unaffiliated with the effective controller; for the election of directors other than the effective controller nominees, the effective controller must vote any shares it held in excess of 10% of company outstanding stock in proportion to the votes</li> </ul> | N/A                              | <ul style="list-style-type: none"> <li>The transaction was between company and effective controller. Conditioned upon majority of unaffiliated stockholder vote. A special committee was formed to negotiate the transaction.</li> <li>Stockholder vote was sufficient to approve the transaction even without counting effective controller's vote. No concern with low voter turnout.</li> <li>Seven of nine board members were originally nominated or recruited by effective controller. Not beholden.</li> <li>Directors associated with effective controller did not participate in the special committee's decision-making process.</li> <li>Effective controller co-authored, co-filed, and co-signed the Proxy statement soliciting approval of the transaction. Deemed not to be an important factor.</li> <li>Effective controller issued press releases on company's behalf in connection with transaction. Deemed not to be an important factor.</li> <li>SEC filings noted the effective controller's influence.</li> </ul> | No         |

|  |  |  |  |   |  |  |  |
|--|--|--|--|---|--|--|--|
|  |  |  |  | <p>cast by stockholders unaffiliated with effective controller; transactions under which the effective controller would receive disparate consideration needed to be approved by a majority of the disinterested directors and stockholders unaffiliated with the effective controller.</p> |  |  |  |
|--|--|--|--|---|--|--|--|

| <b>Case Name</b>    | <b>Own %</b> | <b>Board Control<sup>2</sup></b>   | <b>Committee Control</b>                         | <b>Contractual Rights</b>                          | <b>Other Commercial Leverage</b>   | <b>Other Indicia/Factors</b>   | <b>Y/N</b> |
|---------------------|--------------|--|--|--|--|--|------------|
| <i>Lichtenstein</i> | 35.6%        | 3/6 of the board leading up to transaction were affiliated with and beholden to the effective controller; 2 of 5 lacked independence at the time the transaction was approved. <u>Note</u> : after the transaction was in motion, but before transaction was approved and closed, one director that lacked independence passed away passed away. | N/A  | N/A  | N/A  | <ul style="list-style-type: none"> <li>Effective controller strongly influenced management. An executive of the effective controller served as interim CEO of the company and was replaced by an individual with significant connections to effective controller. CFO was long- standing executive of effective controller’s affiliate.</li> <li>One of the effective controller’s affiliates provided the company services through a Management Services Agreement.</li> <li>Officers of the effective controller acted as “de facto investment bankers” for the Company during period leading up to the challenged transaction.</li> </ul> | Yes        |
| <i>Loral Space</i>  | 35.9%        | 5/8 of board beholden to controller, including chairman.   | 1/2 of special committee beholden to controller. | Contractual rights to block strategic initiatives. | Controller was a significant creditor, with unilateral ability to force redemption of notes. | <ul style="list-style-type: none"> <li>Financially distressed company.</li> <li>Effective controller publicly maintained that it controlled the board.</li> <li>Company 10Ks identified effective controller as the controlling stockholder.</li> <li>CEO beholden to controller.</li> </ul>   | Yes        |
| <i>Tri-Star II</i>  | 36.8%        | 8/10 (3 of 10 were insiders of effective controller; another 2 of 10 were insiders of company with significant financial ties to effective controller; another 3 of 10 were  | N/A  | N/A  | N/A  | <ul style="list-style-type: none"> <li>Effective controller had stockholder agreement with other large stockholders, which together owned 56.6% of the company.</li> <li>Effective controller had stockholder agreement with a 9% stockholder, under which each party agreed to nominate 4 members to the company’s board (for a total of 8 directors) and vote for each other’s nominees.</li> </ul>  | Yes        |

|                 |       |  |     |     |     |   |    |
|-----------------|-------|--|-----|-----|-----|---|----|
|                 |       | significant stockholders of controllers, 2 of which were appointed by controller). |     |     |     |   |    |
| <i>Sea-Land</i> | 39.5% | None   | N/A | N/A | N/A | <ul style="list-style-type: none"> <li>• Other shares were widely held.</li> <li>• Effective controller blocked third-party merger bid until third party agreed to pay effective controller a premium.</li> <li>• The board rejected the effective controller's bid, which was \$2 per share less than third party bidders.</li> <li>• In response to effective controller's bid, the board contacted other potential acquirers.</li> </ul> | No |

| <u>Case Name</u> | <u>Own %</u> | <u>Board Control</u>   | <u>Committee Control</u>   | <u>Contractual Rights</u>  | <u>Other Commercial Leverage</u>   | <u>Other Indicia/Factors</u>   | <u>Y/N</u> |
|------------------|--------------|--|--|--|--|--|------------|
| <i>Basbo</i>     | ~40%         | 2/7 of board lacked independence from effective controller.          | N/A  | <ul style="list-style-type: none"> <li>Controller used contractual blocking rights to cut off company's access to other sources of funding such that the company had no option other than to accept the controller's unfair financing proposal.</li> </ul>   | The controller was a significant creditor. Failed to comply with financing obligations to starve company of funding. | <ul style="list-style-type: none"> <li>The company was financially distressed.</li> <li>Controller's board appointees interfered with the financing process.</li> <li>The effective controller controlled management by subverting them, threatening them, or getting rid of them.</li> <li>The controller used its relationship with the financial advisor to control the company.</li> </ul> | Yes        |
| <i>Primedia</i>  | 40.34%       | Majority of board lacked independence from the effective controller. | N/A  | <ul style="list-style-type: none"> <li>N/A</li> </ul>  | N/A  | <ul style="list-style-type: none"> <li>Public disclosures stated that effective controller was the "influential force" behind the challenged transactions.</li> </ul>  | Yes        |
| <i>Lynch</i>     | 43.3%        | 5/11 of board were designated by and beholden to controller.         | <p>2/3 of the executive committee were beholden.</p> <p>2/9 of compensation committee were beholden.</p> | <ul style="list-style-type: none"> <li>The controller had contractual rights to block any business combination.</li> <li>The controller blocked deals with third party and funneled the company to deal with an affiliate of the controller.</li> <li>When that was rejected, the controller pursued a cash-out merger of the majority.</li> </ul> | N/A  | <ul style="list-style-type: none"> <li>The factual record was replete with instances of the controller making it known to the board and then prevailing in its wishes.</li> <li>The controller ultimately threatened to proceed with a less favorable tender offer if special committee did not accept the controller's cash-out merger offer.</li> </ul>                                      | Yes        |

|                        |     |  |     |   |     |   |    |
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| <i>Superior Vision</i> | 44% | 2/5 of board arguably lacked independence from effective controller. | N/A | <ul style="list-style-type: none"> <li>• Effective controller exercised contractual right to block dividend.</li> <li>• Effective controller had the right to appoint 2 members of 5-person board.</li> </ul> | N/A | N/A   | No |
| <i>Marriott</i>        | 46% | 4/9 of board were members of effective control group.                | N/A | N/A   | N/A | <ul style="list-style-type: none"> <li>• Effective controllers were the founders of the company.</li> <li>• Effective controllers owned 100% of the company before it went public.</li> </ul> | No |

| <u>Case Name</u>        | <u>Own %</u> | <u>Board Control</u>  | <u>Committee Control</u>     | <u>Contractual Rights</u>  | <u>Other Commercial Leverage</u>  | <u>Other Indicia/Factors</u>   | <u>Y/N</u> |
|-------------------------|--------------|---|------------------------------|--|---|--|------------|
| <i>Western National</i> | 46%          | <p>0/8 of board.</p> <p>1/8 (Chairman and CEO) was a former employee of effective controller for over two decades (not beholden).</p> <p>Another 2/8 entered into employment agreements with effective controller in midst of merger negotiations (not beholden).</p> | 0 of 3 of special committee. | <ul style="list-style-type: none"> <li>Ability to purchase an additional 20% of common stock; standstill agreement prohibited effective controller from acquiring more than 79% of company's stock.</li> <li>Ability to nominate two directors.</li> </ul> | Two joint ventures between effective controller and company, in which company was dependent upon effective controller to sell certain products. | <ul style="list-style-type: none"> <li>Two years prior to the events in question, effective controller vetoed a potential acquisition between the company and a third party and then proceeded to acquire that third party on its own.</li> <li>Pitch book prepared by banker set forth a plan for effective controller to buy out remaining stockholders "at a less than premium price."</li> <li>Six of the eight directors of the company were on the board before the effective controller acquired its stake in the company.</li> <li>The special committee tasked with considering strategic alternatives, including a merger with effective controller was fully independent.</li> <li>Special committee's financial advisor was one of twelve banks that participated in an underwriting process with effective controller in the past.</li> </ul> | No         |
| <i>Odyssey</i>          | 46.8%        | 1/6 of board lacked independence from effective controller.   | N/A                          | Effective controller had the contractual right to appoint two directors to the board.  | Effective controller was one of two primary creditors of the company.   | <ul style="list-style-type: none"> <li>The company was financially distressed.</li> <li>Effective controller owned warrants that, if exercised, would give the effective controller majority ownership of the company (50.1%).</li> <li>The effective controller was the company's largest supplier.</li> <li>Record reflected that effective controller did not dictate challenged corporate action.</li> </ul>   | No         |

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| <i>Sugarman</i> | 47.5% | 5/8 (2 of 8 were effective controller's CEO and wife; another 1 of 8 is director of effective controller; 2 of 8 were partners at law firms providing legal services to effective controller). | N/A | N/A | Effective controller was significant debtholder of the company. | N/A | Yes |
|-----------------|-------|--|-----|-----|---|-----|-----|



| <u>Case Name</u> | <u>Own %</u> | <u>Board Control</u>  | <u>Committee Control</u> | <u>Contractual Rights</u>   | <u>Other Commercial Leverage</u>                       | <u>Other Indicia/Factors</u>   | <u>Y/N</u> |
|------------------|--------------|---|--------------------------|---|--|--|------------|
| <i>Highlan</i>   | 48%          | 1/5 of board allegedly beholden to effective controller.  | N/A                      | Effective controller exercised its contractual rights as a debtholder to prevent the company from refinancing its defaulted debt or considering other third-party acquisitions in order to force the company to agree to a transaction with it at a price that was below the stock's trading price. | Owned 82% of the company's debt, which was in default. | <ul style="list-style-type: none"> <li>• Company was financially distressed.</li> <li>• Effective controller was an affiliate of one of the company's other stockholders.</li> </ul>   | Yes        |
| <i>Priceline</i> | 48%          | 6/11 (3 of 11 were members of control group; another 3 of 11 conceivably lacked independence from control group). | N/A                      | N/A   | N/A  | <ul style="list-style-type: none"> <li>• The largest member of control group (32% owner) was founder and former CEO.</li> <li>• Another member of control group was chairman of company's board at the time of the transaction.</li> </ul> | Yes        |

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| <i>Alon USA Energy</i> | 48% | 6/11 (5 of 11 members were executives of the effective controller; 1 of 11 was beholden due to financial ties). | N/A | The effective controller failed to comply with contractual provisions that prevented it from acquiring more than 49.99% of the company's equity or entering into any material contract with the company unless the effective controller first obtained approval from an independent committee of directors. | N/A | <ul style="list-style-type: none"> <li>The company was financially distressed.</li> <li>Effective controller was on record that it wanted to obtain 100% ownership and proposed the challenged transaction.</li> <li>Effective controller exercised its influence to remove and replace two directors of the board in order to work the same change upon the composition of the special committee charged with considering the transaction.</li> <li>Committee allowed member that was beholden to effective controller to lead negotiations on behalf of the committee/minority.</li> <li>Allegations suggest that the effective controller dictated the timing, structure, and price of the merger.</li> <li>Effective controller effectively muzzled the special committee's public statements to reduce share price for the benefit of the effective controller.</li> </ul> | Yes |
|------------------------|-----|---|-----|---|-----|---|-----|

| <u>Case Name</u> | <u>Own %</u> | <u>Board Control</u>  | <u>Committee Control</u> | <u>Contractual Rights</u> | <u>Other Commercial Leverage</u> | <u>Other Indicia/Factors</u>   | <u>Y/N</u> |
|------------------|--------------|---|--------------------------|---------------------------|----------------------------------|--|------------|
| <i>Steego</i>    | 48.8%        | 2/9 of board lacked independence from effective controller. | N/A                      | N/A                       | N/A                              | <ul style="list-style-type: none"> <li>The effective controller consulted with the board on various business matters.</li> <li>Board was agreeable to IEP designating two members of the board after consummation of share offer.</li> </ul> | No         |

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|                   |     |     |     |   |   |   |     |
|-------------------|-----|-----|-----|---|---|---|-----|
| <i>Transworld</i> | 49% | 0/4 | N/A | Effective controller had option to acquire an additional 2% of company stock. | Effective controller held substantially all company debt. | <ul style="list-style-type: none"> <li>• The company was financially distressed.</li> <li>• Effective controller allegedly blocked alternative asset sale with third party in favor of its proposed cash-out merger.</li> <li>• After cash-out merger closed, effective controller caused company to enter into the third-party asset sale that it previously blocked.</li> </ul> | Yes |
|-------------------|-----|-----|-----|---|---|---|-----|

