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What's Fair Enough Is Fair: Entire Fairness Decisions Show M&A Perfection Not Required

Historically, it's been a rarity for a defendant to win once the notoriously stringent entire fairness has been applied as the standard of review in a Chancery case. But that may be changing.

By Ellen Bardash
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What You Need to Know

- The Supreme Court of Delaware has affirmed two key Chancery decisions on the entire fairness standard.
- Lawyers say those decisions make it clear that a perfect deal isn't the standard.
- The entire fairness doctrine may be devolving into a less demanding standard of enhanced scrutiny.

Several recent decisions of the Delaware Court of Chancery—and the state Supreme Court's response to them—have signaled that for corporate defendants, the threat of having the entire fairness standard applied doesn't mean all hope is lost when defending a transaction challenged by shareholders.

In a little less than 18 months, two Chancery cases have followed a similar path: entire fairness applied in a case where a party had connections to companies on both sides of a deal. The case survived the motion to dismiss stage and went to trial. The court found that neither the conflicted party's involvement in the negotiation process nor the price the acquiring corporation ultimately agreed to pay made for a deal unfair enough to overturn. And as of this summer, the Supreme Court agreed.

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Eric Leon, Blair Connelly, and Michele Johnson

"This is not a strict liability standard. It means that in most cases you have to have a trial, and it's going to be searching and exacting," said **Latham & Watkins** partner **Blair Connelly**. "You're actually going to have to explain why the transaction makes sense, to the satisfaction of someone who's likely not an expert in the relevant industry, but you can do it. The plaintiffs seem to think that once they're in entire fairness land and they go to trial, it's free money, and that's just not the case, as has now been proven repeatedly."

In April 2022, then-Vice Chancellor Joseph R. Slights III made that point when he decided while a majority of Tesla directors involved in the acquisition of SolarCity, including Elon Musk, may have been conflicted substantially enough for the deal to be a "parable of unnecessary peril," they put shareholders' interests above their own.

A few months after the SolarCity decision, Vice Chancellor Lori Will decided the merger between

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BGC Partners Inc. and Berkeley Point Financial also passed the entire fairness test.

"This case demonstrates that entire fairness is alive and well in Delaware and serving exactly the function for which it was created," said **Latham & Watkins** partner **Eric Leon**, who defended the BGC decision before the Supreme Court. "Entire fairness, while a heavy burden, is not a strict liability doctrine. It exists to protect minority shareholders, and it does that by ensuring that when it applies, those transactions will be carefully reviewed by the trial court and undergo exacting scrutiny."

Lawrence Hamermesh, professor emeritus at Widener University's Delaware Law School, said SolarCity may have opened the door for judges to use entire fairness as the metric for evaluating deals where it might not have been applied previously, potentially holding deals that had different levels of controller conflict to the same standard.

The key difference between the SolarCity and BGC cases, he said, is that while Musk had roughly equivalent stakes in both Tesla and SolarCity, controlling shareholder Howard Lutnick's stake in target company Berkeley Point Financial was more than double the percentage of his BGC ownership. The vice chancellors in both cases decided to apply entire fairness.

"There's a notable possible expansion of the idea that entire fairness doesn't demand perfection, which of course it doesn't. But the notion of how much wiggle room you have beyond perfection may be expanding," Hamermesh said. "I'm concerned that applying entire fairness too broadly to situations where you don't want to be as demanding might actually degrade the stringency of the test where you really do want it to apply."

The Supreme Court has now affirmed both the SolarCity and BGC decisions, with Justice Karen Valihura issuing a 106-page opinion in June analyzing Slights' application of entire fairness. Valihura wrote it would have been helpful if Slights more thoroughly laid out his method for finding the price was fair, but that his overall evaluation process was comprehensive enough to stand.

"One informs the decision on the other, and you often can't get away from that," said **Michele Johnson** of **Latham & Watkins**.

The court didn't opine on the BGC appeal, issuing an order upholding it on Aug. 10. Leon said if the Court of Chancery had decided in the plaintiff's favor, it's likely the Supreme Court would have affirmed that outcome, as well, considering the high court's deference to trial judges' discretion when there's no legal error in question.

The duo of **Latham & Watkins** and Young Conaway Stargatt & Taylor that won the BGC case have successfully defended Oracle chairman Larry Ellison and CEO Safra Catz in another merger case. Shareholders had argued that as in the other two cases, entire fairness should apply, either because Ellison was a conflicted controller or because he and Catz misled the committee.

After a trial in which the standard of review was a key point of argument, Vice Chancellor Sam Glasscock III decided in May that the business judgment rule applied despite conflicts, writing that while the plaintiffs had put forward enough of an argument that Ellison was a conflicted controller to get past a motion to dismiss, it wasn't enough to prove it at trial.

"Fairness is not perfection," said Connelly, who worked on the Oracle case. "That's an impossible standard, and the law doesn't require it. Fairness means fair."

"It's kind of as if entire fairness is devolving into the less demanding enhanced scrutiny standard," Hamermesh said.

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