Through the Eyes of the "Deal Professor"

New York Times Columnist Steven M. Davidoff Surveys the Corporate Governance Landscape

Professor Davidoff sat down with BLB&G Partner Mark Lebovitch to talk about hot-button issues facing public shareholders and the latest trends in corporate governance and financial regulation.

Professor Steven M. Davidoff writes a weekly column for *The New York Times* as the "Deal Professor." Notably, Professor Davidoff has been named to a list of the 100 most influential governance professionals and institutions in the country by the National Association of Corporate Directors. As of July 1, 2014, he is a faculty member at The University of California, Berkeley School of Law (Boalt Hall). His research focuses primarily on financial regulation, M&A activity, and jurisdictional competition.

BLB&G Partner Mark Lebovitch recently had the opportunity to interview Professor Davidoff about hot-button issues facing public shareholders and the latest trends in corporate governance and financial regulation.

Q *You left private practice after 10 years at a "Biglaw" firm to become a law professor and frequent author. What drove you to change your career path?*

It was a bit random. At the time I was thinking of becoming an investment banker. But the window was closing on my chance to become a law professor. I decided to try something "different" and see if I liked it. So far, it has been a good choice, and far fewer all-nighters.

Q *What do you see as the most significant development in the corporate governance field over the past year or so?*

Activism, activism, activism.

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321,858,263

I am hoping that there will be a shift to favoring corporate governance measures based on empirical and other evidence that they create value rather than because they are the flavor of the month. There are signs that the field is becoming more rigorous, but we are not even close yet.

Q From the perspective of an institutional investor, what do you see as the most worrisome development in the corporate governance field?

I think one most worrisome development is the continued limitations on liability for officers and directors who do wrong. I am not calling to take their houses, but directors who perform misdeeds should at least be liable for returning part of their directors' fees. The same with officers. Similarly, shareholders need to step up and take responsibility for their "vote," engaging with management to produce what everyone wants — a good return.

Q What do you see as the most promising development in the corporate governance field for the institutional investor?

I am hoping that there will be a shift to favoring corporate governance measures based on empirical and other evidence that those measures create value, rather than because they are the flavor of the month. There are signs that the field is becoming more rigorous, but we are not even close yet.

Q If you could make any one change in Delaware corporate law, what would it be and why?

I am a specialist in takeovers, and so my preferred change is admittedly wonky, but I would end the different treatment of stock consideration in takeovers by extending the Delaware Supreme Court's landmark decision in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.* — i.e., duties to, generally, accept the highest reasonably-available bid — to apply to "stock-for-stock" transactions in addition to all-cash deals. I would also eliminate the exemption for appraisal rights, which is the process by which shareholders can ask a court to assess the fair value of their shares, if the consideration in a transaction is stock. The conflicts which justify these rules in cash deals still exist in stock-for-stock mergers and should be treated the same way. I would then apply the *Revlon* standard more rigorously than the deferential reasonableness standard that courts currently apply in cases involving stock-for-stock deals. Essentially, if I had my druthers, I would adopt the U.K. system of a ban on "break fees," which are the fees that a target company has to pay to bidders if the acquisition doesn't go through, and takeover defenses, which are ways that the managers of a target company try to prevent a hostile takeover.

Why would I do all of this? Because I think it would give shareholders a greater say in life-transforming M&A transactions. But I realize that isn't going to happen any time soon.

Q For many years, courts seemed to yearn for greater activism and involvement from shareholders, including taking action in response to wrongdoing and seeking change through the proxy process. Lately, some of the leaders of the corporate M&A bar have expressed views that are outright hostile to shareholder activism. Is shareholder activism a good thing, a bad thing, or somewhere in the middle?

The jury is still out, but there is clearly some good activism which creates value and has been documented empirically. There is also some silly activism like the kerfuffle around Apple. All in all, we are in the early days and will have to see. One thing which appears certain, though, is that activism is here to stay.

Q ***You've written extensively about the rise of shareholders seeking appraisal rights. Are shareholders with a certain profile best able to take advantage of this remedy? Do you see it as a growing avenue for relief in the future? Why or why not?***

Right now appraisal rights are not for the masses. You need to pay attorneys' fees and can receive less than what you paid. Given the illiquidity and risks, many institutional shareholders will likely abstain. The real question is whether the hedge funds that are entering this sphere can have a substantial impact — to be sure they are likely to have some early wins, but there will then be a blowback and the Delaware courts may become more stringent in awards. The law here is also uncertain and may change. And there is substantial risk that a transaction will collapse before the deal closes, leaving the hedge fund with substantial losses. So, I think we have a ways to go before appraisal rights are even *de rigueur* for hedge funds. The question really is whether the potential of a hedge fund seeking appraisal pushes acquirers in management buy-outs, freeze-outs and the like to pay more in the first place. That would be a benefit shared among all shareholders.

Q ***The March 2014 Delaware Supreme Court decision in*** **Kahn v. M&F Worldwide Corp.*****, which held that the deferential business judgment rule can apply to a "going-private" transaction with a controlling shareholder when the transaction is approved by both a special committee of the board of directors and a majority of the minority shareholders, has received a lot of attention. What do you see as the key question that the case raised and what is your view of how the Court answered that question?***

It is funny, but more ink has been spilled on how freeze-outs (transactions where a controlling shareholder buys out the minority shareholders) should be regulated than almost any other topic in the Delaware courts. Yet, how many of these transactions happen in any given year? The key question here is what level of regulation is necessary to make sure that minority shareholders are protected in a freeze-out and who should perform that review. Should it be the courts as the prior standard required — or should it be directors and perhaps shareholders as is required under the new standard? It remains to be seen whether shareholders can act effectively in these situations. At least one study I co-authored showed that majority-of-minority conditions empowered shareholders to vote against conflicted management buy-outs. Presumably, the same would apply in the case of a freeze-out. Still, the question is whether any given conflict is so pernicious that extra court review is needed. *MFW* did not go so far as to get rid of

Professor Steven Davidoff

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court review completely. But there are many open questions. The end result of *MFW* is that even more ink will be spilled on this subject.

Q You have presented papers that criticize the volume of deal litigation that results in no real benefit to shareholders, but you have also praised cases that have made a real difference by providing meaningful benefits to shareholders. How do you differentiate the good cases from those that should not have been filed in the first place?

The good cases (and your firm has brought many) are those that get a real benefit to shareholders. The bad cases don't. We should compensate plaintiffs' lawyers for the good cases (perhaps even paying them more than we currently do), to offset the cases they lose. I really just object to disclosure-only settlements which don't change the shareholder vote and don't really disclose material information. What's the point? If you need to incentivize lawyers to file the good cases, just award more attorneys' fees in the good cases.

Q You have recently written about a "double standard," whereby Wall Street firms are criticized for awarding their employees excessive compensation, while critics are silent about the same practices in Silicon Valley. Should executive compensation be scrutinized across the board? How should shareholders look at what seems like excess compensation? How should courts look at these claims?

The focus has been on the way compensation is paid, not the aggregate number. But perhaps it should be the opposite. Too many perverse things are happening with stock options and restricted stock pay these days. If we went back to cash only, I suspect everyone would be more circumspect. How we get there, I have no idea. But it would be nice to have more scrutiny both in the courts and by shareholders with this in mind.

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Rebecca Boon also helped to prepare this feature. She is an Associate in BLB&G's New York office and can be reached at rebecca.boon@blbglaw.com.

Quotable

"The SEC is fairly effective at paying back investors when it comes to run-of-the-mill financial crimes but it is a poor second to private litigation in big accounting frauds."

Wall Street Journal financial reporter Francesco Guerrera on the results of a study by Emory University Law Professor Urska Velikonja to be published in the *Stanford Law Review* in 2015