Fireside Chat

3:05 PM – 3:40 PM, April 17, 2024

MFW and Match.com

- Overview of MFW framework
  - "Business judgment rule" and how MFW modifies it for controlling shareholder transactions
  - Key conditions required under MFW to invoke the protection of the business judgment rule
  - Application in recent cases - key Delaware cases post-MFW and their implications
- Controlled Transactions
  - Fiduciary duties of controlling shareholders
  - Theory of inherent coercion
  - When a controller stands on both sides of a transaction
  - When a controller receives a non-ratable benefit
- Director Independence
  - When is a director independent and how is it determined
  - When majority independence is not enough
- Derivative Claims and MFW
  - Rule 23.1 and the requirement of pre-suit demand
  - How the demand requirement works in practice
  - Application of the demand requirement to conflicted controller transactions

Full and Fair Disclosure - Brookfield

- The importance of MFW's second prong
- Assessing and disclosing advisor conflicts

Predictability, Market Practice, and the Delaware Forum

- Importance of legal and transactional predictability
- Concerns about the weight given to market practice and increased litigation exposure
- Nevada, Texas and the availability of other fora

On the Horizon

- Kellner - advance notice bylaws
- Dell - attorney fee awards

Merger Guidelines

U.S. Department of Justice and the Federal Trade Commission

Issued: December 18, 2023

1. Overview

These Merger Guidelines identify the procedures and enforcement practices the Department of Justice and the Federal Trade Commission (the "Agencies") most often use to investigate whether mergers violate the antitrust laws. The Agencies enforce the federal antitrust laws, specifically Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1, 2; Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45; and Sections 3, 7, and 8 of the Clayton Act,[1] 15 U.S.C. §§ 14, 18, 19.[2] Congress has charged the Agencies with administering these statutes as part of a national policy to promote open and fair competition, including by preventing mergers and acquisitions that would violate these laws. "Federal antitrust law is a central safeguard for the Nation's free market structures" that ensures "the preservation of economic freedom and our free-enterprise system."[3] It rests on the premise that "[t]he unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions."[4]

Section 7 of the Clayton Act ("Section 7") prohibits mergers and acquisitions where "in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." Competition is a process of rivalry that incentivizes businesses to offer lower prices, improve wages and working conditions, enhance quality and resiliency, innovate, and expand choice, among many other benefits. Mergers that substantially lessen competition or tend to create a monopoly increase, extend, or entrench market power and deprive the public of these benefits. Mergers can lessen competition when they diminish competitive constraints, reduce the number or attractiveness of alternatives available to trading partners, or reduce the intensity with which market participants compete.

Section 7 was designed to arrest anticompetitive tendencies in their incipiency.[5] The Clayton Act therefore requires the Agencies to assess whether mergers present risk to competition. The Supreme Court has explained that "Section 7 itself creates a relatively expansive definition of antitrust liability: To show that a merger is unlawful, a plaintiff need only prove that its effect '*may be* substantially to lessen competition'" or to tend to create a monopoly.[6] Accordingly, the Agencies do not attempt to

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[1] As amended under the Celler-Kefauver Antimerger Act of 1950, Pub. L. No. 81-899, 64 Stat. 1125 (1950), and the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 18a.

[2] Although these Guidelines focus primarily on Section 7 of the Clayton Act, the Agencies consider whether any of these statutes may be violated by a merger. The various provisions of the Sherman, Clayton, and FTC Acts each have separate standards, and one may be violated when the others are not.

[3] *North Carolina State Bd. of Dental Examiners v. FTC*, 574 U.S. 494, 502 (2015).

[4] *NCAA v. Board of Regents*, 468 U.S. 85, 104 n.27 (1984) (quoting *Northern Pac. R. Co. v. United States*, 356 U.S. 1, 4-5 (1958)); *see also NCAA v. Alston*, 141 S. Ct. 2141, 2147 (2021) (quoting *Board of Regents*, 468 U.S. at 104 n.27).

[5] *See, e.g.*, *Brown Shoe Co. v. United States*, 370 U.S. 294, 318 nn.32-33 (1962); *see also United States v. AT&T, Inc.*, 916 F.3d 1029, 1032 (D.C. Cir. 2019) (Section 7 "halt[s] incipient monopolies and trade restraints outside the scope of the Sherman Act." (quoting *Brown Shoe*, 370 U.S. at 318 n.32)); *Saint Alphonsus Medical Center-Nampa v. St. Luke's*, 778 F.3d 775, 783 (9th Cir. 2015) (Section 7 "intended to arrest anticompetitive tendencies in their incipiency." (quoting *Brown Shoe*, 370 U.S. at 322)); *Polypore Intern., Inc. v. FTC*, 686 F.3d 1208, 1213-14 (11th Cir. 2012) (same). Some other aspects of *Brown Shoe* have been subsequently revisited.

[6] *California v. Am. Stores Co.*, 495 U.S. 271, 284 (1990) (quoting 15 U.S.C. § 18 with emphasis) (citing *Brown Shoe*, 370 U.S. at 323).

predict the future or calculate precise effects of a merger with certainty. Rather, the Agencies examine the totality of the evidence available to assess the risk the merger presents.

Competition presents itself in myriad ways. To assess the risk of harm to competition in a dynamic and complex economy, the Agencies begin the analysis of a proposed merger by asking: how do firms in this industry compete, and does the merger threaten to substantially lessen competition or to tend to create a monopoly?

The Merger Guidelines set forth several different analytical frameworks (referred to herein as "Guidelines") to assist the Agencies in assessing whether a merger presents sufficient risk to warrant an enforcement action. These frameworks account for industry-specific market realities and use a variety of indicators and tools, ranging from market structure to direct evidence of the effect on competition, to examine whether the proposed merger may harm competition.

How to Use These Guidelines: When companies propose a merger that raises concerns under one or more Guidelines, the Agencies closely examine the evidence to determine if the facts are sufficient to infer that the effect of the merger may be to substantially lessen competition or to tend to create a monopoly (sometimes referred to as a "prima facie case").[7] **Section 2** describes how the Agencies apply these Guidelines. Specifically, Guidelines 1-6 describe distinct frameworks the Agencies use to identify that a merger raises prima facie concerns, and Guidelines 7-11 explain how to apply those frameworks in several specific settings. In all of these situations, the Agencies will also examine relevant evidence to determine if it disproves or rebuts the prima facie case and shows that the merger does not in fact threaten to substantially lessen competition or tend to create a monopoly. **Section 3** identifies rebuttal evidence that the Agencies consider, and that merging parties can present, to rebut an inference of potential harm under these frameworks.[8] **Section 4** sets forth a non-exhaustive discussion of analytical, economic, and evidentiary tools the Agencies use to evaluate facts, understand the risk of harm to competition, and define relevant markets.

These Guidelines are not mutually exclusive, as a single transaction can have multiple effects or raise concerns in multiple ways. To promote efficient review, for any given transaction the Agencies may limit their analysis to any one Guideline or subset of Guidelines that most readily demonstrates the risks to competition from the transaction.

Guideline 1: Mergers Raise a Presumption of Illegality When They Significantly Increase Concentration in a Highly Concentrated Market. Market concentration is often a useful indicator of a merger's likely effects on competition. The Agencies therefore presume, unless sufficiently disproved or rebutted, that a merger between competitors that significantly increases concentration and creates or further consolidates a highly concentrated market may substantially lessen competition.

Guideline 2: Mergers Can Violate the Law When They Eliminate Substantial Competition Between Firms. The Agencies examine whether competition between the merging parties is substantial since their merger will necessarily eliminate any competition between them.

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[7] *See, e.g.*, *United States v. AT&T, Inc.*, 916 F.3d at 1032 (explaining that a *prima facie* case can demonstrate a "reasonable probability" of harm to competition either through "statistics about the change in market concentration" or a "fact-specific" showing (quoting *Brown Shoe*, 370 U.S. at 323 n.39)); *United States v. Baker Hughes*, 908 F.2d 981, 982-83 (D.C. Cir. 1990).
[8] These Guidelines pertain only to the Agencies' consideration of whether a merger or acquisition may substantially lessen competition or tend to create a monopoly. The consideration of remedies appropriate for mergers that pose that risk is beyond the Merger Guidelines' scope. The Agencies review proposals to revise a merger in order to alleviate competitive concerns consistent with applicable law regarding remedies.

Guideline 3: Mergers Can Violate the Law When They Increase the Risk of Coordination. The Agencies examine whether a merger increases the risk of anticompetitive coordination. A market that is highly concentrated or has seen prior anticompetitive coordination is inherently vulnerable and the Agencies will infer, subject to rebuttal evidence, that the merger may substantially lessen competition. In a market that is not highly concentrated, the Agencies investigate whether facts suggest a greater risk of coordination than market structure alone would suggest.

Guideline 4: Mergers Can Violate the Law When They Eliminate a Potential Entrant in a Concentrated Market. The Agencies examine whether, in a concentrated market, a merger would (a) eliminate a potential entrant or (b) eliminate current competitive pressure from a perceived potential entrant.

Guideline 5: Mergers Can Violate the Law When They Create a Firm That May Limit Access to Products or Services That Its Rivals Use to Compete. When a merger creates a firm that can limit access to products or services that its rivals use to compete, the Agencies examine the extent to which the merger creates a risk that the merged firm will limit rivals' access, gain or increase access to competitively sensitive information, or deter rivals from investing in the market.

Guideline 6: Mergers Can Violate the Law When They Entrench or Extend a Dominant Position. The Agencies examine whether one of the merging firms already has a dominant position that the merger may reinforce, thereby tending to create a monopoly. They also examine whether the merger may extend that dominant position to substantially lessen competition or tend to create a monopoly in another market.

Guideline 7: When an Industry Undergoes a Trend Toward Consolidation, the Agencies Consider Whether It Increases the Risk a Merger May Substantially Lessen Competition or Tend to Create a Monopoly. A trend toward consolidation can be an important factor in understanding the risks to competition presented by a merger. The Agencies consider this evidence carefully when applying the frameworks in Guidelines 1-6.

Guideline 8: When a Merger is Part of a Series of Multiple Acquisitions, the Agencies May Examine the Whole Series. If an individual transaction is part of a firm's pattern or strategy of multiple acquisitions, the Agencies consider the cumulative effect of the pattern or strategy when applying the frameworks in Guidelines 1-6.

Guideline 9: When a Merger Involves a Multi-Sided Platform, the Agencies Examine Competition Between Platforms, on a Platform, or to Displace a Platform. Multi-sided platforms have characteristics that can exacerbate or accelerate competition problems. The Agencies consider the distinctive characteristics of multi-sided platforms when applying the frameworks in Guidelines 1-6.

Guideline 10: When a Merger Involves Competing Buyers, the Agencies Examine Whether It May Substantially Lessen Competition for Workers, Creators, Suppliers, or Other Providers. The Agencies apply the frameworks in Guidelines 1-6 to assess whether a merger between buyers, including employers, may substantially lessen competition or tend to create a monopoly.

Guideline 11: When an Acquisition Involves Partial Ownership or Minority Interests, the Agencies Examine Its Impact on Competition. The Agencies apply the frameworks in Guidelines 1-6 to assess if an acquisition of partial control or common ownership may substantially lessen competition.

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This edition of the Merger Guidelines consolidates, revises, and replaces the various versions of Merger Guidelines previously issued by the Agencies. The revision builds on the learning and experience reflected in those prior Guidelines and successive revisions. These Guidelines reflect the collected experience of the Agencies over many years of merger review in a changing economy and have been refined through an extensive public consultation process.

As a statement of the Agencies' law enforcement procedures and practices, the Merger Guidelines create no independent rights or obligations, do not affect the rights or obligations of private parties, and do not limit the discretion of the Agencies, including their staff, in any way. Although the Merger Guidelines identify the factors and frameworks the Agencies consider when investigating mergers, the Agencies' enforcement decisions will necessarily continue to require prosecutorial discretion and judgment. Because the specific standards set forth in these Merger Guidelines will be applied to a broad range of factual circumstances, the Agencies will apply them reasonably and flexibly to the specific facts and circumstances of each merger.

Similarly, the factors contemplated in these Merger Guidelines neither dictate nor exhaust the range of theories or evidence that the Agencies may introduce in merger litigation. Instead, they set forth various methods of analysis that may be applicable depending on the availability and/or reliability of information related to a given market or transaction. Given the variety of industries, market participants, and acquisitions that the Agencies encounter, merger analysis does not consist of uniform application of a single methodology. The Agencies assess any relevant and meaningful evidence to evaluate whether the effect of a merger may be substantially to lessen competition or to tend to create a monopoly. Merger review is ultimately a fact-specific exercise. The Agencies follow the facts and the law in analyzing mergers as they do in other areas of law enforcement.

These Merger Guidelines include references to applicable legal precedent. References to court decisions do not necessarily suggest that the Agencies would analyze the facts in those cases identically today. While the Agencies adapt their analytical tools as they evolve and advance, legal holdings reflecting the Supreme Court's interpretation of a statute apply unless subsequently modified. These Merger Guidelines therefore reference applicable propositions of law to explain core principles that the Agencies apply in a manner consistent with modern analytical tools and market realities. References herein do not constrain the Agencies' interpretation of the law in particular cases, as the Agencies will apply their discretion with respect to the applicable law in each case in light of the full range of precedent pertinent to the issues raised by each enforcement action.

2. Applying the Merger Guidelines

This section discusses the frameworks the Agencies use to assess whether a merger may substantially lessen competition or tend to create a monopoly.

2.1. Guideline 1: Mergers Raise a Presumption of Illegality When They Significantly Increase Concentration in a Highly Concentrated Market.

Market concentration and the change in concentration due to the merger are often useful indicators of a merger's risk of substantially lessening competition. In highly concentrated markets, a merger that eliminates a significant competitor creates significant risk that the merger may substantially lessen competition or tend to create a monopoly. As a result, a significant increase in concentration in a highly concentrated market can indicate that a merger may substantially lessen competition, depriving the public of the benefits of competition.

The Supreme Court has endorsed this view and held that "a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market[,] is so inherently likely to lessen competition substantially that it must be enjoined in the absence of [rebuttal] evidence."[9] In the Agencies' experience, this legal presumption provides a highly administrable and useful tool for identifying mergers that may substantially lessen competition.

An analysis of concentration involves calculating pre-merger market shares of products[10] within a relevant market (see Section 4.3 for a discussion of market definition and Section 4.4 for more details on computing market shares). The Agencies assess whether the merger creates or further consolidates a highly concentrated market and whether the increase in concentration is sufficient to indicate that the merger may substantially lessen competition or tend to create a monopoly.[11]

The Agencies generally measure concentration levels using the Herfindahl-Hirschman Index ("HHI").[12] The HHI is defined as the sum of the squares of the market shares; it is small when there are many small firms and grows larger as the market becomes more concentrated, reaching 10,000 in a market with a single firm. Markets with an HHI greater than 1,800 are highly concentrated, and a change of more than 100 points is a significant increase.[13] A merger that creates or further consolidates a highly

[9] *United States v. Phila. Nat'l Bank*, 374 U.S. 321, 363 (1963); *see, e.g.*, *FTC v. v. Hackensack Meridian Health, Inc.*, 30 F.4th 160, 172-73 (3d Cir. 2022); *United States v. AT&T, Inc.*, 916 F.3d at 1032.

[10] These Guidelines use the term "products" to encompass anything that is traded between firms and their suppliers, customers, or business partners, including physical goods, services, or access to assets. Products can be as narrow as an individual brand, a specific version of a product, or a product that includes specific ancillary services such as the right to return it without cause or delivery to the customer's location.

[11] Typically, a merger eliminates a competitor by bringing two market participants under common control. Similar concerns arise if the merger threatens to cause the exit of a current market participant, such as a leveraged buyout that puts the target firm at significant risk of failure.

[12] The Agencies may instead measure market concentration using the number of significant competitors in the market. This measure is most useful when there is a gap in market share between significant competitors and smaller rivals or when it is difficult to measure shares in the relevant market.

[13] For illustration, the HHI for a market of five equal firms is 2,000 ($5 \times 20^2 = 2{,}000$) and for six equal firms is 1,667 ($6 \times 16.67^2 = 1667$).

concentrated market that involves an increase in the HHI of more than 100 points[14] is presumed to substantially lessen competition or tend to create a monopoly.[15] The Agencies also may examine the market share of the merged firm: a merger that creates a firm with a share over thirty percent is also presumed to substantially lessen competition or tend to create a monopoly if it also involves an increase in HHI of more than 100 points.[16]

Indicator	Threshold for Structural Presumption
Post-merger HHI	Market HHI greater than 1,800 AND Change in HHI greater than 100
Merged Firm's Market Share	Share greater than 30% AND Change in HHI greater than 100

When exceeded, these concentration metrics indicate that a merger's effect may be to eliminate substantial competition between the merging parties and may be to increase coordination among the remaining competitors after the merger. This presumption of illegality can be rebutted or disproved. The higher the concentration metrics over these thresholds, the greater the risk to competition suggested by this market structure analysis and the stronger the evidence needed to rebut or disprove it.

2.2. Guideline 2: Mergers Can Violate the Law When They Eliminate Substantial Competition Between Firms.

A merger eliminates competition between the merging firms by bringing them under joint control.[17] If evidence demonstrates substantial competition between the merging parties prior to the

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[14] The change in HHI from a merger of firms with shares *a* and *b* is equal to 2*ab*. For example, in a merger between a firm with 20% market share and a firm with 5% market share, the change in HHI is 2 x 20 x 5 = 200.

[15] The first merger guidelines to reference an HHI threshold were the merger guidelines issued in 1982. These guidelines referred to mergers with HHI above 1,000 as concentrated markets, with HHI between 1,000 and 1,800 as "moderately concentrated" and above 1,800 as "highly concentrated," while they referred to an increase in HHI of 100 as a "significant increase." Each subsequent iteration until 2010 maintained those thresholds. *See* Fed. Trade Comm'n & U.S. Dep't of Justice, Horizontal Merger Guidelines § 1.51 (1997); Fed. Trade Comm'n & U.S. Dep't of Justice, Horizontal Merger Guidelines § 1.51 (1992); U.S. Dep't of Justice, Merger Guidelines § 3(A) (1982). During this time, courts routinely cited to the guidelines and these HHI thresholds in decisions. *See, e.g.*, *Chicago Bridge & Iron Co. N.V. v. FTC*, 534 F.3d 410, 431 (5th Cir. 2008); *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 716 (D.C. Cir. 2001); *FTC v. Univ. Health, Inc.*, 938 F.2d 1206, 1211 (11th Cir. 1991). Although the Agencies raised the thresholds for the 2010 guidelines, based on experience and evidence developed since, the Agencies consider the original HHI thresholds to better reflect both the law and the risks of competitive harm suggested by market structure and have therefore returned to those thresholds.

[16] *Phila. Nat'l Bank*, 374 U.S. at 364-65 ("Without attempting to specify the smallest market share which would still be considered to threaten undue concentration, we are clear that 30% presents that threat.").

[17] The competitive harm from the elimination of competition between the merging firms, without considering the risk of coordination, is sometimes referred to as unilateral effects. The elimination of competition between the merging firms can also lessen competition with and among other competitors. When the elimination of competition between the merging firms

merger, that ordinarily suggests that the merger may substantially lessen competition.[18]Although a change in market structure can also indicate risk of competitive harm (see Guideline 1), an analysis of the existing competition between the merging firms can demonstrate that a merger threatens competitive harm independent from an analysis of market shares.

Competition often involves firms trying to win business by offering lower prices, new or better products and services, more attractive features, higher wages, improved benefits, or better terms relating to various additional dimensions of competition. This can include competition to research and develop products or services, and the elimination of such competition may result in harm even if such products or services are not yet commercially available. The more the merging parties have shaped one another's behavior, or have affected one another's sales, profits, valuation, or other drivers of behavior, the more significant the competition between them.

The Agencies examine a variety of indicators to identify substantial competition. For example:

Strategic Deliberations or Decisions. The Agencies may analyze the extent of competition between the merging firms by examining evidence relating to strategic deliberations or decisions in the regular course of business. For example, in some markets, the firms may monitor each other's pricing, marketing campaigns, facility locations, improvements, products, capacity, output, input costs, and/or innovation plans. This can provide evidence of competition between the merging firms, especially when they react by taking steps to preserve or enhance the competitiveness or profitability of their own products or services.

Prior Merger, Entry, and Exit Events. The Agencies may look to historical events to assess the presence and substantiality of direct competition between the merging firms. For example, the Agencies may examine the competitive impact of recent relevant mergers, entry, expansion, or exit events.

Customer Substitution. Customers' willingness to switch between different firms' products is an important part of the competitive process. Firms are closer competitors the more that customers are willing to switch between their products. The Agencies use a variety of tools, detailed in Section 4.2, to assess customer substitution.

Impact of Competitive Actions on Rivals. When one firm takes competitive actions to attract customers, this can benefit the firm at the expense of its rivals. The Agencies may gauge the extent of competition between the merging firms by considering the impact that competitive actions by one of the merging firms has on the other merging firm. The impact of a firm's competitive actions on a rival is generally greater when customers consider the firm's products and the rival's products to be closer substitutes, so that a firm's competitive action results in greater lost sales for the rival, and when the profitability of the rival's lost sales is greater.

Impact of Eliminating Competition Between the Firms. In some instances, evidence may be available to assess the impact of competition from one firm on the other's actions, such as firm choices

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leads them to compete less aggressively with one another, other firms in the market can in turn compete less aggressively, decreasing the overall intensity of competition.

[18] *See also United States v. First Nat'l Bank & Trust Co. of Lexington*, 376 U.S. 665, 669-70 (1964) (per curiam) ("[I]t [is] clear that the elimination of significant competition between [merging parties] constitutes an unreasonable restraint of trade in violation of § 1 of the Sherman Act. . . . It [can be] enough that the two . . . compete[], that their competition [is] not insubstantial and that the combination [would] put an end to it."); *ProMedica Health Sys., Inc. v. FTC*, 749 F.3d 559, 568-70 (6th Cir. 2014), *cert. denied*, 575 U.S. 996 (2015).

about price, quality, wages, or another dimension of competition. Section 4.2 describes a variety of approaches to measuring such impacts.

Additional Evidence, Tools, and Metrics. The Agencies may use additional evidence, tools, and metrics to assess the loss of competition between the firms. Depending on the realities of the market, different evidence, tools, or metrics may be appropriate.

Section 4.2 provides additional detail about the approaches that the Agencies use to assess competition between or among firms.

2.3. Guideline 3: Mergers Can Violate the Law When They Increase the Risk of Coordination.

The Agencies determine that a merger may substantially lessen competition when it meaningfully increases the risk of coordination among the remaining firms in a relevant market or makes existing coordination more stable or effective.[19] Firms can coordinate across any or all dimensions of competition, such as price, product features, customers, wages, benefits, or geography. Coordination among rivals lessens competition whether it occurs explicitly—through collusive agreements between competitors not to compete or to compete less—or tacitly, through observation and response to rivals. Because tacit coordination often cannot be addressed under Section 1 of the Sherman Act, the Agencies vigorously enforce Section 7 of the Clayton Act to prevent market structures conducive to such coordination.

Tacit coordination can lessen competition even when it does not rise to the level of an agreement and would not itself violate the law. For example, in a concentrated market a firm may forego or soften an aggressive competitive action because it anticipates rivals responding in kind. This harmful behavior is more common the more concentrated markets become, as it is easier to predict the reactions of rivals when there are fewer of them.

To assess the extent to which a merger may increase the likelihood, stability, or effectiveness of coordination, the Agencies often consider three primary factors and several secondary factors. The Agencies may consider additional factors depending on the market.

2.3.A. Primary Factors

The Agencies may conclude that post-merger market conditions are susceptible to coordinated interaction and that the merger materially increases the risk of coordination if any of the three primary factors are present.

Highly Concentrated Market. By reducing the number of firms in a market, a merger increases the risk of coordination. The fewer the number of competitively meaningful rivals prior to the merger, the greater the likelihood that merging two competitors will facilitate coordination. Markets that are highly concentrated after a merger that significantly increases concentration (see Guideline 1) are presumptively susceptible to coordination. If merging parties assert that a highly concentrated market is not susceptible to coordination, the Agencies will assess this rebuttal evidence using the framework

[19] *See Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp.,* 509 U.S. 209, 229-30 (1993) ("In the § 7 context, it has long been settled that excessive concentration, and the oligopolistic price coordination it portends, may be the injury to competition the Act prohibits.").

described below. Where a market is not highly concentrated, the Agencies may still consider other risk factors.

Prior Actual or Attempted Attempts to Coordinate. Evidence that firms representing a substantial share in the relevant market appear to have previously engaged in express or tacit coordination to lessen competition is highly informative as to the market's susceptibility to coordination. Evidence of failed attempts at coordination in the relevant market suggest that successful coordination was not so difficult as to deter attempts, and a merger reducing the number of rivals may tend to make success more likely.

Elimination of a Maverick. A maverick is a firm with a disruptive presence in a market. The presence of a maverick, however, only reduces the risk of coordination so long as the maverick retains the disruptive incentives that drive its behavior. A merger that eliminates a maverick or significantly changes its incentives increases the susceptibility to coordination.

2.3.B. Secondary Factors

The Agencies also examine whether secondary factors demonstrate that a merger may meaningfully increase the risk of coordination, even absent the primary risk factors. Not all secondary factors must be present for a market to be susceptible to coordination.

Market Concentration. Even in markets that are not highly concentrated, coordination becomes more likely as concentration increases. The more concentrated a market, the more likely the Agencies are to conclude that the market structure suggests susceptibility to coordination.

Market Observability. A market is more susceptible to coordination if a firm's behavior can be promptly and easily observed by its rivals. Rivals' behavior is more easily observed when the terms offered to customers are readily discernible and relatively observable (that is, known to rivals). Observability can refer to the ability to observe prices, terms, the identities of the firms serving particular customers, or any other competitive actions of other firms. Information exchange arrangements among market participants, such as public exchange of information through announcements or private exchanges through trade associations or publications, increase market observability. Regular monitoring of one another's prices or customers can indicate that the terms offered to customers are relatively observable. Pricing algorithms, programmatic pricing software or services, and other analytical or surveillance tools that track or predict competitor prices or actions likewise can increase the observability of the market.

Competitive Responses. A market is more susceptible to coordination if a firm's prospective competitive reward from attracting customers away from its rivals will be significantly diminished by its rivals' likely responses. This is more likely to be the case the stronger and faster the responses from its rivals because such responses reduce the benefits of competing more aggressively. Some factors that increase the likelihood of strong or rapid responses by rivals include: (1) the market has few significant competitors, (2) products in the relevant market are relatively homogeneous, (3) customers find it relatively easy to switch between suppliers, (4) suppliers use algorithmic pricing, or (5) suppliers use meeting-competition clauses. The more predictable are rivals' responses to strategic actions or changing competitive conditions, and the more interactions firms have across multiple markets, the greater the susceptibility to coordination.

Aligned Incentives. Removing a firm that has different incentives from most other firms in a market can increase the risk of coordination. For example, a firm with a small market share may have less incentive to coordinate because it has more to gain from winning new business than other firms. The same issue can arise when a merger more closely aligns one or both merging firms' incentives with the other firms in the market. In some cases, incentives might be aligned or strengthened when firms compete with one another in multiple markets ("multi-market contact"). For example, firms might compete less aggressively in some markets in anticipation of reciprocity by rivals in other markets. The Agencies examine these and any other market realities that suggest aligned incentives increase susceptibility to coordination.

Profitability or Other Advantages of Coordination for Rivals. The Agencies regard coordinated interaction as more likely to occur when participants in the market stand to gain more from successful coordination. Coordination generally is more profitable or otherwise advantageous for the coordinating firms the less often customers substitute outside the market when firms offer worse terms.

Rebuttal Based on Structural Barriers to Coordination Unique to the Industry. When market structure evidence suggests that a merger may substantially lessen competition through coordination, the merging parties sometimes argue that anticompetitive coordination is nonetheless impossible due to structural market barriers to coordinating. The Agencies consider this rebuttal evidence using the framework in Section 3. In so doing, the Agencies consider whether structural market barriers to coordination are "so much greater in the [relevant] industry than in other industries that they rebut the normal presumption" of coordinated effects.[20] In the Agencies' experience, structural conditions that prevent coordination are exceedingly rare in the modern economy. For example, coordination is more difficult when firms are unable to observe rivals' competitive offerings, but technological change has made this situation less common than in the past and reduced many traditional barriers or obstacles to observing the behavior of rivals in a market. The greater the level of concentration in the relevant market, the greater must be the structural barriers to coordination in order to show that no substantial lessening of competition is threatened.

2.4. Guideline 4: Mergers Can Violate the Law When They Eliminate a Potential Entrant in a Concentrated Market.

Mergers can substantially lessen competition by eliminating a potential entrant. For instance, a merger can eliminate the possibility that entry or expansion by one or both firms would have resulted in new or increased competition in the market in the future. A merger can also eliminate current competitive pressure exerted on other market participants by the mere perception that one of the firms might enter. Both of these risks can be present simultaneously.

A merger that eliminates a potential entrant into a concentrated market can substantially lessen competition or tend to create a monopoly.[21] The more concentrated the market, the greater the magnitude of harm to competition from any lost potential entry and the greater the tendency to create a monopoly. Accordingly, for mergers involving one or more potential entrants, the higher the market concentration, the lower the probability of entry that gives rise to concern.

[20] *See H.J. Heinz Co.*, 246 F.3d at 724.
[21] *United States v. Marine Bancorp.*, 418 U.S. 602, 630 (1974). A concentrated market is one with an HHI greater than 1,000 (See Guideline 1, n.15).

2.4.A. Actual Potential Competition: Eliminating Reasonably Probable Future Entry

In general, expansion into a concentrated market via internal growth rather than via acquisition benefits competition.[22] Merging a current and a potential market participant eliminates the possibility that the potential entrant would have entered on its own—entry that, had it occurred, would have provided a new source of competition in a concentrated market.

To determine whether an acquisition that eliminates a potential entrant into a concentrated market may substantially lessen competition,[23] the Agencies examine (1) whether one or both[24] of the merging firms had a reasonable probability of entering the relevant market other than through an anticompetitive merger, and (2) whether such entry offered a substantial likelihood of ultimately producing deconcentration of the market or other significant procompetitive effects.[25]

Reasonable Probability of Entry. The Agencies' starting point for assessment of a reasonable probability of entry is objective evidence regarding the firm's available feasible means of entry, including its capabilities and incentives. Relevant objective evidence can include, for example, evidence that the firm has sufficient size and resources to enter; evidence of any advantages that would make the firm well-situated to enter; evidence that the firm has successfully expanded into similarly situated markets in the past or already participates in adjacent or related markets; evidence that the firm has an incentive to enter; or evidence that industry participants recognize the company as a potential entrant. This analysis is not limited to whether the company could enter with its pre-merger production facilities, but also considers overall capability, which can include the ability to expand or add to its capabilities on its own or in collaboration with someone other than the acquisition target.

Subjective evidence that the company considered entering absent the merger can also indicate a reasonable probability that the company would have entered without the merger. Subjective evidence that the company considered organic entry as an alternative to merging generally suggests that, absent the merger, entry would be reasonably probable.

Likelihood of Deconcentration or Other Significant Procompetitive Effects. New entry can yield a variety of procompetitive effects, including increased output or investment, higher wages or improved working conditions, greater innovation, higher quality, and lower prices. If the merging firm had a reasonable probability of entering a highly concentrated relevant market, this suggests benefits that would have resulted from its entry would be competitively significant, unless there is substantial direct evidence that the competitive effect would be *de minimis*. To supplement the suggestion that new entry yields procompetitive effects, the Agencies will consider projections of the potential entrant's

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[22] *See Ford Motor Co. v. United States*, 405 U.S. 562, 587 (1972) (referring to the "typical[]" competitive concern when "a potential entrant enters an oligopolistic market by acquisition rather than internal expansion" as being "that such a move has deprived the market of the pro-competitive effect of an increase in the number of competitors").

[23] Harm from the elimination of a potential entrant can occur in markets that do not yet consist of commercial products, even if the market concentration of the future market cannot be measured using traditional means. Where there are few equivalent potential entrants, including one or both of the merging firms, that indicates that the future market, once commercialized, will be concentrated. The Agencies will consider other potential entrants' capabilities and incentives in comparison to the merging potential entrant to assess equivalence.

[24] *United States v. Penn-Olin Chemical Co.*, 378 U.S. 158 (1964) (holding that a merger between two firms, each or both of which might have entered the relevant market, could violate Section 7).

[25] *See id.* at 175-76; *Marine Bancorp.*, 418 U.S. at 622, 633 ("[T]he proscription expressed in § 7 against mergers 'when a "tendency" toward monopoly or [a] "reasonable likelihood" of a substantial lessening of competition in the relevant market is shown' applies alike to actual- and potential-competition cases." (quoting *Penn-Olin*, 378 U.S. at 171)); *see also Yamaha Motor Co. v. FTC*, 657 F.2d 971, 980-981 (8th Cir. 1981) (acquisition of potential entrant violated Section 7).

competitive significance, such as market share, its business strategy, the anticipated response of competitors, or customer preferences or interest.

A merger of two potential entrants can also result in a substantial lessening of competition. The merger need not involve a firm that has a commercialized product in the market or an existing presence in the same geographic market. The Agencies analyze similarly mergers between two potential entrants and those involving a current market participant and a potential entrant.

2.4.B. Perceived Potential Competition: Lessening of Current Competitive Pressure

A perceived potential entrant can stimulate competition among incumbents. That pressure can prompt current market participants to make investments, expand output, raise wages, increase product quality, lower product prices, or take other procompetitive actions. The acquisition of a firm that is perceived by market participants as a potential entrant can substantially lessen competition by eliminating or relieving competitive pressure.

To assess whether the acquisition of a perceived potential entrant may substantially lessen competition, the Agencies consider whether a current market participant could reasonably consider one of the merging companies to be a potential entrant and whether that potential entrant has a likely influence on existing competition.[26]

Market Participant Could Reasonably Consider a Firm to Be a Potential Entrant. The starting point for this analysis is evidence regarding the company's capability of entering or applying competitive pressure. Objective evidence is highly probative and includes evidence of feasible means of entry or communications by the company indicating plans to expand or reallocate resources in a way that could increase competition in the relevant market. Objective evidence can be sufficient to find that the firm is a potential entrant; it need not be accompanied by any subjective evidence of current market participants' internal perceptions or direct evidence of strategic reactions to the potential entrant. If such evidence is available, it can weigh in favor of finding that a current market participant could reasonably consider the firm to be a potential entrant.

Likely Influence on Existing Rivals. Direct evidence that the firm's presence or behavior has affected or is affecting current market participants' strategic decisions is not necessary but can establish a showing of a likely influence. Even without such direct evidence, circumstantial evidence that the firm's presence or behavior had an effect on the competitive reactions of firms in the market may also show likely influence. Objective evidence establishing that a current market participant could reasonably consider one of the merging firms to be a potential entrant can also establish that the firm has a likely influence on existing market participants. Subjective evidence indicating that current market participants—including, for example, customers, suppliers, or distributors—internally perceive the merging firm to be a potential entrant can also establish a likely influence.

2.4.C. Distinguishing Potential Entry from Entry as Rebuttal

When evaluating a potentially unlawful merger of current competitors, the Agencies will assess whether entry by other firms would be timely, likely, and sufficient to replace the lost competition using the standards discussed in Section 3.2. The existence of a perceived or actual potential entrant may not meet that standard when considering a merger between firms that already participate in the relevant market. The competitive impact of perceived and actual potential entrants is typically attenuated

[26] *See United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 533-36 (1973); *Marine Bancorp.*, 418 U.S. at 624-25.

compared to competition between two current market participants. However, because concentrated markets often lack robust competition, the loss of even an attenuated source of competition such as a potential entrant may substantially lessen competition in such markets. Moreover, because the Agencies seek to prevent threats to competition in their incipiency, the likelihood of potential entry that could establish that a merger's effect "may be" to substantially lessen competition will generally not equal the likelihood of entry that would rebut a demonstrated risk that competition may be substantially lessened.

2.5. Guideline 5: Mergers Can Violate the Law When They Create a Firm that May Limit Access to Products or Services That Its Rivals Use to Compete.

The Agencies evaluate whether a merger may substantially lessen competition when the merged firm can limit access to a product, service, or route to market[27] that its rivals may use to compete. Mergers involving products or services rivals may use to compete can threaten competition in several ways, for example: (A) the merged firm could limit rivals' access to the products or services, thereby weakening or excluding them, lessening competition; (B) the merged firm may gain or increase access to rivals' competitively sensitive information, thereby facilitating coordination or undermining their incentives to compete; or (C) the threat of limited access can deter rivals and potential rivals from investing.

These problems can arise from mergers involving access to any products, services, or routes to market that rivals use to compete, and that are competitively significant to those rivals, whether or not they involve a traditional vertical relationship such as a supplier and distributor relationship. Many types of related products can implicate these concerns, including products rivals currently or may in the future use as inputs, products that provide distribution services for rivals or otherwise influence customers' purchase decisions, products that provide or increase the merged firm's access to competitively sensitive information about its rivals, or complements that increase the value of rivals' products. Even if the related product is not currently being used by rivals, it might be competitively significant because, for example, its availability enables rivals to obtain better terms from other providers in negotiations. The Agencies refer to any product, service, or route to market that rivals use to compete in that market as a "related product."

The Agencies analyze competitive effects in the relevant market in which the merged firm competes with rivals that use the related product. The Agencies do not always define a market around the related product, although they may do so (see Section 2.5.A.2).

2.5.A. The Risk that the Merged Firm May Limit Access

A merger involving products, services, or routes to market that rivals use to compete may substantially lessen competition when the merged firm has both the ability and incentive to limit access to the related product so as to weaken or exclude some of its rivals (the "dependent" rivals) in the relevant market.

The merged firm could limit access to the related product in different ways. It could deny rivals access altogether, deny access to some features, degrade its quality, worsen the terms on which rivals

[27] A "route to market" refers to any way a firm accesses its trading partners, such as distribution channels, marketplaces, or customers.

can access the related product, limit interoperability, degrade the quality of complements, provide less reliable access, tie up or obstruct routes to market, or delay access to product features, improvements, or information relevant to making efficient use of the product. All these ways of limiting access are sometimes referred to as "foreclosure."[28]

Dependent rivals can be weakened if limiting their access to the related product would make it harder or more costly for them to compete; for example, if it would lead them to charge higher prices or offer worse terms in the relevant market, reduce the quality of their products so that they were less attractive to trading partners, or interfere with distribution so that those products were less readily available. Competition can also be weakened if the merger facilitates coordination among the merged firm and its rivals, for example by giving the merged firm the ability to threaten to limit access to uncooperative rivals.

Rivals or potential rivals may be excluded from the relevant market if limiting their access to the related product could lead them to exit the market or could deter them from entering. For example, potential rivals may not enter if the merged firm ties up or obstructs so many routes to market that the remaining addressable market is too small. Exclusion can arise when a new entrant would need to invest not only in entering the relevant market, but also in supplying its own substitute for the related product, sometimes referred to as two-stage entry or multi-level entry.

Because the merged firm could use its ability to limit access to the related product in a range of ways, the Agencies focus on the overall risk that the merged firm will do so, and do not necessarily identify which precise actions the merged firm would take to lessen competition.

2.5.A.1. Ability and Incentive to Foreclose Rivals

The Agencies assess the merged firm's ability and incentive to substantially lessen competition by limiting access to the related product for a group of dependent rivals in the relevant market by examining four factors.

1. Availability of Substitutes. The Agencies assess the availability of substitutes for the related product. The merged firm is more able to limit access when there are few alternative options to the merged firm's related product, if these alternatives are differentiated in quality, price, or other characteristics, or if competition to supply them is limited.

2. Competitive Significance of the Related Product. The Agencies consider how important the related product is for the dependent firms and the extent to which they would be weakened or excluded from the relevant market if their access was limited.

3. Effect on Competition in the Relevant Market. The Agencies assess the importance of the dependent firms for competition in the relevant market. Competition can be particularly affected when the dependent firms would be excluded from the market altogether.

4. Competition Between the Merged Firm and the Dependent Firms. The merged firm's incentive to limit the dependent firms' access depends on how strongly it competes with them. If the dependent firms are close competitors, the merged firm may benefit from higher sales or prices in the relevant market when it limits their access. The Agencies may also assess the potential for the merged

[28] *See Illumina, Inc. v. FTC*, No. 23-60167, slip op. at 17 (5th Cir. Dec. 15, 2023) ("[T]here are myriad ways in which [the merged firm] could engage in foreclosing behavior . . . such as by making late deliveries or subtly reducing the level of support services.").

firm to benefit from facilitating coordination by threatening to limit dependent rivals' access to the related product. These benefits can make it profitable to limit access to the related product and thereby substantially lessen competition, even though it would not have been profitable for the firm that controlled the related product prior to the merger.

The Agencies assess the extent of competition with rivals and the risk of coordination using analogous methods to the ones described in Guidelines 2 and 3, and Section 4.2.

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In addition to the evidentiary, analytical, and economic tools in Section 4, the following additional considerations and evidence may be important to this assessment:

Barriers to Entry and Exclusion of Rivals. The merged firm may benefit more from limiting access to dependent rivals or potential rivals when doing so excludes them from the market, for example by creating a need for the firm to enter at multiple levels and to do so with sufficient scale and scope (multi-level entry).

Prior Transactions or Prior Actions. If firms used prior acquisitions or engaged in prior actions to limit rivals' access to the related product, or other products its rivals use to compete, that suggests that the merged firm has the ability and incentive to do so. However, lack of past action does not necessarily indicate a lack of incentive in the present transaction because the merger can increase the incentive to foreclose.

Internal Documents. Information from business planning and merger analysis documents prepared by the merging firms might identify instances where the firms believe they have the ability and incentive to limit rivals' access. Such documents, where available, are highly probative. The lack of such documents, however, is less informative.

Market Structure. Evidence of market structure can be informative about the availability of substitutes for the related product and the competition in the market for the related product or the relevant market. (See Section 2.5.A.2)

2.5.A.2. Analysis of Industry Factors and Market Structure

The Agencies also sometimes determine, based on an analysis of factors related to market structure, that a merger may substantially lessen competition by allowing the merged firm to limit access to a related product.[29] The Agencies' assessment can include evidence about the structure, history, and probable future of the market.

Structure of the Related Market. In some cases, the market structure of the related product market can give an indication of the merged firm's ability to limit access to the related product. In these cases, the Agencies define a market (termed the "related market") around the related product (see Section 4.3). The Agencies then define the "foreclosure share" as the share of the related market to which the merged firm could limit access. If the share or other evidence show that the merged firm is

[29] *See Brown Shoe*, 370 U.S. at 328-34; *Illumina*, slip op. at 20-22 ("There is no precise formula when it comes to applying these factors. Indeed, the Supreme Court has found a vertical merger unlawful by examining only three of the *Brown Shoe* factors." (cleaned up)); *Fruehauf Corp. v. FTC*, 603 F.2d 345, 353 (2d Cir. 1979); *U.S. Steel Corp. v. FTC*, 426 F.2d 592, 599 (6th Cir. 1970).

approaching or has monopoly power over the related product, and the related product is competitively significant, those factors alone are a sufficient basis to demonstrate that the dependent firms do not have adequate substitutes and the merged firm has the ability to weaken or exclude them by limiting their access to the related product. (See Considerations 1 and 2 in Section 2.5.A.1).[30]

Structure of the Relevant Market. Limiting rivals' access to the related product will generally have a greater effect on competition in the relevant market if the merged firm and the dependent rivals face less competition from other firms. In addition, the merged firm has a greater incentive to limit access to the dependent firms when it competes more closely with them. Market share and concentration measures for the merged firm, the dependent rivals, and the other firms, can sometimes provide evidence about both issues.

Nature and Purpose of the Merger. When the nature and purpose of the merger is to foreclose rivals, including by raising their costs, that suggests the merged firm is likely to foreclose rivals.

Trend Toward Vertical Integration. The Agencies will generally consider evidence about the degree of integration between firms in the relevant and related markets, as well as whether there is a trend toward further vertical integration and how that trend or the factors driving it may affect competition. A trend toward vertical integration may be shown through, for example: a pattern of vertical integration following mergers by one or both of the merging companies; or evidence that a merger was motivated by a desire to avoid having its access limited due to similar transactions among other companies that occurred or may occur in the future.

* * *

If the parties offer rebuttal evidence, the Agencies will assess it under the approach laid out in Section 3.[31] When assessing rebuttal evidence focused on the reduced profits of the merged firm from limiting access from rivals, the Agencies examine whether the reduction in profits would prevent the full range of reasonably probable strategies to limit access. When evaluating whether this rebuttal evidence is sufficient to conclude that no substantial lessening of competition is threatened by the merger, the Agencies will give little weight to claims that are not supported by an objective analysis, including, for example, speculative claims about reputational harms. Moreover, the Agencies are unlikely to credit claims or commitments to protect or otherwise avoid weakening the merged firm's rivals that do not align with the firm's incentives. The Agencies' assessment will be consistent with the principle that firms act to maximize their overall profits and valuation rather than the profits of any particular business

[30] *See Brown Shoe*, 370 U.S. at 328 ("If the share of the market foreclosed is so large that it approaches monopoly proportions, the Clayton Act will, of course, have been violated . . . ."). The Agencies will generally infer, in the absence of countervailing evidence, that the merging firm has or is approaching monopoly power in the related product if it has a share greater than 50% of the related product market. A merger involving a related product with share of less than 50% may still substantially lessen competition, particularly when that related product is important to its trading partners.

[31] A common rebuttal argument is that the merger would lead to vertical integration of complementary products and as a result, "eliminate double marginalization," since in specific circumstances such a merger can confer on the merged firm an incentive to decrease prices to purchasers. The Agencies examine whether elimination of double marginalization satisfies the approach to evaluating procompetitive efficiencies in Section 3.3, including examining: (a) whether the merged firm will be more vertically integrated as a result of the merger, for example because it increases the extent to which it uses internal production of an input when producing output for the relevant market; (b) whether contracts short of a merger have eliminated or could eliminate double marginalization such that it would not be merger-specific, and (c) whether the merged firm has the incentive to reduce price in the relevant market given that such a reduction would reduce sales by the merged firm's rivals in the relevant market, which would in turn lead to reduced revenue and margin on sales of the related product to the dependent rivals.

unit. A merger may substantially lessen competition or tend to create a monopoly regardless of the claimed intent of the merging companies or their executives. (See Section 4.1)

If the merged firm has the ability and incentive to limit access to the related product and lessen competition in the relevant market, there are many ways it could act on those incentives. The merging parties may put forward evidence that there are no reasonably probable ways in which they could profitably limit access to the related product and thereby make it harder for rivals to compete, or that the merged firm will be more competitive because of the merger.

2.5.B. Mergers Involving Visibility into Rivals' Competitively Sensitive Information

If rivals would continue to access or purchase a related product controlled by the merged firm post-merger, the merger can substantially lessen competition if the merged firm would gain or increase visibility into rivals' competitively sensitive information. This situation could arise in many settings, including, for example, if the merged firm learns about rivals' sales volumes or projections from supplying an input or a complementary product; if it learns about promotion plans and anticipated product improvements or innovations from its role as a distributor; or if it learns about entry plans from discussions with potential rivals about compatibility or interoperability with a complementary product it controls. A merger that gives the merged firm increased visibility into competitively sensitive information could undermine rivals' ability or incentive to compete aggressively or could facilitate coordination.

Undermining Competition. The merged firm might use visibility into a rival's competitively sensitive information to undermine competition from the rival. For example, the merged firm's ability to preempt, appropriate, or otherwise undermine the rival's procompetitive actions can discourage the rival from fully pursuing competitive opportunities. Relatedly, rivals might refrain from doing business with the merged firm rather than risk that the merged firm would use their competitively sensitive business information to undercut them. Those rivals might become less-effective competitors if they must rely on less-preferred trading partners or accept less favorable trading terms because their outside options have worsened or are more limited.

Facilitating Coordination. A merger that provides access to rivals' competitively sensitive information might facilitate coordinated interaction among firms in the relevant market by allowing the merged firm to observe its rivals' competitive strategies faster and more confidently. (See Guideline 3.)

2.5.C. Mergers that Threaten to Limit Rivals' Access and Thereby Create Barriers to Entry and Competition

When a merger gives a firm the ability and incentive to limit rivals' access, or where it gives the merged firm increased visibility into its rivals' competitively sensitive information, the merger may create entry barriers as described above. In addition, the merged firm's rivals might change their behavior because of the risk that the merged firm could limit their access. That is, the risk that the merger will give a firm the ability and incentive to limit rivals' access or will give the merged firm increased visibility into sensitive information can dissuade rivals from entering the market or expanding their operations.

Rivals or potential rivals that face the threat of foreclosure, or the risk of sharing sensitive information with rivals, may reduce investment or adjust their business strategies in ways that lessen competition. Firms may be reluctant to invest in a market if their success is dependent on continued supply from a rival, particularly because the merged firm may become more likely to foreclose its competitor as that competitor becomes more successful. Firms may use expensive strategies to try to reduce their dependence on the merged firm, weakening the competitiveness of their products and services. Even if the merged firm does not deliberately seek to weaken rivals, rivals or potential rivals may fear that their access will be limited if the merged firm decides to use its own products exclusively. These effects may occur irrespective of the merged firm's incentive to limit access and are greater as the merged firm gains greater control over more important inputs that those rivals use to compete.

2.6. Guideline 6: Mergers Can Violate the Law When They Entrench or Extend a Dominant Position.

The Agencies consider whether a merger may entrench or extend an already dominant position. The effect of such mergers "may be substantially to lessen competition" or "may be . . . to tend to create a monopoly" in violation of Section 7 of the Clayton Act. Indeed, the Supreme Court has explained that a merger involving an "already dominant[] firm may substantially reduce the competitive structure of the industry by raising entry barriers."[32] The Agencies also evaluate whether the merger may extend that dominant position into new markets.[33] Mergers that entrench or extend a dominant position can also violate Section 2 of the Sherman Act.[34] At the same time, the Agencies distinguish anticompetitive entrenchment from growth or development as a consequence of increased competitive capabilities or incentives.[35] The Agencies therefore seek to prevent those mergers that would entrench or extend a dominant position through exclusionary conduct, weakening competitive constraints, or otherwise harming the competitive process.

To undertake this analysis, the Agencies first assess whether one of the merging firms has a dominant position based on direct evidence or market shares showing durable market power. For example, the persistence of market power can indicate that entry barriers exist, that further entrenchment may tend to create a monopoly, and that there would be substantial benefits from the emergence of new competitive constraints or disruptions. The Agencies consider mergers involving dominant firms in the context of evidence about the sources of that dominance, focusing on the extent to which the merger relates to, reinforces, or supplements these sources.

Creating or preserving dominance and the profits it brings can be an important motivation for a firm to undertake an acquisition as well as a driver of the merged firm's behavior after the acquisition. In particular, a firm may be willing to undertake costly short-term strategies in order to increase the chance that it can enjoy the longer-term benefits of dominance. A merger that creates or preserves dominance may also reduce the merged firm's longer-term incentives to improve its products and services.

A merger can result in durable market power and long-term harm to competition even when it initially provides short-term benefits to some market participants. Thus, the Agencies will consider not just the impact of the merger holding fixed factors like product quality and the behavior of other industry participants, but they may also consider the (often longer term) impact of the merger on market

[32] *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 577-578 (1967); *see, e.g.*, *Fruehauf*, 603 F.2d at 353 (the "entrenchment of a large supplier or purchaser" can be an "essential" showing of a Section 7 violation).
[33] *Ford*, 405 U.S. at 571 (condemning acquisition by dominant firm to obtain a foothold in another market when coupled with incentive to create and maintain barriers to entry into that market).
[34] *See, e.g.*, *United States v. Grinnell Corp.*, 384 U.S. 563 (1966) (acquisitions are among the types of conduct that may violate the Sherman Act).
[35] *See*, *e.g.*, *id.* at 570-71.

power and industry dynamics. Important dynamic competitive effects can arise through the entry, investment, innovation, and terms offered by the merged firm and other industry participants, even when the Agencies cannot predict specific reactions and responses with precision. If the ultimate result of the merger is to protect or preserve dominance by limiting opportunities for rivals, reducing competitive constraints, or preventing competitive disruption, then the Agencies will approach the merger with a heightened degree of scrutiny. The degree of scrutiny and concern will increase in proportion to the strength and durability of the dominant firm's market power.

2.6.A. Entrenching a Dominant Position

Raising Barriers to Entry or Competition. A merger may create or enhance barriers to entry or expansion by rivals that limit the capabilities or competitive incentives of other firms. Barriers to entry can entrench a dominant position even if the nature of future entry is uncertain, if the identities of future entrants are unknown, or if there is more than one mechanism through which the merged firm might create entry barriers. Some examples of ways in which a merger may raise barriers to entry or competition include:

- *Increasing Switching Costs.* The costs associated with changing suppliers (often referred to as switching costs) can be an important barrier to competition. A merger may increase switching costs if it makes it more difficult for customers to switch away from the dominant firm's product or service, or when it gives the dominant firm control of something customers use to switch providers or of something that lowers the overall cost to customers of switching providers. For example, if a dominant firm merges with a complementary product that interoperates with the dominant firm's competitors, it could reduce interoperability, harming competition for customers who value the complement.

- *Interfering With the Use of Competitive Alternatives.* A dominant position may be threatened by a service that customers use to work with multiple providers of similar or overlapping bundles of products and services. If a dominant firm acquires a service that supports the use of multiple providers, it could degrade its utility or availability or could modify the service to steer customers to its own products, entrenching its dominant position. For example, a closed messaging communication service might acquire a product that allowed users to send and receive messages over several competing services through a single user interface, which facilitates competition. The Agencies would examine whether the acquisition would entrench the messaging service's market power by leading the merged firm to degrade the product or otherwise reduce its effectiveness as a cross-service tool, thus reducing competition.

- *Depriving Rivals of Scale Economies or Network Effects.* Scale economies and network effects can serve as a barrier to entry and competition. Depriving rivals of access to scale economies and network effects can therefore entrench a dominant position. If a merger enables a dominant firm to reduce would-be rivals' access to additional scale or customers by acquiring a product that affects access such as a customer acquisition channel, the merged firm can limit the ability of rivals to improve their own products and compete more effectively.[36] Limiting access by rivals to customers in the short run can lead to long run entrenchment of a dominant position and tend to create monopoly power.

[36] The Agencies' focus here is on the artificial acquisition of network participants that occurs directly as a result of the merger, as opposed to future network growth that may occur through competition on the merits.

> For example, if two firms operate in a market in which network effects are significant but in which rivals voluntarily interconnect, their merger can create an entity with a large enough user base that it may have the incentive to end voluntary interconnection. Such a strategy can lessen competition and harm trading partners by creating or entrenching dominance in this market. This can be the case even if the merging firms did not appear to have a dominant position prior to the merger because their interoperability practices strengthened rivals.

Eliminating a Nascent Competitive Threat. A merger may involve a dominant firm acquiring a nascent competitive threat—namely, a firm that could grow into a significant rival, facilitate other rivals' growth, or otherwise lead to a reduction in its power.[37] In some cases, the nascent threat may be a firm that provides a product or service similar to the acquiring firm that does not substantially constrain the acquiring firm at the time of the merger but has the potential to grow into a more significant rival in the future. In other cases, factors such as network effects, scale economies, or switching costs may make it extremely difficult for a new entrant to offer all of the product features or services at comparable quality and terms that an incumbent offers. The most likely successful threats in these situations can be firms that initially avoid directly entering the dominant firm's market, instead specializing in (a) serving a narrow customer segment, (b) offering services that only partially overlap with those of the incumbent, or (c) serving an overlapping customer segment with distinct products or services.

Firms with niche or only partially overlapping products or customers can grow into longer-term threats to a dominant firm. Once established in its niche, a nascent threat may be able to add features or serve additional customer segments, growing into greater overlap of customer segments or features over time, thereby intensifying competition with the dominant firm. A nascent threat may also facilitate customers aggregating additional products and services from multiple providers that serve as a partial alternative to the incumbent's offering. Thus, the success and independence of the nascent threat may both provide for a direct threat of competition by the niche or nascent firm and may facilitate competition or encourage entry by other, potentially complementary providers that may provide a partial competitive constraint. In this way, the nascent threat supports what may be referred to as "ecosystem" competition. In this context, ecosystem competition refers to a situation where an incumbent firm that offers a wide array of products and services may be partially constrained by other combinations of products and services from one or more providers, even if the business model of those competing services is different.

Nascent threats may be particularly likely to emerge during technological transitions. Technological transitions can render existing entry barriers less relevant, temporarily making incumbents susceptible to competitive threats. For example, technological transitions can create temporary opportunities for entrants to differentiate or expand their offerings based on their alignment with new technologies, enabling them to capture network effects that otherwise insulate incumbents from competition. A merger in this context may lessen competition by preventing or delaying any such beneficial shift or by shaping it so that the incumbent retains its dominant position. For example, a dominant firm might seek to acquire firms to help it reinforce or recreate entry barriers so that its dominance endures past the technological transition. Or it might seek to acquire nascent threats that might otherwise gain sufficient customers to overcome entry barriers. In evaluating the potential for entrenching dominance, the Agencies take particular care to preserve opportunities for more competitive markets to emerge during such technological shifts.

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[37] The Agencies assess acquisitions of nascent competitive threats by non-dominant firms under the other Guidelines.

Separate from and in addition to its Section 7 analysis, the Agencies will consider whether the merger violates Section 2 of the Sherman Act. For example, under Section 2 of the Sherman Act, a firm that may challenge a monopolist may be characterized as a "nascent threat" even if the impending threat is uncertain and may take several years to materialize.[38] The Agencies assess whether the merger is reasonably capable of contributing significantly to the preservation of monopoly power in violation of Section 2, which turns on whether the acquired firm is a nascent competitive threat.[39]

2.6.B. Extending a Dominant Position into Another Market

The Agencies also examine the risk that a merger could enable the merged firm to extend a dominant position from one market into a related market, thereby substantially lessening competition or tending to create a monopoly in the related market. For example, the merger might lead the merged firm to leverage its position by tying, bundling, conditioning, or otherwise linking sales of two products. A merger may also raise barriers to entry or competition in the related market, or eliminate a nascent competitive threat, as described above. For example, prior to a merger, a related market may be characterized by scale economies but still experience moderate levels of competition. If the merged firm takes actions to induce customers of the dominant firm's product to also buy the related product from the merged firm, the merged firm may be able to gain dominance in the related market, which may be supported by increased barriers to entry or competition that result from the merger.

These concerns can arise notwithstanding that the acquiring firm already enjoys the benefits associated with its dominant position. The prospect of market power in the related market may strongly affect the merged firm's incentives in a way that does not align with the interests of its trading partners, both in terms of strategies that create dominance for the related product and in the form of reduced incentives to invest in its products or provide attractive terms for them after dominance is attained. In some cases, the merger may also further entrench the firm's original dominant position, for example if future competition requires the provision of both products.

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If the merger raises concerns that its effect may be to entrench or extend a dominant position, then any claim that the merger also provides competitive benefits will be evaluated under the rebuttal framework in Section 3. For example, the framework of Section 3 would be used to evaluate claims that a merger would generate cost savings or quality improvements that would be passed through to make their products more competitive or would otherwise create incentives for the merged firm to offer better terms. The Agencies' analysis will consider the fact that the incentives to pass through benefits to customers or offer attractive terms are affected by competition and the extent to which entry barriers insulate the merged firm from effective competition. It will also consider whether any claimed benefits are specific to the merger, or whether they could be instead achieved through contracting or other means.

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[38] *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001) (en banc) (per curiam).

[39] *See id*. at 79 ("[I]t would be inimical to the purpose of the Sherman Act to allow monopolists free reign to squash nascent, albeit unproven, competitors at will. . . .").

2.7. Guideline 7: When an Industry Undergoes a Trend Toward Consolidation, the Agencies Consider Whether It Increases the Risk a Merger May Substantially Lessen Competition or Tend to Create a Monopoly.

The recent history and likely trajectory of an industry can be an important consideration when assessing whether a merger presents a threat to competition. The Supreme Court has explained that "a trend toward concentration in an industry, whatever its causes, is a highly relevant factor in deciding how substantial the anticompetitive effect of a merger may be."[40] It has also underscored that "Congress intended Section 7 to arrest anticompetitive tendencies in their incipiency.[41] The Agencies therefore examine whether a trend toward consolidation in an industry would heighten the competition concerns identified in Guidelines 1-6.

The Agencies therefore closely examine industry consolidation trends in applying the frameworks above. For example:

Trend Toward Concentration. If an industry has gone from having many competitors to becoming concentrated, it may suggest greater risk of harm, for example, because new entry may be less likely to replace or offset the lessening of competition the merger may cause. Among other implications, in the context of a trend toward concentration, the Agencies identify a stronger presumption of harm from undue concentration (see Guideline 1), and a greater risk of substantially lessening competition when a merger eliminates competition between the merging parties (see Guideline 2) or increases the risk of coordination (see Guideline 3).

Trend Toward Vertical Integration. The Agencies will generally consider evidence about the degree of integration between firms in the relevant and related markets and whether there is a trend toward further vertical integration. If a merger occurs amidst or furthers a trend toward vertical integration, the Agencies consider the implications for the competitive dynamics of the industry moving forward. For example, a trend toward vertical integration could magnify the concerns discussed in Guideline 5 by making entry at a single level more difficult and thereby preventing the emergence of new competitive threats over time.

Arms Race for Bargaining Leverage. The Agencies sometimes encounter mergers through which the merging parties would, by consolidating, gain bargaining leverage over other firms that they transact with. This can encourage those other firms to consolidate to obtain countervailing leverage, encouraging a cascade of further consolidation. This can ultimately lead to an industry where a few powerful firms have leverage against one another and market power over would-be entrants or over trading partners in various parts of the value chain. For example, distributors might merge to gain leverage against suppliers, who then merge to gain leverage against distributors, spurring a wave of mergers that lessen competition by increasing the market power of both. This can exacerbate the problems discussed in Guidelines 1-6, including by increasing barriers to single-level entry, encouraging coordination, and discouraging disruptive innovation.

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[40] *United States v. Pabst Brewing*, 384 U.S. 546, 552-53 (1966).
[41] *Phila. Nat'l Bank*, 374 U.S. at 362 (quoting *Brown Shoe*, 370 U.S. at 317).

***Multiple Mergers*.** The Agencies sometimes see multiple mergers at once or in succession by different players in the same industry. In such cases, the Agencies may examine multiple deals in light of the combined trend toward concentration.

2.8. Guideline 8: When a Merger is Part of a Series of Multiple Acquisitions, the Agencies May Examine the Whole Series.

A firm that engages in an anticompetitive pattern or strategy of multiple acquisitions in the same or related business lines may violate Section 7.[42] In these situations, the Agencies may evaluate the series of acquisitions as part of an industry trend (see Guideline 7) or evaluate the overall pattern or strategy of serial acquisitions by the acquiring firm collectively under Guidelines 1-6.

In expanding antitrust law beyond the Sherman Act through passage of the Clayton Act, Congress intended "to permit intervention in a cumulative process when the effect of an acquisition may be a significant reduction in the vigor of competition, even though this effect may not be so far-reaching as to amount to a combination in restraint of trade, create a monopoly, or constitute an attempt to monopolize."[43] As the Supreme Court has recognized, a cumulative series of mergers can "convert an industry from one of intense competition among many enterprises to one in which three or four large [companies] produce the entire supply."[44] Accordingly, the Agencies will consider individual acquisitions in light of the cumulative effect of related patterns or business strategies.

The Agencies may examine a pattern or strategy of growth through acquisition by examining both the firm's history and current or future strategic incentives. Historical evidence focuses on the strategic approach taken by the firm to acquisitions (consummated or not), both in the markets at issue and in other markets, to reveal any overall strategic approach to serial acquisitions. Evidence of the firm's current incentives includes documents and testimony reflecting its plans and strategic incentives both for the individual acquisition and for its position in the industry more broadly. Where one or both of the merging parties has engaged in a pattern or strategy of pursuing consolidation through acquisition, the Agencies will examine the impact of the cumulative strategy under any of the other Guidelines to determine if that strategy may substantially lessen competition or tend to create a monopoly.

2.9. Guideline 9: When a Merger Involves a Multi-Sided Platform, the Agencies Examine Competition Between Platforms, on a Platform, or to Displace a Platform.

Platforms provide different products or services to two or more different groups or "sides" who may benefit from each other's participation. Mergers involving platforms can threaten competition, even when a platform merges with a firm that is neither a direct competitor nor in a traditional vertical relationship with the platform. When evaluating a merger involving a platform, the Agencies apply Guidelines 1-6 while accounting for market realities associated with platform competition. Specifically,

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[42] Such strategies may also violate Section 2 of the Sherman Act and Section 5 of the FTC Act. Fed. Trade Comm'n, *Policy Statement Regarding the Scope of Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act*, at 12-14 & nn.73 & 82 (Nov. 10, 2022) (noting that "a series of . . . acquisitions . . . that tend to bring about the harms that the antitrust laws were designed to prevent" has been subject to liability under Section 5).
[43] H.R. Rep. No. 81-1191, at 8 (1949).
[44] *See Brown Shoe*, 370 U.S. at 334 (citing S. Rep. No. 81-1775, at 5 (1950); H.R. Rep. No. 81-1191, at 8 (1949)).

the Agencies consider competition *between* platforms, competition *on* a platform, and competition to *displace* the platform.

Multi-sided platforms generally have several attributes in common, though they can also vary in important ways. Some of these attributes include:

- Platforms have multiple sides. On each side of a platform, platform participants provide or use distinct products and services.[45] Participants can provide or use different types of products or services on each side.
- A platform operator provides the core services that enable the platform to connect participant groups across multiple sides. The platform operator controls other participants' access to the platform and can influence how interactions among platform participants play out.
- Each side of a platform includes platform participants. Their participation might be as simple as using the platform to find other participants, or as involved as building platform services that enable other participants to connect in new ways and allow new participants to join the platform.
- Network effects occur when platform participants contribute to the value of the platform for other participants and the operator. The value for groups of participants on one side may depend on the number of participants either on the same side (direct network effects) or on the other side(s) (indirect network effects).[46] Network effects can create a tendency toward concentration in platform industries. Indirect network effects can be asymmetric and heterogeneous; for example, one side of the market or segment of participants may place relatively greater value on the other side(s).
- A conflict of interest can arise when a platform operator is also a platform participant. The Agencies refer to a "conflict of interest" as the divergence that can arise between the operator's incentives to operate the platform as a forum for competition and its incentive to operate as a competitor on the platform itself. As discussed below, a conflict of interest sometimes exacerbates competitive concerns from mergers.

Consistent with the Clayton Act's protection of competition "in any line of commerce," the Agencies will seek to prohibit a merger that harms competition within a relevant market for any product or service offered on a platform to any group of participants—i.e., around one side of the platform (see Section 4.3).[47]

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[45] For example, on 1990s operating-system platforms for personal computer (PC) software, software developers were on one side, PC manufacturers on another, and software purchasers on another.

[46] For example, 1990s PC manufacturers, software developers, and consumers all contributed to the value of the operating system platform for one another.

[47] In the limited scenario of a "special type of two-sided platform known as a 'transaction' platform," under Section 1 of the Sherman Act, a relevant market encompassing both sides of a two-sided platform may be warranted. *Ohio v. American Express Co.*, 138 S. Ct. 2274, 2280 (2018). This approach to Section 1 of the Sherman Act is limited to platforms with the "key feature . . . that they cannot make a sale to one side of the platform without simultaneously making a sale to the other." *Id.* Because "they cannot sell transaction services to [either user group] individually . . . transaction platforms are better understood as supplying only one product—transactions." *Id.* at 2286. This characteristic is not present for many types of two-sided or multi-sided platforms; in addition, many platforms offer simultaneous transactions as well as other products and services, and further they may bundle these products with access to transact on the platform or offer quantity discounts.

The Agencies protect competition *between* platforms by preventing the acquisition or exclusion of other platform operators that may substantially lessen competition or tend to create a monopoly. This scenario can arise from various types of mergers:

A. Mergers involving two platform operators eliminate the competition between them. In a market with a platform, entry or growth by smaller competing platforms can be particularly challenging because of network effects. A common strategy for smaller platforms is to specialize, providing distinctive features. Thus, dominant platforms can lessen competition and entrench their position by systematically acquiring firms competing with one or more sides of a multi-sided platform while they are in their infancy. The Agencies seek to stop these trends in their incipiency.

B. A platform operator may acquire a platform participant, which can entrench the operator's position by depriving rivals of participants and, in turn, depriving them of network effects. For example, acquiring a major seller on a platform may make it harder for rival platforms to recruit buyers. The long-run benefits to a platform operator of denying network effects to rival platforms create a powerful incentive to withhold or degrade those rivals' access to platform participants that the operator acquires. The more powerful the platform operator, the greater the threat to competition presented by mergers that may weaken rival operators or increase barriers to entry and expansion.

C. Acquisitions of firms that provide services that facilitate participation on multiple platforms can deprive rivals of platform participants. Many services can facilitate such participation, such as tools that help shoppers compare prices across platforms, applications that help sellers manage listings on multiple platforms, or software that helps users switch among platforms.

D. Mergers that involve firms that provide other important inputs to platform services can enable the platform operator to deny rivals the benefits of those inputs. For example, acquiring data that helps facilitate matching, sorting, or prediction services may enable the platform to weaken rival platforms by denying them that data.

The Agencies protect competition *on* a platform in any markets that interact with the platform. When a merger involves a platform operator and platform participants, the Agencies carefully examine whether the merger would create conflicts of interest that would harm competition. A platform operator that is also a platform participant may have a conflict of interest whereby it has an incentive to give its own products and services an advantage over other participants competing on the platform. Platform operators must often choose between making it easy for users to access their preferred products and directing those users to products that instead provide greater benefit to the platform operator. Merging with a firm that makes a product offered on the platform may change how the platform operator balances these competing interests. For example, the platform operator may find it is more profitable to give its own product greater prominence even if that product is inferior or is offered on worse terms after the merger—and even if some participants leave the platform as a result.[48] This can harm competition in

[48] However, few participants will leave if, for example, the switching costs are relatively high or if the advantaged product is a small component of the overall set of services those participants access on the platform. Moreover, in the long run few participants will leave if scale economies, network effects, or entry barriers enable the advantaged product to eventually gain market power of its own, with rivals of the advantaged product exiting or becoming less attractive. After these dynamics play

the product market for the advantaged product, where the harm to competition may be experienced both on the platform and in other channels.

The Agencies protect competition to *displace* the platform or any of its services. For example, new technologies or services may create an important opportunity for firms to replace one or more services the incumbent platform operator provides, shifting some participants to partially or fully meet their needs in different ways or through different channels. Similarly, a non-platform service can lessen dependence on the platform by providing an alternative to one or more functions provided by the platform operators. When platform owners are dominant, the Agencies seek to prevent even relatively small accretions of power from inhibiting the prospects for displacing the platform or for decreasing dependency on the platform.

In addition, a platform operator that advantages its own products that compete *on* the platform can lessen competition *between* platforms and to *displace* the platform, as the operator may both advantage its own product or service, and also deprive rival platforms of access to it, limiting those rivals' network effects.

2.10. Guideline 10: When a Merger Involves Competing Buyers, the Agencies Examine Whether It May Substantially Lessen Competition for Workers, Creators, Suppliers, or Other Providers.

A merger between competing buyers may harm sellers just as a merger between competing sellers may harm buyers.[49] The same—or analogous—tools used to assess the effects of a merger of sellers can be used to analyze the effects of a merger of buyers, including employers as buyers of labor. Firms can compete to attract contributions from a wide variety of workers, creators, suppliers, and service providers. The Agencies protect this competition in all its forms.

A merger of competing buyers can substantially lessen competition by eliminating the competition between the merging buyers or by increasing coordination among the remaining buyers. It can likewise lead to undue concentration among buyers or entrench or extend the position of a dominant buyer. Competition among buyers can have a variety of beneficial effects analogous to competition among sellers. For example, buyers may compete by raising the payments offered to suppliers, by expanding supply networks, through transparent and predictable contracting, procurement, and payment practices, or by investing in technology that reduces frictions for suppliers. In contrast, a reduction in competition among buyers can lead to artificially suppressed input prices or purchase volume, which in turn reduces incentives for suppliers to invest in capacity or innovation. Labor markets are important buyer markets. The same general concerns as in other markets apply to labor markets where employers are the buyers of labor and workers are the sellers. The Agencies will consider whether workers face a risk that the merger may substantially lessen competition for their labor.[50] Where a merger between

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out, the platform operator could advantage its own products without losing as many participants, as there would be fewer alternative products available through other channels.

[49] *See, e.g.*, *Mandeville Island Farms, Inc. v. Am. Crystal Sugar Co.*, 334 U.S. 219, 235-36 (1948) ("The [Sherman Act] does not confine its protection to consumers, or to purchasers, or to competitors, or to sellers. . . . The Act is comprehensive in its terms and coverage, protecting all who are made victims of the forbidden practices by whomever they may be perpetrated.").

[50] *See, e.g.*, *Alston*, 141 S. Ct. 2141 (applying the Sherman Act to protect workers from an employer-side agreement to limit compensation).

employers may substantially lessen competition for workers, that reduction in labor market competition may lower wages or slow wage growth, worsen benefits or working conditions, or result in other degradations of workplace quality.[51] When assessing the degree to which the merging firms compete for labor, evidence that a merger may have any one or more of these effects can demonstrate that substantial competition exists between the merging firms.

Labor markets frequently have characteristics that can exacerbate the competitive effects of a merger between competing employers. For example, labor markets often exhibit high switching costs and search frictions due to the process of finding, applying, interviewing for, and acclimating to a new job. Switching costs can also arise from investments specific to a type of job or a particular geographic location. Moreover, the individual needs of workers may limit the geographical and work scope of the jobs that are competitive substitutes.

In addition, finding a job requires the worker and the employer to agree to the match. Even within a given salary and skill range, employers often have specific demands for the experience, skills, availability, and other attributes they desire in their employees. At the same time, workers may seek not only a paycheck but also work that they value in a workplace that matches their own preferences, as different workers may value the same aspects of a job differently. This matching process often narrows the range of rivals competing for any given employee. The level of concentration at which competition concerns arise may be lower in labor markets than in product markets, given the unique features of certain labor markets. In light of their characteristics, labor markets can be relatively narrow.

The features of labor markets may in some cases put firms in dominant positions. To assess this dominance in labor markets (see Guideline 6), the Agencies often examine the merging firms' power to cut or freeze wages, slow wage growth, exercise increased leverage in negotiations with workers, or generally degrade benefits and working conditions without prompting workers to quit.

If the merger may substantially lessen competition or tend to create a monopoly in upstream markets, that loss of competition is not offset by purported benefits in a separate downstream product market. Because the Clayton Act prohibits mergers that may substantially lessen competition or tend to create a monopoly in *any* line of commerce and in *any* section of the country, a merger's harm to competition among buyers is not saved by benefits to competition among sellers. That is, a merger can substantially lessen competition in one or more buyer markets, seller markets, or both, and the Clayton Act protects competition in any one of them.[52] If the parties claim any benefits to competition in a relevant buyer market, the Agencies will assess those claims using the frameworks in Section 3.

Just as they do when analyzing competition in the markets for products and services, the Agencies will analyze labor market competition on a case-by-case basis.

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[51] A decrease in wages is understood as relative to what would have occurred in the absence of the transaction; in many cases, a transaction will not reduce wage levels, but rather slow wage growth. Wages encompass all aspects of pecuniary compensation, including benefits. Job quality encompasses non-pecuniary aspects that workers value, such as working conditions and terms of employment.

[52] Often, mergers that harm competition among buyers also harm competition among sellers as a result. For example, when a monopsonist lowers purchase prices by decreasing input purchases, they will generally decrease sales in downstream markets as well. (See Section 4.2.D)

2.11. Guideline 11: When an Acquisition Involves Partial Ownership or Minority Interests, the Agencies Examine Its Impact on Competition.

In many acquisitions, two companies come under common control. In some situations, however, the acquisition of less-than-full control may still influence decision-making at the target firm or another firm in ways that may substantially lessen competition. Acquisitions of partial ownership or other minority interests may give the investor rights in the target firm, such as rights to appoint board members, observe board meetings, influence the firm's ability to raise capital, impact operational decisions, or access competitively sensitive information. The Agencies have concerns with both cross-ownership, which refers to holding a non-controlling interest in a competitor, as well as common ownership, which occurs when individual investors hold non-controlling interests in firms that have a competitive relationship that could be affected by those joint holdings.

Partial acquisitions that do not result in control may nevertheless present significant competitive concerns. The acquisition of a minority position may permit influence of the target firm, implicate strategic decisions of the acquirer with respect to its investment in other firms, or change incentives so as to otherwise dampen competition. The post-acquisition relationship between the parties and the independent incentives of the parties outside the acquisition may be important in determining whether the partial acquisition may substantially lessen competition. Such partial acquisitions are subject to the same legal standard as any other acquisition.[53]

The Agencies recognize that cross-ownership and common ownership can reduce competition by softening firms' incentives to compete, even absent any specific anticompetitive act or intent. While the Agencies will consider any way in which a partial acquisition may affect competition, they generally focus on three principal effects:

First, a partial acquisition can lessen competition by giving the partial owner the ability to influence the competitive conduct of the target firm.[54] For example, a voting interest in the target firm or specific governance rights, such as the right to appoint members to the board of directors, influence capital budgets, determine investment return thresholds, or select particular managers, can create such influence. Additionally, a nonvoting interest may, in some instances, provide opportunities to prevent, delay, or discourage important competitive initiatives, or otherwise impact competitive decision making. Such influence can lessen competition because the partial owner could use its influence to induce the target firm to compete less aggressively or to coordinate its conduct with that of the acquiring firm.

Second, a partial acquisition can lessen competition by reducing the incentive of the acquiring firm to compete.[55] Acquiring a minority position in a rival might blunt the incentive of the partial owner to compete aggressively because it may profit through dividend or other revenue share even when it loses business to the rival. For example, the partial owner may decide not to develop a new product feature to win market share from the firm in which it has acquired an interest, because doing so will

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[53] *See United States v. E. I. du Pont de Nemours & Co.*, 353 U.S. 586, 592 (1957) ("[A]ny acquisition by one corporation of all or any part of the stock of another corporation, competitor or not, is within the reach of [Section 7 of the Clayton Act] whenever the reasonable likelihood appears that the acquisition will result in a restraint of commerce or in the creation of a monopoly of any line of commerce.").
[54] *See United States v. Dairy Farmers of Am., Inc.*, 426 F.3d 850, 860-61 (6th Cir. 2005).
[55] *See Denver & Rio Grande v. United States*, 387 U.S. 485, 504 (1967) (identifying Section 7 concerns with a 20% investment).

reduce the value of its investment in its rival. This reduction in the incentive of the acquiring firm to compete arises even when it cannot directly influence the conduct or decision making of the target firm.

Third, a partial acquisition can lessen competition by giving the acquiring firm access to non-public, competitively sensitive information from the target firm. Even absent any ability to influence the conduct of the target firm, access to competitively sensitive information can substantially lessen competition through other mechanisms. For example, it can enhance the ability of the target and the partial owner to coordinate their behavior and make other accommodating responses faster and more targeted. The risk of coordinated effects is greater if the transaction also facilitates the flow of competitively sensitive information from the investor to the target firm. Even if coordination does not occur, the partial owner may use that information to preempt or appropriate a rival's competitive business strategies for its own benefit. If rivals know their efforts to win trading partners can be immediately appropriated, they may see less value in taking competitive actions in the first place, resulting in a lessening of competition.

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The analyses above address common scenarios that the Agencies use to assess the risk that a merger may substantially lessen competition or tend to create a monopoly. However, they are not exhaustive. The Agencies have in the past encountered mergers that lessen competition through mechanisms not covered above. For example:

A. A merger that would enable firms to avoid a regulatory constraint because that constraint was applicable to only one of the merging firms;

B. A merger that would enable firms to exploit a unique procurement process that favors the bids of a particular competitor who would be acquired in the merger; or

C. In a concentrated market, a merger that would dampen the acquired firm's incentive or ability to compete due to the structure of the acquisition or the acquirer.

As these scenarios and these Guidelines indicate, a wide range of evidence can show that a merger may lessen competition or tend to create a monopoly. Whatever the sources of evidence, the Agencies look to the facts and the law in each case.

Whatever frameworks the Agencies use to identify that a merger may substantially lessen competition or tend to create a monopoly, they also examine rebuttal evidence under the framework in Section 3.

3. Rebuttal Evidence Showing that No Substantial Lessening of Competition is Threatened by the Merger

The Agencies may assess whether a merger may substantially lessen competition or tend to create a monopoly based on a fact-specific analysis under any one or more of the Guidelines discussed above.[56] The Supreme Court has determined that analysis should consider "other pertinent factors" that may "mandate[] a conclusion that no substantial lessening of competition [is] threatened by the acquisition."[57] The factors pertinent to rebuttal depend on the nature of the threat to competition or tendency to create a monopoly resulting from the merger.

Several common types of rebuttal and defense evidence are subject to legal tests established by the courts. The Agencies apply those tests consistent with prevailing law, as described below.

3.1. Failing Firms

When merging parties suggest the weak or weakening financial position of one of the merging parties will prevent a lessening of competition, the Agencies examine that evidence under the "failing firm" defense established by the Supreme Court. This defense applies when the assets to be acquired would imminently cease playing a competitive role in the market even absent the merger.

As set forth by the Supreme Court, the failing firm defense has three requirements:

A. "[T]he evidence show[s] that the [failing firm] face[s] the grave probability of a business failure."[58] The Agencies typically look for evidence in support of this element that the allegedly failing firm would be unable to meet its financial obligations in the near future. Declining sales and/or net losses, standing alone, are insufficient to show this requirement.

B. "The prospects of reorganization of [the failing firm are] dim or nonexistent."[59] The Agencies typically look for evidence suggesting that the failing firm would be unable to reorganize successfully under Chapter 11 of the Bankruptcy Act, taking into account that "companies reorganized through receivership, or through [the Bankruptcy Act] often emerge[] as strong competitive companies."[60] Evidence of the firm's actual attempts to resolve its debt with creditors is important.

C. "[T]he company that acquires the failing [firm] or brings it under dominion is the only available purchaser."[61] The Agencies typically look for evidence that a company has made unsuccessful good-faith efforts to elicit reasonable alternative offers that pose a less severe danger to competition than does the proposed merger.[62]

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[56] *See United States v. AT&T, Inc.*, 916 F.3d at 1032.
[57] *See United States v. Gen. Dynamics Corp.*, 415 U.S. 486, 498 (1974); *Baker Hughes*, 908 F.2d at 990 (quoting *General Dynamics* and describing its holding as permitting rebuttal based on a "finding that 'no substantial lessening of competition occurred or was threatened by the acquisition'").
[58] *Citizen Publ'g Co. v. United States*, 394 U.S. 131, 138 (1969).
[59] *Id.*
[60] *Id.*
[61] *Id.* at 136-39 (quoting *Int'l Shoe Co. v. FTC*, 280 U.S. 291, 302 (1930)).
[62] Any offer to purchase the assets of the failing firm for a price above the liquidation value of those assets will be regarded as a reasonable alternative offer. Parties must solicit reasonable alternative offers before claiming that the business is failing.

Although merging parties sometimes argue that a poor or weakening position should serve as a defense even when it does not meet these elements, the Supreme Court has "confine[d] the failing company doctrine to its present narrow scope."[63] The Agencies evaluate evidence of a failing firm consistent with this prevailing law.[64]

3.2. Entry and Repositioning

Merging parties sometimes raise a rebuttal argument that a reduction in competition resulting from the merger would induce entry or repositioning[65] into the relevant market, preventing the merger from substantially lessening competition or tending to create a monopoly in the first place. This argument posits that a merger may, by substantially lessening competition, make the market more profitable for the merged firm and any remaining competitors, and that this increased profitability may induce new entry. To evaluate this rebuttal evidence, the Agencies assess whether entry induced by the merger would be "timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern."[66]

Timeliness. To show that no substantial lessening of competition is threatened by a merger, entry must be rapid enough to replace lost competition before any effect from the loss of competition due to the merger may occur. Entry in most industries takes a significant amount of time and is therefore insufficient to counteract any substantial lessening of competition that is threatened by a merger. Moreover, the entry must be durable: an entrant that does not plan to sustain its investment or that may exit the market would not ensure long-term preservation of competition.

Likelihood. Entry induced by lost competition must be so likely that no substantial lessening of competition is threatened by the merger. Firms make entry decisions based on the market conditions they expect once they participate in the market. If the new entry is sufficient to counteract the merger's effect on competition, the Agencies analyze why the merger would induce entry that was not planned in pre-merger competitive conditions.

The Agencies also assess whether the merger may increase entry barriers. For example, the merging firms may have a greater ability to discourage or block new entry when combined than they would have as separate firms. Mergers may enable or incentivize unilateral or coordinated exclusionary

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Liquidation value is the highest value the assets could command outside the market. If a reasonable alternative offer was rejected, the parties cannot claim that the business is failing.

[63] *Citizen Publ'g*, 394 U.S. at 139.

[64] The Agencies do not normally credit claims that the assets of a division would exit the relevant market in the near future unless: (1) applying cost allocation rules that reflect true economic costs, the division has a persistently negative cash flow on an operating basis, and such negative cash flow is not economically justified for the firm by benefits such as added sales in complementary markets or enhanced customer goodwill; and (2) the owner of the failing division has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its assets in the relevant market and pose a less severe danger to competition than does the proposed acquisition. Because firms can allocate costs, revenues, and intra-company transactions among their subsidiaries and divisions, the Agencies require evidence that is not solely based on management plans that could have been prepared for the purpose of demonstrating negative cash flow or the prospect of exit from the relevant market.

[65] Repositioning is a supply-side response that is evaluated like entry. If repositioning requires movement of assets from other markets, the Agencies will consider the costs and competitive effects of doing so. Repositioning that would reduce competition in the markets from which products or services are moved is not a cognizable rebuttal for a lessening of competition in the relevant market.

[66] *FTC v. Sanford Health*, 926 F.3d 959, 965 (8th Cir. 2019).

strategies that make entry more difficult. Entry can be particularly challenging when a firm must enter at multiple levels of the market at sufficient scale to compete effectively.

Sufficiency. Even where timely and likely, the prospect of entry may not effectively prevent a merger from threatening a substantial lessening of competition. Entry may be insufficient due to a wide variety of constraints that limit an entrant's effectiveness as a competitor. Entry must at least replicate the scale, strength, and durability of one of the merging parties to be considered sufficient. The Agencies typically do not credit entry that depends on lessening competition in other markets.

As part of their analysis, the Agencies will consider the economic realities at play. For example, lack of successful entry in the past will likely suggest that entry may be slow or difficult. Recent examples of entry, whether successful or unsuccessful, provide the starting point for identifying the elements of practical entry barriers and the features of the industry that facilitate or interfere with entry. The Agencies will also consider whether the parties' entry arguments are consistent with the rationale for the merger or imply that the merger itself would be unprofitable.

3.3. Procompetitive Efficiencies

The Supreme Court has held that "possible economies [from a merger] cannot be used as a defense to illegality."[67] Competition usually spurs firms to achieve efficiencies internally, and firms also often work together using contracts short of a merger to combine complementary assets without the full anticompetitive consequences of a merger.

Merging parties sometimes raise a rebuttal argument that, notwithstanding other evidence that competition may be lessened, evidence of procompetitive efficiencies shows that no substantial lessening of competition is in fact threatened by the merger. This argument asserts that the merger would not substantially lessen competition in any relevant market in the first place.[68] When assessing this argument, the Agencies will not credit vague or speculative claims, nor will they credit benefits outside the relevant market that would not prevent a lessening of competition in the relevant market. Rather, the Agencies examine whether the evidence[69] presented by the merging parties shows each of the following:

Merger Specificity. The merger will produce substantial competitive benefits that could not be achieved without the merger under review.[70] Alternative ways of achieving the claimed benefits are considered in making this determination. Alternative arrangements could include organic growth of one of the merging firms, contracts between them, mergers with others, or a partial merger involving only those assets that give rise to the procompetitive efficiencies.

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[67] *Phila. Nat'l Bank*, 374 U.S. at 371; *Procter & Gamble Co.*, 386 U.S. at 580 ("Congress was aware that some mergers which lessen competition may also result in economies but it struck the balance in favor of protecting competition.").

[68] *United States v. Anthem*, 855 F.3d 345, 353-55 (D.C. Cir. 2017) (although efficiencies not a "defense" to antitrust liability, evidence sometimes used "to rebut a prima facie case"); *Saint Alphonsus Medical Center-Nampa*, 778 F.3d at 791 ("The Clayton Act focuses on competition, and the claimed efficiencies therefore must show that the prediction of anticompetitive effects from the prima facie case is inaccurate.").

[69] In general, evidence related to efficiencies developed prior to the merger challenge is much more probative than evidence developed during the Agencies' investigation or litigation.

[70] If inter-firm collaborations are achievable by contract, they are not merger specific. The Agencies will credit the merger specificity of efficiencies only in the presence of evidence that a contract to achieve the asserted efficiencies would not be practical. *See Anthem*, 855 F.3d at 357.

Verifiability. These benefits are verifiable, and have been verified, using reliable methodology and evidence not dependent on the subjective predictions of the merging parties or their agents. Procompetitive efficiencies are often speculative and difficult to verify and quantify, and efficiencies projected by the merging firms often are not realized. If reliable methodology for verifying efficiencies does not exist or is otherwise not presented by the merging parties, the Agencies are unable to credit those efficiencies.

Prevents a Reduction in Competition. To the extent efficiencies merely benefit the merging firms, they are not cognizable. The merging parties must demonstrate through credible evidence that, within a short period of time, the benefits will prevent the risk of a substantial lessening of competition in the relevant market.

Not Anticompetitive. Any benefits claimed by the merging parties are cognizable only if they do not result from the anticompetitive worsening of terms for the merged firm's trading partners.[71]

Procompetitive efficiencies that satisfy each of these criteria are called cognizable efficiencies. To successfully rebut evidence that a merger may substantially lessen competition, cognizable efficiencies must be of a nature, magnitude, and likelihood that no substantial lessening of competition is threatened by the merger in any relevant market. Cognizable efficiencies that would not prevent the creation of a monopoly cannot justify a merger that may tend to create a monopoly.

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[71] The Agencies will not credit efficiencies if they reflect or require a decrease in competition in a separate market. For example, if input costs are expected to decrease, the cost savings will not be treated as an efficiency if they reflect an increase in monopsony power.

4. Analytical, Economic, and Evidentiary Tools

The analytical, economic, and evidentiary tools that follow can be applicable to many parts of the Agencies' evaluation of a merger as they apply the factors and frameworks discussed in Sections 2 and 3.

4.1. Sources of Evidence

This subsection describes the most common sources of evidence the Agencies draw on in a merger investigation. The evidence the Agencies rely upon to evaluate whether a merger *may* substantially lessen competition or tend to create a monopoly is weighed based on its probative value. In assessing the available evidence, the Agencies consider documents, testimony, available data, and analysis of those data, including credible econometric analysis and economic modeling.

***Merging Parties*.** The Agencies often obtain substantial information from the merging parties, including documents, testimony, and data. Across all of these categories, evidence created in the normal course of business is more probative than evidence created after the company began anticipating a merger review. Similarly, the Agencies give less weight to predictions by the parties or their employees, whether in the ordinary course of business or in anticipation of litigation, offered to allay competition concerns. Where the testimony of outcome-interested merging party employees contradicts ordinary course business records, the Agencies typically give greater weight to the business records.

Evidence that the merging parties intend or expect the merger to lessen competition, such as plans to coordinate with other firms, raise prices, reduce output or capacity, reduce product quality or variety, lower wages, cut benefits, exit a market, cancel plans to enter a market without a merger, withdraw products or delay their introduction, or curtail research and development efforts after the merger, can be highly informative in evaluating the effects of a merger on competition. The Agencies give little weight, however, to the lack of such evidence or the expressed contrary intent of the merging parties.

***Customers, Workers, Industry Participants, and Observers*.** Customers can provide a variety of information to the Agencies, ranging from information about their own purchasing behavior and choices to their views about the effects of the merger itself. The Agencies consider the relationship between customers and the merging parties in weighing customer evidence. The ongoing business relationship between a customer and a merging party may discourage the customer from providing evidence inconsistent with the interests of the merging parties.

Workers and representatives from labor organizations can provide information regarding, among other things, wages, non-wage compensation, working conditions, the individualized needs of workers in the market in question, the frictions involved in changing jobs, and the industry in which they work.

Similarly, other suppliers, indirect customers, distributors, consultants, and industry analysts can also provide information helpful to a merger inquiry. As with other interested parties, the Agencies give less weight to evidence created in anticipation of a merger investigation and more weight to evidence developed in the ordinary course of business.

***Market Effects in Consummated Mergers*.** Evidence of observed post-merger price increases or worsened terms is given substantial weight. A consummated merger, however, may substantially lessen competition even if such effects have not yet been observed, perhaps because the merged firm may be aware of the possibility of post-merger antitrust review and is therefore moderating its conduct.

Consequently, in evaluating consummated mergers, the Agencies also consider the same types of evidence when evaluating proposed mergers.

***Econometric Analysis and Economic Modeling*.** Econometric analysis of data and other types of economic modeling can be informative in evaluating the potential effects of a merger on competition. The Agencies give more weight to analysis using high quality data and adhering to rigorous standards. But the Agencies also take into account that in some cases, the availability or quality of data or reliable modeling techniques might limit the availability and relevance of econometric modeling. When data is available, the Agencies recognize that the goal of economic modeling is not to create a perfect representation of reality, but rather to inform an assessment of the likely change in firm incentives resulting from a merger.

Transaction Terms. The financial terms of the transaction may also be informative regarding a merger's impact on competition. For example, a purchase price that exceeds the acquired firm's stand-alone market value can sometimes indicate that the acquiring firm is paying a premium because it expects to be able to benefit from reduced competition.

4.2. Evaluating Competition Among Firms

This subsection discusses evidence and tools the Agencies look to when assessing competition among firms. The evidence and tools in this section can be relevant to a variety of settings, for example: to assess competition between rival firms (Guideline 2); the ability and incentive to limit access to a product rivals use to compete (Guideline 5); or for market definition (Section 4.3), for example when carrying out the Hypothetical Monopolist Test (Section 4.3.A).

For clarity, the discussion in this subsection often focuses on competition between two suppliers of substitute products that set prices. Analogous analytic tools may also be relevant in more general settings, for example when considering: competition among more than two suppliers; competition among buyers or employers to procure inputs and labor; competition that derives from customer willingness to buy in different locations; and competition that takes place in dimensions other than price or when terms are determined through, for example, negotiations or auctions.

Guideline 2 describes how different types of evidence can be used in assessing the potential harm to competition from a merger; some portions of Guideline 2 that are relevant in other settings are repeated below.

4.2.A. Generally Applicable Considerations

The Agencies may consider one or more of the following types of evidence, tools, and metrics when assessing the degree of competition among firms:

***Strategic Deliberations or Decisions*.** The Agencies may analyze the extent of competition among firms, for example between the merging firms, by examining evidence of their strategic deliberations or decisions in the regular course of business. For example, in some markets, the firms may monitor each other's pricing, marketing campaigns, facility locations, improvements, products, capacity, output, input costs, and/or innovation plans. This can provide evidence of competition between the merging firms, especially when they react by taking steps to preserve or enhance the competitiveness or profitability of their own products or services.

Prior Merger, Entry, and Exit Events. The Agencies may look to historical events to assess the presence and substantiality of direct competition between the merging firms. For example, the Agencies may examine the impact of recent relevant mergers, entry, expansion, or exit events on the merging parties or their competitive behavior.

Customer Substitution. Customers' willingness to switch between different firms' products is an important part of the competitive process. Firms are closer competitors the more that customers are willing to switch between their products, for example because they are more similar in quality, price, or other characteristics.

Evidence commonly analyzed to show the extent of substitution among firms' products includes: how customers have shifted purchases in the past in response to relative changes in price or other terms and conditions; documentary and testimonial evidence such as win/loss reports, evidence from discount approval processes, switching data, customer surveys, as well as information from suppliers of complementary products and distributors; objective information about product characteristics; and market realities affecting the ability of customers to switch.

Impact of Competitive Actions on Rivals. When one firm takes competitive actions to attract customers, this can benefit the firm at the expense of its rivals. The Agencies may gauge the extent of competition among firms by considering the impact that competitive actions by one firm have on the others. The impact of a firm's competitive actions on a rival generally depends on how many sales a rival would lose as a result of the competitive actions, as well as the profitability of those lost sales. The Agencies may use margins to measure the profitability of the sale a rival would have made.[72]

Impact of Eliminating Competition Between the Firms. In some instances, evidence may be available to assess the impact of competition from one or more firms on the other firms' actions, such as firm choices about price, quality, wages, or another dimension of competition. This can be gauged by comparing the two firms' actions when they compete and make strategic choices independently against the actions the firms might choose if they acted jointly. Actual or predicted changes in these results of competition, when available, can indicate the degree of competition between the firms.

To make this type of comparison, the Agencies sometimes rely on economic models. Often, such models consider the firms' incentives to change their actions in one or more selected dimensions, such as price, in a somewhat simplified scenario. For example, a model might focus on the firms' short-run incentives to change price, while abstracting from a variety of additional competitive forces and dimensions of competition, such as the potential for firms to reposition their products or for the merging firms to coordinate with other firms. Such a model may incorporate data and evidence in order to produce quantitative estimates of the impact of the merger on firm incentives and corresponding choices. This type of exercise is sometimes referred to by economists as "merger simulation" despite the fact that the hypothetical setting considers only selected aspects of the loss of competition from a merger. The Agencies use such models to give an indication of the scale and importance of competition, not to precisely predict outcomes.

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[72] The margin on incremental units is the difference between incremental revenue (often equal to price) and incremental cost on those units. The Agencies may use accounting data to measure incremental costs, but they do not necessarily rely on accounting margins recorded by firms in the ordinary course of business because such margins often do not align with the concept of incremental cost that is relevant in economic analysis of a merger.

4.2.B. Considerations When Terms Are Set by Firms

The Agencies may use various types of evidence and metrics to assess the strength of competition among firms that set terms to their customers. Firms might offer the same terms to different customers or different terms to different groups of customers.

Competition in this setting can lead firms to set lower prices or offer more attractive terms when they act independently than they would in a setting where that competition was eliminated by a merger. When considering the impact of competition on the incentives to set price, to the extent price increases on one firm's products would lead customers to switch to products from another firm, their merger will enable the merged firm to profit by unilaterally raising the price of one or both products above the pre-merger level. Some of the sales lost because of the price increase will be diverted to the products of the other firm, and capturing the value of these diverted sales can make the price increase profitable even though it would not have been profitable prior to the merger.

A measure of customer substitution between firms in this setting is the diversion ratio. The diversion ratio from one product to another is a metric of how customers likely would substitute between them. The diversion ratio is the fraction of unit sales lost by the first product due to a change in terms, such as an increase in its price, that would be diverted to the second product. The higher the diversion ratio between two products made by different firms, the stronger the competition between them.

A high diversion ratio between the products owned by two firms can indicate strong competition between them even if the diversion ratio to another firm is higher. The diversion ratio from one of the products of one firm to a group of products made by other firms, defined analogously, is sometimes referred to as the aggregate diversion ratio or the recapture rate.

A measure of the impact on rivals of competitive actions is the value of diverted sales from a price increase. The value of sales diverted from one firm to a second firm, when the first firm raises its price on one of its products, is equal to the number of units that would be diverted from the first firm to the second, multiplied by the difference between the second firm's price and the incremental cost of the diverted sales. To interpret the magnitude of the value of diverted sales, the Agencies may use as a basis of comparison either the incremental cost to the second firm of making the diverted sales, or the revenues lost by the first firm as a result of the price increase. The ratio of the value of diverted sales to the revenues lost by the first firm can be an indicator of the upward pricing pressure that would result from the loss of competition between the two firms. Analogous concepts can be applied to analyze the impact on rivals of worsening terms other than price.

4.2.C. Considerations When Terms Are Set Through Bargaining or Auctions

In some industries, buyers and sellers negotiate prices and other terms of trade. In bargaining, buyers commonly negotiate with more than one seller and may play competing sellers off against one another. In other industries, sellers might sell their products, or buyers might procure inputs, using an auction. Negotiations may involve aspects of an auction as well as aspects of one-on-one negotiation. Competition among sellers can significantly enhance the ability of a buyer to obtain a result more favorable to it, and less favorable to the sellers, compared to a situation where the elimination of competition through a merger prevents buyers from playing those sellers off against each other in negotiations.

Sellers may compete even when a customer does not directly play their offers against each other. The attractiveness of alternative options influences the importance of reaching an agreement to the negotiating parties and thus the terms of the agreement. A party that has many attractive alternative trading partners places less importance on reaching an agreement with any one particular trading partner than a party with few attractive alternatives. As alternatives for one party are eliminated (such as through a merger), the trading partner gains additional bargaining leverage reflecting that loss of competition. A merger between sellers may lessen competition even if the merged firm handles negotiations for the merging firms' products separately.

Thus, qualitative or quantitative evidence about the leverage provided to buyers by competing suppliers may be used to assess the extent of competition among firms in this setting. Analogous evidence may be used when analyzing a setting where terms are set using auctions, for example, procurement auctions where suppliers bid to serve a buyer. If, for some categories of procurements, certain suppliers are often among the most attractive to the buyer, competition among that group of suppliers is likely to be strong.

Firms sometimes keep records of the progress and outcome of individual sales efforts, and the Agencies may use these data to generate measures of the extent to which customers would likely substitute between the two firms. Examples of such measures might include a diversion ratio based on the rate at which customers would buy from one firm if the other one was not available, or the frequency with which the two firms bid on contracts with the same customer.

4.2.D. Considerations When Firms Determine Capacity and Output

In some markets, the choice of how much to produce (output decisions) or how much productive capacity to maintain (capacity decisions) are key strategic variables. When a firm decreases output, it may lose sales to rivals, but also drive up prices. Because a merged firm will account for the impact of higher prices across all of the merged firms' sales, it may have an incentive to decrease output as a result of the merger. The loss of competition through a merger of two firms may lead the merged firm to leave capacity idle, refrain from building or obtaining capacity that would have been obtained absent the merger, lay off or stop hiring workers, or eliminate pre-existing production capabilities. A firm may also divert the use of capacity away from one relevant market and into another market so as to raise the price in the former market. The analysis of the extent to which firms compete may differ depending on how a merger between them might create incentives to suppress output.

Competition between merging firms is greater when (1) the merging firms' market shares are relatively high; (2) the merging firms' products are relatively undifferentiated from each other; (3) the market elasticity of demand is relatively low; (4) the margin on the suppressed output is relatively low; and (5) the supply responses of non-merging rivals are relatively small. Qualitative or quantitative evidence may be used to evaluate and weigh each of these factors.

In some cases, competition between firms—including one firm with a substantial share of the sales in the market and another with significant excess capacity to serve that market—can prevent an output suppression strategy from being profitable. This can occur even if the firm with the excess capacity has a relatively small share of sales, as long as that firm's ability to expand, and thus keep prices from rising, makes an output suppression strategy unprofitable for the firm with the larger market share.

4.2.E. Considerations for Innovation and Product Variety Competition

Firms can compete for customers by offering varied and innovative products and features, which could range from minor improvements to the introduction of a new product category. Features can include new or different product attributes, services offered along with a product, or higher-quality services standing alone. Customers value the variety of products or services that competition generates, including having a variety of locations at which they can shop.

Offering the best mix of products and features is an important dimension of competition that may be harmed as a result of the elimination of competition between the merging parties.

When a firm introduces a new product or improves a product's features, some of the sales it gains may be at the expense of its rivals, including rivals that are competing to develop similar products and features. As a result, competition between firms may lead them to make greater efforts to offer a variety of products and features than would be the case if the firms were jointly owned, for example, if they merged. The merged firm may have a reduced incentive to continue or initiate development of new products that would have competed with the other merging party, but post-merger would "cannibalize" what would be its own sales.[73] A service provider may have a reduced incentive to continue valuable upgrades offered by the acquired firm. The merged firm may have a reduced incentive to engage in disruptive innovation that would threaten the business of one of the merging firms. Or it may have the incentive to change its product mix, such as by ceasing to offer one of the merging firms' products, leaving worse off the customers who previously chose the product that was eliminated. For example, competition may be harmed when customers with a preference for a low-price option lose access to it, even if remaining products have higher quality.

The incentives to compete aggressively on innovation and product variety depend on the capabilities of the firms and on customer reactions to the new offerings. Development of new features depends on having the appropriate expertise and resources. Where firms are two of a small number of companies with specialized employees, development facilities, intellectual property, or research projects in a particular area, competition between them will have a greater impact on their incentives to innovate.

Innovation may be directed at outcomes beyond product features; for example, innovation may be directed at reducing costs or adopting new technology for the distribution of products.

4.3. Market Definition

The Clayton Act protects competition "in any line of commerce in any section of the country."[74] The Agencies engage in a market definition inquiry in order to identify whether there is any line of commerce or section of the country in which the merger may substantially lessen competition or tend to create a monopoly. The Agencies identify the "area of effective competition" in which competition may be lessened "with reference to a product market (the 'line of commerce') and a geographic market (the 'section of the country.')."[75] The Agencies refer to the process of identifying market(s) protected by the Clayton Act as a "market definition" exercise and the markets so defined as "relevant antitrust markets,"

[73] Sales "cannibalization" refers to a situation where customers of a firm substitute away from one of the firm's products to another product offered by the same firm.
[74] 15 U.S.C. § 18.
[75] *Brown Shoe*, 370 U.S. at 324.

or simply "relevant markets." Market definition can also allow the Agencies to identify market participants and measure market shares and market concentration.

A relevant antitrust market is an area of effective competition, comprising both product (or service) and geographic elements. The outer boundaries of a relevant product market are determined by the "reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it."[76] Within a broad relevant market, however, effective competition often occurs in numerous narrower relevant markets.[77] Market definition ensures that relevant antitrust markets are sufficiently broad, but it does not always lead to a single relevant market. Section 7 of the Clayton Act prohibits any merger that may substantially lessen competition "in any line of commerce" and in "any section of the country," and the Agencies protect competition by challenging a merger that may lessen competition in any one or more relevant markets.

Market participants often encounter a range of possible substitutes for the products of the merging firms. However, a relevant market cannot meaningfully encompass that infinite range of substitutes.[78] There may be effective competition among a narrow group of products, and the loss of that competition may be harmful, making the narrow group a relevant market, even if competitive constraints from significant substitutes are outside the group. The loss of both the competition between the narrow group of products and the significant substitutes outside that group may be even more harmful, but that does not prevent the narrow group from being a market in its own right.

Relevant markets need not have precise metes and bounds. Some substitutes may be closer, and others more distant, and defining a market necessarily requires including some substitutes and excluding others. Defining a relevant market sometimes requires a line-drawing exercise around product features, such as size, quality, distances, customer segment, or prices. There can be many places to draw that line and properly define a relevant market. The Agencies recognize that such scenarios are common, and indeed "fuzziness would seem inherent in any attempt to delineate the relevant . . . market."[79] Market participants may use the term "market" colloquially to refer to a broader or different set of products than those that would be needed to constitute a valid relevant antitrust market.

The Agencies rely on several tools to demonstrate that a market is a relevant antitrust market. For example, the Agencies may rely on any one or more of the following to identify a relevant antitrust market.

A. Direct evidence of substantial competition between the merging parties can demonstrate that a relevant market exists in which the merger may substantially lessen competition and can be sufficient to identify the line of commerce and section of the country affected by a merger, even if the metes and bounds of the market are only broadly characterized.

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[76] *Id.* at 325.
[77] *Id.* ("[W]ithin [a] broad market, well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes."). Multiple overlapping markets can be appropriately defined relevant markets. For example, a merger to monopoly for food worldwide would lessen competition in well-defined relevant markets for, among others, food, baked goods, cookies, low-fat cookies, and premium low-fat chocolate chip cookies. Illegality in any of these in any city or town comprising a relevant geographic market would suffice to prohibit the merger, and the fact that one area comprises a relevant market does not mean a larger, smaller, or overlapping area could not as well.
[78] *United States v. Cont'l Can Co.*, 378 U.S. 441, 449 (1964); *see also FTC v. Advoc. Health Care Network*, 841 F.3d 460, 469 (7th Cir. 2016) ("A geographic market does not need to include all of the firm's competitors; it needs to include the competitors that would substantially constrain the firm's price-increasing ability." (cleaned up)).
[79] *Phila. Nat'l Bank*, 374 U.S. at 360 n.37.

B. Direct evidence of the exercise of market power can demonstrate the existence of a relevant market in which that power exists. This evidence can be valuable when assessing the risk that a dominant position may be entrenched, maintained, or extended, since the same evidence identifies market power and can be sufficient to identify the line of commerce and section of the country affected by a merger, even if the metes and bounds of the market are only broadly characterized.

C. A relevant market can be identified from evidence on observed market characteristics ("practical indicia"), such as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors.[80] Various practical indicia may identify a relevant market in different settings.

D. Another common method employed by courts and the Agencies is the hypothetical monopolist test.[81] This test examines whether a proposed market is too narrow by asking whether a hypothetical monopolist over this market could profitably worsen terms significantly, for example, by raising price. An analogous hypothetical monopsonist test applies when considering the impact of a merger on competition among buyers.

The Agencies use these tools to define relevant markets because they each leverage market realities to identify an area of effective competition.

Section 4.3.A below describes the Hypothetical Monopolist Test in greater detail. Section 4.3.B addresses issues that may arise when defining relevant markets in several specific scenarios.

4.3.A. The Hypothetical Monopolist Test

This Section describes the Hypothetical Monopolist Test, which is a method by which the Agencies often define relevant antitrust markets. As outlined above, a relevant antitrust market is an area of effective competition. The Hypothetical Monopolist/Monopsonist Test ("HMT") evaluates whether a group of products is sufficiently broad to constitute a relevant antitrust market. To do so, the HMT asks whether eliminating the competition among the group of products by combining them under the control of a hypothetical monopolist likely would lead to a worsening of terms for customers. The Agencies generally focus their assessment on the constraints from competition, rather than on constraints from regulation, entry, or other market changes. The Agencies are concerned with the impact on economic incentives and assume the hypothetical monopolist would seek to maximize profits.

When evaluating a merger of sellers, the HMT asks whether a hypothetical profit-maximizing firm, not prevented by regulation from worsening terms, that was the only present and future seller of a group of products ("hypothetical monopolist") likely would undertake at least a small but significant and non-transitory increase in price ("SSNIP") or other worsening of terms ("SSNIPT") for at least one

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[80] *Brown Shoe*, 370 U.S. at 325, *quoted in United States v. U.S. Sugar Corp.*, 73 F.4th 197, 204-07 (3d Cir. 2023) (affirming district court's application of *Brown Shoe* practical indicia to evaluate relevant product market that included, based on the unique facts of the industry, those distributors who "could counteract monopolistic restrictions by releasing their own supplies").

[81] *See FTC v. Penn State Hershey Med. Center*, 838 F.3d 327, 338 (3d Cir. 2016). While these guidelines focus on applying the hypothetical monopolist test in analyzing mergers, the test can be adapted for similar purposes in cases involving alleged monopolization or other conduct. *See, e.g.*, *McWane, Inc. v. FTC*, 783 F.3d 814, 829-30 (11th Cir. 2015).

product in the group.[82] For the purpose of analyzing this issue, the terms of sale of products outside the candidate market are held constant. Analogously, when considering a merger of buyers, the Agencies ask the equivalent question for a hypothetical monopsonist. This Section often focuses on merging sellers to simplify exposition.

4.3.B. Implementing the Hypothetical Monopolist Test

The SSNIPT. A SSNIPT may entail worsening terms along any dimension of competition, including price (SSNIP), but also other terms (broadly defined) such as quality, service, capacity investment, choice of product variety or features, or innovative effort.

Input and Labor Markets. When the competition at issue involves firms buying inputs or employing labor, the HMT considers whether the hypothetical monopsonist would undertake at least a SSNIPT, such as a decrease in the offered price or a worsening of the terms of trade offered to suppliers, or a decrease in the wage offered to workers or a worsening of their working conditions or benefits.

The Geographic Dimension of the Market. The hypothetical monopolist test is generally applied to a group of products together with a geographic region to determine a relevant market, though for ease of exposition the two dimensions are discussed separately, with geographic market definition discussed in Section 4.3.D.2.

Negotiations or Auctions. The HMT is stated in terms of a hypothetical monopolist *undertaking* a SSNIPT. This covers settings where the hypothetical monopolist sets terms and makes them worse. It also covers settings where firms bargain, and the hypothetical monopolist would have a stronger bargaining position that would likely lead it to extract a SSNIPT during negotiations, or where firms sell their products in an auction, and the bids submitted by the hypothetical monopolist would result in the purchasers of its products experiencing a SSNIPT.

Benchmark for the SSNIPT. The HMT asks whether the hypothetical monopolist likely would worsen terms relative to those that likely would prevail absent the proposed merger. In some cases, the Agencies will use as a benchmark different outcomes than those prevailing prior to the merger. For example, if outcomes are likely to change absent the merger, e.g., because of innovation, entry, exit, or exogenous trends, the Agencies may use anticipated future outcomes as the benchmark. Or, if suppliers in the market are coordinating prior to the merger, the Agencies may use a benchmark that reflects conditions that would arise if coordination were to break down. When evaluating whether a merging firm is dominant (Guideline 6), the Agencies may use terms that likely would prevail in a more competitive market as a benchmark.[83]

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[82] If the pricing incentives of the firms supplying the products in the group differ substantially from those of the hypothetical monopolist, for reasons other than the latter's control over a larger group of substitutes, the Agencies may instead employ the concept of a hypothetical profit-maximizing cartel comprised of the firms (with all their products) that sell the products in the candidate market. This approach is most likely to be appropriate if the merging firms sell products outside the candidate market that significantly affect their pricing incentives for products in the candidate market. This could occur, for example, if the candidate market is one for durable equipment and the firms selling that equipment derive substantial net revenues from selling spare parts and service for that equipment. Analogous considerations apply when considering a SSNIPT for terms other than price.

[83] In the entrenchment context, if the inquiry is being conducted after market or monopoly power has already been exercised, using prevailing prices can lead to defining markets too broadly and thus inferring that dominance does not exist when, in

Magnitude of the SSNIPT. What constitutes a "small but significant" worsening of terms depends upon the nature of the industry and the merging firms' positions in it, the ways that firms compete, and the dimension of competition at issue. When considering price, the Agencies will often use a SSNIP of five percent of the price charged by firms for the products or services to which the merging firms contribute value. The Agencies, however, may consider a different term or a price increase that is larger or smaller than five percent.[84]

The Agencies may base a SSNIP on explicit or implicit prices for the firms' specific contribution to the value of the product sold, or an upper bound on the firms' specific contribution, where these can be identified with reasonable clarity. For example, the Agencies may derive an implicit price for the service of transporting oil over a pipeline as the difference between the price the pipeline firm paid for oil at one end and the price it sold the oil for at the other and base the SSNIP on this implicit price.

4.3.C. Evidence and Tools for Carrying Out the Hypothetical Monopolist Test

Section 4.2 describes some of the qualitative and quantitative evidence and tools the Agencies can use to assess the extent of competition among firms. The Agencies can use similar evidence and analogous tools to apply the HMT, in particular to assess whether competition among a set of firms likely leads to better terms than a hypothetical monopolist would undertake.

To assess whether the hypothetical monopolist likely would undertake at least a SSNIP on one or more products in the candidate market, the Agencies sometimes interpret the qualitative and quantitative evidence using an economic model of the profitability to the hypothetical monopolist of undertaking price increases; the Agencies may adapt these tools to apply to other forms of SSNIPTs.

One approach utilizes the concept of a "recapture rate" (the percentage of sales lost by one product in the candidate market, when its price alone rises, that is recaptured by other products in the candidate market). A price increase is profitable when the recapture rate is high enough that the incremental profits from the increased price plus the incremental profits from the recaptured sales going to other products in the candidate market exceed the profits lost when sales are diverted outside the candidate market. It is possible that a price increase is profitable even if a majority of sales are diverted outside the candidate market, for example if the profits on the lost sales are relatively low or the profits on the recaptured sales are relatively high.

Sometimes evidence is presented in the form of "critical loss analysis," which can be used to assess whether undertaking at least a SSNIPT on one or more products in a candidate market would raise or lower the hypothetical monopolist's profits. Critical loss analysis compares the magnitude of the two offsetting effects resulting from the worsening of terms. The "critical loss" is defined as the number of lost unit sales that would leave profits unchanged. The "predicted loss" is defined as the number of unit sales that the hypothetical monopolist is predicted to lose due to the worsening of terms. The worsening of terms raises the hypothetical monopolist's profits if the predicted loss is less than the

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fact, it does. The problem with using prevailing prices to define the market when a firm is already dominant is known as the "Cellophane Fallacy."

[84] The five percent price increase is not a threshold of competitive harm from the merger. Because the five percent SSNIP is a minimum expected effect of a hypothetical monopolist of an *entire* market, the actual predicted effect of a merger within that market may be significantly lower than five percent. A merger within a well-defined market that causes undue concentration can be illegal even if the predicted price increase is well below the SSNIP of five percent.

critical loss. While this "breakeven" analysis differs somewhat from the profit-maximizing analysis called for by the HMT, it can sometimes be informative.

The Agencies require that estimates of the predicted loss be consistent with other evidence, including the pre-merger margins of products in the candidate market used to calculate the critical loss. Unless the firms are engaging in coordinated interaction, high pre-merger margins normally indicate that each firm's product individually faces demand that is not highly sensitive to price. Higher pre-merger margins thus indicate a smaller predicted loss as well as a smaller critical loss. The higher the pre-merger margin, the smaller the recapture rate[85] necessary for the candidate market to satisfy the hypothetical monopolist test. Similar considerations inform other analyses of the profitability of a price increase.

4.3.D. Market Definition in Certain Specific Settings

This Section provides details on market definition in several specific common settings. In much of this section, concepts are presented for the scenario where the merger involves sellers. In some cases, clarifications are provided as to how the concepts apply to merging buyers; in general, the concepts apply in an analogous way.

4.3.D.1. Targeted Trading Partners

If the merged firm could profitably target a subset of customers for changes in prices or other terms, the Agencies may identify relevant markets defined around those targeted customers. The Agencies may do so even if firms are not currently targeting specific customer groups but could do so after the merger.

For targeting to be feasible, two conditions typically must be met. First, the suppliers engaging in targeting must be able to set different terms for targeted customers than other customers. This may involve identification of individual customers to which different terms are offered or offering different terms to different types of customers based on observable characteristics.[86] Markets for targeted customers need not have precise metes and bounds. In particular, defining a relevant market for targeted customers sometimes requires a line-drawing exercise on observable characteristics. There can be many places to draw that line and properly define a relevant market. Second, the targeted customers must not be likely to defeat a targeted worsening of terms by arbitrage (e.g., by purchasing indirectly from or through other customers). Arbitrage may be difficult if it would void warranties or make service more difficult or costly for customers, and it is inherently impossible for many services. Arbitrage on a modest scale may be possible but sufficiently costly or limited, for example due to transaction costs or search costs, that it would not deter or defeat a discriminatory pricing strategy.

If prices are negotiated or otherwise set individually, for example through a procurement auction, there may be relevant markets that are as narrow as an individual customer. Nonetheless, for analytic convenience, the Agencies may define cluster markets for groups of targeted customers for whom the

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[85] The recapture rate is sometimes referred to as the aggregate diversion ratio, defined in Section 4.2.B.

[86] In some cases, firms offer one or more versions of products or services defined by their characteristics (where brand might be a characteristic). When customers can select among these products and terms do not vary by customer, the Agencies will typically define markets based on products rather than the targeted customers. In such cases, relevant antitrust markets may include only some of the differentiated products, for example products with only "basic" features, or products with "premium features." The tools described in Section 4.2 can be used to assess competition among differentiated products.

conditions of competition are reasonably similar. (See Section 4.3.D.4 for further discussion of cluster markets.)

Analogous considerations arise for a merger involving one or more buyers or employers. In this case, the analysis considers whether buyers target suppliers, for example by paying targeted suppliers or workers less, or by degrading the terms of supply contracts for targeted suppliers. Arbitrage would involve a targeted supplier selling to the buyer indirectly, through a different supplier who could obtain more favorable terms from the buyer.

If the HMT is applied in a setting where targeting of customers is feasible, it requires that a hypothetical profit-maximizing firm that was the only present or future seller of the relevant product(s) to customers in the targeted group would undertake at least a SSNIPT on some, though not necessarily all, customers in that group. The products sold to those customers form a relevant market if the hypothetical monopolist likely would undertake at least a SSNIPT despite the potential for customers to substitute away from the product or to take advantage of arbitrage. In this exercise, the terms of sale for products sold to all customers outside the region are held constant.

4.3.D.2. Geographic Markets

A relevant antitrust market is an area of effective competition, comprising both product (or service) and geographic elements. A market's geography depends on the limits that distance puts on some customers' willingness or ability to substitute to some products, or some suppliers' willingness or ability to serve some customers. Factors that may limit the geographic scope of the market include transportation costs, language, regulation, tariff and non-tariff trade barriers, custom and familiarity, reputation, and local service availability.

4.3.D.2.a. Geographic Markets Based on the Locations of Suppliers

The Agencies sometimes define geographic markets as regions encompassing a group of supplier locations. When they do, the geographic market's scope is determined by customers' willingness to switch between suppliers. Geographic markets of this type often apply when customers receive goods or services at suppliers' facilities, for example when customers buy in-person from retail stores. A single firm may offer the same product in a number of locations, both within a single geographic market or across geographic markets; customers' willingness to substitute between products may depend on the location of the supplier. When calculating market shares, sales made from supplier locations in the geographic market are included, regardless of whether the customer making the purchase travelled from outside the boundaries of the geographic market (see Section 4.4 for more detail about calculating market shares).

If the HMT is used to evaluate the geographic scope of the market, it requires that a hypothetical profit-maximizing firm that was the only present or future supplier of the relevant product(s) at supplier locations in the region likely would undertake at least a SSNIPT in at least one location. In this exercise, the terms of sale for products sold to all customers at facilities outside the region are typically held constant.[87]

[87] In some circumstances, as when the merging parties operate in multiple geographies, if applying the HMT, the Agencies may apply a "Hypothetical Cartel" framework for market definition, following the approach outlined in Section 4.3.A, n.81.

4.3.D.2.b. Geographic Markets Based on Targeting of Customers by Location

When targeting based on customer location is feasible (see Section 4.3.D.1), the Agencies may define geographic markets as a region encompassing a group of customers.[88] For example, geographic markets may sometimes be defined this way when suppliers deliver their products or services to customers' locations, or tailor terms of trade based on customers' locations. Competitors in the market are firms that sell to customers that are located in the specified region. Some suppliers may be located outside the boundaries of the geographic market, but their sales to customers located within the market are included when calculating market shares (see Section 4.4 for more detail about calculating market shares).

If prices are negotiated individually with customers that may be targeted, geographic markets may be as narrow as individual customers. Nonetheless, the Agencies often define a market for a cluster of customers located within a region if the conditions of competition are reasonably similar for these customers. (See Section 4.3.D.4 for further discussion of cluster markets.)

A firm's attempt to target customers in a particular area with worsened terms can sometimes be undermined if some customers in the region substitute by travelling outside it to purchase the product. Arbitrage by customers on a modest scale may be possible but sufficiently costly or limited that it would not deter or defeat a targeting strategy.[89]

If the HMT is used to evaluate market definition when customers may be targeted by location, it requires that a hypothetical profit-maximizing firm that was the only present or future seller of the relevant product(s) to customers in the region likely would undertake at least a SSNIPT on some, though not necessarily all, customers in that region. The products sold in that region form a relevant market if the hypothetical monopolist would undertake at least a SSNIPT despite the potential for customers to substitute away from the product or to locations outside the region. In this exercise, the terms of sale for products sold to all customers outside the region are held constant.[90]

4.3.D.3. Supplier Responses

Market definition focuses solely on demand substitution factors, that is, on customers' ability and willingness to substitute away from one product or location to another in response to a price increase or other worsening of terms. Supplier responses may be considered in the analysis of competition between firms (Guideline 2 and Section 4.2), entry and repositioning (Section 3.2), and in calculating market shares and concentration (Section 4.4).

4.3.D.4. Cluster Markets

A relevant antitrust market is generally a group of products that are substitutes for each other. However, when the competitive conditions for multiple relevant markets are reasonably similar, it may be appropriate to aggregate the products in these markets into a "cluster market" for analytic convenience, even though not all products in the cluster are substitutes for each other. For example, competing hospitals may each provide a wide range of acute health care services. Acute care for one health issue is not a substitute for acute care for a different health issue. Nevertheless, the Agencies may

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[88] For customers operating in multiple locations, only those customer locations within the targeted region are included in the market.

[89] Arbitrage by suppliers is a type of supplier response and is thus not considered in market definition. (See Section 4.3.D.3)

[90] In some circumstances, as when the merging parties operate in multiple geographies, the Agencies may apply a "Hypothetical Cartel" framework for market definition, as described in Section 4.3.A, n.81.

aggregate them into a cluster market for acute care services if the conditions of competition are reasonably similar across the services in the cluster.

The Agencies need not separately analyze market definition for each product included in the cluster market, and market shares will typically be calculated for the cluster market as a whole.

Analogously, the Agencies sometimes define a market as a cluster of targeted customers (see Section 4.3.D.1) or a cluster of customers located in a region (see Section 4.3.D.2.b).

4.3.D.5. Bundled Product Markets

Firms may sell a combination of products as a bundle or a "package deal," rather than offering products "*a la carte*," that is, separately as standalone products. Different bundles offered by the same or different firms might package together different combinations of component products and therefore be differentiated according to the composition of the bundle. If the components of a bundled product are also available separately, the bundle may be offered at a price that represents a discount relative to the sum of the *a la carte* product prices.

The Agencies take a flexible approach based on the specific circumstances to determine whether a candidate market that includes one or more bundled products, standalone products, or both is a relevant antitrust market. In some cases, a relevant market may consist of only bundled products. A market composed of only bundled products might be a relevant antitrust market even if there is significant competition from the unbundled products. In other cases, a relevant market may include both bundled products and some unbundled component products.

Even in cases where firms commonly sell combinations of products or services as a bundle or a "package deal," relevant antitrust markets do not necessarily include product bundles. In some cases, a relevant market may be analyzed as a cluster market, as discussed in Section 4.3.D.4.

4.3.D.6. One-Stop Shop Markets

In some settings, the Agencies may consider a candidate market that includes one or more "one-stop shops," where customers can select a combination of products to purchase from a single seller, either in a single purchase instance or in a sequence of purchases. Products are commonly sold at a one-stop shop when customers value the convenience, which might arise because of transaction costs or search costs, savings of time, transportation costs, or familiarity with the store or web site.

A multi-product retailer such as a grocery store or online retailer is an example of a one-stop shop. Customers can select a particular basket of groceries from a range of available goods and different customers may select different baskets. Some customers may make multiple stops at specialty shops (e.g., butcher, baker, greengrocer), or they may do the bulk of their shopping at a one-stop shop (the grocery store) but also shop at specialty shops for particular product categories.

There are several ways in which markets may be defined in one-stop shop settings, depending on market realities, and the Agencies may further define more than one relevant antitrust market for a particular merger. For example, a relevant market may consist of only one-stop shops, even if there is significant competition from specialty shops; or it may include both one-stop shops and specialty shops. When a product category is sold by both one-stop shops and specialty suppliers (such as a type of produce sold in grocery stores and produce stands), the Agencies may define relevant antitrust markets for the product category sold by a particular type of supplier, or it may include multiple types of suppliers.

4.3.D.7. Market Definition When There is Harm to Innovation

When considering harm to competition in innovation, market definition may follow the same approaches that are used to analyze other dimensions of competition. In the case where a merger may substantially lessen competition by decreasing incentives to innovate, the Agencies may define relevant antitrust markets around the products that would result from that innovation if successful, even if those products do not yet exist.[91] In some cases, the Agencies may analyze different relevant markets when considering innovation than when considering other dimensions of competition.

4.3.D.8. Market Definition for Input Markets and Labor Markets

The same market definition tools and principles discussed above can be used for input markets and labor markets, where labor is a particular type of input. In input markets, firms compete with each other to attract suppliers, including workers. Therefore, input suppliers are analogous to customers in the discussions above about market definition. In defining relevant markets, the Agencies focus on the alternatives available to input suppliers. An antitrust input market consists of a group of products and a geographic area defined by the location of the buyers or input suppliers. Just as buyers of a product may consider products to be differentiated according to the brand or the identity of the seller, suppliers of a product or service may consider different buyers to be differentiated. For example, if the suppliers are contractors, they may have distinct preferences about who they provide services to, due to different working conditions, location, reliability of buyers in terms of paying invoices on time, or the propensity of the buyer to make unexpected changes to specifications.

The HMT considers whether a hypothetical monopsonist likely would undertake a SSNIPT, such as a reduction in price paid for inputs, or imposing less favorable terms on suppliers. (See Section 4.2.C for more discussion about competition in settings where terms are set through auctions and negotiations, as is common for input markets.)

When defining a market for labor the Agencies will consider the job opportunities available to workers who supply a relevant type of labor service, where worker choice among jobs or between geographic areas is the analog of consumer choices among products and regions when defining a product market. The Agencies may consider workers' willingness to switch in response to changes to wages or other aspects of working conditions, such as changes to benefits or other non-wage compensation, or adoption of less flexible scheduling. Depending on the occupation, alternative job opportunities might include the same occupation with alternative employers, or alternative occupations. Geographic market definition may involve considering workers' willingness or ability to commute, including the availability of public transportation. The product and geographic market definition may involve assessing whether workers may be targeted for less favorable wages or other terms of employment according to factors such as education, experience, certifications, or work locations. The Agencies may define cluster markets for different jobs when firms employ workers in a variety of jobs characterized by similar competitive conditions (see Section 4.3.D.4).

4.4. Calculating Market Shares and Concentration

This subsection further describes how the Agencies calculate market shares and concentration metrics.

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[91] *See Illumina*, slip op. at 12 (affirming a relevant market defined around "what . . . developers reasonably sought to achieve, not what they currently had to offer").

As discussed above, the Agencies may use evidence about market shares and market concentration as part of their analysis. These structural measures can provide insight into the market power of firms as well as into the extent to which they compete. Although any market that is properly identified using the methods in Section 4.3 is valid, the extent to which structural measures calculated in that market are probative in any given context depends on a number of considerations. The following market considerations affect the extent to which structural measures are probative in any given context.[92]

First, structural measures may be probative if the market used to estimate them includes the products that are the focus of the competitive concern that the structural inquiry intends to address. For example, the concentration measures discussed in Guideline 1 will be most probative about whether the merger eliminates substantial competition between the merging parties when calculated on a market that includes at least one competing product from each merging firm.

Second, the market used to estimate shares should be broad enough that it contains sufficient additional products so that a loss of competition among all the suppliers of the products in the market would lead to significantly worse terms for at least some customers of at least one product. Markets identified using the various tools in Section 4.3 can satisfy this condition—for example, all markets that satisfy the HMT do so.

Third, the competitive significance of the parties may be understated by their share when calculated on a market that is broader than needed to satisfy the considerations above, particularly when the market includes products that are more distant substitutes, either in the product or geographic dimension, for those produced by the parties.

4.4.A. Market Participants

All firms that currently supply products (or consume products, when buyers merge) in a relevant market are considered participants in that market. Vertically integrated firms are also included to the extent that their inclusion accurately reflects their competitive significance. Firms not currently supplying products in the relevant market, but that have committed to entering the market in the near future, are also considered market participants.

Firms that are not currently active in a relevant market, but that very likely would rapidly enter with direct competitive impact in the event of a small but significant change in competitive conditions, without incurring significant sunk costs, are also considered market participants. These firms are termed "rapid entrants." Sunk costs are entry or exit costs that cannot be recovered outside a relevant market. Entry that would take place more slowly in response to a change in competitive conditions, or that requires firms to incur significant sunk costs, is considered in Section 3.2.

Firms that are active in the relevant product market but not in the relevant geographic market may be rapid entrants. Other things equal, such firms are most likely to be rapid entrants if they are already active in geographies that are close to the geographic market. Factors such as transportation

[92] For simplicity, the discussion in the text focuses on the case where concerns arise that involve competition among the suppliers of products; analogous considerations may also arise for suppliers of services, or when concerns arise about competition among buyers of a product or service, or when analyzing market shares in certain specific settings (see Section 4.3.D).

costs are important; or for services or digital goods, other factors may be important, such as language or regulation.

In markets for relatively homogeneous goods where a supplier's ability to compete depends predominantly on its costs and its capacity, and not on other factors such as experience or reputation in the relevant market, a supplier with efficient idle capacity, or readily available "swing" capacity currently used in adjacent markets that can easily and profitably be shifted to serve the relevant market, may be a rapid entrant. However, idle capacity may be inefficient, and capacity used in adjacent markets may not be available, so a firm's possession of idle or swing capacity alone does not make that firm a rapid entrant.

4.4.B. Market Shares

The Agencies normally calculate product market shares for all firms that currently supply products (or consume products, when buyers merge) in a relevant market, subject to the availability of data. The Agencies measure each firm's market share using metrics that are informative about the market realities of competition in the particular market and firms' future competitive significance. When interpreting shares based on historical data, the Agencies may consider whether significant recent or reasonably foreseeable changes to market conditions suggest that a firm's shares overstate or understate its future competitive significance.

How market shares are calculated may further depend on the characteristics of a particular market, and on the availability of data. Moreover, multiple metrics may be informative in any particular case. For example:

- Revenues in a relevant market often provide a readily available basis on which to compute shares and are often a good measure of attractiveness to customers.
- Unit sales may provide a useful measure of competitive significance in cases where one unit of a low-priced product can serve as a close substitute for one unit of a higher-priced product. For example, a new, much less expensive product may have great competitive significance if it substantially erodes the revenues earned by older, higher-priced products, even if it earns relatively low revenues.
- Revenues earned from recently acquired customers (or paid to recently acquired buyers, in the case of merging buyers) may provide a useful measure of competitive significance of firms in cases where trading partners sign long-term contracts, face switching costs, or tend to re-evaluate their relationships only occasionally.
- Measures based on capacities or reserves may be used to calculate market shares in markets for homogeneous products where a firm's competitive significance may derive principally from its ability and incentive to rapidly expand production in a relevant market in response to a price increase or output reduction by others in that market (or to rapidly expand its purchasing in the case of merging buyers).
- Non-price indicators, such as number of users or frequency of use, may be useful indicators in markets where price forms a relatively small or no part of the exchange of value.

IN THE SUPREME COURT OF THE STATE OF DELAWARE

CITY OF DEARBORN POLICE AND FIRE REVISED RETIREMENT SYSTEM (CHAPTER 23), MARTIN ROSSON, and NOAH WRIGHT, on behalf of themselves and all other similarly situated former stockholders of TERRAFORM POWER, INC.,	§	No. 241, 2023
	§	Court Below: Court of Chancery of the State of Delaware
Plaintiffs Below, Appellants,	§	
	§	C.A. No. 2022-0097
v.	§	
BROOKFIELD ASSET MANAGEMENT INC., BROOKFIELD INFRASTRUCTURE FUND III GP LLC, ORION US GP LLC, ORION US HOLDINGS I LP, HARRY GOLDGUT, BRIAN LAWSON, RICHARD LEGAULT, SACHIN SHAH, JOHN STINEBAUGH, BROOKFIELD RENEWABLE PARTNERS, L.P., and BROOKFIELD RENEWABLE CORPORATION,	§	
Defendants Below, Appellees.	§	

Submitted: January 17, 2024
Decided: March 25, 2024

Before **SEITZ**, Chief Justice; **VALIHURA**, **TRAYNOR**, **LEGROW**, and **GRIFFITHS**, Justices, constituting the Court *en Banc*.

Upon appeal from the Court of Chancery. **REVERSED**.

Ned Weinberger, Esquire, Mark Richardson, Esquire, Brendan W. Sullivan, Esquire (*argued*) Labaton Sucharow LLP, Wilmington, Delaware. Peter B. Andrews, Esquire, Craig J. Springer, Esquire, David M. Sborz, Esquire, Jackson E. Warren, Esquire, Andrews & Springer LLC, Wilmington, Delaware. *Of Counsel:* John Vielandi, Esquire, Labtaton Sucharow LLP, New York, New York. Jeremy Friedman, Esquire, David Tejtel, Esquire, Friedman Oster & Tejtel PLLC, Bedford Hills, New York, Douglas E. Julie, Esquire, W. Scott Holleman, Esquire, Garam Choe, Esquire, Julie & Holleman LLP, New York, New

York. Brian J. Robbins, Esquire, Stephen J. Oddo, Esquire, Robbins LLP, San Diego, California *for Appellants*.

Kevin G. Abrams, Esquire, Eric A. Veres, Esquire, Abrams & Bayliss LLP, Wilmington, Delaware. *Of Counsel:* John A. Neuwirth, Esquire (*argued*), Stefania D. Venezia, Esquire, Amanda K. Pooler, Esquire, Elizabeth M. Sytsma, Esquire, Tanner S. Stanley, Esquire, Weil, Gotshal & Manges LLP, New York, New York *for Appellees*.

VALIHURA, Justice:

INTRODUCTION

This is an appeal of the Court of Chancery's bench ruling granting Defendants Below-Appellees' motion to dismiss in full. Plaintiffs Below-Appellants filed suit in the Court of Chancery challenging a squeeze-out merger (the "Merger"). They asserted several breach of fiduciary duty claims. Defendants argued that the claims must be dismissed because the Merger satisfied the elements of *Khan v. M & F Worldwide Corp.* ("*MFW*")[1] — entitling the board's actions to business judgment review. The Court of Chancery, in a telephonic ruling, granted Defendants' motion to dismiss.[2]

On appeal, Appellants raise two claims of error. First, they assert that the trial court erred in finding that they failed to adequately allege coercion under *MFW*. Second, they assert that the trial court erred in finding that *MFW* was satisfied because they failed to adequately plead that the proxy statement was materially deficient.

We affirm the trial court's dismissal of the coercion claim. As to the second claim, we conclude that the minority stockholders were not adequately informed of certain alleged conflicts of interest between the special committee's advisors and the counterparty to the Merger. The Court of Chancery recognized that this was a close call, and we agree. But, upon a review of the record, we hold that the Court of Chancery erred as to certain of the disclosure issues concerning the special committee's financial and legal advisors' conflicts

[1] 88 A.3d 635 (Del. 2014), *overruled on other grounds by Flood v. Synutra Int'l, Inc.*, 195 A.3d 754 (Del. 2018).

[2] *See* Court of Chancery's telephonic bench ruling on June 9, 2023 [hereinafter "Bench Ruling"]. Opening Br., Ex. A.

of interest.

Accordingly, we REVERSE the Court of Chancery's judgment.

I. RELEVANT FACTUAL AND PROCEDURAL BACKGROUND[3]

A. The Parties[4]

Plaintiffs Below-Appellants are City of Dearborn Police and Fire Revised Retirement System (Chapter 23) ("Dearborn"), Martin Rosson, and Noah Wright (collectively, "Appellants"). Prior to the Merger, they were stockholders of TerraForm Power, Inc. ("TerraForm"). TerraForm was a Delaware corporation with its principal place of business in New York City. TerraForm acquired, owned, and operated solar and wind energy facilities in North America and Western Europe. TerraForm completed its IPO on July 23, 2014.

Defendants Below-Appellees are affiliates, officers, and other executives of Brookfield Asset Management Inc. ("BAM"), an alternative asset manager (collectively, "Brookfield").[5] Defendant BEP is an exempted limited partnership formed under the laws

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[3] The facts, except as otherwise noted, are taken from the Verified Amended Stockholder Class Action Complaint filed on June 21, 2022 [hereinafter "complaint" or "Compl."] and the Bench Ruling. In this procedural posture, they are presumed to be true.

[4] When addressing the lower court proceedings, we refer to Appellants as "Plaintiffs" and Appellees as "Defendants."

[5] BAM is a Canadian corporation with its principal executive offices in Toronto. BAM conducts its business primarily through direct and indirect subsidiaries, many of which are Delaware entities. A37 (Compl. ¶¶ 16, 17). In their complaint, Plaintiffs defined the Brookfield defendants to include: Brookfield Infrastructure Fund III GP LLC ("BIF"), Orion US GP LLC ("Orion GP"); Orion US Holdings I LP ("Orion LP"), Brookfield Renewable Partners, L.P. ("BEP"), and Brookfield Renewable Corporation ("BEPC"). A30 (Compl., Introduction). Also named as defendants were: Harry Goldgut, Brian Lawson, Richard Legault, Sachin Shah, and John Stinebaugh.

of Bermuda and is an affiliate of Brookfield. BAM and BEP controlled TerraForm. Defendant BEPC is a corporation incorporated under the laws of British Columbia and is an affiliate of Brookfield. Defendant John Stinebaugh served as Managing Partner in Brookfield's Infrastructure Group and served, at all relevant times, as TerraForm's Chief Executive Officer under a 2017 governance agreement between TerraForm and Brookfield. Defendants Brian Lawson, Harry Goldgut, Richard Legault, and Sachin Shah were each, at all relevant times, senior executives of Brookfield and served on the TerraForm board (the "Director Defendants").

B. Background of the Private Placement

On March 6, 2017, Brookfield entered into an agreement to acquire 51% of TerraForm's outstanding Class A common stock pursuant to a merger and sponsorship transaction agreement.[6] The transaction was completed on October 16, 2017, after which Brookfield became TerraForm's controller.[7] Soon thereafter, TerraForm and Brookfield entered into several ancillary agreements that granted Brookfield the right to control significant aspects of TerraForm's governance. Specifically, Brookfield acquired the exclusive power to appoint TerraForm's Chief Executive Officer, Chief Financial Officer, and General Counsel.[8] And as long as Brookfield qualified as TerraForm's controlling

[6] A42 (Compl. ¶¶ 34, 35).

[7] The trial court noted that TerraForm's subsequent SEC filing disclosed that it was a "controlled company[,]" and that Brookfield's interests may diverge from those of the public stockholders. Bench Ruling 5–6.

[8] These three executive officers are not employees of TerraForm and their services are provided under a management services agreement with BAM and certain of its affiliates. A307 (Veres Aff., Ex. 1) (Proxy at 139).

stockholder under applicable exchange listing rules, Brookfield would have the right to designate four of TerraForm's seven board members. Brookfield designated Lawson, Goldgut, Legault, and Shah as TerraForm board members, and they served at the time of the Merger.

Under TerraForm's charter, the three remaining board members were required to be "independent" as defined under SEC and NASDAQ rules and regulations. The three independent board members at the time of the Merger were: Mark McFarland, Carolyn Burke, and Christian Fong. These independent directors formed the conflicts committee ("Conflicts Committee"), which reviewed and approved material transactions that potentially posed a conflict of interest between Brookfield and TerraForm.

In January 2018, Brookfield presented TerraForm with the opportunity to acquire Saeta Yield, S.A. (or "Saeta") for $1.2 billion (the "Saeta Acquisition"). Saeta was a publicly-traded Spanish yield company that owned and operated wind and solar energy assets. Saeta was an attractive target for TerraForm because TerraForm's management predicted that the acquisition would cause an increase in average dividends per share of 6.5% over the first five years — creating more than $100 million in incremental value for its stockholders.[9] At first, TerraForm's management believed that the company could fund the Saeta Acquisition with its existing liquidity.[10] However, as negotiations progressed, Brookfield's and TerraForm's management presented a proposal to the Conflicts

[9] A53 (Compl. ¶ 54); Bench Ruling at 7.

[10] Plaintiffs alleged that TerraForm had the debt capacity to fund most — if not all — of the $1.2 billion purchase price for Saeta. A82 (Compl. ¶ 111).

Committee that envisioned raising between $600 and $700 million through an equity issuance in the public markets. On February 6, 2018, the Conflicts Committee approved a financing plan that included $800 million of TerraForm's available funds and $400 million in public equity issuances including a backstop agreement for Brookfield to purchase all of the unpurchased equity in the offering for $10.66 per share (the "Backstop").[11] TerraForm's stockholders approved the equity issuance at TerraForm's annual meeting on May 23, 2018.[12]

Soon after the stockholder vote, the TerraForm board held a meeting and discussed increasing the equity issuance and the Backstop from $400 million to $650 million. In a subsequent Conflicts Committee meeting, Brookfield stated that it preferred that the entire $650 million equity offering be a backstopped private placement with Brookfield itself (the "Private Placement"). The Conflicts Committee, in turn, approved the Private Placement on June 4, issuing $650 million in equity in a private placement to Brookfield at a per-share price of $10.66. This transaction increased Brookfield's ownership of TerraForm's outstanding common stock from 51% to 65.3%. With this Private Placement funding, TerraForm executed the tender offer for Saeta's shares and then acquired it through a short form merger on July 2, 2018.[13]

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[11] TerraForm publicly announced the Saeta Acquisition on February 7, 2018, and filed a Form 8-K containing details of the financing proposal the following day. A69 (Compl. ¶ 75).

[12] Bench Ruling at 8. On May 3, 2018, TerraForm commenced a tender offer to acquire Saeta.

[13] A81 (Compl. ¶ 108). TerraForm's stock price increased in the aftermath of the Saeta Acquisition and by June 25, 2018, TerraForm's stock was trading at $11.77 per share, 10.4% above the $10.66 per share Private Placement price, representing an unrealized profit of $68 million to Brookfield. A81 (Compl. ¶ 109).

In response to the Private Placement, TerraForm stockholder, Martin Rosson, filed a derivative and class action complaint in the Court of Chancery on September 19, 2019, challenging the Private Placement as unfair to TerraForm's minority stockholders. Soon thereafter, on January 27, 2020, another stockholder, Dearborn, filed its own class action and derivative complaint in the Court of Chancery similarly challenging the Private Placement. The complaint asserted claims against certain Brookfield affiliates arising out of Brookfield's purchase of $650 million in shares of TerraForm stock to finance TerraForm's acquisition of Saeta.[14] The trial court consolidated the actions on February 13, 2020, and designated the complaint filed by Dearborn as the operative complaint in the consolidated action (the "Private Placement Action").[15]

C. Background of the Merger

Early in 2020, Brookfield's subsidiary, BEP, made an all-stock proposal on January 11 to acquire the remaining outstanding shares of TerraForm other than the 62% already owned by Brookfield.[16] BEP's offer contemplated an exchange ratio of 0.36x for each share of TerraForm stock. BEP's proposal stated that it had no interest in selling any of its

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[14] The case was captioned *In re TerraForm Power, Inc. S'holders Litig.*, Consol. C.A. No. 2019-0757.

[15] A88 (Compl. ¶ 126).

[16] A88 (Comp. ¶ 127). In October 2019, TerraForm conducted a $250 million public offering for 14,907,573 shares of common stock at a price of $16.77 per share. Concurrently, Brookfield entered into a second private placement purchasing 2,981,514 shares of TerraForm common stock for $16.77 per share. A363 (Veres Aff., Ex. 1) (Proxy at 199). As a result, Brookfield's equity percentage decreased from 65.3% to 61.5%. The Proxy states that the January 11, 2020 offer represented a premium of 11% over the unaffected closing price of the TerraForm common stock on January 10, 2020, based on the unaffected closing price of BEP units as of such date. A315 (Veres Aff., Ex. 1) (Proxy at 151).

shares or participating in any alternative merger involving a third party. Additionally, because this was a squeeze-out merger, BEP conditioned its proposal on the approval of an independent special committee and a majority of the minority stockholders in an effort to comply with the *MFW* requirements.

1. The Special Committee is Formed

TerraForm's board convened to discuss the proposal the same day. After the board meeting, the Conflicts Committee met to discuss forming a special committee. The Conflicts Committee contemplated that the special committee would have the same members as the Conflicts Committee with McFarland serving as Chair.[17] The Conflicts Committee also discussed financial advisors and decided to request presentations from Greentech Capital Advisors Securities LLC ("Greentech") and Morgan Stanley & Co. LLC ("Morgan Stanley"). The board executed a unanimous written consent on January 12, 2020, to form a special committee consisting of Burke, Fong, and McFarland (Chair) (the "Special Committee").

The TerraForm board granted the Special Committee the exclusive power and authority to: (i) review and evaluate the terms and conditions of the offer, and determine its advisability and any alternative thereto; (ii) negotiate with BEP or any other party as the Special Committee deemed appropriate with respect to the offer or any alternative thereto; (iii) determine whether the offer or any alternative thereto negotiated by the Special Committee was fair to, and in the best interests of TerraForm and all of its stockholders

[17] A92 (Compl. ¶ 138).

other than BEP and its affiliates; (iv) reject the offer and any other alternative transaction and recommend to the TerraForm board what action, if any, should be taken; and (v) take any and all other actions it deemed necessary and advisable in light of any offer or alternative thereto. The board also delegated to the Special Committee the authority to retain its own legal and financial advisors. The Special Committee retained Richards, Layton & Finger, P.A. ("RLF") as its legal advisor.

2. The Special Committee's Retention of Advisors

Consistent with this authority, the Special Committee met on January 12, 2020 to discuss the offer and retain a financial advisor. It interviewed Greentech, who had previously served as a financial advisor to the Conflicts Committee. In its January 12 presentation, Greentech told the Special Committee that "(a) it was not the optimal time to realize maximum value for TerraForm[,] (b) third parties might be willing to value [TerraForm]'s minority stake higher than Brookfield, and (c) a robust market check is a must to ensure maximum value for TerraForm's public shareholders, and to execute the Special Committee[']s fiduciary duty[.]"[18] Greentech also highlighted that Brookfield's offer came at a time when the relative exchange ratio between BEP and TerraForm share prices was at a twelve-month low from TerraForm's perspective.

TerraForm signed an engagement letter that same day with Greentech.[19] The

[18] A93 (Compl. ¶ 141) (internal quotation marks omitted).

[19] We note that the Proxy states that the Special Committee decided to retain Greentech on January 13, not January 12 as alleged in the complaint. A316 (Veres Aff., Ex. 1) (Proxy at 152). This difference is not material to our analysis. Greentech's $6 million fee "was contingent, with Greentech being paid for providing a fairness opinion recommending a transaction and upon closing of such a transaction." A98 (Compl. ¶ 145).

Special Committee convened the next day to hear a presentation from Morgan Stanley. In its January 13, 2020 presentation, Morgan Stanley noted that Brookfield would realize significantly increased management services fees by consolidating TerraForm into BEP. Morgan Stanley deemed Brookfield's expected increase in management fees from any transaction to be "a Key Consideration for the Special Committee" that would warrant a higher premium.[20] Morgan Stanley also stated that a market check might be impracticable because Brookfield's majority ownership might have a negative effect on a third party's willingness to introduce an outside bid. The Special Committee signed an engagement letter with Morgan Stanley on January 17 for Morgan Stanley to serve as a financial advisor to the transaction.[21]

Both Brookfield and TerraForm had previously engaged Morgan Stanley in prior, unrelated matters. Morgan Stanley had received $65 to $90 million in fees from Brookfield in the prior two years and had received $5 to $15 million in fees from TerraForm in the same period. Additionally, Morgan Stanley and its affiliates held a collective stake of $470 million in Brookfield-related entities, and Morgan Stanley was concurrently serving as a lender and participant in certain financings for Brookfield affiliates. Morgan Stanley's

[20] A99 (Compl. ¶ 147). Morgan Stanley explained that Brookfield's management fee would increase because BEP's management fee structure was based on market capitalization and would allow Brookfield to realize significantly increased management service fees simply by consolidating TerraForm into BEP. A98–A99 (Compl. ¶ 147).

[21] Morgan Stanley's "entire $13 million fee was contingent, with Morgan Stanley being paid for providing a fairness opinion recommending a transaction and upon closing of such a transaction." A101 (Compl. ¶ 152).

engagement letter did not disclose those conflicts.[22] At least as alleged, the Special Committee never asked for a conflicts disclosure from Morgan Stanley, nor did it attempt to mitigate Morgan Stanley's conflicts through limitations on its representation or supervision of its negotiations or interactions with Brookfield.

Third, shortly after retaining its financial advisors, the Special Committee retained Kirkland & Ellis LLP ("Kirkland") as its legal counsel for the Merger. Kirkland had previously advised Brookfield affiliates on prior unrelated transactions and was also concurrently advising Brookfield on a separate equity investment. None of this information was disclosed to the Special Committee. In fact, despite this prior relationship and concurrent representation of Brookfield, Kirkland told the Special Committee "that it did not have any conflicts of interest that would affect its ability to serve as legal counsel to the [Special] Committee[.]"[23] The Special Committee never requested a conflict disclosure from Kirkland, nor did it discuss the appropriateness of Kirkland serving as the Special Committee's legal advisor given Kirkland's prior relationship and concurrent representation of Brookfield.

3. Negotiations with Brookfield Proceed

The Special Committee met with both Greentech and Morgan Stanley on January 29, 2020, to discuss the diligence necessary to evaluate a potential transaction with

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[22] A1142 (Weinberger Aff., Ex. 1) (Morgan Stanley Engagement Letter) ("Morgan Stanley has confirmed that there are no (i) current, active and material engagements of Morgan Stanley, or (ii) material engagements of Morgan Stanley that have been active during the two-year period prior to the date of this letter agreement, directly by: [Brookfield], to provide financial advisory or financing services to such entities for which fees paid to Morgan Stanley exceeded $100,000.").

[23] A103 (Compl. ¶ 155) (internal quotation marks omitted).

Brookfield. Greentech and Morgan Stanley discussed a Barclays research report that predicted the positive effect on BEP from an acquisition of TerraForm at Brookfield's proposed 0.36x exchange ratio. Greentech and Morgan Stanley attributed at least part of the accretion to a thirty-five-basis-point improvement from refinancing TerraForm debt under BEP's investment grade balance sheet and removing TerraForm's existing management service fees.[24]

At a meeting on February 4, 2020, the Special Committee advised Greentech and Morgan Stanley that they should not consider transactions with alternative third parties because Brookfield had stated in its initial offer that it would not consider alternative transactions.

The Special Committee met again on February 6, 7, 11, and 18 to discuss Greentech's and Morgan Stanley's other diligence findings. The Special Committee decided against soliciting alternatives due to the very low probability that a third party would have an interest in, and ability to, present a proposal that offered more value to TerraForm's stockholders in view of Brookfield's position.

On January 29, 2020, Dearborn submitted a letter to the board demanding that the Special Committee ensure that the derivative claims of the Private Placement Action be given adequate weight in negotiations. Dearborn's January 29 letter claimed that potential damages from the Private Placement Action could exceed $400 million based on TerraForm's then-trading stock price. Dearborn also requested an in-person meeting with

[24] A104 (Compl. ¶157); Bench Ruling at 12–13.

the Special Committee to discuss the value of these claims and to ensure that they were factored into the purchase price.

When the Special Committee did not respond to this initial outreach, Rosson and Dearborn sent a letter on February 13. The letter expressed concerns that the Special Committee did not intend to obtain fair value for the claims in negotiating a potential merger. Rosson and Dearborn claimed that the total damages could now exceed $576 million because of increases to TerraForm's stock price. As with the earlier letter, Rosson and Dearborn requested an in-person conference with the Special Committee. The Special Committee's counsel forwarded both letters to the Special Committee.

The Special Committee requested that its counsel consider the effect of the Private Placement Action on negotiations and discussed counsel's analysis at its meeting on February 19. The Special Committee concluded that the claims had, at most, a *de minimis* value and were not sufficiently material to factor into the negotiation of economic terms of the proposed transaction. The Special Committee declined to meet with Dearborn and Rosson.

The Special Committee met again on February 26, 2020 to receive presentations from Greentech and Morgan Stanley regarding their respective financial analyses of the 0.36x exchange ratio offered by Brookfield. Both advisors discussed the implications of rejecting the offer. Greentech stated that TerraForm depended on Brookfield for growth, but it noted that BEP's five-year forecasts for TerraForm excluded future growth at the TerraForm level. Greentech's analysis showed that TerraForm's implied exchange ratio would be reduced from an overall valuation range of 0.33x–0.44x to 0.24x–0.34x when excluding growth. It advised the Special Committee that one of the "Key Valuation Issues" was that TerraForm was "nearly fully reliant on Brookfield for growth[,]" and that without Brookfield's continued support absent a deal, TerraForm's value would plummet.[25] Greentech reported that TerraForm management's and BEP's five-year forecasts for TerraForm did not align because "BEP's model excludes future growth at the [TerraForm] level[.]"[26] Greentech summed up the issues by pointing out that agreeing to a deal with Brookfield would alleviate the concerns about the ability and willingness of BEP to grow TerraForm as a standalone entity.

Morgan Stanley also highlighted that TerraForm was dependent on Brookfield for future growth and that rejecting Brookfield's offer could sour the relationship, which Plaintiffs translated into a potential for "Brookfield to retaliate by denying [TerraForm] growth opportunities[.]"[27] Plaintiffs alleged that "Brookfield's refusal to commit to supporting [TerraForm]'s future growth plans in the absence of a merger had the effect of coercing the Special Committee into agreeing to a deal."[28]

Morgan Stanley's presentation also relayed that Brookfield was incentivized to purchase TerraForm to reduce its interest expense and increase its management fees from TerraForm by refinancing its debt after the Merger.[29] Morgan Stanley calculated the net

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[25] A110 (Compl. ¶ 170) (internal quotation marks omitted).

[26] A111 (Compl. ¶ 171) (internal quotation marks and citation omitted).

[27] A112 (Compl. ¶ 172); Bench Ruling at 15.

[28] A113 (Compl. ¶ 173).

[29] According to Plaintiffs, Morgan Stanley determined that Brookfield could receive significant interest expense savings (worth $1.77 per share to Brookfield) and incremental management fee increases (worth $1.19 per share to Brookfield) from TerraForm refinancing its debt pursuant to

present value to Brookfield from this debt refinancing at over $1 billion.

Finally, according to the Plaintiffs, the presentations by both Morgan Stanley and Greentech demonstrated that Brookfield's offer was opportunistic, as it occurred when the implied exchange ratio "was nearly the lowest it had been in two years, significantly favoring Brookfield."[30]

After these presentations, the Special Committee decided to maintain its course and not solicit any third-party interest in a transaction given Brookfield's stated unwillingness to support an alternative transaction, but agreed to re-raise the issue if negotiations with Brookfield faltered. The Special Committee proposed a counteroffer to Brookfield of a 0.42x exchange ratio and a list of noneconomic terms. Brookfield agreed to most of the noneconomic terms, including that TerraForm's minority stockholders would have the option to receive stock in either a limited partnership entity or a corporation under the Brookfield umbrella.

The parties then went back and forth on the exchange ratio. On March 6, 2020, Brookfield countered with a ratio of 0.365x, which Morgan Stanley and Greentech estimated would be dilutive to TerraForm's stockholders' dividends per share. The Special Committee met with its advisors to discuss the offer and determined that an exchange ratio of over 0.37x would be economically advantageous to minority stockholders.

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or after the Merger, which Morgan Stanley calculated had a net present value to *pro forma* Brookfield of over $1 billion. A137 (Compl. ¶ 216).

[30] A115 (Compl. ¶ 175).

On March 10, 2020, the Special Committee responded with a 0.40x exchange ratio.[31] On March 11, Brookfield countered with a 0.37x exchange ratio. The same day, the Special Committee countered with a 0.39x exchange ratio and determined that it would not accept any counter from Brookfield of less than a 0.38x exchange ratio. Brookfield refused the 0.39x offer and responded with a counteroffer of 0.375x.

On March 12, the Special Committee and Brookfield engaged further with the Special Committee pressing its 0.39x offer and Brookfield indicating that it was unwilling to agree to a ratio of 0.39x and was unwilling to go higher than 0.38x. The Special Committee then proposed an exchange ratio of 0.381x, which Brookfield accepted.[32] The Special Committee asked its financial advisors to present their analyses on March 16, 2020.

The Special Committee met with Greentech and Morgan Stanley on March 16, 2020. Both advisors delivered their opinions that the transaction was financially fair to TerraForm's minority stockholders. Using BEP's closing price on March 13, the 0.381x exchange ratio yielded an implied purchase price for TerraForm's stock of $16.34 per share.[33] Based on BEP's March 15, 2020 closing share price, the implied consideration was $14.36 per share (which was below the values calculated by Morgan Stanley and

[31] It appears that the trial court mistakenly stated that the Special Committee's March 10, 2020 counteroffer was a 0.41x exchange ratio instead of 0.40x. Bench Ruling at 17; A119 (Compl. ¶ 180).

[32] A322 (Veres Aff., Ex. 1) (Proxy at 158). According to the Proxy, the 0.381x exchange ratio represented "(i) a premium of 17% to the unaffected closing price of $15.60 per share of [TerraForm] common stock on January 10, 2020, based on the closing price of $38.07 per BEP unit as of such date and (ii) a premium of 20% to the closing price of $12.01 per share of [TerraForm] common stock on March 16, 2020 . . . ."

[33] A123 (Compl. ¶ 189).

Greentech).[34] Greentech and Morgan Stanley presented a host of valuations for TerraForm's stock under different conditions and assumptions. The mid-point of Greentech's valuation pegged TerraForm's per-share value at $15.375 per share. The mid-point in Morgan Stanley's valuations priced TerraForm at $18 per share.[35] Based on the number of TerraForm shares outstanding as of the signing of the Merger Agreement, the Merger valued TerraForm at approximately $3.3 billion.

After noting that BEP's five-year forecasts for TerraForm did not include any growth at the TerraForm level and that "[TerraForm] is fully dependent on Brookfield for future growth," Greentech explained that excluding growth from TerraForm's projections would significantly reduce its implied valuation range for TerraForm.[36] Greentech presented financial analyses for TerraForm under both scenarios depending on whether Brookfield would support TerraForm's future growth. Morgan Stanley also reiterated that Brookfield had substantial influence over TerraForm and could significantly impact TerraForm's ability to execute its business plan.

After receiving these presentations, the Special Committee recommended that the board approve Brookfield's offer at an exchange ratio of 0.381x. On March 16, 2020,

[34] Plaintiffs alleged that the implied $14.36 per share value of the Merger consideration was significantly below Greentech's sum-of-the-parts going-concern valuation of TerraForm of $19.60 to $21.53 based on management's growth plan. A138–A139 (Compl. ¶ 217). They alleged that it was also below Morgan Stanley's DCF valuation for TerraForm based upon TerraForm's net asset value, five-year business plan, and dividend discount model. A139 (Compl. ¶ 218). Finally, they alleged that the implied $14.36 per share value was below Wall Street analysts' price targets for TerraForm. A140 (Compl. ¶ 219).

[35] Bench Ruling at 17–18; A121 (Compl. ¶ 186).

[36] A120 (Compl. ¶ 185).

TerraForm's directors convened to consider the offer.[37] All directors present voted to approve the Merger, and the board instructed authorized officers to prepare and file a proxy statement concerning the proposed Merger.

D. The Proxy Disclosure

TerraForm filed its proxy statement soliciting a stockholder vote on the proposed Merger on June 29, 2020 (the "Proxy").[38] As noted by the trial court, the Proxy was "light on details" concerning the Special Committee's advisors' diligence throughout the process and did not include specifics about any third-party interests. The Proxy did disclose that both TerraForm and Brookfield had previously engaged Morgan Stanley and the fees earned from those engagements for the past two years. The Proxy disclosed that "the [TerraForm] acquisition will likely provide a number of significant benefits to the Brookfield Renewable group[.]"[39] Specifically, the acquisition would simplify the

[37] A324 (Veres Aff., Ex. 1) (Proxy at 160); A125–A126 (Compl. ¶¶ 192, 193). The Bench Ruling states that the Board approved the Merger on March 12. Bench Ruling at 18. This appears to be an error. *See also* A752–A759 (Veres Aff., Ex. 25) (Minutes of a Meeting of the Special Committee dated March 16, 2020); A765–A767 (Veres Aff., Ex. 26) (Minutes of a Meeting of the Board of Directors of TerraForm Power, Inc. dated March 16, 2020).

[38] Because the Plaintiffs in the Private Placement Action ceased to be stockholders of TerraForm following the Merger, they could no longer maintain their derivative claims, and the court dismissed those claims. The defendants in the Private Placement Action filed a motion to dismiss the direct claims in the Private Placement Action which was argued on July 16, 2020. The Court of Chancery denied the motion on October 30, 2020. *See In re TerraForm Power, Inc. S'holders Litig.*, 2020 WL 6375859 (Del. Ch. 2020). On December 14, 2020, this Court accepted an interlocutory appeal and issued a decision on September 20, 2021 reversing. *See Brookfield Asset Mgmt., Inc. v. Rosson*, 261 A.3d 1251 (Del. 2021). We held that plaintiffs' remaining purportedly direct claims were actually derivative claims for which they lacked standing, and we overruled *Gentile v. Rossette*, 906 A.2d 91 (Del. 2006). Because the Merger had extinguished the derivative claims, the Private Placement Action ended.

[39] A330 (Veres Aff., Ex. 1) (Proxy at 166).

Brookfield Renewable Group's ownership structure, eliminate public company costs, expand Brookfield's portfolio in North America and Western Europe, and increase Brookfield's annual $20 million management fee by 1.25% of Brookfield's increased post-Merger value. Additionally, the Proxy disclosed that the Merger would be accretive to Brookfield's cash flows. The Proxy disclosed that the Merger's impact on dividends was uncertain — "there can be no assurance that Brookfield Renewable or BEPC will make comparable distributions or dividends in the future[.]"[40] It also disclosed the existence of the Private Placement Action but stated that the action had a *de minimis* value and, therefore, was not of much relevance.

E. The Court of Chancery Proceedings

Plaintiffs filed their original complaint in this action in the Court of Chancery on January 28, 2022. Defendants subsequently filed their motions to dismiss. The parties then submitted a dismissal of Burke, Fong, and McFarland, which the trial court granted on June 15, 2022. On June 21, Plaintiffs filed the operative amended complaint seeking damages for Defendants' alleged breach of fiduciary duties stemming from the Merger. The amended complaint asserted three counts. In Count I, Plaintiffs alleged that the Brookfield entities breached their fiduciary duties in their capacity as controller. In Count II, Plaintiffs alleged that the Director Defendants breached their fiduciary duties in approving the Merger and issuing a misleading Proxy. In Count III, Plaintiffs alleged that Stinebaugh, in his capacity as CEO, breached his fiduciary duties by participating in,

[40] A405 (Veres Aff., Ex. 1) (Proxy at 241); Bench Ruling at 44.

preparing, and disseminating the Proxy. Generally, Plaintiffs alleged that Defendants failed to satisfy the framework set forth by this Court in *MFW*. Consequently, in their view, the Merger must be analyzed under the exacting entire fairness standard as opposed to the business judgment standard of review.

Defendants, in turn, moved to dismiss the complaint on August 26, 2022, pursuant to Rules 12(b)(1) and 12(b)(6). They argued that Plaintiffs' claims were deficient because the transaction satisfied the elements of *MFW*, entitling the board's actions to the business judgment standard of review. The motion was fully briefed, and the trial court heard oral argument on February 14, 2023. Of the six *MFW* factors, Plaintiffs did not contest three: that Brookfield conditioned the transaction *ab initio* on approval of the Special Committee and a majority of the minority stockholders; that the Special Committee was independent; and that there was no coercion of the minority stockholders.

Instead, Plaintiffs focused their challenge on the third, fourth, and fifth factors arguing that, because the Special Committee was not fully empowered, it failed to meet its duty of care, and the stockholder vote was not informed. They argued that Brookfield had furnished the Special Committee with a set of projections that excluded any growth at TerraForm, and that these projections implicitly threatened that Brookfield would prevent TerraForm's growth if the Special Committee rejected the Merger. They alleged that the Special Committee ultimately acquiesced and recommended a Merger at a sub-optimal price.

The trial court granted Defendants' motion to dismiss in full following a telephonic bench ruling on June 9, 2023. In granting the motion to dismiss, the court determined that

Plaintiffs had failed to demonstrate that the dual prongs of the *MFW* framework were not met in the transaction — those two prongs being the approval of a wholly independent special committee and a majority of the minority stockholders. The court issued a letter supplementing the ruling on June 21, 2023, and issued an order dismissing the complaint on June 23, 2023.

The trial court held that Plaintiffs failed to adequately allege coercion under *MFW* because the allegedly coercive conduct was less extreme than that alleged in *In re Dell Techs. Inc. Class V S'holders Litig.*,[41] which we discuss in more detail later. Unlike in *Dell*, Plaintiffs did not allege that Brookfield signaled that it intended to "bypass" the formal process if the Special Committee chose not to approve the transaction. In short, the trial court concluded that Plaintiffs' theory of coercion depended upon attenuated and unreasonable inferences.

The trial court then addressed Plaintiffs' claims that the Special Committee failed to satisfy its duty of care by (i) failing to conduct a market check, (ii) selecting conflicted advisors, and (iii) assigning *de minimis* value to the derivative Private Placement Action claims.[42] It rejected all three claims.

[41] 2020 WL 3096748 (Del. Ch. 2020).

[42] On June 21, 2023, the Court of Chancery issued a supplemental letter ruling regarding the valuation of the Private Placement Action's derivative claims based on *In re Primedia, Inc. S'holders Litig.*, 67 A.3d 455 (Del. Ch. 2013), *adopted by Morris v. Spectra Energy Partners (DE) GP, LP*, 246 A.3d 121 (Del. 2021). Plaintiffs did not appeal this ruling which concluded that Plaintiffs lacked standing to challenge the fairness of the Merger. We do not address the issue further herein.

As to the market check theory, relying on *BridgeBio Pharma*,[43] the trial court ruled that a failure to conduct a market check can be a factor supporting a claim challenging a sale process, but in this case, it did not impugn the Special Committee's exercise of due care and did not constitute gross negligence.

The court next addressed Plaintiffs' claim that the Special Committee breached its duty of care by selecting Morgan Stanley and Kirkland — both of whom were conflicted. The court approached the issue by focusing on whether the conflicts were material. Starting with Morgan Stanley, the trial court stated that when a plaintiff challenges financial advisors' independence based on its holdings in the counterparty, whether the advisor's financial interest in the transaction is material can inform the analysis.[44] In this case, Plaintiffs challenged Morgan Stanley's $470 million stake in Brookfield entities and its concurrent representation of Brookfield in an unrelated financing matter. Although the trial court determined that the $470 million stake was not material, it expressed its discomfort with the facts:

> I'll be honest, I don't love the fact that Morgan Stanley has this level of financial ties to the controller. But plaintiffs have not pled facts sufficient for this to give rise to a duty of care violation by the special committee. Morgan Stanley was one of two financial advisors to the special committee. Its ownership stake was small relative to its overall holdings, constituting only .1 percent of its portfolio value. This court has found that an investment bank's holdings in a counterparty amounting to .16 percent of its overall portfolio was insufficient to create a material conflict. The plaintiffs have failed to provide a compelling rationale as to why this case should come out differently. Moreover, the fees Morgan Stanley had accrued from both

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[43] *Smart Local Unions and Councils Pension Fund v. BridgeBio Pharma, Inc.*, 2022 WL 17986515 (Del. Ch. 2022), *aff'd,* 303 A.3d 51, 2023 WL 5091086 (Del. 2023) (ORDER).

[44] Bench Ruling at 29–30.

> Brookfield and TerraForm were disclosed in the proxy, demonstrating that the special committee knew of these payments.[45]

The trial court similarly dispensed with Plaintiffs' claims against Kirkland as follows:

> Plaintiffs point to Kirkland's prior representation of Brookfield affiliates and its concurrent work for Brookfield on an unrelated equity transaction as a basic carbon copy. Again, I do not love these alleged conflicts. I wish Kirkland had not concurrently represented Brookfield in an unrelated equity transaction. But the allegations fail to cast doubt on the reasonableness and the good faith nature of the special committee's decision to hire Kirkland following its own diligence. Plaintiffs do not allege that Kirkland represented Brookfield or its affiliates as counterparties to the merger or on any related transaction.[46]

The court concluded its discussion of the Morgan Stanley and Kirkland conflicts/due care claims by concluding that Plaintiffs had not alleged any facts suggesting that "the special committee was grossly negligent in hiring Kirkland[]"[47] or that they were entitled "to an inference of gross negligence simply because the special committee, knowing of this issue, still retained Morgan Stanley."[48] The court then summed up its due care analysis as follows:

> Taken separately and in the aggregate, plaintiffs' allegations fail to impugn the special committee's exercise of [due] care. The special committee convened at least 19 times between February and March 2020 and engaged in feedback with advisors. It successfully bid up the deal price from the initial proposed .36 ratio to a .381 ratio with favorable noneconomic terms. Plaintiffs failed to plead a reasonably conceivable basis to find that the

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[45] *Id.* at 30.

[46] *Id.* at 31.

[47] *Id.*

[48] *Id*. at 30–31.

special committee acted with gross negligence.[49]

Next, the court addressed the disclosure claims. It determined that it had already addressed seven of the nine categories of claims. Because it viewed its decision on the due care claims as having mooted the seven, it addressed them summarily.

To start, the court rejected Plaintiffs' first two claims that the Proxy improperly omitted Greentech's view about the need for a market check and Greentech's view that it was not an optimal time for a transaction. For the market check issue, the court based its reasoning on its prior conclusion that the Special Committee had reasonably concluded that a market check was not needed. As for the timing issue, the court concluded that the statement was merely part of a pitch and that Greentech had ultimately recommended in favor of the transaction at the 0.381x exchange ratio.

Third, the court dispensed with Plaintiffs' theory that the Proxy failed to disclose Brookfield's coercion of the Special Committee by saying that it had "rejected the theories of coercion rendering this disclosure immaterial."[50] Fourth, it rejected Plaintiffs' disclosure claim regarding the value of the derivative Private Placement claims.

In a similar vein, the court rejected Plaintiffs' fifth and sixth claims that the Proxy failed to disclose material information regarding Morgan Stanley's and Kirkland's conflicts because the court had already found that Plaintiffs failed to plead "that Morgan Stanley or Kirkland were meaningfully conflicted as to the merger, rendering those

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[49] *Id.* at 33.

[50] *Id.* at 35.

omissions immaterial."[51] Seventh, the court rejected Plaintiffs' claim that the Proxy failed to disclose how the Special Committee managed Morgan Stanley's and Kirkland's conflicts. It summarily held that "similar to disclosures regarding the alleged conflict, the omission was immaterial."[52]

The court more closely examined the final two disclosure categories: (i) the benefits Brookfield stood to receive from the Merger (including both increased management fees and the interest expense savings if it opted to refinance TerraForm's debt); and (ii) the dilutive effect of the Merger on dividends. As to the management fees, the court was satisfied with the Proxy's statement that the acquisition would "likely provide a number of significant benefits to Brookfield," including simplifying BEP's ownership structure, eliminating public company costs, and generating increased cash flows.[53] In addition, the Proxy disclosed "the method for calculating Brookfield's management fees, an annual management fee of $20 million, plus 1.25 percent of the amount by which the market increased."[54] Accordingly, it held that "the management fees were fully described."[55] The question for the court was "whether the proxy adequately disclosed Morgan Stanley's presentation that Brookfield's five-year gain in management fees would be approximately $130 million."[56]

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[51] *Id.*

[52] *Id.* at 36.

[53] *Id.* at 37 (internal quotation marks omitted).

[54] *Id.*

[55] *Id.* at 38.

[56] *Id.*

Although it found the question to be a "close call," the trial court concluded that this was "the kind of level of detail that doesn't have to be disclosed."[57] It was persuaded that "[t]he disclosure states the exact same methodology that Morgan Stanley used to calculate its $130 million five-year projection."[58] Also, the Proxy disclosed BEP's management fees for the preceding year and "[s]tockholders had enough information to ascertain that Brookfield would receive an increased management fee following the merger."[59] Thus, the court held that the stockholders "were not entitled to further detail in this case."[60]

As to the debt refinancing issue, the trial court held that the alleged omission of the benefits of the debt refinancing fell into the category of hypothetical information. The court ruled that the Proxy disclosed what was certain at the time, namely, Brookfield's outstanding debt, the maturity dates, and the interest rates. A reasonable investor could conclude that refinancing would be advantageous to Brookfield. Beyond that, "[r]equiring a target to disclose their own calculations of hypothetical benefits to an acquirer, a decision over which the target itself has no control, would not necessarily assist stockholders in making an informed vote."[61]

Finally, as for the dilutive effect of the Merger on dividends, the court concluded that the Proxy disclosed the known, certain information by disclosing both TerraForm's

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[57] *Id.*

[58] *Id.* at 40.

[59] *Id.*

[60] *Id.*

[61] *Id.* at 43.

and Brookfield's forecasted standalone dividends per share. Morgan Stanley relied on these forecasts to calculate the expected dilution to TerraForm's stockholders following the Merger. The court found that "[a] stockholder could reach the same conclusion on their own."[62] To conclude, on the whole, the court rejected Plaintiffs' disclosure challenges.

Plaintiffs filed a Notice of Appeal on July 6, 2023.

F. Contentions on Appeal

Appellants raise several arguments on appeal. First, Appellants argue that judicial cleansing is unavailable under *MFW* because they adequately pleaded that the Special Committee had been coerced. The lynchpin of this assertion is that Brookfield threatened the Special Committee by signaling that it would block TerraForm's future growth if it did not agree to a deal with Brookfield.

Second, they contend that judicial cleansing is unavailable under *MFW* because they adequately pleaded that material facts were either not disclosed or were disclosed in a misleading fashion in the Proxy. In particular, they assert that the trial court erroneously rejected their arguments that the Proxy failed to disclose: (i) the Special Committee's advisors' conflicts of interest; (ii) the Special Committee's failure to apprise itself of its legal and financial advisors' conflicts by seeking routine conflict disclosures, and that Morgan Stanley and Kirkland concealed their conflicts from the Special Committee; (iii) the benefits that Brookfield stood to receive from the Merger in the form of increased management fees and the $1 billion in interest expense savings from refinancing its debt;

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[62] *Id.* at 44.

(iv) that the Merger would be dilutive to TerraForm's minority stockholders; and (v) Greentech's caution to the Special Committee that it was a suboptimal time to sell and that a market check was imperative.

II. STANDARD OF REVIEW

"We review *de novo* the dismissal by the Court of Chancery of a complaint under Rule 12(b)(6)."[63] "At the motion to dismiss stage, we must 'accept as true all of the plaintiff's well-pleaded facts,' and 'draw all reasonable inferences' in plaintiff's favor."[64] A motion to dismiss should be denied if the facts pled support a reasonable inference that the plaintiff can succeed on his claims.[65]

III. ANALYSIS

A. The Coercion Claim was Properly Dismissed

1. The MFW Framework and Relevant Aspects at Issue

In *In re Tesla Motors, Inc. S'holder Litig.*,[66] we reviewed the development of our law concerning certain procedural devices that could alter the burden of proof in a conflicted transaction. We observed that *MFW* held that "'the business judgment standard appl[ies] to controller freeze-out mergers where the controller's proposal is conditioned on both Special Committee approval and a favorable majority-of-the-minority vote[.]'"[67]

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[63] *Malpiede v. Townson*, 780 A.2d 1075, 1082 (Del. 2001) (internal citation omitted).

[64] *Olenik v. Lodzinski*, 208 A.3d 704, 714 (Del. 2019) (quoting *Allen v. Encore Energy Partners, L.P.*, 72 A.3d 93, 100 (Del. 2013)).

[65] *Id*.

[66] 298 A.3d 667 (Del. 2023).

[67] *Id.* at 707 (quoting *MFW*, 88 A.3d at 639).

MFW adopted the following standard:

> To summarize our holding, in controller buyouts, the business judgment standard of review will be applied *if and only if*: (i) the controller conditions the procession of the transaction on the approval of both a Special Committee and a majority of the minority stockholders; (ii) the Special Committee is independent; (iii) the Special Committee is empowered to freely select its own advisors and to say no definitively; (iv) the Special Committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority.[68]

Both procedural protections must be "established *prior to trial*[.]"[69] And when they are established, the transaction is then afforded the deferential business judgment standard of review. Under Delaware's business judgment rule, "'the board's decision will be upheld unless it cannot be attributed to any rational business purpose.'"[70]

2. The Court of Chancery Correctly Dismissed the Coercion Claim

Appellants' argument that the Special Committee was coerced "hinges on its contention that, in diligence, BEP's management provided TerraForm with a financial model that did not include growth for TerraForm."[71] Appellants' key piece of evidence is the single set of No Growth Projections. They argue that submission of this "no growth" model was an "implicit threat" from Brookfield that, "if the special committee

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[68] *Id.* at 707–08 (quoting *MFW*, 88 A.3d at 645 (emphasis in original)). In *Synutra*, we clarified that "[t]o avoid one of *Lynch*'s adverse consequences—using a majority-of-the-minority vote as a chit in economic negotiations with a Special Committee—*MFW* reviews transactions under the favorable business judgment rule if 'these *two protections are established up-front*.'" 195 A.3d at 762 (quoting *MFW*, 88 A.3d at 644) (emphasis added)).

[69] *MFW*, 88 A.3d at 646 (emphasis in original).

[70] *Telsa*, 298 A.3d at 708 (quoting *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 74 (Del. 2006) (internal quotation marks and citation omitted)).

[71] Bench Ruling at 24.

recommended against the transaction, Brookfield would let TerraForm wither on the vine."[72]

According to Appellants, the Special Committee and its advisors understood Brookfield's message and its capacity for retribution.[73] They point to the Special Committee's advisors' various warnings regarding TerraForm's reliance on Brookfield for its planned growth and TerraForm's limited ability to operate without Brookfield's continued support, including Morgan Stanley's warning that:

> While any subsequent decrease in [TerraForm]'s stock price resulting from Brookfield's actions would have a near-term impact on the value of Brookfield's stake in [TerraForm], it could also give Brookfield an opportunity to re-bid for the outstanding Class A shares at a lower price at a later point in time.[74]

Appellants also highlight the following note in Greentech's presentation: "Note: [TerraForm] management's 5-year forecast does not align with BEP management's 5-year forecast for [TerraForm] (BEP's model excludes future growth at the [TerraForm] level)."[75] They argue that Brookfield's "implicit threat" undermined the Special Committee's ability to bargain at arms-length and to definitively say "no."

Appellees argue that it would not make sense for Brookfield to "punish a company in which it owned 62% of the equity for an indefinite period of time simply to negotiate a

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[72] *Id.*

[73] As noted earlier, when addressing the appellate proceedings, we refer to the Plaintiffs-Below as "Appellants."

[74] A112–A113 (Compl. ¶ 172).

[75] A952 (Veres Aff., Ex. 38) (Greentech Presentation to the Special Committee dated February 26, 2020, at 12); A111 (Compl. ¶ 171).

better deal for the remaining 38%."[76]

The Court of Chancery held that deducing a threat from these facts "requires inferring that Brookfield through BEP was trying to send a message by submitting its five-year financials exclusive of TerraForm's growth, and that the special committee perceived this as a threat, and . . . felt deprived of a meaningful choice as a result."[77] It found Plaintiffs' implicit coercion claim to be a "stretch" and "inconsistent with the type of coercion allegations that [the Court of Chancery] has found to defeat this element of *MFW*."[78] We agree with the trial court's rejection of the "implicit coercion" claim.

First, the Note and five-year financials upon which Appellants' implicit coercion claim is based, as well as the statements by the financial advisors, reflected the reality that existed in this sponsor-backed, controlled company — namely, that Brookfield had substantial control and influence over TerraForm and TerraForm was fully reliant on Brookfield for growth. The Proxy disclosed Brookfield's substantial control over

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[76] Answering Br. at 24 (internal quotation marks omitted). *See also In re Morton's Rest. Grp., Inc. S'holders Litig.*, 74 A.3d 656, 662 (Del. Ch. 2013) ("Delaware law presumes that large shareholders have strong incentives to maximize the value of their shares in a change of control transaction.") (internal citation omitted)). Moreover, Brookfield's statement in its offer that it would not support transactions other than its preferred deal also does not suggest a type of coercion that would defeat *MFW's* application. *MFW*, 88 A.3d at 651 ("Moreover, under Delaware law, MacAndrews & Forbes had no duty to sell its block, which was large enough, again as a practical matter, to preclude any other buyer from succeeding unless MacAndrews & Forbes decided to become a seller."); *BridgeBio Pharma*, 2022 WL 17986515, at *11 ("[A] controlling stockholder is not required to accept a sale to a third party or to give up its control, and its stated refusal to do so does not preclude review under the *MFW* framework.").

[77] Bench Ruling at 26.

[78] *Id*. at 24.

TerraForm.[79] It also described the suite of agreements entered into by TerraForm and Brookfield and certain of its affiliates providing for various services, sponsorship, and governance arrangements.[80]

The Special Committee's advisors recognized that "[TerraForm] is fully dependent on Brookfield for future growth[.]"[81] The Special Committee was independent, disinterested, and actively engaged in arms-length bargaining resulting in increased consideration for the benefit of the minority stockholders. On appeal, Appellants have abandoned the duty of care claim they pressed against the Special Committee below.[82]

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[79] A247 (Veres Aff., Ex. 1) (Proxy's Introduction Letter) (referencing Brookfield's ownership of 62% of TerraForm's outstanding shares). The Proxy also highlighted other aspects of Brookfield's control over TerraForm:

> Brookfield also is able to control the appointment and removal of BEPC's directors and the directors of BEP's general partner and, accordingly, exercises substantial influence over BEPC and BEP. Simultaneously with the completion of the [TerraForm] acquisition, BEPC intends to enter into voting agreements with BEP and certain indirect subsidiaries of Brookfield to transfer the power to vote their respective shares held of TerraForm Power (or its successor entity) to BEPC. As a result, BEPC (and indirectly BEP) will control and consolidate [TerraForm] upon completion of the [TerraForm] acquisition.

A368 (Veres Aff., Ex. 1) (Proxy at 204).

[80] *See* A359–A361 (Veres Aff., Ex. 1) (Proxy at 195–97).

[81] A703 (Veres Aff., Ex. 24) (Greentech Presentation to the Special Committee dated March 16, 2020, at 18)); A691 (Veres Aff., Ex. 24) (*Id.* at 6) ("With no in-house project development efforts and no/limited M&A staff, [TerraForm] is nearly fully reliant on the Sponsors for growth[.]").

[82] In this case, Appellants confirmed during oral argument that they were not pursuing a due care claim against the Special Committee:

> **The Court**: Is your disclosure claim attempting to encompass at all the duty of care exercised by the Special Committee? Because much of your brief and the complaint complains about the Special Committee sort of taking at face value the Morgan Stanley statements that they had no material engagements with Brookfield and that they never asked for a conflicts disclosure form, same with Kirkland. So, is it strictly limited to disclosure or are you really trying to articulate a care claim?

According to the Proxy, the Special Committee met at least nineteen times during the transaction process. It caused Brookfield to raise its bid on four occasions, achieving an increase in the exchange ratio to 0.381x from 0.36x, along with securing non-economic concessions. It considered a number of factors regarding TerraForm's financial condition and standalone prospects, including TerraForm's potential near- and long-term performance on a standalone basis, its financial projections prepared by management, and the role of and reliance on Brookfield as TerraForm's sponsor.[83] It is not reasonably conceivable that there was an attempt to bypass the Special Committee, or that its ability to freely negotiate and bargain effectively was impeded by the submission of the "no-growth" financials. We agree with the Chancellor that the implicit coercion claim rests on attenuated and unreasonable inferences.

Second, as the Chancellor observed, *Dell* is distinguishable:

> Unlike in *Dell*, plaintiffs do not allege that Brookfield indicated publicly and privately that it intended to "bypass" the formal process if the special committee chose not to approve the transaction, nor that it had a "contingency plan" to do so. Plaintiffs' allegations fail to carry the day on *MFW*'s third prong.[84]

But Appellants are correct that the court in *Dell* recognized that even more subtle conduct may be coercive.[85] In *Dell*, a company had partially financed an acquisition by

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> **Counsel**: No, it's strictly limited to disclosure at this point. We did challenge those aspects below and we have not appealed them.

Oral Argument, at 16:12–58, https://vimeo.com/903752923.

[83] A326–A327 (Veres Aff., Ex. 1) (Proxy at 162–63).

[84] Bench Ruling at 26–27.

[85] *See In re Dell Techs. Inc. Class V S'holders Litig.*, C.A. No. 2018-0816, at 40 (Del. Ch. Mar. 13, 2020) (TRANSCRIPT) (observing that, "[t]he stereotypical mobster is more subtly caring by

issuing new shares of Class V stock. The company retained the option to force a conversion of the Class V shares to Class C stock. That was the least attractive option for the Class V holders.[86] When the company later sought to consolidate the holdings in that target, its board charged the special committee with negotiating a redemption of the Class V shares, conditioned upon the *MFW* requirements. The redemption would have been more favorable to the Class V stockholders, but looming in the back of the process, the company wielded its less advantageous forced conversion right.

The Court of Chancery in *Dell* found it to be reasonably conceivable that the special committee had been coerced in light of plaintiffs' allegations that there was "a steady drumbeat of actions by which the Company signaled its intent to exercise the Conversion Right in the absence of a negotiated redemption."[87] For example, during the negotiation period, the company had leaked to the press that it was considering taking action to exercise the conversion,[88] reiterated its right to do so, and disclosed in SEC filings that it has

saying, 'You better be careful on the way home. I'd hate for something to happen to you.' That's subtle, that's indirect, but fairly communicative."); *see also Dell*, 2020 WL 3096748, at *29 ("[A] controller's explicit or *implicit threats* can prevent a committee from fulfilling its function and having a concomitant effect on the standard of review.") (emphasis added) (citing *In re John Q. Hammons Hotels Inc. S'holder Litig.*, 2009 WL 3165613, at *12 n.38 (Del. Ch. 2009) (noting that a controller can undermine the effectiveness of a committee by engaging in "threats, coercion, or fraud"))).

[86] The Class V shares were subject to a conversion right whereby if the company listed its Class C shares on a national exchange, then it could forcibly convert the Class V shares into Class C shares pursuant to a pricing formula. *Dell*, 2020 WL 3096748, at *1.

[87] *Id.* at *31.

[88] The company leaked to *Bloomberg* that it was considering an initial public offering of the Class C stock. An initial public offering would have enabled the company to exercise the conversion right. After publication of that article, the trading price of the Class V stock plummeted. *Id.* at *6.

explored exercising the conversion right as a contingency plan if the redemption negotiations fell through. By reserving the right to bypass the special committee and engage in a forced conversion, it was reasonably conceivable that the company created a coercive environment that undermined the special committee's ability to bargain effectively and effectively disempowered the committee.[89]

The illustrations given in *Dell* also supported the inference that the stockholders had an incentive to vote in favor of the transaction for reasons other than its merits, rendering the stockholder vote ineffective for purposes of *MFW*.[90] By contrast, the allegations here do not logically support an inference of coercion.

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[89] In particular, the court in *Dell* determined that:

> By failing to include the exercise of the Conversion Right within the definition of a Potential Class V Transaction and the universe of actions that the Company would not take without satisfying the twin-*MFW* conditions, the Company failed to comply with the requirements of *MFW*. The Company did not empower the Special Committee and the Class V stockholders with the ability to say no.

Id. at *16. In other words, the scope of the special committee's mandate in *Dell* was insufficient to satisfy *MFW*. *Id*. at *17 ("By excluding the Forced Conversion from the scope of the Special Committee's authority, the Company deprived the Special Committee of the full power to say 'no' that is necessary for *MFW* to function."). That is not the case here. The Special Committee here was fully empowered and independent. As the Chancellor noted, "Plaintiffs do not dispute that the special committee was facially empowered to complete these tasks by the board's unanimous written consent." Bench Ruling at 24.

[90] *Dell*, 2020 WL 3096748, at *35. The court observed that "what mattered for purposes of coercing the Special Committee and the Class V stockholders was the Company's repeated references to the possibility of exercising the Conversion Right." *Id*. at *34.

B. The Disclosure Issues

1. The Special Committee's Advisors' Conflicts

a. Morgan Stanley's $470 Million Investment in Brookfield

We next address the Proxy's omission of Morgan Stanley's $470 million investment in Brookfield. Appellants maintain that the Proxy's failure to disclose Morgan Stanley's $470 million holdings in Brookfield was a material omission that rendered the minority stockholders' vote uninformed. They also highlighted Morgan Stanley's other financial engagements with Brookfield: Morgan Stanley received tens of millions of dollars in advisory fees from Brookfield prior to the Merger and Morgan Stanley concurrently advised Brookfield affiliates. The trial court, with some hesitation, held that Plaintiffs failed to plead sufficient facts to give rise to a duty of care violation by the Special Committee. Relying on the Court of Chancery's decision in *Micromet*,[91] the trial court resolved the due care claim by holding that Morgan Stanley's conflict was not material given the size of Morgan Stanley's stake in Brookfield compared with the size of Morgan Stanley's overall portfolio.[92] It then resolved the disclosure issue by referring back to its due care analysis.

The trial court's analysis is problematic. First, whether the Special Committee breached its duty of due care in the retention of the advisors does not adequately address the question of whether the conflict was sufficiently material to require disclosure in the

[91] *In re Micromet, Inc. S'holders Litig.*, 2012 WL 681785 (Del. Ch. 2012).

[92] Bench Ruling at 30.

Proxy. Second, that materiality determination must include an examination of the alleged omission from the perspective of the stockholder, not just a comparative analysis based upon the overall size of the advisor's portfolio of business.

The legal standard for determining whether a special committee breached its duty of care in hiring and managing its advisors is whether it is reasonably conceivable that the committee exhibited "gross negligence."[93] By contrast, whether a special committee's advisor's conflicts were material information requiring disclosure is a different inquiry. Our Court recently described the "materiality" standard in *Morrison v. Berry*:

> An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. Framed differently, an omitted fact is material if there is a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available. But, to be sure, this materiality test does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote.[94]

"'Materiality is to be assessed from the viewpoint of the 'reasonable' stockholder . . . .'"[95] Therefore, we first consider whether the Proxy's omission of Morgan Stanley's $470 million stake in Brookfield was material from the stockholders' perspective.

The Proxy disclosed the following information concerning Morgan Stanley's

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[93] *Synutra*, 195 A.3d at 768 ("[T]he Court of Chancery appropriately read *MFW* as requiring it to determine, under the high standard of gross negligence, whether the plaintiff had stated a due care claim.").

[94] 191 A.3d 268, 282–83 (Del. 2018) (internal quotation marks omitted) (quoting *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 944 (Del. 1985) (adopting the standard set forth in *TSC Indus. v. Northway, Inc.*, 426 U.S. 438, 449 (1976))).

[95] *Millenco L.P. v. meVC Draper Fisher Jurvetson Fund I, Inc.*, 824 A.2d 11, 18 (Del. Ch. 2002) (quoting *Arnold v. Soc'y for Sav. Bancorp, Inc.*, 650 A.2d 1270, 1277 (Del. 1994)).

relationship with Brookfield and its affiliates:

> In the two years prior to the date it rendered its opinion in connection with the [TerraForm] acquisition, in addition to the services described in this proxy statement/prospectus, Morgan Stanley and its affiliates provided financial advisory services to TerraForm Power and its affiliates, and received aggregate fees of approximately $5 to $15 million in connection with such services. In addition, in the two years prior to the date it rendered its opinion in connection with the [TerraForm] acquisition, Morgan Stanley and its affiliates provided financial advisory or financing services for BEP or its affiliates, including certain portfolio companies or affiliates of BAM (an affiliate of BEP), and received aggregate fees of approximately $65 to $90 million in connection with such services.[96]
>
> As of March 1, 2020, Morgan Stanley or one of its affiliates was a lender and a participant in certain financings for certain affiliates of BAM, which in each case is unrelated to the transactions contemplated by the transaction documents and for which Morgan Stanley would expect to receive additional customary fees if such transactions are completed.[97]
>
> In addition, Morgan Stanley, its affiliates, directors or officers, including individuals working with the Special Committee in connection with the [TerraForm] acquisition, *may* have committed and *may* commit in the future to invest in private equity funds managed by BAM or its affiliates.[98]

It is reasonably conceivable that from the viewpoint of a stockholder, Morgan Stanley's nearly half a billion-dollar holding in Brookfield was material and would have been material to a stockholder in assessing Morgan Stanley's objectivity. Delaware law places great importance on the need for transparency in the special committee's reliance on its advisors: "'it is imperative for the stockholders to be able to understand what factors

[96] A344 (Veres Aff., Ex. 1) (Proxy at 180).

[97] *Id.*

[98] A345 (Veres Aff., Ex. 1) (Proxy at 181) (emphasis added).

might influence the financial advisor's analytical efforts . . . .'"[99] Further, "[b]ecause of the central role played by investment banks in the evaluation, exploration, selection, and implementation of strategic alternatives, [the Court of Chancery] has required full disclosure of investment banker compensation and potential conflicts."[100]

It does not matter whether the financial advisor's opinion was ultimately influenced by the conflict of interest; the presence of an undisclosed conflict is still significant: "'[t]here is no rule . . . that conflicts of interest must be disclosed only where there is evidence that the financial advisor's opinion was actually affected by the conflict.'"[101] Although the size of the investment vis-à-vis the size of Morgan Stanley's overall portfolio may be considered in the analysis, the stockholder's perspective is paramount.

In any event, *Micromet* is distinguishable. *Micromet* involved plaintiff-shareholders of a target company seeking a preliminary injunction to enjoin an all-cash negotiated tender offer made by a large biopharmaceutical company — Amgen. The plaintiffs argued that the price of the offer was unfair and was the result of an unfair process and that the disclosure materials recommending the tender offer contained materially false

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[99] *RBC Cap. Mkts., LLC v. Jervis*, 129 A.3d 816, 860 (Del. 2015) (quoting *In re Rural Metro Corp.*, 88 A.3d 54, 105 (Del. Ch. 2014) (internal citation omitted)). *See also In re Lear Corp. S'holder Litig.*, 926 A.2d 94, 114 (Del. Ch. 2007) (requiring disclosure of a CEO's conflict of interest, when the CEO acted as a negotiator and observing that, "a reasonable stockholder would want to know an important economic motivation of the negotiator singularly employed by a board to obtain the best price for the stockholders, when that motivation could rationally lead that negotiator to favor a deal at a less than optimal price, because the procession of a deal was more important to him, given his overall economic interest, than only doing a deal at the right price.").

[100] *In re Del Monte Foods Co. S'holders Litig.*, 25 A.3d 813, 832 (Del. Ch. 2011) (internal citation omitted); *Kihm v. Mott*, 2021 WL 3883875, at *17 (Del. Ch. 2021), *aff'd*, 276 A.3d 462, 2022 WL 1054970 (Del. 2022) (ORDER).

[101] *In re John Q. Hammons Hotels Inc. S'holder Litig.*, 2009 WL 3165613, at *16.

and misleading information. One of the plaintiffs' alleged disclosure deficiencies concerned the board's failure to disclose the amount of fees paid by Micromet to its financial advisor in the transaction, Goldman Sachs, and Goldman Sachs' holdings of both Micromet's and Amgen's stock.[102] Goldman held approximately $336 million in Amgen stock, representing approximately 0.16% of its overall investment holdings.

In this case, Morgan Stanley's holdings in Brookfield amounted to 0.10% of its total investment portfolio — an amount less than Goldman's holdings in a counterparty in *Micromet*. But in *Micromet*, Goldman's holdings in Amgen were largely held "on behalf of its clients."[103] Here, Morgan Stanley's stake in Brookfield was invested for its own benefit.[104] And unlike Morgan Stanley here, it is not apparent that Goldman provided any concurrent advisory services to Amgen or its affiliates during the challenged transaction. In sum, the trial court needed to examine the materiality question not just by looking at the stake in comparison to Morgan Stanley's overall portfolio, but also by looking at its materiality to the TerraForm stockholders. We conclude that the $470 million investment, when viewed from the perspective of a reasonable stockholder, was material and should have been disclosed.

Further, the Proxy's use of the word "may" in addressing Morgan Stanley's holdings in Brookfield was misleading.[105] "Just as disclosures cannot omit material information,

[102] *Micromet*, 2012 WL 681785, at *11.

[103] *Id.*

[104] A100 (Compl. ¶ 150).

[105] This point was candidly addressed by Brookfield's counsel at oral argument:

disclosures cannot be materially misleading."[106] In *Morrison*, we explained the standard for evaluating whether partial disclosures are materially misleading:

> As we said in *Arnold v. Society for Savings Bancorp, Inc.*, "once defendants traveled down the road of partial disclosure of the history leading up to the Merger . . . they had an obligation to provide the stockholders with an accurate, full, and fair characterization of those historic events." And, in *Zirn v. VLI Corp.*, we explained that, "even a non-material fact can, in some instances, trigger an obligation to disclose additional, otherwise non-material facts in order to prevent the initial disclosure from materially misleading the stockholders."[107]

The use of "may" in the Proxy is misleading because Morgan Stanley had indeed already invested nearly half a billion dollars.[108] This misleading language also makes it less likely that a stockholder would have been prompted to locate Morgan Stanley's Brookfield holdings in its publicly filed form 13F.

> **The Court**: [Counsel], I have a couple questions on the half a billion-dollar stake issue. First of all, the Proxy said Morgan Stanley may have committed and may commit in the future to invest in private equity funds.
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> **Counsel**: Yeah.
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> **The Court**: So that's not exactly saying straight up that they had in fact invested $470 million dollars.
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> **Counsel**: It's not. And I think that's the same, but the answer is, it's not. It says may, it doesn't say has, but stockholders could gather that information from the 13F, which did have . . . .
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> . . . .
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> **The Court**: But that part of the schedule wasn't in our record.
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> **Counsel**: I believe the only thing that's in the record is the information showing the entire size of Morgan Stanley's portfolio.

Oral Argument, at 36:39–37:54, https://vimeo.com/903752923.

[106] *Morrison*, 191 A.3d at 283.

[107] *Id.* (alteration in original) (quoting *Arnold*, 650 A.2d at 1280, and then quoting *Zirn v. VLI Corp.*, 681 A.2d 1050, 1056 (Del. 1996)).

[108] A877 (Veres Aff., Ex. 35) (Morgan Stanley Form 13F) (Feb. 14, 2020).

b. Kirkland's Conflicts were Problematic

We turn next to the Proxy's non-disclosure of Kirkland's conflicts of interest. The trial court similarly held that Plaintiffs failed "to cast doubt on the reasonableness and the good faith nature of the special committee's decision to hire Kirkland following its own diligence."[109] It held that Plaintiffs "have not alleged any facts suggesting that the special committee was grossly negligent in hiring Kirkland."[110]

Again, the trial court resolved the disclosure issue by applying the "gross negligence" standard in determining whether the Special Committee breached its duty of care in hiring and managing Kirkland. It then summarily dismissed the disclosure claim. To resolve the issue of whether the Proxy was deficient for failing to disclose Kirkland's conflicts, we instead ask whether a reasonable stockholder would consider the information regarding Kirkland's conflicts important in deciding how to vote.[111] Again, because an advisor's concurrent engagement with a transaction counterparty can present legitimate concerns regarding the advisor's objectivity, we disagree with the Chancellor's determination that those representations were not material.[112]

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[109] Bench Ruling at 31.

[110] *Id.*

[111] *See Kahn v. Tremont Corp.*, 694 A.2d 422, 429 (Del. 1997) ("[P]rofessional advisors have the ability to influence directors who are anxious to make the right decision but who are often *in terra cognito*."). *See also Harcum v. Lovoi*, 2022 WL 29695, at *21 (Del. Ch. 2022) ("Although advisor conflicts should be disclosed, a plaintiff must provide sufficient facts to establish that the conflict or potential conflict was *material*.") (internal citation omitted) (emphasis added)).

[112] *See In re PLX Tech. Inc. S'holders Litig.*, 2018 WL 5018535, at *43 (Del. Ch. 2018) (finding that an advisor's "ongoing relationship with [a transaction counterparty] gave [the advisor] a powerful incentive to maintain good will and not push too hard during the negotiations.") (internal

Kirkland's conflicts at issue involved prior representations of Brookfield and its affiliates and a concurrent representation of a Brookfield affiliate on an unrelated transaction. Kirkland's prior representations of Brookfield and its affiliates included: (i) advising Brookfield Infrastructure Partners L.P. concerning its over $500 million term loan facility from December 2019 to January 2020;[113] (ii) representing Brookfield Super-Core Infrastructure Partners on the sale of its $2 billion Cove Point interest to Dominion Energy, Inc. in the fall of 2019, as well as a separate engagement with Brookfield in late 2019 to finance that transaction;[114] and (iii) counseling Brookfield Business Partners L.P. on its take-private of Teekay Offshore Partners L.P. during the Fall of 2019.[115] Kirkland concurrently advised BAM on its $260 million equity investment in Superior Plus Corp. when serving as the Special Committee's legal counsel.[116]

The Proxy failed to disclose Kirkland's prior and concurrent conflicts. Even though, standing alone, Kirkland's prior conflicts with Brookfield may not have been sufficient to state a claim,[117] we hold that it is reasonably conceivable that the details of Kirkland's

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quotation marks and citation omitted)), *aff'd*, 211 A.3d 137, 2019 WL 2144476 (Del. 2019) (ORDER).

[113] A102 (Compl. ¶ 154).

[114] A102–A103 (Compl. ¶ 154).

[115] A103 (Compl. ¶ 154).

[116] *Id.*

[117] *See, e.g., In re Inergy L.P.*, 2010 WL 4273197, at *14 (Del. Ch. 2010) (declining to enjoin a transaction and concluding that a financial advisor's "prior dealings" with a counterparty to the proposed transaction "[did] not show that [the transaction committee]'s decision to retain [that advisor] . . . was unreasonable[.]"); *In re Martha Stewart Living Omnimedia, Inc. S'holder Litig.*, 2017 WL 3568089, at *22 n.104 (Del. Ch. 2017) (an "advisor's prior dealings with a counterparty to a transaction, *standing alone*, will not be adequate to plead a conflict of interest.") (emphasis added)).

conflicts, and particularly, the concurrent conflict, were material facts for stockholders that required disclosure.[118] Kirkland's ongoing relationship with Brookfield raises the legitimate concern that Kirkland might not want to push Brookfield too hard given the nature of their ongoing lawyer-client relationship which includes the ethical duty of zealous advocacy.

The Court of Chancery, in *In re PLX Tech. Inc* ("*PLX*"),[119] drew a similar conclusion concerning a special committee's advisor's concurrent conflict. *PLX* involved an activist campaign that pressured PLX into a sale. A potential bidder soon emerged and expressed an interest in purchasing PLX. The potential bidder was represented by Deutsche Bank on an unrelated acquisition, the same financial advisor that concurrently represented PLX's special committee. In addressing Deutsche Bank's concurrent representation on an unrelated transaction, the court stated that "Deutsche Bank's ongoing relationship with [the bidder] gave it a powerful incentive 'to maintain good will and not push too hard' during the negotiations."[120]

Appellants are not contending that the existence of such conflicts is necessarily disabling. Rather, they contend that at the very least, Kirkland's material conflicts should

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[118] *See Tornetta v. Maffei*, C.A. No. 2019-0649, at 18 (Del. Ch. Feb. 23, 2021) (TRANSCRIPT) (describing a proxy's omission of an advisor's concurrent engagement with a counterparty on an unrelated transaction as a glaring deficiency).

[119] 2018 WL 5018535.

[120] *Id.* at *43 (quoting *In re Rural Metro Corp.*, 88 A.3d at 94); *see also Harcum*, 2022 WL 29695, at *21 (addressing plaintiff's allegation concerning a legal advisor's conflicts: "[a]lthough advisor conflicts should be disclosed, a plaintiff must provide sufficient facts to establish that the conflict or potential conflict was material.") (internal citation omitted)).

have been disclosed to stockholders. We agree that the stockholders were entitled to know about these conflicts so that they could consider them and decide for themselves how to weigh the advice in light of them.[121] Accordingly, we hold that it is reasonably conceivable that the details of Kirkland's conflicts were material and should have been disclosed.

2. The Special Committee's Failure to Apprise Itself of its Advisors' Conflicts

Next, Appellants argue that the Proxy failed to disclose material information concerning the Special Committee's handling of its advisors' conflicts. The trial court summarily held that "similar to disclosures regarding the alleged conflict, the omission [of how the Special Committee managed Morgan Stanley's and Kirkland's conflicts] was immaterial."[122] Appellants contend that the Proxy should have disclosed that the Special Committee merely accepted at face-value and without proper follow-up, the advisors' conclusory representations that they had no material conflicts.

We have already determined that it is reasonably conceivable that Kirkland's and Morgan Stanley's conflicts were material and should have been disclosed in the Proxy. Although a proxy disclosure must disclose material facts to stockholders, Delaware law does not require boards to engage in "self-flagellation" in their public disclosures.[123]

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[121] *See, e.g., David P. Simonetti Rollover IRA v. Margolis*, 2008 WL 5048692, at *14 (Del. Ch. 2008) ("[S]tockholders are entitled to know what material factors, if any, may be motivating the financial advisor."); *In re John Q. Hammons Hotels Inc. S'holder Litig.*, 2009 WL 3165613, at *17 ("[T]he compensation and potential conflicts of interest of the special committee's advisors are important facts that generally must be disclosed to stockholders before a vote.").

[122] Bench Ruling at 36.

[123] *In re Xura, Inc., S'holder Litig.*, 2018 WL 6498677, at *13 (Del. Ch. 2018) (citing *Stroud v. Grace*, 606 A.2d 75, 84 n.1 (Del. 1992)).

Appellants are correct that as alleged, the Special Committee's process in retaining advisors was flawed.[124] But, as noted above, Appellants have abandoned their due care claim on appeal. We think that it is sufficient that we have ruled that certain of the advisors' conflicts were material and should have been disclosed.

3. The Failure to Adequately Disclose the Benefits Brookfield Stood to Receive

Next, we address the Proxy's failure to disclose the "extraordinary benefits" that Brookfield would receive from the Merger. Appellants argue that the Proxy omitted material information concerning the extraordinary value that Brookfield stood to derive from the Merger: (i) $130 million from increased management fees; and (ii) more than $1 billion in interest expense savings from refinancing TerraForm's debt.[125] They contend that knowing the amount of the benefits would have allowed the stockholders to evaluate

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[124] We note that in denying the motion to dismiss in *PLX*, the Court of Chancery held that:

> In my view, the allegations of the complaint support a reasonable inference that the committee did not take sufficient steps at the outset to determine whether Deutsche Bank faced conflicts of interest before retaining the firm in August 2013. The complaint supports a reasonable inference instead that the committee hired Deutsche because of the tail provision without conducting adequate inquiry into Deutsche Bank's relationships, whether they could interfere with the sale process and what steps could be taken to address issues. I also think the allegations of the complaint support a reasonable inference that the committee did not take sufficient steps while overseeing the sale process to determine whether conflicts for Deutsche emerged.

In re PLX Tech. Inc. S'holders Litig., C.A. No. 9880, at 39 (Del. Ch. Sept. 3, 2015) (TRANSCRIPT). As we said in *RBC Capital Markets*, directors must exercise active and direct oversight of the transaction process. This oversight includes learning about actual and potential conflicts — not merely checking a box at the outset based upon conclusory representations which are not properly vetted. *RBC Cap. Mkts.*, 129 A.3d at 855 (directors "need to be active and reasonably informed when overseeing the sale process, including identifying and responding to actual or potential conflicts of interest.") (internal citation omitted)).

[125] Opening Br. at 32.

(as the Special Committee did) whether Brookfield paid a fair price and whether the Special Committee appropriately leveraged that anticipated value. We conclude that the Proxy's omission of the $130 million Brookfield would receive from the increase in management fees is problematic, but we agree with the trial court's dismissal of the debt refinancing claim.

a. The Brookfield Management Fee

With regard to the $130 million increase in management fees, the Proxy disclosed that the TerraForm Merger will "likely provide a number of significant benefits" to Brookfield.[126] The Proxy identified these benefits as follows:

> [T]he Brookfield Renewable group is expected to be one of the largest, integrated, pure-play renewable power companies in the world; the Brookfield Renewable group will continue to be sponsored by BAM; the [TerraForm] acquisition would simplify the Brookfield Renewable group's ownership structure and eliminate the public company costs associated with TerraForm Power being a publicly listed company; the [TerraForm] acquisition is expected [to] be accretive to the Brookfield Renewable group's cash flows; a significant portion of TerraForm Power's revenue is under long-term contracts, enhancing the Brookfield Renewable group's contract profile; the [TerraForm] acquisition will further expand the Brookfield Renewable group's portfolio in North America and Western Europe; and the public float of the BEPC exchangeable shares will increase, enhancing liquidity of such shares.[127]

The Proxy also included a complex formula to calculate Brookfield's management fees:

> [I]n exchange for the management services provided to the Brookfield Renewable group by the Service Providers, Brookfield Renewable pays an annual management fee to the Service Providers of $20 million (adjusted

[126] Bench Ruling at 37; *see also* A330–A331 (Veres Aff., Ex. 1) (Proxy at 166–67).

[127] A330–A331 (Veres Aff., Ex. 1) (Proxy at 166–67).

> annually for inflation at an inflation factor based on year-over-year United States consumer price index) plus 1.25% of the amount by which the market value of the Brookfield Renewable group exceeds an initial reference value. The base management fee is calculated and paid on a quarterly basis. For purposes of calculating the base management fee, the market value of the Brookfield Renewable group is equal to the aggregate value of all outstanding BEP units on a fully-diluted basis, preferred units and securities of the other Service Recipients (including BEPC exchangeable shares) that are not held by Brookfield Renewable, plus all outstanding third party debt with recourse to a Service Recipient, less all cash held by such entities. BRP Bermuda GP Limited L.P., a subsidiary of Brookfield, also receives incentive distributions based on the amount by which quarterly distributions on BRELP units (other than BRELP Class A Preferred Units), as well as economically equivalent securities of the other Service Recipients, including BEPC, exceed specified target levels as set forth in BRELP's limited partnership agreement.[128]

Appellants contend that merely disclosing the formula and not the amount of the projected fees was insufficient.[129] The trial court recognized that this was a "close call," but it ultimately determined that the formula in the Proxy was a sufficient disclosure and that the inclusion of the amount of the anticipated management fees would not have altered the "total mix" of information for stockholders.

We disagree and hold that it is reasonably conceivable that the Proxy's failure to disclose Brookfield's $130 million in projected management fees likely significantly altered the "total mix" of information. As noted by the trial court, a "reasonable stockholder could very well consider a valuable, nonratable [benefit][130] paid to the

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[128] A482 (Veres Aff., Ex. 1) (Proxy at 348).

[129] A150 (Compl. ¶ 237). *See also* A934 (Veres Aff., Ex. 37) (Morgan Stanley Presentation to the Special Committee dated February 26, 2020, at 51) (calculating the "Net Change in Fees to BAM" to be approximately $130 million over five years).

[130] A non-ratable benefit "exists when the controller receives a unique benefit by extracting something uniquely valuable to the controller, even if the controller nominally receives the same

controller when deciding how to vote."[131] In rejecting the claim, the Chancellor described the $130 million increase as more of a "business opportunity to Brookfield to reduce costs and increase value[,]"[132] as opposed to a non-ratable, unique benefit paid to the controller. Even crediting that characterization, we think that Morgan Stanley's description of these fees as a "Key Consideration for the Special Committee" that would warrant a higher premium distinguishes this information from the kind of "tell me more" request which the trial court viewed as more apt.[133]

We next address the question of whether the disclosure of the formula, in the absence of the disclosure of the amount, was a sufficient substitute. We disagree with the trial court that the fees were "fully described" and that the Proxy provided the "exact formula" that would be used to calculate the fee.

Appellants persuasively argue that the Proxy does not fairly set forth the formula needed to calculate Brookfield's total fees. To calculate Brookfield's management fees over a five-year period, a stockholder would need to know the multiple variables listed above that go into calculating the base management fee. Such an endeavor requires consideration of the increase in the market value of the Brookfield Renewable group, the initial reference value, the outstanding third-party debt with recourse to a Service

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consideration as all other stockholders." *In re Viacom Inc. S'holders Litig.*, 2020 WL 7711128, at *16 (Del. Ch. 2020) (internal quotation marks and citation omitted).

[131] Bench Ruling at 36 (internal quotation marks omitted).

[132] *Id.* at 36–37.

[133] *Id.* at 39; A98–A99 (Compl. ¶ 147). *See Dent v. Ramtron Int'l Corp.*, 2014 WL 2931180, at *13 (Del. Ch. 2014).

Recipient, the amount of cash held by such "entities," and the potential impact of payments to BRP Bermuda GP Limited L.P. It is not clear where in the Proxy, or elsewhere, a stockholder must look to find the inputs to calculate the base management fee.[134] Information disclosed in a proxy statement should be presented in a "clear and transparent manner[.]"[135]

Merely because some of the variables needed to complete the calculation are missing does not necessarily equate to a disclosure violation. Although stockholders are entitled to a "fair summary" of a financial advisor's work, disclosures must "'be sufficient for the stockholders to usefully comprehend, not recreate, the analysis.'"[136] But here we have already determined that the projected amount of fees — $130 million — was material. The vague language in the formula cannot reasonably be described as "clear and transparent" or as a sufficient substitute for disclosure of the projected amount of fees.

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[134] *See Voigt v. Metcalf*, 2020 WL 614999, at *24 (Del. Ch. 2020) (quoting *Vento v. Curry*, 2017 WL 1076725, at *3–*4 (Del. Ch. 2017) ("'A stockholder should not have to go on a scavenger hunt,' then 'piece together the answer from information buried' in a lengthy proxy statement.")).

[135] *Vento*, 2017 WL 1076725, at *4.

[136] *In re Saba Software, Inc. S'holder Litig.*, 2017 WL 1201108, at *10 (Del. Ch. 2017) (quoting *In re Merge Healthcare Inc.*, 2017 WL 395981, at *10 (Del. Ch. 2017)). *See also Sommer v. Sw. Energy Co.*, 2022 WL 2713426, at *2 (D. Del. 2022) (a proxy "need not list every variable[,]" rather, "it need only give investors a fair summary of the factors underlying its calculations.") (internal quotation marks and citations omitted)); *Dent*, 2014 WL 2931180, at *12 ("[S]tockholders are entitled only to a fair summary of a financial advisor's work, not the data to make an independent determination of fair value."). In addition, facts are not necessarily material merely because a stockholder may find them to be "helpful." *Skeen v. Jo-Ann Stores, Inc.*, 750 A.2d 1170, 1174 (Del. 2000) ("Appellants are advocating a new disclosure standard in cases where appraisal is an option. They suggest that stockholders should be given all the financial data they would need if they were making an independent determination of fair value. Appellants offer no authority for their position and we see no reason to depart from our traditional standards.").

Consequently, even though stockholders are assumed to be "skilled readers,"[137] the disclosure of the anticipated management fees was inadequate.

b. The Debt Financing Benefit

On the other hand, we are not persuaded by Appellants' argument that the Proxy was deficient because it failed to disclose the $1 billion that Brookfield stood to receive from refinancing TerraForm's debt. A proxy need not disclose information that is "hypothetical" and "inherently speculative."[138] Appellants' own complaint acknowledges the speculative nature of these benefits. For example, they allege that "Brookfield *could* receive significant interest expense savings and incremental management fees from [TerraForm] refinancing its debt[.]"[139] The $1 billion in interest expense savings depends on multiple external factors. Brookfield has no control over future interest rates and market trends, both of which could impact its plan to refinance TerraForm's debt. Delaware law requires that proxies only disclose "certain, known information[.]"[140] The certain, known information that was disclosed here was Brookfield's current outstanding debt, the

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[137] *See Appel v. Berkman*, 180 A.3d 1055, 1064 (Del. 2018) ("[T]he important point is that although stockholders are assumed to be skilled readers, proxy statements are not intended to be mysteries to be solved by their audience.").

[138] *IRA Tr. FBO Bobbie Ahmed v. Crane*, 2017 WL 7053964, at *17 (Del. Ch. 2017). *See also In re Fam. Dollar Stores, Inc. S'holder Litig.*, 2014 WL 7246436, at *21 (Del. Ch. 2014) ("Because the magnitude of potential synergies is dependent, at least in part, on the magnitude of divestitures, and because the required divestitures are not currently known, any statement in the Proxy about potential synergies would amount to speculation, which is not an appropriate subject for a proxy disclosure.") (internal quotation marks and citation omitted)); *Arnold*, 650 A.2d at 1280 ("Delaware law does not require disclosure of inherently unreliable or speculative information which would tend to confuse stockholders or inundate them with an overload of information.").

[139] A116 (Compl. ¶ 176) (emphasis added).

[140] *Crane*, 2017 WL 7053964, at *18.

respective maturity dates, and the respective interest rates.[141] This information sufficiently disclosed Brookfield's current debt status without speculating on future hypotheticals. Accordingly, the $1 billion in benefit that would inure to Brookfield from refinancing TerraForm's debt was inherently speculative and, consequently, was not a material fact requiring disclosure.

4. Whether the Proxy Failed to Disclose that the Merger Would Dilute the Dividends to TerraForm Stockholders

Next, we address Appellants' argument that the Proxy failed to adequately disclose the estimated 5% dilution of dividends to TerraForm stockholders through 2024.[142] They contend that this reduction of dividends was "critical information" for stockholders to know before they voted on the Merger because the main attractiveness for investors in a yield company, such as TerraForm, is the regular distribution of dividends.[143] Accordingly, a 5% dilution of those dividends would alter the total mix of information for stockholders and, therefore, it should have been adequately disclosed in the Proxy.[144] We agree with the trial court's determination that the dilution of the dividends was adequately disclosed in the Proxy.

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[141] Bench Ruling at 42.

[142] Opening Br. at 46.

[143] *Id.* at 46–47.

[144] *Id.*

First, the Proxy disclosed that the Merger's impact on dividends was uncertain: "there can be no assurance that Brookfield Renewable or BEPC will make comparable distributions or dividends in the future or at all."[145]

Second, TerraForm stockholders could have reasonably deduced the Merger's impact on future dividends as the trial court concluded.[146] Although Delaware law does not require a stockholder to engage in a "scavenger hunt" in which they must "piece together the answer from information buried in the disclosures[,]"[147] the information needed to determine the dilutive effect on dividends was not buried in the disclosures. Unlike the situation with Brookfield's management fees, to calculate the dilutive effect of the Merger on dividends, a "skilled reader" could first locate TerraForm's and Brookfield's forecasted standalone dividends per share in the Proxy. The Proxy includes TerraForm's "Five-Year Business Plan Model," and explains that the model "reflects, for the years 2020–2024, TerraForm Power's *existing* portfolio of assets[.]"[148] In the accompanying chart, the column titled "Dividends per share" forecasts future dividends for the five-year projection period.[149] On the *following* page, there is a sub-heading titled "Certain BEP

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[145] A405 (Veres Aff., Ex. 1) (Proxy at 241).

[146] Bench Ruling at 44 (a "stockholder could [have] reach[ed] the same conclusion on their own[]" when calculating the expected dilution to dividends following the Merger).

[147] *Salladay v. Lev*, 2020 WL 954032, at *16 (Del. Ch. 2020) (internal quotation marks and citations omitted).

[148] A374 (Veres Aff., Ex. 1) (Proxy at 210) (emphasis added) (we view the use of the term "existing" as reasonably meaning TerraForm's then-current assets prior to the Merger).

[149] *Id.*

Forecasts."[150] Two pages later, there is a chart that discloses BEP's five-year Management Forecasts that includes a column titled "[d]istributions per unit."[151] Relatively simple multiplication can show the Merger's dilutive effect on TerraForm's dividends.[152] The inputs needed for such a calculation were adequately disclosed in the Proxy within a few pages of each other — unlike the situation with the management fees. The exchange ratio of 0.381x was noted multiple times in the Proxy. The two relevant tables, TerraForm's Five-Year Business Plan Model and the BEP Management Forecasts, were within three pages of each other in the Proxy.[153] These facts differ from those in Appellants' cited precedent, *Vento*, in which stockholders had to sort through two voluminous documents that were filed ten weeks apart from one another.[154] For these reasons, we find no error with the trial court's dismissal of this claim.

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150 A375 (Veres Aff., Ex. 1) (Proxy at 211).

151 A377 (Veres Aff., Ex. 1) (Proxy at 213).

152 *See Kahn on Behalf of DeKalb Genetics Corp. v. Roberts*, 679 A.2d 460, 467 (Del. 1996) ("Simple multiplication would have revealed the allegedly omitted fact. Thus, no material information was withheld and no breach of duty occurred."). As Appellees suggest, one could do simple multiplication to calculate the dilutive effect of the Merger: "multiplying the distributions per unit under BEP's Management Forecasts by the exchange ratio, which is repeated throughout the Proxy, and comparing that figure to the dividends per share under [TerraForm]'s Five-Year Business Plan Model." Answering Br. at 44–45 (internal citation omitted).

153 *See* A374 (Veres Aff., Ex. 1) (Proxy at 210) (TerraForm's Five-Year Business Model); A377 (Veres Aff., Ex. 1) (Proxy at 213) (BEP Management Forecasts).

154 *Vento*, 2017 WL 1076725, at *3 ("[A] stockholder can only make a guess about this information by attempting (with great difficulty) to piece together the answer from information buried in a 248-page Amended Registration Statement and an equally lengthy Form 8–K filed more than ten weeks before the Amended Registration Statement.").

5. *Whether the Proxy Failed to Disclose Greentech's Advice to the Special Committee Regarding Timing and Process*

Last, we consider whether the trial court erred with respect to the Proxy's failure to disclose Greentech's advice to the Special Committee regarding the timing and process of the Merger. Appellants contend that the Proxy failed to disclose Greentech's statements to the Special Committee that it was not the "optimal time" to realize the ideal value for TerraForm and that a "robust market check" was necessary.[155] We agree with the trial court's conclusion that this omitted information was not material because Greentech's comments concerning the "optimal" timing and necessity for a "robust market check" are from a January 12, 2020 "pitch" by Greentech to the Special Committee given before negotiations began.[156] Delaware law does not require a "play-by-play description of every consideration or action taken by a Board[,]" because doing so would "make proxy statements so voluminous that they would be practically useless."[157] Here, Greentech's January 12, 2020 presentation to the Special Committee occurred over two months before the Merger's closing and before the substantive negotiations with Brookfield began.

Turning to the presentation's comments on performing a "robust market check," the trial court correctly held that the Special Committee "later reasonably concluded that a

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[155] Opening Br. at 48. Appellants support this claim by adding that Greentech was "uniquely positioned" to provide advice to TerraForm because it consistently advised it for years prior to the Merger and, therefore, "had a thorough understanding of [TerraForm] and its assets." *Id.* at 50 (internal quotation marks and citation omitted).

[156] A832 (Veres Aff., Ex. 34) (Greentech Proposal to Advise the Special Committee dated January 12, 2020). We note that the presentation's second slide incorrectly states the date as "January 12, 2019" instead of January 12, 2020.

[157] *Crane*, 2017 WL 7053964, at *13 (internal quotation marks and citations omitted).

market check was not necessary, making this disclosure immaterial."[158] The Proxy explicitly disclosed that the Special Committee decided "not to solicit alternative proposals or transactions[.]"[159] This was consistent with Morgan Stanley's advice. It should not be assumed that every suggestion made in an initial pitchbook is worthy of pursuit. We agree with the Chancellor that the absence of a market check here does not impugn the Special Committee's exercise of due care. Greentech ultimately determined that the 0.381x exchange ratio was fair, from a financial point of view, to the holders of TerraForm's outstanding shares, other than shares held by Brookfield stockholders. We are satisfied with the trial court's resolution of the disclosure issues regarding Greentech's advice.

IV. CONCLUSION

Because the Proxy was deficient in its failure to disclose certain of the Special Committee's advisors' conflicts of interest and certain management fees Brookfield anticipated from the Merger, and for the reasons set forth above, we REVERSE the Court of Chancery's grant of Defendants' motion to dismiss.

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[158] Bench Ruling at 34.

[159] A321 (Veres Aff., Ex. 1) (Proxy at 157).

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN RE DELL TECHNOLOGIES INC. CLASS V STOCKHOLDERS LITIGATION	))	Consol. C.A. No. 2018-0816-JTL

OPINION ON FEE AWARD AND INCENTIVE AWARD

Date Submitted: April 19, 2023
Date Decided: July 31, 2023
Date Revised: August 21, 2023

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LASTER, V.C.

The plaintiff settled this class action on the eve of trial in exchange for the defendants' agreement to pay $1 billion in cash. The "b" is not a typo. It is the largest cash recovery ever obtained by a representative plaintiff in this court.

Plaintiff's counsel seek an all-in award of attorneys' fees and expenses equal to 28.5% of the common fund. They ask for permission to pay an incentive award of $50,000 to the plaintiff. The defendants agreed not to oppose those requests.

A 28.5% award falls within the guideline range of percentages for a late-stage settlement under the framework that the Delaware Supreme Court endorsed in *Americas Mining Corp. v. Theriault*, 51 A.3d 1213 (Del. 2012). The *Americas Mining* decision instructs that when a plaintiff has obtained a quantifiable result, the court should derive an indicative fee award as a percentage of the result. To determine the percentage, the court considers the stage of the case when the result was obtained. A court awards a higher percentage when plaintiff's counsel has pushed deeper into the case, which rewards plaintiff's counsel for taking more risk in pursuit of the best outcome. The stage-of-case approach helps counteract the natural human tendency toward risk aversion and gives plaintiff's counsel an incentive to eschew an early, lower-valued settlement.

Providing that incentive is important. Delaware's experience during the M&A litigation epidemic demonstrated that entrepreneurial counsel can profit by filing weak cases on an industrial scale, putting in minimal work, and settling by offering defendants a global release in return for no-cost or low-cost relief plus an agreement not to oppose an attorneys' fee award. That business model worked for everyone directly involved: Entrepreneurial counsel got paid, defense counsel got paid, and the defendants got a release. It only harmed absent class members (who got bupkus), the courts (who had to process the non-litigation litigation), and society as a whole (because real claims were not litigated, and transactional standards deteriorated when the cases always settled anyway). By awarding fees in those cases, the court may well have contributed to the harm that they caused.

The stage-of-case method helped fix that. Viewed in context, *Americas Mining* was an early salvo in Delaware's multi-pronged response to the M&A litigation epidemic, which included changes to the substantive law in *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014) (subsequent history omitted), *C&J Energy Services, Inc. v. City of Miami General Employees*, 107 A.3d 1049 (Del. 2014), and *Corwin v. KKR Financial Holdings, LLC*, 125 A.3d 304 (Del. 2014), plus a tightening of the standards for disclosure-only settlements in *In re Trulia, Inc. Stockholder Litigation*, 129 A.3d 884 (Del. Ch. 2016). The Chancellor recently took another salutary step along the same path in *Anderson v. Magellan Health, Inc.*, --- A.3d ---, 2023 WL 4364524 (Del. Ch. July 6, 2023).

Delaware's response recognizes that our entity law depends on private litigation for enforcement. Entrepreneurial plaintiff's counsel therefore perform a valuable service by pursuing litigation in a world where stockholders are rationally apathetic. Plaintiff's counsel deserves to be well compensated for identifying real cases, investing real money in those cases, and obtaining real results. But the law should not reward plaintiff's counsel for filing weak cases and obtaining insubstantial results.

In this case, plaintiff's counsel brought a real case, invested over $4 million of real money, and obtained a real and unprecedented result. Rather than requesting an unprecedented fee award, plaintiff's counsel asked for 28.5% of the common fund, consistent with *Americas Mining*.

But 28.5% of $1 billion is $285 million. That is a big fee, and it would match the largest fee that this court has ever awarded: the $285 million fee award that the Delaware Supreme Court affirmed in *Americas Mining*.

A group of eight investment funds thinks that $285 million is too much. They argue that the court should reduce the percentage of the benefit awarded as the size of the common fund increases. The declining-percentage method seeks to mitigate a perceived problem of windfall profits. It assumes that it takes a relatively constant amount of work to litigate a case, so awarding the same percentage for a larger benefit risks overcompensation. Scholars have shown that the federal courts use a declining-percentage method in securities law cases and that for settlements of $1 billion or more, the prevailing trend is to award a fee of approximately 10-12%.

The funds have a strong economic motivation for seeking a lower fee award. They collectively own shares comprising 26.1% of the class. Although they did not propose an alternative amount, if the court were to follow the federal trend and award a 10% fee, the objectors would receive another $49 million.

After the court asked whether there was any academic learning on the declining-percentage method, five law professors appeared as *amici curiae*. They make the same arguments as the objectors, but they propose a 15% fee. If the court were to adopt that figure, the objectors would receive another $35.78 million.

The declining percentage method runs counter to *Americas Mining* and the incentive structure that the Delaware Supreme Court created. In practice, the declining-percentage method represents a covert return to the lodestar method, but one that works in the opposite direction. Under the lodestar method, the court starts from a fee based on time billed at customary hourly rates, then applies a multiplier to increase the award to a level that the judge feels appropriately compensates counsel for risk. Under the declining-percentage version, the court starts with a percentage-based fee, then reduces the award to a level where the judge feels that the multiplier does not excessively compensate counsel for risk.

In *Sugarland Industries, Inc. v. Thomas*, 420 A.2d 142 (Del. 1980), the Delaware Supreme Court rejected the lodestar method in favor of the percentage-of-benefit method. In *Americas Mining*, the Delaware Supreme Court underscored that choice by adopting the stage-of-case method. It would not make sense to return covertly to the lodestar method.

Delaware law deals with the problem of overcompensation differently. In *Sugarland*, the Delaware Supreme Court identified a list of factors for a court to consider when determining a reasonable award. The inquiry starts with a percentage of the benefit conferred with the percentage selected from ranges that correspond to the stage of the case. But the inquiry does not end there. The court also considers the extent to which counsel litigated on contingency, the time and effort counsel invested, the relative complexity of the litigation, and the standing and ability of counsel. The court can rely on those other factors to adjust the indicative fee upward or downward. The Delaware Supreme Court made clear in *Americas Mining* that a court can reduce an excessive fee, but that analysis happens using the *Sugarland* factors. It does not happen because of a declining-percentage methodology.

This decision hews to *Americas Mining* and *Sugarland*. After considering precedents involving late-stage, pre-trial settlements, this decision starts with an indicative fee equal to 26.67% of the common fund, or $266.7 million. None of the other *Sugarland* factors warrant an upward or downward adjustment. Plaintiff's counsel is entitled to an all-in award of $266.7 million. From that amount, plaintiff's counsel will pay an incentive award of $50,000 to the plaintiff.

I. FACTUAL BACKGROUND

The facts are drawn from the record presented in connection with the settlement. Additional factual detail appears in the legal analysis.

A. The Transaction

In 2013, Michael Dell and Silver Lake Group LLC took Dell, Inc. private in a management buyout. The acquirer and privately held successor to Dell, Inc. is Dell Technologies Inc. (the "Company"). Dell and Silver Lake control the Company.

In 2016, the Company sought to acquire EMC Corporation. That acquisition would bring with it EMC's ownership of 81.9% of the equity of VMware, Inc., another publicly traded corporation. Dell and Silver Lake wanted to pay cash, but the Company remained highly leveraged after the management buyout and could not fund an all-cash deal. So the Company proposed to acquire EMC using a combination of cash and newly authorized shares of Class V common stock, which would trade publicly and ostensibly track the performance of VMware common stock on a share-for-share basis.

The Company and EMC ultimately completed a transaction that valued EMC at $67 billion. Each share of EMC common stock was converted into the right to receive $24.05 in cash plus 0.11146 of a Class V share. The Company listed the Class V shares on the New York Stock Exchange where they traded under the symbol "DVMT."

DVMT was billed as the "highest quality tracker in the history of trackers." Investment bankers predicted that DVMT would trade at little to no discount relative to VMware's common stock.

They were wrong. DVMT traded at a discount of 30-50% to VMware's publicly traded shares. One reason for the discount was that the Company had the option to forcibly convert the DVMT shares into Class C shares using an opaque and manipulable formula.

After completing the EMC acquisition, Dell and Silver Lake began to explore ways of capturing the value of the DVMT discount by consolidating the Company's ownership of VMware. The Company retained Goldman Sachs & Co. for advice. There were three obvious paths: (i) a transaction with VMware, (ii) a negotiated redemption of the DVMT shares, or (iii) a forced conversion.

Goldman advised that the Company could widen the DVMT discount by creating uncertainty about whether and when the Company would engage in a forced conversion. In late January 2018, the financial press reported that the Company was considering an IPO of its Class C stock, which was a precursor to a forced conversion. DVMT's stock price fell 6.4%, and the DVMT discount increased to 45.6%.

Shortly after those reports, the Company's board of directors created a special committee to negotiate a redemption of the DVMT shares. The committee was not authorized to block an IPO of the Class C stock or a forced conversion. The members of the committee all had close ties to Dell or Silver Lake.

Over the next three months, the Company and its advisors threatened the committee and the DVMT stockholders with alternatives to a negotiated redemption. The committee negotiated in the shadow of those threats, eventually agreeing to a redemption which valued the DVMT shares at $109 per share. That price represented a 32.7% discount to VMware's trading price.

Holders of DVMT stock objected, and the Company did not believe that the DVMT stockholders would approve the deal. Rather than negotiating further with the committee, the Company began negotiating with six investment funds. The Company entered into non-disclosure agreements with the funds to keep them siloed and deployed a divide-and-conquer strategy. Meanwhile, the Company continued to prepare for a forced conversion.

After four-and-a-half months, the Company reached an agreement with the stockholder volunteers. Each holder of DVMT stock could opt to receive (i) shares of newly issued Class C common stock valued at $120 per share, or (ii) $120 per share in cash, with the aggregate amount of cash capped at $14 billion. The new deal valued the DVMT stock in the aggregate at $23.9 billion.

On November 14, 2018, the Company informed the committee of the terms of the transaction. The committee met for an hour and approved it.

During a special meeting of the DVMT stockholders on December 11, 2018, the transaction received approval from unaffiliated holders of 61% of the issued DVMT shares. Two weeks later, the transaction closed.

B. This Litigation

After the announcement of the initial committee-approved redemption, plaintiff Steamfitters Local 449 Pension Plan made a books and records demand. Its counsel filed a putative class action on behalf of the DVMT stockholders. Four similar actions were filed.

The five actions were consolidated, and the lawyers organized themselves into two groups who competed to lead the lawsuit. The court appointed the plaintiff and its counsel. Labaton Sucharow LLP and Quinn Emanuel Urquhart & Sullivan, LLP served as co-lead counsel. Robins Geller Rudman & Dowd LLP, Friedman Oster & Tejtel PLLC, and Andrews & Springer LLC served as additional counsel.

Plaintiff's counsel filed an amended complaint, and the defendants moved to dismiss it. Plaintiff's counsel filed a second amended complaint, and the defendants moved to dismiss again. After full briefing and argument, the court largely denied the defendants' motion, although it dismissed the claims against one director. *See In re Dell Techs. Inc. Class V S'holders Litig.*, 2020 WL 3096748 (Del. Ch. June 11, 2020).

For the next two-and-a-half years, the parties litigated. In February 2021, while fact discovery was ongoing, the parties stipulated to class certification, and the court approved the certification order. The parties completed fact discovery, then expert discovery. In September 2022, after expert discovery closed, the parties participated in a full-day mediation. They did not reach a settlement.

The two sides prepared for trial, which was scheduled to begin on December 5, 2022. Fourteen fact witnesses and three expert witnesses planned to testify live.

At the end of October 2022, the parties filed a fifty-one-page joint pre-trial order and identified 2,887 joint trial exhibits. On November 7, the parties filed lengthy pretrial briefs.

C. The Settlement

After the pre-trial briefs were filed, the mediator asked the parties to consider a mediator's proposal. They agreed, and the mediator proposed a settlement for $1 billion in cash. Both sides accepted, subject to documentation and court approval. Counsel contacted the court and removed the trial from the calendar. After the parties filed a settlement stipulation, the court scheduled a hearing to consider the settlement and an application for an award of fees and expenses. Notice went out to the former DVMT stockholders.

No one objected to the settlement. Pentwater Capital Management L.P. ("Pentwater") filed an objection to the fee application. Dkt. 518 (the "Objection"). Pentwater owned DVMT shares comprising approximately 1.6% of the class. Seven other investment funds[1] joined in the Objection. They collectively owned shares comprising another 24.45% of the class.

The objectors took issue with the "sheer enormity of the fees sought" and claimed that the award would be "far in excess of what is appropriate in these circumstances." *Id.* at 2. They proposed that "[r]ather than basing the attorneys' fee award here on a strict

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[1] The seven other funds are Alpine Associates Management Inc.; Canyon Capital Advisors LLC; Carlson Capital, L.P.; Dodge & Cox; Farallon Capital Management, L.L.C.; Icahn Capital LP; and P. Schoenfeld Asset Management L.P.

percentage of the Settlement Fund," the court should apply "a declining percentage approach." *Id.* The objectors did not propose a particular percentage or suggest a reasonable award.

The court responded with a letter to all of the parties, including the objectors. The court expressed appreciation for the objectors' input and asked all of the parties to provide three additional categories of information.

First, the court noted the objectors had not cited any scholarship about fee awards in mega-fund cases. The court asked whether law professors had anything to say in favor of or against the declining-percentage method.

Second, the court noted that the objectors did not discuss how privately negotiated contingency fee arrangements address large recoveries. The court asked the parties to provide information on that topic.

Third, the court asked for information on the objectors' own compensation arrangements, explaining:

> [I]t occurred to me that the investment managers you represent likely have compensation arrangements that provide for both an annual management fee and a performance fee. The familiar 2-and-20 formula is an example. When a fund achieves gains that result in a performance fee coming due, is the performance fee reduced as the gains increase? In other words, do the investment managers for the objecting funds structure their own incentive compensation in the way that they propose for plaintiffs' counsel?

Dkt. 520 at 2. The court noted that

> because an investment manager receives an annual management fee equal to 2% of assets under management, which lets the managers keep the lights on and pay the employees while swinging for the gains that generate performance fees, the investment managers would seem to be in a less risky

> position than plaintiffs' counsel, who lack a comparable annual fee component.

Id. at 2–3. The court asked the objectors to provide information about their annual management fees and performance fees, as well as any hurdle rates or other features that would affect the level of risk that the fund managers undertook.

One week after the court sent its letter, five law professors sought leave to participate as *amici curiae*, and the court granted their application.[2] In my experience, professors do not generally monitor the docket. They have their own research to conduct and classes to teach, and their syllabi understandably cover the big precedents, so there is less need for vigilant attention to Chancery's every utterance. I have found when attending conferences that professors are sometimes not abreast of recent Chancery decisions, and I would not expect academics to be reviewing letters addressing case management issues (with an acknowledged exception for cases like *Twitter, Inc. v. Musk*). The professors' rapid response to a case management letter therefore seemed noteworthy. Because the professors appeared so quickly, it seemed likely that someone served as an intermediary to recruit them, and because the professors' arguments tracked the objectors' positions, it

[2] The professors are (in alphabetical order) Benjamin Edwards, Associate Professor of Law at the William S. Boyd School of Law of the University of Nevada, Las Vegas; Jessica M. Erickson, the Nancy Litchfield Hicks Professor of Law at the University of Richmond School of Law; Sean J. Griffith, the T.J. Maloney Chair in Business Law at the Fordham University School of Law; Joseph A. Grundfest, Senior Faculty at the Arthur and Toni Rembe Rock Center for Corporate Governance of Stanford Law School; and Adam C. Pritchard, the Frances and George Skestos Professor of Law at the University of Michigan Law School.

seemed likely that the objectors had solicited the professors' involvement. It would not have been the first time that a well-connected party sought like-minded support. One of the professors subsequently found fault with that inference and implied that the objectors were not the link.[3] So be it. The point was a small one and intended only to foreshadow that the professors' views are not the only academic perspective. Other distinguished scholars recommend different approaches for calculating fee awards. Regardless of how the professors managed to appear so promptly, the court is grateful that they did and benefited from their input.

After briefing concluded, the court held a hearing to consider the settlement. The court approved the settlement in an oral ruling. The court took the fee application under advisement.

II. LEGAL ANALYSIS

Plaintiff's counsel seek an all-in award of fees and expenses equal to 28.5% of the common fund, resulting in a total award of $285 million. Plaintiff's counsel seek permission to pay an incentive award of $50,000 to the plaintiff. The defendants agreed not to oppose those requests. The objectors and the professors oppose the fee award. No one objects to the incentive award.

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[3] *See* Alison Frankel, *Whopper $267 million fee award in $1 billion Dell case shows why Delaware is different*, Reuters (Aug. 1, 2023 5:10 pm), available at https://www.reuters.com/legal/transactional/column-whopper-267-million-fee-award-1-billion-dell-case-shows-why-delaware-is-2023-08-01/ (last visited Aug. 21, 2023).

A. The Fee Award

The power to award fees to counsel for creating a common benefit, such as a common fund, "is a flexible one based on the historic power of the Court of Chancery to do equity in particular situations." *Tandycrafts, Inc. v. Initio P'rs*, 562 A.2d 1162, 1166 (Del. 1989). When awarding fees, the court does not defer to what the defendants agreed not to oppose. The court "must make an independent determination of reasonableness." *Goodrich v. E.F. Hutton Gp., Inc.*, 681 A.2d 1039, 1046 (Del. 1996).

The *Sugarland* decision governs how a court awards fees in representative actions. That decision identified factors to consider when awarding fees, but the factors appeared diffusely throughout the opinion. *See Sugarland*, 420 A.2d at 149–50. In *Americas Mining*, the Delaware Supreme Court summarized them as follows: "1) the results achieved; 2) the time and effort of counsel; 3) the relative complexities of the litigation; 4) any contingency factor; and 5) the standing and ability of counsel involved." 51 A.3d at 1254.

The primary factor is the results achieved. If the results are quantifiable, then "*Sugarland* calls for an award of attorneys' fees based upon a percentage of the benefit." *Id.* at 1259. "Hours worked are considered as a crosscheck to guard against windfall awards, particularly in therapeutic benefit cases." *Olson v. EV3, Inc.*, 2011 WL 704409, at *8 (Del. Ch. Feb. 21, 2011). "Secondary factors include the complexity of the litigation, the standing and skill of counsel, and the contingent nature of the fee arrangement together with the level of contingency risk actually involved in the case." *Id.* "Precedent awards from similar cases may be considered for the obvious reason that like cases should be treated alike." *Id.*

1. The Benefit Created By Counsel's Efforts

The primary factor in calculating a fee award is the benefit created by counsel's efforts. The causal dimension is critical, because Delaware public policy calls for compensating counsel "for the beneficial results they produced." *Allied Artists Pictures Corp. v. Baron*, 413 A.2d 876, 878 (Del. 1980). Counsel cannot take credit for results they did not produce, so a court must consider "whether the plaintiff can rightly receive all the credit for the benefit conferred or only a portion thereof." *In re Plains Res. Inc.*, 2005 WL 332811, at *3 (Del. Ch. Feb. 4, 2005). Sometimes, a result will stem from multiple causes, and the court must assess "the degree of causation between counsel's efforts and the result when awarding reasonable attorneys' fees." *Smith v. Fid. Mgmt. & Rsch. Co.*, 2014 WL 1599935, at *11 (Del. Ch. Apr. 16, 2014). If counsel did not cause the full headline benefit, then the court must reduce the value of the benefit to match the extent of counsel's role. *See id.* at *13–15. Although causation is not at issue in this case, it was at issue in some of the precedents on which the objectors rely, and the objectors' failure to consider causation leads them to erroneous conclusions.

When the value of the benefit is quantifiable, *Americas Mining* calls for calculating an indicative fee as a percentage of the benefit. 51 A.3d at 1259. Other *Sugarland* factors may cause the court to adjust the indicative fee up or down, but the starting point under *Americas Mining* is a percentage calculation. Under this method, the "common fund is itself the measure of success." *Id.* "A percentage of a low or ordinary recovery will produce a low or ordinary fee; the same percentage of an exceptional recovery will produce an exceptional fee." *In re Orchard Enters. Inc. S'holder Litig.*, 2014 WL 4181912, at *8 (Del.

Ch. Aug. 22, 2014). "The wealth proposition for plaintiffs' counsel is simple: If you want more for yourself, get more for those whom you represent." *Id.*

In this case, there is an obvious and self-quantifying benefit in the form of $1 billion in cash. There is no reason to look for sufficiently reliable proxies to price non-monetary relief. *Cf. In re Compellent Techs., Inc. S'holder Litig.*, 2011 WL 6382523 (Del. Ch. Dec. 9, 2011) (identifying proxies for that purpose). Plaintiff's counsel was the sole cause of the benefit: But for the litigation, the benefit would not exist. No other causal factor contributed to the outcome.

Because the benefit is quantifiable, *Americas Mining* calls for calculating an indicative fee award as a percentage of the benefit. Plaintiff's counsel seeks an indicative fee calculated using the stage-of-case method from *Americas Mining*. The objectors and professors argue for using the declining-percentage method from federal securities class actions. They also advance other arguments in support of a reduced percentage.

a. The Stage-Of-Case Method

In *Americas Mining*, the Delaware Supreme Court endorsed the practice of setting the percentage for the indicative fee using the stage of the case when the result was reached. 51 A.3d at 1259–60. Awarding increasing percentages as counsel pushes deeper into a case ensures that counsel's incentives remain aligned with the case. A widely acknowledged conflict exists between the incentives of class and counsel:

> The plaintiff's financial interest is in his share of the total recovery less what may be awarded to counsel, *simpliciter*; counsel's financial interest is in the amount of the award to him less the time and effort needed to produce it. A relatively small settlement may well produce an allowance bearing a higher

> ratio to the cost of the work than a much larger recovery obtained only after extensive discovery, a long trial and an appeal.

Saylor v. Lindsley, 456 F.2d 896, 900 (2d Cir. 1972) (Friendly, C.J.). "When the lawyer gains 40 cents to the client's dollar, the lawyer tends to expend too little effort . . . . [H]e would not put in an extra $600 worth of time to obtain an extra $1,000 for his client, because he would receive only $400 for his effort." *Kirchoff v. Flynn*, 786 F.2d 320, 325 (7th Cir. 1986) (Easterbrook, J.).

Scholars who have long studied this conflict recommend awarding an increasing percentage of the benefit as a corrective measure.[4] Awarding an increasing percentage of the benefit "is at best a rough corrective . . . because it substitutes a small number of discrete increments for what is in fact a continuous process — the reduction in the attorney's expected future costs as the case progresses." Miller, *supra*, at 201. It nevertheless "partially mitigates the attorney-client conflicts." *Id.* at 201–02.

Awarding a percentage that increases as the case progresses also counteracts a natural human tendency toward risk aversion. "For plaintiffs' counsel, risk aversion manifests itself as a natural tendency to favor an earlier bird-in-the-hand settlement that will ensure a fee, rather than pressing on for a potentially larger recovery for the class at

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[4] Alon Harel & Alex Stein, *Auctioning for Loyalty: Selection and Monitoring of Class Counsel*, 22 Yale L. & Pol'y Rev. 69, 71 (2004). For now-classic treatments of this problem, see Geoffrey P. Miller, *Some Agency Problems in Settlement*, 16 J. Legal Stud. 189, 198–202 (1987); Kevin M. Clermont & John D. Currivan, *Improving on the Contingent Fee*, 63 Cornell L. Rev. 529, 543–46 (1978); Murray L. Schwartz & Daniel J.B. Mitchell, *An Economic Analysis of the Contingent Fee in Personal-Injury Litigation*, 22 Stan. L. Rev. 1125, 1133–39 (1970).

the cost of greater investment and with the risk of no recovery." *Orchard,* 2014 WL 4181912, at *8. "The promise of a larger potential share of the benefit nudges representative counsel's incentives towards greater alignment with the class or entity on whose behalf they are litigating." *In re Activision Blizzard, Inc. S'holder Litig.*, 124 A.3d 1025, 1071 (Del. Ch. 2015).

Delaware's experience during the M&A litigation epidemic confirms this.[5] Some plaintiff's lawyers pursued business models that involved filing cases indiscriminately against virtually every transaction. They settled those cases quickly, typically for supplemental disclosures and a fee. Sometimes they obtained other easy gives, such as a reduction in the termination fee after it was obvious that no overbidder would emerge. By contrast, other lawyers rejected a cookie-cutter approach, choosing instead to pursue real

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[5] For discussions of the M&A litigation epidemic from different perspectives, see *Magellan*, 2023 WL 4364524, at *7–9 (judicial perspective); Edward B. Micheletti & Jenness E. Parker, *Multi-Jurisdictional Litigation: Who Caused This Problem, and Can It Be Fixed?*, 37 Del. J. Corp. L. 1, 6–14 (2016) (practitioners who primarily represent defendants); Joel Edan Friedlander, *How* Rural/Metro *Exposed the Systemic Problem of Disclosure Settlements*, 40 Del. J. Corp. L. 877, 879–904 (2016) (practitioner who has represented plaintiffs and defendants); Mark Lebovitch & Jeroen van Kwawegen, *Of Babies and Bathwater: Deterring Frivolous Stockholder Suits Without Closing the Courthouse Doors to Legitimate Claims*, 40 Del. J. Corp. L. 491, 493, 509–23 (2016) (practitioners who represent plaintiffs); Jill E. Fisch, Sean J. Griffith & Steven Davidoff Solomon, *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 Tex. L. Rev. 557, 557–72 (2015) (law professors).

cases, develop case-specific theories, invest real effort, and generate real results.[6] The challenge for the courts was to reward the latter business model and not the former.

Americas Mining took an initial step by endorsing the stage-of-case method. After surveying a range of precedents, the Delaware Supreme Court observed that "Delaware case law supports a wide range of reasonable percentages for attorneys' fees, but 33% is the very top of the range of percentages." 51 A.3d at 1259 (internal quotation marks and citation omitted). That level of fee award is reserved for a plaintiff who prevails after trial.

For cases that do not go the distance to a post-trial adjudication, the Delaware Supreme Court provided guideline percentages:

> When a case settles early, the Court of Chancery tends to award 10–15% of the monetary benefit conferred. When a case settles after the plaintiffs have engaged in meaningful litigation efforts, typically including multiple depositions and some level of motion practice, fee awards in the Court of Chancery range from 15–25% of the monetary benefits conferred. . . .

Id. at 1259–60 (internal quotation marks and citations omitted).

Selecting an appropriate percentage requires an exercise of judicial discretion. *Id.* at 1261. The test is not a mechanical one, but the use of guideline ranges promotes consistent awards so that similar cases are treated similarly. Past precedents shape future behavior,

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[6] *See* Friedlander, *supra*, at 904–10 (describing "two-tier plaintiff bar"); *see also* Joel Edan Friedlander, *Vindicating the Duty of Loyalty: Using Data Points of Successful Stockholder Litigation As A Tool for Reform*, 72 Bus. Law. 623, 624–25 (2017) (identifying twelve examples of representative litigation that generated eight-to-nine-figure recoveries); Lebovitch & van Kwawegen, *supra*, at 528–33 (identifying five of the twelve).

and a practice of rarely departing from guideline percentages helps create desirable incentives.[7]

This case involved a late-stage settlement. The parties informed the court that they had reached an agreement in principle on November 16, 2022. That was nineteen calendar days before trial was scheduled to begin. The parties had submitted a fifty-three-page joint pre-trial order and filed their pre-trial briefs. Plaintiff's counsel filed a pre-trial brief that spanned 134 pages and contained 22,908 words. Plaintiff's counsel truly litigated until the eve of trial.

Plaintiff's counsel thus went beyond a mid-stage adjudication that should yield a

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[7] The stage-of-case method is vulnerable to the criticism that it undercompensates counsel who achieve everything they might have obtained after trial through an early-stage settlement. Counsel can rightly argue that they should not receive only 10% of a recovery if they settled at an early stage for everything that the court could have awarded. Counsel can also rightly argue that Delaware law should not provide incentives for over-litigating a case. Those are valid points, and there always will be edge cases that put stress on a system. The challenge for the court is to determine whether counsel achieved everything that the court could have awarded—and to do so in the non-adversarial context of a settlement hearing. One would think that degree of success would be rare. Defendants usually do not settle up front for their maximum potential exposure, and there is a reason why parties retain experts to calculate damages after the close of fact discovery, when everyone has far more information about the case. It is also a short step from seeking a higher percentage for achieving *everything* that counsel might have obtained to seeking a higher percentage for achieving *most* of what counsel might have obtained. And it is only another short step to seeking a higher percentage for achieving different relief (such as therapeutic benefits) that counsel could not have obtained. Across most cases and in most settings, the stage-of-case method creates salutary incentives to obtain the greatest possible relief for the class. In a case where it is clear that counsel achieved *everything* that they sought in their complaint, then perhaps an upward adjustment in the percentage might be warranted, but that type of departure from the *Americas Mining* framework risks inviting similar arguments in every case.

fee of 15–25% ("multiple depositions and some level of motion practice") but stopped short of a full adjudication that would warrant an award of 33%. Plaintiff's counsel did not actually try the case, invest in post-trial briefing, or prepare for and make a post-trial argument. Most significantly, plaintiff's counsel did not accept the risk of an adverse post-trial outcome, and they did not confront the difficulty of defending a monetary judgment on appeal. That final challenge is significant: Since the *Americas Mining* decision in 2012, six cases have resulted in post-trial judgments awarding monetary damages in representative actions. The Delaware Supreme Court affirmed the first two, one in 2014[8] and the other in 2016.[9] The Delaware Supreme Court reversed the next four.[10] During the

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[8] *RBC Cap. Mkts., LLC v. Jervis*, 129 A.3d 816 (Del. 2015) (affirming award of $70 million to class of stockholders).

[9] *CDX Hldgs., Inc. v. Fox*, 141 A.3d 1037 (Del. 2016) (affirming award of $16 million to class of option holders). A dissenting justice would have reversed the liability finding. *See id.* at 1042 (Valihura, J., dissenting).

[10] *Boardwalk Pipeline P'rs, LP v. Bandera Master Fund LP*, 288 A.3d 1083 (Del. 2022) (reversing post-trial judgment of $690 million for plaintiff class of limited partner investors); *Dell, Inc. v. Magnetar Glob. Event Driven Master Fund, Ltd.*, 177 A.3d 1 (Del. 2017) (reversing post-trial judgment awarding fair value of $17.62 per share to appraisal class comprising 5,505,730 shares, resulting in incremental value over deal price of $13.75 per share of $21.3 million (exclusive of interest)); *DFC Glob. Corp. v. Muirfield Value P'rs, L.P.*, 172 A.3d 346 (Del. 2017) (reversing post-trial judgment awarding fair value of $10.21 per share to appraisal class comprising 4,604,683 shares, resulting in incremental value over deal price of $9.50 per share of $3.2 million (exclusive of interest)); *El Paso Pipeline GP Co., L.L.C. v. Brinckerhoff*, 152 A.3d 1248 (Del. 2016) (vacating post-trial judgment of $171 million to be implemented through investor-level remedy).

More recently, the Delaware Supreme Court affirmed a monetary damages award in favor of a class of minority partners, but it was the plaintiffs who took the appeal in pursuit of a larger damages award. The defendants did not contest the liability finding. *See* post-*Americas Mining* era, plaintiffs in representative actions who have prevailed at the trial court level and recovered a monetary judgment have lost on appeal 67% of the time, with a 100% reversal rate since 2016.[11] A plaintiff who takes a case to trial and prevails

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Bell v. AT&T Mobility Wireless Operations Hldgs. LLC, 2023 WL 3880120 (Del. June 7, 2023) (ORDER).

From one perspective, the outcome in *Aruba* could be viewed as a plaintiff's victory, because the Delaware Supreme Court increased the appraisal award from the unaffected market price to a value based on the deal-price minus synergies, but the fair value was still less than what the appraisal claimants would have obtained by accepting the deal consideration, so it remained a loss for the appraisal class. *See Verition P'rs Master Fund Ltd. v. Aruba Networks, Inc.*, 210 A.3d 128 (Del. 2019).

[11] The increased reversal risk appears to be limited to cases in which representative plaintiffs recover money damages, as opposed to increased reversal risk across all cases. Outside of the world of money judgments, representative plaintiffs have fared better, notching three affirmances of post-trial judgments awarding non-monetary relief. *See CCSB Fin. Corp. v. Totta*, 284 A.3d 713 (Del. 2022); *Williams Cos., Inc. v. Wolosky*, 264 A.3d 641 (Del. 2021); *Austin v. Judy*, 65 A.3d 616 (Del. 2013). And outside of the world of representative plaintiffs, large investors have had success on appeal when litigating on their own. In 2019, the Delaware Supreme Court affirmed a judgment for $20.2 million (plus pre- and post-judgment interest) in favor of a large investor who purchased the corporation's claims from a receiver. *See Davenport v. Basho Techs. Holdco B, LLC,* 221 A.3d 100 (Del. 2019) (ORDER). The case was not a representative action, and the only defendant to appeal sought to represent himself, so it was not the most effective appellate challenge. The following year, the Delaware Supreme Court affirmed a judgment for $4.4 million in favor of another large investor, but that case also was brought by a single, large holder that was the sole investor in the fund. *See HOMF II Inv. Corp. v. Altenberg,* 268 A.3d 1013 (Del. 2021) (ORDER). Finally, defendants have enjoyed consistent success on appeal. Since *Americas Mining*, there has been only one reversal of a post-trial judgment for the defendants in a representative action, and it was affirmed after the trial court reached the same conclusion on remand. *Compare Coster v. UIP Cos.*, 255 A.3d 952 (Del. 2021) *with Coster v. UIP Cos.*, --- A.3d ---, 2023 WL 4239581 (Del. June 28, 2023). Other post-trial judgments for defendants in representative actions have been affirmed. *E.g., In re Tesla Motors, Inc. S'holder Litig.*, --- A.3d ---, 2023 WL 3854008 (Del. June 6, 2023); *Brigade Leveraged Cap. Structures Fund Ltd. v. Stillwater Mining Co.,* 240 A.3d 3 (Del.

thus faces significant appellate risk.[12] A settlement renders that risk trivial.[13]

The *Americas Mining* decision did not provide a guideline range for a late-stage

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2020); *In re PLX Tech. Inc. S'holders Litig.*, 211 A.3d 137 (Del. 2019); *ACP Master, Ltd. v. Sprint Corp.*, 184 A.3d 1291 (Del. 2018).

[12] The degree of appellate risk appears to have shifted over time. Because this decision examines fee rulings during the *Americas Mining* era, that decision provides a convenient starting point for assessing appellate outcomes. Extending the date backwards to the turn of the millennium suggests that plaintiffs faced less appellate risk during that era, with the caution that during that period, few representative lawsuits were tried, fewer resulted in plaintiffs' victories, and still fewer were appealed. Between 2000 and the issuance of the *Americas Mining* decision, the Delaware Supreme Court affirmed three post-trial judgments awarding monetary relief to plaintiffs in representative actions. *See Gatz Props., LLC v. Auriga Cap. Corp.*, 59 A.3d 1206 (Del. 2012); *William Penn P'ship v. Saliba*, 13 A.3d 749, 751 (Del. 2011); *Int'l Telecharge, Inc. v. Bomarko, Inc.*, 766 A.2d 437 (Del. 2000). In another representative action, the Delaware Supreme Court affirmed a finding of liability against the defendants but reversed the damages award as too conservative and remanded for consideration of whether the award should have included a control premium. *Gotham P'rs, L.P. v. Hallwood Realty P'rs, L.P.*, 817 A.2d 160 (Del. 2002). The Delaware Supreme Court does not appear to have reversed any post-trial judgments awarding monetary damages to plaintiffs in representative actions in this era, although in one case the high court did so as a practical matter: The Delaware Supreme Court instructed the trial court to reconsider its rulings after excluding particular categories of evidence, the trial court reached a different conclusion on remand that eliminated the damages upside for the plaintiffs, and the Delaware Supreme Court affirmed that result on appeal. *AT&T Corp. v. Lillis*, 970 A.2d 166 (Del. 2009). Defendants had relatively less success on appeal than after *Americas Mining*. In one case, the Delaware Supreme Court reversed a post-trial judgment in favor of the defendants and remanded for further proceedings. *Amirsaleh v. Bd. of Trade of City of N.Y., Inc.*, 27 A.3d 522 (Del. 2011). In another, the Delaware Supreme Court brought to a close the sempiternal appraisal proceeding in *Technicolor* by directing the Court of Chancery to enter judgment using inputs that increased the value of the award. *Cede & Co. v. Technicolor, Inc.*, 884 A.2d 26 (Del. 2005). A set of appellate rulings from the 1990s or the 1980s would likely exhibit different characteristics.

[13] The only path would be for an objector to challenge the settlement, then appeal from the trial court's decision approving the settlement. Such an appeal faces long odds.

settlement, so the parties have looked to precedent. The court has considered eight cases:

- In *Mindbody*, the plaintiffs reached a partial settlement, six weeks before trial, with all but two defendants. The settlement created a gross common fund of $27 million. Counsel incurred expenses of $666,142.95 and asked for reimbursement plus a fee of $7.89 million, representing 30% of the net common fund. The court approved the request. *In re Mindbody, Inc. S'holder Litig.*, C.A. No. 2019-0442-KSJM, at 14, 17, 27–28, 33 (Del. Ch. June 8, 2022) (TRANSCRIPT).

- In *Riche v. Pappas*, the parties settled "just before trial." C.A. No. 2018-0177-JTL, at 23–24 (Del. Ch. Sept. 16, 2020) (TRANSCRIPT). The settlement created a gross common fund of $6.5 million. Counsel asked for a fee equal to 30% of the gross fund plus reimbursement of $250,760.81 in expenses from the common fund. The court deducted the expenses first and granted a fee equal to 30% of the net common fund. *Id.* at 4, 12, 25–26.

- In *Starz*, the parties "litigated right up until the brink of trial." *In re Starz S'holder Litig.*, Consol. C.A. No. 12584-VCG, at 56 (Del. Ch. Dec. 10, 2018) (TRANSCRIPT). The settlement created a gross common fund of $92.5 million. Counsel incurred expenses of $1,689,816.76 and asked for a fee of $26,060,184, representing 28.17% of the net amount. The odd figure and counsel's comments suggest that they based their request on an all-in award equal to 30% of the gross amount. The court approved the award. *Id.* at 10, 56–57.

- In *Jefferies*, the parties settled five weeks before trial. The settlement created a gross common fund of $70 million, with any fee award to be paid separately. After considering the *Sugarland* factors, the court awarded $21.5 million, inclusive of $1 million in expenses. The court noted that the award equated to 23.5% of a gross common fund of $91.5 million. *In re Jefferies Gp., Inc. S'holders Litig.*, 2015 WL 3540662, at *2, *4 (Del. Ch. June 5, 2015).

- In *Activision*, the parties settled one month before trial. The settlement consisted of (i) a payment of $275 million to Activision, (ii) a reduction in the cap on the voting power wielded by Activision's two senior officers from 24.5% to 19.9%, and (iii) the expansion of Activision's board of directors to include two individuals unaffiliated with the two senior officers. The plaintiffs sought an award of $72.5 million, which the defendants agreed not to oppose. The court started from a guideline range of 22.5% to 25% for a late-stage settlement. After putting rough values on the non-monetary benefits, the court found that the requested fee fell between 22.7% and 24.5% of the benefit conferred, within the guideline range. Noting that a negotiated fee that falls within the range deserves some deference, the court approved the award. 124 A.3d at 1042, 1071, 1074–75.

- In *Orchard*, the parties settled two months before trial. The settlement created a common fund of $10,725,000. The plaintiffs asked for an all-in award of $2,810,671, equal to 30% of the fund. The court gave the plaintiff causal credit for a gross benefit of $9,368,904. Counsel incurred $132,000 in expenses. The court stated that "[w]hile there are outliers, a typical fee award for a case settling at this stage of the proceeding ranges from 22.5% to 25% of the benefit conferred." *Orchard*, 2014 WL 4181912, at *8. The court approved an all-in award of $2,250,000, representing 24% of the gross benefit. *Id.*

- In *Rural Metro*, the plaintiffs settled with all but one defendant "deep in the case, after full discovery, on the eve of trial." *In re Rural/Metro Corp. S'holders Litig.*, Consol. C.A. No. 6350-VCL, at 35 (Del. Ch. Nov. 19, 2013) (TRANSCRIPT). The settlement created a gross common fund of $11.6 million. Counsel incurred expenses of $1.3 million. Counsel requested a fee of $3.1 million, representing 30% of the net fund. *Id.* at 5. The court first deducted the expenses, then awarded a fee of $2.9 million, equal to 28% of the net fund. *Id*. at 36–37. At trial, the plaintiffs prevailed against the remaining defendant, resulting in one of the two post-*Americas Mining* judgments that the Delaware Supreme Court affirmed. *See RBC Cap.*, 129 A.3d at 879.

- In *TeleCorp*, a pre-*Americas Mining* case, the parties settled two weeks before trial. *In re TeleCorp PCS, Inc. S'holders Consol. Litig.*, C.A. No. 19260-VCS, at 24, 91 (Del. Ch. Aug. 20, 2003) (TRANSCRIPT). The settlement created a gross common fund of $47.5 million. Evidencing the type of settlements in representative litigation that were prevalent at the time, the transcript contains extensive commentary about the unprecedented nature of a cash recovery. Plaintiff's counsel sought a fee award of $14.2 million plus expenses of approximately $600,000. After deducting expenses, the request equated to 35.5% of the common fund. The court approved an all-in award of $14.25 million, equal to 30% of the gross common fund. *Id.* at 24, 68–69, 91, 101.

In part because *Sugarland* is a multi-factor test, it is difficult to discern a pattern in these precedents. One curiosity is that the written decisions in *Jefferies*, *Activision*, and *Orchard* award lower percentages for eve-of-trial settlements than the five transcript rulings. Another curiosity is that *Activision* and *Orchard* contemplate a guideline range of 22.5% to 25% for late-stage settlements, which places those settlements within the upper half of the *Americas Mining* range for mid-stage settlements and creates a significant gap of 8% between the top percentage available for a settlement and the maximum of 33% available for a final judgment. The five transcript rulings take a different approach in which a late-stage settlement warrants a higher percentage than the upper bound of the range for a mid-stage settlement. Two of the transcript rulings award 28%; three award 30%.

The transcript rulings point to a practice of awarding a higher percentage for a late-stage settlement than for a mid-stage settlement. Eight integers scale from the 25% upper bound for a mid-stage settlement to the 33% maximum for a post-trial adjudication. A distinction should remain between the most that a plaintiff can achieve via settlement and the percentage that a plaintiff can obtain for a post-trial adjudication.[14] As noted earlier, going the distance requires more effort, accepts the risk of receiving nothing after trial, and takes on the additional work and risk associated with an appeal. A late-stage settlement eliminates those issues. That suggests that the percentage awarded in a case that stops short of a fully litigated judgment should top out at 30%, leaving a range of 25% to 30% for a late-stage settlement.

A logical demarcation point for the late-stage phase is the end of expert discovery. Engaging in real litigation in an M&A case requires experts, and experts cost a lot. Once expert discovery has concluded, plaintiff's counsel will have incurred substantial amounts. That is also the point when trial preparation begins in earnest, with key tasks including

[14] *See TeleCorp*, *supra*, tr. at 103 ("I could see holding out the full measure of 33 to maybe 35 percent [so] that there's a promise actually if you go to trial, it will be at the highest end of the range."); *accord Brinckerhoff v. Tex. E. Prod. Pipeline Co., LLC*, 986 A.2d 370, 395 (Del. Ch. 2010).

negotiating the pre-trial order, preparing a pre-trial brief, and presenting any pre-trial motions. Then comes the trial itself and the tasks associated with that effort, such as preparing exhibits, working with witnesses, performing the stand-up trial work, and choreographing the audio-visual component. Finally, there is post-trial briefing and argument.

Here, plaintiff's counsel made it through approximately one-third of the late-stage tasks. That points to a baseline percentage of 26.67%, one-third of the way between 25% and 30%.

Plaintiff's counsel has asked for a percentage 28.5%. That figure is over two-thirds of the way between 25% and 30%. Plaintiff's counsel did not do two-thirds of the late-stage work. Plus, if plaintiff's counsel gets 28.5% in this case, it will be difficult to find room in the late-stage tier for a settlement that occurs during trial, or during post-trial briefing, or after post-trial argument. Judges can find it uncomfortable to reduce an unopposed fee request when plaintiff's counsel performed well, so if this stage of the case warrants 28.5%, then percentages for later-stage settlement would likely float upward. That in turn would compress the relative reward for going the distance to a final adjudication. To reiterate, some step-up should exist for a post-trial adjudication.

Although it means reducing the percentage that plaintiff's counsel receives in this case for a precedent-setting settlement, the most justifiable percentage under *Americas Mining* is 26.67%. The fee calculation will start with that figure.

b. The Declining-Percentage Method

The objectors and the professors argue that a court should reduce the percentage that counsel receive as the size of the common fund increases. The supposed goal of this method is to avoid windfall compensation. It rests on the assumption that a case that generates a big recovery does not involve significantly more work, so rewarding plaintiff's counsel with the same percentage results in excess compensation. That perceived risk is particularly acute in mega-fund cases. There are multiple reasons to reject the declining-percentage approach.

i. Delaware Precedent

Since *Americas Mining*, Delaware decisions have neither endorsed nor applied the declining-percentage method, whether in mega-fund cases or otherwise. The concept itself conflicts with *Americas Mining*, which calls for an increasing percentage as the plaintiff pushes deeper into the case. If layered onto the *Americas Mining* method, it would penalize counsel for seeking a larger recovery. Plaintiff's counsel could count on an increasing percentage for increased risk under *Americas Mining*, only to have the percentage cut if plaintiff's counsel achieved too much. Such an approach would disincentivize taking a case through trial.

The objectors nevertheless attempt to create the impression that Delaware precedent already supports the declining-percentage method. They surprisingly claim that "Delaware has accepted the 'judicial consensus that the percentage of recovery awarded should 'decrease as the size of the [common] fund increases.'" Obj. at 5 (quoting *Goodrich*, 681 A.2d at 1048). That is not so. The *Goodrich* case did not endorse the declining-percentage method, and the *Americas Mining* decision subsequently rejected both the objectors' interpretation of *Goodrich* and the argument that a trial court must decrease the percentage awarded in a mega-fund case.

Goodrich was not about the declining-percentage method, nor was it a mega-fund case. The parties agreed to a settlement that created a gross common fund of $3.3 million for aggrieved brokerage customers who submitted valid notices of claim, with both administrative expenses and any attorneys' fee to be deducted from the fund. The Court of Chancery approved the settlement and awarded a fee equal to one-third of the amounts actually claimed by class members, up to a maximum fee of $515,000. 681 A.2d at 1043. Plaintiff's counsel appealed, arguing that the court erred by not awarding a fee based on the headline amount. *Id.* at 1048. The Delaware Supreme Court observed that when discussing the principles governing fee awards, the Court of Chancery had "acknowledged the merit of the emerging judicial consensus that the percentage of the recovery awarded should decrease as the size of the common fund increases." *Id.* (cleaned up). That was it. The high court did not discuss the concept further. After noting that the Court of Chancery considered multiple factors when exercising its discretion, the Delaware Supreme Court affirmed the award. *Id.* at 1050.

The *Goodrich* decision predated *Americas Mining*, which actually addressed the declining-percentage method and involved a mega-fund case. The defendants argued squarely on appeal that the trial court erred by failing to "correctly apply a declining percentage analysis given the size of the judgment." 51 A.3d at 1252. The Delaware Supreme Court framed the "question presented" as "how to properly determine a reasonable percentage for a fee award in a megafund case." *Id.* at 1260. The defendants advanced the same interpretation of *Goodrich* as the objectors, and the Delaware Supreme Court rejected it. *Id.* at 1258. The high court made clear that a declining-percentage approach is not required, holding instead that "the multiple factor *Sugarland* approach to determining attorneys' fee awards remained adequate for purposes of applying the equitable common fund doctrine." *Id.*

The *Americas Mining* decision engaged with the argument about reducing the fee in a mega-fund case as part of its analysis of the hourly rate cross-check. *Id.* The *Americas Mining* decision makes clear that a trial court can adjust a percentage-based fee downward, but that is "a matter of discretion" and "not required *per se*." *Id.* The Delaware Supreme Court "decline[d] to impose either a cap or the mandatory use of any particular range of percentages for determining attorneys' fees in megafund cases." *Id.* at 1261.

Other than *Goodrich*, the objectors' only other Delaware authorities are transcript rulings. All three predated *Americas Mining.* None supports the objectors' position.

The objectors' best precedent is *Digex*, where the court at least referred to the declining-percentage method in passing and observed that the *Goodrich* case had described that approach as "appropriate and reasonable." *In re Digex, Inc. S'holders Litig.*, at 145–46 (Del. Ch. Apr. 6, 2001) (TRANSCRIPT). The court did not actually apply the declining-percentage method. Instead, the court used a straightforward *Sugarland* analysis.

Digex involved an expedited pre-closing injunction application to stop an interested transaction between the company (Digex) and its controlling stockholder (Worldcom). The court denied the injunction application but held that the plaintiffs had shown a reasonable likelihood of success on a claim that the defendants had breached their fiduciary duties by gratuitously waiving Section 203 of the Delaware General Corporation Law on Worldcom's behalf. *In re Digex Inc. S'holders Litig.*, 789 A.2d 1176, 1208 (Del. Ch. 2000). A special committee had negotiated the original transaction and continued to negotiate with all parties. *Digex*, *supra*, tr. at 5. Shortly after the injunction decision, and with the special committee in a lead role, the parties agreed to a settlement that created a common fund consisting of shares of Worldcom stock valued at $165 million. WorldCom agreed to additional relief in the form of $15 million in reimbursement for Digex's fees and expenses during the litigation, four commercial agreements to support Digex's business, and a commitment to amend Digex's certificate of incorporation to require approvals for interested transactions. *Id.* at 52–53. Plaintiff's counsel valued the total package at $420 million. *Id.* at 52.

Because of the role of the special committee, causation issues loomed large. Two special committee members appeared at the settlement hearing and testified that plaintiff's counsel played only a limited role in generating the settlement. *See id.* at 143. In a later and unrelated case, this court surveyed the shared-credit cases and observed that "[i]n the two most common shared-credit scenarios—those involving topping bidders or special committees—the actor not principally responsible for generating the benefit appears to have been credited with 20% to 25% of the benefit conferred." *Orchard*, 2014 WL 4181912, at *6. Using that range, plaintiff's counsel could claim causal credit for a benefit of $84 million to $105 million.

Plaintiff's counsel sought an all-in award of $24.75 million. *Digex, supra,* tr. at 108. Plaintiff's counsel had entered into an engagement letter with two large institutional investors that provided for a maximum fee equal to 15% of the benefit. *Id.* at 80, 82. Rather than seeking 15% of the entire benefit, plaintiff's counsel asked for 15% of the $165 million fund. *Id.* at 103.

The expedited nature of the case meant that plaintiff's counsel had a lodestar of approximately $1.4 million plus expenses of $580,000. *Id.* at 142. The court worked through the *Sugarland* factors and awarded a fee of $12.3 million, reflecting 7.5% of the settlement fund. *Id.* at 147. The court declined to award the full amount requested because after considering the lodestar crosscheck, the court thought that the award was too generous. *Id.* at 146. The court specifically noted that the 5% suggested by the committee, although consistent with awards in mega-fund cases, would have been "unduly punishing or unfair to the plaintiffs." *Id.* at 149.

The *Digex* decision does not reflect a mega-fund reduction but rather a combination of factors, including (i) shared causation, (ii) an expedited case resulting in a comparatively low lodestar, (iii) a negotiated fee agreement providing for a maximum fee of 15%, and (iv) a traditional *Sugarland* analysis. The *Digex* decision is therefore not a strong case for the declining-percentage method. It also predates *Americas Mining* and its adoption of the stage-of-case method.

Next, the objectors rely on *Crawford*, which they perceive as a *de facto* example of a downward adjustment in a mega-fund case. Not so. The plaintiffs filed suit in *Crawford* just before Christmas. Six weeks later, they obtained a disclosure-based injunction that delayed a merger vote. *La. Mun. Police Empls.' Ret. Sys. v. Crawford*, 2007 WL 625006, at *1 (Del. Ch. Feb. 13, 2007). Two weeks after that, the Court of Chancery held that the merger triggered appraisal rights and issued an injunction that further delayed the merger vote pending additional disclosure. *La. Mun. Police Empls.' Ret. Sys. v. Crawford*, 918 A.2d 1172, 1176 (Del. Ch. 2007). Shortly thereafter, the case settled for an increase in the transaction consideration of $1.60 per share, worth $660 million in the aggregate. Notably, a second bidder had appeared, and the threat of a topping bid played a major role in the price bump. *La. Mun. Police Empls.' Ret. Sys. v. Crawford*, C.A. No. 2635-CC, at 5, 13 (Del. Ch. June 8, 2007) (TRANSCRIPT).

Plaintiff's counsel requested and received an all-in fee of $20 million, which the court approved. The objectors claim that because the fee equated to only 3% of the $660 million bump, it must reflect a downward adjustment for a mega-fund. To the contrary, there was a second bidder, so causation issues again loomed large. Using the rule of thumb of 20% to 25% credit, plaintiff's counsel could credibly claim a benefit of approximately $132 million to $165 million, with the $20 million translating to 12% to 15% that range. Those percentages are in line with an early to mid-stage settlement, which is apt for *Crawford*. The expedited injunction phase of the litigation unfolded over ten weeks, and the case progressed little after that point. The court viewed the application as a measured request, and the lodestar cross-check suggested an implied rate of a "couple thousand dollars or more." *Id.* at 15. The *Crawford* decision was a straightforward application of *Sugarland*, not a percentage reduction in a mega-fund case.

Finally, the objectors rely on the fee award in *Southern Peru*, which the Delaware Supreme Court affirmed in *Americas Mining*. That case involved a derivative recovery of $1.9 billion (including pre-judgment interest). *See In re S. Peru Copper Corp. S'holder Deriv. Litig.*, 52 A.3d 761, 819 (Del. Ch. 2011). Even though the case went all the way to a judgment, the plaintiffs sought only 22.5%, not 33%, which still represented a fee request of $428.2 million. The defendants proposed $14 million. Chief Justice Strine, then serving as Chancellor, reduced the percentage from 22.5% to 15%, citing a series of factors. In a passage that the objectors emphasize, he stated:

> Now, I gave a percentage of only 15 percent rather than 20 percent, 22 1/2 percent, or even 33 percent because the amount that's requested is large. I did take that into account. Maybe I am embracing what is a declining thing. I've tried to take into account all the factors, the delay, what was at stake, and what was reasonable. And I gave defendants credit for their arguments by going down to 15 percent. The only basis for some further reduction is, again, envy or there's just some level of too much, there's some natural existing limit on what lawyers as a class should get when they do a deal.

Ams. Mining, 51 A.3d at 1259 (quoting trial court ruling). The objectors regard this as an endorsement of the declining-percentage approach, but it actually reflects the Chancellor's consideration of all of the *Sugarland* factors, including the plaintiff's delay in prosecuting the case. Elsewhere in the transcript, the Chancellor criticized the concept of a reduction in mega-fund cases. *See In re S. Peru S'holder Litig.*, No. 961-CS, at 77, 83 (Del. Ch. Dec. 19, 2011) (TRANSCRIPT). As part of his remarks, he noted that other contingently compensated professionals, such as investment bankers and fund managers, do not have their fees reduced as the value that they generate increases, and he queried why lawyers should be treated differently. *Id.* at 81–82, 97–99, 102–04. While serving on this court, Chief Justice Strine had made similar comments in other transcript rulings approving fee awards.[15]

As these precedents show, *Americas Mining* and its progeny neither call for nor commend a practice of reducing the percentage of the benefit awarded as a fee in a mega-fund case. The *Americas Mining* framework uses a stage-of-case method that rewards plaintiff's counsel for the greater risk associated with pushing deeper into the case. "The incentive effects of the sliding [fee] scale apply equally to large and small settlements." *Activision*, 124 A.3d at 171. Under *Americas Mining* and *Sugarland*, a court does not make a downward adjustment to the indicative percentage based on the size of the fund.

ii. Federal Securities Cases

The objectors and professors are on stronger ground when they look to fee awards in federal securities actions. They have shown that when awarding fees for settlements of $1 billion or more, federal courts award approximately 10% of the common fund. They have also shown that some federal courts expressly adjust the percentage downward if it

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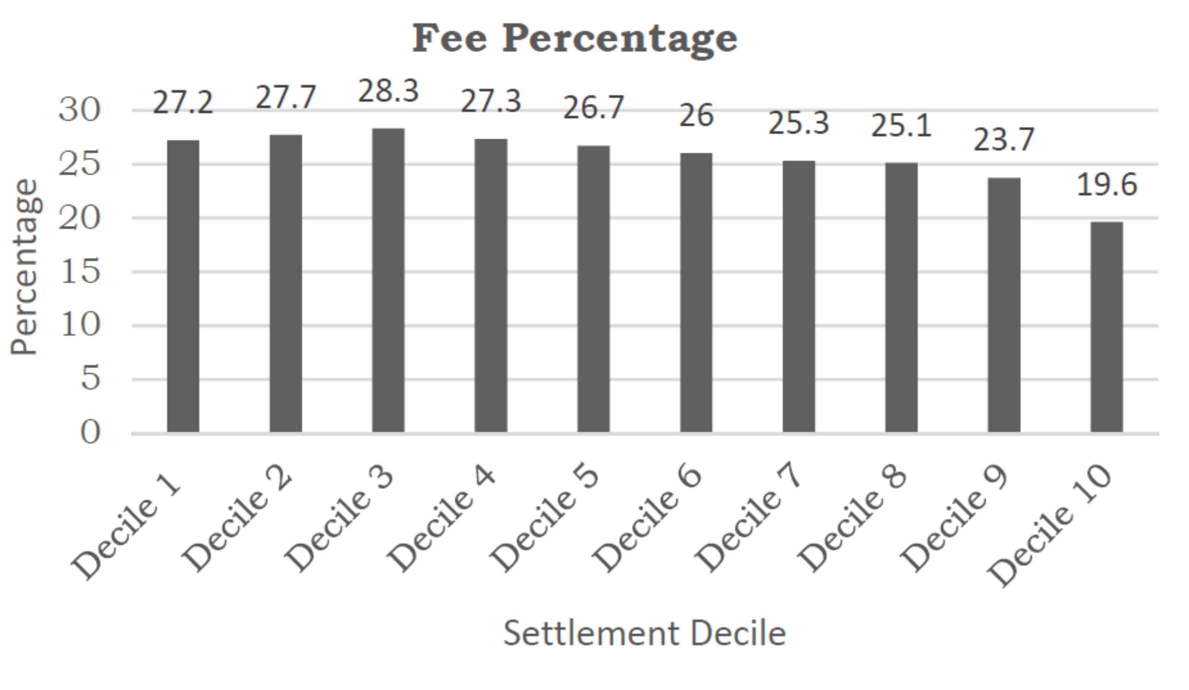
[15] *See In re Clear Channel Outdoor Hldgs., Inc., Deriv. Litig.*, 2013 WL 5563370, at *19 (Del Ch. Sept. 9, 2013) (TRANSCRIPT) ("We've always adhered to the idea that if you get a very solid recovery, you should have a very solid fee. That's the way the best incentive system works. You don't want to say, 'If you get really good results, we're going to shave your fee.' That doesn't make any sense. We should be shaving a fee when there are not really good results."); *Forgo v. Health Grades, Inc.*, 2011 WL 9535201, at 65 (Del. Ch. June 29, 2011) (TRANSCRIPT) ("[T]he declining percentage doesn't interest me because I do think you want people—if people swing for the fences and they hit the home run, they deserve the home run fee."); *In re Am. Int'l Gp., Inc. Cons. Deriv. Litig.*, C.A. No. 769-VCS, at 9–10 (Del. Ch. Jan. 25, 2011) ("I've said this before and I will continue to say it—that, you know, you don't reduce people's fees because they gain much. You should, in fact, want to create an incentive for real litigation.").

generates an implied hourly rate that strikes the judge as too high. But while the objectors and professors have shown that the federal courts use that framework for securities actions, they have not shown that the same framework should apply in a Chancery M&A case where a plaintiff seeks post-closing monetary relief. The two types of litigation are superficially similar, but there are significant differences.

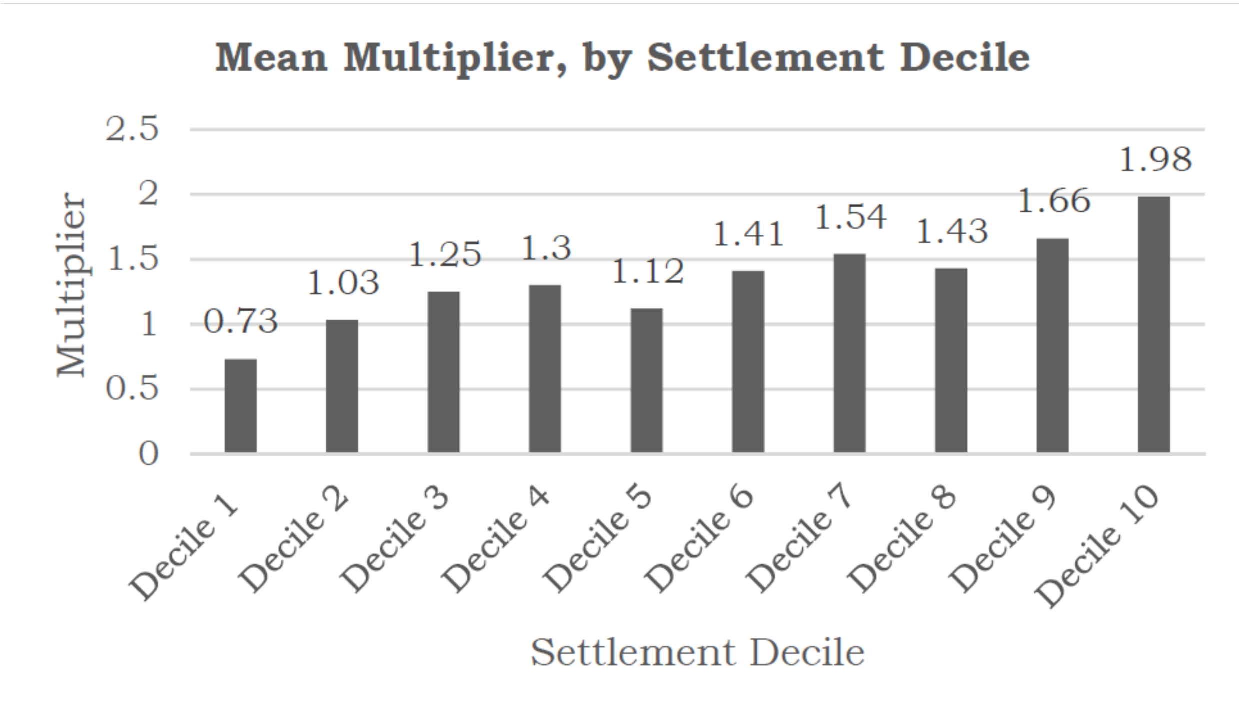
As noted, the objectors and the professors have demonstrated that federal courts use a declining-percentage method for securities class actions. A 2022 report by Nera Consulting that studied federal securities cases from 2012 to 2021 found that the median percentage award gradually declines from 33.5% to 25.8% as the common fund increases from $5 million or less to $500 million. The median percentage falls to 17.7% for common funds between $500 million and $1 billion. The median percentage drops to 10.5% for common funds exceeding $1 billion. Obj., Ex. B at 27. The ten largest federal securities settlements of all time—all common funds of $1 billion or more—generated an average award of 9.4%. *Id.* at Ex. C. Likewise, an academic study published in 2010 found that "fee percentage is strongly and inversely associated with settlement size . . .; [when] a settlement size of $100 million was reached . . . fee percentages plunged well below 20 percent." Brian T. Fitzpatrick, *An Empirical Study of Class Action Settlements and Their Fee Awards*, 7 J. Empirical Legal Stud. 811, 814 (2010). For settlements between $500 million and $1 billion, the median was 12.9%, and for settlements over $1 billion, the median was 9.5%. *Id.* at 839, tbl. 11.

Two of the professors are co-authors of a forthcoming article that drills deeper into these issues. *See* Stephen Choi, Jessica M. Erickson & A.C. Pritchard, *The Business of*

Securities Class Action Lawyering, 99 Ind. L. J. (forthcoming), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4350971 [hereinafter *Securities Lawyering*]. The authors collected data on every federal class action involving a securities disclosure claim against a public company from 2005 and 2018, for a total of 2,492 class actions. From the dockets, they hand-collected more than 200 variables for each case. By any measure, it is an impressive effort. Organizing the cases by deciles, they find that percentage fee awards range between 26% and 28% until the seventh decile, when they decline moderately, then decline further in the tenth decile to 19.6%.



The professors also seek to counter the argument that the declining-percentage method creates disincentives for plaintiff's counsel to litigate large cases. Using their decile-based system, they calculate the fee award as a multiple of lodestar. They find that although the award as a percentage of the common fund declines as the fund increases, the lower percentages generate higher multiples to lodestar. Larger cases are thus more profitable, even with lower percentage-based awards. The professors conclude that the declining-percentage method does not create a disincentive for lawyers to litigate larger securities cases.



The authors of the *Securities Lawyering* article also find that the likelihood of non-recovery for a plaintiff's firm falls dramatically after a securities case survives a motion to dismiss. *Id.* at 60. The authors suggest that the hours that a plaintiff's firm incurs after surviving a motion to dismiss carry a smaller risk of non-recovery and should be worth less when a court awards fees. The article concludes that, relative to risk, plaintiffs' counsel are undercompensated before a motion to dismiss, but overcompensated afterward. Relatedly, the authors find that top-earning plaintiff's firms tend to win lead counsel fights in cases with stronger indicia of wrongdoing. They note that because of those stronger indicia, those cases are more likely to achieve settlements. The professors conclude that for the cases that top-tier lawyers file, the hours are less risky still, suggesting that those firms are overcompensated.

Finally, the professors observe that in federal securities actions, larger issuers will have larger damages (all else equal). *Id.* at 62. Earlier scholars made the same point: "Damages reflect the market losses when the fraud is uncovered. A larger company will have correspondingly larger market losses, regardless of the skills or performance of the law firms in the resulting litigation." Eisenberg & Miller, *supra*, at 64. If a principal driver of the larger recoveries is the larger capitalizations associated with big issuers, then awarding the same percentage of a larger recovery simply rewards plaintiffs' counsel for suing a larger firm.

These all seem to be valid points for federal securities actions, but that does not mean that the declining-percentage method is optimal for judges to use, even in federal securities cases. Professor Brian Fitzpatrick has authored a helpful overview of different approaches for setting fees. *See* Brian T. Fitzpatrick, *A Fiduciary Judge's Guide to Awarding Fees In Class Actions*, 89 Fordham L. Rev. 1141 (2021) [hereinafter *Judge's Guide*]. He argues that judges should attempt to replicate the terms on which a sophisticated client would retain counsel, and he evaluates how sophisticated clients structure contingent fees in the real world. He finds that sophisticated clients consistently opt for a percentage-of-the-benefit model, "either with fixed percentages or escalating percentages as litigation matures." *Id.* at 1160. Professor Fitzpatrick believes that judges likewise should use that method. *Id.* at 1163; *accord id.* at 1153–54. That is what the *Americas Mining* stage-of-case method does.

Professor Fitzpatrick has little good to say about the declining-percentage method. He notes that this approach "is unheard of in the marketplace." *Id.* at 1167. Thus, "[i]f judges want to do what rational absent class members would want to do, then they should not do this." *Id.* He also offers reasons why clients would not want to bargain for a decreasing percentage, notwithstanding the possibility of economies of scale. The reasons include (i) the transaction costs associated with negotiating away from a one-third, fixed-percentage arrangement, (ii) strategic uncertainties if parties have asymmetric information about the merits of the case, and (iii) the need for increased monitoring for premature settlements. *Id.* at 1163. Increased monitoring is necessary because the declining-percentage method fails to provide counsel with a predictable incentive to press forward with the case. Instead, a client (or the court) must assess the legitimacy of the hours that the attorneys have invested to test for overcompensation. *Id.* at 1167. He concludes with the observation that while incorporating the benefits of economies of scale might be desirable, "bringing marginal price down to marginal cost is not free." *Id.* at 1168.

Professor Fitzpatrick makes a strong argument against using the declining-percentage method in federal securities cases, notwithstanding the data that the professors have presented. But assuming the declining-percentage method is a reasonable approach for federal securities litigation, it still may not be a reasonable approach for Chancery M&A litigation.

For starters, the federal courts seem to be using the declining-percentage method as a backdoor—and backward looking—lodestar method. Under the traditional lodestar method, a court begins with counsel's lodestar and applies a risk multiplier to increase the fee to account for risk. Under the declining-benefit method, the court starts with a percentage of benefit conferred, then decreases the fee until the risk multiplier seems appropriate for the risk. In *Sugarland*, the Delaware Supreme Court rejected the lodestar approach. 420 A.2d at 150. This court should not be deploying the declining-percentage methodology to undermine that decision.

Next, it is far from clear that the attributes of Chancery M&A litigation in the post-*Trulia* era are sufficiently similar to federal securities actions to warrant similar treatment. What we lack—and what would be wonderful to have—is a thorough study akin to the analysis conducted in *Securities Lawyering*. For now, I must operate based on my own experience as a judge and practitioner, plus learning from a handful of articles that have looked at aspects of Chancery M&A litigation during the pre-*Trulia* period.[16]

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[16] *See* Matthew B. Cain & Steven Davidoff Solomon, *A Great Game: The Dynamics of State Competition and Litigation*, 100 Iowa L. Rev. 465 (2015); John Armour, Bernard Black & Brian Cheffins, *Delaware's Balancing Act*, 87 Ind. L. J. 1345 (2012); John Armour, Bernard Black & Brian Cheffins, *Is Delaware Losing Its Cases?*, 9 Empirical Legal Stud. 605 (2012); Bernard Black, Brian Cheffins & John Armour, *Delaware Corporate Litigation and the Fragmentation of the Plaintiff's Bar*, 2012 Colum. Bus. L. Rev. 427; Elliott J. Weiss & Lawrence J. White, *File Early, Then Free Ride: How Delaware Law (Mis)Shapes Shareholder Class Actions*, 57 Vand. L. Rev. 1797 (2004); Randall S. Thomas & Robert B. Thompson, *The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions*, 57 Vand. L. Rev. 133 (2004).

At the outset, candor demands conceding the existence of a number of surface-level similarities between federal securities cases and Chancery M&A litigation.

- Both seek to supply private enforcement of legal norms but are vulnerable to abuse.
- Similar types of plaintiffs appear in both types of actions.
- Both types of litigation are largely lawyer driven, and some of the same firms appear in both types of cases.
- Both types of litigation involve contingent compensation arrangements that give rise to similar conflicts of interest and agency costs.

But there are significant differences. One is the sheer volume of federal securities litigation and the magnitude of the recoveries. During the period from 2017 to 2021, there were 850 core federal securities lawsuits that asserted claims under Rule 10b-5. *See* Cornerstone Research, *Securities Class Action Filings: 2021 Year In Review* 4 (2022). Over the same period, there were 397 settlements that generated common funds totaling $15.4 billion. Cornerstone Research, *Securities Class Action Settlements: 2021 Review and Analysis* 3 (2022). Nearly half (46.7%) of the cases resulted in favorable settlements.

Only two articles have examined Chancery M&A litigation post-*Trulia*. One looked at suits in 2017, the first post-*Trulia* year, so its value is limited. Matthew B. Cain et al., *The Shifting Tides of Merger Litigation*, 71 Vand. L. Rev. 603 (2018) [hereinafter *Shifting Tides*]. The other charted a diaspora in which the lawyers responsible for filing the lowest quality lawsuits fled from Delaware to the federal courts. Sean J. Griffith, *Frequent Filer Shareholder Suits in the Wake of* Trulia*: An Empirical Study*, 2020 Wis. L. Rev. 443 (2020) [hereinafter *Frequent Filer*]. Those lawsuits do not generate monetary recoveries and so are not pertinent. I have nevertheless drawn on those articles to the extent possible.

Across the same period (2017 to 2021), there were 913 lawsuits filed in the Delaware Court of Chancery asserting claims for breach of fiduciary duty.[17] More finely grained data is not available, so this figure includes not only M&A litigation but also all other types of fiduciary duty litigation, such as derivative actions. While the topline figure is roughly similar to the number of federal securities filings, the other datapoints are vastly lower. The plaintiff has identified just ten settlements generating common funds in cases subject to entire fairness review, and those cases yielded aggregate settlement proceeds of $449.47 million.[18] They identified another nine settlements generating common funds in cases governed by enhanced scrutiny, and those cases yielded aggregate settlement proceeds of $226 million.[19] Between 2017 and 2021, Chancery M&A litigation thus

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[17] The per-year figures are 142 in 2017, 165 in 2018, 196 in 2019, 194 in 2020, and 216 in 2021.

[18] *See* Dkt. 514 Ex. 7 at 1–7. For the period from 2012 to 2022, the plaintiff identified a total of twenty-three settlements in entire fairness cases. The ten settlements reached in the years from 2017 to 2021 were *Cornerstone* (2017), *Starz* (2018), *Good Technology* (2018), *Calamos* (2019), *Handy & Harmon* (2019), *Schuff* (2020), *Weinstein* (2020), *Malone* (2021), *Amtrust* (2021), and *Alon USA* (2021). There were six settlements reached in 2022: *TD Bank*, *Pivotal*, *Straight Path*, *AVX*, *Akcea*, and *HomeFed*. Those six settlements generated aggregate proceeds of $164 million. There were another seven settlements during the period from 2012 to 2016: *Delphi* (2012), *CNX Gas* (2013), *Orchard* (2014), *Jefferies* (2015), *GFI Group* (2016), *Venoco* (2016), and *C&D Tech* (2016). Those seven settlements generated aggregate proceeds of $199 million. There was also a post-trial settlement in *Dole* in 2016, which the plaintiffs did not identify, that generated a common fund of $115.7 million. The plaintiff identified one settlement from 2023, but to avoid an open-ended inquiry, the court cut off the sample at year-end 2022.

[19] *See* Dkt. 514 Ex. 7 at 8–14. For the period from 2012 to 2022, the plaintiff identified a total of nineteen settlements in enhanced scrutiny cases. The nine settlements reached in the years from 2017 to 2021 were *ExamWorks* (2017), *Dreamworks* (2018),

generated a total of nineteen common fund settlements (versus 397 in federal securities actions) and a total of $675.47 million in proceeds (versus $15.4 billion from federal securities actions). In federal securities actions, settlements were reached in approximately 46.7% of the new filings over the same period. Assuming conservatively that M&A litigation represented one-third of the breach of fiduciary duty cases filed over the same period, settlements were reached in less than 10% of new filings during that period. These figures suggest that per case filed, plaintiff's lawyers in Chancery M&A litigation face far higher rates of dismissal, far lower prospects of settlement, and far smaller potential recoveries.

Another difference is the ability of plaintiff's counsel to identify high quality cases. As the *Securities Litigation* article notes, high quality securities cases often follow the filing of criminal charges, the firing of a top officer, or a financial restatement. *See Securities Litigation*, *supra*, at 13–14. Although half of all securities actions are dismissed at the pleading stage, that statistic plummets for cases where there are strong initial indicia of wrongdoing. Only 9.1% of cases are dismissed where there is a parallel SEC investigation, only 13.9% where there is another government investigation, only 25.9%

Saba Software (2018), *Appel* (2020), *KCG Holdings* (2020), *Tangoe* (2020), *Towers Watson* (2021), *Searles* (2021), and *Weiss* (2021). There were three settlements reached in 2022: *Columbia Pipeline*, *CVR*, and *Mindbody*. Those three settlements generated aggregate proceeds of $184.5 million. There were another seven settlements during the period from 2012 to 2016: *El Paso* (2012), *Gardner Denver* (2014), *Arthrocare* (2014), *Globe Specialty Materials* (2016), *PLX* (2016), *Tibco* (2016), and *Chen v. Howard-Anderson* (2016). Those settlements generated aggregate proceeds of $262.6 million. There was also the damages recovery of $70 million in *Rural Metro* in 2014.

where there is an officer termination, and only 9.6% where there is a restatement. *Id.* at 29. Although derivative actions in the Court of Chancery often follow a corporate trauma, suggesting similar dynamics may be in play, comparable signals do not exist for Chancery M&A litigation. True, some types of M&A cases—such as transactions involving controlling stockholders—involve conflicts of interest and make a complaint more likely to survive a motion to dismiss, but rarely are deals singled out by federal or state prosecutors, flagged by agency investigations, or marked by similar red flags. To the contrary, the defendants in Chancery M&A litigation are well-represented by sophisticated law firms who are trying to craft a record that causes the litigation to fail at the outset. *See generally* Leo E. Strine, Jr., *Documenting the Deal: How Quality Control and Candor Can Improve Boardroom Decision-Making and Reduce the Litigation Target Zone*, 70 Bus. Law. 679 (2015). For Chancery M&A litigation, plaintiff's lawyers must read between the lines of the background section of a proxy statement, then conduct their own investigations using Section 220 of the Delaware General Corporation Law or other tools at hand. I suspect there is no class of M&A cases where dismissal rates resemble the levels reported for high-quality securities class actions.

Along similar lines, the mega-settlements achieved in federal securities actions have often benefited from criminal or regulatory investigations. The massive securities settlements that the objectors and the professors have cited include some of the greatest hits of corporate malfeasance: Enron (2012), Cendant (2000), Petrobras (2018), Bank of America (2013), Nortel (2006), Valeant (2021), Worldcom (2005), Tyco (2007), AOL Time Warner (2006), Household (2016), and Royal Ahold (2006). Prosecutors criminally charged senior executives from Enron, WorldCom, Cendant, Tyco, Petrobras, Nortel, Royal Ahold, and Valeant. They charged mid-level executives from AOL Time Warner. State investigators sued Household and settled for $484 million. The Bank of America issues were the subject of intense investigations into the events leading to the 2008 financial crisis. As the authors of *Securities Litigation* acknowledge, "The billion-dollar settlements in cases against companies like Enron or Petrobas may function as a lottery ticket of sorts." *Securities Litigation*, *supra*, at 36. There is no similar lottery effect in Chancery M&A litigation. Plaintiff's counsel can only secure a large settlement by conducting a detailed investigation before filing suit, surviving a motion to dismiss, building a strong case through discovery, then being prepared to litigate through trial.

A third difference is the relative risk that plaintiff's counsel undertakes after a case survives a motion to dismiss. Securities class actions almost never go to trial, and many settle prior to discovery. *Id.* at 8 n.37, 54. Chancery M&A litigation is different, even for transactions governed by the entire farness test. "While the reverberations of isolated plaintiffs' victories continue to echo in the collective consciousness, scholarly research establishes that only exceptional entire fairness cases result in meaningful damages awards."[20] Since *Americas Mining*, there have been at least ten post-trial decisions in entire

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[20] *Basho*, 2018 WL 3326693, at *35. *See, e.g.*, Reza Dibadj, *Networks of Fairness Review in Corporate Law*, 45 San Diego L. Rev. 1, 22 (2008) (noting that "[w]hile the conventional wisdom might suggest that standards of review are typically outcome determinative, the empirical research suggests the fairness standard is not" and cataloging cases where defendants prevailed (footnote omitted)); Julian Velasco, *A Defense of the Corporate Law Duty of Care*, 40 J. Corp. L. 647, 689 (2015) (collecting cases where

fairness cases where the defendants prevailed,[21] plus three more where the court awarded only nominal damages of $1.00.[22] Not only that, but plaintiffs who have prevailed at trial

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defendants prevailed under entire fairness and noting that "[o]nce applied, the entire fairness test is no longer considered outcome-determinative").

[21] *See In re Oracle Corp. Deriv. Litig.*, 2023 WL 3408772 (Del. Ch. May 12, 2023); *In re BGC P'rs, Inc. Deriv. Litig.*, 2022 WL 3581641 (Del. Ch. Aug. 19, 2022); *Coster v. UIP Cos., Inc.*, 2022 WL 1299127 (Del. Ch. May 2, 2022), *aff'd*, 255 A.3d 953 (Del. 2023); *In re Tesla Motors, Inc. S'holder Litig.*, 2022 WL 1237185 (Del. Ch. Jan. 18, 2022), *aff'd*, --- A.3d ----, 2023 WL 3854008 (Del. June 6, 2023); *Dieckman v. Regency GP LP*, 2021 WL 537325 (Del. Ch. Feb. 15, 2021); *Frederick Hsu Living Tr. v. Oak Hill Cap. P'rs III, L.P.*, 2020 WL 2111476 (Del. Ch. May 4, 2020); *ACP Master, Ltd. v. Sprint Corp.*, 2017 WL 3421142, at *1 (Del. Ch. July 21, 2017), *aff'd*, 184 A.3d 1291 (Del. 2018); *Quadrant Structured Prods. Co. v. Vertin*, 102 A.3d 155 (Del. Ch. 2014); *In re Trados Inc. S'holder Litig.*, 73 A.3d 17 (Del. Ch. 2013); *Zimmerman v. Crothall*, 62 A.3d 676 (Del. Ch. 2013).

Defendants enjoyed success under the entire fairness standard before *Americas Mining* as well. For earlier Delaware Supreme Court decisions affirming post-trial judgments finding that transactions were entirely fair, see *Kahn v. Lynch Commc'n Sys., Inc.*, 669 A.2d 79 (Del. 1995); *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156 (Del. 1995); *Nixon v. Blackwell*, 626 A.2d 1366 (Del. 1993); *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929 (Del. 1985). For earlier Delaware Court of Chancery decisions finding that transactions were entirely fair, see *S. Muoio & Co. LLC v. Hallmark Ent. Invs. Co.*, 2011 WL 863007 (Del. Ch. Mar. 9, 2011), *aff'd*, 35 A.3d 419 (Del. 2011); *In re John Q. Hammons Hotels Inc. S'holder Litig.*, 2011 WL 227634 (Del. Ch. Jan. 14, 2011); *Hanover Direct, Inc. S'holders Litig.*, 2010 WL 3959399 (Del. Ch. Sept. 24, 2010); *Kates v. Beard Rsch., Inc.*, 2010 WL 1644176 (Del. Ch. Apr. 23, 2010); *In re Cysive, Inc. S'holders Litig.*, 836 A.2d 531 (Del. Ch. 2003); *Emerald P'rs v. Berlin*, 2003 WL 21003437 (Del. Ch. Apr. 28, 2003), *aff'd*, 840 A.2d 641 (Del. 2003); *Liberis v. Europa Cruises Corp.*, 1996 WL 73567 (Del. Ch. Feb. 8, 1996), *aff'd*, 702 A.2d 926 (Del. 1997); *Van de Walle v. Unimation, Inc.*, 1991 WL 29303 (Del. Ch. Mar. 7, 1991); *Citron v. E.I. Du Pont de Nemours & Co.*, 584 A.2d 490 (Del. Ch. 1990); *Rabkin v. Olin Corp.*, 1990 WL 47648 (Del. Ch. Apr. 17, 1990), *aff'd*, 586 A.2d 1202 (Del. 1990) (TABLE); *Shamrock Hldgs., Inc. v. Polaroid Corp.*, 559 A.2d 257 (Del. Ch. 1989); *see also Kleinhandler v. Borgia*, 1989 WL 76299 (Del. Ch. July 7, 1989) (summary judgment).

[22] *See Ravenswood Inv. Co., L.P. v. Est. of Winmill*, 2018 WL 1410860 (Del. Ch. Mar. 21, 2018), *aff'd*, 210 A.3d 705 (Del. 2019); *Ross Hldg. & Mgmt. Co. v. Advance*

continue to face significant risk on appeal. As noted previously, since *Americas Mining*, the Delaware Supreme Court has heard appeals from six post-trial damages awards in which representative plaintiffs obtained cash recoveries and the defendants challenged the liability determination. The high court affirmed the first two and reversed the next four. In federal securities litigation, prevailing on a motion to dismiss makes settlement highly likely. Cases are not tried, so there is no risk of a post-trial loss or a reversal of a victory on appeal. In Chancery M&A litigation, the calculus is quite different. Cases are tried. The risk of a post-trial loss is real, and the risk of reversal is high.

That said, the record provides some support for one consideration that the professors rely on to argue for the declining-percentage method in federal securities cases. Data from precedent settlements indicates that just as securities law settlements vary based on market capitalization, Chancery M&A settlements vary based on deal size. While I have neither an extensive dataset nor the professors' statistical expertise, I have run some simple regressions using the settlement data that plaintiff's counsel provided.

The first group consists of twenty-four settlements in deal cases since *Americas Mining* where entire fairness presumably applied. *See* Dkt. 514 Ex. 7. Eight involved transactions valued at less than $100 million (*Handy & Harmon*; *Cornerstone*; *C&D Technology*; *Salladay*; *Good Technologies*; *Schuff*; *Orchard*; and *Weinstein*). Scholars

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Realty Gp., LLC, 2014 WL 4374261 (Del. Ch. Sept. 4, 2014); *In re Nine Sys. Corp. S'holders Litig.*, 2014 WL 4383127 (Del. Ch. Sept. 4, 2014). For an earlier decision awarding only nominal damages, see *Oliver v. Bos. Univ.*, 2006 WL 1064169 (Del. Ch. Apr. 14, 2006).

often exclude deals under $100 million from datasets because they have unique attributes.[23] This decision does the same.

That leaves a total of seventeen datapoints: sixteen precedents plus the settlement in this case.

	Transaction	Transaction Value (Millions)	Settlement Value (Millions)
1	Calamos	$130.00	$30.00
2	Homefed	$156.30	$15.00
3	Venoco	$363.00	$19.00
4	GFI Group	$366.00	$10.75
5	Alon USA Energy	$407.00	$44.75
6	Akcea	$446.50	$12.50
7	CNX Gas	$605.88	$42.70
8	AVX	$1,030.00	$49.90
9	Amtrust	$1,040.00	$40.00
10	Pivotal	$1,430.00	$42.50
11	Jefferies	$2,400.00	$70.00
12	Straight Path	$2,450.00	$12.50
13	Delphi	$2,500.00	$49.00
14	Starz	$4,400.00	$92.50
15	Malone	$7,400.00	$110.00
16	***Dell Class V***	***$23,900.00***	***$1,000.00***
17	TD Bank	$26,000.00	$31.50

A linear regression using this data generates a best-fit line with an R-squared of 0.4109, a P value of 0.0056, and an F value of 10.46, indicating that approximately 41%

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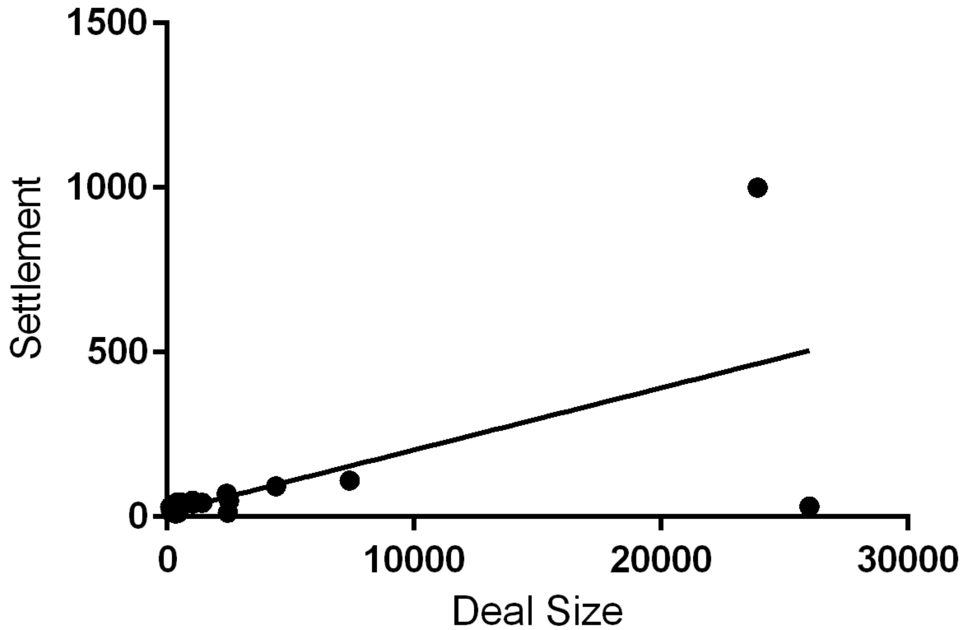
[23] *See, e.g.*, Matthew D. Cain, Antonio J. Macias & Steven Davidoff Solomon, *Broken Promises: The Role of Reputation in Private Equity Contracting and Strategic Default*, 40 J. Corp. L. 565, 579–580 (2015); Brian JM Quinn, *Optionality in Merger Agreements*, 35 Del. J. Corp. L. 789, 809 (2010); Steven M. Davidoff, *The Failure of Private Equity*, 82 S. Cal. L. Rev. 481, 483–84 n.11 (2009).

of the variation in the size of the settlement is explained by the size of the transaction using the formula Y= 0.01885*X + 15.22. The following plot illustrates that result:

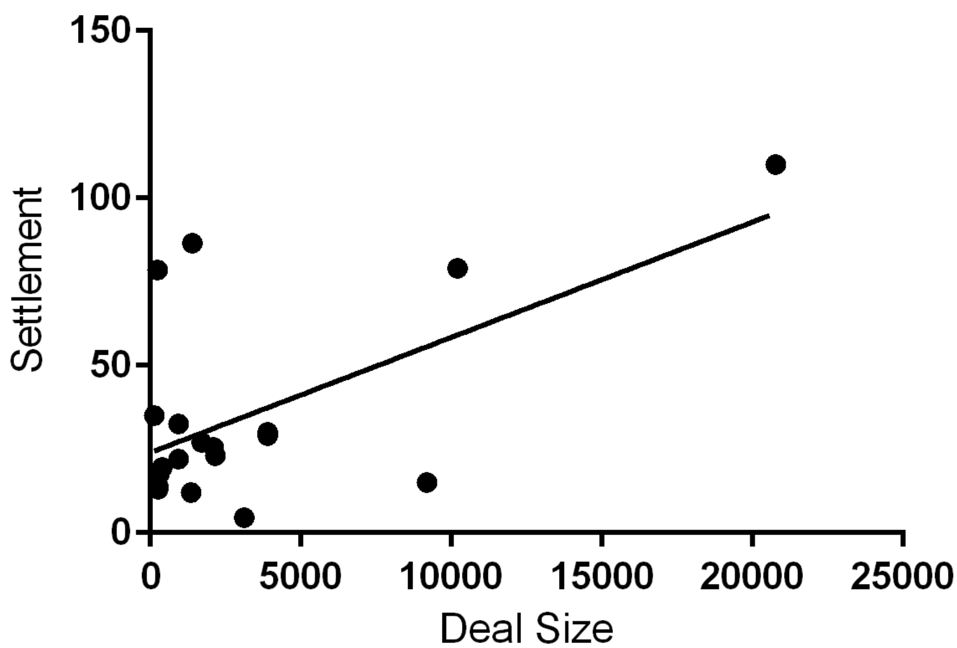


The second group consists of twenty settlements in deal cases since *Americas Mining* where enhanced scrutiny presumably applied. *See* Dkt. 514 Ex. 7. None of the transactions had deal values under $100 million, so none need to be excluded.

	Case	Transaction Value (Millions)	Settlement Value (Millions)
1	Chen	$130.10	$35.00
2	CVR	$240.50	$78.50
3	Tangoe	$256.00	$13.00
4	PLX	$260.00	$14.10
5	Weiss	$302.00	$17.50
6	Saba Software	$400.00	$19.50
7	KCG	$932.00	$22.00
8	Globe Specialty	$937.00	$32.50
9	Arthrocare	$1,360.00	$12.00
10	ExamWorks	$1,400.00	$86.50
11	MindBody	$1,700.00	$27.00

12	Appel v. Berkman	$2,100.00	$25.50
13	Searles v. DeMartini	$2,160.00	$23.00
14	Dreamworks	$3,120.00	$4.50
15	Gardner Denver	$3,900.00	$29.00
16	Tibco	$3,900.00	$30.00
17	Towers Watson	$9,192.00	$15.00
18	Columbia Pipeline	$10,200.00	$79.00
19	El Paso	$20,770.00	$110.00

A linear regression using this data generates a best-fit line with an R-squared of 0.3477, a P value of 0.0079, and an F value of 9.063, indicating that approximately 35% of the variation in the size of the settlement is explained by the size of the transaction using the formula Y= 0.003446*X + 23.98. The following plot illustrates that result:



Although both datasets show a statistically significant relationship between transaction size and settlement size, the sample sizes are small. The relationship could be a Type-I error (false positive), or the explanatory power could be low. I am particularly leery of the latter risk. The settlements in *TD Bank* and this case are prominent outliers in the dataset for entire fairness cases, which is the more relevant dataset for this case.[24] Without those two datapoints, a basic linear regression using the other fifteen datapoints generates a best-fit line with an R-squared of 0.704, a P value of less than 0.0001, and an F value of 30.92, indicating that approximately 70% of the variation in the size of the settlement is explained by the size of the transaction using the formula Y= 0.01246*X + 21.87. Adding the settlements in *TD Bank* reduces the explanatory power of transaction size to approximately 41%. Not only that but the equation without those two datapoints predicts that a settlement in a case challenging a $23.9 billion deal should be around $320 million, yet this case the settlement is over three times that amount, and the settlement in *TD Bank* (a challenge to a $26 billion deal) was under one-tenth that amount.

The indications from the two datasets are not sufficiently persuasive to support a departure from *Americas Mining*. The other reasons that plausibly justify using the declining-percentage method in federal securities actions do not carry over to Chancery M&A litigation. If future research points to greater crossover or otherwise supports a different method, then I personally would be open to considering it. At present, that

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[24] Or so I thought. The separate datasets for enhanced scrutiny and entire fairness cases reflect a prior expectation that the standard of review would affect the distribution of outcomes. Interestingly, using the combined dataset and regressing a dummy variable for whether the transaction was subject to entire fairness review did *not* generate a statistically significant result. When the datasets are combined, the relationship between deal size and settlement size remains significant. A linear regression using the combined dataset generates a best-fit line with an R-squared of 0.3287, a P value of 0.0003, and an F value of 16.65, indicating that approximately 33% of the variation in the size of the settlement is explained by the size of the transaction using the formula Y= 0.01430*X + 10.21.

showing has not been made. One of the professors said it best in a tweet about the *Securities Litigation* study: "Delaware cases are different and not part of our study."[25] I agree.

Turning from the general to the specific, none of the reasons for a mega-fund reduction apply to this case. The risk of a non-recovery in this case (at trial or on appeal) was significant, and the risk intensified as trial approached. The recovery of $1 billion does not seem to have been the product of deal size. It is rather a landmark settlement that dwarfs the aggregate recoveries in all other settlements in entire fairness cases since *Americas Mining*, which total $642 million. The $1 billion recovery in this case is approximately equal to the aggregate recoveries in all of the Chancery M&A settlements since *Americas Mining*, which generated total recoveries of $1.055 billion. Reducing the requested award is not necessary from a compensatory perspective, because the implied rate of approximately $5,000 per hour is lower than rates this court has approved for smaller recoveries. *See* Brief for Plaintiff at 64, *Activision*, 124 A.3d 1025 (2015) (C.A. No. 8885-VCL) (collecting fee awards with higher implied hourly rates). The multiple to lodestar of 7x in this case would not raise a federal eyebrow.[26]

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[25] @ProfJErickson, X f/k/a Twitter (Mar. 2, 2023, 6:24 PM), https://twitter.com/ProfJErickson/status/1631435295840149504.

[26] *See, e.g.*, *Farrell v. Bank of Am. Corp., N.A.*, 827 F. App'x 628, 630 (9th Cir. 2020) (10.15x multiplier); *Kane Cnty., Utah v. United States*, 145 Fed. Cl. 15, 19–20 (Fed. Cl. 2019) (6.13x multiplier; collecting cases approving or referencing multipliers between 5.39x to 19.6x); *In re Doral Fin. Corp. Sec. Litig.*, No. 05-MDL-1706 (S.D.N.Y. July 17, 2007) (Dkt. 107) (10.26x multiplier); *New Eng. Carpenters Health Benefits Fund v. First Databank, Inc.*, 2009 WL 2408560, at *2 (D. Mass. Aug. 3, 2009) (8.3x multiplier); *Stop & Shop Supermarket Co. v. SmithKline Beecham Corp.*, 2005 WL 1213926, at *18 (E.D.

The rationales for using the declining-percentage method in federal securities litigation have not been shown to apply to Chancery M&A litigation. In particular, they do not apply to this case. The court will not make a downward adjustment based on the size of the common fund.

c. Evidence From Arm's-Length Agreements

A separate source of evidence for determining an appropriate percentage of the results obtained comes from privately negotiated contingency fee agreements. The objectors and the professors encouraged the court to look to these sources. Other scholars commend that practice.[27] A series of federal decisions have approved using private fee

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Pa. May 19, 2005) (15.6x multiplier); *In re Merry-Go-Round Enters., Inc.*, 244 B.R. 327, 337–38 (Bankr. D. Md. 2000) (19.6x multiplier); *Conley v. Sears, Roebuck & Co.*, 222 B.R. 181, 182 (D. Mass. 1998) (8.9x multiplier).

[27] *See* Choi, *supra*, at 12–13 ("Sophisticated institutional investors, however, may negotiate an ex ante fee agreement when selecting lead counsel. Although a court is not bound by these agreements, courts often take them into account." (internal footnotes omitted)); Lynn A. Baker, Michael A. Perino & Charles Silver, *Is the Price Right? An Empirical Study of Fee-Setting in Securities Class Actions*, 115 Colum. L. Rev. 1371, 1433–34 (2015) (advocating for a system of "[e]x ante review of fee agreements [to] enable[ ] judges to distinguish lead plaintiffs who are doing their jobs from those who are not, before litigation proceeds very far"); Charles Silver, *Unloading the Lodestar: Toward a New Fee Award Procedure*, 70 Tex. L. Rev. 865, 869 (1992) (advocating the replacement of "the lodestar method in all fee-shifting cases, regardless of the kind of relief sought," with an award system "base[d] . . . on fee agreements plaintiffs enter into with their lawyers"); Charles Silver, *A Restitutionary Theory of Attorneys' Fees in Class Actions*, 76 Cornell L. Rev. 656, 700–01, 702–03 (1991) ("Unjust enrichment occurs in class actions because absent plaintiffs enjoy the fruits of an attorney's labor without purchasing the right to do so. The remedy should therefore require absent plaintiffs to pay an amount which, if offered in advance, an attorney would willingly accept. The best guess at that amount is an attorney's usual and customary rate. . . . In cases waged by contingent fee practitioners, it is inappropriate to focus on effective hourly rates *ex post*; . . . What is important . . . is to

agreements as a basis for determining an appropriate fee award in a common fund case.[28] And this court has considered an attorneys' fee arrangement with its stockholder client when determining a reasonable fee.[29]

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pay attorneys on terms they would probably accept in an *ex ante* bargain . . . ."); Coffee, *supra*, at 669 ("'[L]aw should mimic the market.'. . . [which] mean[s] attempting to award the fee that informed private bargaining . . . might have reached.").

[28] *See In re Trans Union Corp. Priv. Litig.*, 629 F.3d 741, 744 (7th Cir. 2011) (holding that lead counsel in a class action should receive a fee award consistent with the "the contingent fee that the class would have negotiated with the class counsel at the outset had negotiations with clients having a real stake been feasible"); *In re Synthroid Mktg. Litig.*, 264 F.3d 712, 718 (7th Cir. 2001) ("We have held repeatedly that, when deciding on appropriate fee levels in common-fund cases, courts must do their best to award counsel the market price for legal services, in light of the risk of nonpayment and the normal rate of compensation in the market at the time."); *In re Cendant Corp. Litig.*, 264 F.3d 201, 282–84 (3d Cir. 2001) (holding that for purposes of fee awards under the PLSRA, "courts should accord a presumption of reasonableness to any fee request submitted pursuant to a retainer agreement that was entered into between a properly-selected lead plaintiff and a properly-selected lead counsel"); *Allapattah Servs., Inc. v. Exxon Corp.*, 454 F. Supp. 2d 1185, 1211 (S.D. Fla. 2006) ("[T]he more appropriate measure of a reasonable percentage is the market rate for a contingent fee in commercial cases."); *Nilsen v. York Cnty.*, 400 F. Supp. 2d 266, 277–78 (D. Maine 2005) (examining various methods for measuring the reasonableness of a common fund attorneys' fee and concluding that "the methodology of the Seventh Circuit" is the most attractive).

[29] *See Wis. Inv. Bd. v. Bartlett*, 2002 WL 568417, at *6 (Del. Ch. Apr. 9, 2002) ("[A]lthough not specifically listed as [a] factor in our [*Sugarland*] analysis, the terms of a fee arrangement between the law firm and its client are appropriate for the Court to consider. Fee agreements cannot absolve the Court of its duty to determine a reasonable fee; on the other hand, an arm's-length agreement, particularly with a sophisticated client, as in this instance, can provide an initial 'rough cut' of a commercially reasonable fee."), *aff'd*, 808 A.2d 1205 (Del. 2002); *see also Danenberg v. Fitracks, Inc.*, 58 A.3d 991, 997 (Del. Ch. 2012) (noting that when determining a reasonable fee for indemnification or advancement, an arm's-length agreement can provide a starting point for a reasonable fee).

In a 2021 study, Professor Fitzpatrick found that sophisticated clients choose to pay fixed one-third percentages or even higher escalating percentages based on litigation maturity. *Judge's Guide*, *supra*, at 1170. In patent cases, he found that fee agreements provided for either (i) a fixed percentage, with a mean of 38.6%, or (ii) a percentage that escalated as the litigation matured, with a mean percentage of 28% upon filing and up to 40.2% through appeal. *Id.* at 1161. Not only that, but more clients chose the latter (the *Americas Mining* style stage-of-case method) than the former. "No one escalated or deescalated based on recovery size." *Id.*

Professor Fitzpatrick also looked at large antitrust cases in the pharmaceutical industry where classes of large corporations sue other large corporations, such as a class of drug wholesalers suing drug manufacturers. The potential damages were enormous. He found that the fee requests ranged from a fixed percentage of 27.5% to a fixed percentage of one-third, that the one-third figure "*heavily* dominated," and that the average was 32.85%. *Id.* He concluded that "corporations in these cases appear perfectly happy with the percentage method and perfectly happy with the same fixed percentage of one-third that most unsophisticated clients also choose." *Id.* at 1162. Those percentages were all-in percentages, inclusive of expenses. None of the clients sought decreasing fee percentages based on economies of scale. *Id.* at 1163.

A 2012 study reached similar conclusions. *See* David L. Schwartz, *The Rise of Contingent Fee Representation In Patent Litigation*, 64 Ala. L. Rev. 335 (2012). That study examined forty-two contingency fee agreements in patent cases, where large companies sued one another, and found that ten used a fixed flat rate, thirty-two used an increasing rate, and none used a diminishing percentage. *See id.* at 360 & nn.136–37. The mean percentage was 38.6% of the recovery. *Id.* at 360. When clients deviated from a fixed percentage, the fee percentage increased as the case progressed, as under the *Americas Mining* framework, but with higher percentages. Those agreements started at an average percentage of 28% upon filing and ended with an average of 40.2% for taking the case through appeal. *Id.*

Two anecdotal examples comport with those studies. In a recent Chancery M&A case, the fee agreement with a major law firm provided for a fixed, one-third contingency fee which the court described as "quite typical and commercially reasonable." *S'holder Representative Servs. LLC v. Shire US Hldgs., Inc.*, 2021 WL 1627166, at *2 (Del. Ch. Apr. 27, 2021). In another Chancery M&A case, the court noted that the plaintiff hired a white-shoe firm under a contingency agreement that contemplated reimbursement of out-of-pocket expenses plus "40% of any excess recovery as attorneys' fees." *In re Nine Sys. Corp. S'holders Litig.*, 2015 WL 2265669, at *1 (Del. Ch. May 7, 2015). The court enforced the agreement.

The professors suggested that the court ask plaintiff's counsel in this case to produce their past contingent fee agreements for *in camera* review. The court did, and it made the same request of the objectors. Plaintiff's counsel expended significant efforts to provide the information that the court requested. Except for Pentwater, none of the objectors did. Pentwater provided one agreement, and it was not for a Delaware case.

The fee agreements submitted by plaintiff's counsel fully support the base award.

- One firm collected and analyzed 107 responsive *ex ante* fee agreements, constituting approximately one-third of the firm's contingent fee engagements. Approximately 80% were flat percentage arrangements, with the mean and median percentages above the base percentage. That held true in cases with an expected recovery in excess of $100 million. Approximately 15% provided increasing percentages as the amounts recovered increased. Only 5% provided for a decreasing percentage, and only one involved a case with an expected recovery greater than $100 million. Under that agreement, the percentage of the recovery started materially higher than the base percentage such that even after the full decrease, the percentage recovery still exceeded the base percentage.

- A second firm collected and reviewed 339 *ex ante* fee agreements, constituting all of the firm's contingent fee engagements during the past five years. Approximately 69% of that firm's agreements simply permitted the firm to apply for a court-approved fee. Some iterations of the agreement provided for a cap on the application at 33% of the recovery. In a subset of agreements limited to a particular agreement, the cap was set at 25% of the recovery. Less than 1% of the firm's agreements provided for an increasing percentage as the recovery increases. Approximately 3% of the firm's agreements provided for a decreasing percentage as the recovery increases. Some of those agreements are with public entities where a decreasing percentage is mandated by statute. The firm has some stage-of-case arrangements that top out at 33.3% of the recovery.

- A third firm collected and reviewed 210 *ex ante* fee agreements, constituting 23% of the firm's contingent fee agreements during the past five years. Approximately 88% provided for flat percentage regardless of magnitude. Approximately 86% provided for a fee recovery of 25% of higher. Approximately 36% provided for a fee recovery greater than the base award in this case. Approximately 9.5% provided for an increasing percentage. Approximately 2.5% provided for a decreasing percentage.

- A fourth firm collected and reviewed 43 *ex ante* fee agreements, constituting all of the firm's contingent fee agreements during the past five years. All of the agreements permitted the firm to apply for a court-approved award up to a cap of 30% or 33.3% of the total amount of funds received. Eight agreements provided for the 30% cap. The remainder provided for the 33.3% cap. The firm did not have any *ex ante* fee agreements providing for increasing percentages or decreasing percentages.

- A fifth firm does not generally use *ex ante* engagement letters and had negotiated only one during the past five years. It provided for a flat recovery of 25%.

The agreements that plaintiff's counsel provided for *in camera* review demonstrate that when they negotiate *ex ante* fee agreements with private clients, they consistently enter into arrangements that support the indicative fee in this case. The *ex ante* fee agreements provide persuasive evidence against any downward reduction.

The objectors collected fee applications from federal securities actions, including actions in which some of plaintiff's counsel were involved, and those applications sought fee awards consistent with the general trends in federal securities actions. Just as the evidence about the use of the declining-percentage methodology in federal securities cases is not persuasive for purposes of this action, the illustrative fee requests and fee agreements that the objectors collected are not persuasive.

d. The Irony Of The Objectors Arguing For A Declining Percentage

So far, this decision has identified strong reasons for rejecting the declining-percentage method. There is also a particular irony in *who* is arguing for that method, because as fund managers, the objectors do not use similar arrangements. The objectors do, however, engage in litigation, yet they declined to do so in this case. The objectors' arguments therefore come with ill grace.

The objectors concede that the incentive fee arrangements that they have as fund managers do not contemplate a decreasing percentage as fund gain increases. They also concede that no one in the investment industry uses a decreasing-percentage model.

Investors and fund managers thus universally opt for an incentive fee arrangement that scales with the size of the return and does not decline. The general takeaway is that the market for highly trained professionals who use symbolic reasoning based primarily on numbers and secondarily on words to identify opportunities and generate risk-based returns (*i.e.*, financial professionals) does not use incentive-based compensation arrangements in which percentages decline as the amount of the gain increases. The same should be true in the market for highly trained professionals who use symbolic reasoning based primarily on words and secondarily on numbers to identify opportunities and generate risk-based returns (*i.e.*, financially savvy lawyers).

Not surprisingly, the objectors argue that their compensation arrangements as fund managers are not relevant, and the professors join in that effort. The main point is that fund manager agreements are negotiated, and investors can decide whether they want to invest. No similar negotiations took place here, nor is there an opt-out opportunity.

The lack of negotiation is not a distinction. It is the reason why the court is looking to other sources in the first place. The absence of an *ex ante* agreement is what forces the court to consider other sources of market evidence, like the objectors' compensation arrangements.

More aptly, the objectors observe that their compensation arrangements as fund managers contain features designed to reward above-market performance and incorporate past losses. The first issue is addressed through a hurdle rate, which only permits a fund manager to earn performance fees above a specified percentage, sometimes tied to a benchmark index. The second issue is addressed through a loss carryforward, which only entitles the fund manager to receive performance fees on profits in excess of the highest value that an investor’s account has reached. But those issues and their solutions are not unique to fund managers; they apply to any contingently compensated professional. An engagement letter could include a hurdle that would pay counsel only if the lawsuit generated a recovery that exceeded a certain level. And if a client employed counsel across multiple matters, the engagement letter could include a loss carryforward. What distinguishes a court-awarded contingent fee from a fund management arrangement is that the award is a one-off payment, determined after the fact.

The objectors also try to distinguish their compensation arrangements as fund managers on the theory that they receive performance fees on gains, not on invested capital. The objectors then assert “awarding class counsel a straight-percentage of the entire settlement fund would be akin to an investment manager earning a performance fee on the entire value of an investor’s initial investment.” Suppl. Obj. at 14. That is wrong. The value of the initial investment here is not the settlement, but the $20.7 billion in value that the class received at closing. Applying a fund manager’s 20% performance fee to the $1 billion settlement would result in a performance fee of $200 million. That is less than the $266.7 million that plaintiffs’ counsel stand to receive here, but it is only part of the story. In the interim, as fund managers, the objectors would have received a management fee on all of the invested capital, which makes their business model more lucrative and less risky than contingency fee work. A management fee of 2% on the $20.7 billion would have generated another $414 million in fees. And that is without taking into account the different tax treatment afforded to the carried interest that generates the investment manger’s performance fee. Relative to how the objectors are compensated, plaintiff's counsel are undercompensated.

The objectors are thus not well positioned to insist on a declining-percentage method given that they do not use it in their own risk-based businesses. The objectors are also not well positioned to object to the fee application because the objectors could have stepped up and chose not to. All are sophisticated funds. All are highly litigious. Any of them could have hired counsel, negotiated a fee arrangement, and pursued this case. None did. They decided to free ride, then only roused themselves after the $1 billion settlement had been achieved. At that point, they did not object to the settlement itself, nor did they offer to take over the case on the theory that they and their own handpicked counsel could do better. They were content to snipe at the fee.

The settlement was a windfall for the objectors because they did nothing to create it. Two of the objectors signed agreements to support the transaction (Canyon and Dodge & Cox). Another touted its benefits. It was the plaintiff and its counsel that pursued the litigation and generated the results.

Having sat back and done nothing, the objectors now claim that a fee award without a sizable reduction would "not yield equitable results." Obj. at 2. That assertion masks self-interest with an appeal to equity. Wanting more money for yourself is understandable, but it is not grounds for a fee objection. As Chief Justice Strine often observed while serving on this court, envy is not a sound basis for reducing a fee award.[30]

e. The Not-As-Good-As-It-Seems Argument

As a final argument for a lower percentage, the objectors maintain that the settlement is not as good as it seems. They admit that $1 billion is a big number, but they say the outcome is not so impressive given (i) the likelihood of success, (ii) the settlement's value relative to the maximum possible damages, and (iii) the settlement's value as a percentage of transaction value. None of those arguments are persuasive.

Let's start with the basics. The common fund that plaintiff's counsel created is the largest class recovery ever obtained by nearly a factor of four. The next largest class recovery is *Activision* at $275 million. The common fund exceeds the total of all of recoveries achieved in all of the settlements in entire fairness cases over the last decade. It

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[30] *Clear Channel*, *supra*, tr. at *19 ("We don't build fees on envy because there are cases where people get something that sounds like the salary of a former Chicago Bears linebacker for their efforts."); *S. Peru*, *supra*, tr. at 82 ("[T]o me, envy is not an appropriate motivation to take into account when you set an attorney fee. It's not. I'm sure that people will envy the law firms who get awarded this fee. They have to defend this appeal. They had to win it. But that's not rational. We're setting a system here. And if envy was the rule, then, again, I think the real windfall cases I talked about before is where the real envy comes in, where people do nothing or close to nothing and fees are awarded. Those are the cases in our society where we have to be, I think, more careful."); *see also Forgo*, *supra*, tr. at 81 ("I don't believe, when I look at this, that I'm awarding a lower fee in *Alberto-Culver*. That is not what I'm trying to say, lest anyone get a hurt feeling or lest anyone say, 'Hey, . . . the Court loved us more in *Alberto-Culver* than they loved you in *Health Grades*.' That's when I just have a fundamentally different way of looking at it, which is because there's a whole other way of saying, 'Well, actually Chancellor Strine awarded a higher hourly rate to the lawyers in *Health Grades* and compensated their efforts more. And so he actually valued what they did higher.'").

nearly exceeds the total of all of recoveries achieved in all of the settlements in both entire fairness and enhanced scrutiny cases over the same period.

With one exception, the $1 billion recovery is the largest that any representative lawsuit has ever achieved in this court. The lone competitor is the $1.9 billion judgment in *Southern Peru*, which consisted of $1.347 billion in damages plus pre-judgment interest. *See* 52 A.3d at 819. That judgment, however, did not involve cash, and it did not inure only to an injured class. The plaintiffs sued derivatively on behalf of a majority-owned subsidiary (Southern Peru) to challenge a transaction between Southern Peru and its parent (Minera Mexico). Minera Mexico was itself a controlled corporation, and the ultimate controller (Grupo Mexico) caused Southern Peru to acquire Minera Mexico in a stock-for-stock deal. The court found that the exchange rate resulted in Southern Peru overpaying and issuing too much stock. Although the judgment was framed as a cash recovery, the court permitted Grupo Mexico to satisfy the judgment by returning excess shares, so there was no cash outlay. After the transaction, Grupo Mexico held an 81% interest in Southern Peru, and Grupo Mexico benefited from the recovery to that extent. If, for example, Southern Peru had distributed the returned shares as a dividend, then $1.539 billion in value would have gone to Grupo Mexico and only $351 million to the minority stockholders. Here, only the unaffiliated DVMT stockholders will benefit from the $1 billion common fund. The defendants and their affiliates are excluded from the class.

The objectors next argue that the $1 billion common fund is not so impressive because plaintiff's counsel had a high likelihood of prevailing at trial. They say that the combination of the entire fairness test plus as-pled flaws in the deal process meant that "liability was seriously contested but never seriously in doubt." Obj. at 12.

No one who is actually familiar with litigation in this court could think that. "A determination that a transaction must be subjected to an entire fairness analysis is not an implication of liability." *Emerald P'rs v. Berlin*, 787 A.2d 85, 93 (Del. 2001). There may well be a persistent perception that proving entire fairness is something rarely achieved, but common knowledge is not always right, and the data from the past decade suggests otherwise. There are ten reported decisions in which the defendants prevailed at trial under the entire fairness test, and there have been only seventeen settlements in entire fairness cases that generated a cash recovery. If the entire fairness test was as powerful as the objectors claim, one might expect fewer defense victories and more cash settlements. In reality, plaintiff's counsel did not have a laydown hand on liability. They had a strong case that the defendants did not follow a fair process, but fair price was debatable. If this court or the Delaware Supreme Court concluded that the defendants had proved that the price was sufficiently fair to carry their burden on entire fairness, then the class would lose.

Plus, damages were a wildcard. The objectors complain that the class is receiving a relatively small percentage of the maximum potential damages. The plaintiff argued for damages of $10.7 billion, equal to the difference in value between what the class gave up (DVMT stock valued at $158.38 per share for a total of $31.5 billion) and what the class received (cash plus Class C stock valued at $104.27 per share for a total of $20.8 billion). The objectors say confidently that the damages award "was based on simple arithmetic" and "is well supported by expert analyses." Obj. at 12. They criticize the plaintiff for settling for only 9.3% of the maximum potential recovery.

The question of fair price and the magnitude of any recovery would have come down to a battle of the experts. The outcome was particularly unpredictable given the novelty of the DVMT tracking stock and the plaintiff's damages theories. Evidencing the importance of these issues, the parties collectively devoted nearly forty pages in their pre-trial briefs to fair price and damages, drawing extensively from the experts' reports and depositions. Both sides proffered well-respected experts who took parallel approaches but reached diametrically opposite conclusions.

In their briefs, plaintiff's counsel explained persuasively why this court or the Delaware Supreme Court might reject their top-end damages figure entirely or discount the computation. To obtain the full amount, both this court and the Delaware Supreme Court would have had to believe that the Company's credit risk was nearly zero and that virtually all of the DVMT discount was attributable to the controllers. Yet the Company had a highly leveraged, non-investment grade balance sheet, and virtually every tracking stock in history has traded at a meaningful discount, albeit less than DVMT. Investors contemporaneously attributed some of the DVMT discount to credit risk and a conglomerate discount.

To reach $10.7 billion, the plaintiffs would have needed to pitch a perfect game at trial, then repeat that performance on appeal. Assuming the plaintiff had a one-in-five chance of success, then the risk-adjusted recovery would fall to $2.14 billion, and the settlement would represent 46.7% of the likely damages. If liability was a toss-up, then the risk-adjusted damages recovery would fall to $5.35 billion, and the settlement would represent 18.69% of the likely damages. And recall that the Delaware Supreme Court has not affirmed a monetary recovery for a representative plaintiff since 2016. Might a one-in-five estimate, or an even-money chance be putting the odds a bit high?

Recognizing that the $10.7 billion represented a swing for the fences, plaintiff's counsel presented alternative remedies that would support damages between $400 million and $3.1 billion. Those alternatives were tied to contemporaneous evidence and to issues on which the experts agreed. The objectors cannot fathom why those alternative scenarios would be more plausible, but any experienced litigator would perceive why: They are based on what the parties thought at the time, rather than after-the-fact expert opinions, and they produce recoveries that remain stratospheric, but which are far less than the out-of-this-world figure of $10.7 billion. In this court, when plaintiffs prevail, they rarely receive their full requested damages.[31]

When deciding to accept a settlement equal to 9.35% of the maximum possible damages, plaintiff's counsel understandably placed greater weight on the alternative recoveries and discounted heavily the prospect that the court would enter what would be the largest class action judgment in Delaware history by more than an order of magnitude

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[31] *See, e.g.*, *In re Columbia Pipeline Gp., Merger Litig.*, --- A.3d ----, 2023 WL 4307699, at *5–6 (Del. Ch. June 30, 2023) (awarding economic damages of $1 per share where "plaintiffs sought rescissory damages of $3.032 billion with no alternative damages theory"); *Mindbody*, 2023 WL 2518149, at *45–47 (awarding $1 per share in damages where plaintiffs sought damages "of $3.50 per share and quasi-appraisal damages for their disclosure claim in the amount of $5.75 per share"); *Vianix Del. LLC v. Nuance Commc'ns, Inc.*, 2010 WL 3221898 (Del. Ch. Aug. 13, 2010) (noting that the plaintiff "recover[ed] what may be millions of dollars in damages, but far less than it claimed").

and that such a judgment would withstand appeal. If this court or the Delaware Supreme Court rejected any of the core premises of the plaintiff's valuation theories, then any damages recovery could have been significantly reduced or eliminated or the defendants might succeed in proving entire fairness (by demonstrating that the price was sufficiently fair to overcome any process problems).

When approving the settlement, the court found that the common fund reflects an "exceptional result" of approximately 5% of equity value and that "the settlement consideration of $1 billion represents a substantial fraction of the likely recoverable damages." Dkt. 536 at 41. Those observations remain true.

Plaintiff's counsel also demonstrated that the settlement reflected a reasonable percentage of the maximum damages sought when compared to precedent settlements. The calculations are difficult, because reliable public data concerning maximum damages is unavailable. Many cases settle before expert reports are submitted, leaving only the less-precise allegations in pleadings or briefing. Even when the parties have submitted expert reports, references to the quantum of alleged damages are often redacted. Settlement briefs and transcripts of settlement hearings are often unhelpful, because when presenting a settlement to the court, counsel seldom mentions the maximum possible damages, focusing instead on the more plausible, risk-adjusted recoveries. That makes the settlement sound better, and it reflects how the court evaluates the settlement. A court should know what plaintiff's counsel thought their best day would bring, but the real test is what the settlement achieves relative to the risk-adjusted value of the case.

To compare the settlement in this case with precedents, this decision again turns to the twenty-four settlements in deal cases after *Americas Mining* where entire fairness would apply. Plaintiff's counsel could not generate reliable estimates of maximum possible damages for two of the settlements (*TD Bank* and *Calamos*). Plaintiff's counsel did not include the post-trial settlement in *In re Dole Food Co., Inc. Stockholders Litig.*, 110 A.3d 1257 (Del. Ch. 2015). As noted previously, eight of the settlements involved transactions valued at less than $100 million, and the court excludes them.

That leaves fourteen precedents. The deal values range from $156 million (*Homefed*) to $7.4 billion (*Malone*). The mean deal value is $1.785 billion; the median is $1.042 billion. The mean settlement is $43.65 million, and the median is $42.60 million. The precedent transactions are materially smaller in absolute size, averaging less than 10% of the $23.9 billion deal in this case. The gross settlement funds are also materially smaller in terms of absolute size, averaging less than 5% of the settlement achieved in this case. Yet the values as a percentage of maximum damages are much higher, with a mean of 34.34% and a median 16.5%. Those figures are driven upward by outlier results in *GFI Group* ($10.75 million; 176.23%) and *Delphi* ($49 million; 89%), plus three other settlements that involved recoveries of 30% or higher: *AVX* ($49 million; 41.58%); *Malone* ($110 million; 38.19%); and *Starz* ($92 million; 38.07%).

Excluding the two high-end outliers (*GFI* at 176% and *Delphi* at 89%) lowers the mean recovery to 17.95% and the median to 12.35%. Excluding the two high-end outliers and the two low-end outliers (*Straight Path* at 1.13% and *Venoco* at 5.3%) results in the mean recovery increasing to 20.91% and a median recovery staying at 16.5%.

If added to the sample and evaluated as a percentage of claimed maximum damages, the settlement in this case would rank eleventh. The full list appears below:

#	Settlement	Transaction Value (in millions)	Settlement Value (in millions)	As % of Max Damages
1	GFI Group	$366.00	$10.75	176.23%
2	Delphi	$2,500.00	$49.00	89.00%
3	AVX	$1,030.00	$49.90	41.58%
4	Malone	$7,400.00	$110.00	38.19%
5	Starz	$4,400.00	$92.50	38.07%
6	Homefed	$156.00	$15.00	19.80%
7	CNX Gas	$605.88	$42.70	19.00%
8	Alon USA Energy	$407.00	$44.75	14.00%
9	Jefferies	$2,400.00	$70.00	10.70%
10	Akcea	$446.50	$12.50	9.53%
11	***Dell Class V***	***$23,900.00***	***$1,000.00***	***9.34%***
12	Amtrust	$1,040.00	$40.00	9.20%
13	Pivotal	$1,430.00	$42.50	9.00%
14	Venoco	$363.00	$19.00	5.30%
15	Straight Path	$2,450.00	$12.50	1.13%
	Mean (Ex. Dell)	$1,785.31	$43.65	34.34%
	Median (Ex. Dell)	$1,035.00	$42.60	16.50%

I was surprised by the wide variation across outcomes. I suspect that it would require a deeper dive into the settlements to unpack the result. All involve M&A cases, but some of the plaintiffs may have pursued different damages theories. I also suspect that it is easier for a plaintiff to achieve a relatively high percentage recovery in a case where the claimed damages are less than $100 million. The cost to defend an entire fairness case through trial can be high. I would guess conservatively at figures between $10 million and $30 million depending on the number of defendants and firms involved, the hourly rates of the defense lawyers, and the cost of the experts.[32] Settlements at or below that level may present defendants (or their insurers) with an attractive way to mitigate risk. As the dollar value of the settlement gets higher, it becomes more difficult to rationalize the payment as money that would have been spent anyway. It is also notable that six of the fourteen settlements land in the vicinity of $45 million, which could be a sweet spot that takes into account the defense costs that the settlement saves plus something for the elimination of risk.

A less noisy proxy for the strength of a settlement in an M&A case is the magnitude of the recovery as a percentage of the equity value of the transaction. This analysis considers the same sample of entire fairness cases and excludes transactions with a value of $100 million or less. There are fifteen precedents, because the deal size for *TD Bank* is known. The list provided by plaintiff's counsel does not include the settlement in *Dole*, which this decision adds.

This time, deal value ranges from $156 million (*Homefed*) to $26 billion (*TD Bank*). The mean transaction value is $3.26 billion; the median is $1.12 billion. The mean settlement value is $49.43 million, and the median is $42.6 million. Measured as a percentage of the transaction value, the mean settlement value is 4.47% and the median is 2.95%. There is a considerably tighter spread across the dataset.

The settlement in this case is 4.18% of deal value. That puts it just below the mean and above the median for that metric. Strikingly, the settlement in this case dwarfs the only

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[32] In *Mindbody*, plaintiff's counsel represented that the defendants had exhausted a $40 million insurance tower before trial began. *See Mindbody*, *supra*, tr. at 8.

precedent involving a deal of comparable size—*TD Bank* at $26 billion—where a settlement of $31.5 million reflected only 0.12% of deal value. If added to the sample, the settlement in this case ranks seventh. The full list appears below:

#	Settlement	Transaction Value (in millions)	Settlement Value (in millions)	As % of Equity Value of Deal
1	Dole	$1,210.00	$148.20	12.24%
2	Alon USA Energy	$407.00	$44.75	11.00%
3	Homefed	$156.00	$15.00	9.60%
4	CNX Gas	$605.88	$42.70	7.20%
5	Venoco	$363.00	$19.00	5.20%
6	AVX	$1,030.00	$49.90	4.80%
7	***Dell Class V***	***$23,900.00***	***$1,000.00***	***4.18%***
8	Amtrust	$1,040.00	$40.00	3.80%
9	Pivotal	$1,430.00	$42.50	3.00%
10	Jefferies	$2,400.00	$70.00	2.90%
11	Akcea	$446.50	$12.50	2.80%
12	GFI Group	$366.00	$10.75	2.79%
13	Starz	$4,400.00	$92.50	2.10%
14	Delphi	$2,500.00	$49.00	2.00%
15	Malone	$7,400.00	$110.00	1.49%
16	Straight Path	$2,450.00	$12.50	0.51%
17	TD Bank	$26,000.00	$31.50	0.12%
	Mean (Ex. Dell)	$3,262.77	$49.43	4.47%
	Median (Ex. Dell)	$1,125.00	$42.60	2.95%

As the court found when approving the settlement, plaintiff's counsel achieved an excellent outcome. The objectors are correct to point out that what plaintiff's counsel achieved is not as impressive when measured as a percentage of maximum damages claimed, but that is a noisy indicator. They are also correct that the settlement looks more typical when considered as a percentage of deal value, rather than in absolute terms. But the precedents also show that plaintiff's counsel in M&A cases are obtaining low-to-mid eight-figure recoveries. There have been only two nine-figure recoveries, one of $110 million and another of $148.2 million. No one has previously obtained a ten-figure recovery. Plaintiffs' counsel are thus generally hitting singles and doubles, with two triples. This is the first home run.

To the extent the objectors maintain that the court should discount the $1 billion settlement because the defendants were destined to be held liable for a big amount, the court does not share their confidence. Plaintiff's counsel achieved an unprecedented result and deserve the full percentage that the stage-of-case method supports.

2. The Extent To Which The Fee Was Contingent On Results

The lengthy discussion so far has only calculated an indicative fee using the first *Sugarland* factor: the results caused by the litigation. Fortunately, the analysis of the remaining factors is straightforward.

The next factor to be considered is the extent to which counsel's compensation was contingent on the result. *Activision*, 124 A.3d at 1072. It is the "public policy of Delaware to reward risk-taking in the interests of shareholders." *Plains Res.*, 2005 WL 332811, at *6. Accepting contingency risk is what enables counsel to receive an award based on the results generated by the litigation that exceeds their lodestar. When counsel does not litigate on contingency, then counsel cannot receive more than their actual billings and expenses, and if the results-based award under *Sugarland* calls for less, then they receive less. A full contingency fee arrangement is not required. A hybrid fee arrangement could generate a hybrid result.

Here, plaintiff's counsel litigated on a fully contingent basis. If they lost, they would get nothing. They also were responsible for funding their expenses. Plaintiff's counsel are therefore entitled to a results-based fee based on the *Sugarland* factors.

That said, "[n]ot all contingent cases involve the same level of contingency risk." *Activision*, 124 A.3d at 1073. During the litigation epidemic, lawyers filed cases and sought expedited pre-closing injunctive relief in a setting where the desire to close the transaction put pressure on the defendants and there was a ready-made settlement opportunity that took the form of supplemental disclosures or minor transactional tweaks. *See Orchard*, 2014 WL 4181912, at *9. Those cases did not involve real contingency risk.

This case involved true contingency risk. Plaintiff's counsel did not enter the case with a ready-made exit or obvious settlement opportunity. There was a serious possibility that plaintiff's counsel would lose and receive nothing.

The true contingency risk in this case supports a results-based award using the *Americas Mining* percentages. No downward reduction is warranted under this factor.

3. The Time And Effort Of Counsel

The next factor to consider is the time and effort expended by counsel. This factor serves as a cross-check on the reasonableness of a fee award. It has two separate but related components: (i) time and (ii) effort. *In re Sauer-Danfoss Inc. S'holders Litig.*, 65 A.3d 1116, 1138 (Del. Ch. 2011).

Based on the discussion in the prior section, plaintiff's counsel is entitled to an indicative fee equal to 26.67% of the benefit, for an award of $266.7 million. Plaintiff's counsel spent 53,000 hours litigating this case. According to counsel's affidavits, the value of the time incurred at customary rates would be $39,431,415.50. The indicative award represents a multiplier of seven times lodestar and an implied rate of approximately $5,000 per hour. Neither is excessive under this court's precedents.

"The more important aspect is effort, as in what plaintiffs' counsel actually did." *Id.* at 1139. "When an entrepreneurial plaintiffs' firm engages in adversarial discovery, obtains documents from third parties, pursues motions to compel, and litigates merits-oriented issues, they are likely representing the interests of the class." *Id.* The outcome here resulted from significant effort.

The effort that plaintiff's counsel put in began with the filing of a Section 220 demand. That demand enabled plaintiff's counsel to obtain books and records and prepare a strong complaint that survived a motion to dismiss. Considerable effort was necessary, because the transaction had been designed so that on the surface it would meet the requirements of *MFW* and be protected by an irrebuttable version of the business judgment rule. Plaintiff's counsel adeptly advanced arguments to negate the *MFW* structure and create a pleading-stage inference that the entire fairness test would govern the transaction.

After the ruling on the motion to dismiss, an army of skilled defense counsel fought the plaintiffs at every turn. The defendants retained a phalanx of high-powered attorneys from Alston & Bird LLP; Simpson Thacher & Bartlett LLP; Latham & Watkins LLP; Wachtell, Lipton, Rosen & Katz LLP; Williams & Connolly LLP; Abrams & Bayliss LLP; Richards, Layton & Finger, P.A.; and Young Conaway Stargatt & Taylor, LLP. Later in the lawsuit, after Goldman was added as a defendant, Skadden, Arps, Slate, Meagher & Flom LLP joined the mix. Nearly 100 lawyers from those firms entered appearances.

Between June 2020 and March 2022, plaintiff's counsel propounded sixty-six document requests, 710 interrogatories, and 179 requests for admission to the defendants. Plaintiff's counsel also served forty-one non-party subpoenas.

Through these efforts, plaintiff's counsel developed an extensive record that included nearly 2.9 million pages of documents from over forty parties and non-parties. Plaintiff's counsel took thirty-two fact depositions, four of which lasted two days. Plaintiff's counsel also responded to the defendants' expansive discovery demands.

Expert discovery followed. The plaintiff hired one testifying expert. The defendants hired two. The experts served lengthy opening and rebuttal reports and sat for depositions.

As noted, the case did not settle until nineteen calendar days before trial. By that point, the parties had prepared and filed a joint pre-trial order. They had also filed lengthy pre-trial briefs.

In federal securities cases, concern exists that after surviving a motion to dismiss in a case that seems likely to support a large settlement, plaintiff's counsel will not settle promptly because their lodestar will be too low to support an adequate fee. Instead, plaintiff's counsel works the case, churning hours on document review and possibly a handful of depositions to generate the lodestar necessary to make a big fee award plausible. *See* Stephen J. Choi et al., *Working Hard or Making Work? Plaintiffs' Attorneys Fees in Securities Fraud Class Actions*, 17 J. Empirical Legal Stud. 438, 464 (2020). Nothing like that happened here. After surviving the motion to dismiss, plaintiff's counsel engaged in real work and prepared the case for trial. Mediation did not take place until after fact and expert discovery had concluded. The mediation was initially unsuccessful, and plaintiff's counsel continued to prepare the case for trial.

The time and effort expended by counsel supports the indicative award.

4. The Complexity Of The Litigation

"One of the secondary *Sugarland* factors is the complexity of the litigation. All else equal, litigation that is challenging and complex supports a higher fee award." *Activision*, 124 A.3d at 1072.

This case was challenging and complex. The preceding section discusses the extensive discovery that plaintiff's counsel pursued to make the settlement a reality. Fact discovery included multiple third parties, and it involved spoliation issues.

Expert discovery was also challenging. Plaintiff's counsel had to work with their expert to develop novel valuation approaches for a transaction involving a one-of-a-kind tracking stock (DVMT), another complex security (VMware common stock), and a privately held company (Dell). Plaintiff's counsel also had to analyze complicated tax issues, alternative transactions like a forced conversion, and novel questions about market expectations and minority discounts.

The complexity of the litigation supports the indicative award.

5. The Standing And Ability Of Counsel

"Law firms establish a track record over time, and they 'build (and sometimes burn) reputational capital.'" *In re Del Monte Foods Co. S'holders Litig.*, 2010 WL 5550677, at *9 (Del. Ch. Dec. 31, 2010) (quoting *In re Revlon, Inc. S'holders Litig.*, 990 A.2d 940, 956 (Del. Ch. 2010)). Scholars have found that the involvement of a top-tier firm makes a difference for case outcomes in Chancery M&A litigation, although they have been unable to unpack the endogeneity problem and differentiate between selection effects versus an actual positive contribution. *See* Alan B. Badawi & David W. Webber, *Does the Quality of the Plaintiffs' Law Firm Matter in Deal Litigation?*, 41 J. Corp. L. 359, 390–91 (2015). My intuitive answer is "both." Clearly, case selection matters, but the difference that a top plaintiff's firm makes is obvious to a regular observer.

Plaintiff's counsel included experienced advocates who have taken multiple cases through trial and appeal. The standing and ability of counsel supports the indicative award.

6. Should The Percentage Be Adjusted Because It Was Not Paid Separately?

Last, the objectors criticize plaintiff's counsel for not structuring the settlement to provide for a fixed recovery to the class and for the defendants to pay the attorneys' fee award separately. The objectors contend that the court prefers that approach, and they imply that the court should reduce the fee to reflect the parties' failure to acknowledge that preference. This judge does not have such a preference, and under the *Americas Mining* framework, framing a settlement that way simply means that I have to do more math.

This court has traditionally calculated fee awards as a percentage of a gross common fund. The *Americas Mining* percentages are framed that way. That is the general method that courts have long used.[33]

[33] The concept of awarding a fee out of the common fund and not in addition to the common fund dates back to the nineteenth century. *See Cent. R.R. & Banking Co. v. Pettus*, 113 U.S. 116, 125, 128 (1885) (awarding fee out of amounts recovered on behalf of a class

The only post-*Americas Mining* case that the objectors rely on for the side-payment theory is *Jefferies*. There, the parties settled on a common fund of $70 million in cash. The defendants agreed to pay the fee separately and reserved the right to oppose any application. The parties failed to reach agreement, and the plaintiffs sought $27.5 million plus expenses of $1 million. The plaintiffs pitched this request as an implied gross fund of $100 million from which they would recover a fee of approximately 27.5%. The defendants argued that a fee should be calculated using the recovery of $70 million and a percentage of 22.5%, resulting in an award of $15.75 million. *Jefferies*, 2015 WL 3540662, at *2.

In a footnote, the court noted that it was helpful to have adversarial briefing on the fee award. The court also noted that the adversarial briefing likely happened because the parties agreed to have the fee paid separately. *Id.* at *2 n.5. That meant the defendants' total outlay was not capped by the common fund, and they had an incentive to resist the fee. The court observed that "[f]rom a policy perspective, it would be beneficial in my view for fee applications to be subject to adversarial inquiry to provide the Court with a better

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of unsecured creditors; calculating fee as a percentage of the amount recovered); *Trustees v. Greenough*, 105 U.S. 527, 532 (1881) (awarding fee out of amounts recovered on behalf of a class of bondholders; reimbursing plaintiff from fund for amounts paid to counsel); *id.* at 534–35 (citing earlier cases). "The doctrine rests on the perception that persons who obtain the benefit of a lawsuit without contributing to its cost are unjustly enriched at the successful litigant's expense." *Boeing Co. v. Van Gemert*, 444 U.S. 472, 478 (1980). "Jurisdiction over the fund involved in the litigation allows a court to prevent this inequity by assessing attorney's fees against the entire fund, thus spreading fees proportionately among those benefited by the suit." *Id.* The fees are assessed against the entire fund and paid out of the fund, not in addition to the fund. *See id.*; *accord Goodrich*, 681 A.2d at 1045 ("[T]he common fund doctrine permits an attorney to independently request an award of fees from that same settlement fund.").

record with which to evaluate the *Sugarland* factors." *Id.* The objectors cite this passage, but they incorrectly translate a comment about the benefits of adversarial briefing into an endorsement of separately paid fee awards.

If everyone paid fees separately, then it would be easy to compare fee awards across settlements. But when precedents like *Americas Mining* refer to fees as a percentage of a gross fund, then an agreement by the defendants to pay the fee separately means that the court has to convert that structure into the *Americas Mining* format. The commitment to pay the fee separately operates as an additional form of consideration. The resulting benefit is not just the fund, but rather the fund plus whatever amount the court awards as a fee.

A common fund with a fee paid separately is mathematically equivalent to a larger common fund with a lower percentage fee coming out of the gross amount. The *Jefferies* case illustrates this. The court ultimately awarded a fee of $21.5 million, inclusive of expenses, which it described as "approximately 23.5% of the gross value (approximately $91.5 million) of the settlement." *Id.* at *4. The court thus recognized that the side payment of the fee increased the gross amount of the settlement, viewed the gross amount as $91.5 million, and viewed the fee as 23.5% of that gross amount.

The same equivalency operates when parties negotiate a settlement, which enables parties to convert an impasse over the gross amount of the settlement into an agreement on a gross amount plus a dispute over a fee award. The defendants' all-in proposal to the court in *Jefferies* equated to a total outlay of $85.75 million ($70 million to the class plus $15.75 million to counsel). The plaintiffs' all-in proposal in *Jefferies* equated to a total outlay of $100 million ($70 million to the class plus $27.5 million plus expenses to counsel). It is easy to envision that the parties initially bargained on those terms but could not bridge the delta between $85 million and $100 million. The solution was to agree on a net amount, then fight over the fee. The court effectively determined that the right price for the settlement was $91.5 million.

Under Delaware law, parties must agree to the settlement consideration first, before turning to the fee award. The *Jefferies* decision correctly observes that in that setting, the defendants have already capped their total exposure and have little incentive to fight about the fee percentage. That means there is a good public policy reason for separately paid fee awards. But there are other important policy interests, including encouraging settlement. The current method of deducting fees from the total amount serves that goal, precisely because defendants can assess their overall exposure. A standard in which separately paid awards were the norm could reduce settlement rates.

Regardless, to keep levels of compensation consistent, switching to separately paid awards would require reframing the *Americas Mining* ranges as lesser percentages of the implied gross fund. The following table provides them:

Stage of Case	*Americas Mining* Percentage	Paid Separately Percentage
Early	10% to 15%	9% to 13%
Mid	20% to 25%	16% to 20%
Late	25% to 30%	20% to 23%
Max	33%	25%

Unless those adjustments are made, using the *Americas Mining* percentages for a separately paid award simply gives plaintiff's counsel a raise.[34]

Under current law, there is no basis for criticizing the parties for structuring their settlement as they did. The court will award a fee as a percentage of the gross fund.

7. The Overall Conclusion

The *Sugarland* factors support a fee award of $266,700,000. The stage-of-case method endorsed by *Americas Mining* calls for a percentage equal to 26.67% of the benefit caused by the litigation. Grounds do not exist to reduce the award in this case in light of the size of the common fund. The other *Sugarland* factors fully support the award.

B. Out-Of-Pocket Costs

A recurring issue when ruling on fee applications is whether to make an all-in award or to approve a separate reimbursement of out-of-pocket costs.[35] When plaintiff's counsel

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[34] The following table provides illustrative calculations. The general formula is as follows: Equivalent Percentage of Larger Fund = Fee Award / (Common Fund + Fee Award).

Common Fund	*Americas Mining* Percentage	Fee Award	Equivalent Larger Fund	Equivalent Percentage of Larger Fund
$10 million	10%	$1 million	$11 million	9%
$10 million	15%	$1.15 million	$11.5 million	13%
$10 million	20%	$2 million	$12 million	16%
$10 million	25%	$2.5 million	$12.5 million	20%
$10 million	33%	$3.3 million	$13.3 million	24.8%

[35] This decision uses the term "out-of-pocket costs" because seemingly simple terms like "expenses" and "costs" are confusing. On the one hand, the concept of "expenses" can

has pushed deep into the case, the generally optimal approach is reimbursement of out-of-pocket costs with the fee award calculated as a percentage of the net fund.

Court of Chancery decisions have taken a case-by-case approach to this issue. During the era of ritualized disclosure-only and *Cox Communications* settlements, the court expressed a preference for an all-in award. With cases settling early and routinely, an all-in award was easier for the court and encouraged counsel to be efficient. *See In re Celera Corp. S'holder Litig.*, 2012 WL 1020471, at *33 & n.248 (Del. Ch. Mar. 23, 2012), *aff'd in part, rev'd in part on other grounds*, 59 A.3d 418 (Del. 2012); *Telecorp PCS*, *supra*, tr. at 101.

When a plaintiff has engaged in real litigation efforts, then an all-in approach can generate unfairness by reducing the effective percentage of the award. The *Rural Metro*

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encompass more than just out of pocket costs, as shown by Section 145 of the Delaware General Corporation Law. That section uses the term "expenses" to refer collectively both to attorneys' fees and amounts paid out of pocket. *See, e.g.*, 8 *Del. C.* § 145(a) (authorizing a corporation in a proceeding other than one brought by or in the right of the corporation to provide indemnification "against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred"); *id.* § 145(b) (authorizing a corporation in a proceeding brought by or in the right of the corporation to provide indemnification "against expenses (including attorneys' fees) actually and reasonably incurred"); *id.* § 145(c) (mandating corporation to indemnify a director or officer who was successful on the merits or otherwise in defending a proceeding "against expenses (including attorneys' fees) actually and reasonably incurred"). On the other hand, the concept of "costs" can be narrower than any out-of-pocket costs, as shown by the statute which entitles a prevailing party to recover "costs." *See* 10 *Del. C.* § 5106; *Scion Breckenridge Managing Member, LLC v. ASB Allegiance Real Est. Fund*, 68 A.3d 665, 686–88 (Del. 2013). The term "out-of-pocket costs" seeks to bridge the gap by referring to all of the out-of-pocket costs and expenses, as opposed to attorneys' fees, that either a plaintiff or its counsel must incur to pursue a case.

litigation provides an example. Counsel settled with all but one defendant on the eve of trial for a gross settlement fund of $11.6 million. The out-of-pocket costs were $1.29 million, or 11% of the total. If plaintiff's counsel absorbed the out-of-pocket costs, then an all-in award of 30% of the gross settlement fund ($3.48 million) would equate after expenses to an effective award of 18.9%.

Recognizing that problem, some decisions have awarded a fee to counsel as a percentage of the gross fund, then awarded reimbursement of out-of-pocket costs on top of the fee award.[36] That method forces the class to bear all of the out-of-pocket costs from its share of the recovery. It has the opposite effect of an all-in award in that it increases the effective percentage that counsel receives and reduces the class's share. In an extreme case involving a small settlement, the combination could wipe out the class recovery altogether. Just as it is unfair to force counsel to internalize all out-of-pocket costs, it is unfair to put the class in a comparable position.

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[36] *See, e.g.*, *In re TD Banknorth S'holders Litig.*, Cons. C.A. No. 2557, at 5 (Del. Ch. June 25, 2009) (ORDER) (awarding 27.5% of common fund in fees plus $964,086.61 in expenses); *Ryan v. Gifford*, 2009 WL 18143, at *13–14 (Del. Ch. Jan. 2, 2009) (awarding one-third of the monetary portion of the settlement in fees plus $398,100.79 in expenses); *In re Chaparral Res., Inc. S'holders Litig.*, Cons. C.A. No. 2001, at 4 (Del. Ch. Mar. 13, 2008) (ORDER) (awarding one-third of common fund in fees plus expenses of $1,089,298.10); *In re TeleCommunications, Inc. S'holders Litig.*, Cons. C.A. No. 16470, at 9, 13 (Del. Ch. Feb. 1, 2007) (TRANSCRIPT) (awarding 30% of the common fund in fees plus $827,658.91 in expenses); *In re Berkshire Realty Co., Inc. S'holder Litig.*, 2004 WL 5174889 (Del. Ch. Aug. 10, 2004) (ORDER) (awarding 30% of the common fund in fees plus $577,787.61 in expenses).

Some federal courts have resolved the dilemma by deducting out-of-pocket costs first, then awarding a percentage-based fee using the net award.[37] That approach treats the out-of-pocket costs as a higher priority debt claim, representing amounts paid to third parties necessary to generate the residual return. It treats counsel's fee percentage as a carried interest in the net recovery, with counsel participating *pari passu* with the class. The approach still encourages diligence in controlling out-of-pocket costs because "the lawyer and the client share the goal of maximizing the net recovery." *Immunex*, 864 F. Supp. at 145.

In a case where counsel have incurred significant out-of-pocket costs, the approach that best balances the interests of the attorneys and the class is to reimburse for out-of-pocket costs first, then award a fee based on a percentage of the net fund. Here, plaintiff's counsel pushed deep into the case and incurred $4,284,608.04 in out-of-pocket costs. If plaintiff's counsel had asked for out-of-pocket costs to be reimbursed, then the court would have deducted them first and awarded a fee as a percentage of the net benefit.

Why didn't plaintiff's counsel ask the court to reimburse out-of-pocket costs separately? If this case had generated a seven or eight-figure settlement, then plaintiff's counsel likely would have made the request. In this case, the common fund is so large that

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[37] *See In re Immunex Sec. Litig.*, 864 F. Supp. 142, 145 (W.D. Wash. 1994); *Morganstein v. Esber*, 768 F. Supp. 725, 727–28 (C.D. Cal. 1991); *see also Lachance v. Harrington*, 965 F. Supp. 630, 648 (E.D. Pa. 1997).

the out-of-pocket costs become a rounding error. The real action is in the percentage awarded, with each percentage point worth $10 million.

Framing a request is a matter of judgment. Plaintiff's counsel could have been concerned about how a request for reimbursement might land. When the fee award is so large, would it seem greedy to ask for out-of-pocket costs separately? On the other hand, the optics of an all-in award might be helpful. If a request for an all-in award made it palatable for the court to approve an additional percentage point, then plaintiff's counsel would come out ahead by over $5.7 million—itself a decent fee award in many cases.

If I had to guess, plaintiff's counsel made the call that asking for an all-in award of 28.5% sounded better and could pay off in a larger bottom line amount. Because plaintiff's counsel asked for an all-in award, the court will not reimburse expenses separately. If plaintiff's counsel had asked for it, then this decision would have deducted out-of-pocket costs first, then calculated a fee based on a net award. As a practical matter, counsel's decision only cost them $3,141,903.08, reflecting the 73.33% share of the out-of-pocket costs that the class would have born. In the context of the fee award of $266.7 million, that is barely one-tenth of one percent—a rounding error.

C. The Incentive Award

Finally, plaintiff's counsel asks the court to approve an incentive award of $50,000 for the named plaintiff, to be paid out of the fee award, as restitution for the considerable time and effort the plaintiff devoted to this action. The Delaware Supreme Court has recognized that a class representative can receive an incentive fee based on (i) the time, effort, and expertise expended by the class representative, and (ii) the benefit to the class.

Raider v. Sunderland, 2006 WL 75310, at *1 (Del. Ch. Jan. 4, 2006), *cited in Isaacson v. Niedermayer*, 200 A.3d 1205, 1205 n.1 (Del. 2018).

Public policy favors incentive awards in appropriate circumstances: "Compensating the lead plaintiff for efforts expended is not only a rescissory measure returning certain lead plaintiffs to their position before the case was initiated, but an incentive to proceed with costly litigation (especially costly for an actively participating plaintiff) with uncertain outcomes." *Raider*, 2006 WL 75310, at *1. Scholars have provided sound reasons for the Delaware courts to move beyond purely restitution-oriented awards and for expanding, rather than restricting, the payment of incentive fees, albeit with criteria to minimize agency costs and avoid windfalls. *See* Charles R. Korsmo & Minor Myers, *Lead Plaintiff Incentives in Aggregate Litigation*, 72 Vand. L. Rev. 1923 (2019). Incentive awards are common in the federal courts, where scholars have expressed strong support for them, particularly when they reward sophisticated investors for performing a meaningful monitoring function and adding value for the class.[38]

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[38] *See, e.g.*, Theodore Eisenberg & Geoffrey P. Miller, *Incentive Awards to Class Action Plaintiffs: An Empirical Study*, 53 UCLA L. Rev. 1303, 1320 (2006); 5 William B. Rubenstein et al., *Newberg and Rubenstein on Class Actions* § 17:4, at 510–11 (6th ed. 2022), Westlaw (database updated June 2023). The exception is federal securities actions, where they are prohibited by statute. 15 U.S.C. § 78-u-4(a)(4). Scholars have criticized this prohibition as running contrary to the incentive structure crafted by the Private Securities Litigation Reform Act of 1995 and as having deleterious and unintended consequences for the role of sophisticated investors in supervising class actions. *See* Richard A. Nagreda, *Restitution, Rent Extraction, and Class Representatives: Implications of Incentive Awards*, 53 UCLA L. Rev. 1483, 1491 (2006); Eisenberg & Miller, *supra*, at 1348; Charles Silver & Sam Dinkin, *Incentivizing Institutional Investors to Serve as Lead Plaintiffs in Securities Fraud Class Actions*, 57 DePaul L. Rev. 471, 481 (2008).

A restitution-based award necessarily includes out-of-pocket costs, but it must go beyond that to fulfill its mission. A representative plaintiff must devote time to the litigation, and if that time has to be offered *gratis*, then the representative plaintiff effectively pays for taking on the role of class representative. Rather than receiving the same amount as the class, the named plaintiff receives less.

Nor is serving as a representative plaintiff an easy task. In the current litigation environment, a stockholder who files plenary litigation faces "the very real possibility of having their computer and other electronic devices imaged and searched, sitting for a deposition—perhaps more than one if they also institute [Section] 220 litigation—and then perhaps testify at trial." *Verma v. Costolo*, C.A. No. 2018-0509-PAF, at 52–53 (Del. Ch. July 27, 2021) (TRANSCRIPT); *accord Voigt v. Metcalf*, C.A. No. 2018-0828-JTL, at 44–45 (Del. Ch. Jan. 19, 2022) (TRANSCRIPT).

A named plaintiff also accepts reputational risk, as demonstrated by the fate of Herb Chen, the named plaintiff in *Chen v. Howard-Anderson*, 2017 WL 2842185 (Del. Ch. June 30, 2017). Professors Korsmo and Myers tell Chen's story well. *See* Korsmo & Myers, *supra*, at 1938–39. Chen was a securities analyst and professional investor who contributed significantly to the $35 million settlement that the class obtained. As one of the named plaintiffs, Chen was subjected to discovery and deposed. The defendants used the discovery to accuse Chen of trading on confidential information. Although both the court and the SEC cleared Chen of any charges, he incurred substantial expenses defending himself. The allegations ensnared another investor and the original named plaintiff, whom Chen regarded as his mentor, and destroyed their relationship. *See Steinhardt v. Howard-*

Anderson, 2012 WL 29340 (Del. Ch. Jan. 6, 2012). Chen attested that media articles associated with the allegations had prevented him from finding another job on Wall Street. Korsmo & Myers, *supra*, at 1940.

The defendants used a similar playbook against the plaintiff in this case. Although the plaintiff is a pension fund that had no direct involvement in the transaction other than as a passive, outside investor that voted its shares and accepted the consideration, defense counsel pursued discovery from the plaintiff aggressively, serving forty-six document requests, 173 interrogatories, and fifty-nine requests for admission (excluding subparts). Defense counsel demanded that the plaintiff search for documents dating back to its origins as a pension fund and collect documents from multiple members of its board of trustees, even though they had no involvement in the DVMT investment or the litigation. In total, the plaintiff made ten separate document productions, comprising 48,620 pages. At defense counsel's request, the plaintiff provided three separate sets of supplemental or amended interrogatory responses. The defendants also served the plaintiff's outside asset managers and advisors with broad discovery demands. A representative of the plaintiff sat for a full-day deposition, as did a representative from one of its asset managers. Defense counsel did not turn up any evidence of the type of wrongdoing in *Chen v. Howard-Anderson*, but the scorched earth strategy was the same.

Delaware courts have approved meaningful incentive awards under similar circumstances.[39] The requested award of $50,000 is reasonable, even modest, given the time and effort that the plaintiff and its personnel expended to represent the class.

The requested award will be paid out of the fee award, so it does not reduce the recovery to the class. Paying an incentive award from the fee award is customary, and it recognizes that without a successful recovery, the named plaintiff is not entitled to an incentive award, just as plaintiff's counsel is not entitled to a fee. Treating the incentive award as part of the fee recognizes that plaintiff's counsel and the named plaintiff work as a team to pursue the litigation. *See Chen*, 2017 WL 2642185, at *2. The incentive award is "not so large as to raise specters of conflicts of interest or improper lawyer-client entanglements." *See Orchard*, 2014 WL 4181912, at *13.

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[39] *See, e.g., In re El Paso Pipeline P'rs, L.P.*, 2016 WL 451320, at *2 (Del. Ch. Feb. 4, 2016) (ORDER) (incentive award of $450,000 to lead plaintiff); *Fox v. CDx Hldgs., Inc.*, 2015 WL 5163790, at *1 (Del. Ch. Sept. 2, 2015) (ORDER) (incentive award of $100,000 for named plaintiff who "risked his employment to step forward and challenge the treatment of the Class" and "braved the risk of adverse consequences resulting from his decision"); *Activision*, 124 A.3d at 1076–77 (approving award of $50,000 to lead plaintiff who "participated meaningfully in the case, sat for a deposition, and attended hearings and the mediation" and was "subjected to vigorous attacks throughout these proceedings, first by Hayes and his counsel during the leadership fight, next by defendants at the class certification phase, and now by both during the settlement phase"); *Forsythe v. ESC Fund Mgmt. Co. (U.S.), Inc.*, 2012 WL 1655538, at *8 (Del. Ch. May 9, 2012) (approving awards of $35,000, $20,000, and $7,500 for plaintiffs who gave depositions and other assistance); *Brinckerhoff*, 986 A.2d at 396 (approving payment of $100,000 to lead plaintiff who spent approximately 1,000 hours assisting with litigation); *Oliver v. Bos. Univ.*, 2009 WL 1515607, at *1 (Del. Ch. May 29, 2009) (awarding $40,000 to lead plaintiff where he spent approximately 2,000 hours assisting with litigation); *Raider*, 2006 WL 75310, at *2 (approving award of $42,000 for plaintiff who spent a total of 205 hours on litigation and incurred out-of-pocket expenses of $1,400).

III. CONCLUSION

Plaintiff's counsel is entitled to an all-in award of $266.7 million, representing 26.67% of the benefit caused by the litigation. Plaintiff's counsel will pay $50,000 of the fee award to the plaintiff as an incentive award. The parties will confer and submit a form of implementing order that will bring this matter to a close.

654 F.Supp.3d 892
United States District Court, N.D. California,
San Jose Division.

FEDERAL TRADE COMMISSION, Plaintiff,
v.
META PLATFORMS INC., et al., Defendants.

Case No. 5:22-cv-04325-EJD
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Signed January 31, 2023
|
Filed February 3, 2023

Synopsis
Background: Federal Trade Commission (FTC) filed enforcement action to block merger between virtual reality (VR) device provider and VR software developer for VR dedicated fitness application, as alleged antitrust violation of Clayton Act. FTC moved for preliminary injunction to prevent consummation of merger pending outcome of administrative proceedings, and provider and developer moved to dismiss for failure to state claim and to strike expert opinion.

Holdings: The District Court, Edward J. Davila, J., held that:

[1] VR dedicated fitness applications constituted relevant market;

[2] FTC established prima facie case that relevant market was substantially concentrated;

[3] in matter of first impression, reasonable probability standard of proof applied under actual potential competition theory;

[4] FTC was not likely to succeed on merits of claim based on merger substantially lessening actual potential competition; and

[5] FTC was not likely to succeed on merits of claim based on merger substantially lessening perceived potential competition.

Motions denied.

Procedural Posture(s): Motion for Preliminary Injunction; Motion to Dismiss for Failure to State a Claim; Motion to Strike Expert Report.

West Headnotes (54)

[1] **Antitrust and Trade Regulation** Preliminary

In evaluating a motion for a preliminary injunction brought under the FTC Act, courts must: (1) determine the likelihood that the Federal Trade Commission (FTC) will ultimately succeed on the merits, and (2) balance equities. Federal Trade Commission Act § 13, 15 U.S.C.A. § 53(b)(2).

[2] **Antitrust and Trade Regulation** Mergers and Acquisitions

Antitrust and Trade Regulation Preliminary

On a motion by the Federal Trade Commission (FTC) for a preliminary injunction to bar a merger, the federal court is not tasked with making a final determination on whether the proposed merger violates the Clayton Act, prohibiting mergers and acquisitions where the effect may be substantially to lessen competition or to tend to create a monopoly, but rather is charged with making only a preliminary assessment of the merger's impact on competition. Clayton Act § 7, 15 U.S.C.A. § 18; Federal Trade Commission Act § 13, 15 U.S.C.A. § 53(b)(2).

[3] **Antitrust and Trade Regulation** Preliminary

To obtain a preliminary injunction under the FTC Act, the Federal Trade Commission (FTC) must raise questions going to the merits so serious, substantial, difficult, and doubtful as to make them fair ground for thorough investigation, study, deliberation, and determination by the FTC in the first instance and ultimately by the Court of Appeals. Federal Trade Commission Act § 13, 15 U.S.C.A. § 53(b)(2).

[4] **Antitrust and Trade Regulation** Preliminary

On a motion by the Federal Trade Commission (**FTC**) for a preliminary injunction, although a district court may not require the **FTC** to prove the merits, the court must exercise independent judgment about the questions the **FTC** Act commits to it. Federal Trade Commission Act § 13, 15 U.S.C.A. § 53(b)(2).

[5] **Antitrust and Trade Regulation** Preliminary

On a motion by the Federal Trade Commission (**FTC**) for a preliminary injunction, the **FTC** is required to provide more than mere questions or speculations supporting its likelihood of success on the merits, and the district court must decide the motion based on all the evidence before it, from the defendants as well as from the **FTC**. Federal Trade Commission Act § 13, 15 U.S.C.A. § 53(b)(2).

1 Case that cites this headnote

[6] **Antitrust and Trade Regulation** Mergers and Acquisitions

The first step in analyzing a merger challenge under the Clayton Act provision, prohibiting mergers and acquisitions where the effect may be substantially to lessen competition or to tend to create a monopoly, is to determine the relevant market. Clayton Act § 7, 15 U.S.C.A. § 18.

1 Case that cites this headnote

[7] **Antitrust and Trade Regulation** Geographical market; section of country

Antitrust and Trade Regulation Product market; line of commerce

In analyzing an antitrust challenge to a merger, under the Clayton Act, the relevant market is determined by the relevant product market and the relevant geographic market. Clayton Act § 7, 15 U.S.C.A. § 18.

1 Case that cites this headnote

[8] **Antitrust and Trade Regulation** Product market; line of commerce

In analyzing an antitrust challenge to a merger, under the Clayton Act, the outer boundaries of a product market are determined by the reasonable interchangeability of use or cross-elasticity of demand between the product itself and substitutes for it. Clayton Act § 7, 15 U.S.C.A. § 18.

[9] **Antitrust and Trade Regulation** Product market; line of commerce

In analyzing an antitrust challenge to a merger, under the Clayton Act, within the general product market, well-defined submarkets may exist which, in themselves, constitute product markets. Clayton Act § 7, 15 U.S.C.A. § 18.

[10] **Antitrust and Trade Regulation** Questions of law and fact

In analyzing an antitrust challenge to a merger, under the Clayton Act, the definition of the relevant market is basically a fact question dependent upon special characteristics of the industry involved. Clayton Act § 7, 15 U.S.C.A. § 18.

[11] **Antitrust and Trade Regulation** Product market; line of commerce

In analyzing an antitrust challenge to a merger, under the Clayton Act, products need not be fungible to be included in the relevant market, but the relevant market cannot meaningfully encompass an infinite range of substitutes for the product. Clayton Act § 7, 15 U.S.C.A. § 18.

[12] **Antitrust and Trade Regulation** Relevant market in general

In analyzing an antitrust challenge to a merger, under the Clayton Act, the overarching goal of market definition is to recognize competition where, in fact, competition exists. Clayton Act § 7, 15 U.S.C.A. § 18.

[13] **Antitrust and Trade Regulation** Product market; line of commerce

In analyzing an antitrust challenge to a merger, under the Clayton Act, courts use both qualitative and quantitative tools to aid their determinations of relevant markets. Clayton Act § 7, 15 U.S.C.A. § 18.

[14] **Antitrust and Trade Regulation** Product market; line of commerce

In analyzing an antitrust challenge to a merger, under the Clayton Act, a qualitative analysis of the relevant market, including submarkets, involves examining such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors. Clayton Act § 7, 15 U.S.C.A. § 18.

1 Case that cites this headnote

[15] **Antitrust and Trade Regulation** Product market; line of commerce

In analyzing an antitrust challenge to a merger, under the Clayton Act, a common quantitative metric used by parties and the courts to determine relevant markets is the Hypothetical Monopolist Test (HMT). Clayton Act § 7, 15 U.S.C.A. § 18.

1 Case that cites this headnote

[16] **Antitrust and Trade Regulation** Product market; line of commerce

In analyzing an antitrust challenge to a merger, under the Clayton Act, there is no requirement to use any specific methodology in defining the relevant market. Clayton Act § 7, 15 U.S.C.A. § 18.

[17] **Antitrust and Trade Regulation** Product market; line of commerce

In analyzing an antitrust challenge to a merger, under the Clayton Act, the suitability of a submarket as a relevant market turns ultimately upon whether the factors used to define the submarket are economically significant. Clayton Act § 7, 15 U.S.C.A. § 18.

[18] **Antitrust and Trade Regulation** Product market; line of commerce

The factors set forth in *Brown Shoe Co. v. U.S.*, 82 S.Ct. 1502, are practical indicia of a relevant antitrust market such as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors.

1 Case that cites this headnote

[19] **Antitrust and Trade Regulation** Product market; line of commerce

Industry or public recognition factor weighed in favor of Federal Trade Commission's (**FTC**) proposed relevant product market consisting of virtual reality (VR) dedicated fitness applications, in **FTC's** enforcement action seeking injunction to block merger, between VR device provider and software developer for VR dedicated fitness application, that allegedly violated Clayton Act's prohibition against mergers and acquisitions that could substantially lessen competition or tend to create monopoly, since VR dedicated fitness application makers and broader fitness industry viewed VR dedicated fitness applications as economic submarket of VR applications and as constituting distinct market opportunity within VR ecosystem due to application's distinct uses, customers, and prices. Clayton Act § 7, 15 U.S.C.A. § 18.

[20] **Antitrust and Trade Regulation** Computer and internet

Peculiar characteristics and uses factor weighed in favor of Federal Trade Commission's (**FTC**) proposed relevant product market consisting of virtual reality (VR) dedicated fitness applications, in **FTC's** suit seeking injunction to block merger, between VR device provider and software developer for VR dedicated fitness application, that allegedly violated Clayton Act's prohibition against mergers and acquisitions that could substantially lessen competition or tend to create monopoly; compared to other VR applications and non-VR fitness offerings, VR dedicated fitness applications had several peculiar characteristics and uses, as they were specifically marketed to customers for exercise, and that customers could exercise in VR setting was distinct core functionality indicative of submarket. Clayton Act § 7, 15 U.S.C.A. § 18.

[21] **Antitrust and Trade Regulation** Computer and internet

Unique production facilities factor weighed in favor of Federal Trade Commission's (**FTC**) proposed relevant product market consisting of virtual reality (VR) dedicated fitness applications, in **FTC's** enforcement action seeking injunction to block merger, between VR device provider and software developer for VR dedicated fitness application, that allegedly violated Clayton Act's prohibition against mergers and acquisitions that could substantially lessen competition or tend to create monopoly, since VR dedicated fitness applications required unique combination of production inputs, including expertise, equipment, and production facilities. Clayton Act § 7, 15 U.S.C.A. § 18.

[22] **Antitrust and Trade Regulation** Product market

Although relevant antitrust markets are generally defined by demand-side substitutability, supply-side substitution also informs whether alternative products may be counted in the relevant market.

[23] **Antitrust and Trade Regulation** Product market

Supply-side substitution informing whether alternative products may be counted in the relevant antitrust market focuses on suppliers' responsiveness to price increases and their ability to constrain anticompetitive pricing by readily shifting what they produce.

[24] **Antitrust and Trade Regulation** Computer and internet

Distinct customers factor weighed in favor of Federal Trade Commission's (**FTC**) proposed relevant product market consisting of virtual reality (VR) dedicated fitness applications, in **FTC's** enforcement action seeking injunction to block merger, between VR device provider and software developer for VR dedicated fitness application, that allegedly violated Clayton Act's prohibition against mergers and acquisitions that could substantially lessen competition or tend to create monopoly, since users of VR dedicated fitness applications differed from those of other VR applications and several other fitness offerings along multiple axes, including that users of VR dedicated fitness applications tended to have older and more female user base. Clayton Act § 7, 15 U.S.C.A. § 18.

[25] **Antitrust and Trade Regulation** Computer and internet

Distinct prices factor weighed slightly in favor of Federal Trade Commission's (**FTC**) proposed relevant product market consisting of virtual reality (VR) dedicated fitness applications, in **FTC's** enforcement action seeking injunction to block merger, between VR device provider and software developer for VR dedicated fitness application, that allegedly violated Clayton Act's prohibition against mergers and acquisitions that could substantially lessen competition or tend to create monopoly; VR dedicated fitness applications were more likely to have subscription-based pricing model and were much more affordable than non-VR fitness products that came closest to offering level of immersion available in VR. Clayton Act § 7, 15 U.S.C.A. § 18.

[26] **Antitrust and Trade Regulation** Computer and internet

Sensitivity to price changes factor was neutral with respect to Federal Trade Commission's (**FTC**) proposed relevant product market consisting of virtual reality (VR) dedicated fitness applications, in **FTC's** enforcement action seeking injunction to block merger, between VR device provider and software developer for VR dedicated fitness application, that allegedly violated Clayton Act's prohibition against mergers and acquisitions that could substantially lessen competition or tend to create monopoly. Clayton Act § 7, 15 U.S.C.A. § 18.

[27] **Antitrust and Trade Regulation** Computer and internet

Specialized vendors factor was neutral with respect to Federal Trade Commission's (**FTC**) proposed relevant product market consisting of virtual reality (VR) dedicated fitness applications, in **FTC's** enforcement action seeking injunction to block merger, between VR device provider and software developer for VR dedicated fitness application, that allegedly violated Clayton Act's prohibition against mergers and acquisitions that could substantially lessen competition or tend to create monopoly, since **FTC** did not present any evidence that VR dedicated fitness application market required specialized vendors. Clayton Act § 7, 15 U.S.C.A. § 18.

[28] **Antitrust and Trade Regulation** Computer and internet

Balance of factors in *Brown Shoe Co. v. U.S.*, 82 S.Ct. 1502, weighed in favor of Federal Trade Commission's (**FTC**) proposed relevant product market consisting of virtual reality (VR) dedicated fitness applications, in **FTC's** suit seeking injunction to block merger, between VR device provider and software developer for VR dedicated fitness application, that allegedly violated Clayton Act's prohibition against mergers and acquisitions that could substantially lessen competition or tend to create monopoly; industry or public recognition, peculiar characteristics and uses, unique production facilities, distinct customers, and distinct prices indicated VR dedicated fitness applications presented in-market firms with economic opportunity distinct from other VR applications and fitness offerings. Clayton Act § 7, 15 U.S.C.A. § 18.

[29] **Antitrust and Trade Regulation** Product market; line of commerce

In analyzing an antitrust challenge to a merger, under the Clayton Act, the Hypothetical Monopolist Test (HMT) is a quantitative tool used by courts to help define a relevant market by determining reasonably interchangeable products. Clayton Act § 7, 15 U.S.C.A. § 18.

[30] **Antitrust and Trade Regulation** Product market; line of commerce

In analyzing an antitrust challenge to a merger, under the Clayton Act, the Hypothetical Monopolist Test (HMT) asks whether a hypothetical monopolist that owns a given set of products likely would impose at least a small but significant and nontransitory increase in price (SSNIP) on at least one product in the market, including at least one product sold by one of the merging firms; if enough consumers would respond to a SSNIP, often calculated as a 5% increase in price, by making purchases outside the proposed market definition so as to make the

SSNIP not profitable, then the proposed market is defined too narrowly. Clayton Act § 7, 15 U.S.C.A. § 18.

[31] **Federal Courts** Matters of Procedure in General

District court's decision not to rely on challenged portions of report by Federal Trade Commission's (**FTC**) expert rendered moot motion to strike his opinion that virtual reality (VR) dedicated fitness applications constituted relevant product market, in **FTC's** enforcement action seeking injunction to block merger, between VR device provider and software developer for VR dedicated fitness application, that allegedly violated Clayton Act's prohibition against mergers and acquisitions that could substantially lessen competition or tend to create monopoly. Clayton Act § 7, 15 U.S.C.A. § 18.

[32] **Antitrust and Trade Regulation** Geographical market; section of country

In analyzing an antitrust challenge to a merger, under the Clayton Act, the relevant geographic market is the area of effective competition where buyers can turn for alternate sources of supply. Clayton Act § 7, 15 U.S.C.A. § 18.

[33] **Antitrust and Trade Regulation** Geographical market; section of country

In a potential-competition case, under the Clayton Act, prohibiting mergers and acquisitions that could substantially lessen competition or tend to create monopoly, the relevant geographic market or appropriate section of the country is the area in which the acquired firm is an actual, direct competitor; that is, the geographic market must correspond to the commercial realities of the industry. Clayton Act § 7, 15 U.S.C.A. § 18.

[34] **Antitrust and Trade Regulation** Computer and internet

Relevant geographic market for virtual reality (VR) dedicated fitness applications was United States, in analyzing competitive impacts of VR device provider's acquisition of VR software developer for VR dedicated fitness application, in Federal Trade Commission's (**FTC**) enforcement action seeking injunction to block merger, between provider and developer, that allegedly violated Clayton Act's prohibition against mergers and acquisitions that could substantially lessen competition or tend to create monopoly, since content developed in other countries might not be available in United States, and developer's application was not available outside of United States and Canada. Clayton Act § 7, 15 U.S.C.A. § 18.

[35] **Antitrust and Trade Regulation** Presumptions and burden of proof

In analyzing an antitrust challenge to a merger, under the Clayton Act, the two species of potential competition theories, namely, actual potential competition and perceived potential competition, have different elements and are grounded in different presumptions about the market, but they share a common requirement in that they have meaning only as applied to concentrated markets; because both doctrines posit that potential competitors can or will soon impact the market, there would be no need for concern if the market is already genuinely competitive. Clayton Act § 7, 15 U.S.C.A. § 18.

[36] **Antitrust and Trade Regulation** Presumptions and burden of proof

In analyzing an antitrust challenge to a merger, under the Clayton Act, under the potential-competition doctrine, in order to assess whether the relevant market is substantially concentrated, a burden-shifting framework is employed: (1) Federal Trade Commission (**FTC**) may establish a prima facie case that the relevant market is substantially concentrated by introducing evidence of concentration ratios, and once established, (2) the burden shifts to the merging companies to show that the concentration ratios, which can be unreliable indicators of actual market behavior, did not accurately depict the economic characteristics of the relevant market, and if the prima facie case is not rebutted, then the market is suitable for the potential competition doctrines. Clayton Act § 7, 15 U.S.C.A. § 18.

[37] **Antitrust and Trade Regulation** Mergers and acquisitions

Federal Trade Commission (**FTC**) established prima facie case that relevant market for virtual reality (VR) dedicated fitness applications in United States was substantially concentrated, as supported **FTC's** claim that, under potential-competition doctrine, proposed merger between VR device provider and VR software developer for VR dedicated fitness application would violate Clayton Act's prohibition against mergers and acquisitions that could substantially lessen competition or tend to create monopoly, since **FTC** sufficiently presented evidence using concentration ratios for relevant market, all of which reflected market concentration well above what **FTC's** Merger Guidelines designated as highly concentrated. Clayton Act § 7, 15 U.S.C.A. § 18.

[38] **Antitrust and Trade Regulation** Mergers and acquisitions

Federal Trade Commission (**FTC**) was not required to allege oligopolistic, interdependent, or parallel behavior by virtual reality (VR) device provider and VR software developer for VR dedicated fitness application, in order to establish prima facie case that relevant market for VR dedicated fitness applications in United States was substantially concentrated, as supported **FTC's** claim that, under potential-competition doctrine, proposed merger between provider and developer would violate Clayton Act's prohibition against mergers and acquisitions that could substantially lessen competition or tend to create monopoly, since provider and developer, not **FTC**, had burden to present absence of parallel behavior in order to rebut **FTC's** prima facie case of substantial concentration of market. Clayton Act § 7, 15 U.S.C.A. § 18.

[39] **Antitrust and Trade Regulation** Mergers and Acquisitions

In analyzing an antitrust challenge to a merger, under the Clayton Act, under the potential-competition doctrine, the absence of blatantly anti-competitive effects may not necessarily preclude the propriety of potential competition theories, because the high degree of market concentration indicates that the seeds of anti-competitive conduct are present. Clayton Act § 7, 15 U.S.C.A. § 18.

[40] **Antitrust and Trade Regulation** Mergers and Acquisitions

In analyzing an antitrust challenge to a merger, under the Clayton Act, there are two essential preconditions before actual potential competition theory can be applied: (1) the alleged potential entrant must have available feasible means for entering the relevant market other than by acquiring the target company, and (2) those means offer a substantial likelihood of ultimately producing deconcentration of that market or other significant procompetitive effects. Clayton Act § 7, 15 U.S.C.A. § 18.

[41] **Antitrust and Trade Regulation** Mergers and Acquisitions

Reasonable probability standard, in other words, likelihood noticeably greater than 50%, was standard of proof that Federal Trade Commission (**FTC**) was required to present, under actual potential competition theory of whether merger between virtual reality (VR) device provider and VR software developer for VR dedicated fitness application would substantially lessen competition in violation of Clayton Act. Clayton Act § 7, 15 U.S.C.A. § 18.

[42] **Antitrust and Trade Regulation** Preliminary

In determining whether Federal Trade Commission (**FTC**) was entitled to preliminary injunction barring merger between virtual reality (VR) device provider and VR software developer for VR dedicated fitness application, as allegedly substantially lessening competition in violation of Clayton Act based on actual potential competition theory, district court would first consider whether objective evidence presented by **FTC** supported findings and conclusions necessary to satisfy actual potential competition doctrine, and if objective evidence was weak, inconclusive, or conflicting, court would consult subjective evidence to illuminate ambiguities left by objective evidence, with understanding that subjective evidence could not overcome any directly conflicting objective evidence. Clayton Act § 7, 15 U.S.C.A. § 18.

[43] **Antitrust and Trade Regulation** Mergers and Acquisitions

In exploring the feasible means of entry alternative to the challenged acquisition, the court must analyze the incentive and capability of the acquiring firm to enter the relevant market under the actual potential competition theory of an antitrust challenge to a merger, under the Clayton Act. Clayton Act § 7, 15 U.S.C.A. § 18.

[44] **Antitrust and Trade Regulation** Preliminary

Although virtual reality (VR) device provider possessed financial and engineering resources to undertake de novo entry into relevant market for VR dedicated fitness applications in United States, objective evidence that provider presently lacked capability to create fitness and workout content and lacked production studio was probative as to reasonable probability that provider would not enter VR dedicated fitness application market de novo, in support of determining that Federal Trade Commission (**FTC**), seeking injunction barring merger between provider and VR software developer of VR dedicated fitness application, was not likely to succeed on merits of claim that merger would violate Clayton Act, under actual potential competition theory. Clayton Act § 7, 15 U.S.C.A. § 18.

[45] **Antitrust and Trade Regulation** Preliminary

Objective evidence of virtual reality (VR) device provider's incentives and motivations for de novo entry into relevant market for VR dedicated fitness applications did not establish it was reasonably probable that provider would enter relevant market, in support of determining that Federal Trade Commission (**FTC**), seeking injunction barring merger between provider and VR software developer of VR dedicated fitness application, was not likely to succeed on merits of claim that merger would violate Clayton Act, under actual potential competition theory; although demographic, use, and growth metrics undergirded provider's interest in VR fitness, provider would enjoy those incentives even if it remained outside relevant market and provided funding or technical support for in-market developers. Clayton Act § 7, 15 U.S.C.A. § 18.

[46] **Antitrust and Trade Regulation** Preliminary

Subjective evidence of virtual reality (VR) device provider's incentives and motivations for de novo entry into relevant market for VR dedicated fitness applications did not establish it was reasonably probable that provider would enter relevant market, in support of determining that Federal Trade Commission (**FTC**), seeking injunction barring merger between provider and VR software developer of VR dedicated fitness application, was not likely to succeed on merits of claim that merger would violate Clayton Act, under actual potential competition theory, since provider's subjective interest in entering relevant market, either for hardware development or defensive market purposes, did not result in provider ever seriously contemplating de novo entry by building its own VR fitness application. Clayton Act § 7, 15 U.S.C.A. § 18.

[47] **Antitrust and Trade Regulation** Mergers and acquisitions

Where objective evidence is weak or inconclusive and does not strongly point to feasibility of entry de novo into the relevant market, it is incumbent on the court to consider the potential entrant's actual plans of entry into the relevant market for purposes of ensuring that enforcement of Clayton Act provision, prohibiting mergers and acquisitions where the effect may be substantially to lessen competition or to tend to create a monopoly, does not veer into the realm of ephemeral possibilities. Clayton Act § 7, 15 U.S.C.A. § 18.

[48] **Antitrust and Trade Regulation** Preliminary

Virtual reality (VR) device provider's de novo entry into relevant market for VR dedicated fitness applications by expanding its existing rhythm game application into dedicated fitness and partnering with fitness brand was not reasonably probable, in support of determining that Federal Trade Commission (**FTC**), seeking injunction barring merger between provider and VR software developer of VR dedicated fitness application, was not likely to succeed on merits of claim that merger would violate Clayton Act, under actual potential competition theory, since proposal to reposition provider's top-selling VR application into dedicated fitness application did not enjoy uniform or even widespread support among provider's personnel, who were researching VR fitness opportunities. Clayton Act § 7, 15 U.S.C.A. § 18.

[49] **Antitrust and Trade Regulation** Preliminary

Federal Trade Commission (**FTC**) seeking preliminary injunction barring merger between virtual reality (VR) device provider and VR software developer of VR dedicated fitness application was not likely to succeed on merits of claim that merger would violate Clayton Act, under actual potential competition theory that provider's acquisition of developer would have substantially lessened competition by depriving VR dedicated fitness application market of competition that would have arisen from provider's independent entry into market, since provider's entry into market was not reasonably probable due to lack of fitness content creation and studio production facilities, so provider did not have available feasible means to enter market other than by acquisition. Clayton Act § 7, 15 U.S.C.A. § 18.

[50] **Antitrust and Trade Regulation** Mergers and Acquisitions

To prevail on a claim that an acquisition would have eliminated perceived potential competition, the Federal Trade Commission (**FTC**) must establish, in addition to showing a highly concentrated market, the following: (1) defendant possessed the characteristics, capabilities, and economic incentive to render it a perceived potential de novo entrant into the relevant market, and (2) defendant's premerger presence on the fringe of the target market in fact tempered oligopolistic behavior on the part of existing participants in that market. Clayton Act § 7, 15 U.S.C.A. § 18.

[51] **Antitrust and Trade Regulation** Mergers and Acquisitions

The same objective facts regarding a defendant's capability of entering the relevant market under an actual potential competition theory are also probative of violation of the Clayton Act's prohibition against prohibiting mergers and acquisitions where the effect may be substantially to lessen competition or to tend to create a monopoly, through loss of a procompetitive on-the-fringe influence;

however, whereas a claim for actual potential competition may consider the potential entrant's intent to enter the market, a perceived potential competition claim ignores the potential entrant's subjective intent to enter the market and instead focuses on the subjective perceptions of the in-market firms. Clayton Act § 7, 15 U.S.C.A. § 18.

[52] **Antitrust and Trade Regulation** Mergers and acquisitions

Antitrust and Trade Regulation Preliminary

Objective and subjective evidence did not demonstrate it was reasonably probable that virtual reality (VR) device provider was perceived as potential competitor into VR dedicated fitness application market, in support of determining that Federal Trade Commission (**FTC**), seeking injunction barring merger between provider and VR software developer of VR dedicated fitness application, was not likely to succeed on merits of claim that merger of provider and developer would violate Clayton Act, under perceived potential competition theory; provider would enjoy demographic, use, and growth incentives even without entering relevant market, and provider's subjective interest in entering market for hardware development or defensive market purposes did not result in serious contemplation of entry. Clayton Act § 7, 15 U.S.C.A. § 18.

[53] **Antitrust and Trade Regulation** Preliminary

Virtual reality (VR) device provider's presence as potential competitor in VR dedicated fitness applications market lacked reasonable probability of having direct effect on existing participants in that market, in support of determining that Federal Trade Commission (**FTC**), seeking injunction barring merger between provider and VR software developer of VR dedicated fitness application, was not likely to succeed on merits of claim that merger would violate Clayton Act, under perceived potential competition theory, since there was no direct or circumstantial evidence to suggest that provider's presence as potential competitor did in fact temper oligopolistic behavior or result in any other procompetitive benefits. Clayton Act § 7, 15 U.S.C.A. § 18.

[54] **Antitrust and Trade Regulation** Preliminary

Federal Trade Commission (**FTC**) seeking preliminary injunction barring merger between virtual reality (VR) device provider and VR software developer of VR dedicated fitness application was not likely to succeed on merits of claim that merger would violate Clayton Act, under perceived potential competition theory that provider's acquisition of developer would have substantially lessened competition by eliminating competitive influence that provider exerted on firms within market by virtue of its presence on fringes of market; objective evidence did not support reasonable probability that firms in market perceived provider as potential entrant, and no evidence suggested that provider's presence did in fact temper oligopolistic behavior or result in any other procompetitive benefits. Clayton Act § 7, 15 U.S.C.A. § 18.

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ORDER DENYING PLAINTIFF'S MOTION FOR PRELIMINARY INJUNCTION

Re: ECF Nos. 108, 164, 470

EDWARD J. DAVILA, United States District Judge

***903** This action was brought by Plaintiff Federal Trade Commission ("**FTC**") to block the merger between a virtual reality ("VR") device provider and a VR software developer. Defendant **Meta** Platforms Inc. ("**Meta**") has agreed to acquire all shares of Within Unlimited, Inc. ("Within," collectively with **Meta**, "Defendants"). The **FTC** has come before the Court to seek preliminary injunctive relief pursuant to Section 13(b) of the Federal Trade Commission Act, 15 U.S.C. § 53(b), to enjoin Defendants from consummating their proposed merger (the "Acquisition") pending the outcome of ongoing administrative proceedings before the **FTC**. ECF Nos. 101, 164.

In addition to the **FTC's** motion for preliminary injunction, Defendants have filed a motion to dismiss the Amended Complaint ("FAC") and a motion to strike the opinion of the **FTC's** expert, Dr. Hal J. Singer, regarding the relevant product market definition. ECF Nos. 108, 470.

Over the course of a seven-day evidentiary hearing, the Court heard the parties' arguments and evidence. The Court has also received briefing on all pending motions, as well as pre-hearing and post-hearing submissions of the parties' proposed findings of fact. Having considered the parties' submissions and evidence, the Court DENIES Defendants' motion to dismiss, DENIES the Defendants' motion to strike, and DENIES the **FTC's** motion for preliminary injunction.

I. FACTUAL FINDINGS

A. Defendant Meta Platforms, Inc.

1. Defendant **Meta** Platforms, Inc. is a publicly traded corporation organized under Delaware law and headquartered in Menlo Park, California. DX1237, at 11. **Meta** operates a collection of social networking platforms referred to as its "Family of Apps," which includes Facebook, Instagram, Messenger, and WhatsApp. PX0937, at 51. **Meta** also manufactures VR devices, such as the Quest 2 and the Quest

Pro headsets, through its Reality Labs division. Stojsavljevic Hr'g Tr. 71:2–13; 74:10–19.

2. VR technology enables users to experience and interact with a digitally generated three-dimensional environment by wearing a headset with stereoscopic displays in front of each eye. Stojsavljevic Hr'g Tr. 72:25–74:9. Users can download a wide variety of VR software applications ("apps") from digital marketplaces, or app stores, for use on their personal VR devices. Pruett Hr'g Tr. 219:19–25. Quest headsets are designed so that a user's geolocation determines what content is available and at what price. Stojsavljevic Hr'g Tr. 79:23–80:6.

3. In 2020, 2021, and 2022, Meta spent several billion dollars each year on its VR Reality Labs division. Zuckerberg Hr'g Tr. 1280:9–1282:15.

4. Meta operates an app store called the Quest Store, previously known as the Oculus Store. Third-party app developers can request to have their app distributed in the Quest Store, and Meta also actively seeks out and invites developers to bring apps to the Quest Store. Stojsavljevic Hr'g Tr. 79:16–22; Pruett Hr'g Tr. 220:8–13. Apps must meet several content, technical, and ***904** asset requirements before they may be considered for listing on the Quest Store; however, Meta may still reject an app that meets all the requirements pursuant to the Quest Store's curation policy. Pruett Hr'g Tr. 220:25–223:16. Apart from the Quest Store, Meta also operates App Lab, an app distribution service for VR applications that meet basic technical and content requirements but is otherwise free from any editorial curating by Meta. Pruett Hr'g Tr. 260:16–22. Quest users can also download VR apps from other app stores on VR platforms that Meta does not own, such as SideQuest and Steam VR Store. Pruett Hr'g Tr. 274:8–21.

5. The content and apps that are available for a particular VR system plays an important role in the widespread adoption of that system, and many users may purchase a VR system for specific content they want to experience. Zuckerberg Hr'g Tr. 1294:16–125:2; Stojsavljevic Hr'g Tr. 101:6–13, 101:21–27. As a result, high quality and popular VR apps—dubbed as "system sellers"—can drive adoption and sales of the specific headsets for which they are available. Stojsavljevic Hr'g Tr. 107:23–108:5. Broad adoption of a specific VR system, in turn, will attract third-party app developers to create more VR content for that system, a phenomenon referred to as a "flywheel" effect. PX0100, at 2–3; Bosworth Hr'g Tr. 1048:21–1049:3.

6. When a VR app is developed wholly by a developer unaffiliated with Meta, Meta refers to that as third-party ("3P") development. When Meta funds all or most of a VR app's development, Meta refers to that as second-party ("2P") development. When a VR app is developed in-house at Meta, either by acquired VR studios or Meta employees themselves, Meta refers to that as first-party ("1P") development. Stojsavljevic Hr'g Tr. 72:12–16; 106:16–21.

7. Meta encourages third-party VR app developers to build apps for the Quest platform by providing funding and technical VR engineering assistance to those developers. Stojsavljevic Hr'g Tr. 106:5–15. Specifically, Meta provides grants that are designed to improve existing VR software or incentivize the development of software on Quest that may only exist on another platform. Meta also maintains a developer relations engineering team consisting of veteran engineers who work directly with developers to improve software quality, fix bugs, or polish the experience they are building. Pruett Hr'g Tr. 285:19–286:12. Meta's VR content organization spends approximately [Redacted]. PX0066 ("Rubin Dep.") 24:5–25:8.

8. In addition to providing funding or engineering support to third-party VR app developers, Meta has also sought to increase the VR app content available on its platform by acquiring third-party app developers and developing its own apps internally. PX0055 ("Verdu Dep.") 117:5–118:12.

9. Although decisions may be made on a case-by-case basis, Meta typically will seek to acquire or build its own VR app if: [Redacted] PX0127, at 4–5.

10. Similarly, Meta is more inclined to build its own VR app instead of acquiring an existing third-party developer [Redacted] PX0127, at 5.

11. In the past three years, Meta has acquired at least nine VR app studios: Beat Games, Sanzaru Games, Ready at Dawn Studios, Downpour Interactive, BigBox VR, Unit 2 Games, Twisted Pixel, Armature Studio, and Camouflaj. Stojsavljevic Hr'g Tr. 87:5–88:2.

12. The VR apps that Meta has independently developed and released include Horizon Worlds (world building), Horizon Workrooms (productivity), Horizon Venues (live events),

and Horizon Home (social networking). Meta's Answer and Affirmative ***905** Defenses ¶ 35, ECF No. 84. Meta's background and emphasis has been on communication and social VR apps. Zuckerberg Hr'g Tr. 1273:15–1274:22. That said, Meta has also developed and released Dead and Buried, a multiplayer shooter game. Bosworth Hr'g Tr. 1051:18–20.

B. Defendant Within Unlimited, Inc.

13. Defendant Within Unlimited, Inc. is a privately held corporation organized under the laws of Delaware with headquarters in Los Angeles, California. PX0006, at 1, 161. Within is a software development company founded by Chris Milk and Aaron Koblin, who were experienced visual artists. Milk Hr'g Tr. 669:25–670:6; Koblin Hr'g Tr. 649:9–13.

14. Within's flagship product is Supernatural, a subscription VR fitness service launched in April 2020 on the Quest Store. PX0005, at 77. Supernatural releases new workouts daily and continues to add new modalities (*e.g.*, aerobic boxing, meditation) to its lineup of workouts. Koblin Hr'g Tr. 605:15–606:4; Milk Hr'g Tr. 734:1–11. Users access Supernatural's workouts by paying a monthly subscription fee of $18.99 or an annual subscription fee of $179.99. FAC ¶ 24, ECF No. 101-1; Within's Answer and Affirmative Defense ¶ 25, ECF No. 83. [Redacted] Koblin Hr'g Tr. 636:15–22; Milk Hr'g Tr. 735:17–21. Within has never changed Supernatural's prices. Carlton Report ¶ 77. At present, [Redacted] Milk Hr'g Tr. 735:20–21.

C. The Alleged "VR Dedicated Fitness App" Market

15. The FTC alleges that the relevant market consists of VR dedicated fitness apps in the United States. Mot. 13, ECF No. 164. The government defines "VR dedicated fitness apps" as VR apps that are "designed so users can exercise through a structured physical workout in a virtual setting anywhere they choose to use their highly portable VR headset." *Id.*

16. Both Meta and Within have repeatedly referred to VR apps intended to provide immersive at-home structured physical exercise as "deliberate" or "dedicated" fitness apps. *E.g.*, Rabkin Hr'g Tr. 831:12-24; PX0001, at 5; PX0286, at 1; Milk Hr'g Tr. 681:19-21; PX487, at 4; Pruett Hr'g Tr. 263:6–264:2; PX0004, at 169. Meta now describes these apps as "trainer workout apps." PX0060 ("Paynter Dep.") 24:2–12, 56:14–23. VR dedicated fitness apps are sometimes called "VR deliberate fitness apps" or "trainer workout apps." The Court will use the phrase "VR dedicated fitness apps" throughout.

17. VR dedicated fitness apps are marketed to customers for the purpose of exercise. Pruett Hr'g Tr. 263:6–18. Some other VR apps, often called "incidental" or "accidental" fitness apps, may include mechanics that may allow users to exercise as a byproduct but have a primary focus other than fitness (such as gaming). PX0001, at 5 n.10; PX0529, at 2; Carmack Hr'g Tr. 562:12–18. Unlike VR incidental fitness apps, VR dedicated fitness apps often have features like trackable progress goals, heart rate tracking, and motion calibration. PX0001, at 5 n.10; Milk Hr'g Tr. 683:8–21. Additionally, VR dedicated fitness apps generally require the producing company to have expertise and assets that allow them to create exercise content, *e.g.*, workout coaches, green screen studios, stereoscopic capture, post processing pipelines. PX0111; PX0251, at 2–3; PX0127, at 7; Koblin Hr'g Tr. 650:3–12; Garcia Hr'g Tr. 1079:16–24. And because VR dedicated fitness apps create content on an ongoing basis to avoid user boredom, they are better suited than most other VR apps to be priced using a subscription model (although not all VR dedicated fitness apps follow this model). Pruett Hr'g Tr. 269:9–270:17; Singer Hr'g Tr. 359:2–18; Vickey Report ¶ 47.

***906** 18. The user base for VR dedicated fitness apps differs from that of VR overall. VR users generally skew younger and male, but VR dedicated fitness app users tend to have an older and more female set of users. PX0003, at 17; PX0004, at 167; Rubin Dep. 131:19–132:14; PX0127, at 1, 6; Bosworth Hr'g Tr. 1035:18–22. In addition to the diverse appeal of VR dedicated fitness apps, they have strong user retention and rapid growth. Carlton Report ¶¶ 33–35; PX0386, at 12. [Redacted]. PX0003, at 9, 44. [Redacted] PX0386, at 12. [Redacted] Carlton Report ¶ 67, Table 10.

19. Multiple companies that make VR dedicated fitness apps consider their products to compete with the extensive range of methods by which an individual can seek to exercise. According to Within, Supernatural "compete[s] with every product or service or offering that offers fitness or wellness," ranging from connected fitness devices like Peloton equipment to gyms to YouTube videos intended to be mimicked by a viewer. Milk Hr'g Tr. 724:15–25. Within does not, however, consider a VR incidental fitness app to constitute a fitness offering. Koblin Hr'g Tr. 606:5–8. The founder of VirZoom, another VR company with a dedicated fitness app (VZfit), made similar claims, and added that VZfit even "compete[s] with somebody who wants to just jump on their bike and go for a bike ride." Janszen Hr'g Tr. 1143:8–

12; DX1290 ("Janszen Decl.") ¶ 23. However, Odders Lab, another VR company that makes not only a dedicated fitness app but also a rhythm game app and a chess app, stated that its fitness app competed most directly with other fitness dedicated apps, such as Supernatural and FitXR, and that the launch of its fitness app had not diminished sales of its rhythm game app. Garcia Hr'g Tr. 1105:18–1106:21.

20. [Redacted] Apple provides Fitness+, a paid subscription app, and [Redacted] but it does not currently offer its own headset. DX1257, at 3, 24–28; Bosworth Hr'g Tr. 1022:13–16.

21. The customers for more established fitness offerings are perceived to be more likely to have long-term or well-developed fitness routines, while VR dedicated fitness app users are targeted more toward "[Redacted]" who have less fitness experience. PX0051 ("Cibula Dep.") 84:20–25; PX0318, at 1; PX0563, at 1; DX1081, at 1–2. No record evidence suggests that these firms possess VR engineering expertise. PX0118, at 1; Singer Report ¶ 82. As such, these fitness offerings do not create the 360-degree embodiment in a virtual environment provided by VR dedicated fitness apps. *See, e.g.*, Zuckerberg Hr'g Tr. 1298:5–6; Rabkin Hr'g Tr. 835:24–836:3. Although some fitness offerings may display videos of various locations around the world, those videos are displayed on a flat screen. Vickey Hr'g Tr. 1184:12–21.

22. Connected fitness devices are generally stationary and larger than the portable and relatively small VR headset equipment required to use a VR dedicated fitness app. *See, e.g.*, Milk Hr'g Tr. 689:17–25. The upfront device cost can be over $1,000, and users pay a monthly subscription fee to access fitness content; for example, Peloton and Tonal are connected fitness device companies, and cost, respectively $1,445 plus $44 per month and $3,495 plus $49 per month. Singer Report ¶¶ 68–69. There are also more affordable alternatives outside of VR, such as a Peloton mobile app-only subscription, which costs $12.99 per month. *Id.* ¶ 65; DX1081, at 1–2. The subscription model is common in the overall fitness industry—in addition to the examples above, traditional gyms and Fitness+ charge monthly subscriptions. PX0001, at 2; DX1081, at 1–2; DX1257, at 3, 24–28.

23. Within's VR app Supernatural is a dedicated fitness app: it was designed specifically ***907** for fitness and offers "daily personalized full-body workouts and expert coaching from real-world trainers." PX0906, at 1. Within began developing Supernatural in February 2019, and launched it in the Quest Store on April 23, 2020. PX0005, at 77; PX0906, at 1. Supernatural now offers over 800 fully immersive video workouts set to music in various photorealistic landscapes, such as the Galapagos Islands and the Great Wall of China. FAC ¶ 24, ECF No. 101-1; Koblin Hr'g Tr. 604:18–605:19; ECF No. 83 ¶ 25; PX0906, at 1; *see id.* at 3–4, 6, 8. Through deals with major music studios, Supernatural sets each workout to songs from A-list artists like Katy Perry, Imagine Dragons, Lady Gaga, and Coldplay. FAC ¶ 24, ECF No. 101-1. Within optimized the exercise movements in Supernatural through consultations with experts holding PhDs in kinesiology and biomechanics; the workouts are led by personal trainers, calibrated to users' range of motion, mapped out in VR by dance choreographers, and filmed at Within's studio in Los Angeles. PX0712, at 18–20, 27–29. Within's founders are experienced directors of interactive music videos. *Id.* at 3–4. [Redacted] Supernatural is only available to Quest headset users in the United States and Canada. Milk Hr'g Tr. 671:4–9.

24. Other VR dedicated fitness apps include FitXR, Les Mills Bodycombat, VZfit, VZfit Premium, PowerBeats VR, RealFit, Holofit, Liteboxer, Liteboxer Premium VR, and VRWorkout. Singer Report ¶ 39. Like Supernatural, Liteboxer Premium VR costs $18.99 per month. *Id.* Les Mills Bodycombat, PowerBeatsVR, and RealFit have respective one-time costs of $29.99, $22.99, and $19.99; Liteboxer and VRWorkout are free; and the other VR dedicated fitness apps charge monthly subscription prices ranging from about $9 to $12. *Id.* Companies producing VR dedicated fitness apps generally pursue business strategies optimized for growth and market penetration, [Redacted]. Milk Hr'g Tr. 736:15–21; Garcia Hr'g Tr. 1111:8–1112:14; Janszen Hr'g Tr. 1147:22–1148:1. These companies expect that high growth and penetration metrics will render them attractive acquisition targets. *Id.*; Zyda Hr'g Tr. 1227:18–22, 1228:15–18.

25. All of these apps, including Supernatural, were launched within the past five years. Carlton Report ¶ 125. New VR dedicated fitness apps are expected to launch in the near future. *Id.* Supernatural currently possesses an 82.4% share of market revenue among the existing VR dedicated fitness apps (or a 77.6% share of VR apps in the Quest Store's "Fitness and Wellness" category). Singer Report ¶ 75, Tables 2-A, 2-B. [Redacted] Singer Rebuttal Report ¶¶ 124–25, Tables 1-A, 1-B.

26. The **FTC's** economics expert, Dr. Singer, analyzed the concentration of the VR dedicated fitness app market using the Herfindahl-Hirschman Index ("HHI"). Singer Report ¶

76. Dr. Singer performed the HHI calculation multiple times to account for different conceptions of the firms contained within the VR dedicated fitness app market. *Id.* Using a set of firms based off a list of Supernatural competitors provided by **Meta** to the **FTC**, Dr. Singer calculated an HHI of 6,917 by measuring each firm's market share of revenue. *Id.* ¶¶ 46, 76, Table 2-A. Then, to capture broader potential set of firms within the VR dedicated fitness app market, Dr. Singer analyzed all apps listed in **Meta's** Quest Store under its "Fitness & Wellness" category and calculated an HHI of 6,148 (again, based on revenue). *Id.* ¶¶ 48, 76, Table 2-A. Dr. Singer also calculated HHI using market share of total hours spent and identified outputs 6,307 for the set of firms based off **Meta's** list and 4,863 for the broader set of "Fitness & Wellness firms." Singer Rebuttal Report ¶¶ 124–25, Table 1-A. Lastly, Dr. Singer calculated ***908** HHI using market share of monthly active users and identified outputs of 3,377 and 2,098 for the two respective sets of firms. *Id.* ¶¶ 124–25, Table 1-B. Markets are generally considered "highly concentrated" when the HHI is above 2,500 and "moderately concentrated" when the HHI is between 1,500 and 2,500. Singer Report ¶ 76 & n.129.

D. The Challenged Acquisition

27. **Meta** and Zuckerberg first expressed interest in acquiring Within as early as February 22, 2021. PX0170, at 1–2.

28. After Zuckerberg showed some interest in [Redacted], Michael Verdu (Vice President of VR Content) investigated and [Redacted]. PX0118, at 2, Mar. 4, 2022; Verdu Dep. 7:22–8:02.

29. On March 11, 2021, **Meta** employees met to discuss potential VR fitness investments with Mark Rabkin, the head of VR technology at **Meta** and one of the final decision makers to approve any VR investment. PX0179, at 2; Rabkin Hr'g Tr. 800:7–11; Stojsavljevic Hr'g Tr. 189:24–190:12. In advance of this meeting, Ananda Dass (**Meta's** director of non-gaming VR content) and Jane Chiao (business-side employee) prepared a pre-read document analyzing five potential investment options. PX0127, Mar. 10, 2021; Stojsavljevic Hr'g Tr. 69:18–24, 138:11–18, 140:23–141:1, 149:16–151:12. Shortly before this meeting, on March 4, 2021, Jane Chiao had also prepared a document titled, [Redacted]. PX0492, at 7, Mar. 9, 2021. During the meeting, the attendees decided [Redacted]. PX0179.

30. On March 17, 2021, Dass and Chiao summarized the advantages and disadvantages of acquiring Supernatural [Redacted]. At this time, they proposed spending the next few months inquiring into [Redacted]. PX0284, Mar. 17, 2021.

31. On April 20, 2021, Melissa Brown (Head of Developer Relations) prepared an executive summary pre-read in advance of **Meta's** meeting with Within, which was circulated to Verdu and Dass. The executive summary contains [Redacted] PX0565, Apr. 20, 2021.

32. On April 26, 2021, Brown circulated a [Redacted] PX0253, Apr. 26, 2021.

33. On May 26, 2021, Anand Dass [Redacted] DX1012, at 1, 3, May 26, 2021. [Redacted] *Id.*; *see also* PX0123, at 2. [Redacted] PX0117, June 10, 2021.

34. Frank Casanova (Apple's senior director of augmented reality product marketing) testified that Apple [Redacted]. Casanova's personal recollection was that [Redacted]. DX1219 ("Casanova Dep.") 90:20–93:15.

35. In mid-July 2021, **Meta** and Within entered into a non-binding term sheet regarding a potential acquisition. PX0062 ("Milk Dep.") 129:2–14; Milk Hr'g Tr. 720:12–15. **Meta** and Within executed the Merger Agreement on October 22, 2021. DX1072, Oct. 22, 2021.

E. Beat Saber Expansion Proposal

36. Beat Saber is a VR rhythm game in which players use virtual swords to slash oncoming blocks timed to music. FAC ¶ 30; **Meta's** Answer and Affirmative Defenses ¶ 33. Beat Saber is the most popular and best-selling VR app of all time. Stojsavljevic Hr'g Tr. 82:23–83:8; Rabkin Hr'g Tr. 820:9–11.

37. **Meta** acquired Beat Games, the studio that produces Beat Saber, in late 2019. **Meta's** Answer and Affirmative Defenses ¶ 4.

38. At the time it acquired Beat Games, **Meta** viewed Beat Saber as a potential "vector into fitness as a game-adjacent use case." PX0342, at 2, Sept. 27, 2019. There was a continuing internal dialogue at **Meta** regarding a potential fitness version of Beat Saber, which was referred to as the ***909** "perpetual white whale quest to get ... Beat Games to build a fitness version of Beat Saber." Verdu Dep. 112:04–112:12, 178:12–20. The founders of Beat Games were "warm to the idea" and released a "FitBeat" song for Beat Saber, but the idea otherwise did not gain traction. Verdu Dep. 178:12–20; see also PX0123 [Redacted] Sept. 15, 2021.

39. On February 16, 2021, Rade Stojsavljevic (director of Meta's first party studios) was riding his Peloton bike on a workout with a live DJ spinning music when he came up with the idea of a Peloton partnership with Beat Saber. Stojsavljevic Hr'g Tr. 127:20–128:24.

40. Shortly thereafter, Stojsavljevic collaborated on a presentation called "Operation Twinkie," in which he proposed repositioning Beat Saber as a fitness app in a partnership with Peloton. The same presentation recommended [Redacted] PX0527, at 5, 8.

41. On March 4, 2021, Chiao responded to comments regarding partnering with Peloton to create VR content, [Redacted] PX0251, at 2–3, Mar. 4, 2021.

42. On March 11, 2021, Stojsavljevic attended the VR fitness investment meeting with Mark Rabkin. PX0179, at 2; *see also supra* ¶ 31. Alongside the acquisitions of [Redacted] Supernatural, the March 11 meeting concluded that Stojsavljevic was to prepare a presentation to Rabkin to expand Beat Saber to dedicated fitness. PX0179, at 2.

43. On March 15, 2021, Stojsavljevic queried a group chat and solicited feedback on his proposal for a Beat Saber–Peloton partnership. PX0407, at 1, Mar. 15, 2021. The group members discussed different forms the partnership could take. *Id.*

44. On March 25, 2021, Stojsavljevic received a presentation from a consultant, [Redacted], titled "Beat Saber x Peloton Opportunity Identification." PX0121, at 2. The presentation provided a quote for [Redacted] to investigate the Beat Saber and Peloton opportunity, which was to take about 8 weeks and cost $23,500. *Id.* at 8. [Redacted]'s proposed research approach included nine action items, as follows: (1) analyze the home fitness market; (2) analyze the Peloton market; (3) assess the Peloton bike capabilities; (4) analyze the current XR [1] fitness market; (5) analyze Beat Saber's current strategy and its Fitbeat song; (6) identify Beat Saber x Peloton opportunities; (7) identify XR fitness opportunities; (8) define the go-to-market approach; and (9) define how to approach Peloton with the partnership. *Id.* at 5–6. Stojsavljevic ultimately did not engage [Redacted] to undertake this research project. PX0052 ("Stojsavljevic Dep.") 219:23–220:1.

45. Based on the parties' representations and to the best of the Court's review of the evidence, the next reference to the Beat Saber–Peloton proposal was on June 11, 2021, after Meta began pursuing Within as an acquisition target. PX0341, at 2, June 11, 2021. In a chat, Stojsavljevic briefly mentioned that Chiao and Dass had disagreed with his Beat Saber–Peloton proposal and had wanted to [Redacted]. *Id.* At the evidentiary hearing, Stojsavljevic testified that his enthusiasm for the Beat Saber–Peloton proposal had "slowed down" before Meta's decision to acquire Within. Stojsavljevic Hr'g Tr. 165:12–17. He also testified that he had not undertaken the research project that he had promised Rabkin because he had been busy working ***910** on another Meta acquisition. *Id.*; *see also supra* ¶ 44.

46. On September 15, 2021, [Redacted] Jason Rubin—who had just transitioned into his role as the vice president of Metaverse content on August 1, 2021—made comments about Beat Saber in response to [Redacted]PX0123, at 2, Sept. 15, 2021; *see also* Rubin Dep. 28:8–15. Rubin suggested that [Redacted] PX0123, at 2. He subsequently remarked that [Redacted] *Id.*

II. PROCEDURAL HISTORY

Defendants signed an Agreement and Plan of Merger for a proposed acquisition of Within by Meta (the "Acquisition") on October 22, 2021. ECF No. 101-1 ("FAC") ¶ 24; PX0004, at 161. On July 27, 2022, the FTC filed a complaint for a temporary restraining order and preliminary injunction enjoining the Acquisition. *See* Compl., ECF No. 1. At the time of the FTC's filing, Defendants would have been free to consummate the Acquisition after July 31, 2022. *Id.* ¶ 27. On July 29, 2022, the Court granted the parties' stipulated order preventing Defendants from consummating the Acquisition until after August 6, 2022. ECF No. 19. On August 5, 2022, the Court granted the parties' second stipulated order and entered a temporary restraining order enjoining the Acquisition until after December 31, 2022. ECF No. 56. The FTC filed its amended complaint on October 7, 2022, *see* FAC, and Defendants moved to dismiss the amended complaint on October 13, 2022, ECF No. 108 ("MTD"). The Court took the MTD under submission without oral argument on December 2, 2022. ECF No. 388.

On October 31, 2022, pursuant to the parties' stipulated order, the FTC filed its memorandum in support of its motion for a preliminary injunction (the "Motion"). ECF Nos. 86, 164. The evidentiary hearing on the Motion began on December 8, 2022. *See* ECF No. 441. Following the in-Court testimony of the FTC's economics expert, Dr. Hal J. Singer, on December 13, 2022, Defendants orally moved the Court to strike Dr. Singer's testimony. *See* ECF No. 464. Defendants subsequently filed a motion to strike Dr. Singer's opinion regarding the definition of the relevant product market. ECF No. 470. The evidentiary hearing concluded on December 20, 2022, *see* ECF No. 492, and the Court granted the parties' stipulated order extending the temporary restraining order to enjoin the Acquisition until January 31, 2023, ECF No. 508.

On January 31, 2023, the **FTC** filed an emergency motion requesting an extension of the temporary restraining order if the Court either was not prepared to rule on the Motion until after that date or denied the Motion. ECF No. 543 ("Emergency Motion"). The Court's ruling on the Emergency Motion will be filed in a separate order.

The Court now rules on the Motion, the MTD, and the motion to strike Dr. Singer's opinion on the relevant product market definition. *See* ECF Nos. 108, 164, 470.

III. LEGAL CONCLUSIONS

A. Legal Standard

[1] Section 13(b) of the **FTC** Act provides that "[u]pon a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest, and after notice to the defendant, a temporary restraining order or a preliminary injunction may be granted without bond." 15 U.S.C. § 53(b)(2). In evaluating a motion for preliminary injunction brought under Section 13(b), courts must "1) determine the likelihood that the Commission will ultimately succeed on the merits and 2) balance the equities." *F.T.C. v. Warner Commc'ns Inc.*, 742 F.2d 1156, 1160 (9th Cir. 1984) (emphasis added) (citing ***911** *F.T.C. v. Simeon Mgmt. Corp.*, 532 F.2d 708, 713–14 (9th Cir. 1976)).

[2] **[3]** **[4]** **[5]** The federal court is not tasked with "mak[ing] a final determination on whether the proposed merger violates Section 7, but rather [with making] only a preliminary assessment of the merger's impact on competition." *Warner Commc'ns Inc.*, 742 F.2d at 1162. To obtain a preliminary injunction, the **FTC** must "raise questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the **FTC** in the first instance and ultimately by the Court of Appeals." *Id.* (citations omitted); *see also* ***FTC** v. Whole Foods Market, Inc.*, 548 F.3d 1028, 1035 (D.C. Cir. 2008) ("the **FTC** [must] 'raise questions going to the merits so serious, substantial, difficult[,] and doubtful as to make them fair ground for thorough investigation.' "). Although a district court may not "require the **FTC** to prove the merits, ... it must 'exercise independent judgment' about the questions § 53(b) commits to it." *Whole Foods Market, Inc.*, 548 F.3d at 1035 (citations omitted). The **FTC** is therefore required to provide more than mere questions or speculations supporting its likelihood of success on the merits, and the district court must decide the motion based on "all the evidence before it, from the defendants as well as from the **FTC**." *Id.* (citations omitted); *see United States v. Siemens Corp.*, 621 F.2d 499, 506 (2d Cir. 1980) (noting that "the Government must do far more than merely raise sufficiently serious questions with respect to the merits" in demonstrating a "reasonable probability" of a Section 7 violation.).

B. Relevant Market Definition

[6] **[7]** The first step in analyzing a merger challenge under Section 7 of the Clayton Act is to determine the relevant market. *U.S. v. Marine Bancorporation, Inc.*, 418 U.S. 602, 619, 94 S.Ct. 2856, 41 L.Ed.2d 978 (1974) (citing *E.I. Du Pont*, 353 U.S. 586, 593, 77 S.Ct. 872, 1 L.Ed.2d 1057 (1957)); *see* ***FTC** v. Qualcomm Inc.*, 969 F.3d 974, 992 (9th Cir. 2020) ("A threshold step in any antitrust case is to accurately define the relevant market, which refers to 'the area of effective competition.' "). The relevant market for antitrust purposes is determined by (1) the relevant product market and (2) the relevant geographic market. *Brown Shoe Co. v. U.S.*, 370 U.S. 294, 324, 82 S.Ct. 1502, 8 L.Ed.2d 510 (1962).

1. Product Market

[8] **[9]** **[10]** **[11]** **[12]** "The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it." *Brown Shoe*, 370 U.S. at 325, 82 S.Ct. 1502. "Within a general product market, 'well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes.' " *Hicks v. PGA Tour, Inc.*, 897 F.3d 1109, 1121 (9th Cir. 2018) (quoting *Brown Shoe*, 370 U.S.

at 325, 82 S.Ct. 1502); *see also* *Newcal Indus., Inc. v. Ikon Office Sol'n*, 513 F.3d 1038, 1045 (9th Cir. 2008) ("[A]lthough the general market must include all economic substitutes, it is legally permissible to premise antitrust allegations on a submarket."). The definition of the relevant market is "basically a fact question dependent upon the special characteristics of the industry involved." *Twin City Sportservice, Inc. v. Charles O. Finley & Co., Inc.*, 676 F.2d 1291, 1299 (9th Cir. 1982). Products need not be fungible to be included in a relevant market, but a relevant market "cannot meaningfully encompass th[e] infinite range" of substitutes for a product. *Id.* at 1271 (quoting ***912** *Times–Picayune Publishing Co. v. United States*, 345 U.S. 594, 611, 612 n. 31, 73 S.Ct. 872, 97 L.Ed. 1277, (1953)). The overarching goal of market definition is to "recognize competition where, in fact, competition exists." *Brown Shoe*, 370 U.S. at 326, 82 S.Ct. 1502; *see also* *U.S. v. Continental Can Co.*, 378 U.S. 441, 449, 84 S.Ct. 1738, 12 L.Ed.2d 953 (1964) ("In defining the product market between these terminal extremes [of fungibility and infinite substitution], we must recognize meaningful competition where it is found to exist."); ***FTC*** *v. Whole Foods Market, Inc.*, 548 F.3d 1028, 1039 (D.C. Cir. 2008) ("As always in defining a market, we must 'take into account the realities of competition.' ") (citations omitted).

[13] **[14]** **[15]** Courts have used both qualitative and quantitative tools to aid their determinations of relevant markets. A qualitative analysis of the relevant antitrust market, including submarkets, involves "examining such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors." *Brown Shoe*, 370 U.S. at 325, 82 S.Ct. 1502; *see also, e.g., Klein v. Facebook, Inc.*, 580 F. Supp. 3d 743, 766–68 (N.D. Cal. 2022) (applying *Brown Shoe* factors). A common quantitative metric used by parties and courts to determine relevant markets is the Hypothetical Monopolist Test ("HMT"), as described in the U.S. Department of Justice and the **FTC's** 2010 Merger Guidelines. U.S. Dep't of Justice & **FTC**, *Horizontal Merger Guidelines* ("2010 Merger Guidelines") § 4 (2010); *see also, e.g.,* *U.S. v. H & R Block, Inc.*, 833 F. Supp. 2d 36, 51 (D.D.C. 2011) ("An analytical method often used by courts to define a relevant market is to ask hypothetically whether it would be profitable to have a monopoly over a given set of substitutable products. If so, those products may constitute a relevant market.").

[16] **[17]** There is "no requirement to use any specific methodology in defining the relevant market." *Optronic Techs., Inc. v. Ningbo Sunny Elec. Co., Ltd.*, 20 F.4th 466, 482 (9th Cir. 2021). As such, courts have determined relevant antitrust markets using, for example, only the *Brown Shoe* factors, or a combination of the *Brown Shoe* factors and the HMT. *See, e.g.,* *Lucas Auto. Eng., Inc. v. Bridgestone/Firestone, Inc.*, 275 F.3d 762, 766–68 (9th Cir. 2001) (relying on *Brown Shoe* factors alone in review of district court's determination of relevant market); *United States v. Aetna Inc.*, 240 F. Supp. 3d 1, 20–21 (D.D.C. 2017) (using HMT and *Brown Shoe* factors to analyze relevant market). The Ninth Circuit has "repeatedly noted that the *Brown Shoe* indicia are practical aids for identifying the areas of actual or potential competition and that their presence or absence does not decide automatically the submarket issue." *Thurman Indus., Inc. v. Pay 'N Pak Stores, Inc.*, 875 F.2d 1369, 1375 (9th Cir. 1989) (citations omitted). The suitability of a submarket as a relevant antitrust market "turns ultimately upon whether the factors used to define the submarket are 'economically significant.' " *Id.*

The **FTC** proposes a relevant product market consisting of VR dedicated fitness apps, meaning VR apps "designed so users can exercise through a structured physical workout in a virtual setting." Mot. 13. According to the **FTC**, VR dedicated fitness apps are distinct from (1) other VR apps and (2) other fitness offerings. *Id.* 14. To differentiate their proposed market from other VR app markets, the **FTC** claims that VR dedicated fitness apps have distinct customers and pricing strategies. *Id.* The **FTC** further argues that VR dedicated fitness apps are in a separate market from other fitness offerings (*e.g.*, gyms, at-home fitness equipment) because they provide users with "fully immersive, 360-degree ***913** environments," are fully portable, save space, cost less, and target a different type of consumer. *Id.* 14–15. The **FTC** claims that these qualitative product differences satisfy the *Brown Shoe* practical indicia of a relevant market, and that the Hypothetical Monopolist Test conducted by the FTC's economics expert further confirms the relevant product market definition. *Id.* 15.

Unsurprisingly, Defendants disagree. They claim that the FTC's proposed market is impermissibly narrow because it excludes "scores of products, services, and apps" that are "reasonably interchangeable" with VR dedicated fitness apps, including dozens of VR apps categorized as "fitness" apps on the Quest platform, fitness apps on gaming consoles and other VR platforms, and non-VR connected fitness products and services. Opp. 8, ECF No. 216. Defendants argue that members of the FTC's proposed market subjectively consider other VR apps and other fitness offerings to be competing products, and that several such products also possess the very features—portability, immersion, and pricing models—that the FTC highlights as distinguishing or unique to its proposed market. *Id.* 8–10. Defendants also contend that Dr. Singer's HMT analysis is fatally flawed due to methodological errors in the survey underlying the test. *Id.* 11.

In this case, the Court finds the FTC has made a sufficient evidentiary showing that there exists a well-defined relevant product market consisting of VR dedicated fitness apps.

a. *Brown Shoe* Analysis

[18] The Court first examines in turn each of the *Brown Shoe* factors, *i.e.*, "practical indicia [such] as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors." 370 U.S. at 325, 82 S.Ct. 1502.

i. Industry or Public Recognition

[19] The evidence indicates that Defendants and other VR dedicated fitness app makers viewed VR dedicated fitness apps as an economic submarket of VR apps. For example, [Redacted] PX0003, at 44. [Redacted] *Id.* at 9. Within's contemporaneous view of untapped market segments indicates that a "fitness first" app paired with a VR headset—*i.e.*, a VR dedicated fitness app—would be in a distinct segment of the overall VR market. *See id.* at 31. Likewise, as explained in greater detail in the sections below, Meta repeatedly stated that VR dedicated fitness apps constituted a distinct market opportunity within the VR ecosystem due to their unique uses, distinct customers, and distinct prices. *See infra* Sections III.B.1.a.ii., iv., v. And a representative the VR app company Odders Lab testified that the launch of its VR dedicated fitness app did not diminish sales of its VR rhythm app, acknowledging that its VR fitness app "compete[d] more directly with fitness dedicated applications than gaming applications." Garcia Hr'g Tr. 1105:18–1106:21. Industry companies' internal communications showing frequent distinctions between various categories of applications is "strong[ ] support" of a distinct submarket. *Klein*, 580 F. Supp. 3d at 758.

Participants in the broader fitness industry also recognized VR fitness as a "separate economic entity." [Redacted] *See* *United States v. Microsoft Corp.*, 253 F.3d 34, 53 (D.C. Cir. 2001) (rejecting inclusion of middleware products in the relevant market where middleware was a potential, rather than current, competitor).

Defendants claim that members of the VR dedicated fitness app industry understood the market in which they operated to ***914** consist of "[s]cores of products, services, and apps available to consumers who want to exercise." Opp. 8; Milk Hr'g Tr. 724:15–25 ("[Redacted]"); *id.* 779:7–8 ("We have thousands of competitors."); *see also* Janszen Hr'g Tr. 1143:8–12 (VR dedicated fitness app VirZoom "compete[s] with somebody who wants to just jump on their bike and go for a bike ride"). Defendants also contend that "[e]stablished fitness and technology firms ... view VR fitness as competitive with off-VR products," and point as an example to Apple's inclusion of Supernatural and the Peloton Guide in the "competitive landscape" when it [Redacted]. [2] Opp. 9; DX1257, at 3, 24–28.

Defendants' evidence shows that there is a broad fitness market that includes everything from VR apps to bicycles. This in no way precludes the existence of a submarket constituting a relevant product market for antitrust purposes. *Brown Shoe*, 370 U.S. at 325, 82 S.Ct. 1502; *Newcal Indus.*, 513 F.3d at 1045. As the Ninth Circuit has noted, a relevant antitrust market "cannot meaningfully encompass th[e] infinite range" of substitutes for a product—yet this is exactly how Defendants propose to define the market. *Twin City Sportservice, Inc. v. Charles O'Finley & Co., Inc.*, 512 F.2d 1264, 1271 (9th Cir. 1975). The Court therefore acknowledges that VR dedicated fitness apps compete for consumers with every manner of exercise (including gyms, bike rides, and connected fitness), but finds that Defendants and the broader fitness industry recognized VR dedicated fitness apps as an economically distinct submarket.

ii. Peculiar Characteristics and Uses

[20] The evidence indicates that VR dedicated fitness apps have several "peculiar characteristics and uses" in comparison to both other VR apps and non-VR fitness offerings. *Brown Shoe*, 370 U.S. at 325, 82 S.Ct. 1502. Even assuming "[a]lmost all VR applications require body movement," Pruett Hr'g Tr. 264:16, VR dedicated fitness apps are "specifically marketed to customers for the purpose of exercise," *id.* 263:6–18. To support that marketing, VR dedicated fitness apps (unlike other VR apps) are often characterized by their fitness-specific features, such as trainer-led workout regimens, calorie tracking, and the ability to set and track progress toward fitness goals. *See, e.g., id.* 263:14–23; Paynter Dep. 24:2–12 ("what [**Meta**] used to call [dedicated] fitness apps now correspond to a category ... call[ed] ... trainer workout apps"); PX0487, at 4 (VR dedicated fitness apps are "[d]esigned to allow a player to deliberately set and attain fitness goals, with fitness-specific features i.e. coaching, trackable progress"); PX0001, at 5 n.10 ("**Meta** draws a distinction between apps designed to allow users to set and attain fitness goals, with features like coaching and trackable progress (called 'deliberate' or 'dedicated' fitness apps) and games whose primary focus is not fitness that allow users to get a workout as a byproduct (sometimes called 'incidental' or 'accidental' fitness apps).").

The most "peculiar characteristic" of VR dedicated fitness apps in comparison to non-VR fitness offerings is, of course, the VR technology itself. A VR user is "embodied" in a virtual environment. Zuckerberg Hr'g Tr. 1298:5–6. She is "teleported to a different place, feeling like when you move your head and look around, you're in a new space and seeing virtual things as if they are real, which is virtual reality." Rabkin Hr'g Tr. 835:24–836:3. Defendants' fitness industry expert, Dr. Vickey, submitted that non-VR fitness options could also be immersive, describing the non-VR Hydrow rowing machine as an "immersive exercise piece of equipment" because the ***915** Hydrow displayed video footage of various locations on a touchscreen the user viewed while rowing.[3] Vickey Hr'g Tr. 1184:12–21. The Court finds that no matter how crisp or accurate a video may be, a two-dimensional screen display is inherently far less immersive than a 360-degree environment. The evidence does not suggest—and the Court is not aware of—any other at-home fitness offering that can transport the user in this way. That a user of a VR dedicated fitness app can exercise in a VR setting is, therefore, a "distinct core functionality" indicative of a submarket. *Klein*, 580 F. Supp. 3d at 767 (quoting *Datel Holdings, Ltd. v. Microsoft Corp.*, 712 F. Supp. 2d 974, 997 (N.D. Cal. 2010)).

The **FTC** puts forth other hallmarks of VR dedicated fitness apps that generally differ from characteristics of non-VR fitness offerings. For example, the **FTC** argues that "VR headsets are fully portable and take up little space." Mot. 14. These appear to be distinguishing features in relation to bulky connected fitness devices, such as the Peloton Bike or Hydrow rowing machine, but Defendants persuasively argue that mobile fitness apps can offer these same functionalities.[4] Opp. 10. Nonetheless, the virtual reality fitness experience created by VR dedicated fitness apps appears to be vastly different from a workout conducted on a large and stationary device or based off a mobile phone screen.

With respect to "peculiar ... uses," Defendants have shown that consumers use non-VR fitness offerings for exercise. *See supra* Section III.B.1.a.i. Defendants have additionally shown that consumers may use other VR apps for fitness. *See, e.g.*, Carmack Hr'g Tr. 562:12–18 ("You can work up a pretty good sweat in Beat Saber."); PX0529, at 2 ("UXR reports that many users have fitness intent among these [incidental fitness] apps"). As explained above, the existence of a broader fitness market does not mean a relevant submarket does not exist. *Supra* Section III.B.1.a.i. Defendants have themselves recognized the characteristics that distinguish VR dedicated fitness apps from other VR apps. *E.g.*, PX0001, at 5 n.10 ("**Meta** draws a distinction between apps designed to allow users to set and attain fitness goals, with features like coaching and trackable progress (called 'deliberate' or 'dedicated' fitness apps) and games whose primary focus is not fitness that allow users to get a workout as a byproduct (sometimes called 'incidental' or 'accidental' fitness apps)."); Milk Hr'g Tr. 683:8–21 (Supernatural, unlike Beat Saber, "employed experts in movement and fitness[;] built companion apps for the phones and for heart rate tracking integration[; and] calibrate[d to a] range of motion so that [it would not] injury anybody."); *see also* Koblin Hr'g Tr. 606:5–8 ("VR games that require some incidental physical exertion" are not a fitness offering). The Court therefore finds that the "peculiar characteristics and uses" factor of the *Brown Shoe* analysis supports the finding that VR dedicated fitness apps constitute a relevant antitrust product market. *See, e.g., SC Innovations, Inc. v. Uber Techs., Inc.*, 434 F. Supp. 3d 782, 792 (N.D. Cal. 2020) (finding plaintiffs alleged a submarket for ride-sharing services excluding taxis, in part due to distinguishing features such as ability ***916** to rate and review drivers and share rides).

iii. Unique Production Facilities

[21] The parties did not explicitly develop arguments regarding unique production facilities in support of their positions regarding the relevant product market. *See* Mot. 13–16; Opp. 7–11. The Court notes, however, that VR dedicated fitness apps require a unique combination of production inputs. [Redacted] *See* Singer Report ¶ 82 ("[T]he talent needed to create true triple-A VR experiences is going to be scarce and really valuable in a few years.") (citing PX0118, at 1); Pruett Hr'g Tr. 286:6–8 ("I have an engineering team ... [who] are a group of veteran engineers who are particular experts in our VR technology and our hardware."). Similarly, most VR companies are unlikely to have the fitness expertise and equipment necessary to create content for VR dedicated fitness apps. *See* Singer Report ¶ 84 ("[Redacted]") (citing PX0251, at 2–3). Koblin Hr'g Tr. 650:3–12 ("[I]t seemed highly unlikely to me that [**Meta**] would get into virtual reality fitness ... honestly at that level of depth, it just seemed extremely unlikely that they would hire coaches and build a green screen studio and dive deep into the psychology of what makes fitness fitness."); Garcia Hr'g Tr. 1079:16–24 ("[One of the things that we have done in Odders Lab whenever developing any of our apps has always been looking into — been looking at the experts.... And for our fitness app, we also started reaching out to local experts.").

[22] Although relevant markets are generally defined by demand-side substitutability, supply-side substitution also informs whether alternative products may be counted in the relevant market. *Twin City Sportservice, Inc.*, 512 F.2d at 1271 ("While the majority of the decided cases in which the rule of reasonable interchangeability is employed deal with the 'use' side of the market, the courts have not been unaware of the importance of substitutability on the 'production' side as well."); *see also* *Brown Shoe*, 370 U.S. at 325 n.42, 82 S.Ct. 1502 ("The cross-elasticity of production facilities may also be an important factor in defining a product market."); Julian von Kalinowski et al., 2 Antitrust Laws & Trade Regulation § 24.02[1][c], at 24–55 (2d ed. 2012) ("Another important factor in defining a product market is the ability of existing companies to alter their facilities to produce the defendant's product.... The Supreme Court has long recognized the significance of this factor, often referred to as cross-elasticity of supply.") (footnote omitted); 2010 Merger Guidelines, § 5.1 & n.8 (high supply side substitutability may be used to aggregate products into a market description).

[23] Supply-side substitution focuses on suppliers' "responsiveness to price increases and their ability to constrain anticompetitive pricing by readily shifting what they produce." *Federal Trade Commission v. RAG-Stiftung*, 436 F. Supp. 3d 278, 293 (D.D.C. 2020) (citing *Rebel Oil Co. v. Atlantic Richfield Co.*, 51 F.3d 1421, 1436 (9th Cir. 1995) ("reasonable market definition must also be based on 'supply elasticity' "), *cert. denied*, 516 U.S. 987, 116 S.Ct. 515, 133 L.Ed.2d 424 (1995)). Here, as explained above, the evidence indicates that neither general fitness firms nor general VR firms have the production facilities to readily produce a substitute VR dedicated fitness app product, even if VR dedicated fitness apps were to raise prices and make market entry more attractive. *See also* Singer Report, Section F ("Would-Be Suppliers of VR Dedicated Fitness Apps Face Significant Barriers to Entry"). That existing companies are not easily able to alter their facilities to produce VR dedicated fitness apps is additional evidence that ***917** such apps constitute a distinct product market. [5]

iv. Distinct Customers

[24] The **FTC** proffered evidence showing that users of VR dedicated fitness apps differ from those of other VR apps along multiple axes. Internal evaluations by **Meta** and Within found that although overall users of VR apps skewed younger and male, users of VR dedicated fitness apps tended to have an older and more female user base. For example, **Meta** claimed in its response to the **FTC's** Second Request regarding the **Meta**-Within transaction that the overall Quest user base was about [Redacted] *See* PX0004, at 167, May 2, 2022. VR fitness apps, on the other hand, drew far more women. *Id.* [Redacted]; PX0003, at 17 [Redacted] Apr. 23, 2021; PX0127, at 1 [Redacted] Mar. 10, 2021. **Meta** expected that VR dedicated fitness apps would expand the reach of virtual reality to new customer segments. To that end, **Meta's** Vice President of Metaverse Content informed the company's board of directors that "Supernatural, FitXR, and ... other fitness applications, ... unlike our gaming population ... had tended to be more successful with on average an older person, on average more women. It was a very different demographic, and ... we had always been in search of expanding VR beyond gaming into more of a general computing platform." PX0066 ("Rubin Dep.") 131:19–132:14; *see also* PX0127, at 6 ("[g]rowing [dedicated] fitness will broaden and diversify our user base, and bring on a disproportionate % of women").

Defendants acknowledge that VR fitness appeals to different user demographics than other VR apps. Opp. 5 ("Fitness is one such use case that can expand VR's audience beyond gamers (who tend to be younger males) to a broader population (including older and female users)."); *see also* Bosworth Hr'g Tr. 1035:18–22 (**Meta** perceived that "users of VR fitness apps represent[ed] a distinct category of customer compared to overall users of other VR apps on its platform"). Defendants do, however, dispute that VR dedicated fitness apps have a customer base that is distinct from that of non-VR fitness offerings. Opp. 9 n.1. The evidence indicates that VR dedicated fitness apps are targeted more toward "[Redacted]" who have less fitness experience and more difficulty finding motivating fitness products (rather than to individuals who have long-term or well-developed fitness routines.) As stated by Within's executive vice president of business development and finance, it was "Within's understanding that Supernatural appeals to [Redacted] in a way that other existing fitness products do not." PX0051 ("Cibula Dep.") 84:20–25. Within insiders also compared Supernatural to [Redacted] DX1081, at 1–2, Apr. 13, 2020. And in summer 2021—when **Meta** was in negotiations regarding the acquisition of Supernatural —a **Meta** employee described Within's business model as "encouraging users who don't think about fitness much as well as users with a light routine, not the fitness buff who is better served by the likes of Peloton cycling or Crossfit classes." PX0318, at 1, June 22, 2021; [Redacted] The Court finds the VR dedicated fitness apps have a customer base that is distinct from those of both other VR apps and several other fitness offerings—[Redacted] *See, e.g.,* ***FTC*** *v. Sysco Corp.*, 113 F. Supp. 3d 1, 29–30 (D.D.C. 2015) (finding relevant product market in part based on erstwhile ***918** competitors' inability to serve certain types of customers).

v. Distinct Prices

[25] The pricing of VR dedicated fitness apps likewise differs in at least one key respect from other VR apps and non-VR fitness offerings. The main difference in comparison to the former category is that VR dedicated fitness apps are more likely to have a subscription-based pricing model. As one of Within's founders testified, Within's daily release of new workout content requires ongoing revenue, which is supported by a subscription membership. Milk Hr'g Tr. 671:10–19. Likewise, **Meta's** Director of Content Ecosystem testified that "subscriptions are particularly good monetization strategies for [fitness] applications" because "fitness applications need to produce content on an ongoing basis ... in order to not get boring." Pruett Hr'g Tr. 269:9–23. However, subscription pricing does not provide a clear basis for delineating between VR dedicated fitness apps and other VR apps. Some VR dedicated fitness apps do not charge subscription fees, Vickey Report ¶ 47, and other VR apps may also be a good fit for subscription pricing, *see* Pruett Hr'g Tr. 268:22–269:4 (the "fitness, productivity, and social genres ... all seem to be trending towards subscriptions as a default monetization method"). Nonetheless, the evidence indicates that "the majority of the video game applications on the Quest platform are not a good fit for subscriptions" including because "most of them don't have [an] ongoing content pipeline." Pruett Hr'g Tr. 270:12–17.

Many fitness offerings, whether virtual or physical, use subscription models. As **Meta** noted in its June 2022 white paper to the **FTC**, Supernatural's "monthly subscription model ... is similar in structure to other connected fitness solutions included specialized equipment solutions (*e.g.*, Peloton, Mirror, Tonal), paid apps (*e.g.*, Apple Fitness+), and other VR fitness apps (*e.g.*, FitXR, Holofit, VZfit), as well as in-person gym memberships (*e.g.*, Equinox, CrossFit, 24 Hour Fitness)." PX0001, at 2; *see also* DX1081, at 1–2 (listing subscription prices for "leading fitness offering[s]"). The **FTC** argues that despite sharing a subscription pricing model, VR dedicated fitness apps tend to be "far less expensive" than "other at-home smart fitness devices." Mot. 14. The evidence supports this assertion with respect to several connected fitness devices—Supernatural, the most expensive VR dedicated fitness app, [6] costs $399 plus $18.99 per month, while Peloton costs $1,445 plus $44 per month and Tonal costs $3,495 plus $49 per month. Singer Report ¶¶ 68–69. There are, however, digital fitness options—generally mobile phone apps—with subscriptions "in the sort of $8 to $12 range." Milk Hr'g Tr. 732:22–733:1; *see also* DX1081, at 1–2 (noting $12.99 Peloton app-only monthly subscription); Singer Report ¶ 65 (same).

The Court finds that the VR app and non-VR pricing evidence tilts slightly in favor of the existence of a VR dedicated fitness app market. *See, e.g., FTC v. Tronox Ltd.*, 332 F. Supp. 3d 187, 200–01 (D.D.C. 2018) ("The existence of distinct prices ... are 'not what one would expect if North American customers were willing and able to substitute one type of titanium dioxide for another in response to a change in their relative prices.' ") (citations omitted). Testimony from both Within and **Meta** indicate a practical reason for VR fitness apps to be generally best served by ***919** a subscription pricing model, which is in line with broader non-VR fitness offerings. And VR dedicated fitness apps are much more affordable than the non-VR fitness products that come closest to offering the level of immersion available in VR. *See* Vickey Hr'g Tr. 1184:12–21 (opining that touchscreen on Hydrow rowing machine provides immersive experience). However, in light of the evidence that there exist both other VR apps that can strategically employ a subscription model and non-VR fitness offerings that are comparably priced to VR fitness apps, the overall weight of this factor is lessened.

vi. Sensitivity to Price Changes

[26] The sixth *Brown Shoe* factor evaluates the change in sales of a possible substitute product given a change in the price of products within the relevant market. Because this is in essence the same question posed by the HMT, *see* ***FTC** v. Staples*, 970 F. Supp. 1066, 1075 (D.D.C. 1997), the Court will not duplicate its analysis here. Drawing from that analysis, *see infra*, Section III.B.1.b., the Court finds this factor to be neutral as to the existence of a VR dedicated fitness app market.

vii. Specialized Vendors

[27] The final *Brown Shoe* factor considers whether a product's distribution requires vendors with specialized knowledge or practices. *See Brown Shoe*, 370 U.S. at 325, 82 S.Ct. 1502; ***FTC** v. Staples, Inc.*, 190 F. Supp. 3d 100, 120–21 (D.D.C. 2016) (defining product market in part due to necessity that vendors have distinguishing capabilities such as sophisticated IT systems, personalized and high-quality service, and next-day delivery). The **FTC** has not presented evidence that the VR dedicated fitness app market requires specialized vendors.

* * *

[28] For the reasons explained above, the Court finds that the following *Brown Shoe* "practical indicia" support the **FTC's** assertion that VR dedicated fitness apps constitute the relevant product market: industry or public recognition; peculiar characteristics and uses; unique production facilities; distinct customers; and (to a lesser degree) distinct prices. These factors indicate that VR dedicated fitness apps present in-market firms with an economic opportunity that is distinct from both other VR apps and other fitness offerings. *See Thurman Indus., Inc.*, 875 F.2d at 1375. The Court therefore finds that the **FTC** has met its burden of showing that VR dedicated fitness apps constitute a relevant antitrust product market. *Brown Shoe*, 370 U.S. at 325–28, 82 S.Ct. 1502; *see also Lucas Auto. Eng.*, 275 F.3d at 766–68 (relying on *Brown Shoe* factors alone in review of relevant market); *Klein*, 580 F. Supp. 3d at 766–73 (same); *Newcal Indus.*, 513 F.3d at 1051 ("Even when a submarket is an *Eastman Kodak* submarket, though, it must bear the 'practical indicia' of an independent economic entity in order to qualify as a cognizable submarket under *Brown Shoe*.").

b. Hypothetical Monopolist Test (HMT)

[29] **[30]** In the interests of thoroughness, the Court also addresses the parties' HMT arguments. The HMT is a quantitative tool used by courts to help define a relevant market by determining reasonably interchangeable products. *Optronic Techs., Inc.*, 20 F.4th at 482 n.1. The test asks whether a "hypothetical monopolist that owns a given set of products likely would impose at least a small but significant and nontransitory increase in price (SSNIP) on at least one product in the market, including at least one product sold by one of the merging firms." Singer Report ¶ 32; *see* 2010 Merger Guidelines § 4.1.1. If enough consumers would respond to a SSNIP—often calculated as a five percent increase in price—by making ***920** purchases outside the proposed market definition so as to make the SSNIP not profitable, then the proposed market is defined too narrowly. Singer Report ¶ 32; *Optronic Techs., Inc.*, 20 F.4th at 482 n.1.

The **FTC's** economics expert, Dr. Singer, conducted a hypothetical monopolist test on the VR dedicated fitness app market. Singer Report ¶¶ 49–68. To inform his analysis of the response to a SSNIP in the VR dedicated fitness app market, Dr. Singer commissioned Qualtrics to conduct "a survey of Supernatural users to determine what fitness apps they perceive to be a reasonably close substitutes to Supernatural and to VR dedicated fitness products generally." *Id.* ¶ 60. Dr. Singer testified that although an economist's natural path would be to collect data about Supernatural customers' transactions and reactions to any price increases, such data was unavailable here because Supernatural has never changed its price from $18.99 per month. Singer Hr'g Tr. 365:2–13. The survey was his "next best" option, and the approach is supported by the 2010 Merger Guidelines. *Id.* 365:16–18; Singer Report ¶¶ 60–61; 2010 Merger Guidelines § 4.1.3. Based on his analysis of the survey, Dr. Singer determined that VR dedicated fitness apps constituted a relevant market. Singer Hr'g Tr. 360:7–8.

Defendants deride Dr. Singer's survey as "junk science" and urge this Court not to rely on it. Opp. 11; **Meta** Closing Hr'g Tr. 1508:22–1509:3. In support of their arguments, Defendants relied on the expert reports and testimony of Dr. Dube and Dr. Carlton, who the Court found qualified as experts in the design and implementation of surveys and the economics of consumer demand for branded goods, *see* Dube Hr'g Tr. 872:16–873:19, and industrial organizations and microeconomics, *see* Carlton Hr'g Tr. 1355:15–20. Based on the testimony elicited by Defendants from Dr. Singer, Dr. Dube, and Dr. Carlton, the Court is troubled by various apparent flaws in the survey underlying Dr. Singer's HMT. Most pertinently, there appear to be several indications that a high fraction of the 150 surveyed individuals, on whose answers Dr. Singer's analysis necessarily relied, were untruthful in one or more responses. *See, e.g.*, Dube Hr'g Tr. 895:12–25 (respondents claimed to own multiple pieces of bulky, expensive equipment); Carlton Report ¶ 93 (over two dozen respondents claimed to regularly use all 27 fitness products listed on survey). Another facet of concern is the survey's apparent inclusion of a non-VR product in the question designed to capture a hypothetical monopolist's pricing power in a VR-only market. Carlton Hr'g Tr. 1428:21–1429:9. These questions, among others, suggest that the survey data underlying Dr. Singer's HMT analysis may not be reliable, which in turn casts doubt on the conclusions to be drawn from the HMT.

[31] The Court's reservations about the survey do not change its finding that VR dedicated fitness apps constitute a relevant antitrust product market. Because the Court bases its determination of the relevant product market on its *Brown Shoe* analysis, *see supra* Section III.B.1.a., rather than the HMT, it need not determine the validity of Dr. Singer's survey methodology. *See, e.g.*, Singer Hr'g Tr. 450:25–452:17. The *Brown Shoe* factors are sufficient to inform the Court's understanding of the "business reality" of the VR dedicated fitness app market. *Lucas Auto. Eng.*, 275 F.3d at 766–68; *see also United States v. Anthem, Inc.*, 236 F. Supp. 3d 171, (D.D.C. 2017) (noting *Brown Shoe* factors supported the "business reality" of the government's relevant market despite defense argument of "[in]sufficient economic rigor"); *RAG-Stiftung*, 436 F. Supp. 3d at 293 n.3 ("The *Brown Shoe* practical indicia may indeed be old school, ***921** and its analytical framework relegated 'to the jurisprudential sidelines.' But *Brown Shoe* remains the law, and this court cannot ignore its dictates.") (citations omitted). Because the Court does not rely on the challenged portions of Dr. Singer's report, the Court DENIES AS MOOT Defendants' motion to strike Dr. Singer's opinion that VR dedicated fitness apps constitute a relevant product market. [7] ECF No. 470.

2. Geographic Market

[32] **[33]** "The relevant geographic market is the 'area of effective competition where buyers can turn for alternate sources of supply.' " *Saint Alphonsus Med. Ctr.-Nampa Inc. v. St. Luke's Health Sys., Ltd.*, 778 F.3d 775, 784 (9th Cir. 2015) (citations omitted). "[I]n a potential-competition case like this one, the relevant geographic market or appropriate section of the country is the area in which the acquired firm is an actual, direct competitor." *Marine Bancorporation*, 418 U.S. at 622, 94 S.Ct. 2856. That is, the geographic market must "correspond to the commercial realities of the industry." *Brown Shoe*, 370 U.S. at 336, 82 S.Ct. 1502; *see also Staples*, 970 F. Supp. at 1073 (relevant geographic market is region where "consumers can practically turn for alternative sources of the product and in which the antitrust defendant faces competition").

[34] The **FTC** asserts that the United States is the relevant geographic market, and Defendants do not argue to the contrary. Mot. 15; *see generally* Opp. The Court agrees. As one of Within's founders testified, Supernatural is only available to Quest headset users in the United States and Canada mainly [Redacted]. Milk Hr'g Tr. 671:4–9. More broadly, Quest headsets are designed so that a user's geolocation determines the availability and prices of content. Stojsavljevic Hr'g Tr. 79:23–80:6. Because content developed in other countries may not be available in the United States, and because Supernatural is not available outside of the United States and Canada, the Court finds that the United States is an appropriate relevant geographic market. *See* *Staples*, 970 F. Supp. at 1073.

Accordingly, the relevant antitrust market for the analysis of the competitive impacts of **Meta's** acquisition of Within is VR dedicated fitness apps in the United States.

C. Substantial Market Concentration

[35] The **FTC** has challenged **Meta's** acquisition of Within on the basis that the merger would substantially lessen potential competition. The Supreme Court has taken note of two species of potential competition theories: actual potential competition and perceived potential competition. *See* *United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 93 S.Ct. 1096, 35 L.Ed.2d 475 (1973); *United States v. Marine Bancorporation, Inc.*, 418 U.S. 602, 94 S.Ct. 2856, 41 L.Ed.2d 978 (1974). Although the two theories have different elements and are grounded in different presumptions about the market, they share a common requirement: they have "meaning only as applied to concentrated markets." *Marine Bancorporation*, 418 U.S. at 630–31, 94 S.Ct. 2856. Because both doctrines posit that potential competitors can or will soon impact the market, there would be no need for concern if the market is already genuinely competitive. *Id.*

***922** **[36]** In assessing whether the relevant market is "substantially concentrated," the Supreme Court sets forth a burden-shifting framework. First, the **FTC** may establish a prima facie case that the relevant market is substantially concentrated by introducing evidence of concentration ratios. *Id.* at 631, 94 S.Ct. 2856. Once established, the burden shifts to the merging companies to "show that the concentration ratios, which can be unreliable indicators of actual market behavior, did not accurately depict the economic characteristics of the [relevant] market." *Id.* If the prima facie case is not rebutted, then the market is suitable for the potential competition doctrines. *See* *United States v. Black & Decker Mfg. Co.*, 430 F. Supp. 729, 755 (D. Md. 1976).

1. Market Concentration Ratios

[37] The Court finds that the **FTC** has sufficiently presented evidence using concentration ratios as permitted by *Marine Bancorporation.* Here, the **FTC** has provided the Herfindahl-Hirschman Index ("HHI")—a widely accepted measure of industry concentration frequently used by courts considering antitrust merger and acquisition actions—for the relevant market. **FTC** Proposed Post-Hearing Findings of Fact ("**FTC's** Findings") ¶¶ 80–83, ECF No. 516; *Optronic Techs., Inc. v. Ningbo Sunny Elec. Co.*, 414 F. Supp. 3d 1256, 1263 (N.D. Cal. 2019), *aff'd*, 20 F.4th 466 (9th Cir. 2021). The **FTC's** 2010 Merger Guidelines provide that a market is considered "moderately concentrated" when the HHI exceeds 1500 and "highly concentrated" when it exceeds 2500. 2010 Merger Guidelines § 5.3.

The **FTC's** expert, Dr. Singer, calculated the HHI multiple times, accounting for different market definitions and stipulations. Dr. Singer first calculated the HHI by measuring each firm's market share using revenue. Singer Report ¶ 75, Table 2-A. This yielded an HHI of 6,917, [Redacted] *Id.* Dr. Singer also calculated the market's HHI using "total hours spent" and "average monthly active users" as metrics and data collected from the Quest Store. Singer Rebuttal Report ¶¶ 124–25, Tables 1-A, 1-B. The HHI for "total hours spent" was 6,307; and for "monthly active users" was 3,377. *Id.*

The Court finds that—regardless of the metrics used—every one of these ratios reflect a market concentration well above what the Merger Guidelines have designated as "highly concentrated." Accordingly, the **FTC** have made their prima facie showing, and the burden shifts to Defendants to "show that the concentration ratios ... did not accurately depict the economic characteristics of the [relevant] market." *Marine Bancorporation*, 418 U.S. at 631, 94 S.Ct. 2856.

2. Defendants' Pleading Challenges

[38] Before continuing to Defendants' substantive arguments seeking to rebut the **FTC's** prima facie case, the Court first turns to the Defendants' legal attacks on the **FTC's**

pleadings. Defendants argue that the **FTC's** case stumbles right out of the blocks because the complaint does not allege oligopolistic or "interdependent or parallel behavior." Mot. Dismiss FAC ("MTD") 10–13, ECF No. 108. Defendants' position arises from the following language in *Marine Bancorporation*:

> The potential-competition doctrine has meaning only as applied to concentrated markets. That is, the doctrine comes into play only where there are dominant participants in the target market engaging in interdependent or parallel behavior and with the capacity effectively to determine price and total output of goods or services.

418 U.S. at 631, 94 S.Ct. 2856.

Defendants' argument is unpersuasive. Their fidelity to a stilted and strained reading of the Supreme Court's commentary conveniently dodges the actual burden-shifting ***923** framework that *Marine Bancorporation* set forth and applied. *Id.* at 631–32, 94 S.Ct. 2856. In fact, the Supreme Court held that the district court had erred by taking the precise course of action that Defendants urge the Court takes here, *i.e.*, requiring the **FTC** to allege parallel behavior when it is Defendants' burden to present the absence. *Id.* ("In our view, *appellees did not carry this burden*, and the District Court erred in holding to the contrary. Appellees introduced no significant evidence of the absence of parallel behavior in the pricing or providing of commercial bank services in [the relevant market].") (emphasis added). A similar attempt to stretch the language from *Marine Bancorporation* to pin the burden on the government was likewise unsuccessful. *Black & Decker*, 430 F. Supp. at 750 n.41 (rejecting argument that "the government has failed to produce evidence of any interdependent or parallel behavior in the market or of the market firms' capacity to determine price and total output"). Defendants also are unable to identify any authority that has adopted its proposed inversed framework, not even the one Fifth Circuit decision they cited. *See* MTD 6; *Republic of Texas Corp. v. Bd. of Governors*, 649 F.2d 1026, 1045–46 (5th Cir. 1981) ("Concentration ratios of this magnitude establish here ... a prima facie case that the [ ] market is a candidate for the potential competition doctrine, and *shift to Republic the burden to show that the concentration ratios ... do not accurately depict the economic characteristics of the [ ] market.*") (emphasis added).

For all the reasons discussed, Defendants' theory that the **FTC** was required to plead oligopolistic, interdependent, or parallel behavior is without merit. To the extent Defendants' motion to dismiss the FAC is premised on this theory, the Court DENIES Defendants' motion.

3. Economic Characteristics of the "VR Dedicated Fitness App" Market

The **FTC** having established a prima facie case of "substantial concentration" using concentration ratios, the burden now shifts to Defendants to rebut that showing that "the concentration ratios ... did not accurately depict the economic characteristics of the [relevant] market." *Marine Bancorporation*, 418 U.S. at 631, 94 S.Ct. 2856. The touchstone inquiry, however, appears to be whether the relevant market "is in fact genuinely competitive." *Marine Bancorporation*, 418 U.S. at 631, 94 S.Ct. 2856; *Tenneco, Inc. v. **FTC***, 689 F.2d 346, 353 (2d Cir. 1982) (finding the **FTC** was "fully justified in concluding that the [ ] market was not genuinely competitive"); *Republic of Texas*, 649 F.2d at 1046 (finding that rebuttal evidence did not "establish that the overall competition from the thrift institutions was sufficient"); *Black & Decker*, 430 F. Supp. at 755 (noting that "various facets of competitive performance in the gasoline powered chain saw market offer conflicting indications"). The Court addresses each argument that Defendants have raised in rebuttal.

The Court first makes an opening observation that there appear to be at least some characteristics of the market that may be difficult to express with concentration ratios. If nothing else, both parties seem to agree that the VR dedicated fitness app market is a nascent and emerging market, which would be an economic characteristic of the market not fully captured by the concentration ratios. *See* **FTC's** Findings ¶¶ 68–69; Singer Report ¶ 92. However, the Court must consider whether those characteristics indicate that the market is genuinely competitive.

Nascency. The Court has received conflicting expert evidence from both parties as to whether nascent markets are more or less vulnerable to coordinated oligopolistic ***924** behaviors. Dr. Carlton submits that a nascent market with rapidly evolving products is more difficult to coordinate behaviors, while Dr. Singer has asserted that there is no accepted economic theory to support the segmentation of nascent, adolescent, or mature markets. *Compare* Carlton Report ¶¶ 127–29, *with* Singer Rebuttal Report ¶¶ 130-33.

The evidence presented suggests that companies in the VR dedicated fitness market do not exhibit revenue or profit-maximizing behaviors, such as price competition. Koblin Hr'g Tr. 636:11–14; Milk Hr'g Tr. 736:6–8. Instead, their strategies appear to be optimized for growth and penetration—[Redacted]—with the expectation that those qualities will render them an attractive acquisition target. *See, e.g.*, Milk Hr'g Tr. 736:15–21 ("[Redacted]."); Zyda Hr'g Tr. 1227:18–22, 1228:15–18 ("[S]tartups that work in the VR space can get acquired, and that's pretty much the dream of almost every startup."); Garcia Hr'g Tr. 1111:8–1112:14; Janszen Hr'g Tr. 1147:22–1148:1. It is unclear to the Court how this departure from conventional profit-maximization strategies—an assumption often made in defining antitrust markets, *see* 2010 Merger Guidelines § 4.1.1 (noting that the HMT "requires [ ] a hypothetical profit-maximizing firm")—should affect the assessment of genuine competition in this market. [8]

Notwithstanding the experts' robust economics discussions, neither party has presented the Court with a working definition of "nascency," such that it can distinguish a nascent market from a more mature market. Rather, the parties appear to use the "nascency" label—however the lines are drawn—as a proxy for other more observable market descriptions, such as highly differentiated products, unstable market shares, and new entrants. Carlton Report ¶¶ 127–29. Accordingly, the Court will give limited weight to the fact that the VR dedicated fitness market may be characterized as a nascent market and focus instead on the underlying market indicators.

Market Share Volatility. Dr. Carlton claims that the VR dedicated fitness market exhibits changing market shares, but he does not provide any historical data or evidence that the market shares have changed over time. Carlton Report ¶¶ 124–25. Instead, Dr. Carlton relies on the fact that none of the apps were in existence five years ago, that new entries are occurring, and on Dr. Singer's data on changes in *other* VR app markets. *Id.* ¶ 125. But new entrants do not necessarily result in shifting or deconcentrating market shares, and Defendants have not presented evidence of actual historical shifts in shares for the relevant market here. Moreover, [Redacted] *Id.* ¶ 67, Table 10.

New Entrants. Defendants and Dr. Carlton have made much ado about the incoming entrants and the fact that the **FTC's** relevant market has effectively doubled since the initiated this litigation. *See, e.g.*, Opp. 14. Although the "introduction of new firms and fluid condition of market entry and exit can indicate competitive behavior," the bottom line is that these new entrants have not significantly deconcentrated the market, nor do they suggest a trend towards such deconcentration. *Black & Decker*, 430 F. Supp. at 751; *see also* Singer Rebuttal Report ¶¶ 124–25, Tables 1-A, 1-B (indicating *de minimis* shares of new entrants).

Barriers to Entry. Defendants rely on the new entrants into the market as evidence that barriers to entry are low. Opp. ***925** 13. However, the number of new entrants "does not belie the substantial entry barriers characteristic of the [relevant] market." *Black & Decker*, 430 F. Supp. at 751. The evidence presented suggest that barriers to entry are existent but are not insurmountable. As the Court discusses further in this order, there are several ingredients required for a potential entrant considering entry into the VR dedicated fitness app entrant, including financial resources, VR engineering resources, fitness experience and content creation, and studio production capabilities. *See infra* Section III.D.2.a. On the other hand, for most potential entrants into any VR app market, **Meta** provides grants, software development kits, infrastructure code, and even engineering support to third-party VR app developers. Pruett Hr'g Tr. 284:18–285:18.

[39] Having considered the VR dedicated fitness app market's nascency, volatility, new entrants, barriers to entry, and price competition, the Court is inclined to find that Defendants have not rebutted the **FTC's** prima facie case. The Court certainly appreciates that a nascent market with an emerging technology may have some features and market incentives that are not captured by concentration ratios. However, the evidence does not support a finding that the VR dedicated fitness app market exhibits the characteristics or desirable behaviors of a competitive market. And as the Supreme Court noted in *Falstaff Brewing*, the absence of "blatantly anti-competitive effects" may not necessarily preclude the propriety of potential competition theories, because the high degree of market concentration indicates that the "seeds of anti-competitive conduct are present." 410 U.S. 526, 550, 93 S.Ct. 1096; *see also* *id.* n.15 ("[A] market might be so concentrated that even though it is presently competitive, there is a serious risk that parallel pricing policies might emerge sometime in the near future.").

That said, because the Court finds *infra* that the **FTC** has not satisfied the other elements of the potential competition theories they have brought, the Court need—and does not—decide whether the Defendants' showing here is sufficient to rebut the **FTC's** prima facie case on substantial concentration. *See* *United States v. Siemens Corp.*, 621 F.2d 499, 506 (2d Cir. 1980).

D. Actual Potential Competition

[40] The **FTC** first argues that the Acquisition would substantially lessen competition because it deprives the VR dedicated fitness app market of the competition that would have arisen from **Meta's** independent entry into the market, a theory known as the "actual potential competition" or "actual potential entrant" doctrine. *See, e.g.,* *United States v. Marine Bancorporation, Inc.*, 418 U.S. 602, 633, 94 S.Ct. 2856, 41 L.Ed.2d 978 (1974). Although the Supreme Court has twice declined to resolve the doctrine's validity when presented, it has nonetheless identified two essential preconditions before the theory can be applied: (1) the alleged potential entrant must have "available feasible means for entering the [relevant] market other than by acquiring [the target company]"; and (2) those "means offer a substantial likelihood of ultimately producing deconcentration of that market or other significant procompetitive effects." *Id.* The doctrine has since been applied by Courts of Appeal and district courts alike, though the Ninth Circuit has not yet had an opportunity to provide guidance on the actual potential competition theory.

Although "available feasible means" for entry may be established either by *de novo* entry or a toehold acquisition, the **FTC** has not argued that **Meta** could have entered the relevant market through a toehold acquisition, nor does it identify any company ***926** in the relevant market that could have served as such a target. *See, e.g.*, FAC ¶ 57; Mot. 19. "Since the [**FTC**] offered no evidence of a toe-hold purchase that was available and attractive to [**Meta**], any such theory must be rejected for lack of proof." *United States v. Siemens Corp.*, 621 F.2d 499, 508 (2d Cir. 1980). Accordingly, the Court will only consider whether **Meta** had "available feasible means" for entering the relevant market *de novo.*

1. Threshold Issues

Before discussing the evidence, the Court first turns to three threshold disputes of law between the parties, which are: (1) the continued vitality of the actual potential competition theory; (2) the standard of proof the **FTC** must meet; and (3) the roles and consideration of objective and subjective evidence.

a. Doctrinal Validity

Throughout this litigation, Defendants have sought to cast doubt as to the very existence of the actual potential competition theory because it has never been fully endorsed by the Supreme Court. *See, e.g.*, Opp. 2; MTD, at 2, 16–17. Notwithstanding Defendants' doubts, this doctrine has been applied by multiple Circuit Courts of Appeal, *e.g.,* *Yamaha Motor Co. v. **FTC***, 657 F.2d 971 (8th Cir. 1981); *United States v. Siemens Corp.*, 621 F.2d 499 (2d Cir. 1980); ***FTC** v. Atl. Richfield Co.*, 549 F.2d 289 (4th Cir. 1977); the Federal Trade Commission itself, *Altria Group, Inc.*, 2022 WL 622476 (Feb. 23, 2022); *B.A.T. Industries*, 1984 WL 565384 (Dec. 17, 1984); and various district courts, including one that ordered divestiture upon a finding of actual potential competition and whose judgment was affirmed by the Supreme Court. *United States v. Phillips Petroleum Co.*, 367 F. Supp. 1226 (C.D. Cal. 1973), *aff'd sub nom.* *Tidewater Oil Co. v. United States*, 418 U.S. 906, 94 S.Ct. 3199, 41 L.Ed.2d 1154 (1974), and *aff'd*, 418 U.S. 906, 94 S.Ct. 3199, 41 L.Ed.2d 1154 (1974). Given the actual potential competition doctrine's consistent, albeit distant, history of judicial recognition, the Court declines to reject the theory outright and will apply the doctrine as developed. *See* ***FTC** v. Steris Corp.*, 133 F. Supp. 3d 962, 966 (N.D. Ohio 2015) ("[T]he **FTC** has clearly endorsed this theory by filing this case, and the administrative law judge will be employing it during the proceeding .... Accordingly, in deciding the likelihood of success on the merits, the Court will assume the validity of this doctrine.").

To the extent Defendants' motion to dismiss sought dismissal of the **FTC's** actual potential competition claim on the basis that it is a "dead-letter doctrine," ECF No. 108, at 2, Defendants' motion is DENIED.

b. Standard of Proof

There is less consistency among courts as to the proper standard of proof by which the **FTC** must prove its case on actual potential competition, and it is an issue of first impression within the Ninth Circuit. The Fourth Circuit has held that the **FTC** must establish its case with "strict proof." *Atl. Richfield*, 549 F.2d at 295. The Second Circuit has asked whether a defendant "*would likely have* entered the market in the near future." *Tenneco, Inc. v. **FTC***, 689 F.2d 346, 352 (2d Cir. 1982) (emphasis added). The Fifth Circuit adopted the "reasonable probability" standard, which it remarked "signifies that an event has a better than fifty percent chance of occurring [with a] 'reasonable' probability represent[ing] an even greater likelihood of the event's occurrence." *Mercantile Texas Corp. v. Bd. of Governors*, 638 F.2d 1255, 1268–69 (5th Cir. 1981). The Eighth Circuit also appeared to adopt the "reasonable probability." *Yamaha Motor*, 657 F.2d at 977 (defining the inquiry as "would [defendant], absent the joint venture, *probably* have entered the [relevant] market independently") (emphasis added). ***927** Finally, the **FTC** itself has unambiguously adopted a "clear proof" standard. *B.A.T. Industries*, 1984 WL 565384, at *10.

[41] In the absence of guiding Ninth Circuit law, the Court begins with *Brown Shoe*'s teaching that Section 7 deals with neither certainties nor ephemeral possibilities but rather "probabilities." *Brown Shoe Co. v. U.S.*, 370 U.S. 294, 323, 82 S.Ct. 1502, 8 L.Ed.2d 510 (1962). In the context of an actual potential competition claim, however, the Court must not only consider the effects of future scenarios where the Acquisition occurs and where it is blocked, but it must also gauge the likelihood—in the second scenario—that the blocked would-be acquirer would enter the relevant market independently. Furthermore, the harm to competition the doctrine aims to prevent is not the loss of *present* competition but rather the potential loss of a *future* competitor (the acquiring company). Given the many *a priori* inferences required by the doctrine, the Court is wary of any inquiry that strays too close to the specters of ephemeral possibilities, yet it must nonetheless ensure the standard does not require the **FTC** to operate on certainties. The Court accordingly holds that the "reasonable probability" standard—as clarified by the Fifth Circuit to suggest a likelihood noticeably greater than fifty percent—is the standard of proof that the **FTC** must present.

To the extent Defendants' motion to dismiss is based on the assertion that the correct standard of proof is "clear proof," the Court DENIES Defendants' motion.

c. Objective vs. Subjective Evidence

Finally, the Court reaches the parties' disagreement as to the roles of objective and subjective evidence. The **FTC** asserts that it may meet its burden using solely objective evidence regarding **Meta's** "overall size, resources, capability, and motivation." Mot. 18–19; *see also* **FTC** Closing Hr'g Tr. 1494:12–18. Defendants, meanwhile, strenuously emphasize subjective evidence that **Meta** never had any plan to enter the Relevant Market *de novo* and would not do so if the Acquisition is blocked. Opp. 15.

Courts have uniformly recognized the highly probative value of objective evidence in evaluating whether a potential entrant is reasonably probable to enter the market *de novo*; the disagreement only arises as to whether plaintiffs can satisfy their burden using only objective evidence and whether subjective evidence should warrant any consideration. *Compare* *Mercantile Texas*, 638 F.2d at 1270 ("Not only is objective evidence undeniably probative, but subjective evidence is not required to establish a violation of the Clayton Act standard. On remand, the Board may rely exclusively on objective evidence if that evidence is sufficient to support the findings we require.") (internal citation omitted), *with B.A.T. Industries*, 1984 WL 565384, at *26 (noting that "the inherent limitations of economic evidence mean that, standing alone," purely objective evidence could not "establish liability under the actual potential entrant theory") (Bailey, Comm'r, concurring). Many courts have also consulted both objective and subjective evidence in reaching their conclusions. *See, e.g.,* *Siemens*, 621 F.2d at 507; *Yamaha Motor*, 657 F.2d at 979; *Phillips Petroleum*, 367 F. Supp. at 1239 (recognizing that subjective evidence is "relevant and entitled to consideration, [but] cannot be determinative").

[42] Here, the Court will first consider whether the objective evidence presented by the **FTC** supports the findings and conclusions necessary to satisfy the actual potential competition doctrine. If the objective evidence is weak, inconclusive, or conflicting, the Court will consult subjective evidence to illuminate the ambiguities left by the objective evidence, with the ***928** understanding that the subjective evidence cannot overcome any directly conflicting objective evidence. *See* *Falstaff Brewing*, 410 U.S. at 570, 93 S.Ct. 1096 ("[T]he subjective evidence may serve as a counterweight to weak or inconclusive objective data. But when the district court can point to no compelling reason why the subjective testimony should be believed or when the objective evidence strongly points to the feasibility of entry de novo ... it is error for the court to rely in any way upon management's subjective statements.").

2. Objective Evidence

Having disposed of the threshold questions, the Court now proceeds to apply the doctrine. The inquiry can be stated as follows: "Is it reasonably probable that **Meta** would have entered the VR dedicated fitness app market *de novo* if it was not able to acquire Within?" [9]

[43] "In exploring the feasible means of entry alternative to the challenged acquisition, the court must analyze the incentive and capability of the acquiring firm to enter the relevant market." *Black & Decker*, 430 F. Supp. at 755. The Court thus considers in turn the objective evidence on **Meta's** capabilities and incentives to enter the VR dedicated fitness app market.

a. Capabilities of Entry

[44] There can be no serious dispute that **Meta** possesses the financial resources to undertake a *de novo* entry. **Meta** has spent over $12.4 billion in the most recent fiscal year on its VR business, and it anticipates investing more in the VR space. *See, e.g.*, DX1237, at 51, Dec. 31, 2021; ECF No. 514, Defs.' Proposed Post-Hearing Findings of Fact ("Defs.' Findings") ¶¶ 44–47. Unsurprisingly, **Meta** also enjoys a deep and talented pool of engineers in its Reality Labs Division, who could provide the technical VR expertise to develop a VR dedicated fitness app should **Meta** so choose. *See* ECF No. 516, **FTC** Proposed Post-Hearing Findings of Fact ("**FTC's** Findings") ¶¶ 32–33. In fact, **Meta** maintains a team of "veteran engineers who are particular experts in [**Meta's**] VR technology and hardware" and who work directly with third-party VR app developers to "improve the quality of their software or help them fix bugs or [ ] polish the experience that the developer is building." Pruett Hr'g Tr. 286:4–12. The Court finds that the objective evidence establishes that **Meta** has the financial resources and ready access to qualified VR engineers to enter the VR dedicated fitness app market *de novo.*

But financial and engineering capabilities alone are insufficient to conclude it was "reasonably probable" that **Meta** would enter the VR dedicated fitness app market. Indeed, **Meta** seems willing to concede—as is supported by the evidence—that it "does not take a large team or substantial resources to make a successful VR app." Defs.' Findings ¶ 53. Instead, courts often counterbalance undisputed financial capabilities with those capabilities unique to the relevant market, rarely relying solely on the potential entrant's substantial wherewithal. *Siemens*, 621 F.2d at 507 (finding no evidence that potential entrant could "transfer its acknowledged capability with respect to other types of equipment to *nuclear medical equipment*") (emphasis added); *Atl. Richfield*, 549 F.2d at 295 ("[Potential entrant] has no technological skills readily transferrable to the *copper markets*; it has no channels of distribution which may be utilized to distribute copper.") (emphasis added); *cf.* *Yamaha Motor*, 657 F.2d at 978 (noting that ***929** the potential entrant had "requisite experience in the production and marketing of *outboard motors* in areas of the world other than Japan.") (emphasis added). The Court here finds that **Meta** lacked certain capabilities that are unique and critical to the VR dedicated fitness app market. *See* PX0127, at 7 (noting that **Meta** "will need to build 4 new [fitness] functions that are not part of Facebook's pipelines; Content development, instructors, studio production ..., music rights & technology.").

First and foremost, although **Meta** has an abundance of VR personnel on hand, it lacks the capability to create fitness and workout content, a necessity for any fitness product or market. *See* PX0111 ("The answer is content creation.... You need that content variety to serve different ability levels, musical tastes, instructor personalities, etc."), Feb. 23, 2021. As a comparison, Supernatural's VR workouts are led by personal trainers and are optimized for VR activity through consultations with experts holding PhDs in kinesiology and biomechanics. PX0712, at 18, 27. Certainly, this absence is not an insurmountable obstacle; **Meta** could conceivably circumvent it by partnering with an established fitness brand to provide the fitness content, as Odders Lab did with Les Mills.[10] **FTC's** Findings ¶¶ 123, 148; *see also* Garcia Hr'g Tr. 1072:18–1073:1. [Redacted] *see also* *Tenneco*, 689 F.2d at 354 (rejecting as "unsupported speculation" the **FTC's** suggestion that the potential entrant would have entered the market *de novo* "with the aid of a license" for necessary technology). Regardless of any potential workarounds, the objective fact that **Meta** presently lacks the capability to create fitness content is, at the very least, probative as to the reasonable probability that **Meta** would enter the VR dedicated fitness app market *de novo.*

In addition to fitness content, the evidence also indicates that **Meta** lacked the necessary studio production capabilities to create and film VR workouts. Once again comparing to Supernatural, Within records daily workout classes in its Los Angeles studio, and its founders have directed several interactive music videos. PX0712, at 3–4, 29. When **Meta** employees were strategizing VR fitness investments, they recognized that "studio production (e.g. green screen ops, stereoscopic capture, post processing pipelines)" was a new function that was "not part of Facebook's pipelines."[11] PX0127, at 7, Mar. 10, 2021. Contrary to the **FTC's** suggestion, the Court finds that **Meta's** acquisition of Armature Studio—a third-party VR studio with expertise in co-developing VR apps—does not provide the necessary studio production capabilities to develop a VR dedicated fitness app. *See* **FTC's** Findings ¶¶ 125, 290. The evidence indicates that Armature is very much a *game* studio, not a *production* studio [Redacted] PX0527, at 6 (listing Armature's [Redacted] The **FTC** highlights an internal **Meta** presentation that presented Armature as an acquisition target who could "build a fitness-first product based on Beat Saber x their sports experience.") *Id.* However, the basis for this suggestion comes not from any prior production studio experience but rather Armature's experience developing the rendered VR video game, Sports Scramble. *Id.* As with ***930** **Meta's** fitness expertise, its lack of production studio capabilities to film a VR fitness workout is a relevant—though less compelling—factor for the Court's "reasonably probable" consideration.

b. Incentives to Enter

[45] In addition to the objective evidence presented of **Meta's** capabilities of entering the VR dedicated fitness app market, the Court also considers the objective evidence of **Meta's** incentives and motivations for entering this market.

Users and Growth. The record is replete with evidence supporting **Meta's** interest in the VR fitness space. Defs.' Findings ¶ 280 ("[E]mployees at Reality Labs were interested in fitness as a promising VR use case"). First, fitness is a use for VR that appeals to a more diverse population, specifically consumers that are female and older. *Id.* ¶ 280 (citing testimony). This demographic is notably distinct from the typical VR demographic, which tends to skew younger and more male. *Id.*; *see also* *Black & Decker*, 430 F. Supp. at 756 ("[C]ommitment to diversification is an important factor to be considered in analyzing [ ] desire to enter a particular market."). Fitness is also "retentive," meaning that users will tend to regularly use the product or app. PX0386, at 12 (fitness apps had a "strong [Redacted] retention"), Apr. 12, 2022; *see* Stojsavljevic Hr'g Tr. 108:19–25. **Meta's** internal data also indicated that "deliberate fitness apps" were the "fastest growing segment" with [Redacted] year-over-year growth. PX0386, at 12. These promising demographic, use, and growth metrics are especially important to **Meta**, because it has "bet[ ] on VR technology as a general computing platform to join today's PCs, laptops, smartphones, and tablets." Defs.' Findings ¶ 44.

Although they undergird **Meta's** undisputed interest in VR fitness, the aforementioned factors provide limited probative value in assessing **Meta's** likelihood to enter the VR dedicated fitness app market itself. As the Court established earlier in this section, the relevant inquiry is whether it is "reasonably probable" that **Meta** would have entered the VR dedicated fitness app market *de novo*, not whether **Meta** was excited about or interested in more generally investing in VR fitness. **Meta's** interest in the promising VR fitness app metrics—diverse appeal, strong user retention, rapid growth—stems from the potential for broader VR adoption and market penetration. *See* Carlton Report ¶¶ 33–35. And **Meta**, as a competitor in the VR headset market, benefits from that growth so long as high-quality VR fitness apps exist in the VR ecosystem; **Meta** need not itself be a player in that ecosystem. *See* Defs.' Findings ¶ 49. This mutually beneficial relationship between the VR platform and third-party VR apps distinguishes this case from other potential competition cases where potential entrants are typically incentivized to enter the relevant market because they are not capturing any of the neighboring market's growth or profitability. *See, e.g.,* *Black & Decker*, 430 F. Supp. at

755 (electric saw manufacturer entering the gasoline-powered chain saw market); *Phillips Petroleum*, 367 F. Supp. at 1245 (non-California oil company entering the California market for gasoline sales); *Yamaha Motor*, 657 F.2d at 974 (Japanese motor company entering the U.S. outboard motor market). The Court accordingly does not find that these specific features of the VR dedicated fitness app market increase the probability that **Meta** would enter the market *de novo*, because **Meta** would enjoy those incentives even if it remained outside the relevant market and provided funding or technical support for in-market VR fitness app developers, as it already does. [12] *See supra* ¶ 7.

***931** Hardware Integration. Apart from the incentives arising from the VR fitness market itself, the evidence also reflects one other incentive that arises from **Meta's** direct participation in the relevant market. Specifically, entering the VR dedicated fitness app market with its own app would facilitate **Meta's** subsequent development of fitness-related VR hardware. This is an incentive to "first-party" entry that is acknowledge across multiple instances of internal contemporaneous correspondence at **Meta**. *See, e.g.*, PX0127, at 7 [Redacted], Mar. 10, 2021; PX0146, at 10 ("[First-party] will allow us to test and iterate tools in our Fitness platform that we can then surface to other 3P"), June 18, 2021; PX0487, at 5 ("We believe that increasing [headcount] for 1P investment (Option 3) is worth the tradeoffs in order to: 1. Develop a cohesive fitness ecosystem faster by enabling developers and building platform features."), May 14, 2021. That said, the evidence also suggests that *de novo* entry is not strictly necessary to develop fitness hardware, *see* **FTC's** Findings ¶ 185 (indicating that **Meta** has also already produced "wipeable interface, wrist straps, and adjustable knuckle straps"), though independent entry into the market could streamline that development.

Profitability. Finally, there is some evidence of the relevant market's profitability and that it [Redacted] PX0386, at 12. The profitability of the relevant market is unsurprisingly a relevant incentive that many courts consider. *See, e.g.*, *Phillips Petroleum*, 367 F. Supp. at 1245; *Black & Decker*, 430 F. Supp. at 755. While this factor is often quite salient in other potential competition cases, it is somewhat muted here, [Redacted]. PX0062 ("Milk Dep.") 19:8–12. Of course, a market's current profitability does not reflect its future profitability, especially if that market is exhibiting rapid growth as the VR dedicated fitness app market does here. Nonetheless, the fact that [Redacted] would indicate that the profitability of the relevant market warrants less consideration than it otherwise would. [13]

* * *

Having reviewed and considered the objective evidence of **Meta's** capabilities and incentives, the Court is not persuaded that this evidence establishes that it was "reasonably probable" **Meta** would enter the relevant market. **Meta's** undisputed financial resources and engineering manpower are counterbalanced by its necessary reliance on external fitness companies or experts to provide the actual workout content and a production studio for filming and post-production. Furthermore, the record is inconclusive as to **Meta's** incentives to enter the relevant market. There are certainly some incentives for **Meta** to enter the market *de novo*, such as a deeper integration between the VR fitness hardware and software. However, it is not clear that **Meta's** readily apparent excitement about fitness as a core VR use case would necessarily translate to an intent to build its own dedicated fitness app market if it could enter by acquisition.

***932** On balance, the objective evidence does not so "strongly point to the feasibility of entry de novo" that the Court should decline to consider subjective evidence of intent. *Falstaff Brewing*, 410 U.S. at 570, 93 S.Ct. 1096.

3. Subjective Evidence

The Court first notes that it will accord little weight to subjective evidence and statements provided by **Meta** employees during the course of this litigation. Although they are relevant, entitled to some weight, and no doubt offered by persons of character, the bias affiliated with such *ex post facto* testimony is widely recognized and unavoidable. *See, e.g.*, *Falstaff Brewing*, 410 U.S. at 565, 570, 93 S.Ct. 1096 (Marshall, J., concurring). In reviewing the subjective evidence in the record, the Court will refer primarily to contemporaneous statements made by **Meta** employees.

[46] The record reveals certain documents created contemporaneously by **Meta** employees that appear to set forth **Meta's** overall third-party VR investment strategy, along with individualized analyses of various VR fitness investment options. PX0492 ("Quick Fitness / M&A Thoughts"), Mar. 9, 2021; PX0127 ("VR Fitness Content investment thesis v2"), Mar. 10, 2021; PX0146 ("FB Inc. Fitness Strategy Working Draft"), June 18, 2021. The **FTC** has represented that these documents were sponsored by **Meta** employees: Rade Stojsavljevic, who oversaw all of **Meta's** first-party VR gaming studios (Stojsavljevic Hr'g Tr. 69:18–24); Anand Dass, **Meta's** director of non-gaming VR content (*id.* 138:11–18); and Jane Chiao, a business-side employee who reported directly to Mark Rabkin, the head of VR technology at **Meta** (*id.* 140:23–141:1, Rabkin Hr'g Tr. 800:7–11). Furthermore, exhibit PX0127 was a "pre-read" circulated in advance of a meeting with Mark Rabkin, *see* Stojsavljevic Hr'g Tr. 149:16–151:12, who would have been one of the decisionmakers needed to sign off on any significant VR fitness investment. *Id.* 189:24–190:12. These are not "memoranda of lower echelon [ ] employees." *Siemens*, 621 F.2d at 508; *see* also *Atl. Richfield*, 549 F.2d at 297 n.9. Accordingly, the Court finds that the statements in these documents reflect the thoughts and impressions of relatively significant stakeholders, as the authors were generally one or two people away from the final decisionmaker.

The evidence contained in these strategy documents is consistent—**Meta's** subjective motivations to enter the relevant market were primarily to (1) better develop VR fitness hardware or (2) ensure the continued existence of a high-quality VR fitness app in the market. The Court notes that these incentives would apply to both entry by acquisition and entry *de novo*, though perhaps not with equal force.

First, this subjective evidence corroborates the objective evidence that **Meta** primarily wanted to be a first-party firm in the VR dedicated fitness market so it could improve its VR fitness hardware (*e.g.*, headsets, heart monitor, wrist straps). *See* PX0492, at 2 ("Deep integration with hardware and software to create best in class experience that other devs can follow"); PX0127, at 7 ([Redacted]); PX0146 ("1P content is not a goal in itself – *it is only in the service of broader platform objectives* (e.g., help accelerate progress of market phases).") (emphasis added). The importance of this incentive is supported by internal **Meta** communications. *See* PX0179, at 2 (noting that "strategic rationale already exists" to pursue VR fitness, which was to "[c]reate option value for [**Meta's** device], software platform and hand tracking"), Mar. 11, 2021.

Second, the evidence also indicates that **Meta** would want to enter the VR dedicated fitness app market if the availability of ***933** VR fitness apps was at risk of becoming constrained and, therefore, **Meta** could ensure that at least one high-quality VR fitness app remained in the market. Specifically, as early as March 2021, **Meta** employees were expecting Apple to "lock in" VR fitness content to be exclusive with Apple's VR hardware. *See* PX0492, at 2 [Redacted] Mar. 9, 2021; PX0127, at 6 [Redacted], Mar. 10, 2021. This incentive was also corroborated by contemporaneous communications. DX1012, at 1 [Redacted], May 26, 2021. The evidence also suggests that this incentive was the primary animating factor that ultimately compelled **Meta** to pursue Within as an acquisition. *See, e.g.*, PX0117 [Redacted].

Meta's prior ventures into other VR app markets also do not support a subjective intention or proclivity to build its own apps as opposed to an acquisition. Courts have considered a potential entrant's history of acquisitions and expansions in determining its likelihood of *de novo* entry. *See* *Black & Decker*, 430 F. Supp. at 756 (potential entrant had previously "diversified almost exclusively through internal expansion [and] had a definite, if unwritten, policy known to its employees of discouraging growth by acquisition"); *Phillips Petroleum*, 367 F. Supp. at 1240 ("At no time prior to the [ ] acquisition did [the potential entrant] ever enter a new marketing area by acquiring a major company in that market."). The evidence indicates that **Meta** has tended to build its own VR app where the experience did not call for specialized or substantive content, *e.g.*, Horizon Worlds (a world-building app where other users can create worlds in VR), Horizon Workrooms (a productivity app), Horizon Venues (a live-events app), Horizon Home (social networking app). **Meta's** Answer and Affirmative Defenses ¶ 35; *see also* PX0056 ("Carmack Dep.") 101:15–23 (indicating **Meta** does not have "anything internally developed that was a hit outside of our browser application"). Meanwhile, **Meta** has acquired other VR developers where the experience requires content creation from the developer, such as VR video games, as opposed to an app that hosts content created by others. Stojsavljevic Hr'g Tr. 87:5–88:2. With respect to fitness, the Court finds that VR dedicated fitness is more akin to a gaming app—where the emphasis is on the content created or provided by the developer—than a browser or world-building app, where the value is derived from the users' own creativity rather than the developers'. Accordingly, based on **Meta's** past entries into VR app markets, the evidence would suggest an interest in entry by acquisition instead of entry *de novo.*

But even more pertinent than the record of **Meta's** past entries into VR app markets is the evidence that **Meta** had consciously considered and appeared doubtful of the proposition to build its own independent VR fitness app. The pre-read strategy document prepared for Mark Rabkin's attention contains a separate section that "[i]t will be hard to build Fitness from scratch." PX0127, at 7. Specifically, a VR fitness app would require Meta to [Redacted] *Id.* The document also recognized that Meta would have to "build new kinds of expertise at the intersection of software, instructor-led fitness, music, media." *Id.* The decision not to build Meta's own VR fitness app is corroborated by the lack of any other contemporaneous discussion on the topic. The record does, however, indicate that Meta attempted to gauge whether it could expand Beat Saber together with a fitness partner, a prospect the Court delves into further below.

In sum, the subjective evidence indicates that Meta was subjectively interested in entering the VR dedicated fitness app market itself, either for hardware development or defensive market purposes. However, the Court again notes that these ***934** incentives would support both market entry by acquisition and *de novo*, but the Court's inquiry is only concerned with the feasibility of *de novo* entry. For instance, even though Meta's concern about [Redacted] was an incentive to acquire Within, that incentive does not apply with equal force [Redacted] PX0127, at 1. And, as the Court elaborates below, the evidence shows that all these factors—Meta's capabilities and incentives, both objective and subjective—did not result in Meta ever seriously contemplating a *de novo* entry, *i.e.*, building its own VR fitness app.

4. Identified Means of Entry

Up to this point, the Court has only addressed Meta's capabilities, incentives, and intent to enter the VR dedicated fitness app market in the abstract. However, an assessment of the probability and feasibility of a hypothetical *de novo* entry would not be complete without addressing the *actual* means of entry that Meta considered. *See* *Black & Decker*, 430 F. Supp. at 757 ("Three avenues of entry into the gas lawn mower field were explored...."); *Siemens*, 621 F.2d at 502–03 (summarizing multiple possibilities that other acquiring company had considered); *Phillips Petroleum*, 367 F. Supp. at 1243–44 (same).

Nevertheless, the FTC has implied that the Court may infer that Meta would have entered the market *de novo*—irrespective of its actual plans for entry—using "available feasible means" unbeknownst to the parties or the Court. *See* FTC Closing Hr'g Tr. 1494:16–18 ("We don't have to show that Meta actually had a subjective intention to enter the market."). To the extent the FTC implies that—based solely on the objective evidence of Meta's resources and its excitement for VR fitness—it would have inevitably found and implemented some unspecified means to enter the market, the Court finds such a theory to be impermissibly speculative.

The FTC made a similar argument in *BOC International*, where it argued that "[s]imply because no entry had been effectuated at the time the [acquisition] presented itself did not mean that BOC would not have *eventually realized* its 'long-term objectives' of entering the [relevant] market by growth rather than by this major acquisition." *BOC Int'l, Ltd. v. FTC*, 557 F.2d 24, 29 (2d Cir. 1977) (emphasis added). The Second Circuit rejected this "eventual entry" theory as "uncabined speculation," holding that "it seems necessary under Section 7 that the finding of probable entry at least contain some reasonable temporal estimate related to the near future." *Id.* The FTC recently reaffirmed this holding in *Altria Group, Inc.*, 2022 WL 622476, at *70 ("Complaint Counsel is arguing that due to Altria's resources as a large company, and economic incentives to participate in the e-cigarette market, Altria would have eventually had a product competing in that market. *This is precisely the position rejected by the court in* BOC.") (emphasis added). Additionally, insofar as the FTC implies Meta could overcome its lack of fitness experience and content creation by hiring experts or partnering with a fitness brand, the suggestion reflects "the kind of unsupported speculation" rejected in *Tenneco*, 689 F.2d at 354 (rejecting the FTC's "conclusion that [potential entrant] would have entered the market de novo with the aid of a license" for the necessary technology).

[47] The Court here does not hold that every case of actual potential competition will require consideration of a potential entrant's actual and subjective plans for entry. *See* *Falstaff Brewing*, 410 U.S. at 565, 93 S.Ct. 1096 ("We have certainly never suggested that subjective evidence of likely future entry is required to make out a § 7 case.") (Marshall, J., concurring). Nor does the Court suggest that a particular ***935** entry strategy can only be "reasonably probable" and "feasible" if it has reached a certain inflection point in the firm's decision-making process. Such a conclusion would incentivize corporate gamesmanship and reward decisionmakers for reaching merger decisions hastily without exploring non-merger alternatives. *See generally* *id.* at 563–71, 93 S.Ct. 1096 (Marshall, J., concurring). However, where the objective evidence is "weak or inconclusive" and does not "strongly point[ ] to the feasibility of entry de novo," *id.* at 570, 93 S.Ct. 1096, it is incumbent on the Court to consider the potential entrant's actual plans of entry for the purposes of ensuring that Section 7 enforcement does not veer into the realm of ephemeral possibilities. As applied here, the Court holds that the FTC may not rest solely on evidence of Meta's considerable resources and the company's clear zeal for the VR dedicated fitness app market as a whole; the evidence must show that Meta had *some* feasible and reasonably probable path to *de novo* entry.

Turning then to the evidence, the record indicates that Meta would only have entered by acquisition or a Beat Saber collaboration with a fitness content creator; the Court is unaware of any evidence that Meta considered building a VR fitness app on its own. In the strategy document that was prepared for the meeting with Mark Rabkin, Meta personnel had outlined and analyzed five options for investing in VR fitness: (1) acquire Within and Supernatural; (2) acquire [Redacted]; (3) expand Beat Saber into deliberate fitness, likely by partnering with Peloton; (4) increase funding for development of third-party VR fitness apps; and (5) do nothing and maintain the status quo. PX0127, at 2–4. The record reflects that, although Meta initially pursued the first three options in parallel, the frontrunner was the [Redacted] acquisition until approximately June 2021 when Meta pivoted to acquire Within. *See, e.g.*, PX0179, at 1–2 (indicating that action items included pursuing due diligence for both Supernatural and [Redacted] and having Stojsavljevic "present a proposal to Rabkin on expanding Beat Saber to deliberate fitness"), Mar. 11, 2021; PX0284, at 1 (drafting email to Michael Verdu summarizing the "pros/cons of [Redacted] vs. Supernatural"), Mar. 18, 2021; DX1012, at 1, 3 ("[Zuckerberg] asked if we were engaged with [Within].... [Bosworth] responded that our focus has been on [Redacted]."), May 26, 2021. Notably, even though Meta personnel had considered the option to increase third-party funding without entering the market and an option to do nothing as comparison, there was never an option for Meta to build its own VR dedicated fitness app to enter the market *de novo*.

Given the degree of analysis evident from these strategy documents, the Court finds that Meta had only considered the acquisition of Within, the acquisition of [Redacted], and the partnership of Beat Saber with Peloton as feasible means to enter the relevant market. These three options, therefore, comprise the universe of "available feasible means" that the Court will consider for the purposes of the FTC's actual potential competition claim.

a. Entry by Acquisition

Meta's first two means of entry into the relevant market were both entries by acquisitions, either [Redacted]. The evidentiary record indicates that these two options were both among the earliest proposals presented to Mark Zuckerberg, as well as the last two considered before Meta decided to acquire Within. *See, e.g., supra* Section I.D.

The evidence supports a finding that, but for its pursuit of Within as an acquisition, there was a reasonably probability that [Redacted] However, the inquiry before the Court is not whether it was reasonably probable that Meta [Redacted] ***936** The FTC has argued almost exclusively that Meta's "available feasible means" of entering the relevant market is by *de novo* entry, not acquisition. The FTC also does not take the position [Redacted] that could have also conceivably had procompetitive effects. *See, e.g.*, Mot. 21 (noting that Meta's entry into the market would have "introduc[ed] a strong, well-established new rival to Supernatural and FitXR"); *see also* *Marine Bancorporation*, 418 U.S. at 625, 94 S.Ct. 2856 (defining a toehold acquisition as a "small existing entrant").

Accordingly, the Court does not consider the "reasonable probability" that Meta could have entered the VR dedicated fitness market [Redacted] as an "available feasible means" for the purposes of the actual potential competition analysis.

b. Entry by Beat Saber–Peloton Partnership

[48] This brings us to the final means—and the FTC's main theory—by which Meta could have entered the VR dedicated fitness market: expanding its existing rhythm game app Beat Saber into dedicated fitness and partnering with a fitness brand. The FTC claims that Meta scrapped this Beat Saber proposal once it learned that Within was at risk of being acquired by Apple. Mot. 10, 20–21. However, this theory is neither supported by the contemporaneous remarks regarding the Beat Saber proposal nor the timing of the subsequent investigation into this proposal.

First, the evidentiary record is unclear as to what exactly the widely referenced Beat Saber–Peloton proposal would even look like. On some occasions, Stojsavljevic—the proposal's primary advocate—refers to it as a “brand licensing w/ Peloton” or a “co-branding ... Peloton mode inside Beat Saber.” PX0144, at 1, Mar. 8, 2021; PX0407, at 1, Mar. 15, 2021. On other occasions, Stojsavljevic considers whether the proposal would be a separate Quest Store app. PX0407, at 2. Michael Verdu—another proponent of expanding Beat Saber into fitness—also recalled that the proposal never reached a point of “understanding what that partnership would look like.” Verdu Dep. 201:14–23 (“[I]s it a Peloton-branded headset? Is it Peloton-branded content inside of our headset? Like we didn't even get to the point where we were exploring at that level of detail.”). This uncertainty is consistent with the March 2021 “Beat Saber x Peloton Opportunity Identification” presentation that [Redacted] prepared at Stojsavljevic's request, which indicated that part of [Redacted] task would be to define the partnership opportunity and determine how to present the proposal to Peloton. PX0121, at 5–6, Mar. 25, 2021. Ultimately, Stojsavljevic did not even engage [Redacted] to proceed with her proposed research into the Beat Saber proposal. PX0052 (“Stojsavljevic Dep.”) 219:23–220:1.

Second, the Beat Saber–Peloton proposal did not enjoy uniform or even widespread support among the **Meta** personnel who were researching VR fitness opportunities. *See* PX341, at 2 (“Jane and Anand were arguing with me [Stojsavljevic] when I was proposing Beat Saber x Peloton and thought we should buy [Redacted] or Supernatural instead.”), June 11, 2021. Particularly, Jane Chiao had consistently and contemporaneously expressed doubts regarding the feasibility of repositioning Beat Saber to fitness. *See* PX0492, at 1, 7 (“Jane's quick thoughts” included a section titled “Why not Beat Saber?” setting forth reasons against pivoting Beat Saber to fitness), Mar. 9, 2021. In one exchange, Chiao commented that [Redacted].” PX0251, at 2, Mar. 4, 2021. Chiao's opinion was informed by the previous difficulties she had in attempting to reposition **Meta's** social functions for other uses. *Id.* at 2–3 ([Redacted]).

***937** Third, the timeline and dearth of contemporaneous internal discussions on the Beat Games–Peloton proposal is inconsistent with the **FTC's** narrative that the Within acquisition derailed an otherwise full-speed effort to explore the Beat Games proposal. *See generally* DDX07 (Defendants' timeline demonstrative), at 31. In short, the idea was raised and endorsed by Stojsavljevic on March 11, 2021 (PX0179); he solicited feedback from his peers a few days later (PX0407); and on March 25, 2021, he received a quote for a contractor to look into the proposal, but did not proceed with it (PX0121). After this initial scramble, the record reflects no further discussion about expanding Beat Saber into fitness before June 2021, when **Meta** began pursuing Within as an acquisition. Although the **FTC** argues that there is no direct evidence that **Meta** had deliberately dropped the Beat Saber proposal, the absence of active discussions could just as reasonably—and the Court finds that it does—support **Meta's** explanation that the Beat Saber proposal had lost momentum after March 2021. The proposal's main driver, Stojsavljevic, testified that he had already “slowed down before [**Meta's** decision to pursue Within],” because he was busy with another **Meta** acquisition. Stojsavljevic Hr'g Tr. 165:12–17. Although subjective corporate testimony is generally deemed self-serving and entitled to low weight, Stojsavljevic's lack of bandwidth is corroborated by his contemporaneous decision to outsource the research for the Beat Games proposal. *See* PX0121, at 1; *see also* Stojsavljevic Hr'g Tr. 163:25–165:11.

Moreover, when viewed alongside **Meta's** history with Beat Saber, these two months of inactivity between March and June 2021 appear to have been the norm rather than the exception. Although **Meta** employees like Verdu were excited about Beat Saber's potential as a vector into fitness, **Meta** has never been able to execute on that excitement in any of the years since they acquired Beat Saber. Verdu Dep. 178:12–20 (“[I]t was the perpetual white whale quest to get ... Beat Games to build a fitness version of Beat Saber, which was like pushing on a string. We tried and tried and tried, and they never picked it up.”); *see* PX0123 (“[[Redacted]] was on the goal list for the [beat] saber acquisition.... But that goal was never followed up on.”), Sept. 15, 2021.

Finally, the **FTC** cites two instances of contemporaneous **Meta** communications that suggest the Beat Saber proposal had not died on the vine when **Meta** pivoted to acquiring Within. *See* **FTC** Closing Hr'g Tr. 1495:10–24. The first is Verdu's comment on June 20, 2021, that **Meta** was “in the *midst of a strategy exercise to decide between our alternatives* when Supernatural became in play (supposedly pursued by Apple), which accelerated everything.” PX0117, June 10, 2021 (emphasis added). The **FTC** asserts that the referenced “alternatives” included the Beat Saber–Peloton proposal; however, this theory is inconsistent with the fact that there had been no internal discussion of the proposal in the preceding two months. The more likely interpretation is that "alternatives" referred to [Redacted] *See* PX0253, at 1.

The second communication arose in the context of [Redacted] requested a sale price of [Redacted]. PX0123, at 2, Sept. 15, 2021. In discussing alternatives to the Within acquisition, Jason Rubin suggested that another [Redacted] *Id.* He also suggested, "We might be able to buy [Redacted], rebrand and redesign to Beat aesthetics." *Id.* In assessing the weight of these statements, the Court makes a few contextual observations. At the time Rubin made his comments, he had only been in his role for about six weeks; Verdu (an employee with extensive knowledge of **Meta's** history with VR fitness) previously held the role. PX0066 ("Rubin Dep.") 28:8–15 ("On August ***938** 1st, I took or was handed the role that I have right now ... and inherited [the **Meta**–Within] acquisition in full swing."). Rubin also testified that, before switching roles, he "was not aware of anything having to do with fitness at all in the VR world" and had no knowledge of "how the company had come to its decision making to acquire [Within]." *Id.* 126:9–127:11. Perhaps on a record with more corroborating evidence, Rubin's remarks may warrant more substantial weight towards the **FTC's** theory that the Beat Saber fitness proposal remained a live proposition. However, given that Ruben's remarks appeared to have been made off the cuff, are inconsistent with the overall weight of the evidence, and were made at a time when he was likely still unfamiliar with VR fitness and **Meta's** history, the Court is disinclined to accord any significant weight to Rubin's comments.

For all these reasons, the Court finds that it was not "reasonably probable" that **Meta** would have repositioned their top-selling VR app, Beat Saber, into a dedicated fitness app, even assuming that it could have identified a partner willing to provide VR fitness content.

* * *

[49] After reviewing the evidentiary record and the parties' arguments, the Court concludes that it is not "reasonably probable" that **Meta** would enter the market for VR dedicated fitness apps if it could not consummate the Acquisition. Though **Meta** boasts considerable financial and VR engineering resources, it did not possess the capabilities unique to VR dedicated fitness apps, specifically fitness content creation and studio production facilities. As a VR platform developer, **Meta** can enjoy many of the promising benefits of VR fitness growth without itself intervening in the VR fitness app market. Finally, the proposal for **Meta** to expand Beat Saber into fitness was not "reasonably probable" for a whole host of reasons, in addition to the aforementioned obstacles to **Meta's** *de novo* entry.

Accordingly, the Court finds that **Meta** did not have the "available feasible means" to enter the relevant market other than by acquisition. Because the **FTC** has not met its burden on this element, the Court does not proceed to the issue of whether **Meta's** *de novo* entry was substantially likely to deconcentrate or result in other procompetitive effects in the relevant market.

In so finding, the Court concludes that the **FTC** has failed to establish a likelihood that it would ultimately succeed on the merits as to its Section 7 claim based on the actual potential competition theory.

E. Perceived Potential Competition

In addition to its claim that the Acquisition would lessen competition pursuant to the actual potential competition theory, the **FTC** also claims that the Acquisition violates Section 7 under the perceived potential competition theory. FAC ¶¶ 97–102. Under this theory, the **FTC** argues that the Acquisition would eliminate the competitive influence that **Meta** exerts on firms within the relevant market by virtue of its presence on the fringes of the market. *See, e.g., United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 559–60, 93 S.Ct. 1096, 35 L.Ed.2d 475 (1973).

[50] **[51]** To prevail on a claim that the Acquisition would have eliminate perceived potential competition, the **FTC** must establish—in addition to showing a highly concentrated market, *see* Section III.C—the following: (1) **Meta** possessed the "characteristics, capabilities, and economic incentive to render it a perceived potential de novo entrant"; and (2) **Meta's** "premerger presence on the fringe of the target market in fact tempered oligopolistic behavior on the part of existing participants in that market." ***939** *United States v. Marine Bancorporation, Inc.*, 418 U.S. 602, 625, 94 S.Ct. 2856, 41 L.Ed.2d 978 (1974). The same objective facts regarding **Meta's** capability of entering the market under an actual potential competition theory are also "probative of violation of § 7 through loss of a procompetitive on-the-fringe influence." *Falstaff Brewing*, 410 U.S. at 534 n.13, 93

S.Ct. 1096; *see also* *Black & Decker*, 430 F. Supp. at 770. However, whereas a claim for actual potential competition may consider the potential entrant's intent to enter the market, a perceived potential competition claim ignores the potential entrant's subjective intent to enter the market and instead focuses on the subjective perceptions of the in-market firms. *See* *Falstaff Brewing*, 410 U.S. at 533–36, 93 S.Ct. 1096.

1. Potential Entrant Characteristics

[52] In evaluating the **FTC's** perceived potential competition claim, the Court considers the same objective evidence regarding **Meta's** capabilities and incentives to enter the relevant market. Unsurprisingly, and for the same reasons explained above, the objective evidence in the record is insufficient to support a finding that it was "reasonably probable" **Meta** would enter the relevant market for purposes of the perceived potential competition doctrine. *See supra*, Section III.D.2.

Nor does the subjective evidence of the in-market firms' perceptions move the needle on this point. Although the **FTC** produced some evidence that Within co-founders and employees had expressed concern that Beat Saber or its fans could create a fitness version to compete with Supernatural, these statements are mostly stale with some significantly preceding the relevant time period. The **FTC's** strongest evidence that [Redacted] were statements made [Redacted] before Supernatural even entered the VR market in April 2020. *See, e.g.*, PX0627, at 2 [Redacted] The **FTC** has only produced one document that post-dates Supernatural's launch, which is a June 2020 "Supernatural Product Strategy" presentation that noted [Redacted] PX0615, at 8. However, even this document's weight is undercut by the fact that it was created nearly a year before **Meta** began pursuing Within as an acquisition target. [14]

Furthermore, subsequent but still contemporaneous evidence indicated that Within eventually came to [Redacted]" DX1083, at 10, Sept. 22, 2020. In a September 2020 text conversation with a Within investor, Within's co-founder Chris Milk explained that [Redacted] *Id.* at 7. In the same conversation, Milk [Redacted] *Id.* at 67–68.

In summary, the evidentiary record indicates that [Redacted] This finding, in addition to the overall absence of testimony from other in-market firms, would suggest that the **FTC** has failed to demonstrate that it was "reasonably probable" that **Meta** was perceived as a potential competitor into the relevant market. However, even if the **FTC** had prevailed on this element, the Court is convinced that it did not satisfy the second required showing for a perceived potential competition claim.

2. Tempering Effect

[53] Under the second element of the perceived potential competition claim, the ***940** **FTC** must establish that **Meta's** "premerger presence on the fringe of the target market *in fact* tempered oligopolistic behavior on the part of existing participants in that market." *Marine Bancorporation*, 418 U.S. at 624–25, 94 S.Ct. 2856 (emphasis added). In other words, the **FTC** must present evidence that it was "reasonably probable" that **Meta's** presence as a potential competitor had a direct effect on the firms in the VR Dedicated Fitness market.

In setting forth this standard, the Court rejects the **FTC's** suggestion that it need only provide "[p]robabilistic proof of 'likely influence' on existing competitors." Mot. 21. This interpretation arises from the language used by the Supreme Court in a footnote from *Falstaff Brewing*, specifically "[t]he Government did not produce *direct evidence* of how members of the [relevant] market reacted to potential competition from [the potential entrant], but *circumstantial evidence* is the lifeblood of antitrust law." 410 U.S. at 534 n.13, 93 S.Ct. 1096 (emphasis added). The Court reads this language to mean the **FTC** need not provide *direct evidence* of Within adopting its conduct to account for **Meta's** presence (*e.g.*, a hypothetical internal email at Within expressly communicating fear of **Meta's** imminent entry and taking actions in anticipation). Direct evidence, however, is distinguishable from evidence of a *direct effect* experienced within the relevant market (*e.g.*, circumstantial evidence that Within reduced prices shortly after **Meta's** hypothetical public announcement that it was looking into the VR Dedicated Fitness market). This interpretation is supported by the Supreme Court's statement of the law in *Marine Bancorporation*, 418 U.S. at 624–25, 94 S.Ct. 2856 (requiring "presence ... in fact tempered oligopolistic behavior") and the Second Circuit's interpretation in *Tenneco, Inc. v. **FTC***, 689 F.2d 346, at 358 ("The Commission is correct that it need not produce direct evidence that [acquired company] altered its actions in response to a perception of [potential entrant] 'in the wings.' However, it must produce at least circumstantial evidence that [potential entrant's] presence probably *directly affected* competitive activity in the market.") (emphasis added). Accordingly, the **FTC** must produce *some* evidence—direct or circumstantial—that **Meta's** presence had a direct effect on the firms in the relevant market.

Under this standard, the **FTC's** evidence on this element is insufficient. The only evidence that suggests any kind of effect in the relevant market is that Within cited, as reasons not to reduce headcount at Within shortly before launching Supernatural, [Redacted] PX0620, at 36, Mar. 8, 2020. As noted above, Within and Supernatural had not even entered the relevant market at the time of this presentation. Consequently, this cannot be evidence of a direct effect within the VR dedicated fitness app market; rather, they are the preemptive considerations of a firm contemplating entry into the market. Moreover, the evidence indicates that Within had [Redacted]. *See supra* Section III.E.1. Other than this presentation, the **FTC** suggests that [Redacted]" PX0621, at 2, Dec. 8, 2020. Although this is circumstantial evidence that Within was concerned about hypothetical potential entrants, absent further evidence, this email is no basis to infer the critical nexus, *i.e.*, that **Meta** was one such potential entrant.

The Court recognizes that its interpretation of the "effect" requirement sides with Defendants' position set forth in their Motion to Dismiss. ECF No. 108, at 15–16; ECF No. 162, at 10–12. Although the Court ultimately determines that the **FTC's** evidence has not established that **Meta's** presence had a direct effect on Within's behavior, it finds that the **FTC's** *pleadings* are sufficient. The **FTC** had alleged ***941** that Within was "concerned about making any moves that would hurt its ability to compete against **Meta** as a potential entrant" and provided an example. FAC ¶ 101. At the pleadings stage, this satisfies their burden. Accordingly, the Court DENIES Defendants' motion to dismiss the perceived potential competition claim.

[54] In summary, the Court finds that the objective evidence does not support a reasonable probability that firms in the relevant market perceived **Meta** as a potential entrant. Even if it did, the Court finds that there is no direct or circumstantial evidence to suggest that **Meta's** presence did in fact temper oligopolistic behavior or result in any other procompetitive benefits. Accordingly, the **FTC** has not demonstrated a likelihood of ultimate success as to its Section 7 claim arising from perceived potential competition.

F. Balancing of Equities

Because the **FTC** has not demonstrated a likelihood of ultimate success on the merits per the first § 13(b) element, the Court need not proceed to the balance the equities in the second portion of the § 13(b) inquiry.

IV. CONCLUSION

Based on the foregoing reasons, the Court ORDERS as follows:

1. Defendants' Motion to Dismiss is DENIED;

2. Defendants' Motion to Strike is DENIED AS MOOT; and

3. Plaintiff's Motion for Preliminary Injunction is DENIED.

IT IS SO ORDERED.

All Citations

654 F.Supp.3d 892

Footnotes

1 The Court understands "XR" to refer generally to virtual reality, augmented reality, and mixed reality.

2 Apple does not currently offer a VR headset. *See, e.g.*, Bosworth Hr'g Tr. 1022:13–16.

3 Dr. Vickey later testified that he had not used a Hydrow, and that he "would have" evaluated the machine by reviewing the company's website and watching its videos. Vickey Hr'g Tr. 1202:8–18.

4 The Court is not persuaded by Defendants' argument that the Peloton Guide is similarly portable to a VR headset. *See* Opp. 10. [Redacted] Vickey Report ¶ 43 ("[T]he Peloton Guide uses augmented reality features to track the user's motions and a camera to position the user visually near an on-screen instructor.").

5 This supply-side analysis of whether other firms would be able to switch production to VR dedicated fitness apps is independent of the demand-side inquiry (and main focus of the market definition analysis) of whether users would switch consumption to other products in the event of a price increase in VR dedicated fitness apps.

6 Some VR dedicated fitness apps charge a one-time price over $18.99, and another VR dedicated fitness app has a free version as well as a premium version priced equally to Supernatural at $18.99 per month. All other VR dedicated fitness apps charge subscriptions lower than $18.99 per month, and one is free. Singer Report ¶ 39.

7 Having independently reached the same conclusion as Dr. Singer regarding the relevant product market definition, the Court will rely on his subsequent analyses regarding the structure and characteristics of the defined market, which Defendants do not challenge. *See* ECF No. 470.

8 Indeed, the many novel questions of law presented by this case may signal an ill fit between these long-standing antitrust doctrines and the structures of modern technology markets.

9 As noted above, because the **FTC** has not argued that **Meta** could have entered the relevant market through a toehold acquisition, the Court considers only the question of *de novo* entry.

10 The Court can imagine more scenarios, *e.g.*, where **Meta** contracts independent fitness instructors or employs a team of regular fitness instructions, but they would require further speculation.

11 To clarify, the Court cites this internal **Meta** strategy document for its identification of functions that are *objectively* absent from **Meta's** capabilities, and not for any probative value in determining **Meta's** *subjective* intention, such as whether those absences are sufficient to deter it from entering the VR dedicated fitness app market de novo.

12 To be sure, there is incentive for any company to enter a market that has stable consumers and is experiencing high growth, and the Court considers these incentives in assessing reasonable probability of **Meta's** entry. However, those incentives are of a different type and on a different scale from **Meta's** interest in VR dedicated fitness apps as a VR platform developer.

13 As discussed in the "Users and Growth" analysis above, the record reflects that **Meta's** interest in the VR dedicated fitness market stems from the market's potential contribution to broader VR adoption and corresponding headset sales. The Court recognizes that a thriving VR fitness market may contribute to **Meta's** future profitability in headset sales. But that potential profitability in a different market is both too divorced from the likelihood of **Meta's** *de novo* entry in the relevant market, and too speculative to evaluate under this factor.

14 The **FTC** also produces an April 2021 internal communication from ***Meta***, where a **Meta** employee remarked that Within "very much worry that [**Meta**] will create a fitness first app internally that takes their market share." PX0514, at 2, Apr. 23, 2021. The Court is doubtful of the probative value of this hearsay statement, and the **FTC** has not produced any evidence to corroborate this statement. **FTC** Closing Hr'g Tr. 1498:2–9 ("[W]e heard from Ms. Brown, and you may recall that she did not remember much, if anything at all, about this document.... It's up to this court to judge her credibility on that store. But she did say that she was being truthful when she wrote this.").

End of Document

KeyCite Yellow Flag - Negative Treatment
Declined to Extend by Illumina, Incorporated v. Federal Trade Commission, 5th Cir., December 15, 2023

2023 WL 4443412
Only the Westlaw citation is currently available.
United States District Court, N.D. California.

FEDERAL TRADE COMMISSION, Plaintiff,
v.
MICROSOFT CORPORATION, et al., Defendants.

Case No. 23-cv-02880-JSC
|
Signed July 10, 2023

Synopsis
Background: Federal Trade Commission brought action against software company and video game company seeking preliminary injunction to enjoin proposed merger between companies pending administrative trial to determine if merger violated Clayton Act.

Holdings: The District Court, Jacqueline Scott Corley, J., held that:

[1] portable console was not in relevant market for high-performance video game consoles;

[2] personal computers were not in relevant market for high-performance video game consoles;

[3] geographic market for high-performance video game consoles was the United States;

[4] merging software company and video game company did not have incentive to foreclose particular video game from competitors;

[5] Federal Trade Commission was not likely to succeed on merits of its claim that exclusivity of particular video game on software company's game library subscription service would probably substantially lessen competition in subscription services market;

[6] Commission was not likely to succeed on merits of its claim that merger between software company and video game company would probably lessen competition in cloud gaming market; and

[7] balance of equities did not weigh in favor of granting preliminary injunction.

Motion denied.

Procedural Posture(s): Motion for Preliminary Injunction.

West Headnotes (40)

[1] **Antitrust and Trade Regulation** Mergers and Acquisitions

Because the Clayton Act bars mergers whose effect may be substantially to lessen competition, or to tend to create a monopoly, judicial analysis necessarily focuses on probabilities, not certainties; this requires not merely an appraisal of the immediate impact of the merger upon competition, but a prediction of its impact upon competitive conditions in the future. Clayton Act § 7, 15 U.S.C.A. § 18.

[2] **Antitrust and Trade Regulation** Mergers and Acquisitions

A violation of Section 7 of the Clayton Act is proven upon a showing of reasonable probability of anticompetitive effect. Clayton Act § 7, 15 U.S.C.A. § 18.

[3] **Antitrust and Trade Regulation** Presumptions and burden of proof

Claims challenging horizontal mergers under Section 7 of the Clayton Act are generally analyzed under a burden-shifting framework; the plaintiff must first establish a prima facie case that a merger is anticompetitive, and the burden then shifts to the defendant to rebut the prima facie case. Clayton Act § 7, 15 U.S.C.A. § 18.

[4] **Antitrust and Trade Regulation** Presumptions and burden of proof

In vertical merger cases under Section 7 of the Clayton Act, the government must make a fact-specific showing that the proposed merger is likely to be anticompetitive; once the prima facie case is established, the burden shifts to the defendant to present evidence that the prima facie case inaccurately predicts the relevant transaction's probable effect on future competition, or to sufficiently discredit the evidence underlying the prima facie case. Clayton Act § 7, 15 U.S.C.A. § 18.

1 Case that cites this headnote

[5] **Antitrust and Trade Regulation** Preliminary

In determining whether to grant preliminary injunction under Federal Trade Commission Act, court must determine likelihood that Commission will ultimately succeed on merits and balance equities. Federal Trade Commission Act § 13, 15 U.S.C.A. § 53(b).

1 Case that cites this headnote

[6] **Antitrust and Trade Regulation** Preliminary

To satisfy the likelihood of success prong of test for whether to grant preliminary injunction under Federal Trade Commission Act, the Commission must raise questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the Commission in the first instance and ultimately by the Court of Appeals. Federal Trade Commission Act § 13, 15 U.S.C.A. § 53(b).

1 Case that cites this headnote

[7] **Antitrust and Trade Regulation** Preliminary

In evaluating likelihood of success on the merits, as required to issue preliminary injunction under Federal Trade Commission Act, the court must exercise its independent judgment and evaluate the Commission's case and evidence on the merits. Federal Trade Commission Act § 13, 15 U.S.C.A. § 53(b).

[8] **Antitrust and Trade Regulation** Preliminary

The issuance of a preliminary injunction under the Federal Trade Commission Act prior to a full trial on the merits is an extraordinary and drastic remedy; this is particularly true in the acquisition and merger context, because, as a result of the short life-span of most tender offers, the issuance of a preliminary injunction blocking an acquisition or merger may prevent the transaction from ever being consummated. Federal Trade Commission Act § 13, 15 U.S.C.A. § 53(b).

[9] **Antitrust and Trade Regulation** Preliminary

When determining likelihood of success on the merits, as required to issue preliminary injunction under the Federal Trade Commission Act, the district court does not resolve conflicts in the evidence—the question is simply whether the Commission has met its burden of showing a likelihood of success on the merits. Federal Trade Commission Act § 13, 15 U.S.C.A. § 53(b).

[10] **Antitrust and Trade Regulation** Preliminary

The relevant forum for the question of likelihood of success, as required to grant preliminary injunction under Federal Trade Commission Act, is before the administrative law judge (ALJ) in the administrative proceedings. Federal Trade Commission Act § 13, 15 U.S.C.A. § 53(b).

2 Cases that cite this headnote

[11] **Antitrust and Trade Regulation** Relevant market in general

The first step in analyzing a merger challenge under Section 7 of the Clayton Act is to determine the relevant market. Clayton Act § 7, 15 U.S.C.A. § 18.

[12] **Antitrust and Trade Regulation** Geographical market; section of country

Antitrust and Trade Regulation Product market; line of commerce

The relevant market for merger challenges brought under Section 7 of the Clayton Act is determined by (1) the relevant product market and (2) the relevant geographic market. Clayton Act § 7, 15 U.S.C.A. § 18.

[13] **Antitrust and Trade Regulation** Product market; line of commerce

The outer boundaries of a product market are determined, for Clayton Act purposes, by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it; that is, when one product is a reasonable substitute for the other, it is to be included in the same relevant product market even though the products themselves are not the same. Clayton Act § 7, 15 U.S.C.A. § 18.

[14] **Antitrust and Trade Regulation** Product market; line of commerce

For purposes of determining product markets under Clayton Act. a product is construed to be a reasonable substitute for another when the demand for it increases in response to an increase in the price for the other. Clayton Act § 7, 15 U.S.C.A. § 18.

1 Case that cites this headnote

[15] **Antitrust and Trade Regulation** Questions of law and fact

The definition of the relevant market, for Clayton Act purposes, is basically a fact question dependent upon the special characteristics of the industry involved. Clayton Act § 7, 15 U.S.C.A. § 18.

[16] **Antitrust and Trade Regulation** Relevant market in general

For purposes of proceedings under the Clayton Act, the overarching goal of market definition is to recognize competition where, in fact, competition exists. Clayton Act § 7, 15 U.S.C.A. § 18.

[17] **Antitrust and Trade Regulation** Presumptions and burden of proof

The Federal Trade Commission bears the burden of proof and persuasion in defining the relevant market, for purposes of the Clayton Act. Clayton Act § 7, 15 U.S.C.A. § 18.

[18] **Antitrust and Trade Regulation** Relevant market in general

There is no requirement to use any specific methodology in defining relevant market in antitrust action under the Clayton Act. Clayton Act § 7, 15 U.S.C.A. § 18.

[19] **Antitrust and Trade Regulation** Product market; line of commerce

Factors for determining product market in proceedings under the Clayton Act are practical indicia such as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors. Clayton Act § 7, 15 U.S.C.A. § 18.

[20] **Antitrust and Trade Regulation** Preliminary

Portable console was not in relevant market for high-performance video game consoles, for purposes of whether preliminary injunction was warranted in Federal Trade Commission's action against software company and video game company for violation of Clayton Act, based on portable console's price and features, including its portability, screen, and less powerful hardware, and plethora of internal industry documents. Clayton Act § 7, 15 U.S.C.A. § 18; Federal Trade Commission Act § 13, 15 U.S.C.A. § 53(b).

[21] **Antitrust and Trade Regulation** Elasticity of supply and demand

It does not matter whether a defendant's products are fully interchangeable with those of its competitors because perfect fungibility is not required; instead, products must be reasonably interchangeable, such that there is cross-elasticity of demand.

[22] **Antitrust and Trade Regulation** Relevant market in general

The goal of market definition in proceedings under the Clayton Act is to define the boundaries of the competition within which foreclosure or disadvantaging of a participant is likely to reduce innovation, delay rivals' entry, and raise price or reduce variety or quality of the ensuing goods. Clayton Act § 7, 15 U.S.C.A. § 18.

[23] **Antitrust and Trade Regulation** Relevant market in general

The relevant market will encompass those firms whose presence drives this competition and whose foreclosure or disadvantaging may thwart it, for purposes of the Clayton Act. Clayton Act § 7, 15 U.S.C.A. § 18.

[24] **Antitrust and Trade Regulation** Computer and internet

Antitrust and Trade Regulation Preliminary

Personal computers were not in relevant market for high-performance video game consoles, for purposes of preliminary injunction motion in Federal Trade Commission's action against software company and video game company for violation of Clayton Act, although video game customers could "cross-shop" between high-performance consoles and personal computers; there was not reasonable interchangeability of use or cross-elasticity of demand between high-performance consoles and personal computers as substitute. Clayton Act § 7, 15 U.S.C.A. § 18; Federal Trade Commission Act § 13, 15 U.S.C.A. § 53(b).

[25] **Antitrust and Trade Regulation** Geographical market; section of country

For purposes of the Clayton Act, the relevant geographic market must correspond to the commercial realities of the industry and be economically significant. Clayton Act § 7, 15 U.S.C.A. § 18.

[26] **Antitrust and Trade Regulation** Geographical market; section of country

For purposes of the Clayton Act, the "geographic market" encompasses the area to which consumers can practically turn for alternative sources of the product and in which the antitrust defendants face competition. Clayton Act § 7, 15 U.S.C.A. § 18.

[27] **Antitrust and Trade Regulation** Computer and internet

Antitrust and Trade Regulation Preliminary

The geographic market for high-performance video game consoles was the United States, for purposes of preliminary injunction motion in Federal Trade Commission's action against software company and video game company for violation of Clayton Act, although video game consoles were sold in markets outside of the United States; there was no evidence to suggest that consumers in the United States that sought to purchase a console were looking outside of the United States to do so. Federal Trade Commission Act § 13, 15 U.S.C.A. § 53(b); Clayton Act § 7, 15 U.S.C.A. § 18.

[28] **Antitrust and Trade Regulation** Geographical market; section of country

For purposes of the Clayton Act, the geographic market is both the area in which the seller operates, and to which the purchaser can practically turn for supplies. Clayton Act § 7, 15 U.S.C.A. § 18.

[29] **Antitrust and Trade Regulation** Presumptions and burden of proof

In a horizontal merger case under the Clayton Act, the government can establish its prima facie case that the merger is anticompetitive simply by showing that the merger would produce a firm controlling an undue percentage share of the relevant market, and would result in a significant increase in the concentration of firms in that market, typically by presenting market-share statistics, which triggers a presumption that the merger will substantially lessen competition. Clayton Act § 7, 15 U.S.C.A. § 18.

1 Case that cites this headnote

[30] **Antitrust and Trade Regulation** Presumptions and burden of proof

With challenges to proposed vertical mergers under the Clayton Act, the outcome of whether the government has established its prima facie case that the merger is anticompetitive turns on whether, notwithstanding the proposed merger's conceded procompetitive effects, the government has met its burden of establishing, through case-specific evidence, that the merger is likely to substantially lessen competition in the manner it predicts. Clayton Act § 7, 15 U.S.C.A. § 18.

1 Case that cites this headnote

[31] **Antitrust and Trade Regulation** Presumptions and burden of proof

Once the prima facie case is established that a proposed merger violates the Clayton Act, the burden shifts to the defendant to present evidence that the prima facie case inaccurately predicts the relevant transaction's probable effect on future competition, or to sufficiently discredit the evidence underlying the prima facie case; upon such rebuttal, the burden of producing additional evidence of anticompetitive effects shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times. Clayton Act § 7, 15 U.S.C.A. § 18.

1 Case that cites this headnote

[32] **Antitrust and Trade Regulation** Mergers and Acquisitions

In assessing the government's case under Section 7 of the Clayton Act, the court must engage in a comprehensive inquiry into the future competitive conditions in a given market, keeping in mind that the Clayton Act protects competition, rather than any particular competitor. Clayton Act § 7, 15 U.S.C.A. § 18.

[33] **Antitrust and Trade Regulation** Preliminary

To establish a likelihood of success, as required for preliminary injunction under Federal Trade Commission Act, on its ability and incentive foreclosure theory of violation of the Clayton Act, the Commission must show the combined firm (1) has the ability to withhold a product, (2) has the incentive to withhold that product from its rivals, and (3) competition would probably be substantially lessened as a result of the withholding. Clayton Act § 7, 15 U.S.C.A. § 18; Federal Trade Commission Act § 13, 15 U.S.C.A. § 53(b).

[34] **Antitrust and Trade Regulation** Computer and internet

Antitrust and Trade Regulation Preliminary

Merging software company and video game company did not have incentive to foreclose particular video game from competitors, for purposes of determining whether Federal Trade Commission was likely to succeed for preliminary injunction in Commission's action against companies for violation of Clayton Act; software company committed to maintain game on existing platforms and to expand its availability, merger evaluation presented to software company's board of directors included sales of game through competitors post-merger, witnesses consistently testified that there were no plans to make game exclusive to software company's console, game's cross-platform play was critical to its financial success, and software company anticipated irreparable reputational harm if it made game exclusive. Clayton Act § 7, 15 U.S.C.A. § 18; Federal Trade Commission Act § 13, 15 U.S.C.A. § 53(b).

[35] **Antitrust and Trade Regulation** Mergers and acquisitions

Antitrust and Trade Regulation Preliminary

Evidence was insufficient to show that merging software company and video game company had incentive to foreclose particular video game from competitors, for purposes of determining whether preliminary injunction was warranted in Federal Trade Commission's action against companies for violation of Clayton Act; Commission's expert economist assumed 20% conversion rate of gamers who used competitor's console to software company's console was not supported by record, expert did not consider software company's agreement with several competitors to provide ongoing access to game, software company's conduct after acquisition of another game company did not dispute evidence that software company did not have incentive to foreclose game, and there was no evidence that there was incentive for partial foreclosure. Clayton Act § 7, 15 U.S.C.A. § 18; Federal Trade Commission Act § 13, 15 U.S.C.A. § 53(b).

[36] **Antitrust and Trade Regulation** Mergers and Acquisitions

The question in proceedings under the Clayton Act is whether the proposed merger is likely to substantially lessen competition, which encompasses a concept of reasonable probability. Clayton Act § 7, 15 U.S.C.A. § 18.

1 Case that cites this headnote

[37] **Antitrust and Trade Regulation** Computer and internet

Antitrust and Trade Regulation Preliminary

Federal Trade Commission was not likely to succeed on merits of its claim that exclusivity of particular video game on software company's game library subscription service would probably substantially lessen competition in subscription services market, for purposes of determining whether preliminary injunction was warranted in Commission's action against merging software company and video game company for violation of Clayton Act; merger had procompetitive effect of expanding access to game through lower cost of subscription service as compared to cost of buying game itself, which would increase number of users of subscription service, incentivizing software company to invest in other games, and video game company did not plan to put its other games on subscription service. Federal Trade

Commission Act § 13, 15 U.S.C.A. § 53(b); Clayton Act § 7, 15 U.S.C.A. § 18.

1 Case that cites this headnote

[38] **Antitrust and Trade Regulation** Computer and internet
Antitrust and Trade Regulation Preliminary

Federal Trade Commission was not likely to succeed on merits of its claim that merger between software company and video game company would probably lessen competition in cloud gaming market, for purposes of determining whether preliminary injunction was warranted in Commission's action against companies for violation of Clayton Act; software company made agreements with five cloud-streaming providers to provide access to video game company's content, which, prior to merger, was not on any cloud-streaming service, and there was no evidence that video game company would have agreed to put its content on cloud-streaming services if it remained independent. Federal Trade Commission Act § 13, 15 U.S.C.A. § 53(b); Clayton Act § 7, 15 U.S.C.A. § 18.

[39] **Antitrust and Trade Regulation** Computer and internet
Antitrust and Trade Regulation Preliminary

Federal Trade Commission was not likely to succeed on merits of its claim that purpose of merger between software company and video game company was anticompetitive, for purposes of determining whether preliminary injunction was warranted in Commission's action against companies for violation of Clayton Act; Commission's argument that purpose of merger was to transform independent supply of video games into captive supply controlled exclusively by software company did not explain why it demonstrated anticompetitive purpose, software company's investment in game developers and publishers allowed for increased innovation in content, and software company prioritized a “content pipeline”. Federal Trade Commission Act § 13, 15 U.S.C.A. § 53(b); Clayton Act § 7, 15 U.S.C.A. § 18.

[40] **Antitrust and Trade Regulation** Computer and internet
Antitrust and Trade Regulation Preliminary

Balance of equities did not weigh in favor of granting preliminary injunction, in Federal Trade Commission's action against merging software company and video game company for violation of Clayton Act, although Commission argued that difficulty in ordering post-acquisition divestiture was public equity that prevailed; record contained conflicting evidence on anticompetitive effects of proposed merger, there would be no foreclosure of video game to competitors pending decision in administrative trial, and merger was vertical acquisition with no planned dismantling of operations that would make post-acquisition divestiture difficult to order. Federal Trade Commission Act § 13, 15 U.S.C.A. § 53(b); Clayton Act § 7, 15 U.S.C.A. § 18.

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PRELIMINARY INJUNCTION OPINION

REDACTED VERSION

JACQUELINE SCOTT CORLEY

***1** In December 2022, the **FTC** initiated an administrative action to block **Microsoft's** proposed acquisition of **Activision**—publisher of the first-person shooter video-game franchise *Call of Duty*, among other popular video games. The gist of the **FTC's** complaint is *Call of Duty* is so popular, and such an important supply for any video game platform, that the combined firm is probably going to foreclose it from its rivals for its own economic benefit to consumers' detriment. Discovery in the administrative action has closed, and trial before an **FTC** judge is scheduled to commence on August 2, 2023.

Four weeks ago, the **FTC** filed this action to preliminarily enjoin the merger pending completion of the **FTC** administrative action. Because the merger has a July 18 termination date, expedited proceedings were commenced. After considering the parties' voluminous pre-and-post hearing writing submissions, and having held a five-day evidentiary hearing, the Court DENIES the motion for preliminary injunction. The **FTC** has not shown it is likely to succeed on its assertion the combined firm will probably pull *Call of Duty* from Sony PlayStation, or that its ownership of **Activision** content will substantially lessen competition in the video game library subscription and cloud gaming markets.

BACKGROUND

The video gaming industry represents the fastest growing form of media and entertainment with revenues larger than the film, music, and print industries. The industry consists of several components. The three billion worldwide gamers. The videogame developers who create the games. The videogame publishers who release the games. And the companies that make the devices on which gamers play the games. This action involves a merger between **Activision**—the developer of the *Call of Duty* video game franchise—and **Microsoft**—a game developer, publisher, and the manufacturer of the Xbox game console.

A. The Parties

Microsoft made $198 billion in revenue in 2022. (PX9050-043.[1]) Gaming is part of **Microsoft's** More Personal Computing division. (PX9050-014.) Its gaming business includes Xbox, Xbox Game Pass (a gaming subscription service), and Xbox Cloud Gaming. (PX9050-014.) **Microsoft** publishes video games through Xbox Game Studios, comprising 23 game development studios, including nine studios that were included in **Microsoft's** acquisition of ZeniMax Media Inc., announced in September 2020 and finalized in March 2021. (Dkt. No. 226-2, Lee Decl. at ¶ 14; PX0003 at 086-087 (detailing **Microsoft** acquisitions of gaming studios); PX1527-002.)

Activision, a publicly traded corporation, earned $7.5 billion in revenue in 2022. (PX9388-040 (**Activision** 10-K 2022).) "**Activision** develops and publishes video games for consoles, PCs and mobile devices. **Microsoft** often refers to **Activision**, along with EA [Electronic Arts], Take-Two Interactive Software, Inc., and Ubisoft, as one of the 'Big 4' independent video game publishers." (Dkt. No. 226-2, Lee Decl. at ¶ 19.) "**Activision's** most successful video game franchise is *Call* *of Duty*, a first-person shooter video game series playable on video game consoles and PCs. "Activision also produces other popular video games for consoles, including games from the *Diablo, Overwatch, Crash Bandicoot*, and *Tony Hawk* franchises, as well as video games for other devices, including games from the *Candy Crush* (for mobile devices) and *Warcraft* (for PC) franchises." (Dkt. No. 226-2, Lee Decl. at ¶ 21.)

B. The Proposed Merger

***2** On January 18, 2022, Microsoft announced an agreement to acquire Activision for $68.7 billion—one of the largest, if not the largest, tech industry mergers. The agreement provides, among other things, either party may terminate the merger agreement if the transaction has not closed by July 18, 2023. (PX0083-088.) If the agreement is terminated because it has not closed, Microsoft may have to pay Activision a $3 billion termination fee. (PX0083-091, Sec. 8(c).) Following the merger, "[Activision Blizzard] will continue as the surviving corporation of the Merger and a Subsidiary of Parent [Microsoft]." (PX00083-024); *see also* RX5058 (Hood Decl.) at ¶ 6 (discussing Microsoft's plan to maintain Activision as a limited-integration studio).

C. The Video Game Industry

Video gaming generates hundreds of billions of dollars of revenue a year and is projected to grow substantially in the future. (Dkt. No. 283, 6/23/23 Tr. (Spencer) at 404:12–16; Dkt. No. 285, 6/28/23 Tr. (Kotick) at 710:16–17 ("[T]he business has evolved to be what's today probably a $130 billion-a-year industry.").) Gaming grew to record high levels during the global pandemic, with people seeking at-home entertainment options more than ever before. (RX3136; Dkt. No. 285, 6/28/23 Tr. (Bailey) at 789:16–22.)

1. Gaming Platforms

Video games are available to play across a wide range of platforms, including mobile, PC, and console. (Dkt. No. 283, 6/23/23 Tr. (Spencer) at 404:6–405:3 (discussing RX3166-003); *see also* Dkt. No. 284, 6/27/23 Tr. (Bailey) at 661:3–23.) Games can be played on general purpose PCs or gaming PCs, but gaming PCs typically have more advanced hardware to allow them to play more computationally demanding games. (PX8001 (Ryan Decl.) at ¶ 15.) Conversely, games played on mobile have lower graphics and are less sophisticated than games played on consoles or gaming PCs. (PX0003-073.) The three primary console makers are Microsoft (Xbox Series X|S), Sony (PlayStation 5), and Nintendo (Switch). (PX1777-008; Dkt. No. 226-2, Lee Decl. at ¶ 13.)

a. Console Gaming

Video game consoles are consumer devices designed for, and whose primary use is, to play video games. (PX8001 (Ryan Decl.) at ¶ 10.)[Redacted]

[Redacted]

[Redacted]

[Redacted]

While consoles were once the predominant form of home gaming, they now represent a smaller share of video game revenue than either mobile or PC. (Dkt. No. 282, 6/22/23 Tr. (Bond) at 127:16-128:1; RX3166-003.)

b. Mobile Gaming

Most gamers today play on mobile devices, which is also the fastest growing segment as the technical capabilities of mobile devices increase. (Dkt. No. 282, 6/22/23 Tr. (Bond) at 127:24–128:1; Dkt. No. 283, 6/23/23 Tr. (Spencer) at 392:5–6, 392:10–12, 404:11, 404:21-22; Dkt. No. 285, 6/28/23 Tr. (Kotick) at 712:1-12, 732:4-20; *id.* at 712:8-9 ("And so today the bulk of games are played on phones ...."); Dkt. No. 284, 6/27/23 Tr. (Bailey) at 661:6–23; *see also* RX5058 (Hood Decl.) at ¶ 14 ("$113 billion of the game industry's total revenues of $210 billion came from mobile gaming in 2020").) Growth in mobile gaming is expected to continue, as microprocessors equivalent to those used in past video game consoles are increasingly becoming more powerful and incorporated into phones. (*See, e.g.*, Dkt. No. 285, 6/28/23 Tr. (Kotick) at 720:7-11 (explaining mobile is "the biggest part of the market").)

c. PC Gaming

After mobile, PC gaming is the next largest source of video game revenue. (Dkt. No. 284, 6/27/23 Tr. (Bailey) at 661:11-12.) [Redacted]

d. Cross-Platform Play

Games can be single-player or multi-player. Single-player games are normally story-driven, and other characters in the game are computations in the game rather than real people. In multiplayer games, players are matched with other people of similar skill level, and players interact in real time. (Dkt. No. 282, 6/22/23 Tr. (Bond) at 134:5-19.) Gamers can now play certain multiplayer games across platforms. For example, a gamer on PlayStation can now play many games with other gamers playing on another platform, like Nintendo or Xbox or PC. That mode of play is referred to as "cross-platform" gaming or "cross-play." (Dkt. No. 282, 6/22/23 Tr. (Bond) at 135:7-17.) In most multiplayer games, a gamer selects multiplayer game mode, the game matches the gamer with other gamers, and the gamers are then placed in a lobby and either enter the game or are placed in teams. (*See* Dkt. No. 282, 6/22/23 Tr. (Bond), at 134:5-19; Dkt. No. 284, 6/27/23 Tr. (Bailey) at 669:24-670:4, 672:2-7.) Cross-play makes games more valuable to consumers because they can play the game with friends and access larger lobbies of players. (*See, e.g.*, Dkt. No. 284, 6/27/23 Tr. (Bailey) at 669:22-670:4; Dkt. No. 285, 6/28/23 Tr. (Kotick), at 716:5–8; *see also id.* at 713:23-714:10 ("[T]he big evolution of the industry has been this transformation to the social experience."), 715:18-24.) Many of the most popular multiplayer titles (*e.g., Fortnite, PUBG, Call of Duty*, and *Minecraft*) allow gamers to cross-play between at least PC and console. (*See, e.g.*, Dkt. No. 282, 6/22/23 Tr. (Bond) at 152:18-153:2 (*Call of Duty*).)

2. Gaming Content

***3** A game publisher brings games to market and sometimes provides funding to the game developer to do so. (PX7014 (Booty Investigational Hearing "IH" Tr. at 28:5-15.) A developer creates the assets for a game, including writing the code and designing the art. (Dkt. No. 282, 6/22/23 Tr. (Booty) at 50:14-19; PX7014 (Booty IH Tr.) at 28:5-15.) First-party content is created and developed by a console manufacturer at an in-house studio. (Dkt. No. 282, 6/22/23 Tr. (Booty) at 50:25-51:2; Dkt. No. 226-2, Lee Decl. at ¶ 15; PX7014 (Booty IH Tr.) at 58:20–59:9.) **Microsoft's** first-party content is created at Xbox Game Studios. (PX9050-015; PX0003-016.) Some of **Microsoft's** first-party franchises include *DOOM, Forza, Gears of War, Halo, Minecraft*, and *The Elder Scrolls.* (PX9252-001.)

Third-party content refers to games independently developed and published by a third-party publisher. (Dkt. No. 282, 6/22/23 Tr. (Booty) at 51:6-8; Dkt. No. 226-2, Lee Decl. at ¶ 15; PX8001 (Ryan Decl.) at ¶ 5; PX0003-016.) Occasionally, console manufacturers will publish titles developed by a third-party development studio, known as second-party games. (PX8001 (Ryan Decl.) at ¶ 5; PX7003 (Bond IH Tr.) at 152:2-10; PX0003-016.) Console manufacturers typically negotiate publisher license agreements with game publishers setting the terms for any titles the console manufacturer ships from the publisher. (Dkt. No. 283, 6/23/23 Tr. (Spencer) at 420:11-421:2.) For second-or third-party developers, console manufacturers create development kits for those second-or -third-party developers to use to ensure the game will run on the console. (Dkt. No. 282, 6/22/23 Tr. (Bond) at 156:7-17.)

Both consumers and industry participants acknowledge content drives sales. [Redacted]

[Redacted]

a. AAA Content

"AAA" content is an industry term and can be synonymous with "a tentpole title, a marquee title, a big blockbuster title" that has a high development budget and high expectations for sales. (Dkt. No. 282, 6/22/23 Tr. (Bond) at 147:20-148:2) ("[AAA] tends to imply a game of a certain size and scope, a certain level of investment put into the game"); [Redacted]

[Redacted] **Activision** CEO Bobby Kotick concluded sustaining AAA games requires broad and deep capabilities, and even then, a AAA title is not guaranteed (though Mr. Kotick admits **Activision** has the capability to release a AAA game every single year). (Dkt. No. 285, 6/28/23 Tr. (Kotick) at 43:14-22.)

b. Exclusive Content

Each of the three major console companies is also a vertically integrated first-party game developer and publisher. And while each has a collection of platform-exclusive titles, "the Nintendo Switch, the PlayStation, they both have significantly higher number of exclusive games on their platform than Xbox does." (Dkt. No. 283, 6/23/23 Tr. (Spencer) at 346:25–347:2; *see also id.*, 6/23/23 Tr. (Spencer) at 440:24-441:4 (exclusives are "an established part of the console business, the video game business, and Sony and Nintendo are very strong with their exclusive games.").)

[Redacted]

[Redacted]

[Redacted]

In addition to exclusivity, Sony also uses its market power to extract other preferential treatment from third-party game developers, including earlier release dates, exclusive marketing agreements, and exclusive in-game content. (Dkt. No. 282, 6/22/23 Tr. (Bond) at 162:1–4, 186:5–8.) [Redacted]

[Redacted]

c. Activision Content

[Redacted]

i. Call of Duty

The *Call of Duty* games are first-person shooter games based on "military conflict through history." (Dkt. No. 285, 6/28/23 Tr. (Kotick) at 712:21-713:9; Dkt. No. 282, 6/22/23 Tr. (Bond) at 152:18-23; Dkt. No. 282, 6/22/23 Tr. (Hines) at 112:10-20.) [Redacted]

***4** *Call of Duty* games have been continuously available on both PlayStation and Xbox consoles since 2003. (Dkt. No. 285, 6/28/23 Tr. (Kotick) at 714:12-715:12, 720:1-6.) Activision typically releases a new buy-to-play *Call of Duty* game every year. (Dkt. No. 285, 6/28/23 Tr. (Kotick) at 736:12-18 (*Call of Duty* released every year); Dkt. No. 282, Tr. (Bond) at 128:23-25 (games cost $70).) [Redacted]

The latest annual *Call of Duty* titles are playable across platforms via a cross-play feature. (Dkt. No. 282, 6/22/23 Tr. (Bond) at 152:18-153:2.) The introduction of cross-play to *Call of Duty* has significantly improved players' experience; the game's online multiplayer functionality thrives on a large and active player base, and cross-play has increased the number of available players. (Dkt. No. 285, 6/28/23 Tr. (Kotick) at 716:5-8 (explaining cross-play "expands the market and also makes you -- let's say you have a group of friends, not everybody's going to have the same device so it gives you the opportunity to be able to play with your friends").).

Activision also develops and publishes free-to-play versions of *Call of Duty* called *Call of Duty: Warzone*—available on PlayStation, Xbox, and Windows PC—and *Call of Duty: Mobile* ("*COD: Mobile*")—available on iOS and Android mobile devices—which it monetizes through optional in-game microtransactions. (Dkt. No. 282, 6/22/23 Tr. (Bond) at 153:3-15; *see also* Dkt. No. 285, 6/28/23 Tr. (Kotick) at 720:3-11.) "Half of [the *Call of Duty* franchise's] monthly active players play on phones." (Dkt. No. 285, 6/28/23 Tr. (Kotick) at 716:17-21; *see also id.* at 719:2-6 ("[T]he bulk of players [in the *Call of Duty* franchise] are playing on phones.").) Recently, *COD: Mobile* reached 150 million monthly annual users. (Dkt. No. 286, 6/29/23 Tr. (Stuart) at 1033:3-6.) Cross-play also exists in the free-to-play *Call of Duty: Warzone.* (*See* Dkt. No. 285, 6/28/23 Tr. (Kotick) at 719:7-720:2 (noting the free-to-play Warzone is playable on PlayStation, PC, and Xbox).) *Call of Duty: Warzone* will be available on mobile this fall, and like the console and PC versions, it will be available as a multiplayer game across mobile devices. (*See* Dkt. No. 285, 6/28/23 Tr. (Kotick) at 720:1-10; 721:9-13.)

Call of Duty is not currently available on the Nintendo Switch. (Dkt. No. 285, 6/28/23 Tr. (Kotick) at 768:8-13.) It is also not currently available on any cloud gaming services or multigame game subscription libraries upon release. (Dkt. No. 285, 6/28/23, Tr. (Kotick) at 734:2-5, 731:12-14.)

ii. Other Activision Content

King's *Candy Crush* franchise consists of casual, free-to-play puzzle games made for mobile devices. (Dkt. No. 285, 6/28/23 Tr. (Kotick) at 725:25-726:6.) [Redacted] King primarily monetizes *Candy Crush* through optional in-game microtransactions, and also generates revenue through in-game advertising placements. (Dkt. No. 285, 6/28/23 Tr. (Kotick) at 726:24-727:4.)

Blizzard's popular *World of Warcraft* franchise principally consists of a massively-multiplayer-online fantasy role-playing game, and related expansions and content released over the course of the past 20 years. (*See* Dkt. No. 285, 6/28/23 Tr. (Kotick) at 730:1-18.) Blizzard makes *World of Warcraft* available for PCs on a subscription-based model.

(*See, e.g.*, Dkt. No. 285, 6/28/23 Tr. (Kotick) at 730:1-7.) [Redacted]

***5** [Redacted]

Indeed, the only **Activision** titles made available on multigame subscription services have been back-catalog games offered for a limited period of time, often for promotional purposes, rather than new games made available day and date. (Dkt. No. 285, 6/28/23 Tr. (Kotick) at 774:9-24; *see also* Dkt. No. 285, 6/28/23 Tr. (Kotick) at 747:3-10, 750:10-13 (acknowledging occasional placement of "a very old catalog title for a short period of time" on subscription services).)

3. Access to Gaming Content

Gamers can access games through a growing variety of payment and distribution models. The diversity of payment and distribution models has increased the accessibility of games and expanded gamer choice. (Dkt. No. 283, 6/23/23 Tr. (Spencer) at 392:24-393:10.) Most gamers obtain entitlements to access and play console games via the "buy-to-play" model of purchasing the games in the form of a cartridge, DVD or Blu-Ray disc, or digital download for an upfront price (*e.g.*, $70) and adding them to their own libraries. (Dkt. No. 282, 6/22/23 Tr. (Bond) at 128:23-25, 138:2-20.) [Redacted]

a. Multi-Game Content Subscription Services

With multigame subscription offerings, gamers pay a flat monthly fee to access a library of games. In the case of most subscription offerings, subscribers download the games they want to play to their devices (just as they would a buy-to-play game), and then play them using those devices. With some services, gamers can stream games while waiting for the game to download or try out a game before downloading. (Dkt. No. 282, 6/22/23 Tr. (Hines) at 92:23-93:5; Dkt. No. 282, 6/22/23 Tr. (Bond) at 145:12-146:7; *see also* Dkt. No. 285, 6/28/23 Tr. (Bailey) at 790:21-791:9 (telemetry data show xCloud is "largely [used to] play[ ] one game they never played before and not playing it ever again," which is "exactly consistent with" gamers using xCloud while the game downloads).)

In 2017, Xbox launched Game Pass, one of the first multigame subscription offerings. (Dkt. No. 282, 6/22/23 Tr. (Bond) at 140:15-23.) Subscribers can access a broad catalog of games for a set monthly fee of $9.99 (or $14.99 for the Game Pass Ultimate tier) instead of purchasing the games outright (for $70 per game). (Dkt. No. 282, 6/22/23 Tr. (Bond) at 137:23-138:1; RX5044-001.) [Redacted] To make Game Pass more attractive, Xbox includes all games developed by its studios (first-party games) in Game Pass the day of release ("day-and-date"). (Dkt. No. 286, 6/29/23 Tr. (Stuart) at 1047:6-15); Dkt. No. 282, 6/22/23 Tr. (Bond) at 139:6-7; [Redacted]

Aside from Game Pass, **Microsoft** also offers Xbox Live Gold, which provides subscribers with access to online, multiplayer games and a limited selection of downloadable games each month among other benefits, such as audio and visual communications and certain discounts. (PX0003-018; Dkt. No. 282, 6/22/23 Tr. (Bond) at 136:18-24.) Xbox Live Gold does not provide subscribers with access to the vast library of games subscribers of Xbox Game Pass for PC or Console and Game Pass Ultimate receive. (PX0003-018.)

***6** [Redacted]

[Redacted]

[Redacted]

[Redacted] For example, **Activision** does not allow, and has no plans to allow, its games in multigame subscription libraries upon release. (*See* Dkt. No. 285, 6/28/23 Tr. (Kotick), at 731:12-14) ("In our current long-range plan, we don't have any revenues that are being generated from a multigame subscription service"); Dkt. No. 285, 6/28/23 Tr. (Kotick) at 746:19-21 ("I would say it's just not something that we do have any plans to do or have ever done ...."). This "philosophical aversion" to subscription services arises from concerns that multigame subscriptions would "degrade the economics" of **Activision's** buy-to-play business model, are "inconsistent with the idea of starting out with free-to-play as the way that you build game universes and franchises," and possibly could lead to substantial cannibalization. (Dkt. No. 285, 6/28/23 Tr. (Kotick) at 729:3-16, 743:22-24; *see also id.* at 744:8-11 (explaining "cannibalization would play a role" in a decision not to place games in a multigame subscription).)

Activision only rarely allows even its older back-catalog titles to be included in subscription services for brief periods of time. (Dkt. No. 285, 6/28/23 Tr. (Kotick) at 747:3-10, 750:10-13) (acknowledging occasional placement of "a very old catalog title for a short period of time" on subscription services); [Redacted]

b. Cloud Gaming Subscription Services

Cloud gaming (also known as cloud game "streaming") is a potential alternative delivery mechanism to downloading native games for play onto hardware. (Dkt. No. 282, 6/22/23 Tr. (Bond) at 131:20-132:5; PX7060 (Eisler Dep. Tr.) at 29:12-19.) [Redacted] It enables gamers to begin playing a game in seconds, rather than waiting for games to download or update, and streaming rather than downloading avoids burdening the storage limits on a gaming device. (https://support.xbox.com/en-US/help/games-apps/cloud-gaming/playing-console-game-from-cloud-versus-installing ("You can start playing a game in seconds. There's no waiting for games to finish installing or updating ... download times or storage limits aren't a factor."); PX8000 (Eisler Decl.) at ¶ 17.) However, the technology and economics of cloud gaming remain challenging, particularly for latency-sensitive multiplayer games. Due to those latency issues, users sometimes experience a stuttering effect or lags in gameplay. (Dkt. No. 282, 6/22/23 Tr. (Bond) at 145:6-11; Dkt. No. 283, 6/23/23 Tr. (Spencer) at 395:10-16; PX7060 (Eisler Dep. Tr.) at 47:05-47:23.) Cloud gaming is also limited in its ability to replicate controller functions for console games streamed to mobile devices. (Dkt. No. 283, 6/23/23 Tr. (Spencer) at 395:23-396:7; Dkt. No. 285, 6/28/23 Tr. (Kotick) at 733:15-21.)

In 2020, **Microsoft** added cloud gaming to its top-tier multi-game content library subscription service offering, Xbox Game Pass Ultimate. (PX9091 at 001-006.) Xbox Cloud Gaming (also referred to as xCloud) enables Xbox Game Pass Ultimate subscribers to stream certain games, as opposed to downloading games locally, and then to play those games on the device most convenient to them, including consoles, Windows PCs, tablets, and mobile phones. (PX0003 at 018.) **Microsoft** also offers free access to Xbox Cloud Gaming for Epic Games' *Fortnite.* (PX0003 at 019.) [Redacted]

***7** As **Microsoft** Gaming CEO Phil Spencer testified, **Microsoft's** xCloud strategy is to allow those who want to play **Microsoft** games on their mobile phones to "have access to those through streaming," allowing **Microsoft** to "find a significant number of customers given the installed base of people playing games on mobile phones." (Dkt. No. 283, 6/23/23 Tr. (Spencer) at 393:16-394:6.) However, as a result of technical limitations, a large majority of Xbox Cloud Gaming users report relying on the service primarily to play a game while it is being downloaded to play natively on Xbox. (Dkt. No. 282, 6/22/23 Tr. (Bond) at 145:12-146:7; Dkt. No. 283, 6/23/23 Tr. (Spencer) at 394:23-396:7; *see also* Dkt. No. 285, 6/28/23 Tr. (Bailey) at 790:4-791:9 (telemetry data show xCloud is "largely [used to] play[ ] one game they never played before and not playing it ever again," which is "exactly consistent with" gamers using xCloud while the game downloads).)

[Redacted]

D. Microsoft's Post-Complaint Agreements

Two months after the **FTC** filed its complaint, Xbox and Nintendo entered a ten-year agreement to bring future *Call of Duty* titles to Switch (and any successor Nintendo consoles) after the merger closes. [Redacted]

[Redacted]

[Redacted] **Microsoft** executives have nonetheless committed publicly and under oath in court to continue to sell *Call of Duty* to Sony. (Dkt. No. 285, 6/28/23 Tr. (Nadella) at 853:9-11 (Q: "Let me ask you here today, Mr. Nadella, will you commit to continuing to ship *Call of Duty* on the Sony PlayStation?" ... A: "A hundred percent."); Dkt. No. 283, 6/23/23 Tr. (Spencer) at 367:18-24, 368:4-10, 429:21-22, 429:25-430:1 ("my commitment is and my testimony is, to use that word, that we will continue to ship Call of -- future versions of *Call of Duty* on Sony's PlayStation platform").)

PROCEDURAL HISTORY

On February 1, 2022, **Microsoft** reported the planned merger to the **FTC**, as required by the Hart-Scott-Rodino Antitrust Improvements Act ("HSR Act"). The **FTC** thereafter commenced an 11-month investigation, requiring **Microsoft** and **Activision** to produce nearly 3 million documents and sit for 15 investigational hearings. The waiting period under the HSR Act which prevents the parties from closing the transaction was extended by agreement with the **FTC** until November 21, 2022, and the parties thereafter agreed voluntarily to delay closing until December 12, 2022.

On December 8, 2022, the **FTC** filed an administrative complaint against the merger, alleging it violates Section 7 of the Clayton Act, 15 U.S.C. § 18, and Section 5 of the FTC Act, 15 U.S.C. § 45. *See* Part 3 Complaint, In the Matter of **Microsoft**/**Activision**, No. 9412 (F.T.C. Dec. 8, 2022). Fact discovery in the **FTC** administrative proceeding, which included production of nearly 1 million documents and 30 depositions, closed on April 7, 2023, followed by expert discovery. An evidentiary hearing before an administrative law judge (ALJ) is scheduled to begin on August 2, 2023. (Dkt. No. 1, Complaint at ¶ 16.)

Although the Agreement allows either party to terminate the merger agreement if the transaction has not closed by July 18, 2023, and appears to obligate **Microsoft** to pay **Activision** a termination fee of $3 billion, the **FTC** did not file this action to preliminarily enjoin the merger until June 12, 2023 —less than six weeks before the termination date.[2] (Dkt. Nos. 1, 7; PX0083091, Sec. 8(c).) The Court related this action to a pending private antitrust action seeking to stop the merger. (Dkt. No. 21; *see Demartini et al. v. **Microsoft** Corp.*, No. 22-08991-JSC, ––– F.Supp.3d ––––, 2023 WL 2588173 (N.D.Cal. 2023).[3]) The **FTC** filed an emergency motion for a temporary restraining order (TRO) with their Complaint, arguing **Microsoft** intended to proceed with the merger as soon as June 16, 2023, and would not stipulate to a TRO unless the **FTC** filed in the United States District Court for the District of Columbia, rather than the Northern District of California where the **FTC** indicated it intended to file because this Court was already overseeing the *Demartini* action. (Dkt. No. 12-3 at 10-11.) The Court granted the **FTC's** motion for a temporary restraining order and set an evidentiary hearing on the preliminary injunction motion to commence the following week. (Dkt. No. 37.) The five-day evidentiary hearing commenced on June 22, 2023 and was completed on June 29, 2023. The action proceeded on an expedited basis given the Agreement's impending termination date. *See **FTC** v. Warner Commc'ns Inc.*, 742 F.2d 1156, 1165 (9th Cir. 1984) (ordering expedited proceedings "[b]ecause undue delay could force the parties to abandon the proposed merger").

LEGAL FRAMEWORK

***8 [1] [2]** Section 7 of the Clayton Act prohibits mergers and acquisitions "where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." 15 U.S.C. § 18. "Because § 7 of the Clayton Act bars mergers whose effect 'may be substantially to lessen competition, or to tend to create a monopoly,' 15 U.S.C. § 18, judicial analysis necessarily focuses on 'probabilities, not certainties. This 'requires not merely an appraisal of the immediate impact of the merger upon competition, but a prediction of its impact upon competitive conditions in the future; this is what is meant when it is said that the amended § 7 was intended to arrest anticompetitive tendencies in their incipiency.' " *Saint Alphonsus Med. Ctr.-Nampa Inc. v. St. Luke's Health Sys., Ltd.*, 778 F.3d 775, 783 (9th Cir. 2015) (citations omitted). Thus, "[i]t is well established that a section 7 violation is proven upon a showing of reasonable probability of anticompetitive effect." *Warner*, 742 F.2d at 1160.

[3] [4] Section 7 claims challenging horizonal mergers are generally analyzed under a " 'burden-shifting framework.' The plaintiff must first establish a prima facie case that a merger is anticompetitive. The burden then shifts to the defendant to rebut the prima facie case." *Saint Alphonsus*, 778 F.3d at 783 (citations omitted). The Ninth Circuit Court of Appeals has not addressed whether this burden shifting framework applies in vertical merger cases such as this. Indeed, "[t]here is a dearth of modern judicial precedent on vertical mergers and a multiplicity of contemporary viewpoints about how they might optimally be adjudicated and enforced.[4]" *United States v. AT&T, Inc.*, 916 F.3d 1029, 1037 (D.C. Cir. 2019). In *AT&T*, the only court of appeals decision addressing a vertical merger in decades, the court found the burden-shifting framework applied, but "unlike horizontal mergers, the government cannot use a short cut to establish a presumption of anticompetitive effect through statistics about the change in market concentration, because vertical mergers produce no immediate change in the relevant market share." *Id.* at 1032. In vertical merger cases, "the government must make a fact-specific showing that the proposed merger is likely to be anticompetitive. Once the prima facie case is established, the burden shifts to the defendant to present evidence that the prima facie case inaccurately predicts the relevant transaction's probable effect on future competition, or to sufficiently discredit the evidence underlying the prima facie case." *Id.* (cleaned up).

PRELIMINARY INJUNCTION

[5] Section 13(b) of the Federal Trade Commission Act provides "[u]pon a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest ... a preliminary injunction may be granted ....” 15 U.S.C. § 53(b). “In determining whether to grant a preliminary injunction under section 13(b), a court must 1) determine the likelihood that the Commission will ultimately succeed on the merits and 2) balance the equities.” *Warner*, 742 F.2d at 1160 (citing ***FTC*** *v. Simeon Management Corp.*, 532 F.2d 708, 713–14 (9th Cir. 1976)).

[6] **[7]** **[8]** **[9]** To satisfy the first prong, the **FTC** must “raise questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the **FTC** in the first instance and ultimately by the Court of Appeals.” *Warner*, 742 F.2d at 1162 (citations omitted). In evaluating likelihood of success on the merits, the court must exercise its “ ‘independent judgment’ and evaluat[e] the **FTC's** case and evidence on the merits.” *See* ***FTC*** *v. Meta Platforms Inc.*, No. 5:22-CV-04325-EJD, 2022 WL 16637996, at *5 (N.D. Cal. Nov. 2, 2022). Courts require such a rigorous analysis because “the issuance of a preliminary injunction prior to a full trial on the merits is an extraordinary and drastic remedy. This is particularly true in the acquisition and merger context, because, as a result of the short life-span of most tender offers, the issuance of a preliminary injunction blocking an acquisition or merger may prevent the transaction from ever being consummated.” ***FTC*** *v. Exxon Corp.*, 636 F.2d 1336, 1343 (D.C. Cir. 1980) (cleaned up); *see also* *Warner*, 742 F.2d at 1165 (9th Cir. 1984) (ordering expedited proceedings “[b]ecause undue delay could force the parties to abandon the proposed merger.”). However, the Court does not resolve conflicts in the evidence—the question is simply whether the **FTC** “has met its burden of showing a likelihood of success on the merits.” *Warner*, 742 F.2d at 1164.

***9** **[10]** The parties sharply dispute in which forum “the Commission's likelihood of ultimate success,” 15 U.S.C. § 53(b), should be measured. This question appears not to have been squarely addressed by any court other than in *Meta*, 2022 WL 16637996, at *4-6. In *Meta*, the court held “Section 13(b)'s ‘likelihood of ultimate success’ inquiry to mean the likelihood of the **FTC's** success on the merits in the underlying administrative proceedings, as opposed to success following a Commission hearing, the development of an administrative record, and appeal before an unspecified Court of Appeals.” *Id.* at *6. The Court is persuaded by the *Meta* court's analysis of this issue and adopts it here—the relevant forum for the question of likelihood of success is before the ALJ in the administrative proceedings.

ANALYSIS

I. RELEVANT MARKET

[11] **[12]** The first step in analyzing a Section 7 merger challenge is to determine the relevant market. *United States v. Marine Bancorporation, Inc.*, 418 U.S. 602, 619, 94 S.Ct. 2856, 41 L.Ed.2d 978 (1974) (citing *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586, 593, 77 S.Ct. 872, 1 L.Ed.2d 1057 (1957)); *see also* ***FTC*** *v. Qualcomm Inc.*, 969 F.3d 974, 992 (9th Cir. 2020) (“A threshold step in any antitrust case is to accurately define the relevant market, which refers to ‘the area of effective competition.’ ”). The relevant market for antitrust purposes is determined by (1) the relevant product market and (2) the relevant geographic market. *Brown Shoe Co. v. United States*, 370 U.S. 294, 324, 82 S.Ct. 1502, 8 L.Ed.2d 510 (1962).

A. Product Market

[13] **[14]** **[15]** **[16]** **[17]** “The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it.” *Id.* at 325, 82 S.Ct. 1502. That is, “when one product is a reasonable substitute for the other, it is to be included in the same relevant product market even though the products themselves are not the same. A product is construed to be a ‘reasonable substitute’ for another when the demand for it increases in response to an increase in the price for the other.” ***FTC*** *v. Cardinal Health, Inc.*, 12 F. Supp. 2d 34, 46 (D.D.C. 1998); *see also* *Newcal Indus., Inc. v. Ikon Office Sol.*, 513 F.3d 1038, 1045 (9th Cir. 2008). The definition of the relevant market is “basically a fact question dependent upon the special characteristics of the industry involved.” *Twin City Sportservice, Inc. v. Charles O. Finley & Co.*, 676 F.2d 1291, 1299 (9th Cir. 1982). The overarching goal of market definition is to “recognize competition where, in fact, competition exists.” *Brown Shoe*, 370 U.S. at 326, 82 S.Ct.

1502; *see also* *Cardinal Health*, 12 F. Supp. 2d at 46 ("Because the ability of customers to turn to other suppliers restrains a firm from raising prices above the competitive level, the definition of the "relevant market" rests on a determination of available substitutes."). "The **FTC** bears the burden of proof and persuasion in defining the relevant market." ***FTC** v. Arch Coal, Inc.*, 329 F. Supp. 2d 109, 119 (D.D.C. 2004), *appeal dismissed*, No. 04-5291, 2004 WL 2066879 (D.C. Cir. Sept. 15, 2004).

[18] **[19]** There is "no requirement to use any specific methodology in defining the relevant market." *Optronic Techs., Inc. v. Ningbo Sunny Elec. Co., Ltd.*, 20 F.4th 466, 482 (9th Cir. 2021). "[C]ourts have determined relevant antitrust markets using, for example, only the *Brown Shoe* factors, or a combination of the *Brown Shoe* factors and the HMT.[5]" *Federal Trade Commission v. Meta Platforms Inc.*, 2023 WL 2346238, at *9 (N.D.Cal. 2023) (collecting cases). *Brown Shoe* factors are "practical indicia [such] as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors." 370 U.S. at 325, 82 S.Ct. 1502.

***10** The **FTC** contends the *Brown Shoe* factors establish four relevant antitrust markets: (1) high performance consoles (Xbox and Sony PlayStation); (2) multigame content library subscription services; (3) cloud gaming; and (4) a combined library subscription services and cloud gaming market.

1. The Console Market

The **FTC's** primary market is the "high-performance console market" which it defines as Xbox and PlayStation Generation 9 (Gen 9) consoles.

a. The Console Market and Nintendo Switch

[20] The **FTC** seeks to limit the console market to Gen 9 consoles Xbox XIS and the PlayStation 5, and exclude the Nintendo Switch. [Redacted]

[Redacted]

[Redacted]

The **FTC** insists the Nintendo Switch's pricing, performance, and content make it an improper substitute at least for purposes of its preliminary injunction motion. As to pricing, yes, the Xbox Series X and PlayStation 5 are priced the same and a couple of hundred dollars higher than the Switch; however, Xbox set the price of its entry-level Series S to compete with the Switch. (Dkt. No. 286, 6/29/23 Tr. (Stuart) at 1030:5-1031:5 (Q. "And do you look at Switch pricing when you're considering the pricing of Xbox Series S?" A. "Yes." Q. "And is that one of the reasons you set the price where you guys did?" A. "Yes.").)

And, there are functionality differences between the Switch and the PlayStation and Xbox consoles—the Switch is portable, and it has its own screen and less powerful hardware. However, neither the **FTC** nor its expert consider the extent to which the Switch's differentiated features including its price, portability, and battery are factors the customer balances when deciding which console to purchase. (Dkt. No. 283, 6/23/23 Tr. (Spencer) at 436:6-437:4 (describing how Nintendo made "technical decisions to enable an experience that they thought their customers would want to have, and it's the best selling console right now in the market. So when I—when people try to tell me it's not competition—competitive, for any number of reasons, I don't believe that because I just look at what's selling.").)

Finally, yes, there are content differences between the Switch and PlayStation, but many of the most popular games on PlayStation and Xbox consoles are also available on the Switch, including *Fortnite, Minecraft, Rocket League, Lego Star Wars, Fall Guys*, and the *FIFA, MLB The Show*, and *NBA 2K franchises.* (Dkt. No. 285, 6/28/23 Tr. (Bailey) at 782:5-783:10; *see* RX5055-074 (Bailey Report) at ¶ 88.) Although some popular Xbox and PlayStation games are not available on the Switch, many of those titles are platform exclusives [Redacted]

[21] **[22]** **[23]** "It doesn't matter whether [Nintendo's] products are fully interchangeable with those of its competitors because perfect fungibility isn't required." *Gorlick Distrib. Ctrs., LLC v. Car Sound Exhaust Sys., Inc.*, 723 F.3d 1019, 1025 (9th Cir. 2013) (citing *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 394, 76 S.Ct. 994, 100 L.Ed. 1264 (1956)). If this were the requirement, "only physically identical products would be a part of the market." *E.I. du Pont*, 351 U.S. at 394, 76 S.Ct. 994. "Instead, products must be reasonably interchangeable, such that there is cross-elasticity of demand." *Gorlick*, 723 F.3d at 1025 (citing *Brown Shoe*, 370 U.S. at 325, 82 S.Ct. 1502). "The goal of market definition here is to define the boundaries of the competition within which foreclosure or disadvantaging of a participant is likely to reduce innovation, delay rivals' entry, and raise price or reduce variety or quality of the ensuing goods. The relevant market will encompass those firms whose presence drives this competition and whose foreclosure or disadvantaging may thwart it." In the Matter of Illumina, Inc. and Grail, Inc., No. 9401, 2023 WL 2823393, at *20 (F.T.C. Mar. 31, 2023).

***11** If the Court was the final decisionmaker on the merits, it would likely find Nintendo Switch part of the relevant market. But it is not. Instead, on a 13(b) preliminary injunction, the **FTC** need only make a "tenable showing that the relevant market" is Gen 9 consoles. *See* *Warner*, 742 F.2d at 1164. Given the plethora of internal industry documents and the acknowledged differences, the **FTC** has met its preliminary injunction burden to show the Switch is not included in the relevant market.

b. The Console Market does not include PCs

[24] The **FTC** insists, and the Court agrees, the console market does not include PCs. [Redacted] That customers may "cross-shop" between consoles and PCs does not demonstrate "reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it." ***FTC*** *v. Whole Foods Mkt., Inc.*, 548 F.3d 1028, 1040, 1043 (D.C. Cir. 2008).

2. Multigame Content Library Subscription Services and Cloud Gaming Markets

As to the **FTC's** additional markets of the multigame content library subscription services and cloud gaming, while the Court questions whether—as Defendants posit—these are simply alternative ways of playing console, PC, and mobile games, the Court assumes without deciding they are each their own product market when considered singly or in combination.

B. Geographic Market

[25] **[26]** The product market, the relevant geographic market must "correspond to the commercial realities of the industry and be economically significant." *Brown Shoe*, 370 U.S. at 336, 82 S.Ct. 1502. The geographic market encompasses the "area to which consumers can practically turn for alternative sources of the product and in which the antitrust defendants face competition." ***FTC*** *v. Cardinal Health, Inc.*, 12 F.Supp.2d 34, 49 (D.D.C. 1998).

1. The Console Market

[27] The **FTC**, relying largely on Dr. Lee's analysis, insists the relevant market is the United States because (1) game prices and releases vary country-by-country; and (2) gamer preferences and behavior vary country-by-country and inform market participants' strategic decision. [Redacted] Cumulatively, this evidence suggests the relevant market for competition is the United States.

Defendants' arguments in favor of a geographic market beyond the United States are unpersuasive. [Redacted]

[28] The geographic market is both the area "in which the seller operates, *and* to which the purchaser can practically turn for supplies." ***FTC*** *v. RAG-Stiftung*, 436 F. Supp. 3d 278, 308 (D.D.C. 2020) (emphasis added). While there is no dispute consoles are sold in markets outside the United States, there is no evidence to suggest US consumers seeking to purchase a console would look outside the United States to do so.

2. Multigame Content Library Subscription Services and Cloud Gaming Markets

The market for multigame content library subscription services and cloud gaming is a closer question; however, the Court will assume without deciding the geographic market is the United States for these markets as well.

II. EFFECT ON COMPETITION

[29] Section 7 vests courts with the "uncertain task" of making a prediction about the future. *See* *United States* *v. Baker Hughes, Inc.*, 908 F.2d 981, 991 (D.C. Cir. 1990). For this reason, the "allocation of the burdens of proof" assumes particular importance. *Id.* In a horizontal merger case, "the government can establish its prima facie case simply by showing that the merger would produce a firm controlling an undue percentage share of the relevant market, and would result in a significant increase in the concentration of firms in that market," typically "by presenting market-share statistics," *United States v. UnitedHealth Grp. Inc.*, 630 F. Supp. 3d 118, 130 (D.D.C. 2022), *appeal dismissed*, No. 22-5301, 2023 WL 2717667 (D.C. Cir. Mar. 27, 2023) (cleaned up), which "triggers a presumption that the merger will substantially lessen competition," *AT&T*, 310 F. Supp. 3d at 192 (cleaned up). For a vertical merger, such as the **Microsoft**/**Activision** merger, "there is no short-cut way to establish anticompetitive effects, as there is with horizontal mergers." *Id.* at 192 (cleaned up). This is in part because "many vertical mergers create vertical integration efficiencies between purchasers and sellers." *Id.* at 193; *see also* *Nat'l Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831, 840 (D.C. Cir. 2006) ("vertical integration creates efficiencies for consumers"); Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application*, ¶ 755c (online ed. May 2023) ("Vertical integration is ubiquitous in our economy and virtually never poses a threat to competition when undertaken unilaterally and in competitive markets."); Dkt. No. 226-2, Lee Decl. at ¶ 58 ("Unlike in an analysis of a horizontal merger, there is no established screen or presumption of harm based on market shares or concentration for the purposes of evaluating the competitive effects of a vertical merger.").

***12** **[30]** **[31]** **[32]** So, with this proposed vertical merger, the outcome "turn[s] on whether, notwithstanding the proposed merger's conceded procompetitive effects, the [g]overnment has met its burden of establishing, through 'case-specific evidence,' that the merger of [**Microsoft**] and [**Activision**], at this time and in this remarkably dynamic industry, is likely to substantially lessen competition in the manner it predicts." *See* *AT&T*, 916 F.3d at 1037. "Once the prima facie case is established, the burden shifts to the defendant to present evidence that the prima facie case inaccurately predicts the relevant transaction's probable effect on future competition, or to sufficiently discredit the evidence underlying the prima facie case. Upon such rebuttal, the burden of producing additional evidence of anticompetitive effects shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times." *Id.* at 1032 (cleaned up). "In assessing the Government's Section 7 case, the court must engage in a comprehensive inquiry into the 'future competitive conditions in a given market, keeping in mind that the Clayton Act protects competition, rather than any particular competitor.' " *AT&T*, 310 F. Supp. 3d at 190 (cleaned up) (citation omitted).

A. The **FTC's** Theory

"The primary vice of a vertical merger or other arrangement tying a customer to a supplier is that, by foreclosing the competitors of either party from a segment of the market otherwise open to them, the arrangement may act as a 'clog on competition which deprives rivals of a fair opportunity to compete.' " *Brown Shoe*, 370 U.S. at 323-24, 82 S.Ct. 1502. The **FTC** insists the combined firm may deprive rivals —primarily Sony—of a fair opportunity to compete in the above-defined markets by foreclosing an essential supply —*Call of Duty*. In other words, *Call of Duty* is so popular, and has such a loyal and dedicated following, competition will be substantially lessened in the console, content library subscription, and cloud gaming markets unless **Microsoft's** rivals have at least equal access to this particular video game.

The **FTC** argues it can establish this potential anticompetitive effect of the merger through two alternative, but overlapping tests. First, by showing the transaction is likely to give the merged firm the ability and incentive to foreclose *Call of Duty* from its rivals. (Dkt. No. 291-2, **FTC's** Final Proposed Findings of Fact and Conclusions of Law (**FTC's** Findings and Conclusions) at p. 180 ¶ 87.) Second, through examining the *Brown Shoe* factors, such as share of the market foreclosed, the nature and purpose of the transaction, barriers to entry, whether the merger will eliminate potential competition by one of the merging parties, and the degree of market power that would be possessed by the merged enterprise as shown by the number and strength of competing suppliers and purchasers. (*Id.* at ¶ 88 (quoting *Brown Shoe*, 370 U.S. at 328-34, 82 S.Ct. 1502); *see* *Illumina*, 2023 WL 2823393, at *32.)

B. Ability and Incentive to Foreclose

As a threshold matter, the **FTC** contends it need only show the transaction is "likely to increase the ability and/or incentive of the merged firm to foreclose rivals." (Dkt. No. 291-2, **FTC's** Findings and Conclusions at p. 181 ¶ 90.) For support, it cites its own March 2023 decision in *Illumina*, 2023 WL 2823393, at *33. *Illumina* reasons:

> [t]o harm competition, a merger need only create or augment either the combined firm's ability or its incentive to harm competition. ***It need not do both.*** Requiring a plaintiff to show an increase to both the ability and the incentive to foreclose would per se exempt from the Clayton Act's purview any transaction that involves the acquisition of a monopoly provider of inputs to adjacent markets.

2023 WL 2823393, at *38 (cleaned up) (emphasis added). *Illumina*, however, provides no authority for this proposition, nor could it. Under Section 7, the government must show a "reasonable *probability* of anticompetitive effect." *Warner*, 742 F.2d at 1160 (emphasis added). If there is no incentive to foreclose, then there is no probability of foreclosure and the alleged concomitant anticompetitive effect. Likewise, if there is no ability, then a party's incentive to foreclose is irrelevant. Indeed, the FTC's expert, Dr. Lee, analyzed the anticompetitive effects of the merger based on ability *and* incentive. (Dkt. No. 226-2, Lee Decl. at ¶ 87) ("I evaluate whether the Merged Entity would have the *ability* and *economic incentive* to foreclose Microsoft's rivals from Activision content in the two Consoles Markets").

***13** The FTC also appears to contend it need only show the combined firm would have a greater ability and incentive to foreclose *Call of Duty* from its rivals than an independent Activision. (Dkt. No. 291-2, FTC's Findings and Conclusions at p. 181 ¶ 90.) This assertion, however, ignores the text of Section 7 which forbids mergers which may "substantially ... lessen competition." 15 U.S.C. § 18. It is not enough that a merger might lessen competition—the FTC must show the merger will probably *substantially* lessen competition. That the combined firm has more of an incentive than an independent Activision says nothing about whether the combination will "substantially" lessen competition. *See UnitedHealth Grp.*, 630 F. Supp. 3d at 133 ("By requiring that [the defendant] prove that the divestiture would preserve exactly the same level of competition that existed before the merger, the Government's proposed standard would effectively erase the word 'substantially' from Section 7").

[33] Thus, to establish a likelihood of success on its ability and incentive foreclosure theory, the FTC must show the combined firm (1) has the ability to withhold *Call of Duty*, (2) has the incentive to withhold *Call of Duty* from its rivals, and (3) competition would probably be substantially lessened as a result of the withholding.

1. Ability to Foreclose

The Court accepts the combined firm would have the ability to foreclose because it would own the *Call of Duty* franchise.

2. Incentive to Foreclose and the Resulting Lessening of Competition

a. High Performance Console Market

The Court finds the FTC has not shown a likelihood of success on its claim the combined firm would have an incentive to, and thus probably would, foreclose *Call of Duty* from Sony PlayStation.

i. No Incentive to Foreclose *Call of Duty*

[34] ***First***, immediately upon the merger's announcement, Microsoft committed to maintain *Call of Duty* on its existing platforms and even expand its availability. The day after the merger announcement, Microsoft's Satya Nadella and Phil Spencer spoke with Sony CEO Kenichiro Yoshida to emphasize Microsoft's commitment to enter a new agreement to extend Activision's obligation to ship *Call of Duty* at parity on PlayStation. (Dkt. No. 283, 6/23/23 Tr. (Spencer) at 418:16-419:16, 443:18-20; RX2172; Dkt. No. 285, 6/28/23 Tr. (Nadella) at 852:23-853:8.) The next day, Sony PlayStation CEO Jim Ryan wrote his mentor about the proposed merger: "It's not an xbox exclusivity play at all. they're thinking bigger than that, and they have the cash to make moves like this. I've spent a fair bit of time with both Phil and Bobby over the past day. I'm pretty sure we will continue to see COD on PS for many years to come." (RX2064-001.) [Redacted]

Microsoft also contacted its competitor Valve—the company that runs the leading PC game store, Steam. (Dkt. No. 282, 6/22/23 Tr. (Bond) at 172:18-19, 173:16-19.) Xbox sent Valve a signed letter agreement committing to make *Call of Duty* available on Steam for ten years. (RX1184.) Valve did not sign the deal because they "believe strongly that they should earn the business of their—the developers who put on their platform day in and day out, and so they told us that they had had no need to sign that agreement and that they believed us when we said that we would continue to provide [*Call of Duty*] on Steam." (Dkt. No. 282, 6/22/23 Tr. (Bond) at 175:16-20.)

Microsoft even took steps to expand *Call of Duty* to non-**Microsoft** platforms. On the day of the merger's announcement, **Microsoft** called the head of Nintendo North America, Doug Bowser, and Nintendo's lead for partnerships, Steve Singer, to discuss a partnership to bring *Call of Duty* to the Switch. (Dkt. No. 282, 6/22/23 Tr. (Bond) at 167:24-169:18.) Those discussions led to an inked deal to bring *Call of Duty* to the Switch. All of this conduct is inconsistent with an intent to foreclose.

Second, the deal plan evaluation model presented to the **Microsoft** Board of Directors to justify the **Activision** purchase price relies on PlayStation sales and other non-**Microsoft** platforms post-acquisition. [Redacted] This valuation is also inconsistent with an incentive to foreclose.

14** ***Third, the deal plan evaluation model reflects access to mobile content was a critical factor weighing in favor of the deal. [Redacted] **Microsoft's** keen interest in **Activision's** mobile content suggests the combined firm is not incentivized to withhold *Call of Duty* merely to aid the shrinking console market.

Fourth, **Microsoft** witnesses consistently testified there are no plans to make *Call of Duty* exclusive to the Xbox. Mr. Nadella testified he would "[a] hundred percent" "commit to continuing to ship *Call of Duty* on the Sony PlayStation." (Dkt.No. 285, 6/28/23 Tr. (Nadella) 853:9-11.) Mr. Spencer testified "my commitment is and my testimony is, to use that word, that we will continue to ship Call of -- future versions of *Call of Duty* on Sony's PlayStation platform." (Dkt. No. 283, 6/23/23 Tr. (Spencer) at 367:18-24, 368:4-10, 429:21-22, 429:25-430:1.)

Fifth, there are no internal documents, emails, or chats contradicting **Microsoft's** stated intent not to make *Call of Duty* exclusive to Xbox consoles. Despite the completion of extensive discovery in the **FTC** administrative proceeding, including production of nearly 1 million documents and 30 depositions, the **FTC** has not identified a single document which contradicts **Microsoft's** publicly-stated commitment to make *Call of Duty* available on PlayStation (and Nintendo Switch). (RX5056 (Carlton Report at ¶ 127.) The public commitment to keep *Call of Duty* multiplatform, and the absence of any documents contradicting those words, strongly suggests the combined firm probably will not withhold *Call of Duty* from PlayStation.

Sixth, *Call of Duty's* cross-platform play is critical to its financial success. (Dkt. No. 286, 6/29/23 Tr. (Stuart) at 1039 ("Q. And is it also profitable for Xbox to continue to have games like *Minecraft* be multiplatform and cross platform? A. Absolutely. The strength of a game like *Minecraft* comes from that cross-network play. If you, you know, removed one of those platforms and one of those big user bases, not only – not only would you have a massive brand impact, you would lose a significant revenue stream that you just couldn't make up for."); Dkt. No. 285, 6/28/23 Tr. (Kotick) at 715:18-24 ("Well, if you think about like from a business perspective and from a consumer perspective, one of the most important things is building communities of players, especially now that you have the ability to compete and socialize. And so our view has always been that you want to create your content for as many platforms as possible and build your audiences to be as big as possible.").) Cross-play thus creates an incentive to leave *Call of Duty* on PlayStation.

Seventh, **Microsoft** anticipates irreparable reputational harm if it forecloses *Call of Duty* from PlayStation. Mr. Spencer testified: "[u]s pulling *Call of Duty* from PlayStation in my view would create irreparable harm to the Xbox brand after me in so many public places, including here, talking about and committing to us not pulling Call of Duty from PlayStation." (Dkt. No. 283, 6/23/23 Tr. (Spencer) at 367:11–15). **Activision** CEO Bobby Kotick confirmed **Microsoft's** concerns are not unfounded: "if we were to remove *Call of Duty* from PlayStation, it would have very serious reputational – it would cause reputational damage to the company." (Dkt. No. 285, 6/28/23 Tr. (Kotick), at 725:4-7); *see also id.* at 715:18-24 ("Well, you would alienate" gamers "and you would have a revolt if you were to remove the game from one platform."); *id.* at 727:17-22 (explaining if a degraded *Call of Duty* experience were offered on other platforms "you would have vitriol from gamers that would be well deserved, and ... that would be very vocal and also cause reputational damage to the company"). "[I]n assessing [**Microsoft's**] post-merger incentives, the Court must consider the financial and reputational costs to [**Microsoft**] if it were to breach or water down its firewall policies." *See* *UnitedHealth Grp.*, 630 F. Supp. 3d 118; *see also* *AT&T*, 916 F.3d at 1040 (D.C. Cir. 2019) ("Turner [Broadcasting] would not be willing to accept the 'catastrophic' affiliate fee and advertising losses associated with a long-term blackout."). Why would **Microsoft** risk that brand reputational harm? Especially since the video game console market is shrinking—not growing; it is not the future of video gaming. (RX 5055-010.)

15** ***Eighth, the **FTC** has not identified any instance in which an established multiplayer, multi-platform game with cross-play, that is, a game that shares *Call of Duty's* characteristics, has been withdrawn from millions of gamers and made exclusive. (RX5056 (Carlton Report) at ¶ 15.) To the contrary, **Microsoft's** 2014 acquisition of Mojang, the developer of the hugely popular *Minecraft* franchise, exemplifies how a console seller (and **Microsoft** in particular) behaves when acquiring a hugely popular multiplayer cross-platform game. *Minecraft* is one of the most successful games of all time, and is **Microsoft's** largest game by revenue. (Dkt. No. 283, 6/23/23 Tr. (Spencer) at 362:24-25; RX5058-005 (Hood Decl.) at ¶ 11.) It includes a popular multiplayer mode and has produced a large community across platforms. (Dkt. No. 282, 6/22/23 Tr. (Booty) 77:23–78:1.) At the time of the Mojang acquisition, *Minecraft* was available on Xbox, PlayStation, and PC. (*Id.* at 78:2–7.) While **Microsoft** had the ability to make *Minecraft* exclusive, it continued to ship *Minecraft* on all those same platforms post-acquisition and made subsequent games in the franchise (*e.g., Minecraft: Dungeons* and *Minecraft: Legends*) available for Nintendo consoles and even Sony's subscription service, PlayStation Plus. (*Id.* at 78:11-79:4; 6/23/2023 (Spencer) at 421:8-423:1; RX3156.) Xbox CFO Tim Stuart explained the decision to ship *Minecraft* on "all platforms" enabled "its mass, mass, mass market" appeal. (Dkt. No. 286, 6/29/23 Tr. (Stuart) at 976:13-977:5.) The decision was dictated by the economics and the desire not to break up existing gamer communities. (Dkt. No. 283, 6/23/23 Tr. (Spencer) at 365:13-15 ("[I]f we were to acquire something that has found customer love, users, business on another platform, we want to nurture and grow that for the games that we're building"); *id.* at 362:24-363:5 (*Minecraft* "has reached a financial level of success where it's – it's a significant profit driver for us given that it's shipping on all the platforms. So if you can get a game that's at that level of hit and that level of business, the size of the business, our job is to maintain and grow that."); RX1137.)

All of the above evidence points to no incentive to foreclose *Call of Duty*—a 20-year multi-platform franchise—from Sony PlayStation.

[Redacted]

The **FTC** disputes this written offer has any relevance to its *prima facie* burden. It contends **Microsoft's** binding offer is a "proposed remedy" that may not be considered until the remedy phase, that is, after a Section 7 liability finding. As support, it again relies on its own 2023 *Illumina* decision. There, relying on *U.S. v. E.I. du Pont de Nemours & Co.*, 366 U.S. 316, 334, 81 S.Ct. 1243, 6 L.Ed.2d 318 (1961), the Commission held such agreements are "proposed remedies," and that the defendants bear the burden of proving "the offered remedy would actually be effective." So, the **FTC** claims it does not have to account for any agreements in its *prima facie* showing. Illumina, Inc. & Grail, Inc., 2023 WL 2823393, at *49-50. But *E.I. du Pont* does not support the Commission's holding. It involved a remedy proposed *after* a finding of a Section 7 violation. The Court held: "once the Government has successfully borne the considerable burden of establishing a violation of law, all doubts as to the remedy are to be resolved in its favor." *E.I. du Pont*, 366 U.S. at 334, 81 S.Ct. 1243. *E.I. du Pont* says nothing about whether the merger-challenging plaintiff must address offered and executed agreements made before any liability trial, let alone liability finding; that is, whether the **FTC** must address the circumstances surrounding the merger as they actually exist. The caselaw that directly addresses the issue contradicts the **FTC's** position. *See* *AT&T*, 916 F.3d at 1041; *UnitedHealth Grp.*, 630 F.Supp.3d at 139–51; ***FTC*** *v. Arch Coal, Inc.*, No. 04-00534, Dkt. No. 67 (D.D.C. July 7, 2004).

Next, the **FTC** insists **Microsoft's** offer is simply insufficient. In so arguing, it relies exclusively on PlayStation CEO Ryan's testimony. (Dkt. No. 291-2, **FTC's** Findings of Fact and Conclusions of Law at pp. 159-160 ¶¶ 787-796.) The **FTC's** heavy reliance on Mr. Ryan's testimony is unpersuasive. Sony opposes the merger; its opposition is understandable. Before the merger Sony paid **Activision** for exclusive marketing rights that allowed Sony to market *Call of Duty* on PlayStation, but restricted Xbox's ability to do the same. (Dkt. No. 282, 6/22/23 Tr. (Bond) at 162:19-165:8.) After the merger, the combined firm presumably will not agree to such restrictions. Before the merger, a consumer wanting to play a *Call of Duty* console game had to buy a PlayStation or an Xbox. After the merger, consumers can utilize the cloud to play on the device of choice, including, it is intended, on the Nintendo Switch. Perhaps bad for Sony. But good for *Call of Duty* gamers and future gamers.

[Redacted]

ii. The FTC's Incentive Evidence is Insufficient

[35] Notwithstanding the overwhelming evidence of the combined firm's lack of incentive to pull *Call of Duty* from PlayStation, the FTC insists it is probable the combined firm will do so because it is in its financial interests.

a. Professor Lee's Opinion

***16** The lynchpin of the FTC's argument is the expert opinion of Professor Robin Lee, an economist. Prof. Lee opines the economic benefits of making *Call of Duty* exclusive to Xbox outweigh the costs. In particular, he concludes removing *Call of Duty* from PlayStation would result in a 5.5% increase in Xbox's share of the Gen 9 console market. (Dkt. No. 226-2, Lee Decl. ¶ 106.) [Redacted]

Prof. Lee's opinion does not dispute the evidence of Microsoft's lack of an economic incentive. His Vertical Foreclosure model depends on two key quantitative inputs: "the customer lifetime value ('LTV') of purchasers of Xbox consoles and the 'Xbox conversion rate.' " (*Id.* at ¶ 103.) Looking at the conversion rate, Prof. Lee uses projected sales data to calculate the number of expected PlayStation purchasers of *Call of Duty* (2025 version) who would instead choose to play *Call of Duty* 2025 on Xbox consoles if not available on PlayStation. From this number he excludes PlayStation owners (1) who already own an Xbox, or (2) would choose to play *Call of Duty* 2025 on PC if not available on PlayStation. The conversion rate is the fraction of remaining purchasers—"affected users"—that would purchase an Xbox console to play *Call of Duty* 2025 if it was not available on PlayStation. (Dkt. No. 226-2, Lee Decl. at ¶¶ 101, 103, 106.)

Prof. Lee's Vertical Foreclosure model *assumes* a conversion rate of 20%. (Dkt. No. 284, 6/27/23 Tr. (Lee) at 559:2-14 ("So with that subset of users I'm assuming 20 percent of them would purchase a new Xbox[ ]."); *id.* at 560:2-4 (agrees the 20% rate was not computed but instead was just inputted into the model).) So, the 20% figure is not based on evidence—it is an assumed input. Accepting Prof. Lee's LTV of 40%, even lowering the conversion rate just a bit, to say 17.5%, means Prof. Lee's model estimates it would **not** be profitable to withhold *Call of Duty* from PlayStation; that is, the costs in lost PlayStation *Call of Duty* sales outweigh the benefits of more Xbox console sales. This relationship is reflected in Figure 11 from Prof. Lee's report reproduced below:

[Redacted]

[Redacted]

Prof. Lee attempts to defend the reasonableness of his 20% assumption by identifying evidence he contends supports his model's output—the 5.5% share shift. In other words, the 20% assumption must be correct because other evidence supports the model's result. In his direct testimony Prof. Lee identified two pieces of support: (1) an internal 2019 Microsoft strategy memo regarding a potential acquisition, and (2) his share model output. (Dkt. No. 226-2 ¶ 106.) Neither supports his 20% conversion rate assumption.

First, the Microsoft memo states in a parenthetical: "an exclusive AAA release accounts for a 2-4% console share shift in the US and a 1-3% shift worldwide." (PX1136-004). Prof. Lee's reliance on this memo snippet is misplaced. What—if any—data is behind the statement? Who came up with those figures? How were they measuring share shift? Shift from what console(s) to what console(s)? And, were those numbers addressing a new first-party game being released exclusively? Or was the author discussing taking a long-standing multiplatform cross-play game, like *Call of Duty*, exclusive. Prof. Lee does not know. Further, only the global share shift matters in Prof. Lee's model. The memo snippet, for whatever it is worth, posits a 1% to 3% share shift globally. Prof. Lee testified a 2% share shift would **not** make it economically beneficial to make *Call of Duty* exclusive to Xbox consoles; thus, the slide does not support Prof. Lee's 20% conversion rate input. (Dkt. No. 284, 6/27/23 Tr. (Lee) at 581:1-7.) [6]

***17** Second, Prof. Lee points to his share model. (Dkt. No. 226-2, Lee Decl. at ¶ 106.) He says this model results in an 8.6% share shift; therefore, the more conservative 5.5% share shift output from his Vertical Foreclosure model is reasonable. But the share model output is also flawed. As a preliminary matter, it is based on Gen 8 console data from only the United

States, rather than global Gen 9 data. But putting that aside, as Dr. Carlton observed, Prof. Lee's share model "ignores the presence of non-exclusive games in influencing console choice" even though Prof. Lee acknowledges non-exclusive games do influence console choice. (Dkt. No. 294-2, Carlton Decl. at ¶¶ 26-27.) Prof. Lee's reply report's attempt to fix this error fails because he again accords no value to non-exclusive games in consumer choice. (*Id.* at ¶¶ 29-30.) Further, Dr. Carlton also contends Prof. Lee's share model assumes every lost PlayStation 4 results in an additional Xbox sale, even though consumers may choose a different device to play *Call of Duty* (PC, mobile, cloud) or to not play *Call of Duty* on any device at all. (*Id.* at ¶¶ 32-34.) When Dr. Carlton corrects for this error, Prof. Lee's share model is between 1% and 54% of what Prof. Lee predicts and thus does not support his critical 20% conversion rate. (*Id.* at ¶ 35.)

And what does Prof. Lee say about Dr. Carlton's criticism? Nothing in his direct testimony. (*See* Dkt. No. 262-2, Lee Decl.) At the evidentiary hearing on re-direct? Nothing. (Dkt. No. 284, 6/27/23 Tr. (Lee) at 615:9-651:22.) And when the **FTC** cross-examined Dr. Carlton on his written direct testimony? Again, nothing. (Dkt. No. 285, 6/28/23 Tr. (Carlton) at 855:6-898:1.) The **FTC** chose not to challenge, or even address, Dr. Carlton's identification of material flaws in Prof. Lee's share model. The criticism thus stands unscathed —and persuasive. So, the share model does not justify Prof. Lee's reliance on the strategy memo snippet reporting console shares move 1% to 3% globally with exclusive AAA content.

[Redacted]

[Redacted] But Prof. Lee's assumption as to what was being measured was wrong. The slide does not support his conversion rate. In any event, before Prof. Lee could persuasively opine the "pivotal" conversion rate is supported by a survey result, he would need to be familiar with the survey and its design. As his testimony showed, he was not.

Dr. Lee's opinion suffers from several additional weaknesses. It fails to consider **Microsoft's** agreement with Nintendo and the cloud streaming services to provide ongoing access to *Call of Duty*—all of which will increase access. It also fails to consider **Microsoft's** offer to Sony. Nor did he consider any reputational harm to **Microsoft** from pulling *Call of Duty* from millions of players. Regardless, for the reasons explained, his opinion does not show the combined firm will probably have an economic incentive to withhold *Call of Duty* from PlayStation. He simply assumed a concession rate for his model that would make exclusivity profitable, but there is no evidence to support that assumption.

b. ZeniMax

While the **FTC** asserts **Microsoft's** 2014 *Minecraft* acquisition is not relevant to how it will treat *Call of Duty*, it insists **Microsoft's** 2021 acquisition of ZeniMax is predictive of how the combined firm will behave. Specifically, although **Microsoft's** deal valuation shared with the Board of Directors contemplated keeping ZeniMax content multiplatform, it later decided to make two new ZeniMax titles—*Starfield* and *Redfall*—exclusive. Agreed this evidence shows **Microsoft's** deal valuation for the **Activision** acquisition is not dispositive of the incentive question. But it does not dispute the evidence that **Microsoft** does not have an incentive to withdraw *Call of Duty* from PlayStation. Neither *Starfield* nor *Redfall* are remotely similar to *Call of Duty. Starfield* is a role-playing game that has not been released. *Redfall* is a first-person shooter game that was only released in May 2023.

The question is whether it makes financial sense to wrest *Call of Duty* from PlayStation. [Redacted]

c. Effect on Innovation

The **FTC** also insists the merger will decrease innovation because game developers and publishers will not want to work with **Microsoft**. But the only evidence the **FTC** identifies is Sony's reluctance to share its intellectual property with **Microsoft** and provide development kits for its consoles. But this is not merger-specific and it fails to account for all the other developers who might now be incentivized to collaborate with Xbox or one of its studios like **Activision** or Bethesda. *Cf. UnitedHealth Grp.*, 630 F. Supp. 3d at 151 ("The Government did not call a single rival payer to offer corporate testimony that it would innovate less or compete less aggressively if the proposed merger goes through. Nor did any of the rival payer employees who did testify support the Government's theory.") Protecting Sony's decision to delay collaboration with **Microsoft** and therefore PlayStation users' access to **Microsoft's** content is not pro-competitive.

d. Partial Foreclosure

***18** Finally, in its reply brief in support of its preliminary injunction motion (but not its original moving papers), and throughout the evidentiary hearing, the **FTC** alluded to the possibility of partial foreclosure. Partial foreclosure might involve releasing *Call of Duty* later on PlayStation than Xbox, or having a *Call of Duty* Christmas character in the Xbox version, but not the PlayStation version. (*See* Dkt. No. 286, 6/29/23 Tr. (Closing) at 1100:2-4, 1100:17-23.) Or it could be technologically degrading the players' experience on one console versus another. (PX5000-181 (Lee Report) at ¶ 477.)

But the **FTC** has no expert testimony to support a finding the combined firm would have the incentive to engage in such conduct. Prof. Lee did not engage in any quantitative analysis of partial foreclosure. Anyway, under the **FTC's** theory, the goals of full and partial foreclosure are the same: move enough PlayStation users to Xbox such that the benefits to the combined firm outweigh the costs. If the **FTC** has not shown a financial incentive to engage in full foreclosure, then it has not shown a financial incentive to engage in partial foreclosure.

Moreover, Mr. Kotick testified he was unaware of a developer intentionally developing a "subpar game for one platform versus another." (Dkt. No. 285, 6/28/23 Tr. (Kotick) at 728:2–6.) Such conduct would obviously draw "vitriol from gamers that would be well deserved," and would "cause reputational damage to the company." (*Id.* at 727:20–22.) Consistent with that testimony, the record does not include any evidence **Microsoft** has engaged in such conduct in the past—even with Sony. [Redacted] The **FTC's** partial foreclosure theory fails.

***

In sum, the **FTC** has not shown a likelihood of success on its theory the merger may substantially lessen competition in the Gen 9 console market because the combined firm will have the ability and incentive to foreclose *Call of Duty* from PlayStation. While it is possible, *Call of Duty's* long history as a highly popular, multiplatform cross-play game make that result not probable. The Court has focused on *Call of Duty*, rather than other **Activision** AAA content, because the **FTC's** evidence focused on this one game. While other games, such as *Diablo*, are certainly popular, the **FTC** did not offer evidence that if *Call of Duty* remains multiplatform in the console market, making *Diablo* or other **Activision** titles exclusive to Xbox would probably substantially lessen competition in that market.

b. The Remaining Markets

For purposes of the library subscriptions services market and the cloud streaming market, which Dr. Lee refers to collectively as the "Gaming Services Market," the **FTC** contends the merger will probably have anticompetitive effects because **Microsoft** would (1) have a greater economic incentive to engage in foreclosure than an independent **Activision**; and (2) "would likely have the economic incentive to engage in foreclosure." (Dkt. No. 226-2 at ¶¶ 7, 189).

[36] As a threshold matter, the question is not whether **Microsoft** following the merger is more likely to engage in foreclosure than an independent **Activision**. The question is whether "the proposed merger is likely to substantially lessen competition, which encompasses a concept of 'reasonable probability.' " *AT&T*, 916 F.3d at 1032. As **Microsoft** notes, "a vertically integrated firm's incentives are *always* more complex in that respect than the standalone incentives of its components. In other words, if this merger could be condemned simply because the combined company would derive *some* economic benefit from withholding, *any* vertical merger could be condemned on the same ground, despite the indisputable pro-competitive effects of many vertical mergers." (Dkt. No. 292-2, COL at ¶ 152 (emphasis in original).) Accordingly, to prevail on its preliminary injunction motion, the **FTC** must demonstrate a likelihood of success on its assertion there is a reasonable probability the proposed merger will substantially lessen competition in the library subscription services market and cloud streaming market.

(i) Library Subscription Services Market

***19** **[37]** The **FTC** argues Xbox will include *Call of Duty* in its Game Pass library subscription service, but refuse to include it in rival services. This exclusion, it contends, will lessen competition in that market and make it likely Xbox will increase the Game Pass price. (Dkt. No. 291-2, **FTC's** Findings and Conclusions at p. 138 ¶¶ 659, 661.)

It is undisputed the combined firm has significant financial incentives to include *Call of Duty* in Game Pass. (*See* PX1763-013; PX2138-001.) The Court accepts for preliminary injunction purposes it is likely *Call of Duty* will be offered exclusively on Game Pass, and not offered on rival subscription services. The countervailing incentives that exist in the console market—longstanding multiplatform availability, cross-play, historically high revenue from games sold—do not apply to the subscription market since *Call of Duty* is not and never has been offered (in any significant sense) on a multigame library subscription service. (Dkt. No. 285, 6/28/23 Tr. (Kotick) at 731:5-7.) But the record does not support a finding of a serious question as to whether *Call of Duty* Game Pass exclusivity will probably substantially lessen competition in the subscription services market.

First, the merger has the procompetitive effect of expanding access to *Call of Duty.* Adding *Call of Duty* to Game Pass gives consumers a new, lower cost way to play the game day and date. (RX3166-016.) Further, Dr. Carlton explains how adding *Call of Duty*, and **Activision** content in general, will actually lower costs for many game consumers and harm none. (RX5056 (Carlton Report) at ¶¶ 141-142.) Dr. Carlton also opines "the merger can be expected to result in an increased incentive to invest in game development than would occur otherwise" because "adding [*Call of Duty*] to Game Pass will result in an increase in the number of Game Pass users, [and] that increase gives **Microsoft** more incentive to invest in other games, not just **Activision** games." (*Id.* at ¶ 144); *see* *Chi. Pro. Sports Ltd. P'ship v. NBA*, 95 F.3d 593, 597 (7th Cir. 1996) ("The core question in antitrust is output."); ***FTC*** *v. Univ. Health, Inc.*, 938 F.2d 1206, 1222 (11th Cir. 1991) ("[W]hether an acquisition would yield significant efficiencies is an important consideration in predicting whether the acquisition would substantially lessen competition.").

Second, the **FTC** does not identify evidence that disputes these procompetitive effects. Prof. Lee admits "Exclusivity can have both pro and anticompetitive effects." (Dkt. No. 284, 6/27/23 Tr. (Lee) at 603:8; *see* Dkt. No. 226-2, Lee Decl. at ¶¶ 113, 132.) Yet he did not perform any quantitative analysis to estimate whether adding *Call of Duty* to Game Pass, and not other subscription services, will injure competition. Will some people subscribe to Game Pass because of *Call of Duty*? Yes. But there is no analysis of how many, or how it will affect competition with Game Pass competitors such as Amazon, Electronic Arts, Ubisoft and Sony. (Dkt. No. 284, 6/27/23 Tr. (Lee) at 638:11–15 (Lee testifying cloud gaming and content library services are "both relatively nascent and new compared to consoles, and the lack of really good data for these services made it very difficult to perform something that I would view as reliable that's quantitative for those markets."); RX5056 (Carlton Report) at ¶ 138.)

***20** The **FTC's** primary argument appears to be that even without the merger, **Activision** will contract to put its content, including *Call of Duty*, on subscription services. The record evidence is to the contrary. **Activision** believes it is not in its financial interest to do so because it would cannibalize individual sales. (Dkt. No. 285, 6/28/23 Tr. (Kotick) at 744:10-11.) Kotick cannot imagine a subscription service agreeing to the financial terms **Activision** would require to make it a financial win for **Activision**. (*Id.* at 752:17-19, 752:8-11.) [Redacted]

Consistent with Mr. Kotick's testimony, in 2020 Xbox attempted to negotiate placing certain **Activision** titles on Game Pass. **Activision** refused. (Dkt. No. 285, 6/28/23 Tr. (Kotick) at 751:1-8.) [Redacted] And **Activision** has no plans to put its content on a game library subscription service. (Dkt. No. 285, 6/28/23 Tr. (Kotick) at 729:3-7, 746:19-21.) The **FTC** does not offer any explanation, let alone evidence, as to why it would be financially beneficial for **Activision** to change its long-held stance on subscription services.

In sum, the **FTC** has not raised serious questions on whether the merger will probably substantially lessen competition in the game library subscription services market.

(ii) Cloud Streaming Market

[38] The **FTC** has also failed to show a likelihood of success on its claim the merger will probably lessen competition in the cloud gaming market because the combined firm will foreclose **Activision's** content, including *Call of Duty*, from cloud-gaming competitors. This argument is foreclosed by **Microsoft's** post-**FTC** complaint agreements with five cloud-streaming providers. Before the merger, there is no access to **Activision's** content on cloud-streaming services. After the merger, *several* of **Microsoft's** cloud-streaming competitors will—for the first time—have access to this content. The merger will enhance, not lessen, competition in the cloud-streaming market.

At trial the **FTC** argued that the cloud-streaming competitors based outside the United States should not be considered because their servers are likely outside the United States and thus their cloud services are not effective for United States consumers. But the **FTC** is merely guessing; **Microsoft** has offered evidence that "Boosteroid (a Ukrainian company) has gaming servers in Pennsylvania, North Carolina, Texas, Illinois, Florida, Washington." (Dkt. No. 292-2, Defendants' Findings of Fact and Conclusions of Law (Defs' Findings and Conclusions) p. 138 ¶ 163.) [Redacted]

The **FTC's** response, again, is that an independent **Activision** would agree to put its content on cloud-gaming services. But, again, it offers no quantitative evidence to support this bald assertion; Prof. Lee did not model the cloud gaming market. And, the fact is, **Activision** content is not currently on any cloud-streaming service. And it is not likely to be available absent the merger. (*See* Dkt. No. 285, 6/28/23 Tr. (Kotick) at 731:15–18; *id.* at 753:13–15.) **Activision** previously pulled *Call of Duty* from GeForce NOW following beta testing. (*Id.* at 754:1-5.) And it has not been on a cloud-streaming service since. The **FTC** has not shown it is likely an independent **Activision** would do what **Microsoft** has agreed to do by contract *See* *Tenneco, Inc. v.* ***FTC***, 689 F.2d 346, 354 (2d Cir. 1982) (rejecting the **FTC's** "unsupported speculation" "Tenneco would have entered the market ... absent its acquisition of Monroe"); *Fruehauf Corp. v.* ***FTC***, 603 F.2d 345, 355 (2d Cir. 1979) (rejecting the **FTC's** theory of anticompetitive effects as "based on speculation rather than fact").

***21** Finally, the **FTC** argues the cloud-streaming agreements are irrelevant to its *prima facie* showing as they are mere "proposed remedies." The Court's analysis as to the Sony proposal, *infra* at Section II.B.2.a.i, applies equally to the cloud-streaming agreements. Indeed, it has even more force here where the competitor—Nvidia and others—have actually entered into the agreements. The Court cannot ignore this factual reality. The combined firm will probably not have an incentive to breach these agreements and make **Activision** content exclusive to xCloud.

3. FTC's *Brown Shoe* Foreclosure Theory

[39] Alternatively, the **FTC** argues that it has established a likelihood of success on its theory that under "the *Brown Shoe* functional liability factors," the proposed merger's "very nature and purpose" is anticompetitive, there is a "trend toward concentration in the industry," and the merger would "increase entry barriers in the Relevant Markets." (Dkt. No. 291-2), **FTC's** Findings and Conclusions at pp. 181-182 ¶¶ 95-99 (citing *Brown Shoe*, 370 U.S. 294 at 329–30, 82 S.Ct. 1502.) As an initial matter, the **FTC** made no reference to this theory in its opening statement or closing argument. Nor is it discussed by Dr. Lee's expert report; he addressed only **Microsoft's** ability and incentive to foreclose.

As to the theory's merits, the **FTC** does not make any new arguments not considered above. The **FTC** maintains the "[p]roposed Acquisition's purpose is to transform an independent, 'platform-agnostic' source of supply into a captive one controlled exclusively by **Microsoft**," (*Id.* at pp. 181-182 ¶ 95), but this would be true in any vertical merger and does not explain why it demonstrates an anticompetitive purpose. Likewise, while the **FTC** argues **Microsoft's** "past conduct following similar transactions also demonstrates its likely anticompetitive nature," presumably referring to the ZeniMax acquisition, this ignores the Mojang/*Minecraft* acquisition. (*Id.*) To the extent the **FTC** relies on a "trend toward further concentration in the industry" (*Id.* at p. 182 ¶ 96), it fails to explain how this trend is anticompetitive here —**Microsoft's** investment in game developers and publishers allows for increased innovation in content and **Microsoft** has prioritized a "content pipeline." (PX1154-001.)

***

In sum, the **FTC** has not raised serious questions regarding whether the proposed merger is likely to substantially lessen competition in the console, library subscription services, or cloud gaming markets. As such, the **FTC** has not demonstrated a likelihood of ultimate success as to its Section 7 claim based on a vertical foreclosure theory.

III. BALANCING OF THE EQUITIES

[40] Because the **FTC** has not demonstrated a likelihood of ultimate success on the merits, the Court need not proceed to the balance of equities question. *See* *United States v. Siemens Corp.*, 621 F.2d 499, 506 (2d Cir. 1980). The Court finds, however, that even if the **FTC** had met its burden, the balance of equities do not fall in its favor. The **FTC** correctly notes private equities, such as the potential skuttling of the merger if it does not close by July 18, "cannot on its own overcome the public equities that favor the **FTC**." ***FTC*** *v. Wilh. Wilhelmsen Holding ASA*, 341 F. Supp. 3d 27, 73-74 (D.D.C. 2018); *see also* *Warner*, 742 F.2d at 1165 ("When the Commission demonstrates a likelihood of ultimate success, a countershowing of private equities alone does not justify denial of a preliminary injunction").

But the balancing of equities is not a pointless exercise. In *Warner*, for example, the Ninth Circuit observed "public equities may include beneficial economic effects and pro-competitive advantages for consumers." *Id.* at 1165 (cleaned up). Because in that case the record contained "conflicting evidence on the anticompetitive effects of the merger," the Ninth Circuit held it was unclear whether those public equities supported the grant or denial of the preliminary injunction. *Id.* It nonetheless held the public equities outweighed the private because the Commission would be denied effective relief if it ultimately prevailed and ordered divestiture. The court reasoned: "Since the proposed joint venture calls for Polygram to dismantle its distribution operations, it would be exceedingly difficult for Polygram to revive the operations to comply with a divestiture order." *Id.*

***22** Here, at best "the record contains conflicting evidence on the anticompetitive effects of the merger"; thus, the **FTC** cannot point to beneficial economic effects as a public equity. *Id.* Moreover, the administrative trial before the ALJ commences on August 2, in just a few weeks. By pre-existing contract, *Call of Duty* will remain on PlayStation through the end of 2024. There will be no foreclosure of *Call of Duty* pending the ALJ's decision. Gamers will be able to play just as they always have.

The **FTC** insists the difficulty in ordering post-acquisition divestiture is the public equity that prevails. (Dkt. No. 291-2, **FTC's** Findings and Conclusions at p. 194-195 ¶ 153.) But it does not cite anything specific about this merger to support that assertion. It is a vertical acquisition. **Microsoft** and **Activision** will act as parent and subsidiary. There is no planned dismantling of operations, as in *Warner.* What exactly about the merger would make it difficult to order an effective divestiture? The **FTC** does not say. Its argument, at bottom, is the equities always weigh in favor of a preliminary injunction. But that argument ignores the law. So, the balance of equities is a separate, independent reason the **FTC's** motion must be denied.

CONCLUSION

Microsoft's acquisition of **Activision** has been described as the largest in tech history. It deserves scrutiny. That scrutiny has paid off: **Microsoft** has committed in writing, in public, and in court to keep *Call of Duty* on PlayStation for 10 years on parity with Xbox. It made an agreement with Nintendo to bring *Call of Duty* to Switch. And it entered several agreements to for the first time bring **Activision's** content to several cloud gaming services.

This Court's responsibility in this case is narrow. It is to decide if, notwithstanding these current circumstances, the merger should be halted—perhaps even terminated—pending resolution of the **FTC** administrative action. For the reasons explained, the Court finds the **FTC** has not shown a likelihood it will prevail on its claim this particular vertical merger in this specific industry may substantially lessen competition. To the contrary, the record evidence points to more consumer access to *Call of Duty* and other **Activision** content. The motion for a preliminary injunction is therefore DENIED.

This Opinion constitutes the findings of fact and conclusions of law required by Federal Rule of Civil Procedure 52. Given the compressed time the Court had to issue a written opinion in light of the impending termination date, there will likely be errors in the citations. And, for the same reason, the Opinion does not address every argument the **FTC** makes in its 196-page post-trial submission, nor cite every piece of evidence supporting the Court's findings. Because the decision on the **FTC's** request for a preliminary injunction "effectively terminate[s] the litigation and constitute[s] a final order," this case is DISMISSED. *See **FTC** v. Hackensack Meridian Health, Inc.*, 30 F.4th 160, 165 n.2 (3d Cir. 2022). The Court **MODIFIES** its temporary restraining order such that the temporary restraining order will **dissolve at 11:59 p.m. on July 14, 2023** unless the **FTC** obtains a stay pending appeal from the Ninth Circuit Court of Appeals.

This Opinion is filed under seal. At the same time it is filed, the Court will file a redacted version under seal. In an abundance of caution, it is overly redacted. The parties shall meet and confer with the non-parties, and on or before July 18, 2023, submit a new proposed redacted version of this Opinion.

***23 IT IS SO ORDERED.**

All Citations

--- F.Supp.3d ----, 2023 WL 4443412

Footnotes

1 Exhibit citations are to the exhibit number and the page number associated with the exhibit number. For hearing testimony, the Court has endeavored to include citations to the associated docket number. Other record citations are to material in the Electronic Case File ("ECF") with pinpoint citations to the ECF-generated page numbers at the top of the documents.

2 [footnote text missing]

3 Shortly after the **FTC** filed its administrative complaint, a group of *Call of Duty* players filed their own action in this Court to stop the merger pursuant to Clayton Act, Sections 7 and 16. *Demartini et al. v. **Microsoft** Corp.*, No. 22-08991-JSC. In that action, **Microsoft** stipulated on the record that the acquisition would not close before May 22, 2023. (Dkt. No. 193 at 87:2-12.)

4 "[A] dearth of authority that is unsurprising, considering that the Antitrust Division apparently has not tried a vertical merger case to decision in *four* decades!" *United States v. AT&T Inc.*, 310 F. Supp. 3d 161, 193–94 (D.D.C. 2018), *aff'd*, 916 F.3d 1029 (D.C. Cir. 2019) (emphasis in original).

5 The HMT is a common quantitative metric used by parties and courts to determine relevant markets. *See* U.S. Dep't of Justice & **FTC**, Horizontal Merger Guidelines ("2010 Merger Guidelines") § 4 (2010); *see also* *United States v. H & R Block, Inc.*, 833 F. Supp. 2d 36, 51 (D.D.C. 2011) ("An analytical method often used by courts to define a relevant market is to ask hypothetically whether it would be profitable to have a monopoly over a given set of substitutable products. If so, those products may constitute a relevant market."). Defendants insist the HMT does not apply to vertical mergers. The Court need not decide this issue as it accepts, without deciding, the **FTC's** definition of the relevant markets here.

6 Undaunted, Prof. Lee insists even the 2-3% share shift is consistent with his 5.5% estimate because *Call of Duty* has such high sales compared to other AAA titles, so *Call of Duty's* share shift will be higher. (Dkt. No.226-2, Lee Decl. at ¶¶ 32, 104; Dkt. No. 291-2, **FTC's** Findings and Conclusions at pp. 100-101 ¶ 499.) That circular assertion, however, relies upon his share model which, discussed next, is flawed.

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IN THE SUPREME COURT OF THE STATE OF DELAWARE

IN RE FOX CORPORATION /SNAP INC. SECTION 242 LITIGATION	§	Nos. 120 &121, 2023 (Consolidated)
	§	Court Below: Court of Chancery of the State of Delaware
	§	C.A. Nos. 2022-1007; 2022-1032

Submitted: October 18, 2023
Decided: January 17, 2024
Revised: January 25, 2024

Before **SEITZ**, Chief Justice; **VALIHURA**, **TRAYNOR**, **LEGROW**, and **GRIFFITHS**, Justices; constituting the Court *en Banc*.

Upon appeal from the Court of Chancery. **AFFIRMED**.

Gregory V. Varallo, Esquire, Daniel E. Meyer, Esquire, BERNSTEIN LITOWITZ BERGER & GROSSMANN LLP, Wilmington, Delaware; Mark Lebovitch, Esquire, Edward G. Timlin, Esquire (*argued*), BERNSTEIN LITOWITZ BERGER & GROSSMANN LLP, New York, New York *for Appellants Electrical Workers Pension Fund, Local 103, I.B.E.W. and Karen Sbroglio*.

William B. Chandler III, Esquire, Brad D. Sorrels, Esquire (*argued*), Amy L. Simmerman, Esquire, Daniyal M. Iqbal, Esquire, Nora M. Crawford, Esquire, WILSON SONSINI GOODRICH & ROSATI, P.C., Wilmington, Delaware; Mark R. Yohalem, Esquire, WILSON SONSINI GOODRICH & ROSATI, P.C., Los Angeles, California *for Appellee Fox Corporation*.

William M. Lafferty, Esquire, Susan W. Waesco, Esquire, Alexandra M. Cumings, Esquire, MORRIS, NICHOLS, ARSHT & TUNNELL LLP, Wilmington, Delaware *for Appellee Snap Inc.*

SEITZ, Chief Justice:

Section 242(b)(2) of the Delaware General Corporation Law requires a separate class stockholder vote to amend a corporate charter with a multi-class capital structure if the amendment would "alter or change the powers, preferences, or special rights of the shares of such class so as to affect them adversely." In 2022, Fox Corporation and Snap Inc. adopted officer exculpation charter amendments authorized by recent Delaware legislation. Fox and Snap Class A non-voting common stockholders filed suit in the Court of Chancery and sought to invalidate the amendments. They claimed that a separate class vote was required because the amendments deprived them of the "power" to sue officers for damages for duty of care violations.

The Court of Chancery granted summary judgment to Fox and Snap. The court held that, even though the Class A stockholders had a good plain-meaning argument – a stockholder's "power" included the power to sue – the defendants had linked the "powers" in Section 242(b)(2) to the "powers" in Section 102 of the DGCL, which requires those "powers" to be stated in the charter. The right to sue corporate officers for damages for breach of the duty of care is not a class-based power stated in either charter. Thus, the Fox and Snap exculpatory charter amendments did not require separate Class A stockholder votes.

Although the court had reservations about this interpretation, it ultimately held that two decisions controlled the outcome – *Hartford Accident & Indemnity Co. v. W.S. Dickey Clay Mfg. Co.* and *Orban v. Field*.[1] In these long-standing decisions that interpreted the charter amendment statute in its various forms, our Court and the Court of Chancery held that a separate class stockholder vote was required only when the charter amendment adversely affected a peculiar attribute of the class of stock rather than rights incidental to stock ownership. Finally, the Court of Chancery noted the lack of treatises or commentary supporting the plaintiffs' position, and long-standing practitioner understanding about how the statute works.

On appeal, the plaintiffs repeat their plain-meaning argument, challenge the precedential value of the two key decisions, and advance parts of the Court of Chancery's analysis that it ultimately decided not to follow. We affirm the Court of Chancery's judgment. Based on long-standing precedent, which the Class A Stockholders have not asked us to overrule, the powers, preferences, or special rights of class shares in Section 242(b)(2) refers to the powers, preferences, or special rights authorized for a class by Section 151(a) and expressed in the charter as required by Sections 102(a)(4) and 151(a). The powers, preferences, or special rights of class shares expressed in the charter include default provisions in the

[1] 24 A.2d 315 (Del. 1942) [hereinafter *Dickey Clay*]; 1993 WL 547187 (Del. Ch. Dec. 30, 1993) [hereinafter *Orban*].

DGCL, which are part of every charter under Section 394. The ability to sue directors or officers for duty of care violations is an attribute of the Companies' stock, but not a power, preference, or special right of the Class A common stock under Section 242(b)(2).

I.

A.

The facts are undisputed. In 2019, through a spin-off from its former corporate parent, News Corporation, Fox Corporation became a standalone, publicly traded company. Since the transaction closed, Fox has had a dual-class stock structure. Fox's Class B common stockholders have one vote per share. Fox's Class A common stockholders have no voting rights, except as stated in Fox's certificate of incorporation or when required by the Delaware General Corporation Law ("DGCL").

At Fox's 2022 annual meeting, the board recommended a charter amendment that would exculpate Fox's officers for duty of care damages liability under the newly amended Section 102(b)(7) of the DGCL ("Fox Amendment"). Fox's Class B common stockholders voted to approve the amendment. Fox did not solicit a vote from the Class A common stockholders.

The story was the same for Snap Inc. (f/k/a Snapchat Inc.), which has had a three-class stock structure since its IPO in March 2017. Snap's Class A common stock – which is widely held and publicly available – generally has no power to vote, except as set forth in Snap's certificate of incorporation or when required by Delaware law. Snap's Class B common stock is entitled to one vote per share and is not publicly traded. Snap's Class C common stock has ten votes per share and is not publicly traded.

On August 24, 2022, Snap's board recommended a charter amendment that would exculpate Snap's officers from duty of care damages liability under the newly amended Section 102(b)(7) of the DGCL ("Snap Amendment"). Snap's Class C common stockholders executed written consents adopting the amendment. The Class A stockholders did not vote on the amendment.

B.

In November 2022, a Fox Class A stockholder and a Snap Class A stockholder ("Class A Stockholders") filed separate class action complaints in the Court of Chancery which were eventually consolidated against Fox and Snap (together, the "Companies"). They sought, among other things, a declaration that the charter amendments did not comply with Section 242(b)(2) and were invalid. The parties brought cross-motions for summary judgment, each offering a different interpretation of Section 242(b)(2).

Section 242(b)(2) states, in part, that:

> The holders of the outstanding shares of a class shall be entitled to vote as a class upon a proposed amendment, whether or not entitled to vote

> thereon by the certificate of incorporation, if the amendment would increase or decrease the aggregate number of authorized shares of such class, increase or decrease the par value of the shares of such class, or alter or change the *powers, preferences, or special rights of the shares of such class* so as to affect them adversely.[2]

The Class A Stockholders claimed that Section 242(b)(2) unambiguously required a class vote before adopting the exculpatory charter provisions.[3] As they argued, stockholders have three fundamental "powers" – to vote, sell, and sue. A power, according to Black's Law Dictionary, includes "[t]he ability to act or not act[.]"[4] It follows, they claimed, that "powers" includes the ability to sue officers for damages for duty of care violations.

The Class A Stockholders also relied on a prior version of Section 242 and its predecessor statute, Section 26.[5] The prior iterations of Section 242(b)(2) required a vote if an amendment would adversely affect the "preferences, special rights or powers" of a class of stock. A 1969 amendment to the statute, which brought Section 242(b)(2) to its current form, rearranged the language "preferences, special rights or

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[2] 8 *Del. C.* § 242(b)(2) (emphasis added).

[3] Pls.' Omnibus Opening Br. in Supp. of Mots. for Summ. J. at 10–19 [hereinafter Pls.' Opening MSJ].

[4] *Id.* at 13 (citing *Power*, Black's Law Dictionary (11th ed. 2019); *Power*, Merriam-Webster (last visited Nov. 29, 2022), https://www.merriam-webster.com/dictionary/power; *Strougo v. Hollander*, 111 A.3d 590, 595 n.21 (Del. Ch. 2015)).

[5] *Id.* at 15; 8 *Del. C.* § 242(d)(2) (1967) ("If any proposed amendment would alter or change the preferences, special rights or powers given to any one or more classes of stock by the certificate of incorporation, so as to affect such class or classes of stock adversely . . . ."); *Del. Rev. C.* § 2058, sec. 26 (1935) ("[T]hat if any such proposed amendment would alter or change the preferences, special rights or powers given to any one or more classes of stock, by the Certificate of Incorporation, so as to affect such class or classes of stock adversely . . . .").

powers" to "powers, preferences, or special rights[.]" The Class A Stockholders argued that this change removed any ambiguity and clarified that "powers" was not cabined to "some unique or 'special' power or right allocated to the class of security at issue."[6]

Even if the court found that "powers" is susceptible to more than one meaning, the Class A Stockholders claimed that "powers" should be read in the context of the DGCL as a whole.[7] They pointed to other code sections that employed the word "powers" associated with the ability to sue and be sued – Section 121(a) (describing expansive powers of the corporation and its officers, directors, and stockholders); Section 122(2) (describing a corporation's power to sue and be sued); Sections 279 and 291 (describing a trustee's or receiver's power to prosecute suits in the corporation's name); and Section 123 (describing the corporation's power to exercise power respecting securities of other corporations and entities).

Finally, the Class A Stockholders claimed that *Dickey Clay* and *Orban* were "inapposite." As they argued, the "*Dickey Clay* Court merely addressed changes to a capital structure, and not the elimination of a personal power (or even a right) appurtenant to ownership of that stock."[8] The same was true, they claimed, for *Orban*. The Class A Stockholders argued that "the fact 'special rights' are not

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[6] Pls.' Opening MSJ at 15–16.
[7] *Id.* at 17–18.
[8] *Id.* at 22.

implicated by the issuance of a new class of preferred stock that necessarily dilutes the percentage of the company's overall voting shares represented by the common stock is not pertinent to whether a stocks' [sic] 'powers' – which, at a minimum, include the ability to vote, to sell, and to sue – are adversely affected by elimination of the right to sue."[9]

The Companies countered that Sections 242(b)(2), 151(a), and 102(a)(4) – with their overlapping use of the terms "powers," "preferences," and "special rights" – must be read together.[10] They argue that a contextual reading of Section 242(b)(2) reveals that the statute covers class voting on charter amendments adversely affecting only the special characteristics of the class delineated under Section 151(a). Thus, a stockholder's ability to sue officers for damages for breach of the duty of care is not a power, preference, or special right of shares of a class or series within the meaning of Section 151, which are set forth under Section 102(a)(4).

As for dictionary definitions, the Companies contended that isolating a single word in the statute ignores the words surrounding it. According to the Companies, "powers" is part of a series of words that includes "preferences, or special rights of the shares of such class."[11] The dictionary definitions of those related words include

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[9] *Id.* at 25 (emphasis omitted).
[10] Defs.' Omnibus Opening Br. in Supp. of Mots. for Summ. J. & Answering Br. in Opp. to Pls.' Mots. For Summ. J. at 17–29 [hereinafter Defs.' Opening MSJ].
[11] *Id.* at 23–25.

phrases or terms such as "treating some persons or things more advantageously" and "unusual" or "extraordinary."[12] In their view, "powers" should be interpreted similarly. The Companies argued that the Class A Stockholders ignore the modifying phrase "of the shares of such class," which confirmed that it is the peculiar attributes of the class that must be adversely affected, not rights general to all stockholders.[13]

Finally, the Companies contended that *Dickey Clay* and *Orban* "are the seminal precedents" interpreting Section 242(b)(2), consistent with decades of academic and practitioner understanding and usage.[14] The cases hold that a charter amendment class vote is required only when the proposed amendment adversely affects "the peculiar, unusual, or superior qualities of a particular class."[15] They argued that the Court in *Dickey Clay* "considered and accounted for all the relevant words when declaring its construction of the statute" and did not limit its holding to the corporation's capital structure.[16] Both cases "concerned charter amendments that adversely affected common stockholders' power to vote."[17]

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[12] *Preference*, Black's Law Dictionary (11th ed. 2019); *Special*, Black's Law Dictionary (11th ed. 2019).
[13] Defs.' Opening MSJ at 27–28.
[14] *Id.* at 31–32.
[15] *Id.* at 31.
[16] *Id.* at 33–34.
[17] *Id.* at 34.

C.

The Court of Chancery observed that "there's a lot to be said for the plaintiff's plain-meaning argument[,]" and if it were writing on a blank slate, it would "suggest" that the power to sue for damages was not "readily modifiable" without a separate class vote under Section 242(b)(2).[18] But after the court wrestled with various hypotheticals as it worked through Section 242(b)(2)'s language and how the statute fit into the DGCL as a whole, the court moved past the plain-meaning argument and concluded that "the officer exculpation amendment does not require a class vote of the company's non-voting stock because the officer exculpation amendment does not affect a power, preference, or special right that appears expressly in the charter."[19]

The court based its ruling on four grounds: (1) a textual argument that links the powers, preferences, and special rights in Section 242(b)(2) to the powers, preferences, and rights of the class set forth in the charter or certificate of designations under Section 102(a)(4) or stated expressly in the DGCL;[20] (2) *Dickey Clay* and *Orban*, which held that, under Section 242(b)(2) and its predecessor statute, a class vote is only required to enact a charter amendment when it would

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[18] *Elec. Workers Pension Fund, Local 103, I.B.E.W. v. Fox Corp.*, C.A. No. 2022-1007-JTL at 61, 66 (Del. Ch. Mar. 29, 2023) (TRANSCRIPT) [hereinafter *Decision*].
[19] *Id.* at 69.
[20] *Id.* at 61–63.

impair a "peculiar, or special" characteristic of class shares rather than rights incidental to share ownership;[21] (3) the absence of support for the Class A Stockholders' interpretation from commentators;[22] and that (4) "Delaware practitioners have long viewed *Dickey Clay* as supporting the Companies' reading of Section 242(b)(2)."[23]

The Class A Stockholders raise three issues on appeal – whether the Court of Chancery erred by (1) rejecting the Class A Stockholders' plain-meaning argument that the word "powers" in Section 242(b)(2) includes the ability to sue officers for damages for breaching their duty of care; (2) holding that "fealty" to *Dickey Clay* and *Orban* dictated the outcome; and (3) considering long-standing expectations of commentators and practitioners to support its decision. We review the Court of Chancery's decision *de novo*.[24]

II.

We start with the statutory framework of the DGCL and the precedential gloss addressing class-based stock voting and charter amendments. In 1899, the General Assembly enacted the DGCL which authorized corporations to issue separate classes

[21] *Id.* at 4; *Id.* at 32 (quoting *Dickey Clay*, 24 A.2d at 318–19); *Id.* at 36–37 (quoting *Orban*, 1993 WL 547187, at *8).
[22] *Id.* at 66–67 ("The company has pointed to the absence of any commentary saying anything different over the past decades.").
[23] *Id.*
[24] *See Croda Inc. v. New Castle Cnty.*, 282 A.3d 543, 547 (Del. 2022) ("We review the court's summary judgment ruling *de novo*. We also review questions of statutory interpretation and constitutional law *de novo*.").

of stock with different rights.[25] The General Assembly amended the DGCL in 1901 to permit multi-class capital structures through Section 151's predecessor statute, Section 13.[26] In 1917, the General Assembly enacted the first statute requiring a class vote for stock issuances.[27] Section 26, the predecessor statute to Section 242(b)(2), required a class vote for charter amendments:

> if any such proposed amendment would alter or change the preferences given to any one or more classes of preferred stock, authorized by the certificate of incorporation, or would increase or decrease the amount of the authorized stock of such class or classes of preferred stock, or would increase or decrease the par value thereof.[28]

By Section 26's terms, the "preferences" that triggered a class vote referred to those "authorized by the certificate of incorporation." In 1927, the General Assembly amended Section 26 to eliminate the word "preferred," and thereby broadened the scope of the class voting provision. It also included language limiting the right to vote as a class on a proposed amendment only when it "affect[ed] such class or classes of stock adversely."[29] Section 26 was once again amended in 1931 to the form examined in *Dickey Clay*. It required a separate class vote on a charter amendment:

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[25] Section 137, Chapter 273, Volume 21 Laws of Delaware (enacting the DGCL).
[26] *Id.* (citing Section 13, Chapter 167, Volume 22 Laws of Delaware).
[27] *Hartford Acc. & Indem. Co. v. W. S. Dickey Clay Mfg. Co.*, 21 A.2d 178, 182 (Del. Ch. July 9, 1941) (citing Section 12, Chapter 113, Volume 29 Laws of Delaware).
[28] Section 12, Chapter 113, Volume 29 Laws of Delaware.
[29] Section 10, Chapter 85, Volume 35 Laws of Delaware.

> If any such proposed amendment would alter or change the preferences, special rights or powers given to any one or more classes of stock, by the Certificate of Incorporation, so as to affect such class or classes of stock adversely . . . .[30]

In *Dickey Clay*, the board of directors recommended a charter amendment that increased the amount of authorized class A stock.[31] The common stockholders would not receive dividends until the class A stock was retired.[32] Voting as a class, the class A stockholders approved the amendment – as did a majority of the combined vote of two other classes of preferred and common stock.[33] If counted alone, a majority of the common stock voted against the amendment. A common stockholder filed suit to enjoin the amendment. They argued that, under Section 26, increasing the authorized class A shares adversely affected their rights by diluting their relative voting power, dividends, and assets distributed upon dissolution.[34]

The Court looked to Section 13 and its class-based provisions to discern Section 26's effect on the common stockholders' right to a separate class vote.[35] The

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[30] Section 8, Chapter 129, Volume 37 Laws of Delaware.
[31] *Dickey Clay*, 24 A.2d at 320.
[32] *Id.* at 317.
[33] *Id.*
[34] *Id.* at 320. The class A stockholders also argued unsuccessfully that the amendment was unfair, violated their due process rights under the Delaware and Federal Constitutions, and violated the Contract Clause of the Federal Constitution. *Id.* at 320–21.
[35] *Id.* at 319 (adopting the Court of Chancery's analysis in *Starring v. Am. Hair & Felt Corp.*, 191 A. 887, 890 (Del. Ch. 1937), *decree aff'd*, 2 A.2d 249 (Del.)) ("The Chancellor, in his effort to discover, if possible, the meaning of 'special' shares, was compelled to refer, and did refer, to the language of Section 13 authorizing the issuance of various kinds or classes of shares. His discussion of the language of this section and his conclusions thereupon are particularly apposite here.").

Court held that the amendment did not adversely affect the "preferences, special rights or powers" of the common stockholders. According to the Court, it is only when the "peculiar, or special quality with which [the class shares]" are endowed is adversely affected that a class vote is required:

> The statute, in listing the amendable rights, or rights and powers, attached to stock, first speaks of preferences. It then speaks of rights, and employs specific descriptive words, followed by the general and embracive words, 'other special.' Whatever may be said with respect to the necessity for the use of the word 'special', as applied to a right attached to stock, in view of the prior descriptive words, it is clear enough that the word was used in the sense of shares having some unusual or superior quality not possessed by another class of shares . . . . [T]he relative position of one class of shares in the scheme of capitalization is not to be confused with rights incident to that class as compared with other classes of shares . . . . The peculiar, or special, quality with which they are endowed, and which serves to distinguish them from shares of another class, remains the same.[36]

In other words, even though the charter amendment adversely affected the relative position of the common stock in the corporation's capital structure, a separate class vote was not required because the amendment did not "alter or change preferences, or special rights or powers, given to a class of shares so as to affect adversely the class."[37]

Over two decades after *Dickey Clay*, Section 26 became Section 242(d)(2) as part of the 1967 amendments to the DGCL, without material language changes.[38]

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[36] *Id.*
[37] *Id.* at 320.
[38] Section 242(d)(2), Subchapter 8, Chapter 50, Volume 56 Laws of Delaware.

Contemporaneous commentary from two members of the Delaware Corporation Law Revision Committee, Samuel Arsht and Walter Stapleton, suggested that the changes did not deviate from the historical understanding of Section 26.[39] Professor Folk, who had been engaged by the Revision Committee to recommend amendments to the DGCL, explained that "class voting on amendments adversely affecting *class interests* is intended as a safeguard."[40] The Professor recommended expanding Section 242 to provide a separate "series" vote when less than an entire class is affected by a proposed amendment.[41]

In 1969, the General Assembly amended the statute to take on its modern form, now existing in Section 242(b)(2). The 1969 amendment: moved "[i]f any proposed amendment would alter or change[,]" to after "the holders of the stock . . . shall be entitled to vote as a class upon such amendment[;]" changed "preferences, special rights or powers given to any one or more classes of stock by the certificate of incorporation" to "powers, preferences, and special rights of the shares of such class[;]" and added Professor Folk's suggestion to address series voting.[42] Arsht and Stapleton stated once again that no major changes occurred, and explained that

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[39] *See* S. Samuel Arsht & Walter K. Stapleton*, Analysis of the New Delaware Corporation Law*, 2 P-H Corp. 311, 321 & 337 (1967).
[40] Ernest L. Folk, *Review of the Delaware Corporation Law (1965-1967)*, at 176 (emphasis added) [hereinafter 1967 Folk Report]; Arsht & Stapleton, *supra* note 39, at 337.
[41] 1967 Folk Report at 176–77.
[42] Section 21, Chapter 148, Volume 57 Laws of Delaware.

the 1969 amendment to Section 242(b)(2) "rewords and reorganizes [the] section in an attempt to clarify it" and that the statute would operate just "like the prior one."[43]

In 1993, the Court of Chancery revisited Section 242(b)(2). In *Orban*, the common stockholders argued that they were entitled to a class vote to approve a recapitalization and merger that involved a new class of preferred stock.[44] The new stock issuance diluted the common stock's relative voting power. Chancellor Allen began by noting that "[t]he jurisprudence of class votes in Delaware is not highly developed."[45] Even so, the Chancellor applied this Court's decision in *Dickey Clay* to interpret Section 242:

> The language of [Section 242] makes clear that it affords a right to a class vote when the proposed amendment *adversely affects the peculiar legal characteristics of that class of stock*. The right to vote is not a peculiar or special characteristic of common stock in the capital structure of [the company]. All classes of stock share that characteristic . . . . That this is correct is demonstrated by the important case of [*Dickey Clay*]. There the Delaware Supreme Court held that an amendment increasing the number of authorized preferred shares was not subject to a class vote by common stock. In so concluding the Court held that the stock rights that trigger a statutory right to a class vote are

[43] S. Samuel Arsht & Walter K. Stapleton, *Analysis of the 1969 Amendments to the Delaware Corporation Law*, 2 P-H Corp. 347, 353–54 (1969); *see also* Robert S. Saunders, et al., *Folk on the Delaware General Corporation Law* § 242.03 (7th ed. 2023 supp.) (noting that *Dickey Clay's* construction "still appears applicable, and indeed [S]ection 242(b)(2) codifies the result" (citing *Folk*, § 242 (1st ed. 1972)).
[44] 1993 WL 547187.
[45] *Id.* at *8.

> rights ("powers, preferences or special rights") not shared with other classes . . . .[46]

In other words, the charter amendment did not adversely affect the common stockholders' ability to cast a vote as provided by the corporate charter and the DGCL. Instead, it changed only the relative or incidental voting power associated with their shares.[47] And, as with *Dickey Clay*, the effect of an amendment on an incidental right did not require a vote because such a right was not a "peculiar, or special quality" with which such shares were permitted under Section 151(a).

III.

Against this background, we summarize the Companies' textual argument explaining how the current DGCL provisions that address class-based voting work together. Section 102(a)(4) addresses the contents of a certificate of incorporation, which requires that the "powers, preferences and rights" of class-based stock be set forth in the corporate charter:

> The certificate of incorporation shall also set forth a statement of the designations and the *powers, preferences and rights*, and the qualifications, limitations or restrictions thereof, which are permitted by § 151 of this title in respect of any class or classes of stock or any series of any class of stock of the corporation . . . .[48]

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[46] *Id.* (emphasis in original); *see also Monk v. Imaging Automation, Inc.*, 805 A.2d 902 (Del. Aug. 29, 2002) (ORDER) (recognizing the analysis of Section 242(b)(2)'s applicability was "clearly controlled by this Court's decision in [*Dickey Clay*]. *See also* [*Orban*].").
[47] *Orban*, 1993 WL 547187 at *8 ("According to this argument the issuance of Series C preferred reduced the voting power of the common stock below 10% and this adversely affected the common stock in a foreseeable way . . . .").
[48] 8 *Del. C.* § 102(a)(4) (emphasis added).

Section 102(a)(4) references Section 151, which authorizes class-based stock and its attributes:

> Every corporation may issue 1 or more classes of stock . . . and which classes or series may have such *voting powers*, full or limited, or no voting powers, and such *designations, preferences and relative, participating, optional or other special rights*, and qualifications, limitations or restrictions thereof, as shall be stated and expressed in the certificate of incorporation or of any amendment thereto . . . .[49]

Section 242 addresses amendments to the certificate of incorporation. Section 242(a) authorizes charter amendments and Section 242(b)(1) requires that stockholders approve charter amendments by the affirmative vote of a majority of the outstanding stock entitled to vote on the amendment.[50] Typically, non-voting class-based stock would not have a vote on a charter amendment under Section 242(b)(1), unless otherwise required by the DGCL. But Section 242(b)(2) is an exception which requires a separate class vote of non-voting class shares "if the amendment would . . . alter or change the powers, preferences, or special rights of the shares of such class so as to affect them adversely."

The words "powers," "preferences," and "special rights" are unique to these DGCL statutes.[51] Although the "powers, preferences, or special rights" of a class

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[49] 8 *Del. C.* § 151(a) (emphasis added).

[50] 8 *Del. C.* § 242(b)(1).

[51] "[R]elated statutes must be read together rather than in isolation . . . ." *Richardson v. Bd. of Cosmetology & Barbering of State*, 69 A.3d 353, 357 (Del. 2013) (citing *Watson v. Burgan*, 610 A.2d 1364, 1368 (Del. 1992); *State Farm Mut. Auto. Ins. Co. v. Wagamon*, 541 A.2d 557, 560 (Del. 1988)). This is consistent with the goal to give effect to legislative intent when interpreting a statute. *Id.*; *see Dickey Clay*, 24 A.2d at 319 ("The appellant points out that the Chancellor

are not defined in Section 242(b)(2), it was not by accident that the same sequence of words was used in Sections 151(a) and 102(a)(4). Those sections work together with Section 242(b)(2) to limit the "powers, preferences, or special rights" of a class to those authorized by Section 151(a) and expressed in the charter under Sections 151(a) and 102(a)(4).[52] The "powers, preferences, or special rights" expressed in a charter are those authorized and required to be set forth in the charter by being stated in the charter or by a default provision in the DGCL, which is part of every charter under Section 394.[53] The ability to sue directors or officers for duty of care

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nowhere indicated that Section 26 of the Corporation Law was involved; and, generally, the effect of the decision is waived aside by saying that a different section of the law was under consideration. This is superficial. The [DGCL] must be read and considered in its entirety."); 2A Norman J. Singer, *Sutherland Statutory Construction* § 51:1 (7th ed.); *see also Hudson Farms, Inc. v. McGrellis*, 620 A.2d 215, 218 (Del. 1993) ("[I]t is presumed that the General Assembly is aware of existing law when it acts . . . .").

[52] The Class A Stockholders point out that Section 242(b)(2) does not reference Sections 151(a) and 102(a)(4) and vice versa. Based on this observation, they contend that reading the statutes together produces an "unduly – and incorrectly – cramped" interpretation of "powers." Reply Br. at 13. The reference in Section 102(a)(4) to Section 151 shows that the statutes are related. *Richardson*, 69 A.3d at 357 ("[R]elated statutes must be read together rather than in isolation, particularly when there is an express reference in one statute to another statute." (citing *Watson*, 610 A.2d at 1368)). The lack of a cross reference to Section 242(b)(2) does not create the negative inference that the statutes are unrelated. The common subject matter, and sequence of words in Sections 151, 102, and 242(b)(2) demonstrate that the statutes are related. *Terex Corp. v. S. Track & Pump, Inc.*, 117 A.3d 537, 543 (Del. 2015) ("Statutory construction . . . is a holistic endeavor. A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme—because the same terminology is used elsewhere in a context that makes its meaning clear . . . ." (citing *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371 (1988)).

[53] Answering Br. at 26 ("The Companies argued that 'powers, preferences, or special rights' are class-based rights imbued under Section 151, which are typically stated in the charter or certificate of designations but can include class-based rights incorporated via gap-filler provisions of the DGCL . . . ." (citing App. to Answering Br. at B0158)); 8 *Del. C.* § 394 ("This chapter and all amendments thereof shall be a part of the charter or certificate of incorporation of every corporation except so far as the same are inapplicable and inappropriate to the objects of the corporation."); *See Dickey Clay*, 24 A.2d at 321 ("[T]here is impliedly written into every corporate

violations is an attribute of the Companies' stock, but not a power, preference, or special right of the Class A common stock under Section 242(b)(2).

A.

On appeal, the Class A Stockholders have abandoned their 1969 amendment argument but still disagree with the Companies' textual approach. They argue that we should limit our analysis to dictionary definitions of "powers" which are broad enough to include the power to sue officers for damages for duty of care violations. Stated plainly, they contend that we should pluck a single word from the statute, apply a generic dictionary definition to that word, and put on blinders to the rest of the words in the statute and the statute's place in the DGCL.

While dictionary definitions can help discern the meaning of words in a statute, they can also be inconclusive and subject to selection bias.[54] For example,

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charter as a constituent part thereof the pertinent provisions of the State Constitution and statutes. Specifically, [Section 394's predecessor] declares that all amendments to the law shall be a part of the charter of every corporation formed under it except in so far as they are inapplicable or inappropriate to the objects of such corporation.").

[54] *See, e.g.*, *Freeman v. X-Ray Assocs., P.A.*, 3 A.3d 224, 228 (Del. 2010) (refusing to rely on one of three dictionary definitions, and instead applying other principles of statutory interpretation). As the Court of Chancery has stated, while referencing commentary from a distinguished jurist: "a court cannot read words in isolation." *In re P3 Health Grp. Hldgs., LLC*, 282 A.3d 1054, 1066 (Del. Ch. 2022); Frank H. Easterbrook, *Text, History, and Structure in Statutory Interpretation*, 17 Harv. J.L. & Pub. Pol'y 61, 67 (1994) ("In interesting cases, meaning is not 'plain'; it must be imputed; and the choice among meanings must have a footing more solid than a dictionary—which is a museum of words, an historical catalog rather than a means to decode the work of legislatures."); A. Raymond Randolph, *Dictionaries, Plain Meaning, and Context in Statutory Interpretation*, 17 Harv. J.L. & Pub. Pol'y 71, 73–74 (1994) ("A statute, however, cannot be understood merely by understanding the words in it. Judge Easterbrook thinks dictionaries are like 'word museums.' I think they are also like 'word zoos.' One can observe an animal's features in

the Class A Stockholders rely on one definition of "powers" in Black's Law Dictionary – "[t]he ability to act or not act."[55] At summary judgment, the Companies countered with another dictionary definition – "[d]ominance, control, or influence over another."[56] They also included the complete text of the Class A Stockholder's definition: "The ability to act or not act; esp., *a person's capacity for acting in such a manner as to control someone else's responses*."[57] The dictionary definitions offered by the parties lack context and point in different directions.

The Class A Stockholders' stilted approach to statutory interpretation ignores the context in which the word "powers" is used and how Section 242(b)(2) interacts with other sections of the DGCL employing the same words.[58] As the Companies have argued, "powers" must be read together with "preferences," "special rights," and "shares of such class," and the other DGCL sections addressing class-based powers. The word "powers" in Section 242(b)(2) refers to specific class powers

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the zoo, but one still cannot be sure how the animal will behave in its native surroundings. The same is true of words in a text.").

[55] Opening Br. at 25–26 (citing *Power*, Black's Law Dictionary (11th ed. 2019); *Power*, Merriam-Webster (last visited Nov. 29, 2022), https://www.merriam-webster.com/dictionary/power; *Strougo v. Hollander*, 111 A.3d 590, 595 n.21 (Del. Ch. 2015)).

[56] Defs.' Opening MSJ at 26 (citing *Power*, Black's Law Dictionary (11th ed. 2019)).

[57] *Id.*

[58] *See Osgood v. State*, 2023 WL 8532754, at *4 (Del. 2023) ("[W]ords in a statute should be given meaning through the context in which they are used."); *Agar v. Judy*, 151 A.3d 456, 473 (Del. Ch. 2017) (stating that words must "'be interpreted in the context of words surrounding them'" (quoting *Zimmerman v. Crothall*, 2012 WL 707238, at *7 (Del. Ch. Mar. 27, 2012)).

under Section 151(a), made express in the corporate charter as required by Section 102, and not to general powers incidental to stock ownership.

The Class A Stockholders also point to other DGCL provisions where "power" is used to describe the authority to file suit. They cite Section 122, which states "[e]very corporation created under this chapter shall have the power to: . . . [s]ue and be sued in all courts . . . ;"[59] Section 279, which grants trustees and receivers of dissolved corporations the "power to prosecute and defend;"[60] and Section 291, which grants receivers of insolvent corporations the "power to prosecute and defend."[61]

Those statutes show that the ability to sue is a power in certain contexts, but none are useful in defining the "powers . . . of the shares of such class." As the Court of Chancery noted in its transcript ruling, Sections 122, 279, and 291 all speak to a different subject matter than stockholder powers.[62] Worse for the Class A Stockholders' argument is that all three statutes explicitly define the ability to sue as a "power" within the context of their own statute, whereas Section 242(b)(2) does not. At most, these statutes show that the ability to sue is a "power" in certain

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[59] 8 *Del C.* § 122.
[60] 8 *Del C.* § 279.
[61] 8 *Del C.* § 291.
[62] *Decision* at 23.

contexts, but as the Court of Chancery determined correctly, not in the context of the "the shares of such class."[63]

In another argument, the Class A Stockholders claim that the Companies' textual argument results in an "incoherent" interpretation of the DGCL. Their main point is that an "express rights" reading – meaning a separate class vote is required only when corporate action adversely affects a class-based "power" stated in the charter – leads to unequal treatment of identical rights, turning on whether the right is stated in the charter or is a gap-filling power stated in the DGCL.[64]

As the Court of Chancery recognized, however, Section 394 makes the DGCL a part of the certificate of incorporation of every Delaware corporation.[65] Certain powers or rights, if unstated in the charter, are determined by default provisions in the DGCL – for example, Section 212(a) of the DGCL, where a share carries voting

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[63] The Class A Stockholders also rely on Section 121(a), which states that, "[i]n addition to the powers enumerated in § 122," the "corporation, its officers, directors and stockholders" can exercise the powers granted by the DGCL, the charter, and "powers incidental hereto." They say that the ability to sue for breaches of fiduciary duty to "police corporate misconduct" is a fundamental power of the stock – and that power is subject to Section 242(b)(2)'s voting requirements. But it is not a "power[] . . . of the shares of such class." Rather, it is a power that is – as Section 121 states – "incidental" to the status of being a stockholder, irrespective of the class of stock held.

[64] Opening Br. at 29.

[65] *Decision* at 61–64. *See* 8 *Del. C.* § 394 ("This chapter and all amendments thereof shall be a part of the charter or certificate of incorporation of every corporation except so far as the same are inapplicable and inappropriate to the objects of the corporation."); *STAAR Surgical Co. v. Waggoner*, 588 A.2d 1130, 1136 (Del. 1991) ("[I]t is a basic concept that the General Corporation Law is a part of the certificate of incorporation of every Delaware company."). The court held that whether or not the gap-filler provisions of the DGCL were included in the express rights reading of Section 242(b)(2), the power to sue would still not be one of the "powers, preferences, or special rights of the shares of such class." *Decision* at 62.

power equal to one vote per share.[66] Class-based powers or rights incorporated through the DGCL's default provisions are also expressed in the charter for purposes of Section 242(b)(2).

Further, under Section 151(g), a board may issue shares of preferred stock in a class or in a series of a class through a certificate of designations. Once the certificate of designations is filed with the Secretary of State as required by Section 103, it amends and becomes a part of the certificate of incorporation.[67] The terms of the certificate of designations are also expressed in the charter under Section 102(a)(4).[68]

The Companies' textual argument adheres to how Section 242(b)(2) operates as an exception to Section 242(b)(1). The Class A Stockholders' rigid interpretation of "powers" upsets the balance between Sections 242(b)(1) and (2). Section 242(b)(2) is intended as a "safeguard" to protect the powers, preferences and special

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[66] 8 *Del. C.* § 212(a) ("Unless otherwise provided in the certificate of incorporation and subject to § 213 of this title, each stockholder shall be entitled to 1 vote for each share of capital stock held by such stockholder.").

[67] *Matulich v. Aegis Commc'ns Grp., Inc.*, 942 A.2d 596, 600 (Del. 2008) ("Accordingly, the special rights and limitations of preferred stock are created by the corporate charter or a certificate of designation, which acts as an amendment to a certificate of incorporation."); *Kaiser Aluminum Corp. v. Matheson*, 681 A.2d 392, 394 n.3 (Del. 1996) ("When the Certificate of Designations became effective in February of 1994, it had the effect of amending the Certificate of Incorporation so that the rights of the preferred stockholders fixed by the Certificate became part of the Certificate of Incorporation" (citing 8 *Del. C.* §§ 102(a)(4); 151(g))).

[68] 8 *Del. C.* § 102(a)(4) ("The certificate of incorporation shall also set forth a statement of the designations . . . which are permitted by § 151 of this title . . . ."); 8 *Del. C.* § 151(g).

rights authorized by Section 151 and expressed in the charter. It is not a broad grant of the right to vote on any amendment affecting any attribute of stock ownership.[69]

B.

According to the Class A Stockholders, *Dickey Clay* "merely [held] that the relative position of stock in the capital structure is not a 'power, preference, or special right' under Section 242(b)(2), so an adverse effect on such position does not trigger a class vote."[70] In other words, "adverse changes to the 'relative position' of one class in the capital structure through a charter amendment authorizing the issuance of additional, superior shares does not require a separate vote of the inferior class."[71] They also contend that the Court of Chancery "subordinated its own logic and reasoning" when it found that *Dickey Clay* and *Orban* dictated the outcome.

But a court's ruling is rarely limited to the specific facts before it.[72] *Dickey Clay* held that "[t]he *peculiar, or special, quality* with which [the class shares] are

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[69] 1967 Folk Report at 176; *Dickey Clay*, 24 A.2d at 322 ("The right of veto by class vote was never conferred on the common shares, and this is not at all surprising in view of their origin. What the appellant would have the Court to do is to reconstruct the contract by giving to the common shares a right never intended to be given.").

[70] Opening Br. at 9.

[71] *Id.* at 34.

[72] One academic paper describes "confining a case to its facts" as a doctrinal workaround to *stare decisis*, where a court can "overrule everything a decision stands for except for its precise result." Daniel B. Rice & Jack Boeglin, *Confining Cases to Their Facts*, 105 VA. L. REV. 865 (2019). And "[o]nce a case has been confined to its facts, the operative question becomes whether a new case is factually distinguishable from it in any respect." *Id.* at 870. Ordinary methods of treating precedent do not call upon courts to engage in "purely fact-bound adjudication." *Id.* We promote "stability in our DGCL." *Stream TV Networks, Inc. v. SeeCubic, Inc.*, 279 A.3d 323, 354 (Del. 2022). Interpreting precedent solely on the facts, rather than the reasoning stated by this Court, undermines the predictability of our corporate law. *Acct. v. Hilton Hotels Corp.*, 780 A.2d 245,

endowed, and which serves to distinguish them from shares of another class, remains the same."[73] In *Orban*, the Court of Chancery held that Section 242(b)(2) "makes clear that it affords a right to a class vote when the proposed amendment adversely affects the peculiar legal characteristics of that class of stock."[74] Those cases gave meaning to the phrase "powers, preferences, or special rights" to be applied in future cases.[75] And the "peculiar, or special quality" of which class shares are endowed are the powers, preferences, and special rights which are attributed to and define the class under Section 151.[76]

For three quarters of a century, *Dickey Clay* has stood for two points: 1) that rights incidental to stock ownership are not a peculiar characteristic of the shares of a class of stock, and 2) that Section 242(b)(2) should be read considering other

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248 (Del. 2001) ("[*S*]*tare decisis* finds ready application in Delaware corporate law."); *Speiser v. Baker*, 525 A.2d 1001, 1008 (Del. Ch. Mar. 19, 1987) ("Delaware courts, when called upon to construe the technical and carefully drafted provisions of our statutory corporation law, do so with a sensitivity to the importance of the predictability of that law.").

[73] *Dickey Clay*, 24 A.2d at 318–19 (emphasis added).

[74] 1993 WL 547187, at *8 (emphasis in original).

[75] This Court in *Dickey Clay*, and the Court of Chancery in *Orban*, based their decisions on a prior iteration of Section 242(b)(2). That circumstance does not render the "peculiar, or special" limitation as *dictum*. The rule is not, as the Class A Stockholders would have it, whether some hypothetically narrower holding would result in the same outcome of the case, but rather whether the actual holding had an "effect on the outcome of [the] case." *In re MFW S'holders Litig*., 67 A.3d 496, 521 (Del. Ch. 2013) (citing *Brown v. United Water Delaware, Inc*., 3 A.3d 272, 277 (Del. 2010)).

[76] *Dickey Clay*, 24 A.2d at 319 (approving of the use of Section 151's predecessor, Section 13, when searching for the meaning of "special" shares).

provisions of the DGCL. The Court of Chancery faithfully applied *Dickey Clay*, and the Class A Stockholders have not asked us to overrule it.[77]

C.

At summary judgment, the Companies identified nine public multi-class corporations that adopted director exculpation charter amendments shortly after Section 102(b)(7) was enacted.[78] Eight of those corporations did not seek a separate class vote, and the ninth stated that such a vote was not required, though it sought one for the amendment because it was presented to stockholders in a suite of other charter amendments.[79] The Court of Chancery determined that this evidence fit its understanding that "[i]n the nearly 40 years since 1986 and the adoption of Section 102(b)(7) for directors, no one has taken the position until this case that an exculpation amendment requires a class vote."[80]

Although the Class A Stockholders argue otherwise, the Court of Chancery did not make practitioner experience central to its ruling. Instead, it simply observed

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[77] The Class A Stockholders did not ask the Court of Chancery to assess whether equitable considerations should be part of the analysis. *See Schnell v. Chris-Craft Indus., Inc*., 285 A.2d 437, 439 (Del. 1971) ("[I]nequitable action does not become permissible simply because it is legally possible.").

[78] Defs.' Opening MSJ at 36–38.

[79] *Id.*

[80] *Decision* at 67–68 ("Speaking for myself, I never previously thought that an exculpation amendment required a class vote.").

that a statutory interpretation which deviated from the historical understanding would conflict with the stability of our corporate law.[81]

IV.

The judgment of the Court of Chancery is affirmed.

[81] *Stream TV Networks, Inc.*, 279 A.3d at 353–54 ("'Our General Assembly has [ ] recognized the need to maintain balance, efficiency, fairness, and predictability in protecting the legitimate interests of all stakeholders, and to ensure that the laws do not impose unnecessary costs on Delaware entities.'" (quoting *Salzberg v. Sciabacucchi*, 227 A.3d 102, 136 (Del. 2020)).

Multi-Case Filing Detail: The document above has been filed and/or served into multiple cases, see the details below including the case number and name.

Transaction Details

Court: DE Supreme Court

Document Type: Opinion

Document Title: Opinion decided on 1-17-24 by Seitz, CJ. Revised: 1-25-24. Upon appeal from the Court of Chancery. AFFIRMED. (CJS, KLV, GFT, AML, NCG). (dmd)

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Case Details

Case Number	Case Name
120,2023C	In re Fox Corporation/Snap Inc. Section 242 Litigation
121,2023C	In re Fox Corporation/Snap Inc. Section 242 Litigation

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

TED D. KELLNER, Plaintiff and Counterclaim-Defendant, v. AIM IMMUNOTECH INC., Defendant and Counterclaim-Plaintiff, and THOMAS EQUELS, WILLIAM MITCHELL, STEWART APPELROUTH, AND NANCY K. BRYAN, Defendants.	))	C.A. No. 2023-0879-LWW

OPINION

Date Submitted: December 5, 2023
Date Decided: December 28, 2023

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William R. Denny, Matthew F. Davis, Nicholas D. Mozal & Caneel Radinson-Blasucci, POTTER ANDERSON & CORROON LLP, Wilmington, Delaware; Stefan Atkinson, Mary T. Reale & Mason E. Reynolds, KIRKLAND & ELLIS LLP, New York, New York; Michael F. Williams & Don Hong, KIRKLAND & ELLIS LLP, Washington, D.C.; *Counsel for Thomas Equels, William Mitchell, Stewart Appelrouth, Nancy K. Bryan, and AIM ImmunoTech Inc.*

WILL, Vice Chancellor

This post-trial decision resolves an expedited action regarding the adoption and enforcement of advance notice bylaws. It harkens back to a related case heard last year and hints at what coming activism disputes may bring. One could say that my holiday season was visited by litigation past, present, and future.

In 2022, a group schemed to run a proxy contest against AIM Immunotech Inc. A dissident nomination was submitted after a potential director candidate asked his friend to purchase AIM shares and front the attempt. The stockholder's notice raised the board's suspicion that treachery was afoot since it appeared to be a continuation of a prior failed nomination—one orchestrated by a felon who had meddled with AIM's business. Because the notice neglected to mention any arrangement or understanding involving the broader group, as required by AIM's advance notice bylaws, it was rejected. The stockholder moved for a preliminary injunction in this court, but the mandatory relief he sought was unprocurable on a disputed factual record.

Now, a renewed nomination attempt is before me. It is, in many ways, smarter than the preceding effort. The nomination is being pressed by a sophisticated investor with a substantial number of AIM shares. Perhaps understanding the high bar to obtaining a mandatory injunction on a preliminary record, he has taken his claims through trial. Yet his notice suffers from the same primary defect as his predecessor's: it obscures obvious arrangements or understandings pertaining to the nomination.

The plaintiff also lodged a facial challenge to a set of amended advance notice bylaws recently adopted amid dark skies, arguing that they threaten stockholders' ability to make future nominations. Several of the bylaws are so shrouded in layers of murky text that their limits are a mystery. Reviewed through the lens of enhanced scrutiny, they are disproportionate responses to any threatened corporate objectives.

Thus, the opinion that follows is a tale of wins and losses on both sides. As with the past effort, the present nomination notice contravened valid bylaws. The board's rejection of the notice withstands inquiry. Certain bylaws, however, must fall because they inequitably imperil the stockholder franchise to no legitimate end. Perhaps these lessons will be heeded in matters still to come.

I. BACKGROUND

The following facts were stipulated to by the parties or proven by a preponderance of the evidence at trial.[1] The trial record includes the testimony of 10 fact and 2 expert witnesses, 22 deposition transcripts, and 1,241 joint exhibits.[2]

A. AIM ImmunoTech

AIM ImmunoTech Inc. ("AIM" or the "Company") is an immuno-pharma company incorporated in Delaware with its principal place of business in Ocala, Florida.[3] Its stock is traded on the NYSE American exchange.[4] AIM's stock price has decreased by 99% since 2016 and it has a single drug with the requisite regulatory approvals to be commercialized.[5] The Company's lead product is an investigational drug called Ampligen, which is in clinical trials for immune system disorders, viral diseases, and cancers.[6]

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[1] Joint Pre-trial Stipulation and Order (Dkt. 234) ("PTO").

[2] Facts drawn from exhibits jointly submitted by the parties are referred to by the numbers provided on the parties' joint exhibit list and cited as "JX __" unless otherwise defined. Dkt. 253. Deposition transcripts are cited as "[Name] Dep." *See* Dkts. 238-40, 252. Trial testimony is cited as "[Name] Tr." *See* Dkts. 264-66.

[3] PTO ¶ 10.

[4] *Id.*

[5] *See* JX 901 at 2; JX 701 at 8.

[6] PTO ¶ 10.

AIM's board of directors (the "Board") has four members: Thomas Equels, William Mitchell, Stewart Appelrouth, and Nancy K. Bryan.[7] Equels, a lawyer by training, is AIM's Chief Executive Officer and has served on the Board since 2008.[8] Mitchell, a physician, is a long-tenured Board member who serves as Chairman.[9] He holds a Ph.D. in biochemistry and has studied Ampligen since its early development in the mid-1980s.[10] Appelrouth, an accountant, joined the Board in 2016.[11] Bryan is the newest addition to the Board, having been appointed in March 2023.[12] She is the President of BioFlorida, Inc., of which AIM is a member.[13]

B. Tudor's Interest in AIM

AIM's stockholder base is primarily composed of retail investors. One, Franz Tudor, began to beset AIM management with frequent communications in the summer of 2020. On July 30, 2020, Tudor sent a Twitter direct message to AIM's public relations manager advising on how to "be taken seriously."[14] Tudor stated: "I

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[7] *Id.*

[8] *Id.* ¶ 11; Equels Tr. 494. Equels began his tenure at the Company while it was called Hemispherx. PTO ¶ 10.

[9] PTO ¶ 12; Mitchell Tr. 630.

[10] Mitchell Tr. 630-32.

[11] PTO ¶ 13; Appelrouth Tr. 682.

[12] PTO ¶ 14.

[13] *Id.*

[14] JX 45.

now represent over 1 mil[lion] shares b[etween] the various funds [I] consult and my own ownership. Why do you think [the] stock didn't break 2.65 today? That was us buying every share sub 2.70."[15]

Around the same time, Tudor contacted Equels and asked to obtain a position as an international business development consultant for the Company.[16] Equels looked into Tudor's background and learned that in 2009, Tudor pleaded guilty to securities fraud and conspiracy to commit securities fraud as part of an insider trading scheme at Galleon Group.[17] Tudor is permanently enjoined from engaging in certain activities related to penny stocks—a class of microcaps that includes AIM.[18]

On August 4, Tudor emailed Equels to thank him for the "opportunity to assist AIM in its business development initiatives."[19] AIM "pass[ed]" on Tudor's proposal.[20] After losing touch with Equels, Tudor attempted to contact other Board members and the Company's investor relations representative.[21] In a September 25

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[15] *Id.* at 2.

[16] Tudor Dep. 55-56; *see* JX 362 ("Equels Aff.") ¶ 6.

[17] PTO ¶ 17.

[18] Equels Aff. ¶ 5; *see also id.* Ex. A.

[19] JX 47. Tudor also asked Equels if Ampligen could be shipped to his spouse's family in Ecuador. JX 49 at 2.

[20] JX 49 at 1.

[21] JX 56; JX 79 at 161.

message to Appelrouth, Tudor said that he “represent[ed] some of AIM[’]s largest shareholders” and would like to share “feedback as to how to improve operations and drive shareholder value.”[22] He requested a “group conference call” with the Board.[23] Tudor’s messages went unanswered.

Tudor then began representing to third parties—including principal investigators in Ampligen clinical trials and a U.S. Food and Drug Administration lobbyist—that he was associated with AIM.[24] On October 16, AIM’s counsel asked Tudor to cease and desist representing that he was “authorized to speak on behalf of AIM.”[25] The warning was ignored.[26]

In February 2021, AIM commenced litigation against Tudor in Florida state court to prevent him from interfering with AIM’s business.[27] AIM subsequently obtained an injunction that permanently enjoined Tudor from contacting the Company’s business relations.[28]

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[22] JX 56 (Tudor noting that he had sent a similar message to Mitchell).

[23] *Id.* Tudor sent over 50 Twitter direct messages to AIM representatives between late July 2020 and early January 2021. JXs 75-76; *see also* JX 77 at 31.

[24] JXs 61-62; JX 66; JX 68; JX 74 at 113; *see also* Equels Aff. ¶ 9.

[25] JX 67.

[26] Equels Aff. ¶ 12.

[27] *Id.* ¶ 13.

[28] JX 92; JX 96.

C. The Lautz Nomination

Tudor was not alone in his campaign to find influence with AIM. He was joined by his former colleague at Galleon Group, Todd Deutsch.[29] Deutsch beneficially owns 1,716,100 shares of AIM common stock—about 3.5% of the Company's outstanding shares.[30] He previously worked for a wealth management services company and spent 20 years as a trader with Goldman Sachs and various hedge funds.[31] Since leaving client services in 2012, Deutsch manages his own home office portfolio.[32]

Like Tudor, Deutsch began repeatedly contacting AIM in the summer of 2020, conveying his growing frustration with the Company's management and his significant losses.[33] Some of his communications were strikingly similar in style and tone to those Tudor sent at the same time—even after Tudor was enjoined from contacting AIM.[34] Other emails from Tudor were forwarded by Deutsch to Equels.[35]

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[29] *See* Deutsch Tr. 161; Tudor Dep. 48-49.

[30] PTO ¶ 16.

[31] *Id.*

[32] *Id.*

[33] JXs 51-52; JX 90; JX 126; *see also* JX 78 at 2 ("Had your chance. . . . Idiots[.]").

[34] *Compare* JX 145, *with* JX 146.

[35] JXs 190-93.

In late 2021, Tudor told fellow AIM stockholder Walter Lautz that he had a plan to "oust[]" the Board.[36] By the spring, Tudor had identified two potential director nominees: Daniel Ring and Robert Chioini.[37] Tudor had known Chioini for years, having worked together at Rockwell Medical Technologies—a dialysis company Chioini co-founded.[38] Rockwell Medical and Chioini parted ways in 2018 after the company publicly announced that its board determined Chioini "lacked key attributes necessary to oversee the [company's] growth and long-term success."[39] Ring was another business acquaintance of Tudor.[40]

On April 18, Tudor texted Deutsch that "[m]y BMY guy [Ring] can be on the AIM [Board]."[41] Tudor noted: "We will need a shareholder to make the nomination and [I] will get everything together."[42] Tudor introduced Chioini to Lautz by email, forwarded Ring's resume to Lautz, and prepared materials for the nomination.[43] Later that day, Lautz submitted a notice to AIM purporting to nominate Ring and

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[36] JX 125; *see* JX 124; JX 131; JX 280.

[37] JX 197; JX 203; JX 199; JX 418 at 13-14.

[38] PTO ¶ 15; Chioini Tr. 8; Equels Tr. 529.

[39] JX 28. Whether Chioini "left" Rockwell of his own accord or was fired became a matter of debate at trial. *See* Chioini Tr. 9, 128; JX 28.

[40] JX 418 at 31, 36.

[41] JX 197.

[42] *Id.*; *see* Deutsch Tr. 182-83.

[43] JXs 195-96; JX 198; JX 203.

Chioini to the Board.[44] The nomination notice was drafted by Tudor and untouched by Lautz before its submission.[45] The notice, however, made no mention of Tudor.[46]

D. Kellner's Growing Interest

Deutsch kept another major AIM stockholder, Ted D. Kellner, apprised of these efforts. Kellner is a retired founder and portfolio manager of Fiduciary Management, Inc., a philanthropist, and a minority owner of the Milwaukee Bucks.[47] Kellner and Deutsch have known each other for over two decades.[48] Kellner first purchased AIM stock in early 2021 at Deutsch's suggestion.[49] Today, Kellner is the record holder of 1,000 shares of AIM common stock and beneficially owns a substantial stake.[50]

Around February 2021, Deutsch began sending Kellner information from Tudor about AIM's stock performance, mostly by forwarding Kellner emails written by Tudor.[51] Kellner thought the Company had promise but was stunted by

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[44] JX 200.

[45] *Id.*; JX 201; Tudor Dep. 62.

[46] *See* JX 200.

[47] Kellner Tr. 218-20; PTO ¶ 8.

[48] Kellner Tr. 220; Deutsch Tr. 146.

[49] Kellner Tr. 220-21; Deutsch Tr. 172.

[50] PTO ¶ 9.

[51] JXs 88-89; JX 91; JX 108. Kellner received this information either directly from Deutsch or indirectly through his executive assistant. *Compare* JX 116, *with* JX 118.

mismanagement.[52] Like Deutsch, Kellner lost most of the value of his AIM investment.[53] By the fall of 2021, Kellner became more involved in Tudor and Deutsch's correspondence with the Company.[54]

On April 19—one day after Lautz submitted his attempted nomination notice—Deutsch sent Kellner an investment analysis about AIM that Tudor had prepared.[55] Kellner printed out the email and marked it up by hand.[56] At the top of the page, Kellner wrote: "48 million shares. What do we own? 15 to 18%[?]"[57] The "we" referred to Kellner, Tudor, and Deutsch.[58]

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[52] JX 93; JX 111; Kellner Tr. 220, 222-23.

[53] Kellner Tr. 222.

[54] *E.g.*, JX 116 at 1 (Kellner to Deutsch: "Have you and Franz drafted the letter we were intending to send to the AIM management team?"); JX 122 (Deutsch to Kellner: "[W]e need you[r] help[.] I have CEO and board members['] emails.").

[55] JX 205.

[56] *Id.*

[57] *Id.* at 1.

[58] Kellner Tr. 253-54 ("I knew that I had a 3 percent stake, roughly. I knew that Todd had a little bit more. It was my belief that, as was conveyed over some time, that Franz Tudor had a stake of a like amount. . . . I thought if there was one or two other shareholders, that there could be another 2 or 3 percent[] owners in the company."); *id.* at 291, 323-24.

E. Preparations for a Proxy Fight

On April 28, AIM rejected Lautz's purported notice for non-compliance with federal securities laws.[59] It became apparent that a better prepared, advised, and funded effort would be needed.

Chioini sought financial support from his fellow co-founder of Rockwell Medical, Michael Xirinachs.[60] Xirinachs is a trader who pleaded guilty in 2022 to criminal charges involving fraudulent securities trading, promotion and material misrepresentations to investors, and misuse of funds.[61] On April 29, Chioini sent Xirinachs a copy of AIM's bylaws and flagged the advance notice provisions.[62] On May 1, Chioini emailed Xirinachs to set up a call with Tudor regarding the "AIM deal."[63]

By May 2, Tudor had contacted counsel from Baker & Hostetler LLP ("BakerHostetler") to advise on a potential proxy contest.[64] On May 3, Xirinachs, Tudor, and Chioini received a calendar invite from an attorney at BakerHostetler

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[59] JX 235.

[60] Chioini Tr. 77 ("[W]ith Mr. Xirinachs, I wanted him to be part of the group to help finance the proxy contest.").

[61] JX 397 at 25. Xirinachs was also found to have committed wire fraud, with the Securities and Exchange Commission (SEC) obtaining a judgment against him and his company. JX 16 at 6-9.

[62] JX 238.

[63] JX 239.

[64] JX 179.

with the subject "Potential Engagement: Proxy Contest."[65] A few hours after the scheduled call, Tudor sent a text message to Lautz stating: "Fyi haven[']t given up. Been doing lawyer calls to work out a strategy."[66]

On May 4, Deutsch forwarded Kellner an email that Tudor had sent to AIM's investor relations representative with the subject "AIM Needs the Right and Good People."[67] In handwritten notes on a printout of the email, Kellner highlighted the directors' salaries and wrote "poor mgt!" and "[r]eplace mgt?"[68] His notes-to-self exclaimed: "Why are we picking this fight!"[69] After AIM's investor relations team ignored Tudor's May 4 correspondence, Tudor sent another email stating: "By totally ignoring me and not acting professionally you now get gloves off. . . . This is just [d]isgusting."[70]

F. Kellner's Surprise and Lautz's Lament

Tudor continued to express his frustration to Equels in early June.[71] After Deutsch forwarded one of Tudor's emails to Kellner on June 2, Kellner

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[65] JX 244. Chioini does not "recall canceling the meeting." Chioini Tr. 73.

[66] JX 245. Although the recipient's identity is not obvious from the face of the document, it appears to be Lautz.

[67] JX 247.

[68] JX 248.

[69] *Id.* During his testimony, Kellner did not recall who the "we" mentioned in his notes referred to. Kellner Tr. 299.

[70] JX 255.

[71] *See* JX 265 at 2.

responded: “Ridiculous!! Did they have an annual meeting yet Todd?”[72] Deutsch then forwarded another email to Kellner from Tudor that said:

> If you would like to send to Ted. [sic]
>
> Their annual shareholder meeting for the past 2 years has been on Oct[ober] 7th. . . . There is a window of June 6 to July 7 to run a proxy battle and nominate BOD members. . . .
>
> I have 2 strong candidates to run and get control of the [Board]. I have spoken with legal counsel and it would cost an estimated $100k in legal fees and $50k for the proxy solicitor. If the proxy battle is won then the Company would reimburse the proxy battle expenses. I have a shareholder who is will[ing] to have their name as the lead but so far have not been able to find anyone to front the $150k.[73]

Kellner printed the email, highlighted it, and made handwritten notes to himself.[74]

Kellner subsequently learned that Tudor owned drastically fewer shares than Kellner had believed.[75] On June 4, Kellner texted Deutsch to say: “In my discussions with Franz . . . I was frankly stunned to learn he only owned 45,000 shares of the stock. Not a strong [text cuts off].”[76] Deutsch responded: “It[’]s a huge part of his net worth [since] he had two unfort[unate] events th[a]t almost bankrupt[ed] him . . . I promise [you] he is as smart [as] they come in [the] space . . . So we are

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[72] *Id.* at 1.

[73] *Id.*

[74] *Id.*

[75] Kellner Tr. 253-54.

[76] JX 433 at 1.

aligned."[77] Deutsch went on to say that Tudor was "all in on this" and "d[idn't] want to let [Kellner] and [Deutsch] down."[78] Kellner responded that Tudor "doesn't need to worry nor you about Teddy!!![13 emojis, including thumbs up and smiley faces]."[79]

Although Tudor hoped that Lautz would be the stockholder submitting the nomination, Lautz declined. On June 14, Lautz wrote Tudor an email with the subject line "FYI – Potential Dirt on Me."[80] Lautz told Tudor that he "just came to think" about the fact that he had been "fired from Merrill for 'selling away.'"[81] Lautz noted that he had been the subject of "a FINRA investigation" and "was terminated from one of the largest brokerage houses on the planet," which "may not be a good look" for the nomination effort.[82] Tudor sent Lautz's email to Chioini, who copied Xirinachs on a response offering to "have the attorney look at it."[83]

Chioini and Xirinachs kept in regular contact with one another and with counsel at BakerHostetler throughout the summer of 2022. The two circulated

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[77] *Id.*

[78] *Id.* at 2.

[79] *Id.*

[80] JX 274 at 1.

[81] *Id.*

[82] *Id.*

[83] *Id.*

multiple iterations of a draft nomination notice (before a stockholder to submit it had been found).[84] They are jointly responsible for the legal fees associated with the eventual 2022 nomination and related litigation in this court.[85]

G. More Surprise for Kellner

In mid-June, AIM's outside counsel sent correspondence to Deutsch, Kellner, and Tudor's counsel demanding that they comply with the requirements of Section 13(d) of the Securities and Exchange Act of 1934.[86] AIM became concerned after Deutsch attempted to have Tudor attend "as an undisclosed party, a telephone conference between AIM's [investor relations] firm," Deutsch, and Kellner.[87] The correspondence mentioned Deutsch's hostility towards AIM's management, that Tudor was convicted of insider trading, and that AIM had obtained a permanent injunction against Tudor.[88]

These revelations about Tudor surprised Kellner.[89] In handwritten notes on a copy of the letter, Kellner wrote "FRANZ TUDOR – IS A FELON?" and "INSIDER

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[84] JX 392; JX 401; JX 416; JX 454; JX 990; JX 1000; JX 1020; *see* Harrington Tr. 426-27. A number of these documents were withheld as attorney-client privileged under a common interest. *See* JX 392.

[85] Chioini Tr. 111.

[86] JX 277 at 4-5; JX 292 ("Mr. Tudor has surreptitiously engaged himself in a stockholder group consisting of, at a minimum, Mr. Deutsch and Mr. Kellner.").

[87] JX 292; JX 277 Ex. A.

[88] JX 277 at 5.

[89] Kellner Tr. 258-59.

TRADING?"[90] Kellner also wrote the names "Robb [sic] Chioini" and "Michael Zeaniack [Xirinachs]," noting: "our plans – get a lawyer."[91]

H. The Jorgl Nomination

In late June, the nomination effort needed both a stockholder nominator and a nominee since Ring dropped out. On June 21, Lautz texted Tudor and asked, "were you able to find someone to be the face of the activist?"[92] Tudor responded: "We are still looking."[93]

The next day, Chioini recruited Michael Rice to be his co-nominee.[94] Rice is a co-founder of Life Sci Advisers, which served as Rockwell Medical's investor relations consultant during Chioini's tenure.[95] Like Chioini, Rice is not an AIM stockholder.[96] Chioini sent Rice's contact information to Tudor, and Tudor sent Rice a description of AIM.[97]

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[90] JX 278 at 1.

[91] *Id.*

[92] JX 280.

[93] *Id.*

[94] Chioini Tr. 78.

[95] JX 404 at 44.

[96] JX 393 at 52.

[97] JX 284; JX 283.

Rice was able to supply the "body" (to use Chioini's word) to make the nomination.[98] At Rice's request, Jonathan Jorgl—a friend that Rice surfed with—bought 1,000 shares of AIM stock on June 27.[99] Jorgl had never heard of AIM beforehand, but was willing to join the cause so long as he was not responsible for attorneys' fees.[100] With help from Rice and Xirinachs, Jorgl put the shares into his name of record just before the nomination deadline.[101] On July 8, Jorgl submitted his nomination notice with Chioini and Rice as his proposed nominees.[102]

The next day, Kellner had a call with Tudor to discuss the nomination.[103] During the call, Kellner took contemporaneous handwritten notes. He wrote: "Annual meeting is October 7th[.] Franz submitted 2 new directors on Friday July 8th: 1. Mike Rice[;] 2. Rob Chioini."[104]

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98 JX 291 at 2 (Chioini to Rice: "We really need to get your body to by [sic] the shares today every day matters."); JX 295.

99 Jorgl Dep. 17, 32-33; *see Jorgl v. AIM Immunotech Inc.*, 2022 WL 16543834, at *1 (Del. Ch. Oct. 28, 2022).

100 *See* JX 321; Jorgl Dep. 63 (noting that he was unwilling to take on legal fees).

101 *See* JX 288; JX 290; JX 294; JX 321.

102 JX 322.

103 *See* JX 325.

104 *Id.* at 1. Kellner testified that he was mistaken in noting that Tudor submitted the nomination and meant to write Jorgl. But since Jorgl did not enter the picture until late June and Kellner was in regular contact with Tudor, it makes more sense that Kellner's notes reflect his belief that Tudor was driving the effort. *See* Kellner Tr. 239-40 ("Q: Why did you identify the stockholder as Mr. Franz Tudor if, as you just testified, that is not correct? Kellner: Well, I can only describe—the Jorgl name had only become known to me, I think, a month before, and when the Jorgl suit here—I've never, to this day, talked

On July 19, AIM rejected Jorgl's nomination notice.[105] AIM General Counsel Peter Rodino wrote that Jorgl's notice "fail[ed] to satisfy Section 1.4 of [AIM's] [b]ylaws and applicable law by, among other things, making false and misleading statements in lieu of providing [the required] information."[106] Section 1.4(c) of AIM's bylaws, as adopted in 2016 (the "2016 Bylaws"), required a stockholder proposal to disclose "arrangements or understandings . . . pursuant to which the nomination(s) are to be made."[107] Because the deadline for providing notice of nominations for the 2022 annual meeting had passed, Jorgl was unable to amend his notice or submit a new one.[108]

On July 29, Jorgl filed a Verified Complaint in this court seeking a declaration that the Board had violated AIM's advance notice bylaw by refusing to accept his notice.[109] On August 1, he filed a motion for a preliminary injunction to cause the

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with Mr. Jorgl. I didn't remember."). Kellner's testimony that he meant "Jorgl" instead of "Franz" is also belied by his August 2022 description of the prospective proxy contest. *See infra* note 143 and accompanying text; *see also* JX 522.

[105] JX 344.

[106] *Id.*

[107] JX 23 ("2016 Bylaws") § 1.4(c).

[108] JX 344.

[109] *Jorgl*, 2022 WL 16543834, at *9.

Board to place his nominees on AIM's universal proxy card.[110] Expedited discovery ensued.

Litigation was simultaneously unfolding in Florida, where AIM sued Tudor, Deutsch, Kellner, Jorgl, Lautz, Chioini, and Rice.[111] AIM alleged that the defendants violated Section 13(d) of the Exchange Act and sought a permanent injunction to prevent them from "committing any further violations of federal securities laws."[112] AIM later amended its complaint to remove Chioini and Rice as parties.[113]

I. The 2022 Annual Meeting

On August 23, 2022, while litigation in Delaware and Florida was ongoing, Kellner drafted an update to The Beta Fund Investment Club.[114] The club members are Kellner's fraternity brothers for whom he manages an investment portfolio.[115] The fund's portfolio includes AIM stock. Preparing to update the "Beta Funders," Kellner wrote:

> In Aim's case, there is now a legal suit, which I am a part of, to replace management. . . . My view, along with two others joining me in the proxy battle, is that management has done an abominable job. . . . A couple of weeks ago, Todd Deutsch, who is known to several of you,

[110] *Id.*

[111] JX 1117 at 1.

[112] *Id.* ¶¶ 48-50, 53.

[113] *See* JX 497 at 1. Chioini and Rice were dropped from the lawsuit because the two "claimed to not be stockholders" of AIM. Equels Tr. 611-12.

[114] JX 522; *see* Kellner Tr. 331-32.

[115] *See* JX 951 at 5.

> and a gentleman named Franz Tudor, commenced a proxy to replace all of the directors and ultimately management [of AIM]. ***I am now a party to that proxy fight***, which will hopefully commence with the replacement of the management team in the next twelve months. More on that as time progresses.[116]

Meanwhile, Kellner was preparing for the 2022 annual meeting. On October 27, Kellner's assistant told Tudor that "[Kellner] asked [her] to coordinate a breakfast" before the meeting and "would like for Thomas [sic] Jorgl, Robert Chioini, and Michael Rice to also come."[117] Jorgl's preliminary injunction motion was denied the next day.[118]

Though the breakfast did not go forward, Kellner attended AIM's annual meeting in person. He found the experience disappointing and felt that his questions were brushed off.[119] All three company director nominees were reelected.[120] While driving home from the meeting, Kellner "became increasingly frustrated and angry o[ver] what had transpired."[121]

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[116] JX 522 at 3 (emphasis added). Kellner testified that the "proxy fight" referenced him voting his shares for the "gold card slate" at the annual meeting. Kellner Tr. 249. That testimony is inconsistent with the record, as no gold card existed until September 15 when Jorgl filed his preliminary proxy statement. JX 397. Kellner could not have voted the gold card until after Jorgl filed his definitive proxy statement. *See* Kellner Tr. 340.

[117] JX 451; *see* Kellner Tr. 342.

[118] *Jorgl*, 2022 WL 16543834, at *17.

[119] JX 467 ("At the outset they excused me from the meeting to see if I could be included given the fact that I did not vote the white proxy."); Kellner Tr. 225-26.

[120] JX 473; JX 474 at 1; JX 475 at 1-2.

[121] Kellner Tr. 226.

That evening, Kellner reached out to Deutsch and Tudor via text message to "get a sense as to what Jorgl and his team [wa]s up to" and discuss "next steps."[122] Kellner was "hoping this thing w[ould] still move forward and Jorgl [wa]s fully committed."[123] Kellner remarked that he and Deutsch were "the only two guys wi[th] skin in the game" and that they were "underwater by several million dollars."[124] He asked to convene a call with "the Jorgl team and the three of us [Kellner, Tudor, and Deutsch] to ascertain what the next steps are."[125]

Chioini, for his part, remained committed to getting on AIM's Board. On November 3, Chioini told the group's proxy solicitor: "We do intend to contest next year and will submit our nomination well in advance of the deadline to avert any antics like this year."[126] Chioini copied Rice on the message and forwarded it to Xirinachs.[127]

J. Preparations for 2023

On November 9, the Board publicly announced that it had "initiated a process to add two directors who bring diversity and additional biotechnology

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[122] JX 467.

[123] *Id.*

[124] *Id.*

[125] *Id.*

[126] JX 468 at 1; *see* Chioini Tr. 97-100. When questioned about who "we" referred to, Chioini testified "[t]he 'we' is me." Chioini Tr. 18.

[127] JX 468 at 1.

commercialization experience."[128] The announcement stated that the Board would also engage an independent consultant to evaluate the compensation structure of AIM's executives.[129] Mitchell noted that the Board was "taking these important steps in response to the feedback [the Board] received from shareholders in connection with the recent 2022 Annual Meeting."[130]

Chioini interpreted the press release as a "an opportunity to open dialogue with AIM and the board."[131] He directed John Harrington, his counsel from BakerHostetler, to relay to AIM his and Rice's continued interest in being directors.[132] Harrington shared these sentiments in a November 13 email to the Board sent "on behalf of [his] clients" Chioini and Rice.[133] Harrington stated: "[W]e recommend that you appoint Mr. Chioini and Mr. Rice to the Board and appropriate committees promptly. As you know, your stockholders have already expressed very strong support for the election of both of them."[134]

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[128] JX 487 at 1.

[129] *Id.*

[130] *Id.*

[131] Chioini Tr. 19-20.

[132] *Id.* at 20-21.

[133] JX 499 at 3. Oddly, Harrington did not represent an AIM stockholder in making this request. He was acting on behalf of two individuals who felt that they were entitled to a Board seat because they viewed votes cast in the prior proxy contest as favorable to them.

[134] *Id.*

Chioini instructed Harrington to follow up, and on December 5, Harrington called AIM's Delaware counsel, Michael Pittenger of Potter Anderson & Corroon LLP.[135] Harrington told Pittenger that Chioini and Rice wanted to "avoid another proxy contest" and would be amenable to "mutually agreeable directors" joining the Board.[136] Harrington stressed that Chioini and Rice grew "impatient" and would be "ready to come out guns blazing" and "better organized next year."[137] Afterward, Harrington emailed Chioini a recap of the call. Harrington relayed that Pittenger "would be surprised if the AIM board appointed [Chioini] or Mike Rice based [on] everything that ha[d] happened."[138]

Some days later, Chioini and Kellner spoke for the first time. In a December 14 text message to Harrington, Chioini recounted that he "spoke with Kellner last week."[139] Chioini told Harrington that Kellner was "very interested in working with [them] to remove these guys" and "want[ed] to keep in touch."[140]

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[135] *See* JX 825 at 5.

[136] Pittenger Tr. 709-11; *see* Harrington Tr. 392.

[137] JX 825; JX 526; Pittenger Tr. 709-11; Harrington Tr. 393-94.

[138] JX 525 at 1.

[139] JX 541.

[140] *Id.*; *see* Kellner Tr. 349 (testifying that he recalls the call with Chioini happened but not what was discussed).

The following week, Kellner sent a final update letter to the Beta Fund Investment Club.[141] Regarding AIM, he wrote: "Two other investors are joining me in a proxy battle to replace an inept management team. More on that as time progresses."[142] It is more likely than not that the referenced "two other investors" were Deutsch and Tudor.[143]

In January 2023, Kellner texted Deutsch about their "AIM game plan" and expressed his intention to "get this ball rolling!![hands clapping emoji; smiley emoji]"[144] On February 15, counsel at BakerHostetler sent Tudor and Deutsch's Florida counsel an email with the subject line "AIM Immunotech - Question re Share Ownership."[145] This message was forwarded by Deutsch's counsel to Deutsch and Kellner.[146] Kellner's associate sent back the requested figures reflecting the Kellner family's AIM holdings as of February 14, 2023.[147]

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[141] JX 557.

[142] *Id.* at 2.

[143] At trial, Kellner testified that the "two individuals" joining him were Chioini and Rice. Kellner Tr. 245-46. But Chioini and Rice were not "investors." *See* JX 557. Kellner had just met Chioini. Moreover, Kellner's August 2022 draft update expressly referred to Tudor and Deutsch. *Compare* JX 522, *with* JX 557; *see also* Post-trial Oral Arg. Tr. (Dkt. 272) 33-34 (Kellner's counsel arguing that Kellner was "confused").

[144] JX 570; *see* Deutsch Tr. 199-200.

[145] JX 606 at 2.

[146] *Id.* at 1.

[147] *Id.*

K. The Amended Bylaws

Around this time, the Board began to consider amending AIM's advance notice bylaws.[148] On March 17, Potter Anderson sent a proposed set of amendments to the Board. An accompanying memo explained that certain amendments were in response "to significant activist activity during 2022 in which an activist group . . . engag[ed] in efforts to conceal who was supporting and who was funding the nomination efforts and to conceal the group's plans for the Company."[149] There were also changes "to update and modernize certain aspects" of the bylaws and "bring the [b]ylaws in line with recent amendments to" the Delaware General Corporation Law.[150] Many of the proposed amendments focused on the advance notice procedures governing stockholder proposals and nominations for director elections.[151]

During a March 20 Board meeting, AIM's directors discussed the possible bylaw amendments.[152] Pittenger presented the amendments to the Board and described that "certain of the revisions [we]re designed to help better ensure that stockholders seeking to propose business or make nominations cannot attempt to

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[148] Pittenger Tr. 712-13.

[149] JX 633 at 1.

[150] *Id.*

[151] *Id.* at 5-11.

[152] JX 646 at 1-2.

engage in the types of manipulative, misleading, and improper conduct in which Mr. Jorgl, his nominees, Mr. Tudor, and others acting in concert with them engaged in connection with their attempted nominations in 2022."[153] The Board discussed making additional changes.[154]

The Board concluded that the bylaw provisions were not "preclusive or unreasonably restrictive" of stockholders' ability to make proposals or nominations.[155] The directors determined that the amendments "clarified and enhanced the rules and procedures for providing advance notice of stockholder proposals and nominations and for regulating the conduct of stockholder meetings."[156] On March 28, after minor changes and revisions to reflect director feedback, the amendments were unanimously adopted by the Board (the "Amended Bylaws").[157]

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[153] JX 647 at 2.

[154] *Id.*

[155] *Id.*

[156] *Id.*

[157] JX 679; *see* JX 686 ("Am. Bylaws").

On March 29, Kellner had a phone call with his attorney and Deutsch regarding AIM.[158] On March 31, Chioini sent the Amended Bylaws to counsel at BakerHostetler.[159]

L. The Effort Blooms

During the spring of 2023, Kellner, Deutsch, and Chioini continued their work toward a potential proxy contest. At some point in April or May, Kellner had breakfast with Tudor in Florida.[160] The two discussed the efficacy of Ampligen.[161]

Other than this meeting, Tudor curiously faded from view. He is now employed by Deutsch to do "back office" tasks.[162] Tudor "works three hours a day" sending Deutsch's "trades to the prime brokers and the firms."[163]

On May 19, Kellner asked Deutsch to "[p]lease reach out [to Chioini] to hear what his plan and that of Teresa [Goody Guillén of BakerHostetler] is regarding AIM."[164] Kellner continued: "Time is becoming critical in moving this ball forward.

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[158] *See* JX 695.

[159] JX 700.

[160] Tudor Tr. 440-41.

[161] *Id.* at 442.

[162] Deutsch Tr. 161-62.

[163] *Id.* at 162; *see also* JX 407; Tudor Dep. 48-49.

[164] JX 740.

Let's please talk later today."[165] Kellner followed that text with another to Chioini saying: "Todd will call you momentarily[.]"[166]

On June 15, counsel from BakerHostetler sent Kellner's attorney a financial breakdown of what a proxy contest would cost and the possible outcomes of that contest.[167] Counsel advised "not to have the shares transferred into [Kellner's] name until we have all our ducks in a row lined up" and cautioned that if the notice was denied and litigated, the case could get assigned "to the Vice Chancellor who we had last year (who favors defendants, not us)."[168] These emails were forwarded to Kellner, whose assistant printed them for him.[169] Kellner's assistant relayed that Kellner would call Deutsch and Kellner's counsel the next day.[170]

Kellner's assistant next began coordinating a "series of private jet stops" two weeks later for a meeting at BakerHostetler's Washington, D.C. offices.[171] The planned passengers were Kellner, Chioini, Deutsch, and Kellner's counsel. Rice was to join by video conference.[172]

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[165] *Id.*

[166] JX 745.

[167] JX 758 at 3-4.

[168] *Id.*

[169] *Id.* at 2.

[170] *Id.* at 1.

[171] JX 765; *see* Kellner Tr. 352.

[172] Chioini Tr. 30.

On July 11, the group met in Washington, D.C. as scheduled. Kellner characterized the meeting as a "final fact gathering meeting to determine what, if anything, we would do."[173] The next day, BakerHostetler sent a draft engagement letter to Kellner, Deutsch, Chioini, and Kellner's counsel.[174] On July 14, Kellner sent a text message to Deutsch and Chioini stating that he was willing to risk more and "commit more dollars proportionally to AIM going forward."[175] Kellner promised to "commit [a] million dollars" and so long as Deutsch and Chioini "committed $150,000," Kellner would also "commit the next $200k up to $1.5 million of legal cost[s]."[176] Kellner said that in his "view this [wa]s still a VERY good offer for" Deutsch and Chioini.[177] The final engagement letter with BakerHostetler was signed by Kellner, Deutsch, and Chioini on July 17.[178]

M. The Kellner Nomination

On July 24, Harrington emailed AIM on Kellner's behalf to request the Company's form of director and officer (D&O) questionnaire and a representation

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[173] Kellner Tr. 354. Chioini and Rice both asserted privilege when asked about the discussions at the meeting. Chioini Dep. 138.

[174] JX 776.

[175] JX 781.

[176] *Id.*

[177] *Id.*

[178] JX 782 at 6.

and agreement referenced in the Amended Bylaws.[179] The Amended Bylaws gave AIM five business days to respond.[180] In the interim, AIM revised its D&O questionnaire to require additional information.[181]

On July 27, Kellner submitted a Schedule 13D filing with the SEC.[182] The filing stated Kellner "intend[ed] to provide notice to [AIM] of his intent to nominate directors for election at the 2023 annual meeting of stockholders."[183]

On July 31, Rodino sent BakerHostetler the requested forms.[184] The same day, Equels contacted the Board to schedule a discussion about the "second attempt of [a] hostile takeover."[185]

At 7:52 p.m. on August 3—the evening before the nomination deadline—BakerHostetler submitted a letter from Kellner.[186] The letter provided notice of Kellner's intent to nominate himself, Chioini, and Deutsch as director candidates for election at AIM's 2023 annual meeting (the "Kellner Notice").[187]

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[179] JX 821 at 2-3.

[180] Am. Bylaws § 1.4(e).

[181] Pittenger Tr. 732-35; *see* JX 821 at 1; *compare* JX 858, *with* JX 1131, *and* JX 943.

[182] JX 831.

[183] *Id.* at 5.

[184] JX 1226 at 1.

[185] *See* JX 842.

[186] JX 870.

[187] *Id.* at 2; JX 875 ("Kellner Notice").

On August 7, AIM's outside communications advisor sent a draft press release to Equels, AIM's counsel, and AIM's investor relations representatives.[188] The draft said that "[a] hostile takeover of the Board would not only put shareholders' investments at risk, it would also be detrimental to the patients for whom we are working to bring new life-saving oncology therapies to market—most notably by repurposing our lead drug, Ampligen."[189] Counsel recommended revisions to the messaging since "no determination ha[d] been made yet as to whether the notice complies with AIM's advance notice bylaws."[190] The draft press release was a "contingency" that AIM would issue should they reject the Kellner Notice.[191] It was not shared with the Board beyond Equels.[192]

N. The Board's Rejection

The Board met on three occasions to discuss the Kellner Notice: August 8, August 21, and August 22.

On August 8, the Board held a 50 minute meeting at which Equels and counsel provided information about the 2022 proxy contest, the Amended Bylaws'

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[188] JX 1140; *see* Equels Tr. 605-06.

[189] JX 1142 at 5.

[190] *Id.* at 4.

[191] Equels Tr. 606.

[192] *See id.* at 609.

requirements, and the process for evaluating the notice.[193] During the meeting, Equels noted that many of the players from Jorgl's 2022 nomination were involved in Kellner's submission.[194] Equels cautioned that "protecting stockholders was paramount" in "view of the troubling background"—namely, the failed 2022 nomination, the "guns blazing" call in December 2022, and overlapping persons present in the current and prior efforts.[195] Equels also highlighted that Kellner, Deutsch, and Chioini intended to seek "reimbursement from AIM for their expenses relating to the 2023 Annual Meeting, as well as all the expenses (including litigation expenses) incurred by the 2022 Group related to the 2022 Attempt."[196] The Board decided to hire Potter Anderson and Kirkland & Ellis LLP to evaluate the Kellner Notice.[197]

Also on August 8, AIM's legal team filed a motion to alter or amend the previous Florida order, or, alternatively, a motion for relief from the order.[198] The motion characterized the Kellner Notice as "fail[ing] to account for the remaining 8.5% to 11.5% of AIM common stock that Kellner believed the Group beneficially

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[193] JXs 881-83.

[194] JX 883 at 1-3.

[195] *Id.* at 3.

[196] *Id.* at 2.

[197] *Id.* at 3; *see* Bryan Tr. 660.

[198] JX 878.

owned in 2022."[199] It also claimed that Kellner and Deutsch's Schedule 13D filing was misleading since it "disclose[d] only a July 26, 2023 group agreement with Chioini, omitting any reference to their mutual cooperation in the attempted proxy contest in 2022 or any other member of the Group."[200] These failings were, according to AIM, evidence that Kellner, Deutsch, and other group members posed an "ongoing . . . threat to AIM and its shareholders."[201]

The Board met again on August 21, with counsel in attendance.[202] Before the meeting, counsel distributed materials to the Board that provided a chronological overview of the Kellner Notice, explained the Board's fiduciary duties in connection with its review of the notice, and analyzed whether the notice complied with the Amended Bylaws.[203] These issues were discussed with the Board during the meeting.[204]

Counsel advised that they found numerous deficiencies in the Kellner Notice.[205] These included:

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[199] *Id.* at 9.

[200] *Id.* at 10.

[201] *Id.*

[202] JX 907; *see* Pittenger Tr. 740.

[203] JX 909; JX 911; *see* Pittenger Tr. 741-42.

[204] *See* JX 907 at 3-23.

[205] JX 909 at 14-21.

- undisclosed agreements, arrangements, and understandings, including between and among Kellner, Deutsch, Chioini, Lautz, Ring, and Xirinachs;
- failure to disclose known supporters of Kellner's purported nominations;
- failure to disclose specific dates of first contact between relevant parties; and
- other undisclosed information, including adverse recommendations from proxy advisor firms concerning other public company board service as called for in AIM's form of D&O questionnaire.[206]

After outlining these perceived deficiencies, counsel presented on "potential next steps."[207] Counsel also discussed "offensive litigation options" the Board could take against Kellner and his party.[208] The Board concluded that it needed additional time to consider the Kellner Notice and information provided by counsel.

The Board reconvened the following morning to continue its consideration of the Kellner Notice.[209] The Board unanimously approved resolutions rejecting the Kellner Notice for violating the Amended Bylaws. It observed that the notice was "designed to omit and conceal information and to provide incomplete or misleading disclosures that destabilize the important disclosure function that [AIM's] Advance

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206 *Id.*

207 *Id.* at 23.

208 *Id.* at 24.

209 *See* JX 911 at 8-10.

Notice Provisions were designed to serve."[210] The Board also authorized a letter to Kellner summarizing the notice's defects and the Board's rejection of the notice.[211]

On August 23, AIM's counsel notified BakerHostetler that the Kellner Notice had been rejected.[212] The letter detailed the notice's deficiencies and noncompliance with provisions of the Amended Bylaws.[213] It also highlighted that because the deadline for submitting a timely nomination notice had passed, "any nominations that purport to be made pursuant to the [Kellner] Notice w[ould] be disregarded and [not] considered at the 2023 Annual Meeting."[214]

Later that day, BakerHostetler circulated emails with the subject line "Re: Draft Complaint – AIM Nomination Notice Litigation" to Chioini, Kellner, Deutsch, and others.[215] On August 28, the Kellner group issued a press release urging AIM stockholders to "disregard communications by AIM and its Board" with respect to the proxy contest.[216] It also announced that Kellner had filed litigation.

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[210] *Id.* at 9-10.

[211] *Id.*

[212] JX 378.

[213] *Id.*; JX 918.

[214] JX 378 at 14. Kellner attempted to submit a supplemental nomination notice on October 9 during this litigation. JX 975.

[215] JX 925 at 2.

[216] JX 929 at 1.

O. This Litigation

On August 25, Kellner filed a Verified Complaint in this court against AIM and its directors.[217] It advances three counts. Count I seeks a declaration that the Amended Bylaws are invalid.[218] Count II seeks, additionally and alternatively, a declaration that the Board's application of the Amended Bylaws to reject Kellner's notice is unlawful and inequitable.[219] Count III seeks a declaration that the Board members breached their fiduciary duties by adopting the Amended Bylaws and rejecting Kellner's notice.[220]

On September 11, the defendants answered the complaint and AIM filed a counterclaim against Kellner.[221] The counterclaim seeks a declaratory judgment that the Amended Bylaws are valid and lawful.[222]

After expedited discovery, a three day trial was held on October 30 through November 1.[223] Post-trial argument was held on November 21.[224] After submissions regarding a trial exhibit submitted for *in camera* review were filed, the matter was

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[217] Dkt. 1

[218] Compl. ¶¶ 103-13.

[219] *Id.* ¶¶ 114-28.

[220] *Id.* ¶¶ 129-33.

[221] Defs.' Answer to Verified Compl. and Verified Countercl. (Dkt. 13) ¶¶ 100-01.

[222] *Id.* ¶¶ 67-73.

[223] Dkt. 256.

[224] Dkt. 268.

taken under advisement on December 5.[225] AIM's 2023 annual meeting is set to occur on or around December 29.[226]

II. LEGAL ANALYSIS

Kellner challenges both the Board's adoption and application of the Amended Bylaws. He first argues that the Amended Bylaws are invalid.[227] He next asserts that his notice complied with the Amended Bylaws' requirements and that, even if it did not, the Board applied the Amended Bylaws inequitably. The defendants contend that the converse is true.[228]

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[225] Dkts. 269, 271.

[226] Dkt. 270. At least, it was set to occur on December 29 as of the time that this decision was being prepared for filing. The afternoon of December 28—at the proverbial eleventh hour—counsel alerted chambers that AIM would push back its annual meeting another week. I am unaware of the new annual meeting date.

[227] According to Kellner, AIM's corresponding counterclaim "should have been asserted . . . [a] compulsory counterclaim[] in the Jorgl Action." Pl.'s Pre-trial Br. (Dkt. 243) 59-61. As the defendants correctly point out, however, AIM seeks a declaratory judgment regarding Kellner's nomination notice—not Jorgl's. Defs.' Post-trial Br. (Dkt. 261) 69. The court "is not confronted with a situation in which a [counter]plaintiff has filed a second action against defendants they previously sued regarding the same transaction." *Grunstein v. Silva*, 2011 WL 378782, at *8 (Del. Ch. Jan. 31, 2011). AIM's counterclaim is properly raised in this action.

[228] The defendants aver that the doctrine of unclean hands "bar[s] [Kellner's] claims for equitable relief." Defs.' Post-trial Br. 70. The court "has broad discretion" to apply the doctrine. *RBC Cap. Mkts., LLC v. Jervis*, 129 A.3d 816, 876 (Del. 2015) (citation omitted). I decline to do so here. Kellner's conduct was not "so offensive to the integrity of the court that [his] claims should be denied, regardless of their merit." *Portnoy v. Cryo-Cell Int'l, Inc.*, 940 A.2d 43, 81 (Del. Ch. 2008) (quoting *Gallagher v. Holcomb & Salter*, 1991 WL 158969, at *4 (Del. Ch. Aug. 16, 1991)).

My analysis of these arguments proceeds in three steps. I begin by considering the policy and practice integral to advance notice bylaws. With those principles in mind, I assess whether the Amended Bylaws at issue are facially valid. I then consider whether Kellner satisfied the relevant advance notice bylaws and whether the Board acted reasonably in rejecting the Kellner Notice.

A. The Role of Advance Notice Bylaws

Delaware law recognizes that stockholders have a fundamental right to participate in the voting process, including the right to nominate directors.[229] Yet the Delaware General Corporation Law is nearly silent on how a stockholder should nominate a director candidate for election.[230] As a result, public companies commonly implement advance notice bylaws to promote "orderly meetings and election contests."[231]

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[229] *E.g.*, *EMAK Worldwide, Inc. v. Kurz*, 50 A.3d 429, 433 (Del. 2012) ("The fundamental governance right possessed by shareholders is the ability to vote for the directors the shareholder wants to oversee the firm. Without that right, a shareholder would more closely resemble a creditor than an owner.").

[230] *See* JX 973 (Expert Report of Edward Rock) ("Rock Report") ¶ 23; 8 *Del. C.* § 211(b).

[231] *Openwave Sys. Inc. v. Harbinger Cap. P'rs Master Fund I, Ltd.*, 924 A.2d 228, 239 (Del. Ch. 2007); *see also BlackRock Credit Allocation Income Tr. v. Saba Cap. Master Fund, Ltd.*, 224 A.3d 964, 980 (Del. 2020) (describing advance notice bylaws as "commonplace" (quoting *Goggin v. Vermillion, Inc.*, 2011 WL 2347704, at *4 (Del. Ch. June 3, 2011))); 8 *Del. C.* § 109(b).

Modern advance notice bylaws have two primary functions: timing and disclosure.[232] Regarding the former, advance notice bylaws set a deadline "by which stockholders must give notice of their intention to nominate director candidates in advance of an annual meeting."[233] In furtherance of the latter, advance notice bylaws may require stockholders to provide information "allowing boards of directors to knowledgably make recommendations about nominees and ensuring that stockholders cast well-informed votes."[234]

Advance notice bylaws have evolved over time to serve these purposes. So-called first generation advance notice bylaws obligated the proponent stockholder to notify the company of its intention to nominate by a fixed time before the meeting date and to provide basic information about the stockholder and its nominees.[235] In

[232] *See Openwave Sys.*, 924 A.2d at 238-39; *Sternlicht v. Hernandez*, 2023 WL 3991642, at *14 (Del. Ch. June 14, 2023) (explaining that advance notice bylaws "serve dual purposes: marshalling orderly meetings and election contests where the nominees are fixed in advance of the annual meeting, and providing fair warning to the corporation so that it can respond to stockholder nominations"); *see also* Arthur Fleischer, Jr., Gail Weinstein, & Scott B. Luftglass, *Takeover Defense: Mergers and Acquisitions*, § 6.06[C][1] (9th ed. 2022) ("Advance notice bylaw provisions provide several benefits to a company, including giving a board time to evaluate the proposed candidates and preventing last-minute 'surprise attacks' by third parties for control or board representation.").

[233] *Strategic Inv. Opportunities LLC v. Lee Enters., Inc.*, 2022 WL 453607, at *9 (Del. Ch. Feb. 14, 2022).

[234] *Id.*

[235] *See Nomad Acquisition Corp. v. Damon Corp.*, 1988 WL 383667, at *8 (Del. Ch. Sept. 20, 1988) (considering whether the plaintiffs had a reasonable probability of success in their challenge to the validity of a bylaw requiring stockholders to provide 60 days of notice before submitting a nomination for a director election); *see also Hubbard v. Hollywood Park Realty Ent., Inc.*, 1991 WL 3151, at *11 (Del. Ch. Jan. 14, 1991) (addressing an

response to case law developments and activism trends, a second generation of advance notice bylaws emerged post-2008 that expanded on these requirements. Second generation advance notice bylaws often include provisions mandating the completion of nominee questionnaires and the disclosure of derivative positions, compensation information, and persons acting in concert with the stockholder proponent and its nominees.[236] The scope of typical advance notice bylaws continues to develop through an iterative process as new case law, rules, and regulations emerge.[237]

Advance notice bylaws are an area of renewed focus after the SEC's November 2021 adoption of Rule 14a-19, which requires registrants to use a universal proxy card in contested elections.[238] Previously, the company and a

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advance notice bylaw requiring the movants to give notice of their intent to nominate a competing slate of directors in light of a material post-deadline change of position by the incumbent directors).

[236] *See* Donald F. Parsons & Jason S. Tyler, *Activist Stockholders, Corporate Governance Challenges, and Delaware Law*, RESEARCH HANDBOOK ON MERGERS & ACQUISITIONS 7 n.13 (Claire A. Hill & Steven Davidoff Solomon eds., 2016); *see also* Marc Weingarten & Erin Magnor, *Second Generation Advance Notification Bylaws*, Harvard Law School Forum on Corporate Governance (Mar. 17, 2009), https://corpgov.law.harvard.edu/2009/03/17/second-generation-advance-notification-bylaws/; Charles Nathan, *Second Generation Advance Notice Bylaws and Poison Pills*, Harvard Law School Forum on Corporate Governance (Apr. 22, 2009), https://corpgov.law.harvard.edu/2009/04/22/second-generation-advance-notice-bylaws-and-poison-pills/.

[237] Rock Report ¶ 25.

[238] 17 CFR § 240.14a-19; *see* U.S. Securities and Exchange Commission, *Final Rule, Universal Proxy*, https://www.sec.gov/rules/2021/11/universal-proxy (last visited Dec. 16, 2023).

dissident stockholder nominating director candidates would each distribute separate proxy cards. Now, the company must include the dissident nominees on a universal proxy card, allowing stockholders to mix and match between slates.[239] Numerous public companies have amended their advance notice bylaws to account for the rule change.[240] Many have also taken the opportunity to revisit and enhance other advance notice requirements.[241] Some have gone to extremes.[242]

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[239] *See* U.S. Securities and Exchange Commission, *Universal Proxy*, https://www.sec.gov/corpfin/universal-proxy-secg (last visited Dec. 16, 2023) ("The amendments will allow shareholders voting by proxy to choose among director nominees in an election contest in a manner that more closely reflects the choice they could make by voting in person at a shareholder meeting.").

[240] *See* Rock Report ¶ 26 (citing Aaron Wendt & Krishna Shah, *2023 Proxy Season Briefing: Key Trends and Data Highlights*, Harvard Law School Forum on Corporate Governance (Aug. 17, 2023), https://corpgov.law.harvard.edu/2023/08/17/2023-proxy-season-briefing-key-trends-and-data-highlight/ ("More than 685 companies in our coverage amended advance notice bylaws in response to universal proxy[.]")); *id.* ¶ 37; *see also* Douglas K. Schnell & Daniyal Iqbal, *Lessons from the 2023 Proxy Season: Advance Notice Bylaws and Officer Exculpation*, Harvard Law School Forum on Corporate Governance (Sept. 5, 2023), https://corpgov.law.harvard.edu/2023/09/05/lessons-from-the-2023-proxy-season-advance-notice-bylaws-and-officer-exculpation/ ("[O]f the 70 companies in the SV150 that amended their bylaws between November 1, 2021, and July 31, 2023, 50 amended their bylaws explicitly to address Rule 14a-19, with 90 percent of those amendments occurring after the August 31, 2022, effective date of Rule 14a-19."); Maia Gez et al., *Amending Charters to Address Universal Proxy, Shareholder Activism and Officer Exculpation*, Harvard Law School Forum on Corporate Governance (July 10, 2023), https://corpgov.law.harvard.edu/2023/07/10/amending-charters-to-address-universal-proxy-shareholder-activism-and-officer-exculpation/ (reporting that based on a law firm survey, "200 companies in the S&P 500 have amended their bylaws to address the SEC's universal proxy rule and shareholder activism").

[241] *See supra* note 240 (listing sources).

[242] *E.g.*, Verified Compl. for Breach of Fiduciary Duties, *Politan Capital Mgmt. L.P. v. Kiani*, C.A. No. 2022-0948-NAC (Del. Ch. Oct. 21, 2022) (Dkt. 1) (challenging the validity of advance notice bylaws requiring any stockholder seeking to nominate directors to identify, among other things, the investment fund's limited partners, all arrangements or

Since the universal proxy rules took effect in August 2022, this court has only begun to hear disputes involving the wave of new and amended advance notice bylaws.[243] Even with this limited set, it is apparent that the court must—more than ever—carefully balance the competing interests at play.[244] On one hand, it is legitimate for companies to refresh their bylaws to comport with SEC rules and further the twin goals of order and disclosure. On the other hand, onerous bylaws that stray far afield from these purposes risk frustrating any nomination of alternative director candidates.

Advance notice requirements are "often construed and frequently upheld as valid by Delaware courts"—particularly those adopted on a clear day.[245] But the discretion afforded a board's adoption of advance notice bylaws is not limitless.[246] If advance notice bylaws that materially interfere with stockholders' voting rights

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understandings between the limited partners and their family members, and plans the fund has to nominate directors at other companies in the next year).

[243] *See, e.g., id.*; *Paragon Techs., Inc. v. Cryan*, 2023 WL 8269200 (Del. Ch. Nov. 30, 2023) (addressing a challenge to bylaws adopted after the universal proxy rules were enacted).

[244] *See Paragon Techs.*, 2023 WL 8269200, at *7 (remarking that the corporate goals of advance notice bylaws "must be carefully balanced against stockholders' 'fundamental governance right' of voting for directors" (quoting *Kurz*, 50 A.3d at 433)).

[245] *Openwave Sys.*, 924 A.2d at 239.

[246] *See Lee Enters.*, 2022 WL 453607, at *14 ("*Schnell* empowers the court to invalidate certain board actions, including those that inequitably manipulate the corporate machinery to impair the rights of stockholders. Put simply, directors' inequitable acts towards stockholders do not become permissible because they are legally possible." (citing *Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437, 439 (Del. 1971))).

are implemented, the justification for judicial deference is diminished.[247] Thus, constraints on stockholder voting power must be reasonably tailored to a legitimate corporate end. Bylaws that "unduly restrict the stockholder franchise or are applied inequitably [] will be struck down."[248]

B. The Adoption Claim

Kellner contends that the defendants breached their fiduciary duties by approving the Amended Bylaws. In Kellner's view, the Amended Bylaws were adopted for the inequitable purpose of thwarting stockholders' ability to run a competing slate of director nominees.[249] He asks that I declare the Amended Bylaws invalid, meaning that AIM has no advance notice bylaws and must place his slate on the 2023 ballot.

Enhanced scrutiny—Delaware's intermediate equitable standard of review[250]—guides my assessment of this claim. Unlike the 2016 Bylaws, the

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[247] *See* Jill E. Fisch, *Governance by Contract: The Implications for Corporate Bylaws*, 106 CALIF. L. REV. 373, 409 (2018) ("[S]everal aspects of existing law limit the ability of shareholders to participate on an equal footing with boards in the private ordering process. This asymmetry undermines the justification for broad judicial deference.").

[248] *Openwave Sys.*, 924 A.2d at 239.

[249] Pl.'s Post-trial Br. (Dkt. 260) 23.

[250] *See generally In re Trados Inc. S'holder Litig.*, 73 A.3d 17, 43 (Del. Ch. 2013) ("Enhanced scrutiny is Delaware's intermediate standard of review. Framed generally, it requires that the defendants 'bear the burden of persuasion to show that their motivations were proper and not selfish' and that 'their actions were reasonable in relation to their legitimate objective.'" (quoting *Mercier v. Inter-Tel (Del.), Inc.*, 929 A.2d 786, 810 (Del. Ch. 2007))).

Amended Bylaws were not adopted on a clear day.[251] The skies were overcast in March 2023, with storm clouds of a proxy contest gathering on the horizon.[252]

Kellner argues that because enhanced scrutiny applies, the Board must prove that it had a "compelling justification" for its actions.[253] He misstates the applicable standard of review.[254] Instead, as the Delaware Supreme Court recently pronounced in *Coster*, the court should apply *Unocal* "with sensitivity to the stockholder franchise" that integrates the spirit of *Blasius* and *Schnell*.[255]

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[251] *Cf. Jorgl*, 2022 WL 16543834, at *15 (finding that the 2016 Bylaws were "adopted on a clear day . . . long before Tudor, Xirinachs, or Jorgl entered the picture"); *see also AB Value P'rs, LP v. Kreisler Mfg. Corp.*, 2014 WL 7150465, at *3 (Del. Ch. Dec. 16, 2014) (upholding an advance notice bylaw adopted on a "clear day" that was "long before the present proxy challenge was contemplated by" the challengers).

[252] *See infra* notes 269-72 and accompanying text (discussing the Board's awareness of the potential for another proxy contest).

[253] Pl.'s Pre-trial Br. 2; *see also id.* at 3, 29, 31-32, 37; Pl.'s Post-trial Br. 2-4, 26.

[254] *See Lee Enters.*, 2022 WL 453607, at *16 (explaining that review of board action in the advance notice bylaw context is fundamentally "one of reasonableness" viewed through *Unocal*); *see also Mentor Graphics v. Quickturn Design Sys.*, 728 A.2d 25, 43 (Del. Ch. 1998) (rejecting a challenge to an advance notice bylaw based on "the fiduciary principles embodied in *Unocal*"); *Mercier*, 929 A.2d at 788, 810.

[255] *Coster v. UIP Cos., Inc.*, 300 A.3d 656, 673 (Del. 2023) ("Experience has shown that *Schnell* and *Blasius* review, as a matter of precedent and practice, have been and can be folded into *Unocal* review to accomplish the same ends—enhanced judicial scrutiny of board action that interferes with a corporate election or a stockholder's voting rights in contests for control." (citing Lawrence A. Hamermesh et. al., *Optimizing the World's Leading Corporate Law: A Twenty-Year Retrospective and Look Ahead*, 77 BUS. LAW. 321, 331 (2022))).

This approach "requires a context-specific" review of the directors' conduct.[256] "Fundamentally, the standard to be applied is one of reasonableness."[257] First, the court "review[s] whether the board faced a threat 'to an important corporate interest or to the achievement of a significant corporate benefit.'"[258] Second, the court "review[s] whether the board's response to the threat was reasonable in relation to the threat posed and was not preclusive or coercive to the stockholder franchise."[259] The defendants bear the burden of proof.[260]

Here, the Amended Bylaws are a mixed bag. Certain of the Amended Bylaws reflect changes to address Rule 14a-19 and cohere with the DGCL.[261] Kellner does not quibble with these amendments,[262] and neither will I. Other aspects of the

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[256] *Coster*, 300 A.3d at 671 (quoting *Lee Enters.*, 2022 WL 453607, at *16); *see also Paragon Techs.*, 2023 WL 8269200, at *12.

[257] *Lee Enters.*, 2022 WL 453607, at *16; *see In re Gaylord Container Corp. S'holders Litig.*, 753 A.2d 462, 474-75 (Del. Ch. 2000) ("In itself, the *Unocal* test is a straightforward analysis of whether what a board did was reasonable."); *see also In re Dollar Thrifty S'holder Litig.*, 14 A.3d 573, 598 (Del. Ch. 2010) ("In a situation where heightened scrutiny applies, the predicate question of what the board's true motivation was comes into play. The court must take a nuanced and realistic look at the possibility that personal interests short of pure self-dealing have influenced the board['s decision making].").

[258] *Coster*, 300 A.3d at 672 (quoting *Phillips v. Insituform of N. Am., Inc.*, 1987 WL 16285, at *7 (Del. Ch. Aug. 27, 1987)).

[259] *Id.* at 672-73.

[260] *Id.* at 672.

[261] *E.g.*, Am. Bylaws §§ 1.4(c)(3)(b), 1.4(g); *see* JX 647; JX 635; Mitchell Tr. 637; Appelrouth Tr. 687; Pittenger Tr. 712-13, 719-20.

[262] Pl.'s Post-trial Br. 31 ("The updates to technical mechanics . . . and those addressing legal developments . . . are not at issue.").

Amended Bylaws are bolstered disclosure requirements that Kellner insists are inequitable and invalid. Although the Board has proven it reasonably identified a threat to proper corporate objectives that prompted it to amend AIM's bylaws, it has failed to show that certain of the provisions are proportionate in relation to those objectives.

1. <u>Reasonableness</u>

The first *Unocal* prong requires the Board to demonstrate that it conducted a reasonable and good faith investigation through which it identified "grounds for concluding that a threat to the corporate enterprise existed."[263] The classic *Unocal* pattern is an imperfect fit for advance notice bylaws. "Corporate democracy is not an attack" in and of itself.[264] The threat identified cannot simply be that the board feels certain director nominees would be worse for the company than themselves.[265]

[263] *Versata Enters., Inc. v. Selectica, Inc.*, 5 A.3d 586, 599 (Del. 2010); *accord Coster*, 300 A.3d at 661-62.

[264] *In re Aerojet Rocketdyne Hldgs., Inc.*, 2022 WL 2180240, at *15 (Del. Ch. June 16, 2022).

[265] *See Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 663 (Del. Ch. 1988) (explaining that though it may be true "for any number of matters" that "the board knows better" than shareholders what is in the company's best interest, "it is irrelevant (except insofar as the shareholders wish to be guided by the board's recommendation) when the question is who should comprise the board of directors"); *see also Coster*, 300 A.3d at 672 ("As Chancellor Allen stated long ago, the threat cannot be justified on the grounds that the board knows what is in the best interests of the stockholders."); *Mercier*, 929 A.2d at 811.

Instead, the threat must be to matters of "corporate policy and effectiveness which touches on issues of control."[266]

AIM's Board had an objective of obtaining transparency from a stockholder seeking to nominate director candidates. The Board's Delaware counsel advised it on the importance of knowing "who is making and supporting [a] proposal or nominations" and "whether they have conflicts of interest or other interests, motives, or plans that should be disclosed to the board and stockholders."[267] The Board asked counsel to update AIM's advance notice bylaws "to better protect AIM and its stockholders against potentially abusive and deceptive practices."[268]

The Board made a reasonable assessment, in reliance on the advice of counsel, that this information-gathering objective was threatened.[269] AIM had just endured a proxy contest where it seemed that the nominating stockholder was a façade concealing the identities of individuals responsible for the effort.[270] By December 2022, the Board had reason to believe that the group behind the prior proxy contest

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[266] *In re Ebix, Inc. S'holder Litig.*, 2018 WL 3545046, at *7 (Del. Ch. July 17, 2018) (citation omitted).

[267] JX 635 at 5; *see also* Equels Tr. 524; Mitchell Tr. 638.

[268] JX 635 at 1.

[269] *See id.*; Equels Tr. 525, 531; Appelrouth Tr. 688; Pittenger Tr. 827.

[270] *See* JX 647; *Jorgl*, 2022 WL 16543834, at *17.

was "threatening to revive [its] efforts" for the 2023 election.[271] In revisiting AIM's advance notice bylaws, the Board sought to prevent "the types of manipulative, misleading, and improper conduct" experienced in 2022 from happening again.[272]

2. Proportionality

The second *Unocal* prong requires the court to undertake a substantive review of the Board's response to the perceived threat.[273] I begin by considering whether the Amended Bylaws are "draconian, by being either preclusive or coercive."[274] If they are not, I must assess whether the challenged provisions fall "within a range of reasonable responses" in relation to the corporate interest at risk.[275]

Kellner asserts that the Amended Bylaws are preclusive because they eliminate any prospect of election competition and coercive because they prevent dissident nominations, leaving the incumbents as the sole choice.[276] This coercion

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[271] JX 600 at 5; *see also* Equels Tr. 624; Pittenger Tr. 712; Mitchell Dep. 188-90; Pittenger Dep. 73-74; JX 526; JX 601; JX 940; JX 948.

[272] JX 647.

[273] *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 92 (Del. Ch. 2011) ("Once the board has reasonably perceived a legitimate threat, *Unocal* prong 2 engages the Court in a substantive review of the board's defensive actions: Is the board's action taken in response to that threat proportional to the threat posed?").

[274] *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1367 (Del. 1995).

[275] *Id.*

[276] Pl.'s Post-trial Br. 37 (citing *Chesapeake Corp. v. Shore*, 711 A.2d 293, 333-34 (Del. Ch. 2000)); *see also* Pl.'s Pre-trial Br. 39.

argument rests on the premise that the bylaws are preclusive. If the bylaws were not preclusive, then the vote would be uncoerced.

A measure is preclusive if it makes a dissident's "ability to wage a successful proxy contest . . . 'realistically unattainable.'"[277] The Amended Bylaws are lengthy, dense, and require meaningful effort to satisfy. That does not mean that they are preclusive.[278] The line may be crossed where bylaws contain requirements that unduly restrict the stockholder franchise.[279]

Kellner focuses on six specific provisions of the Amended Bylaws in arguing that the Board's response was out of line with its objectives.[280] For two provisions,

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[277] *Selectica*, 5 A.3d at 601 (citing *Carmody v. Toll Bros., Inc.*, 723 A.2d 1180, 1195 (Del. Ch. 1998)).

[278] *See Yucaipa Am. All. Fund II, L.P. v. Riggio*, 1 A.3d 310, 354 (Del. Ch. 2010) (holding that a rights plan was not coercive where the plaintiff could "succeed in a proxy contest"), *aff'd*, 15 A.3d 218 (Del. 2011); *Unitrin*, 651 A.2d at 1383.

[279] *See JANA Master Fund, Ltd. v. CNET Networks, Inc*., 954 A.2d 335, 344 (Del. Ch. 2008) (warning that "when advance notice bylaws unduly restrict the stockholder franchise . . . they will be struck down" (citing *Openwave Sys.*, 924 A.2d at 239)), *aff'd*, 947 A.2d 1120 (Del. 2008) (TABLE).

[280] Pl.'s Post-trial Br. 8-11. Various other provisions were addressed at times in pre-trial briefing or in expert reports. Given the expedited nature of this decision, it is unnecessary (and would be irresponsible) to opine on every provision that changed between the 2016 Bylaws and Amended Bylaws. I therefore focus on the provisions expressly challenged in Kellner's post-trial brief. *See In re IBP, Inc. S'holders Litig.*, 789 A.2d 14, 62 (Del. Ch. 2001) (noting that a party waived an argument by omitting it from post-trial briefing); *Oxbow Carbon & Mineral Hldgs., Inc. v. Crestview-Oxbow Acq., LLC*, 202 A.3d 482, 502 n.77 (Del. 2019) ("The practice in the Court of Chancery is to find that an issue not raised in post-trial briefing has been waived, even if it was properly raised pre-trial." (citation omitted)).

the Board proved that they are non-preclusive and reasonable means to obtaining enhanced disclosure. It fell short regarding four others.

a. The AAU Provision

Section 1.4(c)(1)(D) of the Amended Bylaws (the "AAU Provision") requires the disclosure of all arrangements, agreements, or understandings ("AAUs"), "whether written or oral, and including promises," relating to a Board nomination.[281] Generally speaking, this bylaw promotes a proper corporate objective: enabling the

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[281] Am. Bylaws § 1.4(c)(1)(D). The full text of the provision states:

> a complete and accurate description of all agreements, arrangements or understandings (whether written or oral, and including promises) between or among any two or more of any Holder, any Stockholder Associated Person (as such terms "Holder" and "Stockholder Associated Person" are defined in this Section 1.4), any Stockholder Nominee, any immediate family member of such Stockholder Nominee, any Affiliate or Associate of such Stockholder Nominee, any person or entity acting in concert with any of the foregoing persons or entities with respect to the nominations or the Corporation (including the full legal name (and any alias names) of any such person or entity acting in concert), and/or any other person or entity (including the full legal name (and any alias names) of any such person or entity), existing presently or existing during the prior twenty-four (24) months relating to or in connection with the nomination of any Stockholder Nominee or any other person or persons for election or re-election as a director of the Corporation, or pursuant to which any such nomination or nominations are being made, or relating to or in connection with the funding or financing of any nomination or nominations of any person or persons (including, without limitation, any Stockholder Nominee) for election or re-election to the Board of Directors, including, without limitation, the funding or financing of any proxy solicitation or litigation relating to such nomination or nominations.

See infra note 293 (defining "Holder"); *infra* note 294 and accompanying text (defining "Stockholder Associated Person," "Affiliate," and "Associate").

Company and Board to evaluate who is making and supporting a proposal.[282] Such information would also be important to stockholders' consideration of a nominator or nominees' motivations when voting to elect directors.[283]

The AAU Provision builds on a similar requirement found in the 2016 Bylaws.[284] The record suggests that the AAU Provision was amended in 2023 to better "protect AIM and its stockholders against potentially abusive and deceptive practices by activists or hostile acquirors."[285] The Board would have been sensitive

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[282] *See* JX 635; *see also* Equels Tr. 524; Mitchell Tr. 638.

[283] *See Jorgl*, 2022 WL 16543834, at *16 ("[This] information would have been important to stockholders in deciding which director candidates to support."); *see also Brisach v. The AES Corp.*, C.A. No. 4287-CC, at 21 (Del. Ch. July 8, 2009) (TRANSCRIPT) (noting that a diminished disclosure requirement "impoverishes the informational base available to other investors in a situation when it may be extremely relevant to know what the economic motivations are of the proponents of some important corporate action"); Rock Report ¶¶ 60, 68 (observing that many public companies have AAU provisions in their advance notice bylaws).

[284] The 2016 Bylaw provision stated:

> For any Stockholder Proposal that seeks to nominate persons to stand for election as directors of the Corporation, the stockholder's notice also shall include (i) a description of all arrangements or understandings between such stockholder and each proposed nominee and any other person or persons (including their names) pursuant to which the nomination(s) are to be made.

JX 23 at 4. This version of the bylaw was adopted on a clear day. *See Jorgl*, 2022 WL 16543834, at *15 (stating that the 2016 Bylaws were "adopted on a clear day").

[285] *See* JX 635; JX 647 at 2 (counsel advising that "certain of the revisions are designed to help better ensure that stockholders seeking to propose business or make nominations cannot attempt to engage in the types of manipulative, misleading, and improper conduct" observed in 2022).

to this risk given its experience in the 2022 proxy contest where a nominating stockholder seemingly evaded disclosure requirements.

As before, the Board's objective to discover AAUs behind a nomination is reasonable.[286] But Kellner argues that the revised AAU Provision's terms sweep too far.[287] He highlights two aspects of the AAU Provision that he deems particularly problematic.

First, the AAU Provision contains a bespoke 24-month lookback provision.[288] The record reflects that this term was added after Equels questioned whether the bylaw was ambiguous since it did not specify the time period for which AAUs were to be disclosed.[289] The Board wanted to clarify this in light of the 2022 proxy contest, where the plaintiff took the position that certain persons had dropped out of the contest just before the nomination notice was submitted.[290] The revision adopted by the Board reduced the risk of gamesmanship through overly narrow readings of the bylaw. The 24-month period was chosen after the Board considered that the

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[286] *See Jorgl*, 2022 WL 16543834, at *16 ("There are legitimate reasons why the Board would want to know whether a nomination was part of a broader scheme relating to the governance, management, or control of the Company.").

[287] Pl.'s Pre-trial Br. 39; Pl.'s Post-trial Br. 37-38.

[288] Rock Tr. 807.

[289] Pittenger Tr. 722 (expressing agreement with Equels that the bylaw was ambiguous since "it wasn't clear if it was just seeking present, current [AAUs] that are still in effect or whether it goes back in time. And if it goes back in time, does it go back to the beginning of time.").

[290] *See id.* at 722-23.

2022 nomination followed about 18 months of activity.[291] The lookback is neither preclusive nor unreasonable. A stockholder could easily understand what it requires and disclose information accordingly.

Second, the AAU Provision requires a nominating stockholder to disclose AAUs both with persons acting in concert with the stockholder and any "Stockholder Associated Person" (or "SAP").[292] Stockholder Associated Person is defined, in relation to a "Holder,"[293] as:

> (i) any person acting in concert with such Holder with respect to the Stockholder Proposal or the Corporation, (ii) any person controlling, controlled by, or under common control with such Holder or any of their respective Affiliates and Associates, or a person acting in concert therewith with respect to the Stockholder Proposal or the Corporation, and (iii) any member of the immediate family of such Holder or an Affiliate or Associate of such Holder.[294]

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[291] Equels Tr. 529-30; Pittenger Tr. 724.

[292] Am. Bylaws § 1.4(c)(1)(D). I note that the SAP term is used at least thirty times in the Amended Bylaws, typically alongside additional references to persons acting in concert with, a family member of, or in another relationship with other persons. Unless the information is required to be disclosed under SEC rules or regulations, the use of the SAP term appears quite broad in a number of instances. I decline to issue an advisory opinion on every provision mentioning SAPs. Instead, I have addressed the use of the term in the Amended Bylaw provisions that Kellner raises in his post-trial brief and that are relevant to my expedited determination of whether Kellner's nominees should be placed on the 2023 ballot.

[293] "Holder" is defined as the nominating stockholder and each beneficial holder on whose behalf the nomination is made. Am. Bylaws § 1.4(i)(6).

[294] Am. Bylaws § 1.4(i)(8). "Affiliate" and "Associate" have "the meaning[s] attributed to such term[s] in Rule 12b-2 under the Exchange Act." *Id.* § 1.4(c)(i)(1), (2); *see* 17 CFR § 240.12b-2 (stating that "[a]n 'affiliate' of, or a person 'affiliated' with, a specified person, is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified"); *id.* (stating that

In the context of the AAU Provision, a nominating stockholder would need to disclose any AAUs that an SAP had with a holder, nominee (and his or her immediate family members, affiliates, or associates), persons acting in concert with any SAP, holder, nominee (and family, affiliates, or associates), and "any other person or entity."[295]

It is here that the AAU Provision goes off the rails, undermining an otherwise reasonable and appropriate bylaw. Read literally, the interplay of the various terms—"acting in concert," "Associate," "Affiliate," and "immediate family" within the SAP definition, and SAPs within the AAU Provision—causes them to multiply, forming an ill-defined web of disclosure requirements.[296] For example, if the mother of an associate of a beneficial holder had an agreement with the estranged sister of a nominee to finance the nomination of a third-party nominee to the Board (who is unknown to both the nominating stockholder and the nominee), then the nominating

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"the term 'associate' used to indicate a relationship with any person, means (1) any corporation or organization (other than the registrant or a majority-owned subsidiary of the registrant) of which such person is an officer or partner or is, directly or indirectly, the beneficial owner of 10 percent or more of any class of equity securities, (2) any trust or other estate in which such person has a substantial beneficial interest or as to which such person serves as trustee or in a similar fiduciary capacity, and (3) any relative or spouse of such person, or any relative of such spouse, who has the same home as such person or who is a director or officer of the registrant or any of its parents or subsidiaries").

[295] Am. Bylaws § 1.4(c)(1)(D).

[296] *See supra* notes 281, 293-94 and accompanying text.

stockholder would (arguably) be required to mention it in the notice.[297] The nominating stockholder would also seemingly be required to disclose an oral arrangement between the brother of an affiliate of a beneficial holder of the stockholder and any "any other person" "relating to or in connection with" AIM director nominations.[298] There are unending permutations of this hypothetical.[299]

The Board presented no evidence to suggest that the inclusion of broadly defined SAPs in the AAU Provision is proportionate to its objective of preventing stockholders from misconstruing and evading the Amended Bylaws' disclosure requirements.[300] The expansive text is more akin to a tripwire than an information

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[297] This interpretation reads the phrase "any member of the immediate family of such Holder or an Affiliate or Associate of such Holder" in the definition of SAP to mean an immediate family member of: (1) the Holder, or (2) an Affiliate of the Holder or (3) an Associate of the Holder. One could also read it to mean the family member of the Holder *or* an Associate of the Holder *or* an Affiliate of the Holder.

[298] Am. Bylaws § 1.4(c)(1)(D).

[299] *Cf. Williams Cos. S'holder Litig.*, 2021 WL 754593, at *37 (Del. Ch. Feb 26, 2021) (finding a rights plan's "acting in concert" feature to unreasonably "sweep[] up benign stockholder communications," giving the board discretion to determine if the plan was triggered, and using language that "gloms on" a "daisy-chain concept that operates to aggregate stockholders even if members of the group have no idea that other stockholders exist"), *aff'd*, 264 A.3d 641 (Del. 2021) (TABLE).

[300] The defendants argue that incorporation of the SAP term in the AAU Provision does not cause the nominator and nominees to disclose persons "unlinked" to them. Defs.' Post-trial Br. 38. They believe that is fair to require the nominator and nominees "to disclose any AIM nomination related AAUs among, on the one hand, themselves or persons with whom they have a discernable connection—family members, SAPs, persons acting in concert with SAPs, etc.—and, on the other hand, any other person or entity." *Id.* Yet the inclusion of the SAP definition (and terms within it) significantly expands the scope of what a nominator is obligated to disclose. The requirement is far more onerous than the

gathering tool. It renders the AAU Provision overbroad, unworkable, and ripe for subjective interpretation by the Board.[301] Knowing that a proxy contest was coming, augmenting the AAU Provision with vague requirements about far-flung, multi-level relationships suggests an intention to block the dissident's effort.

b. The Consulting/Nomination Provision

Section 1.4(c)(1)(E) of the Amended Bylaws requires disclosure of AAUs between the nominating stockholder or an SAP, on one hand, and any stockholder nominee, on the other hand, regarding consulting, investment advice, or a previous nomination for a publicly traded company within the last ten years (the "Consulting/Nomination Provision").[302] The provision not only suffers from the

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closest comparator provision found in the defendants' expert's sample set. *See* JX 985 (Rebuttal Report of Andrew M. Freeman) ("Freeman Report") ¶¶ 58-59; Rock Tr. 815.

[301] *See* Freeman Tr. 846; Freeman Report ¶ 101.

[302] Am. Bylaws § 1.4(c)(1)(E). The Consulting/Nomination Provision requires the noticing stockholder to disclose, as to each nominee:

> (i) a complete and accurate description of all agreements, arrangements or understandings (whether written or oral, and including promises) between or among each Holder and/or any Stockholder Associated Person (as such terms "Holder" and "Stockholder Associated Person" are defined in this Section 1.4), on the one hand, and any Stockholder Nominee, on the other hand, (x) to consult or advise on any investment or potential investment in a publicly listed company (including the Corporation), and/or (y) to nominate, submit, or otherwise recommend the Stockholder Nominee for appointment, election or re-election (or, for the avoidance of doubt, as a candidate for appointment, election or re-election) to any officer, executive officer or director role of any publicly listed company (including the Corporation), in each case, during the past ten (10) years; and (ii) a complete and accurate description of the outcome of any situations described pursuant to the foregoing clause (i).

same problem as the AAU Provision insofar as it includes SAPs. It also imposes ambiguous requirements across a lengthy term.

The defendants made no effort to justify this provision in relation to their stated objectives, except to argue that this court previously blessed advance notice bylaws requiring the disclosure of AAUs "towards the shared goal of the nomination."[303] The Consulting/Nomination Provision does not stop with the present nomination—or even AAUs about AIM. It implicates a decade of AAUs (including "advice" on "potential investments") involving *other* publicly traded companies as well. Would a notice need to reveal if the spouse of an associate of a nominee had an understanding with the nominating stockholder nine years ago that they would exchange investment tips and was told that Apple shares were a good buy, but the investment was not pursued?

Mitchell acknowledged that the importance of the information sought in the Consulting/Nomination Provision is "arguable" at best.[304] At worst, it is draconian

[303] Defs.' Post-trial Br. 41 (quoting *Jorgl*, 2022 WL 16543834, at *12); *id.* at 41 n.19 (mentioning the Consulting/Nomination Provision once); *see* Freeman Report ¶ 47 (noting that the defendants did not ask their expert to address the propriety of the Consulting/Nomination Provision and observing that the bylaw is "uncommon"); Mitchell Dep. 152 (testifying that he is not aware of similar provisions); Appelrouth Dep. 159 (same).

[304] Mitchell Dep. 150.

and would give the Board license to reject a notice based on a subjective interpretation of the provision's imprecise terms.[305]

c. The Known Supporter Provision

Section 1.4(c)(4) requires the nominator and nominees to list all known supporters (the "Known Supporter Provision").[306] The defendants argue that this bylaw requires disclosure of known supporters in accordance with the Court of Chancery's decision in *CytoDyn*.[307] But the provision goes farther than what the precedent supports. In *CytoDyn*, Vice Chancellor Slights observed that a bylaw mandating the disclosure of known *financial* supporters elicited information that is "vitally important" to voting stockholders.[308] By contrast, the Known Supporter Provision here seeks disclosure of any sort of support whatsoever, including that of other stockholders known by SAPs to support the nomination.

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[305] Freeman Tr. 846 (opining that the Consulting/Nomination Provision is "egregious," "overbroad," and allows "subjective" interpretation).

[306] The provision requires that the nominator disclose, as to each nominee:

> the names (including, if known, the full legal names and any alias names used) and addresses of other stockholders (including beneficial owners) known by any Holder or Stockholder Associated Person to support such Stockholder Proposal or Stockholder Proposals (including, without limitation, any nominations), and to the extent known, the class or series and number of all shares of the Corporation's capital stock owned beneficially or of record by each such other stockholder or other beneficial owner.

Am. Bylaws § 1.4(c)(4).

[307] Defs.' Post-trial Br. 31 (citing *Rosenbaum v. CytoDyn, Inc.*, 2021 WL 4775140, at *19 (Del. Ch. Oct. 13, 2021)).

[308] *CytoDyn*, 2021 WL 4775140, at *19.

The limits of this provision are ambiguous—both in the terms of the types of support and supporters one must disclose. For example, if Kellner had posted on social media that he was running a proxy contest and an AIM stockholder liked his post, would Kellner be required to mention it in his notice? Or would Kellner need to disclose if his associate's mother (an SAP) learned that an AIM stockholder who attends her church offered prayers for the proxy contest to succeed? The defendants presented no evidence to demonstrate that such information is reasonably linked to the objectives they identified. And even if a stockholder attempted to comply, the Board could take a broad reading of the Known Supporter Provision and reject the nomination as noncompliant for reasons a stockholder could not realistically anticipate.

Had the Board crafted a bylaw mandating the disclosure of known supporters providing financial support or meaningful assistance in furtherance of a nomination, it might have taken a legitimate approach to ensuring adequate disclosure.[309] Instead, it overreached. As drafted, the Known Supporter Provision impedes the stockholder franchise while exceeding any reasonable approach to ensuring thorough disclosure.

[309] In fact, the AAU Provision requires the disclosure of AAUs concerning "funding or financing" arrangements related to the nominations. Am. Bylaws § 1.4(c)(1)(D).

d. The Ownership Provision

Section 1.4(c)(3)(B) requires a nominating stockholder to disclose, among many other things, a Holder's ownership in AIM stock (including beneficial, synthetic, derivative, and short positions) (the "Ownership Provision").[310]

[310] Am. Bylaws § 1.4(c)(3)(B). The Ownership Provision requires that a notice disclose, as to Holders:

> as of the date of the notice (which information, for the avoidance of doubt, shall be updated and supplemented pursuant to subclause (g) of this Section 1.4), (i) the class or series and number of shares of capital stock of the Corporation of each such class and series which are, directly or indirectly, held of record or owned beneficially by each Holder and any Stockholder Associated Person (provided that, for purposes of this Section 1.4, any such person or entity shall in all events be deemed to beneficially own any shares of stock of the Corporation as to which such person has a right to acquire beneficial ownership at any time in the future (whether such right is exercisable immediately or only after the passage of time or the fulfillment of a condition, or both)), (ii) any short position, profits interest, option, warrant, convertible security, stock appreciation right or similar rights with an exercise or conversion privilege or a settlement payment or mechanism at a price related to any class or series or shares of the Corporation or with a value derived in whole or in part from the value or any class or series of shares of the Corporation or with a value derived in whole or in part from the value of any class or series of shares of the Corporation, or any derivative or synthetic arrangement having the characteristics of a long position in any class or series of shares of the Corporation, or any contract, derivative, swap or other transaction or series of transactions designed to produce economic benefits and risks that correspond substantially to the ownership of any class or series of shares of the Corporation, including due to the fact that the value of such contract, derivative swap or other transaction or series of transactions is determined by reference to the price, value or volatility of any class or series of shares of the Corporation, whether or not such instrument, contract or right shall be subject to settlement in the underlying class or series of shares of the Corporation, through the delivery of cash or other property, or otherwise, and without regard to whether the Holder and any Stockholder Associated Person may have entered into transactions that hedge or mitigate the economic effect of such instrument, contract or right, or any other direct or indirect opportunity to profit or share in any profit derived from any

increase or decrease in the value of shares of the Corporation (any of the foregoing, a “Derivative Instrument”) directly or indirectly owned or held, including beneficially, by each Holder or any Stockholder Associated Person, (iii) a description of any proxy, contract ,agreement, arrangement, understanding or relationship pursuant to which each Holder and/or any Stockholder Associated Person has any right to vote or has granted a right to vote any shares or stock or any other security of the Corporation, (iv) any agreement, arrangement, understanding, relationship or otherwise, including any repurchase or similar so-called “stock borrowing” agreement or arrangement, involving any Holder or any Stockholder Associated Person, on the one hand, and any person acting in concert therewith, on the other hand, directly or indirectly, the purpose or effect of which is to mitigate loss to, reduce the economic risk (of ownership or otherwise) of any class or series of the shares of the Corporation by, manage the risk of share price changes for, or increase or decrease the voting power of, such Holder or any Stockholder Associated Person with respect to any class or series of the shares or other securities of the Corporation, or which provides, directly or indirectly, the opportunity to profit or share in any profit derived from any decrease in the price or value of any class or series of the shares or other securities of the Corporation (any of the foregoing, a “Short Interest”), and any Short Interest held by each Holder or any Stockholder Associated Person within the last twelve (12) months in any class or series of the shares or other securities of the Corporation, (v) any rights to dividends or payments in lieu of dividends on the shares of the Corporation owned beneficially by each Holder or any Stockholder Associated Person that are separated or separable from the underlying shares of stock or other securities of the Corporation, (vi) any proportionate interest in shares of stock of any class or series or other underlying securities of the Corporation or Derivative Instruments held, directly or indirectly, by a general or limited partnership or limited liability company or other entity in which any Holder or any Stockholder Associated Person is a general partner or directly or indirectly beneficially owns an interest in the manager or managing member of a limited liability company or other entity, (vii) any performance-related fees (other than an asset-based fee) that each Holder or any Stockholder Associated Person is or may be entitled to based on any increase or decrease in the value of the stock or other securities of the Corporation or Derivative Instruments, if any, including without limitation, any such interests held by members of the immediate family as such Holder or any Stockholder Associated Person, (viii) any direct or indirect legal, economic, or financial interest (including Short Interest) of each Holder and each Stockholder Associated Person, if any, in the outcome of any (X) vote to be taken at any annual or special meeting of stockholders of the Corporation or (Y) any meeting of stockholders of any other entity

The requirements extend to SAPs, immediate family members, and persons acting in concert with a nominee.[311]

I cannot say whether the Ownership Provision would choke a horse.[312] But it has certainly flummoxed this judge. Mitchell testified that the bylaw was written in such a way that "no one would read it" and that if the directors had started reading it "line by line" during their March 2023 Board meeting, they "would still be in the meeting."[313] Though I have tried to read and understand it, the bylaw—with its 1,099 words and 13 subparts—is indecipherable.

> with respect to any matter that is related, directly or indirectly, to any nomination or business proposed by any Holder under these by-laws, (ix) any direct or indirect legal, economic or financial interest or any Derivative Instrument or Short Interests in any principal competitor of the Corporation held by each Holder or any Stockholder Associated Person, (x) any direct or indirect interest of each Holder or any Stockholder Associated Person in any contract with the Corporation, any Affiliate of the Corporation, or any principal competitor of the Corporation (including, in any such case, any employment agreement or consulting agreement); and (xi) any material pending or threatened action, suit or proceeding (whether civil, criminal, investigative, administrative or otherwise) in which any Holder or any Stockholder Associated Person is, or is reasonably likely to be made, a party or material participant involving the Corporation or any of its officers, directors or employees, or any Affiliate of the Corporation, or any officer, director or employee of such Affiliate (the information specified in this paragraph (c)(3)(B) of this Section 1.4 shall be referred to as the "Specified Information").

[311] Am. Bylaws § 1.4(c)(3)(B).

[312] *PS Fund 1, LLC v. Allergan, Inc.*, C.A. No. 10057-CB, at 35 (Del. Ch. Sept. 22, 2014) (TRANSCRIPT) (describing a bylaw that would require a stockholder to disclose two years of trading history and all associates in which the stockholder held a stake of more than 10 percent as a "horse-choker of a bylaw").

[313] Mitchell Dep. 161-63.

The Board apparently set out to add a bylaw requiring the disclosure of not only beneficial ownership but also synthetic and derivative ownership, short interests, and hedging arrangements.[314] Provisions to that end are "very common."[315] They appear to have proliferated as a means to close loopholes in Section 13(d) involving synthetic equity.[316]

A provision requiring a stockholder to disclose such information seems perfectly legitimate. The problem for AIM is that the Ownership Provision as drafted sprawls wildly beyond this purpose. As one example, it requires the disclosure of "legal, economic, or financial" interests "in any principal competitor" of AIM.[317] The term "principal competitor" is undefined, creating ambiguity.[318] As another example, it calls for disclosure of "[a]ny performance-related fees that each Stockholder Associated Person is entitled to, including interests held by family members."[319] The plain terms of this requirement call for the disclosure of

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[314] *See* JX 635; Pittenger Tr. 730-31.

[315] Pittenger Tr. 730-31; *see* Rock Report ¶ 67.

[316] Although these provisions emerged as part of the second generation of advance notice bylaws, they also respond to recent changes to Schedule 13D's beneficial ownership reporting requirement. *See supra* note 236 (discussing second generation advance notice bylaws); Rock Report ¶ 25 n.14 (listing sources).

[317] Am. Bylaws § 1.4(c)(3)(B)(ix).

[318] *See generally Levitt Corp. v. Office Depot, Inc.*, 2008 WL 1724244 (Del. Ch. Apr. 14, 2008) (considering an ambiguous bylaw); *Sherwood v. Chan Tsz Ngon*, 2001 WL 6355209 (Del. Ch. Dec. 20, 2011) (same); *JANA Master Fund*, 954 A.2d 335 (same).

[319] Am. Bylaws § 1.4(c)(3)(B)(vii).

performance-related fees that any family members of SAPs may receive. Since SAPs include immediate family members, would a nominating stockholder be required to disclose the entitlement of her mother's second cousin to such fees? Or would she be required to track down and disclose her affiliate's father's regular investments in actively managed mutual funds or ETFs that are, in turn, invested in one of AIM's "principal competitors"? I cannot say for sure.

Any justifiable objectives that might be served by aspects of the Ownership Provision are buried under dozens of dense layers of text. The provision seems designed to preclude a proxy contest for no good reason; none were given. A stockholder could not fairly be expected to comply.

e. The First Contact Provision

Section 1.4(c)(1)(H) of the Amended Bylaws requires disclosure of the dates of first contact among those involved in the nomination effort (the "First Contact Provision").[320] The defendants argue that this provision is not preclusive because one could "determine, from any number of sources . . . the dates (or at the very least, the approximate dates) they first had contact with their nominees regarding director

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[320] *Id.* § 1.4(c)(1)(H) (requiring a notice to set out "the dates of first contact between any Holder and/or Stockholder Associated Person, on the one hand, and the Stockholder Nominee, on the other hand, with respect to (i) the Corporation and (ii) any proposed nomination or nominations of any person or persons (including, without limitation, any Stockholder Nominee) for election or re-election to the Board of Directors").

nominations or AIM."[321] I agree. With a few email or text message searches, a nominee should be able to discern when they first had these contacts.[322]

Kellner asserts that the provision is unusual, but that is not the test. The First Contact Provision is tailored to provide "a logical and reasoned approach [to] advanc[e] a proper objective" unique to AIM.[323] It relates to the Board's desire to elicit sufficient information for the Board to make a recommendation about the nominations and stockholders to cast informed votes. The Board would have been focused on securing this knowledge after its experience with the 2022 proxy contest. The First Contact Bylaw would help alert the Board and stockholders to similar maneuvering.

f. The Questionnaire Provisions

Sections 1.4(c)(1)(L) and 1.4(e) of the Amended Bylaws require nominees to complete a form of D&O questionnaire (the "Questionnaire Provisions").[324] Such

[321] Defs.' Post-trial Br. 39.

[322] Unlike the problems with the use of the SAP term discussed above, the provision here calls for a more defined set of information that could be known or knowable with reasonable diligence.

[323] *Dollar Thrifty*, 14 A.3d at 598.

[324] Am. Bylaws § 1.4(c)(1)(L) (requiring the nominating stockholder to submit, for each nominee, "a completed and signed questionnaire, representation and agreement and any and all other information required by paragraph (e) of this Section 1.4"); *see id.* § 1.4(e) (requiring each nominee to "deliver in writing" "a written questionnaire in the form provided by the Secretary with respect to the background, qualifications, and independence of such Stockholder Nominee (which questionnaire shall be provided by the Secretary upon

provisions are fairly standard in second generation advance notice bylaws and have been for some time.[325] Appropriately so. "Requiring that nominees submit responses to a questionnaire" created by the company "furthers the information-gathering and disclosure functions of advance notice bylaws."[326]

There is nothing unreasonable about the Questionnaire Provisions on their faces. Kellner questions one aspect: the allowance of five business days for AIM to send the form of questionnaire to a stockholder, which he avers might allow the company time to make unfair revisions.[327] It would amount to hair splitting for me to conclude that five days is unreasonable, but a slightly shorter time period (say, three days) is not. If the directors had manipulative goals in mind, one would assume that they could readily achieve them in a shorter time period. Such matters are better addressed in considering whether the Board's enforcement of the Questionnaire Provisions was equitable.

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Four of the challenged Amended Bylaw provisions (the AAU Provision, Competitor/Nominating Provision, Known Supporter Provision, and Ownership

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written request of any stockholder of record identified by name within five (5) Business Days of such written request").

[325] *See* Rock Report ¶¶ 46-47, 61; Pittenger Tr. 729.

[326] *Lee Enters.*, 2022 WL 453607, at *18.

[327] Pl.'s Post-trial Br. 11-12.

Provision), as drafted, do not afford stockholders "a fair opportunity to nominate candidates."[328] Rather than further the identified purpose of obtaining transparency thorough disclosure, these provisions seem designed to thwart an approaching proxy contest, entrench the incumbents, and remove any possibility of a contested election. As a result, they run afoul of Delaware law.[329] The provisions are "of no force and effect."[330]

That does not mean that the Amended Bylaws are void in total, as Kellner would have me declare. In Kellner's view, I should take an "all or nothing" approach

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[328] *Hubbard*, 1991 WL 3151, at *11.

[329] *See* 8 *Del. C.* § 109(b) ("The bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees."); *Blasius*, 564 A.2d at 659 (recognizing that "[t]he shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests"); *cf. Hubbard*, 1991 WL 3151 at *11 ("[A]n advance notice by-law will be validated where it operates as a reasonable limitation upon the shareholders' right to nominate candidates for director. More specifically, such a by-law must, on its face and in the particular circumstances, afford the shareholders a fair opportunity to nominate candidates.").

[330] *Hollinger Int'l Inc. v. Black*, 844 A.2d 1022, 1082 (Del. Ch. 2004), *aff'd*, 872 A.2d 559, 564, 567 (Del. 2005); *see Openwave Sys.*, 924 A.2d at 239; *In re Osteopathic Hospital Ass'n of Del.*, 191 A.2d 333, 336 (Del. Ch. 1963) ("It is accepted law that a by-law which is unreasonable, unlawful, or contrary to public polic[y] may be declared void though adopted by legitimate procedures."); *see also Frantz Mfg. Co. v. EAC Indus.*, 501 A.2d 401, 407 (Del. 1985) ("The bylaws of a corporation are presumed to be valid, and the courts will construe the bylaws in a manner consistent with the law rather than strike down the bylaws. A bylaw that is inconsistent with any statute or rule of common law, however, is void.").

to analyzing the validity of the Amended Bylaws as adopted.[331] That blunt tactic would yield extreme and unnecessary relief, especially given that the Board identified a proper corporate interest that it sought to protect by adopting the Amended Bylaws. Instead, I have undertaken a careful analysis of the specific provisions Kellner highlighted and found some aspects of the Amended Bylaws to be inequitable.[332] The rest of the Amended Bylaws stand.

C. The Application Claim

Kellner contends that the Board cannot lawfully reject his notice because it satisfies AIM's advance notice bylaws and that—even if it did not—the Board's application of the bylaws was inequitable. Analyzing the enforcement of an advance notice bylaw begins with a contractual analysis. If circumstances require, the court will go on to assess whether there is a "basis in equity to excuse strict compliance" with the bylaws.[333]

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[331] *See* Pl.'s Post-trial Br. 34. This is unlike the situation highlighted in Kellner's brief where the court looked at "all of the circumstances" surrounding the adoption of defensive actions. *Phillips*, 1987 WL 16285, at *7. Of course, it may be appropriate to consider how bylaws work together in assessing whether they are reasonable. But one bylaw straying too far does not mean other legitimate bylaws should be invalidated.

[332] *See Hollinger*, 844 A.3d at 1078 ("Delaware's public policy interest in vindicating the legitimate expectations stockholders have of their corporate fiduciaries requires its courts to act when statutory flexibility is exploited for inequitable ends."); *Giuricich v. Emtrol Corp.*, 449 A.2d 232, 239 (Del. 1982) (explaining that the court must apply "careful judicial scrutiny" where "the right to vote for the election of successor directors has been effectively frustrated").

[333] *Sternlicht*, 2023 WL 3991642, at *14; *see also Schnell*, 285 A.2d at 439 (stating that equity will prohibit attempts to "utilize the corporate machinery" for the "purpose of

1. <u>Whether the Notice Complied with the Bylaws</u>

Corporate bylaws are "part of a binding broader contract among directors, officers and stockholders formed within the statutory framework of the Delaware General Corporation Law."[334] Delaware courts employ "principles of contract interpretation" when construing a corporation's bylaws.[335] In the context of advance notice bylaws, the court asks: "were the bylaws clear and ambiguous, did the stockholder's nomination comply with the bylaws, and did the company interfere with the plaintiff's attempt to comply."[336]

When analyzing the first two questions, unambiguous terms will be "given their commonly accepted meaning"[337] and "[a]ny ambiguity in an advance notice bylaw is resolved 'in favor of the stockholder's electoral rights.'"[338] The third question likewise draws upon contract law. Compliance with advance notice requirements is effectively a condition precedent to a company being obligated to

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obstructing the legitimate efforts of dissident stockholders in the exercise of their right to undertake a proxy contest against management"); *Coster*, 300 A.3d at 667 (explaining that Delaware courts deploy the *Schnell* doctrine in "cases where the board acts within its legal power, but is motivated for selfish reasons to interfere with the stockholder franchise").

[334] *Hill Int'l, Inc. v. Opportunity P'rs L.P.*, 119 A.3d 30, 38 (Del. 2015).

[335] *Brown v. Matterport, Inc.*, 2022 WL 89568, at *3 (Del. Ch. Jan. 10, 2022), *aff'd*, 2022 WL 2960331 (Del. Ch. July 27, 2022) (ORDER).

[336] *Lee Enters.*, 2022 WL 453607, at *9; *see also Sternlicht*, 2023 WL 3991642, at *14.

[337] *Hill Int'l*, 119 A.3d at 38 (quoting *Airgas, Inc. v. Air Prods. & Chems., Inc.*, 8 A.3d 1182, 1188 (Del. 2010)).

[338] *Jorgl*, 2022 WL 16543834, at *10 (quoting *Saba Cap.*, 224 A.3d at 977).

act, such as by accepting a stockholder proposal.[339] "Delaware courts follow the principle that a party who wrongfully prevents a thing from being done cannot avail itself of the nonperformance it has occasioned."[340] Kellner bears the burden of showing that his notice fulfills the bylaws' requirements.[341]

a. The AAU Provision

The bulk of the parties' briefing focuses on whether the Kellner Notice complied with the AAU Provision. As discussed above, Section 1.4(c)(1)(D) of the Amended Bylaws is invalid because aspects of it are inequitable.[342] Its prior iteration in the 2016 Bylaws (the "2016 AAU Provision") does not suffer from the same flaws as the amended version. The scope of the 2016 AAU Provision is fully within and narrower than the 2023 AAU Provision. Given the vital corporate considerations at risk if nominating stockholders conceal AAUs, it would risk further inequity to excuse the Kellner Notice from disclosing them when AIM had a validly enacted

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[339] *See Lee Enters.*, 2022 WL 453607, at *13 n. 142.

[340] *W & G Seaford Assocs. v. E. Short Mkts.*, 714 F. Supp. 1336, 1341 (D. Del. 1989) (describing the "cardinal principle of contract law regarding conditions" (citing Restatement (Second) of Contracts § 245 (1981))).

[341] *See Totta v. CCSB Financial Corp.*, 2022 WL 1751741, at *12 (Del. Ch. May 31, 2022), *aff'd*, 302 A.2d 387 (Del. 2023); *Jorgl*, 2022 WL 16543834, at *13-14.

[342] *See supra* note 301 and accompanying text.

provision in place pre-amendment.[343] Accordingly, I revert to assessing whether the Kellner Notice complied with the 2016 AAU Provision.

The 2016 AAU Provision requires a notice to describe "all arrangements or understandings between such stockholder and each proposed nominee and any other person or persons (including their names) pursuant to which the nomination(s) are to be made."[344] "Arrangements" and "understandings" are not defined in the 2016 Bylaws. When met with undefined contract terms, Delaware courts turn "to dictionaries for assistance in determining the plain meaning."[345] "Arrangement" means "a measure taken or plan made in advance of some occurrence sometimes for a legal purpose; an agreement or settlement of details made in anticipation."[346] "Understanding" means "an agreement, especially of an implied or tacit nature."[347] These terms are unambiguous.

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[343] *See Hollinger*, 844 A.3d at 1078 (holding that bylaws are improperly adopted when "they were adopted for an inequitable purpose" despite being statutorily sound and taking a provision-by-provision approach to reviewing them); *cf. Rainbow Mountain, Inc. v. Begeman*, 2017 WL 1097143, at *2 (Del. Ch. Mar. 23, 2017) (holding that without "any proof [a later set of bylaws] were ratified" the earlier and properly adopted set "remain[ed] the operative bylaws").

[344] 2016 Bylaws § 1.4(c).

[345] *Lorillard Tobacco Co. v. Am. Legacy Found.*, 903 A.2d 728, 738 (Del. 2006).

[346] *Arrangement*, Black's Law Dictionary (11th ed. 2019).

[347] *Understanding*, Black's Law Dictionary (11th ed. 2019).

In *Jorgl*, this court construed the meaning of the 2016 AAU Provision using the terms' commonly accepted meanings.[348] The decision explained that the phrase "arrangement or understanding," as it relates to nominations, requires disclosure of "any advance plan, measure taken, or agreement—whether explicit, implicit, or tacit, with any person toward the shared goal of the nomination."[349] A "quid pro quo" is not required, but mere discussions or sharing of information "is not alone sufficient" to form an "arrangement or understanding."[350] Because "arrangements" and "understandings" include "agreements," the fact that the 2016 Bylaws do not expressly mention "agreements" does not diminish the bylaw's scope.[351] It can be interpreted consistent with the discussion of AAUs in other corporate law contexts.[352]

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[348] 2022 WL 16543834, at *11.

[349] *Id.* at *11-12.

[350] *Id.*

[351] *Jorgl*, 2022 WL 16543834, at *11-12 (noting that "an 'arrangement' can be shown by an 'agreement'") (citing Black's Law Dictionary (11th ed. 2019)).

[352] *E.g.*, *Totta*, 2022 WL 1751741, at *24-25 (discussing how "the general corporate law understanding that persons act in concert when they have an agreement, arrangement, or understanding regarding the voting or disposition of shares"); *Chesapeake Corp. v. Shore*, 771 A.2d 293, 353 (Del. Ch. 2000) (discussing that in the context of Section 203, the terms "agreement," "arrangement," or "understanding" "permit a fairly high degree of informality in the form in which the parties come together" but "presuppose[] a meeting of the minds").

Since the 2016 Bylaws lack a 24 month lookback, I consider only whether the Kellner Notice omits or misrepresents AAUs for the current effort.[353] The Kellner Notice states that before July 2023, "no decision was made [for any of Kellner, Deutsch, or Chioini] to work together to advance potential nominations or otherwise take any action with respect to the Company."[354] This statement is false.

Kellner, Chioini, and Deutsch testified that no AAU relating to the 2023 effort existed until July 11 when they flew together on Kellner's jet for a meeting at BakerHostetler's offices.[355] This day was perhaps the culmination of the group's labors. But an AAU can "take the form of a 'measure' or 'plan' before an event."[356] Well before July, Chioini, Kellner, and Deutsch took measures to prepare for nominations and a proxy contest.

The 2023 effort was—in many ways—a continuation of the 2022 attempt. As early as November 2022, Kellner requested a meeting with Tudor and the Jorgl team

[353] Were the 24-month lookback in place, this section of my analysis would have provided an extended discussion of the central role Tudor played in the 2022 nomination effort. Strikingly, the Kellner Notice does not disclose any AAU with Tudor. Because the AAU Provision exceeded equity's limits, the reader was spared additional pages in this already lengthy decision.

[354] Kellner Notice 11.

[355] Chioini Tr. 29; Kellner Tr. 229; Deutsch Tr. 188-89; JX 765; *see also* Pl.'s Post-trial Brief 51.

[356] *Jorgl*, 2022 WL 16543834, at *12.

to discuss "next steps."[357] At the same time, Chioini expressed that he and Rice intended to pursue nominations in 2023.[358] In December, Chioini spoke to Kellner and told his counsel that Kellner was "very interested in working with us to remove these guys" and "want[ed] to keep in touch."[359]

Kellner's update to his fraternity brothers shortly after he spoke to Chioini is particularly revealing.[360] Kellner wrote that "[t]wo other investors [we]re joining [him] in a proxy battle."[361] Although he could not recall at trial who the two other investors were, he had named Deutsch and Tudor in an earlier draft.[362] About two weeks after sending the final update, Kellner told Deutsch that he was reaching out to his attorney and would loop Deutsch in to "get this ball rolling!!"[363]

The ball rolled—albeit slowly since AIM's annual meeting was 10 months away. Still, in February, BakerHostetler began requesting information from Kellner's attorney about his AIM stock ownership in emails forwarded to both

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[357] JX 467.

[358] JX 468; *see also* JX 498; JX 526.

[359] JX 541.

[360] JX 557; *see* Kellner Tr. 346.

[361] JX 557.

[362] *See supra* note 143 (discussing that the reference was not to Chioini and Rice because they are not investors).

[363] JX 570.

Kellner and Deutsch.[364] Various calls were scheduled between Kellner, Deutsch, Chioini, and counsel throughout the spring.[365] The group kept abreast of AIM's bylaw amendments.[366]

Kellner's May 19 text to Deutsch further reflects that the group's activities since late 2022 or early 2023 were coordinated actions directed toward a shared goal of nominating director candidates.[367] In the text, Kellner directed Deutsch to contact Chioini and learn his plan "regarding AIM."[368] Because the annual stockholder meeting approached and the stockholder nomination deadline was imminent, time was "becoming critical."[369] Kellner was ready to "mov[e] th[e] ball forward" once again with Deutsch and Chioini.[370] There is no evidence that any other potential nominees were considered for Kellner's nomination.

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[364] JXs 605-06.

[365] JX 695; JX 713; JX 740; JX 746.

[366] JX 700.

[367] JX 740.

[368] *Id.*

[369] *Id.*

[370] *Id.*; Deutsch 199-200. Deutsch testified that Kellner's use of the idiom "get the ball rolling" could "mean many things." Deutsch Tr. 199-200. In common parlance, "get the ball rolling" means to "begin an activity or process." *Get/set/start the ball rolling*, Merriam-Webster, https://www.merriamwebster.com/dictionary/get%2Fset%2Fstart%20the%20ball%20rolling (last visited Dec. 21, 2023). Kellner had consulted his attorney and asked Deutsch to get in touch with Chioini to start working towards submitting a nomination. There was no other reason to reach out to Chioini except to advance his nomination in 2023. Chioini was not (and is not) an AIM stockholder.

Even if the exact time at which an AAU among Kellner, Deutsch, and Chioini arose could not be identified with precision, it preceded July 2023. It is possible that no formal decision was reached before then for Kellner, Deutsch, or Chioini to submit a slate to AIM. But there was undoubtedly a tacit understanding before that while multiple preparations were undertaken. The Kellner Notice therefore omitted and misrepresented meaningful AAUs.

b. Other Bylaw Provisions

Beyond the non-disclosure of AAUs, AIM detailed numerous other purported flaws in the Kellner Notice.[371] They are of varying degrees of importance.[372] Because I have already found that the notice was deficient regarding the misstatements about AAUs for the 2023 nomination, I will highlight just two others.

First, the Kellner Notice violated the First Contact Provision. Kellner was required to disclose "the dates of first contact between a nominating stockholder and/or [any SAP], on the one hand, and the Stockholder Nominee, on the other hand" regarding AIM or the Board nominations.[373] The Kellner Notice does not include

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[371] *See* JX 378.

[372] For example, AIM's rejection letter states that the Kellner Notice did not list the full name of Deutsch's family office or its address. JX 378 at 9. It also states that the Kellner Notice fails to provide information required by Schedule 14A because each nominee consented to "being named as a nominee in any proxy statement" rather than "being named in ***proxy statements***." *Id.* at 11 (emphasis in original).

[373] Am. Bylaws § 1.4(c)(1)(H).

any date of first contact between Kellner and Deutsch about the present nomination.[374] Kellner attempts to justify this omission by asserting that "the Bylaw Amendments do not require an exact date."[375] Maybe so. He made no attempt, however, to provide an approximate date. Regarding Chioini, the Kellner Notice merely states that Kellner was first in contact with him about AIM or the nominations in "late 2022."[376] This is fuzzy. Kellner only needed to check his record to give specifics.

Second, the Kellner Notice does not comply with the requirement that questionnaires submitted by nominees be certified as accurate in accordance with Section 1.4(c)(5) of the Amended Bylaws.[377] The questionnaires required nominees to disclose any adverse recommendation from proxy advisory firms in connection with their service on other boards.[378] Kellner, Deutsch, and Chioini each had prior "withhold" recommendations that they neglected to disclose.[379]

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[374] Kellner Notice 11 ("In and around early 2021, Mr. Deutsch, who had started investing in the Company in the prior year, shared with Mr. Kellner his views on the significant potential of the Company's lead candidate, Ampligen, for multiple indications. Thereafter, Mr. Kellner invested in the Company and the Reporting Persons continued to communicate from time to time with respect to their investments in the Company.").

[375] Pl.'s Post-trial Br. 60.

[376] Kellner Notice 11.

[377] *Id.* at 20.

[378] Kellner Notice 35, 79, and 123.

[379] *Id.* at 35, 79, and 123; JX 2; JX 6; JX 10; JX 13; JX 20; JX 34; JX 263; JXs 1013-14. When a plurality voting standard is used, proxy advisors issue a "for" or "withhold"

The three maintain that they were unaware of any withhold recommendations until this litigation and note that such recommendations are not publicly available.[380] One would expect that, with the assistance of sophisticated counsel, Kellner, Deutsch, and Chioini could have gathered the data needed to respond. In any event, their questionnaires could have explained that they were unaware of any adverse recommendations or that they lacked knowledge. Instead, they each affirmatively checked "no."[381] Those representations were untrue.

2. Whether the Rejection of the Kellner Notice Was Equitable

Kellner's notice contravened the clear and unambiguous requirements of AIM's bylaws. "The court's analysis does not necessarily end if a stockholder fails to comply with the plain terms of an advance notice bylaw."[382] "Delaware courts have reserved space for equity to address the inequitable application of even validly-enacted" provisions.[383] Where appropriate, the court will consider whether a board "utilize[d] the corporate machinery . . . [to] obstruct[] the legitimate efforts of

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recommendation. If a board uses a plurality voting standard, a "withhold" recommendation is the adverse recommendation. *See* Harrington Tr. 403; Equels Tr. 567.

[380] *See* Chioini Tr. 40; Harrington Tr. 402; JX 960 at 8-12.

[381] Defs.' Post-trial Br. 55; Kellner Notice 35, 79, 123.

[382] *Lee Enters.*, 2022 WL 453607, at *9.

[383] *CytoDyn*, 2021 WL 4775140, at *15 (emphasis omitted).

dissident stockholders in the exercise of their rights to undertake a proxy contest against management."[384]

That inquiry is warranted here. I have already found that the Board unreasonably implemented certain bylaws that infringed upon the stockholder franchise after it anticipated a proxy contest. Further, Kellner insists that the Board's process in rejecting the Notice was unreasonable, inequitable, and manipulative.

The parties agree that the Board's decision to reject Kellner's notice is subject to enhanced scrutiny. As discussed above, the relevant standard is a "situationally specific" application of *Unocal*.[385] The Board must prove that it identified a threat "to an important corporate interest" and that its response was "reasonable in relation to the threat posed."[386]

a. Reasonableness

The Board has proven that its actions served proper corporate objectives. Specifically, it sought to obtain full and fair disclosure so that it could adequately evaluate a nomination and that stockholders could cast informed votes.[387] The Board retained independent counsel to evaluate the Kellner Notice with these goals in

[384] *Schnell*, 285 A.2d at 439. If a board frustrated a stockholder's effort to comply with an advance notice bylaw, the stockholder's non-compliance would arguably be excused as a matter of contract law as well as equity. *See supra* notes 339-40 and accompanying text.

[385] *Coster*, 300 A.3d at 672; *see supra* notes 256-57.

[386] *Coster*, 300 A.3d at 672-73.

[387] *See, e.g.*, *Lee Enters.*, 2022 WL 453607, at *9; *Jorgl*, 2022 WL 16543834, at *14-16.

mind.[388] Counsel provided a detailed analysis.[389] The Board then considered that advice when reviewing the Notice.[390]

With the guidance of counsel and based on its experience in 2022, the Board concluded that the Kellner Notice failed to disclose AAUs.[391] The Board viewed the Kellner Notice as obscuring the roles of Deutsch, Tudor, and others in the 2022 nomination effort.[392] It also decided that the Kellner Notice was false and misleading with regard to the group's plans for the 2023 nomination effort.[393] It was reasonable for the Board to conclude that the objective of preserving an informed stockholder vote was threatened.

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[388] *See* Equels Tr. 544-52, 625-28; Mitchell Tr. 640-41; Bryan Tr. 660-61, 666-67; Appelrouth Tr. 694-95.

[389] JX 907.

[390] JX 911; *see Cirillo Fam. Tr. v. Moezinia*, 2018 WL 3388398, at *12 (Del. Ch. July 11, 2018) ("Delaware law statutorily encourages directors to rely on . . . counsel[] to inform themselves and properly discharge their fiduciary duties." (citing 8 *Del. C.* § 141(e)); *Carlton Invs. v. TLC Beatrice Int'l Hldgs, Inc.*, 1997 WL 305829, at *12 (Del. Ch. May 30, 1997).

[391] JX 911; *see also* Pittenger Tr. 741-45.

[392] Equels Tr. 543-77; Bryan Tr. 611-64; Pittenger Tr. 738-49; Appelrouth Tr. 693-95. The Board had another reason to be concerned. A fee shifting petition remains pending in the *Jorgl* action, BakerHostetler's fees from the 2022 litigation are unpaid, and the Kellner Notice expressly stated that if successful, the group would seek repayment of fees from 2022. The Board considered the intended reimbursement and determined that payment of $2 million for Chioini and Xirinachs' 2022 expenses would harm AIM. *See* JX 911; Equels Tr. 554; Pittenger Tr. 749; Appelrouth Tr. 691-92.

[393] Equels Tr. 556-57; Bryan Tr. 662-63; Pittenger Tr. 742-45.

b. Proportionality

The Board has also proven that rejecting the Kellner Notice was a proportionate means to promote the Board's objectives. "[T]he context in which the Board received" the Kellner Notice "cannot be ignored."[394] The Kellner Notice followed a proxy contest where Jorgl became an AIM stockholder solely to front a nomination and shield undisclosed persons behind the scenes. Those persons included two white collar criminals—one of whom had become increasingly hostile to AIM and had misrepresented himself as an AIM representative to third parties. It would have been obvious to the Board that the new nomination behind Kellner carried over from the prior year. Chioini was a constant, Deutsch remained involved (now as a nominee), and BakerHostetler continued to advise the effort. The threat to return "guns blazing" in 2023 came to fruition.[395]

The rejection was not, as Kellner argues, preordained. Kellner cites to a filing in the Florida litigation and a draft press release as evidence that the Board prejudged the Kellner Notice.[396] The weight of the record shows otherwise.[397] With regard to the filing, AIM told the Florida court that the Kellner Notice violated federal

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[394] *Jorgl*, 2022 WL 16543834, at *16.

[395] JX 825; JX 526.

[396] *See* Pl.'s Post-trial Br. 69-70; Pl.'s Pre-trial Br. 46-47.

[397] *See supra* notes 388-93 and accompanying text.

securities laws one business day after the notice was submitted.[398] But Equels credibly testified that the filing was to rebut Kellner and Deutsch's representation to the Florida court that a "[Schedule] 13D issue" had become "moot."[399] As to the press release, it was prepared by an outside public relations advisor, was "contingent," and (of the Board members) only shared with Equels.[400]

Further, the Board's actions were not manipulative. The Board did nothing to prevent Kellner from complying with the valid provisions of AIM's advance notice bylaws.[401] Kellner seems to believe that AIM's advance notice requirements are problematic because stockholders are required to comply with them while incumbent directors are not.[402] But that is how advance notice bylaws work.

This is both non-controversial and logical. Incumbent directors are subject to fiduciary duties and certain securities law disclosure requirements that do not apply to nominating stockholders.[403] Additionally, the company already has access to information about incumbent directors that it can disclose to stockholders. Advance

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[398] JX 878 at 9.

[399] Equels Tr. 601; *id.* at 595. This testimony is not inconsistent with the filing.

[400] Equels Tr. 626-67; *see* JX 1140; JX 1142.

[401] *See Lee Enters.*, 2022 WL 453607, at *17.

[402] *See* Pl.'s Post-trial Br. 72; Am. Bylaws §§ 1.4(a)(1), (a)(2), (c).

[403] *See generally* Equels Tr. 547, 557-58; Pittenger Tr. 731; Bryan Tr. 671-72; *see also* Rock Report ¶ 42 (noting that "the proxy rules do not require any evidence that the nominating stockholder has complied" with SEC Rule 14a-19).

notice bylaws elicit information about nominating stockholders and their nominees so that the Board and stockholders can become informed.[404]

Kellner also avers that the Board's revision of the D&O questionnaire during the five days between his request and receipt of the form amounts to manipulation.[405] The form was made 14 pages longer through two rounds of edits during that five-day period.[406] Although undertaking revisions after the form was requested is suboptimal, there is no evidence of bad faith.[407] The 2016 Bylaws lacked a provision requiring nominees to complete questionnaires. The addition of the D&O Questionnaire Provision necessitated a change to the Company's form so that it also applied to nominees.[408] After the form was revised, AIM's incumbent directors likewise completed it.[409]

Moreover, amending the questionnaire did not amount to the sort of material changes indicative of manipulation targeting stockholder rights.[410] The revisions to

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[404] *See Saba Cap.*, 224 A.3d at 980.

[405] *See* JX 834; JX 841; *see also* JX 821 at 2.

[406] JX 834; JX 841.

[407] *See* Pittenger Tr. 734 (testifying that he meant to update the form before the window closed and the delay was inadvertent).

[408] Pittenger Tr. 732-35.

[409] *Compare* JXs 941-43, *and* JX 1131 *with* JX 875; *see also* JX 821 at 1.

[410] *E.g.*, *Hubbard*, 1991 WL 3151, at *11-13 (holding that post-deadline actions that "result[ed] in potentially significant changes in the corporation's management personnel and operational changes in its business policy and direction" and "generat[ed] controversy and shareholder opposition" were inequitable); *Lerman v. Diagnostic Data, Inc.*, 421 A.2d

the questionnaire are non-preclusive. The updated form is longer than the previous questionnaire originally designated for directors. It includes an additional section for stockholder nominees.[411] But it mostly consists of yes or no questions. Kellner was able to answer a majority of the sections that required narrative explanations with internal references to other parts of the completed notice.[412]

* * *

Ultimately, the nondisclosure of certain AAUs is fatal to Kellner's nomination effort. After the *Jorgl* litigation, Kellner, Chioini, Deutsch and their counsel should have been closely attuned to the importance of completely disclosing all relevant arrangements and understandings. Still, they flouted the Company's advance notice requirements. Because of the timing of Kellner's submission—the night before the submission deadline—there was no possibility of correcting any deficiencies.[413]

The concealment of arrangements and understandings that go to the heart of a nomination effort risks undermining the essential disclosure function of advance

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906, 912-14 (Del. Ch. 1980) (concluding that a board lacked a justification for setting a meeting date that made it impossible for a stockholder to timely give notice of an intention to nominate); *see also Schnell*, 285 A.2d at 439.

[411] Kellner Notice 150.

[412] *Id.* at 33-162.

[413] JX 911 at 3; *see CytoDyn*, 2021 WL 4775140, at *2 ("Where Plaintiffs ultimately went wrong here is by playing fast and loose in their responses to key inquiries embedded in the advance notice bylaw, and then submitting their Nomination Notice on the eve of the deadline, leaving no time to fix the deficient disclosures when the incumbent Board exposed the problem.").

notice bylaws. Directors and stockholders would justifiably want to know whether a nomination is part of a broader scheme. Such information was withheld from or obfuscated in the Kellner Notice.

In these circumstances, the Board acted reasonably and equitably in rejecting the Kellner Notice. It did not breach its fiduciary duties in enforcing valid advance notice bylaws. The plaintiff's group—not the Board—are "the ones engaging in manipulative conduct."[414]

III. CONCLUSION

Regarding Kellner's claim concerning the validity of the Amended Bylaws and AIM's counterclaim, judgment is entered for Kellner in part and for AIM in part. Regarding Kellner's claim concerning his compliance with the Amended Bylaws and the Board's rejection of the Kellner Notice, judgment is entered in favor of the defendants. Counsel for the parties shall confer on a form of order to implement this decision as soon as practicable, and no later than five days.

[414] *Jorgl*, 2022 WL 16543834, at *17.

UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION

COMMISSIONERS: **Lina M. Khan, Chair**
Noah Joshua Phillips
Rebecca Kelly Slaughter
Christine S. Wilson

In the Matter of

Nvidia Corporation,

a corporation,

Softbank Group Corporation,

a corporation,

and

Arm, Ltd.,

a corporation.

Docket No. 9404

REDACTED-PUBLIC VERSION

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act ("FTC Act"), and by virtue of the authority vested in it by the FTC Act, the Federal Trade Commission ("Commission"), having reason to believe that Respondents Nvidia Corporation ("Nvidia"), Softbank Group Corporation ("Softbank"), and Arm Ltd. ("Arm") have executed a merger agreement in violation of Section 5 of the FTC Act, 15 U.S.C. § 45, which if consummated would violate Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the FTC Act, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint pursuant to Section 5(b) of the FTC Act, 15 U.S.C. § 45(b), and Section 11(b) of the Clayton Act, 15 U.S.C. § 21(b), stating its charges as follows:

NATURE OF THE CASE

1. Nvidia is one of the world's largest and most valuable computing companies. Nvidia proposes to acquire Arm, the world's largest and most significant licensor of designs and architectures for computer processors, in a deal valued at more than $40 billion (the "Proposed Acquisition"). If consummated, the Proposed Acquisition would allow the combined firm to use its control of Arm to harm Nvidia's rivals in ways that substantially lessen competition—including innovation, price, and feature competition—in multiple markets.

2. Arm develops and licenses central processing unit ("CPU") designs and architectures ("Arm Processor Technology"). Arm Processor Technology consists of specific designs for CPUs that Arm develops and licenses to others and a CPU instruction set architecture that Arm licenses to others who want to develop their own specific CPU designs. As part of the Arm Processor Technology business, Arm also provides customers with corresponding services, support, and ancillary products. Through the combination of its advanced technology and neutral licensing business model, Arm has become a de facto industry standard for CPU processor technology contained in billions of computer chips worldwide. According to Nvidia's CEO, Arm is "the world's most popular computing platform."

3. Arm Processor Technology is at the foundation of many innovative products of our modern digital age, including nearly every smartphone on the market, advanced driver assistance features in recent and upcoming cars, web servers that can provide significantly better cost performance over the most comparable non-Arm servers, and many other examples. In these products, Arm Processor Technology is a critical input. The wide deployment of Arm's Processor Technology has fostered a vibrant ecosystem of software and hardware developers, software, and devices.

4. Arm does not make or sell computer chips ("chips") or chip-based devices. Rather, Arm licenses Arm Processor Technology, also referred to in the industry as CPU intellectual property or "IP," using an industry-described neutral, open licensing approach. Arm is often dubbed the "Switzerland" of the semiconductor industry for this approach. Arm partners with its licensees to promote and support Arm's technologies, even as those partners compete with each other to sell chips and devices relying on Arm Processor Technology in downstream markets (the "Downstream Markets"). Arm's partnerships with its licensees regularly result in Arm receiving sensitive business information from its licensees. The fact that Arm does not itself compete in the Downstream Markets gives its partners a high level of trust in Arm as a critical input supplier that will not exploit its control over those inputs to gain a competitive advantage against its partners.

5. Unlike Arm, Nvidia supplies and markets finished chips and devices. Nvidia is best known as the dominant supplier of standalone graphics processing units ("GPUs") for personal computers ("PCs") and datacenters, which are computing facilities with large numbers of server computers. GPUs are widely used for artificial intelligence ("AI") processing and graphics processing, among other computational tasks.

6. For years, Nvidia has licensed Arm's Processor Technology to create a wide range of computing products, many of which compete with products of other Arm licensees. For

example, Nvidia and its competitors alike use Arm Processor Technology to create chips for advanced driver assistance systems for passenger cars. Nvidia and other companies also develop additional categories of Arm-based products, including advanced networking products and datacenter CPUs, among other products. While Nvidia's designs for standalone GPUs do not incorporate Arm Processor Technology, Nvidia integrates or plans to integrate its GPU technology with Arm Processor Technology in certain products, such as its chips for advanced driver assistance systems for passenger cars.

7. The Proposed Acquisition will substantially lessen competition in multiple markets because it will create a combined firm that has both the ability and the incentive to use its control of Arm to diminish competition by undermining Nvidia's rivals.

8. Post-Acquisition, Nvidia will have the ability to disadvantage its rivals through its control of Arm through various mechanisms, including by manipulating levers such as Arm's pricing, the terms and timing of access to Arm's Processor Technology (including withholding or delaying access), Arm's technological developments and features, and Arm's provision of service and support, among other mechanisms.

9. Post-Acquisition, Nvidia will have strong incentives to harm its Arm-reliant rivals. In markets in which Nvidia competes using Arm Processor Technology, the profits on additional sales that Nvidia would earn as a chip supplier are generally higher than the profits that Arm would earn from licensing its Processor Technology to Nvidia's rivals. Here, this relationship gives Nvidia a strong economic incentive to preference winning business for its own downstream products over licensing Arm Processor Technology or providing the same level of support, access, and investment to its own rivals after the Proposed Acquisition.

10. In addition to the harm Nvidia can directly inflict on its rivals, aligning Arm with Nvidia will likely result in further harms due to a critical loss of trust in Arm by its own licensees, and overall investment and innovation in the Arm ecosystem will likely be reduced. Today, for example, Arm's licensees—including Nvidia's rivals—share competitively sensitive information with Arm. Recognizing that Nvidia would be able to misuse this information for Nvidia's own competitive purposes, Nvidia's rivals will be less likely to share competitively sensitive information with Arm if the Proposed Acquisition closes. Innovation and other procompetitive actions that otherwise would have occurred through the open sharing of information with Arm will be chilled.

11. The Proposed Acquisition also will likely further harm innovation because, today, Arm regularly receives innovative ideas from its licensees across the semiconductor industry and pursues new technological developments that it believes will yield the most benefit to its business. But Nvidia would be less likely to dedicate Arm's resources toward otherwise beneficial innovative developments of Arm Processor Technology that would harm Nvidia.

12. These effects are likely to be felt throughout the computing industry. Among the markets affected, the Proposed Acquisition is likely to substantially lessen competition in key emerging and quickly-developing markets for products used in datacenters, including for networking and central processing, and in advanced driver assistance systems that are increasingly used in the automotive industry.

JURISDICTION

13. Respondents Nvidia, Arm, and Softbank are each "corporations" as defined in Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44, and in Section 1 of the Clayton Act, 15 U.S.C. § 12.

14. Respondents are engaged in activities in or affecting "commerce" as defined in Section 4 of the Federal Trade Commission Act, 15 U.S.C. § 44, and in Section 1 of the Clayton Act, 15 U.S.C. § 12.

15. The Proposed Acquisition constitutes a merger subject to Section 7 of the Clayton Act, 15 U.S.C. § 18.

RESPONDENTS AND THE PROPOSED ACQUISITION

16. Respondent Nvidia is a publicly-traded Delaware corporation, headquartered in Santa Clara, California, and founded in 1993. Its total revenues in the fiscal year ended January 31, 2021 were $16.68 billion. Nvidia develops and markets microprocessor products and associated software. Nvidia is the leading global supplier of standalone GPUs and has consistently maintained its position as the dominant supplier of such products. Nvidia also develops and markets chips, devices, and associated software for other applications, including advanced networking products, advanced driver assistance systems, datacenter CPUs, and other product lines.

17. Respondent Arm is a corporation, headquartered in Cambridge, United Kingdom, and founded in 1990. Arm's total revenues in 2020 were $1.86 billion. Arm is currently owned by SoftBank, which acquired Arm in 2016. Arm develops semiconductor processor technology, licenses it to chip designers, and provides related service and support. Arm describes itself as [redacted] As of January 2020, Arm had over [redacted] licensees.

18. Respondent Softbank is a corporation, headquartered in Tokyo, Japan, and established in 1986. Softbank owns Arm. Softbank operates as a strategic investment holding company, aiming to invest in "a diverse group of companies with outstanding technologies or business models in their respective fields." As of March 31, 2021, Softbank counted 335 subsidiaries and affiliates among its group companies. Softbank's net sales in fiscal year 2020 were 5,204.4 billion yen (approximately $47 billion). Softbank began exploring the sale of Arm in [redacted] In June 2020, Arm's CEO described the company in an email to a Softbank board member as [redacted]

19. Ultimately, Softbank and affiliated entities entered into a Share Purchase Agreement to sell Arm to Nvidia on September 13, 2020. The deal was valued at $40 billion at signing. Due to increases in the value of Nvidia's stock since then, it is now valued at over $50 billion.

20. Before the merging parties entered into the Share Purchase Agreement, the merging parties and industry analysts recognized that the Proposed Acquisition was likely to face significant antitrust scrutiny. In recognition of this problem, Nvidia agreed to pay Arm's owner, Softbank, a $1.25 billion fee if the transaction terminates after a failure to obtain antitrust approvals.

BACKGROUND

21. This case is about Nvidia's proposed takeover of Arm. Arm Processor Technology is incorporated in billions of chips and devices sold today—including products from Nvidia's competitors as well as Nvidia itself. If the Proposed Acquisition were allowed to proceed, Nvidia would gain control of Arm's Processor Technology, a critical input that currently enables these competitors to compete vigorously with Nvidia. Nvidia will have the ability and incentive to use its control of Arm's Processor Technology to undermine its competitors, reducing competition and ultimately resulting in reduced product quality, reduced innovation, higher prices, and less choice, harming the millions of Americans who benefit from products that incorporate Arm's Processor Technology.

I. Arm and Its Neutral Licensing Model

22. Arm licenses Arm Processor Technology to more than a thousand licensees. These range from innovative startups who have yet to make their first sale to large, established technology companies. Many of Arm's licensees, including Nvidia, are "fabless" semiconductor companies. This means that they design and market computer chips (or products containing chips) but outsource the physical manufacturing of these chips to specialized manufacturers.

23. Arm achieved its status as a foundational technology for so many innovative products because of its neutral licensing business model that fosters trust, collaboration, and engagement between Arm and its licensees. As Arm's longtime chief architect has explained, [redacted]

24. Arm's licensing model is based on upfront license fees and royalties. Arm offers two basic categories of technology licenses: architectural licenses and implementation licenses. Architectural licenses grant holders the right to create their own Arm-based CPU designs using Arm's instruction set architecture ("ISA"). Implementation licenses grant holders the right to use Arm's own specific CPU designs in their products. Arm's business model is based on its current commercial incentives and has contributed substantially to the growth, innovation, and success of Arm and the Arm ecosystem.

25. Arm typically profits when its licensees sell more units. Thus, Arm has an incentive to expand the usage of Arm Processor Technology under its royalty-based model. Arm therefore devotes considerable effort to enabling its licensees to succeed. According to Arm's president, [redacted]

26. Arm actively solicits input from its licensees for enhancing Arm's ISA and implementation designs. Arm also collaborates with licensees on the development of major features. Licensees regularly suggest new features to Arm, expecting that if Arm agrees to implement their suggestion, Arm will incorporate the feature in a manner that permits the new feature's proponent to benefit, while also generally making the improvement available to other licensees. This joint innovation and research and development benefits the computing industry and, ultimately, consumers.

27. Licensees routinely share confidential and commercially sensitive information with Arm when collaborating. Licensees share information such as strategic plans, project timelines and development schedules, manufacturing process plans, use cases, customer requirements, and product bugs or challenges. This type of information sharing depends on trust, enables licensees to bring better products to market faster, and is critical to Arm's success and history of innovation.

28. Arm also collaborates and works with licensees to develop, produce, troubleshoot, and implement the licensees' Arm-based products. For instance, Arm may advise licensees that a particular technical decision is unlikely to succeed, thereby steering the licensee away from a costly error. Arm also helps its licensees by explaining aspects of the Arm architecture and resolving technical difficulties.

29. In tandem with collaborating with licensees on product innovation and development, Arm also dedicates time, effort, and resources to promoting the adoption of Arm-based products in Downstream Markets that include multiple licensees' products. Arm interacts with its licensees' customers to understand their markets, explain Arm's capabilities and benefits, and help sell licensees' products. Arm's actions to promote its licensees' Arm-based products today involve supporting and promoting the products of multiple licensees who themselves are competitors.

II. Computer Processors

30. There are different types of computer processors. According to Nvidia, three of the most important are central processing units ("CPUs"), graphics processing units ("GPUs"), and data processing units ("DPUs"). Nvidia's CEO has described the CPU, GPU, and DPU as "the three most important," "central," "fundamental" technologies in a computer.

31. CPUs are processors that execute the primary computing instructions for electronic computing devices such as laptops, smartphones, datacenter servers, and chips supporting advanced driver assistance features in a passenger vehicle. When one or more CPUs are combined on a single chip with additional circuitry for performing other functions of a computer system, such as memory or co-processors, the resulting chip is sometimes termed a "system-on-a-chip" or "SoC." CPUs may consist of one or more CPU "cores," which are the individual processing units within a CPU chip. Multiple cores may be combined into one multi-core "CPU" chip or SoC. At times, however, the terms "cores" and "CPUs" are used interchangeably in the industry.

32. CPUs are based on an instruction set architecture ("ISA"). CPU ISAs include the Arm ISA, the x86 ISA, the RISC-V ISA, and the MIPS ISA, among others.

33. Software written for use by CPUs based on one ISA is generally not natively compatible with CPUs based on a different ISA. Each ISA has its own ecosystem of associated and natively compatible software, hardware, developers, and users. An ecosystem is generally more attractive if it has more software, hardware, developers, and users for any given computing market.

34. The x86 ISA has predominantly been deployed in CPUs for laptops, desktops, and servers. Intel created the x86 ISA, and Intel and AMD are the only two suppliers of x86 CPUs. Historically, the x86 ISA has not been licensable, and Intel and AMD have designed and marketed their own chips based on the x86 ISA. In 2021, Intel indicated that it planned to make some x86 technology available for license by customers of its chip manufacturing plants under certain circumstances. [redacted] involves limitations, including the apparent requirement to use Intel manufacturing plants and relying on a potentially competing chip supplier, Intel, for a critical input.

35. RISC-V is a free, open-source ISA that researchers at the University of California, Berkeley first developed. RISC-V was released to the public in 2011. Development of the RISC-V ISA is managed by a nonprofit foundation. The RISC-V ISA has predominantly been deployed in less complex applications, such as for low-end, embedded processors that do not run external software applications—for instance, processors found in relatively simple 'Internet of Things' devices like 'smart' doorbells or other 'smart' appliances. Many Arm licensees view the RISC-V technology and software ecosystem as inferior to Arm Processor Technology and the Arm ecosystem for many applications.

36. MIPS is an ISA that MIPS Computer Systems developed and that Wave Computing owns today. The MIPS architecture is declining in relevance and Wave Computing has announced that it will no longer develop MIPS in the future.

37. CPUs based on the Arm ISA are found in billions of chips worldwide, making Arm "the world's most popular computing platform" and [redacted] according to Nvidia. Arm-based CPUs, which are known in particular for their low power consumption, are found in the vast majority of smartphones, tablets, and other low-powered computing devices.

38. Arm-based CPUs also are increasingly found in laptop and desktop personal computers (PCs), and in datacenter servers. For example, in 2020, Apple began switching its entire line of Mac laptops and desktops from Intel x86 CPUs to an Arm-based SoC that Apple designed (called the "M1"). When Apple launched the M1, it emphasized its high performance and low power consumption, describing it as "the world's best CPU performance per watt," enabling significant computing performance increases "all while enabling battery life up to 2x longer than previous-generation Macs." Arm-based CPUs from chip suppliers such as MediaTek and Qualcomm are also deployed in laptops, and [redacted] Similarly, large cloud service providers, such as [redacted] are now deploying or planning to deploy Arm-based CPUs in datacenter servers. Because cloud datacenters often consume large amounts of electricity, the lower power consumption of Arm-based CPUs is seen as particularly attractive.

39. Most of the chip suppliers competing to supply SoCs for high-level automotive advanced driver assistance systems (ADAS) use Arm-based chip designs, including Nvidia. High-Level ADAS systems for passenger vehicles offer computer-assisted driving functions, such as automated lane changing, lane keeping, highway entrance and exit, and collision prevention, as discussed below.

40. Some computing devices also contain one or more GPUs to assist in certain tasks. As the name suggests, GPUs were originally developed to perform specific graphics tasks in applications such as video games. However, because GPUs excel more generally at parallel processing tasks, GPUs are now deployed in many other applications including in datacenters for accelerating tasks like machine learning algorithms (a type of artificial intelligence processing). Nvidia also integrates or plans to integrate its GPUs into other devices, such as its ADAS SoCs. GPUs do not run on their own without a host CPU. Nvidia anticipates GPUs to be central in "modern AI — the next era of computing — with the GPU acting as the brain of computers, robots and self-driving cars that can perceive and understand the world."

41. DPUs or DPU SmartNICs (also referred to as infrastructure processing units ("IPUs")) are an important emerging category of networking devices designed for datacenters and other networked environments. As Nvidia describes it, "The DPU places a 'computer in front of the computer' for each server, delivering separate, secure infrastructure provisioning that is isolated from the server's application domain." More specifically, a DPU is a network interface device that incorporates software-programmable CPU cores for offloading and isolating networking, security, virtualization, and other datacenter support tasks from the server's main (or "host") CPU. By isolating these tasks away from the host CPU, DPUs provide added security and free up the host CPU to focus on running users' desired applications, rather than datacenter infrastructure functions. Nvidia, in its internal documents, refers to DPUs as one of the "three pillars" or the "holy trinity" of computing, along with CPUs and GPUs, and Nvidia believes that eventually every server will incorporate a DPU. Nvidia's DPUs rely on Arm Processor Technology, as do those of most other competitors.

III. Nvidia and Its Arm-Based Products Today

42. Nvidia is one of the largest and most valuable chip suppliers in the world. Nvidia competes in a wide range of computing markets today and expects to compete in more markets in the future.

43. Nvidia has been an Arm licensee for many years. During that time, Nvidia has successfully developed and sold chips that incorporate Arm-based designs that Nvidia developed itself using an architectural license from Arm as well as chips that incorporate Arm-based designs that Nvidia obtained from Arm via implementation licenses.

44. Nvidia can already receive the benefits of Arm Processor Technology without acquiring Arm. Nvidia has invested in the Arm ecosystem over many years and continually developed innovative, cutting-edge products by combining Arm Processor Technology with Nvidia's proprietary technology. For example:

a. Nvidia's Orin product is an Arm-based SoC for High-Level advanced driver assistance systems (ADAS) that is "the new mega brain of the software-defined vehicle," capable of "power[ing] all the intelligent computing functions inside vehicles."

b. Nvidia's Grace product is an Arm-based CPU that Nvidia views as the "basic building block of the modern data center." According to Nvidia, this product is capable of "deliver[ing] 10x the performance of today's fastest servers on the most complex AI and high performance computing workloads."

c. Nvidia's Bluefield-3 product is an Arm-based DPU SmartNIC that "delivers the most powerful software-defined networking, storage and cybersecurity acceleration capabilities available for data centers," with processing equivalent to "up to 300 CPU cores, [thereby] freeing up valuable CPU cycles to run business-critical applications."

d. Nvidia makes other Arm-based computing products, including chips for video gaming consoles, high-performance "Internet of Things" industrial devices, and more.

45. Nvidia committed to developing a wide variety of Arm-based products long before pursuing this Proposed Acquisition. On September 14, 2020, Nvidia's CEO told investors (in a public investor call announcing the Proposed Acquisition) that "last year"—before Softbank had even offered Arm for sale—Nvidia had already "decided [for datacenters] that we would adopt and support the Arm architecture for the full NVIDIA stack, and that was a giant commitment." "The day we decided to do that," he continued, "we realized this is going to be for as long as we shall live. And the reason for that is because once you start supporting the ecosystem, you can't back out."

IV. The Proposed Acquisition Will Result in an Anticompetitive Change in Incentives

46. Prior to the Proposed Acquisition, Arm's incentive has been to expand broadly the use of Arm Processor Technology because Arm typically profits when its licensees sell more units. To that end, Arm partners with its licensees to develop competitive products. This collaboration includes development of major features of Arm Processor Technology, support for licensees' own efforts to innovate using Arm Processor Technology, and promotion (and other sales help) for its licensees as they compete to sell their products. In short, Arm's incentives as an independent firm cause it to encourage the success of Arm licensees in the Downstream Markets.

47. Nvidia's incentives are starkly different than Arm's. Nvidia competes to sell its products against many of Arm's other licensees. Nvidia makes profits when it makes a sale and loses profits when another Arm licensee makes a sale in its place.

48. After the Proposed Acquisition, the combined firm will not have Arm's same premerger incentive to enable its licensees' success in the Downstream Markets. Instead, the combined firm will have the incentive to engage in foreclosure strategies. Foreclosure strategies involve withholding a critical input from rivals, delaying or degrading access to the input (including delaying or degrading service and support), unfavorably changing the terms on which the input is made available to rivals, or otherwise using the critical input to raise their costs or

disadvantage them. In each relevant market at issue in this case, Nvidia already has a strategic imperative to win sales from its rivals, and Nvidia's profits on additional sales in the downstream market are likely to be larger than the profits from continuing to neutrally license Arm's Processor Technology or to provide the same level of support, access, and investment to licensees. Moreover, because of the evolving nature of computing markets, Nvidia's incentives to use Arm to harm its rivals are amplified by the benefits of preventing innovations in Arm Processor Technology that could lead to greater future competition against Nvidia, including competition with Nvidia's GPU business.

49. Arm employees recognize the problematic change in incentives that the Proposed Acquisition will cause. For example, in response to the Proposed Acquisition, Arm employees asked (or predicted licensees would ask) questions highlighting the basic conflicts of interest associated with Nvidia buying Arm, such as:

a. [redacted]

b. [redacted]

c. [redacted]

d. [redacted]

50. Arm's CEO likewise has recognized that [redacted] He further recognized that [redacted]

51. Nvidia insiders also recognized the anticompetitive change in incentives. For example, insiders asked:

a. [redacted]

b. [redacted]

c. [redacted]

d. [redacted]

e. [redacted]

f. [redacted]

52. Nvidia insiders also [redacted] For example, a Bank of America Securities analyst noted "[a]ny potential deal could face intense and prolonged regulatory scrutiny given ARM's currently neutral position as a technology enabler for the entire semis industry including many of [Nvidia's] competitors." An analyst from another large investment firm wrote: "[T]here could be a myriad of conflict of interest issues whereby [Nvidia] could have access to competitor strategies/technologies in a variety of [Nvidia] markets, notably Auto and perhaps to an increasing extent, datacenter."

53. Post-Acquisition, the combined firm will also have the ability to harm Nvidia's Arm-reliant rivals. There are numerous full or partial foreclosure strategies that it can use to disadvantage its rivals—sometimes without the rival ever knowing the strategy was executed.

RELEVANT MARKETS AND ANTICOMPETITIVE EFFECTS

54. The Proposed Acquisition is likely to substantially lessen competition in multiple relevant antitrust markets, resulting in reduced innovation and more expensive or lower quality products.

55. The Proposed Acquisition will result in a combined firm with the ability and incentive to use foreclosure strategies involving a critical input to undermine its rivals in one or more relevant markets, and the Acquisition will not produce cognizable procompetitive effects.

56. The transaction is likely to substantially lessen competition in relevant antitrust markets for DPU SmartNICs, High-Level Automotive ADAS Central Compute SoCs, and Arm-Based Datacenter CPUs for Cloud Computing Service Providers.

57. In addition, the transaction is likely to harm competition by giving Nvidia access to the competitively sensitive information of Arm's licensees and by decreasing the incentive for Arm to pursue innovations in its Processor Technology that are perceived to conflict with Nvidia's business interests.

I. DPU SmartNICs are a Relevant Product Market

58. DPU SmartNICs are a relevant product market for evaluating the likely competitive effects of the Proposed Acquisition. The corresponding relevant geographic market is worldwide.

59. DPU SmartNICs are network interface devices that incorporate software-programmable CPU cores for offloading and isolating processing tasks related to networking, security, virtualization, and other datacenter support services from the server's main CPU (also called the "host" CPU). DPU SmartNICs increase server compute efficiency and security.

60. The DPU SmartNIC market is nascent but growing rapidly.

61. Nvidia is a significant, aggressive, and rapidly growing participant in this market with its Arm-based Bluefield product line.

62. Nvidia competes against several other companies currently vying to supply DPU SmartNIC solutions, including Pensando, [redacted] Xilinx, Broadcom, Marvell, and Intel. All of these suppliers use Arm-based designs for DPU SmartNIC products, including Intel, despite its unfettered access to the x86 architecture.

63. There are no commercially reasonable interchangeable substitutes for DPU SmartNICs. For example, Network Interface Controllers (NICs) that lack software-programmable CPU cores are not reasonably interchangeable substitutes. These products are part of a spectrum of network devices that range from "basic" NICs with no offload capabilities to more advanced NICs that also perform some networking acceleration processing tasks but lack software-programmable CPU cores. DPU SmartNICs have distinct features and functionality compared to such products. For instance, DPU SmartNICs allow valuable network security features by isolating computing workloads to protect applications running on the main server CPU from attacks. DPU SmartNICs also have distinct (and higher) prices compared to other NIC products.

II. The Proposed Acquisition is Likely to Harm Competition for DPU SmartNICs

64. The Proposed Acquisition would result in a combined firm with the ability and incentive to engage in foreclosure strategies targeting Nvidia's rivals in the market for DPU SmartNICs.

65. After the Proposed Acquisition, the combined firm would have the ability to harm Nvidia's rivals for DPU SmartNICs. Arm Processor Technology is a critical input for DPU SmartNIC products. Virtually all major DPU SmartNIC suppliers, including Nvidia and its direct competitors, incorporate Arm Processor Technology and rely on the Arm architecture as a critical component in their products. According to Nvidia's own definition, DPUs include "[a]n industry-standard, high-performance, software-programmable, multi-core CPU, ***typically based on the widely used Arm architecture***. . . ." (emphasis added).

66. DPU SmartNICs depend on Arm Processor Technology for multiple reasons, including, but not limited to:

a. Arm Processor Technology offers the ability to build high-performance CPU cores that are customizable and scalable.

b. Arm-based cores offer the necessary high performance without the cost of increased power usage. Efficient power usage is critical for DPU SmartNIC applications because these applications often have power constraints.

c. Significant investments have been made in Arm-compliant software, which would be costly and risky to reinvent. Arm has developed and delivered on a vibrant roadmap, which has sparked the development of a rich set of tools and applications comprising the Arm ecosystem.

d. Arm provides broad support for product development and improvement. Arm collaborates with and provides assistance to its partners on the development and deployment of DPU SmartNICs, including on design, features, production, testing, marketing, sales, and other activities.

67. There are no close substitutes for Arm Processor Technology for DPU SmartNICs. Even if there were a close alternative to Arm, switching, in and of itself, is a large cost to impose on Arm's customers. Such architectural switches are time and resource intensive and expensive.

68. Other CPU architectures are not close alternatives to Arm for DPU SmartNICs. MIPS is an ISA whose use in the computing industry has been declining and which lacks a vibrant ecosystem, especially compared to Arm. RISC-V lacks the performance, support, and advanced software ecosystem that characterize Arm. x86 CPUs are not well suited for DPU SmartNIC applications. Even Intel, the company that introduced and owns the x86 CPU ISA, is using Arm Processor Technology in certain Intel DPU SmartNIC products.

69. The Proposed Acquisition would give the combined firm the ability to use foreclosure strategies to disadvantage rivals in the market for DPU SmartNICs through a variety of mechanisms, including by controlling Arm's pricing, the terms and timing of access to its Processor Technology, its technological development and features, and its provision of services and support, among other mechanisms. Arm already has such abilities today, but it does not have the incentive to use such mechanisms to undermine Nvidia's rivals.

70. The Proposed Acquisition also would give the combined firm the incentive to use foreclosure strategies to harm Nvidia's DPU SmartNIC rivals. Nvidia already views winning the DPU SmartNIC market as a key strategic priority. As Nvidia's CEO put it in one email, [redacted]

71. Nvidia's dedication makes good sense. The DPU SmartNIC market is expected to grow rapidly into a multi-billion dollar market as the DPU SmartNIC takes its place as what Nvidia views as the third pillar in datacenters next to CPUs and GPUs.

72. Post-Acquisition, the combined firm would likely have a substantial incentive to engage in foreclosure strategies because profits from additional sales of DPU SmartNICs would

be higher than any foregone proceeds of licensing Arm Processor Technology to Nvidia's DPU SmartNIC rivals.

73. Current competition with Arm licensees has already forced Nvidia to lower its DPU SmartNIC prices and drives Nvidia to improve its product. [redacted] Internal business documents confirm Nvidia's Bluefield [redacted] Internal documents also show that [redacted]

74. The Proposed Acquisition will create a firm with the incentive and ability to harm rivals in the DPU SmartNIC market using foreclosure strategies. Consequently, the Proposed Acquisition is likely to result in a substantial lessening of competition in the DPU SmartNIC market leading to reduced innovation and more expensive or lower quality products.

75. DPU SmartNICs are a relevant antitrust market. The anticompetitive effects of the Proposed Acquisition alleged in the paragraphs above are also likely to occur in any relevant antitrust market that contains DPU SmartNICs.

III. <u>High-Level Automotive Advanced Driver Assistance System Central Compute SoCs are a Relevant Product Market</u>

76. High-Level Advanced Driver Assistance System ("ADAS") Central Compute SoCs ("High-Level ADAS market") are a relevant product market for evaluating the competitive effects of the Proposed Acquisition. The corresponding relevant geographic market is worldwide.

77. The level of automation in a given vehicle is generally categorized using an industry-wide standard set by SAE International, a professional standard setting organization in the mobility industry. SAE specifies six levels of automation for a given vehicle, ranging from L0 (minimal driver assistance such as lane departure and blind spot warnings) to L5 (a fully automated vehicle driving itself with no restrictions).

78. High-Level ADAS refers to SAE Levels 2 through Level 3, including the industry-recognized "L2+" or "advanced L2" level, which refers to the most advanced L2 capabilities. Within High-Level ADAS, L2+ and L3 are especially important for future competition, as automakers are now developing competing solutions incorporating L2+/L3 features for release in the coming years. High-Level ADAS provides advanced, computerized driving assistance along with various automated features that still require the driver to participate in driving the car (at L2) or to remain ready to take control of the car at a moment's notice (at L3). L2 ADAS typically incorporates features such as using automated lane centering, acceleration, and braking technologies simultaneously, while keeping a human driver in ultimate control of the vehicle. L3 ADAS typically incorporates L2 capabilities as well as higher-level functions capable of location-to-location routing monitored by the automated system when certain traffic conditions are met. While the car is in ultimate control at the L3 level, the driver must be ready to take back control on short notice. High-Level ADAS systems rely on SoCs that

provides the required performance, power efficiency, and programmability to enable the system to run features specific to High-Level ADAS. This complaint refers to SoCs that handle the compute workload necessary to enable the features of High-Level ADAS as "Central Compute SoCs." Market participants may refer to these high-performance ADAS SoCs by a number of names, including "central compute," "brain of the system," and "features" SoCs.

79. High-Level ADAS systems may also incorporate other chips besides the Central Compute SoC. Other chips within High-Level ADAS systems, such as those used for discrete sensor processing (e.g., the Front View Camera), generally do not have to be as high performing or as highly programmable as those used for Central Compute processing. As such, Central Compute SoCs have distinct competitive conditions compared to other chips used for other purposes within High-Level ADAS systems. Therefore, chips for other purposes within High-Level ADAS systems, such as discrete sensor processing, are not included in the relevant market.

80. The Entry-Level (L0/L1) ADAS category is generally characterized by more competitors, lower performance requirements, and lower prices. These Entry-Level systems generally require a lower level of chip performance than High-Level ADAS. Competition for supplying chips for Entry-Level ADAS systems is therefore not included in the relevant market.

81. The Fully Autonomous (L4/L5) category is at an earlier stage of development, and it is not yet technologically viable to implement Fully Autonomous private passenger vehicles on a commercial scale. The Fully Autonomous category is generally characterized by uncertain, though likely higher, performance requirements, additional competitors exclusively focused on developing Fully Autonomous solutions (rather than ADAS), and distinct opportunities wholly separate from High-Level ADAS opportunities. Additionally, the Fully Autonomous category is likely to initially focus on commercial vehicles, such as "robotaxis," rather than private passenger vehicles. In contrast, High-Level ADAS opportunities are generally for private passenger vehicles. Competition for supplying chips for Fully Autonomous (L4/L5) systems is therefore not included in the relevant market.

82. The market for High-Level ADAS Central Compute SoCs consists mainly of competitors selling Arm-based chips. Nvidia competes head-to-head against these other chipmakers who rely on Arm Processor Technology, including Qualcomm and Renesas. These companies all sell High-Level ADAS Central Compute SoCs to automakers or automotive suppliers. [redacted] The only significant chip supplier that Nvidia competes against for High-Level ADAS Central Compute SoCs that does not use Arm Processor Technology for the CPU function in its ADAS SoC is Mobileye, which uses chips based on the MIPS ISA.

IV. <u>The Proposed Acquisition is Likely to Harm Competition for High-Level Automotive Advanced Driver Assistance System Central Compute SoCs</u>

83. The Proposed Acquisition would result in a combined firm with the ability and incentive to engage in foreclosure strategies targeting Nvidia's rivals in the market for High-Level ADAS Central Compute SoCs.

84. After the Proposed Acquisition, the combined firm would have the ability to harm Nvidia's rivals for High-Level ADAS Central Compute SoCs. Arm Processor Technology is a critical input for most competitors in this market. Arm-based SoCs are well-suited to high-performance workloads, while consuming relatively little power, which is important given the limited available power in automobiles. In addition, Arm-based SoCs are highly programmable and support extensive third-party software ecosystems. These are features that many automakers require for their High-Level ADAS Central Compute SoCs.

85. Customers rely on Arm to such a degree that Arm considers itself the [redacted] for L2+ ADAS, and industry participants have acknowledged that the automotive industry is reliant on Arm for ADAS development. Arm has developed a product line of its Processor Technology targeted specifically for automotive end uses, including ADAS, under the "Automotive Enhanced" label, with the goal of [redacted]

86. Other ISAs are not close substitutes for Arm for automotive applications. x86-based CPUs are generally not used for High-Level ADAS. Not even Intel's automotive subsidiary, Mobileye, uses x86-based CPUs for High-Level ADAS. Nor does any significant competitor for High-Level ADAS today use RISC-V-based CPUs. RISC-V-based CPUs generally do not have the level of technical performance that High-Level ADAS system designers require, and, as a less mature architecture, they lack a comparable ecosystem and [redacted] Finally, MIPS, which Intel's Mobileye division uses, is not a viable future architecture for High-Level ADAS chips from other competitors. [redacted] And, the owner of MIPS is expected to phase out the MIPS architecture completely. Thus, while Mobileye currently competes for High Level ADAS Central Compute SoCs with a MIPS-based solution, MIPS is not a viable future architecture for High-Level ADAS for other competitors.

87. The Proposed Acquisition would give the combined firm the ability to foreclose, raise rivals' costs, or otherwise disadvantage rivals in the market for High-Level ADAS Central Compute SoCs through a variety of mechanisms, including by controlling Arm's Processor Technology with respect to its pricing, the terms and timing of access, technological development and features, and provision of services and support, among other mechanisms. Arm already has such abilities today, but it does not have the incentive to use such mechanisms to harm Nvidia's rivals.

88. The Proposed Acquisition would also give the combined firm the incentive to use foreclosure strategies to harm Nvidia's High-Level ADAS Central Compute SoC rivals.

89. Nvidia views winning this growing market as a strategic priority. The market is expected to grow exponentially over the next decade. Projections from a variety of sources, [redacted] indicate that the High-Level ADAS market, while currently small in terms of cars on the road, will grow significantly by 2030. Further, success in this market may provide an installed base that can facilitate successful chip vendors' transition into becoming preferred suppliers for Fully Autonomous vehicle solutions once those become technically feasible for deployment in passenger vehicles.

90. Post-Acquisition, the combined firm would likely have a substantial incentive to engage in foreclosure strategies because profits from additional sales of High-Level ADAS Central Compute SoCs would be higher than any foregone proceeds of licensing Arm Processor Technology to Nvidia's High-Level ADAS rivals.

91. Indeed, within the High-Level ADAS Central Compute SoC market, Nvidia has already competed closely against Arm-based competitors for valuable business opportunities at some of the world's largest automakers. Nvidia will have the incentive to harm Arm-reliant High-Level ADAS rivals as opposed to working collaboratively with them to help them succeed, as Arm does today, because Nvidia competes closely against these rivals for major business opportunities in High-Level ADAS.

92. The Proposed Acquisition will create a firm with the incentive and ability to harm rivals in the High-Level ADAS market using foreclosure strategies. Consequently, the Proposed Acquisition is likely to result in a substantial lessening of competition in the High-Level ADAS market leading to reduced innovation and more expensive or lower quality products.

93. High-Level ADAS Central Compute SoCs are a relevant antitrust market. However, the anticompetitive effects of the Proposed Acquisition alleged in the paragraphs above are likely to occur under any market definition that contains High-Level ADAS Central Compute SoCs.

V. Arm-Based Datacenter CPUs for Cloud Computing Service Providers is a Relevant Product Market

94. Arm-based datacenter CPUs for cloud computing service providers (including customized Arm CPU chips, or "ASICs") is a relevant product market for assessing the effects of the Proposed Transaction. The corresponding relevant geographic market is worldwide.

95. Datacenters consist of large numbers of server computers. Arm-based datacenter CPU technology is a new and emerging technology that leverages Arm's Processor Technology to meet the performance, power efficiency, and customizability needs of modern datacenters providing cloud computing services.

96. "Cloud computing" refers to the increasingly popular computing business model in which large datacenter operators provide computing services remotely and/or directly offer computing resources for rent, as well as provide other support services to customers who can then run applications, host websites, or perform other computing tasks on the leased remote servers—i.e., "the cloud." Cloud service providers ("CSPs") make their computers and associated services available for a price to many different types of computing customers in the general public, including individuals, businesses, and other organizations. CSPs are distinct from enterprise datacenter operators. Enterprise datacenters typically involve businesses, government agencies, or other organizations who operate their own on-premises server computers, while cloud computer service providers typically offer their customers off-premise, remote computing resources and services whose usage the customer can purchase incrementally. In general, cloud computing is growing, and datacenters overall are in transition from the

traditional computing model provided by on-premises enterprise servers to a model in which many computer services are cloud-based.

97. In the past, Arm-based CPUs were perceived as not having powerful enough performance to serve as datacenter server CPUs. As a result, datacenter CPUs have been historically dominated by x86-based products offered by Intel Corporation and AMD.

98. But after many years of research and development, innovation, and investment by Arm and Arm's licensees, datacenter CPUs using Arm Processor Technology have emerged as a distinct and highly attractive product offering capable of powering servers for CSPs. Arm-based CPUs now offer server-class compute performance, while also offering low costs per CPU core, high power efficiency, and a high degree of customizability. These attributes are particularly well-suited to the demands of cloud computing.

99. x86-based datacenter CPUs are more distant competitors to Arm-based datacenter CPUs and are thus properly excluded from the relevant product market. Arm-based datacenter CPUs are distinct from x86-based datacenter CPUs. Because the most fundamental "language" of the CPUs, the Instruction Set Architecture, differs between Arm-based CPUs and x86-based CPUs, these products cannot directly replace one another without significant costs, because they "speak" different "languages." As a result, they also have different associated ecosystems. Arm-based CPUs also typically have greater power efficiency and customizability. Power efficiency is an important product attribute for CSPs because electricity consumption is one of the largest costs for large datacenters and a better environmental footprint is also desirable. Greater customizability in chip design is also valuable to CSPs. Arm-based datacenters CPUs also have distinct prices, typically a significantly lower price per core than relevant x86-based CPUs.

100. Because there are numerous practical distinctions between the needs and capabilities of CSPs and operators of traditional on-premises datacenters at businesses or other organizations, the relevant product market is properly defined as Arm-based datacenter CPUs for CSPs. In particular, the large scale of CSPs' datacenters particularly benefit from the performance, power efficiency, and customizability advantages of Arm-based CPUs. And these CSPs' control over their large-scale datacenters and many computing workloads also makes them well-positioned to overcome the hurdle of ensuring that existing and new software is written to be both compatible and optimized for use with the Arm ISA. Further, Nvidia and other chip suppliers have the ability to easily identify CSP customers, and, through individual negotiations with CSPs, the combined firm would have the ability to engage in price discrimination for CSP customers.

101. Companies designing Arm-based datacenter CPUs today include Marvell, Ampere Computing, and Nvidia. Some CSPs, such as Amazon Web Services, also design their own Arm-based datacenter CPUs.

VI. The Proposed Acquisition Would Harm Competition for Arm-Based Datacenter CPUs for Cloud Computing Service Providers

102. The Proposed Acquisition would result in a combined firm with the ability and incentive to engage in foreclosure strategies targeting Nvidia's rivals in the market for Arm-based datacenter CPUs for CSPs.

103. The Proposed Acquisition would give the combined firm the ability to use foreclosure strategies to disadvantage rivals in the market for Arm-based datacenter CPUs for CSPs through a variety of mechanisms, including by controlling Arm's pricing, the terms and timing of access to its Arm Processor Technology, its technological development and features, and its provision of services and support, among other mechanisms. Arm already has such abilities today, but it does not have the incentive to use such mechanisms to undermine Nvidia's rivals.

104. Arm already has the ability to control whether licensees can produce Arm-based CPUs given its ownership of Arm Processor Technology. But, as with other markets, licensees rely on Arm as a trusted partner to develop and license Processor Technology on a neutral basis and to collaborate and provide support to bring new products to market. Indeed, Arm's support is so important that merely discontinuing it could result in licensees bringing inferior products to market, or licensees' products failing altogether.

105. The Proposed Acquisition would give the combined firm the incentive to use foreclosure strategies to impair the ability of Nvidia's rivals to compete in the market for Arm-based Datacenter CPUs for CSPs.

106. This market is a strategic priority for Nvidia. Nvidia views datacenters as core to its business and future, and espouses the importance of all three "pillars" of computing for datacenters—the CPU, the GPU, and DPU. In April 2021, Nvidia announced its plans to launch an Arm-based datacenter CPU product, called "Grace," which it has touted as the "basic building block of the modern datacenter." Nvidia also seeks to sell customized Arm-based datacenter CPUs to CSPs in the future. Nvidia's announcement of Grace came as multiple CSPs were deploying or planning to deploy Arm-based datacenter CPUs from other sources, [redacted]

107. Nvidia already can provide all three "pillars" of datacenter computing today because it has developed its own Arm-based datacenter CPU, "Grace," and it has the capability to design additional Arm-based CPUs, including custom and semi-custom designs, using its Arm license. Indeed, Nvidia told investors in 2021 that, "With Grace, NVIDIA has a 3-chip strategy with GPU, DPU and now CPU."

108. One of the rationales of the Proposed Acquisition was that the acquisition would [redacted] As Nvidia's CEO wrote to his Board of Directors regarding Arm, [redacted] Further emphasizing the relevance of Arm-based CPUs for CSPs to Nvidia's goals, Nvidia's CEO noted in a December 2020 email that [redacted] But as a

licensee of Arm, Nvidia can already supply such chips on equal footing with Arm's other licensees today. [redacted]

109. Post-Acquisition, the combined firm would likely have a substantial incentive to engage in foreclosure strategies because profits from selling additional Arm-based CPUs to CSPs would be higher than any foregone proceeds of licensing Arm Processor Technology to Nvidia's CPU rivals.

110. The Proposed Acquisition will create a firm with the incentive and ability to harm rivals in the market for Arm-based datacenter CPUs used by CSPs through foreclosure strategies. Consequently, the Proposed Acquisition is likely to result in a substantial lessening of competition in the market for Arm-based datacenter CPUs for CSPs, leading to reduced innovation, and more expensive or lower quality products.

111. Arm-based datacenter CPUs for CSPs is a relevant antitrust market. The anticompetitive effects of the Proposed Acquisition alleged in the paragraphs above are likely to occur in any relevant antitrust market that contains Arm-based datacenter CPUs for CSPs.

VII. The Proposed Acquisition Will Harm Competition By Providing Nvidia with Access to Rivals' Competitively Sensitive Information

112. The Proposed Acquisition will result in an additional substantial lessening of competition due to a critical loss of trust in Arm and its ecosystem. Today, Arm's licensees—including Nvidia's rivals—routinely share competitively sensitive information with Arm. Licensees rely on Arm for support in developing, designing, testing, debugging, troubleshooting, maintaining, and improving their products. As part of this collaborative relationship, Nvidia's rivals routinely share a broad spectrum of competitively sensitive information with Arm. Indeed, effective collaboration between Arm and its licensees often depends on this information sharing because of the competitive importance of innovation, feature competition, and fast time-to-market in the technology industry. Arm licensees are willing to share their competitively sensitive information with Arm because Arm is a neutral partner, not a rival chipmaker.

113. Nvidia's ownership of Arm would fundamentally upend Arm's status as a neutral partner and, at the same time, enable Nvidia to obtain access to its rivals' competitively sensitive information. With the benefit of its rivals' secrets, Nvidia could adjust its activities to undermine competition and harm customers. Recognizing that Nvidia would be able to misuse this otherwise unobtainable information, Nvidia's rivals will likely curtail their highly productive information sharing with Arm and otherwise refrain from making the same procompetitive contributions that they would have absent Nvidia's access to their information. Nvidia's potential misuse of competitively sensitive information and the related chilling effect on collaboration among Arm and its licensees is a further anticompetitive effect of the Proposed Acquisition, and is likely to result in reduced innovation, and more expensive or lower quality products regardless of whether Arm engages in foreclosure strategies.

VIII. The Proposed Acquisition Will Further Harm Innovation By Skewing the Path of Arm Processor Technology Development

114. In addition to the harms to innovation that will result from the foreclosure strategies and the access to competitively sensitive information described above, the Proposed Acquisition is likely to lead to an additional substantial lessening of competition by eliminating innovations that Arm would have pursued but for a conflict with Nvidia's interests.

115. Today, Arm develops its Processor Technology based on input from its licensees and its analysis of the marketplace. Its roadmap for development thus reflects the input of the Arm ecosystem. Absent the transaction, innovation will continue in this direction.

116. But because the transaction would put Nvidia in charge of Arm's Processor Technology roadmap and future development, the merged firm would have less incentive to develop or enable otherwise beneficial new features or innovations if Nvidia determines they are likely to harm Nvidia. The innovation interests of Nvidia are not synonymous with the Arm ecosystem, but the transaction will inevitably skew innovation in the direction of Nvidia's interests. As one Arm executive observed about Nvidia's proposed takeover of Arm, [redacted]

117. Nvidia would have the ability and incentive to ensure that Arm does not develop features or innovations that could threaten its downstream businesses, including its GPU business. For example, in some contexts, CPUs and GPUs compete with each other as alternative processors for handling evolving computing workloads, and Nvidia, for instance, actively markets its GPUs for AI inferencing workloads, which some CPUs, including Arm-based CPUs, also perform. In recent years, Arm expended substantial efforts to add certain built-in AI processing functionality directly into its CPU technology. The development of on-chip AI functions and innovations for CPUs and SoCs that are not tied to Nvidia's proprietary hardware or software is not likely to be in Nvidia's interest.

118. Consequently, innovation is likely to be harmed since Nvidia is unlikely to undertake or permit substantial efforts at attempting CPU innovations that could threaten demand for Nvidia's chips, including GPUs. Post-Acquisition, Nvidia would have the incentive to channel Arm's innovation activities in directions that ensure Arm's CPU technology does not pose any threats to its own chip businesses, including its GPU-centric computing business.

ABSENCE OF ADDITIONAL FACTORS

119. Respondents cannot demonstrate that entry or expansion of products in the Relevant Markets that do not incorporate Arm Processor Technology would be timely, likely, or sufficient to reverse the anticompetitive effects of the Proposed Acquisition.

120. Respondents cannot demonstrate that the Proposed Acquisition would likely generate verifiable, cognizable, merger-specific efficiencies that would reverse the likely competitive harm from the Proposed Acquisition. [redacted] Thus, regardless

of the Proposed Acquisition, Nvidia has and will continue to have access to all Arm Processor Technology, and it can continue to innovate and develop Arm-based products, as it was already planning to do, and as many other companies, including Nvidia's competitors, also do. Indeed, as one Arm executive observed, in response to a report about the potential for the Proposed Acquisition by Nvidia, [redacted]

VIOLATION

COUNT I – ILLEGAL ACQUISITION

121. The allegations above in paragraphs 1 to 120 are incorporated by reference as though fully set forth.

122. The Proposed Acquisition, if consummated, would be likely to lessen competition substantially in interstate trade and commerce in the Relevant Markets throughout the country. If the Proposed Acquisition were to proceed, it would result in substantial harm to competition, including as a result of the combined firm's ability and incentive to disadvantage rival suppliers of downstream products in the Relevant Markets, the chilling effect on innovation induced by the combined firm's access to its rivals' competitively sensitive information supplied to Arm, and the combined firm's ability and incentive to stifle innovations that are unfriendly to its business interests.

123. The Proposed Acquisition violates Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18 and is an unfair method of competition that violates Section 5 of the FTC Act, as amended, 15 U.S.C. § 45.

NOTICE

Notice is hereby given to the Respondents that the ninth day of August, 2022, at 10:00 a.m., is hereby fixed as the time, and the Federal Trade Commission offices at 600 Pennsylvania Avenue, N.W., Room 532, Washington, D.C. 20580, as the place, when and where an evidentiary hearing will be had before an Administrative Law Judge of the Federal Trade Commission, on the charges set forth in this complaint, at which time and place you will have the right under the Federal Trade Commission Act and the Clayton Act to appear and show cause why an order should not be entered requiring you to cease and desist from the violations of law charged in the complaint.

You are notified that the opportunity is afforded you to file with the Commission an answer to this complaint on or before the fourteenth (14th) day after service of it upon you. An answer in which the allegations of the complaint are contested shall contain a concise statement of the facts constituting each ground of defense; and specific admission, denial, or explanation of each fact alleged in the complaint or, if you are without knowledge thereof, a statement to that effect. Allegations of the complaint not thus answered shall be deemed to have been admitted.

If you elect not to contest the allegations of fact set forth in the complaint, the answer shall consist of a statement that you admit all of the material facts to be true. Such an answer shall constitute a waiver of hearings as to the facts alleged in the complaint and, together with the complaint, will provide a record basis on which the Commission shall issue a final decision containing appropriate findings and conclusions and a final order disposing of the proceeding. In such answer, you may, however, reserve the right to submit proposed findings and conclusions under Rule 3.46 of the Commission's Rules of Practice for Adjudicative Proceedings.

Failure to file an answer within the time above provided shall be deemed to constitute a waiver of your right to appear and to contest the allegations of the complaint and shall authorize the Commission, without further notice to you, to find the facts to be as alleged in the complaint and to enter a final decision containing appropriate findings and conclusions, and a final order disposing of the proceeding.

The Administrative Law Judge shall hold a prehearing scheduling conference not later than ten (10) days after the Respondents file their answers. Unless otherwise directed by the Administrative Law Judge, the scheduling conference and further proceedings will take place at the Federal Trade Commission, 600 Pennsylvania Avenue, N.W., Room 532, Washington, D.C. 20580. Rule 3.21(a) requires a meeting of the parties' counsel as early as practicable before the pre-hearing scheduling conference (but in any event no later than five (5) days after the Respondents file their answers). Rule 3.31(b) obligates counsel for each party, within five (5) days of receiving the Respondents' answers, to make certain initial disclosures without awaiting a discovery request.

NOTICE OF CONTEMPLATED RELIEF

Should the Commission conclude from the record developed in any adjudicative proceedings in this matter that the Acquisition challenged in this proceeding violates Section 5 of the Federal Trade Commission Act, as amended, and/or Section 7 of the Clayton Act, as amended, the Commission may order such relief against Respondents as is supported by the record and is necessary and appropriate, including, but not limited to:

1. A prohibition against any transaction between Nvidia and Arm that combines their businesses, except as may be approved by the Commission.

2. If the Acquisition is consummated, divestiture or reconstitution of all associated and necessary assets, in a manner that restores two or more distinct and separate, businesses, with the ability to offer such products and services as Nvidia and Arm were offering and planning to offer prior to the Acquisition.

3. A requirement that, for a period of time, Nvidia and Arm provide prior notice to the Commission of acquisitions, mergers, consolidations, or any other combinations of their businesses with any other company.

4. A requirement to file periodic compliance reports with the Commission.

5. Requiring that Respondents' compliance with the order may be monitored at Respondents' expense by an independent monitor, for a term to be determined by the Commission.

6. Any other relief appropriate to correct or remedy the anticompetitive effects of the Acquisition or to restore Arm as an independent business.

IN WITNESS WHEREOF, the Federal Trade Commission has caused this complaint to be signed by its Secretary and its official seal to be hereto affixed, at Washington, D.C., this second day of December, 2021.

By the Commission.

April J. Tabor
Secretary

SEAL:

IN THE SUPREME COURT OF THE STATE OF DELAWARE

IN RE TESLA MOTORS, INC.	§	
STOCKHOLDER LITIGATION	§	No. 181, 2022
	§	
	§	Court Below: Court of Chancery
	§	of the State of Delaware
	§	
	§	C.A. No. 12711
	§	

Submitted: March 29, 2023
Decided: June 6, 2023

Before **SEITZ**, Chief Justice; **VALIHURA**, **VAUGHN**, and **TRAYNOR**, Justices; and **WALLACE**, Judge, constituting the Court *en Banc*.[1]

Upon appeal from the Court of Chancery. **AFFIRMED**.

Jay W. Eisenhofer, Esquire, Christine M. Mackintosh, Esquire, Kelly L. Tucker, Esquire, Vivek Upadhya, Esquire, GRANT & EISENHOFER P.A., Wilmington, Delaware; Michael Hanrahan, Esquire (*argued*), Kevin H. Davenport, Esquire, Samuel L. Closic, Esquire, PRICKETT, JONES & ELLIOTT, P.A., Wilmington, Delaware. *Of Counsel*: Daniel L. Berger, Esquire, GRANT & EISENHOFER P.A., New York, New York; Lee D. Rudy, Esquire, Eric L. Zagar, Esquire, Justice O. Reliford, Esquire, Matthew Benedict, Esquire, KESSLER TOPAZ MELTZER & CHECK, LLP, Radnor, Pennsylvania; Randall J. Baron, Esquire, David T. Wissbroecker, Esquire, ROBBINS GELLAR RUDMAN & DOWD LLP, San Diego, California *for Plaintiffs-Below/Appellants*.

David E. Ross, Esquire, Garrett B. Moritz, Esquire, ROSS ARONSTAM & MORITZ LLP, Wilmington, Delaware. *Of Counsel*: Evan R. Chesler, Esquire (*argued*), Daniel Slifkin, Esquire, Vanessa A. Lavely, Esquire, CRAVATH, SWAINE & MOORE LLP, New York, New York *for Defendant-Below/Appellee*.

Robert K. Beste, Esquire, SMITH KATZENSTEIN & JENKINS LLP, Wilmington, Delaware *for Amicus Curiae, Corporate Law Professors, in support of Appellants*.

VALIHURA, Justice:

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[1] Justice Vaughn and Judge Wallace are sitting by designation under Del. Const. art. IV, §§ 38 & 12, respectively, and Supreme Court Rules 2(a) and 4(a) to complete the quorum.

INTRODUCTION

This is an appeal of an April 27, 2022, post-trial opinion by the Court of Chancery. At issue is the 2016 all-stock acquisition (the "Acquisition") of SolarCity Corporation ("SolarCity") by Tesla, Inc. ("Tesla"). In this suit, Tesla's stockholders claim that Elon Musk caused Tesla to overpay for SolarCity through his alleged domination and control of the Tesla board of directors (the "Tesla Board"). At trial, the foundational premise of their theory of liability was that SolarCity was insolvent at the time of the Acquisition. Because the Court of Chancery assumed, without deciding, that Musk was a controlling stockholder, it applied Delaware's most stringent standard of review: entire fairness.

The Court of Chancery found the Acquisition to be entirely fair. In this appeal, the two sides vigorously dispute various aspects of the trial court's legal analysis, including, primarily, the degree of importance the trial court placed on market evidence in determining whether the price Tesla paid was fair. Importantly, Appellants do not challenge any of the trial court's factual findings. Rather, they raise only a legal challenge, focused solely on the application of the entire fairness test. Much of Appellants' case on appeal asks that we re-weigh the evidence and come to different conclusions as to whether certain process flaws preponderated over the process strengths and whether the flaws in the process "infected" the price. We are convinced, after a thorough review of the extensive trial record, that the trial court's decision is supported by the evidence and that the court committed no reversible error in applying the entire fairness test.

Both Appellants and *amicus curiae* (the "*amici*") set forth a doomsday argument based upon their contention that the trial court grounded its entire fairness ruling almost exclusively on the unaffected June 21, 2016 stock price of SolarCity, which they say was unreliable due to material, nonpublic information that was not factored into the June 21 stock price. *Amici* refer to the trial court's analysis as "market evidence run amok" and contend that, if affirmed, this case will disincentivize any board from utilizing the procedural protections this Court endorsed in *Kahn v. M & F Worldwide Corp.* ("*MFW*").[2] Although the trial court erred in this portion of its analysis, we reject the contention that the June 21 stock price was the sole basis of the trial court's fair price determination and that any error in that aspect of the analysis necessitates reversal. Other bases for the court's fair price determination are sufficient to support the opinion, particularly in the face of the total collapse of Appellants' insolvency theory — their only fair price theory at trial. Our decision to affirm is also driven, in part, by our deferential standard of review as to the numerous unchallenged credibility and factual findings underpinning the trial court's determination that certain process flaws did not predominate or cause the process either to be unfair or to infect the price.

On appeal, Appellants do not challenge the trial court's rejection of their insolvency theory. Instead, they now accuse the trial court of "rote reliance" on market price, applying a bifurcated entire fairness test, refusing to consider the trial experts' discounted cash flow ("DCF") analyses in determining fair price (even though they disclaimed reliance on this methodology at trial), and improperly relying on Evercore's "flawed" analyses and on the stockholder vote in support of its determination that the transaction was entirely fair. We

[2] 88 A.3d 635 (Del. 2014).

reject each of these challenges, and, for the reasons explained below, we AFFIRM the decision of the Court of Chancery.

I. RELEVANT FACTUAL AND PROCEDURAL BACKGROUND[3]

A. The Parties

Plaintiffs Below, Appellants are Arkansas Teachers Retirement System, Roofers Local 149 Pension Fund, Oklahoma Firefighters Pension and Retirement System, KBC Asset Management NV, Erste Asset Management GmbH, and Stitching Blue Sky Active Large Cap Equity Fund USA (collectively, "Appellants"). Appellants were Tesla stockholders and were selected by the Court of Chancery to serve as co-lead plaintiffs in the action below.

Defendant Below, Appellee Musk is a co-founder of Tesla, as well as its largest stockholder.[4] Musk "has continuously served as Tesla's CEO since October 2008" and "also served as the chairman of the Tesla Board from April 2004 to November 2018[.]"[5] As the Court of Chancery noted, "Tesla is 'highly dependent on [Musk's] services,' and [Musk's] departure from the company would likely 'disrupt [its] operations, delay the development and introduction of [its] vehicles and services, and negatively impact [its] business, prospects and operating results.'"[6]

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[3] The facts, except as otherwise noted, are taken from the Court of Chancery's post-trial opinion below. *See In re Tesla Motors, Inc. S'holder Litig.*, 2022 WL 1237185 (Del. Ch. Apr. 27, 2022) ("*Trial Op.*").

[4] Musk "owned approximately 22% of Tesla's common stock at the time of the Acquisition." *Id.* at *1.

[5] *Id.* at *3.

[6] *Id.* (internal citation omitted).

Nominal defendant below, Tesla, is a publicly traded Delaware corporation that designs, develops, manufactures, and sells electric vehicles ("EVs") and energy storage products. It bills itself as "the world's only vertically integrated energy company, offering end-to-end clean energy products, including generation, storage and consumption."[7]

Non-party SolarCity was a publicly traded Delaware corporation founded in 2006 by Musk's cousins, Peter Rive and Lyndon Rive. SolarCity developed and produced solar panels for residential and commercial use. Musk was both the chairman of the SolarCity board of directors from 2006 until the Acquisition's closing in 2016 and its largest stockholder, holding approximately 21.9% of SolarCity's common stock.

Non-party Space Exploration Technologies Corporation ("SpaceX") "is a private aerospace manufacturer and space transport services company founded by [Musk] in 2002."[8] SpaceX bought $255 million in SolarCity corporate bonds — termed "Solar Bonds" — between March 2015 and March 2016.

The Tesla Board consisted of seven members: Musk, Kimbal Musk (Musk's brother), Brad Buss, Robyn Denholm, Ira Ehrenpreis, Antonio Gracias, and Stephen Jurvetson.[9] Although all seven Tesla Board members were named as defendants in this litigation, all except Musk settled all claims against them for $60 million, funded by insurance, which was approved by the Court of Chancery on August 17, 2020.

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[7] B18 (Tesla, Inc. Form 10-K for fiscal year ended December 31, 2016 at 1).

[8] *Trial Op.*, 2022 WL 1237185, at *3.

[9] *See id.* at *4. We refer to the individual Tesla Board members by their last names and without honorifics. To avoid confusion with his brother, we use Kimbal Musk's first name. We intend no familiarity or disrespect.

According to the Appellants, all of Tesla's directors, except for Denholm, were conflicted in varying degrees with respect to the Acquisition.[10] Denholm had served on the Tesla Board since August 2014 and has served as the Tesla Board chair since November 2018. She served as the "Executive Vice President and Chief Financial Officer of Juniper Networks, Inc. from August 2007 to February 2016, as well as its Chief Operations Officer from July 2013 to February 2016."[11] Denholm has never held any financial interest in SolarCity, and Appellants do not challenge, on appeal, her disinterestedness or independence in the Acquisition.[12]

The other five Tesla Board members — apart from Musk and Denholm — were all conflicted to some degree, according to Appellants. Appellants alleged that Kimbal was conflicted because he is Musk's brother. Kimbal was also a SolarCity stockholder and had significant margin loans on his SolarCity shares at the time of the Acquisition. But Kimbal was not recused from either voting on or discussions regarding the Acquisition. Buss also had a connection to SolarCity: he served as SolarCity's Chief Financial Officer from 2014 until February 2016 — overlapping with his time on the Tesla Board. During negotiations regarding the Acquisition, approximately 45% of Buss's wealth was attributable to his

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[10] *See id.* Rather than making factual findings as to each Tesla Board member's alleged conflicts, the trial court assumed that a majority of the Tesla Board was conflicted. "Whether by virtue of [Musk's] control, or by virtue of *irreconcilable board-level conflicts*, there is a basis for assuming that entire fairness is the governing standard of review." *Id.* at *30 (emphasis added) (internal citations omitted).

[11] A1140 (Joint Pre-Trial Order ¶ 70). Further, by "the time of the Acquisition, Denholm did not hold an officer or other management position with any company." *Id.* at ¶ 71.

[12] In its summary judgment opinion, the trial court noted that Appellants' "allegations that Denholm lacked independence are threadbare." *In re Tesla Motors, Inc. S'holder Litig.*, 2020 WL 553902, at *12 (Del. Ch. Feb. 4, 2020) ("*SJ Op.*").

relationship with Musk and Musk's companies. According to Tesla's public disclosures, Buss did not qualify as an independent director under the NASDAQ Listing Rules.

Ehrenpreis is the co-founder and co-managing partner of a venture capital fund, DBL Equity Fund-BAEF II, L.P. ("DBL"). DBL held 928,977 shares of SolarCity common stock at the time of the Acquisition, making it one of SolarCity's largest investors. Further, Ehrenpreis's co-founder at DBL is Nancy Pfund, who served on SolarCity's board and its special committee for the Acquisition.

Gracias, in addition to his role on the Tesla Board, served on SolarCity's board until the Acquisition's closing. He was recused from certain Tesla Board discussions regarding the Acquisition and from voting on the Acquisition. Finally, Jurvetson, like Ehrenpreis, was associated with a venture capital fund possessing ties to SolarCity. He was a managing director of Draper Fisher Jurvetson ("DFJ"), SolarCity's third-largest institutional stockholder, which held 4,827,000 shares as of the Acquisition.[13] Jurvetson personally owned 417,000 shares of common stock in SolarCity.[14]

B. Tesla's Master Plan

Although Tesla is known to many as an EV manufacturer, Musk has had a much broader vision for the company. In 2006, Musk authored the "Tesla Motors Master Plan" (the "Master Plan"), wherein he publicly declared that "Tesla's mission is to accelerate the world's transition to sustainable energy" and "to help expedite the move from a mine-and-

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[13] *Trial Op.*, 2022 WL 1237185, at *5. One of Jurvetson's partners at DFJ served on SolarCity's board. *See id.* Jurvetson also served as a SpaceX director at the time of the Acquisition.

[14] Jurvetson testified at trial that this amounted to a single-day swing of his net worth. *See id.*

burn hydrocarbon economy towards a solar electric economy[.]"[15] The Master Plan contains three fundamental pillars upon which the transition to clean energy would rest: "(1) sustainable energy generation from clean sources, such as solar power; (2) energy storage in batteries; and (3) energy consumption through EVs."[16]

The three pillars are crucial to the Master Plan. According to Musk, "[i]f any one of those three parts are missing, then we will not have a sustainable energy future."[17] The Master Plan envisioned that SolarCity would be a part of a vertical integration[18] scheme and a key to Tesla's vision for a renewable energy future. The Master Plan states that Tesla "will be offering a modestly sized and priced solar panel from SolarCity, a photovoltaics company[.]"[19]

C. Tesla Prior To The Acquisition

Tesla's main product line, initially, was its EVs. In order to transition to the

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[15] *Id.* at *1 (internal quotation marks and citation omitted). As the trial court summarized, the Tesla Board was familiar with and agreed upon the vision laid out in the Master Plan. *See id.* at *6 ("Tesla's directors uniformly testified that they understood from the outset that Tesla's long-term goal was to 'accelerate the world's transformation to an alternative energy future.'") (internal citation omitted).

[16] *Id.*

[17] A1378 (Elon Musk Trial Test. at 23:2–4) [hereinafter Musk Trial Test. at _].

[18] Vertical integration is an economic concept. "In a vertically integrated value chain, a single company combines two or more stages of production, such as basic research and further development of some technology, ordinarily performed by separate companies." Peter Lee, *Innovation and the Firm: A New Synthesis*, 70 Stan. L. Rev. 1431, 1435 (2018).

Musk testified that vertical integration was a focus of his: "I wanted [SolarCity] to be acquired so that we could do the product integration of the solar battery. So rather than for them to spend a few months raising capital, it would have been better to do the acquisition and be able to move forward with the solar battery product that I felt was essential for a sustainable energy future." A1433 (Musk Trial Test. at 241:13–20).

[19] A1378 (Musk Trial Test. at 23:17–19).

sustainable energy world, Tesla invested heavily in batteries for its EVs and energy storage products well before the Acquisition. To fully transform production output, Tesla decided to build its own company-operated factory to supply batteries. In February 2014, Tesla announced the construction of its "Gigafactory," a massive lithium-ion battery manufacturing factory that "was intended to produce more [lithium-ion] batteries … than the entire manufacturing battery production of every other manufacturing facility on the planet earth combined."[20]

With the Gigafactory's capacity for mass production came the opportunity for Tesla to bring the other core elements of the Master Plan to fruition, including the second pillar: energy storage. And with the Gigafactory, Tesla soon thereafter moved forward "with the design and production of solar energy storage products, including 'Powerwalls' designed to store solar energy for home use, and 'Powerpacks,' designed to store solar energy for commercial use."[21]

In March 2015, after the Tesla Board toured the Gigafactory, it discussed Tesla's long-stated goal of acquiring a solar company. A little over a month later, Tesla publicly launched Tesla Energy and debuted its Powerwall and Powerpack products. As the trial court noted, "Tesla set the stage for a combination of its battery storage capability with solar energy."[22] Musk himself confirmed Tesla's vision during the public launch of the Powerwall and Powerpack: "[T]he path that I've talked about, the solar panels and the

[20] *Trial Op.*, 2022 WL 1237185, at *7 (internal quotation marks and citation omitted).

[21] *Id.*

[22] *Id.* at *8.

batteries, it's the only path that I know that can do this. And I think it's something that we must do and we can do and that we will do."[23]

D. *SolarCity Prior To The Acquisition*

1. *SolarCity's Business*

Founded in 2006 by Musk's cousins, Peter and Lyndon Rive, SolarCity was an enterprise dedicated to the production and sale of solar panels for both residential and commercial use. It brought solar panels to the market through a variety of channels, from door-to-door sales to call centers to placements at Home Depot. To address the high cost of solar panels, SolarCity offered consumers a financing option, wherein SolarCity would pay the cost of installing and activating the solar panels in exchange for the customer's commitment to repay SolarCity incrementally, with interest, over a period of 20–30 years.

But entering the solar energy space required substantial capital. In order to maintain and expand its business model, SolarCity turned to capital raising to bridge the gap between its short-term costs and long-term cash flows. With a sophisticated capital markets team, SolarCity succeeded at raising capital. As the trial court noted, by 2016's end, SolarCity sponsored over 54 financing funds with 22 investors and carried substantial debt. The Solar Bonds, which SolarCity mainly sold to SpaceX and Musk, were another key component of the capital raising plan.

Despite being in a competitive — and rapidly developing — industry, SolarCity grew to be quite successful. By 2016, SolarCity "was the undisputed market share and cost

[23] *Id.* (internal quotation marks and citation omitted).

leader in the solar energy sector, with over 30% market share for U.S. residential solar, 22% market share for U.S. commercial solar, and 15% of total U.S. solar."[24] With respect to residential solar installations and revenues, SolarCity exceeded its two closest competitors combined.

2. SolarCity's Financial Outlook

By fall of 2015, massive capital outlays, debt maturities coming due, and lower-than-anticipated installations caused cash balances to drop. Management feared that the company would soon face "a major liquidity crisis[.]"[25] SolarCity needed to maintain an average monthly cash balance of approximately $116 million to remain compliant with its revolving debt facility's "Liquidity Covenant." A breach would trigger a default on SolarCity's revolver and cross-defaults on other debts. But management predicted that cash levels could fall to just $35 million, and SolarCity's war chest of cash — which was $1.1 billion in January 2015 — was expected to be just $200 million by 2015's end.

SolarCity decided to increase monetization to prevent further problems from arising due to its lack of cash. At a meeting of SolarCity executives in December 2015, Tanguy Serra, who served as SolarCity's President and CFO until just before the Acquisition's closing, pitched his idea of "cash equity" transactions to address the cash issue. These cash equity transactions involved selling a portion of the future cash flows from recurring customer payments to a third-party investor in exchange for an upfront payment. Serra

[24] *Id.* at *11.

[25] *Id.* at *10 (internal quotation marks and citation omitted).

intended the cash equity transactions to be part of a four-year plan.

The cash equity transaction idea proved successful, at least initially. The first cash equity transaction occurred with John Hancock Financial in May 2016, and two more transactions came in the second half of 2016. "SolarCity retained the rest of its future cash flows, which it estimated to be worth billions of dollars."[26] By the second quarter of 2016, SolarCity had accumulated what it estimated to be $2.2 billion (net present value or "NPV") in retained value.

But the cash equity transactions did not prove to be sustainable. Although SolarCity brought in more cash than it had previously, it still lacked the required capital to meet Serra's four-year plan. To address that problem, SolarCity's board decided to shift its focus to cash sales and began reducing costs. And SolarCity — which relied heavily on its ability to attract and raise capital — soon found its credit rating in jeopardy. At the start of 2016, the company's credit-rating was downgraded. Shortly thereafter, by the end of the first quarter of 2016, the company secured "$305 million in tax equity financing," an impressive sum, but far "short of the $940 million originally projected."[27]

Nevertheless, the trial court found that SolarCity was still a valuable company in 2016. It continued to raise billions of dollars from sophisticated financial institutions that had "deep access" to SolarCity's financials. Further, its cash challenges "were ramifications of rapid growth, not market disinterest in its products or poor business

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[26] *Id.* at *10.

[27] *Id.* at *11.

execution."[28]

E. Musk's Initial Pitch For The Acquisition

It is against this backdrop of SolarCity's worsening cash problems that Musk first broached the subject of a deal between Tesla and SolarCity. In February 2016, Lyndon Rive[29] — Musk's cousin and co-founder of SolarCity — held an emergency meeting to discuss SolarCity's growing need for cash. Musk attended. At this meeting, management discussed various measures to stop the bleeding, such as ranking accounts payable to modulate costs and developing guidelines to suspend certain installations based on their cash impact. Once the meeting ended, Musk and Lyndon discussed Tesla potentially acquiring SolarCity.

In advance of a special Tesla Board meeting scheduled for February 29, 2016, Musk asked Tesla's CFO, Jason Wheeler, to prepare a financial analysis of a Tesla/SolarCity merger and give a presentation at the meeting. At the meeting, Wheeler gave his presentation on a potential merger between the two companies, noting that SolarCity's stock historically traded at a low price. The Tesla Board, notwithstanding Musk's strong endorsement, did not approve moving forward on a potential merger and instead renewed its focus on getting Tesla's EV production up-and-running, particularly the Tesla Model X. However, the Tesla Board did authorize management to gather additional details and to further explore and analyze a potential transaction with SolarCity or other related

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[28] *Id.*

[29] We refer to Lyndon Rive by his first name to avoid confusion with his brother, Peter Rive. No disrespect or familiarity is intended.

businesses.

The Tesla Board next met in March 2016 and again discussed the possibility of Tesla acquiring SolarCity. And again, it declined to proceed further with an acquisition, but — as in the February 2016 meeting — the Tesla Board reiterated that the topic be postponed to a later date. The Tesla Board and management did discuss the steps required should the Tesla Board decide to move forward with negotiations in the future. One such step involved retaining Wachtell, Lipton, Rosen & Katz ("Wachtell") to advise the Tesla Board regarding a potential transaction.

F. SolarCity's Worsening Financial Outlook

Amidst the backdrop of Musk's overtures to the Tesla Board regarding a potential transaction, SolarCity's cash flows continued to decline. The company reported $32 million in net negative cash flow by the end of 2016's first quarter. Negative cash flow was projected for the second quarter to be over $139 million before turning positive in the latter half of the year. To address these concerns, Musk tasked Lyndon with managing SolarCity's financial position until May 2016, a time when Musk wanted to revisit deal discussions.[30] Lyndon discussed SolarCity's financial state at an April 26, 2016 SolarCity board meeting. SolarCity anticipated substantially fewer installations than forecasted and ran the risk of tripping its Liquidity Covenant. The problems spilled over throughout SolarCity's enterprise, and the company soon found itself battling employee turnover, especially in its sales department, which was crucial to getting its solar panels out to

[30] *See Trial Op.*, 2022 WL 1237185, at *13.

consumers. As of June 30, 2016, total cash on hand equaled $145.7 million — less than $30 million above the Liquidity Covenant.

In a call between Lyndon and Musk in May 2016, Lyndon conveyed that he wanted to move forward with a potential merger between the two companies. In response, Musk told Lyndon that any negotiations would have to be pushed to June. It was then that Lyndon expressed the desire that a bridge loan accompany any offer or else SolarCity would have to put off any transaction to raise equity. Musk replied that any Tesla acquisition proposal would come with a bridge loan to SolarCity.

G. The Acquisition's Negotiation Process

1. Tesla Retains Independent Advisors

As noted, in March 2016, the Tesla Board retained Wachtell as deal counsel.[31] The Tesla Board later retained Evercore Partners ("Evercore"), a leading investment bank, as its financial advisor for the potential merger. Although Musk was involved in the retention of Wachtell, he was not involved in retaining Evercore.[32]

Musk again raised the possibility of a deal with SolarCity to the Tesla Board on

[31] *See supra* Section I.E. Musk was involved — with assistance from Gracias and Tesla's general counsel — in retaining Wachtell "before the Tesla Board had decided it wanted to pursue a transaction" with SolarCity. *Trial Op.*, 2022 WL 1237185, at *13 n.169.

[32] *See id.* at *15. The trial court found that "Tesla selected independent, top-tier advisors to represent the Tesla Board in the Acquisition (Wachtell and Evercore)." *Id.* at *36. Regarding Wachtell, the Vice Chancellor noted that Appellants "did not demonstrate a longstanding relationship or conflict between [Musk] or Tesla and Wachtell. To the contrary, based on the evidence, I am satisfied that Wachtell was an independent and effective advisor to the Tesla Board." *Id.* at *13 n.169. For this reason, the Vice Chancellor found that "the failure to disclose the circumstances or timing of Wachtell's engagement in the Proxy was immaterial." *Id.* Likewise, "Evercore had not previously worked for Tesla or SolarCity." *Id.* at *15.

May 31, 2016. The Tesla Board thought the timing was now right for an acquisition because the company had addressed the problems with the Model X rollout. Once the Tesla Board determined to move forward with an acquisition of SolarCity, it was determined that both Musk and Gracias should be recused from any vote relating to the transaction. Recusal was deemed necessary as both had served on the SolarCity board, presenting a clear conflict of interest. Although Musk and Gracias were recused from any voting, the Tesla Board determined that they could still participate in certain meetings and high-level strategic discussions regarding the Acquisition, as their experience and knowledge of the solar industry and of SolarCity's business operations was viewed as helpful.[33]

On June 20, 2016, the Tesla Board had another special meeting. Evercore presented an overview of various potential solar acquisition targets[34] and indicated that, among Tesla's options for a strategic merger, SolarCity represented the best option. SolarCity's financial condition was discussed during the meeting, including the company's ability to

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[33] *See id.* The definitive proxy statement (the "Definitive Proxy") informed Tesla and SolarCity stockholders that:

> [T]he Tesla Board determined that *the strategic vision, expertise and perspectives* of Messrs. Elon Musk and Antonio Gracias would continue to be helpful to the Tesla Board's *evaluation of a potential acquisition of a solar energy company because of their involvement in the solar industry*, but that Messrs. Elon Musk and Antonio Gracias, as a result of their service on the SolarCity Board, should recuse themselves from any vote by the Tesla Board on matters relating to a potential acquisition of SolarCity, including evaluation, negotiation and approval of the economic terms of any such acquisition.

AR501 (Definitive Proxy at 59) (emphases added).

[34] *See* AR3–108 (Evercore Presentation).

meet its current and future obligations. Evercore advised the Tesla Board that the market favored a stock-for-stock transaction between the companies. The Tesla Board focused on the strategic rationale for the transaction and recognized the potential benefits, including the "significant synergies" a solar acquisition would bring to the table.

Musk, who attended the June 20 meeting, "noted that the price had to be 'publicly defensible,' meaning 'in the middle … of precedent premia paid.'"[35] During this initial presentation by Evercore, Musk "appear[ed] to have proposed a 30% premium over SolarCity stock's 4-week trailing price, which amounted to $28.50 per share."[36] Evercore recognized the need to pay a premium and recommended a stock exchange ratio equating to a $25–$27 per share offer.[37] The Tesla Board, by contrast, discussed a range of 0.122 to 0.131 Tesla shares per SolarCity share, equating to $26.50–$28.50 per SolarCity share. As the trial court noted, Musk was not keen on a range of exchange ratios. Denholm — who led Tesla's negotiations — preferred to use ranges because she felt they played a role in negotiating, including providing flexibility. Musk and Gracias then left the meeting, and the Tesla Board continued to discuss the potential acquisition.

2. Tesla's Initial Offer

In Musk's and Gracias' absence, the Tesla Board approved a preliminary,

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[35] *See Trial Op.*, 2022 WL 1237185, at *15 (internal citation omitted).

[36] *Id.* at *16.

[37] Later, at trial, Courtney McBean — Evercore's lead banker — testified that "Solar City was [] a high-growth company" and "the market leader." A1689 (Courtney C. McBean Trial Test. at 1454:20–22) [hereinafter McBean Trial Test. at _]. She explained that "in order to get shareholder approval from the SolarCity stockholders, we believed that we would need to pay a premium." *Id.* (McBean Trial Test. at 1454:23–1455:1).

nonbinding proposal to acquire SolarCity, subject to due diligence. On June 20, 2016, Tesla made an offer to acquire SolarCity at an exchange ratio approved by the Tesla Board of 0.122 to 0.131 shares of Tesla stock per share of SolarCity stock (the "Initial Offer"). This equated to a 21% to 30% premium over SolarCity's trading price at the time.

Included in the Initial Offer was a common deal feature: a majority-of-the-minority voting provision. This provision conditioned the Acquisition on the approval of a majority of disinterested SolarCity stockholders and Tesla stockholders voting on the transaction. A second common deal feature was not employed: the formation of a special, independent negotiating committee of the Tesla Board. As the trial court noted, the Tesla Board opted not to form a special committee "for reasons unexplained."[38] Another aspect from the early discussions regarding the potential Acquisition, however, did not make its way into the Initial Offer. Despite Musk's request, the Tesla Board and Evercore concluded that a bridge loan would not be in Tesla's best interest, and so it was not included in the Initial Offer.

The Initial Offer was publicly announced the next day, June 21, 2016, following the market's close. Reactions to the Initial Offer were swift. The price of Tesla's stock fell "more than 10%, or $3.07 billion—an amount greater than SolarCity's entire market capitalization."[39] Although Tesla's stock price ultimately rebounded and rose above the

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[38] *Trial Op.*, 2022 WL 1237185, at *34. Appellants did not ask Musk, during his two depositions or two days of trial testimony, any questions regarding the creation of a Tesla special committee. *See id.* at *34 n.408. Accordingly, the trial court refused to "surmise that the failure to form a special committee was somehow [Musk's] doing" since there was no evidence to that effect. *Id.*

[39] *Id.* at *16. On June 22, 2016, Tesla's stock closed at $196.66 from the prior day's close of $219.61. *See* A1182 (Joint Pre-Trial Order).

unaffected price by mid-July, it was clear that the market had a gut reaction to the Acquisition. SolarCity, for its part, fared no better following the Initial Offer's public announcement. Its credit rating was downgraded, and it finished the second quarter with approximately $216 million in negative cash flow. Despite these problems, Bank of America continued to lend to, and even deepen its ties with, SolarCity. As the trial court found, SolarCity's financing counterparties participated in financing transactions with Solar City in excess of $3 billion from the fourth quarter of 2015 through the fourth quarter of 2016 — a timeframe when Appellants asserted SolarCity was insolvent.

Upon receipt of the Initial Offer from Tesla, SolarCity formed a special committee (the "SolarCity Committee") of two directors: Nancy Pfund and Don Kendall. The SolarCity Committee retained Lazard Ltd. ("Lazard") as its financial advisor for the Acquisition. Lazard expressed concerns that the company teetered on the edge of breaching the Liquidity Covenant and would be operating with little margin of error until October 2016.

3. *Tesla's Negotiation Strategy*

Denholm, whom the Vice Chancellor described as "an extraordinarily credible witness," led negotiations for Tesla.[40] As noted above, however, Tesla did not form a special committee of the Tesla Board, instead choosing to vest negotiating power in Denholm.[41] The trial court found Denholm's mastery over the negotiations to be critical.

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[40] *Trial Op.*, 2022 WL 1237185, at *17 n.233.

[41] The trial court commented on Denholm's credibility when weighing her role in the Acquisition. "If [Denholm] says she was in charge, then she was in charge." *Id.*

She spent almost six weeks and hundreds of hours on the Acquisition. It was Denholm who corresponded with the SolarCity Committee, assisted by Evercore, updated the Tesla Board, and led the exchange of offers and counteroffers.

Denholm also fleshed out the details and diligence of the Acquisition. Evercore and Wachtell assisted her and the Tesla Board during the negotiations. Evercore staffed the matter with a team of ten bankers, who reviewed SolarCity's financial condition, conducted valuation analyses, and negotiated with the Lazard team.

During this time, Musk kept abreast of the negotiation strategy, and Lyndon kept Musk apprised of SolarCity's financials and the need for bridge financing. The Tesla Board and Evercore, however, remained opposed to a bridge loan, despite Musk having earlier pushed for one. In response to an email request from Lyndon on July 10 to speak with Musk about a bridge loan, Musk advised Lyndon that, despite Musk's wishes, the Tesla Board would not authorize a bridge loan.

4. Tesla's Advisors Uncover SolarCity's Financial Issues

Evercore's diligence process was deliberate and encompassing. Evercore's lead banker on the deal, Courtney McBean, led her team's investigation and analysis of SolarCity's financial state. One core component of Evercore's diligence included discussions with the Lazard team on the SolarCity side. During a call on July 15, 2016, Lazard advised Evercore that it was unaware that SolarCity was at risk of breaching the Liquidity Covenant. Following Evercore's discovery of Lazard's failure to comprehend the financial risk SolarCity faced, McBean called Musk. Musk was surprised that Lazard did not appreciate the risk of tripping the Liquidity Covenant.

Following his discussion with Evercore's McBean, Musk turned his focus to the status of diligence. To increase the pace, he set up daily meetings with Evercore, but as the trial court found, "[i]t is not clear from the record if [Musk's] meetings with Evercore came at the suggestion of the Tesla Board."[42] The first of these calls between Musk and Evercore occurred on July 16, 2016 — one day after Evercore's concerning call with Lazard — and mainly focused on Evercore's workflows. Following this call, Evercore accelerated its pace, with McBean telling her team that the deal would likely be finalized within days.

SolarCity's financial issues became the focus of Evercore's work in the days following those two July calls. Evercore created "downside" projections on SolarCity and the Acquisition. Those projections were presented to Evercore's Fairness Committee, which proposed some changes. At the Tesla Board meeting on July 19, 2016, Evercore explained to the Tesla Board that SolarCity could trip its Liquidity Covenant by July 30, 2016 and warned of the financial consequences. These facts led Evercore to recommend that the Tesla Board lower its offer from the terms of the Initial Offer. That recommendation was first made to Musk in a call with Evercore on July 21, 2016, and then to the Tesla Board on July 22.

Right after the Tesla Board meeting on July 19, Musk self-published the second phase of the Master Plan, which he entitled the "Master Plan Part Deux."[43] As Musk

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[42] *Id.* at *18.

[43] *See id.* at *19.

testified, the impetus behind the Master Plan Part Deux “was to remind people of the purpose of the company, which was to accelerate the advent of sustainable energy.”[44] As the trial court found, Musk “stated that ‘the time has come’ for Tesla to acquire SolarCity and ‘sell integrated solar and energy storage systems.’”[45] Publishing the Master Plan Part Deux was Musk’s way of directly communicating with Tesla stockholders that Tesla’s vision for the future could not be achieved without a solar company.

The Tesla Board next met again on July 24 to discuss Evercore’s July 19 presentation and its recommendation that the Tesla Board lower its offer. Musk attended. He echoed Evercore’s message that SolarCity’s financial condition warranted a lower deal price, but he stressed that the Acquisition still made strategic sense. Once Musk conveyed his thoughts to the Tesla Board, he left the meeting.[46] Evercore presented next and gave an updated presentation on its valuation of SolarCity, confirming its recommendation that the Tesla Board lower its offer. The question, then, became one of timing: the Tesla Board discussed whether to submit a revised offer to SolarCity before SolarCity released its second quarter results. Doing so could lower SolarCity’s stock price. After discussion, the Tesla Board determined to make a revised proposal at a lower price prior to SolarCity’s announcement of its second quarter results. The new exchange ratio was 0.105 shares of Tesla stock per SolarCity share.

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[44] A1393 (Musk Trial Test. at 84:6–8).

[45] *Trial Op.*, 2022 WL 1237185, at *19 (internal citation omitted).

[46] Gracias — who, like Musk, was recused from any potential vote — left the room, as well.

H. The Acquisition's Terms And Public Announcement

In the days following the Tesla Board's July 24 meeting, negotiations continued as the two sides hashed out the details of the Acquisition. The final terms were proposed by the Tesla Board and then conveyed to the SolarCity Committee on July 30 (the "Final Offer"). Tesla offered 0.110 shares of Tesla stock per share of SolarCity stock — significantly below the Initial Offer's range of 0.122 to 0.131 shares. Evercore presented its fairness opinion to the Tesla Board on July 30, 2016, opining that the Final Offer was fair, from a financial point of view, to Tesla. "[T]he Acquisition price fell within or below each of the seven stock price ranges Evercore presented to the Tesla Board (plus two illustrative reference ranges)."[47] Neither Musk nor Gracias took part in the Tesla Board vote on the Final Offer.

On July 31, 2016, Tesla and SolarCity executed an Agreement and Plan of Merger (the "Merger Agreement"), that was announced publicly on August 1. The Merger Agreement required SolarCity to receive Tesla's approval before issuing any equity or taking on any new debt. It also required SolarCity to remain in compliance with its debt covenants pending closing. Tesla then filed a Form 8-K with the U.S. Securities and Exchange Commission (the "SEC"), with the Form 8-K disclosing that the Acquisition's exchange ratio represented an equity value for SolarCity of approximately $2.6 billion, or $25.37 per share, based on a five-day volume-weighted average of Tesla's trading price as of July 29, 2016. The final Acquisition consideration — 0.110 Tesla shares for each share

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[47] *Trial Op.*, 2022 WL 1237185, at *21.

of SolarCity stock — resulted in Tesla paying an equity value of $20.35 per share of SolarCity common stock or approximately $2.1 billion at closing.

Signing the Merger Agreement did not ameliorate SolarCity's financial difficulties. Real risk remained of a Liquidity Covenant breach before the parties could close on the Acquisition. Pressed for cash, SolarCity turned to bond offerings. Musk and his cousins, Peter and Lyndon Rive, purchased $100 million of 12-month 6.5% Solar Bonds, which solved SolarCity's short-term cash needs. Other options to raise capital were not on the table due, in part, to constraints imposed by the Merger Agreement's ordinary course covenant.

I. The Tesla Stockholder Vote

On August 31, 2016, Tesla filed with the SEC a preliminary proxy statement, which contained an explanation of the Acquisition's strategic rationale, the deal process, estimated synergies, fairness opinions and the valuation methodologies of Lazard and Evercore.[48] As the Vice Chancellor explained, it:

> [D]isclosed three sets of SolarCity financial projections to the Tesla stockholders: (1) the SolarCity Base Case: the base case reflecting the best view of SolarCity's management on the company's future as of 2016; (2) the Evercore Sensitivity Case: the sensitivity case prepared by Evercore and Tesla by adjusting the SolarCity Base Case to "reduce[] SolarCity's projected capital needs;" and (3) the Lazard Sensitivity Case: the sensitivity case prepared by Lazard and SolarCity that assumed SolarCity faced challenges accessing the capital markets and with borrowing costs.[49]

Evercore's initial fairness analyses were based on the SolarCity Base Case and Evercore

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[48] *See id.* at *22.

[49] *Id.* (internal citations omitted).

Sensitivity Case because the Lazard Sensitivity Case had not yet been provided to Tesla or Evercore.

Evercore reran its cash flow analysis upon learning that Lazard had developed a downside case.[50] "Evercore determined that the Evercore Sensitivity Case was more conservative than the Lazard Sensitivity Case, which generated uniformly higher values for SolarCity."[51] Lazard's SolarCity cash flow analysis, for example, began at $6 million and topped off at $801 million. Evercore's analysis, however, was more cautious, with Evercore's SolarCity cash flow analysis ranging from negative $226 million to $437 million.[52] As Evercore's lead banker, Courtney McBean, testified, "given that [Lazard's model] generates so much more cash, it's pretty clear that it's less conservative."[53] Evercore then presented its conclusions about the SolarCity–Lazard sensitivity model.

On October 12, 2016, Tesla and SolarCity filed the Definitive Proxy with the SEC.[54] Reaction to the Acquisition came from many sources. Institutional stockholders formed

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[50] Evercore was not aware that Lazard planned to run a sensitivity case and only learned of its existence once the Evercore team reviewed the preliminary proxy statement. *See* A1690 (McBean Trial Test. at 1458:5–15).

[51] *Trial Op.*, 2022 WL 1237185, at *22. The SolarCity Base Case is referred to in the Definitive Proxy as the "Unrestricted Liquidity Case." The Evercore Sensitivity Case is referred to in the Definitive Proxy as the "Revised Sensitivity Forecasts." This case was prepared by Evercore and Tesla by adjusting the SolarCity Base Case to reduce SolarCity's projected capital needs. The Lazard Sensitivity Case is referred to in the Definitive Proxy as the "Liquidity Management Case." It was prepared by Lazard and SolarCity and assumed SolarCity faced challenges accessing the capital markets and with borrowing costs.

[52] *See* A1691 (McBean Trial Test. at 1462:5–10).

[53] *Id.* (McBean Trial Test. at 1463:24–1464:2).

[54] *See* AR434 (Definitive Proxy).

the base of Tesla's stockholder franchise,[55] and many had mixed-to-hesitant reactions to the Acquisition. The two main proxy advisory firms, Institutional Shareholder Services ("ISS") and Glass, Lewis & Co. ("Glass Lewis"), both offered recommendations on the Acquisition in advance of the vote. ISS recommended that stockholders vote in favor of the Acquisition and noted that it helped strengthen Tesla's goal of becoming a fully integrated energy company. Glass Lewis, on the other hand, advocated against the Acquisition, calling it a "thinly veiled bail-out plan" and expressing the view that SolarCity was "increasingly and materially incapable of supporting itself."[56]

To quell the concerns of the institutional investors, Musk decided that a demonstration of a product in development at SolarCity — the Solar Roof — would show investors the promise of the Acquisition.[57] He involved himself in the pitches to the market, especially when it came to the product demonstrations. He demonstrated the Solar Roof in a joint Tesla/SolarCity presentation on October 28, 2016, showcasing a future combination of the Solar Roof, solar storage through the Powerwall, and Tesla EVs powered by solar.

The stockholder vote came a few weeks later, on November 17, 2016. The results

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[55] For example, as of September 30, 2016, 11 institutional investors each held 1% or more of Tesla's stock. This list includes many well-known institutional investors: from Fidelity and Blackrock to T. Rowe Price and Vanguard. *See* A483 (Daniel R. Fischel Expert Report at Exhibit D).

[56] *Trial Op.*, 2022 WL 1237185, at *23 (internal quotation marks and citation omitted).

[57] At his deposition, Musk testified: "[I]t stands to reason that if you are trying to explain to investors why the combination makes sense, then you have to explain the products and the synergies that will result from the -- from the combination. Otherwise, they will not understand why it should be done." A339 (Elon Musk Dep. Trans. at 421:15–20).

were overwhelming, with roughly 85% of the votes cast by Tesla's stockholders voting in favor of the Acquisition. Most of those votes were cast by sophisticated, institutional investors.

J. The Closing

On November 21, 2016, the Acquisition closed. By the time "of closing, SolarCity brought substantial value to Tesla. It had 15,000 employees, $200 million a month in business, over $3 billion in future cash flows, over 300,000 customers, and net assets in excess of its market capitalization (as confirmed by KPMG)[.]"[58] As the trial court found, this led to "Tesla booking an $89 million gain on the Acquisition" and that "as of closing, SolarCity had accumulated and continued to accumulate substantial net retained value."[59]

After the closing, however, Tesla faced more challenges at the start of 2017. The time had come for Tesla to launch its first full-scale production EV — the Model 3. But production delays hampered the Model 3 roll-out and, with much on the line, Musk directed all of Tesla's focus, post-Acquisition, toward the Model 3 launch. This shift in focus included redeploying former SolarCity employees who had been transitioned into Tesla's workforce. As a result, the solar energy business was put on hold, and Tesla even started to outsource production and installation of solar panels to third parties. Despite that, Tesla largely achieved the vision Musk outlined in the Master Plan.[60] As the trial court observed, "[a]s long-promised, following the Acquisition, Tesla became the world's first vertically

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[58] *Trial Op.*, 2022 WL 1237185, at *24 (internal citations omitted).

[59] *Id.*

[60] *See id.* at *25.

integrated sustainable energy company, offering end-to-end clean energy products."[61] The court found that "[t]he preponderance of the evidence suggests that the Acquisition was and is synergistic."[62] It also found that Tesla realized approximately $1 billion in nominal cash flows and conservatively expected to realize at least $2 billion more from the legacy SolarCity systems. Tesla also achieved significant cost and revenue synergies.

K. Proceedings In The Court Of Chancery

Litigation began in the fall of 2016, when several Tesla stockholders filed separate actions challenging the Acquisition. The Court of Chancery consolidated the actions in mid-October 2016 and appointed lead plaintiffs and counsel.

1. Pre-Trial Motions Practice

On March 28, 2018, the trial court denied the then-Defendants' motion to dismiss.[63] The then-Defendants had moved to dismiss under *Corwin v. KKR Financial Holdings LLC*,[64] and then-Plaintiffs, now-Appellants, opposed, arguing that Musk was Tesla's controlling stockholder and, thus, *Corwin* did not apply. The trial court agreed with Appellants and noted that, although it was "a close call," it was reasonably conceivable that Musk, a minority blockholder, was Tesla's controlling stockholder and exerted control over the Tesla Board in connection with the Acquisition.[65] The Court of Chancery

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[61] *Id.* (internal quotation marks and citation omitted).

[62] *Id.* at *25.

[63] *See In re Tesla Motors, Inc. S'holder Litig.*, 2018 WL 1560293 (Del. Ch. Mar. 28, 2018) ("*MTD Op.*").

[64] 125 A.3d 304 (Del. 2015).

[65] *MTD Op.*, 2018 WL 1560293, at *1.

summarized its pleadings-stage assessment of Musk's status as Tesla's alleged controller as follows:

> Whether Musk has regularly exercised control over Tesla's Board, or whether he did so only with respect to the Acquisition, is not entirely clear from the Complaint. For purposes of my decision on the motion, however, that distinction does not matter. At the very least, the Complaint pleads sufficient facts to support a reasonable inference that Musk exercised his influence as a controlling stockholder with respect to the Acquisition. Specifically, the combination of well-pled facts relating to Musk's voting influence, his domination of the Board during the process leading up to the Acquisition against the backdrop of his extraordinary influence within the Company generally, the Board level conflicts that diminished the Board's resistance to Musk's influence, and the Company's and Musk's own acknowledgements of his outsized influence, all told, satisfy Plaintiffs' burden to plead that Musk's status as a Tesla controlling stockholder is reasonably conceivable.[66]

Thus, the court provisionally established entire fairness as the standard of review.[67]

Both sides then moved for summary judgment, and the trial court denied summary judgment with limited exceptions not relevant to the issues presented on appeal.[68] Because genuine disputes of material fact existed as to whether Musk was Tesla's controlling stockholder, whether the stockholder vote was fully informed, whether a majority of

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[66] *Id.* at *19. The then-Defendants sought an interlocutory appeal of the Court of Chancery's opinion denying their motion to dismiss. We refused the interlocutory appeal. *See Musk v. Ark. Teacher Ret. Sys.*, 184 A.3d 1292, 2018 WL 2072822 (Del. May 3, 2018) (ORDER).

[67] *See MTD Op.*, 2018 WL 1560293, at *19 (noting that "[t]he facts developed in discovery may well demonstrate otherwise") (internal citation omitted). As the Court of Chancery emphasized in its order denying certification of the interlocutory appeal, the standard of review remained to be determined. *See In re Tesla Motors, Inc. S'holder Litig.*, 2018 WL 2006678, at *3 (Del. Ch. Apr. 27, 2018) ("As the Opinion makes clear, the standard of review remains to be determined.") (internal citation omitted).

[68] *See SJ Op.*, 2020 WL 553902. The only claims that the court dismissed on summary judgment were "certain disclosure claims that [were] not viable, either a matter of undisputed fact or as a matter of law." *Id.* at *2.

Tesla's Board faced disqualifying conflicts of interest, and whether the Acquisition constituted waste, the court set the case for trial and noted that the then-Defendants could "avoid liability if the transaction was fair."[69]

Shortly before the court's summary judgment decision, the litigants reached a settlement to dismiss the claims against all of the then-Defendants, save Musk. On August 17, 2020, the trial court approved the partial settlement, for an aggregate of $60 million (funded by insurance), as to those then-Defendants. The trial court then assumed then-Plaintiffs, now-Appellants' "best case on standard of review—that entire fairness applies—and consider[ed] the trial evidence through that lens."[70]

2. Trial Testimony

The trial commenced in July 2021 and spanned ten days of in-person testimony and one day of remote testimony. The witness list was expansive: 11 live fact witnesses (and one by deposition video) and 7 live expert witnesses testified at trial. Musk testified first.[71]

As is common in an entire fairness trial, both sides put forward expert testimony opining on the Acquisition.[72] Appellants presented three experts: Ronald Quintero, Murray Beach, and Jeurgen Moessner.[73] A common theme emerged from Appellants'

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[69] *Id.* at *7.

[70] *Trial Op.*, 2022 WL 1237185, at *27.

[71] *See* A1374–440 (Musk Trial Test.).

[72] *See S. Muoio & Co. LLC v. Hallmark Entm't Invs. Co.*, 2011 WL 863007, at *17 (Del. Ch. Mar. 9, 2011) ("As has become common in entire fairness proceedings of this sort, the parties presented the testimony of competing valuation experts in an effort to convince [the Court of Chancery] that their valuation was the most accurate."), *aff'd*, 35 A.3d 419 (Del. 2011) (ORDER).

[73] *See Trial Op.*, 2022 WL 1237185, at *6. Quintero founded two firms: R.G. Quintero & Co., which focuses on accounting, and Chartered Capital Advisers, Inc., which focuses on financial

presentation: insolvency. As the trial court put it, Appellants were "all in" on the theory that SolarCity was insolvent, and, thus, Tesla overpaid.[74] Quintero's testimony was key, and "he doubled down on his sworn testimony that SolarCity was worth nothing."[75] Appellants "placed their valuation case entirely in Quintero's hands, and Quintero, in turn, relied exclusively on a single valuation theory: insolvency."[76] Further, Appellants' "other experts did not opine on valuation."[77]

Musk presented four experts: Dan Reicher, Jonathan Foster, Frederick Van Zijl,

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services for M&A transactions. *See* A583 (Ronald G. Quintero Expert Report at 2) [hereinafter Quintero Rep. at _]. He was retained "to evaluate the ability of SolarCity to meet its financial obligations absent the acquisition and also to determine the fair value of SolarCity common stock as of the merger date." A1504 (Ronald G. Quintero Trial Test. at 695:2–5) [hereinafter Quintero Trial Test. at _].

Beach is the president of Business Consulting Group, LLC. *See* A2218 (Beach Demonstrative Exhibits). He was retained "to determine if a seasoned equity offering [] would be possible" for SolarCity and if a raise between $250–$300 million would have been feasible. A1633 (Murray Beach Trial Test. at 1078:18–22).

Moessner founded Global Capital Finance, a firm specializing in the renewable energy sector. He was retained "to assess the reasonableness of the projections that were used by the Tesla board in order to determine whether or not to pursue the merger" and "to determine whether or not it was necessary to make any adjustments to those projections in order to address the operative reality and the business situation of SolarCity at the time of the merger." A1483 (Jeurgen Moessner Trial Test. at 609:14–21) [hereinafter Moessner Trial Test. at _].

[74] *See Trial Op.*, 2022 WL 1237185, at *40.

[75] *Id.*

[76] *Id.* (internal citations omitted).

[77] *Id.* at *40 n.470. Their other two experts offered similar testimony regarding SolarCity's financial state, which they depicted as dire. According to Beach, SolarCity could not succeed on an equity offering, putting its ability to finance itself in question. According to Moessner, the projections by Evercore and Lazard valuing SolarCity were inflated and too optimistic. *See id.* at *6.

and Daniel Fischel.[78] Musk's experts discussed the strategic rationale behind the Acquisition. They focused their testimony on the Master Plan and the potential for synergistic value to catapult Tesla to the next level. Reicher's testimony focused on the potential synergies of the Acquisition and the benefits that would flow to Tesla stockholders. Foster testified as to the process employed by the Tesla Board that culminated in the Acquisition. Van Zijl rebutted Quintero's view that SolarCity was insolvent, and Fischel — Musk's main expert — testified that the price Tesla paid was fair.[79]

Following post-trial briefing, the trial court heard post-trial oral argument on January 18, 2022.[80] The court issued its written opinion on April 27, 2022. We discuss the trial court's key findings next.

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[78] *See id.* Reicher serves as the Executive Director of Stanford University's Steyer-Taylor Center for Energy Policy and Finance. His "expert report extensively detailed the immense growth potential of the solar industry in particular." *Id.* at *47 n.551.

Foster is "an M&A practitioner" who was retained to review the "steps that a board should follow, when considering a major acquisition, to be consistent with custom and practice; or evaluating target companies, various potential targets should be considered." A1826–27 (Jonathan Foster Trial Test. at 2459:3–6; 2461:15).

Van Zijl is a capital markets expert with "35 years of investment banking experience" who "has advised on hundreds of leveraged finance transactions." A2132 (Musk's Post-Trial Reply Br. at 8 n.15).

Fischel is a scholar in the law and economics field and served as the dean of the University of Chicago Law School. He was retained "to analyze the economic evidence in connection with the allegations" made by Appellants regarding the Acquisition. A1832 (Daniel R. Fischel Trial Test. at 2481:8–12) [hereinafter Fischel Trial Test. at _].

[79] *See Trial Op.*, 2022 WL 1237185, at *6.

[80] On September 20, 2021, this Court issued its opinion in *Brookfield Asset Mgmt., Inc. v. Rosson*, 261 A.3d 1251 (Del. 2021). As a result, the parties below stipulated to decertify the class, dismiss the direct claims, and submit only the derivative claims for decision.

3. The Trial Court's Fair Dealing Findings

The court first addressed the fair dealing analysis of the unitary entire fairness standard. The Vice Chancellor observed that "a controlling stockholder brings with him into the boardroom an element of 'inherent coercion.'"[81] But the court found "that any control [Musk] may have attempted to wield in connection with the Acquisition was effectively neutralized by a board focused on the *bona fides* of the Acquisition, with an indisputably independent director leading the way."[82] Although the court described Musk's "presence in the boardroom" as "problematic[,]" at times, it weighed the flaws against the process strengths and found that "the credible evidence produced at trial shows that" Musk did not exercise his purported control over the Tesla Board with respect to the Acquisition.[83]

The Vice Chancellor looked first at the flaws in the process, particularly Musk's involvement in negotiating the Acquisition. The court made 11 factual findings showing that Musk had participated in the deal process to a degree greater than he should have.[84] The "process flaws" — as the trial court described them — were:

- Several of Musk's communications with SolarCity's management about the Acquisition that were not disclosed to the Tesla Board.

- Musk's overtures to the Tesla Board about the Acquisition and his direction to Tesla's CFO to prepare a presentation on the Acquisition.

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[81] *Trial Op.*, 2022 WL 1237185, at *33 (quoting *In re Pure Res., Inc. S'holders Litig.*, 808 A.2d 421, 436 (Del. Ch. 2002) and *SJ Op.*, 2020 WL 553902, at *5–6).

[82] *Id.* at *33.

[83] *Id.*

[84] *See id.* at *34.

- Musk's participation in the selection of Wachtell.
- Musk's review of the letter and blog post announcing the Initial Offer.
- Musk's involvement in Evercore's initial presentation to the Tesla Board and his push for a higher premium.
- Musk's frequent communications with the Evercore team, obtaining updates on timing and diligence.
- Musk's publication of the Master Plan Part Deux in an apparent attempt to garner Tesla stockholder support.
- Evercore informing Musk — before informing the Tesla Board — that it recommended lowering the terms of the Initial Offer.
- Musk's presence during part of a Tesla Board meeting regarding a revised offer.
- Musk's demonstration of the Solar Roof and his promises concerning the timing of the product launch.
- Kimbal's failure to be recused from both Tesla Board meetings and voting on the Acquisition.[85]

The trial court noted that these "process flaws flow[ed] principally from [Musk's] apparent inability to acknowledge his clear conflict of interest and separate himself from Tesla's consideration of the Acquisition."[86]

Upon recognizing these process flaws, the court then turned to what it identified as the strengths. It found six. The first involved the timing of the Acquisition, with the court noting that the Tesla Board did not begin negotiations upon Musk's initial requests but

[85] *See id.* at *34–35.

[86] *Id.* at *34.

rather waited until Tesla addressed issues with its EVs.[87] The second was the deal structure: notably, the inclusion of the majority-of-the-minority stockholder vote provision, Musk's and Gracias' recusals from voting, the selection of independent, experienced advisors to represent the Tesla Board, and Denholm's lead on the negotiations. Third, the court cited the due diligence and negotiations — overseen by Denholm — that resulted in the lower Final Offer.[88]

The fourth was the fact that the Tesla Board operated independently of Musk: it did not begin negotiations when he said to, it did not include a bridge loan in its offers, and it took its time doing due diligence.[89] The Tesla Board's insistence on a walkaway right in the event of a SolarCity debt covenant breach was also significant. The court found that these facts suggested "an ultimately productive board dynamic that protected the interests of stockholders, despite [Musk's] assumed 'managerial supremacy' and the assumed board-level conflicts."[90]

Public knowledge of the Acquisition by the market, and by the Board during negotiations, was the fifth strength, with the court noting that there were "well-publicized debates and transaction modeling."[91] It found that "[t]he material aspects of the Acquisition were known to Tesla stockholders."[92] Moreover, the Definitive Proxy

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[87] *See id.* at *36.

[88] *See id.* at *37.

[89] *See id.*

[90] *Id.*

[91] *Id.* at *38.

[92] *Id.*

disclosed which Tesla Board meetings Musk attended and that, on two occasions, voting members had asked Musk to provide his technical and strategic insights.[93]

Denholm's role leading the negotiations, according to the trial court, was the last process strength, with the court finding that she was "an independent, powerful and positive force during the deal process who doggedly viewed the Acquisition solely through the lens of Tesla and its stockholders."[94] She "served as an effective buffer between [Musk] and the Tesla Board's deal process."[95]

Regarding fair dealing, the trial court noted that the road leading to the Acquisition was not entirely smooth. The court found, however, that the "Tesla Board meaningfully vetted the Acquisition" and Musk "did not *impede* the Tesla Board's pursuit of a fair price."[96] Although Appellants assert that the court failed to make a finding of fair dealing, the court's opinion can only reasonably be read and understood as concluding that the flaws did not overcome the findings of the process strengths and that the process, overall, was the product of fair dealing. We address this point more fully in Section IV of this Opinion.

4. The Trial Court's Fair Price Findings

The focus next turned to the fair price analysis and the battle of the competing

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[93] *See* AR500–09 (Definitive Proxy at 58–67); *see also* AR508 (Definitive Proxy at 66) (stating that at the July 22, 2016 special meeting of the Tesla Board, "[t]he Tesla Board requested that Mr. Elon Musk join the meeting to discuss with the other directors his views and expectations, in his capacity as Chief Executive Officer of Tesla, following a potential acquisition with respect to SolarCity's solar panel manufacturing operations and competitive positioning relative to the solar energy industry generally."). Following that, Musk left the meeting. *See id.*

[94] *Trial Op.*, 2022 WL 1237185, at *38.

[95] *Id.*

[96] *Id.* at *39 (emphasis in original).

experts. The court found that Musk prevailed in establishing that the price was fair: Musk "presented the most persuasive evidence regarding SolarCity's value and the fairness of the price Tesla paid to acquire it."[97] The court pointed to six factors and categories of evidence it relied upon in reaching its determination on fair price.

First, the trial court found that SolarCity was not insolvent, despite Appellants placing all of their eggs in the insolvency basket. Their theory was simple: SolarCity had no value and, thus, Tesla overpaid. The trial court rejected Quintero's testimony "that SolarCity was worthless[,]" instead finding that SolarCity "was solvent, valuable and never in danger of bankruptcy."[98] Second, the court found that the proffered DCF models by Quintero and Fischel were unhelpful and, thus, the court disregarded them.[99] Third, the court considered market evidence, which supported its finding of fair price. The trial court noted three pieces of market-based evidence: SolarCity traded in an efficient market, Tesla paid, at most, a small premium for SolarCity, and Tesla stockholders overwhelmingly

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[97] *Id.* at *40.

[98] *Id.* At trial, SolarCity executives — including its CEO, CFO, and former CFO — confirmed that SolarCity was not insolvent or headed into bankruptcy. *See* A1758–59 (Lyndon Rive Trial Test. at 1732:18–1733:7); A1612 (Tanguy Serra Trial Test. at 997:18–24); A1810 (Brad Buss Trial Test. at 2393:3–10). Unrebutted testimony established that SolarCity never contemplated filing for bankruptcy and never took steps to retain restructuring advisors or counsel.

In addition, Quintero — Appellants' main valuation expert — abandoned his four illustrative valuations at trial. *See* A1586 (Quintero Trial Test. at 890:20–891:4). *See also Glob. GT LP v. Golden Telecom, Inc.*, 993 A.2d 497, 510 (Del. Ch. 2010) (declining to "engage in a speculative exercise based on tinkering with analyses that the two experts themselves essentially do not stand behind"), *aff'd*, 11 A.3d 214 (Del. 2010).

[99] *See Trial Op.*, 2022 WL 1237185, at *41 (stating that "Quintero and Fischel both performed DCF valuations" and that "neither expert persuaded me that a DCF analysis is the proper method by which to value SolarCity given the facts of this case, and so I decline to rely on the DCFs when analyzing whether the Acquisition was fair to Tesla's stockholders."). The court also noted that "the parties did not focus on DCF at trial or in their post-trial briefs[.]" *Id.*

voted in favor of the Acquisition. The court took into account Appellants' "argument regarding the quality (or not) of the Tesla stockholder vote"[100] in finding the stockholder vote compelling evidence of fairness.

Fourth, the trial court examined SolarCity's current and future cash flows. SolarCity derived its value from long-term cash flows, and that benefit flowed to Tesla after the Acquisition. As the court found, "Tesla has already realized approximately $1 billion in nominal cash flows and expects to realize at least $2 billion more from the legacy SolarCity systems."[101] Fifth, the trial court relied on Evercore's fairness opinion. Based upon Evercore's work negotiating for Tesla and doing due diligence, the trial court found Evercore's work credible and rejected a suggestion from Appellants that "Evercore was beholden to [Musk]."[102] And, finally, the trial court found that the potential synergies weighed in favor of finding fair price. Looking at the evidence put forth by Musk's experts, the court found that "Tesla expected the Acquisition to result in cost synergies of at least $150 million per year[.]"[103] The overlap between the two companies led to a vertically integrated enterprise with a renewed focused on renewable energy solutions, like EVs and solar panels, creating significant value, as the trial court found.[104]

Summarizing the fair price part of the entire fairness analysis, the trial court

[100] *Id.* at *44 n.515.

[101] *Id.* at *45.

[102] *Id.* at *46.

[103] *Id.* at *47.

[104] *See id.*

acknowledged that "where there are process infirmities, the Court is obliged to study fair price even more carefully."[105] Its review of the evidence put forth at trial regarding the price Tesla paid for SolarCity led it to conclude that the price was fair. Given that Appellants had proffered only "incredible" testimony that SolarCity was insolvent, the trial court's review of the evidence convinced it that no "fairer" price existed and that the price was not near the low end of a range of fairness but, rather, was "'*entirely*' fair in the truest sense of the word."[106] Because of that, it found that Musk satisfied the entire fairness standard and, thus, did not breach his fiduciary duty.

L. *Contentions On Appeal*

Appellants filed a timely appeal to this Court following the Court of Chancery's issuance of its post-trial opinion.[107] They do not challenge the factual findings by the trial court. Instead, they challenge the Vice Chancellor's application of Delaware's entire fairness standard of review. Appellants contend that:

> The gravamen of the trial court's Opinion, based on an apples-to-oranges comparison, was that SolarCity's stock price on ***June 21, 2016*** (which was "affected" by pre-offer rumors and did not reflect full information) was marginally higher than the price paid for SolarCity with Tesla stock on ***November 21, 2016***, so the price was entirely fair.[108]

Regarding fair dealing, Appellants contend that the trial court "refused to issue any

[105] *Id.* at *48.

[106] *Id.* (emphasis in original).

[107] *See* A1 (Court of Chancery Docket).

[108] Opening Br. at 1–2 (emphases in original).

ruling at all with regard to fair process."[109] They raise three arguments regarding the court's fair dealing analysis: (1) the court "failed to find that Musk had not met his burden to prove fair dealing[,]" (2) the court focused its entire fairness analysis exclusively on fair price, and (3) the court "erroneously found that the unfair process did not affect the fairness of the price."[110]

As to fair price, Appellants contend that the trial court committed legal error in five ways: (1) the court "applied a bifurcated entire fairness test that focused exclusively on fair price[,]" (2) the court "failed to determine SolarCity's value at the time the Acquisition closed" and instead improperly compared SolarCity's stock price from June 21, 2016 to its stock price right before the November 21, 2016 closing, (3) the court considered the "$1-3 billion of cash from SolarCity assets" Tesla expected to receive "but failed to include the $5.35 billion of SolarCity liabilities that Tesla immediately assumed as part of the Acquisition[,]" (4) the court "determined that discounted cash flow ('DCF') analyses were inappropriate to value SolarCity, yet relied on post-close undiscounted cash flows and the flawed DCF analyses from Tesla's financial advisor [Evercore]," and (5) the court "held that the Tesla stockholder vote supported a finding of fair price despite: (i) clear precedent that votes are presumed coerced in conflicted controlling stockholder transactions;" and (ii) acknowledging certain disclosure and cross-ownership issues meant the vote deserved "less weight[.]"[111]

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[109] *Id.* at 6.

[110] *Id.*

[111] *Id.* at 6–7.

Musk responds that what the Appellants really seek is to retry this case. He contends that the Appellants push for a rigid approach to entire fairness not grounded in Delaware law. According to Musk, the trial court did not engage in a "bifurcated" entire fairness analysis, but rather, recognized that price plays a "paramount" role in the analysis.

This appeal — and the questions it raises regarding our highest level of judicial review — has also attracted the presence of a group of corporate law professors from institutions across the United States — the *amici* — who argue that the Court of Chancery erred when it put "heavy reliance" on "market-based evidence" to support its determination of fair price.[112] As explained below, we reject their characterization of the trial court's opinion.

II. STANDARD OF REVIEW

"The standard and scope of appellate review of the Court of Chancery's factual findings following a post-trial application of the entire fairness standard to a challenged merger is governed by *Levitt v. Bouvier*."[113] "Accordingly, this Court will not ignore the

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[112] Amicus Br. at 2. We note with disappointment that the *amici* state in their brief that "the Court of Chancery's opinion below placed 'heavy reliance'—indeed, nearly exclusive reliance—on 'market-based evidence' in concluding 'that Tesla paid a fair price for SolarCity.'" *Id.* They then cite to several pages of the trial court's opinion. The trial court's opinion, however, never uses the words "heavy reliance" in its market-based evidence discussion. Nor is it fair to say that the trial court nearly exclusively relied on market-based evidence.

Submission of *amicus* briefs lies solely within this Court's discretion, should we believe the submission will be helpful. A brief built upon an inaccurate premise and a misquotation of the trial court's opinion, however, is not helpful. Nor is it helpful to use disparaging phrases to describe a trial court opinion — for example, "this is deference to market evidence run amok." *Id.* at 5.

[113] *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1178 (Del. 1995) ("*Cinerama II*") (citing 287 A.2d 671, 673 (Del. 1972)). In *Levitt*, we stated:

findings of the Court of Chancery if they are sufficiently supported by the record and are the product of an orderly and logical deductive process."[114] "Our review of the formulation and application of legal principles, however, is plenary and requires no deference."[115] "In addition, this Court accords 'a high level of deference' to Court of Chancery findings based on the evaluation of expert financial testimony."[116]

III. ANALYSIS

The Court of Chancery examined the Acquisition through the lens of the entire fairness standard — our corporate law's most rigorous standard of review. The trial court assumed, without finding, that the entire fairness standard applied. For example, it made no finding that Musk was Tesla's controlling stockholder.[117] Nor did it explicitly find that

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> In exercising our power of review, we have the duty to review the sufficiency of the evidence and to test the propriety of the findings below. We do not, however, ignore the findings made by the trial judge. If they are sufficiently supported by the record and are the product of an orderly and logical deductive process, in the exercise of judicial restraint we accept them, even though independently we might have reached opposite conclusions. It is only when the findings below are clearly wrong and the doing of justice requires their overturn that we are free to make contradictory findings of fact. When the determination of facts turns on a question of credibility and the acceptance or rejection of "live" testimony by the trial judge, his findings will be approved upon review. If there is sufficient evidence to support the findings of the trial judge, this Court, in the exercise of judicial restraint, must affirm.

287 A.2d at 673 (internal citations omitted).

[114] *Cinerama II*, 663 A.2d at 1179 (citing *Levitt*, 287 A.2d at 673).

[115] *Kahn v. Lynch Commc'n Sys., Inc.*, 669 A.2d 79, 84 (Del. 1995) ("*Lynch II*"). *See also Kahn v. Tremont Corp.*, 694 A.2d 422, 428 (Del. 1997) ("*Tremont*") (noting that we "exercise *de novo* review concerning the application of legal standards.").

[116] *Cinerama II*, 663 A.2d at 1179 (quoting *Kahn v. Household Acq. Corp.*, 591 A.2d 166, 175 (Del. 1991)).

[117] We save for another day whether a stockholder with 22% of the voting power, but who may exercise "managerial supremacy," is a controlling stockholder. As the Vice Chancellor noted, "the source of [Musk's] control was hotly disputed. [Appellants] focused at trial on [Musk's]

a majority of the Tesla Board was conflicted.[118] Instead, the court "skipped" straight to entire fairness. As the Vice Chancellor put it, "[w]hether by virtue of [Musk's] control, or by virtue of irreconcilable board-level conflicts, there is a basis for *assuming that entire fairness is the governing standard of review*."[119]

On appeal, the parties do not dispute that entire fairness controls. In keeping with our practice of addressing only issues fairly presented, we, too, view the Acquisition through the lens of entire fairness. This Court described the entire fairness standard of review in our seminal decision, *Weinberger v. UOP, Inc.*,[120] as follows:

'managerial supremacy,' not his stock ownership or the voting power flowing from his stock. Of course, that argument brings the controlling stockholder debate in clear focus. Again, I have chosen not to enter into the fray of this debate, as the outcome does not depend on whether [Musk] is or is not a controller (or a controlling stockholder, if that is different)." *Trial Op.*, 2022 WL 1237185, at *30 n.377 (internal citations omitted).

The fact that such a stockholder lacks the voting power to elect directors, approve transactions, or perhaps use her voting power to block transactions makes the question an important one, which can greatly affect the direction of our law, as well as the outcome of individual cases. For example, expanding the definition of a "controller" expands the universe of persons who could be liable to stockholders under fiduciary principles, and it potentially excludes persons from "*Corwin* cleansing" and subjects them to the rigorous entire fairness standard of review.

[118] *See id.* at *2. On potential Tesla Board conflicts, the Vice Chancellor noted the following:

> With regard to board-level conflicts, I acknowledge [Appellants'] arguments that each member of the Tesla Board, save Denholm, was either interested or lacked independence with respect to the Acquisition. I have already reviewed the relevant evidence in that regard as I introduced each Tesla Board member in the Background section of this opinion. Suffice it to say, there is a *bona fide* dispute regarding whether a majority of the Tesla Board was conflicted as it considered, negotiated and ultimately approved the Acquisition. There is, therefore, a factual basis to justify an assumption that entire fairness is the standard of review on this basis alone.

Id. at *30 n.376.

[119] *Id.* at *30 (emphasis added) (internal citations omitted).

[120] 457 A.2d 701 (Del. 1983).

> The concept of fairness has two basic aspects: fair dealing and fair price. The former embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. The latter aspect of fairness relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock. However, the test for fairness is not a bifurcated one as between fair dealing and price. All aspects of the issue must be examined as a whole since the question is one of entire fairness.[121]

"The *requirement of fairness is unflinching in its demand* that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts."[122] "[E]ntire fairness is the highest standard of review in corporate law[,]"[123] and "the defendants bear the burden of proving that the transaction with the controlling stockholder was entirely fair to the minority stockholders."[124]

"A determination that a transaction must be subjected to an entire fairness analysis is not an implication of liability."[125] Even under our entire fairness standard, "[a] finding

[121] *Id.* at 711 (internal citations omitted).

[122] *Id.* at 710 (emphasis added).

[123] *MFW*, 88 A.3d at 644. *See also In re Trados Inc. S'holder Litig.*, 73 A.3d 17, 44 (Del. Ch. 2013) (explaining that entire fairness is "Delaware's most onerous standard").

[124] *Ams. Mining Corp. v. Theriault*, 51 A.3d 1213, 1239 (Del. 2012).

[125] *Emerald P'rs v. Berlin*, 787 A.2d 85, 93 (Del. 2001) (citing *Nixon v. Blackwell*, 626 A.2d 1366, 1376 (Del. 1993)). For example, this Court has affirmed decisions of the Court of Chancery holding that a conflicted transaction was entirely fair. *See, e.g.*, *ACP Master, Ltd. v. Sprint Corp.*, 184 A.3d 1291 (Del. 2018) (ORDER); *S. Muoio & Co. LLC*, 35 A.3d 419 (Del. 2011) (ORDER); *Emerald P'rs v. Berlin*, 840 A.2d 641 (Del. 2003) (ORDER); *Lynch II*, 669 A.2d 79. *See also Cinerama II*, 663 A.2d at 1163 ("Because the decision that the *procedural* presumption of the business judgment rule has been rebutted does not establish *substantive* liability under the entire fairness standard, such a ruling does not necessarily present an insurmountable obstacle for a board of directors to overcome.") (emphases in original); *id.* ("Thus, an initial judicial determination that

of perfection is not a *sine qua non* in an entire fairness analysis."[126] Entire fairness is a unitary test, and both fair dealing and fair price must be scrutinized by the Court of Chancery. "It is a standard by which the Court of Chancery must carefully analyze the factual circumstances, apply a disciplined balancing test to its findings, and articulate the bases upon which it decides the ultimate question of entire fairness."[127]

The burden of proof rests with the defendant to prove that the transaction was entirely fair to stockholders. Although this Court has stated that "which party bears the burden of proof [in an entire fairness case] must be determined, *if possible*, before the trial begins[,]"[128] the trial court here did not determine — before trial — which party bore the burden of proof.[129] The court stated that it "need not decide the burden of proof question" because, in the court's words, "the evidence favoring the defense is that compelling."[130] Appellants contend that the Vice Chancellor "functionally shifted the burden to [Appellants] to prove that every aspect of the *process* was unfair,"[131] especially in

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a given breach of a board's fiduciary duties has rebutted the presumption of the business judgment rule does not preclude a subsequent judicial determination that the board action was entirely fair, and is, therefore, not outcome-determinative *per se*.").

[126] *Cinerama II*, 663 A.2d at 1179.

[127] *Id.*

[128] *Ams. Mining*, 51 A.3d at 1243 (emphasis added).

[129] *See Trial Op.*, 2022 WL 1237185, at *32.

[130] *Id.* (internal citations omitted).

[131] Opening Br. at 3 (emphasis added). *See also* Reply Br. at 11 ("Thus, the trial court [] shifted the unfairness burden to [Appellants.]").

Appellants also contend that the trial court engaged in a burden shift when it "held that [Appellants] must satisfy this burden by proving Musk used actual threats and bullying tactics, rather than the inherent coercion that accompanied his status at Tesla and his improper intrusions into the deal process." *Id.*

connection with their theory of inherent coercion.[132] Again, we do not think that is an accurate reading of the trial court's opinion. The trial court stated, for example, that "[i]n sum, [Musk] proved that the process did not 'infect' the price."[133] It also found that Musk "presented credible evidence that Tesla paid a fair price for SolarCity[,]" whereas Appellants "answered by proffering incredible testimony that SolarCity was insolvent[.]"[134] The Court of Chancery, thus, correctly assumed that Musk had the burden.[135]

IV. THE COURT OF CHANCERY DID NOT ERR IN ITS FAIR DEALING ANALYSIS

We begin with a brief overview of the fair dealing aspect of the entire fairness test. "The element of 'fair dealing' focuses upon the conduct of the corporate fiduciaries in effectuating the transaction."[136] A fair dealing analysis looks to "how the purchase was initiated, negotiated, structured and the manner in which director approval was obtained."[137] Fair dealing "also embraces the duty of candor owed by corporate fiduciaries

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[132] *See* Opening Br. at 33 (arguing that the trial court required Appellants to show "evidence of actual exploitation of Musk's inherent coercion," rather than require Musk to show that he did not impede the fairness of process).

[133] *Trial Op.*, 2022 WL 1237185, at *39. The court also stated that it would "give no deference to [Musk] (or his fellow Tesla Board members) and will review [Appellants'] breach of fiduciary [duty] claim with the highest degree of scrutiny recognized in our law." *Id.* at *30.

[134] *Id.* at *48.

[135] *See Ams. Mining*, 51 A.3d at 1243 ("[I]f the record does not permit a pretrial determination that the defendants are entitled to a burden shift, the burden of persuasion will remain with the defendants throughout the trial to demonstrate the entire fairness of the interested transaction.").

[136] *Tremont*, 694 A.2d at 430.

[137] *Id.* at 431.

to disclose all material information relevant to corporate decisions from which they may derive a personal benefit."[138]

"This Court has held that arm's-length negotiation provides 'strong evidence that the transaction meets the test of fairness.'"[139] Deal mechanisms commonly employed to replicate arm's-length negotiating include the use of a special committee and a majority-of-the-minority voting provision for stockholder approval. Given the unitary nature of the test, findings in one area may seep into the findings of the other. As a result, "[a] fair process usually results in a fair price."[140] The opposite is also true: "an unfair process can infect the price[.]"[141]

Although the entire fairness test is a fact-intensive analysis, Appellants do not challenge any of the factual findings or credibility determinations made by the Vice Chancellor.[142] But in many respects, they ask us to re-weigh the evidence regarding the Acquisition's deal process and to reach the opposite conclusion: namely, that the factual findings demand a finding of unfair dealing.[143]

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[138] *Mills Acq. Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1280 (Del. 1989) (internal citation omitted). *See also Weinberger*, 457 A.2d at 711.

[139] *Cinerama II*, 663 A.2d at 1172 (quoting *Weinberger*, 457 A.2d at 709 n.7).

[140] *Ams. Mining*, 51 A.3d at 1244.

[141] *In re Trados*, 73 A.3d at 78 (internal citation omitted).

[142] Appellants confirmed that it is "[n]ot true" that they seek to "ask[] this Court to make contradictory findings." Reply Br. at 4. They stated the same at oral argument before this Court. *See* Oral Argument, at 19:36–40, https://livestream.com/accounts/5969852/events/10769099/videos/235611407, ("We're not challenging specific, factual findings.").

[143] For example, they argue that, based upon the trial court's findings, "the trial court should have ruled that the process was unfair as a matter of law." Opening Br. at 36. In our decision after remand in *Lynch II*, we observed that "[t]he absence of certain elements of fair dealing does not

A. The Factual Findings Support A Determination Of Fair Dealing

1. The Trial Court Made a Finding of Fair Dealing That is Supported by the Record

The so-called *Weinberger* factors — how the deal was initiated and timed, how it was structured and negotiated, and how it was approved[144] — form the core of a court's fair dealing analysis. Despite *Weinberger* setting forth a helpful analytical path for a trial court to follow, the trial court here did not organize its discussion that way.[145] The court's opinion, heavily laden with findings in footnotes, perhaps left it vulnerable to the challenge that its analysis was incomplete and that the court, as Appellants put it, essentially wrote fair dealing out of the *Weinberger* analysis. Although our review was also made more difficult as a result, we believe the trial court's opinion can only reasonably be read as finding that, despite the process flaws, Musk carried his burden of establishing fair dealing.[146] In addition to its process-focused factual findings, the trial court, for example,

mandate a decision that the transaction was not entirely fair." 669 A.2d at 83 (emphasis added) (internal quotation marks and citation omitted); *see also Cinerama II*, 663 A.2d at 1179. The rigorous entire fairness analysis is heavily fact-driven and requires the court to make fact and credibility determinations after trial, to carefully scrutinize the transaction process, and to critically evaluate valuation and other evidence, including expert analyses, of fair price.

[144] *See* 457 A.2d at 711.

[145] The trial court's discussion of the process strengths, however, largely coincides with the *Weinberger* factors.

[146] Of course, as we have recognized, there is great flexibility in how opinions are crafted. *See, e.g.*, *Ams. Mining*, 51 A.3d at 1244 (noting that "[b]ecause the issues relating to fair dealing and fair price were so intertwined, the Court of Chancery did not separate its analysis, but rather treated them together in an integrated examination" and finding that approach to be "consistent with the inherent non-bifurcated nature of the entire fairness standard of review."). Nevertheless, clear and delineated findings, when possible, facilitate effective appellate review and may mitigate challenges founded on an alleged lack of clarity or incompleteness. *See Nixon*, 626 A.2d at 1378 ("The decision of the trial court did not plainly delineate and articulate findings of fact and

recognized "that a fair price does not ameliorate a process that was beyond unfair."[147] Further, we have thoroughly reviewed the extensive record and conclude that the record, including the trial court's unchallenged fact and credibility findings, supports a finding of fair dealing.

The parties put forth extensive evidence, and the Vice Chancellor grouped his factual findings and legal determinations into two categories: the process strengths and the process flaws. Using *Weinberger*'s list of factors, we consider Appellants' specific challenges to the trial court's findings and analysis.

a. Initiation of the Acquisition

Appellants contend that the trial court found that Musk was "the catalyst and a vocal proponent of the Acquisition"[148] and that this supports a conclusion that Musk failed to meet his burden of proving his compliance with the *Weinberger* fair dealing factors. Musk points to other findings by the trial court, responding that the Vice Chancellor found that the Tesla Board declined to explore a transaction when Musk originally asked.[149] We also note, for example, the trial court's unchallenged finding that "Evercore reviewed the solar industry as a whole before recommending SolarCity as the obvious choice to be acquired."[150]

conclusions of law so that this Court, as the reviewing court, could fathom without undue difficulty the bases for the trial court's decision.").

[147] *Trial Op.*, 2022 WL 1237185, at *32 (internal quotation marks and citation omitted).

[148] Opening Br. at 31 (quoting *Trial Op.*, 2022 WL 1237185, at *1).

[149] *See* Answering Br. at 31.

[150] *Trial Op.*, 2022 WL 1237185, at *36.

For the trial court, calling Musk the "catalyst" behind the Acquisition did not tip the scale in favor of finding unfair dealing.[151] As the trial court found, Musk did not force the hand of any Tesla Board member.[152] And when Musk initially proposed — in February 2016 — a combination with SolarCity, the Tesla Board declined to follow through on his suggestion.

Appellants contend, as a general matter, "that Musk did exploit his inherently coercive status by repeatedly and improperly injecting himself into the Acquisition process."[153] This concept of inherent coercion[154] was a focus of the trial court's overall fair dealing fact finding, as it "searched during [its] deliberations for persuasive evidence that [Musk] exploited the coercion inherent in his status as a controller to influence the Tesla Board's" process.[155] But the trial court, after examining the evidence, including observing live testimony, rejected Appellants' contention that Musk exerted domination and control over the transaction process. Instead, it specifically found that:

> [T]he evidence reveals that any control [Musk] may have attempted to wield in connection with the Acquisition was effectively neutralized by a board

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[151] For example, we have observed that "[i]nitiation by the seller, standing alone, is not incompatible with the concept of fair dealing so long as the controlling shareholder does not gain financial advantage at the expense of the controlled company." *Tremont*, 694 A.2d at 431.

[152] *See Trial Op.*, 2022 WL 1237185, at *37 (finding that "the Tesla Board was not dominated by [Musk]").

[153] Opening Br. at 33.

[154] The concept of "inherent coercion" has often percolated in controlling stockholder transactions. This Court discussed the potential for inherent coercion in *Kahn v. Lynch Communication Systems, Inc.*, 638 A.2d 1110 (Del. 1994) ("*Lynch I*"). There, we stated that "'[e]ven where no coercion is intended, shareholders voting on a parent subsidiary merger might perceive that their disapproval could risk retaliation of some kind by the controlling stockholder.'" *Id.* at 1116 (quoting *Citron v. E.I. Du Pont de Nemours & Co.*, 584 A.2d 490, 502 (Del. Ch. 1990)).

[155] *Trial Op.*, 2022 WL 1237185, at *33.

> focused on the *bona fides* of the Acquisition, with an indisputably independent director leading the way. [Musk] did not "engage[] in pressure tactics that went beyond ordinary advocacy to encompass aggressive, threatening, disruptive, or punitive behavior." In other words, even assuming [Musk] had the ability to exercise control over the Tesla Board, the credible evidence produced at trial shows that he simply did not do so with respect to the Acquisition.[156]

The court's overarching determination that Musk did not exploit any inherent coercion was adequately supported by numerous factual findings, which relate to other aspects of the fair dealing inquiry.[157] For example, the trial court concluded that there were "several instances where the Tesla Board simply refused to follow [Musk's] wishes."[158] It noted that the Tesla Board rejected Musk's wish to include a bridge loan in any offer; the Tesla Board insisted on having a walkaway right in the Final Offer should SolarCity breach the Liquidity Covenant; and the Tesla Board conducted significant due diligence, resulting in a lower deal price.[159] Because Appellants do not challenge any of these findings on appeal, they are entitled to deference by this Court.

b. Timing of the Acquisition

At trial, Appellants "assert[ed] that [Musk] bailed out SolarCity on a schedule that worked for him."[160] As they contend before this Court: "Musk testified that the Acquisition was initiated because SolarCity either needed to raise money or be

[156] *Id.* (internal citations omitted).

[157] *See id.* at *36–39.

[158] *Id.* at *37.

[159] *See id.*

[160] *Id.* at *36.

acquired."[161] This, they argue, suggests unfair dealing on Musk's part.

However, the trial court found the Acquisition's timing to be a process strength indicating fairness. In rejecting the argument that Musk engineered a bailout convenient to his own timetable, the trial court found that "there was no bailout and the facts illustrate the timing was right for Tesla."[162] Further, the Vice Chancellor found that, due to "macroeconomic headwinds in the industry, solar company stocks were trading at historic lows."[163] And rather than proceed with a SolarCity deal when Musk originally pitched it in February 2016, the Tesla Board decided to wait and first address the company's rollout of the Model X. The trial court's assessment of the industry conditions at the time support its finding of fair dealing, as the Tesla Board did not acquiesce in Musk's proposed timing, but instead, waited until the time was right for the company to explore a transaction. We defer to these unchallenged findings that point to fair dealing.

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[161] Opening Br. at 31 (internal quotation marks and citations omitted).

[162] *Trial Op.*, 2022 WL 1237185, at *36 (internal citation omitted). In *Lynch II*, in our decision after remand, in upholding the Court of Chancery's finding that the conflicted transaction was entirely fair, we observed that:

> More to the point, the timing of a merger transaction cannot be viewed solely from the perspective of the acquired entity. A majority shareholder is naturally motivated by economic self-interest in initiating a transaction. Otherwise, there is no reason to do it. Thus, mere initiation by the acquirer is not reprehensible so long as the controlling shareholder does not gain a financial advantage at the expense of the minority.

669 A.2d at 85 (citing *Cinerama II*, 663 A.2d at 1172 and *Jedwab v. MGM Grand Hotels, Inc.*, 509 A.2d 584, 599 (Del. Ch. 1986)).

[163] *Trial Op.*, 2022 WL 1237185, at *36. These "headwinds" included the fact that SunEdison, Inc. (one of SolarCity's competitors) filed for bankruptcy, changes in net metering laws, and the prospect that certain federal tax credits available to solar customers were possibly set to expire.

c. Structure of the Acquisition

One common deal mechanism was included in the Final Offer: a majority-of-the-minority stockholder voting provision. The trial court found that this provision, which it called "one of the most extolled and powerful protections afforded Delaware stockholders," was another indicium of fair dealing.[164] Our case law recognizes "that the presence of a non-waivable 'majority of the minority' provision is an indicator at trial of fairness because it disables the power of the majority stockholder to both initiate and approve the merger."[165] It was not legal error for the Vice Chancellor to view the majority-of-the-minority voting provision as a strong indicator of fair dealing.[166]

Appellants claim that our affirmance of the trial court's opinion would disincentivize boards from complying with certain procedural mechanisms, like the use of a special, independent committee, in conflicted transactions. Appellants suggest that Tesla's failure to employ an independent negotiating committee is an indicium of unfair dealing. *Amici* argue that the Court of Chancery's approach threatens to fatally undermine the framework set forth in *MFW* by substantially negating the incentives *MFW* promotes.[167]

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[164] *Id.*

[165] *Gesoff v. IIC Indus., Inc.*, 902 A.2d 1130, 1148 (Del. Ch. 2006) (citing *Jedwab*, 509 A.2d at 599–600 and *In re Pure Res.*, 808 A.2d at 442).

[166] In assessing the weight of the stockholder vote, the Vice Chancellor factored in the argument that the magnitude of the approval vote might be overstated given "the likelihood that *many stockholders who approved the Acquisition also owned SolarCity stock*." *Trial Op.*, 2022 WL 1237185, at *36 n.430 (emphasis added).

[167] For example, in *Americas Mining*, this Court observed that:

> A fair process usually results in a fair price. Therefore, the proponents of an interested transaction will continue to be incentivized to put a fair dealing process in place that promotes judicial confidence in the entire fairness of the transaction

Because one of Appellants' main arguments on appeal is that affirmance of the opinion below will undermine the best practices established by our decision in *MFW*, we explain why we reject that argument and why the record does not support that assertion.

By way of background, *Weinberger* recognized that certain procedural devices could alter the burden of proof in a conflicted transaction: there, we held that "where corporate action has been approved by an informed vote of a majority of the minority shareholders, [] the burden entirely shifts to the plaintiff to show that the transaction was unfair to the minority."[168] The standard of review remained entire fairness, but the potential for a burden shift created an incentive for boards in conflicted transactions to include majority-of-the-minority voting provisions.

In 1994, this Court, in *Lynch I*,[169] clarified the effect of certain procedural cleansing mechanisms in the context of controller squeeze-outs.[170] Relying on our decisions in *Weinberger* and *Rosenblatt v. Getty Oil Co.*,[171] we held in *Lynch I* that "an approval of the transaction by an independent committee of directors or an informed majority of minority shareholders *shifts the burden of proof* on the issue of fairness from the controlling or

> price. Accordingly, we have no doubt that the effective use of a properly functioning special committee of independent directors and the informed conditional approval of a majority of minority stockholders will continue to be integral parts of the best practices that are used to establish a fair dealing process.

51 A.3d at 1244.

[168] 457 A.2d at 703.

[169] 638 A.2d 1110.

[170] *See also In re Pure Res.*, 808 A.2d at 436 (noting that *Lynch I* addresses "the 'inherent coercion' that exists when a controlling stockholder announces its desire to buy the minority's shares.").

[171] 493 A.2d 929 (Del. 1985).

dominating shareholder to the challenging shareholder-plaintiff."[172] Thus, the standard of review remained entire fairness.[173]

But the Court of Chancery, in the roughly decade following *Lynch I*, observed that the framework we outlined — which created the opportunity for controllers, in certain transactions, to shift the burden of proof — was not being fully utilized. Further, use of the two procedural mechanisms would yield no greater result than a burden shift under the entire fairness standard.[174] Then-Vice Chancellor Strine, in *In re Cox*, noted that what *Lynch I* created was "a modest procedural benefit" but little more than that.[175] In *dicta*, he suggested that Delaware law evolve and expand on *Lynch I* and suggested the following change to our standard of review governing certain transactions:

> The reform would be to invoke the business judgment rule standard of review when a going private merger with a controlling stockholder was effected

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[172] 638 A.2d at 1117 (emphasis added). The potential to shift the burden in an entire fairness case creates strong incentives to employ such devices. *See Weinberger*, 457 A.2d at 703. *See also Rosenblatt*, 493 A.2d at 937 ("However, approval of a merger, as here, by an informed vote of a majority of the minority shareholders, while not a legal prerequisite, shifts the burden of proving the unfairness of the merger entirely to the plaintiffs.").

[173] *See Lynch I*, 638 A.2d at 1117.

[174] Our opinion in *Lynch I* "created a strong incentive for the use of special negotiating committees in addressing mergers with controlling stockholders." *In re Cox Commc'ns, Inc. S'holders Litig.*, 879 A.2d 604, 618 (Del. Ch. 2005). But one result of that, as we explained in *Flood v. Synutra International Inc.*, was a preference to only use special committees because a majority-of-the-minority vote "'added an element of transactional risk without much liability-insulating compensation in exchange.'" 195 A.3d 754, 762 (Del. 2018) (quoting *In re Cox*, 879 A.2d at 618). Further, until *MFW*, the debate continued over what had been perceived by many to be an inability by a defendant to prevail on a pleadings-stage motion to dismiss a claim challenging a merger with a controlling stockholder.

[175] 879 A.2d at 617; *id.* (observing also that "[n]o defendant in *Lynch*, and no defendant since, has argued that the use of an independent special committee *and* a Minority Approval Condition sufficiently alleviates any implicit coercion as to justify invocation of the business judgment rule" and "[f]or this reason, it is important not to assume that the Supreme Court has already rejected this more precisely focused contention.") (emphasis in original).

> using a process that mirrored *both* elements of an arms-length merger: 1) approval by disinterested directors; and 2) approval by disinterested stockholders.[176]

The Court of Chancery in *In re Cox* was of the view that its suggested reform "would improve the protections [offered] to minority stockholders and the integrity of the representative litigation process[.]"[177] Such a view, however, remained *dictum*, but became known as the "unified standard."[178]

The Court of Chancery confronted the concept of the "unified standard" and the potential consequences of *Lynch I* five years after *In re Cox* in *In re CNX Gas Corp. Shareholders Litigation*.[179] There, the court, looking to *In re Cox*, stated that "if a freeze-out merger is both (i) negotiated and approved by a special committee of independent directors and (ii) conditioned on an affirmative vote of a majority of the minority stockholders, then the business judgment standard of review presumptively applies."[180] But the trial court explicitly recognized in *In re CNX* that the question of which standard of review to apply remained an open question of law that this Court had yet to address:

> I recognize that by applying the unified standard, I reach a different conclusion than the recent *Cox Radio* decision, which opted to follow *Pure Resources*. The choice among *Lynch*, *Pure Resources*, and *Cox Communications* implicates fundamental issues of Delaware law and public policy that only the Delaware Supreme Court can resolve. Until the Delaware Supreme Court has the opportunity to address *Lynch* and *Siliconix*

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[176] *Id.* at 606 (emphasis in original).

[177] *Id.* at 606.

[178] *See, e.g.*, Edward P. Welch et al., *Folk on the Delaware General Corporation Law, Fundamentals* § 141.02[N], at GCL-326 (2020 ed.).

[179] 4 A.3d 397 (Del. Ch. 2010).

[180] *Id.* at 412–13 (citing *In re Cox*, 879 A.2d at 606).

> definitively, I believe the unified standard from *Cox Communications* offers the coherent and correct approach.[181]

Then came *MFW*. *MFW* answered a doctrinal question the corporate bar long had: did "the business judgment standard appl[y] to controller freeze-out mergers where the controller's proposal is conditioned on both Special Committee approval and a favorable majority-of-the-minority vote[?]"[182] *MFW* answered the question in the affirmative. In *MFW*, this Court adopted the standard that the Court of Chancery had suggested in the *In re Cox* and *In re CNX* decisions and described it as follows:

> To summarize our holding, in controller buyouts, the business judgment standard of review will be applied *if and only if:* (i) the controller conditions the procession of the transaction on the approval of both a Special Committee and a majority of the minority stockholders; (ii) the Special Committee is independent; (iii) the Special Committee is empowered to freely select its own advisors and to say no definitively; (iv) the Special Committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority.[183]

Both procedural protections must be "established *prior to trial*[.]"[184] And when they are established, the transaction is then afforded the deferential business judgment

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[181] *Id.* at 414 (internal citation omitted).

[182] 88 A.3d at 639. As the Court of Chancery had observed, although language in *Lynch I* could be read to suggest that there were no scenarios where a merger with a controlling stockholder could avoid entire fairness review, that language was *dictum* because this Court had never squarely addressed the question of the appropriate standard of review where the merger was conditioned on both special committee approval and a majority-of-the-minority vote. *See In re MFW S'holders Litig.*, 67 A.3d 496, 522–24 (Del. Ch. 2013), *aff'd*, 88 A.3d 635.

[183] 88 A.3d at 645 (emphasis in original). In *Synutra*, we clarified that "[t]o avoid one of *Lynch*'s adverse consequences—using a majority-of-the-minority vote as a chit in economic negotiations with a Special Committee—*MFW* reviews transactions under the favorable business judgment rule if these *two protections are established up-front*." 195 A.3d at 762 (citing *MFW*, 88 A.3d at 644) (emphasis added) (internal quotation marks omitted).

[184] *MFW*, 88 A.3d at 646 (emphasis in original).

standard of review. Under Delaware's business judgment rule, "the board's decision will be upheld unless it cannot be 'attributed to any rational business purpose.'"[185]

The absence of *MFW* protections, however, does not automatically result in a finding of liability. Appellants contend that the Vice Chancellor "acknowledged that the Board did not even consider creating an independent committee, which, as the trial court acknowledged, is the proper mechanism to negotiate a conflicted transaction."[186] Musk responds that they "advocate for a *per se* rule unsupported by case law" that would establish that failing to employ a special committee in a conflicted transaction would require "imposition of liability 'as a matter of law.'"[187] But Appellants respond that their position is not one advocating for a *per se* rule, but rather, is "that the absence of a special committee ***plus*** the numerous specific process flaws" requires the imposition of liability as a matter of law.[188]

As to the Tesla Board's decision not to form a special committee, the Vice Chancellor noted the following:

> There was a right way to structure the deal process within Tesla that likely would have obviated the need for litigation and judicial second guessing of fiduciary conduct. First and foremost, [Musk] should have stepped away from the Tesla Board's consideration of the Acquisition entirely, providing targeted input only when asked to do so under clearly recorded protocols. The Tesla Board should have formed a special committee comprised of indisputably independent directors, even if that meant it was a committee of one. The decision to submit the Acquisition for approval by a majority of the minority

[185] *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 74 (Del. 2006) (quoting *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971)).

[186] Opening Br. at 35 (internal citations omitted).

[187] Answering Br. at 27 (internal citation omitted).

[188] Reply Br. at 6 (emphasis in original).

> of Tesla's stockholders was laudable, and had the deal process otherwise been more compliant with the guidance provided by this court and our Supreme Court over many decades, it is likely there would be no basis to challenge the stockholder vote as uninformed. Of course, none of that happened.[189]

In other words, our decisions — which we continue to adhere to — have established a "best practices" pathway that, if followed, allow for conflicted transactions, such as the Acquisition, to avoid entire fairness review. Tesla's and Musk's determination not to form a special committee invited much risk (not to mention incursion of costs and diversion of personnel to litigation matters).[190] Although the Vice Chancellor aptly observed that perhaps the Tesla Board subjected itself to "unnecessary peril," we also recognize that there may be reasons why a board decides not to employ such devices, including transaction execution risk. Also, a board may wish to maintain some flexibility in the process, as the Tesla Board did here, by having the ability to access the technical expertise and strategic vision and perspectives of the controller.[191] Although we continue to encourage the use of special negotiation committees as a "best practice," nothing in Delaware law *requires* a

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[189] *Trial Op.*, 2022 WL 1237185, at *33 n.397.

[190] We have "repeatedly held that any board process is materially enhanced when the decision is attributable to independent directors. Accordingly, judicial review for entire fairness of how the transaction was structured, negotiated, disclosed to the directors, and approved by the directors will be significantly influenced by the work product of a properly functioning special committee of independent directors." *Ams. Mining*, 51 A.3d at 1243–44 (internal citations omitted).

[191] This is not to say that such access cannot be achieved effectively where a special negotiating committee and proper protocols have been established. *See, e.g.*, *Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd.*, 177 A.3d 1, 12, 30 (Del. 2017) (noting that, although not a controlling stockholder, Michael Dell — who had 15% of the equity and pledged that his voting power would go to any higher bidder, voting in proportion to other shares — was available to all parties throughout the go-shop period).

board to form a special committee in a conflicted transaction.[192] Here, the price of not utilizing a special committee was being subjected to entire fairness review — an expensive, risky, and "heavy lift" in the litigation arena.[193]

Although Appellants argue that both *MFW* factors are required to neutralize the inherent coercion of a controller, that was exactly the issue the parties fought out in the trial on the merits. After hearing extensive testimony and reviewing voluminous evidence, the trial court "searched during [its] deliberations for persuasive evidence that [Musk] exploited the coercion inherent in his status as a controller" to influence the Tesla Board.[194] The court concluded that "any control [Musk] may have attempted to wield in connection with the Acquisition *was effectively neutralized* by a board focused on the *bona fides* of the Acquisition, with an indisputably independent director leading the way."[195] It amplified that holding, adding that "even assuming [Musk] had the ability to exercise control over the Tesla Board, *the credible evidence produced at trial* shows that he simply did not do so with respect to the Acquisition."[196] Thus, Appellants' theory that both *MFW* mechanisms were needed to neutralize Musk was tested in the trial arena, and the court

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[192] *See, e.g.*, *Lynch II*, 669 A.2d at 85 (observing that "[h]ere Alcatel could have presented a merger offer directly to the Lynch Board, which it controlled, and received a quick approval" but adding that "[h]ad it done so, of course, it would have born the burden of demonstrating entire fairness in the event the transaction was later questioned."); *Rosenblatt*, 493 A.2d at 938 n.7 (noting that "the use of [a special] committee is not essential to a finding of fairness."); *In re Trados*, 73 A.3d at 76 (finding, in a transaction approved by a conflicted board, that "[a]lthough the defendant directors did not adopt any protective provisions . . . they nevertheless proved that the transaction was fair.").

[193] *See, e.g.*, *In re Trados*, 73 A.3d at 78.

[194] *Trial Op.*, 2022 WL 1237185, at *33.

[195] *Id.* (emphasis added).

[196] *Id.*

rejected it. The record supports the trial court's conclusion, which, we note, is heavily dependent upon unchallenged fact and numerous credibility determinations.

d. Negotiation of the Acquisition

Although the process here had some flaws, the trial court found that "[t]he Tesla Board's process included several redeeming features that emulated arms-length bargaining to the benefit of Tesla stockholders."[197] For example, the Court of Chancery found that Denholm, whose independence was unquestioned, led the negotiations on Tesla's behalf. Appellants disputed this fact at trial, but the Vice Chancellor found that "Denholm led due diligence and negotiations with SolarCity" and that Denholm was "an extraordinarily credible witness."[198]

By Denholm's side were Tesla's indisputably independent advisors — Evercore and Wachtell. Evercore, in particular, updated the Tesla Board on its discussions with Lazard, including over SolarCity's liquidity concerns.[199] Neither Wachtell nor Evercore had performed work for either Tesla or SolarCity prior to their work on the Acquisition. Appellants did not seriously question their independence. As the trial court found,

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[197] *Id.* at *36.

[198] *Id.* at *17 and *17 n.233. In the trial below, Appellants disputed that Denholm was in charge because "there are no Tesla Board minutes or resolutions that state the Tesla Board put Denholm in charge of the negotiations." *Id.* at *17 n.233. The Vice Chancellor explicitly rejected this contention and found the opposite: he noted that "[a]ll director testimony is consistent that Denholm was in charge. And there are special meeting minutes that imply the same." *Id.*

[199] In particular, the trial court made credibility determinations regarding Evercore, finding: "[i]n aid of Denholm's efforts, Evercore performed extensive diligence. McBean *credibly testified* that Evercore's 10-member team spent thousands of hours reviewing SolarCity's financial condition, conducting valuation analyses and negotiating with Lazard." *Id.* at *17 (emphasis added) (internal citation omitted).

"Wachtell was an independent and effective advisor to the Tesla Board."[200] The court, as to Evercore, found that "Evercore was a diligent advisor with no previous ties to Tesla, and McBean credibly explained and defended its work and advice."[201]

Tesla made two formal offers — the Initial Offer and the Final Offer — before both sides approved the Acquisition. And as the Vice Chancellor found, "[t]he information discovered during the due diligence process was used to lower the price substantially—even below the original offer range."[202]

Appellants contend that Musk pressed Evercore to accelerate the Acquisition process. After trial, the Vice Chancellor did find that Musk "was in frequent communication with Evercore outside the boardroom throughout the process,"[203] but the court also found that "the preponderance of the evidence suggests that the purpose of [Musk's meetings with Evercore] was to speed up diligence, *not to influence the bankers* regarding substantive aspects of the Acquisition."[204]

Appellants also argue that Musk played an integral and decisive role in the entire deal process. The Vice Chancellor found that Musk had an "apparent inability to

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[200] *Id.* at *13 n.169. With respect to Wachtell, the Vice Chancellor noted that although Musk "should not have been involved in the selection of counsel to advise the Tesla Board, as explained above, I am convinced that Wachtell was a qualified, independent advisor, not beholden to [Musk] in any way." *Id.* at *34 n.413.

[201] *Id.* at *21 n.276.

[202] *Id.* at *37.

[203] *Id.* at *34.

[204] *Id.* at *34 n.416 (emphasis added). McBean testified at trial that Musk never asked Evercore to change any of its presentations or advice that it provided to the Tesla Board. *See* A1732 (McBean Trial Test. at 1628:5–8).

acknowledge his clear conflict of interest and separate himself from Tesla's consideration of the Acquisition."[205] We agree with the Vice Chancellor that the spillover effects of Musk's actions could have been mitigated had the Tesla Board formed a special negotiating committee. But we also note that Tesla's advisors, led by Wachtell, did work to insulate Musk from the process to a certain extent, namely, his recusal from certain meetings and from voting overall.

Here, the credibility findings made by the trial court regarding Tesla's lead negotiator are critical in this part of the analysis. The Vice Chancellor gave significant weight to Denholm's testimony. Denholm "served as an effective buffer between [Musk] and the Tesla Board's deal process."[206] Further, "[h]er credible and unequivocal endorsement of the Acquisition is highly persuasive evidence of its fairness."[207] At trial, Appellants did not challenge Denholm's independence or disinterestedness: in fact, according to them, she was the only Tesla director who was not conflicted.[208] What the record shows, then, is a negotiation process led by an indisputably qualified, disinterested director who was advised by indisputably independent legal counsel and financial advisors.

That negotiation process, led by Denholm, resulted in the Final Offer, which by its terms, was lower than the Initial Offer and Musk's first pitch. The trial court found that:

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[205] *Trial Op.*, 2022 WL 1237185, at *34.

[206] *Id.* at *38.

[207] *Id.* The trial court referred to Denholm as a "disinterested decisionmaker[.]" *Id.* at *34.

[208] *See id.* at *4. Curiously, despite not challenging the factual findings on appeal, Appellants refer to Denholm as a "purportedly independent director" in their papers before this Court. *See* Reply Br. at 11.

> Denholm led the diligence and negotiations . . . The information discovered during the due diligence process was used to lower the price substantially—even below the original offer range. Price increases or decreases that are the products of hard-nosed negotiations are strong evidence of fairness.[209]

The Vice Chancellor also found "that Evercore was dutiful in keeping the Tesla Board apprised of new developments and concerns, including the concerns related to SolarCity's growing liquidity challenges."[210] Negotiations that are "vigorous and spirited" are an indicium of fair dealing.[211]

e. Approval of the Acquisition

The question under the last *Weinberger* fair dealing factor involves how the Acquisition was approved.[212] As we have noted, Appellants challenged all of the Tesla Board directors as conflicted except for Denholm. The Vice Chancellor explicitly stated that he "assum[ed] (*without deciding*) that . . . the Tesla Board was conflicted[.]"[213] Appellants' contention on appeal that "[t]he negotiation was handled by a conflicted Board that failed to supervise Musk"[214] is directly refuted by fact and credibility findings that they

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[209] *Trial Op.*, 2022 WL 1237185, at *37 (internal citations omitted). The Tesla Board also secured an exchange ratio that would capture the benefit of an intervening price change for Tesla's stockholders. *See* AR507 (Definitive Proxy at 65) ("The Tesla board instructed its advisors to reject the Special Committee's proposal that the acquisition consideration should be based on a fixed value per share of SolarCity common stock, rather than a fixed exchange rate, given the increased uncertainty and risk of increased dilution to Tesla stockholders.").

[210] *Trial Op.*, 2022 WL 1237185, at *37.

[211] *Gesoff*, 902 A.2d at 1148. The trial court found that Denholm "directed Evercore in its selection of acquisition targets and was actively engaged with Evercore with respect to the development and delivery of its fairness opinion." *Trial Op.*, 2022 WL 1237185, at *38.

[212] Fair dealing "embraces questions of . . . how the approvals of the directors . . . were obtained." *Weinberger*, 457 A.2d at 711.

[213] *Trial Op.*, 2022 WL 1237185, at *2 (emphasis added).

[214] Opening Br. at 39.

do not challenge. We find no error in the trial court's heavily fact-and-credibility-laden determination[215] that the directors, following a rigorous negotiation process led by Denholm, were not "dominated" or "controlled" by Musk when they voted to approve the Acquisition.[216] In the next section, we explain why the Vice Chancellor's reliance on the stockholder vote as an indicium of fairness was not error.

2. *The Trial Court's Finding that the Stockholder Vote was Informed is Supported by the Record*

The final contention on appeal by Appellants regarding the deal process concerns the stockholder vote on the Acquisition. They contend that the trial court erred in relying on the stockholder vote, for five reasons. Those reasons are: (1) Musk's involvement in the deal process was not properly disclosed to stockholders; (2) Tesla's disclosures about the Solar Roof were misleading; (3) Evercore's warning to the Tesla Board about a potential breach of SolarCity's Liquidity Covenant was not disclosed; (4) SolarCity's credit

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[215] "As an appellate court, we do not review determinations of credibility." *VonFeldt v. Stifel Fin. Corp.*, 714 A.2d 79, 83 (Del. 1998).

[216] For example, the Vice Chancellor stated that he was "satisfied that the Tesla fiduciaries placed the interests of Tesla stockholders ahead of their own." *Trial Op.*, 2022 WL 1237185, at *34. We note, however, that the Vice Chancellor found that "[e]ach arguably conflicted director credibly testified (and, in detail, explained how) he made his decision consistent with his duty of loyalty. Yet the facts implicating the potential for self-interest or lack of independence, all similar to scenarios where Delaware courts have found a reasonably conceivable disabling conflict on pled facts, were proven at trial (*e.g.*, familial ties, personal friendships, 'thick' business relationships, cross-investments, etc.)." *Id.* at *30 n.378. As he framed it, "[t]his raises the question whether credible (and convincing) testimony revealing loyal decision making can overcome proven facts revealing recognized scenarios where the *potential* for conflict exists. Here again, I raise but do not answer the question." *Id.* (emphasis in original).

Our decision to affirm does not rest upon potentially conflicted director testimony. As this Opinion makes clear, we are confident — after a full review of the record and oral argument of the parties — that Musk satisfied his burden of proving entire fairness.

downgrades were material to stockholders; and (5) several institutional stockholders held shares of both Tesla and SolarCity, raising questions of their disinterest and a reliance on their votes.

Delaware law on disclosure is well-settled. "An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote."[217] In other words, it must be substantially likely that the omitted fact would have been viewed as having "significantly altered the total mix of information made available."[218] The duty of disclosure extends beyond material omissions, as "disclosures cannot be materially misleading" either.[219] It is against this well-established backdrop that we weigh Appellants' five disclosure contentions on appeal.

First, Appellants contend that certain aspects of Musk's involvement in the deal process were not disclosed to stockholders. They raise five sub-arguments:

> Musk's (i) failure to inform the Board about SolarCity's looming financial crisis; (ii) daily calls with Tesla's advisors and management; (iii) July 21, 2016 call with Evercore concerning Evercore's recommendation that Tesla lower its offer; (iv) preliminary discussions with his cousin about Tesla acquiring SolarCity; and (v) proposal to the Board at the March 2016 meeting to acquire SolarCity.[220]

These sub-arguments largely center around the extent to which Musk involved himself in the process. However, we reject them based upon our examination of the record

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[217] *Morrison v. Berry*, 191 A.3d 268, 282 (Del. 2018) (internal quotation marks and citation omitted).

[218] *Arnold v. Soc'y for Sav. Bancorp, Inc.*, 650 A.2d 1270, 1277 (Del. 1994) (internal quotation marks and citation omitted).

[219] *Morrison*, 191 A.3d at 283.

[220] Opening Br. at 40.

evidence, which supports the Vice Chancellor's findings. As the trial court found, the Definitive Proxy "*did* disclose that [Musk] and Lyndon" Rive — Musk's cousin — had conversations, including in February 2016, about Tesla acquiring SolarCity.[221] Regarding the calls between Musk and Evercore, the Vice Chancellor stated that such an "omission may well have been material given [Musk's] conflicts."[222] Musk argues in response that a single disclosure issue, standing in the aggregate, does not change the calculus, especially in an entire fairness analysis. He points us to *In re Orchard Enterprises, Inc. Stockholder Litigation*, where the Court of Chancery stated that "a single disclosure problem may not be outcome-determinative" at trial.[223]

We agree that the trial court must evaluate an alleged disclosure violation in the context of the evidence as a whole. It is possible a single disclosure violation could, in certain circumstances, indicate larger issues with the deal process. It is equally possible that a single disclosure violation would not affect the total mix provided to stockholders.[224] As we previously noted, the Vice Chancellor found that the purpose of the calls between Musk and Evercore was not to set the terms of any potential offers, but rather, to check on the pace of diligence. Appellants do not challenge these factual findings, and we see no basis to disturb the Vice Chancellor's finding or weighing of this evidence.

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[221] *Trial Op.*, 2022 WL 1237185, at *12 n.156 (emphasis in original).

[222] *Id.* at *18 n.250.

[223] 88 A.3d 1, 29 (Del. Ch. 2014).

[224] *See Brown v. Perette*, 1999 WL 342340, at *8 (Del. Ch. May 14, 1999) (noting that "disclosure of a single unadorned fact can quickly snowball into wide-ranging disclosure of facts and opinions that otherwise would never come before the shareholders."); *Khanna v. McMinn*, 2006 WL 1388744, at *34 n.272 (Del. Ch. May 9, 2006) (same).

Second, Appellants contend that Tesla affirmatively made misleading disclosures regarding the Solar Roof. They point to the demo Musk did in late October 2016, as well as a tweet sent out by Musk concerning the availability of the product. It is true that the trial court identified as a process flaw that Musk "publicly demonstrated the (inoperable) Solar Roof and made promises about the timing of the product launch to the market."[225] The court, however, expressly found no disclosure violations in connection with the Solar Roof:

> Although the Solar Roof demonstration was intended to garner stockholder support for the Acquisition, these statements either occurred after the stockholder vote, were qualified or were accurate. I am satisfied investors knew the Solar Roof was a part of Tesla's "vision for the future" and a "goal," not a ready-for-market product offering.[226]

As the trial court found, "Tesla filings and press releases regarding the Solar Roof presentation were qualified with language that made clear the product was part of Tesla's 'vision for the future' and something 'the combined company *will be* able to create.'"[227]

And as to Appellants' claim that Musk's tweets about the Solar Roof constituted disclosure violations, the Vice Chancellor found that Appellants exhibited "temporal confusion" because Musk's comments about the Solar Roof occurred after the stockholder vote, meaning, logically, that his comments could not have affected the vote.[228] Regarding certain of Musk's tweets that occurred *prior* to the vote, the Vice Chancellor found that

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[225] *Trial Op.*, 2022 WL 1237185, at *34.

[226] *Id.* at *34 n.420 (internal citations omitted).

[227] *Id.* at *45 (internal citation omitted) (emphasis in original).

[228] *See id.* at *45.

they "were optimistic—perhaps overly so—but Tesla did, in fact, expect a product launch in mid-2017."[229] The trial court found that SolarCity had been working on the Solar Roof since 2015 and that Musk's statements were "not a prop created to secure the vote."[230] The record supports that conclusion.

Third, Appellants argue that the Vice Chancellor "found that Evercore advised the Board that a SolarCity breach of its liquidity covenant would threaten SolarCity's solvency" — which, they contend, was not disclosed to Tesla stockholders.[231] However, the trial court found that "[t]he market generally understood SolarCity's liquidity challenges"[232] and that Appellants' "expert witnesses, Moessner and Beach, conceded that market participants were aware of the risk that SolarCity might breach its Liquidity Covenant."[233] These unchallenged factual findings are supported by the record and cannot be squared with Appellants' contention that material facts were not disclosed to the stockholders by the time of the vote.

Fourth, Appellants contend that a disclosure violation exists because Tesla stockholders were not informed about SolarCity's credit downgrades.[234] They also claim that the Vice Chancellor erred in holding that "SolarCity's failure to disclose information

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[229] *Id.*

[230] *Id.*

[231] Opening Br. at 42.

[232] *Trial Op.*, 2022 WL 1237185, at *38.

[233] *Id.* at *42. Further, the preliminary proxy statement contained "a description of the risks posed by SolarCity's liquidity challenges." *Id.* at *22.

[234] *See* Opening Br. at 42.

related to its credit downgrades was immaterial."[235] Among other things, the court observed that "[i]f SolarCity's largest lender was undeterred by the change in credit rating, it is difficult to see how or why the market would have viewed the information differently."[236] We agree with the trial court's weighing of the evidence in assessing the materiality of this information. The trial court also expressly grounded its holding on the "credible evidence presented at trial." We have no basis in the record to disturb these findings.

Appellants' *fifth* disclosure contention relates to the potential crossholdings of stock by institutional investors. Appellants contend that the Court of Chancery did not decide the issue of whether these stockholders were disinterested and yet still factored the vote into the analysis. However, as the trial court stated, Fischel analyzed Appellants' "cross-holdings" claim. For example, Fischel analyzed 25 of Tesla's top institutional holders. Of those, 17 also held SolarCity stock, "[b]ut only 5 of those 17 had greater stakes in SolarCity than Tesla."[237] The trial court, considering the "quality" of the stockholder vote, ultimately concluded that "[e]ven with these issues in mind, however, I cannot, as factfinder, conclude that such a large majority of Tesla's stockholders would have voted to approve a transaction whereby Tesla would acquire an insolvent energy company, as [Appellants] would have me believe."[238] The Vice Chancellor explained that he gave "less weight to

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[235] *Trial Op.*, 2022 WL 1237185, at *43.

[236] *Id.*

[237] A1845 (Fischel Trial Test. at 2532:13–14).

[238] *Trial Op.*, 2022 WL 1237185, at *44 n.515.

the Tesla stockholders' approval of the Acquisition than [he] might have otherwise in recognition of [Appellants'] disclosure arguments and their argument that the magnitude of the approval vote might be overstated given the likelihood that many stockholders who approved the Acquisition also owned SolarCity stock."[239] We find no error with the Vice Chancellor's determination to give the vote some weight.

In weighing the stockholder vote on the Acquisition, the court again found Fischel's testimony particularly persuasive. Fischel testified that the Tesla stockholder vote was "the ultimate market test," that if anyone believed that SolarCity was insolvent, "all they had to do was reject the offer[,]" and similarly for Tesla stockholders who thought the deal was beneficial, they could vote in favor of it.[240] He testified as to the robust public commentary regarding liquidity issues, as well as commentary characterizing the deal as a "bailout" and the result of a process "steeped in conflicts."[241] He further testified as to the sophistication of the stockholder base, which contained "many of the most sophisticated institutions in the world."[242]

In sum, we reject all five claims of error. The record supports the Vice Chancellor's conclusion that "[t]he material aspects of the Acquisition were known to Tesla stockholders."[243]

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[239] *Id.* at *36 n.430.

[240] *Id.* at *44 (internal quotation marks and citation omitted).

[241] *Id.*

[242] A1844 (Fischel Trial Test. at 2529:20–21).

[243] *Trial Op.*, 2022 WL 1237185, at *38.

Finally, we reject Appellants' contention that the Vice Chancellor failed to adequately find that the Acquisition was the product of fair dealing. Musk was required to prove fair dealing. Both aspects of the entire fairness test — fair dealing and fair price — must be satisfied. "[A] party does not meet the entire fairness standard simply by showing that the price fell within a reasonable range that would be considered fair."[244]

The trial court, citing cases to this effect, recognized that principle and found that Musk carried his heavy burden. The trial court's findings — which, again, are factual determinations not challenged by the Appellants — support the conclusion that the process, overall, was the product of fair dealing. The Vice Chancellor did not ignore the process flaws, but rather, he considered them in his overall assessment of the process. For example, he noted that "the recusal protocol was not precise" as to Musk attending certain Tesla Board meetings and that this was a flaw in the process.[245] But he also acknowledged that "the Tesla Board believed that [Musk's] and Gracias' perspectives regarding the solar industry and SolarCity, in particular, would be helpful, so it was agreed that the two could participate in certain high-level strategic discussions regarding the Acquisition."[246] This

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[244] *William Penn P'rship v. Saliba*, 13 A.3d 749, 757 (Del. 2011); *id.* at 758 ("Merely showing that the sale price was in the range of fairness, however, does not necessarily satisfy the entire fairness burden when fiduciaries stand on both sides of a transaction and manipulate the sales process.") (internal citation omitted). *See also Tremont*, 694 A.2d at 432 ("[H]ere, the process is so intertwined with price that under *Weinberger*'s unitary standard a finding that the price negotiated by the Special Committee might have been fair does not save the result."); *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993) (holding that "directors must establish to the *court's* satisfaction that the transaction was the product of both fair dealing *and* fair price.") (emphases in original), *modified on other grounds*, 636 A.2d 956 (Del. 1994).

[245] *Trial Op.*, 2022 WL 1237185, at *15 n.197.

[246] *Id.* at *15.

was disclosed in the Definitive Proxy.[247]

The court found that overall, "the preponderance of the evidence reveals that [Musk's] influence did not degrade the entire fairness of the Acquisition."[248] It noted that "[t]he Tesla Board's process included several redeeming features that emulated arms-length bargaining to the benefit of Tesla stockholders."[249] Further, "an ultimately productive board dynamic [] protected the interests of stockholders, despite [Musk's] assumed 'managerial supremacy' and the assumed board-level conflicts."[250] And specifically, the court concluded that "under Denholm's leadership, the Tesla Board meaningfully vetted the Acquisition"[251] and that, under Denholm's direction and influence as a "disinterested decisionmaker," the "Tesla fiduciaries placed the interests of Tesla stockholders ahead of their own."[252] Thus, although the trial court could have stated its fair dealing conclusion more clearly and explicitly, its opinion — fairly read — determines that despite certain process flaws, the Acquisition was the product of fair dealing. We also conclude, based upon our independent review of the record, that the record supports such a determination.

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247 *See id.* at *15 n.197.

248 *Id.* at *33.

249 *Id.* at *36.

250 *Id.* at *37 (internal citation omitted).

251 *Id.* at *39.

252 *Id.* at *34.

V. THE TRIAL COURT DID NOT REVERSIBLY ERR IN ITS FAIR PRICE ANALYSIS

We now turn to fair price. We conclude that the record supports the Court of Chancery's legal conclusion that the price paid was a fair one and that the trial court did not misapply the entire fairness standard.

As this Court has said, a fair price analysis typically applies "recognized valuation standards[.]"[253] "In resolving issues of valuation[,] the Court of Chancery undertakes a mixed determination of law and fact."[254] Our "precedent establishes that the fair price and fair value standards call for equivalent economic inquiries."[255] It is important to note, however, that "[t]he fair price aspect of the entire fairness test, by contrast, is not in itself a remedial calculation."[256] Thus, "[a] price may fall within the range of fairness for purposes of the entire fairness test even though the point calculation demanded by the

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[253] *Lynch II*, 669 A.2d at 87. *See also Rosenblatt*, 493 A.2d at 940 ("Fair price involves all relevant economic factors of the proposed merger, such as asset value, market value, earnings, future prospects, and any other elements that affect the inherent or intrinsic value of a company's stock.") (citing *Weinberger*, 457 A.2d at 711); *Weinberger*, 457 A.2d at 713 (noting that a fair price analysis requires use of "techniques or methods which are generally considered acceptable in the financial community").

[254] *Tremont*, 694 A.2d at 432. Such a determination is entitled to deference by this Court: "[w]e recognize the thoroughness of the [Court of Chancery's] fair price analysis and the considerable deference due [its] selection from among the various methodologies offered by competing experts." *Id.*

[255] *In re Orchard*, 88 A.3d at 30. *See also Gesoff*, 902 A.2d at 1152 n.127 ("[I]n general, the techniques used to determine the fairness of price in a non-appraisal stockholder's suit are the same as those used in appraisal proceedings.").

[256] *ACP Master, Ltd. v. Sprint Corp.*, 2017 WL 3421142, at *18 (Del. Ch. July 21, 2017), *aff'd*, 184 A.3d 1291. *See also Reis v. Hazelett Strip-Casting Corp.*, 28 A.3d 442, 465 (Del. Ch. 2011) ("The fair price analysis is part of the entire fairness standard of review; it is not itself a remedial calculation.").

appraisal statute yields an award in excess of the merger price."[257]

Here, Appellants attack Musk's evidence on fair price, which the Court of Chancery largely found to be credible. Their fair price challenge is five-fold: (1) the trial court applied a bifurcated entire fairness test; (2) the trial court employed "rote reliance" on market price; (3) the trial court did not look to SolarCity's value at the time of closing; (4) the trial court erroneously considered cash flows and synergies; and (5) the stockholder vote did not prove fair price.[258] We consider each challenge and conclude that the trial court committed no reversible error.

A. The Trial Court Did Not Apply A Bifurcated Analysis

Appellants first contend that the "court applied a bifurcated entire fairness test, concluding that its separate fair price analysis alone satisfied entire fairness."[259] In essence, they argue that the Vice Chancellor looked at price and price alone.[260] We disagree with Appellants' reading of the Court of Chancery's opinion, which, among other things, makes extensive fact and credibility findings relating to the Acquisition's process. The trial court also expressly recognized that "[e]ntire fairness is a composite" and is not a bifurcated

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[257] *In re Orchard*, 88 A.3d at 30. The Court of Chancery has noted that our case law "has not equated satisfying the standards of review that govern fiduciary duty claims with carrying the burden of proof in an appraisal proceeding. Because the two inquiries are different, a sale process might pass muster for purposes of a breach of fiduciary claim and yet still constitute a sub-optimal process of an appraisal." *Merion Cap. L.P. v. Lender Processing Servs., Inc.*, 2016 WL 7324170, at *15 (Del. Ch. Dec. 16, 2016).

[258] *See* Opening Br. at ii.

[259] *Id.* at 44.

[260] The *amici* join in and argue that Musk satisfied his burden "by reference chiefly to the pre-announcement price[.]" Amicus Br. at 21.

test.[261]

Nevertheless, Appellants are correct that fair price played a large role in the trial court's analysis. Though the entire fairness test is a unitary one, we have long recognized that, sometimes, a fair price is the most important showing.[262] "Evidence of fair dealing has significant probative value to demonstrate the fairness of the price obtained. The *paramount consideration, however, is whether the price was a fair one*."[263] That is not to say that an alleged controller can shirk her fiduciary duties and hide behind the price she pays. "[T]he range of fairness is not a safe-harbor that permits controllers to extract barely fair transactions."[264] Here, given the process flaws as found by the trial court, the court had to conclude that those flaws did not infect the price in order to find that the price was fair. That is what it did, finding that, ultimately, the process did not impact the price, which was "not near the low end of a range of fairness[.]"[265] Although Appellants raise certain legitimate criticisms as to a certain part of the trial court's fair price analysis, given the

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[261] *Trial Op.*, 2022 WL 1237185, at *31.

[262] In *Weinberger*, this Court stated that "in a non-fraudulent transaction we recognize that price may be the *preponderant consideration* outweighing other features of the merger." 457 A.2d at 711 (emphasis added). When looking at fair price, we analyze a variety of factors, as does the trial court. *See In re Dole Food Co., Inc. S'holder Litig.*, 2015 WL 5052214, at *34 (Del. Ch. Aug. 27, 2015) ("The principal evidence on the issue of fair price consists of the expert opinions at trial, the Committee's negotiations, Lazard's fairness opinion, and market indications.").

[263] *Ams. Mining*, 51 A.3d at 1244 (emphasis added). *See also In re Dole Food*, 2015 WL 5052214, at *34 ("Fair price can be the predominant consideration in the unitary entire fairness inquiry.").

[264] *ACP Master*, 2017 WL 3421142, at *19. *See also Basho Techs. Holdco B, LLC v. Georgetown Basho Invs., LLC*, 2018 WL 3326693, at *37 (Del. Ch. July 6, 2018) (same), *aff'd*, 221 A.3d 100 (Del. 2019) (ORDER).

[265] *Trial Op.*, 2022 WL 1237185, at *48 (internal quotation marks and citation omitted).

other evidence of fair price, we find no reversible error in the court's overall determination that the price was fair.

B. The Credible Evidence Supports The Fairness Of The Price

1. Musk Presented "Persuasive Evidence" of SolarCity's Solvency, While Quintero's Insolvency Valuation Theory was "Incredible"

Appellants' claims as to fair price focus on whether the court afforded too much weight to market evidence. They contend that "[t]he trial court rejected all expert valuation methodologies and concluded that Tesla paid a fair price by relying on a stale SolarCity stock price from when Tesla's preliminary proposal was announced."[266] More specifically, they assert that "[t]he only valuation 'methodology' the court purported to employ . . . was to look at the $20.35/share value of the Tesla stock paid at closing ***on November 21*** compared to SolarCity's $21.19/share 'unaffected stock price' ***from June 21***[.]"[267] As a result of that mistake, they say the court erred in concluding that Tesla paid no premium.

However, market evidence of SolarCity's stock price was only one part of the evidence considered by the trial court in its fair price analysis. Although it is true that the court addressed market evidence to a greater degree than the DCF analysis, for example, that is a function of how the parties litigated the case. Appellants gloss over the fact that they pressed a single fair price valuation theory at trial, namely, that SolarCity was insolvent. As the Vice Chancellor found, Appellants "placed their valuation case entirely in Quintero's hands, and Quintero, in turn, relied exclusively on a single valuation theory:

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[266] Opening Br. at 46.

[267] Reply Br. at 19 (emphases in original).

insolvency."[268] However, that strategy did not pan out.[269]

At trial, Quintero calculated and relied upon what he determined to be SolarCity's "net liquidation value," which he stated was the appropriate measurement due to SolarCity's failure as a going concern.[270] To reach his conclusion that SolarCity was insolvent, Quintero ran two types of tests: balance sheet tests and cash flow tests, each with two variations. Both tests, in his view, resulted in the same conclusion: SolarCity was not a going concern. The two balance sheet tests looked at current liabilities versus current assets and then all assets and all liabilities.[271] According to Quintero, SolarCity had a net working capital deficit of $422.9 million.[272] The two cash flow tests employed by Quintero looked at whether SolarCity could pay its obligations as they came due and then the size of SolarCity's capital.[273] Under both the balance sheet and cash flow tests, SolarCity was, in Quintero's opinion, insolvent.[274]

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[268] *Trial Op.*, 2022 WL 1237185, at *40 (internal citations omitted).

[269] As the Vice Chancellor described, they "went 'all in' on insolvency, arguing that SolarCity was worthless when Tesla acquired it, so any price paid by Tesla was too high." *Id.* at *40. And as the Vice Chancellor put it, their strategy consisted of "swinging for the fences" and arguing for a SolarCity maximum value of zero dollars. Based upon their proffered valuation of zero dollars for SolarCity, Appellants argued that "compensatory damages should be the full value of the Acquisition consideration: $2.058 billion (at $20.35/share) to $2.443 billion (at $24.16/share)." A2113 (Appellants' Post-Trial Reply Br. at 33).

[270] A586 (Quintero Rep. at 5). Quintero testified at trial that, "[b]ased on the financial performance and condition of SolarCity as of the merger date, net liquidation value is the appropriate premise of value." A1507 (Quintero Trial Test. at 706:20–22).

[271] *See id.* (Quintero Trial Test. at 708:2–17).

[272] *See* A1532 (Quintero Trial Test. at 807:14–16).

[273] *See* A1508 (Quintero Trial Test. at 709:6–14).

[274] *See id.* (Quintero Trial Test. at 710:5).

Quintero's expert report (the "Quintero Report") focused on one key aspect of SolarCity: liquidity problems, including the risk of tripping the Liquidity Covenant.[275] "SolarCity was highly debt dependent"[276] and had "[l]iabilities that exceeded net assets (excluding the net assets of the [variable interest entities]) by approximately $650 million as of the" Acquisition.[277] Net liquidation value — the key financial calculation in the Quintero Report — is defined as "the net amount that would be realized if the business is terminated and the assets are sold piecemeal."[278] The Quintero Report relied upon "orderly liquidation value," which "[a]ssumes the assets are sold piecemeal with a reasonable amount of time allowed for market exposure."[279] It concluded that the average net liquidation value of SolarCity was negative $1.952 billion.[280] Thus, according to the Quintero Report, "the common stock of SolarCity would be worthless on a liquidation basis."[281]

SolarCity's stock trading price did not factor into Quintero's analysis, as he concluded that its stock "essentially became a Tesla tracking stock up until the

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[275] *See* A605–20 (Quintero Rep. at 24–39). *See also supra* Sections I.D.2, I.F., I.G.2, I.G.4. One of the Appellants' other experts, Juergen W. Moessner, testified at trial that the market was aware of the risk SolarCity had with tripping the Liquidity Covenant. *See* A1502 (Moessner Trial Test. at 686:9–20).

[276] A624 (Quintero Rep. at 43).

[277] A628 (Quintero Rep. at 47).

[278] A652 (Quintero Rep. at 71).

[279] *Id.* Orderly liquidation value differs from "forced liquidation value," which "[a]ssumes the assets are sold piecemeal with less than normal exposure as in a distressed sale." *Id.*

[280] *See* A805 (Quintero Rep. at Exhibit 53).

[281] *See id.*

[Acquisition] closed, and SolarCity shareholders actually received Tesla common stock in exchange for their SolarCity common stock."[282] Although Quintero prepared a DCF analysis, he assigned it no value.[283] He also rejected the fairness opinions of Evercore and Lazard, as he found they did "not provide an appropriate basis for determining the fair value of SolarCity" since they both determined that the company operated as a going concern.[284] At trial, Quintero testified as to his net liquidation analysis. He confirmed repeatedly that it was the proper method by which to value SolarCity.

Musk's lead expert at trial, Fischel, testified that Quintero's net liquidation valuation was "irrelevant for analyzing what I consider to be the relevant economic question in this case, which is the value of the assets purchased to SolarCity that are going to continue [] as opposed to SolarCity being liquidated."[285] Upon his review of "economic data, stock price data, acquisition data, all kinds of data from analysts on price targets and all kinds of different types of analysis, economic data[,]" he did not see "a single piece of evidence that supports the claim that SolarCity was insolvent at the time of the acquisition."[286] According to Fischel, no one in the industry — apart from Quintero — "thought it was

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[282] A677 (Quintero Rep. at 96).

[283] *See* A724 (Quintero Rep. at 143). Quintero testified at trial that he viewed DCF analysis as a highly speculative approach. *See* A1580 (Quintero Trial Test. at 868:19–24).

[284] A726 (Quintero Rep. at 145). *See also* A1529 (Quintero Trial Test. at 795:23–796:4).

[285] A1833 (Fischel Trial Test. at 2485:15–19).

[286] *Id.* (Fischel Trial Test. at 2486:2–10). Fischel testified that, if stockholders believed SolarCity was insolvent, they would not have voted for the Acquisition "because they were the ones who would have been the most harmed." A1845 (Fischel Trial Test. at 2533:1–2). He also pointed to SolarCity's trading price on June 21 of $21.19 and opined that "[i]nsolvent firms don't have equity trading at $21.19." A1835 (Fischel Trial Test. 2493:5–6).

appropriate to value SolarCity based on liquidation value."[287] In rejecting Quintero's insolvency analysis, the trial court cited Musk's "persuasive valuation evidence."[288] In addition to Fischel's testimony, Musk's evidence included: a contemporaneous analysis done by KPMG, showing that SolarCity was not insolvent; Tesla's 10-K, reporting an $89 million gain on the Acquisition; Evercore's analysis; and other financial testimony on cash flows and retained value.[289]

The trial court weighed evidence as to SolarCity's supposed insolvency and resoundingly rejected the insolvency theory. As the court noted, Quintero "doubled down" on his insolvency theory to such a degree that, when weighed against the evidence put forth by Musk's experts, Appellants "undermined the credibility of their fair price case completely."[290] Thus, the trial court found that, despite SolarCity's financial issues, the company "was solvent, valuable and never in danger of bankruptcy."[291] A review of the record and the opinion below reveals that this finding is adequately supported by the record.

The trial court attempted to ascertain whether Appellants relied on any other fair price theory or analysis besides insolvency. In response to questions from the trial court, Quintero completely disclaimed reliance on any valuation metric or methodology other than his insolvency valuation theory:

THE COURT: All right. I just have a couple questions to understand the

[287] A1850 (Fischel Trial Test. at 2554:5–6).

[288] *Trial Op.*, 2022 WL 1237185, at *41.

[289] *See id.* at *41 n.481

[290] *Id.* at *40.

[291] *Id.*

big picture of what you are telling the Court. As I understand it, the flag that you put in the ground on valuation, and that you would have me adopt, is a liquidation value of Tesla [*sic*] as of November, the date of the closing of this merger. That's the value that you believe in, as you have analyzed the data provided to you. Is that fair?

THE WITNESS: Yes, sir, based on professional appraisal.

THE COURT: The rest of this illustrative -- I'm trying to understand the point of the illustrative valuations. As I understand that, those are not methodologies that you believe in for this company. Is that accurate?

THE WITNESS: That is correct. Not as of the merger date.

THE COURT: All right. So as I look at the big picture of your testimony and your report, what I should be focusing on is whether I believe in the liquidation value premise that you are offering. Right? That's the main essence of your testimony?

THE WITNESS: That is correct.

THE COURT: So the DCF, for example, that you performed, you don't believe in that valuation?

THE WITNESS: No, it is only alternative information I have provided you for informational purposes.

THE COURT: But I guess that's what I'm trying to get at. What is the information that gives me that is useful in terms of deciding the dispute? Because it's a valuation that you do not endorse. Is that --

THE WITNESS: The sole purpose would be if, Your Honor, you came to a view that Tesla was a going concern, I have provided you four alternative valuation analyses, albeit with very substantial caveats.

THE COURT: Right. And my understanding is that, as to each of them, from your perspective, they do not reflect the appropriate means by which to value this company.

THE WITNESS: That's correct, based upon professional appraisal standards.[292]

The result, after the court found Quintero's insolvency theory to be "incredible" — and Appellants disavowed any other theories — is that Appellants were left with no credible fair price evidence. As the trial court recognized, "in a plenary breach of fiduciary

[292] A1585–86 (Quintero Trial Test. at 889:6–891:4).

duty action, the court's function when assessing fair value is not to conduct its own appraisal but to land where the preponderance of the credible and competent evidence of value takes it."[293] In the end, the Vice Chancellor found "no credible basis in the evidence to conclude that a 'fairer' price was available, and therefore, no basis to conclude that the price paid was not entirely fair."[294]

Musk, on the other hand, in addition to refuting Appellants' insolvency theory, "presented the most persuasive evidence regarding SolarCity's value and the fairness of the price Tesla paid to acquire it."[295] Musk's experts not only offered evidence demonstrating that SolarCity was not insolvent, but they also presented other evidence in order to prove the fairness of the price. And, as explained more fully below, market-based evidence was only one piece of Musk's fair price case. We now turn to the question of whether the trial court erred in finding that Musk had established the fairness of the price and whether the court erred in applying this aspect of the analysis.

2. *Musk's Evidence Adequately Supports the Trial Court's Finding of Fair Price*

a. *The Record Supports a Finding that Evercore's Fair Price Evidence Supports the Fairness of the Price*

As Tesla's financial advisor on the Acquisition, Evercore and its work were a focus at trial. Evercore's fairness opinion was based upon seven different valuation analyses,

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[293] *Trial Op.*, 2022 WL 1237185, at *40. *See also Dell*, 177 A.3d at 22 (observing that "it is possible that a factfinder, even the same factfinder, could reach different valuation conclusions on the same set of facts if presented differently at trial.").

[294] *Trial Op.*, 2022 WL 1237185, at *48.

[295] *Id.* at *40.

including DCF and non-DCF methodologies. In addition to the DCF analyses, Evercore's valuation methodologies, which were described in detail in its presentation to the Tesla Board, included a sum-of-the-parts ("SOTP") analysis and a premiums paid analysis.[296] Evercore credibly demonstrated to the court that the price paid was fair.

Appellants argue that the Court of Chancery committed legal error by disregarding the DCF evidence. Their position is that the Vice Chancellor refused to consider a DCF methodology.[297] Appellants also contend that the trial court's DCF analysis was inconsistent with several of its other findings. According to them, there are two issues. The first is that the trial court erred in relying on Evercore's fairness opinion, which was based, in part, on a DCF analysis they say was flawed.[298] The second is that the court ignored SolarCity's liabilities: as they frame it, "Tesla did not just pay $2.1 billion of stock, it ***also*** immediately assumed SolarCity's ***$5.35 billion of liabilities***."[299] Musk argues

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[296] *See* AR519–24 (Definitive Proxy at 77–82) (summarizing Evercore's financial analyses). At trial, McBean testified that Evercore's primary valuation methodologies were DCF, SOTP, and precedent premiums analysis. *See* A1688 (McBean Trial Test. at 1450:16–1451:18); A1689 (McBean Trial Test. at 1454:7–13). Appellants, in their post-trial briefing, described Evercore's two main valuation methodologies as the DCF and SOTP analyses.

[297] *See* Opening Br. at 52.

[298] Appellants criticize Evercore's DCF analysis for failing to account for the phasing out of an investment tax credit ("ITC") program. Fischel believed that there were no cash flows in the terminal period from the residential tax credit. *See* A1871 (Fischel Trial Test. at 2636:3–11). McBean testified that Evercore knew that the ITC program was ending, but it did not "make specific assumptions" about the ITC in its aggregate analysis of its DCF sensitivity case. A1687 (McBean Trial Test. at 1448:4–23). She also testified that Evercore's DCF analysis was consistent with the expected ITC phasedown, *see* A1687–88 (McBean Trial Test. at 1448:24–1449:2), and that Evercore did "extensive diligence" when it reached its conclusion that SolarCity would have other sources of cash available even with the end of the ITC program. *See* A1688 (McBean Trial Test. at 1449:10–20). Notably, Evercore's SOTP analysis took account of the ITC issue, as noted in the Definitive Proxy. *See* AR520 (Definitive Proxy at 78).

[299] Opening Br. at 54 (emphases in original).

that Appellants focus on the liabilities but ignore the $8.5 billion in assets Tesla acquired in the deal.

First, the trial court did consider the DCF analyses, except "neither expert [Quintero or Fischel] persuaded [the court] that a DCF analysis is the proper method by which to value SolarCity[.]"[300] Quintero testified that a DCF was not the appropriate way to value SolarCity. Fischel testified that he conducted a DCF as a check on the other market evidence, which he found to be more reliable.

Appellants assert that the trial court erred in finding that the DCF analyses were "not helpful," despite finding Evercore's analyses strong evidence of fair price. Credibility findings explain, in part, the trial court's reliance on McBean and Evercore. The court rejected the suggestion that Evercore's overall fairness opinion was unreliable, finding that "Evercore was a diligent advisor with no previous ties to Tesla, and McBean credibly explained and defended its work and advice."[301] It also expressly found that "[t]he preponderance of the evidence reveals this opinion [by Evercore] was reliable, honest and

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[300] *Trial Op.*, 2022 WL 1237185, at *41. Quintero testified that a DCF analysis for SolarCity was "an unreliable valuation approach" and "highly speculative[.]" A1580 (Quintero Trial Test. at 868:19–24). Fischel testified that "the market evidence in this case is more probative, more reliable than an after-the-fact DCF analysis conducted by me or anybody else." A1856 (Fischel Trial Test. at 2579:19–21). *See also Rosenblatt*, 493 A.2d at 940 (observing "that the relative importance of the several tests of value depends upon the circumstances of each case.") (citing *Sterling v. Mayflower Hotel Corp.*, 93 A.2d 107, 115–16 (Del. 1952) (reasoning that net asset value was of less importance than earning power, given the nature of the assets of the two companies)). Nor did the trial court here rely upon Fischel's stock indexing methodology, which the Court of Chancery had criticized in other decisions. *See Trial Op.*, 2022 WL 1237185, at *44 n.509.

[301] *Id.* at *21 n.276.

independently given."[302] The trial court found that Evercore's work was based upon "weeks of due diligence."[303] The record supports this finding, as McBean testified at trial that "we did a tremendous amount of work on this transaction, thousands of hours with -- among our team. It was a very thorough process. This was probably one of the most involved diligence processes I've ever undergone."[304]

Further, at oral argument before this Court, when pressed as to this inconsistency point regarding the DCF analyses (*i.e.*, finding DCF analyses unhelpful, yet relying upon Evercore's analyses), Musk argued that the projections relied upon by Tesla's management were contemporaneous, as opposed to being litigation-driven analyses prepared by experts.[305] The trial court concluded that "Evercore's analysis and projections were based

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[302] *Id.*

[303] *Id.* at *46.

[304] A1733 (McBean Trial Test. at 1631:11–15). She testified further that the Acquisition "was a great deal for Tesla, a strategic rationale which we believed in, and we stand behind our work." *Id.* (McBean Trial Test. at 1631:18–20).

[305] The following colloquy occurred:

> THE COURT: How do you respond to Mr. Hanrahan's suggestion that there's some tension between the court's finding that the DCF analyses were not helpful and, yet, as part of its six factors that it looked at in fair price and finding the price to be fair, it looked at SolarCity's current and future cash flows?
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> COUNSEL: My answer is I think Mr. Hanrahan left one important fact out, which is the distinction between contemporaneous discounted cash flow analyses that were done at the company and the made-for-litigation discounted cash flow analyses, which the court did not credit. That's the distinction. Both sides came in with after-the-fact experts who did discounted cash flow analyses. Mr. Quintero said, "I did it, but don't rely upon it and don't pay any attention to it." Dr. Fischel did it and said, "I'm giving it to you. I don't think these are particularly useful after the fact, but here it is if you want to consider it because the other side did one." The court said, "I'm not considering those." What the court considered was not the made-for-litigation DCFs but the contemporaneous DCFs, which the company was actually using to conduct its business. Those, the court found, were relied upon by Evercore and were appropriate.

on ‘extensive discussion and analysis’ between Tesla and Evercore[.]”[306]

The record contains other quantitative analyses performed by Evercore. For example, McBean testified about Evercore’s two SOTP analyses — another key component of Evercore’s fairness opinion work. She stated that these analyses resulted in a range of $31 to $46 for the management case and a range of $16 to $26 for the revised sensitivity case.[307] She observed that “[t]he final deal price is below or within those ranges” and that “[s]pecifically, it’s below the SolarCity management case and within the range for the revised sensitivity case.”[308] We find no error in the trial court’s determination that Evercore credibly explained and defended its work or in the trial court’s overall reliance on Evercore’s fairness opinion as “just one of many pieces of evidence that justify the price paid in the Acquisition.”[309]

In addition to Evercore’s fairness opinion, the trial court relied upon the contemporaneous KPMG analysis and the fact that Tesla booked an $89 million gain on the Acquisition.[310] As to Appellants’ claim that the trial court ignored SolarCity’s liabilities, the trial court’s finding that SolarCity’s “net assets [were] in excess of its market capitalization (as confirmed by KPMG)” and that it “brought substantial value to Tesla”

Oral Argument, at 40:50–41:59, https://livestream.com/delawaresupremecourt/events/10769099/videos/235611407:

[306] *Trial Op.*, 2022 WL 1237185, at *46 (internal citation omitted).

[307] A1689 (McBean Trial Test. at 1453:5–8).

[308] *Id.* (McBean Trial Test. at 1453:11–14).

[309] *Trial Op.*, 2022 WL 1237185, at *21 n.276.

[310] *See id.* at *41 n.481.

are supported by the record.[311] The trial court found that, "as of closing, SolarCity had accumulated and continued to accumulate substantial net retained value."[312] The trial court also relied upon cash flow and synergies analyses, which we discuss below.

b. The Trial Court did not err as to its Cash Flow Findings

Appellants argue that the Court of Chancery erred when it relied upon SolarCity's cash flows and upon "encumbered future cash flows that might never materialize."[313] They contend that the Vice Chancellor relied upon "undocumented and unsupported testimony by Musk" that Tesla would realize $1 billion in nominal cash flows and at least $2 billion more from legacy SolarCity systems.[314] They suggest a similar logical inconsistency,[315] namely, that the trial court considered cash flows, yet also stated that it would reject the discounted cash flow analyses prepared by the experts. Musk responds that the cash flows represented "SolarCity's business model and part of the value proposition the Acquisition presented to Tesla" and that "the trial court found the cash flows supported by documentary evidence and credible testimony from five witnesses."[316]

The trial court found that "part of SolarCity's value came from the long-term cash flows it generated."[317] It flows logically, then, that those cash flows are part of the "get"

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[311] *Id.* at *24.

[312] *Id.*

[313] Opening Br. at 53.

[314] *Id.* at 53–54.

[315] *See supra* Section V.B.2.a.

[316] Answering Br. at 53–54 (internal citations omitted).

[317] *Trial Op.*, 2022 WL 1237185, at *45. *See also supra* Sections I.D.2. and I.J. *See also DFC Glob. Corp. v. Muirfield Value P'rs, L.P.*, 172 A.3d 346, 349–50 (Del. 2017) ("It is, of course,

Tesla received from the Acquisition and factored into the fair price analysis. And, as the trial court's opinion demonstrates, the court did not solely rely upon Musk's testimony as to cash flows. Rather, the trial court considered evidence from Tesla's directors and from SolarCity's officers that cash flows were an integral part of SolarCity's business.[318] For example, the trial court noted that "[u]sing a 'retained value' methodology (calculating the net present value ('NPV') after accounting for the repayment of associated debt), SolarCity valued its future cash flows as of Q2 2016 at $2.2 billion (NPV) in retained value."[319] It found that "[t]his amount was available for monetization at the time of the Acquisition."[320] Further, the trial court found that "SolarCity's financing counterparties participated in financing transactions with SolarCity worth more than $3 billion from" the fourth quarter of 2015 through the fourth quarter of 2016.[321] We find no error in the trial court's

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natural for all buyers to consider how likely a company's cash flows are to deliver sufficient value to pay back the company's creditors and provide a return on equity that justifies the high costs and risks of an acquisition.").

[318] *See Trial Op.*, 2022 WL 1237185, at *45 nn.524–26. For example, the Vice Chancellor pointed to Serra testifying "that the cumulative amount of cash flow would be $2.2 billion value today" and to Gracias testifying that it was "a very good deal for us, to pay 2-, $2-1/2 billion for a business that, on its face, was going to cash flow to us 3 billion off of leases alone." *Id.* at n.524 (internal quotation marks and citations omitted).

Van Zijl also testified that the cash flow stream "would probably be upwards of 3 billion" and was not encumbered but rather available for monetization. *Id.* (internal citation omitted).

[319] *Trial Op.*, 2022 WL 1237185, at *10 n.136 (internal citation omitted).

[320] *Id.*

[321] *Id.* at *17. Appellants argue that Bank of America — SolarCity's largest lender — repeatedly downgraded SolarCity's credit rating. Although that is true, those downgrades did not stop Bank of America from lending to SolarCity. In fact, the opposite occurred. As the trial court found, "[a]fter SolarCity's credit rating was downgraded, Bank of America (SolarCity's principal lender) reacted by *not only continuing to transact business with SolarCity but seeking to deepen the lender/borrower relationship*." *Id.* at *43 (emphasis added).

consideration of SolarCity's cash flows as supporting a finding of fair price.[322]

c. The Trial Court's Synergy Findings Support Fair Price

Appellants contend that the trial court erred in relying on synergies as evidence of the fairness of the price. They argue that finding the Acquisition to be synergistic does not make the transaction entirely fair. But synergistic values are a relevant input for a court to consider in assessing the entire fairness of an acquisition. Potential synergies are often a prime motivator for an acquiring company.[323] That was the case here.[324] Following the trial, the Vice Chancellor found that "synergies were a focus of the Tesla Board from the very beginning of its consideration, and there is evidence to support them. At trial, numerous directors testified they were laser-focused on the potential synergies throughout

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[322] The Vice Chancellor found that at "[t]he moment Tesla acquired SolarCity, it became the beneficiary of these cash flows. In fact, Tesla has already realized approximately $1 billion in nominal cash flows and expects to realize at least $2 billion more from the legacy SolarCity systems." *Id.* at *45.

[323] The same is true here: "the Tesla Board recognized the significant potential product synergies" at the first board meeting — on February 29, 2016 — where the possibility of a deal between Tesla and SolarCity was first raised. *Id.* at *12.

[324] The Definitive Proxy listed numerous reasons why Tesla believed the Acquisition was in the best interest of the company and its stockholders, with a focus on synergies. Among them: "its belief that the Combined Company will operate more efficiently to create fully integrated residential, commercial and grid-scale products[,] its expectation of substantial cost synergies[,] its expectation of substantial revenue synergies[, and] its belief that a combination of Tesla's and SolarCity's business could eliminate certain of the costs and complexities currently associated with transactions between Tesla and SolarCity[.]" AR513 (Definitive Proxy at 71).

In fact, the Definitive Proxy's first page specified the "strategic rationale" behind the Acquisition, informing stockholders that "Tesla and SolarCity believe that this is an opportune time to combine in order to operate more efficiently and fully integrate our products" and that "[t]he Combined Company is expected to achieve approximately $150 million in cost synergies in the first full year after closing[.]" AR443 (Definitive Proxy at 1).

the deal negotiations."[325] Fischel testified that "standalone value is relevant, but synergies are also relevant [] in light of Tesla's objective of becoming an integrated, sustainable energy company[.]"[326]

We conclude that the Vice Chancellor properly found that the synergistic value in Tesla acquiring SolarCity could be "considered in assessing the value" of the Acquisition.[327] The trial court credited Fischel's testimony that the relevant economic question is the value of the purchased assets to Tesla, and that synergies were a strong rationale for the Acquisition and, thus, were properly considered in assessing the value of SolarCity to Tesla. We find no error in his determination, which is supported by the record evidence.[328]

Appellants also challenge the magnitude of the synergies, contending that the trial court further erred by crediting all potential cost, revenue, and global strategic synergies

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[325] *Trial Op.*, 2022 WL 1237185, at *46. For example, Denholm testified:

> I believed that it was in the best interests of Tesla shareholders to actually continue the mission of Tesla, which was to accelerate the world towards sustainable energy. And the best way to do that was to have the solar generation capability within the four walls of Tesla so that we could continue in terms of the technology journey that it would take to satisfy the mission, and I believed that it was in the best interests of all Tesla's shareholders.

Id. at *46 n.539. Buss testified that Tesla got "this really good asset that was part of our long-term vision really at a great price[.]" *Id.* (internal quotation marks omitted). And Ehrenpreis testified that, following the Acquisition, Tesla became "a fully integrated, sustainable energy company and really the only one of its kind[.]" *Id.*

[326] A1833 (Fischel Trial Test. at 2484:4–7).

[327] *Trial Op.*, 2022 WL 1237185, at *46.

[328] "It is the expectation of such synergies [*i.e.*, those to be created by the changes that the bidder contemplates] that allows a rational bidder to pay a premium when he negotiates an acquisition." *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1134, 1143 (Del. Ch. 1994) ("*Cinerama I*"), *aff'd*, *Cinerama II*, 663 A.2d 1156.

Tesla might eventually realize as elements of SolarCity's value. According to Appellants, these were "speculative synergies" that should not have factored into the fair price analysis. The trial court recognized that it should consider only cognizable synergies, not speculative synergies.[329] Fischel testified at trial that he pressure-checked Tesla's projection of $150 million in cost synergies per year.[330] These included "cost synergies that are described as various ways of reducing costs, including reducing headcount."[331] The Court of Chancery also noted that the synergies stemming from the Acquisition were known to Tesla stockholders:

> [P]rior to the close of the Acquisition, Tesla identified and disclosed to stockholders three categories of synergies that it expected to realize: (1) cost synergies (from "[s]ales and marketing efficiencies" and "corporate and overhead savings"); (2) revenue synergies (from leveraging Tesla's retail capabilities and the companies' overlapping customer bases); and (3) global strategic synergies (by creating the "world's only integrated sustainable energy company").[332]

Here, the potential synergies were estimated to be "at least $150 million per year," which the trial court found supported a finding of fair price.[333] The record supports these conclusions.

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[329] *See Trial Op.*, 2022 WL 1237185, at *46.

[330] *See* A1846–47 (Fischel Trial Test. at 2539:12–2540:5). Evercore confirmed that $150 million in synergies was reasonable. *See Trial Op.*, 2022 WL 1237185, at *47 n.542.

[331] A1847 (Fischel Trial Test. at 2542:4–6).

[332] *Trial Op.*, 2022 WL 1237185, at *46 (internal citation omitted).

[333] *Id.* at *47.

d. The Trial Court Properly Accorded Some Weight to the Stockholder Vote

Appellants also contend that the Court of Chancery erred when it accorded weight to the stockholder vote on the Acquisition. They claim that "[a] coerced, uninformed vote by stockholders with conflicting equity interests is not even sufficient to change the standard of review, much less to prove fair price."[334] Musk responds that the court was free to consider the stockholder vote in evaluating the actual merits of these claims at trial and that the amount of weight accorded "is a classic example of trial court discretion[.]"[335] We agree.

In *Weinberger*, this Court expressly stated that the entire fairness standard "embraces questions [like] how the approvals of the directors *and the stockholders were obtained*."[336] And in *Cinerama II*, we found that "an overwhelming majority of" stockholders voting in favor of a transaction "constituted substantial evidence of fairness."[337] For the reasons we explained in Section IV.A.2. above, the trial court's finding — that the stockholder vote, wherein roughly 85% of Tesla stockholders approved the Acquisition, weighed in favor of fairness — was not erroneous.[338]

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334 Opening Br. at 55.

335 Answering Br. at 56.

336 457 A.2d at 711 (emphasis added). *See also Bomarko, Inc. v. Int'l Telecharge, Inc.*, 794 A.2d 1161, 1182 (Del. Ch. 1999), *aff'd*, 766 A.2d 437 (Del. 2000).

337 663 A.2d at 1176. The Court of Chancery has also held that stockholder approval is an indicium of fairness. *See, e.g., ACP Master*, 2017 WL 3421142, at *29 ("[A]pproval of the merger at $5.00 per share by a supermajority of Clearwire's minority stockholders is compelling evidence that the price was fair.").

338 As we noted there, the Vice Chancellor gave the stockholder vote less weight than he otherwise may have due to Appellants' disclosure contentions and the crossholdings point. *See also Trial*

e. Some, but not all, Market Evidence Supports Fair Price

As evident from the preceding discussion, and from the trial court's direct statement that Evercore's fairness opinion was "one of many pieces of evidence" that justified the price, only part of Musk's evidence on fair price focused on market evidence. And even within the trial court's discussion on market evidence, the June 21 stock price was not the sole aspect considered — it was one of three aspects of market evidence. The other two included the fact that the market for SolarCity was efficient (which neither side disputed)[339] and that the stockholders overwhelmingly voted for the Acquisition.[340] Our review of the record reveals no error by the Vice Chancellor in his consideration of these aspects of Musk's market evidence as supporting a finding of fair price.

As for the efficiency of the market, experts for both Appellants and Musk testified that SolarCity traded in an efficient market, leading the Vice Chancellor to conclude the

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Op., 2022 WL 1237185, at *36 n.430. We also note that the stockholder vote is but one component of the trial court's fair price analysis. *See id.* at *44–45.

339 Fischel testified, for example, that throughout 2016, Tesla's stock price reflected all publicly available information and would react quickly and without bias to all newly disclosed, value-relevant information. *See* A1866 (Fischel Trial Test. at 2618:13–19). He observed that "[t]hat's the general definition of 'semi-strong efficient markets.'" *Id.* (Fischel Trial Test. at 2618:22–23).

340 *See Trial Op.*, 2022 WL 1237185, at *42–45. Fischel explained at trial how he concluded that both SolarCity and Tesla stock traded in an efficient market:

> [T]hey're both actively traded on NASDAQ. They're actively followed by analysts. Prices reacted quickly to information. Basically, all the traditional indicia of trading in an efficient market really was satisfied by the stocks of both companies.

A1834 (Fischel Trial Test. at 2490:1–6). He observed that there was "[m]assive scrutiny" of SolarCity's economic position by analysts and "voluminous discussion of SolarCity's liquidity position" in the market commentary. A1834–35 (Fischel Trial Test. at 2490:10; 2494:9–10).

same.[341] The trial court found, for example, "that SolarCity accurately disclosed the existence and terms of its debt covenants, that its covenant compliance margins decreased in Q1 and Q2 of 2016, the potential consequences of a breach, its quarterly cash balances and its debt maturities."[342] It found that Appellants' experts "conceded that market participants were aware of the risk that SolarCity might breach its Liquidity Covenant."[343] Further, "[t]he unrebutted trial evidence establishe[d] that SolarCity appropriately and timely disclosed guidance reductions consistent with its internal projections."[344] Finally, as we held above, given the credible evidence presented at trial, SolarCity's failure to disclose information related to its credit downgrades was immaterial. The record supports these conclusions.[345]

As for the second piece of Musk's market evidence, the Vice Chancellor found the stockholder vote to be credible evidence of fairness.[346] As to the court's consideration of

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[341] *See Trial Op.*, 2022 WL 1237185, at *42. Trading in an efficient market means that the market quickly assimilates all publicly available information into a company's stock price. *See Fir Tree Value Master Fund, LP v. Jarden Corp.*, 236 A.3d 313, 326 (Del. 2020); *see also Dell*, 177 A.3d at 16 (observing that the efficient market hypothesis teaches that the price of a company's stock reflects all publicly available information).

Evidence of a stock's trading price in "an efficient market is generally a more reliable assessment of fair value than the view of a single analyst, especially an expert witness who caters her valuation to the litigation imperatives of a well-heeled client." *Id.* at 24.

Conversely, "reliance on a price determined in a thinly traded, illiquid, market is evidence of a price's unfairness." *Gesoff*, 902 A.2d at 1154.

[342] *Trial Op.*, 2022 WL 1237185, at *42.

[343] *Id.*

[344] *Id.*

[345] McBean, in addition to Fischel, testified that, as of the time of the stockholder vote, the market knew about SolarCity's liquidity situation. *See* A1732 (McBean Trial Test. at 1626:17–20).

[346] *See also supra* Section IV.A.2 (discussing how the stockholder vote indicates fair dealing).

this market-based evidence, we find no error. Market evidence, in fact, is one of the explicit factors we first listed in *Weinberger* for determining if a price paid was fair: the price "aspect of fairness relates to the economic and financial considerations of the proposed merger, including all relevant factors [including] *market value*[.]"[347]

3. The Trial Court Erred in its Analysis of the June 21 Stock Price

Lastly, we turn to the third aspect of market evidence and to Appellants' argument that "the trial court erred by rote reliance on market price."[348] They contend that affirmance by this Court would reduce the entire fairness analysis to the single question of whether the purchase price is sufficiently near the unaffected stock price.[349] Appellants argue that "[t]he trial court did not determine SolarCity's value *on November 21, 2016*, as it was required to do, because it based its fair price holding on what it claimed was 'market evidence,' specifically SolarCity's June 21, 2016 stock price."[350] They say that the Vice Chancellor looked to the trading price of $21.19 per share for SolarCity's stock on June 21, the day Tesla announced the Acquisition and then compared that trading price to the ultimate exchange ratio for the Acquisition, which implied a $20.35 per share price. This, they argue, led the court to conclude erroneously that this was "a discount of 84 cents per

[347] 457 A.2d at 711 (emphasis added).

[348] Opening Br. at ii, 45.

[349] The *amici* similarly urge that "[i]f a conflicted party can rely on little more than the pre-announcement transaction price to demonstrate the fairness in question, the party has little to gain from submitting to the procedural protections in *MFW*." Amicus Br. at 21. *See also id.* at 4 ("The Court of Chancery's approach, thus, threatens to fatally undermine *MFW* by substantially negating the incentives *MFW* promotes.").

[350] Opening Br. at 48 (emphasis in original).

share" and that "Tesla paid no premium for SolarCity as of closing."[351]

In arguing that the June 21 stock price could not be trusted as a proxy for value, they point to certain pieces of information regarding SolarCity that were not known to the market as of June 21 but became known later during the summer and fall. The information they point to consists of two items, namely, SolarCity's liquidity problems and SolarCity's credit downgrades. As the trial court noted, neither was known to the Tesla Board when the Acquisition was first announced in June. The Tesla Board only learned of SolarCity's liquidity problems on July 19, when Evercore presented on SolarCity's direct liquidity situation and explained that SolarCity could trip its Liquidity Covenant by July 30, 2016. The Vice Chancellor credited the "new developments and concerns" uncovered by Evercore during the summer of 2016, which the court found were "used to lower the price substantially[.]"[352] Further, Evercore acknowledged that SolarCity's stock did not reflect non-public information Evercore discovered in due diligence.[353] The Vice Chancellor also found that SolarCity failed to disclose information related to its credit downgrades during negotiations.[354] This information, according to Appellants, was not factored into the stock

[351] *Id.* at 48–49 (quoting *Trial Op.*, 2022 WL 1237185, at *43).

[352] *Trial Op.*, 2022 WL 1237185, at *37 (internal citation omitted).

[353] At trial, Evercore's McBean testified: "The market had certain information. We had additional information, having done nonpublic diligence. So the market had some information about the liquidity situation of SolarCity, but not complete information." A1704 (McBean Trial Test. at 1515:8–12). She further testified that there would typically be a decrease in stock price for SolarCity if the public knew that the company would trip its Liquidity Covenant. *See* A1714 (McBean Trial Test. at 1553:24–1554:1).

[354] *Trial Op.*, 2022 WL 1237185, at *43 (holding that the failure to disclose this information, however, was immaterial).

price relied upon by the Vice Chancellor. We focus mainly on the "liquidity information" issue, as we have already found no error in the trial court's determination that the credit downgrades were immaterial.

Appellants' criticism of the court's reliance on the June 21 stock price has some merit for two reasons. First, the trial court never explained why it was reasonable to rely on the June 21 stock price in the face of the nonpublic information it identified as not being available in June.[355] This is an error in its analysis. Second, the court did not explain, at least in a general sense, the weight it gave to the June 21 stock price.

As to the weighting issue, in *DFC*, in the appraisal context, we emphasized that the Court of Chancery should explain its weighing of indications of value in a manner that is grounded in the record.[356] We acknowledge that specific weighting of valuation methodologies takes on more significance in the appraisal context, where the court is

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[355] We note, however, that the Vice Chancellor did provide a reason for why he specifically selected June 21. After looking at the evidence, including various analyst reports and testimony by Fischel and McBean, which set the unaffected trading price date as June 21, 2016, the Vice Chancellor noted that he was "likewise persuaded that the June date is the appropriate date upon which to set SolarCity's unaffected stock price." *Id.* at *43 n.504.

[356] *See DFC*, 172 A.3d at 388. In *DFC*, this Court stated that:

> [T]he Court of Chancery must exercise its considerable discretion while also explaining, with reference to the economic facts before it and corporate finance principles, why it is according a certain weight to a certain indicator of value. In some cases, it may be that a single valuation metric is the most reliable evidence of fair value and that giving weight to another factor will do nothing but distort that best estimate . . . . What is necessary in any particular case though is for the Court of Chancery to explain its weighting in a manner that is grounded in the record before it.

Id.

required to derive a single numerical estimate of fair value.[357] In entire fairness cases, the court's analysis — although no less rigorous — is less aimed at deriving a specific fair value amount than at a range of values, where the price is deemed to be fair. "A court could conclude that a price fell within a range of fairness and would not support fiduciary liability, yet still find that the point calculation demanded by the appraisal statute yields an award in excess of the merger price."[358] As we said in *Cinerama II*, "[t]he standard of entire fairness is also not in the nature of a litmus that 'lend[s] itself to bright line precision or rigid doctrine.'"[359] "Rather, it is a standard by which the Court of Chancery must carefully analyze the factual circumstances, apply a disciplined balancing test to its findings, and articulate the bases upon which it decides the ultimate question of entire fairness."[360]

Notwithstanding that the analysis, as well as the court's function, in appraisal cases is different,[361] it is helpful to the reviewing court for the trial court to provide a general sense of how it weighed the valuation methodologies and fair price evidence. In the absence of this information, Appellants speculate that the trial court solely relied on the June 21 stock price. Although this argument is refuted, in our view, by the opinion itself, the litigants and our Court would have been greatly aided by a more fulsome discussion of

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[357] Pursuant to 8 *Del. C.* § 262, the Court of Chancery assesses the company's fair value as of "the effective date of the merger[.]" 8 *Del. C.* § 262(h).

[358] *In re Trados*, 73 A.3d at 78.

[359] 663 A.2d at 1179 (quoting *Nixon*, 626 A.2d at 1381).

[360] *Id.* at 1179.

[361] *See infra* note 257.

how the trial court weighed the valuation evidence.

Although this is a buy-side alleged overpayment case and not an appraisal case, *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*,[362] a statutory appraisal case, highlights the other problematic aspect of reliance on the June 21 price, namely the fact that it did not take account of the depth of the liquidity issues.[363] The trial court in *Aruba* had looked to market price as a measure of the fair value of the corporation, but it relied upon an outdated, unaffected market price that did not factor in certain material, nonpublic information. There, Hewlett-Packard Company ("HP") approached Aruba Networks, Inc. ("Aruba") about a possible combination. Negotiations between the two ensued and, eventually, HP submitted a bid, which Aruba accepted. The problem, however, was that HP knew about Aruba's strong quarterly results long before those results were disclosed to the market. But the *Aruba* trial court failed to factor that into its analysis of Aruba's fair value, instead holding that Aruba's thirty-day unaffected market price represented Aruba's fair value.

We reversed and explained that our decisions in *Dell* and *DFC* did not "compel" any reliance on market price as the sole indicator of fair value. The issue in *Aruba* was that HP had access to nonpublic information that the market did not factor in, thus giving HP an advantage. As we explained:

> Under the semi-strong form of the efficient capital markets hypothesis, the unaffected market price is *not assumed to factor in nonpublic information*. In this case, however, HP had signed a confidentiality agreement, done

[362] 210 A.3d 128 (Del. 2019).

[363] Musk does not cite *Aruba* in his papers before this Court.

> exclusive due diligence, *gotten access to material nonpublic* information, and had a much sharper incentive to engage in price discovery than an ordinary trader because it was seeking to acquire all shares.[364]

We reversed because the Court of Chancery in *Aruba* placed sole reliance on the unaffected market price, but that "unaffected market price was a measurement *from three to four months prior to the valuation date*, a time period during which it is possible for new, material information relevant to a company's future earnings to emerge."[365]

Our discussion in *Aruba* should have cautioned against reliance on a stock price that did not account for material, nonpublic information, especially where the trial court has expressly found that certain information had not been factored into that stock price. Although *Aruba* reveals the flaw in that aspect of the trial court's analysis, it does not undermine the trial court's overall fair price finding for several reasons.

First, the other evidence — which the trial court found to be credible and persuasive — amply supports the court's finding that the price was fair. Musk presented an array of valuation and fair price evidence, and the trial court found that he "presented the most persuasive evidence regarding SolarCity's value and the fairness of the price Tesla paid to acquire it[,]"[366] including Evercore's fairness opinion and its supporting analyses. As the trial court stated, "Evercore's fairness opinion is just one of the many pieces of evidence that justify the price paid in the Acquisition."[367] And as the court found, "there [was] no

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[364] *Aruba*, 210 A.3d at 140 (emphases added).

[365] *Id.* at 139 (emphasis added). We observed, for example, that HP had material, nonpublic information that "could not have been baked into the public trading price." *Id.* at 139.

[366] *Trial Op.*, 2022 WL 1237185, at *40.

[367] *Id.* at *21 n.276.

reason to doubt Evercore in this case."[368] Although Appellants argue that Fischel was Musk's lead financial expert and that Musk, on appeal, is "switching horses" by relying more on Evercore, the Vice Chancellor carefully evaluated all of the evidence and accepted some of it, and rejected other aspects of it. There can be no doubt that Evercore, as Tesla's financial advisor for the Acquisition, played a key role in both the overall Acquisition process and at trial.

"When faced with differing methodologies or opinions the [trial] court is entitled to draw its own conclusions from the evidence."[369] Further, "[s]o long as the court's ultimate determination of value is based on the application of recognized valuation standards, its acceptance of one expert's opinion, to the exclusion of another, will not be disturbed."[370] Here, the court relied on Evercore's fairness opinion analyses and portions of Fischel's analyses, and rejected Quintero's analysis altogether. It expressly rejected the claim that Evercore's opinion "was unreliable"[371] and found that "the Acquisition price fell within or below each of the seven stock price ranges Evercore presented to the Tesla Board (plus two illustrative reference ranges)."[372]

In addition to Evercore's DCF and SOTP analyses, which are based upon recognized valuation standards, SolarCity's current and future cash flows, the substantial

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[368] *Id.* at *46.

[369] *Lynch II*, 669 A.2d at 87.

[370] *Id.* at 87–88.

[371] *Trial Op.*, 2022 WL 1237185, at *21 n.276 (internal quotation marks and citation omitted).

[372] *Id.* at *21.

synergies flowing to Tesla from the Acquisition, the other aspects of market evidence, including the stockholder vote, and the evidence of SolarCity's solvency, including the KPMG analysis and related retained value analyses, also support the trial court's finding of fair price.[373]

And with the rejection of Appellants' lone insolvency valuation theory, there was no credible countervailing evidence.[374] The Court of Chancery, after examining all of the expert testimony and fair price evidence, found that the fair price case was not even close.[375] Thus, even without the June 21 price, there is ample support in the record to support the fairness of the price.

VI. UNITARY FAIRNESS ANALYSIS

Finally, having gone through the fair dealing and fair price analyses of the entire fairness test, we address whether, under the unitary application of the test, Musk proved entire fairness. In *Weinberger*, this Court stated that "the test for fairness is not a bifurcated one as between fair dealing and price. All aspects of the issue must be examined as a whole since the question is one of entire fairness."[376] Since then, we have recognized that the

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[373] *See id.* at *40.

[374] *See supra* Section V.B.1. *See also infra* note 293.

[375] *See Trial Op.*, 2022 WL 1237185, at *48 ("I have no credible basis in the evidence to conclude that a 'fairer price' was available, and therefore, no basis to conclude that the price paid was not entirely fair. Indeed, the price was, in my view, not 'near the low end of a range of fairness,' but '*entirely*' fair in the truest sense of the word.") (emphasis in original) (internal citations omitted).

[376] 457 A.2d at 711. *See also Lynch II*, 669 A.2d at 84 ("An important teaching of *Weinberger*, however, is that the test is not bifurcated or compartmentalized but one requiring an examination of all aspects of the transaction to gain a sense of whether the deal in its entirety is fair."); *Encite LLC v. Soni*, 2011 WL 5920896, at *20 (Del. Ch. Nov. 28, 2011) ("Although fair dealing and fair

entire fairness test is a "unitary standard."[377] The Court of Chancery has succinctly summarized why the unitary determination of the test is so important: "[a] strong record of fair dealing can influence the fair price inquiry, *reinforcing the unitary nature of the entire fairness test*. The converse is equally true: process can infect price."[378]

Although the Vice Chancellor concluded that the Acquisition, on a unitary basis, was entirely fair, he did not set forth that analysis in a separate section. We are, nevertheless, satisfied that the court evaluated the effect the process flaws had on the overall fairness of the process and the Acquisition. For example, the court concluded that:

> With the Tesla Board's deal process front of mind, and after careful consideration, for the reasons just explained, [Musk's] compelling "evidence on price fairness was ultimately persuasive," such that I can conclude the Acquisition was entirely fair.[379]

Although some of this analysis is in lengthy footnotes — like the one quoted above — it is there. For example, the Court of Chancery recognized that "[i]n instances where there are process infirmities, the Court is obliged to study fair price even more carefully."[380] At the beginning of his analysis, the Vice Chancellor stated:

> I explain my finding that [Musk] has proven the Acquisition was entirely fair and, therefore, he did not breach his fiduciary duties. The evidence adduced at trial proved the Acquisition process, like most worldly things, had both flaws and redeeming qualities. The linchpin of this case, though, is that

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price concern separate lines of inquiry, the determination of entire fairness is not a bifurcated analysis.").

[377] *Tremont*, 694 A.2d at 432. *See also Basho Techs.*, 2018 WL 3326693, at *40 (addressing the unitary determination of fairness); *In re Dole Food*, 2015 WL 5052214, at *37–38 (same); *In re Trados*, 73 A.3d at 76 (same).

[378] *Reis*, 28 A.3d at 467 (emphasis added).

[379] *Trial Op.*, 2022 WL 1237185, at *48 n.555 (quoting *In re Trados*, 73 A.3d at 66).

[380] *Id.* at *48.

> [Musk] proved that the price Tesla paid for SolarCity was fair—and a patently fair price ultimately carries the day.[381]

There can be no dispute that the trial court weighed both fair dealing and fair price and found that Musk proved his case. The record demonstrates that the negotiations were conducted at arm's-length, in good faith, with the advice of independent financial and legal advisors, led by an indisputably independent director, and, thus, constituted a fair process that led to a fair price.[382] But the trial court's opinion could have been aided by separately and expressly setting forth its process and price conclusions and by identifying its unitary determination of entire fairness in a separate section at the end.

In sum, although, as we have highlighted, there was an error in the trial court's fair price analysis, and we have suggested how the presentation of its findings could have been more helpful, there is no reversible error.[383] We are convinced that the record supports the conclusion that the Acquisition was entirely fair. The trial court's opinion is replete with factual findings and credibility determinations, and those determinations have not been challenged and decidedly weigh in favor of Musk. Neither the Vice Chancellor nor this Court applauds the process here as pitch perfect. But it does not have to be. The question

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[381] *Id.* at *27.

[382] *See Cinerama I*, 663 A.2d at 1144 (despite a flawed process, the transaction was fair where "the board was insufficiently informed to make a judgment worthy of presumptive deference, nevertheless considering the whole course of events, including the process that was followed, the price that was achieved and the honest motivation of the board to achieve the most financially beneficial transaction available").

[383] *See Cinerama II*, 663 A.2d at 1179 ("A finding of perfection is not a *sine qua non* in an entire fairness analysis" because "perfection is not possible, or expected as a condition precedent to a judicial determination of entire fairness.") (internal quotation marks and citation omitted).

is whether the Acquisition was entirely fair. We agree with the Vice Chancellor that it was.

VII. CONCLUSION

For the reasons set forth above, we AFFIRM the Court of Chancery's opinion.