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# The "Spy" Problem in the Proposed Amendments to Delaware's Corporate Law

By Carl L. Stine[1]

Delaware corporate law has long been recognized as the gold standard in the United States for balancing the interests of public shareholders with the interests of controlling shareholders. However, a new proposed amendment to Delaware corporate law threatens to erode this balance by allowing a special committee negotiating a cash-out merger with a controlling shareholder to include interested, non-independent directors, as long as they do not constitute a majority of the directors on the committee. This proposal is deeply flawed and dangerous because it would undermine the integrity of special committees, create more opportunities for conflicts of interest, and threaten to compromise the fairness of the negotiation process. Most alarmingly, it would potentially permit a "spy" for the controlling shareholder to sit in on negotiations, gaining access to confidential strategic discussions and placing minority shareholders at a severe disadvantage.

## The Proposed Law: Senate Bill 21 (SB 21)

The proposed amendment, Senate Bill 21 (SB 21), among other things, seeks to modify the requirements for special committees in transactions involving controlling shareholders. Specifically, the bill would permit special committees to include directors who are not entirely independent, as long as they do not constitute a majority. According to the proposed legislation, a special committee may include one or more directors who are not disinterested or independent with respect to the matter presented to the committee. The proposal provides a safe harbor for the potential transaction, which includes, among other thing, approval or recommendation by a special committee, "provided that the committee does not include the controlling stockholder and that a majority of the members of the committee approving such controlling stockholder transaction are disinterested directors."

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This proposal is a change from recent Delaware case law requiring a special committee in this context be made up entirely of disinterested directors. The proposed change has sparked significant debate among legal experts and corporate governance advocates. Critics argue that permitting interested directors to serve on special committees, even as a minority, could strongly undermine the committees' independence and effectiveness.

## The Purpose of Special Committees and the Threat of Interested Directors

Special committees in cash-out mergers serve a critical function: they provide a layer of independent review to protect minority shareholders from self-dealing and coercion by controlling shareholders. These committees are supposed to be composed of independent directors who negotiate at arm's length with the controller to ensure that the transaction is fair. Under the existing Delaware legal framework, such independence is key to ensuring that the controlling shareholder does not abuse its position to secure a purchase price that is unfairly low for minority shareholders, and is part of a process (with a majority-of-the minority provision) that would supposedly replicate an arm's-length transaction.

By allowing interested directors to sit on special committees, even as a minority, the proposed law fundamentally compromises this system. The presence of directors who have ties to the controller creates an inherent tension and introduces the risk that their loyalties will lie with the controller-counterparty rather than with the independent shareholders they are supposed to protect. This weakens the credibility and effectiveness of special committees, compromises even independent directors' willingness to speak candidly, and erodes investor confidence in Delaware corporations.

## The "Spy" Problem: Undermining Effective Negotiations

One of the most egregious consequences of this proposed change is that it would allow a potential "spy" for the controlling shareholder to participate in critical negotiations. Unlike committees that are tasked with voting up or down on derivative demands, special committees negotiating a buyout with the company's controlling shareholder engage in strategic discussions about valuation, alternative transaction structures, and negotiation tactics—all with the goal of maximizing the merger consideration for the minority shareholders. If an interested director with ties to the controlling shareholder is present, that person can potentially relay confidential insights about the committee's strategy to the very counterparty the committee is negotiating against.

The mere possibility that an interested director could serve as a conduit for information to the controller would chill the effectiveness of special committees. Independent directors would logically be less candid in internal deliberations for fear that their negotiating positions could be exposed. This dynamic creates a lopsided process in which the controller has a significant advantage, potentially gaining information about the committee's weaknesses, pressure points, or even their ultimate bottom line. As a result, minority shareholders would be left vulnerable to fear and uncertainty (which a sophisticated dominating shareholder could easily exploit), coercion, and unfair pricing. Permitting this certainly would certainly not replicate an arm's-length transaction where the counterparty is a stranger or competitor.

## The Erosion of Investor Confidence

Delaware's reputation as the premier jurisdiction for corporate law rests on its ability to maintain a fair and predictable legal framework that protects all corporate constituencies, both on the investor and management side. Litigants appearing before the Court of Chancery know that the court, as a court of equity, possesses the flexibility to craft an appropriate and fair remedy based on all relevant facts and applicable precedent. If SB 21 is enacted, it would send a troubling signal to investors that Delaware is prioritizing the interests of controlling shareholders and management over public investors. This perception could conceivably drive some institutional and activist investors to seek to invest in companies incorporated in jurisdictions with stronger protections for the public, potentially weakening Delaware's dominance as the "First State" for business disputes.

Corporate governance watchdogs have already warned that SB 21 is a step backwards. A robust, fully independent special committee process is one of the most effective safeguards against overreach from controllers, and any dilution of this safeguard threatens to undermine trust in Delaware-incorporated entities.

## Conclusion

The proposed amendment to the DCGL permitting interested directors to serve on special committees, would allow controllers to gain undue leverage in negotiations and could severely compromise the fairness of the controller buyout process. Most dangerously, it would enable a spy for the controller to participate in confidential discussions, undermining the very purpose of special committees. If Delaware wishes to maintain its status as the preeminent corporate governance jurisdiction, it must reject this proposal.


Carl Stine
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## About the Author

**Carl Stine, Partner**

Carl L. Stine is a graduate of Fordham University School of Law (J.D., 1989) where he was the Editor in Chief of the Fordham International Law Journal. After law school, Carl was a litigation associate in the New York office of Willkie Farr & Gallagher. Carl has been recognized by Super Lawyers as one of the Top 100 lawyers in the New York metropolitan area from 2014 through 2020, and for 2022 through 2024.

Since joining Wolf Popper in June of 1995, Carl has participated in the prosecution of merger and acquisition litigation challenging transactions involving, among others, MSG Networks, Inc., GGP, Inc., Lineage Cell Therapeutics, Inc., AmTrust Financial Services, Inc., Hansen Medical, Handy & Harman, Metrologic Instruments, Inc., Zale, Fusion-io, National Interstate, M&F Worldwide Corp., Venoco, Inc., EDAC Technologies Corp., KSW Inc., MModal, Inc., RAE Systems, Inc., eResearch Technology, Inc., Icagen, Inc., American Surgical Holdings, Inc., Wachovia Corporation, OpenTV Corp., Indevus Pharmaceuticals, Inc., The Topps Co., EDO Corp., James River Group, Inc., ftd.com, Genencor International, Inc., Uni-Marts, Inc., Nassda Corp., William Lyon Homes, and Net2Phone, Inc. Carl has also litigated securities class actions such as against AmTrust Financial Services, Inc., Seitel, Inc., Sunbeam Corp., Archer Daniels Midland Co., Caremark, Inc., and Leslie Fay Co., and consumer fraud class actions against, for example, Walgreen Co., Walmart Inc., GNC Holdings, Inc., Nutra Manufacturing LLC, International Vitamin Corp., Dr.'s Best, Inc., Express Scripts, Inc., H.I.P of Greater New York, Sprint PCS, Chase Manhattan Mortgage Corp., and NYNEX.

Carl is admitted to the New York State Bar, and the Bars of the United States District Courts for the Southern and Eastern Districts of New York, the Eastern District of Michigan, the District of Colorado, the Third Circuit Court of Appeals, and the Supreme Court of the United States.

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Wolf Popper's attorneys are experienced litigators, many of whom have prior experience at AmLaw 100 firms or in government agencies. Wolf Popper's reputation and expertise has been repeatedly recognized by courts, which have appointed Wolf Popper and its attorneys as lead counsel in complex litigations throughout the country. Over the past eighty years, Wolf Popper has recovered billions of dollars for its clients.

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