BRICKS FOR THE BUSINESS JUDGMENT CITADEL—RECENT DEVELOPMENTS IN DELAWARE CORPORATE LAW

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I. INTRODUCTION

The bedrock of corporate governance is the business judgment rule that protects the board of directors of a corporation in the good faith exercise of their duties and decision-making prerogatives.[1] During the last year the protection afforded by the business judgment rule was strengthened by several decisions of the Delaware Supreme Court. This article summarizes developments in Delaware corporate law since a previous article appeared on this subject in July of 1983.[2] Because pertinent Delaware cases during the past year are too numerous for an analysis of each decision, this article will discuss only the most noteworthy decisions. On a whole, these prominent decisions followed traditional legal doctrines and, as such, did not drastically alter Delaware corporate law.

II. THE BUSINESS JUDGMENT RULE IN THE SUPREME COURT

The leading decision in the Delaware courts in 1984 was *Aronson v. Lewis*.[3] In the context of deciding a motion to dismiss a stockholder's derivative suit based on the plaintiff's failure to make a demand on the board of directors, the court stated that the business judgment rule protected directors from liability for their decisions unless gross negligence could be shown.[4] The court appeared to excuse directors for their negligent actions if made in good faith and absent self-dealing. Referencing "a long line of Delaware cases," the court wrote that

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1. "That doctrine bars judicial inquiry into actions of corporate directors taken in good faith in the exercise of honest judgment in the lawful and legitimate furtherance of corporate purposes." Auerbach v. Bennet, 47 N.Y.2d 619, 625, 393 N.E.2d 994, 1000 (1974). *See also* Hanson, *The Business Judgment Rule and* Maldonado—*Another Perspective*, 6 CORP. L. REV. 131, 135-36 (1983).

2. Terrell & Nolen, *Recent Developments in Delaware Corporate Law*, 7 DEL. J. CORP. L. 407 (1983).

3. 473 A.2d 805 (Del. 1984).

4. *Id.* at 812.

"director liability is predicated on a standard which is less exacting than simple negligence."[5] Was the court condoning directors' careless or inattentive behavior? The answer lies in the facts of *Aronson v. Lewis* and in the context in which the issues posed in *Aronson* reached the Delaware Supreme Court.

The *Aronson* case caused the Delaware Supreme Court to focus on an issue left open in the court's earlier decision of *Zapata Corp. v. Maldonado*;[6] the question of when a stockholder's demand upon board of directors to redress a corporate wrong would be deemed excused as futile and unnecessary, so as to permit the stockholder to immediately file the derivative suit.[7] In *Aronson*, the stockholder Lewis alleged that it would have been futile for him to have demanded that the board of directors of Meyers' Parking System bring suit against one of the directors, Leo Fink, who owned forty-seven percent of Meyers' outstanding stock, for an alleged wasteful employment agreement, which included a bonus and liberal termination rights, a consulting agreement, and interest free loans.[8] Lewis alleged that this agreement led to transactions which served " 'no valid business purpose'" and were a " 'waste of corporate assets.' "[9] The defendants contended that the transactions were protected by the business judgment rule and that, in any event, plaintiff had failed to first demand that the board of directors of the corporation sue Fink to recover the alleged wasteful payments to him.[10] The vice-chancellor held that the plaintiff's allegations raised a "reasonable inference" that the business judgment rule would not be applicable.[11] Accordingly, the vice-chancellor denied defendants' motion to dismiss for failure to make a demand since he agreed with the plaintiff's position, i.e., that demand would have been futile under the facts alleged in Lewis' complaint. The vice-chancellor suggested that alleged self-dealing by the board and dominance of the board by Fink cast doubt upon the board's ability to exercise independent business judgment.[12] The supreme court granted an interlocutory appeal and reversed.[13]

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5. *Id.* at 812 n.6. *See also* Veasey & Manning, *Codified Standard—Safe Harbor or Unchartered Reef? An Analysis of the Model Act Standard of Care as Compared with Delaware Law*, 35 BUS. LAW. 919, 928 (1980).

6. 430 A.2d 779 (Del. 1981).

7. *Aronson*, 473 A.2d at 807.

8. *Id.* at 808-09.

9. *Id.* at 809.

10. *See* Lewis v. Aronson, 466 A.2d 375, 384 (Del. Ch. 1983), *rev'd*, 473 A.2d 305 (Del. 1984).

11. *Id.* at 381.

12. *Id.* at 386.

The reversal in *Aronson v. Lewis* turned upon the supreme court's analysis of whether the business judgment rule would be applicable to the charges contained in Lewis' allegations. The vice-chancellor had developed a "reasonable inference" standard, whereby a demand upon the board would be excused if it could be reasonably inferred from the allegations in the complaint that the directors were not independent, thereby making the business judgment rule inapplicable.[14] The supreme court characterized the possible ramifications of this standard as follows: "As is clear from this case, and the conclusory allegations upon which the Vice Chancellor relied, demand futility becomes virtually automatic under such a test,"[15] according to the court. In rejecting the vice-chancellor's test, the supreme court determined that the more appropriate test was "reasonable doubt:"[16]

> Our view is that in determining demand futility in the Court of Chancery in the proper exercise of its discretion must decide whether, under the particularized facts alleged, a reasonable doubt is created that: (1) the directors are disinterested and independent and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment.[17]

The court's reasonable doubt test would require the court of chancery to make a two-fold inquiry where an issue arises as to the alleged futility of a demand: first, whether the directors were independent and disinterested; and, second, if the board of directors were disinterested and independent, whether their decision would be protected by the business judgment rule. This two-step analysis is integrated into the fundamentals of the business judgment rule.[18]

The protections offered by the business judgment rule "can only be claimed by disinterested directors [who] can neither appear on both sides of a transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally."[19] The second element of the business judgment rule is that directors must

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13. *Id.* at 384.
14. *Aronson*, 473 A.2d at 814.
15. *Id.*
16. *Id.*
17. *Id.*
18. *See generally* Pease, Aronson v. Lewis: *When Demand is Excused and Delaware's Business Judgment Rule*, 9 DEL. J. CORP. L. 39 (1984).
19. *Aronson*, 473 A.2d at 812.

act knowledgeably.[20] On this point, the *Aronson* case poses a warning to directors. It held that the business judgment rule requires the directors "to inform themselves, prior to making a business decision, of all material information reasonably available to them. Having become so informed, they must then act with requisite care in the discharge of their duties."[21] Thus, the court in *Aronson* was not condoning careless or inattentive behavior by directors. The directors must act with care and seek to inform themselves on matters before them, due to the large corporate responsibilities they carry.

A fundamental precept of corporation law is that it is the prerogative of the board of directors to manage the corporation, while it is the right of the shareholders to seek redress for wrongs to the corporation.[22] Consequently the business judgment rule and the demand requirement for derivative litigation will tend to collide as they did in *Aronson v. Lewis*.[23] *Aronson v. Lewis* seems to strengthen the business judgment rule, by permitting disinterested directors to rely on their informed and good faith business judgment, unless their gross negligence is shown.[24] As a result, a stockholder filing a derivative suit which challenges corporate action is excused from initially making a demand on the board to institute the action only where the business judgment rule is not available to the directors, or at least where the court has reasonable doubt as to the applicability of the business judgment rule under the particular facts alleged in the complaint.

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20. *Id.*

21. *Id.*

22. *Id.* at 813 (citing *Zapata*, 430 A.2d at 784).

23. *Aronson*, 473 A.2d at 811-12.

> By its very nature the derivative action impinges on the managerial freedom of directors. Hence the demand requirement of Chancery Rule 23.1 exists at the threshold, first to insure that a stockholder exhausts his intracorporate remedies, and they do provide a safeguard against strike suits. Thus, by promoting this form of alternate dispute resolution, rather than immediate recourse to litigation, the demand requirement is a recognition of the fundamental precept that directors manage the business and affairs of corporations.

Id.

24. "While the Delaware cases use a variety of terms to describe the applicable standard of care, our analysis satisfies us that under the business judgment rule director liability is predicated upon concepts of gross negligence." *Id.* at 812 (footnote omitted). The court, in a footnote to this pronouncement, pointed to a long line of Delaware cases holding that director liability is "predicated on a standard which is less exacting than simple negligence," (citing, *inter alia*, Sinclair Oil Corp. v. Levien, 280 A.2d 717, 722 (Del. 1971), *rev'g* 261 A.2d 911 (1969) ("fraud or gross overreaching"); Getty Oil Co. v. Skelly Oil Co., 267 A.2d 883, 887 (Del. 1970), *rev'g* 255 A.2d 717 (Del. Ch. 1969) ("gross or palpable overreaching"); and Warshaw v. Calhoun, 221 A.2d 487, 492-93 (Del. 1966) ("bad faith . . . or a gross abuse of discretion). *Id.* at n.6.

Whether the facts alleged in *Aronson v. Lewis* created a reasonable doubt as to the applicability of the business judgment rule is open to debate. Lewis claimed that Fink dominated and controlled the board due to Fink's ownership of forty-seven percent of the stock and that he " 'personally selected' " each director.[25] Citing cases where ownership of less than a majority of stock was held to be insufficient proof of domination or control, the court stated that "in the demand context even proof of majority ownership of a company does not strip the directors of the presumption of independence, and that their acts have been taken in good faith and in the best interests of the corporation."[26] In requiring that the complaint plead facts that would demonstrate control,[27] the court held that it was not enough that directors were nominated or elected by the controlling stockholders.[28] Further, it was not enough that the entire board approved the transaction under challenge.[29] "In Delaware mere directorial approval of a transaction, absent particularized facts supporting a breach of fiduciary duty claim, or otherwise establishing the lack of independence or disinterestedness of a majority of the directors, is insufficient to excuse demand."[30] To contend that demand is excused where the directors would have to sue themselves is merely a "bootstrap argument."[31] According to the court:

> Its acceptance would effectively abrogate Rule 23.1 and weaken the managerial power of the directors. Unless facts are alleged with particularity to overcome the presumptions of independence and a proper exercise of business judgment, in which case the directors could not be expected to sue themselves, a bare claim of this sort raises no legally cognizable issue under Delaware corporate law.[32]

An important question in *Aronson* is whether Lewis could have plead more specifically to excuse the demand requirement under Rule 23.1 of the court of chancery. Since only Fink personally benefited from the transactions challenged in the suit, Lewis could not allege any specific acts of self-dealing by the other directors. Lewis simply

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25. *Aronson*, 473 A.2d at 815.
26. *Id.* (citing *Kaplan v. Centex Corp.*, 284 A.2d 119 (Del. Ch. 1971)).
27. *Aronson*, 473 A.2d at 815.
28. *Id.* at 816.
29. *Id.* at 817.
30. *Id.*
31. *Id.* at 818.
32. *Id.*

contended that the directors could not realistically be expected to sue the director who owned nearly half of the corporation's stock and who was the principal officer of the corporation, for accepting payment under agreements approved by the corporation's board of directors.[33] If the court agreed with Lewis, it would follow that the business judgment rule would have little meaning wherever a large stockholder played a prominent role in the corporation's affairs. Such a role for the business judgment rule was apparently not intended by the supreme court, as is evident from another recent decision.

Three months after deciding *Aronson v. Lewis*, the supreme court affirmed the court of chancery's dismissal of a stockholder's derivative suit where plaintiff failed to make a demand on the board of directors or to allege with particularity that demand was futile pursuant to Chancery Court Rule 23.1.[34] In *Pogostin v. Rice*, Pogostin charged the board of directors of City Investing Company with having wrongfully rejected a tender offer for its shares, resulting in an alleged loss by stockholders of the tender offer's substantial premium over market value. The court found that the vice-chancellor had properly applied the principles enunciated in *Aronson v. Lewis*.[35] In accord with its approach in *Aronson*, the court in *Pogostin* began by observing that the board of directors had managerial authority under Delaware law:

> The bedrock of the General Corporation Law of the State of Delaware is the rule that the business and affairs of a corporation are managed by and under the direction of its board. *See* 8 *Del. C.* § 141(a). It follows that the existence and exercise of this power carries with it certain fundamental fiduciary obligations to the corporation and its stockholders. *Aronson v. Lewis*, 473 A.2d at 811 [citing Loft, Inc. v. Guth, 2 A.2d 225 (Del. Ch. 1938), *aff'd*, 5 A.2d 503 (Del. 1939)] balanced against the managerial power of directors is the derivative action enabling shareholders to sue on behalf of the corporation where those in control of the enterprise refuse to assert a claim belong to it. . . .
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> However, because the derivative action impinges on the managerial freedom of directors, the law imposes cer-

33. *Id.* at 810 ("The Vice Chancellor then dealt with plaintiff's contention that Fink, as a 47% shareholder of Meyers, dominated and controlled each director, thereby making demand futile." *Id.*).

34. *Pogostin v. Rice*, 480 A.2d 619 (Del. 1984).

35. *Id.* at 622.

> tain prerequisites to the exercise of this remedy. . . .
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> The test for determining demand futility reflects the interrelationship of business judgment, director independence and interest. It requires a bifurcated factual analysis based upon a reasonable doubt standard. Under the demand futility test, the facts alleged in the complaint are examined to determine whether they create a reasonable doubt that: (1) the directors are disinterested and independent and (2) the challenged transaction otherwise was the product of a valid exercise of business judgment.[36]

The court next analyzed Pogostin's allegations under the *Aronson* standard. In addition to charging the board with wrongfully rejecting the tender offer, Pogostin also attacked excessive payments and issuance of stock options to four officer-directors under a compensation plan. The board of directors has broad authority under Delaware law to fix the remuneration of directors, to compensate its officers and agents, and to provide for stock options, incentive and other compensation plans. The board's authority to issue stock options and rights is absolute, absent actual fraud.[37] In *Pogostin* the compensation plans had been adopted by a majority of disinterested directors and ratified by stockholders. Applying these principles of law to Pogostin's allegations, the court felt that the business judgment rule was applicable and that demand was not excused.

The court stated that the business judgment rule, as discussed in *Aronson*, was "equally applicable" in the context of a takeover.[38] The following paragraph from the decision by Justice Moore, who was also the author of *Aronson v. Lewis*, will undoubtedly be cited by directors to defend their conduct in resisting a takeover.

> Thus, an informed decision to reject a takeover proposal, hostile or friendly, will not excuse demand absent particularized allegations of a breach of fiduciary duty, such as self-dealing, fraud, overreaching, or lack of good faith. Where, for example, allegations detail the manipulation of corporate machinery by directors for the sole or primary purpose of perpetuating themselves in office, the test of *Aronson* is met and demand is excused. . . .It is the plaintiff's burden

36. *Id.* at 624.

37. *Id.* at 625 (citing DEL. CODE ANN. tit. 8, §§141 (h), 122(5), 122(15), and 157 (1983); Michelson v. Duncan, 407 A.2d 211 (Del. 1979)).

38. *Pogostin*, 480 A.2d at 627.

> to allege with particularity that the improper motive in a given set of circumstances, i.e., perpetuation of self in office or otherwise in control, was the sole or primary purpose of the wrongdoer's conduct.[39]

Pogostin v. Rice is support for the action of the board of directors who in good faith resist a takeover.[40] The business judgment rule will hereafter be applied to directors of a target company who attempt to resist a tender offer, absent specific allegations demonstrating that perpetuation in office was their sole or primary motive. In *Pogostin* the plaintiff failed to demonstrate that there were divided loyalties or personal financial benefits for the directors which would remove the protection of the business judgment rule.[41] The plaintiff essentially failed to adequately particularize his allegations of a breach of fiduciary duty. Presumably, directors can reject even attractive tender offers, if they do so in good faith and if their sole primary purpose is not to perpetuate themselves in control.

In *Aronson* and *Pogostin* the court was emphatic that directors have a "duty" to make an "informed decision" in order to avail themselves of the business judgment rule.[42] While this is no change in Delaware law, the proposition that directors are obligated to make informed decisions has been reaffirmed by the court.[43] Other recent Delaware decisions evidence a trend to support a reasonable exercise of business judgment by directors.[44]

The broad discretion accorded the board of directors in determining whether to declare a dividend was upheld by the supreme court,

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39. *Id.* (citations omitted).

40. *Id.*

41. *Id.* at 626.

42. *Id. Aronson*, 473 A.2d at 812 ("[T]o invoke the rule's protection directors have a duty to inform themselves, prior to making a business decision, of all material information reasonably available to them. Having become so informed, they must then act with requisite care in the discharge of their duties.").

43. *See* Gimbel v. Signal Cos., 316 A.2d 599 (Del. Ch.), *aff'd*, 316 A.2d 619 (Del. 1974).

44. Subsequent to the supreme court's decision in *Aronson v. Lewis*, the court of chancery has rendered several decisions interpreting the "demand" requirement under rule 23.1: Lewis v. Daum, No. 6733 (Del. Ch. May 24, 1984) (demand not excused where plaintiff challenged a stock repurchase from a large shareholder); Good v. Texaco, Inc., No. 7501 (Del. Ch. May 14, 1984) (demand excused where the board of directors personally benefited from a stock repurchase); Kaufman v. Belmont, No. 5655 (Del. Ch. May 8, 1984) (demand not excused in a challenge to a board's decision to pay executives certain stock option benefits). Each of the chancery decisions inspected whether the complaint established a reasonable doubt that the directors were disinterested and that their conduct fell outside the protection of the business judgment rule.

which applied the business judgment rule in *Gabelli & Co. v. Liggett Group, Inc.*[45] In this class action a minority stockholder sought to compel the payment of a dividend on the theory that the majority stockholder breached its fiduciary duty to the minority stockholders. According to the plaintiff, the decision not to declare a dividend was made solely to enable the majority stockholder to obtain all the funds which had been available for the dividend, after a merger of the corporation with a wholly-owned subsidiary of the majority stockholder.[46] The court stated that:

> [i]t is settled law in this State that the declaration and payment of a dividend rests in the discretion of the corporation's board of directors in the exercise of its business judgment; that, before the courts will interfere with the business judgment of the board of directors in such matter, fraud or gross abuse of the discretion must be shown.[47]

Under this standard the plaintiff could not meet its burden of showing an abuse of discretion by the board as a result of the alleged domination and control by the majority stockholder. The court appears to apply the same burden on the plaintiff to plead domination with particularity as it had in *Aronson*.

III. THE BUSINESS JUDGMENT RULE IN THE COURT OF CHANCERY

The court of chancery's decisions in 1984 generally reinforce the broad deference accorded the actions of the board of directors in managing the corporation. In *Reading Co. v. Trailer Train Co.*,[48] the vice-chancellor denied a stockholder's application for injunctive relief when the board of directors of Trailer Train proposed to enter into a reorganization which involved its loaning over $50 million to its subsidiary. Reading claimed that the reorganization, with the loan obligation, was a waste of corporate assets. Relying on *Aronson v. Lewis*,[49] the court upheld the board of directors' business judgment in entering into the reorganization. The court found that the directors discharged their duty to inform themselves prior to making their business decision. The court's opinion is strong support for the business judgment rule:

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45. No. 114, 1983 (Del. May 29, 1984).
46. *Id.* at 5.
47. *Id.* at 8 (citation omitted).
48. No. 7422 (Del. Ch. Mar. 15, 1984).
49. 473 A.2d 805 (Del. 1984).

> The business judgment rule allows for the possibility that other people might disagree with a board's decision. Indeed it is acknowledged that a board's decision, otherwise properly based, could be wrong and still withstand attack. And this is as it should be. In the context of our corporate business world, courts should be loathe to interfere with the internal management of corporations or to interfere with their business decisions unless statutory or case law indicates they have overstepped their bounds. But the corporations should not be bounced back and forth, with every decision scrutinized, merely because somebody else has a different opinion. The stockholders have made their choice and they are entitled to that Board's unfettered lawful exercise of its management prerogatives.[50]

The power of the board to manage the corporation goes so far as to encompass the ability to take matters away from the stockholders. In *American International Rent A Car, Inc. v. Cross*,[51] the vice-chancellor denied a stockholder's application for a preliminary injunction to restrain the board of directors from issuing stock. The board had submitted to the stockholders a bylaw amendment to remove a limitation on the number of shares that could be issued. During the course of the meeting in which the stockholders were to vote, the board decided to adopt the bylaw without waiting for the shareholders to vote. The vice-chancellor concluded that the board retained the authority to amend the bylaw.[52] The court was not "persuaded that it is a *per se* breach of fiduciary duty for the Board to act in a manner which it may believe is contrary to the wishes of a majority of the company's stockholders."[53]

In the *American International* case, the plaintiff argued that the stockholders would have rejected the bylaw proposal that was adopted by the board of directors at the luncheon recess of the stockholders' meeting. While the *American International* decision is not an invitation for the board to disregard the views of the stockholders, the board appears to be protected if it acts in good faith and in what it believes to be in the best interest of the company and its stockholders, even

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50. *Reading*, slip op. at 10-11.

51. No. 7583 (Del. Ch. May 9, 1984).

52. *Id.* at 7. "At this stage of the proceedings, plaintiff has not met its burden of rebutting the presumption of the business judgment rule that the Board acted to amend the bylaw in the good faith belief that such action was in the best interests of the company and its stockholders." *Id.*

53. *Id.*

where it usurps a matter that had been put before the stockholders.[54]

The court of chancery has applied the business judgment rule to management's defense tactics in a takeover. In *Thompson v. ENSTAR Corp.*,[55] the court upheld the validity of a "lock-up" agreement which gave a bidder unqualified control over the voting rights in the company's largest asset, an interest in an oil and gas joint venture. Although the court found lock-up provisions "troublesome," it determined that "[t]he test of whether a lock-up provision should be upheld is whether management acted reasonably."[56] The court revised its opinion to note that the outcome might have been different if competing offers had been made sooner.

ENSTAR did not validate every "lock-up" regardless of the circumstances, as demonstrated less than two weeks later when the court of chancery refused to grant a preliminary injunction enforcing a lock-up option granted without consideration by a target board. In *DMG, Inc. v. Aegis Corp.*,[57] the target had granted an option to purchase the majority of the stock of its subsidiary, but the option was only to operate if another entity acquired forty percent of the target. When an unfriendly suitor gained control, the target sought, unsuccessfully, to invalidate the option.

Other defensive tactics have also survived attack when viewed as an exercise of business judgment. In *National Education Corp. v. Bell & Howell Co.*,[58] the chancellor refused to enjoin the issuance of a new class of preferred stock as a dividend on the common stock. The plaintiff argued that the new stock was intended to prevent a takeover, because the terms of the preferred stock tended to inhibit front-end loaded two-tier tender offers and partial tender offers. The court noted, however, that the stock provisions were adopted prior to any announced tender offer. The court refused to expand *Telvest, Inc. v. Olson*,[59] where the court of chancery had prevented the target board from creating and issuing "blank check" preferred stock,[60] and cautioned that the preferred stock must not be a "sham" security, but it should have the attributes of preferred stock.[61] The decision, however, should be

54. *Id.*
55. Nos. 7641 & 7643 (Del. Ch. June 20, 1984), *revised on* Aug. 16, 1984.
56. *Id.* at 12.
57. No. 7619 (Del. Ch. June 29, 1984).
58. No. 7278 (Del. Ch. Aug. 25, 1983).
59. No. 5798 (Del. Ch. Mar. 8, 1979).
60. Since the *Telvest* decision, § 151(g) of Delaware General Corporation Law has been amended, and now permits a certificate of designation to set forth rights and preferences of previously authorized but unissued preferred stock.
61. *Bell & Howell*, slip op. at 9-10.

read narrowly in light of the plaintiff's burden to convince the court at the injunctive stage of a substantial likelihood of success on the merits.[62]

Another defensive tactic is to include a supermajority vote requirement in the certificate of incorporation in order to approve a merger or to take over significant action. In *Dofflemeyer v. W.F. Hall Printing Co.*,[63] the Federal District Court for the District of Delaware granted partial summary judgment for the defendant board on claims relating to a supermajority bylaw provision. There the supermajority vote was triggered only by a transaction with a "related entity." The court remarked that the board of directors had the authority under the bylaw to determine the question of who was a "related entity," concluding the board had made that determination based upon "reasonable investigation and the advice of counsel."[64] The *Bell & Howell* and the *Dofflemeyer* cases indicate that a preferred stock or a bylaw provision designed to restrict a takeover is not *per se* unlawful in Delaware.

IV. MAJORITY STOCKHOLDER'S DUTIES

The Delaware Supreme Court's 1983 decision of *Weinberger v. UOP, Inc.*[65] dealt with the majority stockholder's duty of fairness to the minority stockholders. To the court in *Weinberger*, "fairness" meant both "fair dealing" and "fair price."[66] In May of 1984, the court of chancery applied *Weinberger* in a case involving a well-publicized tender offer made by the Royal Dutch Shell Group for the public's minority stock in Shell Oil Co. *Joseph v. Shell Oil Co.*[67] dealt with a number of issues, including "fair dealing," and disclosure. In *Joseph*, the majority stockholder, Royal Dutch Shell Group, proposed a cash-out merger to Shell Oil Company's board of directors at $55 per share in cash. The majority of Shell Oil's board of directors were outside directors who had no connection with Royal Dutch Shell. The board appointed a special committee which, upon the advice of an investment banking firm and other consultants, concluded that $75 per share was the lowest figure that fell within the range of fairness. Royal Dutch chose not to negotiate with the Shell Oil special committee, which had in effect

62. *Id.* at 11.
63. No. 82-77-WKS (D. Del. June 19, 1984).
64. *Id.* at 8.
65. 457 A.2d 701 (Del. 1983).
66. *Id.* at 711.
67. 482 A.2d 335 (Del. Ch. 1984).

rejected Royal Dutch's $55 per share offer. Instead, Royal Dutch announced a tender offer for all outstanding Shell Oil stock which it did not own at $58 per share. In its tender offer Royal Dutch stated that it would not increase its tender offer or propose a merger at a price higher than $58 for at least eighteen months. On behalf of the minority shareholders, Joseph sued in the Delaware Court of Chancery and sought injunctive relief.[68]

Vice-Chancellor Hartnett granted a preliminary injunction on the grounds that Royal Dutch had failed to disclose to the Shell Oil shareholders the existence of the Shell Oil management's projection of a hypothetical going concern value of $91 per share and that Royal Dutch had instructed its investment banker to examine only public information.[69] Nonpublic information would have included probable reserves and other confidential data that might have resulted in a higher price per share. The court ordered disclosure to the shareholders of additional information and granted a right of rescission to shareholders who had already tendered. Applying prior case law, the court wrote that there was a "reasonable probability that the defendants have not offered a fair price for the shares of Shell held by the minority stockholders and that defendants have not made a full and complete disclosure of all pertinent facts with complete candor."[70]

Joseph holds that a majority shareholder who makes a tender offer for the minority shares has a fiduciary duty of complete candor.[71] The remedy was recirculation with full disclosure and the right of rescission.[72] Royal Dutch was required to supplement the information and to order its investment banker to review in good faith the data developed by the independent Shell Oil special committee and thereafter to once again express its opinion as to value. The investment banker's opinion did not change as to the fair price of $58 per share.

As a practical matter one might quarrel as to whether the additional disclosure was meaningful to the shareholders. The Shell Oil stockholders had already received Shell Oil's conclusion that a price of less than $75 was not fair and there was wide publicity of the battle. The additional disclosure ordered by the court might have influenced stockholders to rescind their tender or not to tender. Because of the

68. *Id.* at 338.
69. *Id.* at 342-43.
70. *Id.* at 340.
71. As to the disclosure requirement and standard under Delaware law, see Lynch v. Vickers Energy Corp., 383 A.2d 278 (Del. 1977).
72. *Joseph*, 482 A.2d at 345.

lack of meaningful alternatives for the Shell Oil stockholders, it might be questioned whether a financially prudent minority shareholder would ever receive more than the tender offer price. This position finds support in the fact that the subsequent freeze-out merger by Royal Dutch was at exactly the same price as the tender offer.[73] The minority stockholders of Shell could not have reasonably expected an increased price from Royal Dutch after the court's decision. The court did not, for example, order Royal Dutch to negotiate with the special committee or to increase its tender offer. Royal Dutch had publicly announced that its merger price would be the same as its tender offer price.

Joseph clarifies that in a tender offer, a majority stockholder need not negotiate with an independent committee of the corporation's board of directors concerning the price to be offered to the minority shareholders. Nor does the majority stockholder have a legal duty to offer the minority any particular price, including a "fair price."[74] The vice-chancellor noted that the tender offer to the minority did not have to be the same as the price that would have applied had the entire company been purchased.[75] Hence, the majority stockholder is implicitly entitled to discount the value of the minority stock in light of its lack of control of the corporation.

The court's decision might have been different if the majority of Shell Oil's board of directors had not been independent and if Royal Dutch had access to inside information in formulating its offer. The decision in *Joseph v. Shell* walks a tightrope between the majority stockholder's fiduciary duty and its freedom to make a tender offer:

> While I agree with the general rule that a stockholder, if there has been a complete disclosure to him of all germane facts with complete candor, should be left free to make his own decision as to whether to tender or keep his shares, there is an exception when the maker of the tender offer, who has a fiduciary duty to the offeree, structures the offer in such a way as to result in an unfair price being offered and the disclosures are unlikely to call the unwary stockholder's attention to the unfairness.[76]

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73. Under Delaware law, a corporation owning 90% or more of the stock of another corporation may merge that corporation into itself without a vote by the minority shareholders. DEL. CODE ANN. tit. 8, § 253 (1983).

74. *Joseph*, 482 A.2d at 340-41.

75. *Id.* at 344-45.

76. *Id.* at 341.

The court's ability in *Joseph v. Shell* to fashion a remedy is consistent with *Weinberger* and its progeny. In April of 1984, the court of chancery declined to exclude the possibility of rescissionary damages in the *Weinberger* freeze-out merger.[77] In the *Weinberger* decision where it was held that fairness was required in the freeze-out merger between Signal and UOP, the court was concerned with UOP's report prepared by directors who sat on both companies' boards of directors. The report was given to Signal's board but not to the other UOP directors and the UOP stockholders. The case was sent back to the court of chancery for reconsideration of the fairness of the price offered in light of the supreme court's decision. The chancellor denied Signal's request for a ruling that rescissionary damages were not appropriate.[78] Since the supreme court had already determined that Signal had been guilty of unfair dealing with the UOP stockholders, the chancellor felt constrained to retain rescissionary damages as a possible remedy.

Where nondisclosure and misrepresentation are not alleged, the likelihood of an injunction against a tender offer or a merger is more remote. In *Rabkin v. Philip A. Hunt Chemical Corp.*,[79] the court relegated minority stockholders who challenged the fairness of a merger to their appraisal remedy. Olin had acquired 63.4% of Philip A. Hunt Chemical Corporation's (Hunt) outstanding common agreement stock from Turner & Newell Industries, Inc. pursuant to a stock purchase. The agreement further provided that if Olin were to acquire substantially all of the remaining common stock within one year, Olin would pay $25 a share to minority shareholders. Olin did not exercise the "one year commitment," but rather waited until the expiration of the year, and then decided to acquire the minority interest through a cash merger. The price of $20 per share was decided upon, on the basis of Olin's investment bankers' opinion and the opinion of the board's Special Committee of outside directors (which approved the price but gave a fair range of $19 to $25). Hunt's board of directors approved the merger proposal and issued a proxy statement.[80]

The court in *Rabkin* granted the motion to dismiss because appraisal was deemed to be an adequate remedy under the facts alleged in the complaint, which did not include allegations of nondisclosure or misrepresentations.[81] Moreover, absent fraud, appraisal was held to

77. Weinberger v. UOP, Inc., No. 5642 (Del. Ch. Apr. 24, 1984).
78. *Id* at 15.
79. No. 7547 (Del. Ch. July 3, 1984).
80. *Id.* at 5-6.
81. *Id.* at 14-15.

be the exclusive remedy. Further, mere allegations of oppressive treatment or unfair dealings will not survive a motion to dismiss. The court additionally rejected plaintiffs' argument that Olin breached its fiduciary duty by manipulating the timing of the merger for an inequitable purpose, i.e., to offer less money.[82] In stating that Olin had no fiduciary duty and the minority shareholders had no rights arising out of Olin's contractual obligation running to Turner & Newall, the court deemed it significant that the plaintiffs had no right to be cashed-out during the one-year period.

In the first court of chancery trial following *Weinberger v. UOP* dealing with the fairness of a merger price, that court concluded that the price offered the minority shareholders was fair.[83] *Rosenblatt v. Getty Oil Co.* was a class action brought by a minority stockholder of Skelly Oil Company, challenging the fairness of the 1977 merger of Skelly into Getty Oil Company. Prior to the merger Getty had directly or indirectly owned eighty percent of Skelly's stock. Under the merger Skelly's minority stockholders received Getty stock in exchange for their shares. The chancellor determined that the applicable test was whether the Skelly minority stockholders received in Getty stock the "substantial equivalent in value of what [they] had before."[84]

Rosenblatt is instructive on the requisite burden of proof in actions challenging the fairness of a merger. Absent a showing that the majority stockholder used its position to control and to fix the terms of the merger for its own benefit, the court declined to shift the burden to Getty to prove that the price was "intrinsically fair."[85] The merger had been approved by a majority of the minority stockholders, which was relevant to the fairness issue but did not relieve the majority stockholder of its burden of proof. The court assumed for the purpose of its opinion that the burden of proving fairness rested upon Getty, since the evidence presented at trial demonstrated to the chancellor that in any event Getty had proven that the price offered was fair. The court found useful the traditional Delaware method of determining value, by weighing relative asset, market and earnings value (although this method is no longer conclusive in merger cases).[86]

Although on their face the court of chancery decisions of *Joseph*

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82. *Id.* at 12.

83. Rosenblatt v. Getty Oil Co., No. 5278 (Del. Ch. Sept. 19, 1983).

84. *Id.* at 2.

85. *Id.* at 2. The chancellor relied on Sterling v. Mayflower Hotel Corp., 93 A.2d 107, 114 (Del. 1952).

86. *See* Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

and *Rosenblatt* involve distinct facts and issues, both cases apply *Weinberger* principles of fairness in determining the obligations of a majority stockholder in the merger and tender offer situations. Both cases illustrate the court's ability to inspect closely the facts. In the lengthy *Rosenblatt* opinion, Chancellor Brown carefully sifted through the evidence to find the terms of the merger fair. The facts relating to Shell Oil Company's value were ordered to be disclosed by the majority stockholder in *Joseph* but the court did not interfere with the majority stockholder's discretion to set its own offering price.

V. CONCLUSION

Generally, the prominent 1984 Delaware corporate decisions followed traditional legal doctrines. Consequently, corporate law has not been drastically altered in the past year. Yet there have been a number of noteworthy cases, particularly in the area of the business judgment rule.

The cases of *Aronson v. Lewis* and *Pogostin v. Rice* clarified and strengthened the business judgment doctrine. They held that absent self-dealing, a director's liability cannot be predicated on simple negligence. Thus, *Aronson* and *Pogostin* were responsible for adding bricks to the citadel of the business judgment rule.