Commentary from the Bar

1986 DEVELOPMENTS IN DELAWARE CORPORATE LAW

By Andrew J. Turezyn*

I. Introduction

In recent decisions, Delaware courts have made important rulings concerning fiduciary duty principles and issues arising under the Delaware General Corporation Law (GCL).[1] The Delaware corporation statute was also amended in 1986 in several important respects. These recent decisions and statutory amendments are of importance not only to corporate legal advisors, but also to anyone involved in the management of a Delaware corporation.

This article summarizes developments in Delaware corporate law during 1986. While summarization of the extensive body of Delaware corporate law and review of every Delaware corporate decision in 1986 are beyond the scope of this article, a wide range of the corporate issues addressed by the Delaware Court of Chancery and Delaware Supreme Court in 1986 will be considered. The legislative response to the widely reported directors' and officers' liability insurance crisis[2] will also be reviewed.

II. Case Law in the Supreme Court and the Court of Chancery

A. *Lock-ups*

Takeovers provided the background for several important decisions concerning the fiduciary responsibilities of a target company's board of directors.[3] In *Revlon, Inc. v. MacAndrews & Forbes Holdings,*

---

* Mr. Turezyn practices law in the Delaware office of Skadden, Arps, Slate, Meagher & Flom. The views expressed in this article do not necessarily reflect the views of his firm or any of its clients.

1. Del. Code Ann. tit. 8, §§ 101-398 (1974).

2. *See* legislative commentary to 1985 and 1986 Delaware Corporation Law Amendments, S.B. 116, 133d General Assembly, 65 Del. Laws, ch. 127 (1985), and S.B. 533, 133d General Assembly, 65 Del. Laws, ch. 289 (1986).

3. *See, e.g.*, Smith v. Van Gorkom, 488 A.2d 858 (Del 1985) (comprehensive discussion of the duty of care under Delaware law). *See also* Gimbel v. Signal Companies, Inc., 316 A.2d 599, 615 (Del. Ch.), *aff'd,* 316 A.2d 619 (Del. 1974) (enjoining a proposed sale of assets after finding that the "hasty method" employed

Inc.,[4] the supreme court continued its recent review of board action designed to deter hostile acquisition of the corporation.[5] In *Revlon*, the court addressed for the first time the use of an asset lock-up option[6] in connection with a board of directors' decision to enter into a merger agreement with a favored bidder in the midst of a battle for corporate control.

Pantry Pride, Inc. had been rebuffed in its efforts to gain business information from Revlon or negotiate with its board concerning acquisition of Revlon.[7] After Revlon's completion of a self-tender exchange offer[8] and adoption of a rights plan[9] failed to deter Pantry

---

by the directors to approve the transaction produced "a dollar result which appears perhaps to be shocking"). *See* Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939) (thorough discussion of the duty of loyalty).

4. 506 A.2d 173 (Del. 1986). While the court rendered an oral decision on November 1, 1985, its written opinion was not released until March 13, 1986.

5. *See, e.g.*, Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985); Datapoint Corp. v. Plaza Sec. Co., 496 A.2d 1031 (Del. 1985); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985); Pogostin v. Rice, 480 A.2d 619 (Del. 1984).

6. An asset lock-up option involves "making some [corporate] asset available to the potential buyer at a price less than those assets would bring in an orderly sale, thereby tending to foreclose further bidding for the target company." Hanson Trust PLC v. ML SCM Acquisition, Inc., 781 F.2d 264, 284 (2d Cir. 1986) (Oakes, J., concurring). Most lock-ups are employed in a "defensive" manner to facilitate the intervention and success of a white knight. However, potential acquirers can also use a lock-up in an "offensive" manner by negotiating agreements with the target or its stockholders to help ensure the success of the takeover bid. *See* EAC Indus., v. Frantz Mfg. Co., No. 8003 (Del. Ch. June 28, 1985), *reprinted in* 11 DEL. J. CORP. L. 608 (1986), *aff'd*, 501 A.2d 401 (Del. 1985); Thompson v. Enstar Corp., 509 A.2d 578 (Del. Ch. 1984); Repairman's Serv. Corp. v. National Intergroup, Inc., No. 7811 (Del. Ch. Mar. 15, 1985), *reprinted in* 10 DEL. J. CORP. L. 902 (1985). *See generally* Lamb & Turezyn, Revlon *and* Hanson Trust: *Unlocking the Lock-Ups*, 12 DEL. J. CORP. L. 497 (1987) (extensive discussion of lock-ups).

7. *Revlon*, 506 A.2d at 176.

8. Revlon exchanged one senior subordinated note of $47.50 principal at 11.75% interest, due 1995, and one-tenth of a share of $9 cumulative convertible exchangeable preferred stock valued at $100 per share for each of the 10 million shares. *Id.* at 177. The notes contained covenants which would have hindered Revlon's ability to incur additional debt, sell assets, or pay dividends unless otherwise approved by the "independent" members of the board. *Id.*

9. *Id.*

> Under the [rights] plan, each Revlon stockholder was to receive as a dividend one Note Purchase Right (Rights) for each share of common stock, with the Rights entitling the holder to exchange one common share for a $65 principal Revlon note at 12% interest with a one-year maturity. The Rights would become effective whenever anyone acquired beneficial ownership of 20% or more of Revlon's shares, unless the purchaser acquired all of the company's stock for cash at $65 or more per share.

Id.

Pride, Revlon recognized that the company would be sold. It entered into negotiations with Forstmann Little & Co., a white knight,[10] that resulted in a $56 per share leveraged buyout proposal from Forstmann.[11] After Pantry Pride topped that offer,[12] Forstmann made a new merger proposal of $57.25 to Revlon's board subject to several conditions. The principal demand was a lock-up option to purchase for $525 million Revlon's Vision Care and National Health Laboratories Divisions, exercisable if another acquiror acquired 40% of Revlon's shares.[13] The consideration offered by Forstmann Little was approximately $100-175 million below the value ascribed to the assets by Revlon's investment banker.[14] In return for the lock-up, a "no-shop" provision[15] and a $25 million cancellation fee, Forstmann also agreed to support the par value of the notes that had been issued by Revlon in the self-tender exchange offer two months earlier.[16] The notes had begun to fall in value and Revlon's directors anticipated that they would be sued by the noteholders.[17] Despite its awareness of Pantry Pride's stated intention to top any offer from Forstmann, the Revlon board unanimously approved the agreement with Forstmann.[18]

The supreme court affirmed the trial court's entry of a preliminary injunction,[19] concurring with the lower court's finding that

---

10. A white knight is a potential acquiror sought to rescue a target company from an unfriendly takeover. *See generally* Gutman, *Tender Offer Defensive Tactics and the Business Judgment Rule*, 1984 SEC. L. REV. 325.

11. *Revlon*, 506 A.2d at 177-78.

12. *Id.* at 178. The revised Pantry Pride offer was "[s]ubject to nullification of the rights, waiver of the note covenants, and the election of three Pantry Pride directors to the Revlon board." *Id.* Then, on October 9, representatives of Pantry Pride, Forstmann, and Revlon met. The court found that at that meeting, Pantry Pride informed the other parties that it would engage in fractional bidding and top any Forstmann offer by a slightly higher one. *Id.*

13. *Id.*

14. *Id.*

15. A "no-shop" provision requires the target company to forebear from entering into competing or inconsistent agreements until after the stockholders vote on the transaction. *See* Jewel Cos. v. Pay Less Drug Stores Northwest, Inc., 741 F.2d 1555, 1561 (9th Cir. 1984) (directors did not breach their fiduciary duties under California law by agreeing to a no-shop clause as part of a negotiated merger).

16. *Revlon*, 506 A.2d at 178-79.

17. *Id.* at 178. "The Notes, which originally traded near par, dropped to $87.50 by October 8. One [Revlon] director . . . reported . . . a 'deluge' of telephone calls from irate noteholders and, on October 10, the Wall Street Journal reported threats of litigation by these creditors." *Id.*

18. *Id.* at 179.

19. *Id.* at 185.

Revlon's directors had breached their fiduciary duties by making concessions to Forstmann out of concern for their liability to the holders of the notes, rather than seeking to maximize the sale price of the company for the stockholders' benefit.[20] The *Revlon* court concluded that the board of directors' actions ended the auction for the target company, thereby depriving the target's shareholders of the opportunity to gain the highest price for their shares.[21] Although the court has sustained other defensive tactics which are arguably contrary to the best interests of shareholders, it found that in this case Revlon's directors had breached the fundamental duty of care.[22] Thus, their actions could not be afforded the protections of the business judgment rule.[23]

The court began its analysis of the lock-up by reviewing the status of lock-ups under Delaware law and the circumstances under which they may be appropriate:

> A lock-up is not *per se* illegal under Delaware law. Its use has been approved in an earlier case. *Thompson v. Enstar Corp.*, Del. Ch. (1984). Such options can entice other bidders to enter a contest for control of the corporation, creating an auction for the company and maximizing shareholder profit. Current economic conditions in the takeover market are such that a "white knight" like Forstmann might only enter the bidding for the target company if it receives some form of compensation to cover the risks and costs involved. . . . However, while those lock-ups which draw bidders into the battle benefit shareholders, similar measures which end an active auction and foreclose further bidding operate to the shareholders' detriment.[24]

With these general principles set forth, the court turned its attention to the facts. The court stated that because the Revlon board had shifted its position from a defense of the company to a recognition

---

20. *See id.*

21. *Id.* at 183-84.

22. *See, e.g.*, Moran v. Household Int'l, 500 A.2d 1346 (Del. 1985). In *Moran*, the appellant, Moran, unsuccessfully argued to the court that the adoption of a "poison pill" defense was contrary to the best interest of the target stockholders because, among other things, it deprived them of the opportunity to gain premiums offered in the tender offer process. *See Opening Brief of Appellant Moran* in Moran v. Household Int'l, 500 A.2d 1346 (Del. 1985).

23. *Revlon*, 506 A.2d at 185.

24. *Id.* at 183 (citations omitted).

that it would be sold, it was inappropriate to remove Pantry Pride from the bidding.[25] The recognition by the board of directors that a sale was inevitable significantly altered its fiduciary responsibilities under *Unocal Corp. v. Mesa Petroleum Co.*[26] Its role, according to the court, "changed from defenders of the corporate bastion to auctioneers charged with getting the best price for stockholders . . . ."[27]

The directors breached their duty of care because they failed to understand fully the ramifications of their prior decision to sell the company. By agreeing to lock-up the transaction with Forstmann without even exploring whether Pantry Pride would make good its promise to top any bid, the directors failed to satisfy their duty of obtaining and considering all material information relevant to the board's new role as auctioneer of Revlon for the benefit of its stockholders.[28]

Breach of the duty of loyalty was also a substantial basis for the court's invalidation of the lock-up in *Revlon* . The court stated that the directors' focus on supporting the value of the notes in response to "the noteholders' ire as well as their subsequent threats of suit," was inconsistent with their "primary responsibility" to the stockholders.[29] The court then held that "when the Revlon board entered into an auction-ending lock-up agreement with Forstmann on the basis of impermissible considerations at the expense of the

---

25. *Id.* at 182.

26. 493 A.2d 946 (Del. 1985). In *Unocal*, the supreme court vacated the court of chancery's issuance of a preliminary injunction as to Unocal's self-tender for its shares which excluded from participation Mesa Petroleum Company, a stockholder making a hostile tender offer for the company's stock. The court concluded that

> there was directorial power to oppose the Mesa tender offer, and to undertake a selective stock exchange made in good faith and upon a reasonable investigation pursuant to a clear duty to protect the corporate enterprise. Further, the selective stock repurchase plan chosen by Unocal is reasonable in relation to the threat that the board rationally and reasonably believed was posed by Mesa's inadequate and coercive two-tier tender offer.

Unocal, 493 A.2d at 958.

27. *Revlon*, 506 A.2d at 182.

28. *Id.* As the court noted in *In re* Anderson, Clayton Shareholders Litig., 519 A.2d 694, 697 (Del. Ch. June 2, 1986), "Surely the obligation of the board at this time is to explore in good faith an alternative that, if available, would appear to have a significantly greater present value than [another proposal]." The board's duty to avail themselves of all material information prior to making a decision involving a change in corporate control was discussed in detail in Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

29. *Revlon,* 506 A.2d at 182.

shareholders, the directors breached their primary duty of loyalty."[30] The court noted that while a target board can properly consider non-shareholder constituencies during a battle for corporate control, there must be some "rationally related benefit" to target shareholders.[31]

The board's concern for its corporate constituencies was found to justify two other defensive measures taken by Revlon's board prior to its decision to sell and to grant the lock-up—the rights plan and the self-tender exchange offer.[32] The former, like the rights plan considered by the supreme court in *Moran v. Household International, Inc.*,[33] "afforded a measure of protection consistent with the directors' fiduciary duty in facing a takeover threat perceived as detrimental to corporate interests," namely a "bust-up" takeover bid at an inadequate price.[34] Similarly, the court upheld the self-tender offer because it was based on the good faith, informed conclusion of Revlon's board that Pantry Pride's then proposed any-and-all cash offer[35] was "grossly inadequate" and the board had "reasonable grounds to believe that there existed a harmful threat to the corporate enterprise."[36]

Finally, the court determined that it was impermissible for the Revlon directors to approve the "no-shop" clause in the face of an active bidding contest:

> The no-shop provision, like the lock-up option, while not *per se* illegal, is impermissible under the *Unocal* standards

---

30. *Id.*

31. *Id.* at 176. The *Revlon* decision has been read as creating a dichotomy between takeover responses designed to maintain the target company's independence, in which non-stockholder constituencies may properly be considered, and the auction alternative, in which the board's objective must be to maximize stockholder values without regard to those other constituencies. Whether the *Revlon* decision should be read that literally, and whether that dichotomy is workable as a practical matter or sensible as a policy matter, will undoubtedly be addressed in future litigation. *See* Sussman & Sussman, *Litigation Intensifies on Duties of Target's Directors*, Legal Times, May 26, 1986, at 10, col. 1.

32. *Revlon*, 506 A.2d at 180-81.

33. 500 A.2d 1346 (Del. 1985). In *Moran*, the supreme court affirmed a court of chancery decision which upheld the board's decision to adopt a rights plan "as a legitimate exercise of business judgment by Household." *Id.* at 1348.

34. *Revlon*, 506 A.2d at 180-81.

35. An any-and-all offer is an offer where the bidder states an intention to purchase any and all tendered shares, as long as all conditions of the offer are satisfied.

36. *Id.* at 181.

> when a board's primary duty becomes that of an auctioneer responsible for selling the company to the highest bidder. The agreement to negotiate only with Forstmann ended rather than intensified the board's involvement in the bidding contest. . . . After the directors authorized management to negotiate with other parties, Forstmann was given every negotiating advantage that Pantry Pride had been denied: cooperation from management, access to financial data, and the exclusive opportunity to present merger proposals directly to the board of directors. Favoritism for a white knight to the total exclusion of a hostile bidder might be justifiable when the latter's offer adversely affects shareholder interests, but when bidders make relatively similar offers, or dissolution of the company becomes inevitable, the directors cannot fulfill their enhanced *Unocal* duties by playing favorites with the contending factions. Market forces must be allowed to operate freely to bring the target's shareholders the best price available for their equity.[37]

A post-*Revlon* decision by the court of chancery demonstrated that at least one type of lock-up could be used in certain circumstances. In *Hecco Ventures v. Sea-Land Corp.*,[38] the court declined to enjoin issuance of a stock option lock-up or to issue a temporary restraining order against the consummation of a cash tender offer made by a subsidiary of CSX Corporation for all outstanding shares of Sea-Land at $28 per share.[39] CSX had conditioned its offer on Sea-Land's grant to it of an option to purchase 6.5 million shares of Sea-Land stock at $28 per share. In declining to enjoin consummation of the transaction, the court noted that "Sea-Land's directors had authorized a broad search for bids . . . over five months but yielded only two interested bidders. . . . At no time did Sea-Land favor one bidder over the other. Both received the same information, and [the other interested bidder] was specifically invited to make a bid in excess of CSX's $28 proposal," but chose not to.[40]

---

37. *Id.* at 184 n.16.

38. No. 8486 (Del. Ch. May 19, 1986), *reprinted in* 12 DEL. J. CORP. L. 282 (1987).

39. *Id.*, slip op. at 15, *reprinted in* 12 DEL. J. CORP. L. at 292.

40. *Id.*, slip op. at 11, *reprinted in* 12 DEL. J. CORP. L. at 289. The other interested bidder, Harold Simmons and entities controlled by him, owned 39.5% of Sea-Land's 23.4 million shares of stock outstanding at the time of CSX's offer. *Id.*, slip op. at 2, 4, *reprinted in* 12 DEL. J. CORP. L. at 285, 286. After CSX publicly

The court also noted other factors which distinguished this lock-up case from *Revlon* . The court stated that *Revlon* involved a situation, unlike the one in the present case, where corporate directors acted out of "self interest" in ending an auction for the company.[41] Furthermore, it pointed out that the option in this case was granted at the conclusion of the auction process, not in the middle as in *Revlon*.[42] Thus, *Hecco Ventures* reaffirms the vitality of lock-up options in Delaware in factual situations not involving a breach of fiduciary duty.

B. *Mergers and Recapitalizations*

The intermediate form of judicial review undertaken by the supreme court in *Unocal Corp. v. Mesa Petroleum Co.*[43] and *Revlon* in reviewing board action designed to defeat a threatened change in control was also applied in *AC Acquisitions Corp. v. Anderson, Clayton*

---

announced its proposal on April 21, 1986, CSX and Simmons conducted negotiations between themselves on April 22 and 23. The result was that CSX acquired, for a price of $5 per share, an option to purchase all of the Simmons interests' Sea-Land shares for $28 per share. *Id.*, slip op. at 5, *reprinted in* 12 DEL. J. CORP. L. at 286. CSX's representatives informed Sea-Land that the option with Simmons was separate and apart from the $28 offer to Sea-Land and that $28 was the top price CSX was willing to offer for Sea-Land. Despite the agreement with Simmons, CSX insisted on the option with Sea-Land rather than "risk that it might end up holding a minority stock position in the event that less than 50 per cent" of Sea-Land's shares were tendered and if the Simmons interests, for whatever reason, failed to perform under the [option to purchase their stock granted to CSX]." *Id.*, slip op. at 6, *reprinted in* 12 DEL. J. CORP. L. at 287. Ultimately, however, the option between Sea-Land and CSX was structured so that it would not become effective unless the Simmons entities failed to perform under the option they granted to CSX. *Id.*, slip op. at 6 n.2, *reprinted in* 12 DEL. J. CORP. L. at 287 n.2.

41. *Id.*, slip op. at 10, *reprinted in* 12 DEL. J. CORP. L. at 289.

42. *Id.*, slip op. at 11, *reprinted in* 12 DEL. J. CORP. L. at 290.

43. 493 A.2d 946 (Del. 1985). In *Unocal*, the supreme court addressed for the first time the validity of a corporation's self-tender exchange offer which excluded from participation a stockholder making a hostile tender offer for the company's stock. *Id.* at 949. The court noted that "[b]ecause of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders, there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred." *Id.* at 954. The court held that the directors had to "show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed because of another person's stock ownership." *Id.* at 955. That burden can be satisfied by a showing of good faith and reasonable investigation. *Id.* The defendants must also show that the defensive measure is "reasonable in relation to the threat posed." *Id.* After finding that the defendants had made the necessary showings, the court reversed the court of chancery's issuance of a preliminary injunction against the exchange offer. *Id.* at 958-59.

& Co.[44] The chancellor explained the rationale for modifying the traditional burden of proof mechanisms in cases involving board action affecting control:

> Because the effect of the proper invocation of the business judgment rule is so powerful and the standard of entire fairness so exacting, the determination of the appropriate standard of judicial review frequently is determinative of the outcome of derivative litigation. Perhaps for that reason, the Delaware Supreme Court recognized in *Unocal* . . . that where a board takes action designed to defeat a threatened change in control of the company, a more flexible, intermediate form of judicial review is appropriate. In such a setting the "omnipresent specter that a board may be acting primarily in its own interests," justifies the utilization of a standard that has two elements. First, there must be shown some basis for the Board to have concluded that a proper corporate purpose was served by implementation of the defensive measure and, second, that measure must be found reasonable in relation to the threat posed by the change in control that instigates the action.[45]

As the decision in *AC Acquisitions Corp.* demonstrated, scrutiny under the intermediate form of judicial review can be exacting. The court found that the board of directors' decision to offer stockholders an alternative to a previous offer by a hostile acquiror served a proper corporate purpose of giving stockholders a choice.[46] Nevertheless, the court found the terms of the self-tender approved by the board to be an unreasonable response in relation to the threat posed

---

44. 519 A.2d 103 (Del. 1986).

45. *Id.* at 111 (citations omitted).

46. *Id.* at 112. Through a newly formed corporation, plaintiffs made a tender offer for any and all shares of Anderson, Clayton & Co. at $56 per share cash. Plaintiffs' stated intention, if they succeeded in acquiring 51% of the stock, was to do a follow-up merger at $56 per share cash. On the day following the announcement of the tender offer, Anderson, Clayton announced the commencement of a self-tender offer for approximately 65% of its outstanding stock at $60 per share cash. The company also announced that, in connection with the closing of the self-tender offer, it would sell stock to a newly-formed Employee Stock Ownership Plan amounting to 25% of all issued and outstanding stock following such sale. *Id.* at 104. The court noted that the record was "uncontradicted" that the value of the company's stock following the effectuation of the self-tender offer would be "materially less than $60 per share." *Id.* at 113.

by the hostile offer because the self-tender did not serve, but rather defeated, the purported corporate purpose.[47] According to the court, "no rational shareholder could afford not to tender into the Company's self-tender" since, by failing to tender, the stockholder would "very likely" run the risk of experiencing "a substantial loss in market value of his holdings" upon consummation of the self-tender.[48] The court enjoined the self-tender as unreasonable because its timing effectively precluded the very choice it was said to create.[49]

Merritt v. Colonial Foods, Inc.[50] also resulted in a finding of breach of duty by directors. The court found that a cash-out merger had been effected for the purpose of terminating derivative litigation that sought a recovery from the directors and controlling stockholders of the company.[51] Furthermore, the court concluded that no independent board committee, counsel, or investment banker had provided any basis for concluding either that the claims asserted were without value or that the merger price was fair in view of the value of the claims to the corporation.[52] Thus, the court found that the directors

---

47. *Id.* at 112-14. The court's requirement of a "corporate purpose" stems from the *Unocal* requirement that a board of directors must show that they had a "reasonable ground for believing that a danger to corporate policy or effectiveness exists" before their defensive action may be upheld. *Unocal*, 493 A.2d at 955. The court stated that the *Unocal* requirement was merely a "particularization" of the more general "corporate purpose" requirement. *AC Acquisitions Corp.*, 519 A.2d at 112. Thus, in the instant case, the board of directors had the burden of showing that the self-tender served a valid corporate purpose. *Id.*

48. *AC Acquisitions Corp.*, 519 A.2d at 113.

49. *Id.* at 112-14. The timing of the self-tender effectively precluded any rational choice because a target shareholder would not tender into the hostile offer and risk being frozen out of the self-tender, assuming the hostile offer failed to close. *Id.* at 114. Although the hostile offeror could have cured the coercive aspects of the self-tender by making its offer unconditional, it had no legal duty to do so. *Id.* at 114 n.12.

50. 505 A.2d 757 (Del. Ch. 1986).

51. *Id.* at 758, 763. The general rule in Delaware is that a cash-out merger will terminate the standing of a plaintiff to continue to maintain derivative claims on behalf of the corporation of which he was (but no longer is) a stockholder. Lewis v. Anderson, 477 A.2d 1040, 1049-50 (Del. 1984). The chancellor noted in *Merritt* that "[d]espite contrary dicta in some Delaware cases . . . it seem[ed] apparent to [the chancellor] that the rule of *Anderson* should apply even where the purpose of the cash-out merger is to cause a premature termination of derivative litigation." *Merritt*, 505 A.2d at 763 n.3 (citations omitted).

52. *Merritt*, 505 A.2d at 758. The court noted that "at a minimum, what was required in this instance was a disinterested judgment that litigation of the claims asserted derivatively was not in Colonial's best interests and an unbiased and expert view of the value of those claims." *Id.* at 765.

had breached the duty of fair dealing which they owed to minority shareholders.[53]

The court noted that Delaware corporate law was "inflexible" in its requirement that self-dealing fiduciaries deal with the corporation and its stockholders only on entirely fair terms.[54]

> Accordingly, only where there exists a basis for a reviewing court to conclude that this supervening equitable obligation has been satisfied and that therefore a cash-out merger effectuated for the purpose of terminating pending derivative litigation does not constitute a breach of trust, will a cash-out merger provide an appropriate alternative to the *Maldonado* procedure [for seeking dismissal of derivative litigation].[55]

---

53. *Id.* at 758. The cash-out merger constituted a breach of the fiduciary duty of fair dealing because:

> (1) it was effectuated for the purpose of precluding the public shareholders from requiring the [board of directors] to account for the self-dealing transactions in which those fiduciaries had elected to engage, and
>
> (2) because the merger was effectuated by a process that supplied no dependable basis to conclude in fact (a) that the corporate interest and not simply the personal interests of the [board of directors] was served by the termination of the derivative litigation and (b) that the merger price was fair considering the value of the then pending derivative claims to the corporation.

Id. at 765-66.

54. *Id.* at 765. The court emphasized that self-dealing per se is not prohibited by Delaware law. *Id.* at 763-64. *See generally* Del. Code Ann. tit. 8, § 144 (1983). The court noted that under Delaware law when a controlling shareholder utilizes his power to set the terms of the transaction and compel its effectuation, he bears the burden of establishing to an independent body that the transaction is "fully fair." *Merritt*, 505 A.2d at 764. This independent body could consist of a court in litigation, an independent committee, or disinterested shareholders. *Id.* In this case, the board failed to subject the transaction to any independent scrutiny. *Id.* Furthermore, it attempted to use the cash-out merger as a method of disposing of the derivative litigation. While this was not a per se violation of fiduciary duty, the court stated that the approach used by the board to terminate the litigation was not fair to shareholders. *Id.* at 764-65.

55. *Merritt*, 505 A.2d at 765. The supreme court's 1981 decision in Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981), approved a procedure by which those charged with the management of a corporation may unilaterally begin a process by which derivative litigation that is not in the corporation's interests to pursue may be terminated. The procedure requires an independent, disinterested committee of the board to make a determination that the litigation should not be pursued. It also provides the additional safeguard of judicial review of that determination. *See* Lewis v. Fuqua, No. 7188 (Del. Ch. Nov. 12, 1985) (revised Nov. 14 & 19, 1985), *reprinted in* 11 DEL. J. CORP. L. 928 (1986).

The fairness requirements of Delaware corporate law also extend to actions designed to defeat threatened changes of control through proxy contests. Delaware courts have granted relief where management has wrongfully attempted to perpetuate itself in office by issuing securities that would have an adverse impact on a stockholder seeking to obtain majority control or to assert majority control already obtained.[56] In *Packer v. Yampol*,[57] the court of chancery preliminarily enjoined the voting of supervoting preferred stock after finding that the defendants' primary purpose in authorizing the issuance of the stock was to entrench themselves in control of Graphic Scanning Corporation by obstructing plaintiffs' ability to wage a meaningful proxy contest.[58] The court found that the creation of the supervoting preferred, which would have represented almost 33% of the total voting power of the company, served no necessary purpose.[59]

The court of chancery also enjoined effectuation of a dual stock recapitalization plan in *Lacos Land Co. v. Arden Group, Inc.*,[60] after

---

56. *See, e.g.,* Telvest v. Olson, No. 5798 (Del. Ch. Mar. 8, 1979) (board engaged in defensive tactics to counteract supposed takeover and altered voting rights previously granted to shareholders); Condec Corp. v. Lunkenheimer Co., 230 A.2d 769 (Del. Ch. 1967) (issuance of stock by majority shareholders for the primary purpose of "freezing out" minority interest is actionable without regard to fair price); Canada Southern Oils v. Manahi Exploration Co., 96 A.2d 810 (Del. Ch. 1953) (evidence sufficient to establish primary purpose behind the sale of shares was to deprive majority shareholder of voting control).

57. No. 8432 (Del. Ch. Apr. 18, 1986), *reprinted in* 12 DEL. J. CORP. L. 332 (1987).

58. *Id.*, slip op. at 39, *reprinted in* 12 DEL. J. CORP. L. at 358. Graphic Scanning Corporation's (Graphic) directors caused it to issue to its chairman and chief executive officer, Barry Yampol, and also to two Netherlands Antilles corporations, Battery, N.V. (Battery) and Monar Company, N.V. (Monar), shares of two newly-created series (Series A and Series B) of Graphic Preferred Stock. Because each series of preferred stock possessed "supervoting" features, the result was to create 17,700,000 additional votes which Yampol, Monar, and Battery would be entitled to cast at the May 12, 1986 stockholders meeting. The creation and issuance of the Series A and the Series B Preferred Stock to Yampol, Monar, and Battery (i) increased Yampol's voting power from 17.2% to 23.1% of the outstanding Graphic shares entitled to vote, (ii) conferred upon Battery and Monar voting power representing approximately 21% of the outstanding shares of Graphic entitled to vote, and (iii) conferred upon Yampol, Battery, and Monar collectively, aggregate control over 44% of Graphic's total voting power. *Id.*, slip op. at 2-3, *reprinted in* 12 DEL. J. CORP. L. at 336-37.

59. *Id.*, slip op. at 22, 43, *reprinted in* 12 DEL. J. CORP. L. at 347, 360.

60. 517 A.2d 271 (Del. Ch. 1986). The recapitalization was designed to create a new Class B Common Stock possessing 10 votes per share and entitled, as a class, to elect 75% of the directors of the defendant corporation. *Id.* at 272. With respect to dividend rights, the old Class A Common Stock would, following the

finding that the recapitalization was not a device to raise capital but rather a technique to transfer stockholder control of the enterprise to the chairman of the defendant corporation.[61] While what the new Class B common stock defendants sought to create was to be available on a share-for-share basis to all holders of the company's Class A common stock, defendants acknowledged that it had been deliberately fashioned to be attractive only to the chairman of the defendant company.[62]

The basis for the court's decision to enjoin the recapitalization, despite stockholder approval,[63] was its finding that the stockholder vote

> was inappropriately affected by an explicit threat of [the chairman] that unless the proposed amendments were approved, he would use his power (and not simply his power *qua* shareholder) to block transactions that may be in the best interests of the Company, if those transactions would dilute his ownership interest in [the company].[64]

The court noted that if the chairman had spoken only as a stockholder, and had been so understood, the result might have been different than if his "support" could be interpreted as involving the exercise of his power as an officer or director.[65] Since officers and directors have a duty to act with complete loyalty to the interests of the

---

initial issuance of Class B Shares, have the right to receive a one-time dividend of $.30 per share; Class B shares would have no right to participate to any extent in that cash dividend. Excepting the one-time $.30 dividend, each share of Class B stock would be entitled to participate in all dividends declared and paid with respect to a share of Class A stock but only to the extent of 90% of such dividend. *Id.* at 273-74. Pursuant to the terms of the pending exchange offer, the new Class B stock would be available on a share-for-share basis to all holders of the corporation's Class A Common Stock. *Id.* at 272.

61. *Id.* at 272-73.

62. *Id.*

63. *Id.* at 273.

64. *Id.* at 276. The court also took exception to the integrity of the shareholder vote opposing the charter amendment. Specifically, the court found that the vote was defective by reason of material misrepresentations and omissions in the company's proxy statement. *Id.* at 279. The court viewed the proxy statement as "misleading" because of the manner in which it set forth the role of the chairman in the recapitalization scheme. *Id.* According to the court, the proxy statement had the potential to mislead a shareholder into believing that the chairman would not be able to essentially single-handedly satisfy the threshold percentage of voting power. *Id.* at 279-81.

65. *Id.* at 277.

corporation and its stockholders,[66] the chairman had no right to suggest that he would withhold his support for a favorable transaction, "even if benevolently motivated in doing so."[67]

In *Jedwab v. MGM Grand Hotels, Inc.*,[68] the court of chancery declined to preliminarily enjoin a merger despite allegations by a preferred stockholder that the merger contemplated an unfair apportionment between the company's common and preferred stockholders of the total merger consideration.[69]

> [W]ith respect to matters relating to preferences or limitations that distinguish preferred stock from common, the duty of the corporation and its directors is essentially contractual and the scope of the duty is appropriately defined by reference to the specific words evidencing that contract; where however the right asserted is not to a preference as against the common stock but rather a right shared equally with the common, the existence of such right and the scope of the correlative duty may be measured by equitable as well as legal standards.[70]

While it found that the target company's majority stockholder had exercised power in apportioning the elements of the merger consideration "of a kind and in circumstances justifying invocation of the

---

66. *Id.* at 278 (citing Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983); Guth v. Loft, 5 A.2d 503 (Del. 1939).

67. *Lacos Land Co.*, 517 A.2d at 278. In contrast, the court noted in 1986 that the fact that the timing and economic terms of a particular offer induce stockholders to tender does not make the offer "coercive." *See* MacFadden Holdings, Inc. v. John Blair & Co., No. 8489, slip op. at 14-15 (Del. Ch. July 2, 1986); Katz v. Oak Indus., Inc., 508 A.2d 873 (Del. Ch. 1986).

68. 509 A.2d 584 (Del. Ch. 1986).

69. *Id.* at 587. The plaintiff claimed that the effectuation of the proposed merger would constitute a breach of the duty of loyalty by the defendant board of directors and its controlling shareholder to the preferred shareholders. *Id.* at 591. The plaintiff argued that directors of a Delaware corporation (MGM) have a duty in a merger transaction to approve only a merger that apportions the merger consideration fairly among classes of the company's stock. *Id.* According to the plaintiff, to favor one class of stock over another is a breach of the duty of loyalty to the shareholders of the corporation and to the corporation itself. *Id.* However, the court concluded that the plaintiff did not establish a legal right of the preferred to equivalent consideration in a merger, and that although preferred stockholders have a right to fair apportionment of the merger proceeds, the plaintiff did not establish a reasonable probability that the right would be violated by the proposed merger. *Id.* at 592-97.

70. *Id.* at 594.

heightened standard of judicial review,"[71] the court found the defendants likely to meet the burden thus imposed upon them.[72]

C. *Disclosure*

Claims involving inadequate or misleading disclosures to stockholders were also addressed in various decisions of the court of chancery in 1986. In *In re Anderson, Clayton Shareholders' Litigation*,[73] the court enjoined a proposed recapitalization of Anderson, Clayton. Certain plaintiffs wished to offer an alternative transaction to shareholders, and claimed that the recapitalization was designed to preclude this transaction.[74] Although proxy supplement disclosures by Anderson, Clayton in connection with the recapitalization made it appear that it was open-minded and was currently exploring and would continue to explore the option that the plaintiffs' proposal represented, the court determined preliminarily that the board had no such intention.[75] The court therefore found a reasonable probability that the proxy supplement would be shown to be materially misleading in a way that would be relevant to a reasonable stockholder voting to approve or disapprove the recapitalization.[76] The court declined to afford the directors the protection of the business judgment rule concerning the disclosures, noting that

> the question whether shareholders have, under the circumstances, been provided with appropriate information upon which an informed choice on a matter of fundamental corporate importance may be made, is not a decision concerning the management of business and affairs of the enterprise . . . of the kind the business judgment rule is intended to protect.[77]

---

71. *Id.* at 596. The court concluded that the mere fact that a controlling shareholder set the disparate terms of the merger for different classes of stock did not warrant the invocation of the intrinsic fairness test. However, the court found that the controlling shareholder, because he apportioned to his own shares a different type of consideration than was conferred upon other holders of common stock, was subject to heightened standards of judicial review. *Id.*

72. *Id.*

73. 579 A.2d 669 (Del. Ch. 1986).

74. *Id.*, slip op. at 1, 12-13.

75. *Id.*, slip op. at 7-9, 20-21.

76. *Id.*, slip op. at 21. The court concluded that the proxy statement was misleading in that it conveyed the impression that the board was attempting to explore the hostile offer. The facts of the case indicated otherwise. *Id.*

77. *Id.*, slip op. at 13.

The court of chancery also addressed the standard by which the disclosure of "soft information"[78] should be governed. While various courts have adopted a per se rule that such soft information is too unreliable to be the subject of mandated public disclosure,[79] the Third Circuit in *Flynn v. Bass Brothers Enterprises*[80] adopted a case-by-case balancing approach. In *Edick v. Contran Corp.*[81] and *Wacht v. Continental Hosts, Ltd.*,[82] the court of chancery, relying upon *Flynn*, denied motions to dismiss claims that certain types of soft information were

78. The term "soft information" is generally understood as referring to projections, appraisals, and other forms of predictive, evaluative, or subjective material. *See* Schneider, *Nits, Grits and Soft Information in SEC Filings*, 121 U. PA. L. REV. 254 (1972).

79. *See, e.g.*, Starkman v. Marathon Oil Co., 772 F.2d 231 (6th Cir. 1985); *Repairman's Serv. Corp.*, No. 7811, slip op. at 20, *reprinted in* 10 DEL. J. CORP. L. at 915 ("Generally, 'soft' information, such as projections . . . need not be disclosed . . . . ").

80. 744 F.2d 978 (3d Cir. 1984). "As a matter of public policy, the SEC and the courts generally have not required the inclusion of appraised asset valuations, projections, and other 'soft' information in proxy materials or tender offers." *Id.* at 985 (citations and footnote omitted). The court noted, however, "indications that the law, in response to developing corporate trends, such as the increase in mergers, has begun to favor more disclosure of soft information." *Id.* at 986. In 1978, for example, the SEC issued a safe harbor rule for "forward-looking" statements made in good faith. *See* 17 C.F.R. § 230.175 (1983). Then, in 1980, the SEC authorized disclosure of good faith appraisals made on a reasonable basis in proxy contests in which a principal issue is the liquidation of some or all of a company's assets. *See* SEC Release No. 34-16833, Fed. Sec. L. Rep. (CCH) ¶ 24,117 (May 23, 1980) (codified at 17 C.F.R. § 241.16833 (1983)).

In *Flynn*, the court held that, henceforth,

> [c]ourts should ascertain the duty to disclose asset valuations and other soft information on a case by case basis, by weighing the potential aid such information will give a shareholder against the potential harm such as undue reliance, if the information is released with a proper cautionary note.
>
> The factors a court must consider in making such a determination are: the facts upon which the information is based; the qualifications of those who prepared or compiled it; the purpose for which the information was originally intended; its relevance to the stockholders' impending decision; the degree of subjectivity or bias reflected in its preparation; the degree to which the information is unique; and the availability to the investor of other more reliable sources of information.

Flynn, 744 F.2d at 988 (citations and footnotes omitted).

81. No. 7662 (Del. Ch. Mar. 18, 1986), *reprinted in* 12 DEL. J. CORP. L. 244 (1987).

82. No. 7954 (Del. Ch. Apr. 11, 1986), *reprinted in* 12 DEL. J. CORP. L. 418 (1987). The court noted that, in Delaware, "[i]t is settled law that completeness, rather than adequacy, is required to satisfy the duty of candor and that all information which a reasonable stockholder would consider important in deciding on the transaction must be disclosed." *Id.*, slip op. at 7, *reprinted in* 12 DEL. J. CORP. L. at 422 (citing Lynch v. Vickers Energy Corp., 383 A.2d 278, 281 (Del. 1977)).

required to be disclosed, holding that it was unable to conclude that claims based upon a failure to disclose financial projections were clearly without merit either as a matter of law or fact.[83] And in *In re Anderson, Clayton*,[84] the chancellor, recognizing that "it is not feasible to set forth a single test" to determine whether disclosure of asset appraisals should be required and that such a "determination must of necessity be made on a case by case basis,"[85] adopted the *Flynn* standard as a "reasonably complete . . . intermediate guide in attempting to assess whether a shareholder would likely find the appraisal results of actual significance."[86] Thus, it appears that at least the court of chancery has adopted the *Flynn* approach as a reasonable method for sifting out soft information that may be considered reliable from that which cannot be.[87]

In *Weinberger v. Rio Grande Industries*,[88] the court applied *Flynn* but concluded that the plaintiff had failed to establish that certain *pro formas* "had sufficient indicia of reliability to require disclosure."[89] Among the bases for the court's conclusion in *Rio Grande* were the facts that the *pro formas* (i) were not intended to be relied upon by management or the stockholders as evidence of the company's value, but were intended as an "advocacy" document for the purpose of inducing the Interstate Commerce Commission to grant Rio Grande certain benefits in connection with a merger involving its competitors, and (ii) reflected highly speculative assumptions and uncertain variables.[90]

The *Edick* and *Wacht* decisions in the court of chancery also evidenced an increasing unwillingness to dismiss actions challenging mergers on the ground that the plaintiff's exclusive remedy is an appraisal pursuant to section 262 of the GCL.[91] Relying in part on the supreme court's 1985 decision in *Rabkin v. Philip A. Hunt Chemical Corp.*,[92] the court in *Edick* held that allegedly material omissions in

83. *Edick*, No. 7662, slip op. at 8, *reprinted in* 12 DEL. J. CORP. L. at 248; *Wacht*, No. 7954, slip op. at 7, *reprinted in* 12 DEL. J. CORP. L. at 422.

84. 519 A.2d 680 (Del. Ch. 1986).

85. *Id.* at 692.

86. *Id.*

87. *Id.*

88. No. 7791, slip op. at 30 (Del. Ch. Oct. 22, 1986).

89. *Id.*

90. *Id.* at 36.

91. *See* DEL. CODE ANN. tit. 8, § 262 (1983).

92. 498 A.2d 1099 (Del. 1985). In *Rabkin*, plaintiffs attacked the cash-out merger of a wholly-owned subsidiary of Olin Corporation (Olin) into Philip A.

an information statement combined with allegations as to the manner in which the reverse stock split at issue was effectuated stated a claim for breach of the duty of entire fairness.[93] In *Wacht*, the court found that the complaint stated a claim for unfair dealing based on alleged failures to disclose material information with which the stockholders could have determined to seek an appraisal.[94] The court rejected defendants' arguments that *Rabkin v. Philip A. Hunt Chemical Corp.*[95] and *Weinberger v. UOP, Inc.*[96] were inapplicable because stockholder approval of the merger was not sought.[97]

Hunt Chemical Corporation (Hunt), whereby the public stockholders of Hunt were to receive $20 per share. *Id.* at 1103. Olin had acquired 63.4% of Hunt's outstanding common stock on March 1, 1983 pursuant to a stock purchase agreement which provided that if Olin were to acquire all or substantially all of the remaining Hunt shares within one year of the closing date, Olin would pay the equivalent of at least the net purchase price per share (approximately $25) (the "one year commitment"). The merger at issue was agreed upon approximately one month after the expiration of the one year commitment at a price of $20 per share. *Id.*

In addition to numerous more general allegations as to the inadequacy of the price, the Rabkin complaint alleged that the price was grossly inadequate because Olin manipulated the timing of the merger to avoid the one year commitment. In reversing the dismissal of the Rabkin complaint, the supreme court stated:

> In *Weinberger* we observed that the timing, structure, negotiation, and disclosure of a cash-out merger all had a bearing on the issue of procedural fairness. The plaintiffs contend *inter alia* that Olin breached its fiduciary duty of fair dealing by purposely timing the merger, and thereby unfairly manipulating it, to avoid the one year commitment. In support of that contention plaintiffs have averred specific facts indicating that Olin knew it would eventually acquire Hunt, but delayed doing so to avoid paying $25 per share.
>
> . . . .
>
> While we do not pass on the merits of such questions, Olin's alleged attitude toward the minority . . . coupled with the apparent absence of any meaningful negotiations as to price, all have an air reminiscent of the dealings between Signal and UOP in *Weinberger*. . . . These are issues which an appraisal cannot address, and at this juncture are matters that cannot be resolved by a motion to dismiss.

Id. at 1105-06.

93. *Edick*, No. 7662, slip op. at 7-8, *reprinted in* 12 DEL. J. CORP. L. at 248. The complaint alleges that defendants committed a fraud upon the public stockholders by withholding material information as to value. *See id.*, slip op. at 7, *reprinted in* 12 DEL. J. CORP. L. at 248.

94. *Wacht*, No. 7954, slip op. at 9, *reprinted in* 12 DEL. J. CORP. L. at 423. The court found that the alleged failure to disclose financial projections was not without merit and denied that the plaintiff's exclusive remedy was an appraisal. *Id.*, slip op. at 9, *reprinted in* 12 DEL. J. CORP. L. at 423.

95. 498 A.2d 1099 (Del. 1985).

96. 457 A.2d 701 (Del. 1983).

97. *Wacht*, No. 7954, slip op. at 6-7, *reprinted in* 12 DEL. J. CORP. L. at 422.

D. *Rule 23.1*

The demand requirements under Rule 23.1[98] in stockholder derivative actions were also the subject of litigation in the court of chancery in 1986. In *Tomczak v. Morton Thiokol, Inc.*,[99] the court denied a motion to dismiss the complaint for failure to make a pre-suit demand on the board of Morton Thiokol pursuant to Rule 23.1.[100] Although it noted that the "reasonable doubt" standard found appropriate by the supreme court in *Aronson v. Lewis*[101] was "nebulous" and "obviously a very high standard,"[102] the court found that allegations concerning Morton Thiokol's sale of one of its divisions to Dow Chemical raised a reasonable doubt as to whether the Morton Thiokol board's approval of the sale was the product of a valid exercise of business judgment.[103] In particular, the court noted

---

98. DEL. CH. CT. R. 23.1. That rule provides in pertinent part:

> The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and the reasons for his failure to obtain the action or for not making the effort. The action shall not be dismissed or compromised without the approval of the Court, and notice by mail, publication or otherwise of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the Court directs; except that if the dismissal is to be without prejudice or with prejudice to the plaintiff only, then such dismissal shall be ordered without notice thereof if there is a showing that no compensation in any form has passed directly or indirectly from any of the defendants to the plaintiff or plaintiff's attorney and that no promise to give any such compensation has been made.

99. No. 7861 (Del. Ch. May 7, 1986), *reprinted in* 12 DEL. J. CORP. L. 381 (1987).

100. *Id.*, slip op. at 1, *reprinted in* 12 DEL. J. CORP. L. at 382-83 (facts alleged in amended complaint and construed in a light most favorable to the plaintiff were enough to excuse a pre-suit demand and satisfy Chancery Rule 23.1).

101. 473 A.2d 805 (Del. 1984). Under *Aronson*, a pre-suit demand will be excused if there is a reasonable doubt that "(1) the directors are disinterested and independent [or] (2) the challenged transaction was otherwise the product of a valid exercise of business judgment." *Id.* at 814. *See also* Pogostin v. Rice, 480 A.2d 619 (Del. 1984) (plaintiff stockholders failed to meet the particularity requirement of Chancery Rule 23.1 and complaint failed to create a reasonable doubt that the defendant directors were entitled to the protections of the business judgment rule pursuant to the *Aronson* test).

102. *Tomczak*, No. 7861, slip op. at 7, *reprinted in* 12 DEL. J. CORP. L. at 385.

103. *Id.*, *reprinted in* 12 DEL. J. CORP. L. at 385-86. The amended complaint alleged that Dow Chemical Co. (Dow) began to acquire Morton Thiokol's common stock on the market after Morton Thiokol refused to negotiate with Dow concerning purchase of Morton Thiokol's Texize Division. After Dow filed a Schedule 13D with the SEC suggesting it might decide at some time to acquire Morton Thiokol, Morton Thiokol began negotiations with Dow. These negotiations quickly resulted in an agreement which was made subject to the approval of Morton Thiokol's

allegations that only two of Morton Thiokol's twelve directors had any real notice of the proposed transaction before the board meeting at which the decision to sell was made, that the board was not apprised of the investment banker's valuation of the assets and that the directors ignored opportunities to obtain a higher price for the assets.[104]

In *Good v. Getty Oil Co.*,[105] on the other hand, the court dismissed the derivative complaint with leave to amend on the ground that it did not allege particularized facts sufficient to create a reasonable doubt that the directors were disinterested and independent or that the challenged transaction was the product of a valid exercise of business judgment.[106] The court noted, however, that "the fact that the derivative action is against a third person for dealings with the corporation does not necessarily require that the control of the litigation be vested in the board of directors."[107]

After plaintiffs amended their complaint, defendant Texaco again moved to dismiss and requested permission to establish a factual record in support of its motion.[108] Simultaneously with that motion, Texaco petitioned the court to certify to the Delaware Supreme Court, pursuant to Chancery Rule 72(b), the question of whether "a factual record may be established in an appropriate fashion to demonstrate the incorrectness of the factual allegations of the Complaint. . . ."[109] The court denied the petition for certification on the basis that neither *Aronson* nor *Pogostin v. Rice*[110] precludes consideration of factual matters when the issue of demand futility is raised in a context other than

---

board of directors. The agreement provided that Morton Thiokol would sell its Texize Division to Dow in exchange for: (1) $131 million in cash; (2) all of Dow's Morton Thiokol stock (approximately 1.4 million shares); and (3) Dow's promise to forego further purchase of Morton Thiokol's stock for a period of 10 years. *Id.*, slip op. at 2-3, *reprinted in* 12 DEL. J. CORP. L. at 383.

104. *Id.*, slip op. at 7-8, *reprinted in* 12 DEL. J. CORP. L. at 386.

105. 514 A.2d 1104 (Del. Ch. 1986).

106. *Id.* at 1109. The plaintiffs, two stockholders of Texaco, Inc., purportedly acting derivatively on behalf of Texaco, sought to assert a claim against Getty Oil Company, Gordon P. Getty, Trustee of the Sarah C. Getty Trust, the J. Paul Getty Museum, and former directors of Getty. The suit sought to set aside indemnity undertakings by Texaco in favor of the Getty defendants. It also sought to recover Texaco's damages resulting from a $10.5 billion judgment against Texaco rendered in connection with the acquisition of Getty Oil Company by Texaco. *Id.* at 1106.

107. *Id.* at 1109.

108. Good v. Getty Oil Co., 518 A.2d 973 (Del. Ch. 1986).

109. *Id.*

110. 480 A.2d 619 (Del. 1984). In *Pogostin*, the supreme court affirmed the chancery court's dismissal of a shareholder derivative action for failure to make a demand upon the board of directors or to allege with particularity that demand

a motion to dismiss the complaint.[111] The court suggested that the demand futility issue could be resolved on a factual record using the summary judgment procedures of Rule 56 or trial of the separate issue of demand futility under Rule 42(b).[112] It held that a motion to dismiss, which assumes that the well-pleaded allegations of the complaint are true, was not the appropriate procedural mechanism where the moving party requires development of a factual record to support its motion.[113]

The supreme court addressed the notice and court approval provisions of Rule 23.1 in 1986. In *Lipton v. News International, plc*,[114] the court found that, although News International[115] had pleaded claims against the defendants in the trial court that supported both individual and derivative causes of action,[116] it had proceeded with its individual action only and therefore was not required to comply with the notice and court approval provisions of Rule 23.1 in dismissing its action against the defendants.[117] The court stated, "A shareholder whose complaint arguably asserts both derivative and individual claims but who eschews any effort to proceed derivatively should be permitted to resolve his individual claim, provided it does not prejudice or adversely affect the viability of a perceived derivative claim."[118]

The court of chancery relied on *News International* in *Rabkin* in finding that allegations that a merger unfairly affected minority stockholders stated a direct, as opposed to derivative, claim. As a result, the court declined to dismiss claims that certain of Hunt's directors had breached their fiduciary duties.[119]

---

was futile, pursuant to Rule 23.1 of the Delaware Court of Chancery Rules. *Pogostin*, 480 A.2d at 627.

111. *Good*, 518 A.2d at 974.

112. *Id.*

113. *Id.*

114. 514 A.2d 1075 (Del. 1986).

115. News International, plc, is an English company controlled by K. Rupert Murdoch. *Id.* at 1076.

116. The court explained that the test for determining whether a claim is individual or derivative is whether the plaintiff has alleged special injury, which the court in Elster v. American Airlines, Inc., 34 Del. Ch. 94, 100 A.2d 219 (1953), implicitly defined as "a wrong inflicted upon him alone or a wrong affecting any particular right which he is asserting." *Id.* at 99, 100 A.2d at 222. Examples of such special injury include decisions affecting preemptive rights as a stockholder, rights involving the control of the corporation, or a wrong affecting the stockholders and not the corporation. *Id.*

117. *News Int'l, plc*, 514 A.2d at 1080.

118. *Id.*

119. No. 7547, slip op. at 15 (Del. Ch. Dec. 4, 1986) (decision on remand

E. *Proxy and Consent Solicitations*

In 1986, the Delaware courts also issued important opinions relevant to proxy and consent solicitations. In *Empire of Carolina, Inc. v. Deltona Corp.*,[120] the supreme court addressed the issue of whether any notice that stockholder consents will be solicited under section 228[121] precludes a board of directors from acting under section 213(a) to set a record date for stockholder consent action different from the record date established by operation of section 213(b)(2).[122] The court affirmed the lower court decision[123] which held "that for a record date to be 'fixed,' a soliciting shareholder must clearly, explicitly, directly and unmistakably make known to the corporation: (1) that a written consent bearing a given date has been obtained; and (2) the substance of the shareholder action consented to under section 228."[124]

Notwithstanding section 228,[125] a board of directors acting within the parameters of section 213(a)[126] may exercise its business judgment

---

from Delaware Supreme Court). *See supra* note 92 (discussion of supreme court's decision on the case).

120. 514 A.2d 1091 (Del. 1986).

121. DEL. CODE ANN. tit. 8, § 228 (1983) provides in relevant part:

> Unless otherwise provided in the certificate of incorporation, any action required by this chapter to be taken at any annual or special meeting of stockholders of a corporation, or any action which may be taken at any annual or special meeting of such stockholders, may be taken without a meeting, without prior notice and without a vote, if a consent in writing, setting forth the action so taken, shall be signed by the holders of outstanding stock having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voted.

Id.

122. DEL. CODE ANN. tit. 8, § 213 (1983). *See Empire of Carolina*, 514 A.2d at 1092. Section 213 establishes two procedures for determining record dates. Under the general rule set forth in § 213(a), a record date of not more than 60 days nor less than 10 days before the date of the meeting may be set. Section 213(b) provides an alternative which is available only when the board of directors has not acted to fix a record date. Under the alternative in § 213(b), the record date is the day on which the first written consent is expressed. Pursuant to a 1987 amendment to § 213(b), the record date set by the board for a consent solicitation cannot "be more than ten days after the date upon which the resolution fixing the record date is adopted by the board of directors." DEL. CODE ANN. tit. 8, § 213(b) (1987 Interim Supplement).

123. Empire of Carolina, Inc. v. Deltona Corp., 501 A.2d 1252 (Del. Ch.), *aff'd*, 514 A.2d 1091 (Del. 1986).

124. *Empire of Carolina*, 514 A.2d at 1093.

125. *See supra* note 121.

126. *See supra* note 122.

in fixing a record date for stockholder action by written consent.[127] In addition, given the plaintiff's concession that the board of directors had not impermissibly manipulated the corporate machinery, the court found that the setting of a record date six weeks in the future fell within the board's business judgment.[128] While the supreme court's 1985 decision in *Datapoint Corp. v. Plaza Securities Co.*[129] had invalidated a bylaw provision that imposed a sixty day delay upon all stockholder action by written consent, the court distinguished *Datapoint* from the facts in *Empire of Carolina* based on section 213(a)'s placement of the traditional and primary authority to fix a record date upon a board of directors.[130]

The court of chancery also addressed the entitlement of dissident stockholders to information in the company's possession identifying certain beneficial owners of the company's stock. Under Securities and Exchange Commission Rule 14b-1(c),[131] effective January 1, 1986, registered brokers and dealers are required to provide the company with a list of their customers who are beneficial owners of the company's securities and who have not objected to disclosure of that information, a so-called NOBO list. In ordering production of the NOBO list in *Shamrock Associates v. Texas American Energy Corp.*,[132] the court rejected defendant's arguments that a stockholder is statutorily entitled to inspect only the corporation's stock ledger and its list of stockholders and that, if read more broadly, Delaware law is preempted by federal law.[133] The court explained that "the stocklist materials provided to a stockholder should include all of those forms of stockholder data readily available to the corporation. This approach promotes the interests of all stockholders by providing them the most prompt and complete information concerning the corporate decision at hand."[134] Thus the court found that its reading of section 220 "will foster rather than obstruct" the purpose of the federal law.[135]

---

127. *Empire of Carolina*, 514 A.2d at 1097.

128. *Id.*

129. 496 A.2d 1031 (Del. 1985).

130. *Empire of Carolina*, 514 A.2d at 1096-97.

131. 17 C.F.R. § 240.14b-1(c) (1987).

132. 517 A.2d 658 (Del. Ch. 1986).

133. *Id.* at 660. The plaintiff, a record stockholder of the defendant corporation, demanded the defendant's stocklist, NOBO list, and related materials for the purpose of soliciting proxies for the election of directors at the corporation's upcoming annual meeting. *Id.*

134. *Id.* at 661.

135. *Id.* at 662. The court was referring to Rule 14a-13(b)(2) of the Securities and Exchange Commission, which provides that a corporation which obtains a

The court also held in *Shamrock Associates* that the defendant corporation could not, as a general matter, condition its release of the stocklist materials on execution of a confidentiality agreement.[136] On the other hand, the court agreed with the defendant's position that the NOBO list must be kept confidential, reasoning that since the corporation is expressly limited in its use of the NOBO list by virtue of Rule 14a-13(b)(2), plaintiff should be bound similarly.[137]

III. THE 1986 AMENDMENTS TO THE GCL

As a result of heightened director concern about personal liability arising from highly publicized recoveries in recent lawsuits and severe dislocation in the market for directors' and officers' liability insurance,[138] several amendments to the GCL were adopted in 1986 in an effort to alleviate these problems.[139] While legislation that would have expanded greatly the power of Delaware corporations to in-

---

NOBO list, "shall . . . [u]se the information so furnished for purposes of corporate communications." *Id.* at 660. The court rejected the defendant's assertion that the Rule means that no entity other than the corporation may use the list even to communicate about corporate matters. *Id.* at 662. The court stated that the SEC neither compels disclosure nor prohibits it. *Id.* Furthermore, the SEC has opined that a rule may be necessary which would allow tender offerors or proxy contestants access to the NOBO list in order to effectuate the purposes of the Williams Act. Thus, § 220 will serve as an aid in carrying out the Williams Act. *Id.*

136. *Id.* at 663.

137. *Id.*

138. *See* legislative commentary to 1986 Delaware Corporate Law Amendments, S.B. 533, 133d General Assembly, 65 Del. Laws, ch. 289 (1986); L. Black & A. Sparks, Analysis of the 1986 Amendments to the Delaware Corporation Law, 3 Corporation Statutes (P-H) 311 (July 29, 1986) [hereinafter Black & Sparks]; Mallen & Evans, *Surviving the Directors' and Officers' Liability Crisis: Insurance and the Alternatives*, 12 DEL. J. CORP. L. 439 (1987).

139. 65 Del. Laws, ch. 289, 1 & 2 (1986). The full text of the legislative synopsis of the 1986 amendments is as follows:

> Section 102(b)(7) and the amendments to Section 145 represent a legislative response to recent changes in the market for directors' liability insurance. Such insurance has become a relatively standard condition of employment for directors. Recent changes in that market, including the unavailability of the traditional policies (and, in many cases, the unavailability of any type of policy from the traditional insurance carriers) have threatened the quality and stability of the governance of Delaware corporations because directors have become unwilling, in many instances, to serve without the protection which such insurance provides and, in other instances, may be deterred by the unavailability of insurance from making entrepreneurial decisions. The amendments are intended to allow Delaware corporations to provide substitute protection, in various forms, to their directors and to limit director liability under certain circumstances.

demnify directors and officers was considered,[140] the amendments adopted permit stockholders to limit director liability if they so choose.

The most significant of the 1986 amendments expands section 102(b) of the GCL to authorize insertion into the certificate of incorporation a provision which would, subject to certain limitations, limit or eliminate a director's liability for monetary damages for breaches of fiduciary duty.[141] Such provisions cannot limit or eliminate a director's liability for breaches of the duty of loyalty; for acts or omissions not in good faith or involving intentional misconduct or knowing violation of law; for the payment of unlawful dividends or unlawful stock repurchases or redemptions; or for transactions in which the directors received an improper personal benefit.[142] The amendments to section 102(b) have no effect on the availability of equitable remedies such as an injunction or rescission based upon a director's breach of a fiduciary duty.[143]

The 1986 amendments also made relatively minor changes in section 145 of the GCL, which governs indemnification of directors and employees.[144] Among other changes, the amendments to section 145 shift the burden of making the findings required for entitlement to indemnification from the director or employee claimant to the corporation, and make it clear that advances of expenses are meant to be included within the non-exclusivity concept of section 145(f).[145]

---

140. Black & Sparks, *supra* note 138, at 311.

141. DEL. CODE ANN. tit. 8, § 102(b)(7) (1986).

142. Legislative commentary to 1986 amendments to § 102(b)(7), S.B. 533, 133d General Assembly, 65 Del. Laws, ch. 289 (1986). The full text of the legislative comments to the revision of § 102(b)(7) is as follows:

> This provision enables a corporation in its original certificate of incorporation or an amendment thereto validly approved by stockholders to eliminate or limit personal liability of members of its board of directors or governing body for violations of a director's fiduciary duty of care. However, the amendment makes clear that no such provision shall eliminate or limit the liability of a director for breaching his duty of loyalty, failing to act in good faith, engaging in intentional misconduct or knowingly violating a law, paying a dividend or approving a stock repurchase which was illegal under 8 *Del. C.* § 174, or obtaining an improper personal benefit. This provision would have no effect on the availability of equitable remedies, such as an injunction or rescission, for breach of fiduciary duty.

143. DEL. CODE ANN. tit. 8, § 102(b) (1986).

144. *Id.* § 145.

145. *See* legislative commentary to 1986 amendments to § 145, S.B. 533, 133d General Assembly, 65 Del. Laws, ch. 289 (1986). The full text of the legislative comments to the revision of § 145 is as follows:

> *Commentary on Section 145(b):*
>
> Paragraph (b) has been amended to conform the standard for indemni-

A director's or officer's right to have litigation expenses paid by the corporation in advance of the disposition of the proceeding may be expanded and other rights may be granted by a bylaw provision, contract, or board or stockholders' resolution so long as no public policy is violated.[146]

IV. CONCLUSION

The recent developments in Delaware corporate law have refined, rather than radically altered, important legal concepts. The supreme court's decision in *Revlon* provides further guidance to directors concerning their obligations of due care and loyalty in the consideration of proposed acquisitions. The various decisions in the court of chancery concerning disclosure obligations indicate that these obligations cannot be taken lightly. The judicial decisions and the legislative response to the directors' and officers' liability insurance crisis reflect well-considered responses to a variety of legal questions in the corporate context.

---

fication under the statute with the recent holdings of the Delaware Supreme Court. No substantive change in the law is intended.

Commentary on Section 145(e):

The first amendment to Section 145(e) deletes the previous requirement for authorization of advancement of litigation expenses, "as authorized by the board of directors in the specific case" so as to permit general authorization of advancement of expenses including a mandatory certificate of incorporation or by-law [sic] provision to that effect. The second amendment to Section 145(e) changes the undertaking required for the advancement of expenses to directors and officers so as not to create an obligation to repay unless a specific determination is made that the director or officer is not entitled to be indemnified as authorized in Section 145. Nothing in these changes to subsection (e) relieves the board of directors from its affirmative duty to see that the determination required by subsection (d) is made for any indemnification under subsections (a) and (b).

Commentary of Section 145(f):

The addition of the phrase "and advancement of expenses" is intended to make clear that the "other rights" provided for in Section 145(f) may include rights to have expenses advanced on terms other than those provided in Section 145(e). The phrase "and shall continue as to a person who has ceased to be a director, officer, employee or agent" has been relocated to a new subsection (j).

Commentary on Section 145(j):

New subsection 145(j) has been added to set forth the provision from Section 145(f) referred to above. No substantive change in the law is intended.

146. *Id.*