Commentary from the Bar

1988 DEVELOPMENTS IN DELAWARE CORPORATE LAW

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I. INTRODUCTION

Delaware courts have made important rulings concerning principles of fiduciary duty and issues arising under the Delaware General Corporation Law (GCL)[1] in 1988. The Delaware Court of Chancery and Delaware Supreme Court have issued seminal decisions concerning the sale of corporate control, including decisions relating to the conduct of auctions and the redemption of rights issued pursuant to shareholder rights plans. The GCL was also amended in 1988 in several important respects. These recent decisions and statutory amendments are important to corporate legal advisors and to anyone involved in the management of a Delaware corporation.

This article summarizes developments in Delaware corporate law during 1988. While summarization of the extensive body of Delaware corporate law and review of every Delaware corporate decision in 1988 are beyond the scope of this article, a wide range of the corporate issues addressed by the Delaware courts in 1988 will be considered. The amendments to the GCL in several important areas will also be reviewed.

II. CASE LAW APPLYING DELAWARE CORPORATE LAW

A. *Proper Conduct of a Post-*Revlon *Auction*

In 1986 the Delaware Supreme Court decided *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[2] As a result of this case, it is now well settled that the responsibilities of directors change from "the

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1. DEL. CODE ANN. tit. 8, §§ 101-398 (1974 & Supp. 1988).
2. 506 A.2d 173 (Del. 1986).

preservation of [the company] as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit"[3] once it is determined that the company is for sale. In a series of recent decisions in the United States District Court for the District of Delaware, the Delaware Supreme Court, and court of chancery, various issues have been clarified which were not resolved by *Revlon*.

One such issue, considered by the federal district court in *Black & Decker Corp. v. American Standard, Inc.*,[4] is when a corporation can be considered to be "for sale" thus implicating *Revlon*. In response to a tender offer by Black & Decker for all of American Standard's shares, American Standard's Board announced that it intended to proceed with a recapitalization of the company. In addition,

> [t]he board amended the company's retirement and savings plan and established a severance plan for salaried employees assigned to corporate staff functions "in order to provide that, in the event of a potential change of control," payments [would] be accelerated under the retirement and savings plan and specified salaried employees [would] be entitled to severance benefits.[5]

According to an affidavit submitted by Black & Decker and accepted by the court as "uncontroverted," the amendments would cost American Standard approximately $130 million.[6] The court, in its decision, placed considerable importance on the fact that American Standard specifically exempted its own recapitalization plan from the definition of a "change of control."[7]

After distinguishing the facts from the Delaware Supreme Court's 1987 decision in *Ivanhoe Partners v. Newmont Mining Corp.*,[8] the court

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3. *Id.* at 182.

4. 682 F. Supp. 772 (D. Del. 1988).

5. *Id.* at 776. While plaintiffs also challenged American Standard's use of a shareholder rights plan, they abandoned that challenge after American Standard's directors voted to terminate the rights plan if a majority of the company's shares were purchased pursuant to a formal tender offer. *Id.* at 778.

6. *Id.* at 776.

7. *Id.* This was important because the court had to determine whether the recapitalization plan would result in an actual change in control of the corporation. A change in control is the threshold inquiry in determining whether the duties imposed under *Revlon* are implicated.

8. 535 A.2d 1334 (Del. 1987). In response to a hostile tender offer for 42% of the stock of Newmont Mining Corporation (Newmont), Newmont adopted a

in *Black & Decker* concluded that the recapitalization plan constituted a sale of control of American Standard sufficient to make *Revlon* applicable.[9] The court so concluded in part because public shareholders would own only 45.5% of the outstanding common stock on a fully diluted basis after the recapitalization, while management and the savings plan and Employee Stock Ownership Plan (ESOP) would own the remainder.[10] Comparing the facts in *Ivanhoe Partners*, the court found that

> [w]hereas all Newmont shareholders were treated equally with the distribution of the dividend, and whereas Gold Fields purchased its stock on the open market, American Standard's Recapitalization Plan provides for the transfer of stock and options to management and the ESOP without providing for the same opportunity to the public shareholder.[11]

The court concluded that "[t]he effect of the plan is to treat the competing bidders unfairly," since the recapitalization provided, without any justification, a $130 million disadvantage to Black & Decker in its effort to acquire American Standard.[12]

> Finally, it is difficult to see how the amendment to the Retirement Plans and the enactment of the Severance Plan benefit the shareholders. *Revlon, Inc.* makes clear that "con-

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restructuring proposal consisting of the declaration of a $33.00 dividend and the negotiation of a standstill agreement with Consolidated Gold Fields PLC (Gold Fields), a major shareholder in Newmont. *Id.* at 1339. The dividend facilitated Gold Fields' "street sweep" and acquisition of 15.8 million shares of Newmont while the standstill agreement ensured that Gold Fields' interest in Newmont would not exceed 49.9% and that its representation on Newmont's Board would be limited to 40%. *Id.* at 1340. The supreme court found that Newmont had never been for sale and that there had never been a bidding contest or a sale of the company. *Id.* at 1345.

9. *Black & Decker*, 682 F. Supp. at 682-84.

10. *Id.* at 782. The court found support for its conclusion that a sale of control amounts to a "sale" under *Revlon* in Edelman v. Fruehauf Corp., 798 F.2d 882 (6th Cir. 1986), and Freedman v. Restaurant Assocs. Indus., Inc., No. 9212 (Del. Ch. Oct. 16, 1987), *reprinted in* 13 DEL. J. CORP. L. 651 (1988). *Black & Decker*, 682 F. Supp. at 781.

11. *Black & Decker*, 682 F. Supp. at 783. The court found that the shareholders were "acceding control in the corporation through the medium of stock options." *Id.* at 784. The court, in comparing Newmont's restructuring in *Black & Decker*, stated that in Newmont's restructuring plan, "the public shareholders retained a majority of the outstanding stock and majority representation in the board." *Id.*

12. *Id.* at 786.

> cern for non-stockholder interests is inappropriate when an auction among active bidders is in progress, and the object is no longer to protect or maintain the corporate enterprise but to sell it to the highest bidder." Thus, it is probable that the Board abrogated its duty when it adopted the amendments to the Retirement Plans and enacted the Severance Plan in order to provide for its employees when its concern should have been to sell the company to the highest bidder. No doubt one could conclude in a different situation with different timing that severance and retirement plans are legitimate corporate functions designed to reward corporate officers fidelity and performance. Indeed, in other situations, courts have found the plans [sic] due to the deference accorded the business judgment rule. But these Plans were designed to deter bidding and, in the *Revlon* context, provide a substantial basis for concluding that Black & Decker will succeed on the merits.[13]

The court of chancery also considered the conduct of auctions for control of corporations in several cases in 1988. In *In re J.P. Stevens & Co. Shareholders Litigation*,[14] the court declined a request that it enjoin enforcement of provisions of an amended merger agreement between J.P. Stevens & Co., Inc. (Stevens) and Odyssey Partners (Odyssey) providing for payment by Stevens of up to $25 million in expenses and a "topping fee"[15] to Odyssey under certain circumstances.[16] Stevens had entered into the original merger agreement with Odyssey at the apparent conclusion of an auction of five weeks duration for control of Stevens.[17] A special committee of Stevens' Board of Directors (Special Committee) had selected Odyssey's $61.50 cash offer over competing bids from West Point-Pepperell, Inc. (West

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13. *Id.* at 786-87 (citations omitted).

14. 542 A.2d 770 (Del. Ch. 1988).

15. A "topping fee" is a fee payable to a bidder in the event its bid is topped by another bidder. In this case, the topping fee was 20% of any amount realized by Stevens' stockholders over that provided in the merger agreement (with an $8 million cap). *Id.* at 777.

16. *Id.* at 785.

17. *Id.* at 773-76. The auction for control of Stevens began when "Palmetto, Inc., a company formed by members of Stevens' senior management," sent Stevens' Board a buy-out proposal whereby Palmetto would acquire Stevens' stock at a per share price of $38 in cash and $5 in junior subordinated debentures. *Id.* at 773.

Point) and Stevens' senior management.[18] The original merger agreement provided for reimbursement of up to $17 million of Odyssey's expenses under certain circumstances.[19]

After the merger agreement was signed, West Point announced that it would commence a tender offer for Stevens' stock at $62.50 cash per share or enter into a merger agreement with Stevens for $64 cash per share.[20] Stevens and Odyssey then amended their merger agreement to provide for payment of $64 cash per share.[21] Pursuant to the amended agreement, Odyssey was granted an additional "topping fee" of 20% of any amount over $64 that the shareholders ultimately realized, to a maximum of $8 million.[22]

The court's legal analysis centered on its interpretation of the supreme court's 1986 opinion in *Revlon*.[23] While the court recognized that *Revlon* "may be viewed as a case in which a finding of divided loyalty did not play a critical part,"[24] the court viewed *Revlon* as a case involving a board that was in a "conflict situation" due to divided loyalties.[25] As the court stated:

> *Revlon* recognizes that once a change in control is concededly in the works, the responsibility of the board is limited to a [sic] facilitating and achieving the best possible transaction for the shareholders. *Revlon*, however, does not purport to restrict the powers of a disinterested board from entering into agreements of the kind here under attack if, in doing so, the board acts in good faith and with appropriate care. While it is true, that once agreements of this kind are in place, they do have the effect of tilting the playing field in favor of the holder of such rights, that fact, alone, does not establish that they necessarily are not in the best interest of shareholders. It is the shareholders to

18. *See id.* at 775-76. While West Point had proposed to pay $62.50 in cash per share, the Special Committee determined that Odyssey's offer was "more likely to close and to do so sooner" than West Point's offer due to perceived antitrust problems with West Point's offer. *Id.* at 776.

19. *Id.* at 776. This agreement was entered into after Odyssey agreed to drop, among other things, its demand for a "topping fee." *Id.*

20. *Id.* This offer was made by Magnolia Partners, L.P., which consisted of West Point and another corporate entity. *Id.*

21. *Id.* at 777-78.

22. *Id.* at 777.

23. 506 A.2d 173 (Del. 1986).

24. *In re J.P. Stevens*, 542 A.2d at 779.

25. *Id.* at 778-79, 781.

> whom the board owes a duty of fairness, not to persons seeking to acquire the Company. To continue with the metaphor, the board may tilt the playing field if, but only if, it is in the shareholders' interest to do so.[26]

After reviewing "the apparently attentive and conscientious way" in which the Stevens Special Committee had performed,[27] the court applied the business judgment rule to the Special Committee's decisions concerning the payment of topping fees and expenses[28] and other conduct concerning the auction.[29] The court limited its substantive review of the transaction to the question of whether any decision of the Special Committee was "so beyond the bounds of reasonable judgment in the circumstances as to give rise to an inference of bad faith."[30] The court's inquiry revealed no such evidence and it therefore denied plaintiffs' motions in all respects.[31]

In *In re Fort Howard Corp. Shareholders Litigation*,[32] the court of chancery denied a motion to preliminarily enjoin the closing of a public tender offer by an entity formed by Morgan Stanley Group, Inc. (Morgan Stanley) for up to all of the outstanding shares of Fort

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26. *Id.* at 781-82 (footnote omitted). Price need not be the only concern of directors in the auction context. Other factors such as form of transaction, timing and risk of non-consummation may also be considered where applicable. *Id.* at 781 n.6.

27. *Id.* at 781. The court concluded that the Special Committee had acted in good faith in conducting the auction. *Id.* at 780. In contrast, the court in *In re* Trans World Airlines Shareholders Litig., No. 9844 (Del. Ch. Oct. 21, 1988), *reprinted in* 14 DEL. J. CORP. L. 870 (1989), found that "the directors did not seem to understand that their duty was to strive to negotiate the highest or best available transaction for the shareholders whom they undertook to represent." *Id.*, slip op. at 10, *reprinted in* 14 DEL. J. CORP. L. at 879. Nevertheless, despite finding that the plaintiffs' claims were plausible, the court held that the claims of unfair dealing related ultimately to the fairness of the price offered and that the essential interests of the class would be fully protected by an award of compensatory damages if found warranted after a trial. *Id.*, slip op. at 5, *reprinted in* 14 DEL. J. CORP. L. at 876.

28. As to the payment of such fees and expenses, the court noted that they were "reasonably conventional and . . . not invalid per se." *In re J.P. Stevens*, 542 A.2d at 783 (citing *Revlon*, 506 A.2d at 183). The court stated that such fees have been struck down when they are the product of disloyal action or a grossly negligent process. *Id.* (citing Edelman v. Fruehauf Corp., 798 F.2d 882 (6th Cir. 1986); Hanson Trust PLC v. ML SCM Acquisition, Inc., 781 F.2d 264 (2d Cir. 1986)).

29. *In re J.P. Stevens*, 542 A.2d at 780-81.

30. *Id.* at 781.

31. *Id.* at 781, 785.

32. No. 9991 (Del. Ch. Aug. 8, 1988), *reprinted in* 14 DEL. J. CORP. L. 699 (1989).

Howard Corporation (Fort Howard) at $53 cash per share.[33] The plaintiffs claimed the process followed by the Fort Howard directors in negotiating the buyout agreement pursuant to which the offer was made, and their conduct since, constituted a violation of duties arising in connection with a sale of the company.[34]

The court found that, while the Special Committee established by the board did not conduct an auction of any kind before signing an agreement of merger with Morgan Stanley, it did publicly announce that upon signing the agreement Fort Howard would entertain third party interests and extend the tender offer to include a thirty business day period from the date of the announcement.[35] The court held that such procedures were "adopted in good faith and [were] effective to give the board an informed, dependable basis for the view that the Morgan Stanley offer is the best available transaction from the point of view of the Fort Howard shareholders."[36]

As to the board's role in the context of an auction, the court stated that:

> [m]ore generally, a board need not be passive even in an auction setting. It may never appropriately favor one buyer over another for a selfish or inappropriate reason, such as occurred in *Revlon*, but it may favor one over another if in good faith and advisedly it believes shareholder interests would be thereby advanced. Even in the auction context, if one deal is all cash and more likely to close and sooner, a disinterested board might prefer it to a deal that may be thought to represent a somewhat higher price, but is not all cash and not capable of closing as quickly. The need to exercise judgment is *inescapably* put on the board at points in an auction process and the validity of the exercise of

33. *Id.*, slip op. at 1, 4, *reprinted in* 14 DEL. J. CORP. L. at 703, 705. The tender offer represented the first step of a planned two-step leveraged buyout transaction. *Id.*, slip op. at 1, *reprinted in* 14 DEL. J. CORP. L. at 704.

34. *Id.*, slip op. at 1, *reprinted in* 14 DEL. J. CORP. L. at 704.

35. *Id.*, slip op. at 3, 15-17, *reprinted in* 14 DEL. J. CORP. L. at 705, 711-12. If a competing party outbid the buyout group, the buyout group would be entitled to be paid up to approximately $1.00 per share ($67 million) in topping fees and expense reimbursement. *Id.*, slip op. at 16-17, *reprinted in* 14 DEL. J. CORP. L. at 712-13.

36. *Id.*, slip op. at 3, *reprinted in* 14 DEL. J. CORP. L. at 705. The court did suggest, however, that the fact that Fort Howard's chief executive officer appeared to handpick the members of the Special Committee and its counsel was not the "best practice." *Id.*, slip op. at 30, *reprinted in* 14 DEL. J. CORP. L. at 719-20.

that judgment is appropriately subjected to a business judgment form of judicial review.[37]

The court of chancery also addressed the methods used by directors in obtaining bids for the company in *Yanow v. Scientific Leasing, Inc.*[38] The directors of Scientific Leasing, Inc. (SLI) sought bidders for the company but would only negotiate with parties willing to sign a confidentiality agreement and would not announce publicly that SLI was for sale.[39] Negotiations with LINC Group, Inc. (LINC) led to SLI Board approval of a tender offer of $15.375 per share and a follow-up merger at the same price.[40] While the Agreement between SLI and LINC included the grant of a stock option to LINC, an expense reimbursement provision and a "window shop" clause,[41] SLI refused to grant a break-up fee or "no-shop" clause requested by LINC.[42]

After finding that the benefits granted to LINC were not the type of provisions that improperly preclude competing bids and that no competing bidder had appeared,[43] the court refused to grant the

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37. *Id.*, slip op. at 35 (citation omitted), *reprinted in* 14 DEL. J. CORP. L. at 719-20.

38. Nos. 9536 & 9561 (Del. Ch. Feb. 5, 1988) (revised Feb. 8, 1988), *reprinted in* 13 DEL. J. CORP. L. 1273 (1988).

39. *Id.*, slip op. at 4, *reprinted in* 13 DEL. J. CORP. L. at 1277.

40. *Id.*, slip op. at 5, *reprinted in* 13 DEL. J. CORP. L. at 1278.

41. The "window shop" provision entitled SLI to give financial information to a bidder if SLI's financial advisors advised that the terms of its offer were economically superior and if SLI's legal advisors opined that the directors had a fiduciary duty to provide the information. *Id.*, slip op. at 6, *reprinted in* 13 DEL. J. CORP. L. at 1278.

42. *Id.*, slip op. at 6, *reprinted in* 13 DEL. J. CORP. L. at 1278. The "no-shop" clause would have restricted SLI from negotiating a transaction at a higher price with any other bidder after the agreement with LINC was signed. *Id.*, slip op. at 5, *reprinted in* 13 DEL. J. CORP. L. at 1278.

43. *Id.*, slip op. at 11, 15, *reprinted in* 13 DEL. J. CORP. L. at 1281, 1283. The court found that

> the LINC option is not a "lock up" option that would operate to preclude higher bids. That option, if exercised, would result in LINC owning only 16% of SLI and would involve only a minimal cost to a higher bidder ($620,000 for each additional $1 per share offering price). The grant of the option was necessary to induce LINC to make an offer at a premium over market price, and, as such, is the type of arrangement that has met with judicial approval. Similarly, the expense reimbursement provision was necessary to induce LINC to bid, since LINC would otherwise have been unwilling to outlay considerable sums for acquisition-related expenses that would be nonrecoverable if a higher bidder succeeded in acquiring SLI. The reimbursement clause, which becomes applicable only if SLI

requested injunctive relief.[44] The court found that the "real dispute boils down to what specific methods corporate directors may use to elicit bids from potential acquirers. That issue would appear to be normally a matter of director judgment that necessarily must vary with each case."[45]

The contest for control of Macmillan, Inc. also resulted in important rulings concerning director conduct in connection with the sale of a company. In *Robert M. Bass Group, Inc. v. Evans*,[46] the court of chancery preliminarily enjoined a planned restructuring of Macmillan, Inc. sponsored by its management in response to the threat of a hostile tender offer by the plaintiff Robert M. Bass Group, Inc. (Bass Group).[47] The plaintiff alleged that, notwithstanding Macmillan's valuation of its restructuring at $64.15 per share,[48]—only fifteen cents more than the plaintiff's initial offer[49] and nearly $9 less than its current offer[50]—Macmillan and its management never attempted to negotiate with the plaintiff and continued to pursue the restructuring. This was despite a second offer from the plaintiff either to (i) pay $73 per share cash or (ii) accomplish a transaction providing to the stockholders the identical consideration offered in the restructuring plus an additional $5.65 in cash.[51]

After noting that the circumstances of each individual case and the nature of the threat posed determine the reasonableness of an antitakeover defense,[52] the court reviewed the nature of the threat posed by the Bass Group and the board's response to it.[53] In considering whether and to what extent the plaintiff's offers constituted a threat, the court found that the Macmillan Board was required to

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> breaches the agreement or if a third party acquires SLI, is also reasonable. The "window shop" clause of the acquisition agreement expressly allows SLI to cooperate with a *bona fide* higher bidder and, as such, is also consistent with the Board's fiduciary duties.

Id., slip op. at 12 n.6 (citations omitted), *reprinted in* 13 DEL. J. CORP. L. at 1281 n.6.

44. *Id.*, slip op. at 13, *reprinted in* 13 DEL. J. CORP. L. at 1280.

45. *Id.*, slip op. at 14, *reprinted in* 13 DEL. J. CORP. L. at 1283.

46. Nos. 9909 & 9953 (Del. Ch. July 14, 1988) (revised July 18, 1988).

47. *Id.*, slip op. at 58.

48. *Id.*, slip op. at 25.

49. *Id.*, slip op. at 17. The initial offer was contingent upon obtaining adequate financing. *Id.*

50. *Id.*, slip op. at 28.

51. *Id.*

52. *Id.*, slip op. at 41.

53. *Id.*, slip op. at 41-48.

consider the antitakeover devices already at its disposal.[54] Given that "Macmillan's arsenal was formidable"[55] and that the threat was that the "Bass [Group's] $73 . . . proposal, while fair, was not the highest price that might be available if [Macmillan] were being sold, [the court suggested that a] reasonable response . . . would be to develop a more valuable economic alternative."[56]

> Thus, given the nature of the threat, a reasonable response would, at a minimum, offer stockholders higher value than the Bass Group offer or, at the very least, offer stockholders a choice between equivalent values in different forms. The management restructuring offers neither. Not only does it offer inferior value to the shareholders, it also forces them to accept it. No shareholder vote is afforded; no choice is given. The restructuring is crafted to take the form of a dividend, requiring only director approval. On that basis alone . . . I find preliminarily that the restructuring is a coercive, and economically inferior, response to the Bass Group "threat."[57]

The court made a preliminary finding "that the restructuring involv[ed] a transfer of effective control that under normal market conditions would [have] command[ed] a control premium."[58] It concluded that the restructuring represented "a windfall to management at the expense of Macmillan's public stockholders."[59]

The contest for control of Macmillan did not end with the court's July opinion.[60] The restructuring was abandoned in mid-September when Macmillan's directors determined that Macmillan should be sold.[61] A bidding war resulted between entities controlled

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54. *Id.*, slip op. at 39.
55. *Id.*
56. *Id.*, slip op. at 41.
57. *Id.*, slip op. at 42-43 (citations omitted).
58. *Id.*, slip op. at 46.
59. *Id.*, slip op. at 53.
60. Entities controlled by Robert Maxwell commenced a tender offer to acquire Macmillan for $80 per share on August 12, 1988. Mills Acquisition Co. v. Macmillan, Inc., No. 10,168 (Del. Ch. Oct. 17, 1988), *reprinted in* 14 DEL. J. CORP. L. 772 (1989), *rev'd*, Record, Nos. 415 & 416 (Del. Nov. 2, 1988), 559 A.2d 1261 (Del. 1989) (written opinion).
61. *Id.*, slip op. at 1, *reprinted in* 14 DEL. J. CORP. L. at 777. While the Bass Group had increased its offer to $75 per share in July of 1988, it withdrew its offer in September 1988 after significantly higher bids by MCC and KKR. *Id.*, slip op. at 9 n.4, *reprinted in* 14 DEL. J. CORP. L. at 781.

by Mr. Robert Maxwell (MCC) and Kohlberg Kravis Roberts & Co. (KKR).[62] After several rounds of bidding, Macmillan concluded the auction on September 27, 1988 when it declared KKR's offer valued at $90.05 to be the winning bid.[63] Macmillan then granted KKR a lock-up option to acquire four of Macmillan's important divisions for $865 million and agreed to a "break-up fee" and reimbursement of KKR's expenses in certain circumstances.[64]

MCC challenged the conduct of the auction in the court of chancery, alleging, among other things, that the auction was fatally imbalanced in favor of KKR as a result of: (i) a telephone call from Macmillan's Chairman to KKR "tipping" the amount of MCC's bid but withholding comparable information as to KKR's bid from MCC; and (ii) the reading by Macmillan's investment banker of a specially prepared script to KKR (but not to MCC) that "drew a veritable road map" for KKR to formulate its successful bid.[65]

The court of chancery denied MCC's application to invalidate and enjoin performance of the lock-up and break-up fee provisions in *Mills Acquisition Co. v. Macmillan, Inc.*[66] Despite its recognition that the auction for control of Macmillan "was hardly even-handed or neutral" due in part to the tipping of MCC's bid to KKR and other conduct which assisted the favored bidder,[67] the court found that the auction did not preclude the opportunity for MCC to submit its best bid.[68]

However, in a bench ruling announced after oral argument on an appeal in early November, the supreme court reversed the court of chancery's decision as to the lock-up option and the break-up fee

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62. *Id.*, slip op. at 1, *reprinted in* 14 DEL. J. CORP. L. at 777.

63. *Id.*, slip op. at 2, *reprinted in* 14 DEL. J. CORP. L. at 777. MCC responded by increasing its all cash tender offer to $90.25 per share. *Id.*, slip op. at 3, *reprinted in* 14 DEL. J. CORP. L. at 778.

64. *Id.*, slip op. at 3 n.3, *reprinted in* 14 DEL. J. CORP. L. at 778.

65. *Id.*, slip op. at 36, *reprinted in* 14 DEL. J. CORP. L. at 796. Plaintiffs also challenged the refusal of Macmillan's investment banker to respond to MCC's request for information as to whether Macmillan had received a higher bid and his failure to tell MCC "in a pointed way" that it would have to raise its bid in order to win (as he had told KKR). *Id.*, slip op. at 36-37, *reprinted in* 14 DEL. J. CORP. L. at 796.

66. No. 10,168 (Del. Ch. Oct. 17, 1988), *reprinted in* 14 DEL. J. CORP. L. 772 (1989), *rev'd*, Record, Nos. 415 & 416 (Del. Nov. 2, 1988), 559 A.2d 1261 (Del. 1989) (written opinion).

67. *Id.*, slip op. at 38, *reprinted in* 14 DEL. J. CORP. L. at 797.

68. *Id.*, slip op. at 45-46, *reprinted in* 14 DEL. J. CORP. L. at 800-01.

and expense reimbursement provisions.[69] The supreme court found that the record did not demonstrate "the most scrupulous adherence to ordinary principles of fairness in the conduct of an auction" required by *Revlon*.[70] The court held that the matter was governed by "principles of intrinsic fairness" since Macmillan's senior management was a party to the breaches of fiduciary duty and had a personal interest in the outcome of the board's action.[71]

In *In re Holly Farms Corp. Shareholders Litigation*,[72] the court of chancery granted a request by bidder Tyson Foods, Inc. (Tyson) for a preliminary mandatory injunction to enjoin an asset option lock-up and termination and expense reimbursement fee provisions contained in an agreement of merger entered into between Holly Farms Corporation (Holly) and ConAgra, Inc., a third party bidder favored by Holly's Board.[73] After Tyson commenced a cash tender offer for all of Holly's outstanding common stock at $52 per share on October 21, Tyson was informed on November 11 that Holly's Board would meet on November 16 to consider all of its alternatives and that no decision had yet been reached as to whether Holly was for sale.[74] At its November 16 meeting, Holly's Board determined that the company should be sold, and decided to sell it to ConAgra.[75] As part of the agreement, Holly's Board acquiesced to ConAgra's conditions. Specifically, they decided to extend to ConAgra a lock-up option on Holly's prime poultry operations and agreed to a termination fee of $15 million and reimbursement of expenses should the deal fail to close.[76]

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69. Record, *Mills Acquisition Co.* (Nos. 415 & 416). The court issued a subsequent written opinion which addressed the lock-up issue. The court held that the "record reflecte[d] breaches of the duties of loyalty and care by various corporate fiduciaries which tainted the evaluative and deliberative processes of the Macmillan Board, thus adversely affecting general stockholder interests. *Mills Acquisition Co.*, 559 A.2d at 1264-65. Because of the existence of divided loyalties on the part of certain board members, and the lack of serious oversight by allegedly independent directors, the court judged the lock-up under the intrinsic fairness test. *Id.* at 1265. Upon review of the record, the court found that the director's conduct in the auction failed to meet the test, stating that "such conduct of an auction for corporate control is insupportable." *Id.*

70. Record at 1, *Mills Acquisition Co.* (Nos. 415 & 416).

71. *Id.* at 2.

72. No. 10,350 (Del. Ch. Dec. 30, 1988), *reprinted in* 14 DEL. J. CORP. L. 1062 (1989).

73. *Id.*, slip op. at 16-17, *reprinted in* 14 DEL. J. CORP. L. at 1073-74.

74. *Id.*, slip op. at 4-5, *reprinted in* 14 DEL. J. CORP. L. at 1067-68.

75. *Id.*, slip op. at 5-6, *reprinted in* 14 DEL. J. CORP. L. at 1068.

76. *Id.*

The court found that, under *Revlon*, Holly's Board should have assumed the role of an auctioneer bound to maximize the sale price of Holly after it determined to sell the corporation.[77] The court found Holly's claim that the auction had to be conducted within the constraints of a "no shop" provision demanded by ConAgra "fatally flawed."[78] While it viewed the "no shop" provision as having possibly served a valid purpose, the court concluded that the "mere disclosure" of the board's decision to sell the company could not have violated such provision.[79]

As to the continued vitality of lock-ups after *Revlon*, the court stated:

> While the granting of a lock[-]up may be rational where it is reasonably necessary to encourage a prospective bidder to submit an offer, lock-ups "which end an active auction and foreclose further bidding operate to the shareholders' detriment" are extremely suspect. The presumptions of the business judgment rule will generally not protect acts of directors who grant a lock[-]up in an active bidding situation where there is more than one bona fide bidder.[80]

The court of chancery also had the opportunity to address issues relating to the conduct of an auction after a full trial. In *Citron v. Fairchild Camera & Instrument Corp.*,[81] the court found that the directors of Fairchild Camera and Instrument Corporation (Fairchild) were entitled to the protection of the business judgment rule in connection with their consideration and recommendation of a cash tender offer for all of Fairchild's stock by an affiliate of Schlumberger.[82] Fairchild's directors accepted Schlumberger's offer of $66 in cash per share for all of Fairchild's shares and rejected an offer by Gould, Inc. of $70

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77. *Id.*, slip op. at 12, *reprinted in* 14 DEL. J. CORP. L. at 1071. "At that moment the Board was required to do everything reasonably necessary to sell the corporation for the highest price available." *Id.*, slip op. at 12-13, *reprinted in* 14 DEL. J. CORP. L. at 1071.

78. *Id.*, slip op. at 14-15, *reprinted in* 14 DEL. J. CORP. L. at 1072.

79. *Id.*, slip op. at 15, *reprinted in* 14 DEL. J. CORP. L. at 1072.

80. *Id.*, slip op. at 16, *reprinted in* 14 DEL. J. CORP. L. at 1073 (quoting *Revlon*, 506 A.2d at 183 (citations omitted)). The court found that the record did not substantiate Holly Farms' claim that the lock-up was necessary to obtain ConAgra's proposal. *Id.*

81. No. 6085 (Del. Ch. May 19, 1988), *reprinted in* 14 DEL. J. CORP. L. 273 (1989).

82. *Id.*, slip op. at 45-46, 50-51, *reprinted in* 14 DEL. J. CORP. L. at 302, 304-05.

in cash for approximately 42% of Fairchild's share and Gould preferred stock for the remainder of Fairchild's stock in a back-end merger.[83] While Gould had made two proposals in the month before the May 19, 1979 board meeting at which the Fairchild Board considered final offers,[84] Schlumberger's offer was made on the morning of the board meeting and was contingent on acceptance by noon on May 19.[85]

In finding the board's conduct in considering the offers to be reasonable and rejecting the plaintiff's argument that the board acted hastily,[86] the court noted that:

> where a disinterested board in good faith considers the significance of the decision called for, the available information of which it and its advisors are aware and the time constraints imposed upon it, and in those circumstances, the board makes a decision that it *is* in the best interests of the corporation to act, that decision itself is entitled to the benefits of the business judgment rule.[87]

As to the board's substantive decision to accept the $66 offer, the court held that "the decision to reject a purportedly higher offer on terms in favor of an all cash offer with an arguably lower value does not, on these facts, constitute a breach of the duty of loyalty."[88]

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83. *Id.*, slip op. at 31-38, *reprinted in* 14 DEL. J. CORP. L. at 294-98. While Gould's investment banker orally suggested that the preferred stock would be worth $70 per share, neither he nor Gould put that in writing or indicated terms for such stock. *Id.*, slip op. at 33, *reprinted in* 14 DEL. J. CORP. L. at 295.

84. *Id.*, slip op. at 8-9, 14-15, *reprinted in* 14 DEL. J. CORP. L. at 282, 285-86. On April 25, 1979, Gould proposed to acquire 45% of Fairchild's stock for $54 cash and the remainder in exchange for Gould common stock. *Id.*, slip op. at 8, *reprinted in* 14 DEL. J. CORP. L. at 282. After that proposal was rejected, Gould notified Fairchild of its intention to make a tender offer for up to 46% of Fairchild's stock at $57 per share and acquire the remainder of the stock for common stock or other equity securities of Gould. *Id.*, slip op. at 14-15, *reprinted in* 14 DEL. J. CORP. L. at 285.

85. *Id.*, slip op. at 31, *reprinted in* 14 DEL. J. CORP. L. at 294. Schlumberger's offer was also conditioned on rejection of the Gould proposal, unanimous approval by Fairchild's Board, and execution of an agreement and a joint public announcement that day. *Id.*

86. *Id.*, slip op. at 47-48, *reprinted in* 14 DEL. J. CORP. L. at 303.

87. *Id.*, slip op. at 49-50, *reprinted in* 14 DEL. J. CORP. L. at 304.

88. *Id.*, slip op. at 47, *reprinted in* 14 DEL. J. CORP. L. at 303. In consideration of a settlement in Shingala v. Becor W. Inc., Nos. 8858 & 8859 (Del. Ch. Feb. 3, 1988), *reprinted in* 13 DEL. J. CORP. L. 1232 (1988), the court also noted in discussing valuation bids in an auction context that "it does not strike me as

The board's "duty can only be to try in good faith, in such a setting, to get the best available transaction for the shareholders. Directors are not insurers."[89]

B. *Shareholder Rights Plans*

The proper use of shareholder rights plans again assumed center stage in a series of opinions by the court of chancery in 1988. Although the supreme court had indicated in its seminal 1985 decision in *Moran v. Household International, Inc.*[90] that a board of directors did "not . . . have unfettered discretion in refusing to redeem" stockholder purchase rights,[91] no Delaware decision had ordered redemption of such rights prior to 1988. But "it was only a matter of time [before] courts would be asked to decide under what circumstances a board of directors are obligated, as fiduciaries, to redeem an outstanding 'poison pill' rights plan."[92] In several 1988 decisions, including several cases previously discussed[93] and cases involving control of Staley Continental, Inc.,[94] Facet Enterprises, Inc.,[95] Damon

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inappropriate to consider the amount of time that would be necessary to consummate a transaction in determining the overall value of each bid." *Id.*, slip op. at 11, *reprinted in* 13 DEL. J. CORP. L. at 1240.

89. *Citron*, No. 6085, slip op. at 44 n.17, *reprinted in* 14 DEL. J. CORP. L. at 301.

90. 500 A.2d 1346 (Del. 1985).

91. *Id.* at 1354. A brief discussion of the mechanics and effect of one such rights plan is contained in Grand Metropolitan PLC v. Pillsbury Co., Nos. 10,319 & 10,323 (Del. Ch. Dec. 16, 1988).

92. Facet Enters., Inc. v. Prospect Group, Inc., No. 9746, slip op. at 16-17 (Del. Ch. Apr. 15, 1988), *reprinted in* 14 DEL. J. CORP. L. 310, 320 (1989).

93. BNS Inc. v. Koppers Co., 683 F. Supp. 458 (D. Del. 1988); *In re* Holly Farms Corp. Shareholders Litig., No. 10,350 (Del. Ch. Dec. 30, 1988), *reprinted in* 14 DEL. J. CORP. L. 1062 (1989).

94. Tate & Lyle PLC v. Staley Continental, Inc., No. 9813 (Del. Ch. May 9, 1988), *reprinted in* 14 DEL. J. CORP. L. 418 (1989). While the court refused to order redemption of the rights in *Tate & Lyle*, it agreed to preliminarily enjoin (upon posting of a $65 million bond) the operation of a funding trust, the purpose of which was to fund compensation plans which the court found benefit inside and outside directors upon a change of control. *Id.*, slip op. at 18, 25, *reprinted in* 14 DEL. J. CORP. L. at 423, 436. The court found that the directors had not carried their burden of demonstrating a reasonable probability that creation of the funding trust was "intrinsically fair." *Id.*, slip op. at 18, *reprinted in* 14 DEL. J. CORP. L. at 423. The court applied the intrinsic fairness test after finding that "[a]ll the directors who approved the creation of the Trust had a direct personal interest in one or another of the compensation plans to be funded by the Funding Trust." *Id.*

95. Facet Enters., Inc. v. Prospect Group, Inc., No. 9746 (Del. Ch. Apr. 15, 1988), *reprinted in* 14 DEL. J. CORP. L. 310 (1989).

Corporation,[96] Doskocil Companies Inc.,[97] and Prime Computer,[98] the courts refused to order redemption of such rights on the records existing at the time the motions were heard.

As the court of chancery recognized in *Doskocil Cos. v. Griggy*,[99] several principles guide the courts in refusing to order redemption of the rights:

> First, a target board is not required to redeem the rights in the face of a non-coercive all cash tender offer. Where the board has determined that the offered price is inadequate and has decided to conduct an auction for the company, it may be appropriate to keep the rights in place in order to allow time for higher bids to be made. Second, even if the offered price is not inadequate, it may be appropriate to maintain the rights in order to promote the continuation of the auction. Third, when conducting a *Revlon* auction, the target board may favor one bidder over another "if in good faith and advisedly it believes shareholder interests would be thereby advanced."[100]

As a New York federal court applying Delaware law noted in *CRTF Corp. v. Federated Department Stores*,[101] a rights plan, if properly used, "provides the directors with a shield to fend off coercive offers, and with a gavel to run an auction."[102]

While the redemption issue had arisen only during the pendency of an ongoing auction in the early cases, the court of chancery was presented with a different set of facts in *City Capital Associates v. Interco*

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96. Nomad Acquisition Corp. v. Damon Corp., Nos. 10,173 & 10,189 (Del. Ch. Sept. 16, 1988) (revised Sept. 20, 1988), *reprinted in* 14 DEL. J. CORP. L. 814 (1989).

97. Doskocil Cos. v. Griggy, No. 10,095 (Del. Ch. Oct. 7, 1988), *reprinted in* 14 DEL. J. CORP. L. 682 (1989).

98. MAI Basic Four, Inc. v. Prime Computer, Inc., No. 10,428 (Del. Ch. Dec. 20, 1988), *reprinted in* 14 DEL. J. CORP. L. 1086 (1989).

99. No. 10,095 (Del. Ch. Oct. 7, 1988), *reprinted in* 14 DEL. J. CORP. L. 682 (1989).

100. *Id.*, slip op. at 5-6 (citations omitted), *reprinted in* 14 DEL. J. CORP. L. at 686 (quoting *In re Fort Howard*, No. 9991, slip op. at 35, *reprinted in* 14 DEL. J. CORP. L. at 699).

101. 683 F. Supp. 422 (S.D.N.Y. 1988) (applying Delaware law).

102. *Id.* at 439.

Inc.[103] In *Interco*, the court found that the directors of Interco had breached their fiduciary duties to the stockholders in failing to redeem stock rights originally distributed as part of a defense against unsolicited takeover attempts.[104] Interco's directors were seeking to defeat a $74 cash tender offer for all shares and endeavoring to implement a major restructuring of Interco which they claimed could have a value of at least $76 per share.[105]

Based on facts it found not to be "legitimately in dispute,"[106] the court held that the board's determination to leave the rights in place was a defensive step that could not be justified at the end stage of the contest for control. The board's actions were not reasonable in relationship to the threat to the corporation or its shareholders posed by the $74 offer.[107] The court also noted that:

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103. No. 10,105 (Del. Ch. Nov. 1, 1988). Two weeks before release of the court's opinion in *Interco*, the court of chancery granted plaintiff's request for an order requiring redemption of stockholder purchase rights in Mills Acquisition Co. v. Macmillan, Inc., No. 10,168 (Del. Ch. Oct. 17, 1988), *reprinted in* 14 DEL. J. CORP. L. 772 (1989). The court found that "the fact that the auction has concluded should not deprive the shareholders of the opportunity to consider," as an alternative to the KKR offer, MCC's higher bid. *Id.*, slip op. at 50, *reprinted in* 14 DEL. J. CORP. L. at 803.

104. *Interco*, No. 10,105, slip op. at 1.

105. *Id.*

106. *Id.*, slip op. at 18. The court considered this fact important since the affirmative relief requested as to the rights would, if granted, constitute relief that could not later be effectively reversed after trial. *Id.*, slip op. at 17-18.

107. *Id.*, slip op. at 26-28. The court stated:

> In this instance, there is no threat of shareholder coercion. The threat is to shareholders' economic interests posed by an offer the board has concluded is "inadequate." If this determination is made in good faith (as I assume it is here . . .), it alone will justify leaving a poison pill in place, even in the setting of a noncoercive offer, for a period while the board exercises its good faith business judgment to take such steps as it deems appropriate to protect and advance shareholder interests in light of the significant development that such an offer doubtless is. That action may entail negotiation on behalf of shareholders with the offeror, the institution of a *Revlon*-style auction for the Company, a recapitalization or restructuring designed as an alternative to the offer, or other action.
>
> Once that period has closed, and it is apparent that the board does not intend to institute a *Revlon*-style auction, or to negotiate for an increase in the unwanted offer, and that it has taken such time as it required in good faith to arrange an alternative value-maximizing transaction, then, in most instances, the legitimate role of the poison pill in the context of a noncoercive offer will have been fully satisfied. The only function then left for the pill at this end-stage is to preclude the shareholders from exercising a judgment about their own interests that differs from the

> Our corporation law exists, not as an isolated body of rules and principles, but rather in a historical setting and as a part of a larger body of law premised upon shared values. To acknowledge that directors may employ the recent innovation of "poison pills" to deprive shareholders of the ability effectively to choose to accept a noncoercive offer, after the board has had a reasonable opportunity to explore or create alternatives, or attempt to negotiate on the shareholders behalf, would, it seems to me, be so inconsistent with widely shared notions of appropriate corporate governance as to threaten to diminish the legitimacy and authority of our corporation law.[108]

Significantly, the court nevertheless recognized that there might exist a case where "some special circumstance" might make it appropriate for a board to use a rights plan to permanently foreclose stockholder consideration of a noncoercive offer.[109] But *Interco* was not such a case.

The court of chancery again considered the propriety of purchase rights in two decisions arising out of Pillsbury's attempt to defeat a hostile tender offer. In a November 7 decision in *Grand Metropolitan PLC v. Pillsbury Co.*,[110] the court refused a request by bidder Grand Metropolitan PLC (Grand Met) that it order Pillsbury's directors to redeem the rights that precluded Grand Met from consummating a $60 per share tender offer for all of Pillsbury's stock.[111] The court found that the board was independent, that no significant challenge had been made to its good faith and that its investigation had not been unreasonable.[112] The court also commented on the possibility

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judgment of the directors, who will have some interest in the question.
Id. (footnotes omitted).

The court noted that only two prior cases in the court of chancery had found defensive steps undertaken by a corporation to be disproportionate to a threat posed by a takeover attempt: *Interco*, No. 10,105, slip op. at 22 n.9 (citing AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103 (Del. Ch. 1986)); and Robert M. Bass Group, Inc. v. Evans, Nos. 9909 & 9953 (Del. Ch. July 14, 1988) (revised July 18, 1988).

108. *Interco*, No. 10,105, slip op. at 31.

109. *Id.*, slip op. at 28.

110. Nos. 10,319 & 10,323 (Del. Ch. Nov. 7, 1988) (revised Nov. 9, 1988), *reprinted in* 14 DEL. J. CORP. L. 1042 (1989).

111. *Id.*, slip op. at 5, *reprinted in* 14 DEL. J. CORP. L. at 1045.

112. *Id.*, slip op. at 2-3, *reprinted in* 14 DEL. J. CORP. L. at 1044.

that Pillsbury might determine to keep its rights plan in place if a better offer did not materialize:

> Pillsbury's exploration of alternatives may go on indefinitely, but a "just say no" posture may not justify keeping a Pill in place when its only purpose is to bar all stockholders from having an opportunity to consider an all-cash, all-shares offer to sell their shares. Such an offer, while not coercive, may, however, be a threat to stockholders' economic interests if it is "inadequate."[113]

Five weeks later, the court was again asked to address the Pillsbury Board's decision not to redeem its rights for Grand Met's offer.[114] While Grand Met increased the per share price of its offer to $63 on the date of oral argument, affidavits offered by Pillsbury's investment bankers indicated their view that such a price was inadequate.[115] Instead, Pillsbury's Board offered stockholders a plan which contemplated a spin-off of Pillsbury's Burger King subsidiary and a sale of both Burger King and Pillsbury's remaining assets within five years.[116] Pillsbury's investment bankers opined that the per share present minimum value of Pillsbury's plan was $68.[117]

Against that factual background, the court assessed whether or not the board's defensive measures were reasonable in relation to any threat posed by Grand Met's offer. In the court's view, the only threat posed was "to shareholder value—nothing whatsoever affects the corporate entity or any other constituency."[118] The court found that the "real threat" to stockholder value related to "what will probably happen if the Pill remains in place and Grand Met's Offer is withdrawn"—a possible loss of $1.5-1.9 billion to Pillsbury's stockholders.[119] After reviewing the supreme court's opinions in *Unocal*

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113. *Id.*, slip op. at 4, *reprinted in* 14 DEL. J. CORP. L. at 1044-45 (citing City Capital Assocs. v. Interco Inc., No. 10,105 (Del. Ch. Nov. 1, 1988)).

114. Grand Metropolitan PLC v. Pillsbury Co., Nos. 10,319 & 10,323 (Del. Ch. Dec. 16, 1988).

115. *Id.*, slip op. at 6 n.4, 12, 20 n.9, 22.

116. *Id.*, slip op. at 21-22.

117. *Id.*, slip op. at 22.

118. *Id.*, slip op. at 23. The court concluded that Pillsbury had made no showing that redemption of the rights or a successful Grand Met tender offer would endanger the policy or effectiveness of Pillsbury as a corporation. *Id.*, slip op. at 17.

119. *Id.*, slip op. at 23-24.

Corp. v. Mesa Petroleum Co.,[120] *Moran v. Household International, Inc.*,[121] and *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,[122] the court suggested that "[i]t would be ironic, indeed, if those cases and the shareholder-protective principles which they created were now turned 180 degrees and applied *against* Pillsbury stockholders who pose no threat of any kind to the corporate enterprise."[123] Holding that the board's decision to keep the rights plan in place was not reasonable in relation to any threat posed, the court granted Grand Met's request that it order Pillsbury's directors to redeem the rights.[124]

C. Section 203—The Delaware Business Combination Statute

On several occasions during 1988, the United States District Court for the District of Delaware considered challenges to the constitutionality of section 203 of the GCL, the Delaware Business Combination statute adopted in February of 1988.[125] Section 203, in simple terms, prevents a "business combination" between an "interested stockholder" and the target corporation for a three-year period unless one of the exceptions stated in the statute applies.[126]

In *BNS Inc. v. Koppers Co.*[127] the district court held that section 203 was "most likely constitutional."[128] While the court stated that section 203 "alters the balance between target management and the offeror, perhaps significantly,"[129] it found that the statute "will be constitutional . . . so long as it does not prevent an appreciable number of hostile bidders from navigating the statutory exceptions."[130] The court therefore concluded that:

> [n]otwithstanding section 203's possible injurious effects, because it benefits stockholders, and because the leg-

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120. 493 A.2d 946 (Del. 1985).

121. 500 A.2d 1346 (Del. 1985) (board of director's adoption of preferred share purchase rights plan was legitimate exercise of business judgment).

122. 506 A.2d 173 (Del. 1986) (when sale of company becomes inevitable, duty of the board of directors changes from preservation of the corporate entity to maximization of the company's value at a sale for stockholders' benefit).

123. *Grand Metropolitan*, Nos. 10,319 & 10,323, slip op. at 27 (Del. Ch. Dec. 16, 1988).

124. *Id.*, slip op. at 30.

125. DEL. CODE ANN. tit. 8, § 203 (1988).

126. *See infra* notes 199-202 and accompanying text (detailing discussion of § 203).

127. 683 F. Supp. 458 (D. Del. 1988).

128. *Id.* at 461.

129. *Id.* at 470.

130. *Id.*

> islature presumably has balanced the countervailing effects and found the degree of stockholder protection to offset potential harm to stockholders, . . . the statute will be in all likelihood constitutional and not preempted. If the method Delaware has chosen to protect stockholders in fact on balance harms them, then at that time reconsideration of the statute's congruence with the Williams Act will be warranted.[131]

The district court again refused to enjoin enforcement of section 203 in *RP Acquisition Corp. v. Staley Continental, Inc.*[132] The court rejected the position taken in an amicus curiae brief filed by the Securities and Exchange Commission (SEC) that the statute was unconstitutional as preempted by the Williams Act.[133]

The court noted that, "at the same time that Section 203 achieves shareholder protection, it also exercises substantial deterrent effects on tender offers. . . . The crucial inquiry, then, is whether hostile offers still have a meaningful opportunity for success despite the operation of Section 203."[134] After reviewing additional evidence on that point not before the court in *BNS Inc. v. Koppers Co.*, the court concluded that "hostile tender offers retain a meaningful opportunity for success . . . ."[135]

The court found that "Section 203 can be characterized as a good faith effort by the General Assembly to comply with the Constitution and specifically with the *CTS* decision. [W]e discern no reason to disturb the balance the General Assembly struck."[136] The court found no support in the Supreme Court's opinion in *CTS*[137] for the SEC's proposal that the court should enter into an extended analysis of whether Delaware had chosen the best mechanism for shareholder protection.[138]

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131. *Id.* at 472.
132. 686 F. Supp. 476 (D. Del. 1988).
133. *Id.* at 482-83, 486.
134. *Id.* at 482.
135. *Id.* at 484.
136. *Id.* at 485.
137. CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69 (1987). In *CTS*, the United States Supreme Court upheld the constitutionality of the Indiana takeover statute.
138. *RP Acquisition*, 686 F. Supp. at 488 n.16.

While the constitutionality of section 203 was also challenged in various other actions in the Delaware federal court in 1988,[139] none of the challenges were successful. No appellate opinion concerning the constitutionality of section 203 was issued in 1988.[140]

D. Exercise of Shareholder Consent Under Section 228

Delaware courts also issued important opinions in 1988 concerning a board of directors' power to limit the ability of stockholders to take action by consent as permitted by section 228.[141] In *Allen v. Prime Computer, Inc.*,[142] the Delaware Supreme Court affirmed a court of chancery decision enjoining Computervision Corporation from enforcing bylaws which delayed, for at least twenty days, the effectiveness of certain stockholder action taken by written consent.[143] The court found that neither section 228, providing for stockholder action by written consent, nor the court's prior decision in *Datapoint Corp. v. Plaza Securities Co.*,[144] sanctioned the delays which the bylaws countenanced.[145] The court reaffirmed the view it expressed in *Datapoint* that "bylaws which 'defer consummation of shareholder action by consent in lieu of meeting until a ministerial-type review has been performed'" may be valid.[146]

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139. *See* SWT Acquisitions Corp. v. TW Servs., Inc., 700 F. Supp. 1323 (D. Del. 1988). In *TW Services*, the court dismissed a hostile tender offeror's action, seeking a declaration that a provision of Delaware's takeover law which required offeror to obtain approval of two-thirds of the common shares it did not then own or were not tendered to it, for failure to state a justiciable case or controversy. *See also* City Capital Assocs. v. Interco Inc., 696 F. Supp. 1551 (D. Del.), *aff'd on other grounds*, 860 F.2d 60 (3d Cir. 1988). In *Interco*, the court refused to preliminarily enjoin enforcement of Delaware's antitakeover statute where the evidence failed to show the statute deprived shareholders of the opportunity to decide whether to tender their shares so as to harm shareholders and frustrate the purposes of the Williams Act.

140. *See, e.g.*, City Capital Assocs. v. Interco Inc., 696 F. Supp. 1551 (D. Del.), *aff'd on other grounds*, 860 F.2d 60 (3d Cir. 1988).

141. DEL. CODE ANN. tit. 8, § 228 (1988).

142. 540 A.2d 417 (Del.), *aff'g*, 538 A.2d 1113 (Del. Ch. 1988).

143. *Id.* at 418. With an exception not relevant to the issue at bar, § 12 of the challenged bylaws delayed the effectiveness of any action taken by written consent for an absolute minimum period of twenty days, beginning with the commencement of a solicitation. Section 13 of the challenged bylaws established the procedure to be followed in inspecting, counting and challenging the validity of the consents. *Id.* The text of the challenged bylaws is appended to the court's opinion. *Id.* at 421-23.

144. 496 A.2d 1031 (Del. 1985).

145. *Prime Computer*, 540 A.2d at 420-21.

146. *Id.* at 420 (quoting *Datapoint*, 496 A.2d at 1036).

Perhaps most importantly, however, the court announced standards governing the validity of such ministerial-type bylaws:

> In evaluating the reasonableness of a bylaw, which purports to establish ministerial review of the validity of consents, several factors are relevant. First, a court must determine the purpose sought to be served. A bylaw whose real purpose is delay of shareholder action is per se unreasonable. Second, the court should consider the impact of the bylaw upon the effective exercise of the power conferred under § 228. Finally, the bylaw should contain only the minimal requisites for a reliable and prompt ministerial review to ensure the orderly function of corporate democracy. Such ministerial review must not be unduly elaborate, should contain reasonable time periods only necessary to the circumstances, and should be one which, when administered in good faith, is reasonable and balanced.[147]

The court of chancery considered the stockholders' right to take action by consent as it related to the board's ability to take action which was in good faith but designed to impede the exercise of stockholder rights, in *Blasius Industries v. Atlas Corp.*[148] In *Blasius*, the court invalidated action taken by defendant Atlas to add two new members to its seven member board of directors in response to the delivery to Atlas by stockholder Blasius of a form of stockholder consent that, if joined by the owners of a majority of Atlas' stock, would have increased the board of Atlas from seven to fifteen members and would have allowed for the election of eight new directors nominated by Blasius.[149] The court found that "the facts . . . presented the question [of] whether a board acts consistently with its fiduciary duty when it acts, in good faith and with appropriate care, for the primary purpose of preventing or impeding an unaffiliated majority of shareholders from expanding the board and electing a new majority."[150] The court concluded "that, even though defendants here acted on their view of the corporation's interest and not selfishly,

147. *Id.*

148. No. 9720 (Del. Ch. July 25, 1988).

149. *Id.*, slip op. at 1-2. The court also resolved issues relating to the outcome of Blasius' consent solicitation. *See id.*, slip op. at 34-54.

150. *Id.*, slip op. at 1. The court recognized that, as a general matter, the board "is under no fiduciary obligation to suspend its active management of the firm while the consent solicitation process goes forward." *Id.*, slip op. at 9-10.

their December 31 action constituted an offense to the relationship between corporate directors and shareholders that has traditionally been protected in courts of equity."[151]

The board's motivation in adding the two new members to the board was crucial to the court's analysis:

> The conclusion that, in creating two new board positions on December 31 and electing Messrs. Devaney and Winters to fill those positions the board was principally motivated to prevent or delay the shareholders from possibly placing a majority of new members on the board, is critical to my analysis of the central issue posed . . . . If the board in fact was not so motivated, but rather had taken action completely independently of the consent solicitation, which merely had an incidental impact upon the possible effectuation of any action authorized by the shareholders, it is very unlikely that such action would be subject to judicial nullification.[152]

The court concluded that "[o]ur authorities, as well as sound principles, suggest that the central importance of the franchise to the scheme of corporate governance, requires that, in this setting, [the business judgment] rule not be applied and that closer scrutiny be accorded to such transaction."[153] The court refused plaintiff's suggestion that a per se rule be applied in such situations:

> In my view, our inability to foresee now all of the future settings in which a board might, in good faith, paternalistically seek to thwart a shareholder vote, counsels against the adoption of a per se rule invalidating, in equity, every board action taken for the sole or primary purpose of thwarting a shareholder vote, even though I recognize the transcending significance of the franchise to the claims to legitimacy of our scheme of corporate governance. It

151. *Id.*, slip op. at 1-2.

152. *Id.*, slip op. at 9.

153. *Id.*, slip op. at 21. The court recognized that Delaware courts "have long exercised a most sensitive and protective regard for the free and effective exercise of voting rights." *Id.*, slip op. at 23 n.2. *See, e.g.*, Schnell v. Chris-Craft Indus., 285 A.2d 437 (Del. 1971) (holding that management may not subvert Delaware law to perpetuate itself in office); Lerman v. Diagnostic Data, Inc., 421 A.2d 906 (Del. Ch. 1980) (holding that directors may not set annual meeting 63 days in advance after amending bylaws to require 70 days advance notice of nominees in opposition to management).

may be that some set of facts would justify such extreme action. This, however, is not such a case.[154]

E. Examination of Stock List Under Section 220

Section 220 of the GCL provides for the right of a stockholder to examine the stock list and/or books and records of the corporation under certain circumstances.[155] In *RB Associates v. Gillette Co.*,[156] the court of chancery determined that, under section 220, a Delaware corporation has no obligation to obtain a nonobjecting beneficial owner (NOBO) list[157] from each of the brokers and banks who are the registered owners of its stock for the sole purpose of furnishing such lists to a shareholder, when the corporation itself has not obtained and does not plan on obtaining such lists for its own use.[158]

The court found that:

> Neither broad concepts of fairness, nor the words of Section 220, in my opinion, require that a corporation be forced, in each instance, to exercise the option created by the applicable SEC Rules at the behest of a shareholder. What fairness does require, and what our opinions repeatedly return to, is the principle that relief in a Section 220 case

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154. *Blasius*, No. 9720, slip op. at 30-31 (footnote omitted).

155. DEL. CODE ANN. tit. 8, § 220 (1983) provides, in pertinent part:

> (b) Any stockholder, in person or by attorney or other agent, shall, upon written demand under oath stating the purpose thereof, have the right during the usual hours for business to inspect for any proper purpose the corporation's stock ledger, a list of its stockholders, and its other books and records, and to make copies or extracts therefrom. A proper purpose shall mean a purpose reasonably related to such person's interest as a stockholder.

156. No. 9711 (Del. Ch. Mar. 22, 1988), *reprinted in* 13 DEL. J. CORP. L. 1220 (1988).

157. NOBO lists provide the names and addresses of beneficial owners of a corporation's stock who do not object to the disclosure of such information to the corporation for the limited purpose of facilitating direct communication on corporate matters. *RB Assocs.*, No. 9711, slip op. at 1, *reprinted in* 13 DEL. J. CORP. L. at 1222. Such NOBO lists are a recent creation of federal law. *See* 17 C.F.R. § 240.14a-13, b-1, c-7 (1988) (Securities and Exchange Commission Rules).

158. *RB Assocs.*, No. 9711, slip op. at 17-18, *reprinted in* 13 DEL. J. CORP. L. at 1231. In Shamrock Assocs. v. Texas Am. Energy Corp., 517 A.2d 658 (Del. Ch. 1986), the court held that a corporation that had procured NOBO lists in connection with the solicitation of proxies for an annual meeting was required to share those lists with a stockholder who had established its right to inspect a stock list under DEL. CODE ANN. tit. 8, § 220 (1983).

> should afford to a shareholder the same information regarding the identity of stockholders as the corporation has in its books, records and other papers.
>
> That obligation, of course, includes a NOBO list if a corporation has such a list.[159]

F. Appraisal and Fraud Claims Arising from a Merger

The Delaware Supreme Court also addressed issues arising from its 1983 opinion in *Weinberger v. UOP, Inc.*[160] In *Cede & Co. v. Technicolor, Inc.*,[161] the court addressed questions of "first impression" concerning the standing and right of a minority shareholder who has commenced an appraisal proceeding, to assert and pursue a later discovered individual claim of fraud in the merger through an action for rescissory damages for breach of fiduciary duty.[162] The supreme court affirmed the trial court's ruling declining to dismiss the fraud action. The court, however, reversed the lower court's ruling declining to consolidate the appraisal and fraud actions and requiring plaintiff to make a binding election of remedies before trial.[163]

The court began its analysis by reviewing the two types of actions:

> [I]n a section 262 appraisal action the only litigable issue is the determination of the value of the appraisal petitioners' shares on the date of the merger, the only party defendant is the surviving corporation and the only relief available is a judgment against the surviving corporation for the fair value of the dissenters' shares. In contrast, a fraud action asserting fair dealing and fair price claims affords an expansive remedy and is brought against the alleged wrongdoers to provide whatever relief the facts of a particular case may require.[164]

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159. *RB Assocs.*, No. 9711, slip op. at 16-17 (citation omitted), *reprinted in* 13 DEL. J. CORP. L. at 1231.

160. 457 A.2d 701 (Del. 1983). This case held that minority shareholders' challenge to merger must allege specific acts of fraud to demonstrate the unfairness of the merger terms. The remedy available to minority shareholders is an appraisal to determine fair value of shares, such appraisal to be based on all relevant factors.

161. 542 A.2d 1182 (Del. 1988).

162. *Id.* at 1183.

163. *Id.* at 1184-85.

164. *Id.* at 1187.

While the court found that inclusion of fraud claims in a statutory appraisal action "would impermissibly broaden the legislative remedy,"[165] it held that the appraisal plaintiff could file a fraud action based on information gained in discovery and seek consolidation of the two actions for trial, subject to the limitation of a single recovery judgment after trial.[166] The court found that "[c]onsolidation of the actions is . . . necessary to put [plaintiff] in a position equivalent to the position it would arguably be in had defendants exercised 'complete candor' in disclosing all material information associated with the merger to the minority shareholders."[167]

G. *Fiduciary Duties*

Delaware courts also issued important rulings in 1988 concerning the scope of a director's fiduciary duties and addressed questions as to whom a director owes fiduciary duties. In *Anadarko Petroleum Corp. v. Panhandle Eastern Corp.*,[168] the supreme court affirmed a grant of summary judgment against Anadarko Petroleum Corporation (Anadarko) in its suit against three of its former directors and its former parent, Panhandle Eastern Corporation (Panhandle), for an alleged breach of fiduciary duty in modifying certain contracts between Anadarko and Panhandle.[169] The lawsuit arose after Panhandle's directors approved a spin-off of Panhandle's production and explo-

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165. *Id.* at 1189. "A determination of fair value does not involve an inquiry into claims of wrongdoing in the merger." *Id.* (citing Felder v. Anderson, Clayton & Co., 159 A.2d 278 (Del. Ch. 1960)).

166. *Id.* at 1191.

167. *Id.* In determining whether the obligation of complete candor has been satisfied, the trial court is required to:

> "examine what information defendants had and to measure it against what they gave to the minority stockholders, in a context in which 'complete candor' is required. In other words, the limited function of the Court was to determine whether defendants had disclosed all information in their possession germane to the transaction in issue. And by 'germane' we mean, for present purposes, information such as a reasonable shareholder would consider important in deciding whether to sell or retain stock.
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> * * *
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> . . . . Completeness, not adequacy, is both the norm and the mandate under present circumstances."

Weinberger, 457 A.2d at 710 (quoting Lynch v. Vickers Energy Corp., 383 A.2d 278, 281 (Del. 1977)). *See also* Bershad v. Curtiss-Wright Corp., 535 A.2d 840 (Del. 1987).

168. 545 A.2d 1171 (Del. 1988).

169. *Id.* at 1172.

ration assets in exchange for a distribution of Anadarko stock.[170] After the stock dividend was declared but prior to the date of distribution, the boards of Panhandle and Anadarko approved the contract modifications.[171] Anadarko claimed that the modified contracts were voidable because they were unfair and were approved in violation of fiduciary duties owed to the prospective stockholders of Anadarko.[172]

The supreme court recognized that the case presented a "novel issue: whether a corporate parent and directors of a wholly-owned subsidiary owe fiduciary duties to the prospective stockholders of the subsidiary after the parent declares its intention to spin-off the subsidiary."[173] The court held that "prior to the date of distribution the interests held by Anadarko's prospective stockholders were insufficient to impose fiduciary obligations on the parent and the subsidiary's directors."[174]

While the court recognized the general rule that contractual rights of a stockholder to a cash dividend become fixed upon the declaration of the dividend,[175] it held that the same rule does not extend to stock dividends because "the nature of the res distributed and the shareholders' right to and interest in the dividend are less certain."[176]

The court also noted that the concept of "beneficial ownership" of stock had "become a term of art for purposes of establishing fiduciary duties under Delaware law."[177] The court found no separation of legal and equitable ownership as to the Anadarko stock since the information statement concerning the dividend had put Anadarko's prospective stockholders on notice that Panhandle intended to continue to exercise both legal and equitable ownership

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170. *Id.* at 1173. The dividend approved provided that one share of Anadarko stock would be distributed for each issued and outstanding share of Panhandle stock.

171. *Id.* An understanding of the nature of the modifications is not necessary for an understanding of the issues presented in the appeal. *Id.* at 1174 n.2.

172. *Id.* at 1174.

173. *Id.* at 1172.

174. *Id.*

175. *Id.* at 1175. The corporation becomes indebted to the stockholder upon valid declaration of the dividend. *Id.* (citing Selly v. Fleming Coal Co., 180 A.2d 326 (Del. Super. Ct. 1935); Wilmington Trust Co. v. Wilmington Trust Co., 15 A.2d 665 (Del. Ch. 1940)).

176. *Anadarko*, 545 A.2d at 1175.

177. *Id.* at 1176 (citing Sundlun v. Executive Jet Aviation, Inc., 273 A.2d 282, 285 (Del. Ch. 1970)).

of Anadarko until the date of distribution of the dividend and that the ownership would be used to effect contractual arrangements between the two companies.[178]

In *Simons v. Cogan*,[179] the supreme court affirmed the grant of a motion to dismiss a class action brought by a holder of convertible subordinated debentures against the issuing corporation and its controlling shareholders, among others.[180] Plaintiff's complaint asserted claims based on violations of fiduciary duty, breach of indenture, and common law fraud.[181] The supreme court held that the issuing corporation and its directors owed no fiduciary duty to the debenture holders.[182] "Until the debenture is converted into stock the convertible debenture holder acquires no equitable interest, and remains a creditor of the corporation whose interests are protected by the contractual terms of the indenture."[183]

The court of chancery considered the scope of a director's duty of loyalty in *Hoover Industries v. Chase*[184] in determining whether the court had personal jurisdiction over the defendant pursuant to Delaware's director service statute. The defendant claimed that service of process on him pursuant to section 3114[185] was ineffective because the suit was premised on alleged acts done in his capacity as an officer of Hoover, not in his capacity as a director.[186] The complaint alleged that Chase had diverted corporate resources, funds, labor, and materials to himself or his affiliates.[187]

In rejecting Chase's claim, the court explained the duty of loyalty owed by directors of Delaware corporations:

> The duty of loyalty of a director is, in my opinion, a broad and encompassing duty that, in appropriate circumstances,

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178. *Anadarko*, 545 A.2d at 1176-77.

179. 549 A.2d 300 (Del. 1988).

180. *Id.* at 301.

181. *Id.*

182. *Id.* at 301, 304.

183. *Id.* at 304.

184. No. 9276 (Del. Ch. July 13, 1988), *reprinted in* 14 DEL. J. CORP. L. 332 (1989).

185. DEL. CODE ANN. tit. 10, § 3114 (1988).

186. Section 3114(a) authorizes substituted service of process on directors of Delaware corporations in civil actions for violations of duties as directors. By its terms, the statute does not reach officers of Delaware corporations in their capacity as officers. DEL. CODE ANN. tit. 10, § 3114(a) (1988).

187. *Hoover*, No. 9276, slip op. at 2, *reprinted in* 14 DEL. J. CORP. L. at 336.

> is capable of impressing a special obligation upon a director in any of his relationships with the corporation.
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> * * * *
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> The duty of loyalty includes, in some circumstances, a duty of disclosure. The intentional failure or refusal of a director to disclose to the board a defalcation or scheme to defraud the corporation of which he has learned, itself constitutes a wrong, unless a recognized privilege against disclosure pertains.
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> * * * *
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> A director does breach his duty of loyalty if he knows that the company has been defrauded and does not report what he knows to the board or to an appropriate committee of the board, at the very least when he is involved in the fraud and keeps silent in order to escape detection.[188]

H. The Demand Requirement of Rule 23.1

The Delaware Supreme Court considered the demand on directors requirement of Delaware Chancery Court Rule 23.1[189] for derivative suits in two cases in 1988. In *Grobow v. Perot*,[190] the court affirmed the court of chancery's dismissal of a derivative suit for failure to make a prior demand on the board of General Motors Corporation despite finding that the trial court had formulated an "excessive criterion" for compliance with the relevant legal test.[191]

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188. *Id.*, slip op. at 4, 5, 6, *reprinted in* 14 DEL. J. CORP. L. at 337, 338, 338. Nor does a director of a Delaware corporation have a vested right to serve out a full term. *See* Roven v. Cotter, 547 A.2d 603 (Del. Ch. 1988).

189. DEL. CH. CT. R. 23.1 (1974). Rule 23.1 provides, in pertinent part:

> In a derivative action brought by 1 or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall allege that the plaintiff was a shareholder or member at the time of the transaction of which he complains or that his share or membership thereafter devolved on him by operation of law. 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.

Id.

190. 539 A.2d 180 (Del. 1988).

191. *Id.* at 183-84. The plaintiffs challenged a repurchase by General Motors Corp. (GM) of specific securities and notes which were previously issued to the defendant, H. Ross Perot (Perot), a member of GM's Board of Directors, and to

The trial court interpreted the "reasonable doubt" standard of *Aronson v. Lewis*[192] to establish futility of a demand on directors "requiring plaintiffs to plead particularized facts sufficient to sustain 'a judicial finding' either of director interest or lack of director independence, or whether the directors exercised proper business judgment in approving the challenged transaction . . . ."[193] The supreme court rejected the test applied by the court of chancery stating:

> First, the [trial] Court's "judicial finding" criterion would impose a more stringent standard for demand futility than is warranted under *Aronson*. The test for demand futility should be whether the well-pleaded facts of the particular complaint support a reasonable doubt of business judgment protection, not whether the facts support a judicial finding that the directors' actions are not protected by the business judgment rule.
>
> Second, given the highly factual nature of the inquiry presented to the Trial Court by a Rule 23.1 defense, we conclude that it would be neither practicable nor wise to attempt to formulate a criterion of general application for determining reasonable doubt. The facts necessary to support a finding of reasonable doubt either of director disinterest or independence, or whether proper business judgment was exercised in the transaction will vary with each case. Reasonable doubt must be decided by the trial court on a case-by-case basis employing an objective analysis. Were we to adopt a standard criterion for resolving

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other individuals. Grobow v. Perot, 526 A.2d 914, 917 (Del. Ch. 1987), *aff'd*, 539 A.2d 180 (Del. 1988). As alleged in the complaint, the total cost of the buy-back transaction to GM was $742.8 million, which Perot reportedly characterized as including a "'giant premium' paid to him." *Id.* at 919. In the buy-back transaction, Perot agreed to refrain from criticizing GM management and to pay liquidated damages of up to $7.5 million if he violated the agreement. It was also agreed that for stipulated periods of time, Perot would refrain from purchasing GM stock, starting a business that would compete with GM's Electronic Data Systems (EDS) subsidiary and recruiting EDS executives to another company. *Id.*

192. 473 A.2d 805 (Del. 1984). The "standard or test for determining whether a derivative complaint states a demand futility claim under Rule 23.1 is: whether taking the well-pleaded facts as true, the allegations raise a reasonable doubt as to (i) director disinterest or independence or (ii) whether the directors exercised proper business judgment in approving the challenged transaction." *Grobow*, 539 A.2d at 186 (citing Pogostin v. Rice, 480 A.2d 619, 624 (Del. 1984); *Aronson*, 473 A.2d at 814).

193. *Grobow*, 539 A.2d at 183.

> a motion to dismiss based on Rule 23.1, the test for demand excusal would, in all likelihood, become rote and inelastic.
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> * * *
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> Therefore, we decline to approve the use of a "judicial finding" standard as the minimum criterion below which presuit demand will not be excused. We think it sufficient simply to say that the Court of Chancery must weigh the presumption of the business judgment rule that attaches to a board of directors' decision against the well-pleaded facts alleged in a plaintiff's demand-futility complaint. In that respect, the suggestion in the Trial Court's Opinion that a transaction is first analyzed from the standpoint of fairness is erroneous. Fairness becomes an issue only if the presumption of the business judgment rule is defeated.[194]

In *Kaplan v. Peat, Marwick, Mitchell & Co.*,[195] the supreme court addressed two issues of first impression relating to Rule 23.1: "[(i)] whether a defendant, other than the corporation on whose behalf the derivative action is asserted, has standing to raise demand related defenses under Delaware Chancery Court Rule 23.1 [and (ii)] whether a neutral position taken by the subject corporation constitutes acquiescence to the derivative action thereby excusing demand."[196] The court concluded

> that the Vice Chancellor properly held that third parties do have standing to assert demand related defenses. However, we disagree with the Chancery Court's holding that demand is not excused by Chase's position of neutrality. Instead, we hold that when a corporation chooses to state its position in regards to the propriety of the derivative litigation it must do so affirmatively. A position of neutrality is viewed as inconsistent with objection to the continued

194. *Id.* at 186-87 (citations omitted).

195. 540 A.2d 726 (Del. 1988). Plaintiffs charged that Peat, Marwick, Mitchell & Co. breached its duty of care and contractual duties owed to the corporation by failing to conduct proper audits in the so-called "Drysdale" and "Penn Square" matters in which the corporation became involved in 1982. Kaplan v. Peat, Marwick, Mitchell & Co., 529 A.2d 254, 255 (Del. Ch. 1987), *aff'd in part, rev'd in part on other grounds*, 540 A.2d 726 (Del. 1988).

196. *Kaplan*, 540 A.2d at 727.

prosecution of the derivative action and thus serves to excuse demand.[197]

I. Jurisdiction

In *Sternberg v. O'Neil*,[198] the supreme court considered the dismissal of a "double derivative"[199] suit against GenCorp Inc., an Ohio corporation qualified to do business in Delaware under section 371,[200] its wholly owned subsidiary, RKO General, Inc. (a Delaware corporation) and certain officers and directors of both companies.[201] The trial court dismissed the complaint as to all defendants after finding that it lacked personal jurisdiction over GenCorp., an indispensable party.[202] On appeal, the supreme court concluded that the court of chancery erred, as a matter of law, when it determined that it lacked personal jurisdiction over GenCorp.[203]

> First, when GenCorp registered to do business in Delaware and appointed an agent in Delaware to receive service of process, it consented to the general jurisdiction of Delaware courts. Second, we hold alternatively, that GenCorp's own-

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197. *Id.* The court of chancery also considered an issue relating to Rule 23.1 in Abbey v. Computer & Communications Technology Corp., 457 A.2d 368 (Del. Ch. 1983): whether the appointment of a special committee to act for the board with respect to a derivative action automatically requires the two-step approach of Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981), be applied in connection with a motion to dismiss. *Kaplan*, 529 A.2d at 263. In Spiegel v. Buntrock, No. 8936 (Del. Ch. Nov. 17, 1988), the court held that Abbey should not be read as holding that the appointment to "a special committee itself, in all instances, moots the question whether the lawsuit was properly initiated as a derivative action." *Id.*, slip op. at 7-8.

198. 550 A.2d 1105 (Del. 1988).

199. "A 'double derivative' action is a derivative action maintained by the shareholders of a parent corporation or holding company on behalf of a subsidiary company. The wrongs addressed include wrongs directly incurred by the parent corporation as well as those indirectly incurred, wrongs suffered by the subsidiary company." *Sternberg*, 550 A.2d at 1107 n.1 (citation omitted).

200. DEL. CODE ANN. tit. 8, § 371 (1987). Section 371 requires foreign corporations to make the appropriate filing with the Secretary of State before they are permitted to do any business in Delaware. After the Secretary receives the filings and associated fees and provided that the name of the corporation is distinguishable from the names of domestic corporations and those foreign corporations registered to do business in the state, the Secretary will issue the corporation a certificate authorizing it to do business in the state. *Id.*

201. *Sternberg*, 550 A.2d at 1107.

202. *Id.*

203. *Id.*

ership of a Delaware corporation, whose alleged mismanagement is the subject of the double derivative suit, constitutes a "minimum contact" with Delaware which satisfies due process and enables Delaware courts to exercise specific personal jurisdiction over GenCorp in this matter.[204]

III. THE 1988 AMENDMENTS TO THE GCL

The 1988 amendments to the GCL, involving eleven sections,[205] made a number of changes to the statute. The most important change was the adoption of a new antitakeover statute, section 203,[206] to replace the "first generation" antitakeover statute, repealed in 1987.[207] Many of the other amendments were prompted by amendments to the Delaware Revised Uniform Limited Partnership Act.[208]

Section 203 prohibits a Delaware corporation from engaging in a "business combination" with an "interested stockholder" for three years following the date that such person becomes an interested stockholder.[209] An "interested stockholder" is a person, or affiliate

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204. *Id.*

205. *See* 66 Del. Laws ch. 204, § 1 (1988) (adding a new § 203 to title 8 of the Delaware Code); 66 Del. Laws ch. 352, §§ 1-14 (1988) (amending §§ 102, 103, 246, 254, 257, 262, 263, 312, 371, and 391 of title 8 of the Delaware Code).

206. DEL. CODE ANN. tit. 8, § 203(a) (1988).

207. *See* 66 Del. Laws ch. 136, § 6 (1988) (repealing Delaware's first generation antitakeover statute, effective July 1, 1987).

208. The amendments to the Delaware Revised Uniform Limited Partnership Act, which are beyond the scope of this article, appear at 66 Del. Laws ch. 316 (1988) (codified at DEL. CODE ANN. tit. 6, §§ 17-101 to -1109 (Supp. 1988)).

209. DEL. CODE ANN. tit. 8, § 203(a) (1988). Legislative commentary to the 1988 adoption of § 203 provides:

> Section 203 is intended to strike a balance between the benefits of an unfettered market for corporate shares and the well documented and judicially recognized need to limit abusive takeover tactics. To achieve this end, the statute will delay for three years business combinations with acquirors not approved by the board unless the acquiror is able to obtain in his offer 85% of the stock as defined in the statute. This provision is intended to encourage a full and fair offer. Following the principles of corporate democracy, two-thirds of the stockholders other than the acquiror may vote to exempt a given business combination from the restrictions of the statute. Any corporation may decide to opt out of the statute within 90 days of enactment by action of its board or, at any time, by action of its stockholders. The effect of stockholder action in this regard is delayed for 12 months to avoid circumvention of the statute.
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> The statute is not intended to alter the case law development of directors'

or associate of such person, who either owns 15% or more of the corporation's outstanding voting stock, or is an affiliate or associate of the corporation and owned 15% or more of its outstanding voting stock in the previous three years.[210] "Business combination" is broadly defined to include various types of transactions which could result in unfairness to minority stockholders.[211] The three-year prohibition on business combinations does not apply if any one of three tests are satisfied: (i) if the board of directors approves the business combination or the transaction which results in the person becoming an interested stockholder before the person becomes an interested stockholder; (ii) if the interested stockholder acquires 85% of the target's voting stock in the same transaction that makes him an interested stockholder (excluding from the 85% calculation shares owned by directors who are also officers and shares held by employee stock plans which do not permit employees to decide confidentially whether to tender stock); and (iii) if, on or after the date a person becomes an interested stockholder, the board approves the business combination, which is also approved at a stockholders' meeting by the holders of two-thirds of the voting stock not owned by the interested stockholder.[212]

Section 102[213] of the GCL was amended, among other things, to require that a new Delaware corporation have a name distinguishable from a name registered or reserved by a limited partnership. Section 103, as amended, adds new subsections which declare that the Secretary of State will not be liable for preclearing, filing, or indexing defective documents[214] and permits any signature on an instrument filed with the Secretary to be a facsimile.[215]

Section 246 of the GCL, which required the Secretary of State to furnish a composite certificate of incorporation upon request, has

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> fiduciary duties of care and loyalty in responding to challenges to control or the burden of proof with regard to compliance with those duties. Nor is the statute intended to prevent the use of any other lawful defensive measure.

H.R. 396, 134th Gen. Assembly, 2d Sess. synopsis (1988).

210. DEL. CODE ANN. tit. 8, § 203(c)(5) (1988).

211. *Id.* § 203(c)(3).

212. *Id.* § 203(a).

213. *Id.* § 102.

214. *Id.* § 103.

215. *Id.* § 103(h).

been repealed in its entirety.[216] Sections 254[217] and 257,[218] dealing with the contents of merger agreements, were amended in various respects to conform to section 251 and to require clarification in the merger agreement of the type of property for which share, membership, or other interests are exchanged.[219]

The 1988 amendments also added a new section 263 to the GCL which authorizes mergers or consolidations between and among domestic corporations and certain limited partnerships.[220] An amendment to section 262[221] extends appraisal rights to stockholders of constituent corporations involved in such a merger or consolidation.

Finally, the 1988 amendments made changes in the language of section 312 concerning extension of a certificate of incorporation;[222] section 371 concerning qualification of foreign corporations to do business in Delaware;[223] and section 391 concerning taxes and fees payable to the Secretary of State.[224]

IV. CONCLUSION

The recent developments in Delaware corporate law again have refined, rather than radically altered, important legal concepts. The various decisions applying *Revlon* and *Moran* in the takeover context provide further guidance to directors concerning their fiduciary obligation of due care and loyalty in the consideration of proposed acquisitions. Delaware's new takeover statute provides important protections to Delaware corporations. The judicial decisions and legislative refinement of the GCL reflect well-considered responses to a variety of the year's most important corporate questions.

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216. DEL. CODE ANN. tit. 8, § 246 (1983), *repealed by* 66 Del. Laws ch. 352, § 3 (1988).
217. DEL. CODE ANN. tit. 8, § 254 (1988).
218. *Id.* § 257.
219. *See id.* §§ 254(c)(3), 257.
220. *Id.* § 263.
221. *Id.* § 262.
222. *Id.* § 312.
223. *Id.* § 371.
224. *Id.* § 391.