Commentary From the Bar

1989 DEVELOPMENTS IN DELAWARE CORPORATE LAW

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I. Introduction

Decisions rendered in 1989 again marked a year in which Delaware courts made important rulings concerning corporate governance and issues arising under the Delaware General Corporation Law (GCL).[1] Both the Delaware Supreme Court and Delaware Court of Chancery issued seminal decisions concerning the sale of corporate control, including decisions relating to the conduct of auctions and election contests. These recent decisions 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 1989. While summarization of the extensive body of Delaware corporate law and review of every Delaware corporate decision in 1989 are beyond the scope of this article, a wide range of the corporate issues addressed by the Delaware courts in 1989 will be discussed.

II. Case Law Applying Delaware Corporate Law

A. *Fiduciary Duties Arising Out of a Sale of the Company*

Since the Delaware Supreme Court's 1986 decision in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,[2] it has been settled that when a company is for sale, the duties of its directors change from "the preservation of [the company] as a corporate entity to the maximization of the company's value at a sale for the stockholders'

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1. Del. Code Ann. tit. 8, §§ 101-398 (1983).
2. 506 A.2d 173 (Del. 1986).

benefit."[3] In a series of later decisions,[4] Delaware courts again have clarified various issues raised by *Revlon* relating to the directors' duties to maximize stockholder value.

In *Mills Acquisition Co. v. Macmillan, Inc.*,[5] the Delaware Supreme Court reversed a lower court decision which had upheld the conduct of the directors of Macmillan in connection with the sale of the company.[6] At issue in the case was the validity of an asset option agreement—commonly known as a "lockup"—granted by Macmillan to Kohlberg Kravis Roberts & Co. (KKR), Macmillan management's favored bidder.[7] Also at issue was the propriety of additional steps taken to disadvantage entities controlled by Robert Maxwell (Maxwell), the unsuccessful bidder.[8]

In evaluating the manner in which Macmillan conducted the auction, the court found "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."[9] The court found that KKR had received improper advice from Macmillan's investment bankers who were running the auction, and that Macmillan's Board was uninformed as to such advantages.[10] The court also found that the chairman's knowing concealment of the fact that advantages had been

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3. *Id.* at 182.

4. *See infra* pp. 97-111 and notes accompanying text (discussing the recent cases).

5. 559 A.2d 1261 (Del. 1988).

6. Robert M. Bass Group, Inc. v. Evans, 552 A.2d 1227 (Del. Ch.), *rev'd mem. sub nom.* Mills Acquisition Co. v. MacMillan, Inc., 550 A.2d 35 (Del. 1988), and No. 10,168 (Del. Ch. Oct. 17, 1988) (revised Oct. 18, 1988), *reprinted in* 14 DEL. J. CORP. L. 772 (1989).

7. The lockup option permitted KKR, an investment firm specializing in leveraged buyouts, to acquire seven of Macmillan's "crown-jewel" divisions for $865 million. *Macmillan*, 559 A.2d at 1285-86. As the supreme court noted, the purpose of such a lockup is to "place [assets] under option at bargain prices as a device to defeat an unwanted takeover attempt." *Id.* at 1286 n.37.

8. Maxwell challenged the integrity with which the auction was conducted, alleging, among other things, that the auction was fatally imbalanced in favor of KKR as a result of (1) a telephone call from Macmillan's Chairman to KKR "tipping" the amount of Maxwell's bid but withholding comparable information as to KKR's bid from Maxwell; and (2) the reading by Macmillan's investment banker of a specially prepared script to KKR (but not to Maxwell) that "drew a veritable roadmap" which enabled KKR to formulate its successful bid. *Id.* at 1282-84.

9. *Id.* at 1264-65.

10. *Id.* at 1281.

given to a favored bidder from the other board members was an explicit acknowledgment of culpability.

> As the duty of candor is one of the elementary principles of fair dealing, Delaware law imposes this unremitting obligation not only on officers and directors, but also upon those who are privy to material information obtained in the course of representing corporate interests. At a minimum, this rule dictates that fiduciaries, corporate or otherwise, may not use superior information or knowledge to mislead others in the performance of their own fiduciary obligations. The actions of those who join in such misconduct are equally tainted.[11]

The court characterized the efforts undertaken by the board in its efforts to establish a truly independent auction as "torpid, if not supine . . . ."[12] It found that the directors impermissibly delegated the creation and administration of the auction to a group of the interested chairman's "hand-picked investment advisors."[13] Given the divided loyalties the court found to exist on the part of certain directors financially interested in KKR's offer, and "the absence of any serious oversight by the allegedly independent directors," the court analyzed the transaction under the rigorous test of intrinsic fairness.[14]

While reviewing established principles concerning the conduct of an auction, the court recognized that a board's proper objective in conducting an auction is to "obtain the highest price reasonably available for the company, provided it [is] offered by a reputable and responsible bidder."[15] The court noted that:

> [i]n assessing the bid and the bidder's responsibility, a board may consider, among various proper factors, the

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11. *Id.* at 1283 (citations omitted).
12. *Id.* at 1280.
13. *Id.* at 1281.
14. *Id.* at 1265 (citing Weinberger v. UOP, Inc., 457 A.2d 701, 710-11 (Del. 1983)). The court found that the "judicial reluctance to assess the merits of a business decisions ends in the face of illicit manipulation of a board's deliberative processes by self-interested corporate fiduciaries." *Id.* at 1279. As the court of chancery has recognized, "Because the effect of the proper invocation of the business judgment rule is so powerful and the standard of entire fairness so exacting, the determination of the appropriate standard of judicial review frequently is determinative of the outcome of derivative litigation." AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 111 (Del. Ch. 1986).
15. *Macmillan*, 559 A.2d at 1282 (citing *Revlon*, 506 A.2d at 182, 184).

> adequacy and terms of the offer; its fairness and feasibility; the proposed or actual financing for the offer, and the consequences of that financing; questions of illegality; the impact of both the bid and the potential acquisition on other constituencies, provided that it bears some reasonable relationship to general shareholder interests; the risk of nonconsumation [sic]; the basic stockholder interests at stake; the bidder's identity, prior background and other business venture experiences; and the bidder's business plans for the corporation and their effects on stockholder interests.[16]

The court also indicated that a board's refusal to entertain offers may constitute a valid exercise of business judgment:

> Circumstances may dictate that an offer be rebuffed, given the nature and timing of the offer; its legality, feasibility and effect on the corporation and the stockholders; the alternatives available and their effect on the various constituencies, particularly the stockholders; the company's long[-]term strategic plans; and any special factors bearing on stockholder and public interests.[17]

The court dedicated part of its opinion to reviewing the standards by which the grant of lockups and no-shop provisions would be judged. While such tactics are not per se illegal, only those lockups which draw bidders into a contest are permissible. The courts, on the other hand, will not sanction "similar measures which end an active auction and foreclose further bidding."[18] In this case, the court found that a nominally enhanced bid from KKR "was a *de minimis* justification for the lockup."[19] Moreover,

> [e]ven if the lockup is permissible, when it involves "crown jewel" assets careful board scrutiny attends the decision. When the intended effect is to end an active auction, at the very least the independent members of the board must attempt to negotiate alternative bids before granting such a significant concession.[20]

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16. *Id.* at 1282 n.29 (citations omitted).
17. *Id.* at 1285 n.35 (citations omitted).
18. *Revlon*, 506 A.2d at 183. *See also* Hanson Trust PLC v. ML SCM Acquisition Inc., 781 F.2d 264, 272 (2d Cir. 1986).
19. *Macmillan*, 559 A.2d at 1286.
20. *Id.* (citations omitted).

The court also viewed the use of no-shop clauses as even more limited than a lockup agreement: "[a]bsent a material advantage to the stockholders from the terms or structure of a bid that is contingent on a no-shop clause, a successful bidder imposing such a condition must be prepared to survive the careful scrutiny which that concession demands."[21]

Perhaps the most significant feature of this opinion is the court's discussion regarding the standards by which directors' actions while conducting an auction are to be judged.

> Directors are not required by Delaware law to conduct an auction according to some standard formula, only that they observe the significant requirement of fairness for the purpose of enhancing general shareholder interests. That does not preclude differing treatment of bidders when necessary to advance those interests. Variables may occur which necessitate such treatment. However, the board's primary objective, and essential purpose, must remain the enhancement of the bidding process for the benefit of the stockholders. . . . We do not intend to limit the broad negotiating authority of the directors to achieve the best price available to the stockholders. To properly secure that end may require the board to invoke a panoply of devices, and the giving or receiving of concessions that may benefit one bidder over another. But when that happens, there must be a rational basis for the action such that the interests of the stockholders are manifestly the board's paramount objective.[22]

In assessing the directors' conduct, the enhanced judicial scrutiny required by *Unocal Corp. v. Mesa Petroleum Co.*[23] may be required.[24]

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21. *Id.* (citing *Revlon*, 506 A.2d at 184).
22. *Macmillan*, 559 A.2d at 1286-87 (citations omitted).
23. 493 A.2d 946 (Del. 1985).
24. As the court stated:

> At the outset, the plaintiff must show, and the trial court must find, that the directors of the target company treated one or more of the respective bidders on unequal terms. It is only then that the two-part threshold requirement of *Unocal* is truly invoked, for in *Revlon* we held that "[f]avoritism for a white knight to the total exclusion of a hostile bidder might be justifiable when the latter's offer adversely affects shareholder interests, but . . . the directors cannot fulfill their enhanced *Unocal* duties by playing favorites with the contending factions." . . . In the face of disparate treatment, the trial court must first examine whether the directors properly

The duties of directors in selling a company were also considered by the supreme court in a post-trial appeal in *Citron v. Fairchild Camera & Instrument Corp.*[25] The court affirmed the court of chancery's conclusion 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 Schlumberger (California), Incorporated.[26] Fairchild's directors accepted Schlumberger's cash offer of $66 per share for all of Fairchild's shares. In doing so, they also rejected an offer by Gould, Inc. of $70 in cash for approximately forty-two percent of Fairchild's shares and an unspecified amount of Gould preferred stock for the remainder of the stock.[27] While Gould made several proposals in the month before the May 19, 1979 board meeting at which the Fairchild Board considered final offers,[28] Schlumberger's offer was made on the morning of the board meeting and was contingent upon acceptance by noon that same day.[29]

> perceived that shareholder interests were enhanced. In any event the board's action must be reasonable in relation to the advantage sought to be achieved, or conversely, to the threat which a particular bid allegedly poses to stockholder interests. . . . If on the basis of this enhanced *Unocal* scrutiny the trial court is satisfied that the test has been met, then the directors' actions necessarily are entitled to the protections of the business judgment rule. The latitude a board will have in responding to differing bids will vary according to the degree of benefit or detriment to the shareholders' general interests that the amount or terms of the bids pose. We stated in *Revlon*, and again here, that in a sale of corporate control the responsibility of the directors is to get the highest value reasonably attainable for the shareholders. Beyond that, there are no special and distinct "Revlon duties[.]" Once a finding has been made by a court that the directors have fulfilled their fundamental duties of care and loyalty under the foregoing standards, there is no further judicial inquiry into the matter.

Macmillan, 559 A.2d at 1288 (citations omitted).

25. 569 A.2d 53 (Del. 1989).

26. *Id.* at 55.

27. *Id.* at 61-64. 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 the preferred stock. *Id.* at 61-62.

28. *Id.* at 56-59. 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.* at 56-57. 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.* at 58-59. On May 18, 1979, Gould's Board of Directors approved a third proposal to acquire 2,250,000 shares of Fairchild for $70 per share cash. *Id.* at 61.

29. *Id.* at 62. Schlumberger's offer was also conditioned on rejection of the

In finding that the board's decision to accept the $66 offer was protected by the business judgment rule, the court held that the "indefinite nature of Gould's final proposal," coupled with the certainty that Schlumberger's offer was for all cash "from a company rich in cash resources," was a "classic factor[ ] upon which a board may base a proper business decision to accept or reject a proposal."[30] The court also emphasized that directors have "a right, indeed a firm duty, to consider a host of factors in determining whether to entertain" an offer.[31]

As to the board's fidelity to Schlumberger's four-hour deadline, the court noted that facts as to who imposed the deadline and the board's ability to make a rational choice must be considered in determining whether any decision by the board was reasonable.[32] Given that the board knew enough as of May 19 concerning Fairchild's value to make an informed decision and the board's respect for the bargaining tactics of the bidder, the court concluded that "the time constraints placed on the Fairchild board were not of the board's making and did not compromise its deliberative process . . . ."[33]

The supreme court also reviewed "*Revlon* issues" in considering a challenge to consummation of a settlement in *Barkan v. Amsted Industries, Inc.*[34] In *Barkan*, an objector to the settlement of several

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Gould proposal, unanimous approval by Fairchild's Board, and execution of an agreement and a joint public announcement that day. *Id.*

30. *Id.* at 66-67 (citing *Macmillan*, 559 A.2d at 1282 n.29 & 1285 n.35; Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1341-42 (Del. 1987); *Revlon*, 506 A.2d at 182-83; *Unocal*, 493 A.2d at 955-56). *See also* Norberg v. Young's Market Co., Nos. 11,208 & 11,253 (Del. Ch. Dec. 19, 1989), *reprinted in* 16 DEL. J. CORP. L. 351 (1991), *aff'd*, 571 A.2d 787 (Del. 1990) (refusing to enjoin board acceptance of a merger proposal where a "higher" competing bid was subject to an escrow and several other conditions).

31. *Citron*, 569 A.2d at 68. The court then reviewed the list of factors discussed in *Macmillan*, including: (1) the nature and the timing of an offer; (2) its legality, feasibility, and effect on the corporation and the shareholders; (3) the alternatives available and their effect on the various constituencies, particularly the shareholders; (4) the company's long-term strategic plans; and (5) any special factors bearing on shareholders and public interests). *Id.* (quoting *Macmillan*, 559 A.2d at 1282 n.29 & 1285 n.35).

32. *Id.* at 67.

33. *Id.* The court rejected the plaintiff's claim that the facts relating to the directors' consideration of Schlumberger's offer were similar to those in Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985), in which the court found that directors had breached their fiduciary duties in selling the company without adequate information. *Id.*

34. 567 A.2d 1279 (Del. 1989).

class action lawsuits argued that the court of chancery applied an "impermissibly strict" standard in determining the likelihood of success of a claim that the directors of Amsted breached their fiduciary duties by failing to implement procedures designed to maximize Amsted's sale price once its sale became inevitable.[35] The objector claimed that Amsted's adherence to a "no-shop" restriction was impermissible where a management-sponsored leveraged buyout of Amsted and a newly formed employee stock ownership plan (ESOP) were approved by a special committee of Amsted's Board of Directors established to consider the company's sale.[36]

While it recognized its limited standard and scope of review in considering the court of chancery's approval of the settlement,[37] the supreme court offered some guidance as to the proper scope of judicial review of board actions in the takeover context. Given the "evolving techniques and financing devices employed in today's corporate environment,"[38] the court refused to suggest a single blueprint that a board must follow to fulfill its duties. "Rather, a board's actions must be evaluated in light of relevant circumstances to determine if they were undertaken with due diligence and in good faith."[39] The court acknowledged that while "certain fact patterns demand certain responses from the directors[,] . . . *Revlon* does not demand that every change in the control of a Delaware corporation be preceded by a heated bidding contest."[40]

As to the validity of the "no-shop" provision, the court indicated that while such restrictions create an "inference that the board seeks to forestall competing bids," the board's knowledge that no bidder would be able to surpass the existing bid for valid reasons was sufficient in this case to justify the board's decision to proceed.[41]

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35. *Id.* at 1281.

36. *Id.* at 1281, 1285.

37. *Id.* at 1283. The supreme court limited its review to a determination as to whether the court of chancery had abused its discretion in approving the settlement. *Id.* at 1284. *See* Polk v. Good, 507 A.2d 531, 536 (Del. 1986).

38. *Barkan*, 567 A.2d at 1286.

39. *Id.*

40. *Id.* The court suggested that the guiding principle of *Revlon* was that "[w]hen it becomes clear that [an] auction will result in a change of corporate control, the board must act in a neutral manner to encourage the highest possible price for shareholders." *Id.* The court also noted that *Revlon* was "merely one of an unbroken line of cases that seek to prevent the conflicts of interest by demanding that directors act with scrupulous concern for fairness to shareholders." *Id.*

41. *Id.* at 1287-88. The court noted, however, that "while numerous factors,

The court concluded, however, that "[i]t must be clear that the board had sufficient knowledge of relevant markets to form the basis for its belief that it acted in the best interests of the shareholders."[42]

The court of chancery also considered several cases in 1989 which resulted in important decisions concerning the duties of directors in connection with a change in control. In *In re RJR Nabisco, Inc. Shareholders Litigation*,[43] the court declined to enjoin the closing of a pending tender offer by entities organized by KKR for up to seventy-four percent of the outstanding stock of RJR Nabisco (RJR).[44] The court found that the "only serious competition" for the KKR proposal came from proposals advanced by RJR's senior management. While the last bid by the management group was claimed to have a value of $112 per share and included a higher proportion of cash than the KKR proposal, RJR's financial advisors valued it at approximately $108.50-$109.00 per share, or substantially equivalent to KKR's last offer.[45] After the Special Committee established by RJR's Board to consider proposals received these substantially equivalent bids, it decided not to seek additional bids, but rather agreed to accept KKR's offer.[46]

The court organized plaintiffs' theories into three categories: (1) a challenge to the good faith of the Special Committee; (2) a claim that the decision to accept KKR's bid was the result of gross negligence; and (3) a claim based on the *Revlon* case that the Special Committee had a duty to keep the auction open in order to get the highest bid.[47]

[i.e.,] timing, publicity, tax advantages, and Amsted's declining performance—point to the directors' good faith belief that the shareholders were getting the best price, we decline to fashion an iron-clad rule for determining when a market test is not required." *Id.* at 1288. Pursuant to such a market test, other possible bidders are canvassed to see if higher bids may be elicited, and the market is made aware of the opportunity to bid. *See In re* Fort Howard Corp. Shareholders Litig., No. 9991 (Consolidated) (Del. Ch. Aug. 8, 1988), *reprinted in* 14 DEL. J. CORP. L. 699 (1989).

42. *Barkan*, 567 A.2d at 1288.

43. No. 10,389 (Consolidated) (Del. Ch. Jan. 31, 1989), *reprinted in* 14 DEL. J. CORP. L. 1132 (1989).

44. *Id.*, slip op. at 1, *reprinted in* 14 DEL. J. CORP. L. at 1137. The total value of the transaction, including the tender offer and a follow-up merger, was approximately $25 billion. *Id.*

45. *Id.*, slip op. at 1, *reprinted in* 14 DEL. J. CORP. L. at 1138. The first proposal to acquire RJR had been made by RJR's management at a price of $75 per share. *Id.*, slip op. at 10, *reprinted in* 14 DEL. J. CORP. L. at 1142.

46. *Id.*, slip op. at 3, *reprinted in* 14 DEL. J. CORP. L. at 1138.

47. *Id.*, slip op. at 4-7, *reprinted in* 14 DEL. J. CORP. L. at 1138-41.

After reviewing the evidence, the court concluded that there was no indication that the members of the Special Committee had any motivation "other than the honest pursuit of the corporation's welfare."[48] Based upon the facts presented, the court also found that "no neglect of duty of any sort" had occurred in this case.[49] Finally, the court held:

> (1) the *Revlon* case does not establish a basis for director liability or for the issuance of the protective remedy of injunction independent of the traditional bases for such liability or such relief: a beach of the duty of loyalty or of the duty of care with resulting injury; (2) that there is not sufficient evidence to permit the conclusion that plaintiffs have a reasonable probability of establishing that the Special Committee was motivated to favor KKR and impede the Management Group; and (3) that the decision to enter into a merger agreement with KKR appears at this time to represent a decision made with due care. Directors in a similar position could have decided without being grossly negligent that the bids in hand were substantially equivalent in value; that KKR's bid had nonfinancial aspects that permitted a reasonable person to prefer it; and that effectively testing at that stage of this contest whether some additional amount could be extracted entailed risks that one could prudently decide in the circumstances should be avoided.[50]

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48. *Id.*, slip op. at 48, *reprinted in* 14 DEL. J. CORP. L. at 1163.

49. *Id.*, slip op. at 49, *reprinted in* 14 DEL. J. CORP. L. at 1163. The court rejected the plaintiffs' view that, under *Revlon*,

> if on a *post hoc* review an auction is said to be unfair (presumably to shareholders to whom the board owes its fiduciary duty) or ineffective or "unauction-like" in some material respect, the results may be set aside even if no breach of directorial duty of care or loyalty is involved.

Id., slip op. at 54, *reprinted in* 14 DEL. J. CORP. L. at 1166. *See also In re* J.P. Stevens & Co. Shareholders Litig., 542 A.2d 770 (Del. Ch. 1988) (stating that a "level playing field" is not required in an auction if directors act with care and in good faith pursuit to stockholder interests); *In re* Fort Howard Corp. Shareholders Litig., No. 9991 (Consolidated) (Del. Ch. Aug. 8, 1988), *reprinted in* 14 DEL. J. CORP. L. 699 (1989) (holding a premerger agreement auction not required where directors' mechanism to achieve information on alternatives puts board in position to exercise fully informed judgment).

50. *In re RJR Nabisco, Inc. Shareholders Litig.*, No. 10,389, slip op. at 8-9 (citations omitted), *reprinted in* 14 DEL. J. CORP. L. at 1141. The court also noted

In *Paramount Communications, Inc. v. Time Inc.*,[51] the court of chancery again considered the propriety of director conduct within the context of choosing among competing acquisition proposals. The court in *Paramount* refused to preliminarily enjoin a tender offer by Time Inc. for the outstanding shares of Warner Communications Inc. (Warner). Plaintiffs Paramount Communications, Inc. (Paramount) and certain stockholders of Time sought to block Time's tender offer for fifty-one percent of Warner's outstanding shares in an effort to permit stockholder consideration of Paramount's tender offer of $200 per share.[52]

Plaintiffs argued that the Time Board of Directors had a duty under *Revlon*[53] to sell the company because an original merger agreement between Time and Warner constituted a transfer of control of Time to Warner.[54] The court acknowledged that a board of directors who has not consciously decided to "sell" a company nevertheless may find itself in the "radically altered state recognized by the *Revlon* case" if it approves an extraordinary transaction that in fact effects a change of control.[55] The court found that the merger agreement did not contemplate a change of control of Time, however, because

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> the decision not to attempt to break the tie but to accept one of the bids at that point and thus avoid the risk of the loss of that bid—no matter that my personal view might be that the risk was rather small—can in no event be seen as justifying an inference that those who made such a choice must have had some motivation other than the honest pursuit of the corporation's welfare.

Id., slip op. at 47-48, *reprinted in* 14 DEL. J. CORP. L. at 1163 (citing *In re J.P. Stevens & Co. Shareholders Litig.*, 542 A.2d at 780 n.5).

51. Nos. 10,866, 10,670 (Consolidated), & 10,935 (Del. Ch. July 14, 1989) (revised July 17, 1989), *reprinted in* 15 DEL. J. CORP. L. 700 (1990), *aff'd*, 571 A.2d 1140 (Del. 1989).

52. *Id.*, slip op. at 1-2, *reprinted in* 15 DEL. J. CORP. L. at 706-07. While Time and Warner had originally entered into a merger agreement pursuant to which Warner stockholders would receive stock in Time, they amended the merger agreement to provide for the tender offer by Time after Paramount commenced an unsolicited cash tender offer for all of Time's outstanding shares for $175 per share. *Id.*, slip op. at 21-22, 36-40, *reprinted in* 15 DEL. J. CORP. L. at 710-19, 726-28.

53. 506 A.2d 173 (Del. 1986).

54. By the terms of this agreement, Warner shareholders were to receive 62% of Time. *Paramount Communications, Inc.*, Nos. 10,866, 10,670 (Consolidated), & 10,935, slip op. at 54-55, *reprinted in* 15 DEL. J. CORP. L. at 734-37.

55. *Id.*, slip op. at 51-52, 57-58, *reprinted in* 15 DEL. J. CORP. L. at 734-35, 739. "[A] corporate transaction that represents a change in corporate control does place the board in a situation in which it is charged with the single duty to maximize current share value." *Id.*, slip op. at 59, *reprinted in* 15 DEL. J. CORP. L. at 739.

the Warner stockholders' expected sixty-two percent ownership of Time would have been a "fluid aggregation of unaffiliated shareholders" that involved no control block. As the court stated, control would have "remained in a large, fluid, changeable and changing market" just as it had been in the past.[56]

Plaintiffs also argued that Time's tender offer for Warner was itself a defensive response to a change of control threat and thus should be judged under the *Unocal* test. In their view, the Paramount offer did not represent a "threat" to Time's stockholders, and accordingly, the revised merger agreement was not a reasonable response to a reasonably perceived threat.[57]

The court concluded that, although the original merger agreement was "chiefly motivated by strategic business concerns," the revised merger agreement was a defensive reaction to the Paramount tender offer and thus should be reviewed under *Unocal*.[58] Applying the *Unocal* analysis, the court determined that the Paramount offer posed a threat to Time's "most important corporate policy" of achieving a previously existing, long-term, strategic plan of combining with Warner.[59] The court also found Time's defensive response to this threat—i.e., the revised transaction with Warner—to be rea-

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56. *Id.*, slip op. at 56, 60, *reprinted in* 15 DEL. J. CORP. L. at 737, 739. The court also rejected the argument that the "preclusion of a future change in control transaction ought to be deemed to trigger Revlon duties," *id.*, slip op. at 60, *reprinted in* 15 DEL. J. CORP. L. at 740, finding that such a holding "would constitute an expansion of *Revlon* beyond the traditional principle . . . which underlies that case." *Id.*, slip op. at 63, *reprinted in* 15 DEL. J. CORP. L. at 741. "Under our law, the validity of 'defensive' measures is addressed under a *Unocal* analysis, not under the narrower *Revlon* case." *Id.*, slip op. at 63, *reprinted in* 15 DEL. J. CORP. L. 741-42.

57. *Id.*, slip op. at 68-70, *reprinted in* 15 DEL. J. CORP. L. at 746-48.

58. *Id.*, slip op. at 68, *reprinted in* 15 DEL. J. CORP. L. at 748. The *Unocal* form of review applies "to all actions taken after a hostile takeover attempt has emerged that are found to be defensive in character" and "when a preemptive defensive measure is deployed, where the principal purpose of the action (and not simply a collateral, practical effect) is defensive in a change of control sense." *Id.*, slip op. at 69 & n.21, *reprinted in* 15 DEL. J. CORP. L. at 745. *See, e.g.*, AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103 (Del. Ch. 1986).

59. *Paramount Communications, Inc.*, Nos. 10,866, 10,670 (Consolidated), & 10,935, slip op. at 74, *reprinted in* 15 DEL. J. CORP. L. at 748. Thus,

> where the board has not elected explicitly or implicitly to assume the special burdens recognized by *Revlon*, but continues to manage the corporation for long-term profit pursuant to a preexisting business plan that itself is not primarily a control device or scheme, the corporation has a legally cognizable interest in achieving that plan.

Id., slip op. at 75, *reprinted in* 15 DEL. J. CORP. L. at 748.

sonable in relation to the threat.[60] The revised transaction furthered the goal of realizing Time's strategic plan, which was "seen as of unquestionably great importance by the board."[61] More importantly, the action taken was "effective but not overly broad [because] [t]he board did only what was necessary to carry forward a preexisting transaction in an altered form" without precluding a future hostile takeover of the combined enterprise of Time-Warner.[62]

The court did not consider dispositive the fact that many, or indeed most, of Time's stockholders might prefer a Paramount acquisition of Time to a Time acquisition of Warner. The decision to pursue the Warner acquisition was viewed as a matter of business judgment of Time's Board subject, as a result of Paramount's tender offer, to the additional requirements imposed by *Unocal*.[63] As the court stated, "The corporation law does not operate on the theory that directors, in exercising their powers to manage the firm, are obligated to follow the wishes of a majority of shares. In fact, directors, not shareholders, are charged with the duty to manage the firm."[64]

The plaintiffs' final argument concerned the amendment of the original merger agreement by the Time Board to eliminate the requirement of a vote by Time stockholders. They considered such action improper, especially when Paramount's tender offer created serious doubt that Time's stockholders would approve the Time-Warner merger.[65] The court rejected the notion that the Time Board somehow was obligated to preserve a stockholder vote simply because the original merger agreement contemplated a vote:

> I am aware of no principle, statute or rule of corporation law that would hold that once a board approved an agreement of merger, it loses power to reconsider that action prior to a shareholder vote. Equally fundamentally, Delaware law creates no power in shareholders to authorize a merger without the prior affirmative action of the board of directors. Thus, a board resolution rescinding approval of an agreement of merger and removing the matter from the

60. *Id.*, slip op. at 75-76, *reprinted in* 15 DEL. J. CORP. L. at 749.
61. *Id.*
62. *Id.*
63. *Id.*, slip op. at 76-78, *reprinted in* 15 DEL. J. CORP. L. at 748-50.
64. *Id.*, slip op. at 77-78, *reprinted in* 15 DEL. J. CORP. L. at 649-50.
65. *Id.*, slip op. at 64-68, *reprinted in* 15 DEL. J. CORP. L. at 742-44.

> agenda of an annual meeting is altogether different from a resolution designed to interfere with the statutory shareholder power to act through consent.[66]

Thus, the court concluded that the decision by the Time Board "to recast" the transaction in which Time and Warner would be combined did not "intru[de] upon the effective exercise of a [franchise] right possessed by the shareholders."[67]

The court of chancery also refused to enjoin preliminarily the effectuation of a proposed merger between American Home Shield Corporation (AMS) and ServiceMaster, L.P. (ServiceMaster) in *Braunschweiger v. American Home Shield Corp.*[68] The buyout group in this case was comprised of an affiliation of senior management of AMS with ServiceMaster.

On April 5, 1989, AMS announced that it had reached an agreement in principle the prior day providing for the acquisition of AMS subject to the execution of a definitive merger agreement.[69] A merger agreement was executed on April 22, which provided for a break-up fee of $2.5 million (25¢ per share) under certain circumstances.[70] The advisors to the Special Committee of AMS's directors established to consider offers opined that the break-up fee would not deter third-party bidders.[71] However, no other bidders appeared at any time, even though over six months intervened between the April 5 announcement and the October 27 meeting at which AMS's stockholders voted on the transaction.[72]

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66. *Id.*, slip op. at 66-67, *reprinted in* 15 DEL. J. CORP. L. at 743.

67. *Id.*, slip op. at 67, *reprinted in* 15 DEL. J. CORP. L. at 744.

68. No. 10,755 (Del. Ch. Oct. 26, 1989), *reprinted in* 15 DEL. J. CORP. L. 997 (1990).

69. *Id.*, slip op. at 11, *reprinted in* 15 DEL. J. CORP. L. at 1005-06. The proposed merger called for the payment of $9.50 per share in cash and $3.50 per share in Contingent Payment Rights (CPRs). "Each CPR entitles the holder to receive cash payments of up to $3.50 over a period of 3-1/2 years, depending upon earnings of the surviving corporation during certain periods." *Id.*, slip op. at 10, *reprinted in* 15 DEL. J. CORP. L. at 1005.

70. *Id.*, slip op. at 11, *reprinted in* 15 DEL. J. CORP. L. 1005-06. ServiceMaster was entitled to receive the break-up fee if, among other things, the merger was not consummated and the directors withdrew their recommendation that the merger agreement be adopted by the stockholders. *Id.*, slip op. at 12, *reprinted in* 15 DEL. J. CORP. L. at 1006.

71. *Id.* The court found that the break-up fee was "no[t] onerous." *Id.*, slip op. at 19, *reprinted in* 15 DEL. J. CORP. L. 1010.

72. *Id.*, slip op. at 14, *reprinted in* 15 DEL. J. CORP. L. at 1007.

Plaintiffs challenged the transaction on two grounds. Their first allegation of disclosure claims was viewed by the court as relating to "essentially trivial" facts.[73] Next, the plaintiffs' principal claim was that the defendants had not proceeded "with care and with the single intention to achieve the best available transaction for the benefit of [AMS] shareholders."[74]

While the court expressed certain reservations about the board's search for alternative bidders, it refused to enjoin consummation of the merger:

> While the *Revlon* case does not require that whenever a corporation is to be sold for cash an auction be held, it does require, in my opinion, at the least that directors take reasonable steps designed to assure that they have probed for alternatives and have a reasonable basis to conclude that the choice that they make is the best available alternative. Here, while there had earlier been inquiry by [AMS's] management of available finance-oriented deals, it is not apparent that any serious check was done to uncover potential strategic buyers either before announcement of the acceptance of ServiceMaster's proposal or after it.
> . . . However, I need not assess that claim more finely, or defendants' various answers to it, as I have concluded that entry of an order precluding effectuation of the merger would appear at this time to be at least as likely to injure the economic interests of [AMS's] shareholders as to protect or enhance those interests. In these circumstances, a preliminary injunction is not warranted.[75]

In *In re Formica Corp. Shareholders Litigation*,[76] the court of chancery again refused to preliminarily enjoin the closing of a cash tender offer for Formica Corporation. Members of Formica's senior management, Dillon, Read & Co. and Wertheim, Schroder & Co. comprised the buyout group, offering $18 per share for all outstanding shares.[77] The merger agreement required that the tender offer remain open for thirty business days, during which Formica would conduct

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73. *Id.*, slip op. at 22, *reprinted in* 15 DEL. J. CORP. L. at 1011.

74. *Id.*, slip op. at 1, *reprinted in* 15 DEL. J. CORP. L. at 1000.

75. *Id.*, slip op. at 16-18 (citations omitted), *reprinted in* 15 DEL. J. CORP. L. at 1008-09.

76. No. 10,598 (Consolidated) (Del. Ch. Mar. 22, 1989).

77. *Id.*, slip op. at 1, 39.

a market search and actively solicit higher bids.[78] If a higher bid were received and accepted, the management investment group would receive a break-up fee of $5 million, and its expenses would be reimbursed up to $5.5 million.[79]

The court rejected each of the plaintiffs' claims, including challenges to (1) the propriety of permitting Formica's chairman to explore Formica's strategic alternatives to a prior unsolicited merger proposal at a time when he was actively considering a management leveraged buyout; and (2) the engagement of an investment banker, which had previously represented Formica and had ties to its management, to represent the Special Committee of Formica's Board established to consider offers.[80] While the court found "some merit" to these criticisms, they provided an insufficient basis, by themselves, to invalidate the transaction, given the existence of "adequate countervailing procedural safeguards, calculated to protect the shareholders' interests."[81]

One set of facts did cause the court of chancery to enjoin a tender offer in 1989. In *In re Envirodyne Industries Inc. Shareholders Litigation*,[82] the court preliminarily enjoined an all-cash tender offer for all of the common stock of Envirodyne Industries, Inc. by a group including Salomon Brothers Inc (Salomon) and Donald P. Kelly, among others.[83]

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78. *Id.*, slip op. at 22. Formica's investment banker contacted approximately 125 potential acquirors regarding a possible acquisition of Formica. *Id.* No higher bids emerged. *Id.*, slip op. at 23. Nor did any potential bidders complain that the 30 day period was too short to enable them to bid. *Id.*, slip op. at 34.

79. *Id.*, slip op. at 20-22.

80. *Id.*, slip op. at 23-28. The court noted that, because of the "inherent conflict" that arises when management is a bidder for control,

> the responsibility to represent the shareholders' interests adequately falls upon the independent directors, who must exercise the utmost good faith and the appropriate degree of care to assume "the most scrupulous adherence to ordinary principles of fairness in the conduct of an auction for the sale of the corporate enterprise."

Id., slip op. at 28-29 (quoting Mills Acquisition Co. v. Macmillan, Inc., Nos. 415 & 416, 1988 (Consolidated) (Del. Nov. 2, 1988) (bench ruling)).

81. *Id.*, slip op. at 31 n.14.

82. No. 10,702 (Consolidated) (Del. Ch. Apr. 20, 1989), *reprinted in* 15 DEL. J. CORP. L. 175 (1990).

83. *Id.*, slip op. at 2, *reprinted in* 15 DEL. J. CORP. L. at 177. Pursuant to the offer, the stockholders of Envirodyne were to receive $40 cash per share with the exception of ARTRA Group, Inc., the holder of 26.3% of Envirodyne's common stock, which was to receive a package of cash, subordinated debentures and stock in the entity which was to acquire Envirodyne. ARTRA's package was worth between $26-30 per share and was apparently agreed to due to ARTRA's need for cash. *Id.*, slip op. at 3, *reprinted in* 15 DEL. J. CORP. L. at 178.

The offer was challenged on two grounds. Plaintiffs claimed that defendants breached their duty of candor to shareholders by failing to disclose certain material information. Plaintiffs also claimed that the defendant-directors had violated their duties under *Revlon* in approving the merger agreement by not conducting an auction of the corporation.[84] The court found that certain confidential revenue and profit breakdowns of Envirodyne's three principal divisions used by Salomon in forecasting Envirodyne's profitability and by Envirodyne's Board in considering the offer should have been disclosed to stockholders.[85] The court held that "[s]uch divisional information is material where the offeror utilizes such information in formulating its bid."[86] However, the court did not feel that Envirodyne or its board of directors breached any other fiduciary duties to the corporation. Therefore, the closing of the tender offer was enjoined until at least ten days after the defendant mailed supplementary materials to Envirodyne's stockholders which cured the disclosure defect.[87]

B. Employee Stock Ownership Plans

While ESOPs are not a development of recent vintage, the theory that they may be useful as a defensive measure to help prevent a hostile acquisition has only recently been widely accepted. In a January opinion issued after the thirteen-day trial of *Shamrock Holdings, Inc. v. Polaroid Corp.*,[88] the court of chancery considered an attack upon the validity of an ESOP adopted by Polaroid Corporation.[89]

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84. *Id.*, slip op. at 9, *reprinted in* 15 DEL. J. CORP. L. at 181.

85. *Id.*, slip op. at 8, *reprinted in* 15 DEL. J. CORP. L. at 180.

86. *Id.* (citing Rothberg v. Rosenbloom, 771 F.2d 818 (3d Cir. 1985), *cert. denied*, 481 U.S. 1017 (1987); Burlington Indus. v. Edelman, 666 F. Supp. 799 (M.D.N.C. 1987); Essex Chem. Corp. v. Gurit-Heberlein AG, No. 88-2478 (D.N.J. June 24, 1988), *aff'd*, 857 F.2d 1463 (3d Cir. 1988)).

87. *In re* Envirodyne Indus. Inc. Shareholders Litig., No. 10,702, slip op. at 11, *reprinted in* 15 DEL. J. CORP. L. at 181.

88. 559 A.2d 257 (Del. Ch. 1989).

89. The parameters of the Polaroid ESOP are outlined as follows:

> Approximately 14% of Polaroid's outstanding stock (9.7 million shares) was issued to the ESOP in late July, 1988. A small portion of that stock was then retroactively allocated to the Polaroid employees entitled to participate in the ESOP. Similar allocations will be made twice a year over the next 10 years so that, at the end of 10 years, all 9.7 million shares will have been allocated to the employees' retirement accounts. The ESOP stock becomes available to the employees (or their estates) only upon termination, retirement or death. For the next ten years, dividends

The court upheld the ESOP and entered judgment on behalf of the defendants.[90]

The court considered issues relating to both the care exercised by Polaroid's Board in adopting the ESOP and the possibility that the ESOP was an antitakeover device. The court determined that it need not resolve those issues since "neither a board's failure to become adequately informed nor its failure to apply a *Unocal* analysis [for an antitakeover measure], where such an approach is required, will automatically invalidate the corporate transaction."[91] The court scrutinized the board's action to see if it was "entirely fair."[92] Among the factors considered by the court in reviewing the board's action in adopting the ESOP under the "entire fairness" standard were its impact on business operations,[93] its antitakeover effect,[94] and its dilutive effect on current shareholders.[95]

> earned on the stock allocated to each employee's account will be used to help pay for the stock. Thereafter, dividends will be credited to the employees' accounts.

Id. at 272-73.

90. *Id.* at 275-76.

91. *Id.* at 271. In the court's view, the case raised interesting questions related to Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985). While the directors claimed that the ESOP was not adopted as a defensive measure, the court found that the management directors were acting to prevent a possible takeover and that the outside directors may have been. *Polaroid*, 559 A.2d at 270-71. The court found that no case addressed the issue, "arguably presented here, of whether a board, largely composed of disinterested directors, should be deemed to be acting from the same motives as the members of management who proposed the transaction." *Id.* at 271. The court also found little guidance in prior decisions on the question of whether it could "undertake the *Unocal* analysis for the board where the directors failed to do so." *Id.* (citing *Unocal*, 493 A.2d at 955).

92. *Polaroid*, 559 A.2d at 271. The court placed the burden of proof on these issues with the defendants. *Id.*

93. *Id.* The court found no direct evidence that Polaroid's ESOP "is likely to do anything but improve productivity." *Id.* at 272. It accepted the evidence that "ESOPs generally promote better employee morale and productivity." *Id.*

94. *Id.* The court found it appropriate to consider the ESOP's antitakeover effect even though "stockholders have no contractual right to receive tender offers or other takeover proposals." *Id.* at 272 (citing Moran v. Household Int'l, Inc., 490 A.2d 1059, 1070 (Del. Ch.), *aff'd*, 500 A.2d 1346 (Del. 1985)). In analyzing the ESOP's antitakeover effect, the court noted that Polaroid's ESOP provided for confidential and "mirrored" voting and tendering. Thus, the trustee was obligated to honor and keep confidential the directions of ESOP stockholders as to allocated shares and tender the same proportion of unallocated shares as the ESOP stockholders tendered. *See id.* at 273. The court concluded that the "ESOP may mean that a potential acquiror will have to gain the employees' confidence and support in order

Vice-Chancellor Berger wrote:

> In reviewing a decision to establish an ESOP it seems that the same strong indicia of fairness is established where an ESOP is fully funded by the employees and where they control the disposition and voting of the ESOP stock. Such an ESOP, as a general rule, would seem to have the elements necessary to commend itself to a wholly independent board of directors. . . .
>
> After considering all of the evidence, including the timing of the ESOP's establishment, its structure and operation, its purpose and likely impact (both as a motivational device and as an anti-takeover device), I am satisfied that the Polaroid ESOP is fundamentally fair. It is essentially stockholder neutral although it does have some dilutive effect. It is structurally fair in its voting and tendering provisions and I do not find either the timing of its implementation or its possible anti-takeover effect objectionable under the facts of this case. . . .
>
> . . . The fact that the ESOP was partly defensive . . . does not make it unfair. This is a defensive device (assuming it is one) that is designed to and appears likely to add value to the company and all of its stockholders. It does not prevent the stockholders from receiving or considering alternatives. In sum, the plan adopted by the directors, whether adequately considered or not, is fair and should not be invalidated.[96]

In March, the court considered further challenges to new defensive measures adopted by Polaroid.[97] This time the court upheld

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to be successful in its takeover effort. However, there has been no showing that such support is or would be impossible to obtain." *Id.* at 274.

95. *Id.* at 271. The court found that "[t]here is and can be no hard evidence as to what the dilutive effect of the ESOP will be." *Id.* at 274. On balance, the court concluded that "a minimal reduction in earnings per share is fair where, as here, it is necessary in order to promptly implement a large ESOP that is intended to increase corporate earnings." *Id.* The court noted, however, that "[i]f the ESOP's only purpose were to help thwart hostile takeovers, I doubt that it would be considered entirely fair where it dilutes the public stockholders' earnings per share." *Id.*

96. *Id.* at 275-76 (citations omitted).

97. Shamrock Holdings, Inc. v. Polaroid Corp., 559 A.2d 278 (Del. Ch. 1989).

the issuance of $330 million of convertible preferred stock to a third party,[98] an $800 million self-tender by Polaroid,[99] and a $325 million post-tender stock buy-back.[100] Upon reconsideration, at the request of the Delaware Supreme Court, of its January decision upholding Polaroid's adoption of its ESOP, the court also reaffirmed that decision.[101]

In analyzing the conduct of the Polaroid directors under the intermediate *Unocal* standard of review applied to antitakeover actions, the court found that (1) the directors acted in good faith after reasonably investigating Shamrock's offer, and (2) the stock was issued to the third party on commercially reasonable terms for the valid purpose of obtaining a portion of the funds needed to implement the repurchase program.[102] The court found it "difficult to understand how, as a general matter, an inadequate all cash, all shares tender offer, with a back end commitment at the same price in cash, can be considered a continuing threat under *Unocal*."[103] However, the court concluded that Polaroid's upcoming patent damage trial against Kodak[104] justified "some level of defensive response," as it created

98. Plaintiffs claimed that the sale of $300 million of securities to Corporate Partners was designed to thwart a tender offer by Shamrock Holdings, Inc. and to defeat Shamrock in an upcoming proxy contest. *Id.* at 279. In exchange for $300 million, Polaroid agreed to issue to Corporate Partners and two other entities $100 million of Series B Cumulative Convertible Preferred Stock with annual cumulative cash dividends of 11%, $200 million of Series C Cumulative Convertible Pay-in-Kind Preferred Stock with annual cumulative pay-in-kind dividends at 11.5%, and warrants for 635,000 shares of common stock exercisable at $50 per share. *Id.* at 283. In addition, Corporate Partners was given two seats on Polaroid's Board. *Id.* at 284.

99. Polaroid sought to purchase up to 16 million shares of its common stock at $50 per share. *Id.* at 284-85.

100. Polaroid announced that it intended to repurchase $325 million in shares in the open market or in privately negotiated transactions after the self-tender and a judicial determination of the validity of the issuance of the preferred stock. *Id.* at 285.

101. *Id.* at 291-92. After hearing oral argument on the appeal of the court of chancery's January 6, 1989 decision on the Polaroid ESOP and recognizing the interrelationship between the facts of that case and the new allegations concerning the sale of preferred stock and stock buy-backs, the supreme court remanded the ESOP case for "such further supplemental findings of fact and rulings . . . that appear appropriate . . . ." *In re* Polaroid Corp. Shareholders Litig., No. 13,1989, slip op. at 2 (Del. Mar. 6, 1989) (Horsey, J.) (order).

102. *Polaroid*, 559 A.2d at 287-88.

103. *Id.* at 289.

104. The court noted that Polaroid was about to begin trial of the damages portion of its patent infringement litigation against Kodak, in which Polaroid sought approximately $5.7 billion in damages. *Id.*

"a valid basis for concern that the Polaroid stockholders will be unable to reach an accurate judgment as to intrinsic value of their stock . . . ."[105]

C. *Stockholder Rights Plans*

Questions concerning redemption of rights issued pursuant to stockholder rights plans were again considered by Delaware courts in 1989. In *TW Services, Inc. v. SWT Acquisition Corp.*,[106] the court of chancery declined to order the board of directors of TW Services Inc. to redeem rights issued pursuant to a stockholder rights plan, where the consummation of a proposed tender offer was conditioned on the company's entry into a merger agreement. The court reached its conclusion notwithstanding the fact that approximately eighty-eight percent of the stock of TW Services was either owned by or had been tendered to the bidder.[107]

In dicta, the court framed several important issues that were raised by the facts, but which did not have to be answered by the court in order to rule on the preliminary injunction motion.

> May a board find itself thrust involuntarily into a Revlon mode in which it is required to take only steps designed to maximize current share value and in which it must desist from steps that would impede that goal, even if they might otherwise appear sustainable as an arguable step in the promotion of "long term" corporate or share values? . . .
>
> . . . [W]hat of a situation in which the holders of some 88% of the Company's stock in effect declare . . . that they do seek a current share value maximizing transaction now? Does a director's duty of loyalty to "the corporation and its shareholders" require a board . . . to enter a Revlon mode?[108]

The court determined that it did not need to resolve those questions "in light of the particularities of the circumstances" faced by the directors of TW Services.[109] The tender offer was contingent

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105. *Id.* at 290.

106. Nos. 10,427 & 10,298 (Consolidated) (Del. Ch. Mar. 2, 1989), *reprinted in* 14 DEL. J. CORP. L. 1169 (1989).

107. *Id.*, slip op. at 1, *reprinted in* 14 DEL. J. CORP. L. at 1173.

108. *Id.*, slip op. at 23-24, *reprinted in* 14 DEL. J. CORP. L. at 1186 (footnote omitted).

109. *Id.*, slip op. at 25, *reprinted in* 14 DEL. J. CORP. L. at 1187.

upon two conditions. First, the purchaser must have been "'satisfied that the board of directors of the company [had] approved the Offer and recommended that the stockholders of the company accept the Offer and tender their Shares and that the company has entered into a satisfactory merger agreement with Purchaser or an affiliate of Purchaser'" (the Approval Condition).[110] The offer was also contingent upon the availability of sufficient funds to purchase the shares at the time of closing (the Financing Condition).[111]

In view of these conditions, the TW Services' Board considered the offer not a *bona fide* offer but merely an invitation to the board to enter into merger negotiations for the possible acquisition of TW Services. The directors indicated that they would consider pursuing an extraordinary transaction only if and when they were faced with an offer they concluded was *bona fide*, i.e., one that included neither the Approval Condition nor the Financing Condition.[112]

In reviewing prior decisions on this issue, the court noted that courts had only ordered redemption of rights in two situations. The first involved cases where the board itself had elected to pursue a sale of the company and had completed an auction. Redemption was also ordered where the board had decided to pursue a defensive restructuring that in form and effect was a close proximation of, and an alternative to, a pending cash tender offer for all shares.[113] The rationale for ordering redemption of the rights in those cases was that the central purpose of the rights plan—"to give a board time to negotiate on shareholders' behalf or to consider alternatives"—had been fully served.[114] In the court's view, the cases ordering redemption did not involve circumstances in which a board had elected, in good faith, to continue managing the enterprise for the long-term and not to consider an extraordinary transaction in-

110. *Id.*, slip op. at 9 (emphasis omitted), *reprinted in* 14 DEL. J. CORP. L. at 1178 (quoting SWT's Offer to Purchase, p. 1).

111. *Id.*, slip op. at 9 (emphasis omitted), *reprinted in* 14 DEL. J. CORP. L. at 1178 (quoting SWT's Offer to Purchase, p. 1).

112. *Id.*, slip op. at 10-12, *reprinted in* 14 DEL. J. CORP. L. at 1179-80.

113. *Id.*, slip op. at 27-28, *reprinted in* 14 DEL. J. CORP. L. at 1188. *See, e.g.*, Grand Metro. PLC v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988) (poison pill enjoined where board seeks to sell division and implement restructuring); City Capital Assocs. v. Interco, Inc., 551 A.2d 787 (Del. Ch. 1988) (poison pill not justified in face of mild threat).

114. *TW Servs.*, Nos. 10,427 & 10,298, slip op. at 28, *reprinted in* 14 DEL. J. CORP. L. at 1188.

volving control. The court accepted the view of TW Services' directors that the primary issue was whether they had breached a duty owed to the corporation and its shareholders in concluding that the circumstances did not require them to consider whether or not to place the corporation in a current share value maximizing mode.[115]

Inasmuch as the tender offer constituted only a proposal to negotiate a merger, the court followed past precedent and analyzed the board's response under the business judgment rule.[116] The court found that the board's decision to decline to enter into merger discussions and to continue to manage the corporation to enhance long-term share value was legitimate and made in good faith. Since the court found no basis to question the board's due care in reaching its decision, it concluded that the board's actions were protected under the business judgment rule.[117]

Finally, the court concluded that TW Services' Board was justified in not further addressing the question of whether it should deviate from its long-term management goals in order to enter into a transaction to maximize current value. Until it had considered whether or not to abandon its long-term view, the board did not reach the stage at which it could be required to dismantle its rights plan defense.[118]

The court of chancery also considered various rights plan issues in *Davis Acquisition Inc. v. NWA Inc.*[119] The action in *Davis* arose out of the commencement by entities controlled by Marvin Davis of a public tender offer for all of NWA's shares for $90 per share in cash and a proxy solicitation to elect Davis' nominees to NWA's Board.[120] Chancellor Allen refused to preliminarily enjoin the issuance by NWA of defensive stock rights to its stockholders until after the holding of NWA's annual meeting on May 15, 1989.

The defensive rights plan adopted by NWA contained an unusual provision (the Delayed Redemption Provision) which provided that

> any board that is comprised predominately of members who were not nominated by the incumbent board (and for whom

115. *Id.*, *reprinted in* 14 DEL. J. CORP. L. at 1189.
116. *Id.*, slip op. at 34, *reprinted in* 14 DEL. J. CORP. L. at 1191-92.
117. *Id.*, slip op. at 33, *reprinted in* 14 DEL. J. CORP. L. at 1191.
118. *Id.*, slip op. at 34-35, *reprinted in* 14 DEL. J. CORP. L. at 1191-92.
119. No. 10,761 (Del. Ch. Apr. 25, 1989), *reprinted in* 15 DEL. J. CORP. L. 156 (1990).
120. *Id.*, slip op. at 1, *reprinted in* 15 DEL. J. CORP. L. at 159.

> there had not been 45 days' prior notice that they would be nominated) may in no event redeem the stock rights for a period of 180 days following its election, if to do so would facilitate a transaction with an "interested person . . . ."[121]

Neither the incumbent board nor a successor that is predominately composed of persons nominated to office by the incumbent board would suffer under any such limitation.[122]

The plaintiffs challenged the Delayed Redemption Provision as, among other things, (1) a direct impairment of the voting process,[123] (2) a manipulation of the corporate machinery for the purpose of self-interested entrenchment,[124] and (3) beyond the power of defendants in that it limited the power of a future board to take such actions as it deemed at the time to be in NWA's best interest.[125]

In analyzing the competing interests, the court found that its "function is to strive to protect established rights . . . while being mindful that the expression of opinion by a court may have an impact upon the outcome of the election."[126] In the court's view,

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121. *Id.*, slip op. at 2, *reprinted in* 15 DEL. J. CORP. L. at 160.

122. *Id.*, slip op. at 2, *reprinted in* 15 DEL. J. CORP. L. at 160. Such an incumbent board or its successors "would be free, in the exercise of its business judgment, to redeem the stock rights at any time before they became exercisable." *Id.*

123. *Id.*, slip op. at 3, *reprinted in* 15 DEL. J. CORP. L. at 160. Plaintiffs alleged that the Delayed Redemption Provision was, therefore, "an offense to the principal-agent, legal relation that exists between the board and the shareholders." *Id.* (citing Aprahamian v. HBO & Co., 531 A.2d 1204 (Del. Ch. 1987)) (parties seeking election to board entitled to injunction when management changed shareholder meeting date suddenly on the day before); Lerman v. Diagnostic Data, Inc., 421 A.2d 906 (Del. Ch. 1980) (stockholder meeting invalid when called on less notice than required under bylaws for opposition candidates to submit information); Blasius Indus. Inc. v. Atlas Corp., No. 9720 (Del. Ch. July 25, 1988) (directors' decision to add two new members to board was unintended violation of a shareholders' voting right).

124. *Davis Acquisition*, No. 10,761, slip op. at 4, *reprinted in* 15 DEL. J. CORP. L. at 161. Plaintiffs claimed that the Delayed Redemption Provision was such a manipulation since they never had a chance to give the required 45 days' notice of an intention to nominate directors. *Id.* (citing Schnell v. Chris-Craft Indus., 285 A.2d 437 (Del. 1971)) (board may not subvert corporate machinery for illegitimate purposes even if the law is followed).

125. *Davis Acquisition*, No. 10,761, slip op. at 4, *reprinted in* 15 DEL. J. CORP. L. at 161 (citing Chapin v. Benwood Found., 402 A.2d 1205 (Del. Ch. 1975), *aff'd sub nom.* Harrison v. Chapin, 415 A.2d 1068 (Del. 1980); Abercrombie v. Davis, 123 A.2d 893 (Del. Ch. 1956), *rev'd on other grounds*, 130 A.2d 338 (Del. 1957)).

126. *Davis Acquisition*, No. 10,761, slip op. at 11, *reprinted in* 15 DEL. J. CORP. L. at 164.

the balance of harm was critical in assessing the relative positions of the parties.[127]

The court was "rather unimpressed that plaintiffs' fear that the Delayed Redemption Provision [would] be a material factor to those NWA shareholders who might otherwise vote for the Davis slate [was] well grounded."[128] The injurious effect of an improvident injunction, coupled with the existence of alternative means to minimize the threat to the voting process, compelled the court to decline to issue the injunction.[129] The court agreed, upon timely application, to hear and finally determine the validity of the Delayed Redemption Provision within forty-five days of the closing of the polls at the annual meeting. In addition, the court required defendants to give notice to NWA's stockholders of the challenge to that provision and of the courts' intention to promptly determine its validity.[130]

The lengthy litigation arising out of the contest for control of Holly Farms Corporation also resulted in an important ruling concerning redemption of rights. In *In re Holly Farms Corp. Shareholders Litigation*,[131] the court of chancery refused to preliminarily enjoin Holly Farms from taking steps to effectuate a merger agreement entered into between Holly Farms and ConAgra, Inc. or to require Holly Farms to redeem rights issued pursuant to a stockholder rights plan.[132]

The court found that although the directors of Holly Farms had "consistently favored [ConAgra] in the bidding,"[133] their acceptance of ConAgra's latest proposal "was in the best interests of the share-

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127. *Id.*, slip op. at 12, *reprinted in* 15 DEL. J. CORP. L. at 165.

128. *Id.*

129. *Id.*, slip op. at 15, *reprinted in* 15 DEL. J. CORP. L. at 166.

130. *Id.*, slip op. at 15-17, *reprinted in* 15 DEL. J. CORP. L. at 167-68.

131. 564 A.2d 342, 343 (Del. Ch. 1989). Many of the facts underlying the contest for control of Holly Farms Corporation are discussed in prior opinions of the court in the action: *In re* Holly Farms Corp. Shareholders Litig., No. 10,350 (Consolidated) (Del. Ch. May 18, 1989) (Revised May 19, 1989), *reprinted in* 15 DEL. J. CORP. L. 189 (1990); *In re* Holly Farms Corp. Shareholders Litig., No. 10,350 (Consolidated) (Del. Ch. Mar. 22, 1989); and *In re* Holly Farms Corp. Shareholders Litig., No. 10,350 (Consolidated) (Del. Ch. Dec. 30, 1988), *reprinted in* 14 DEL. J. CORP. L. 1062 (1989).

132. *In re Holly Farms Corp. Shareholders Litig.*, 564 A.2d at 343.

133. *Id. See also id.* at 348-49. In its December 30, 1988 opinion in the case, the court preliminarily enjoined enforcement of an asset option lockup and termination and expense reimbursement fee provisions contained in an agreement of merger between Holly Farms and ConAgra. *In re Holly Farms Corp. Shareholders Litig.*, No. 10,350, slip op. at 1 (Del. Ch. Dec. 30, 1988), *reprinted in* 14 DEL. J. CORP. L. 1066.

holders." Therefore, the court believed that "no injunction to prevent its effectuation should be entered despite the unfairness of the bidding process to Tyson [Foods, Inc.]."[134] The court also found that the rights plan was enhancing a legitimate interest of the stockholders of Holly Farms in that it encouraged "a noncoercive stockholder vote on the ConAgra proposal . . . ."[135] As a result, it refused to require redemption of the rights.

The court noted that the existence of unequal or unfair treatment of one bidder over another does not end the court's inquiry.[136] In order to set aside an agreement providing for the sale of control of a corporation, the court must also "'examine whether directors properly perceived that shareholder interests were enhanced'" by the challenged action.[137] The court found that it was reasonably probable that the directors of Holly Farms had a justifiable reason to believe that a deal between the only two bidders—Tyson Foods and ConAgra—could occur at any moment, and that if it did occur ConAgra would withdraw its latest offer worth approximately $66-$67 per share and the stockholders of Holly Farms would be left with the bid of Tyson Foods at $63.50 per share.[138] Faced with this threat, the court found that the board's action in accepting the significantly higher ConAgra offer before it could be withdrawn, in the absence of a new bid by Tyson Foods, seemed to have been "'reasonable in relation to the advantage sought to be achieved, or conversely, to the threat which a particular bid allegedly pose[d] to stockholder interests.'"[139]

The court also found that Tyson had failed to show irreparable harm.[140] If an injunction were not granted, the proposed merger

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134. *In re Holly Farms Corp. Shareholders Litig.*, 546 A.2d at 343.

135. *Id.* The court found that the rights plan contributed to serve a "valid purpose," "until such time as Tyson's offer becomes competitive with the ConAgra proposal." *Id.* at 352. The court also noted that

> if the shareholders reject the ConAgra merger proposal, thereby, in effect, expressing a preference for the offer of Tyson Foods, it would seem likely that the directors of Holly Farms should then fulfill their fiduciary duties, which they so proudly proclaim, and redeem the poison pill so that at long last Tyson could complete its tender offer.

Id.

136. *In re Holly Farms Corp. Shareholders Litig.*, 564 A.2d at 349 (citing Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1989)).

137. *Id.* (quoting *Mills Acquisition Co.*, 559 A.2d at 1288).

138. *Id.*

139. *Id.* (quoting *Mills Acquisition Co.*, 559 A.2d at 1288).

140. *Id.*

between Holly Farms and ConAgra still had to be approved by a two-thirds affirmative vote of the Holly Farms stockholders.[141] Tyson Foods was also free to make a new enhanced offer which might be accepted by the stockholders.[142]

D. *Meetings of Stockholders*

The contest for control of Prime Computer, Inc. (Prime) raised important issues relating to the holding of Prime's 1989 annual meeting of stockholders. In *MAI Basic Four, Inc. v. Prime Computer, Inc.*,[143] the court of chancery declined to issue a preliminary mandatory injunction to compel the directors of Prime to hold their annual stockholders meeting on June 14, 1989, a date previously scheduled but subsequently postponed.[144] After considering "all the facts and circumstances," the court found that "the directors of Prime had a sufficient reason to postpone the meeting," despite the fact that their directorships were being contested.[145]

On June 1, MAI Basic Four, Inc. (Basic) withdrew its long-standing $20 cash tender offer for all Prime shares and made a new tender offer of $19.50 cash for seventy-five percent of Prime's shares and "junk" paper for the remaining twenty-five percent of the shares in a second-step squeeze-out merger.[146] Finding that the new offer

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141. *Id.*

142. *Id.* The court of chancery also addressed a situation where stockholders challenged a board's decision not to adopt defensive measures in response to an unsolicited all-cash tender offer. In Day v. Quotron Sys., Inc., No. 8502 (Del. Ch. Nov. 20, 1989), *reprinted in* 16 DEL. J. CORP. L. 297 (1991), the court held that while "directors owe an affirmative duty to the corporation and its stockholders to protect and defend their interests," the board was "entitled to have its decision not to enact a defensive measure protected by the business judgment rule" since it was adequately informed and disinterested. *Id.*, slip op. at 12, *reprinted in* 16 DEL. J. CORP. L. at 306-07.

143. No. 10,868 (Del. Ch. June 13, 1989), *reprinted in* 15 DEL. J. CORP. L. 690 (1990).

144. *Id.*, slip op. at 1, *reprinted in* 15 DEL. J. CORP. L. at 692. The directors postponed the annual meeting of Prime from June 14, 1989 to July 26, 1989. *Id.*, slip op. at 3, *reprinted in* 15 DEL. J. CORP. L. at 693. Prime had previously postponed the annual meeting from May 12, 1989 to June 14, 1989. *Id.*, slip op. at 2, *reprinted in* 15 DEL. J. CORP. L. at 692.

145. *Id.*, slip op. at 1, *reprinted in* 15 DEL. J. CORP. L. at 692.

146. *Id.*, slip op. at 3, *reprinted in* 15 DEL. J. CORP. L. at 693. Basic and Choice Corporation had commenced an all-cash tender offer for all shares of Prime at $20 per share on November 15, 1988. *Id.*, slip op. at 2, *reprinted in* 15 DEL. J. CORP. L. at 692. On May 15, 1989, Prime announced that it would not seek to prevent Basic from buying Prime for $20 per share in cash. *Id.*, slip op. at 2, *reprinted in* 15 DEL. J. CORP. L. at 693.

was "the type of coercive tender offer which has been consistently criticized by the courts of Delaware,"[147] the court found that Prime's

> directors have acted in the best interests of the stockholders . . . in delaying the annual meeting for a reasonable time in order to permit the stockholders to evaluate the new and much less attractive offer of Basic and in order to give the directors of Prime reasonable time to find alternatives to Basic's new offer.[148]

If the annual meeting was permitted to go forward as scheduled, the court agreed that "any chance for a higher price for Prime shares may vanish."[149]

The *Holly Farms* takeover contest also yielded a decision concerning the holding of a stockholder vote. In *In re Holly Farms Corp. Shareholders Litigation*,[150] the court of chancery refused to enjoin a stockholder vote on a merger agreement between Holly Farms and ConAgra, pending final resolution of Tyson Foods' challenge to the validity of the merger agreement and a related asset option lockup agreement.[151]

In a previous decision, the court had preliminarily enjoined effectuation of the lockup along with the termination fee and expense reimbursement provisions of the merger agreement.[152] Holly Farms felt that the court's subsequent decision in *In re RJR Nabisco, Inc. Shareholders Litigation*[153] had somehow overruled the court's opinion

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147. *Id.*, slip op. at 3, *reprinted in* 15 DEL. J. CORP. L. at 693 (citing Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334 (Del. 1987); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985)).

148. *Id.*, slip op. at 4, *reprinted in* 15 DEL. J. CORP. L. at 693.

149. *Id.* The court also rejected the plaintiffs' claim that § 211(c) mandated the holding of the meeting as scheduled. DEL. CODE ANN. tit. 8, § 211(c) (Supp. 1989). *See Prime Computer*, No. 10,868, slip op. at 5, *reprinted in* 15 DEL. J. CORP. L. at 694.

150. No. 10,350 (Consolidated) (Del. Ch. Mar. 22, 1989). *See supra* notes 131-42 and accompanying text (discussing *In re* Holly Farms Corp. Shareholders Litig., 564 A.2d 342 (Del. Ch. 1989)).

151. *Id.*, slip op. at 2-3. Holly Farms granted ConAgra a lockup option on Holly Farms' prime poultry operations and agreed to a termination fee of $15 million and reimbursement of expenses should the deal fail to close. *In re Holly Farms Corp. Shareholders Litig.*, No. 10,350 (Consolidated), slip op. at 5-6 (Del. Ch. Dec. 30, 1988), *reprinted in* 14 DEL. J. CORP. L. at 1068.

152. *In re* Holly Farms Corp. Shareholders Litig., No. 10,350 (Consolidated) (Del. Ch. Dec. 30, 1988), *reprinted in* 14 DEL. J. CORP. L. 1062 (1989).

153. No. 10,389 (Consolidated) (Del. Ch. Jan. 31, 1989), *reprinted in* 14 DEL. J. CORP. L. 1132 (1989).

granting the preliminary injunction.[154] In response to that argument, the court noted:

> There may be some theoretical appeal to the proposition that unless a court can ascertain some subjective intention by a board to do wrong, a facially objective board should be given unfettered leave to conduct an auction as it pleases or displeases. I, however, have seldom been able to ascertain the subjective intent of board members except by reviewing the objective effect of their acts and I do not believe that it is possible for a court to meaningfully review an auction except by reviewing the objective procedures used.[155]

The court then noted that an "even greater burden" than that normally imposed on one who seeks a preliminary injunction is imposed on one who seeks to preclude the holding of a stockholders meeting. This is due to the fact that the right to vote a share of stock is an incident of ownership and a valuable property right.[156]

While the court concluded that the auction of Holly Farms was still being chilled by the existence of the lockup, it put off consideration of the validity of the lockup and its effect on the vote until after any counteroffers had been made and the voting had been completed.[157] However, in view of the possibility that the merger could be consummated shortly after the vote, the court amended the

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154. *In re* Holly Farms Corp. Shareholders Litig., No. 10,350 (Consolidated), slip op. at 23 (Del. Ch. Mar. 22, 1989).

155. *Id.*

156. *Id.*, slip op. at 25. *See* Cavalcade Oil Corp. v. Texas Am. Energy Corp., No. 7605 (Del. Ch. May 22, 1984), *reprinted in* 9 DEL. J. CORP. L. 417 (1984); Columbia Pictures Indus. v. Kerkorian, No. 6394, slip op. at 2-3 (Del. Ch. Dec. 16, 1980); Bell v. Lavino, No. 5319 (Del. Ch. Apr. 26, 1977), *reprinted in* 3 DEL. J. CORP. L. 572 (1978); Lenahan v. National Computer Analysts Corp., 310 A.2d 661 (Del. Ch. 1973); Campbell v. Loew's Inc., 134 A.2d 565 (Del. Ch. 1957); Empire S. Gas Co. v. Gray, 46 A.2d 741 (Del. Ch. 1946). *See also* Phillips v. Insituform of N. Am., No. 9173 (Del. Ch. Aug. 27, 1987), *reprinted in* 13 DEL. J. CORP. L. 774 (1988) (enjoining a merger but refusing to enjoin stockholder meeting to vote on the merger). The court noted that "[o]ne of the reasons that a court hesitates to interfere with a stockholder vote is that the right to vote a share of stock is an incident of ownership and is a valuable property right." *In re Holly Farms Corp. Shareholders Litig.*, No. 10,350 (Consolidated), slip op. at 26 (Del. Ch. Mar. 22, 1989) (quoting Drob v. National Memorial Park, Inc., 41 A.2d 589 (Del. Ch. 1945)).

157. *In re* Holly Farms Corp. Shareholders Litig., No. 10,350 (Consolidated), slip op. at 27 (Del. Ch. Mar. 22, 1989).

preliminary injunction it had previously granted to include a prohibition against closing the ConAgra offer.[158]

E. Stockholder Voting

Delaware courts also issued several important opinions in 1989 concerning the tabulation of stockholder votes and the validity of various forms of proxies. In *Berlin v. Emerald Partners*,[159] the supreme court announced reasons for a decision rendered from the bench in August 1988 which reversed a decision of the court of chancery preliminarily enjoining the consummation of a merger involving May Petroleum, Inc. (May). The court of chancery had granted the injunction on the grounds that, under a provision of May's certificate of incorporation, a supermajority vote of stockholders on the merger was required. At the special meeting of stockholders, either no quorum was present or the merger did not receive the requisite supermajority vote.[160] The supreme court reversed, holding that the supermajority vote provision was not applicable to the merger proposal, and that even if it were, the requisite supermajority vote had been achieved.[161]

With respect to action taken by the inspectors of election at the meeting, the court found that they properly excluded 1.3 million shares to which voting power was withheld on the merger proposal, from the "universe" of voting power present to which the supermajority standard applied.[162] The court also found that they were correct in counting all voting securities which were present in person or by proxy at the meeting as present for the purposes of the "greater universe" of the quorum requirement set forth in the certificate of incorporation.[163] Once a quorum was established, the certificate provision provided that 66-2/3% of the voting power present (those entitled to vote on the subject) had to vote affirmatively to approve the merger.[164] Accordingly, the court concluded that the quorum requirement and the voting power provision of the charter were correctly applied and satisfied.[165]

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158. *Id.*, slip op. at 28-29.
159. 552 A.2d 482 (Del. 1989).
160. *Id.* at 487, 492.
161. *Id.* at 490-91, 495.
162. *Id.* at 494.
163. *Id.* at 495.
164. *Id.*
165. *Id.*

Justice Holland further stated in his opinion:

> [A] stockholder who is present by proxy for quorum purposes may not be voting power present for all purposes. Voting power present is synonymous with the number of shares represented which are "entitled to vote on the subject matter." A stockholder who is present in person *or* represented at a meeting by a *general* proxy, is present for quorum purposes *and* is also voting power present on all matters. However, if the stockholder is represented by a *limited* proxy and does not empower its holder to vote on a particular proposal, then the shares represented by that proxy cannot be considered as part of the voting power present with respect to that proposal.
>
> Therefore, unless the certificate of incorporation provides to the contrary, the legal and practical effect of executing a limited proxy is that a stockholder will contribute to the establishment of a quorum and will be bound by a majority decision of the voting power present on a proposal from which he has withheld the authority to vote.[166]

The court of chancery also issued an important opinion on the validity of proxies in connection with the election of directors in *Parshalle v. Roy*.[167] In the process of resolving the challenges, the court again summarized much of the Delaware case law concerning proxies.

The first challenge considered by the court was based on a claim that the person who executed a second and later proxy on behalf of

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166. *Id.* at 493 (quoting DEL. CODE ANN. tit. 8, tit. 216(2) (Supp. 1988)). The court also noted:

> Under Delaware law, a stockholder has no obligation to attend a meeting. However, it is also firmly established that stockholders who are present at a meeting are properly counted in the determination of a quorum *even though the shares are not voted*. A stockholder can be present for quorum purposes and yet not vote, because a stockholder has a right to attend the meeting but has "no legal duty to vote at all." It follows logically that a stockholder who is present in person at a meeting has a right to withhold his vote on any particular proposal and, in fact, can leave the meeting. However, a stockholder who is counted in reaching a quorum, cannot defeat the quorum, once established, by not voting or by walking out of the meeting.

Id. (citations omitted) (quoting Ringling Bros.-Barnum & Bailey Combined Shows, Inc. v. Ringling, 53 A.2d 441, 447 (Del. 1947)).

167. 567 A.2d 19 (Del. Ch. 1989). The opinion represented the decision of the court after a final hearing on the merits. *Id.* at 20.

a limited partnership had no authority to do so and that the inspector of election erred as a matter of law in counting that proxy. The petitioners claimed that the second of the two proxies submitted on behalf of the partnership was the result of a failure of communication between two of the partners and, therefore, that such proxy should have been disregarded and a prior-dated proxy voting the opposite way should have been counted.[168] The court found that both Delaware case law and an agreement between the parties governing the election required the inspector to give effect to the later-dated proxy when faced with two identical proxies having differing dates.[169] "That an internal mistake or misunderstanding among [the] general partners may have led to the later-dated proxy, is not a fact of which the [i]nspector or this [c]ourt may take cognizance."[170]

The second challenge—one of "first impression in Delaware"—was to the validity of "datagram" proxies.[171] As the court described it, "[A] datagram proxy is a procedure in which a record shareholder, by using a toll-free telephone number, is able to communicate his vote in telegraphic or 'datagram' form."[172] In addressing the general or statutory validity of the data proxies obtained by respondents,[173] the court found they "lack the fundamental indicia of authenticity and genuineness needed to accord them a presumption of validity."[174] The court based its conclusion

> upon the fact that the datagrams lack any written signature or signature equivalent (such as a signature stamp or facsimile), or other identifying mark or characteristic that would verifiably link the proxy to a specific shareholder of record. As a consequence, it cannot be presumed that that

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168. *Id.* at 21-22.

169. *Id.* at 22-23 (citing Standard Power & Light Corp. v. Investment Assocs., Inc., 51 A.2d 572, 580 (Del. 1947)).

170. *Parshalle*, 567 A.2d at 23 (citing Blasius Indus. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988); Williams v. Sterling Oil of Okla., 273 A.2d 264, 265 (Del. 1971)).

171. *Id.* at 26. Petitioners claimed that the datagram proxies were invalid because they did not comply with § 212(c) and Realist's bylaws and that those proxies lacked the indicia of authenticity and genuineness needed to accord them a presumption of validity. *Parshalle*, 567 A.2d at 26 (citing DEL. CODE ANN. tit. 8, § 212(c) (1983)).

172. *Id.* at 25.

173. *Id.* at 26.

174. *Id.*

shareholder consented to the agency relationship that the respondents' datagram proxies purport to evidence.[175]

Given its invalidation of the datagram proxies which stockholders had "no reason to anticipate," coupled with the determinative effect of the court's decision on the election, the court found that "the only fair and equitable" remedy was to order a new election.[176]

Similar issues were addressed in *Concord Financial Group, Inc. v. Tri-State Motor Transit Co.*,[177] in which the court of chancery reviewed a challenge to the report of the inspector of election following a proxy contest involving Tri-State Motor Transit Co. (Tri-State). The report certified that the nominees of Tri-State's management (Management) had been re-elected and the dissident committee's (the Committee) nominees had been defeated.[178]

The court began its analysis by reviewing certain of the legal principles governing the counting of votes in corporate elections.[179]

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175. *Id.*

The court then summarized the fundamental requirements for a valid proxy:

> Accordingly, even though Delaware law does not prescribe a particular "form" of proxy, a proxy, whatever form it may take, must possess at least this fundamental attribute: to be accepted as valid evidence of an agency relationship, the proxy must evidence that relationship in some authentic, genuine way. Proxies meeting that fundamental requirement will enjoy a presumption of validity.
>
> What is needed for a proxy to meet that requirement? The authenticity and genuineness of a proxy are normally established by the stockholder affixing his signature on the proxy, either in writing, or by a signature stamp or facsimile which have come to be regarded as signature equivalents. The presence of a signature or signature equivalent is significant not in and of itself, but because of what it represents. The act of placing one's signature on a legal document, whether in writing or by a facsimile or stamp, is regarded as the most deliberate, conscious way that a person may manifest his intent to consent to, and be bound by, the terms of that document.

Id. at 27 (citations omitted).

The court went on to note that it did not mean to suggest that a signature equivalent was the only possible indicia of genuineness and authenticity. "In this age of technological innovation, it must be assumed that other methods exist, or will be developed, to evidence in some verifiable way that the proxy and the instructions thereon are authentic (i.e., originated from the stockholder-principal) and genuine (i.e., accurately reflect his wishes)." *Id.* The court noted, for example, that some corporations issue a confidential identification number to each stockholder which, in the case of a datagram proxy, must be disclosed to the telephone operator before the proxy will be processed. *Id.* at 27 n.8.

176. *Id.* at 29.

177. 567 A.2d 1 (Del. Ch. 1989).

178. *Id.* at 5.

179. *Id.* at 5-6.

It noted that while Delaware courts have vigilantly guarded against stockholder disenfranchisement in contested corporate elections, the policy is "counterbalanced, in appropriate circumstances, by the need for finality in corporate elections . . . ."[180] The inspectors must

> reject all identical but conflicting proxies when the conflict cannot be resolved from the face of the proxies themselves or from the regular books and records of the corporation. . . . This rule satisfies the corporate need for finality in elections by simply requiring that stockholders exercise their right to vote by proxy with a reasonable degree of care.[181]

While the inspector's report is presumed to be correct, the court may examine the facts to correct any errors of law.[182] In this case, the court reviewed several of the inspector's decisions.

The first decision reviewed concerned conflicting proxies granted by the same stockholder on the same day. The inspector received a proxy in favor of Management dated July 10, 1989 and postmarked July 11, 1989. The inspector also received a proxy granted by the same stockholder in favor of the Committee dated July 10, 1989 and postmarked July 12, 1989. The court held that since the multiple proxies had the same date, the inspector should have looked to the postmarks on the envelopes and, based on a later postmark, counted the proxy as voting in favor of the Committee.[183]

Next, the court reviewed a decision involving an undated proxy granted in favor of the Committee which, arguably, was of a later date than a previously granted proxy in favor of Management. In this situation, the court held that it was unnecessary to determine if the undated proxy was, in fact, the later proxy because the record reflected that the updated proxy had not been properly voted at the annual meeting.[184] "After the [i]nspector had closed the polls, counted

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180. *Id.* at 6. *See also Williams*, 273 A.2d at 265.

181. *Concord Fin. Group*, 567 A.2d at 6 (quoting *Williams*, 273 A.2d at 265).

182. *Id.* (quoting *Berlin*, 552 A.2d at 491). *See supra* note 159 and accompanying text (discussing the facts and holding of *Berlin*).

183. *Concord Fin. Group*, 567 A.2d at 6-9.

184. *Id.* at 9-11. The undated proxy had authorized Management's proxy holders to vote the shares, but had been delivered to the proxy solicitor for the Committee. Management's proxy holders never became aware of, or attempted to vote, the undated proxy. The court held that instead of delivering the proxy card with the Committee's master ballot, the Committee's proxy solicitor should have given the undated proxy card to Management's representative and demanded that they vote for the Committee's nominees. *Id.* at 11-12.

the votes, and announced the preliminary results of the election, it [was] then too late to open the polls and receive the vote of any stockholder who had not voted."[185]

The court also considered certain proxies which were delivered by telecopy. Problems arose from the fact that only one side of each proxy was telecopied, and the telecopied side of the proxy card did not appoint anyone to vote the shares. The inspector ruled that in the absence of an appointment of someone to vote the shares, the telecopied proxies could not be counted.[186] Upon review of the inspector's ruling, the court held that "[w]ithout a facsimile of the entire proxy, there was no way for the [i]nspector to know who was appointed to vote the stockholders' shares."[187] Thus, the inspector properly refused to recognize the Committee's attempt to vote such proxies.[188]

The fourth group of proxies which the court reviewed involved persons who signed and mailed two proxy cards, one in favor of Management and the other in favor of the Committee, on the same day.[189] The court noted that each of these proxies, on its face, revoked all prior proxies and were plainly in conflict. As a result, the inspector properly concluded that each of the proxies presented a "standoff."[190] Even assuming "that the instructions to each proxy representative may have been consistent on the issue of the director's election, the designation of both representatives to vote on all discretionary issues and the mutual revocation language presented the [i]nspector with a conflict that could not be resolved on the face of the proxies."[191]

Finally, with respect to certain shares registered in the name of the corporation which were voted by a proxy signed by an individual, the court found that the individual's apparent authority to sign the proxy card was reflected on Tri-State's own books and records. Thus, the proxy should have been counted by the inspector.[192]

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185. *Id.* at 12 (citing Atterbury v. Consolidated Coppermines Corp., 20 A.2d 743, 748 (Del. Ch. 1941)).

186. *Id.*

187. *Id.* at 13.

188. *Id.*

189. *Id.*

190. *Id.* at 13-14.

191. *Id.* at 14 (citing *Williams*, 273 A.2d at 265).

192. *Id.* at 17. Finally, three proxies in favor of the Committee were received by "proxygram"—"a method by which a stockholder is notified, and votes, by mailgram." *Id.* The court held that, in light of the rulings that had already been made, it was unnecessary and inappropriate to decide whether or not the proxygrams

In *Hammersmith v. Elmhurst-Chicago Stone Co.*,[193] the court of chancery considered cross-motions for summary judgment in an action brought pursuant to section 225[194] to determine the results of certain votes taken at a special stockholders' meeting of Elmhurst-Chicago Stone Co. (Elmhurst). The issue presented to the court was whether certain trust shares, which were present at the meeting but not voted, should be counted for purposes of determining the number needed to obtain a majority vote.[195] Pursuant to a ruling by an Illinois court in a companion case, neither of the two trustees battling for control of Elmhurst could vote the trust shares unless they both agreed on how to vote. Not surprisingly, the trustees were unable to agree on how to vote.[196]

Applying the analysis used by the Delaware Supreme Court in *Berlin v. Emerald Partners*,[197] the court found that the trust shares were not "entitled to vote in the sense that there was no one empowered to cast a vote with respect to those shares."[198] The trust shares, therefore, should not have been counted in determining whether a majority of the votes were cast in favor of certain proposed bylaw amendments.[199] Since no voluntary decision was made by the trustees not to vote, "their situation is far more similar to that of a limited proxy holder [who might not be permitted to vote on all issues] than it is to that of an individual stockholder who chooses not to vote."[200]

F. Charter and Bylaw Amendments

The court of chancery also considered various challenges to the validity of charter and bylaw provisions alleged to have been adopted

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were permissible as a matter of Delaware law. *Id.* at 19. However, in totaling the votes of the Committee in its conclusion, the court did not count the votes received by proxygram in the Committee's total. *Id.*

193. No. 10,837 (Del. Ch. Aug. 17, 1989), *reprinted in* 15 DEL. J. CORP. L. 632 (1990).

194. DEL. CODE ANN. tit. 8, § 225 (Supp. 1988).

195. *Hammersmith*, No. 10,837, slip op. at 1, *reprinted in* 15 DEL. J. CORP. L. at 633-34.

196. *Hammersmith*, No. 10,837, slip op. at 2-3, *reprinted in* 15 DEL. J. CORP. L. at 635. *See* Hammersmith v. Hammersmith, No. 88 CH 0190 (Ill. Cir. Ct. May 12, 1989) (order).

197. 552 A.2d 482 (Del. 1989). *See supra* note 166 and accompanying text (discussing the court's analysis).

198. *Hammersmith*, No. 10,837, slip op. at 7, *reprinted in* 15 DEL. J. CORP. L. at 637.

199. *Id.*

200. *Id.*

in violation of Delaware law or in breach of directors' fiduciary duties. In *Edelman v. Authorized Distribution Network, Inc.*,[201] the court of chancery declined the motions of counterclaim-plaintiffs for summary judgment and a preliminary injunction against enforcement of certain bylaws adopted by the board of directors of Datapoint Corporation (Datapoint).[202] The focal point of the dispute concerned the validity of Datapoint's bylaw 44(b), which required stockholders wishing to solicit written consents to request, and then allow, Datapoint's Board of Directors to fix the record date for the consents.[203]

In denying the request for a summary judgment invalidating bylaw 44(b), the court found:

> In a straightforward manner, bylaw 44(b) establishes a procedure for the board of directors to fix the record date whenever stockholder action by written consent is undertaken. Nothing in bylaw 44(b) impedes a stockholder's right to initiate a consent solicitation. Nor does it thwart the consummation or implementation of a stockholder consent solicitation action. Datapoint stockholders have the same power to authorize corporate action by written consents under bylaw 44(b)'s provisions as before its adoption. The purpose of bylaw 44(b) is to create a procedure for determining *which* stockholders will be able to take part in a written consent action.[204]

The counterclaim-plaintiffs argued that the requirements of bylaw 44(b) directly conflicted with their claimed right to fix the record date under section 213(b).[205] In resolving this apparent conflict, the

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201. No. 11,104 (Del. Ch. Nov. 3, 1989).

202. *Id.*, slip op. at 20.

203. *Id.*, slip op. at 1. Bylaw 44(b) directs the board, upon receipt of the required request from a stockholder wishing to solicit written consent to corporate action, to convene promptly (but in all events within ten days of the request) to adopt a resolution fixing a record date. The record date fixed by the resolution must be within ten days of the date the resolution is adopted. Thus, the second date must be set, at a maximum, within 20 days of the stockholder's request. *Id.*, slip op. at 3-4 (setting out text of the bylaw).

204. *Id.*, slip op. at 8-9.

205. Section 213(b) states:

(b) In order that the corporation may determine the stockholders entitled to consent to corporate action in writing without a meeting, the board of directors may fix a record date, which record date shall not precede the date upon which the resolution fixing the record date is adopted by the board of directors, and which date shall not be more than 10 days after

court applied a two-prong test it found implicit in the Delaware Supreme Court's 1986 decision in *Empire of Carolina, Inc. v. Deltona Corp.*[206] Under the first prong of the test, the court considered whether the board's primary authority to fix a record date[207] had been preempted by the alternative method, set out in section 213(b), for fixing a record date. After finding that it had not been preempted, the court considered whether the board acted within the parameters of section 213(b), exercised business judgment, and did not impermissibly manipulate the corporate machinery.[208] Due to factual disputes involving the last two parts of the second prong, the court reserved judgment as to bylaw 44(b)'s entire validity. The court indicated that "[t]he ultimate question of bylaw 44(b)'s entire validity largely depends upon the intentions and motivations of the individual directors who enacted it."[209]

In *Siegman v. Tri-Star Pictures, Inc.*,[210] the court of chancery considered motions to dismiss an action challenging a transaction (the Combination) in which Tri-Star Pictures, Inc. (Tri-Star) acquired the entertainment business and related assets of The Coca-Cola Co. (Coca-Cola), and Coca-Cola received common stock and

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> the date upon which the resolution fixing the record date is adopted by the board of directors. If no record date has been fixed by the board of directors, the record date for determining stockholders entitled to consent to corporate action in writing without a meeting, when no prior action by the board of directors is required by this chapter, shall be the first date on which a signed written consent setting forth the action taken or proposed to be taken is delivered to the corporation by delivery to its registered office in this State, its principal place of business or an officer or agent of the corporation having custody of the book in which proceedings of meetings of stockholders are recorded. Delivery made to a corporation's registered office shall be by hand or by certified or registered mail, return receipt requested. If no record date has been fixed by the board of directors and prior action by the board of directors is required by this chapter, the record date for determining stockholders entitled to consent to corporate action in writing without a meeting shall be at the close of business on the day on which the board of directors adopts the resulution [sic] taking such prior action.

DEL. CODE ANN. tit. 8, § 213(b) (Supp. 1988).

206. 514 A.2d 1091 (Del. 1985). The court found that *Empire of Carolina* stood "for the proposition that if a board abdicates its primary authority to fix a record date, such authority can be preempted by stockholder action." *Edelman*, No. 11,104, slip op. at 16.

207. *Edelman*, No. 11,104, slip op. at 15.

208. *Id.*, slip op. at 17.

209. *Id.*, slip op. at 19.

210. No. 9477 (Del. Ch. May 5, 1989) (Revised May 30, 1989), *reprinted in* 15 DEL. J. CORP. L. 218 (1990).

other securities of Tri-Star.[211] The court also considered motions to dismiss challenges to certain provisions of Tri-Star's certificate of incorporation.

With respect to Article Fifth, which gave directors the exclusive power to fill board vacancies, the court held that plaintiff's challenge to the validity of that article was without merit.[212] Article Sixth purported to eliminate the liability of directors for breaches of fiduciary duty in specified circumstances involving the taking of corporate opportunities.[213] The court concluded that, under at least one plausible state of facts, Article Sixth would arguably operate to eliminate or limit the directors' liability for breach of their duty of loyalty to Tri-Star or its stockholders in violation of section 102(b)(7) of the GCL.[214] That possibility alone was sufficient to warrant the denial of defendants' motion to dismiss as to Article Sixth, in the

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211. *Id.*, slip op. at 1-5, *reprinted in* 15 DEL. J. CORP. L. at 224-26. The court first rejected a claim that Home Box Office, Inc. (HBO), which was a significant stockholder of Tri-Star, had breached fiduciary duties to Tri-Star and its stockholders in connection with the Combination and had aided and abetted alleged breaches of fiduciary duty by Coca-Cola and Tri-Star's directors. The court found that the complaint had alleged no facts from which it could be inferred that HBO was a fiduciary of Tri-Star or its stockholders. *Id.*, slip op. at 7-9, *reprinted in* 15 DEL. J. CORP. L. at 227-28. With respect to aiding and abetting claims directed against HBO, the court found that there was no adequate pleading of "knowing participation" against HBO and that it could not be inferred that HBO or its representatives were aware of or conspired in any breaches of fiduciary duty. *Id.*, slip op. at 10-11, *reprinted in* 15 DEL. J. CORP. L. at 228-29.

212. *Id.*, slip op. at 16-18, *reprinted in* 15 DEL. J. CORP. L. at 232-34. The relevant section of Article Fifth stated:

> Subject to the rights of the holders of any series of Preferred Stock, and unless the Board of Directors otherwise determines, all vacancies on the Board of Directors and newly created directorships resulting from any increase in the authorized number of directors shall be filled exclusively by a majority of the directors then in office, although less than a quorum, or by a sole remaining director, and shall not be filled by the stockholders.

Id., slip op. at 16, *reprinted in* 15 DEL. J. CORP. L. at 223. The court found that "[t]he permissive language of § 223, coupled with the more general authority of § 102(b)(1), is sufficient to authorize a certificate provision that vests exclusive power in the board to fill board vacancies and newly created directorships." *Id.*, slip op. at 18 (footnote omitted), *reprinted in* 15 DEL. J. CORP. L. at 233. *See also* Campbell v. Loew's, Inc., 134 A.2d 852, 857 (Del. Ch. 1957) (observing that although DEL. CODE ANN. tit. 8, § 223 (1983) did not specifically address whether stockholders could divest themselves of the power to fill newly created directorships, that result could be attained by appropriate "strong by-law [sic] language").

213. *Siegman*, No. 9477, slip op. at addendum, p. 1, *reprinted in* 15 DEL. J. CORP. L. at 242 (quoting text of Article Sixth in addendum).

214. *Id.*, slip op. at 22, *reprinted in* 15 DEL. J. CORP. L. at 236.

court's opinion.[215] Finally, with respect to Article Seventh,[216] the court held that "[n]either [section 102(b)(7)] [n]or its underlying policy forbids a corporation from exempting its directors from liability as may be authorized by future amendatory legislative enactments."[217] Defendants' motion to dismiss that claim was therefore granted.

G. *Section 203—The Delaware Takeover Statute*

Delaware's takeover statute[218] was also the subject of an important opinion in 1989. In *Siegman v. Columbia Pictures Entertainment, Inc.*,[219] the court of chancery declined to issue a preliminary injunction against the acquisition of Columbia Pictures Entertainment, Inc. (Columbia Pictures) by Sony USA Inc. (Sony), concluding that the plaintiff had not shown a reasonable probability that any violation of section 203 would occur as a result of the acquisition by Sony of Columbia Pictures.[220] The plaintiff had shown the reasonable probability that Sony became an "interested stockholder" for purposes of section 203 on the afternoon of September 27 when it entered into a contingent agreement with Coca-Cola to acquire shares of Columbia Pictures.[221] Also, the court held that the contingent agreement was an "agreement" within the meaning of section 203.[222] However, the court found that earlier on the same day the board of Columbia Pictures had approved the takeover and, therefore, the three-year limitation on certain mergers in section 203(a)(1) did not apply.[223] The court interpreted the words "prior to such date" as they appear in section 203 to mean "before that time."[224]

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215. *Id.*

216. The relevant portion of Article Seventh states as follows:

> If the Delaware General Corporation Law is amended to authorize corporate action further eliminating or limiting the personal liability of directors, then the liability of a director or [Tri-Star] shall be eliminated or limited to the fullest extent permitted by the Delaware General Corporation Law, as so amended.

Id., slip op. at 23 (emphasis omitted), *reprinted in* 15 DEL. J. CORP. L. at 236.

217. *Id.*, slip op. at 24, *reprinted in* 15 DEL. J. CORP. L. at 237.

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

219. No. 11,152 (Del. Ch. Oct. 31, 1989) (Revised Nov. 9, 1989).

220. *Id.*, slip op. at 2.

221. *Id.*, slip op. at 2, 6, 12-18.

222. *Id.*, slip op. at 18.

223. *Id.*, slip op. at 6-7, 19-26.

224. *Id.*, slip op. at 25. Section 203(a)(1), in pertinent part, states:

> § 203. Business combinations with interested stock holders [sic]
>
> (a) Notwithstanding any other provisions of this chapter, a corporation

H. The Demand Requirement of Rule 23.1

In *In re NVF Company Litigation*,[225] the court of chancery again considered the demand requirement for derivative actions pursuant to Rule 23.1.[226] The complaint challenged the sale of an NVF asset at an emergency board meeting allegedly necessitated by the financial condition of NVF on the sale date. The asset was sold to Victor Posner, NVF's chairman and a thirty-eight percent stockholder.[227]

Accepting as true the plaintiff's claims that at least five of the six NVF directors who took part in the meeting were receiving compensation as directors or officers of other Posner-affiliated companies and that three of the six were related to Posner, the court found that "a reasonable doubt exist[ed] as to the directors' disinterestedness in a transaction directly benefiting Posner."[228] The court also found that the complaint supported a reasonable doubt that the transaction was the product of a valid exercise of business judgment. This was due to the fact that the "telephonic board meeting involved no deliberations, documents, negotiations or questions [but] resulted, however, in the sale of NVF's most valuable (and marketable) asset."[229] The court went on to note that although "[a]n emergency so pressing as to preclude all discussion is imaginable . . . and might in certain conceivable circumstances yield a different result," the facts here indicated that the "emergency" was foreseeable.[230]

> shall not engage in any business combination with any interested stockholder for a period of 3 years following the date that such stockholder became an interested stockholder unless:
>
> (1) Prior to such date the board of directors of the corporation approved either the business combination or the transaction which resulted in the stockholder becoming an interested stockholder . . . .

DEL. CODE ANN. tit. 8, § 203(a)(1) (Supp. 1988). The court noted that "[n]eedless to say, the draftsmanship of 8 *Del. C.* § 203 leaves much to be desired." *Siegman*, No. 11,152, slip op. at 21.

225. No. 9050 (Consolidated) (Del. Ch. Nov. 21, 1989), *reprinted in* 16 DEL. J. CORP. L. 361 (1991).

226. Rule 23.1 provides in relevant part:

> In a derivative action brought by one or more shareholders or members to enforce a right of a corporation [t]he complaint shall . . . 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.

DEL. CH. CT. R. 23.1

227. *In re NVF Co. Litig.*, No. 9050, slip op. at 1-2, *reprinted in* 16 DEL. J. CORP. L. at 368.

228. *Id.*, slip op. at 12-13, *reprinted in* 16 DEL. J. CORP. L. at 374.

229. *Id.*, slip op. at 13, *reprinted in* 16 DEL. J. CORP. L. at 374.

230. *Id.*, slip op. at 14, *reprinted in* 16 DEL. J. CORP. L. at 375. The court of

In *Levine v. Smith*,[231] the court of chancery granted a motion to dismiss a stockholder derivative action against the directors of General Motors Corporation (GM) based upon the failure of the plaintiff to allege particularized facts sufficient to create a reasonable doubt that GM's Board of Directors wrongfully rejected the plaintiff's presuit demand.[232] The plaintiff challenged GM's repurchase at a premium of certain GM Class E stock and contingent notes owned by H. Ross Perot, a dissident GM director.[233]

The court found that Delaware Chancery Court Rule 23.1 requires stockholders "to seek redress of their grievances through the corporation's board of directors, or, alternatively, to justify their entitlement to act on the corporation's behalf independently of the board."[234] The derivative action is an exception to the rule that the directors control the corporation's actions and policies and "may be invoked only in those cases where the board is legally disabled from

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chancery also considered a motion to dismiss a complaint for failure to make a demand in Siegman v. Tri-Star Pictures, Inc., No. 9477 (Del. Ch. May 5, 1989) (Revised May 30, 1989), *reprinted in* 15 DEL. J. CORP. L. 218 (1990). *See supra* notes 212-19 and accompanying text. The court in *Siegman* held that, assuming without deciding that the complaint alleges derivative claims, the pleaded facts excused the making of a demand. *Id.*, slip op. at 33, *reprinted in* 15 DEL. J. CORP. L. at 241-42. Two circumstances created a reasonable doubt that a majority of Tri-Star directors were disinterested. The first was the fact that three of Tri-Star's directors were senior executives of either Coca-Cola or a Coca-Cola affiliate. "Those relationships would cause one reasonably to question whether these directors were economically motivated to favor the interests of their employer, Coca-Cola, in considering a shareholder demand." *Id.*, slip op. at 28, *reprinted in* 15 DEL. J. CORP. L. at 239. Second, six directors owned substantial shares of Coca-Cola, and would be receiving a pro rata share of the special dividend that Coca-Cola would pay to its stockholders as part of the Combination. Those six directors therefore "stood to gain a personal financial benefit from the challenged transaction that would not be equally shared by Tri-Star's other stockholders." *Id.*, slip op. at 29, *reprinted in* 15 DEL. J. CORP. L. at 240. The court rejected plaintiff's argument that certain prior employment relationships of directors with Coca-Cola also created a disabling conflict. *Id.*, slip op. at 28-29 n.14, *reprinted in* 15 DEL. J. CORP. L. at 239.

231. No. 8833 (Del. Ch. Nov. 27, 1989), *reprinted in* 16 DEL. J. CORP. L. 333 (1991).

232. *Id.*, slip op. at 26, *reprinted in* 16 DEL. J. CORP. L. at 349-50. The plaintiff had demanded, on December 11, 1986, that GM's Board rescind the repurchase. On January 5, 1989, GM's Board unanimously rejected the demand. *Id.*, slip op. at 1, *reprinted in* 16 DEL. J. CORP. L. at 338.

233. *Id.*, slip op. at 1, *reprinted in* 16 DEL. J. CORP. L. at 338. Other Delaware opinions have also addressed GM's buyout of Perot. *See* Grobow v. Perot, 526 A.2d 914 (Del. Ch. 1987), *aff'd*, 539 A.2d 180 (Del. 1988).

234. *Levine*, No. 8833, slip op. at 10, *reprinted in* 16 DEL. J. CORP. L. at 343.

acting on the corporation's behalf due to circumstances that would deprive its decision of the business judgment rule's protections."[235] The question of whether a derivative action may go forward arises either when a demand for redress would be futile, so-called "demand futility," or when a demand for redress has been refused.[236] In a so-called "demand refused" case, such as this, the plaintiff will be permitted to proceed with the derivative suit if the court is satisfied that the board's rejection was wrongful.[237]

After examining several possible standards for determining whether a demand was wrongfully rejected, the court concluded that the applicable standard is the same as that for determining "demand futility" with the focus of the inquiry being "whether the business judgment rule protects the [board's] decision to reject a shareholder demand."[238] The court next considered whether the complaint alleged particularized facts that created a reasonable doubt as to whether the board was disinterested and independent when it rejected the demand, or whether its decision to reject the demand was the product of informed business judgment. Upon consideration of these questions, the court concluded that "the plaintiff [had] not met his burden of justifying his entitlement to proceed derivatively on the corporation's behalf."[239]

I. Appraisal

Delaware courts also issued important rulings in 1989 concerning the appraisal remedy granted by section 262.[240] In *Cavalier Oil Corp. v. Harnett*,[241] the supreme court affirmed an opinion of the court of chancery following trial of an appraisal action involving the stock of EPIC Mortgage Servicing, Inc. (EMSI).[242] Cavalier Oil Corporation's (Cavalier) principal contentions on appeal were that the trial court had erred in valuing a corporate opportunity claim asserted by Harnett because that claim was, among other things, not appropriate in a statutory appraisal proceeding. Cavalier also asserted that

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235. *Id.*, slip op. at 11, *reprinted in* 16 DEL. J. CORP. L. at 343.
236. *Id.*, slip op. at 11-12, *reprinted in* 16 DEL. J. CORP. L. at 344.
237. *Id.*, slip op. at 12, *reprinted in* 16 DEL. J. CORP. L. at 344.
238. *Id.*, slip op. at 16, *reprinted in* 16 DEL. J. CORP. L. at 346.
239. *Id.*, slip op. at 18-25, *reprinted in* 16 DEL. J. CORP. L. at 346, 347-50.
240. DEL. CODE ANN. tit. 8, § 262 (Supp. 1988).
241. 564 A.2d 1137 (Del. 1989).
242. *Id.* at 1139.

the court had erred in refusing to apply a minority discount in valuing Harnett's interest in EMSI.[243]

The court found that:

> [w]hile ordinarily a section 262 appraisal proceeding does not lend itself to any claims other than those incident to the appraisal proceeding itself, the unusual facts of this case, particularly the consent of the parties as reflected in [an order in a prior case] providing that the derivative-like claims are viable for appraisal purposes, require that Harnett's corporate opportunity claim be considered in valuing his shares.[244]

The court cautioned, however, that its ruling under these unique facts should not be "viewed as undercutting the holding in *Cede & Co. v. Technicolor, Inc.*,[245] that derivative claims are lost in subsequent appraisal proceedings because the derivative plaintiff loses his standing to assert these claims on behalf of the corporation."[246]

Cavalier also contended that Harnett's "de minimis" (1.5%) interest in EMSI was one of the relevant factors which must be considered in valuing Harnett's stock under the *Weinberger v. UOP, Inc.*[247] expanded valuation standard.[248] The court rejected Cavalier's claim, holding that the objective of the appraisal proceeding was to value the corporation itself, as distinguished from a specific portion of its shares held by any one stockholder.[249] The court concluded:

> Discounting individual share holdings injects into the appraisal process speculation on the various factors which may dictate the marketability of minority shareholdings. More important, to fail to accord to a minority shareholder the full proportionate value of his shares imposes a penalty for lack of control, and unfairly enriches the majority share-

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243. *Id.*
244. *Id.* at 1143.
245. 542 A.2d 1182 (Del. 1988).
246. *Cavalier Oil Corp.*, 564 A.2d at 1143.
247. 457 A.2d 701 (Del. 1983).
248. *Cavalier Oil Corp.*, 564 A.2d at 1144. The standard for determining the "fair value" of the company's outstanding shares was liberalized in *Weinberger*, which broadened the process from the exclusive use of the "Delaware Block" method to include all generally accepted techniques of valuation used in the financial community. *Id.* at 1142. *See Cede*, 542 A.2d at 1186-87; *Weinberger*, 457 A.2d at 712-13.
249. *Cavalier Oil Corp.*, 564 A.2d at 1144-45.

> holders who may reap a windfall from the appraisal process by cashing out a dissenting shareholder, a clearly undesirable result.[250]

The court also rejected Harnett's claim that he was entitled to additional shares of EMSI. It found that consideration of such claims in an appraisal proceeding "would inject into the proceeding a nonvaluation task incompatible with the appraisal purpose."[251]

And in *Salomon Brothers Inc. v. Interstate Bakeries Corp.*,[252] the court of chancery addressed a claim that the petitioner had lost its right to seek appraisal since it had begun purchasing stock in Interstate Bakeries Corporation (Interstate) after the merger plans had been announced.[253] The court rejected Interstate's argument after concluding that nothing in the history of Delaware's appraisal statute supported such a limitation on the appraisal remedy.[254] The court also concluded that Interstate's "interpretation, if accepted, could add to the appraisal process a variety of collateral issues that would tend to frustrate the goals of expediency and certainty."[255]

III. CONCLUSION

The recent developments summarized in this article have clarified important issues in Delaware corporate law. The decisions underscore Delaware's pre-eminent role in deciding important corporate legal issues.

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250. *Id.* at 1145.
251. *Id.* at 1146.
252. 576 A.2d 650 (Del. Ch. 1989).
253. *Id.* at 651.
254. *Id.* at 652.
255. *Id.* at 653.