1990 DEVELOPMENTS IN DELAWARE CORPORATE LAW

By Andrew J. Turezyn*

I. Introduction

In 1990, Delaware courts again made important rulings concerning corporate governance and other issues arising under the Delaware General Corporation Law (GCL).[1] Both the Supreme Court of Delaware and the state's court of chancery issued seminal decisions concerning the sale of corporate control, including decisions relating to the conduct of auctions and election contests. The GCL was also amended in 1990 in several important respects. These recent decisions and statutory amendments are important to corporate attorneys and to anyone involved in the management of a Delaware corporation.

This article summarizes some of the major developments in Delaware corporate law during 1990. While summarization of the extensive body of Delaware corporate law and review of every Delaware corporate decision in 1990 are beyond the scope of this article, a wide range of the corporate issues addressed by the Delaware courts in 1990 will be discussed. Several of the more important amendments to the GCL will also be reviewed.

II. Case Law Applying Delaware Corporate Law

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

The Supreme Court of Delaware's 1986 decision in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[2] settled that the duties of a corporate board of directors change once the board determines that the company is for sale.[3] The duties shift from "the preservation of [the company] as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit."[4] In a series

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1. Del. Code Ann. tit. 8, §§ 101-398 (1983 & Supp. 1990).
2. 506 A.2d 173 (Del. 1986).
3. *Id.* at 182.
4. *Id.*

of later decisions,[5] Delaware courts have again clarified various issues raised by *Revlon* relating to directors' duties to maximize stockholder value.

In *Paramount Communications Inc. v. Time Inc.*,[6] the Supreme Court of Delaware affirmed the court of chancery's decision denying the request of Paramount Communications Inc. (Paramount) and certain stockholders of Time Inc. (Time) for an injunction to halt Time's tender offer for 51% of Warner Communications Inc. (Warner).[7] The court concluded that Paramount's earlier uninvited tender offer for Time "was reasonably perceived by Time's board to pose a threat to Time and that the Time board's 'response' to that threat was, under the circumstances, reasonable and proportionate."[8] Applying the test for determining the validity of defensive measures announced in *Unocal Corp. v. Mesa Petroleum Co.*,[9] the court rejected "the argument that the only corporate threat posed by an all-shares, all-cash tender offer is the possibility of inadequate value."[10] The court also found "that Time's board did not by entering into its initial merger agreement with Warner come under a *Revlon* duty either to auction the company or to maximize short-term shareholder value, notwithstanding the unequal share exchange."[11]

The factual background of the dispute was critical to the court's conclusions. On March 3, 1989, Time and Warner entered into a merger agreement, under the terms of which Warner would be merged into a wholly-owned subsidiary of Time, with Warner emerging as the surviving corporation.[12] Subsequently, the Warner stock was to be converted to Time stock at an agreed rate, with the

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5. *See infra* text accompanying notes 6-144 (discussing these decisions).

6. 571 A.2d 1140 (Del. 1990).

7. *Id.* The opinion of the court of chancery is reported at No. 10,866 (Del. Ch. July 14, 1989) (revised July 17, 1989), *reprinted in* 15 DEL. J. CORP. L. 700 (1990).

8. *Paramount*, 571 A.2d at 1142.

9. 493 A.2d 946 (Del. 1985). Under *Unocal*, the protections of the business judgment rule may only be conferred to protect director action in adopting a defensive measure where directors "show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed" and the challenged action is "reasonable in relation to the threat posed." *Id.* at 955.

10. *Paramount*, 571 A.2d at 1142.

11. *Id.* at 1142. Approximately three months prior to Paramount's tender offer for Time, Time and Warner had entered into a merger agreement. *Id.* at 1146. This original plan of merger with Warner was subject only to evaluation under the business judgment rule according to the court. *Id.*

12. *Id.* at 1146.

surviving corporation being named Time-Warner, Inc.[13] The proposed combination of Time and Warner was the culmination of a long-term effort to position Time strategically as a vertically integrated entertainment and communications organization in an emerging global economy.[14]

On June 7, 1989, Paramount disturbed the proposed arrangement by commencing a $175 per share cash tender offer for all outstanding Time shares.[15] Time's Board rejected the Paramount tender offer as inadequate and determined to conclude the combination with Warner.[16] Accordingly, Time and Warner amended the merger agreement to provide for a cash tender offer by Time for 51% of the outstanding shares of Warner.[17] The tender offer was to be followed by a merger transaction in which the remaining Warner shares would be acquired by Time for a combination of cash and securities worth $70 per share.[18]

In reaction to the revised merger agreement, Paramount increased its tender offer to $200 per share and again professed its willingness to negotiate all aspects of the offer.[19] Time's Board remained of the view that a proposed combination with Warner offered greater long-term value for stockholders and, unlike the Paramount offer, posed no threat to Time's survival or its recognition as "an institution built upon a foundation of journalistic integrity."[20] Time's

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13. *Id.*

14. *See id.* at 1143-46. Various provisions of the proposed transaction sought to address the concerns of the Time Board, and particularly its outside directors, that the "Time Culture," which refers to journalistic integrity, be preserved through a pro-Time senior management. *Id.* at 1146. In the aggregate, Warner stockholders were expected to receive approximately 62% of the outstanding shares of common stock of the combined Time-Warner enterprise. *Id.* The transaction was subject to approval by the stockholders of both Time and Warner. Time stockholder approval was required by the rules of the New York Stock Exchange but not by Delaware law. *Id.* The vote of Time's stockholders was scheduled to be held on June 23, 1989. *Id.* at 1147.

15. *Id.* at 1147. The offer was said to be "fully negotiable." *Id.*

16. *Id.* at 1147-48. Time's Board was advised that the tender offer was inadequate and highly conditional. *Id.* In addition, "certain Time directors expressed their concern that Time stockholders would not comprehend the long-term benefits of the Warner merger" and, as a consequence, might mistakenly elect to tender into Paramount's eleventh hour cash offer. *Id.* at 1148.

17. *Id.* at 1148.

18. *Id.* Warner insisted that the amended merger agreement have virtually no conditions, including no fiduciary-out provision. *Id.*

19. *Id.* at 1149.

20. *Id.* at 1149, 1143 n.4.

Board thus formally rejected the revised Paramount offer, and Paramount filed suit in the Delaware Court of Chancery.[21]

On appeal from that court, the Supreme Court of Delaware began its legal analysis by posing what it viewed as the critical questions to be considered: "Did Time's board, having developed a strategic plan of global expansion to be launched through a business combination with Warner, come under a fiduciary duty to jettison its plan and put the corporation's future in the hands of its shareholders?"; and "Did Time, by entering into the proposed merger with Warner, put itself up for sale?"[22]

The court, noting that it is "unwise to place undue emphasis upon long-term versus short-term corporate strategy,"[23] stated that the directors' mandate to manage the business and affairs of the corporation "includes a conferred authority to set a corporate course of action, including time frame, designed to enhance corporate profitability."[24] Additionally, the court held that "absent a limited set of circumstances as defined under *Revlon*, a board of directors, while always required to act in an informed manner, is not under any *per se* duty to maximize shareholder value in the short term, even in the context of a takeover."[25]

The court then addressed the plaintiffs' *Revlon* argument.[26] The court stated:

> Under Delaware law there are, generally speaking and without excluding other possibilities, two circumstances which

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21. *Id.* at 1149.

22. *Id.* at 1149-50.

23. *Id.* at 1150.

24. *Id.* Thus, as stated by the court, "[T]he question of 'long-term' versus 'short-term' values is largely irrelevant because directors, generally, are obliged to chart a course for a corporation which is in its best interests without regard to a fixed investment horizon." *Id.*

25. *Id.*

26. The *Revlon* argument was asserted only by the shareholder plaintiffs. *Id.* at 1149. In short, they contended that the original Time-Warner agreement put Time up for sale, which triggered *Revlon* duties "requiring Time's board to enhance short-term shareholder value and to treat all other interested acquirors on an equal basis." *Id.*

The chancellor had "found the original Time-Warner merger agreement not to constitute a 'change of control' and concluded that the transaction did not trigger *Revlon* duties." *Id.* at 1150. This conclusion was premised on a finding that "[b]efore the merger agreement was signed, control of the corporation existed in a fluid aggregation of unaffiliated shareholders representing a voting majority—in other words, in the market." *Id.*

> may implicate *Revlon* duties. The first, and clearer one, is when a corporation initiates an active bidding process seeking to sell itself or to effect a business reorganization involving a clear break-up of the company. However, *Revlon* duties may also be triggered where, in response to a bidder's offer, a target abandons its long-term strategy and seeks an alternative transaction involving the breakup of the company.[27]

The court also noted that "[i]f, however, the board's reaction to a hostile tender offer is found to constitute only a defensive response and not an abandonment of the corporation's continued existence, *Revlon* duties are not triggered, though *Unocal* duties attach."[28] The court concluded that the Time-Warner merger agreement did not trigger *Revlon* duties.[29]

Turning to the *Unocal*[30] claim, the court found "ample evidence in the record to support the Chancellor's conclusion that the Time board's decision to expand the business of the company through its . . . merger with Warner was entitled to the protection of the business judgment rule."[31] The court did note that the court of chancery, in interpreting *Unocal*, had "suggested that an all-cash, all-shares offer, falling within a range of values that a shareholder might reasonably prefer, cannot constitute a legally recognized 'threat' to shareholder

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27. *Id.* (citation and footnote omitted).

28. *Id.* at 1150-51. The court also found that expressions of concern by certain Time directors that the Warner transaction might be viewed as effectively putting Time up for sale and the use of a lock-up agreement, a no-shop clause, and so-called "dry-up" agreement were insufficient to invoke *Revlon* duties. *Id.* at 1151. The court declined to "extend *Revlon*'s application to corporate transactions simply because they might be construed as putting a corporation either 'in play' or 'up for sale.' The adoption of structural safety devices alone does not trigger *Revlon*. Rather . . . such devices are properly subject to a *Unocal* analysis." *Id.* (footnote and citations omitted).

29. *Id.* at 1151. While the court upheld the chancellor's findings, the court premised its rejection of plaintiffs' *Revlon* claim "on different grounds, namely, the absence of any substantial evidence to conclude that Time's board, in negotiating with Warner, made the dissolution or break-up of the corporate entity inevitable, as was the case in *Revlon*." *Id.* at 1150.

30. The *Unocal* claim, which was asserted by all plaintiffs, essentially denied that Time's Board reasonably perceived any threat to the company's corporate policy and effectiveness, and also contested the board's response, assuming that a threat did exist, as unreasonable. *Id.* at 1149.

31. *Id.* at 1152.

interests sufficient to withstand a *Unocal* analysis."[32] Under this analysis the plaintiffs argued that the only conceivable "threat" was inadequate value because Paramount's offer was all-cash.[33] However, the court disapproved of such a "narrow and rigid construction of *Unocal*."[34]

In turning to the second part of the *Unocal* analysis, the court stated that the "obvious requisite to determining the reasonableness of a defensive action is a clear identification of the nature of the threat"[35] and that "[a]s applied to the facts of this case, the question is whether the record evidence supports the [c]ourt of [c]hancery's conclusion that the restructuring of the Time-Warner transaction, including the adoption of several preclusive defensive measures, was a *reasonable response* in relation to a perceived threat."[36] The court affirmed "that Time's responsive action to Paramount's tender offer was not aimed at 'cramming down' on its shareholders a management-sponsored alternative, but rather had as its goal the carrying

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32. *Id.* (citing Grand Metro., PLC v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988); City Capital Assocs. v. Interco, Inc., 551 A.2d 787 (Del. Ch. 1988); AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103 (Del. Ch. 1986)).

33. *Id.*

34. *Id.* at 1153. The court stated that

> precepts underlying the business judgment rule militate against a court's engaging in the process of attempting to appraise and evaluate the relative merits of a long-term versus a short-term investment goal for shareholders. To engage in such an exercise is a distortion of the *Unocal* process and, in particular, the application of the second part of *Unocal*'s test.

Id. Regarding the "threat" perceived by the board, the court stated:

> In this case, the Time board reasonably determined that inadequate value was not the only legally cognizable threat that Paramount's all-cash, all-shares offer could present. Time's board concluded that Paramount's eleventh hour offer posed other threats. One concern was that Time shareholders might elect to tender into Paramount's cash offer in ignorance or a mistaken belief of the strategic benefit which a business combination with Warner might produce. Moreover, Time viewed the conditions attached to Paramount's offer as introducing a degree of uncertainty that skewed a comparative analysis. Further, the timing of Paramount's offer to follow issuance of Time's proxy notice was viewed as arguably designed to upset, if not confuse, the Time stockholders' vote. Given this record evidence, we cannot conclude that the Time board's decision of June 6 that Paramount's offer posed a threat to corporate policy and effectiveness was lacking in good faith or dominated by motives of either entrenchment or self-interest.

Id.

35. *Id.* at 1154.

36. *Id.*

forward of a pre-existing transaction in an altered form."[37] Thus, the court held that Time's response was reasonably related to the perceived threat.[38] The court also noted "that the revised agreement and its accompanying safety devices did not preclude Paramount from making an offer for the combined Time-Warner company or from changing the conditions of its offer so as not to make the offer dependent upon the nullification of the Time-Warner agreement."[39] Thus, the response was proportionate to the perceived threat.[40]

The Court of Chancery of Delaware also had several opportunities in 1990 to address questions concerning the fiduciary duties of directors in control contests. In *Citron v. E.I. du Pont de Nemours & Co.*,[41] the court of chancery granted judgment to the defendants, after trial on the merits, in a class action suit commenced in 1980 by a Remington Arms Company (Remington) shareholder who challenged the merger of Remington into E.I. du Pont de Nemours & Co. (Du Pont).[42] At the time of the merger, Du Pont owned about 70% of Remington's common stock and over 99% of its preferred stock.[43] In the merger, Du Pont acquired all of the remaining shares of Remington by exchanging .574 Du Pont share for each share of Remington.[44]

The shareholder filed suit against Du Pont, Remington, and the board of directors of Remington.[45] The Remington Board consisted of eight directors, three of whom were employees of Du Pont and two of whom were or had been employees of Remington.[46] The other three directors were completely independent, except for their board positions, of both Remington and Du Pont.[47] These three had formed an independent merger committee to evaluate Du Pont's initial proposal for the minority shares of Remington.[48] Furthermore,

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37. *Id.* at 1154-55.
38. *Id.* at 1155.
39. *Id.*
40. *Id.*
41. 584 A.2d 490 (Del. Ch. 1990).
42. *Id.* at 492. The merger was consummated on February 1, 1980, and the case was tried during May of 1988. *Id.*
43. *Id.* When the merger was first proposed, Remington had been a majority-owned subsidiary of Du Pont for over 40 years. *Id.* at 492-93.
44. *Id.* at 492.
45. *Id.* at 493.
46. *Id.*
47. *Id.* at 494.
48. *Id.* This committee took upon itself to hire independent legal and financial advisors and took many steps to protect its independence from Remington's and Du Pont's influence. *Id.* at 494-95.

only those directors who were not employees of Du Pont took part in any discussions concerning approval or disapproval of Du Pont's merger proposal.[49] Notwithstanding these precautions, the plaintiff charged that the merger terms were grossly unfair and that the proxy statement disseminated in connection with the merger was false and misleading.[50]

The court first held that "[t]he only Remington directors against whom any arguable claim can be asserted are those who were not affiliated with Du Pont, because the Du Pont director-designees played no role in the Merger Committee's, or the Board's, decisionmaking [sic] process."[51] Thus, the Du Pont-affiliated directors were absolved from liability.[52] As to the independent Remington directors, the plaintiff did not dispute that their conduct was subject to the business judgment form of review.[53] The plaintiff's sole claim was that those directors had failed to exercise appropriate due care.[54] In response, the court held that the evidence[55] established "that the Committee understood its fiduciary obligations, discharged those

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49. *Id.* at 495-96.

50. *Id.* at 492.

51. *Id.* at 499. Du Pont retained the investment banking firm of Morgan Stanley & Company to independently recommend merger terms that Du Pont would propose to Remington. Du Pont did insist, however, that the merger consideration consist solely of Du Pont stock. *Id.* at 493. Du Pont placed no constraints on Morgan Stanley's valuation methodology or on the terms it might recommend. *Id.* Du Pont also agreed to subject its merger proposal to a "majority of the minority" vote requirement, so that Remington's minority stockholders could veto the merger proposal if they so desired. *Id.* After Du Pont initially proposed exchanging .52 share of Du Pont stock for each share of Remington's stock, Remington's board of directors created a merger committee to respond to the proposal. *Id.* at 494. After retaining legal and financial advisors, the merger committee considered the proposal and rejected it as inadequate. *Id.* at 496. The merger committee finally accepted a revised Du Pont proposal pursuant to which the exchange ratio could vary from .52 to .581 Du Pont share, depending on changes in Du Pont's stock price. *Id.* At the meeting of Remington stockholders held to vote on the merger proposal, 91% of the minority shares that were voted were cast in favor of the merger. *Id.* at 497-98.

52. *Id.* at 499.

53. *Id.*

54. *Id.* The plaintiff made no argument that Remington's independent directors acted in bad faith or had any disqualifying self-interest in connection with this merger. Rather, she alleged that the directors were grossly negligent in considering, evaluating, negotiating, and approving the merger. *Id.* at 498.

55. The court noted that the merger committee hired and oversaw independent advisors, evaluated the initial proposal for over two months, and then negotiated a better proposal. *Id.* at 510.

obligations carefully and faithfully, and produced an improved transaction that was fair to Remington's minority stockholders."[56]

With respect to the liability standard applicable to Du Pont's conduct, the court held that the validity of the merger and of Du Pont's conduct as majority stockholder had to be evaluated in accordance with the "entire fairness" standard.[57] However, since the merger was ratified by a fully informed majority of Remington's minority stockholders, the burden was shifted to the plaintiff to prove that the merger was unfair.[58] The court stated that "in a parent-subsidiary merger context, shareholder ratification operates only to shift the burden of persuasion, not to change the substantive standard of review (entire fairness)."[59]

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56. *Id.* at 512.

57. *Id.* at 499-500. "That standard flows from the principle that where a majority stockholder stands on both sides of a challenged transaction, it has the burden of demonstrating, after careful scrutiny by the Court, that the transaction was entirely fair to the minority." *Id.* at 500 (citing Rosenblatt v. Getty Oil Co., 493 A.2d 929, 937 (Del. 1985); Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983); Sterling v. Mayflower Hotel Corp., 93 A.2d 107, 109-10 (Del. 1952)). As the court noted in a footnote,

> [t]he precise circumstances that will trigger the "entire fairness" standard of review have not been consistently articulated in the Delaware cases. *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971), holds that the plaintiff must demonstrate that the parent corporation stood on both sides of the transaction and have dictated its terms. *See also, Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1279 n.27 (Del. 1988). However, *Bershad v. Curtiss-Wright Corp.*, 535 A.2d 840, 845 (Del. 1987); *Rosenblatt*, 493 A.2d at 937; *Weinberger v. UOP, Inc.*, 457 A.2d at 710; and *Sterling*, 93 A.2d at 109-10, indicate that to invoke that exacting review standard, all that is required is that the parent corporation have stood on both sides of the transaction.

Citron, 584 A.2d at 500 n. 13.

58. *Id.* (citing *Rosenblatt*, 493 A.2d at 937).

59. *Id.* at 502. The fact that the merger was negotiated by a committee of independent directors also did not alter the standard of review applied by the court. *Id.*

> Thus, shareholder ratification and disinterested director intervention have a different procedural effect where the transaction is a parent-subsidiary merger, than in cases where the transaction is with a fiduciary that does not control the corporation. Although the Delaware cases do not articulate a distinction in those terms, a plausible basis exists for it. Parent subsidiary mergers, unlike stock options, are proposed by a party that controls, and will continue to control, the corporation, whether or not the minority stockholders vote to approve or reject the transaction. The controlling stockholder relationship has the inherent potential to influence, however subtly, the vote of minority stockholders in a manner that is not likely to occur in a transaction with a noncontrolling party.

Id.

In addressing the fairness claims, the court examined the basic aspects of fair dealing and fair price.[60] The court held that the merger was the product of fair dealing: "Built into the process by which the merger terms were set were procedural protections that tended to assure a fair result and to approximate what independent parties would have arrived at in an arm's[-]length bargain."[61]

In holding that the merger was made for a fair price, the court stated that "[t]he correct test of fairness in a merger is that 'the minority stockholder shall receive the substantial equivalent in value of what he had before.'"[62] The court concluded that the evidence supported the conclusion that such equivalence did exist.[63] The court noted that Du Pont's fiduciary duty to Remington did not require that fairness be measured or determined by any specific valuation method or procedure as long as this "substantial equivalent" value element was satisfied.[64]

With respect to the allegedly inadequate proxy materials, the court first noted that "for shareholder ratification of any corporate action to be valid, the vote of the minority shareholders must be fully informed"[65] and that "[t]he parties who assert the defense of

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60. *Id.* at 504-10. The concepts of fair dealing and fair price were explained by the supreme court in *Weinberger*.

> The concept of fairness has two basic aspects: fair dealing and fair price. The former embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. The latter aspect of fairness relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock.

Weinberger, 457 A.2d at 711.

61. *Citron*, 584 A.2d at 504. Among the procedural protections referred to by the court were that: (1) Du Pont did not dictate the terms of the transaction, other than to prescribe that it would be a stock-for-stock merger; (2) Remington directors independent of Du Pont negotiated the merger on Remington's behalf; (3) the approval of a majority of Remington's minority stockholders was required; (4) Du Pont nominees on Remington's board were not part of the negotiating or decision-making processes; and (5) the merger committee acted independently with the advice of "attorneys and investment bankers that it had selected and overseen." *Id.*

62. *Id.* at 505 (quoting *Rosenblatt*, 493 A.2d at 940).

63. *Id.* at 505-10.

64. *Id.* at 508.

65. *Id.* at 502. The court noted that "[t]hat means, in this context, that the proxy statement must have disclosed all facts material to the Remington minority stockholders' decision to approve or disapprove the proposed merger." *Id.* (citing *Rosenblatt*, 493 A.2d at 944-45; *Weinberger*, 457 A.2d at 710).

shareholder ratification have the burden to establish that they fully disclosed all material facts in their proxy disclosures."[66] The court concluded that the plaintiff's claims that the proxy statement was inadequate were without merit.[67]

In *Roberts v. General Instrument Corp.*,[68] the court of chancery denied an application by a stockholder of General Instrument Corporation (General Instrument) to enjoin the closing of a tender offer for General Instrument's stock by a subsidiary of Forstmann Little & Co. (Forstmann).[69] The offer was made pursuant to an agreement of merger negotiated with the board of directors of General Instrument.[70]

The plaintiff's claim was twofold. First, he alleged that the General Instrument Board was not properly informed of the company's value in a change of control context or of the availability of alternatives to a sale to Forstmann.[71] Second, it was claimed that the defendants, including General Instrument, its board, and Forstmann, failed to make the appropriate disclosures with respect to Forstmann's offer.[72]

The court first addressed the reasonableness of the board's actions with respect to the merger proposal and concluded that the plaintiff had failed to show a reasonable probability of success on the merits concerning his claims that the board did not pursue an appropriate process in connection with the sale of the company.[73]

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66. *Id.* (citing *Rosenblatt*, 493 A.2d at 934; *Weinberger*, 457 A.2d at 703).

67. *Id.* at 503. The plaintiff's proxy claims related to an internal financial study of Remington (some of the key assumptions of which had been rejected by the supervisor of the person who had prepared it), the book value of certain assets, and the alleged inadequacy of the investment banker's valuation methodology. *Id.*

68. No. 11,639 (Del. Ch. Aug. 13, 1990), *reprinted in* 16 DEL. J. CORP. L. 1540 (1991).

69. *Id.*, slip op. at 4, *reprinted in* 16 DEL. J. CORP. L. at 1545-46. Forstmann offered to purchase all outstanding shares of General Instrument's common stock for cash at $44.50 per share. *Id.*, slip op. at 1, *reprinted in* 16 DEL. J. CORP. L. at 1544.

70. *Id.*, slip op. at 1, *reprinted in* 16 DEL. J. CORP. L. at 1544. The merger agreement entered into between Forstmann and General Instrument contained a "fiduciary-out" provision and a $1.00 per share break-up fee. *Id.*, slip op. at 3, *reprinted in* 16 DEL. J. CORP. L. at 1545.

71. *Id.*, slip op. at 2, *reprinted in* 16 DEL. J. CORP. L. at 1544.

72. *Id.*, slip op. at 21, *reprinted in* 16 DEL. J. CORP. L. at 1557.

73. *See id.*, slip op. at 16-21, *reprinted in* 16 DEL. J. CORP. L. at 1553-57. The plaintiffs claimed that the board of directors of General Instrument did not have adequate information concerning the value of the company in a change of control context. *Id.*, slip op. at 16, *reprinted in* 16 DEL. J. CORP. L. at 1553. In

Given that corporate control issues were involved, the court applied the enhanced scrutiny necessary to determine whether the deference of the business judgment rule would be applied in reviewing the transaction.[74] The court stated:

> In such a setting the additional level of inquiry comes to this: whether the circumstances afford a disinterested and well motivated director a basis reasonably to conclude that if the transactions contemplated by the merger agreement close, they will represent the best available alternative for the corporation and its shareholders. This inquiry involves consideration *inter alia* of the nature of any provisions in the merger agreement tending to impede other offers, the extent of the board's information about market alternatives, the content of announcements accompanying the execution of the merger agreement, the extent of the company's contractual freedom to supply necessary information to competing bidders, and the time made available for better offers to emerge.[75]

Applying this test, the court found that the plaintiff had not shown a reasonable probability of success on the merits.[76]

Next, the court addressed the disclosure issues.[77] The court summarily rejected each of the plaintiff's claims, however, holding that they were not supported by substantial evidence to show a

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particular, the plaintiffs claimed that General Instrument did not explore alternatives to Forstmann's proposal. *Id.*

74. *Id.*, slip op. at 17-18, *reprinted in* 16 DEL. J. CORP. L. at 1554.

75. *Id.*, slip op. at 18-19, *reprinted in* 16 DEL. J. CORP. L. at 1555.

76. *Id.*, slip op. at 19-21, *reprinted in* 16 DEL. J. CORP. L. at 1555-56. While the court determined to treat the transaction as a management affiliated leveraged buyout transaction because General Instrument's chief executive "had every reason to hope" that he would be retained after a merger, there was insufficient evidence that the executive affected the negotiations to support an injunction. *Id.*, slip op. at 19-20, *reprinted in* 16 DEL. J. CORP. L. at 1555-56. The court also concluded that, while General Instrument's board had "acted quickly," it had adequate information to enter into the merger agreement. *Id.*, *reprinted in* 16 DEL. J. CORP. L. at 1556.

77. The plaintiff had alleged that the defendants failed to make adequate disclosures with respect to financial projections and certain "hidden conflicts." *Id.*, slip op. at 21-22, *reprinted in* 16 DEL. J. CORP. L. at 1557. These hidden conflicts involved outside investors' roles with the companies involved and with management's alleged hidden interest in post-acquisition investment in the surviving company. *Id.*, slip op. at 22, *reprinted in* 16 DEL. J. CORP. L. at 1557.

reasonable likelihood of success on the merits.[78] The plaintiff's request to enjoin the merger was, therefore, denied.[79]

In *In re Wheelabrator Technologies Inc. Shareholders Litigation*,[80] the court of chancery declined to preliminarily enjoin a proposed merger between Wheelabrator Technologies Inc. (WTI) and Waste Management, Inc. (Waste Management).[81] Pursuant to the proposed merger, Waste Management planned to increase its ownership of WTI's outstanding shares from 22% to 55%.[82]

The court found that WTI's management and directors had reason to believe that the market for the sale of WTI had been explored prior to the time WTI and Waste Management began their merger discussions in late 1989 and that there were no other buyers offering a satisfactory price for WTI.[83] After WTI rejected Waste Management's initial proposal of a stock-for-stock, no premium exchange offer by Waste Management for 33% of WTI's outstanding shares, the parties negotiated a stock-for-stock merger.[84] The proposal required the following terms: (1) that the merger agreement would require the approval of a majority of the shares of WTI not owned by Waste Management;[85] (2) that there was no "break-up fee," expense reimbursements provision, asset option, lock-up, or other impediment to the emergence of a better offer;[86] (3) a fiduciary-out provision which permitted WTI to entertain unsolicited better offers;[87] and (4) five "Ancillary Agreements" negotiated by Waste Management and WTI that defined the companies' future relationship in several critical areas.[88]

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78. *Id.*, slip op. at 22-28, *reprinted in* 16 DEL. J. CORP. L. at 1557-61.

79. *Id.*, slip op. at 28, *reprinted in* 16 DEL. J. CORP. L. at 1561.

80. No. 11,495 (Consolidated) (Del. Ch. Sept. 6, 1990), *reprinted in* 16 DEL. J. CORP. L. 1653 (1991).

81. *Id.*, slip op. at 21, *reprinted in* 16 DEL. J. CORP. L. at 1669.

82. *Id.*, slip op. at 1, *reprinted in* 16 DEL. J. CORP. L. at 1656.

83. *Id.*, slip op. at 3, *reprinted in* 16 DEL. J. CORP. L. at 1657.

84. *Id.*, slip op. at 4-5, *reprinted in* 16 DEL. J. CORP. L. at 1658-59. Under the agreement, each WTI share would be converted into .574 share of WTI and .469 share of Waste Management with the value of the Waste Management shares to be issued having 10% greater value than the ten-day market value of the WTI shares being acquired. *Id.*

85. *Id.*, slip op. at 5, *reprinted in* 16 DEL. J. CORP. L. at 1659.

86. *Id.*

87. *Id.*

88. *Id.*, slip op. at 5-6, *reprinted in* 16 DEL. J. CORP. L. at 1659. The ancillary agreements, which called for substantial interaction between WTI and Waste Management, are described in the court's opinion. *Id.*, slip op. at 6 n.3, *reprinted in* 16 DEL. J. CORP. L. at 1659 n.3.

The plaintiffs challenged the transaction on the grounds that the proxy statement for the transaction contained materially false and misleading disclosures and that the directors of WTI failed to seek the best available transaction for stockholders, as required by *Revlon*.[89] The court first rejected the disclosure claims, finding that the proxy statement was "notable for the extensiveness of its disclosures" and, "far from being deficient, more closely resemble[d] a model of detailed, candid disclosure."[90]

The court also refused to consider claims that the WTI directors were grossly negligent and had not discharged their *Revlon*-mandated duty to seek the best possible transaction.[91] These claims were rejected because the WTI stockholders were to vote on the merger in the near future and, if they approved the merger, that approval would be based upon a fully informed vote.[92] According to the court, "That result flows from the more general principle that except in cases where the transaction is claimed to involve waste of assets, fraud, or *ultra vires*, valid shareholder ratification operates as a complete defense to a claim that the transaction was the product of gross negligence."[93] The court also noted that, even if the *Revlon* claim were not extinguished by an informed stockholder vote, injunctive relief was not justified because it would deprive stockholders of the benefit of the offer "without offering them any realistic prospect of a superior alternative, or, for that matter, any alternative."[94]

In *Rabkin v. Olin Corp.*,[95] the court of chancery entered judgment after trial in favor of defendant Olin Corporation (Olin) and certain

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89. *Id.*, slip op. at 9, *reprinted in* 16 DEL. J. CORP. L. at 1661 (citing *Revlon*, 506 A.2d at 173).

90. *Id.*, slip op. at 11, 18, *reprinted in* 16 DEL. J. CORP. L. at 1663, 1667.

91. *Id.*, slip op. at 19, *reprinted in* 16 DEL. J. CORP. L. at 1667.

92. *Id.*, *reprinted in* 16 DEL. J. CORP. L. at 1668. *See also* Smith v. Van Gorkom, 488 A.2d 858, 889 (Del. 1985) (holding that "[a] merger can be sustained, notwithstanding the infirmity of the Board's action, if its approval by majority vote of the stockholders is found to have been based on an informed electorate").

93. *In re Wheelabrator Technologies Inc. Shareholders Litig.*, No. 11,495, slip op. at 19, *reprinted in* 16 DEL. J. CORP. L. at 1668 (citing Michelson v. Duncan, 407 A.2d 211, 218-19 (Del. 1979); Weiss v. Rockwell Int'l, No. 8811 (Del. Ch. July 19, 1989), *reprinted in* 15 DEL. J. CORP. L. 777 (1990), *aff'd per curiam*, 574 A.2d 264 (Del. 1990)).

94. *Id.*, slip op. at 20, *reprinted in* 16 DEL. J. CORP. L. at 1669.

95. No. 7547 (Consolidated) (Del. Ch. Apr. 17, 1990), *reprinted in* 16 DEL. J. CORP. L. 851 (1991), *aff'd*, 586 A.2d 1202 (Del. 1990). Prior opinions in this litigation are reported at 480 A.2d 655 (Del. Ch. 1984); 498 A.2d 1099 (Del. 1985); and 547 A.2d 963 (Del. 1986).

of its directors.[96] The plaintiffs'[97] claims arose out of a cash-out merger of Philip A. Hunt Chemical Corporation (Hunt) with Olin, its majority stockholder.[98] Olin had offered $20 per share for the Hunt minority stock, an offer which was approved by the Hunt Board.[99] The plaintiffs challenged the entire fairness of the transaction and charged that the individual defendants, as directors of Hunt, had breached their duty of loyalty to the minority stockholders of Hunt.[100] The plaintiffs' claim that the merger was not entirely fair was based in part on a contractual commitment by Olin[101] to pay at least a $25 minimum price per share in the event that it sought to acquire all or substantially all of the Hunt stock that it did not already own during a one-year period that expired shortly before the merger.[102]

Since Olin was Hunt's majority stockholder and was acting in its self-interest in purchasing the minority interest, the defendants had the obligation to establish by a preponderance of the evidence that the challenged transaction was entirely fair.[103] The court held that the approval of the transaction by an independent special committee was not sufficient to shift this burden to the plaintiffs because the majority stockholder dictated the terms of the merger and the special committee had no real bargaining power that it could exercise

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96. *Rabkin*, No. 7547, slip op. at 2, *reprinted in* 16 DEL. J. CORP. L. at 854.

97. The plaintiffs were minority stockholders of Philip A. Hunt Chemical Corporation. *Id.*, slip op. at 1, *reprinted in* 16 DEL. J. CORP. L. at 853.

98. *Id.*, slip op. at 7-9, *reprinted in* 16 DEL. J. CORP. L. at 857-59. Prior to the challenged merger, Olin owned 64% of Hunt's stock. *Id.*, slip op. at 2-6, *reprinted in* 16 DEL. J. CORP. L. at 854-57.

99. *Id.*, slip op. at 6-7, *reprinted in* 16 DEL. J. CORP. L. at 857.

100. *Id.*, slip op. at 7-9, *reprinted in* 16 DEL. J. CORP. L. at 857-59.

101. The contractual commitment arose out of Olin's original purchase of its 64% interest in Hunt from an English company, Turner & Newall Industries (Turner & Newall). *Id.*, slip op. at 2-3, *reprinted in* 16 DEL. J. CORP. L. at 854-55. Olin had purchased Turner & Newall's block of Hunt stock for $25 per share, and Turner & Newall required that Olin enter into the one-year price commitment to protect itself from liability for expropriating an acquisition premium in the event that Olin acquired the rest of Hunt's outstanding stock. *Id.*, slip op. at 3, *reprinted in* 16 DEL. J. CORP. L. at 855.

102. *Id.*, slip op. at 3, 8, *reprinted in* 16 DEL. J. CORP. L. at 855, 858-59. The court accepted as "uncontested" the defendants' explanation of the one-year commitment "as a routine item requested by sellers of control blocks of stock to protect them from liability for expropriating an acquisition premium." *Id.*, slip op. at 3, *reprinted in* 16 DEL. J. CORP. L. at 855.

103. *Id.*, slip op. at 12, *reprinted in* 16 DEL. J. CORP. L. at 860. *See Mills Acquisition Co.*, 559 A.2d at 1279 n.27.

with the majority stockholder on an arm's-length basis.[104] The court stated that "the Hunt special committee was given the narrow mandate of determining the monetary fairness of a non-negotiable offer," and that "Olin dictated the terms of the merger and there were no arm's[-]length negotiations."[105] However, after reviewing the facts, the court found that Olin "did not in any way unfairly deal with the Hunt minority by deliberately timing the merger to avoid the one year price commitment."[106]

The defendants also claimed that Olin was obligated to pay a price per share in the merger "greater or less than $25, 'depending upon the developments with respect to the business of [Hunt] and general economic and other conditions'" because of disclosure to that effect in Olin's Schedule 13D.[107] The court determined that the language of the Schedule 13D disclosure did not establish a "special" price obligation on Olin's part or "require valuation methods other than those routinely employed by this Court in determining fair price."[108] The court then concluded that the minority shareholders were treated with entire fairness.[109]

In *Freedman v. Restaurant Associates Industries*,[110] the court considered a motion to dismiss the second amended complaint in a class action seeking to enjoin or rescind a management leveraged buyout (MBO) of Restaurant Associates Industries, Inc. (RA).[111] The management group, which controlled 48% of RA's stock and six of

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104. *Rabkin*, No. 7547, slip op. at 14-15, *reprinted in* 16 DEL. J. CORP. L. at 861-62. The burden of proof concerning "entire fairness" entirely shifts to the plaintiffs to show that the transaction was unfair to the minority stockholders if a merger is contingent on approval by a majority of the minority stockholders. *Id.*, slip op. at 13, *reprinted in* 16 DEL. J. CORP. L. at 861; *Weinberger*, 457 A.2d at 703. The existence and operation of a special committee can also operate to shift the burden of proof when the majority shareholder does not "dictate the terms of the merger" and has "real bargaining power that it can exercise with the majority shareholder on an arm['']s[-]length basis." *Rabkin*, No. 7547, slip op. at 14-15, *reprinted in* 16 DEL. J. CORP. L. at 861-62 (citing *Rosenblatt*, 493 A.2d at 937).

105. *Rabkin*, No. 7547, slip op. at 15, *reprinted in* 16 DEL. J. CORP. L. at 862.

106. *Id.*, slip op. at 26, *reprinted in* 16 DEL. J. CORP. L. at 868.

107. *Id.*, slip op. at 26-27, *reprinted in* 16 DEL. J. CORP. L. at 868. *See also id.*, slip op. at 4-5, *reprinted in* 16 DEL. J. CORP. L. at 856 (quoting text of the relevant Schedule 13D disclosure).

108. *Id.*, slip op. at 28, *reprinted in* 16 DEL. J. CORP. L. at 869.

109. *Id.*, slip op. at 29, *reprinted in* 16 DEL. J. CORP. L. at 870.

110. No. 9212 (Del. Ch. Sept. 19, 1990), *reprinted in* 16 DEL. J. CORP. L. 1462 (1991).

111. *Id.*, slip op. at 1, *reprinted in* 16 DEL. J. CORP. L. at 1465.

eleven seats on RA's Board, agreed to acquire RA for $18 per share prior to the October 1987 stock market crash.[112] The six directors who were members of the management group rejected an attempt by a special committee of RA's outside directors to facilitate a higher bid by AWR Acquisition Corporation (AWR), a third party unaffiliated with RA.[113] After the stock market crash, the management group revised its offer to $14.25 per share.[114]

The court granted the defendants' motion to dismiss only with respect to those allegations directed specifically at the alleged failure of the special committee to shop the company at the pre-1987 market crash stage of the transaction[115] and with respect to any allegations of breach of fiduciary duty in connection with the special committee's recommendation and the board's approval of the management group's pre-crash offer of $18 per share.[116]

In granting this portion of the motion, the court held that the plaintiffs were incorrect in their assumption that *Revlon* imposed an obligation to shop RA, stating that "[t]he special committee had an obligation only to make an informed and reasonable business judgment in the best interests of the shareholders and to act reasonably in attempting to obtain the best deal for the shareholders."[117] Although the board may fulfill its obligation by conducting an auction, an auction is not always necessary.[118] Furthermore, in rejecting the

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112. *Id.*, slip op. at 1-2, *reprinted in* 16 DEL. J. CORP. L. at 1465-66.

113. *Id.*, slip op. at 5-7, *reprinted in* 16 DEL. J. CORP. L. at 1468-69. AWR and the special committee agreed in principle that the special committee would recommend that RA's Board negotiate an agreement pursuant to which AWR would pay a nonrefundable $2 million in exchange for an option to purchase at least 1 million RA shares of common stock within 10 days. *Id.*, slip op. at 6, *reprinted in* 16 DEL. J. CORP. L. at 1469. The 10-day time period was to allow AWR to perform due diligence. *Id.* AWR's proposal was defeated by a 6-5 vote, with all six "management group directors" voting against the deal. *Id.*

114. *Id.*, slip op. at 7-8, *reprinted in* 16 DEL. J. CORP. L. at 1469-70.

115. *Id.*, slip op. at 12-14, *reprinted in* 16 DEL. J. CORP. L. at 1472-73.

116. *Id.*, slip op. at 16, *reprinted in* 16 DEL. J. CORP. L. at 1475. The court concluded that the claims arising out of the $18 proposal were moot because no injury could have arisen out of the abandoned deal. *Id.*

117. *Id.*, slip op. at 12-14, *reprinted in* 16 DEL. J. CORP. L. at 1472-73 (citing *Mills Acquisition Co.*, 559 A.2d at 1286-87).

118. *Id.*, slip op. at 13, *reprinted in* 16 DEL. J. CORP. L. at 1473. *See* Barkan v. Amsted Indus., 567 A.2d 1279, 1286 (Del. 1989) ("*Revlon* does not demand that every change in control of a Delaware corporation be preceded by a heated bidding contest"); *In re* Formica Corp. Shareholders Litig., No. 10,598 (Del. Ch. Mar. 22, 1989); *In re* Fort Howard Corp. Shareholders Litig., No. 9991 (Consolidated) (Del. Ch. Aug. 8, 1988), *reprinted in* 14 DEL. J. CORP. L. 699 (1989)).

plaintiffs' claims that the members of the management group breached their fiduciary duties by refusing to sell their shares to an alternate bidder, the court noted that "[i]t is readily apparent that this is not the law in Delaware."[119]

The court denied the motion to dismiss with respect to the claims that the defendants made misleading disclosures concerning a 1985 recapitalization of RA.[120] The court noted that "[a] full and truthful disclosure of the purpose sought to be served by securing stockholder authorization [of the recapitalization plan] does not . . . implicitly limit the power authorized to that purpose."[121] However, the court also stated that, assuming that the allegation was that the managing directors intended in the 1985 recapitalization to use the increased voting power that the recapitalization made possible to assist in a buyout transaction, the failure to disclose such a fact in a discussion of the purpose of the transaction would constitute a violation of the directors' duty of candor.[122] Assuming that this was the intent of the plaintiffs' pleading, the court denied the motion with respect to this claim.[123]

The court also denied the motion to dismiss with respect to a claim that the directors breached their fiduciary duty in rejecting an opportunity to obtain an alternate bid which would have resulted in the dilution of their position in the company.[124] Analyzing the claim

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119. *Freedman*, No. 9212, slip op. at 14, *reprinted in* 16 DEL. J. CORP. L. at 1473. As the supreme court stated, "Clearly, a stockholder is under no duty to sell its holdings in a corporation, even if it is a majority shareholder, merely because the sale would profit the minority." *Bershad*, 535 A.2d at 845.

120. *Freedman*, No. 9212, slip op. at 10-12, *reprinted in* 16 DEL. J. CORP. L. at 1471-72. The 1985 recapitalization raised the management group's equity interest in RA from 37% to 48%. *Id.*, slip op. at 3 n.2, *reprinted in* 16 DEL. J. CORP. L. at 1467 n.2.

121. *Id.*, slip op. at 11, *reprinted in* 16 DEL. J. CORP. L. at 1472 (citing Bernstein v. Vestron, Inc., No. 8404 (Del. Ch. Mar. 11, 1986)).

122. *Id.*, slip op. at 12, *reprinted in* 16 DEL. J. CORP. L. at 1472. "In a proxy solicitation, where management chooses to disclose its motives as to the purposes of a transaction, it has an obligation to disclose those purposes honestly and candidly." *Id.* (citing Rubinstein v. IU Int'l Corp., 506 F. Supp. 311, 315 (E.D. Pa. 1980)).

123. *Id.*

124. *Id.*, slip op. at 14-16, *reprinted in* 16 DEL. J. CORP. L. at 1473-74. This is because "[d]irectors have fiduciary obligations to act in the best interests of the corporation [and in doing so must] put aside their own personal interests . . . ." *Id.*, slip op. at 14-15, *reprinted in* 16 DEL. J. CORP. L. at 1474.

under section 144 of the GCL,[125] the court concluded that the board's decision would be upheld only if the defendants met their burden of proving that it was a fair decision.[126]

With respect to claims arising from the reduced offer following the October 1987 stock market crash, the court held that in light of the claim that "the management group could (and did) veto any action of the special committee that was not agreeable to the conflicted interests of the management directors," the complaint sufficiently alleged "a self-interested transaction that will require the interested directors to prove the entire fairness of that transaction to the minority shareholders."[127] The court further noted that the outside directors stood in a different relation to the transaction.[128] However, the court held:

> The plaintiffs, in alleging that the special committee did not shop the company and agreed to the sale of the company at a point in time, immediately following the October 1987 market break, when its stock price was particularly depressed[,] . . . have alleged circumstances that, if true, might support a conclusion that the special committee did not act reasonably.[129]

With respect to management's purpose in lowering its offer following the crash, the court held that, "[a]lthough management may have no general obligation to disclose its purposes or motivation, once it undertook to disclose its purpose in revising the offer, it had an obligation to do so truthfully and candidly."[130] Therefore, the post-crash claims were not dismissed.[131]

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125. DEL. CODE ANN. tit. 8, § 144 (1983 & Supp. 1990). As the court described it, section 144 "states that a self-dealing transaction is not void by virtue of self-dealing if the transaction is approved by vote of the shareholders, or if the transaction was fair when authorized." *Freedman*, No. 9212, slip op. at 15-16, *reprinted in* 16 DEL. J. CORP. L. at 1474.

126. *Freedman*, No. 9212, slip op. at 16, *reprinted in* 16 DEL. J. CORP. L. at 1474.

127. *Id.*, slip op. at 17-18, *reprinted in* 16 DEL. J. CORP. L. at 1475-76.

128. *Id.*, slip op. at 18, *reprinted in* 16 DEL. J. CORP. L. at 1476. The court stated that the outside directors appeared to have been "financially disinterested in the sale transaction." *Id.*

129. *Id.*

130. *Id.*, slip op. at 19, *reprinted in* 16 DEL. J. CORP. L. at 1476.

131. *Id.*, slip op. at 19-20, *reprinted in* 16 DEL. J. CORP. L. at 1476-77.

Finally, the court rejected the defendants' argument that the plaintiffs had no standing to bring the disclosure claims because they did not tender their stock.[132] The court stated that "a nontendering stockholder may suffer an injury, and therefore may state a claim upon which relief will be granted, when, as alleged, 'false information and omissions . . . led others [sic] to tender their shares.'"[133]

The court of chancery also dismissed a class action claim in *In re KDI Corporation Shareholders Litigation*,[134] an action brought by stockholders of KDI Corporation (KDI), which challenged a management leveraged buyout of KDI. The complaint alleged that the defendants[135] breached their fiduciary duties of care, loyalty, and candor during the course of merger negotiations by: "(i) favoring the management group's bid and thereby preventing a fair auction for KDI; (ii) failing to reasonably inform themselves as to the best available transaction; and (iii) failing to make full disclosure in [their] Offer to Purchase."[136] The court held that the complaint should be dismissed without leave to amend.[137]

The plaintiffs claimed that the special committee breached its duty of care by (1) waiting until management made its first offer before seeking other bidders; (2) failing to pursue expressions of interest by third parties who might have paid more than management; (3) approving a stock purchase agreement with KDI's major stockholder, which "locked up" 49.5% of KDI's stock; and (4) agreeing not to pursue alternative transactions.[138] The court stated that there is no special method that must be followed by directors to satisfy the duty of due care in connection with a buyout proposal.[139] The court concluded that the plaintiffs' allegations could not sustain due care claims when viewed in light of the other allegations set forth

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132. *Id.*

133. *Id.*, *reprinted in* 16 DEL. J. CORP. L. at 1476 (quoting Plaine v. McCabe, 790 F.2d 742, 746 (9th Cir. 1986)).

134. No. 10,278 (Consolidated) (Del. Ch. Dec. 13, 1990).

135. The complaint named as defendants, among others, KDI's Board of Directors. *Id.*, slip op. at 1, 6.

136. *Id.*, slip op. at 1. On November 1, 1988, the court had denied the plaintiffs' motion for a preliminary injunction in the case. *In re* KDI Corp. Shareholders Litig., No. 10,278 (Consolidated) (Del. Ch. Nov. 1, 1988), *reprinted in* 14 DEL. J. CORP. L. 759 (1989).

137. *In re* KDI Corp. Shareholders Litig., No. 10,278 (Consolidated), slip op. at 1 (Del. Ch. Dec. 13, 1990).

138. *Id.*, slip op. at 7.

139. *Id.*, slip op. at 6-7 (citing *Barkan*, 567 A.2d at 1286).

in the complaint.[140] The court also stated that certain limitations in the stock purchase agreement and merger agreement provided no basis for a claim that the special committee breached its duty of care since the agreements were not executed until the process of selling KDI was at a close.[141] The agreements could also have been terminated if a higher offer were made, which would allow the special committee to provide confidential information to, and negotiate with, any possible higher bidder.[142]

With respect to asserted breaches of the duty of loyalty, the court held that the fact that four of KDI's directors were affiliated with or appointed by KDI's major stockholder did not, without more, constitute a conflict.[143] Nor did the record support an inference that the board members elected by the major stockholder were conflicted or interested by virtue of the stockholder's alleged desire to sell its stock at any price.[144]

The plaintiffs also claimed that the defendants breached their duty of candor by failing to make proper disclosures in the Offer to Purchase.[145] The court rejected these allegations, however, noting that their disclosure claims were considered and rejected in connection with the plaintiffs' motion for a preliminary injunction.[146]

B. Stockholder Rights Plans

The court of chancery also considered the obligations of directors in connection with stockholder rights plans in 1990. In *Sutton Holding Corp. v. DeSoto, Inc.*,[147] the court considered an application for a mandatory preliminary injunction compelling the directors of DeSoto, Inc. (DeSoto) to redeem rights issued pursuant to a stockholder rights plan adopted in response to an all-cash tender offer by Sutton Holding Corporation (Sutton).[148] The court concluded that the plaintiffs had "shown the reasonable probability that the directors of DeSoto, Inc.

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140. *Id.*, slip op. at 7. For example, the complaint established that KDI was "in play" for more than three months and that the special committee was seeking third-party bidders for at least the last month of that period. *Id.*

141. *Id.*, slip op. at 8.

142. *Id.*

143. *Id.*, slip op. at 9 (citing Yanow v. Scientific Leasing, Inc., Nos. 9536 & 9561, slip op. at 13 (Del. Ch. Feb. 5, 1988) (revised Feb. 8, 1988), *reprinted in* 13 DEL. J. CORP. L. 1273 (1988)).

144. *Id.*, slip op. at 9-10.

145. *Id.*, slip op. at 10.

146. *Id.*, slip op. at 10-11.

147. Nos. 11,221 & 11,222 (Consolidated) (Del. Ch. Feb. 5, 1990), *reprinted in* 16 DEL. J. CORP. L. 434 (1991).

148. *Id.*, slip op. at 2, *reprinted in* 16 DEL. J. CORP. L. at 437.

have not properly discharged their fiduciary duties in considering the tender offer."[149] However, the court declined to order the immediate redemption of the rights.[150]

The court stated that, in ruling on an application for a preliminary mandatory injunction to order redemption of rights, it

> must first determine if the board, in adopting the challenged rights plan, was sufficiently disinterested so that its decision falls within the protection of the business judgment rule. If so, the Court then must decide if the board "had reasonable grounds for believing that a danger to corporate policy and effectiveness existed."[151]

The court found that eight of the ten members of DeSoto's Board were independent and that the directors had obtained an investment banker's opinion that the tender offer price per share was not fair.[152] The court found, therefore, that the plaintiffs had not shown that the board acted improperly in adopting the rights plan and in initially resisting the tender offer.[153]

After reviewing the holdings of the Delaware Supreme Court in *Moran v. Household International, Inc.*[154] and *Barkan v. Amsted Industries, Inc.*,[155] however, the court concluded that the plaintiffs had met their burden of showing a reasonable probability that the directors' subsequent actions in response to the tender offer had not been reasonable.[156] In obtaining a fairness opinion, the directors "did not

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149. *Id.*

150. *Id.*, *reprinted in* 16 DEL. J. CORP. L. at 437-38.

151. *Id.*, slip op. at 16, *reprinted in* 16 DEL. J. CORP. L. at 444-45 (quoting *Unocal*, 493 A.2d at 955). The court noted that a rights plan "has the effect of preventing a stockholder from selling his shares of stock for the highest price being offered and, because [its] object is to prevent a transfer of corporate control, the directors face an inherent conflict of interest when adopting or maintaining it." *Id.*, slip op. at 14, *reprinted in* 16 DEL. J. CORP. L. at 443.

152. *Id.*, slip op. at 17, *reprinted in* 16 DEL. J. CORP. L. at 445.

153. *Id.*, *reprinted in* 16 DEL. J. CORP. L. at 445.

154. 500 A.2d 1346 (Del. 1985). In *Moran*, the supreme court stated that

> the Rights Plan is not absolute. When the Household Board of Directors is faced with a tender offer and a request to redeem the Rights, they will not be able to arbitrarily reject the offer. They will be held to the same fiduciary standards any other board of directors would be held to in deciding to adopt a defensive mechanism, the same standard as they were held to in originally approving the Rights Plan.

Id. at 1354.

155. 567 A.2d 1279 (Del. 1989).

156. *Sutton Holding Corp.*, Nos. 11,221 & 11,222, slip op. at 20, *reprinted in* 16 DEL. J. CORP. L. at 447.

obtain or receive a fair value range, notwithstanding that plaintiffs publicly announced a willingness to consider raising their offering price and their apparent ability to do so. The directors therefore were not in a position to know if plaintiffs' highest offer would have been fair."[157] The court also found that DeSoto's chief executive had made no effort to determine what the plaintiffs' higher offer would be and refused to meet with the plaintiffs or their representatives.[158] Nor was any effort made

> to canvas the market to learn if there were other possible suitors or even to preliminarily learn if a canvas of the market would be worthwhile. In short, the management of DeSoto did nothing to attempt to maximize shareholder values except to assert that a modest restructuring plan which had been prepared in the ordinary course of business protected the corporation from a tender offer.[159]

The court concluded that "[i]n sum, the directors' response to the tender offer [did] not appear to be a reasonable response or to have been done in good faith. In the absence of other factors this would likely result in the ordering of the immediate redemption of the [rights]."[160]

However, the court noted that certain factors counseled against an immediate redemption of the rights and that refusal of the court to order early redemption of poison pills "has resulted in increased tender offers in several other cases."[161] Among other factors, the court noted that immediate redemption of the rights could permit the plaintiffs to acquire DeSoto at an inadequate price, that changed circumstances as to certain of DeSoto's assets had to be considered, and that unresolved questions existed as to the ability of the plaintiffs to comply with certain conditions in their tender offer.[162] The court

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157. *Id.*

158. *Id.*, slip op. at 21, *reprinted in* 16 DEL. J. CORP. L. at 447.

159. *Id.*, *reprinted in* 16 DEL. J. CORP. L. at 447-48.

160. *Id.*, slip op. at 21-22, *reprinted in* 16 DEL. J. CORP. L. at 448. *See, e.g.*, Grand Metro. PLC v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988).

161. *Sutton Holding Corp.*, Nos. 11,221 & 11,222, slip op. at 22, *reprinted in* 16 DEL. J. CORP. L. at 448. *Cf. 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); Nomad Acquisition Corp. v. Damon Corp., Nos. 10,173 & 10,189 (Consolidated) (Del. Ch. Sept. 16, 1988) (revised Sept. 20, 1988), *reprinted in* 14 DEL. J. CORP. L. 814 (1989).

162. *Sutton Holding Corp.*, Nos. 11,221 & 11,222, slip op. at 22-23, *reprinted in* 16 DEL. J. CORP. L. at 448.

concluded that the directors should "face up" to their fiduciary duties and "take the necessary steps to assure a maximization of shareholder value."[163] The motion for a preliminary mandatory injunction, therefore, was denied.[164]

In *Stahl v. Apple Bancorp, Inc.*,[165] the court of chancery considered the "beneficial ownership" provision of a rights plan. In *Stahl*, the court denied a motion for partial summary judgment by the plaintiff, Stanley Stahl (Stahl), with respect to a claim that the definition of beneficial ownership in the stockholder rights plan of Apple Bancorp, Inc. (Bancorp) "causes the rights to have certain impermissible or inequitable effects upon the exercise of the corporate franchise."[166] Stahl had commenced a cash tender offer for any and all of Bancorp's common shares and was conducting a proxy contest to increase the size of Bancorp's Board and elect a majority of new members.[167]

The plaintiff asserted that the beneficial ownership provision of Bancorp's rights plan was invalid to the extent that it applied to revocable voting agreements or the granting and solicitation of revocable proxies that did not legally bind any person to vote in one way or another.[168]

The court noted that the "validity of stock rights must be assessed at the time of the corporate action creating them; validity of corporate securities cannot rise or fall on future contingencies once issued."[169] The court stated that "it is an assessment of the reasonably foreseeable consequences that a pill is likely to have on legitimate election activities . . . that is relevant for a determination [of] whether the

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163. *Id.*, slip op. at 23, *reprinted in* 16 DEL. J. CORP. L. at 448-49.

164. *Id.*, *reprinted in* 16 DEL. J. CORP. L. at 449.

165. No. 11,510 (Del. Ch. Aug. 9, 1990), *reprinted in* 16 DEL. J. CORP. L. 1573 (1991).

166. *Id.*, slip op. at 4-5, *reprinted in* 16 DEL. J. CORP. L. at 1579.

167. *Id.*, slip op. at 1, *reprinted in* 16 DEL. J. CORP. L. at 1576.

168. *Id.*, slip op. at 5, 7-8, *reprinted in* 16 DEL. J. CORP. L. at 1579-81. There was no dispute that Stahl could not enter into agreements *binding* another shareholder to vote in a certain manner, and the parties both assumed that Stahl was

> precluded from entering into an agreement with other shareholders (if those shareholders own .7% of Bancorp's stock) to serve on the same slate of directors in opposition to the management slate; from agreeing to indemnify (or be indemnified by) other shareholders in connection with running for office; and from asking for and receiving permission to use the name of another stockholder for purposes of endorsing his slate, even if there were no irrevocable proxy given or other promises made.

Id., slip op. at 7-8, *reprinted in* 16 DEL. J. CORP. L. at 1580-81.

169. *Id.*, slip op. at 13, *reprinted in* 16 DEL. J. CORP. L. at 1584.

action was authorized and whether it constituted a breach of duty of loyalty."[170] The plaintiff failed to show that the Bancorp directors could not have reasonably concluded that the restrictions imposed by the stock rights plan were immaterial to conducting a proxy fight effectively.[171] Also, the court was "unable to say that stockholders have an absolute right to reach agreements with each other concerning the voting of stock (excepting agreements reflected in the granting of a revocable proxy)."[172] For these reasons, the court refused to deem the provision defining beneficial ownership invalid.[173]

The plaintiff also claimed that it was a breach of fiduciary duty for the board to retain the challenged provisions of the rights plan.[174] His argument was "founded upon the undoubtedly correct premise that a board has a continuing duty to assess the impact of its stock rights plan upon the corporation and its stockholders . . . ."[175] However, because of the board's legitimate concerns with Stahl's offer, the court concluded that the position of the board to leave in place

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170. *Id.*

171. *Id.*, slip op. at 15-16, *reprinted in* 16 DEL. J. CORP. L. at 1585-86.

172. *Id.*, slip op. at 15, *reprinted in* 16 DEL. J. CORP. L. at 1585.

173. *Id.*, *reprinted in* 16 DEL. J. CORP. L. at 1585-86. In considering the validity of the rights plan in Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985), the Delaware Supreme Court concluded that the rights plan's impact on proxy contests would be minimal and rejected the contention that the rights plan would impermissibly burden a proxy contest. The supreme court's analysis in *Moran* provided support for the court's ruling in *Stahl*. *See Stahl*, No. 11,510, slip op. at 11-15, *reprinted in* 16 DEL. J. CORP. L. at 1583-85.

174. *Stahl*, No. 11,510, slip op. at 16, *reprinted in* 16 DEL. J. CORP. L. at 1586. The court stated the defendants' position as follows:

> The board contends that it is not faced with a simple proxy contest, but with a cash tender offer for all shares at what it reasonably believes to be an unfair price. It is currently exploring economic alternatives to this low offer but it is doing so under a handicap: the existence of Mr. Stahl's 30% block of stock itself creates a disincentive for other bidders to invest the time and resources necessary to bring a competing proposal forward. The board contends that if Mr. Stahl is able to reach agreements with other shareholders (such as agreements to run on the same slate) this disincentive will be increased. If Stahl gets stronger by whatever means, the board gets weaker in dealing with him. Thus, the argument runs, it is in the corporation's interest to isolate him and do what can legitimately be done to weaken his current prospects for success in the proxy contest. Perception of a weakened state, it is asserted, will encourage others to bid and will encourage Stahl to bargain, when that time comes.

Id., slip op. at 9, *reprinted in* 16 DEL. J. CORP. L. at 1581-82.

175. *Id.*, slip op. at 16, *reprinted in* 16 DEL. J. CORP. L. at 1586.

and enforce the beneficial ownership term of the rights plan was reasonable in relation to the threat posed by Stahl.[176]

C. *Stockholder Derivative Suits*

Both the Supreme Court of Delaware and Delaware's Court of Chancery issued important opinions in 1990 concerning the demand requirement of Chancery Rule 23.1.[177] In *Spiegel v. Buntrock*,[178] the Supreme Court of Delaware affirmed the decision of the court of chancery dismissing a derivative action by a stockholder of Waste Management.[179] The plaintiff had instituted a derivative suit against certain officers and directors of Waste Management alleging that they had acquired stock in another company based on inside information during the two years prior to Waste Management's tender offer for that company.[180] The plaintiff did not make a demand on Waste Management's Board of Directors, arguing that demand was excused.[181] When his failure to make a pre-suit demand was raised by Waste Management, however, the plaintiff made a demand.[182] After the demand was filed, the board of directors responded by appointing a special litigation committee with complete authority to

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176. *Id.*, slip op. at 19, *reprinted in* 16 DEL. J. CORP. L. at 1588. As the court stated:

> [U]nder these particular circumstances, I conclude that whatever small impact the present issue is likely to have, one way or the other, it will most importantly be upon the possible emergence of an alternative and not on the outcome of the contest, if no alternative is produced. Thus, considering his stock position, his cash offer and the other circumstances, I conclude that the impact of effectively precluding Mr. Stahl from forming a joint slate with other shareholders or otherwise entering into revocable agreements with them concerning the voting of stock is likely to have a "minimal" impact upon his proxy campaign (except insofar as it might marginally protect and preserve the board's opportunity to locate a better proposal). Moreover, I conclude also that such minimal impact as it may have is justified in the circumstances by the benefit of preserving to some extent the board's ability to shop the bank in the interim before the next annual meeting.

Id., *reprinted in* 16 DEL. J. CORP. L. at 1587-88.

177. Rule 23.1 sets forth certain demand requirements in derivative actions brought by one or more shareholders. DEL. CH. CT. R. 23.1.

178. 571 A.2d 767 (Del. 1990).

179. *Id.* at 770.

180. *Id.* at 769-70.

181. *Id.* at 770.

182. *Id.*

review and act upon the demand.[183] The special litigation committee rejected the demand.[184]

The court generally noted that "where demand on a board has been made and refused, [courts] apply the business judgment rule in reviewing the board's refusal . . . ."[185] The plaintiff, however, argued that the business judgment rule was inapplicable in this case and urged that the special procedures for judicial review set forth in *Zapata Corp. v. Maldonado*[186] be invoked.[187]

The plaintiff's argument that these special procedures apply was twofold. First, he argued that demand was excused notwithstanding the fact that he had made a demand on the board.[188] He urged "that demand should be encouraged by permitting a demand to be made, while at the same time permitting the argument, that demand was excused, to be preserved."[189] The court rejected this argument, holding that "[b]y making a demand, a stockholder tacitly acknowledges the absence of facts to support a finding of futility."[190] "A shareholder who makes a demand can no longer argue that demand is excused. . . . The effect of a demand is to place control of the derivative litigation in the hands of the board of directors."[191] As a result, when a demand is refused, the board's decision is subject to judicial review under the traditional business judgment rule.[192]

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183. *Id.*

184. *Id.*

185. *Id.* at 774 (citing Aronson v. Lewis, 437 A.2d 805, 813 (Del. 1984)). The court further noted that "the business judgment rule operates as a judicial acknowledgement of a board of directors' managerial prerogatives." *Id.* (citing *Aronson*, 473 A.2d at 812).

186. 430 A.2d 779 (Del. 1981). As the supreme court noted in *Aronson*:

> Under *Zapata*, the Court of Chancery, in passing on a committee's motion to dismiss a derivative action in a demand excused case, must apply a two-step test. First, the court must inquire into the independence and good faith of the committee and review the reasonableness and good faith of the committee's investigation. Second, the court must apply its own independent business judgment to decide whether the motion to dismiss should be granted.

Aronson, 473 A.2d at 813 (citations omitted).

187. *Spiegel*, 571 A.2d at 774.

188. *Id.*

189. *Id.* at 774-75.

190. *Id.* at 775. "Thus, when a demand is made, the question of whether demand was excused is moot." *Id.* (citing Stotland v. GAF Corp., 469 A.2d 421, 422-23 (Del. 1983)).

191. *Id.*

192. *Id.* at 775-76.

The plaintiff also argued that the full board, by referring his demand to a special litigation committee and giving that committee the authority to review and act upon Spiegel's demand, had conceded that the full board was interested and demand was, therefore, excused.[193] The court distinguished the present case from *Abbey v. Computer & Communications Technology Corp.*,[194] in which a plaintiff made a demand and then filed suit alleging demand was excused, to which the board responded by appointing a special litigation committee.[195] In *Abbey*, the court had held that, after making his demand, the plaintiff was entitled to bring a derivative suit without waiting for a decision of the committee.[196] In the present case, which the court found to be the "procedural reverse of *Abbey*," the board responded to the derivative suit by filing a motion to dismiss and only appointed the special litigation committee after the plaintiff had finally made his demand.[197] The court confirmed "that the decision of a board of directors to appoint a special litigation committee . . . is not, *in all instances*, an acknowledgement that demand was excused."[198]

In considering the appropriate standard of review of the special litigation committee's decision, the court noted that "[j]udicial review

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193. *Id.* at 776.

194. 457 A.2d 368 (Del. Ch. 1983).

195. *Id.* at 369-70. The board in *Abbey* delegated full authority to the special litigation committee to handle the derivative action and never made any attempt to address the derivative litigation itself. *Id.* at 370-71, 373. "The [c]ourt of [c]hancery concluded, in *Abbey*, that the board had 'in effect, conceded its disqualification, and . . . thereby conceded [that demand was excused and that] the plaintiff [was entitled] to bring the [derivative] suit without awaiting word from it . . . .'" *Spiegel*, 571 A.2d at 776 (quoting *Abbey*, 457 A.2d at 374).

196. *Abbey*, 457 A.2d at 374.

197. *Spiegel*, 571 A.2d at 776. The court noted:

> The significance of this procedural distinction was recognized by the [c]ourt of [c]hancery in *Richardson v. Graves*. The plaintiff in *Richardson*, like Spiegel, relying on *Abbey*, argued that the board of directors had conceded that demand was excused as futile by the appointment of a special litigation committee. In *Richardson*, the [c]ourt of [c]hancery distinguished *Abbey* on the grounds that the board in *Abbey* did not file a motion to dismiss pursuant to Rule 23.1 until *after* it had surrendered exclusive control of the derivative action to a special litigation committee. By contrast, the *Richardson* board, like the Waste Management board, *first* filed a motion to dismiss Spiegel's complaint due to his failure to make a demand and *later*, after Spiegel did make a demand, appointed a special litigation committee to respond to that demand.

Id. at 776-77 (citations omitted).

198. *Id.* at 777.

of the merits of a special litigation committee's decision to refuse a demand is limited to those cases where demand upon the board of directors is excused and the board has decided to regain control of litigation through the use of an independent special litigation committee."[199] The court determined that the appropriate standard of review here was the business judgment rule.[200] Review under the business judgment rule involves the issues of independence, reasonableness of investigation and good faith.[201] "By electing to make a demand, a shareholder . . . concedes the independence of a majority of the board to respond."[202] The court concluded that the decision of the special litigation committee met the requirements of reasonableness of investigation and good faith.[203]

In *Grobow v. Perot*,[204] the court of chancery also considered the issue of failure to make a demand on directors as required by Rule 23.1. In *Grobow*, the court dismissed a second amended complaint in a stockholders' derivative action brought on behalf of General Motors Corporation (GM) for failure to satisfy the demand requirement of Court of Chancery Rule 23.1.[205] The plaintiffs challenged GM's repurchase at a premium of certain GM securities and notes owned by, among others, H. Ross Perot, a dissident GM director.[206]

The plaintiffs advanced two principal claims in support of their allegations of demand futility. The first allegation was that the GM Board was not independent, because the management directors "dominated" and "controlled" the outside directors by deceiving

199. *Id.* at 778.

200. *Id.* at 777-78 (citing *Zapata*, 430 A.2d at 784-87).

201. *Id.* at 777.

202. *Id.*

203. *Id.* at 778.

204. No. 8759 (Consolidated) (Del. Ch. Jan. 2, 1990), *reprinted in* 16 DEL. J. CORP. L. 310 (1991).

205. *Id.*, slip op. at 23, *reprinted in* 16 DEL. J. CORP. L. at 325. The court's decision dismissing the first amended complaint for failure to meet the demand requirements of Rule 23.1 is reported at 526 A.2d 914 (Del. Ch. 1987). That decision was affirmed by the supreme court in a decision reported at 539 A.2d 180 (Del. 1988). The court of chancery permitted the plaintiffs to file a second amended complaint after the plaintiffs claimed that new material evidence had been uncovered during discovery proceedings in a related New York case. *Grobow*, No. 8759, slip op. at 2-3, *reprinted in* 16 DEL. J. CORP. L. at 314. The court agreed to consider only those claims based on the newly discovered evidence. *Id.*, slip op. at 13, *reprinted in* 16 DEL. J. CORP. L. at 320.

206. *Grobow*, No. 8759, slip op. at 1, *reprinted in* 16 DEL. J. CORP. L. at 313.

them about the status of various matters.[207] The court noted that "the GM Board (Perot excluded) consisted of 21 directors, of which 7 were 'inside,' and 14 were 'outside,' directors."[208] The court stated that "the GM Board would have been capable of impartially considering a demand" so long as a majority of the directors were independent.[209] The court concluded that the well-pleaded allegations of the second amended complaint were not sufficient to create a reasonable doubt as to whether a majority of the directors were independent, or were misled as to a material fact.[210] The reasoning behind the court's decision was that the legal theory that otherwise independent directors become "dominated" and "controlled" as a result of being deceived, even if conceptually valid, would implicate only two of GM's fourteen outside directors.[211]

The second allegation was that GM's "outside" directors, in approving the buyout, failed to exercise the requisite degree of care in failing to investigate the buyout before approving it and acting without the benefit of Perot's input.[212] The court noted that, to survive, the complaint must create a "reasonable doubt that the challenged transaction, viewed substantively, was the product of a valid exercise of directorial business judgment."[213] In making this inquiry, the court, instead of assuming the transaction wronged the corporation, presumed that the board properly exercised its business judgment.[214] The court found the plaintiffs' allegations insufficient "to draw into reasonable question the informed nature" of the board's decision or the materiality of any misinformation that at most adversely implicated only two directors.[215]

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207. *Id.*, slip op. at 13-14, 17, *reprinted in* 16 DEL. J. CORP. L. at 320, 322. Among the matters the outside directors were claimed to have been deceived about were the true reason for the buyout of Perot, the status of various disputes between GM and Perot, certain audits, pricing issues and executive compensation. *Id.*

208. *Id.*, slip op. at 17, *reprinted in* 16 DEL. J. CORP. L. at 322.

209. *Id.*, slip op. at 17-18, *reprinted in* 16 DEL. J. CORP. L. at 322.

210. *Id.*, slip op. at 18-19, *reprinted in* 16 DEL. J. CORP. L. at 322-23.

211. *Id.*, slip op. at 18, *reprinted in* 16 DEL. J. CORP. L. at 322. The court found that, even if the plaintiffs' theory was accepted, only 9 of GM's 21 directors could have lacked independence. *Id.* The court also noted that "the alleged deception concerns facts that, in this context, were not material." *Id.*

212. *Id.*, slip op. at 20, *reprinted in* 16 DEL. J. CORP. L. at 323.

213. *Id.*

214. *Id.*

215. *Id.*, slip op. at 21, *reprinted in* 16 DEL. J. CORP. L. at 324. The court found no allegations of particularized facts to support the claim that GM's Board could not have made a valid business judgment concerning the purchase of stock

In *Harris v. Carter*,[216] the court of chancery denied various motions to dismiss a shareholder's action which arose out of the allegedly negligent sale of Atlas Energy Corporation (Atlas) to a buyer who had allegedly looted the corporation.[217] The litigation arose from the negotiation and sale by a group of controlling stockholders (the Carter group) of a control block of Atlas stock to Frederic Mascolo.[218] The Carter group then resigned as directors of Atlas and Mascolo's designees were appointed as directors.[219] Mascolo and certain of his associates then allegedly "looted" Atlas.[220]

The plaintiff initially brought the action as a class action to "enjoin a (later abandoned) transaction that plaintiff alleged would constitute a breach of the directors' fiduciary duty; to rescind certain transactions effected by the Mascolo group; and, to collect damages from the Mascolo group."[221] After discovery, the plaintiff filed an amended complaint which sought to assert derivative claims on behalf of Atlas.[222] The amended complaint alleged that demand on the

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from Perot, who the court noted was the one GM director "clearly interested" in the buyout. *Id.*, slip op. at 22-23, *reprinted in* 16 DEL. J. CORP. L. at 324.

216. 582 A.2d 222 (Del. Ch. 1990).

217. *Id.* at 223. In addition to issues arising under Rule 23.1, the court also considered certain other "novel questions of Delaware law" raised by the defendants' motion to dismiss. *Id.* at 232. The court found that the most basic of the questions was "whether a controlling shareholder or group may under any circumstances owe a duty of care to the corporation in connection with the sale of a control block of stock." *Id.* After reviewing inconsistent decisions in other jurisdictions, the court concluded

> that while a person who transfers corporate control to another is surely not a surety for his buyer, when the circumstances would alert a reasonably prudent person to a risk that his buyer is dishonest or in some material respect not truthful, a duty devolves upon the seller to make such inquiry as a reasonably prudent person would make, and generally to exercise care so that others who will be affected by his actions should not be injured by wrongful conduct.

Id. at 233-35.

218. *Id.* at 223-25. The Carter group owned 52% of the stock of Atlas. *Id.* at 225. The Carter group and Mascolo entered into a stock exchange agreement dated March 28, 1986. *Id.* The agreement provided that the Carter group would exchange its Atlas stock for Mascolo's stock in Insuranshares of America (ISA). *Id.* The parties also agreed that the members of the Carter group would resign as Atlas directors as part of the transaction in a way that assured that Mascolo and his nominees were appointed as directors. *Id.* at 225-26.

219. *Id.* at 225-26.

220. *Id.* at 224.

221. *Id.*

222. *Id.* The first claim alleged against the Carter group in the amended complaint was that they breached a duty of care they owed to Atlas to take steps

board at the time the action was instituted would have been futile because all the board members were affiliated with the Mascolo group.[223] It also alleged that Mascolo had transferred his stock to a third party who engaged in a self-dealing transaction, but did not claim that the demand on the third-party controlled board would be futile.[224]

The defendants first moved to dismiss the amended complaint for failure to make a demand under Rule 23.1, alleging that demand was not futile and, therefore, not excused.[225] The court concluded that

> prior demand upon the board of Atlas was excused at the time the original pleading was filed; that that pleading raised, if it did not denominate as derivative, the claims now brought as derivative claims and that the later amendment to the complaint does not require the plaintiff to initiate the Rule 23.1 procedure, even if it were assumed that the Atlas board at the time of the filing of the amended complaint was capable of exercising a valid business judgment with respect to the question whether the corporation itself should assert these claims. This conclusion is fully consistent with the policy underlying Section 141(a) of our corporation law, for a number of options lie open to a disinterested board in such a circumstance.[226]

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to investigate Mascolo's good faith. *Id.* The plaintiff claimed that both the Carter and Mascolo groups participated in an act of corporate waste relating to a $100,000 payment made by Atlas after the change in control to a broker who acted for the Carter group in connection with its sale of the Atlas stock. *Id.* The plaintiff also claimed that the Mascolo defendants injured Atlas through a series of complex corporate transactions. *Id.*

223. *Id.* at 224-25.

224. *Id.* at 225. The complaint did not allege that this "self-dealing transaction" was unfair to Atlas. *Id.*

225. *Id.* at 227. The court found that the motion raised the question of whether the proper time to measure demand futility was when the original pleading was filed or later when the amended complaint first purported to state a derivative claim from the same facts. *Id.* at 228.

226. *Id.* at 228 (footnote and citation omitted). In reaching its conclusion, the court noted that the Supreme Court of Delaware had held, in Lipton v. News Int'l PLC, 514 A.2d 1075, 1078 (Del. 1986), that the nature of the pleading and not the pleader's characterization of the claims determines whether a claim is derivative or not. *Harris*, 582 A.2d at 229. The court recognized that the complaint could allege facts sufficient to excuse demand even if it contained no conclusory allegation

The court recognized that the new, third party board could affect the pending litigation by asking the court to allow the board

> to take control of the litigation by being re-aligned as a party plaintiff[, by moving] to dismiss the case as not, in the board's business judgment, in the corporation's best interest [or,] through a formal understanding or by simply failing to act, [by allowing] the representative plaintiff and his counsel to carry the litigation forward. These options fully protect the legitimate rights of the new board under section 141(a) to manage the corporation's business and affairs.
>
> Thus, when during the pendency of a derivative litigation there occurs a change in the composition of a board that had been disabled by conflict, and the board as newly constituted is capable of validly exercising judgment concerning that corporate claim, it has sufficient avenues open to it to meet its Section 141(a) responsibilities. There are good reasons not to go further and require that a derivative plaintiff interrupt litigation, when amending his pleading or otherwise, to make a demand upon such a newly constituted board.[227]

The court of chancery also made several other important rulings in derivative cases in 1990. In *Avacus Partners, L.P. v. Brian*,[228] the court held that a purchaser of stock becomes a stockholder of the corporation for purposes of instituting derivative litigation only upon the settlement of the trade.[229] The court also found that a claim that the board improperly acted to entrench itself by issuing stock that

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that demand was excused. *Id.* As to the Harris complaint, the court concluded:

> The circumstances alleged, in which the Mascolo group acquired its controlling interest on March 28, 1986, and immediately achieved board approval for a series of very complex transactions that are alleged to have been wasteful, and indeed fraudulent, itself is sufficient to raise a reasonable doubt that the challenged board decisions would qualify for the protection of the business judgment rule.

Id. The court also concluded that existence of an arguably independent board of directors at the time of the filing of the amended complaint was "relevant to a Rule 23.1 inquiry, but only with respect to derivative claims not already validly in litigation." *Id.* at 230.

227. *Harris*, 582 A.2d at 230-31 (footnote and citations omitted).

228. No. 11,001 (Del. Ch. Oct. 24, 1990), *reprinted in* 16 DEL. J. CORP. L. 1425 (1991).

229. *Id.*, slip op. at 11, *reprinted in* 16 DEL. J. CORP. L. at 1437.

impacted the stockholders' voting power was an individual claim where there was no allegation that the stock was issued for inadequate consideration.[230]

In *Cottle v. Standard Brands Paint Co.*,[231] the court found that the plaintiff's purported demand letter, which had been sent prior to the taking of the actions complained of and instructed the board to "[s]ue those responsible if the corporation takes actions contrary" to certain suggested actions, was deficient because it antedated the alleged wrongs and did not identify any act or omission that was allegedly wrongful.[232]

In *In re Radiology Associates, Inc. Litigation*,[233] the court found that "[t]iming a merger to eliminate a derivative suit is not . . . a *per se* breach of fiduciary duty" and that there was no credible evidence that elimination of the plaintiff's standing as a derivative plaintiff was specifically intended as the result of the merger.[234] The court noted, however, that "[i]t is troubling that our law would allow the elimination of a potentially meritorious action, even if such elimination was unintended by the party ultimately benefited."[235]

D. Duty of Candor Claims

The court of chancery also considered various claims that corporations and directors breached fiduciary duties of candor in connection with disclosure or non-disclosure of material corporate information.[236]

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230. *Id.*, slip op. at 13, *reprinted in* 16 DEL. J. CORP. L. at 1438-39.

231. Nos. 9342, 9405 & 9151 (Del. Ch. Mar. 22, 1990), *reprinted in* 16 DEL. J. CORP. L. 702 (1991).

232. *Id.*, slip op. at 16-18, *reprinted in* 16 DEL. J. CORP. L. at 716-17.

233. No. 9001 (Del. Ch. May 16, 1990).

234. *Id.*, slip op. at 22, 25.

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

236. The court of chancery issued some important disclosure rulings in cases not discussed in text below. In Glinert v. Wickes Cos., No. 10,407 (Del. Ch. Mar. 27, 1990), *reprinted in* 16 DEL. J. CORP. L. 764 (1991), *aff'd*, 586 A.2d 1201 (Del. 1990), the court held that "[w]arrant holders who have no role in approving [a] transaction have no right arising from fiduciary duties to demand disclosure, complete or otherwise." *Id.*, slip op. at 27, *reprinted in* 16 DEL. J. CORP. L. at 784.

In Raskin v. Birmingham Steel Corp., No. 11,365 (Del. Ch. Dec. 4, 1990), the court stated that "[i]f the board does not seek shareholder action . . . it has . . . no distinctive state law duty to disclose material developments with respect to the company's business. There are good business reasons to permit the company to treat material information confidentially." *Id.*, slip op. at 11.

In Highland Capital, Inc. v. Longview Fibre Co., No. 11,321 (Del. Ch. Jan. 22, 1990), *reprinted in* 16 DEL. J. CORP. L. 325 (1991), the court, in denying

In *Smith v. Shell Petroleum, Inc.*,[237] the court found, after trial, that Shell Petroleum, Inc. (Holdings) had breached its fiduciary duties to the stockholders of Shell Oil Company (Shell) when it, as the majority stockholder of Shell, cashed out Shell's minority stockholders in a short-form merger.[238] The court found that Holdings "did not adequately disclose to the minority stockholders of Shell Oil Company all the material facts a dissenting stockholder would reasonably need to make a fully informed decision whether or not to seek an appraisal."[239]

The plaintiffs' primary disclosure claim involved an error made by a Shell employee which resulted in an understatement in the disclosure materials of Shell's oil and gas reserves by approximately $1 billion in value, or $3.00-3.45 per share.[240] As a result of this error, the defendants disclosed that there had been a decline in the value of Shell's reserves when in fact there was an increase of over 5%.[241] The court found that this information would have been viewed

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a plaintiff's claim that certain proxy materials, if rearranged, would have altered the total mix of information available to the shareholders, stated that "[t]his is not to say that organization may not itself be pertinent in some instances in determining whether an obligation of candor has been satisfied" and that "matters of urgent importance or significance should have a prominent place in a proxy statement and should not be 'buried.'" *Id.*, slip op. at 9-10, *reprinted in* 16 DEL. J. CORP. L. at 332.

See also Herd v. Major Realty Corp., No. 10,707, slip op. at 21 n.2 (Del. Ch. Dec. 21, 1990) ("the duty of candor requires disclosure of all material facts only in connection with a transaction on which shareholders are asked to vote").

237. No. 8395 (Del. Ch. June 19, 1990), *reprinted in* 16 DEL. J. CORP. L. 870 (1991). In a subsequent proceeding, Smith v. Shell Petroleum, Inc., No. 8395 (Del. Ch. Nov. 26, 1990) (modified Jan. 2, 1991), the court awarded $2 per share to those stockholders who were sent defective disclosure materials and did not seek an appraisal. *Id.*, slip op. at 2.

238. *Smith*, No. 8395, slip op. at 2 (Del. Ch. June 19, 1990), *reprinted in* 16 DEL. J. CORP. L. at 874-75.

239. *Id.*, *reprinted in* 16 DEL. J. CORP. L. at 875. The court noted that "[t]he burden of establishing the fairness of the cash-out merger effectuated pursuant to [§ 253 of the Delaware Code] falls on the defendant, Holdings, because as the majority shareholder of Shell Oil, it controlled both sides of the transaction. Furthermore, Holdings also bears the burden of showing complete disclosure of all material facts relevant to a minority shareholders' [sic] decision whether to accept the short-form merger consideration or opt for an appraisal." *Id.*, slip op. at 30, *reprinted in* 16 DEL. J. CORP. L. at 890 (citations omitted). The court also stated that "[t]he standards applicable to disclosure materials distributed to shareholders in a going-private or freeze-out transaction are even greater than those applied to proxy statements in connection with a shareholder vote." *Id.*, slip op. at 31, *reprinted in* 16 DEL. J. CORP. L. at 891 (citations omitted).

240. *Id.*, slip op. at 34, *reprinted in* 16 DEL. J. CORP. L. at 892-93.

241. *Id.*, slip op. at 36, *reprinted in* 16 DEL. J. CORP. L. at 893-94.

by a reasonable investor as significantly altering the total mix of the information available and that the error was material.[242] The court also found that, although Holdings did not know of the error at the time it was published, "[l]iability for the error . . . turns not on whether Holdings knew about the error, but whether Holdings should have known about it," and that "Holdings' duty of complete candor included a responsibility to know the truth of the information it provided to the minority shareholders."[243]

The plaintiff also claimed that Holdings should have prepared and disclosed certain updates of previously disclosed evaluations.[244] The court concluded that the preparation of a prior evaluation alone "did not impose any duty on Holdings to disclose a similar updated evaluation," but that in light of the information Shell did produce, "it would have been better to have done so."[245] The court stated that the failure to include an updated analysis, standing alone, was not fatal to the defendants' position, but that it was "indicative of a conscious decision of the defendant to be less than candid."[246]

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242. *Id.*, slip op. at 41-42, *reprinted in* 16 DEL. J. CORP. L. at 896.

243. *Id.*, slip op. at 44-45, *reprinted in* 16 DEL. J. CORP. L. at 898.

244. *Id.*, slip op. at 46, *reprinted in* 16 DEL. J. CORP. L. at 898-99.

245. *Id.*, slip op. at 48-49, *reprinted in* 16 DEL. J. CORP. L. at 899-900. In Lewis v. Leaseway Transp. Corp., No. 8720 (Del. Ch. May 16, 1990), *reprinted in* 16 DEL. J. CORP. L. 815 (1991), the court noted that it was "not aware of a *per se* rule that . . . documents must be updated after a certain time" and that "[i]f there were such a rule, [it would not likely] include documents . . . that are only six months old." *Id.*, slip op. at 16, *reprinted in* 16 DEL. J. CORP. L. at 827.

246. *Smith*, No. 8395, slip op. at 49 (Del. Ch. June 19, 1990), *reprinted in* 16 DEL. J. CORP. L. at 900. The court also concluded that the minority stockholders should have been told that Morgan Stanley & Co., Inc. (Morgan Stanley), Holdings' investment banker, used different economic and financial assumptions than Shell had used in placing a value on Shell. *Id.*, slip op. at 51-57, *reprinted in* 16 DEL. J. CORP. L. at 901-04. The court rejected the plaintiffs' claims that Morgan Stanley deliberately skewed its valuation of Shell or that Morgan Stanley was unduly biased due to its fee arrangement with Holdings. *Id.*, slip op. at 60, *reprinted in* 16 DEL. J. CORP. L. at 906.

The plaintiffs also urged the court to specifically incorporate the requirements of Schedule 13E-3, Item 8, promulgated under S.E.C. Rule 13e-3(e), into Delaware's duty of candor by finding that Holdings should have published all of the factors considered by Morgan Stanley and the weightings attached by Morgan Stanley to those factors. *Id.*, slip op. at 60-61, *reprinted in* 16 DEL. J. CORP. L. at 906. The court stated that "[w]hile Delaware courts do apply the federal test of materiality in determining whether Delaware's duty of complete candor has been met, there is no Delaware precedent holding that the test of materiality incorporates the specific disclosure requirements of the statutorily based S.E.C. rules." *Id.*, slip op. at 61, *reprinted in* 16 DEL. J. CORP. L. at 906. The court added that

> the cornerstone of Delaware's duty of candor continues to be materiality, and therefore this Court must decline to specifically incorporate Schedule

In *Gaffin v. Teledyne, Inc.*,[247] the court of chancery found after trial "that defendant Teledyne, Inc. ('Teledyne') was guilty of equitable fraud in that it distributed a February 9, 1976 Tender Offer Circular that did not adequately disclose to its stockholders all the material facts a stockholder reasonably needed to make a fully informed decision whether or not to tender."[248] After considering all of the facts and circumstances, including that the disclosure omissions were of marginal significance and that rescissionary damages were inappropriate, the court awarded damages of $1 per share.[249]

The court found three materially misleading disclosures or omissions by Teledyne. First, the court found that Teledyne's February 1976 offer to purchase

> was slightly misleading when it stated that the [o]ffer was not open to Teledyne's officers and directors when, in fact, the [o]ffer was technically open to the two most senior officers and directors of Teledyne . . . because of their roles as members of the Administrative Committee in charge of Teledyne's Pension Plan Trust.[250]

The court also found that Teledyne's failure to state the purpose of the tender offer in its offer was a material omission.[251] In doing so, the court rejected Teledyne's defense that the purpose of the offer was obvious (and therefore did not need to be disclosed) as without merit because "there can be numerous reasons for such a self tender offer."[252] Finally, the court found that Teledyne did not adequately disclose all material financial information in a timely manner prior to the close of the offer.[253]

13E-3, Item 8 requirements into Delaware's duty of complete candor in the absence of a legislative directive to do so, although a disclosure in accordance with the S.E.C. rules would carry great weight with this Court. *Id.*, *reprinted in* 16 DEL. J. CORP. L. at 906-07.

247. No. 5786 (Del. Ch. Dec. 4, 1990).

248. *Id.*, slip op. at 2. The court first reviewed the elements of an action for equitable fraud, noting that "[i]n an action at equity for relief from fraud, there is no requirement that the defendant have known or believed its statement to be false or to have made the statement in reckless disregard of the truth." *Id.*, slip op. at 15-16. The court further stated that equity provides relief even from negligent or innocent misrepresentations. *Id.*

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

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

251. *Id.*, slip op. at 26.

252. *Id.*

253. *Id.*, slip op. at 28-35. Because Teledyne's offer to purchase failed to disclose any financial information, the issue before the court was whether Teledyne's

Duty of candor claims also arose in connection with attempts by stockholders to enjoin corporate control transactions. In *In re Genentech, Inc. Shareholders Litigation*,[254] the court of chancery denied a motion to preliminarily enjoin Genentech, Inc. (Genentech) and its officers and directors from allowing Genentech stockholders to vote on a transaction transferring control of the company from the public to Roche Holdings, Inc. (Roche) until disclosure of certain allegedly material information was made to the stockholders.[255] The plaintiffs' sole claim on their motion for preliminary injunction was that the defendants breached their duty of complete candor in connection with the proxy statement.[256] The court rejected disclosure claims relating to the value of consideration to be received by stockholders and held, in part, "that Genentech had no obligation to offer an opinion as to the post-transaction market price of the new, redeemable security" to be distributed in connection with the transaction and that "[f]orcing Genentech to make such a disclosure would be to compel pure speculation on its part, with the likely charge later that its disclosure was misleading."[257] In holding that the proxy statement need not explain to stockholders the concept of the time value of money, the court noted that "'[c]orporations are not required to address their stockholders as if they were children in kindergarten.'"[258]

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omissions were covered by prior, public disclosures of similar information by way of press releases and public filings or were instead covered by the distribution of Teledyne's 1975 annual report to stockholders just prior to the close of the offer. *Id.*, slip op. at 28-29. The court found that Teledyne "failed to establish that substantially all of its shareholders received [its] 1975 Annual Report before the close of the [o]ffer, or that those stockholders who received the report had adequate time to consider the information before deciding to tender or not." *Id.*, slip op. at 31. The court also rejected Teledyne's claim that certain public disclosures prior to the tender offer constituted a sufficient "total mix" of information available to stockholders. *Id.*, slip op. at 32-34.

254. No. 11,377 (Consolidated) (Del. Ch. June 6, 1990), *reprinted in* 16 DEL. J. CORP. L. 745 (1991).

255. *Id.*, slip op. at 1, 26, *reprinted in* 16 DEL. J. CORP. L. at 748, 763. Pursuant to the challenged transaction, Genentech was to continue to be a public company (with Roche as its 60% owner) whose stock was listed on the New York Stock Exchange and would have a 13-person board on which Roche would be limited to two representatives for five years. *Id.*, slip op. at 10, *reprinted in* 16 DEL. J. CORP. L. at 753. Upon consummation of the proposed transaction, Genentech's public stockholders would receive $18 in cash and a one-half share of a new Genentech redeemable common stock per share. *Id.*, slip op. at 9, *reprinted in* 16 DEL. J. CORP. L. at 753.

256. *Id.*, slip op. at 12, *reprinted in* 16 DEL. J. CORP. L. at 754-55.

257. *Id.*, slip op. at 15-16, *reprinted in* 16 DEL. J. CORP. L. at 756-57.

258. *Id.*, slip op. at 17, *reprinted in* 16 DEL. J. CORP. L. at 757 (quoting

The court also concluded that the plaintiffs' claim that the proxy statement failed to disclose material facts and analyses concerning the value of Genentech was without merit, noting that Delaware law does not require that analyses produced by financial advisors and given to the board must also be given to the stockholders if those analyses are not material.[259] The court noted that certain extreme "ranges of value," or long-term projections, that were not given serious consideration by the board or investment bankers and sales and revenue projections for each individual drug in Genentech's research pipeline were not material.[260] While disclosures of sales and revenue projections for each individual drug in Genentech's pipeline "might be of marginal benefit, they are more likely to cause a great deal of harm due to their highly speculative and uncertain nature."[261]

The court also concluded that the proxy statement adequately disclosed the limited nature of an investor's continued participation in Genentech's future prospects during the period in which the stock was redeemable.[262] Furthermore, the court held that the proxy statement need not disclose certain computations concerning the value to Roche of an option to acquire the 40% equity interest of Genentech retained by the public.[263]

Richland v. Crandall, 262 F. Supp. 538, 554 (S.D.N.Y. 1967)). In another case decided in 1990, the court stated that "[t]he duty of complete candor cannot possibly mean that companies are required to disclose not only all material existing facts but also the *absence* of all other relevant facts." *Cottle*, Nos. 9342, 9405 & 9151, slip op. at 13, *reprinted in* 16 DEL. J. CORP. L. at 714.

259. *In re Genentech, Inc. Shareholders Litig.*, No. 11,377, slip op. at 17-18, *reprinted in* 16 DEL. J. CORP. L. at 758.

260. *Id.*, slip op. at 18-19, *reprinted in* 16 DEL. J. CORP. L. at 758. The court noted that "[r]equiring such disclosure, of figures . . . of marginal value, would only serve to weaken the proxy statement." *Id.*, slip op. at 19, *reprinted in* 16 DEL. J. CORP. L. at 759.

261. *Id.*, slip op. at 21, *reprinted in* 16 DEL. J. CORP. L. at 760 (citing Flynn v. Bass Bros. Enters., 744 F.2d 978, 988 (3d Cir. 1984); Weinberger v. Rio Grande Indus., Inc., 519 A.2d 116, 129 (Del. Ch. 1986)). *See also* TCG Sec., Inc. v. Southern Union Co., No. 11,282 (Del. Ch. Jan. 31, 1990), *reprinted in* 16 DEL. J. CORP. L. 449 (1991) (noting that "[t]he simple fact of the matter is that a reasonable line has to be drawn or else disclosures in proxy solicitations will become so detailed and voluminous that they will no longer serve their purpose"). *Id.*, slip op. at 18, *reprinted in* 16 DEL. J. CORP. L. at 461. The court in TCG also rejected the plaintiff's request that the court adopt "a bright line test that would make all material disclosures contained in footnotes of proxy statements inadequate." *Id.*, slip op. at 15, *reprinted in* 16 DEL. J. CORP. L. at 459.

262. *In re Genentech, Inc. Shareholders Litig.*, No. 11,377, slip op. at 22, *reprinted in* 16 DEL. J. CORP. L. at 760.

263. *Id.*, slip op. at 24-26, *reprinted in* 16 DEL. J. CORP. L. at 762-63.

E. Annual Meetings of Stockholders

The court of chancery also made several important rulings relating to the holding of annual meetings of stockholders. In *Gintel v. XTRA Corp.*,[264] the court permitted a fifteen-day delay of the annual meeting of stockholders of XTRA Corporation (XTRA) to permit the incumbent board of directors to disseminate information concerning certain decisions it had made three days before the scheduled annual meeting.[265]

The plaintiffs, Robert Gintel and the XTRA Corporation Independent Stockholders Committee (Gintel), conducted a proxy contest to unseat the incumbent directors of XTRA.[266] One of the issues in the proxy contest was whether or not XTRA should be sold as Gintel suggested. On February 25, 1990, three days before the scheduled annual meeting, the incumbent directors determined that they would consider a possible sale of XTRA.[267] They also announced a thirty-day delay of the annual meeting which was purportedly designed for the dual purpose of enabling the board to disseminate news of its decision to stockholders and allowing the board time to effectuate such a transaction.[268]

In granting a fifteen-day postponement, the court drew important distinctions between the two reasons for the delay urged by the incumbent directors. The court stated:

> [D]rawing the distinction I do between legitimate interests of the shareholders in being informed and what I for the moment am willing to think of as the invalid attempt in these circumstances to continue in office long enough to effectuate a deal leads me to the conclusion that what is appropriate is a delay for so long as is necessary to be assured that the shareholders understand the circumstance that occurred [concerning the possible sale,] but not so long as is necessary to permit the incumbent board to negotiate a transaction.[269]

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264. Transcript of Argument on Plaintiffs' Motion for Preliminary Injunction, No. 11,422 (Del. Ch. Feb. 27, 1990).
265. *Id.* at 59-61.
266. *Id.* at 5-6.
267. *Id.* at 6.
268. *Id.* at 57.
269. *Id.* at 60-61.

In *Stahl v. Apple Bancorp, Inc.*,[270] the court of chancery refused to grant a preliminary mandatory injunction ordering the defendants to hold the annual meeting of stockholders of Apple Bancorp, Inc. (Bancorp) by a date requested by the plaintiff.[271] On March 19, 1990, Bancorp's Board fixed April 17, 1990 as the record date for the annual meeting.[272] While no date for the meeting was actually fixed, it was anticipated that it would be held in May 1990.[273] On March 28, 1990, the plaintiff, a holder of thirty percent of Bancorp's outstanding common stock, commenced a conditional tender offer to purchase any and all of Bancorp's outstanding common stock.[274] He also announced that he would commence a proxy contest at the annual meeting in support of a proposal to amend Bancorp's bylaws and elect a slate of directors.[275] Bancorp's Board then resolved to withdraw the April 17 record date to allow more time to pursue alternatives to Stahl's offer.[276]

The plaintiff argued that the board's action constituted "an impermissible manipulation of the corporate machinery having the effect of disenfranchising the company's stockholders and entrenching the incumbent directors."[277] He urged that the board's action could only be sustained if it established a "compelling justification" for the decision.[278]

The court began its analysis by reviewing whether or not it was appropriate to analyze the board's conduct using the fiduciary duty analysis employed in cases dealing with board action designed to

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270. 579 A.2d 1115 (Del. Ch. 1990).
271. *Id.* at 1117-18, 1125.
272. *Id.* at 1119.
273. *Id.*
274. *Id.* at 1117, 1119.
275. *Id.* at 1119.
276. *Id.* Bancorp had received advice from its advisors that the offer was inadequate and unfair from a financial point of view and that the board would likely lose the proxy contest if it did not present the stockholders with an economic alternative to the tender offer. *Id.* The directors then decided that "it is not in the best interest of the company and its stockholders to hold the annual meeting until the company has had a fair opportunity to explore and pursue alternatives to the [tender] offer which would enable the company to maximize stockholder value." *Id.* at 1119-20. Neither § 211 nor Bancorp's bylaws required an annual meeting to be held before September 1990. *Id.* at 1120; DEL. CODE ANN. tit. 8, § 211 (1990).
277. *Stahl*, 579 A.2d at 1120.
278. *Id.*

impact on the stockholder vote.[279] As stated by Chancellor Allen:

> [T]he fundamental question when the motion is evaluated under these cases may be expressed as whether the defendants have exercised corporate power inequitably. In answering that question, it is necessary to ask, in the context of this case, whether they have taken action for the purpose of impairing or impeding the effective exercise of the corporate franchise and, if they have, whether the special circumstances are present (compelling justification) warranting such an unusual step.
>
> In my opinion one employing this method of analysis need not inquire into the question of justification in this instance, for I cannot conclude that defendants have taken action for the primary purpose of impairing or impeding the effective exercise of the corporate franchise.
>
> . . . .
>
> . . . I place my opinion on the narrow ground that the action of deferring this company's annual meeting where no meeting date has yet been set and no proxies even solicited does not impair or impede the effective exercise of the franchise to any extent. . . . While the refusal to call a shareholder meeting when the board is not obligated to do so might under some imaginable circumstance breach a fiduciary duty, such a decision does not itself constitute an impairment of the exercise of the franchise that sparked the close judicial scrutiny of *Schnell*, *Blasius*, etc.[280]

While the court recognized that its "view may be criticized as placing undue emphasis on the formal act of fixing the date of the annual meeting," it noted that "that is an act of some dignity and significance."[281] The court concluded that "while postponement of a noticed meeting will in some circumstances constitute an inequitable manipulation, I can in no event see that the franchise process can be said to be sufficiently engaged before the fixing of this meeting date to give rise to that possibility."[282]

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279. *Id.* at 1121. *See, e.g.*, Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988); Aprahamian v. HBO & Co., 531 A.2d 1204 (Del. Ch. 1987).

280. *Stahl*, 579 A.2d at 1122-23.

281. *Id.* at 1123.

282. *Id.*

Since it did not view the board's decision to defer the annual meeting "as a decision that does threaten the legitimacy of the electoral process," the court concluded that the decision should be evaluated under the intermediate form of business judgment review identified in *Unocal*.[283] The court upheld the board's decision under *Unocal* after concluding that the board's response to the legitimately perceived threat was "extremely mild."[284] It noted, however:

> To delay a meeting once called would constitute a more substantial question of disproportionality. As one moves closer to a meeting date and closer to the announced conclusion of a contested election, attempts to postpone a meeting would likely require a greater and greater showing of threat in order to justify interfering with the conclusion of the election contest.[285]

In *Walsh v. Search Exploration, Inc.*,[286] the court of chancery considered the request of certain directors of a newly formed Delaware corporation that the court order an annual meeting of the corporation's stockholders at which the stockholders would choose the best course of action for the corporation to pursue through a contested election of directors.[287] While management of the corporation agreed that a meeting of stockholders should be called, it allegedly sought a delay until January 25, 1991 to permit it to collect and disseminate more information concerning the courses of action available to the corporation.[288] Management also argued that it was not currently in violation of section 211 of the Delaware Code, because it was not actually organized as a corporation until December 1989, when it acquired certain assets.[289]

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283. *Id.* at 1123-24.

284. *Id.* at 1124.

285. *Id.*

286. No. 11,673 (Del. Ch. Aug. 31, 1990), *reprinted in* 16 DEL. J. CORP. L. 1640 (1991).

287. *Id.*, slip op. at 1, *reprinted in* 16 DEL. J. CORP. L. at 1642.

288. *Id.*, slip op. at 3, *reprinted in* 16 DEL. J. CORP. L. at 1644.

289. *Id.* In another case decided in 1990, the court held that the plaintiffs who were no longer stockholders of a corporation had no standing under § 211 to compel the holding of an annual meeting. Silverstein v. David J. Stone & Co., No. 11,480 (Del. Ch. Oct. 17, 1990), *reprinted in* 16 DEL. J. CORP. L. 1569 (1991); DEL. CODE ANN. tit. 8, § 211 (1990). The court also considered a standing issue under § 211 in Walentas v. Builders Transp., Inc., No. 11,567 (Del. Ch. June 26, 1990). The *Walentas* court rejected the argument that a statutory claim for relief

The court rejected management's arguments and held that the requirement of section 211 commenced at the time of actual incorporation.[290] The court also rejected management's claim that the meeting should be delayed so that management could prepare audited financial statements in order to solicit proxies under SEC rules.[291] "While audited financial statements may be important and in some contexts crucial to shareholders, in the context of this contest for control, the need for audited financials is not such in my opinion, as would justify delaying the company's annual meeting an additional five months."[292] The court nevertheless concluded that some delay may be appropriate, ordering that an annual meeting be held no later than ninety days from September 3, 1990.[293]

F. Consent Solicitations

The court of chancery also considered a question relevant to the solicitation of consents under section 228 of the GCL in 1990.[294] In *Centaur Partners IV v. National Intergroup, Inc.*,[295] the court of chancery ruled on the validity of certain consents solicited pursuant to section 228 of the GCL. The plaintiff, Centaur Partners IV (Centaur), sought a declaration under section 225 that two proposed amendments to the bylaws of National Intergroup, Inc. (NII), which were the subject of a consent solicitation by plaintiff Centaur, "received valid and unrevoked consents of those who held a majority of the outstanding shares of NII as of the February 15 record date."[296]

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under § 211 could be filed before the expiration of the prescribed statutory periods where the corporation has "unequivocally determined" not to comply with the statutory deadline. *Id.*, slip op. at 7. The court noted, however, that "[i]n an appropriate case, such circumstances might conceivably give rise to a claim for injunctive or other equitable relief based upon common law fiduciary principles." *Id.* The court also rejected the argument that the right to compel an annual meeting where no meeting has been held for thirteen months arises only where "no date has been designated." *Id.*, slip op. at 5. The court recognized that "[t]hat result is sensible, for otherwise a board could 'designate' a meeting for a date many months beyond the thirteen month anniversary of the last meeting without any accountability to shareholders." *Id.*, slip op. at 6.

290. *Walsh*, No. 11,673, slip op. at 4-5, *reprinted in* 16 DEL. J. CORP. L. at 1644-45.

291. *Id.*, slip op. at 6-7, *reprinted in* 16 DEL. J. CORP. L. at 1645-46.

292. *Id.*, slip op. at 7, *reprinted in* 16 DEL. J. CORP. L. at 1646.

293. *Id.*, slip op. at 8, *reprinted in* 16 DEL. J. CORP. L. at 1646-47.

294. DEL. CODE ANN. tit. 8, § 228 (1990).

295. No. 11,572 (Del. Ch. July 5, 1990), *reprinted in* 16 DEL. J. CORP. L. 691 (1991), *aff'd*, 582 A.2d 923 (Del. 1990).

296. *Id.*, slip op. at 2, *reprinted in* 16 DEL. J. CORP. L. at 694.

The court found that Centaur was entitled under section 228 to deliver consents to NII until May 7 (sixty days after the date of the earliest dated consent) and that Centaur received and timely delivered consents representing votes of greater than 50.1% of the outstanding shares of NII.[297] The court rejected the argument that the plaintiff's repeated statements that it would cease the "solicitation" of consents as of a particular date meant that it would only receive and deliver to the inspectors consents which were solicited after that date.[298]

G. *Charter and Bylaw Amendments*

The court of chancery also considered the validity of certain charter and bylaw amendments in 1990. In *Stroud v. Grace*,[299] the court considered a motion for summary judgment which challenged certain recently adopted charter and bylaw amendments of Milliken & Company (Milliken). The only challenge deemed by the court to have merit was plaintiffs' objection to a bylaw provision providing a new method for nomination of directors.[300]

The court found that the traditional business judgment rule was the standard to be used in reviewing the acts of the Milliken directors of adopting the bylaw amendments and voting to propose the charter amendments.[301] The court found that, under the business judgment rule, the Milliken directors had not breached their fiduciary duties, because there was no evidence that the directors were not reasonably informed.[302] The court noted that the directors were not required to obtain expert financial advice regarding the effect of the amendments.[303] The court concluded, however, that because the charter and bylaw amendments affected the "shareholders' franchise, particularly their right to nominate directors, the validity of these amendments must be reviewed for their intrinsic fairness rather than considered pursuant to the business judgment rule."[304]

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297. *Id.*
298. *Id.*, slip op. at 10-14, *reprinted in* 16 DEL. J. CORP. L. at 699-701.
299. No. 10,719 (Del. Ch. Nov. 1, 1990) (revised Dec. 11, 1990), *reprinted in* 16 DEL. J. CORP. L. 1588 (1991).
300. *Id.*, slip op. at 2, *reprinted in* 16 DEL. J. CORP. L. at 1591.
301. *Id.*, slip op. at 19, *reprinted in* 16 DEL. J. CORP. L. at 1601.
302. *Id.*, slip op. at 20, *reprinted in* 16 DEL. J. CORP. L. at 1601.
303. *Id.* (citing Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985)).
304. *Id.*, slip op. at 21, *reprinted in* 16 DEL. J. CORP. L. at 1602.

Newly-adopted Article Eleventh of Milliken's charter provided that a majority of Milliken's directors had to be "individuals who have had substantial experience in line (as distinct from staff) positions in the management of substantial business enterprises or substantial private institutions, who are not officers, employees or stockholders, whether of record or beneficially, of the corporation or any of its subsidiaries."[305] Further, at least three directors had to be beneficial stockholders of Milliken, and no more than two directors could be individuals who were or had ever been Milliken's chief executive officer, chief operating officer, or president.[306] The court held that section 141 of the GCL expressly authorizes qualifications for directors; that a requirement that a majority of directors be non-stockholders was not unreasonable or unfair; and that a requirement that directors have "substantial" experience was not unreasonable or unfair, even though it was vague.[307]

The court also considered the validity of Milliken's charter provision which required a 75% stockholder vote to approve the issuance of any Milliken stock.[308] The court upheld the validity of the provision, concluding that section 102(b)(1)[309] authorizes any provision limiting and regulating the powers of directors, if such provision is not contrary to any other law.[310]

Lastly, the court considered the validity of Milliken's bylaw which required that stockholders give the board at least fourteen days notice of nominations, but did not require that the stockholders receive notice of the board's determination concerning the qualifications of the stockholders' nominees.[311] The court noted that, if a stockholder nominee is found to be unqualified at the meeting, the stockholder making the nomination would be precluded from nominating a substitute because of the fourteen-day notice of nomination requirement.[312] The court held that the bylaw was "unreasonable and unfair, on its face" since a "stockholder would have no mean-

305. *Id.*, slip op. at 6-7, *reprinted in* 16 DEL. J. CORP. L. at 1594.
306. *Id.*, slip op. at 7, *reprinted in* 16 DEL. J. CORP. L. at 1594.
307. *Id.*, slip op. at 23-26, *reprinted in* 16 DEL. J. CORP. L. at 1603-05.
308. *Id.*, slip op. at 27-28, *reprinted in* 16 DEL. J. CORP. L. at 1606.
309. DEL. CODE ANN. tit. 8, § 102(b)(1) (1990).
310. *Stroud*, No. 10,719, slip op. at 27-28, *reprinted in* 16 DEL. J. CORP. L. at 1606.
311. *Id.*, slip op. at 29-30, *reprinted in* 16 DEL. J. CORP. L. at 1606-07.
312. *Id.*, slip op. at 30, *reprinted in* 16 DEL. J. CORP. L. at 1607.

ingful opportunity to vote for an alternate nominee and therefore would be disenfranchised."[313]

III. THE 1990 AMENDMENTS TO THE GCL

The 1990 amendments to the GCL[314] made various important changes to sixteen sections of Delaware's corporation law. One of the most important changes was made to section 151(b), which was, in part, amended to permit the redemption of common and preferred stock so long as at least one class or series of stock with full voting powers is not redeemable.[315]

Several changes concerning the voting process were also made in the statute. Section 212 was amended in several important ways.[316]

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313. *Id.*, slip op. at 29, 31, *reprinted in* 16 DEL. J. CORP. L. at 1606-07, 1608.

314. *See* 67 Del. Laws ch. 376, §§ 1-30 (1990) (amending §§ 102, 104, 145, 151, 170, 212, 228, 231, 242, 251, 254, 256, 262, 280, 287 & 502).

315. DEL. CODE ANN. tit. 8, § 151(b) (1990). Legislative commentary to the 1990 amendment to § 151(b) provides:

> Subject to two provisions already present in the statute, this subsection has been amended to permit the redemption of common, as well as preferred, stock so long as at least one class or series of stock with full voting powers is not redeemable. The two provisos are (i) with respect to regulated investment companies and (ii) corporations which hold government licenses or franchises or are members of national securities exchanges. The former proviso has been amended to provide that stock may be made redeemable at the option of the corporation as well as at the option of the holder, and to delete as surplusage limitations already imposed by Section 160. The latter proviso has been amended to provide for the possibility that the license, franchise or membership is held indirectly, rather than directly by the corporation.

S.467, 135th Gen. Assembly, 2d Sess. synopsis (1990).

316. DEL. CODE ANN. tit. 8, § 212 (1990). Legislative commentary to the 1990 amendments to § 212 provides:

> The amendment to Section 212 adds to that section two new subsections and renumbers pre-existing subsection (c) as subsection (e). New subsection (c) provides several nonexclusive means for a stockholder to validly grant the power of a proxy to another person. That subsection specifically authorizes the creation of a proxy relationship by telegram, cablegram or other means of electronic transmission provided that the telegram, cablegram or electronic transmission either sets forth or is submitted with information from which it can be determined that the telegram, cablegram or other electronic transmission was authorized by the stockholder. Also, if such proxies are determined to be valid, the person making that determination must specify the information establishing the proper authorization of such proxies.
>
> New subsection (d) allows for the use of copies or reproductions of proxies for any purpose for which the original could be used provided that the entire proxy is reproduced. Included within this broad authorization is the use of "telecopied" proxies at meetings of the stockholders.

S.467, 135th Gen. Assembly, 2d Sess. synopsis (1990).

First, subsection (c) provides several means for a stockholder to grant the power of a proxy to another person. It specifically authorizes the creation of a proxy relationship by telegram, cablegram or other means of electronic transmission if the transmission sets forth or is submitted with information from which it can be determined that the transmission was authorized by the stockholder.[317] Further, subsection (d) allows for the use of, among other things, telecopied proxies provided that the entire proxy is reproduced.[318]

The 1990 amendments also added a new section 231 which contains certain provisions relating to voting procedures at meetings of stockholders of certain corporations.[319] New section 231 requires the appointment of inspectors of elections for stockholder meetings and specifies the duties of such inspectors, requires the announcement of the date and time for the opening and closing of the polls for each matter on which the stockholders will vote at the meeting, and

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317. DEL. CODE ANN. tit. 8, § 212(c) (1990).

318. *Id.* § 212(d).

319. *Id.* § 231. Legislative commentary to new § 231 provides:

> Section 231 is an entirely new section which sets forth certain provisions relating to voting procedures at meetings of the stockholders. The section is only applicable to corporations which are listed on a national securities exchange, authorized for quotation on an interdealer quotation system or which have shares held of record by more than 2,000 shareholders.
>
> Subsection (a) requires that the corporation appoint inspectors of election for each meeting of the shareholders, and subsection (b) specifies the duties of the inspectors. Subsection (c) requires the announcement at each stockholder meeting of the date and time for the opening and closing of the polls for each matter upon which the stockholders will vote at that meeting. After the polls are closed, the inspectors may not accept any new votes, ballots or proxies and may not accept any revocations or changes to any ballots, proxies or votes.
>
> Subsection (d) specifies the information the inspectors may consider in determining the validity and counting proxies and ballots. This subsection is intended to be a codification of pre-existing common law with two exceptions. One change from the pre-existing common law is that inspectors are permitted to examine "reliable information" other than the proxies, ballots and books and records of the corporation, but only for the limited purpose of reconciling bank and broker "over votes" *viz.*, proxies and ballots which represent more votes than the holder of the proxy is authorized by the record owner to cast or more votes than the stockholder holds of record. If the inspectors consider other reliable information for that limited purpose, the inspectors must specify the precise information considered by them. The second change is that the inspectors are permitted to consider information submitted with "telegraphic" or "electronic" proxies as authorized by Section 212(c)(2).

S.467, 135th Gen. Assembly, 2d Sess. synopsis (1990).

specifies the information the inspectors may consider in determining the validity and counting of proxies and ballots.[320]

The amendment to sections 242[321] and 251[322] would permit the board of directors of certain corporations to abandon a proposed amendment of the certificate of incorporation and a merger agreement, respectively, under certain circumstances.

Other amendments include those made to sections 102, 170, and 256 concerning nonstock corporations;[323] section 104 deleting its former reference to section 244;[324] section 145 clarifying that the expenses which a corporation may advance include attorneys' fees;[325] section 228 replacing the reference to "stockholders" with a reference to "members";[326] section 254 concerning a merger or consolidation of a domestic corporation and a joint stock or other association;[327] section 262 concerning appraisal notice requirements;[328] sections 280 and 281 concerning dissolved corporations;[329] and section 502 changing a reference to another section.[330]

IV. CONCLUSION

As the cases decided in 1990 demonstrate, the Delaware Court of Chancery continues as the preeminent trial court for the prompt and fair adjudication of corporate control cases and other corporate issues. No other trial court in the United States has the expertise in corporate law possessed by the Delaware Court of Chancery. Finally, as set forth above, Delaware's General Corporation Law was again amended in 1990 in several important respects, maintaining the statute's place as the most modern corporate statute in the country. The amendments to sections 151 and 212 and the addition of section 231 demonstrate Delaware's continuing commitment to respond promptly to the ever-changing requirements and needs of the corporate community.

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320. DEL. CODE ANN. tit. 8, § 231 (1990).
321. *Id.* § 242.
322. *Id.* § 251.
323. *Id.* §§ 102, 170 & 256.
324. *Id.* § 104.
325. *Id.* § 145.
326. *Id.* § 228.
327. *Id.* § 254.
328. *Id.* § 262.
329. *Id.* §§ 280, 281.
330. *Id.* § 502.