1991 DEVELOPMENTS IN DELAWARE CORPORATE LAW

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I. Introduction

In 1991, Delaware courts again made important rulings concerning corporate governance and other issues arising under the Delaware General Corporation Law (DGCL).[1] While the number of mergers and acquisitions contested in Delaware courts decreased in 1991, both the Delaware Supreme Court and the Delaware Court of Chancery issued decisions concerning corporate control and the fiduciary duties of directors and controlling stockholders. These decisions are important to corporate attorneys and to anyone involved in the management of a Delaware corporation.

Although summarization of the extensive body of Delaware corporate law and review of every Delaware corporate decision in 1991 are beyond the scope of this article, this article summarizes a wide range of the corporate issues addressed by the Delaware courts in 1991.

II. Cases Applying Delaware Corporate Law

A. *Derivative Suits and Compliance with Rule 23.1*

The Delaware Supreme Court again, in 1991, considered the procedural requirements for derivative suits. In *Levine v. Smith*,[2] a consideration on appeal of two separate cases, *Levine v. Smith*[3] and *Grobow v. Perot*,[4] the court considered the business judgment rule's application to actions of the board of directors of General Motors Corporation (GM) in connection with derivative suits challenging GM's buyout of stock from H. Ross Perot, a dissident director.[5]

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1. Del. Code Ann. tit. 8, §§ 101-398 (1983 & Supp. 1991).
2. 591 A.2d 194 (Del. 1991).
3. No. 8833 (Del. Ch. Feb. 4, 1987).
4. No. 8759 (Del. Ch. Dec. 4, 1986), *aff'd*, 539 A.2d 180 (Del. 1988).
5. *Levine*, 591 A.2d at 197-98.

These two appeals highlight the differing legal standards controlling stockholder standing to pursue derivative claims depending on whether the stockholder asserts a claim of demand futility or wrongful refusal of a demand made pursuant to Chancery Rule 23.1.[6] In the *Grobow* appeal, which involved a derivative claim based on futility of demand, the plaintiffs contended that their Second Amended Complaint pled particularized facts sufficient to excuse demand.[7] In the *Levine* appeal, the plaintiff contended that his Amended Complaint pled particularized facts sufficient to create a reasonable doubt that GM's directors wrongly refused Levine's presuit demand.[8]

Each of the derivative suits challenged GM's repurchase on December 1, 1986, from H. Ross Perot, at the time GM's largest stockholder, of all Perot's GM Class E stock and contingent notes as well as those of certain of his close associates.[9] All GM's directors, Perot and three of Perot's associates were named as defendants.[10]

In the *Grobow* appeal, the supreme court affirmed the court of chancery's holding that the plaintiffs' claims based on "newly discovered evidence" were insufficient to establish demand futility, requiring the dismissal of the Second Amended Complaint under Rule 23.1.[11] The newly discovered evidence was that GM's outside directors were misled about key provisions and consequences of the buyout and that the board's approval of the buyout was hasty and ill-informed.[12]

Rejecting plaintiffs' position, the supreme court reviewed the standards governing demand futility:

> In determining the sufficiency of a complaint to withstand dismissal under Rule 23.1 based on a claim of demand futility, the controlling legal standard is well established. The trial court is confronted with two related but distinct questions: (1) whether threshold presumptions of director

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

7. *Levine*, 591 A.2d at 197. The Delaware Supreme Court previously had affirmed the court of chancery's decision dismissing the plaintiffs' amended complaint in Grobow v. Perot, 539 A.2d 180 (Del. 1988).

8. *Levine*, 591 A.2d at 197-98.

9. *Id.* at 198.

10. *Id.* at 199.

11. *Id.* at 197, 201.

12. *Id.* at 201-02. "The newly discovered evidence consisted of the depositions of two of GM's outside directors obtained in May or June 1987 in a related New York action and a book published in early 1988 titled *Call Me Roger.*" *Id.* at 199.

> disinterest or independence are rebutted by well-pleaded facts; and, if not, (2) whether the complaint pleads particularized facts sufficient to create a reasonable doubt that the challenged transaction was the product of a valid exercise of business judgment.
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> The premise of a shareholder claim of futility of demand is that a majority of the board of directors either has a financial interest in the challenged transaction or lacks independence or otherwise failed to exercise due care. On either showing, it may be inferred that the [b]oard is *incapable* of exercising its power and authority to pursue the derivative claims directly. When lack of independence is charged, a plaintiff must show that the [b]oard is either dominated by an officer or director who is the proponent of the challenged transaction or that the [b]oard is so under his influence that its discretion is "sterilize[d]."
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> Assuming a plaintiff cannot prove that directors are interested or otherwise not capable of exercising independent business judgment, a plaintiff in a demand futility case must plead particularized facts creating a reasonable doubt as to the "soundness" of the challenged transaction sufficient to rebut the presumption that the business judgment rule attaches to the transaction. The point is that in a claim of demand futility, there are two alternative hurdles, either of which a derivative shareholder complainant must overcome to successfully withstand a Rule 23.1 motion.[13]

In the *Levine* appeal, the supreme court found that "[t]he reasons underlying the adoption in *Aronson v. Lewis*[14] of the 'reasonable doubt' test to a claim of demand futility have equal application to standing of a derivative plaintiff to maintain a claim of wrongful refusal of

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13. *Id.* at 205-06 (citations omitted).

14. 473 A.2d 805 (Del. 1984). In *Aronson*, the supreme court formulated the "reasonable doubt" pleading standard for determining the sufficiency of a complaint under Rule 23.1, where demand is claimed to be futile. There, the court stated that:

> In sum the entire review is factual in nature. The [c]ourt of [c]hancery in the exercise of its sound discretion must be satisfied that a plaintiff has alleged facts with particularity which, taken as true, support a reasonable doubt that the challenged transaction was the product of a valid exercise of business judgment. Only in that context is demand excused.

Id. at 815.

demand."[15] The court affirmed the chancery court's rejection of the plaintiff's assumption that a claim for wrongful refusal of demand is reviewed under a more lenient pleading standard than a claim based on demand futility.[16] The court also rejected the defendants' contention that a pleading standard more stringent than "reasonable doubt" was appropriate in considering alleged wrongful refusal of a demand.[17]

The court then reviewed the legal standards for determining the sufficiency of Levine's Amended Complaint:

> The focus of a complaint alleging wrongful refusal of demand is different from the focus of a complaint alleging demand futility. The legal issues are different; therefore, the legal standards applied to the complaints are necessarily different. A shareholder plaintiff, by making demand upon a board before filing suit, "tacitly concedes the independence of a majority of the board to respond. Therefore, when a board refuses a demand, the only issues to be examined are the good faith and reasonableness of its investigation."[18]

Applying that analysis, the court affirmed the court of chancery's finding that the refusal of plaintiff's demand was not wrongful.[19] The court noted in particular that the GM Board's decision to not let Levine make an oral presentation to it did not evidence a lack of due care or unreasonable conduct.[20]

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15. *Levine*, 591 A.2d at 210 (citations omitted).

16. *Id.* at 211. The supreme court also affirmed the court of chancery's grant of the defendants' motion for a protective order against discovery prior to the determination of the Rule 23.1 motion to dismiss. *Id.* at 208-10. The court noted that "[i]f discovery were permitted in demand refused cases, and not in demand excused cases other than in the *Zapata* situation, our careful distinctions between demand excused and demand refused would be upset by favoring the latter with limited discovery without first satisfying the pleading requirements of Rule 23.1." *Id.* at 210. *See* Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981).

17. *Levine*, 591 A.2d at 212.

18. *Id.* (quoting Spiegel v. Buntrock, 571 A.2d 767, 777 (Del. 1990)).

19. *Id.* at 212-15.

20. *Id.* at 214. The Delaware Court of Chancery also issued rulings in several cases in 1991 concerning compliance with Rule 23.1. *See, e.g.*, Heineman v. Datapoint Corp., [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,529, at 92,428 (Del. Ch. Dec. 23, 1991), *reprinted in* 17 DEL. J. CORP. L. 1196 (1992) (in dismissing derivative suit for failure to make demand, the court, per Vice-Chancellor Hartnett, noted that "[o]ne of the purposes of Rule 23.1 is to discourage so-called 'strike suits' where a business judgment of the directors, in hindsight, appears unwise"); Kells-Murphy v. McNiff, No. 11,609, 1991 Del. Ch. LEXIS 127 (Del.

B. *Fiduciary Duties Arising out of a Sale of the Company*

While there were fewer litigated mergers and acquisitions in the Delaware Court of Chancery in 1991, several important decisions were issued. In *Cinerama, Inc. v. Technicolor, Inc.*,[21] the court of chancery, per Chancellor Allen, after a forty-seven-day trial found for the defendants[22] in an action seeking to impose personal liability upon the directors of Technicolor, Inc. (Technicolor) for alleged breach of their duty to exercise directorial power with care and in the best interests of the corporation and its stockholders.[23] The litigation arose out of a third-party, two-step acquisition of all of Technicolor's stock by a subsidiary of MacAndrews & Forbes, Inc. (MAF) for $23 per share in cash.[24]

The plaintiff, Cinerama, Inc. (Cinerama), was the beneficial owner of 4.4% of Technicolor.[25] Cinerama did not tender into the first step of the acquisition transaction and dissented from the second-step merger, seeking a judicial appraisal.[26]

Addressing a variety of care, loyalty, and disclosure claims, the chancery court held that there was insufficient evidence to support a claim that Technicolor's Board failed to act independently with respect to its decision to enter into the MAF merger agreement and

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Ch. July 12, 1991), *reprinted in* 17 DEL. J. CORP. L. 632 (1992) (finding that no demand was required on directors where plaintiff's allegations concerning two prior transactions approved by the company's board raised a reasonable doubt as to the willingness of the company's directors to act independently of the company's chairman in connection with the challenged transaction); Mount Moriah Cemetery v. Moritz, [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,900, at 99,400 (Del. Ch. Apr. 4, 1991), *aff'd*, 599 A.2d 413 (Del. 1991) (dismissal of derivative suit and rejection of a claim challenging the adequacy of an investigation conducted by a special committee of directors appointed to investigate a demand); Strougo v. Carroll, [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,815, at 98,914 (Del. Ch. Jan. 29, 1991), *reprinted in* 17 DEL. J. CORP. L. 352 (1992) (demand futility held to have been adequately pleaded where a majority of company's directors were allegedly connected with claims of insider trading).

21. No. 8358, 1991 Del. Ch. LEXIS 105 (Del. Ch. June 21, 1991) (revised June 24, 1991), *reprinted in* 17 DEL. J. CORP. L. 551 (1992).

22. *Id.* at *6, *reprinted in* 17 DEL. J. CORP. L. at 559.

23. *Id.* at *1, *reprinted in* 17 DEL. J. CORP. L. at 556-57.

24. *Id.* at *1-2, *reprinted in* 17 DEL. J. CORP. L. at 557. The court noted that Technicolor's stock had traded at a price of between $9.00-$11.50 per share in the weeks preceding the emergence of MAF as a party interested in acquiring Technicolor. *Id.*

25. *Id.* at *2.

26. *Id.* The court of chancery's decision in the appraisal action was issued on October 19, 1990.

to endorse the tender offer and merger contemplated by that agreement.[27] The court also concluded that the directors acted in good faith with respect to the merger agreement and the transactions it contemplated.[28] Further, the court found that a majority of the directors were motivated to promote the best interests of the stockholders.[29]

With respect to the level of care taken, the court concluded that the plaintiff's claim that the board was insufficiently informed was a "close question."[30] This was due to several factors. First, no *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[31] auction had been performed.[32] Second, the board did not negotiate an "effective post-agreement 'market check' mechanism."[33] Finally, the board was "hurried and ill-advised."[34] However, the court stated that questions of due care need not be addressed for, "even if a lapse of care is assumed, plaintiff is not entitled to a judgment on this record [because] in this situation, where there is no self-dealing or other breach of loyalty, it is plaintiff's burden to establish by evidence that it was injured as a result of the board's action."[35]

The court also ruled that MAF had no duty, under certain circumstances, to pay any price in the January merger other than the $23 price it had negotiated at arm's-length.[36] Relevant factors included: (1) negotiation by the controlling stockholder of the terms of the transaction at a time when it had no interest in Technicolor and acted, and was seen by all as acting, as a third party;[37] (2) completion of the second-step merger within the Technicolor Board's

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27. *Id.* at *6-7, *reprinted in* 17 DEL. J. CORP. L. at 559. Moreover, the court stated that a review of the credible evidence persuaded it not only that the board as a whole had no such disability, but that only one member of the board had a material financial interest conflicting with that of the corporation's stockholders. *Id.* at *7, *reprinted in* 17 DEL. J. CORP. L. at 559.

28. *Id.* at *7-8, *reprinted in* 17 DEL. J. CORP. L. at 559.

29. *Id.* at *8, *reprinted in* 17 DEL. J. CORP. L. at 559.

30. *Id.*

31. 506 A.2d 173 (Del. 1986).

32. *Id.*

33. *Id.*

34. *Id.*

35. *Id.* at *9, *reprinted in* 17 DEL. J. CORP. L. at 560. *See also id.* at *52-58, *reprinted in* 17 DEL. J. CORP. L. at 580-84 (stating that plaintiff bears the burden of establishing not only what the injury was, but that the injury was proximately caused by the breach of the duty of care).

36. *Id.* at *10, *reprinted in* 17 DEL. J. CORP. L. at 560.

37. *Id.*

anticipated transaction negotiation time-frame; and (3) no material changes in Technicolor's underlying value "during the intervening three months."[38] The court stated that "where these three factors are present a person who arguably assumes the mantel [sic] of a fiduciary towards minority shareholders by closing the first step of a negotiated two-step transaction does not violate a fiduciary duty by exercising rights acquired under the merger agreement."[39]

The court of chancery also considered breach of fiduciary duty claims arising out of a merger in *Van de Walle v. Unimation, Inc.*[40] In this case, a class action challenged a February 15, 1983, merger between Unimation, Inc. (Unimation) and a wholly owned subsidiary of Westinghouse Corporation (Westinghouse).[41] The directors of Unimation at the time of the merger, Unimation and Condec Corporation (Condec), were all named as defendants.[42] In the merger, Westinghouse acquired all of the outstanding common stock of Unimation for $21 per share.[43] Prior to the merger, Condec owned 78.4% of Unimation's common stock.[44] The plaintiff, a class composed of all the public common shareholders of Unimation, alleged that the terms of the merger were unfair because the defendants did not make an informed decision in negotiating and approving the merger terms, and the proxy statement concerning the merger omitted material facts.[45] The plaintiff further argued that the merger was timed to occur under unfavorable circumstances (in this case, a recession), and without procedural safeguards, such as independent bargaining representatives or a "majority of the minority" veto power, which were needed to protect the minority stockholders.[46]

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38. *Id.*

39. *Id.* at *10, *reprinted in* 17 DEL. J. CORP. L. at 560-61 (footnote and citation omitted).

40. [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,834, at 99,023 (Del. Ch. Mar. 6, 1991), *reprinted in* 17 DEL. J. CORP. L. 390 (1992).

41. *Id.* at 99,024, *reprinted in* 17 DEL. J. CORP. L. at 393. The day before, on February 14, 1983, the court of chancery denied the plaintiff's motion to preliminarily enjoin the merger. Van de Walle v. Unimation, Inc., No. 7046 (Del. Ch. Feb. 14, 1983) (order denying preliminary injunction), *reprinted in* 8 DEL. J. CORP. L. 418 (1983).

42. *Van de Walle*, [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 99,024, *reprinted in* 17 DEL. J. CORP. L. at 393.

43. *Id.*

44. *Id.* The remaining 21.6% of the stock was publicly held. *Id.*

45. *Id.*

46. *Id.* at 99,029, *reprinted in* 17 DEL. J. CORP. L. at 404.

Addressing the appropriate standard of liability, the court rejected the plaintiff's argument for a standard of complete fairness noting that:

> [t]he rationale for employing the intrinsic fairness standard is that where corporate fiduciaries, because of a conflict, are disabled from safeguarding the interests of the stockholders to whom they owe a duty, the [c]ourt will furnish compensatory procedural safeguards by imposing upon the fiduciaries an exacting burden of establishing the utmost propriety and fairness of their actions.[47]

The court determined that the business judgment rule was the appropriate standard for evaluating the plaintiff's claims "[b]ecause in substance and in form the merger was a *bona fide* arm's-length transaction negotiated with a third party . . . ."[48] Despite that determination, the court decided to review the transaction under the more stringent entire fairness test. The court justified using the entire fairness test by stating that "a determination of the merits ought not to turn upon the standard of review or burden of proof, except where that standard or burden is truly outcome determinative."[49]

The court concluded that the defendants had dealt fairly with the minority stockholders.[50] It recognized that Condec, as a fiduciary, "was not free to time the transaction so as to financially injure the minority and correspondingly benefit itself,"[51] but found no evidence that Condec had received value at the minority's expense, or that the minority had been financially injured as a result of the merger

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47. *Id.* at 99,030-31, *reprinted in* 17 DEL. J. CORP. L. at 407 (citation omitted). The court recognized that the entire fairness standard is "normally applied in parent-subsidiary mergers and other situations where the fiduciary stands on both sides of the transaction and derives a benefit to the exclusion of and detriment to the stockholders." *Id.* at 99,030, *reprinted in* 17 DEL. J. CORP. L. at 405. Under that standard, the defendants have the burden of establishing that a merger was entirely fair to the minority. *Id.* (citing Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983); Sterling v. Mayflower Hotel Corp., 93 A.2d 107, 109-10 (Del. 1952)).

48. *Id.* at 99,031 (emphasis added), *reprinted in* 17 DEL. J. CORP. L. at 408.

49. *Id.*

50. *Id.* The court went on to state, "In this case it does not matter what standard is applied, because even if measured by the exacting standard of entire fairness, the challenged merger easily passes muster." *Id.*

51. *Id.* (citing Jedwab v. MGM Grand Hotels, Inc., 509 A.2d 584, 599 (Del. Ch. 1986)).

as timed.[52] While Condec had entered into certain side agreements with Westinghouse (including a share purchase agreement) to which the minority were not parties, the agreements "had a valid business rationale and they required Condec to assume financial obligations to which the minority were not subjected."[53] The court also held that the Unimation directors had "no disabling conflict"[54] and were "fully informed and knowledgeable,"[55] and that the absence of a "majority of the minority" stockholder vote requirement did not result in unfair treatment of the minority stockholders.[56]

As to the fairness of the price, the court stated that "[t]he most persuasive evidence of the fairness of the $21 per share merger price is that it was the result of arm's-length negotiations between two independent parties, where the seller (Condec and Unimation) was motivated to seek the highest available price, and a diligent and extensive canvass of the market had confirmed that no better price was available."[57] The court also stated that "[t]he fact that a transaction price was forged in the crucible of objective market reality (as distinguished from the unavoidably subjective thought process of a valuation expert) is viewed as strong evidence that the price is fair."[58]

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52. *Id.* Although the court found that minority stockholders received payment for their shares two to three weeks after Condec received its payment, the court concluded that "this *de minimis* departure" from the standard that all shareholders be treated equally did not amount to an actionable breach of fiduciary duty. *Id.* at 99,032, *reprinted in* 17 DEL. J. CORP. L. at 411.

53. *Id.* Condec was required to make various representations and warranties and entered into a series of ancillary agreements pursuant to which it undertook certain obligations. These were not required of Unimation's public stockholders. *Id.* at 99,028, *reprinted in* 17 DEL. J. CORP. L. at 401. The various agreements are described on page 99,028 of the court's opinion, as reported in the Federal Securities Law Reports.

54. *Id.* at 99,032, *reprinted in* 17 DEL. J. CORP. L. at 411.

55. *Id.* at 99,033, *reprinted in* 17 DEL. J. CORP. L. at 412.

56. *Id.*, *reprinted in* 17 DEL. J. CORP. L. at 413. The court noted that while the presence of such a veto power "typically constitutes an indicium of fairness," its absence does not of itself indicate a breach of fiduciary duty. *Id.* In any event, the court noted that an approval by a majority of the minority had been obtained under one formulation, because the approval of a majority of the minority shares actually voted, rather than of those entitled to vote, had been obtained. *Id.* Such a formulation of the majority of the minority veto power was employed in Citron v. E.I. DuPont de Nemours & Co., 584 A.2d 490, 493 (Del. Ch. 1990).

57. *Van de Walle*, [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 99,035, *reprinted in* 17 DEL. J. CORP. L. at 417.

58. *Id.* The court also found that none of the higher valuations proposed by the plaintiff were "credible or worthy of acceptance, nor do they otherwise provide

The Delaware Court of Chancery also considered challenges to director decisions arising from an acquisition in *Yanow v. Scientific Leasing, Inc.*[59] In *Yanow*, the court granted motions for summary judgment and to dismiss in an action relating to an acquisition agreement by which LINC Acquisition Corporation, a subsidiary of LINC Group, Inc. (LINC), acquired Scientific Leasing, Inc. (SLI).[60] The plaintiffs alleged that the SLI directors, aided and abetted by LINC and SLI, had violated their fiduciary duties to SLI stockholders.[61] The primary issue in dispute was the method by which SLI's directors elicited bids from potential purchasers.[62]

The court first noted that Delaware law clearly establishes that once a board of directors decides to sell a corporation, its responsibility is to obtain "the highest value reasonably attainable for the stockholders."[63] The court, applying the enhanced *Unocal* standard to the challenged conduct of SLI's directors,[64] stated, "[W]here, as here, issues of corporate control are at stake, the actions of even a disinterested board must satisfy an enhanced' level of scrutiny before they will qualify for the deference that courts ordinarily accord to good[ ]faith business judgments."[65]

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a basis to call into question the fairness of the merger price." *Id.* at 99,040, *reprinted in* 17 DEL. J. CORP. L. at 477.

59. [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,189, at 91,005 (Del. Ch. July 31, 1991), *reprinted in* 17 DEL. J. CORP. L. 659 (1992).

60. *Id.* at 91,006, *reprinted in* 17 DEL. J. CORP. L. at 665.

61. *Id.* Of particular concern was whether or not SLI's Board properly discharged their responsibility to get the highest value attainable for the holdings of their stockholders after determining to sell the corporation. *Id.* at 91,010, *reprinted in* 17 DEL. J. CORP. L. at 673.

62. *Id.* at 91,009, *reprinted in* 17 DEL. J. CORP. L. at 672.

63. *Id.* at 91,010, *reprinted in* 17 DEL. J. CORP. L. at 673 (citing Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1288 (Del. 1988); *Revlon*, 506 A.2d at 182).

64. *Id.* at 91,011, *reprinted in* 17 DEL. J. CORP. L. at 676. Under Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985), 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 that the challenged action is "reasonable in relation to the threat posed." *Id.* at 955.

65. *Yanow*, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 91,011, *reprinted in* 17 DEL. J. CORP. L. at 675. The court held that it would not apply the "entire fairness" standard of review in assessing the plaintiff's claims concerning the acquisition since at least five of SLI's seven directors were disinterested in the transaction and there was no evidence of a special "side deal" on the part of the largest stockholder of SLI which would cause its designees to become interested. *Id.* at 91,010, *reprinted in* 17 DEL. J. CORP. L. at 675.

The *Unocal* standard requires a court to determine whether there was disparate treatment of bidders and, if so, "whether the board properly perceived that stockholder interests were enhanced by such treatment."[66] If this is the case, the court must then determine "whether the board's action was reasonable in relation to the advantage it sought to achieve."[67] In *Yanow*, although there was only one actual bidder (LINC), the court concluded that there was evidence of disparate treatment. SLI and its directors failed to invite a potential bidder (Mediq) to bid, and subsequently entered into an acquisition agreement that precluded SLI from dealing with Mediq or any other potential bidder unless they had first made a firm offer for a higher price (the window shop clause).[68]

In examining the justification for such disparate treatment, the court decided that the directors "properly perceived that the shareholders' interests would be enhanced by not approaching potential bidders directly or by publicly announcing that SLI was for sale,"[69] because they "reasonably concluded that SLI's realizable value in a sale would be diminished if SLI's availability for sale were publicly disclosed."[70] The court also concluded that the disparate treatment was reasonable in relation to the advantage sought to be achieved because the "board's course of action was carefully designed to elicit the highest available bid, while at the same time avoiding the risks of public disclosure."[71] Moreover, the court held that the window shop clause did not operate as a "lock-up" since the agreement had "fiduciary-out" procedures that expressly permitted a higher bid and created a fiduciary obligation to entertain those offers.[72]

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66. *Id.* at 91,011, *reprinted in* 17 DEL. J. CORP. L. at 676.

67. *Id.*

68. *Id.*, *reprinted in* 17 DEL. J. CORP. L. at 677.

69. *Id.* at 91,012, *reprinted in* 17 DEL. J. CORP. L. at 678.

70. *Id.* at 91,011, *reprinted in* 17 DEL. J. CORP. L. at 677.

71. *Id.* at 91,012, *reprinted in* 17 DEL. J. CORP. L. at 678. The court specifically noted the board's concern that in a service business such as SLI's, key employees could be raided by, or might defect to, competitors. *Id.* at 91,011, *reprinted in* 17 DEL. J. CORP. L. at 677. The court also found that the record did not support any suggestion of improper or self-interested motives on the part of the directors in not contacting a potential bidder directly. *Id.* at 91,012, *reprinted in* 17 DEL. J. CORP. L. at 678. Nor was any public announcement or direct contact of potential acquirors necessary since it was already known in the industry that SLI might be for sale. *Id.*

72. *Id.* at 91,012, *reprinted in* 17 DEL. J. CORP. L. at 679. The court also rejected the aiding and abetting charge against LINC and SLI, arising out of an allegation that LINC threatened a rival bidder with a "Pennzoil/Texaco-type"

The court of chancery also considered issues arising out of a majority stockholder's acquisition of the minority shares it did not already own.[73] In *Kumar v. Racing Corp. of America, Inc.*,[74] the court considered a request to continue injunctive relief barring a cash-out merger of Racing Corporation of America, Inc. (RCA) by its majority stockholder, TVI Corporation (TVI).[75] The plaintiffs, one of whom being RCA director Roger Kumar (Kumar), had obtained a prior temporary restraining order that enjoined the defendants from taking any further steps to effectuate the merger.[76]

Certain members of the Veale family owned defendant TVI, which, in turn, owned 62% of RCA's stock prior to the merger.[77] The plaintiffs had entered into a stockholders agreement with RCA and TVI, among others (the Agreement).[78] The Agreement gave the plaintiffs the right to put to TVI and another company for $2.50 per share the RCA common stock they received on conversion of the RCA preferred stock.[79] As RCA's condition worsened over time, Kumar notified the defendants in February 1991 of his election to convert some of his preferred shares and to put the maximum number of shares allowable under the Agreement.[80]

On March 29, 1991, a "notice of meeting" was mailed to Kumar announcing the scheduling of a board meeting for April 2, 1991.[81] While the notice sent to Kumar included no agenda, all of RCA's other directors were sent documents relating to the proposed merger.[82] The merger was approved by the directors present at the meeting, over Kumar's objection, and approved by written consent of RCA's stockholders.[83]

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litigation. Those claims failed since no underlying breach of a fiduciary relationship by SLI's directors had been established. *Id.* at 91,013, *reprinted in* 17 DEL. J. CORP. L. at 681.

73. In addition to the cases discussed in text below, see *In re* Ocean Drilling & Exploration Co. Shareholders Litig., [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,898, at 99,431 (Del. Ch. Apr. 30, 1991), *reprinted in* 17 DEL. J. CORP. L. 326 (1992).

74. [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,896, at 99,419 (Del. Ch. Apr. 26, 1991), *reprinted in* 17 DEL. J. CORP. L. 274 (1992).

75. *Id.* at 99,420, *reprinted in* 17 DEL. J. CORP. L. at 277.

76. *Id.*

77. *Id.*

78. *Id.*, *reprinted in* 17 DEL. J. CORP. L. at 278.

79. *Id.* at 99,421, *reprinted in* 17 DEL. J. CORP. L. at 279.

80. *Id.*, *reprinted in* 17 DEL. J. CORP. L. at 280.

81. *Id.* at 99,422, *reprinted in* 17 DEL. J. CORP. L. at 281.

82. *Id.*

83. *Id.*, *reprinted in* 17 DEL. J. CORP. L. at 282.

The court found "no question" that the "rigorous standards" of entire fairness applied to the merger because the "defendant directors stood on both sides of the transaction, fixed its terms and caused it to be effectuated,"[84] and that the plaintiffs had established a reasonable likelihood of success on the merits of their entire fairness claims.[85] The court also found that the timing of the merger injured the plaintiffs and provided a corresponding benefit to TVI and to the Veale directors.[86]

Further, the court also found that the structure, negotiation, and disclosure of the merger indicated unfair dealing.[87] The court noted that "[a]lthough the procedures followed in the merger of a small corporation may not normally be as elaborate as those followed by larger companies, fair dealing is still required."[88] The court also found that there appeared to have been no effort to negotiate with anyone on behalf of either the public minority stockholders or the plaintiffs. According to the court, the plaintiffs appeared to have been deliberately kept in the dark.[89] Additionally, the court found that the merger price "may also be less than fair."[90]

Finally, the court found that the plaintiffs were likely to prevail on their claim that the defendants breached their duty of care in connection with the decision-making process of the merger.[91] The court rejected the defendants' contention that since the Veale family directors had discussed the proposed merger, and had given it some thought prior to the board meeting, it did not matter that Kumar was left out of the "deliberations."[92] The court stated that "[t]he board of directors, as a whole, must be informed."[93]

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84. *Id.*

85. *Id.* at 99,423, *reprinted in* 17 DEL. J. CORP. L. at 283.

86. *Id.* The court noted that "[t]he timing of a merger constitutes unfair dealing when: (1) the minority stockholders are financially injured by the timing and (2) the controlling stockholder gains from the timing of the transaction what the minority lost." *Id.* (citing *Jedwab*, 509 A.2d at 599; Rabkin v. Philip A. Hunt Chem. Corp., 498 A.2d 1099, 1105-07 (Del. 1985) (holding that it is a breach of fiduciary duty to deliberately time a merger to avoid a contractual obligation to the minority)).

87. *Id.*

88. *Id.*

89. *Id.*

90. *Id.*, *reprinted in* 17 DEL. J. CORP. L. at 284.

91. *Id.*

92. *Id.*

93. *Id.* Given the "fundamental breaches of fiduciary duty," the court granted injunctive relief notwithstanding the plaintiffs' limited showing of irreparable harm.

In *Wiegand v. Berry Petroleum Co.*,[94] the court of chancery considered cross-motions for summary judgment in an action brought on behalf of the former stockholders of Norris Oil Company (Norris) against Berry Petroleum Company (Berry).[95] The plaintiff alleged that Berry, which owned 80.6% of Norris' common shares, breached its fiduciary duties to the plaintiff stockholder class in connection with the merger of Norris into a subsidiary of Berry.[96]

Since the parties agreed that the entire fairness standard governed review of all the plaintiff's claims other than those relating to disclosure, the court considered whether summary judgment on the question of the entire fairness of the merger was appropriate for either the plaintiff or the defendant based on the existing record.[97] The plaintiff advanced two arguments as to unfair dealing. First, the plaintiff argued that unfair dealing was established because Berry provided no procedural protections (such as independent negotiators, legal and financial advisors or a majority of the minority veto) to the Norris minority stockholders in connection with the merger.[98] The court found that those facts "constitute[d] evidence of unfair dealing as a matter of law."[99]

Second, the plaintiff argued that Berry unfairly timed the merger in relation to the joint venture development of one of its major assets, with the result that its inherent value was not realized or fully credited in determining the merger exchange ratio.[100] The court found that "[i]f such improper timing is found to have occurred and benefitted the fiduciary (Berry) at the expense of the minority shareholders, that circumstance may establish unfair dealing."[101] The court

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Id. at 99,425, *reprinted in* 17 DEL. J. CORP. L. at 287. The court refused, however, to order the defendants to include Kumar as a continuing member of RCA's Board of Directors. *Id.*, *reprinted in* 17 DEL. J. CORP. L. at 289. Analogizing to the relief afforded in cases under Delaware Code Annotated title 7, § 225 of the Delaware General Corporation Law, the court provided that arrangements should be made so that Kumar received notice from RCA's Board of any act proposed to be taken out of the ordinary course of business.

94. No. 9316, 1991 Del. Ch. LEXIS 37 (Del. Ch. Mar. 27, 1991).

95. *Id.* at *1.

96. *Id.*

97. *Id.* at *18.

98. *Id.* at *21.

99. *Id.* (citing Sealy Mattress Co. of N.J., Inc. v. Sealy, Inc., 532 A.2d 1324, 1336 (Del. Ch. 1987); *Jedwab*, 509 A.2d at 599).

100. *Id.* at *22.

101. *Id.*

refused to grant summary judgment, however, since disputes of fact existed.[102]

C. *General Fiduciary Duties Owed to Stockholders by Directors in Other Contexts*

In a decision after trial in *Blackwell v. Nixon*,[103] the court of chancery found that the defendant directors of E.C. Barton & Company (Barton) had breached their fiduciary duties to the plaintiffs by distributing Barton's profits through employee benefits rather

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102. *Id.* at *28. The defendant claimed entitlement to summary judgment on the ground that the plaintiff voted for the merger and did not assert his appraisal rights. *Id.* While the court noted that "[a]n informed minority shareholder who either votes in favor of a merger or accepts its benefits cannot thereafter attack the fairness of the merger price," the court refused to grant summary judgment since factual issues remained to be resolved. *Id.* Among those issues was whether information generated during the negotiating stage of a joint venture transaction was immaterial as a matter of law since no agreement had yet been reached as to the price or structure of a transaction. *Id.* at *30. The defendant contended that the "bright line" rule set forth in the Delaware Supreme Court's opinion in Bershad v. Curtiss-Wright Corp., 535 A.2d 840 (Del. 1987), foreclosed the plaintiff's claims as a matter of law. *Id.* The court refused to dismiss the disclosure claims under the *Bershad* rule since "it is claimed that the sole reason that no agreement as to price and structure had been reached as of the Prospectus date is that Berry deliberately manipulated events to achieve that result, in order to avoid having to disclose any value-related facts that the negotiations might generate." *Id.* at *31-32.

The Delaware Supreme Court and the court of chancery also considered disclosure claims in several cases in 1991, including Kahn v. Household Acquisition Corp., 591 A.2d 166 (Del. 1991), in which the court affirmed the trial court's holding that supplemental disclosure would have added little to the information already available in the proxy statement.

> While the duty of complete disclosure should apply with equal force to supplemental as well as original proxy materials, subsequent events may have significance, and thus require disclosure, only as they relate to information originally disclosed. If subsequent events impart a new and significant slant on information already discussed, their disclosure is mandated. If the subsequent event is tentative, ill defined or adds little to material already disclosed, the duty of fresh disclosure is limited.

Id. at 171 (citations omitted). *See also In re* Brae Corp. Shareholders Litig., [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,004, at 90,024 (Del. Ch. May 14, 1991) (holding that disclosure of facts surrounding an inchoate derivative suit against the defendants, arising out of an earlier transaction, was sufficient to meet duty of disclosure; omitting the legal conclusion that the defendants were liable on the derivative suit was not a breach of duty); Braunschweiger v. American Home Shield Corp., No. 10,755, 1991 Del. Ch. LEXIS 7 (Del. Ch. Jan. 7, 1991) (discussing other cases in which disclosure claims were reviewed).

103. No. 9041, 1991 Del. Ch. LEXIS 150 (Del. Ch. Jan. 7, 1991), *reprinted in* 17 DEL. J. CORP. L. 1083 (1992).

than dividends.[104] The plaintiffs were owners of Barton's Class B non-voting common stock.[105] All Barton's Class A voting stock was owned by its directors, and by present or former officers or employees.[106] The individual defendants, who comprised all the Barton directors at the time that the suit was filed, owned approximately 47.5% of Barton's outstanding voting stock.[107]

The court found that, because no market existed for Barton's stock, the Class B stockholders had no means of recognizing the value of their stock.[108] While Barton had offered to purchase Class B stock, the price it offered was well below book value and determined solely by Barton.[109] Employee stockholders, on the other hand, were given the option to sell their shares to Barton at various times pursuant to an annual valuation performed by independent accountants.[110] Barton also purchased key man life insurance policies in part to enable it to buy the stock owned by its top management at the time of each officer's death.[111]

Another liquidity problem for the plaintiffs was that the defendants allocated very little of Barton's available cash to dividends.[112] The court found that, while more than half of Barton's discretionary revenue was distributed directly or indirectly to its employees, less than 1% of it was distributed to the Class B stockholders.[113]

The court determined that the defendants had met the burden of proving the entire fairness of their compensation.[114] Nevertheless, the court concluded that the evidence demonstrated that the defendants had favored their own interests as stockholders over the plaintiffs' interests.[115] The court found it inherently unfair that the defendants purchased key man life insurance in order to provide liquidity for themselves, while providing no method by which the plaintiffs could liquidate their stock at fair value.[116] The court stated

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104. *Id.* at *17-18, *reprinted in* 17 DEL. J. CORP. L. at 1092.
105. *Id.* at *1, *reprinted in* 17 DEL. J. CORP. L. at 1085.
106. *Id.*
107. *Id.*
108. *Id.* at *2, *reprinted in* 17 DEL. J. CORP. L. at 1086.
109. *Id.* at *3, *reprinted in* 17 DEL. J. CORP. L. at 1086.
110. *Id.*
111. *Id.*
112. *Id.* at *3-4, *reprinted in* 17 DEL. J. CORP. L. at 1086.
113. *Id.* at *4-15, *reprinted in* 17 DEL. J. CORP. L. at 1086-91..
114. *Id.* at *12-14, *reprinted in* 17 DEL. J. CORP. L. at 1086-91.
115. *Id.* at *16-17, *reprinted in* 17 DEL. J. CORP. L. at 1092.
116. *Id.* at *17, *reprinted in* 17 DEL. J. CORP. L. at 1092.

that "the needs of all stockholders must be considered and addressed when decisions are made to provide some form of liquidity."[117]

Two other 1991 court of chancery decisions considered claims relating to the fiduciary duties of directors and/or majority stockholders and the sale of their stock.[118] In *Endervelt v. Nostalgia Network, Inc.*,[119] the court of chancery dismissed claims that two former directors of The Nostalgia Network, Inc. (TNN) breached their fiduciary duties of care and loyalty to TNN's stockholders by selling their TNN stock to the defendant, Gold 'N M Television, Inc. (Gold).[120]

In early July 1989, a decision was made to sell TNN, and TNN hired an investment banking firm to advise the company in the transaction.[121] In mid-July 1989, Gold made an offer to purchase all shares of TNN beneficially owned by the executive officers and directors of TNN and two other major stockholders.[122] That offer, however, was superseded by a second, and later a third, offer directed only to TNN's executive officers and directors.[123] Approximately six weeks after the third offer had expired, TNN's chairman of the board of directors and another director agreed to sell Gold their entire equity interest, which amounted to approximately 40% of TNN's outstanding stock.[124] Gold also purchased additional shares, approximately 10% of TNN's outstanding stock, from an unrelated third party.[125]

The plaintiffs' first claim was that the defendants, the chairman of the board and the director, "wrongfully appropriated an opportunity belonging to all of the shareholders of TNN to sell their shares to Gold at an advantageous price."[126] The court dismissed the claim

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117. *Id.*

118. Thorpe v. CERBCO, Inc., [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,416, at 91,769 (Del. Ch. Nov. 15, 1991) (revised Nov. 20, 1991), *reprinted in* 17 DEL. J. CORP. L. 1284 (1992); Endervelt v. Nostalgia Network, Inc., [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,249, at 91,315 (Del. Ch. July 23, 1991), *reprinted in* 17 DEL. J. CORP. L. 596 (1992).

119. [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,249, at 91,315 (Del. Ch. July 23, 1991), *reprinted in* 17 DEL. J. CORP. L. 596 (1992).

120. *Id.* at 91,319, *reprinted in* 17 DEL. J. CORP. L. at 606.

121. *Id.* at 91,315, *reprinted in* 17 DEL. J. CORP. L. at 599.

122. *Id.* at 91,316, *reprinted in* 17 DEL. J. CORP. L. at 600.

123. *Id.*

124. *Id.* at 91,316, *reprinted in* 17 DEL. J. CORP. L. at 600.

125. *Id.*

126. *Id.* The plaintiffs claimed that the sale violated the directors' duty of loyalty by putting their personal interests ahead of the interests of the other stockholders. *Id. See* Guth v. Loft, 5 A.2d 503, 510 (Del. 1939).

since the complaint did not establish a violation of any duty owed by the directors under the circumstances.[127]

The plaintiffs' second claim was that the two defendants were obligated as directors and controlling stockholders in TNN to exercise care and loyalty to TNN's other stockholders and to refrain from self-dealing.[128] The court noted that a director who uses his corporate office to advantage himself in a way denied to other stockholders may be found to have breached his fiduciary duties.[129] The court found, however, that the complaint failed to allege that the selling directors were "controlling stockholders, that they used their corporate offices to manipulate the transaction to their own advantage, or that they relied on confidential information or used corporate assets for their own benefit."[130] Nor was there any allegation that the selling directors "dictated the terms of the transaction or had any power over the scope or conditions of Gold's offer."[131] Thus, the court dismissed the plaintiff's second claim.[132]

The principles discussed in *Endervelt* were again considered by the court of chancery in *Thorpe v. CERBCO, Inc.*[133] In *Thorpe*, the court considered a motion to dismiss a derivative and class action suit brought by holders of the Class A stock of CERBCO, Inc. (CERBCO) against CERBCO and Robert and George Erikson (the

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127. *Endervelt*, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 96,317, *reprinted in* 17 DEL. J. CORP. L. at 602. The court noted that the complaint and the offers made clear that the proposals to purchase the stock were directed to officers and directors of TNN as individual stockholders. Since no opportunity existed for the public stockholders to sell to Gold, no claim for usurpation of a corporate opportunity was properly stated. *Id.*

128. *Id.*

129. *Id. See, e.g.*, Brophy v. Cities Serv. Co., 70 A.2d 5, 5-7 (Del. Ch. 1949) (denying a motion to dismiss complaint which alleged that a director secured a better deal for himself through use of inside information); Citron v. Steego Corp., No. 10,171, 1988 Del. Ch. LEXIS 119 (Del. Ch. Sept. 9, 1988), *reprinted in* 14 DEL. J. CORP. L. 634 (1989) (denying plaintiffs' motion for preliminary injunction, which was based on allegations that director secured a better deal for himself in exchange for a promise to promote acquiror's interests).

130. *Endervelt*, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 91,318, *reprinted in* 17 DEL. J. CORP. L. at 604.

131. *Id.*

132. *Id.* The court also dismissed a claim based on Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986). *Endervelt*, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 91,318, *reprinted in* 17 DEL. J. CORP. L. at 604.

133. [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,416, at 91,769, (Del. Ch. Nov. 15, 1991) (revised Nov. 20, 1991), *reprinted in* 17 DEL. J. CORP. L. 1284 (1992).

Eriksons), two of its directors who held the majority of its Class B stock.[134] CERBCO's principal asset was a controlling stock interest in Insituform East, Inc., a sublicensee of Insituform of North America, Inc. (INA), which holds certain rights to a process used in the *in situ* repair of buried pipes.[135] The individual defendants, who owned almost 80% of the Class B stock, had the right to elect three of CERBCO's four directors.[136]

In March 1990, the Eriksons entered into a letter of intent to sell their Class B stock in CERBCO to INA for $24.24 per share at a time when the market price for the Class B stock was $3.00 per share.[137] The letter of intent stated that the Eriksons would "'cause the respective facilities, management, books and records and key employees of CERBCO and [its] subsidiaries' to be available for review by INA."[138]

Responding to the defendants' claim that they had the right to sell their stock for any price without accounting to any other stockholders for any premium, the court stated that the complaint alleged more than a simple sale of stock by majority stockholders.[139] The court noted that the "[l]etter of [i]ntent contemplated that the stockholders would exercise *corporate power* in order to effectuate the change in control transaction."[140] The court found that "[t]he ability to involve corporate property, personnel or processes was (presumably)

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134. *Id.*

135. *Id.*

136. *Id.* at 91,769-70, *reprinted in* 17 DEL. J. CORP. L. at 1290. CERBCO's capital structure derived from a capitalization concluded in 1982. While the Eriksons owned less than 43% of CERBCO's common stock before the recapitalization, they owned almost 80% of the Class B stock by 1991 as a result of the conversion of much of the Class B stock to Class A stock since 1982. *Id.*

137. *Id.* at 91,770, *reprinted in* 17 DEL. J. CORP. L. at 1290-91.

138. *Id.* The plaintiffs made a demand on the board of directors of CERBCO to rescind the proposed transaction, or to demand an accounting for the control premium, and claimed that the proposed sale represented a diversion of an advantageous opportunity belonging to CERBCO to sell its control of Insituform East. A special committee composed of two CERBCO directors was established to review the demand (the Special Committee). *Id.* The Special Committee prepared a report and its members then resigned from the CERBCO Board. CERBCO never made the Special Committee's report public. *Id.*

Less than a month after the plaintiffs instituted their suit to enjoin the proposed stock sale or to impress any control premium received with a constructive trust, the Eriksons announced that the letter of intent had expired without the completion of the sale. They also announced that they were no longer interested in selling their stock in CERBCO. *Id.*

139. *Id.* at 91,771, *reprinted in* 17 DEL. J. CORP. L. at 1293-94.

140. *Id.*

a material item in the buyers [sic] negotiation and indisputably constitutes corporate participation in the sale of control transaction."[141] The court held that

> [t]he shareholders of the corporation—that is all of the shareholders—are entitled to demand that the corporation itself not be used by a controlling shareholder in a way that facilitates a change in corporate control if that change benefits only the controlling shareholder and not the corporation itself or all of its shareholders.[142]

The court also found a more significant distinction between a simple sale of a controlling block of stock and a transaction in which the buyer was interested in acquiring a corporate asset (Insituform East) and was not primarily interested in buying the Class B stock of CERBCO.[143] The court stated that

> if it is proven that the Eriksons did use their control over CERBCO to preclude an advantageous corporate sale of CERBCO's Insituform East stock, in which INA was or would have been interested, in order to promote the prospects of their sale of their CERBCO stock, they will have been shown to have violated their duty to CERBCO and its other shareholders.[144]

D. *Issuance of Stock*

Also in 1991, the Delaware Supreme Court delivered an important opinion concerning the issuance of preferred stock in *STAAR Surgical Co. v. Waggoner*.[145] The court ruled on the validity of two million shares of STAAR Surgical Company (STAAR) common stock issued to STAAR's former president and CEO, Thomas R. Waggoner (Waggoner) and his wife.[146] The court of chancery had assumed that the Waggoners' preferred shares were technically invalid because STAAR failed to issue them in conformity with section 151 of the

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141. *Id.*
142. *Id.*
143. *Id.*
144. *Id.*
145. 588 A.2d 1130 (Del. 1991).
146. *Id.* at 1131.

DGCL.[147] Despite this technical infirmity, the court of chancery held that "the Waggoners were equitably entitled to ownership and voting control of the common shares."[148]

The supreme court held that the court of chancery had erroneously granted equitable relief.[149] The court noted that the "Waggoners received their common stock through the exercise of conversion options attached to the preferred shares"[150] and that "[s]ince the preferred shares were invalid, the trial court had no basis to ignore established principles of Delaware corporate law and should not have invoked equitable remedies to resuscitate plainly void stock."[151]

In so holding, the supreme court emphasized that the STAAR Board never formally executed either a board resolution or a certificate of designation relating to the issuance of the preferred stock.[152] The court also noted that it is a basic concept of Delaware's corporation law that "in the absence of a clear agreement to the contrary, preferred stock rights are in derogation of the common law and must be strictly construed."[153] The court stated that "[i]f the preferred shares were void, it follows *a fortiori* that the common shares, which purportedly derived from the preferred, also were invalid."[154] The court held that "if the preferred shares were void, as the [c]ourt of [c]hancery assumed, then the common stock could not be created out of whole cloth."[155]

The court found unpersuasive the Waggoners' attempt to "trivialize the unassailable facts" of the case as mere "technicalities."[156] The court stated that "[t]he issuance of corporate stock is an act of fundamental legal significance having a direct bearing upon questions of corporate governance, control and the capital structure of the enterprise."[157] The court noted that the law "requires certainty in

147. *Id.* (citing Waggoner v. STAAR Surgical Co., No. 11,185, 1990 Del. Ch. LEXIS 33 (Del. Ch. Mar. 15, 1990), *reprinted in* 16 DEL. J. CORP. L. 968 (1991), *rev'd*, STAAR Surgical Co. v. Waggoner, 588 A.2d 1130 (Del. 1990)); DEL. CODE ANN. tit. 8, § 151 (1991).

148. *STAAR Surgical*, 588 A.2d at 1131.

149. *Id.*

150. *Id.*

151. *Id.*

152. *Id.* at 1135.

153. *Id.* at 1136.

154. *Id.* at 1134.

155. *Id.* at 1136.

156. *Id.*

157. *Id.*

such matters."[158] The court emphasized that Delaware courts "must act with caution and restraint when granting equitable relief in derogation of established principles of corporate law."[159]

E. Elections of Directors

Both the supreme court and the court of chancery issued important opinions in 1991 regarding elections of directors and the conduct of stockholder meetings. In *In re Bicoastal Corp.*,[160] the supreme court affirmed the court of chancery's decision, declaring that Mesa Holdings Limited Partnership (Mesa) had validly elected three directors to constitute a new majority of directors of the board of Bicoastal Corporation (Bicoastal).[161]

Pursuant to Bicoastal's certificate of incorporation, Mesa had the right to elect a majority of Bicoastal's directors upon fifteen days advance notice if Bicoastal failed to redeem the shares of Bicoastal junior preferred stock held by Mesa in a timely manner.[162] In addition, pursuant to a "nonredemption provision" contained in Mesa's certificate of incorporation, Bicoastal was prohibited "from redeeming the junior preferred stock if such redemption would violate any covenant . . . of Bicoastal."[163] A "restricted payment clause" in a junior subordinated promissory note between Mesa and Bicoastal prohibited any redemption of any capital stock of Bicoastal unless that junior note had been satisfied in full.[164]

As a result of Bicoastal's failure to redeem the junior preferred stock by the required date, on November 6, 1989, Mesa gave notice of the election of its right to name a majority of Bicoastal's directors.[165] However, on November 10, eleven days before the fifteen-day advance notice period was to expire, Bicoastal filed a petition in bankruptcy court.[166] On November 20, Mesa rejected Bicoastal's offer to redeem the junior preferred stock on the grounds that the nonredemption provision in Bicoastal's certificate of incorporation "pro-

158. *Id.*
159. *Id.* at 1137 n.2 (citing Alabama By-Products Corp. v. Neal, 588 A.2d 255, 258 n.1 (Del. 1991)).
160. 600 A.2d 343 (Del. 1991).
161. *Id.* at 346.
162. *Id.* at 346, 347 n.5.
163. *Id.* at 346.
164. *Id.* at 346-47.
165. *Id.* at 347.
166. *Id.*

hibited redemption since the junior note had not yet been satisfied."[167]

The bankruptcy court subsequently held that the automatic stay that occurs upon the filing of a petition in bankruptcy prevented Mesa from further pursuing its election right at that time.[168] On January 22, 1991, the stay was modified to allow Mesa to assert its election right.[169] Immediately thereafter, Mesa acted by written consent to name three directors of Bicoastal.[170] After Bicoastal challenged the election, the court of chancery determined that Mesa had validly elected the three new directors of Bicoastal.[171]

On appeal, Bicoastal contended that Mesa had improperly rejected Bicoastal's redemption tender.[172] The supreme court affirmed the court of chancery's ruling that the nonredemption provision was valid under title 8, section 151(a) of the DGCL and that Mesa's rejection of the tender was proper since the tender was barred under the nonredemption provision.[173] The court also rejected Bicoastal's argument that the preference arising from the nonredemption provision was invalid under section 151(a).[174] The court concluded that "[t]he nonredemption provision clearly puts all relevant constituents on notice that Bicoastal is prohibited from redeeming the junior preferred stock if such redemption would violate any contract of Bicoastal."[175] The court also rejected Bicoastal's contention that the preference arising from the nonredemption provision violated section 242 of the DGCL.[176]

In an opinion after trial in *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.*,[177] the court of chancery considered an action under section 225 of the DGCL seeking determination of who constituted the lawfully elected Board of Directors of MGM-Pathe Communications Company (MGM).[178] The foremost plaintiff in the action was Credit Lyonnais Bank Nederland, N.V. (CLBN), a lender

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167. *Id.* at 347-48.
168. *Id.* at 347.
169. *Id.* at 348.
170. *Id.*
171. *Id.*
172. *Id.*
173. *Id.*
174. *Id.* at 350; DEL. CODE ANN. tit. 8, § 151(a) (1991).
175. *Bicoastal*, 600 A.2d at 350.
176. *Id. See* DEL. CODE ANN. tit. 8, § 242 (1991).
177. No. 12,150, 1991 Del. Ch. LEXIS 215 (Del. Ch. Dec. 30, 1991), *reprinted in* 17 DEL. J. CORP. L. 1099 (1992).
178. *Id.* at *1, *reprinted in* 17 DEL. J. CORP. L. at 1103-04.

to both MGM and Pathe Communications Corporation (PCC), MGM's parent.[179] CLBN claimed to be the legal owner, at least for voting purposes, of PCC's controlling block of MGM stock by reason of claimed defaults by PCC on loans from CLBN that were secured by the block of stock.[180] The defendants in the action were PCC and the three individuals, including Giancarlo Parretti, whom CLBN purported to remove from MGM's Board on June 16, 1991.[181]

CLBN's claim was based on the defendants' alleged breach of the Corporate Governance Agreement (CGA), which was entered into by the parties in April of 1991, along with other agreements, to facilitate CLBN's loan for $145 million to MGM.[182] Due to the alleged breach, CLBN claimed that it was given the "legal power" to divest the defendants of their board of director positions.[183] CLBN sought a validation by the court of the removal and replacement of the defendants and an injunction for the enforcement of the CGA, as well as the protection from violations in the future.[184]

The issue central to the case was "whether Mr. Parretti breached the [CGA] either by failing to make certain disclosures at the time the agreement was executed . . . or by material interference in MGM's management during the following two months."[185] After reviewing the evidence, the court concluded that Parretti had "insistently and continually breached the foundational requirement of all contracting parties: to act with respect to the subject matter of the contract with good faith and to deal fairly."[186] The court noted that "[t]his requirement means, in general, that a contracting party is not free to deprive his promisee of the benefit of the contract or to impair that benefit materially."[187] The court found that because of Parretti's willful breach of the agreement, CLBN was legally entitled to remove himself and his associates from MGM's Board of Directors.[188]

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179. *Id.* at *2.
180. *Id.*
181. *Id.*
182. *Id.* at *3, *reprinted in* 17 DEL. J. CORP. L. at 1103.
183. *Id.*
184. *Id.* at 1103-4.
185. *Id.* at *9, *reprinted in* 17 DEL. J. CORP. L. at 1106.
186. *Id.* at *10, *reprinted in* 17 DEL. J. CORP. L. at 1107.
187. *Id.*
188. *Id.* The court concluded that Parretti had not given truthful testimony under oath when testifying in the case. *Id.* at 1106.

As to the defendants' counterclaim, the court concluded that CLBN had not

The court of chancery also issued rulings in 1991 in connection with ongoing proxy contests. In *Sutton Holding Corp. v. DeSoto, Inc.*,[189] the court of chancery denied a motion for summary judgment by plaintiff Sutton Holding Corporation (Sutton), the holder of 8.9% of the stock of DeSoto, Inc. (DeSoto).[190] Sutton was engaged in a proxy contest to elect a slate of directors at DeSoto's annual meeting.[191] Sutton claimed that an effective and open election was being thwarted by the defendants, who constituted a majority of DeSoto's Board of Directors.[192] Sutton sought a declaratory judgment on the question of whether election of the challengers' slate would constitute a "change of control" as that term was used in DeSoto's two pension plans.[193]

In December 1987, DeSoto had amended its two existing pension plans to insert a change of control provision, which provided that for a period of five years following a change of control, DeSoto could not abolish the plans nor amend them in a manner that would reduce benefits to the plan's beneficiaries.[194] Despite the provisions, DeSoto's existing board resolved to terminate the pension plans and distribute the excess funding to DeSoto's stockholders.[195] While the challengers' slate announced a similar intention, the change in control provisions raised questions as to whether they could do so.[196]

The court stated that "[p]rovisions in corporate instruments that are intended principally to restrain or coerce the free exercise of the stockholder franchise are deeply suspect."[197] "Absent quite extraordinary circumstances . . . it constitutes a fundamental offense to the dignity of [the office of corporate director] for a director to use corporate power to seek to coerce shareholders in the exercise of the vote."[198] Thus, the court could, but not on the record before it, hold that adoption of the 1987 provision "constituted a breach of

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breached its agreements with Parretti or his affiliates or acted in an inequitable or unfair way toward them. The court dismissed the counterclaims with prejudice. *Id.* at *44-48, *reprinted in* 17 DEL. J. CORP. L. at 1159.

189. [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,012, at 90,063 (Del. Ch. May 14, 1991), *reprinted in* 17 DEL. J. CORP. L. 363 (1992).

190. *Id.* at 90,064, *reprinted in* 17 DEL. J. CORP. L. at 365.

191. *Id.*

192. *Id.*

193. *Id.*

194. *Id.*

195. *Id.* at 96,065, *reprinted in* 17 DEL. J. CORP. L. at 367.

196. *Id.*

197. *Id.* at 96,064, *reprinted in* 17 DEL. J. CORP. L. at 366 (citing Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988)).

198. *Id.*

the duty of loyalty that the members of the DeSoto board at that time owed to the company and its shareholders."[199]

In *Hubbard v. Hollywood Park Realty Enterprises, Inc.*,[200] the court of chancery granted a motion for a preliminary injunction directing that an advance notice bylaw of Hollywood Park Realty Enterprises, Inc. (Realty) be waived.[201] The bylaw required stockholders, who intended to nominate candidates for the board of directors election, give notice of such intent to the corporation in advance of the annual stockholders meeting.[202] Unless enjoined, the enforcement of the bylaw would have resulted in the management slate running unopposed at Realty's annual meeting scheduled for January 28, 1991.[203]

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199. *Id.* Even if the provisions were adopted in breach of fiduciary duty, the court found that the provisions created litigable claims by plan beneficiaries to rights governed by federal law. *Id.* at 90,064-65, *reprinted in* 17 DEL. J. CORP. L. at 366-67. While the defendants adopted a resolution after the filing of the complaint in this action which provided that election of the challengers' slate would not trigger the change in control provisions, the court refused to rule on the effectiveness of the resolution without the presence of plan beneficiaries. *Id.* at 90,066, *reprinted in* 17 DEL. J. CORP. L. at 367. The court suggested that it might be possible to require the defendants to postpone the forthcoming annual meeting for a short period in the event that

> plaintiff (derivatively) undertakes to commence and promptly requests expedited treatment of a defendant class declaratory judgment action against plan beneficiaries, seeking an adjudication of the questions necessary to determine whether the DeSoto board has, consistently with federal law, exempted the plaintiff's slate of candidates from the change in control provisions of the Company's pension plans.

Id. at 90,066-67 (footnotes omitted), *reprinted in* 17 DEL. J. CORP. L. at 371.

200. No. 11,779, 1991 Del. Ch. LEXIS 9 (Del. Ch. Jan. 14, 1991), *reprinted in* 17 DEL. J. CORP. L. 238 (1992).

201. *Id.* at *41, *reprinted in* 17 DEL. J. CORP. L. at 261.

202. *Id.* at *2, *reprinted in* 17 DEL. J. CORP. L. at 243. The advance notice bylaw was adopted in mid-1989 under circumstances divorced from any contest for control. *Id.* at *6, *reprinted in* 17 DEL. J. CORP. L. at 245. It required stockholders who desired to nominate candidates for director at the annual meeting to furnish certain information to the corporation, "'not less than 90 days in advance of that meeting or, if later, the seventh day following the first public announcement of the date of such meeting.'" *Id.* at *7, *reprinted in* 17 DEL. J. CORP. L. at 243 (footnote omitted) (quoting advance notice bylaw).

203. *Id.* at *2, *reprinted in* 17 DEL. J. CORP. L. at 243. This action was originally filed by R.D. Hubbard (Hubbard), a substantial stockholder of Realty and its sister corporation, Hollywood Park Operating Company (Operating). *Id.* Hubbard, who desired to significantly change the direction and management of both corporations, commenced a proxy contest and consent solicitation to remove and replace those companies' respective boards of directors. *Id.* After those boards refused his request for a 30-day extension of the advance notice bylaw deadline, Hubbard brought this action on October 26, 1990, against Realty, Operating and their respective directors,

The Realty stockholders sought to enjoin the enforcement of the bylaw in order to nominate an opposing slate of director candidates.[204]

In considering the motion, the court stated that "an advance notice by-law [sic] will be validated where it operates as a reasonable limitation upon the shareholders' right to nominate candidates for director. More specifically, such a by-law [sic] must, on its face and in the particular circumstances, afford the shareholders a fair opportunity to nominate candidates."[205] The court stated that "[b]ecause the facial validity of the Realty by-law [sic] is not contested, the inquiry ultimately focuses on whether the by-law [sic], as applied in these circumstances, has afforded the shareholders a fair opportunity to nominate director candidates."[206]

The court stated that

> this is a case where the Realty Board itself took certain action, after the by-law [sic] nomination deadline had passed, that involved an unanticipated change of allegiance of a majority of its members. It was foreseeable that that shift

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for a judgment declaring that bylaw invalid on its face. *Id.* at *3, *reprinted in* 17 DEL. J. CORP. L. at 243 (footnote omitted). A settlement was later reached between Hubbard and the Realty Board on November 19, 1990. *Id.* Pursuant to that settlement, Hubbard voluntarily dismissed his complaint as against Realty and its directors, but not as against Operating. *Id.* Thereafter, on December 6, 1990, Operating and several of its directors instituted a cross-claim against Realty and its directors, including Hubbard, who had been appointed to the Realty Board as part of the settlement. *Id.* at *3-4, *reprinted in* 17 DEL. J. CORP. L. at 243 (footnote omitted). The cross-claimants also moved for a preliminary injunction to restrain the Realty Board from enforcing the advance notice bylaw as to them. *Id.*

204. *Id.* at *2, *reprinted in* 17 DEL. J. CORP. L. at 243. The moving parties relied on two lines of Delaware case law. They first relied on the "well-established doctrine that where directors take action that, while legally permissible, is done for an inequitable purpose, such action is a breach of fiduciary duty that may be remedied by equity." *Id.* at *22, *reprinted in* 17 DEL. J. CORP. L. at 252 (citing Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437 (Del. 1971)). "That doctrine has been applied to invalidate board action constituting an inequitable manipulation of the corporate machinery that affected adversely the stockholders' right to conduct a contested election of directors." *Id.* (citing Lerman v. Diagnostic Data, Inc., 421 A.2d 906 (Del. Ch. 1980)). They also relied on the doctrine articulated in Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988), "that where a board acts intentionally to impede or thwart the shareholders' exercise of voting power, those actions, even if taken in good faith, will be invalidated unless the directors can show a compelling justification." *Id.* at *24, *reprinted in* 17 DEL. J. CORP. L. at 253 (citing Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988)).

205. *Hubbard*, No. 11,779, 1991 Del. Ch. LEXIS 9, at *35, *reprinted in* 17 DEL. J. CORP. L. at 258.

206. *Id.*

> in allegiance would result in potentially significant changes in the corporation's management personnel and operational changes in its business policy and direction.[207]

The court held that "[u]nder those circumstances, considerations of fairness and the fundamental importance of the shareholder franchise dictated that the shareholders be afforded a fair opportunity to nominate an opposing slate, thus imposing upon the board the duty to waive the advance notice requirement of the by-law [sic]."[208] The court went on to say, "[T]hat duty exists, even though concededly the Realty Board has acted in good faith and took no steps overtly to change the electoral rules themselves."[209] Finally, the court stated that "policy, as well as purely equitable, considerations also require this result"[210] noting that

> [t]he Realty by-law [sic] serves the proper purpose of assuring that stockholders and directors will have a reasonable opportunity to thoughtfully consider nominations and to allow for full information to be distributed to stockholders, along with the arguments on both sides. Unless the advance notice requirement is waived here, that purpose will be frustrated.[211]

The Delaware Supreme Court considered the impact of a bylaw on an election of directors in *Oberly v. Kirby*.[212] The dispute in *Oberly* involved the affairs of the F.M. Kirby Foundation, Inc. (the Foundation), a Delaware nonstock charitable corporation.[213] The case began as a proceeding by certain members of the Kirby family (the

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207. *Id.* at *39, *reprinted in* 17 DEL. J. CORP. L. at 260. The court noted that "this is not a case where the shareholders, unprovoked by any board action, unilaterally and belatedly changed their minds and decided to nominate a slate of candidates for director." The court indicated that "relief should clearly be denied" in such a case. *Id.*

208. *Id.* at *40, *reprinted in* 17 DEL. J. CORP. L. at 260.

209. *Id.*

210. *Id.*

211. *Id.* (citation omitted). The court concluded that "the policy underlying the shareholders' fundamental right to exercise their franchise significantly outweighs the policies favoring the continued enforcement of the by-law [sic]," and that "[t]he harm caused to shareholders from enforcing the by-law [sic] will greatly outweigh its benefits." *Id.* at *41, *reprinted in* 17 DEL. J. CORP. L. at 261.

212. 592 A.2d 445 (Del. 1991).

213. *Id.* at 451.

Kirby plaintiffs) to determine the identity of the directors and members of the Foundation.[214]

Among other things, the court found that a bylaw amendment adopted by the Kirby plaintiffs was invalid not solely because it violated Delaware law, but because it was wholly inconsistent with the Foundation's certificate of incorporation.[215] The certificate of incorporation provided that new members were to be elected by a majority of old members.[216] The bylaw adopted by the Kirby plaintiffs, pursuant to a provision of the certificate of incorporation that allowed the directors to establish rules governing membership of the Foundation,[217] provided that only directors could be members of the Foundation.[218] The court found that the bylaw was inconsistent with the overall structure of the Foundation and with the specific requirements of the certificate of incorporation concerning the election of members.[219] The court stated that the members' power was intended to resemble that of stockholders.[220] The court, therefore, concluded that the Foundation's members could not be ousted by the very directors whom they had elected.[221]

F. Appraisal of Fair Value of Stock Pursuant to Section 262

The Delaware Supreme Court and court of chancery also considered claims under Delaware's appraisal statute[222] in 1991. In *Alabama By-Products Corp. v. Neal*,[223] the supreme court affirmed the decision of the court of chancery, thus rejecting the respondents' contention that the court of chancery committed an error of law by relying on evidence of wrongdoing in a merger when determining value in an appraisal proceeding.[224]

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214. *Id.*
215. *Id.* at 459-61.
216. *Id.* at 458.
217. *Id.*
218. *Id.* at 454.
219. *Id.* at 458.
220. *Id.* at 458-59.
221. *Id.* at 459. The supreme court also addressed various other issues in its opinion, two of which are noteworthy. First, the supreme court concluded that a member's conduct in dismissing his siblings from directors' positions and appointing his wife and children as members was a breach of fiduciary duty. Second, the court held that an "interested transaction" in which the corporation sold a large block of stock in a for-profit corporation was "intrinsically fair." *Id.* at 461-72.
222. DEL. CODE ANN. tit. 8, § 262 (1983 & Supp. 1991).
223. 588 A.2d 255 (Del. 1991).
224. *Id.* at 256.

While the court reaffirmed that "claims for unfair dealing cannot be litigated in the context of a *statutory* appraisal,"[225] it stressed the importance of "the distinction between the propriety of considering an *act of unfair dealing*, which may relate to a party's credibility, and the impropriety of considering an *action for unfair dealing* in an appraisal proceeding."[226] The court held that:

> [t]here is nothing in the appraisal statute or this [c]ourt's prior holdings, including *Cede*, which suggests that the [c]ourt of [c]hancery may not consider the respondents' conduct at the time of the merger in assessing the credibility of the respondents' testimony in support of their valuation contentions in an appraisal proceeding.[227]

Significantly, the court also noted that:

> [t]his [c]ourt has consistently held that there is no basis for expanding the limited remedy which is provided for in the Delaware appraisal statute by the invocation of equitable principles. The invocation of equitable principles to override established precepts of Delaware corporate law must be exercised with caution and restraint. Otherwise, the stability of Delaware law is imperiled. While the doctrine of *Schnell v. Chris-Craft Industries, Inc.* is an important part of our jurisprudence, its application, or that of similar concepts, should be reserved for those instances that threaten the fabric of the law, or which by an improper manipulation of the law, would deprive a person of a clear right. Since claims of unfair dealing cannot be litigated in a statutory appraisal proceeding, an act of unfair dealing cannot be the equitable basis for independently attributing value to stock in such an action. In a statutory appraisal proceeding, an act of unfair dealing is only relevant to assess the credibility of those supplying information in support of a valuation contention.[228]

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225. *Id.* at 257 (citing Cede & Co. v. Technicolor, Inc., 542 A.2d 1182, 1189 (Del. 1988)).

226. *Id.*

227. *Id.* at 258 (footnote omitted).

228. *Id.* at 258 n.1 (footnotes and citations omitted). In Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437 (Del. 1971), the Delaware Supreme Court found that a corporate bylaw had been amended for an inequitable purpose. With knowledge

In *In re Radiology Associates, Inc. Litigation*,[229] the court of chancery was called upon to appraise the fair value of the shares of Radiology Associates, Inc. (Radiology). The court's opinion carefully reviewed several alternative valuation approaches utilized by the parties' experts.[230] The plaintiff's expert attempted to value Radiology by using a comparable company methodology and a discounted cash flow (DCF) approach.[231] The comparable company approach attempts to value a company first by finding comparable publicly traded companies,[232] then calculating the value of the company whose stock is being appraised "through the use of earnings and other multiples."[233] Although the court of chancery has affirmed the general validity of the comparable company methodology,[234] the court refused to apply it in valuing Radiology because the suggested comparable companies were so dissimilar to Radiology that any comparison was meaningless.[235]

The DCF approach attempts to value a company by estimating and discounting future cash flows.[236] The court applied the DCF approach in valuing Radiology, although it rejected certain adjustments proposed by the plaintiff's expert that would have (1) added an additional premium over the calculated value to compensate for an implicit minority discount and (2) added a premium to reflect Radiology subchapter S corporation status.[237]

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of an impending proxy contest, directors amended the corporation's bylaws to advance the annual meeting date by more than one month. The court nullified the new date after finding that the directors' action had been taken to limit the time for the proxy contest and would have given the plaintiff little chance to wage a successful proxy contest. *Id.*

229. 611 A.2d 485 (Del. Ch. 1991).

230. *Id.* at 489-99.

231. *Id.* at 489.

232. *Id. See* Harris v. Rapid-American Corp., No. 6462, 1990 Del. Ch. LEXIS 166 (Del. Ch. Oct. 2, 1990), *reprinted in* 16 DEL. J. CORP. L. 1478 (1991), *aff'd in part, rev'd in part*, 603 A.2d 796 (Del. 1992).

233. *Radiology Assocs.*, 611 A.2d at 489.

234. *Id.* (citing Harris v. Rapid-American Corp., No. 6462, 1990 Del. Ch. LEXIS 166 (Del. Ch. Oct. 2, 1990), *reprinted in* 16 DEL. J. CORP. L. 1478 (1991), *aff'd in part, rev'd in part*, 603 A.2d 796 (Del. 1992)).

235. *Radiology Assocs.*, 611 A.2d at 490.

236. *Id.* Delaware courts have affirmed the validity of the DCF method of valuation "repeatedly." *Id. See, e.g.*, Neal v. Alabama By-Products Corp., No. 8282, 1990 Del. Ch. LEXIS 127 (Del. Ch. Aug. 1, 1990), *aff'd*, 588 A.2d 255 (Del. 1991); Cede & Co. v. Technicolor, Inc., No. 7129, 1990 Del. Ch. LEXIS 171 (Del. Ch. Oct. 19, 1990).

237. *Radiology Assocs.*, 611 A.2d at 494-95. The court also affirmed the validity of the Capital Asset Pricing Model in determining an appropriate discount rate. *Id.* at 492.

The defendants' expert attempted to value Radiology using the "Delaware block" method.[238] The Delaware block method measures and blends asset value, market value and earnings value to arrive at an appropriate fair value.[239] The court decided not to apply the Delaware block method in part because that approach relies on historical measures of value as opposed to future prospects.[240] The court found:

> [it is] intrinsically more appealing to rely on the future prospects of a company, where reliable projections are available, than the historical earnings of the company because the theoretically more correct measure of the entity's value, under an earnings valuation approach, is the present value of its future cash flows or earnings.[241]

G. *Fiduciary Duties in the Context of Partnerships*

The court of chancery also considered fiduciary duty issues in the context of Delaware limited partnerships in 1991. In *In re USA-Cafes, L.P. Litigation*,[242] the court of chancery considered various motions to dismiss filed by the defendants in a consolidated action arising out of the 1989 purchase by Metsa Acquisition Corporation (Metsa) of substantially all of the assets of USACafes, L.P. (the Partnership).[243] The plaintiffs, holders of limited partnership units, sought relief, including the imposition of constructive trusts on monies received by the defendants as a result of the Metsa sale, and an award of damages to the class caused by the sale.[244] The defendants included the corporate general partner of the partnership (the General Partner), the individual members of the board of directors of the General Partner, and Metsa, the purchaser of the Partnership's assets.[245]

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238. *Id.* at 496.

239. *Id.* The court recognized that "[e]ven though the Delaware courts have used the Delaware Block Method infrequently since *Weinberger*, the Delaware courts still consider it an acceptable procedure for valuing a company." *Id.* (citing Rosenblatt v. Getty Oil Co., 493 A.2d 929, 940 (Del. 1985)).

240. *Id.* at 497.

241. *Id.* at 497-98.

242. 600 A.2d 43 (Del. Ch. 1991).

243. *Id.* at 45.

244. *Id.*

245. *Id.* at 45-46.

The chancery court denied the motion to dismiss the breach of duty claim, rejecting the argument by the directors of the General Partner that they owed the limited partners no duties of loyalty or care, but owed duties only to the General Partner itself and to the stockholders of the General Partner.[246] Although the court did not attempt to define the scope of the fiduciary duties owed by the directors to the limited partners, the court concluded that it surely entailed "the duty not to use control over the partnership property to advantage the corporate director at the expense of the partnership."[247]

The court of chancery also rejected the defendants' motion to dismiss for lack of personal jurisdiction, holding that it could assert jurisdiction over the defendants without violating the constitution.[248] The court, because it rejected the premise that Delaware law imposed no duties upon directors of the corporate General Partner which ran to the Partnership and the limited partners, concluded that it was in keeping with "traditional notions of fairness to require those who have chosen to serve as directors of the General Partner to defend their actions here rather than elsewhere."[249] The court also concluded that because the directors of the corporate General Partner did owe a duty of loyalty in their "capacity" as directors, service of process was authorized by section 3114 of the Delaware Code.[250]

The court of chancery considered similar issues in *In re Mesa Limited Partnership Preferred Unitholders Litigation*,[251] in which the court denied a motion to prevent a December 12, 1991, unitholder vote on the proposed conversion of the limited partnership into a Texas corporation that had been filed by holders of preference units of Mesa Limited Partnership (Mesa).[252] Under the conversion, the unitholders' rights in the limited partnership were to be converted into common stock of the new corporation.[253] The General Partner's rights were to be converted into partnership interests in the new corpor-

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246. *Id.* at 47-50.

247. *Id.* at 49.

248. *Id.* at 50-52.

249. *Id.* at 52 (citing Shaffer v. Heitner, 433 U.S. 186, 222-24 (1977) (Brennan, J., concurring in part and dissenting in part)).

250. *Id.* at 53; DEL. CODE ANN. tit. 10, § 3114 (1991).

251. [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,454, at 92,001 (Del. Ch. Dec. 10, 1991), *reprinted in* 17 DEL. J. CORP. 1244 (1992).

252. *Id.* at 92,001, *reprinted in* 17 DEL. J. CORP. at 1247.

253. *Id.* at 92,003, *reprinted in* 17 DEL. J. CORP. at 1251.

ation's subsidiaries in order to avoid triggering certain adverse provisions in Mesa's indentures.[254]

The plaintiffs alleged that the unitholders' vote and the consummation of the transaction should be preliminarily enjoined because, among other things, the conversion ratios and the consideration to be received by the general partner were unfair.[255] The court found that the plaintiffs failed to carry their burden of showing a reasonable probability of unfairness.[256] The court noted that the terms of the conversion were set forth in the proxy materials so that the unitholders could form their own business judgment as to the economic desirability of the transaction.[257] The court further noted that, in any event, fully informed unitholders could ratify actions of directors that might otherwise constitute breaches of fiduciary duty,[258] and that such ratification would preclude judicial scrutiny of those actions.[259]

H. The Internal Affairs Doctrine

Also in 1991, the court of chancery considered the internal affairs doctrine in *Rosenmiller v. Bordes*.[260] In *Rosenmiller*, the court

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254. *Id.* at 92,002-03, *reprinted in* 17 DEL. J. CORP. at 1249-50.

255. *Id.* at 92,005, *reprinted in* 17 DEL. J. CORP. at 1255.

256. *Id.* at 92,005-06, *reprinted in* 17 DEL. J. CORP. at 1256.

257. *Id.* at 92,006, *reprinted in* 17 DEL. J. CORP. at 1256.

258. *Id.* at 92,006, *reprinted in* 17 DEL. J. CORP. at 1256 (citing Lewis v. Hat Corp. of Am., 150 A.2d 750 (Del. Ch. 1959)).

259. *Id.* (citing Gottlieb v. Heyden Chem. Corp., 91 A.2d 57 (Del. 1952)). Only actions involving an illegal gift of assets or fraudulent, illegal, or *ultra vires* action may not be ratified by a fully informed stockholder vote. *Id.* (citing Fidanque v. American Maracaibo Co., 92 A.2d 311 (Del. Ch. 1952)).

In an opinion by Vice-Chancellor Hartnett dated December 31, 1991, the court of chancery denied another motion to preliminarily enjoin Mesa's conversion to a Texas corporation. *In re* Mesa Limited Partnership Preferred Unitholders Litig., No. 12,243 (Consolidated), 1991 Del. Ch. LEXIS 216 (Del. Ch. Dec. 31, 1991). After the December 12, 1991 special meeting of unitholders to vote on the transaction, the independent inspector certified that a majority of Mesa's preferred and common unitholders, voting as separate classes, had voted in favor of the transaction. *Id.* at *2. The plaintiffs then challenged the validity of several of the proxies under Delaware law and claimed that the required approval was not achieved if those proxies were invalidated. *Id.*

The court found no evidence that the independent inspector had acted unreasonably or improperly in connection with the vote. *Id.* at *2-3. The court held that "a presumption of the validity of the vote results." *Id.* After reviewing the claims, the court concluded that there was no evidence that any vote of any unitholder was not counted as the unitholder desired and indicated that all of the challenged proxies "bore sufficient signatories or identifying characteristics to establish authenticity and were easily verifiable." *Id.* at *3-4. The court denied the plaintiffs' motion. *Id.* at *2-3.

260. 607 A.2d 465 (Del. Ch. 1991).

considered the parties' motions for summary judgment on claims seeking appointment of a custodian for Greater Media, Inc. (GMI) under title 8, section 226, of the DGCL and specific performance of a stockholders' voting agreement.[261] One of the plaintiffs and one of the defendants, each 50% stockholders of GMI, entered into a stockholders' voting agreement in 1976 in which they agreed to vote their shares so that each party was entitled to elect one director of GMI.[262] The voting agreement also provided that if one of them decided to sell his stock, he would receive 110% of book value.[263] The voting agreement further provided that it was to be governed by New Jersey law.[264]

By 1988, the relationship between the two stockholders had deteriorated.[265] In 1989, the plaintiffs sought appointment of a custodian for GMI.[266] The defendants sought to block the appointment of a custodian by claiming that the voting agreement set forth the obligations of the stockholders and remained in effect under New Jersey law.[267] The plaintiffs claimed that the validity of the voting agreement had to be governed by Delaware law, notwithstanding the agreement's express choice of law provision in favor of New Jersey law.[268] The choice of law issue was dispositive because, under section 218 of the DGCL, the term of such a voting agreement may not exceed ten years.[269]

The court held that the voting agreement was governed by Delaware law because Delaware had a materially greater interest in the controversy.[270] The internal affairs doctrine requires that the state that has created the corporation be the only state whose law controls the relationships among the corporate entity, directors, officers, and stockholders.[271] The court concluded that application of the internal affairs doctrine was mandated by constitutional principles except in the "rarest" situations.[272] Thus, the application of Delaware law

261. *Id.* at 466.
262. *Id.*
263. *Id.*
264. *Id.*
265. *Id.* at 467.
266. *Id.*
267. *Id.* at 468.
268. *Id.* at 467.
269. *Id.* at 467-68.
270. *Id.* at 469.
271. *Id.* at 468.
272. *Id.* (citing McDermott, Inc. v. Lewis, 531 A.2d 206, 217 (Del. 1987)).

rendered the agreement unenforceable because pursuant to the ten year life span mandated by section 218 of the DGCL,[273] it had expired in 1986.

III. CONCLUSION

As the cases decided in 1991 demonstrate, the Delaware Court of Chancery continues to be 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, nor does any appellate court have the expertise in corporate law possessed by the Delaware Supreme Court.

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273. *Id.* at 469. The court also denied the plaintiffs' motion for summary judgment on their claim seeking appointment of a custodian, after finding that there were disputed questions of fact relevant to the issue. *Id.* The court noted that the issue of what occurred at GMI's November 1990 annual meeting soon would become moot because of the upcoming 1991 annual meeting. *Id.* at 470. The court indicated that it would view with strong disfavor any effort to postpone the 1991 annual meeting or any conduct at the annual meeting that departed from scrupulous fairness. *Id.* The court suggested that if the obviously evenly divided stockholders failed to elect directors at the annual meeting, the court likely would appoint a custodian under § 226 of Delaware Corporation Law. *Id.*