Commentary From The Bar

1992 DEVELOPMENTS IN DELAWARE CORPORATE LAW

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I. INTRODUCTION

In 1992, Delaware courts continued to rule on important issues arising under the Delaware General Corporation Law (DGCL).[1] The Supreme Court of Delaware and Delaware's Court of Chancery issued decisions concerning corporate control and the fiduciary duties of directors and controlling stockholders. These decisions affect corporate attorneys and anyone involved in the management of a corporation registered in Delaware.

This article summarizes the major developments in Delaware corporate law during 1992. While a complete summary of this extensive body of law and a review of every Delaware corporate decision in 1992 are beyond the scope of this article, a wide range of corporate issues will be addressed.

II. CASE LAW APPLYING DELAWARE CORPORATE LAW

The Supreme Court of Delaware and the Delaware Court of Chancery issued several noteworthy opinions in 1992 concerning the fiduciary duties of directors of Delaware corporations. The various opinions address the directors' duty of disclosure, the duties of care and loyalty in connection with the sale of a corporation, and the duty owed to creditors upon insolvency.

A. The Directors' Duty to Disclose Material Information

In 1992, the Supreme Court of Delaware issued an important decision concerning directors' disclosure of material information when

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1. DEL. CODE ANN. tit. 8, §§ 101-398 (1991 & Supp. 1992).

seeking corporate action. In *Stroud v. Grace*,[2] the court considered a series of disputes between Milliken Enterprises, Inc. (Milliken), a privately held Delaware corporation, and certain Milliken stockholders, primarily members of the Stroud branch of the Milliken family.[3] The plaintiffs disputed the validity of certain charter amendments recommended to the stockholders by the boards and the validity of a bylaw which established the procedure for nominating candidates to Milliken's Board of Directors.[4] They also challenged the adequacy and accuracy of the disclosures made by the Milliken Board in the notice of meeting at which the charter amendments were to be considered.[5] Individual and derivative claims were brought against Milliken, and the board of directors, charging the directors with a breach of their fiduciary duties.[6]

With respect to the plaintiffs' disclosure arguments, the supreme court found that the duty of candor "represents nothing more than the well-recognized proposition that directors of Delaware corporations are under a fiduciary duty to disclose fully and fairly all material information within the board's control when it seeks shareholder action."[7] The court also noted that the use of the term "duty of

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2. 606 A.2d 75 (Del. 1992).

3. *Id.* at 78.

4. *Id.*

5. *Id.*

6. *Id.* The court of chancery granted summary judgment for the defendants on all of the Strouds' claims except their attack on the bylaw. Stroud v. Grace, No. 10,719, 1990 Del. Ch. LEXIS 185, at *61 (Del. Ch. Nov. 1, 1990), *reprinted in* 16 DEL. J. CORP. L. 1588, 1621 (1991). The court of chancery ruled that "the board's actions would not be reviewed under the standards set forth in Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985), and found that the notice of the annual meeting was not inadequate or misleading." *Stroud*, 606 A.2d at 78. The court of chancery also held that the board was under a duty to disclose more information in its notice than required in DEL. CODE ANN. tit. 8, §§ 222(a), 242(b)(1) (1991). *Stroud*, 606 A.2d at 78. The trial court also ruled that Milliken did not have to disclose any confidential information to stockholders who had not first executed a reasonable confidentiality agreement. *Id.* Finally, the court of chancery assessed the Strouds' challenge to the validity of the amendments and the bylaw under the "compelling justification" standard set forth in its opinion in Blasius Indus. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988). *Stroud*, 606 A.2d at 78. The amendments were determined to be fair, but the bylaw was deemed unreasonable on its face because it potentially prevented nominations of candidates by shareholders for Milliken's Board of Directors. *Id.* at 78-79.

7. *Stroud*, 606 A.2d at 84. The duty of disclosure was explained by the United States Supreme Court in TSC Indus. v. Northway, Inc., 426 U.S. 438, 449 (1976), and was fully adopted by the Supreme Court of Delaware in Rosenblatt v. Getty Oil Co., 493 A.2d 929, 944 (Del. 1985).

candor" was "confusing and imprecise." It was more appropriate for courts to speak in terms of a "duty of disclosure based on a materiality standard."[8]

Addressing the disclosure violations alleged by the plaintiffs,[9] the court noted that "questions of disclosure beyond those mandated by statute become less compelling" where no proxy violation is involved.[10] Considering all the circumstances, including the fact that Milliken was a non-public privately held corporation, the court found that the directors had no duty to disclose beyond the notice requirements of sections 222(a) and 242(b)(1).[11] In addition, the court found that the directors were only required to disclose, according to these sections, in the notice of the meeting at which the charter amendments were to be considered.[12]

The court noted in its discussion of confidentiality:

> [i]n recognition of the essential nature of keeping financial information confidential in privately-held corporations like Milliken, it is entirely reasonable for a court to make the execution of a confidentiality agreement a prerequisite to disclosure of confidential information to stockholders for purposes of any meeting where a vote is taken.[13]

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8. *Stroud*, 606 A.2d at 84. The court found its statement concerning the duty of disclosure to be "entirely consistent" with prior statements of Delaware law concerning disclosure duties. *Id.*

9. The plaintiffs alleged that:

> (1) the directors failed to explain the differences between the 1989 amendments and the previously proposed and withdrawn amendments; (2) the board misstated [the Supreme Court of Delaware's] resolution of the first *Stroud* decision; (3) the board misleadingly stated that it consisted of a majority of outside directors; (4) the board's disclosure of financial data and its responses to shareholder inquiries at the annual meeting was hasty and inadequate; and finally (5) the board falsely informed the shareholders that an independent valuation of the corporation's shares was accurate.

Id.

10. *Id.* at 86.

11. DEL. CODE ANN. tit. 8, §§ 222(a), 242(b)(1) (1991).

12. *Stroud*, 606 A.2d at 87 (finding that "[s]ection 222 delineates the information which must be disclosed in a notice of annual meeting" and does not require the board to disclose the purpose of a regularly scheduled annual meeting).

When a company seeks to amend its certificate of incorporation, § 242(b)(1) requires conformity to the notice provisions of § 222, "obligating the board to include a resolution declaring the advisability of the amendment" and either the text of the proposal or a "brief summary of the changes." *Id.*

13. *Stroud*, 606 A.2d at 89. The court recognized that "[w]hile it is the duty of the court to protect the rights of stockholders, it is equally their duty to safeguard the rights of the corporation as such." *Id.* (quoting State *ex rel.* Cochran v. Penn-Beaver Oil Co., 143 A. 257, 260 (Del. 1926) (en banc)).

In *Shell Petroleum, Inc. v. Smith*,[14] the Supreme Court of Delaware affirmed a decision of the court of chancery and awarded damages to a class consisting of all former minority stockholders of Shell Oil Company (Shell), as a result of "material misstatements" made by Shell Petroleum, Inc. (Holdings) in connection with a short-form "freeze-out" merger.[15]

Holdings, which owned 94.6% of Shell's outstanding stock at the time of the merger, distributed several documents to the minority stockholders in connection with the short-form merger.[16] The documents included a table of discounted future net cash flows for Shell's oil and gas reserves.[17] Due to a computer programming error, the information failed to account for 295 million barrel equivalents of proven oil and gas reserves.[18] This error caused the future net cash flow table to reflect a discounted future net cash flow of up to $1.1 billion, or the equivalent of $3 to $3.45 per share.[19] As a result, Shell indicated a slight decline in the value of its oil and gas reserves from 1984 to 1985, when there actually had been an increase.[20]

The court of chancery found that the error was material and misleading and that Holdings, by virtue of its role in preparing and distributing the materials, was liable for the error.[21] The court awarded the stockholder class $2 per share in damages.[22]

On appeal, Holdings raised several arguments.[23] Holdings claimed that the error was not material, and that, in any event, it should not be liable for the error.[24] Regarding the issue of materiality, the Supreme Court of Delaware rejected the argument that the error was insignificant when viewed in context, noting that the 220 million barrel discovery had been considered important enough to merit coverage on the front page of *The Wall Street Journal*.[25] The court also rejected the argument advanced by Holdings that the error was not significant enough to affect a stockholder's decision to seek

14. 606 A.2d 112 (Del. 1992).
15. *Id.* at 113.
16. *Id.*
17. *Id.*
18. *Shell Petroleum*, 606 A.2d at 113.
19. *Id.*
20. *Id.*
21. *Id.* at 113-14.
22. *Shell Petroleum*, 606 A.2d at 114.
23. *Id.* at 114-17.
24. *Id.* at 115-16.
25. *Id.* at 114-15.

appraisal.[26] The question was not whether the information would have changed a stockholder's decision, but whether "the fact in question would have been relevant" to the stockholder.[27] Holdings' argument that the discounted cash flow was not material because it was only an estimate was likewise rejected.[28] The court found that it was reasonable for a stockholder to conclude that the estimate was "accurately prepared based on all available information."[29]

In discussing whether Holdings should not be held responsible for Shell's disclosure materials, the court found that Holdings played a substantial role in the "preparation and distribution"[30] of the disclosure materials.[31] It concluded that "a majority shareholder who directs a subsidiary to prepare certain disclosure materials and then distributes those materials to minority shareholders should be held accountable for any errors contained therein."[32]

The Delaware Court of Chancery also issued several opinions in 1992 concerning the disclosure duties of directors. In *Gilmartin v. Adobe Resources Corp.*,[33] the court of chancery granted a preliminary injunction to preferred stockholders of Adobe Resources Corporation (Adobe).[34] The plaintiffs sought to enjoin a scheduled vote and the consummation of a proposed merger of Adobe into Santa Fe Resources, Inc. (Santa Fe).[35]

Adobe's largest common stockholder was Minorco (USA), Inc. (Minorco), which owned 47.5% of Adobe common stock.[36] The

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26. *Shell Petroleum*, 606 A.2d at 115.

27. *Id.* (quoting Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1289 (Del. 1989)).

28. *Id.*

29. *Id.*

30. *Shell Petroleum*, 606 A.2d at 115-16.

31. *Id.* at 116.

32. *Id.* The Supreme Court of Delaware also considered disclosure issues in *Gaffin v. Teledyne, Inc.*, 611 A.2d 467 (Del. 1992). In *Gaffin*, the supreme court reversed a court of chancery decision which had awarded damages to a class of Teledyne, Inc. (Teledyne) stockholders after finding Teledyne guilty of equitable fraud in connection with a repurchase offer for its common stock. *Id.* at 467-68. The supreme court held that a class action could not be maintained in a purely common law or equitable fraud case, because "individual questions of law or fact concerning each individual shareholder's justifiable reliance predominated over any questions of law or fact common to the class." *Id.* at 468.

33. No. 12,467, 1992 Del. Ch. LEXIS 80 (Del. Ch. Apr. 6, 1992), *reprinted in* 18 DEL. J. CORP. L. 255 (1993).

34. *Id.* at *44, *reprinted in* 18 DEL. J. CORP. L. at 281.

35. *Id.* at *2, *reprinted in* 18 DEL. J. CORP. L. at 261.

36. *Id.* at *5, *reprinted in* 18 DEL. J. CORP. L. at 263.

proposed merger with Santa Fe was precipitated by Minorco's decision to cease considering its investment in Adobe to be long-term.[37]

In the proposed merger, each share of Adobe common stock would be converted into .60 share of Santa Fe's common stock. In addition, each share of Adobe preferred stock would be converted into a fractional share of Santa Fe's common stock and a fractional share of a newly issued Santa Fe preferred stock.[38] The merger required the vote of both a majority of Adobe's common stockholders, and a vote of two-thirds of Adobe's preferred stockholders present in person or represented by proxy at the stockholders' meeting.[39] Minorco and Adobe's officers owned 49.3% of Adobe's common stock, making approval by the common stockholders "virtually assured."[40] Adobe's officers, directors, and affiliates controlled 27.4% of the votes entitled to be cast by Adobe's preferred stockholders at the meeting which required only 51% to be present for a quorum.[41] The merger required the vote of at least 34% of the preferred stockholders, or 6.6% of the unaffiliated preferred stockholders.[42]

The plaintiffs sought to enjoin the merger contending both that it was substantively unfair and that the proxy disclosures were inadequate.[43] Addressing the disclosure claims, the court of chancery concluded that the plaintiffs failed to demonstrate a reasonable probability of success as to all but one of the claims.[44] The surviving claim asserted that the defendants failed to disclose that the chairman

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37. *Gilmartin*, No. 12,467, 1992 Del. Ch. LEXIS 80, at *11, *reprinted in* 18 DEL. J. CORP. L. at 266.

38. *Id.* at *6, *reprinted in* 18 DEL. J. CORP. L. at 263.

39. *Id.* at *6-7, *reprinted in* 18 DEL. J. CORP. L. at 263.

40. *Id.* at *7, *reprinted in* 18 DEL. J. CORP. L. at 264.

41. *Gilmartin*, No. 12,467, 1992 Del. Ch. LEXIS 80, at *7-8, *reprinted in* 18 DEL. J. CORP. L. at 264.

42. *Id.*

43. *Id.* at *22-23, *reprinted in* 18 DEL. J. CORP. L. at 271. The court declined to address the plaintiffs' substantive unfairness contentions, concluding that, on the record, the plaintiffs probably would be unable to prove the proposed merger was other than an arm's-length transaction with a third party, and that unaffiliated preferred stockholders had the legal right to veto the transaction at the stockholders' meeting. *Id.* at *26, *reprinted in* 18 DEL. J. CORP. L. at 273. "Thus, if the Preferred Stockholders' vote was fully informed, no reason exists for [the court] to intervene on substantive unfairness grounds in a transaction that the Preferred Stockholders themselves were empowered to prevent." *Id.* at *26-27, *reprinted in* 18 DEL. J. CORP. L. at 273. However, the court noted, the preferred stockholders' ability to vote down the merger "would be dispositive only if their vote was fully informed." *Id.* at *27, *reprinted in* 18 DEL. J. CORP. L. at 273.

44. *Id.* at *27, *reprinted in* 18 DEL. J. CORP. L. at 273.

of the board and chief executive officer of Adobe (and at least one other board member) believed that it was a bad time to sell Adobe because of the depressed oil and gas market.[45] The chairman and chief executive officer had informed both the board and Minorco of that belief.[46]

The claim in the proxy statement that the preferred stockholders would receive a fair price in the merger, unqualified by a disclosure that two of the directors believed this a bad time to sell Adobe, was found to be materially misleading.[47] This was particularly true in light of the preferred stockholders' dividend rights and liquidation preferences, giving them "separate and distinct economic interests . . . ."[48] The omitted fact also rendered other disclosures materially misleading, in addition to being materially misleading in its own right.[49]

The court concluded that the appropriate remedy under the circumstances was a preliminary injunction for a period of time "sufficient to enable the defendants to cure the disclosure defect."[50] The court stated that such relief would "enable the Preferred Stockholders to cast an informed vote without depriving them of the opportunity presented by the merger, should they decide to approve it."[51]

In *Marhart, Inc. v. CalMat Co.*,[52] the court of chancery considered a motion to dismiss a complaint which alleged fraud and breach of

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45. *Gilmartin*, No. 12,467, 1992 Del. Ch. LEXIS 80, at *27, *reprinted in* 18 DEL. J. CORP. L. at 273-74.

46. *Id.* at *27-28, *reprinted in* 18 DEL. J. CORP. L. at 274.

47. *Id.* at *30-31, *reprinted in* 18 DEL. J. CORP. L. at 275.

48. *Id.* at *33-34, *reprinted in* 18 DEL. J. CORP. L. at 276.

49. *Gilmartin*, No. 12,467, 1992 Del. Ch. LEXIS 80, at *34, *reprinted in* 18 DEL. J. CORP. L. at 276. Among the other disclosures rendered misleading by the omitted fact were disclosures: that the board of directors unanimously had recommended that stockholders vote for the merger; that due to the nature of the buyer (an oil and gas company) the depressed state of the oil and gas industry would have minimal or no impact on the fairness of the merger consideration received; that a liquidation of Adobe might benefit the preferred stockholders; that there was a possibility that a liquidation may not be "advantageously accomplished"; and that Minorco decided "to dispose of its Adobe stock." *Id.* at *34-40, *reprinted in* 18 DEL. J. CORP. L. at 276- 79. The court found that each of such disclosures was materially misleading without also disclosing the views of the board members, one of whom was the chairman of Adobe, that it was a bad time to sell Adobe. *Id.* at *40, *reprinted in* 18 DEL. J. CORP. L. at 279.

50. *Id.* at *28, *reprinted in* 18 DEL. J. CORP. L. at 274.

51. *Id.* at *28-29, *reprinted in* 18 DEL. J. CORP. L. at 274.

52. [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,655, at 93,096 (Del. Ch. Apr. 22, 1992), *reprinted in* 18 DEL. J. CORP. L. 330 (1993).

a fiduciary duty in connection with a corporate restructuring.[53] While the corporate restructuring complained of involved transactions that did not require stockholder action, CalMat disclosed certain information to the public concerning the transactions.[54] The plaintiffs claimed that the information disclosed by CalMat misrepresented the restructuring plan.[55]

The defendants moved to dismiss the complaint.[56] In support of this motion, CalMat argued that the plaintiffs' allegations failed to state a claim, since directors of Delaware corporations owe no fiduciary duty of full and fair disclosure absent a transaction requiring stockholder action.[57] The court rejected the defendants' argument, stating that directors of Delaware corporations "are fiduciaries and are held to a high standard of conduct."[58] The court found that "[i]t is entirely consistent with this settled principle of law that fiduciaries who undertake the responsibility of informing stockholders about corporate affairs, be required to do so honestly."[59] The court held that the complaint stated a cause of action for breach of the fiduciary duty of full disclosure because the defendants had "allegedly issued press releases that materially misrepresented their restructuring plans."[60]

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53. *Id.*, *reprinted in* 18 DEL. J. CORP. L. at 333.

54. *Id.* at 93,097, *reprinted in* 18 DEL. J. CORP. L. at 333.

55. *Id.*, *reprinted in* 18 DEL. J. CORP. L. at 334.

56. *Marhart*, [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,655, at 93,096 (Del. Ch. Apr. 22, 1992), *reprinted in* 18 DEL. J. CORP. L. at 333.

57. *Id.* at 93,097, *reprinted in* 18 DEL. J. CORP. L. at 335.

58. *Id.* at 93,098, *reprinted in* 18 DEL. J. CORP. L. at 336.

59. *Id.* The court found support in two prior decisions of the court of chancery. *See* Kelly v. Bell, 254 A.2d 62, 71 (Del. Ch. 1969), *aff'd*, 266 A.2d 878 (Del. 1970) (stating that "directors owe a duty to honestly disclose all material facts when they undertake to give out statements about the business to stockholders"); Freedman v. Restaurant Assocs. Indus., Inc., [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,617, at 97,889 (Del. Ch. Sept. 19, 1990), *reprinted in* 16 DEL. J. CORP. L. 1462, 1476 (1991) (recognizing that even absent an obligation to disclose certain information, the information must be stated truthfully and candidly if it is volunteered).

60. *Marhart*, [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,655, at 93,098, *reprinted in* 18 DEL. J. CORP. L. at 336. The Delaware Court of Chancery also considered disclosure issues in several other corporate cases in 1992. *In re* Arkla Exploration Co. Shareholders Litig., [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,517, at 92,353 (Del. Ch. Jan. 14, 1992), *reprinted in* 18 DEL. J. CORP. L. 215 (1993), contained a claim that there was inadequate disclosure as to what the plaintiffs considered to be the majority stockholder's primary motivation to acquire the minority's stock, and claims that the disclosure falsely represented that the parent company's historical annual dividend was guaranteed. *Id.* at 92,356,

B. *The Directors' Duties of Care and Loyalty*

The Supreme Court of Delaware's opinion in *Stroud v. Grace*,[61] discussed earlier in this article,[62] also addressed the plaintiffs' claim that the Milliken Board's decision to approve and recommend certain charter amendments violated their fiduciary duty of care, and implicitly, their duty of loyalty.[63] The plaintiffs claimed that the trial court erred in applying the business judgment rule to the challenged conduct.[64] The Strouds argued that the court should have applied a stricter standard of review, based upon the Supreme Court of Delaware's decision in *Unocal Corp. v. Mesa Petroleum Co.*[65]

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reprinted in 18 DEL. J. CORP. L. at 221. The court concluded that, though "some of the disclosures could have been more detailed, none of them were so inadequate" as to justify issuance of preliminary injunctive relief against the exchange offer. *Id.*

In *In re* Tri-Star Pictures, Inc. Litig., No. 9477 (Consolidated), 1992 Del. Ch. LEXIS 30 (Del. Ch. Feb. 21, 1992), *reprinted in* 18 DEL. J. CORP. L. 347 (1993), the court rejected the plaintiff's contention that a proven violation of the duty of candor constitutes actionable harm per se and automatically results in an individual injury compensable in money damages to the class members. *Id.* at *27, *reprinted in* 18 DEL. J. CORP. L. at 363. The court concluded that "where compensatory (as distinguished from restitutionary) damages are sought in a claim for breach of the duty of candor, individual damage to the plaintiffs is an essential element of that claim." *Id.* at *29-30, *reprinted in* 18 DEL. J. CORP. L. at 364.

In Norman v. Paco Pharmaceutical Servs., [1992-1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,201, at 94,811 (Del. Ch. Oct. 21, 1992), *reprinted in* 18 DEL. J. CORP. L. 1065 (1993), the court of chancery granted the defendants' cross-motion for summary judgment as to the plaintiff's claims that the defendants violated the federal securities laws, and the common law, in connection with the disclosure set forth in a debenture offering. *Id.* at 94,817, *reprinted in* 18 DEL. J. CORP. L. at 1082. The plaintiff's claim "was based on his assertion that the disclosure materials contained a materially misleading stated purpose for the offering." *Id.* at 94,811, *reprinted in* 18 DEL. J. CORP. L. at 1065. The court also noted that registration materials were not materially misleading merely because they omitted a discussion of contingent or indefinite plans or because they failed to predict future actions. *Id.* at 94,816, *reprinted in* 18 DEL. J. CORP. L. at 1079. Therefore, the defendants' failure to disclose that the company had begun investigating certain companies as possible acquisition candidates could not be considered a materially misleading omission as a matter of law. *Id.*

61. 606 A.2d 75 (Del. 1992).

62. *See supra* notes 2-13.

63. *Stroud*, 606 A.2d at 81.

64. *Id.* at 82.

65. *Id.* at 81 (citing *Unocal*, 493 A.2d at 954-55). *Unocal* reaffirmed the application of the business judgment rule in the context of a hostile battle for control of a Delaware corporation where board action is taken to the exclusion of, or in limitation upon, a valid stockholder vote. *See Unocal*, 493 A.2d at 954. *Unocal* recognized that directors are often faced with an inherent conflict of interest during contests for corporate control "[b]ecause of the omnipresent specter that a board

The supreme court noted that inherent in the application of the *Unocal* standard "is a presumption that a board acted in the absence of an informed shareholder vote ratifying the challenged action."[66] The court explained that "[t]his significant distinction, in addition to the fact that [the] Milliken [Board] faced no threat to corporate policy and effectiveness, or to the board's control, is fatal to [the] plaintiffs' *Unocal* arguments."[67] The court found that "[n]o Delaware court ha[d] applied *Unocal* in the absence of a danger to corporate policy and effectiveness, or as here, in the face of a valid shareholder vote ratifying the challenged board action."[68]

The Delaware Court of Chancery also considered directors' fiduciary duties of care and loyalty in 1992. In the case of *In re Wheelabrator Technologies Inc. Shareholders Litigation*,[69] the court of chancery granted in part and denied in part the defendants' motion to dismiss a stockholder class action.[70] The complaint sought declaratory relief and money damages in connection with a merger between Wheelabrator Technologies, Inc. (WTI) and Waste Management, Inc. (Waste), or, alternatively, rescission of the merger.[71] The complaint included allegations that WTI and its directors breached their duties under the Supreme Court of Delaware's decision in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[72] (*Revlon*). The duties allegedly breached included the duty to maximize stockholder value in the merger transaction, as well as the duties of care and loyalty.[73] The plaintiffs also alleged that Waste aided and abetted WTI and its directors in some of these breaches of duty.[74]

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may be acting primarily in its own interests, rather than those of the corporation and its shareholders . . . ." *Id. Unocal* thus requires a reviewing court to apply an enhanced standard of review to determine whether the directors "had reasonable grounds for believing that a danger to corporate policy and effectiveness existed" and that the board's response was "reasonable in relation to the threat posed." *Id.* at 955. If the board action meets the *Unocal* standard, it is accorded the protection of the business judgment rule. *Id.* at 958.

66. *Stroud*, 606 A.2d at 83.

67. *Id.*

68. *Id.*

69. No. 11,495 (Consolidated), 1992 Del. Ch. LEXIS 196 (Del. Ch. Sept. 1, 1992), *reprinted in* 18 DEL. J. CORP. L. 778 (1993).

70. *Id.* at *42, *reprinted in* 18 DEL. J. CORP. L. at 802.

71. *Id.* at *1, *reprinted in* 18 DEL. J. CORP. L. at 784.

72. 506 A.2d 173 (Del. 1986).

73. *Wheelabrator*, No. 11,495, 1992 Del. Ch. LEXIS 196, at *6, *reprinted in* 18 DEL. J. CORP. L. at 786.

74. *Id.*

Turning to the plaintiffs' *Revlon* claim, the court of chancery noted that the Supreme Court of Delaware's decisions in *Barkan v. Amsted Industries*[75] and *Paramount Communications, Inc. v. Time, Inc.*,[76] which examined the issue of when *Revlon* duties are triggered, "are not easily reconciled . . . ."[77] "Under *Barkan* it appears that a board becomes subject to *Revlon* duties whenever 'a fundamental change of corporate control occurs or is contemplated' . . . ."[78] The court stated that the premise of *Paramount*, however, appeared more narrow.[79] The vice-chancellor explained that *Paramount* defined *Revlon* duties as arising "when 'the dissolution or break-up of the corporate entity [is] inevitable.'"[80] The court found that "*Barkan* appears not to fit within *Paramount*'s categories . . . ."[81] The court recognized that it is "possible that *Paramount* rejects the more generic *Barkan* formulation as to when *Revlon* duties arise and, thus, overrules *Barkan sub silentio* on that point."[82] However, the court concluded that it

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75. 567 A.2d 1279 (Del. 1989).

76. 571 A.2d 1140 (Del. 1989).

77. *Wheelabrator*, No. 11,495, 1992 Del. Ch. LEXIS 196, at *24, *reprinted in* 18 DEL. J. CORP. L. at 794.

78. *Id.* at *25, *reprinted in* 18 DEL. J. CORP. L. at 795 (quoting *Barkan*, 567 A.2d at 1286). The court read *Barkan* as holding "that when only one bidder is present, the directors have a duty, to be adequately informed of the value of their own company before committing it to a change-of-control transaction. If the directors act without that knowledge, they breach that duty unless they first conduct an auction or canvass the market." *Id.* at *25-26, *reprinted in* 18 DEL. J. CORP. L. at 795.

79. *Id.* at *26, *reprinted in* 18 DEL. J. CORP. L. at 795.

80. *Id.* (quoting *Paramount*, 571 A.2d at 1150). In *Paramount*, the Supreme Court of Delaware described the circumstances where that event will generally occur:

> Under Delaware law there are, generally speaking and without excluding other possibilities, two circumstances which may implicate *Revlon* duties. The [f]irst, and clearer one, is when a corporation initiates an active bidding process seeking to sell itself or to effect a business reorganization involving a clear breakup of the company. However, *Revlon* duties may also be triggered where, in response to a bidder's offer, a target abandons its long-term strategy and seeks an alternative transaction involving the breakup of the company.

Paramount, 571 A.2d at 1150 (citation omitted).

81. *Wheelabrator*, No. 11,495, 1992 Del. Ch. LEXIS 196, at *27, *reprinted in* 18 DEL. J. CORP. L. at 796. The court noted that "*Paramount* expressly rejects the proposition that *Revlon* duties automatically arise whenever a corporate transaction 'might be construed as putting a corporation "in play" or "up for sale"'—two situations arguably satisfying the *Barkan* 'fundamental change of corporate control' standard." *Id.* (citation omitted).

82. *Id.* at *28, *reprinted in* 18 DEL. J. CORP. L. at 796. The court was not prepared to so conclude, however, absent a clear indication to that effect from the Supreme Court of Delaware. *Id.*

was not required to reconcile the standard of *Paramount* with *Barkan*, as the plaintiffs had failed under either standard to plead a cognizable *Revlon* claim.[83] This conclusion was based upon the plaintiffs' clear inability to satisfy "the requirements of *Paramount*,"[84] and the plaintiffs' failure to allege facts, as required by *Barkan*, that supported the claim that WTI's directors were so uninformed about WTI's value that they violated their *Revlon* duties by failing to conduct an active survey of the market.[85]

All claims against WTI were dismissed except the claim of equitable fraud.[86] The court noted that, "while it is correct that the corporate entity as such is not a fiduciary to its stockholders and cannot be held liable to them on that basis, the corporation can be held liable in cases involving fraud or affirmative misconduct."[87] However, the court found that "Waste owed no fiduciary duties to WTI's shareholders before the merger, and that Waste's designees on WTI's Board violated no fiduciary duties since they did not participate in the merger negotiations on WTI's behalf."[88]

In *Litle v. Waters*,[89] the court of chancery considered a minority stockholder's claim that the controlling stockholder breached his fiduciary duties in connection with payment of dividends.[90] The plaintiff, who owned approximately thirty-two percent of the stock of DMGT Corporation (DMGT),[91] alleged that DMGT refused to pay dividends sufficient to enable DMGT's stockholders to cover taxes

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83. *Id.*

84. *Id.*

85. *Id.* at *28-29, *reprinted in* 18 DEL. J. CORP. L. at 796-97.

86. *Wheelabrator*, No. 11,495, 1992 Del. Ch. LEXIS 196, at *42, *reprinted in* 18 DEL. J. CORP. L. at 802.

87. *Id.* at *32, *reprinted in* 18 DEL. J. CORP. L. at 798.

88. *Id.* at *34, *reprinted in* 18 DEL. J. CORP. L. at 798-99. Regarding the claim that Waste and its designees on WTI's Board aided and abetted WTI's other directors in breaching their fiduciary duty to WTI's stockholders, the court held that the facts asserted in the complaint did not state a case for knowing participation in the breach of a fiduciary relationship. *Id.* at *35, *reprinted in* 18 DEL. J. CORP. L. at 799. The court noted that the allegations that Waste "dictated" terms to a self-dealing WTI Board, after having threatened to dispose of its minority position in WTI if its terms were not met, if true, "lead to an inference of hard bargaining on the part of Waste—conduct in which Waste had every right to engage—not of complicity in whatever breaches of duty WTI's [B]oard may have committed." *Id.* at *35-36, *reprinted in* 18 DEL. J. CORP. L. at 799.

89. No. 12,155, 1992 Del. Ch. LEXIS 25 (Del. Ch. Feb. 10, 1992), *reprinted in* 18 DEL. J. CORP. L. 315 (1993).

90. *Id.* at *8, *reprinted in* 18 DEL. J. CORP. L. at 321.

91. *Id.* at *2 n.1, *reprinted in* 18 DEL. J. CORP. L. at 318 n.1.

incurred as a result of the corporation's Subchapter S election.[92] The plaintiff alleged that DMGT's majority stockholder caused DMGT not to pay dividends so that he could buy the plaintiff's shares "on the cheap."[93] The plaintiff "allege[d] that DMGT's Board ha[d] issued Stock Appreciation Rights ('SARs') rather than stock to its key officers so that the no-dividend policy would hurt only Litle . . . ."[94] DMGT moved to dismiss the suit.[95]

The court found as an initial matter that the entire fairness standard of review was applicable to the decision not to declare dividends for purposes of the motion to dismiss.[96] This determination was reached after a finding that both of the defendant directors would be considered "interested"[97] directors for purposes of the motion.[98]

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92. *Id.* at *3-5, *reprinted in* 18 DEL. J. CORP. L. at 319-20.

93. *Litle*, No. 12,155, 1992 Del. Ch. LEXIS 25, at *5, *reprinted in* 18 DEL. J. CORP. L. at 320.

94. *Id.*

95. *Id.* at *1, *reprinted in* 18 DEL. J. CORP. L. at 318.

96. *Id.* at *14, *reprinted in* 18 DEL. J. CORP. L. at 324. Under the "entire fairness" standard, "the burden shifts to defendants to demonstrate that the decision to not declare dividends and to repay the company's debt to Waters was intrinsically fair." *Id.* at *14- 15, *reprinted in* 18 DEL. J. CORP. L. at 324.

97. The court stated that "[a]n interested director is one that stands on both sides of a transaction or expects to derive personal financial benefit from the transaction in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally." *Litle*, No. 12,155, 1992 Del. Ch. LEXIS 25, at *11, *reprinted in* 18 DEL. J. CORP. L. at 322. *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984). However, a director is not an interested director in every case where he has a financial interest that differs from stockholders generally. Cinerama, Inc. v. Technicolor, Inc., No. 8358, 1991 Del. Ch. LEXIS 105, at *33 (Del. Ch. June 21, 1991) (Revised June 24, 1991), *reprinted in* 17 DEL. J. CORP. L. 551, 571 (1992). The decision as to whether a director is disinterested depends on whether

> the director . . . involved had [a] material financial or other interest in the transaction different from the shareholders generally. "Material" in this setting refers to a financial interest that in the circumstances created a reasonable probability that the independence of the judgment of a reasonable person in such circumstances could be affected to the detriment of the shareholders generally.

Litle, No. 12,155, 1992 Del. Ch. LEXIS 25, at *11-12, *reprinted in* 18 DEL. J. CORP. L. at 323 (quoting *Cinerama*, No. 8358, 1991 Del. Ch. LEXIS 105, at *37, *reprinted in* 17 DEL. J. CORP. L. at 573).

98. *Litle*, No. 12,155, 1992 Del. Ch. LEXIS 25, at *14, *reprinted in* 18 DEL. J. CORP. L. at 324. The court held that the director, who was the controlling stockholder of DMGT, had "served his own personal financial interests in making his decision to have DMGT not declare dividends" since, under the circumstances, he would receive a greater share of the cash available for corporate distributions through certain loan repayments. *Id.* at *12, *reprinted in* 18 DEL. J. CORP. L. at

The court, with respect to the plaintiff's claim of oppression, reviewed cases in other jurisdictions regarding oppression, because of a lack of Delaware case law on the subject.[99] The court analyzed the plaintiff's claims under two different standards for determining oppression.[100] The first standard defines oppression as "a violation of the 'reasonable expectations' of the minority," with those reasonable expectations being "the spoken and unspoken understandings on which the founders of a venture rely when commencing a venture."[101] The second standard defines oppression as "burdensome, harsh and wrongful conduct; a lack of probity and fair dealing in the affairs of the company to the prejudice of some of its members; or a visible departure from the standards of fair dealing, and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely."[102] The court concluded that the plaintiff adequately alleged a violation of his reasonable expectations and that a reasonable person could interpret the attempt to squeeze out the plaintiff as a visible departure from the standards of fair dealing and fair play.[103] The "oppression" claim, therefore, stated a claim upon which relief could be granted.[104]

C. *The Directors' Fiduciary Duties to Creditors Upon Insolvency*

In *Geyer v. Ingersoll Publications Co.*,[105] the court of chancery considered the question of when fiduciary duties are owed to creditors.[106] The court denied the motion of defendant Ralph Ingersoll II (Ingersoll) to dismiss the plaintiff's claims alleging breaches of

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323. In addition, the court determined that the decision also enabled the majority stockholder to put pressure on the plaintiff to sell his shares to him at a discount since the shares were a liability to the plaintiff. *Id.* The court also noted that the allegations that the other director- defendant was dominated by the majority stockholder, because his lucrative position as an officer of DMGT as well as the value of his stock appreciation rights completely depended on the majority stockholder's support, required the court to consider him an interested director for purposes of the motion. *Id.* at *13-14, *reprinted in* 18 DEL. J. CORP. L. at 324.

99. *Id.* at *20-22, *reprinted in* 18 DEL. J. CORP. L. at 326-27.

100. *Id.* at *21-22, *reprinted in* 18 DEL. J. CORP. L. at 327.

101. *Id.* (quoting Gimpel v. Bolstein, 477 N.Y.S.2d 1014, 1018-19 (N.Y. 1984)).

102. *Litle*, No. 12,155, 1992 Del. Ch. LEXIS 25, at *22, *reprinted in* 18 DEL. J. CORP. L. at 327-28 (citing *Gimpel*, 477 N.Y.S.2d at 1018).

103. *Id.* at *24, *reprinted in* 18 DEL. J. CORP. L. at 328.

104. *Id.* at *25, *reprinted in* 18 DEL. J. CORP. L. at 329.

105. 621 A.2d 784 (Del. Ch. 1992).

106. *Id.*

fiduciary duties, fraudulent conveyances, and the right to judgment on a promissory note (the Note) on an alter ego theory.[107]

Ingersoll Publications Company (IPCO) repurchased the plaintiff's IPCO shares in the fall of 1988 in return for the Note.[108] "The Note obligated IPCO to make monthly payments of principal and interest . . . with a balloon payment due . . . on October 15, 1991."[109] However, IPCO failed to make its June 15, 1991 payment or any subsequent payments.[110] The plaintiff's complaint alleged that IPCO's inability to make payments on the Note came about after Ingersoll caused IPCO to surrender and cancel certain newspaper management agreements in return for benefits to Ingersoll personally and for inadequate consideration to IPCO.[111]

Ingersoll first argued that the court lacked personal jurisdiction over him.[112] Ingersoll had been served with process pursuant to section 3114, which authorizes service on non-resident directors for breaches of duties owed as directors.[113] Ingersoll argued that the plaintiff was merely a creditor of IPCO to whom he owed no fiduciary duties.[114] The plaintiff alleged, on the other hand, that Ingersoll owed him fiduciary duties no later than when IPCO became insolvent.[115]

The court recognized that, as a general rule, "directors do not owe creditors duties beyond the relevant contractual terms absent 'special circumstances . . . e.g., fraud, insolvency, or a violation of a statute.'"[116] The issue for the court was "whether insolvency arises so as to create a fiduciary duty to creditors when insolvency exists in fact or when a party institutes statutory proceedings (e.g.[,] bankruptcy."[117] The court determined "that insolvency means insolvency in fact rather than insolvency due to a statutory filing in defining insolvency for purposes of determining when a fiduciary duty to creditors arises."[118] The court stated:

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107. *Id.* at 790-94.
108. *Id.* at 786.
109. *Geyer*, 621 A.2d at 786.
110. *Id.*
111. *Id.*
112. *Id.*
113. DEL. CODE ANN. tit. 10, § 3114 (1992).
114. *Geyer*, 621 A.2d at 787.
115. *Id.*
116. *Id.* (quoting Harff v. Kerkorian, 324 A.2d 215, 222 (Del. Ch. 1974), *rev'd in part on other grounds*, 347 A.2d 133 (Del. 1975) (emphasis omitted)).
117. *Id.*
118. *Geyer*, 621 A.2d at 787.

> The existence of the fiduciary duties at the moment of insolvency may cause directors to choose a course of action that best serves the entire corporate enterprise rather than any single group interested in the corporation at a point in time when shareholders' wishes should not be the directors only concern. Furthermore, the existence of the duties at the moment of insolvency rather than the institution of statutory proceedings prevents creditors from having to prophesy when directors are entering into transactions that would render the entity insolvent and improperly prejudice creditors' interests.[119]

The court based its determination on Delaware case law and the ordinary meaning of the word "insolvency."[120] As a result, the court found that section 3114 provided a statutory basis for jurisdiction over Ingersoll and denied his motion to dismiss based upon lack of personal jurisdiction.[121]

Ingersoll's motion to dismiss all counts of the complaint for failure to state a claim was also denied.[122] The court denied the motion to dismiss the plaintiff's breach of fiduciary duty count since Ingersoll owed the plaintiff fiduciary duties based upon IPCO's alleged insolvency.[123] Ingersoll also moved to dismiss the plaintiff's fraudulent conveyance claim on the theory that, among other things, the cancellations of the management contracts were not "conveyances."[124] The court found that the cancellations of the management agreements fell "within the ambit of the term release,"[125] which is included in the definition of a "conveyance" under section 1301(2),[126] because the agreements were assets that could have been used to pay creditors.[127] The court also determined that the complaint satisfied the other pleading requirements for a fraudulent conveyance claim.[128]

Finally, Ingersoll's motion to dismiss the plaintiff's claim that he was liable on the Note based on an alter ego theory was also

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119. *Id.* at 789.
120. *Id.*
121. *Id.* at 790.
122. *Geyer*, 621 A.2d at 794.
123. *Id.* at 791.
124. *Id.*
125. *Id.*
126. DEL. CODE ANN. tit. 6, § 1301(2) (1974).
127. *Geyer*, 621 A.2d at 791.
128. *Id.* at 792.

denied.[129] Ingersoll argued that the Note contractually bound the plaintiff to look only to IPCO for its satisfaction.[130] The court stated that if the plaintiff's claim against Ingersoll based upon the Note had stated a contract claim, the court would have had to dismiss the claim because of the "no recourse" provision.[131] However, the court opined that the claim "purports to hold Mr. Ingersoll liable for the Note, not because he is bound contractually, but rather, because he is the alter ego of IPCO."[132] The court held that such an equitable claim is not barred by the "no recourse" provision and noted that it could "pierce the corporate veil of an entity where there is fraud or where a subsidiary is in fact a mere instrumentality or alter ego of its owner."[133]

D. Derivative Suits and Compliance With Rule 23.1

In recent years, Delaware courts have issued several opinions addressing the ability of stockholders to continue derivative suits and to comply with Chancery Rule 23.1. In *Heineman v. Datapoint Corp.*,[134] the Supreme Court of Delaware reversed the court of chancery's dismissal of a stockholder's derivative suit alleging corporate waste and breach of fiduciary duty.[135] The court of chancery had dismissed the plaintiff's amended complaint for failure to allege with particularity facts sufficient to excuse demand and had denied the plaintiff permission to amend his complaint a second time.[136]

The supreme court, in its analysis, first reviewed the standards by which demand futility is to be judged.[137] The court stated:

> Equity will not require a useless act. . . . Where demand upon the board would be "futile," the demand requirement will be excused. In this context, futility does not mean that there is no likelihood that a board will agree to the demand. Rather, demand is futile where a reasonable doubt exists that the board has the ability to exercise its

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129. *Id.* at 794.
130. *Id.* at 793.
131. *Geyer*, 621 A.2d at 793.
132. *Id.*
133. *Id.*
134. 611 A.2d 950 (Del. 1992).
135. *Id.* at 951.
136. *Id.*
137. *Id.* at 952.

> managerial power, in relation to the decision to prosecute, within the strictures of its fiduciary obligations. If a board's disability as to a particular transaction is attributable to self-interest or lack of independence, then presuit demand is not required. The standard for pleading such futility as set forth in [the court's opinion in] *Aronson* [*v. Lewis*] is "whether, under the particularized facts alleged, a reasonable doubt is created that: (1) the directors are disinterested and independent and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment."[138]

The plaintiff's amended complaint alleged four claims against the directors of Datapoint Corporation (Datapoint).[139] The supreme court held that allegations that a majority of Datapoint's Board reimbursed themselves for the costs incurred in the successful proxy contest, through which they won their offices by voting funds from the corporate treasury in excess of $1 million, recited sufficient facts of apparent self-dealing to raise a reasonable doubt concerning director disinterest.[140] Demand was excused regarding this claim.[141]

The plaintiff's second claim alleged the existence of "an 'arrangement' by a majority of Datapoint's Board to divert a substantial amount of the corporation's assets to an arbitrage pool whose participants include entities in which a majority of the directors [held] an interest."[142] The court found that such an allegation "paint[s] a picture of directors funneling corporate assets to their private use, a practice at clear variance with the directors' fiduciary obligation."[143] The court held that the trial court's dismissal of this claim for failure to make demand represented too stringent an application of the standards governing demand.[144]

The two remaining claims concerned a consulting agreement between Datapoint and a company controlled by its chairman[145] and

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138. *Heineman*, 611 A.2d at 952 (quoting Aronson v. Lewis, 473 A.2d 805, 814 (Del. 1984) (citations omitted)).

139. *Id.* at 952-53.

140. *Id.* at 953.

141. *Id.*

142. *Heineman*, 611 A.2d at 954.

143. *Id.* (citing Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1989); Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983); Sterling v. Mayflower Hotel Corp., 93 A.2d 107 (Del. 1952); Guth v. Loft, Inc., 5 A.2d 503 (Del. 1939)).

144. *Id.*

145. *Id.* at 954-55.

also an agreement between Datapoint and a corporation whose sole stockholder was Datapoint's chairman.[146] The court stated that neither allegations of controlling stock ownership, nor a solitary claim of interlocking directorships, "raise, per se, a reasonable doubt as to the board's independence."[147] "To raise such a doubt a party attacking a corporate transaction must advance particularized factual allegations from which the [c]ourt of [c]hancery can reasonably infer that the board members who approved the transaction are acting at the direction of the allegedly dominating individual or entity."[148] The court stated that "an allegation that directors are dominated and controlled, standing alone, does not meet the demand futility standard."[149] "There must be some alleged nexus between the domination and the resulting personal benefit to the controlling party."[150] After finding that the allegations presented a "close question as to the board's independence,"[151] the court remanded the claims with the direction that the court of chancery permit the plaintiff "to file a second amended complaint to further articulate the assertion of self-interest and lack of independence . . . ."[152]

In several 1992 cases the Delaware Court of Chancery also considered whether a demand on directors was excused.[153] In *Abajian v. Kennedy*,[154] the court of chancery considered a motion to dismiss a class and derivative action challenging a series of four related

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146. *Heineman*, 611 A.2d at 956.

147. *Id.* at 955.

148. *Id.* (citing Kaplan v. Centex Corp., 284 A.2d 119, 122-23 (Del. Ch. 1971)).

149. *Id.* (citing *Aronson*, 473 A.2d at 816).

150. *Heineman*, 611 A.2d at 955 (citing *Aronson*, 473 A.2d at 815).

151. *Heineman*, 611 A.2d at 955.

152. *Id.*

153. *See In re* Chrysler Corp. Shareholders Litig., [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,996, at 94,347 (Del. Ch. July 27, 1992), *reprinted in* 18 DEL. J. CORP. L. 619 (1993); Canal Capital Corp. v. French, No. 11,764, 1992 Del. Ch. LEXIS 133 (Del. Ch. July 2, 1992), *reprinted in* 18 DEL. J. CORP. L. 611 (1993); Boeing Co. v. Shrontz, No. 11,273, 1992 Del. Ch. LEXIS 84 (Del. Ch. Apr. 20, 1992), *reprinted in* 18 DEL. J. CORP. L. 225 (1993); Chrysogelos v. London, No. 11,910, 1992 Del. Ch. LEXIS 61 (Del. Ch. Mar. 25, 1992), *reprinted in* 18 DEL. J. CORP. L. 237 (1993); Andreae v. Andreae, [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,571, at 92,646 (Del. Ch. Mar. 3, 1992) (Revised Mar. 5, 1992), *reprinted in* 18 DEL. J. CORP. L. 197 (1993); Abajian v. Kennedy, No. 11,425, 1992 Del. Ch. LEXIS 6 (Del. Ch. Jan. 17, 1992), *reprinted in* 18 DEL. J. CORP. L. 179 (1993).

154. No. 11,425, 1992 Del. Ch. LEXIS 6 (Del. Ch. Jan. 17, 1992), *reprinted in* 18 DEL. J. CORP. L. 179 (1993).

transactions (the Transactions) which were authorized by the board of directors of Alaska Air Group, Inc. (Alaska Air).[155] The plaintiffs alleged that the Transactions constituted a breach of the fiduciary duties owed by the directors to the corporation and its stockholders.[156]

The court first determined whether the plaintiffs' failure to make a demand upon the board of Alaska Air before instituting suit was excused.[157] The court noted that the "[demand excused] test asks whether, accepting the specific facts pleaded as true, they create a reasonable doubt that the board's judgment attacked as constituting a wrong will not qualify for business judgment protection."[158] After reviewing the allegations of substantive wrongdoing, the court stated that it seemed apparent that each element of the Transactions was within the legal authority of the Alaska Air directors.[159] The plaintiffs claimed, however, that the legal authority was exercised for imper-

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155. *Id.* at *1, *reprinted in* 18 DEL. J. CORP. L. at 181. The first of the challenged Transactions was a long-term lease for up to 24 aircraft entered into by a subsidiary of Alaska Air with International Lease Finance Corporation (ILFC), a California corporation also named as a defendant. *Id.* at *4, *reprinted in* 18 DEL. J. CORP. L. at 182. The second was Alaska Air's issuance of a new class of redeemable convertible preferred stock in the principal amount of $62.5 million. *Id.* The stock carried a 10.2% dividend and represented approximately 15% of the voting power of Alaska Air. *Id.* at *4-5, *reprinted in* 18 DEL. J. CORP. L. at 182. ILFC paid Alaska Air $59.4 million (giving it an expected rate of return of 10.75%) in exchange for the right to vote and collect all dividends with respect to such stock. *Id.* at *5, *reprinted in* 18 DEL. J. CORP. L. at 182. Members of Alaska Air's management paid $3.1 million for options that entitled them, periodically after three years, to cause Alaska Air to redeem the preferred stock and subjected the common stock into which it was convertible to a purchase option at $27 per share. *Id.* Significantly, the preferred stock, which after the completion of a share repurchase plan would represent 19% of the vote of Alaska Air in the hands of ILFC, was subject to restrictions as to how it could be voted and made subject to Alaska Air's control in some respects. *Id.* at *6- 7, *reprinted in* 18 DEL. J. CORP. L. at 183. The third transaction was the creation of an employee stock ownership plan (ESOP) and a loan of $20 million made to the ESOP. *Id.* at *5, *reprinted in* 18 DEL. J. CORP. L. at 182. Finally, a share repurchase program would be instituted to purchase up to 3.5 million shares (22% of Alaska Air's outstanding stock), 3 million in a "Dutch-auction" self- tender offer and the balance in the market or in private transactions. *Id.* at *5-6, *reprinted in* 18 DEL. J. CORP. L. at 183.

156. *Id.* at *8-9, *reprinted in* 18 DEL. J. CORP. L. at 184.

157. *Id.* at *13, *reprinted in* 18 DEL. J. CORP. L. at 186.

158. *Abajian*, No. 11,425, 1992 Del. Ch. LEXIS 6, at *13, *reprinted in* 18 DEL. J. CORP. L. at 186. The legal test has been clarified in a series of recent Supreme Court of Delaware opinions, including Levine v. Smith, 591 A.2d 194 (Del. 1991); Spiegel v. Buntrock, 571 A.2d 767 (Del. 1990); Aronson v. Lewis, 473 A.2d 805 (Del. 1984).

159. *Abajian*, No. 11,425, 1992 Del. Ch. LEXIS 6, at *15, *reprinted in* 18 DEL. J. CORP. L. at 187.

missible reasons.[160] The plaintiffs alleged, for example, that the placement of restricted voting preferred stock in the hands of a third party was not a concession to an arm's-length negotiating partner, but rather was designed by the Alaska Air directors in order to serve their personal interests.[161] The court found that various facts supported the conclusion that the preferred stock aspect of the Transactions was designed principally as a method of substituting restricted voting preferred stock for common stock in order to entrench the existing board.[162]

The decision was based in part on the fact that, "[b]ut for the restrictions on voting of the preferred stock, one might conclude that viewed in isolation every aspect of the Transactions plainly constituted the exercise by the board of its business judgment."[163] However, the court found that "[t]he issuance of the preferred stock . . . when considered in context [did] create a reasonable doubt that the Alaska Air [B]oard of [D]irectors was disinterested . . . ."[164] In addition, the court noted that "[t]he restrictive voting provisions that are impressed upon that stock while in the hands of [the third party] plainly . . . have the effect of protecting the incumbency of the existing board."[165] Therefore, demand on the directors was excused.[166]

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160. *Id.*

161. *Id.*

162. *Id.* at *15-18, *reprinted in* 18 DEL. J. CORP. L. at 187-88.

163. *Abajian*, No. 11,425, 1992 Del. Ch. LEXIS 6, at *16, *reprinted in* 18 DEL. J. CORP. L. at 187.

164. *Id.* at *17-18, *reprinted in* 18 DEL. J. CORP. L. at 188.

165. *Id.* at *18, *reprinted in* 18 DEL. J. CORP. L. at 188. The court stated that "[e]ven if one assumes that there could be valid corporate purposes served by consensually restricting the ability of a substantial shareholder to oppose management or communicate with other shareholders, it seems nevertheless to be the case that such restrictions do raise the prospect of impermissible motivation as one plain possibility." *Id.*

166. *Id.* at *23, *reprinted in* 18 DEL. J. CORP. L. at 191. The court noted that:

> [i]n recent years, there have been a number of cases in which [the court of chancery] has concluded that allegations of voting restrictions with respect to a block of shares was sufficient to establish a reasonable doubt that the corporation's directors were disinterested for purposes of the Rule 23.1 demand requirement.

Id. at *19-20, *reprinted in* 18 DEL. J. CORP. L. at 189. *See* L A Partners, L.P. v. Allegis Corp., No. 9033 (Del. Ch. Oct. 22, 1987), *reprinted in* 13 DEL. J. CORP. L. 1185 (1988); Edelman v. Phillips Petroleum Co., No. 7899 (Del. Ch. Feb. 12, 1985), *reprinted in* 10 DEL. J. CORP. L. 835 (1985); Seibert v. Harper & Row Publishers, Inc., No. 6639 (Del. Ch. Dec. 5, 1984), *reprinted in* 10 DEL. J. CORP. L. 645 (1985); Good v. Texaco, Inc., No. 7501 (Del. Ch. May 14, 1984), *reprinted in* 9 DEL. J. CORP. L. 461 (1984).

The court of chancery also found that demand on directors was excused in three other derivative suits in 1992. In *Andreae v. Andreae*,[167] the court found that the plaintiffs had alleged facts sufficient to excuse demand in connection with a claim that one of the defendants had effectively diverted a portion of the proceeds of an asset sale to himself by conditioning it on payment of $500,000 to him for a non-competition and confidentiality agreement.[168] In *Chrysogelos v. London*,[169] claims relating to a stock repurchase from the estate of the corporation's co-founder and the delayed disclosure of an acquisition proposal were found legally sufficient to excuse a demand, since they supported the claim that the corporation's directors acted for the sole or primary purpose of entrenching themselves in office.[170] Also, in *In re Chrysler Corp. Shareholders Litigation*,[171] allegations that Chrysler's directors were motivated by entrenchment concerns in connection with their decision to reduce the trigger on Chrysler's Rights Plan were deemed sufficient to excuse demand.[172]

E. Elections of Directors

The court of chancery decided a case concerning a contested election of directors in 1992. In *Koch v. Stearn*,[173] the court of chancery determined the proper officers and directors of Showcase Communications Network, Ltd. (Showcase), in an action brought pursuant to section 225.[174]

"Immediately prior to a board meeting held on April 7, 1992, there were four members of Showcase's [B]oard of [D]irectors . . . ."[175] Two of the directors were elected by Leathem Stearn as the holder of Showcase's common stock. Two of the directors were elected by

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167. [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,571, at 92,646 (Del. Ch. Mar. 3, 1992) (Revised Mar. 5, 1992), *reprinted in* 18 DEL. J. CORP. L. 197 (1993).

168. *Id.* at 92,651, *reprinted in* 18 DEL. J. CORP. L. at 210.

169. No. 11,910, 1992 Del. Ch. LEXIS 61 (Del. Ch. Mar. 25, 1992), *reprinted in* 18 DEL. J. CORP. L. 237 (1993).

170. *Id.* at *26-29, *reprinted in* 18 DEL. J. CORP. L. at 253-55.

171. [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,996, at 94,347 (Del. Ch. July 27, 1992), *reprinted in* 18 DEL. J. CORP. L. 619 (1993).

172. *Id.* at 94,349, 94,351, *reprinted in* 18 DEL. J. CORP. L. at 626, 628-29.

173. No. 12,515, 1992 Del. Ch. LEXIS 163 (Del. Ch. July 28, 1992), *reprinted in* 18 DEL. J. CORP. L. 730 (1993).

174. *Id.* at *1, 19, *reprinted in* 18 DEL. J. CORP. L. at 732, 740; DEL. CODE ANN. tit. 8, § 225 (1991).

175. *Koch*, No. 12,515, 1992 Del. Ch. LEXIS 163, at *1, *reprinted in* 18 DEL. J. CORP. L. at 732.

David Koch as the holder of Showcase's preferred stock.[176] The terms of the preferred stock also gave Koch the right to elect a fifth director under "certain circumstances."[177] As a result of actions taken at the Showcase Board meeting, held on April 7, 1992, Stearn was removed as president and chief executive officer of Showcase and a fifth director was elected by Koch.[178]

The court held that the validity of the board's removal of Stearn from office depended on whether Stearn was "tricked or deceived into attending the meeting."[179] "If so, the general rule is that actions taken at such a meeting are void,"[180] but "[n]otwithstanding any deceit that may have been involved in calling a meeting, the actions taken will not be invalidated where the deceived director remains at the meeting and participates throughout, . . . or where that director suffers no disadvantage in his ability to participate meaningfully in the meeting."[181]

The court held that Stearn had been tricked into attending the meeting since he was misled as to the matters that would be considered at the meeting.[182] Also, "Stearn did not vote or otherwise participate in the meeting after the resolution calling for his removal [or,] [a]lternatively, . . . was disadvantaged by the other directors' failure to communicate their plans to him."[183] Therefore, the court concluded that "the actions taken at the April 7th board meeting were void and of no effect."[184]

F. Indemnification of Directors

In *Citadel Holding Corp. v. Roven*,[185] the Supreme Court of Delaware considered an "appeal from a decision of the [s]uperior [c]ourt

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176. *Id.* at *5, *reprinted in* 18 DEL. J. CORP. L. at 734.

177. *Id.* at *3-4, *reprinted in* 18 DEL. J. CORP. L. at 733.

178. *Id.* at *8, 10-11, *reprinted in* 18 DEL. J. CORP. L. at 736-37.

179. *Koch*, No. 12,515, 1992 Del. Ch. LEXIS 163, at *11, *reprinted in* 18 DEL. J. CORP. L. at 737.

180. *Id.* (citing Schroder v. Scotten, Dillon Co., 299 A.2d 431, 436 (Del. Ch. 1972)).

181. *Id.* (citing Dillon v. Berg, 326 F. Supp. 1214, 1221 (D. Del.), *aff'd*, 453 F.2d 876 (3d Cir. 1971); Pepsi-Cola Bottling Co. v. Woodlawn Canners, Inc., No. 6161, slip op. at 28-29 (Del. Ch. Mar. 14, 1983)).

182. *Id.* at *13-14, *reprinted in* 18 DEL. J. CORP. L. at 738.

183. *Koch*, No. 12,515, 1992 Del. Ch. LEXIS 163, at *15, *reprinted in* 18 DEL. J. CORP. L. at 738.

184. *Id.*

185. 603 A.2d 818 (Del. 1992).

awarding damages in an action brought by a former director against Citadel Holding [C]orporation ('Citadel') under an indemnification agreement."[186] The supreme court affirmed the trial court's ruling that "the director, Alfred Roven ('Roven'), was entitled to reimbursement for sums paid or costs incurred by him to defray litigation expenses in a federal court action brought against him by Citadel"[187] for alleged violations of section 16(b) of the Securities Exchange Act of 1934.[188]

In May 1987, Roven and Citadel entered into an indemnity agreement (the Agreement).[189] The stated purpose of the Agreement was for Roven to gain additional protections beyond those already provided to him by Citadel's certificate of incorporation, bylaws, and insurance.[190] The Agreement contained indemnity for "any expense or liability," but was limited by exceptions, including one for cases arising under section 16(b).[191] One paragraph of the Agreement entitled Roven to require Citadel to advance the costs of defending certain lawsuits.[192] Roven invoked this paragraph of the Agreement in support of his breach of contract action.[193]

Citadel argued, among other things, that because a suit under section 16(b) was specifically excluded from indemnification under the Agreement, Roven had no right to advancement of expenses in such a suit.[194] The court rejected Citadel's argument, finding that the Agreement "in no way renders the right to advances dependent upon the right to indemnity."[195]

Citadel next argued that it was obligated to pay only reasonable expenses incurred in "defending" the suit.[196] The court concluded that the term "defense" had a "broad meaning" which included affirmative defenses and counterclaims in the section 16(b) action.[197] The court also found that Citadel's obligation to pay expenses was subject to a requirement that the expenses be reasonable.[198]

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186. *Id.* at 819.
187. *Id.*
188. *Id.* at 820-21.
189. *Citadel*, 603 A.2d at 820.
190. *Id.*
191. *Id.*
192. *Id.*
193. *Citadel*, 603 A.2d at 820.
194. *Id.* at 822.
195. *Id.*
196. *Id.* at 824.
197. *Citadel*, 603 A.2d at 824.
198. *Id.* at 823-24.

G. *Stockholders' Entitlement to Corporate Documents Under Section 220*

The court of chancery also issued important rulings in two cases brought by stockholders seeking various corporate records. In *Food & Allied Service Trades Department, AFL-CIO v. Wal-Mart Stores, Inc.*,[199] the court of chancery ordered the defendant, Wal-Mart Stores, Inc. (Wal-Mart), to permit the plaintiff, Food and Allied Service Trades Department, AFL-CIO (FAST), to inspect Wal-Mart's stockholder list and related materials.[200]

In accordance with section 220,[201] FAST delivered a written demand under oath to Wal-Mart for a list of Wal-Mart's stockholders.[202] The stated purpose of the demand was to permit FAST to solicit proxies from Wal-Mart's stockholders with respect to a resolution calling for the preparation of a report to Wal-Mart's Board of Directors and stockholders concerning Wal-Mart's buying policies in China.[203]

Wal-Mart contended that the stated purpose was not "proper" under section 220 because it was not "'reasonably related to [FAST's] interest as a stockholder.'"[204] Wal-Mart argued that the proxy solicitation purpose was a pretext to get the stockholder list for an inappropriate purpose, such as union organization.[205] Wal-Mart claimed that the purpose was to injure Wal-Mart to the advantage of competitors who employ union workers.[206]

The court rejected Wal-Mart's assertion that FAST's purpose was a pretext, noting that FAST was willing to agree to restrictions on its use of the list and to the removal from the list of the names of individual employees who owned stock through company benefit

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199. No. 12,551, 1992 Del. Ch. LEXIS 108 (Del. Ch. May 19, 1992), *reprinted in* 18 DEL. J. CORP. L. 651 (1993).

200. *Id.* at *11, *reprinted in* 18 DEL. J. CORP. L. at 657.

201. Section 220 provides, in pertinent part, that "any stockholder, in person or by attorney or other agent, shall, upon written demand under oath stating the purpose thereof, have the right during the usual hours for business to inspect for any proper purpose the corporation's . . . list of stockholders . . . and to make copies or extracts therefrom." DEL. CODE ANN. tit. 8, § 220 (1991).

202. *Food & Allied Serv. Trades*, No. 12,551, 1992 Del. Ch. LEXIS 108, at *2, *reprinted in* 18 DEL. J. CORP. L. at 653.

203. *Id.* at *2-3, *reprinted in* 18 DEL. J. CORP. L. at 653-54.

204. *Id.* at *3-4, *reprinted in* 18 DEL. J. CORP. L. at 654 (quoting DEL. CODE ANN. tit. 8, § 220 (1991)).

205. *Id.* at *8, *reprinted in* 18 DEL. J. CORP. L. at 656.

206. *Food & Allied Serv. Trades*, No. 12,551, 1992 Del. Ch. LEXIS 108, at *8, *reprinted in* 18 DEL. J. CORP. L. at 656.

plans.[207] The court accepted that FAST's principal purpose in seeking the stockholder list was to facilitate a solicitation of proxies in support of its resolution.[208] FAST could not persuasively argue that it sought the list in order to benefit its interest as a Wal-Mart stockholder.[209]

Relying on a 1972 Supreme Court of Delaware decision,[210] the court found that section 220 "permits a stockholder to inspect a corporation's stockholder list if that stockholder's purpose in seeking such inspection is to solicit proxies in support of a resolution that it has proposed solely for moral and political reasons."[211] The court stated:

> Rather than seeking to benefit itself and certain nonshareholders at the expense of the corporation, FAST seeks to ensure that the corporation complies with its legal obligations in the interest of forced laborers in China. This purpose, while principally directed towards other interests, is consistent with management's conception of the corporation's long-term interest.[212]

In *BBC Acquisition Corp. v. Durr-Fillauer Medical, Inc.*,[213] the court of chancery denied the plaintiff's request for an order compelling inspection of corporate books and records under section 220.[214] The plaintiff, BBC Acquisition Corporation (BBC), a wholly-owned subsidiary of Bergen Brunswig Corporation (Bergen), made a cash tender offer for the stock of Durr-Fillauer Medical, Inc. (Durr), the defendant.[215] Durr had earlier entered into an agreement to be acquired

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207. *Id.* "FAST propose[d] that Wal-Mart [excise] from the materials FAST [was] to receive the names of individual employee shareholders who own stock through company benefit plans." *Id.* at *7, *reprinted in* 18 DEL. J. CORP. L. at 656. FAST also stated that it was "prepared to agree that it be ordered not to use the list for any purpose other than soliciting proxies for the present resolution and to return the list after the meeting. *Id.* at *7-8, *reprinted in* 18 DEL. J. CORP. L. at 656.

208. *Id.* at *9, *reprinted in* 18 DEL. J. CORP. L. at 656-57.

209. *Id.*, *reprinted in* 18 DEL. J. CORP. L. at 651, 657. The court noted that FAST was the owner of only 23 shares of Wal-Mart stock, which it purchased for approximately $300. *Id.*

210. Credit Bureau Reports, Inc. v. Credit Bureau of St. Paul, Inc., 290 A.2d 691 (Del. 1972).

211. *Food & Allied Serv. Trades*, No. 12,551, 1992 Del. Ch. LEXIS 108, at *9-10, *reprinted in* 18 DEL. J. CORP. L. at 657.

212. *Id.* at *11, *reprinted in* 18 DEL. J. CORP. L. at 657.

213. 623 A.2d 85 (Del. Ch. 1992).

214. *Id.* at 86.

215. *Id.* at 86-87.

by Cardinal Distribution, Inc. (Cardinal).[216] Bergen, through BBC, the record owner of shares of Durr, made a formal written demand pursuant to section 220 to inspect Durr's records, including all books, records, and other documents furnished to Cardinal.[217] Durr delivered its stock list and related materials to BBC, but refused to provide BBC with the other information furnished previously to Cardinal.[218] BBC sought to compel Durr to provide it with this information.[219]

The court noted that a stockholder who complies with the statute's procedural requirements and who satisfactorily proves a proper purpose for inspection of books and records is entitled to inspection.[220] This entitlement is restricted, however, to an inspection of the books and records "necessary, essential and sufficient" for the stockholder's purpose.[221]

The court rejected Durr's contention that inspection should be conditioned upon BBC's compliance with a "fiduciary out" clause of the agreement between Durr and Cardinal, noting that a stockholder's right of inspection can only be taken away by statutory enactment,[222] and cannot be abridged or abrogated by an act of the corporation.[223] Likewise, the fact that BBC was a business competitor did not, without more, defeat the statutory right of inspection.[224]

Nevertheless, the court found that BBC had failed to establish a proper purpose for the inspection and, therefore, was not entitled to inspect the documents.[225] The court found that BBC's purpose for wanting to inspect non-public information previously furnished

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216. *Id.* at 87.

217. *BBC Acquisition*, 623 A.2d at 87. Durr had argued that BBC was not the stockholder of record, because the Durr stock which BBC claimed to own was originally issued to "MILN Corporation." *Id.* at 89. However, BBC introduced evidence at trial that MILN Corporation had changed its name to BBC Acquisitions Corporation; and, therefore, it was the owner of the stock. *Id.*

218. *Id.* at 87.

219. *Id.* at 86-87.

220. *Id.* at 88.

221. *BBC Acquisition*, 623 A.2d at 88 (citing Petition of B&F Towing & Salvage Co., 551 A.2d 45, 51 (Del. 1988); Helmsman Management Servs., Inc. v. A&S Consultants, Inc., 525 A.2d 160, 167 (Del. Ch. 1987)).

222. *Id.* at 90 (citing Rainbow Navigation, Inc. v. Pan Ocean Navigation, Inc., 535 A.2d 1357, 1359 (Del. 1987)).

223. *Id.* (citing *Rainbow Navigation*, 535 A.2d at 1359; State *ex rel.* Cochran v. Penn-Beaver Oil Co., 143 A. 257, 259 (Del. 1926)).

224. *Id.* (citing E.L. Bruce Co. v. State, 144 A.2d 533, 534 (Del. 1958); SafeCard Servs., Inc. v. Credit Card Serv. Corp., No. 6426, slip op. at 7 (Del. Ch. Sept. 5, 1984), *reprinted in* 10 DEL. J. CORP. L. 298, 304 (1985)).

225. *BBC Acquisition*, 623 A.2d at 90.

to Cardinal was to gain information to allow it to place a value on Durr so that BBC could consider whether to increase its offer price for Durr.[226] This purpose, viewed within the requirements of section 220, was deemed improper by the court.[227] Notwithstanding BBC's argument that it sought to value BBC's stock interest in Durr, the court found that BBC's primary purpose was to place a value on Durr itself and not to value BBC's nominal stock interest.[228] The court noted that "valuing a stockholder's interest in the corporation is a proper purpose. Valuing the corporation for the sole purpose of acquiring it, unrelated and without regard to the acquiror's particular and pre-existing investment in the corporation, is not."[229]

H. Appraisal Under Section 262

The Supreme Court of Delaware issued two important opinions in 1992 after reviewing appraisal hearings conducted in the court of chancery. In *Rapid-American Corp. v. Harris*,[230] the Supreme Court of Delaware considered an appeal challenging the results of a statutory appraisal of Rapid-American Corporation (Rapid) stock pursuant to which dissenting stockholders (Harris) were awarded $51 per share plus simple interest.[231] The merger price consisted of cash and securities worth approximately $28 per share.[232]

Rapid argued that the trial court's decision was erroneous since it was based upon an improper decision to adopt Harris' suggested comparable company valuation technique.[233] Harris also claimed that the trial court erred when it failed to include a "control premium" in its valuation of Rapid since such a premium was necessary to "compensate Rapid's shareholders for their 100% ownership of its three operating subsidiaries."[234] Harris also challenged the trial court's award of simple, rather than compound interest on the appraisal award, characterizing the court's decision as an abuse of discretion.[235]

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226. *Id.* at 90-91.
227. *Id.*
228. *Id.* at 91. The court believed that BBC's primary purpose for inspecting the non-public information was not "reasonably related to [BBC's] interest as a shareholder." *Id.* (citation omitted).
229. *BBC Acquisition*, 623 A.2d at 91.
230. 603 A.2d 796 (Del. 1992).
231. *Id.* at 798-99.
232. *Id.*
233. *Id.*
234. *Rapid-American*, 603 A.2d at 798-99.
235. *Id.* at 799, 807.

The supreme court affirmed the trial court's decision to adopt Harris' valuation technique.[236] The court found that the trial court had not abused its discretion by independently valuing Rapid's three major subsidiaries according to their value as going concerns.[237] Rapid's claim that the trial court's considerations of its debt at market value was erroneous[238] was also rejected.

The court reversed the denial of a control premium to Harris[239] and found that the trial court had a duty to consider "the nature of the enterprise as an element of its valuation."[240] In assuring the value of Rapid, a parent company owning 100% interest in three valuable subsidiaries, the trial court should have adjusted its inherent value as a going concern "to reflect the economic reality of its structure at the *corporate level*."[241] The court found that the valuation technique applied by the trial court artificially discounted Rapid's ownership interest in its subsidiaries and "deprived *all* of Rapid's shareholders of fair value."[242] The court concluded that the exclusion of a control premium had "artificially and unrealistically treated Rapid as a minority shareholder."[243]

Finally, the award of simple interest to Harris was affirmed.[244] The court noted that the "clear and precise" statutory language of

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236. *Id.* at 799. The court noted that it was "well-settled" that "'a high level of deference' to a trial court's determination of value in a statutory appraisal proceeding" was appropriate. *Id.* at 802 (quoting Kahn v. Household Acquisition Corp., 591 A.2d 166, 175 (Del. 1991) (citing Alabama By-Products Corp. v. Neal, 588 A.2d 255, 258-59 (Del. 1991); Cavalier Oil Corp. v. Harnett, 564 A.2d 1137, 1146 (Del. 1989)).

237. *Id.* at 803. The court noted that "[i]t is now 'axiomatic' that in a statutory appraisal proceeding, the dissenting shareholders are entitled to receive 'fair value' representing their 'proportionate interest in a going concern.'" *Id.* at 802 (quoting *Cavalier*, 564 A.2d at 1144 (quoting Tri-Continental Corp. v. Battye, 74 A.2d 71, 72 (Del. 1950))). "The court must consider 'all relevant factors' to determine 'fair value' exclusive of 'post-merger events or other possible business combinations.'" *Id.* (citing *Kahn*, 591 A.2d at 174; *Alabama By-Products*, 588 A.2d at 257-58; *Cavalier Oil Corp.*, 564 A.2d at 1144; Weinberger v. UOP, Inc., 457 A.2d 701, 713 (Del. 1983); DEL. CODE ANN. tit. 8, § 262(h) (1991)).

238. *Rapid-American*, 603 A.2d at 803-04. The court noted that the trial court "was free to consider the realities of the market place [sic] in its evaluation of Rapid's intrinsic value." *Id.* at 804 (citing *Alabama By-Products*, 588 A.2d at 258; *Cavalier*, 564 A.2d at 1143; *Weinberger*, 457 A.2d at 713).

239. *Id.* at 807.

240. *Id.* at 799.

241. *Id.*

242. *Rapid-American*, 603 A.2d at 799.

243. *Id.* at 806.

244. *Id.* at 809.

section 262(i)[245] gave the trial court broad discretion to award either simple or compound interest.[246]

In *In re Appraisal of Shell Oil Co.*,[247] the supreme court considered an appeal from an appraisal action which arose out of the same merger that was the subject of the supreme court's April 23, 1992 opinion in *Shell Petroleum, Inc. v. Smith*.[248]

After the merger was complete, over one million shares of Shell's stock qualified for appraisal under section 262, which provides for the judicial determination of the fair value of a corporation's stock in connection with a merger.[249] During the seven day trial in the court of chancery, the parties offered extensive evidence regarding the value of Shell Oil Company's (Shell) shares as of the date of the merger, primarily through the testimony of competing experts.[250]

The petitioners' expert witness employed three different valuation approaches: a present value of equity analysis;[251] a comparative deal market analysis;[252] and a trading market analysis.[253] The three methodologies used by the petitioners' expert resulted in a range of values from $89 to $143 per share of Shell stock.[254]

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245. Section 262(i) provides: "The Court shall direct the payment of the fair value of the shares, together with interest, if any, by the surviving or resulting corporation to the stockholders entitled thereto. Interest may be simple or compound, as the Court may direct." DEL. CODE ANN. tit. 8, § 262(i) (1991).

246. *Rapid-American*, 603 A.2d at 808-09.

247. 607 A.2d 1213 (Del. 1992).

248. 606 A.2d 112 (Del. 1992).

249. *Shell Oil*, 607 A.2d at 1216. Section 262(a) provides in pertinent part:

> Any stockholder of a corporation of this State who holds shares of stock on the date of the making of a demand pursuant to subsection (d) of this section with respect to such shares, who continuously holds such shares through the effective date of the merger or consolidation . . . shall be entitled to an appraisal by the Court of Chancery of the fair value of his shares of stock under the circumstances described in subsections (b) and (c) of this section.

DEL. CODE ANN. tit. 8, § 262(a) (1991).

250. *Shell Oil*, 607 A.2d at 1216.

251. *Id.* The present value of equity analysis involved a "determination of the liquidation value of Shell's upstream assets, such as oil and gas reserves and exploratory acreage, and the valuation of Shell's downstream assets, such as its Oil Products and Chemical Products divisions, on a return on investment basis." *Id.*

252. *Id.* The comparative deal market analysis involved "comparing the results yielded by [the present value of equity analysis] with share prices reflected in similar transactions in the oil and gas industry . . . ." *Id.*

253. *Id.* The trading market analysis added a premium to the hypothetical prices the expert believed Shell would have traded for in the open market if no offer had been made. *Id.*

254. *Shell Oil*, 607 A.2d at 1216.

Shell's expert also offered three valuation models to assist the court in valuing the shares of Shell stock.[255] Shell's expert offered a liquidation study,[256] a merger market analysis,[257] and its own trading market analysis.[258] The analyses of Shell's expert yielded a range of values from $43 to $60 per Shell share.[259]

After reviewing each of the analyses and noting the biases they reflected, the court of chancery settled on the present value of equity analysis presented by the petitioners' expert as deserving the most weight.[260] However, as a result of certain flaws in the data used, the court applied a twenty percent discount of petitioners' expert's present value of equity valuation and arrived at a fair value for Shell stock of $71.20 per share.[261]

In connection with its review of the valuation evidence, the court of chancery expressed dissatisfaction with the "lack of objectivity" in the presentations.[262] The court of chancery opined that it was "obvious . . . that the dynamics of this litigation and the economic interest of the parties contributed to the wide differences in the expert opinions . . . ."[263] Despite the lack of objectivity, the court indicated it believed that, in determining fair value of the shares to be appraised, it was limited "'to the record as established by the parties.'"[264]

The Supreme Court of Delaware affirmed the court of chancery's judgment as to the fair value of Shell's shares as of the date of the merger, noting that the lower court's conclusions were "amply supported by the record and the product of an orderly and logical deductive process."[265] Perhaps more importantly for the development

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255. *Id.*

256. *Id.* The liquidation study used "a discounted cash flow of Shell's upstream assets and an estimate of the value of Shell's downstream assets based largely on a trading market analysis." *Id.*

257. *Id.* at 1217. The merger market analysis compared Shell with other similar companies that had been acquired. *Id.*

258. *Shell Oil*, 607 A.2d at 1217. The trading market analysis was based upon a calculation of what the Shell stock would have traded for in the absence of a merger offer. *Id.*

259. *Id.*

260. *Id.* at 1217-18.

261. *Id.* at 1218.

262. *Shell Oil*, 607 A.2d at 1218.

263. *Id.* (quoting *In re* Appraisal of Shell Oil Co., No. 8080, 1990 Del. Ch. LEXIS 199, at *93 (Del. Ch. Dec. 11, 1990)).

264. *Id.* (quoting *In re* Appraisal of Shell Oil Co., No. 8080, 1990 Del. Ch. LEXIS 199, at *93 (Del. Ch. Dec. 11, 1990)).

265. *Id.* at 1221.

of appraisal law in Delaware, the supreme court addressed "a recurring theme in recent appraisal cases—the clash of contrary, and often antagonistic, expert opinions on value."[266] The court recognized that "[t]he presentation of widely divergent views reflecting partisan positions in appraisal proceedings adds to the burden of the [c]ourt of [c]hancery's task of fixing value."[267] If the trial court is "limited to the biased presentation of the parties, it is often forced to pick and choose from a limited record without the benefit of objective analysis and opinion."[268] "To compensate for this handicap," the supreme court indicated that the court of chancery should consider, in a proper case, the appointment of its own expert witness.[269]

The Supreme Court of Delaware indicated that a Delaware court has never appointed a neutral expert witness upon its own initiative;[270] however, federal courts have not hesitated to make such appointments.[271] The question of whether to appoint such an expert and the selection of the expert are solely within the discretion of the trial judge.[272]

I. Dissolution Under Sections 280-282

The court of chancery considered the application of several new statutory provisions that significantly revised Delaware law governing the dissolution and winding up of Delaware corporations[273] in the case of *In re RegO Co.*[274] These provisions, which include sections

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266. *Shell Oil*, 607 A.2d at 1222.

267. *Id.*

268. *Id.*

269. *Id.*

270. *Shell Oil*, 607 A.2d at 1222.

271. *Id.* The courts derive their authority to make appointments from their inherent powers and from the express language of Rule 706 of the Federal Rules of Evidence. *Id.*

272. *Id.* at 1223. The supreme court noted that the trial judge could appoint an expert of the court's own choosing or seek a list of nominations from the parties. *Id.* The court-appointed expert would be subject to the same standards that govern other expert witnesses under the Delaware Rules of Evidence. *Id.* The expert must advise the parties of all findings and submit to depositions. *Id.* Once trial commences, it would be incumbent upon the trial judge to arrange for the court's expert witness to testify if neither party called him as a witness. *Id.* The court also indicated that the trial court's expert should be reasonably compensated by the parties in such proportion and at such intervals as the trial court determined. *Id.*

273. DEL. CODE ANN. tit. 8, §§ 280-282 (1991).

274. 623 A.2d 92 (Del. Ch. 1992). This petition provides the first application of "these novel statutory enactments." *Id.* at 94.

280-282 of the General Corporation Law,[275] provide a judicial procedure "designed to afford fair treatment to foreseeable future, yet unknown[,] claimants of a dissolved corporation . . . ."[276] At the same time, these provisions provide "corporate directors with a mechanism that will both permit distributions upon corporate dissolution and avoid the risk that a future corporate claimant will . . . be able to establish that such distribution was in violation of any duty owed to the corporation's creditors on dissolution."[277]

Faced with many large judgments in products liability suits, RegO Company (RegO) filed a certificate of dissolution with the Delaware Secretary of State, and its directors elected to make distributions on dissolution pursuant to the elective procedure of section 280(a).[278] After giving notice to all persons and entities known to have a claim or potential action against the company, RegO received a widespread response by potential claimants who sought security from RegO for their anticipated claims.[279] General creditors were paid in the ordinary course of winding up, but RegO rejected all claims for security on pending suits against RegO involving products liability claims and claims of the same type that might be brought in the future.[280]

In reviewing the matter, the court first concluded that RegO's present assets would most likely be inadequate to compensate all of the future claimants that it had reason to expect would eventually make claims.[281] With this in mind, the court concluded that, where the total fund appears inadequate to compensate all qualifying future claimants, the innovative aspects of sections 280-281 required that

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275. DEL. CODE ANN. tit. 8, §§ 280-282 (1991).

276. *RegO Co.*, 623 A.2d at 94.

277. *Id.* The court noted that this motion sought court approval of a plan of security for corporate claimants. *Id.* The court stated:

> The effects of such approval include (1) the preclusion of liability on the part of the directors of the dissolved corporation to claimants of the dissolved corporation for matters arising out of the making of liquidation distributions, (2) the limitation of potential liability of stockholders to the lesser of a *pro rata* share of each claim against the corporation, or the amount distributed in dissolution, and (3) the establishment of a limitations period for actions against stockholders on claims against the corporation.

Id.

278. *Id.* at 99.

279. *Id.*

280. *RegO Co.*, 623 A.2d at 99.

281. *Id.* at 100.

"a mechanism be utilized to assure that some part of the fund remains for the more distant foreseeable claimants."[282]

The central issue presented by this proceeding arose under section 280(c).[283] That issue was "whether the Claimants['] Trust (the Trust) provide[d] security that [would be] sufficient for the claims of present claimants, and [would be] reasonably likely to be sufficient for claims that have not been made known or that have not yet arisen . . . ."[284] In this case, where the "dissolved corporation was dedicating all of its assets to the security arrangement offered under section 280(c), . . . the inadequacy of those assets to offer full security" did not deprive the directors of RegO from proceeding under sections 280 and 281(a).[285] The court noted that sufficiency of the security agreement may be achieved in spite of the inability to assure or secure future compensation in full to all foreseeable future claimants:

> Where the dissolved corporate assets are in total inadequate to secure full compensation to all foreseeable future claimants, the sufficiency of the security arrangement will inescapably involve questions of the fairness of the proposed security among various claimants or classes of claimants. In making those judgments, the Court may be guided by the policies reflected in the statutes as a whole and especially by the innovative aspects of [s]ection[s] 281(a) and (b).[286]

Here, "the more difficult questions presented by the Claimants['] Trust [were] whether its terms, especially the preference that it accord[ed] to present claimants over unknown or future claimants, [were] appropriate."[287] The court concluded that, in light of the legislative intent reflected in sections 281(a) and 281(b), the preference was "not justified in this factual context."[288]

The court emphasized that sections 280 and 281 created (or recognized) rights for future claimants.[289] Such future claimants now have a right under sections 280 and 281(a)'s optional procedure "for

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282. *Id.*
283. *Id.* at 102.
284. *RegO Co.*, 623 A.2d at 102.
285. *Id.*
286. *Id.* at 102-03.
287. *Id.* at 103.
288. *RegO Co.*, 623 A.2d at 103.
289. *Id.* at 106.

a judicial determination of reasonable security and the funding of that security."[290] Under section 281(b), "future claimants have an entitlement to such provisions as will be reasonably likely to be sufficient to provide compensation for future claims."[291]

The creation of these entitlements may have consequences not just for stockholders, but for present creditors.[292] A "corporation in dissolution which cannot pay its present creditors" or make "adequate provision for contingent and future claims" and which follows the section 281(b) procedure, is "directed not to pay its current creditors in full but to pay them ratably."[293] The court noted that, "[w]hile in this respect [s]ection 281(b) is no doubt a radical change in the law, it is within the constitutional power of the state of incorporation to so regulate the dissolution of a domestic corporation . . . ."[294]

After reviewing these statutory provisions, and considering the policies underlying the statutes, the court held that:

> where it appears that all of the assets of a dissolved corporation are likely to be inadequate to compensate all foreseeable future claims, fidelity to the abundantly clear policy of [s]ection[s] 281(a), (b) and (e) requires this court, in passing upon the reasonableness of a proposed security arrangement under [s]ection 280(c), to decline to approve discrimination among claimants of the same class based upon "the relative times at which any claims mature or are reduced to judgment."[295]

Since the Trust did reflect such discrimination, the court held that it could not be approved to that extent.[296]

Having concluded that it would be inappropriate to approve a security mechanism that authorized the Trust to prefer existing claimants over future claimants, the court turned to the question of what security mechanism it could approve.[297] Since the directors of RegO and the court were dealing with likely future events over an undefined

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290. *Id.*
291. *Id.*
292. *RegO Co.*, 623 A.2d at 106.
293. *Id.*
294. *Id.* at 106 n.32.
295. *Id.* at 107 (quoting DEL. CODE ANN. tit. 8, § 281(e) (1991)).
296. *RegO Co.*, 623 A.2d at 108.
297. *Id.* at 109.

term, mathematical certainty was not possible.[298] RegO had proposed that "an interim limit of $500,000 per claim be tentatively established, and that the appropriateness of that limitation be revisited in five years . . . ."[299]

In response to RegO's proposal, the court noted that the statutory command of section 280(c) does not afford to the dissolving corporation, or the court, an election to fail to afford security for foreseeable claimants simply because their claims will arise in several years.[300] In adopting the limitation provision contained in section 280(c), the legislature left the determination of an appropriate liability cutoff date to the substantive law of the state in which the claim arises.[301] In light of this statutory approach, the court could not say, in the context of the facts concerning RegO's potential liability, that the period implied by the $500,000 interim limit (under which the Trust would be exhausted in approximately eight years) was an appropriate point to terminate all rights of future claimants.[302] However, an interim limit of $300,000 per claim suggested by the guardian was viewed by the court as more likely to permit the Trust to satisfy claims for the entire period in which it is reasonable to predict that claims will arise.[303]

The court concluded by holding that certain future indemnification claims by officers and directors were liabilities that the Trust should accept.[304] The court also held that a provision in the Trust authorizing the trustee, after five years, to recommend and apply to the court for the determination of a cutoff date on payments to claimants was inappropriate given the claims history of RegO.[305]

III. CONCLUSION

As the cases decided in 1992 demonstrate, the Delaware Court of Chancery continues as the preeminent trial court for the prompt and fair adjudication of corporate control cases and other corporate issues. No other trial court in the United States has the expertise in corporate law possessed by the Delaware Court of Chancery, nor

298. *Id.*
299. *Id.* at 110.
300. *RegO Co.*, 623 A.2d at 110.
301. *Id.*
302. *Id.*
303. *Id.*
304. *RegO Co.*, 623 A.2d at 111.
305. *Id.*

does any appellate court have the expertise in corporate law possessed by the Supreme Court of Delaware.