Comment

CEDE & CO. v. TECHNICOLOR, INC.: A WHOLE NEW BALL GAME FOR DISSENTING SHAREHOLDERS

I. INTRODUCTION

For more than fifty years Delaware courts have wrestled with the nature of the remedies available to dissenting shareholders in a variety of corporate merger transactions.[1] At issue has been the relationship between the statutory appraisal right granted under Delaware's General Corporation Law[2] and a stockholder's common-law right to seek to have a merger enjoined on grounds of breach of fiduciary duty or fraud.[3] The landmark decision of *Weinberger v. UOP, Inc.*,[4] decided by the Delaware Supreme Court in 1983, purported to resolve the tension between the two rights by announcing a liberalized appraisal standard that takes into account all relevant factors pursuant to the Delaware statute.[5] The decision, of disarming simplicity, has proven somewhat difficult to apply.

In *Cede & Co. v. Technicolor, Inc.*,[6] the Delaware Supreme Court addressed for the first time the question of whether a minority shareholder, who has dissented from a cash-out merger and begun an appraisal proceeding under section 262 of Delaware's General Corporation Law, may pursue a subsequently discovered individual

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1. One of the earliest cases to specifically address the problem was Cole v. National Cash Credit Ass'n, 18 Del. Ch. 47, 56, 156 A. 183, 187 (1931) (dissenting shareholder has option to elect to take stock in the consolidated company or receive the value of his stock in money).

2. DEL. CODE ANN. tit. 8, § 262 (1983) (governing a stockholder's right to appraisal of the fair value of his shares by the court of chancery).

3. *See* Loeb v. Schenley Indus., Inc., 285 A.2d 829, 830 (Del. Ch. 1971) ("The statute in question purports to furnish an exclusive remedy to a dissenting shareholder and is to be distinguished from a stockholder's common law right to seek to have a merger enjoined." *Id.* (citations omitted)).

4. 457 A.2d 701 (Del. 1983).

5. *Id.* at 714. *See also* DEL. CODE ANN. tit. 8, § 262(h) (1983).

6. 542 A.2d 1182 (Del. 1988).

claim for fraud in the merger.[7] Cinerama, Inc.,[8] a substantial shareholder of Technicolor prior to a January 1983 cash-out merger, filed two related actions. The first sought an appraisal of the fair value of Cinerama's shareholdings under section 262.[9] The second, filed after substantial discovery had revealed evidence of alleged fraud, sought damages, rescission of the merger, and other equitable relief.[10] Cinerama moved to amend its pleadings in the appraisal action to include the fraud and unfair dealing claims asserted in its fraud action, and, in the alternative, to consolidate its fraud action and its appraisal action for trial.[11] The defendants in the second suit moved to dismiss the fraud action on the ground that, having elected to pursue its appraisal rights, Cinerama was precluded from litigating a claim based on breach of fiduciary duty.[12]

The court of chancery denied all motions,[13] holding that: (1) a shareholder who elects to pursue his appraisal remedy is not thereby precluded from bringing a later action to rescind the merger, when at the time of his election he did not know and had no reason to know the facts upon which the equitable claim rested;[14] (2) he may not simultaneously litigate to judgment both actions;[15] and (3) he must elect which remedy he will pursue no later than the time at which either of the two actions is scheduled for trial.[16] Both parties appealed, and the consolidated interlocutory appeals were heard by the Delaware Supreme Court on October 14, 1987.

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7. *Id.* at 1183.

8. Cinerama, Inc. was the beneficial owner of 201,200 shares, or approximately 4.5% of the issued and outstanding common stock of respondent Technicolor, Inc. Cede & Co. was the record owner of the shares of Technicolor stock owned beneficially by Cinerama. Hereinafter, Cinerama, Inc. and Cede & Co. will be collectively referred to as "Cinerama." *Id.* at 1184.

9. Cede & Co. v. Technicolor, Inc., No. 7129 (Del. Ch. Oct. 22, 1984), *reprinted in* 10 DEL. J. CORP. L. 158 (1985).

10. Cede & Co. v. Technicolor, Inc., Nos. 7129 & 8358, slip op. at 1 (Del. Ch. Jan. 13, 1987), *reprinted in* 13 DEL. J. CORP. L. 225, 229 (1988), *aff'd in part and rev'd in part*, 542 A.2d 1182 (Del. 1988).

11. Petitioners moved to amend or, in the alternative, consolidate on April 10, 1986. *Id.*, slip op. at 2, *reprinted in* 13 DEL. J. CORP. L. at 229.

12. Defendants Macanfor Corporation, MacAndrews & Forbes Group, Inc., and Ronald O. Perelman, moved to dismiss the fraud action on March 14, 1986. All other defendants filed a separate motion to dismiss on March 27, 1986. *Id.*, slip op. at 2, *reprinted in* 13 DEL. J. CORP. L. at 229-30.

13. *Id.*, slip op. at 23, *reprinted in* 13 DEL. J. CORP. L. at 240.

14. *Id.*, slip op. at 2, *reprinted in* 13 DEL. J. CORP. L. at 230.

15. *Id.*, slip op. at 3, *reprinted in* 13 DEL. J. CORP L. at 230.

16. *Id.*, slip op. at 4, *reprinted in* 13 DEL. J. CORP. L. at 230.

The court affirmed the trial court's ruling declining to dismiss Cinerama's fraud action but reversed its ruling declining to consolidate the appraisal and fraud actions for trial.[17] On remand, the court said that the chancellor would determine the appropriate remedy based on the circumstances of the case.[18]

It is the thesis of this article that the Delaware Supreme Court's decision in *Cede & Co.* will significantly alter the nature of the merger "game," as played by both minority and majority shareholders. Pregame strategies will focus increasingly on discovery issues. No matter who wins this new ball game, the playing field will be more level and the entire fairness doctrine of *Weinberger* will govern.

In support of this thesis, this article will briefly examine the common law and legislative history leading to *Weinberger*; early efforts to interpret *Weinberger*; the court of chancery's decision in *Cede & Co.*; the Delaware Supreme Court's decision in that case and its effect on how the merger game will play out in the future.

II. BACKGROUND

A. *Dissenting Shareholder's Rights in the Nineteenth Century*

It is generally understood that directors are charged with managing the daily affairs of the corporation.[19] As a judicial gloss to the statutory authority granted directors, the business judgment rule shields directors in the exercise of prudent, informed judgment.[20] The standard of liability under the rule is gross negligence.[21]

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17. *Cede & Co.*, 542 A.2d at 1184-85.

18. *Id.* at 1185.

19. Section 141(a) of the Delaware corporation law provides that "[t]he business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . . ." DEL. CODE ANN. tit. 8, § 141(a) (1974).

Significantly, while much has been said and written under the rubric, "corporate democracy," perhaps nowhere is its essence more clearly sensed than in the careful balancing of rights allotted to corporate directors and stockholders in the nineteenth century.

20. *See* Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981), in which the court said:

> The "business judgment" rule is a judicial creation that presumes propriety, under certain circumstances, in a board's decision. . . . It is generally used as a defense to an attack on the decision's soundness . . . [and] evolved to give recognition and deference to directors' business expertise when exercising their managerial power under § 141(a).

Id. at 782 (footnote omitted).

21. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

To balance this virtually unlimited authority, stockholders have the right to vote for the election of directors,[22] and the right to vote on all "fundamental" corporate changes.[23] While stockholders have little or no role to play in the day-to-day operations of the corporation, their right to vote is closely guarded by the courts.[24]

Under the common law, a single shareholder could defeat any fundamental change in the corporation's business, including a merger.[25] Gradually, however, state legislatures began to perceive the need for greater flexibility to meet the needs of the marketplace. Statutes were passed specifically authorizing certain types of mergers when approved by a corporation's board of directors and a majority or supermajority of the corporation's shareholders.[26] While all forms of take-out mergers were defeated in the courts through the 1920's, eventually even cash mergers were authorized.[27] It was, as one commentator has noted, a question of "balancing the relative dangers of oppression by the majority and harassment by the minority and what weight is accorded the importance of giving considerable leeway for change and growth."[28]

In light of the billion-dollar mergers that have become commonplace today, it is difficult to conceptualize what a radical change the new merger freedom represented to the nineteenth century mind. Professor Manning has characterized it thus:

> The shareholders of corporation A somehow became shareholders of corporation B and no longer shareholders of corporation A. The mere statement of such a preposterous

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22. DEL. CODE ANN. tit. 8, § 211(b) (1974).

23. Stockholders have the right to vote on any amendment to the certificate of incorporation, DEL. CODE ANN. tit. 8, § 242(b)(1) (1974); dissolution, DEL. CODE ANN. tit. 8, § 275(b) (1974); mergers, DEL. CODE ANN. tit. 8, § 251(c) (1974); and the sale of all or substantially all of the assets, DEL. CODE ANN. tit. 8, § 271(a) (1974).

24. *See* Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437 (Del. 1971) (invalidating a corporate act that was legal under corporate law because the right to vote is so essential that the law cannot be used to subvert it). *See also* DEL. CODE ANN. tit. 8, § 211 (1974) (providing for a summary proceeding by the court of chancery to compel a stockholders' meeting upon application of a single stockholder if it has been more than 13 months since the last meeting).

25. *See* Weiss, *Balancing Interests in Cash-Out Mergers: The Promise of* Weinberger v. UOP, Inc., 8 DEL. J. CORP. L. 1, 2 (1983).

26. *Id.* at 4.

27. *Id.* at 7-8.

28. Vorenberg, *Exclusiveness of the Dissenting Stockholder's Appraisal Right*, 77 HARV. L. REV. 1189, 1216-17 (1964).

> proposition did violence to fundamental principles. How *could* a man who owned a horse suddenly find that he owned a cow? . . . [S]urely it could not constitutionally be done without the owner's consent. You might try to persuade him to sell his horse or to exchange it for a cow, but surely you could not whisk it away from him.[29]

As compensation for abrogation of the common law right of a single shareholder to defeat a merger, the statutory right of appraisal was given to stockholders.[30] Thus, a shareholder has a choice: he can go along with the merger or he can dissent and seek appraisal of the value of his shares.[31] The right of a dissenting shareholder to appraisal is considered absolute.[32]

B. Statutory Appraisal Rights

Section 262 of the General Corporation Law affords to dissenting shareholders, who have neither voted in favor of the merger or consolidation nor consented to it in writing, the right to have the fair value of their shares appraised by the court of chancery[33] and to receive payment of the fair value of those shares by the surviving corporation.[34] The right to appraisal is available for shares of any class or series of stock of a constituent corporation in all mergers

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29. Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 246 (1962).

30. Chicago Corp. v. Munds, 172 A. 452, 455 (Del. 1934) ("a provision was written into the modern statutes giving the dissenting stockholder the option completely to retire from the enterprise and receive the value of his stock in money"). *See also* Heilbrunn v. Sun Chem. Corp., 150 A.2d 755 (Del. 1959); Kaye v. Pantone, Inc., 395 A.2d 369 (Del. Ch. 1978); and Francis I. du Pont & Co. v. Universal City Studios, Inc., 343 A.2d 629 (Del. Ch. 1975).

Delaware established the right to appraisal in 1899. 21 Del. Laws 1899, ch. 273, § 56, at 463. As of June 30, 1986, 52 jurisdictions had provided for appraisal (50 states plus the District of Columbia and Puerto Rico). Model Business Corp. Act § 13.02 (1984 & Supp. 1987). All jurisdictions specify certain types of mergers as among the triggering events. *Id.* Delaware's statute is limited to mergers and consolidations. DEL. CODE ANN. tit. 8, § 262(a) (1983).

31. Stauffer v. Standard Brands, Inc., 187 A.2d 78 (Del. 1962). *See also* Cole v. National Cash Credit Ass'n, 18 Del. Ch. 47, 156 A. 183 (1931).

32. Felder v. Anderson, Clayton & Co., 159 A.2d 278, 286 (Del. Ch. 1960).

33. DEL. CODE ANN. tit. 8, § 262(a) (1983).

34. DEL. CODE ANN. tit. 8, § 262(i) (1983).

and consolidations except stockholders of the parent in a short-form merger.[35] The statute further provides that:

> the Court shall appraise the shares, determining their *fair* value exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation, together with a fair rate of interest, if any. . . . In determining such *fair* value, the Court shall take into account *all relevant factors*.[36]

The Delaware Supreme Court noted in *Weinberger* that the statutory history strongly suggests "a legislative intent to fully compensate shareholders for whatever their loss may be, subject only to the narrow limitation that one can not [sic] take speculative effects of the merger into account."[37]

The procedural niceties of the statute, however, have often subverted this remedial intent. As one commentator has observed, "Altogether, the dissenting shareholder faces an unattractive and complex procedural obstacle course—supervised by a judiciary which, if not hostile, is disposed to present its stern Jehovan aspect."[38] Since "the right to an appraisal in a merger proceeding is entirely a creature of statute,"[39] a dissenting shareholder must be careful to "cross all t's and dot all i's" if he desires to take advantage of the remedy. He must be a stockholder of record.[40] Thus, if he is the beneficial

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35. DEL. CODE ANN. tit. 8, § 262(a), (b) (1983). However, no appraisal rights are available for shares of any class or series of stock listed on a national securities exchange or held of record by more than 2,000 stockholders. DEL. CODE ANN. tit. 8, § 262(b)(1) (1983). This limitation assumes that a viable market exists for the shares in question. *See, e.g.*, 1 R. BALOTTI & J. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 9.31 (rev. perm. ed. 1986); M. EISENBERG, THE STRUCTURE OF THE CORPORATION 79 (1976). While it is true that stockholders in a publicly held corporation appear to have less need of appraisal since they can withdraw from the enterprise by selling their shares on the market, this does not take into account the "gyrations" of the market or the myriad factors "that contribute to [its] nervous leaps from dejected melancholy to exhilarated enthusiasm and then back again from joy to grief," all of which might cause the stockholder to receive considerably less than fair value at the time he is forced to sell. *See Chicago Corp.*, 172 A. at 455.

36. DEL. CODE ANN. tit. 8, § 262(h) (1983) (emphasis added). The word "fair" was added by amendment in 1976. 60 Del. Laws ch. 371, § 7 (1976). The statutory mandate to consider "all relevant factors" was added by amendment in 1981. 63 Del. Laws ch. 25, § 14 (1981).

37. *Weinberger*, 457 A.2d at 714.

38. Manning, *supra* note 29, at 231.

39. *Loeb*, 285 A.2d at 831.

40. DEL. CODE ANN. tit. 8, § 262(a) (1983).

owner, he has no right to demand an appraisal. The demand must be made by the record owner.[41] Similarly, if the dissenter has voted in favor of the merger or tendered his shares, he has lost standing to pursue his appraisal remedy.[42] To perfect his appraisal right, the dissenting stockholder must deliver to the corporation a written demand for the value of his shares before the vote on the merger.[43] If that demand is late, through no fault of the stockholder, the right to appraisal is not perfected.[44]

If the dissenting shareholder successfully perfects his appraisal right, it is still not clear that the remedy is of much benefit to him. On the one hand, it provides an orderly method of withdrawal from the corporation by a dissenting stockholder.[45] On the other hand, it is expensive, time-consuming, complex, and the outcome is uncertain.[46] In the end, the dissenter may receive less than the merger price,[47] and the award is taxable, whereas the stockholder who goes along with the merger may incur no tax liability.[48]

Furthermore, the valuation methodology is complex and susceptible to manipulation through the weighting of individual factors.[49] While *Weinberger* mandates that proof of value may be arrived at "by any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in

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41. *See* Enstar Corp. v. Senouf, 535 A.2d 1351, 1355 (Del. 1987) (quoting American Hardware Corp. v. Savage Arms Corp., 136 A.2d 690, 692 (1957)).

42. DEL. CODE ANN. tit. 8, § 262(a) (1983). *See also* Bershad v. Curtiss-Wright Corp., 535 A.2d 840, 842 (Del. 1987).

43. DEL. CODE ANN. tit. 8, § 262(d)(1) (1983).

44. *See* Tabbi v. Pollution Control Indus., Inc., 508 A.2d 867 (Del. Ch. 1986) (demand letter which arrived between five minutes and one hour after the vote on a merger because an "overnight" delivery service took two days to deliver it was untimely).

45. *Loeb*, 285 A.2d at 830.

46. *See, e.g.*, Vorenberg, *supra* note 28, at 1201; Manning, *supra* note 29, at 233.

47. *See, e.g.*, *In re* Olivetti Underwood Corp., 246 A.2d 800 (Del. Ch. 1968) (appraised value was $9.78 compared to the merger price of $14.50); Sporborg v. City Specialty Stores, Inc., 35 Del. Ch. 560, 123 A.2d 121 (1956) (fair value was less than cash-out price).

48. Manning, *supra* note 29, at 233.

49. The Delaware Block Approach was the exclusive method of valuation until *Weinberger* expressly overruled Lynch v. Vickers Energy Corp., 429 A.2d 497 (Del. 1981) to the extent that it limited a stockholder's award to a specific damage formula. *Weinberger*, 457 A.2d at 703-04.

It has been suggested that this valuation technique is easily manipulated by the majority shareholders to achieve a desired result. Weiss, *supra* note 25, at 22 n.141.

court,"[50] management still controls the flow of information and may deliberately or inadvertently conceal facts, like the grant of a patent,[51] or time the transaction so as to depress market prices to deceive the appraiser.[52]

In short, while it may be true as one commentator has noted that "[a]ppraisal rights . . . have, in the past, served as a countervailing power to force the insiders to tailor their plans to minimize the number of dissenters by getting the best deal possible,"[53] it is equally true that, from the viewpoint of the dissenting shareholder, "It is, in short, a remedy of desperation."[54]

C. *The Early Cases*

From the beginning, dissenting shareholders have sought to take advantage of the more flexible equitable remedy for breach of fiduciary duty. The tension between the two remedies is evident in the early cases. Appraisal, however, has been interpreted by the courts to be the exclusive remedy for a dissenting shareholder unless he can prove breach of fiduciary duty or fraud.[55] Because of the

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50. *Weinberger*, 457 A.2d at 713.

51. Vorenberg, *supra* note 28 at 1202.

52. Management's ability to manipulate the timing of a merger to the disadvantage of the minority has been recognized as grounds for breach of its fiduciary duty. The prototype instance has been defined as follows:

> when it could be shown both (1) that the minority was financially injured by the timing (i.e., from their point of view it was an especially poor time to be required to liquidate their investment) and (2) that the controlling shareholder gained from the timing of the transaction what the minority lost.

Jedwab v. MGM Grand Hotels, Inc., 509 A.2d 584, 599 (Del. Ch. 1986). Thus, a breach was found in: Rabkin v. Philip A. Hunt Chem. Corp., 498 A.2d 1099 (Del. 1985) (merger timed to avoid one-year contractual commitment to pay higher price than that offered in the merger); Smith v. SPNV Holdings, Inc., No. 8395, and *In re* Appraisal of Shell Oil Co., No. 8080 (consolidated) (Del. Ch. Oct. 28, 1987) (revised Nov. 2, 1987) (merger date one business day before record date for dividends benefited the majority to the disadvantage of the minority), *reprinted in* 13 DEL. J. CORP. L. 1242 (1988); Sealy Mattress Co. of N.J., Inc. v. Sealy, Inc., 532 A.2d 1324 (Del. Ch. 1987) (merger was timed when the corporation was difficult, if not impossible, to value in a deliberate effort to depress price).

53. Folk, *De Facto Mergers in Delaware*: Hariton v. Arco Electronics, Inc., 49 VA. L. REV. 1261, 1293 (1963).

54. EISENBERG, *supra* note 35, at 83.

55. Although the Delaware statute is silent on the issue of exclusivity, the Delaware courts have construed appraisal as an exclusive remedy in the absence of fraud. *See, e.g.*, David J. Greene & Co. v. Schenley Indus., Inc., 281 A.2d 30,

presumptions of the business judgment rule, fraud is difficult to prove and the burden often proves insuperable for the plaintiff shareholder since "mere inadequacy of price will not reveal fraud."[56] The appraisal remedy, on the other hand, requires no fixing of blame. One commentator has observed an inverse correlation between the availability of the appraisal remedy and a plaintiff's success in an action for fraud, noting that "courts will . . . enjoin a transaction if it strikes them as grossly unfair, but they are less disposed to find that degree of unfairness if the plaintiff has the remedy [of appraisal] open to him."[57] If a plaintiff's breach of fiduciary duty claim fails, he may be left with no remedy because he has forgone his right to appraisal.[58] To make matters worse, the courts have also held that an appraisal election is irrevocable under the statute once a dissenting shareholder has perfected the right.[59]

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35 (Del. Ch. 1971); *Stauffer*, 187 A.2d at 80.

This interpretation is consistent with the Model Business Corporation Act. The official comment to § 13.02(b) states:

> The remedy is the exclusive remedy unless the transaction is "unlawful" or "fraudulent." The theory underlying this section is as follows: when a majority of shareholders has approved a corporate change, the corporation should be permitted to proceed even if a minority considers the change unwise or disadvantageous. . . . Since dissenting shareholders can obtain the fair value of their shares, they are protected from pecuniary loss.

Model Business Corp. Act § 13.02(b) (1984 & Supp. 1987). Of the 52 jurisdictions with appraisal statutes, 25 *expressly* provide that dissenters' rights are an exclusive remedy in certain instances. *Id.*

56. *Cole*, 18 Del. Ch. at 58, 156 A. at 188 ("The inadequacy must be so gross as to lead the court to conclude that it was due not to an honest error of judgment but rather to bad faith, or to a reckless indifference to the rights of others interested.").

57. Manning, *supra* note 29, at 247 n.38.

58. *Rabkin*, 498 A.2d at 1107 (plaintiffs will be cautious in claiming price offered is the result of unfair dealing since a judgment in defendants' favor may have cost plaintiffs their unperfected appraisal rights).

59. *See, e.g.*, Dofflemeyer v. W.F. Hall Printing Co., 432 A.2d 1198, 1200 (Del. 1981) (under the express language of § 262(i) [now § 262(k)], a shareholder may not withdraw from appraisal without the written approval of the corporation); Southern Prod. Co. v. Sabath, 87 A.2d 128, 136 (Del. 1952) (the rights of the stockholder and of the corporation with respect to appraisal are fixed at the time the right to appraisal is perfected, subject only to the happening of one of the three conditions specified in the statute).

Under § 262(k), a stockholder who elects to pursue his appraisal remedy under the Delaware General Corporation Law may not rescind that election unless (1) the petition for appraisal is not filed within the time provided in the statute; (2) such stockholder delivers a written withdrawal of his demand to the surviving or resulting corporation within 60 days after the effective date of the merger; or (3)

In response to this situation, the courts have sought to make the appraisal remedy more flexible, holding that, because a stockholder is entitled to be paid for that which has been taken from him, "his proportionate interest in a going concern," the appraiser must take into consideration "all factors" which might reasonably enter into the fixing of value.[60] The courts have also sought to lighten plaintiffs' burden of proof in cases involving a breach of fiduciary duty by reaffirming the principle that if directors stand on both sides of a transaction, as in the case of a parent-subsidiary merger, they have the burden of proving the entire fairness of the transaction.[61] Additionally, the entire fairness standard was applied to the valuation of stock in an appraisal proceeding. The Delaware Supreme Court affirmed a chancery court ruling that "all relevant value factors must be considered in arriving at a fair value."[62]

But, even with the enunciation of the entire fairness doctrine, the distinctions between the two forms of relief have continued to trouble courts and plaintiffs alike. Thus, in an action seeking to enjoin a proposed merger on the grounds that it was grossly unfair and an attempt at self-dealing, the court of chancery stated:

> While a court of equity should stand ready to prevent corporate fraud and any overreaching by fiduciaries of the rights of stockholders, by the same token this Court should not impede the consummation of an orderly merger under the Delaware statutes, an efficient and fair method having been furnished, which permits a judicially protected withdrawal from a merger by a disgruntled stockholder.[63]

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thereafter obtains the written approval of the corporation to withdraw his demand. DEL. CODE ANN. tit. 8, § 262(k) (1983). *But see* Dofflemeyer v. W.F. Hall Printing Co., 558 F. Supp. 372 (D. Del. 1983), where the court predicted that the Delaware Supreme Court would hold that "a stockholder who elects appraisal in ignorance of fraud in the merger will be entitled to rescind that election upon discovery of the fraud even though his election would otherwise be irrevocable under the appraisal statute." *Id.* at 381.

60. Tri-Continental Corp. v. Battye, 74 A.2d 71, 72 (Del. 1950) (exploring for the first time the meaning of the word "value" under the corporation law and concluding it meant the true or intrinsic value and might not be measured by any single element).

61. Sterling v. Mayflower Hotel Corp., 93 A.2d 107 (Del. 1952).

62. *Id.* at 306-07, 93 A.2d at 114 (quoting Sterling v. Mayflower Hotel Corp., 33 Del. Ch. 20, 27, 89 A.2d 862, 866 (1952)).

63. *David J. Greene & Co.*, 281 A.2d at 36 (citation omitted).

Since it appeared that it was merely a dispute as to value, the chancery court concluded that appraisal should be an adequate remedy.[64]

While the courts continued to explore both the adequacy and the exclusivity of the appraisal remedy, they sought to create new procedural protections to assure a fair result. The most problematic of these was the so-called "business purpose test" developed in a trilogy of cases.[65] In *Singer*, the court rejected defendants' argument that plaintiffs' exclusive remedy for dissatisfaction with the merger was an appraisal. The court held that the allegation that the merger was made for the sole purpose of freezing out minority shareholders on a cash-out basis stated a cause of action against the majority shareholders for breach of fiduciary duty.[66] In *Tanzer*, the court held that even when the majority stockholder had a bona fide purpose in seeking the merger, it still had to be prepared to show that it had met its duty of "entire fairness" to the minority.[67] And, finally, in *Roland*, the court held that the majority must establish a proper business purpose as a threshold requirement in meeting its duty of fairness to the minority, regardless of the type of merger involved.[68] For, the court said, the law of fiduciary duty arises not from the operation of the corporation law but independent of it, from long-standing principles of equity.[69] While the business purpose test was a good faith effort to provide additional protection to minority shareholders, it was easily circumvented by the majority, who had no difficulty in alleging a business purpose for the merger.

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64. *Id.* at 33.

65. Roland Int'l Corp. v. Najjar, 407 A.2d 1032 (Del. 1979) (merger was a "going private" transaction); Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977) (merger followed takeover by a previously unrelated corporation); Tanzer v. International Gen. Indus., Inc., 379 A.2d 1121 (Del. 1977) (merger of two affiliated corporations). *See infra* notes 77-78 and accompanying text (discussing the subsequent abandonment of the business purpose test by the Delaware Supreme Court).

66. *Singer*, 380 A.2d at 980. The court acknowledged that the common-law right of a single stockholder to simply veto a merger was gone but said that "just as a minority shareholder may not thwart a merger without cause, neither may a majority cause a merger to be made for the sole purpose of eliminating a minority on a cash-out basis." *Id.* at 978.

67. *Tanzer*, 379 A.2d at 1124. The court said that the chancellor erred in discussing fairness only in terms of price. The test required by *Singer*, which applied the rule of *Sterling*, required judicial scrutiny for "entire fairness" as to all aspects of the transaction. *Id.* at 1125.

68. *Roland*, 407 A.2d at 1037.

69. *Id.* at 1036.

D. *Weinberger v. UOP, Inc.*

Weinberger rejuvenated the appraisal remedy by expanding its parameters, and thus its utility, and by reaffirming it as a stockholder's basic remedy.[70] In the lower court action, a minority shareholder brought a class action on behalf of all subsidiary shareholders who had not exchanged their shares for the merger price, seeking to have the merger set aside or, in the alternative, an award of monetary damages.[71] The court of chancery granted judgment for the defendants, holding *inter alia* that: there was a proper purpose for the merger; there were no material misrepresentations or failure to disclose material information; there was no breach of fiduciary duty to minority shareholders in approval of the merger; and the merger price was fair to minority shareholders of the subsidiary.[72]

In reversing, the supreme court held that: (1) the merger did not meet the test of entire fairness because a feasibility study indicating that a higher price than that offered for the subsidiary's shares would be a good investment was not disclosed to the subsidiary's outside directors;[73] and (2) on remand, minority shareholders would be entitled to damages based on the fair value of their shares as determined by taking into account all relevant factors, *including the*

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70. *Weinberger*, 457 A.2d at 715.

71. Weinberger v. UOP, Inc., 426 A.2d 1333, 1335 (Del. Ch. 1981), *rev'd*, 457 A.2d 701 (Del. 1983). Prior to trial on this case, defendants had moved to dismiss the complaint for failure to state a cause of action. The motion was granted, but plaintiff was given leave to amend his complaint so as to allege specific acts of fraud and misrepresentation sufficient to challenge the fairness of the merger. *See* Weinberger v. UOP, Inc., 409 A.2d 1262 (Del. Ch. 1979). The present case was a decision after a trial on the merits.

72. *Weinberger*, 426 A.2d at 1362-63. The court reached its decision after an exhaustive analysis of *Singer* and its progeny, which led it to conclude that the appropriate legal standard to be applied was the *Sterling* rule of entire fairness. That rule required examination of all "pertinent" elements of the transaction to ensure that the minority had been treated fairly. Once plaintiff had demonstrated some basis for his charge that the terms were unfair to the minority, the majority bore the ultimate burden of demonstrating by a "preponderance of the evidence" that it had discharged its duty of fairness to the minority.

73. *Weinberger*, 457 A.2d at 701. At the request of Signal (the former majority shareholder of UOP), two Signal officers, who were also directors of UOP, were asked to make a feasibility study concerning the possible acquisition of the balance of UOP's outstanding shares. The resulting report concluded that the UOP shares would be a good investment at any price up to $24 each. *Id.* at 705. The actual price offered and paid was $21 per share. *Id.* at 707. The difference in price represented more than $17 million to the minority, although the difference to Signal in terms of return on investment was only two-tenths of one percent. *Id.* at 709.

elements of rescissory damages if proven and appropriate to the issue of fairness.[74]

With this sweeping pronouncement, the *Weinberger* court appeared to offer the plaintiff the best of all possible worlds, the fair value of his shares *and* equitable relief for any injury sustained as the result of unfair dealing. The implication was clear. Although plaintiff had forgone his appraisal remedy, he was entitled to an entire fairness hearing on all aspects of the merger transaction.[75]

In fashioning the liberalized appraisal remedy, the court overruled its earlier holding in *Lynch v. Vickers Energy Corp.*[76] to the extent that it purported to limit a stockholder's monetary relief to a specific damage formula,[77] and announced that the business purpose rule established in the *Singer* trilogy of cases was no longer the law of Delaware.[78] The court added a final caveat, namely; "The appraisal remedy we approve *may* not be adequate in certain cases, particularly where fraud, misrepresentation, self-dealing, deliberate waste of corporate assets, or gross and palpable overreaching are involved."[79] In such a case, the court said, the chancellor had broad discretion to fashion any form of equitable relief deemed appropriate, including rescissory damages.[80] It is these dicta that are implicated in the case under analysis and that have obscured understanding of how far the *Weinberger* appraisal remedy reaches.

*E. The Post-*Weinberger *Cases*

In the first case to apply the *Weinberger* entire fairness analysis,[81] a class action challenging the fairness of the merger, the supreme

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74. *Id.* at 714 (emphasis added). Upon remand, the trial court found that rescissory damages would be inappropriate because the proof offered was too speculative, and compensatory damages could not be determined with sufficient precision. The court concluded that an award of $1.00 per share plus interest was fair compensation. Weinberger v. UOP, Inc., No. 5642 (Del. Ch. Jan. 30, 1985), *reprinted in* 10 DEL. J. CORP. L. 945 (1985), *aff'd*, 497 A.2d 792 (Del. 1985).

75. *Weinberger*, 457 A.2d at 714. Plaintiff had not sought an appraisal, but rescissory damages.

76. 429 A.2d 497 (Del. 1981).

77. *Weinberger*, 457 A.2d at 714. The dissent in *Lynch* had criticized that portion of the majority opinion which suggested that the chancellor did not have discretion to apply an out-of-pocket appraisal damage remedy.

78. *Id.* at 715. The court reasoned that the need for such protection as the business purpose rule was intended to provide to minority shareholders was obviated by the combined benefits granted them by the entire fairness test, the enhanced appraisal remedy, and the broad discretion of the chancellor to create such relief as the particular circumstances of the case warranted.

79. *Id.* at 714 (emphasis added).

80. *Id.*

81. Rosenblatt v. Getty Oil Co., 493 A.2d 929 (Del. 1985). The court of

court reaffirmed the requirement that both aspects of fairness, fair dealing and fair price, be examined together[82] and that the latter analysis included consideration of all relevant economic factors of the proposed merger "along with damages, including rescissory damages."[83]

Two chancery court decisions issued after *Weinberger* focused on the adequacy of the appraisal remedy.[84] In *Shapiro v. Pabst*, the court granted defendants' motion to dismiss on the grounds that appraisal was the plaintiff's exclusive remedy since the complaint failed to allege facts that would render the appraisal remedy inadequate.[85] The court noted that *Weinberger* stated only that appraisal *might* not be an adequate remedy in cases involving self-dealing or waste, not that such allegations automatically entitled a stockholder to maintain an entire fairness class action.[86] The court concluded that if the plaintiff could prove that he was damaged by the unfair dealing, those damages could be included in the appraisal award.[87] The court reached the same conclusion in *Stepak v. Scharffenberger*.[88] While *Weinberger* "left the door open for future attacks on mergers, outside appraisal proceedings," the court indicated that that route was available only when circumstances rendered the appraisal remedy inadequate.[89] Otherwise, the court concluded that unfair dealing claims might be considered in an expanded appraisal proceeding.[90]

The supreme court had its first opportunity to examine the exclusivity of the appraisal remedy, raised in a pretrial context, in *Rabkin v. Philip A. Hunt Chemical Corp.*[91] In the chancery court action,

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chancery held that the merger and exchange ratio were entirely fair to minority shareholders, and the supreme court affirmed.

82. *Id.* at 937 (citing *Weinberger*, 457 A.2d at 711).

83. *Id.* at 940.

84. *See* Stepak v. Scharffenberger, No. 6530 (Del. Ch. Aug. 9, 1985), *reprinted in* 11 DEL. J. CORP. L. 711 (1986) (individual and purported class action challenging short-form merger on grounds of misrepresentation of material information), *aff'd*, No. 298, 1985 (Del. Jan. 30, 1986); Shapiro v. Pabst Brewing Co., No. 7339 (Del. Ch. July 30, 1985), *reprinted in* 11 DEL. J. CORP. L. 704 (1986) (class action alleging wrongful manipulation of tender offer battle).

85. *Shapiro*, No. 7339, slip op. at 11, *reprinted in* 11 DEL. J. CORP. L. at 710.

86. *Id.*, slip op. at 10-11, *reprinted in* 11 DEL. J. CORP. L. at 710.

87. *Id.*, slip op. at 11, *reprinted in* 11 DEL. J. CORP. L. at 710 (citing *Weinberger*, 457 A.2d at 713).

88. No. 6530 (Del. Ch. Aug. 9, 1985), *reprinted in* 11 DEL. J. CORP. L. 711 (1986).

89. *Id.*, slip op. at 6, *reprinted in* 11 DEL. J. CORP. L. at 715.

90. *Id.*, slip op. at 8, *reprinted in* 11 DEL. J. CORP. L. at 716.

91. 498 A.2d 1099 (Del. 1985).

the shareholders of a chemical corporation brought suit to enjoin a proposed merger on the ground that the price offered was grossly inadequate as the result of unfair manipulation of the timing of the merger.[92] The court of chancery dismissed the complaint, holding that *Weinberger* mandated appraisal in the absence of deception.[93] In reversing, the supreme court stated that the trial court had misconstrued *Weinberger* and ignored the specific proviso that "appraisal is not necessarily a stockholder's sole remedy," particularly when the complaint alleged facts which, if proven, constituted breaches of fiduciary duty that might have had an impact on the price offered.[94] "[T]he trial court's narrow interpretation of *Weinberger* would render meaningless our extensive discussion of fair dealing found in that opinion," the court said.[95] Thus, the court reaffirmed the "ever-present power of equity to deal with illegality or fraud."[96]

The distinction between these cases and the case under review is that none of them was brought as an appraisal action, leaving open the question of whether claims of unfair dealing seeking rescissory damages may be litigated within an appraisal action.[97]

III. *CEDE & CO.*: THE DELAWARE COURT OF CHANCERY

Cede & Co. v. Technicolor, Inc.[98] is the first case to challenge the flexibility of the post-*Weinberger* appraisal remedy. Since "[t]he uniqueness of equity is its ability to react on a case-by-case basis without the rigidity of pigeonholes,"[99] the facts in *Cede & Co.* are critical to ultimate determination of the appropriate remedy.

Effective January 24, 1983, Macanfor Corporation (Macanfor), a wholly-owned subsidiary of MacAndrews & Forbes Group, Incor-

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92. Rabkin v. Philip A. Hunt Chem. Corp., 480 A.2d 655 (Del. Ch. 1984) (complaint alleged that merger was the result of a preconceived scheme to purposely avoid a one-year commitment to pay a set price per share higher than that ultimately offered to minority shareholders), *rev'd*, 498 A.2d 1099 (Del. 1985).

93. *Id.* at 660.

94. *Rabkin*, 498 A.2d at 1104.

95. *Id.*

96. *Stauffer*, 187 A.2d at 80, *aff'g*, 40 Del. Ch. 202, 178 A.2d 311 (1962).

97. *Cede & Co.*, Nos. 7129 & 8358, slip op. at 22 n.3, *reprinted in* 13 DEL. J. CORP. L. at 240 n.3.

98. Nos. 7129 & 8358 (Del. Ch. Jan. 13, 1987), *reprinted in* 13 DEL. J. CORP. L. 225 (1988).

99. *Roland*, 407 A.2d at 1038.

porated (MAF) was merged into Technicolor.[100] Technicolor was the surviving corporation and, as a result of the merger, became a wholly-owned subsidiary of MAF.[101] By the terms of the merger, Technicolor's public stockholders were cashed out at a price of $23 per share.[102] Cinerama rejected the merger price as being unfair (based on valuations of the stock as high as $40 per share)[103] and, on March 18, 1983, filed its appraisal action.[104] Cinerama asserts that at the time it elected appraisal it had no reason to believe there was any unfair dealing involved.[105] During discovery, Cinerama learned facts that suggested unfair dealing by Technicolor, including testimony that the merger was not authorized by the required shareholder vote and therefore was void *ab initio*.[106] As a result of the alleged wrongs uncovered in discovery,[107] Cinerama filed a second action in January

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100. Appellants' Opening Brief at 1, Cede & Co. v. Technicolor, Inc., 542 A.2d 1182 (Del. 1988) (Nos. 18,1987 & 19,1987). The merger agreement provided that Macanfor would make a cash tender offer for all of Technicolor's common stock at a price of $23 per share, to be followed by a cash-out merger at the same price. *Id.* at 7.

101. *Id.* at 1.

102. *Id.*

103. Technicolor Director Charles S. Simone based his belief that the price was inadequate on a statement made to him a year earlier by fellow Director Guy M. Bjorkman that the stock was worth at least $40 per share. *Id.* at 10. The investment banking firm Goldman, Sachs & Co. (Goldman), retained by Technicolor Director Morton Kamerman to render a fairness opinion on the $23 price, concluded that a leveraged buy-out was feasible even at prices in excess of $27 per share. *Id.* at 17. One chart prepared by Goldman, which was not shown to the directors at the special board meeting October 29, 1982, when the merger was allegedly authorized, showed a range of prices for the Technicolor stock of up to $32 per share. *Id.* at 18. At $23 per share, Cinerama would have received $4.6 million for its shares, compared to more than $8 million at a price of $40 per share.

104. *Cede & Co.*, Nos. 7129 & 8358, slip op. at 1, *reprinted in* 13 DEL. J. CORP. L. at 229.

105. Appellants' Opening Brief at 1-2, Cede & Co. v. Technicolor, Inc., 542 A.2d 1182 (Del. 1988) (Nos. 18,1987 & 19,1987).

106. *Id.* at 2. Technicolor's charter contained a 95% supermajority provision that required a proposed merger to be approved by 95% of the issued and outstanding shares of its stock. This provision could be waived only by the unanimous vote of Technicolor's directors. According to Charles S. Simone's deposition, although he was then a director of Technicolor, he did not vote in favor of waiving the 95% supermajority provision. Since the merger at issue was approved by less than 95% of the outstanding shares, it is argued that the merger was illegal.

107. Cinerama alleged numerous breaches of fiduciary duty by members of Technicolor's board, including breaches of the duty of candor, the duty of loyalty, and the duty of care, and charged defendants MacAndrews & Forbes and its chairman, Ronald O. Perelman, with conspiracy and common law fraud. *Cede & Co.*, Nos. 7129 & 8358, slip op. at 6-7, *reprinted in* 13 DEL. J. CORP. L. at 232.

1986, seeking damages, rescission of the merger, and other equitable relief.[108]

The chancellor analyzed the case in terms of three important issues:

1. Whether a shareholder who elects to pursue his appraisal remedy under section 262[109] is precluded from bringing a later action to rescind the merger, when at the time of the election he did not know and had no reason to know the facts supporting an action for equitable relief?[110]
2. Whether a former shareholder may simultaneously litigate to judgment an appraisal action and an action for fraud or breach of fiduciary duty?[111]
3. When must a shareholder, who did not know of the alleged fraudulent activity at the time he chose appraisal, elect between that remedy and equitable relief?[112]

The first issue is essentially a question of standing.[113] Technicolor argued that a plaintiff who has perfected his appraisal rights has, in a sense, changed his status from that of a stockholder to a quasi-creditor, thereby losing his right to recover in a class action suit for rescission of the merger or other equitable relief.[114] Acknowledging that this might be the case in a derivative suit governed by somewhat different principles,[115] the court, rejecting the argument, stated that the quasi-creditor, a former stockholder, is not materially different

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108. *Id.*, slip op. at 1, *reprinted in* 13 DEL. J. CORP. L. at 229.

109. DEL. CODE ANN. tit. 8, § 262 (1983).

110. *Cede & Co.*, Nos. 7129 & 8358, slip op. at 2, *reprinted in* 13 DEL. J. CORP. L. at 230.

111. *Id.*, slip op. at 2-3, *reprinted in* 13 DEL. J. CORP. L. at 230.

112. *Id.*, slip op. at 3, *reprinted in* 13 DEL. J. CORP. L. at 230.

113. *See id.*, slip op. at 8, *reprinted in* 13 DEL. J. CORP. L. at 232-33.

114. *Id.*, slip op. at 7-8, *reprinted in* 13 DEL. J. CORP. L. at 232-33. Technicolor found support for its standing argument in: Braasch v. Goldschmidt, 41 Del. Ch. 519, 531, 199 A.2d 760, 766 (1964) (citing *Dofflemeyer*, 558 F. Supp. at 381) (stockholder who elects the statutory appraisal remedy may not subsequently sue derivatively on behalf of the corporation); Southern Prod. Co. v. Sabath, 87 A.2d 128 (Del. 1952) (effect of appraisal action was to convert the status of the plaintiffs from that of stockholders to that of creditors, and since they were no longer stockholders, they could not maintain a representative action)). *Id.*, slip op. at 7-8, *reprinted in* 13 DEL. J. CORP. L. at 232-33.

115. *Id.*, slip op. at 10, *reprinted in* 13 DEL. J. CORP. L. at 234. In a merger, derivative claims of mismanagement become the property of the surviving corporation. Thus, continuing stockholder status is necessary to assure an actual interest in the claim being litigated and the recovery sought. *Id.*, slip op. at 9, 11, *reprinted in* 13 DEL. J. CORP. L. at 233.

from the former shareholder who cashed-out his shares.[116] The court reasoned that, since the latter clearly had standing to litigate claims of breach of duty arising from the merger,[117] the law should afford the same relief to the former.[118] To find otherwise, the court said, would violate a "bedrock proposition of our corporation law: that a corporate fiduciary will be held to answer for wrongs to his corporation or its shareholders that flow from his acts despite the fact that he had a legal right to so act."[119]

In response to the second question, the court held that Cinerama, though not precluded from bringing the fraud action, was required, at some point, to choose which remedy to pursue since "[o]bviously these forms of relief are inconsistent."[120] Chief among the essential differences, the court said, is the fact that in an appraisal the court is not required to find any wrongdoing to grant the remedy, whereas the equitable remedy requires a determination of breach of duty.[121] The second major difference identified by the court is the time at which the remedy is measured. The appraisal remedy is tied to the value of the stock at the time of the merger, and the equitable remedy is more likely to be measured by the value of the stock at the time of judgment.[122] With the lapse in time between a merger and trial

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116. *Id.*, slip op. at 12, *reprinted in* 13 DEL. J. CORP. L. at 235. Both the "quasi-creditor" and the cashed-out shareholder, neither of whom are present stockholders, have an economic interest in a rescissory remedy. *Id.*, slip op. at 11, *reprinted in* 13 DEL. J. CORP. L. at 234.

117. *Id.*, slip op. at 11, *reprinted in* 13 DEL. J. CORP. L. at 234. The court cited Rabkin v. Philip A. Hunt Chem. Corp., 498 A.2d 1099 (Del. 1985), *rev'g*, 480 A.2d 655 (Del. Ch. 1984); Rosenblatt v. Getty Oil Co., 493 A.2d 929 (Del. 1985); Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983), *rev'g*, 426 A.2d 1333 (Del. Ch. 1981); Lynch v. Vickers Energy Corp., 429 A.2d 497 (Del. 1981). *Cede & Co.*, Nos. 7129 & 8358, slip op. at 11-12, *reprinted in* 13 DEL. J. CORP. L. at 234-35.

118. *Cede & Co.*, Nos. 7129 & 8358, slip op. at 12, *reprinted in* 13 DEL. J. CORP. L. at 235.

119. *Id.*, slip op. at 12 n.1, *reprinted in* 13 DEL. J. CORP. L. at 235. The court's conclusion was based on its reading of the Delaware Supreme Court decision in Dofflemeyer v. W.F. Hall Printing Co., 432 A.2d 1198 (Del. 1981).

120. *Cede & Co.*, Nos. 7129 & 8358, slip op. at 14, *reprinted in* 13 DEL. J. CORP. L. at 236.

121. *Id.*, slip op. at 16, *reprinted in* 13 DEL. J. CORP. L. at 237. In the court's view, this distinction between the remedies would mean that the issues for determination at trial would necessarily be different. *Id.*, slip op. at 16-17, *reprinted in* 13 DEL. J. CORP. L. at 237.

122. *Id.*, slip op. at 17-18, *reprinted in* 13 DEL. J. CORP. L. at 237-38. The chancellor appears to have misinterpreted § 262, which in its present version contains no limitation on the date of valuation of the stock. *See* DEL. CODE ANN. tit. 8, §

of an entire fairness claim, the court concluded that the damages element would "be entirely different from that of an appraisal case."[123] The court also expressed concern about the differences to be expected in the litigation of the two types of claims, citing the issues of liability and burden of proof as examples.[124]

The chancellor rejected outright Cinerama's argument that *Weinberger*[125] expressly approved litigation of an appraisal claim and a claim for rescission in the same case.[126] Rather, he interpreted the court's holding in that case to be limited to the liberalization of the valuation process in an appraisal action and reaffirmation of the exclusivity of the appraisal remedy when the minority shareholders were in essence attacking the fairness of the merger price.[127] To read *Weinberger* as authorizing the expansion of the appraisal claim to include a fraud claim, the court said, would "destroy the distinctive nature of an appraisal and . . . result in an unwieldly [sic] form of action."[128] This, the court maintained, would be contrary to legislative intent as "the legislature has narrowed the issues involved [in an appraisal] in order to provide a fair and economical remedy for

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262(h) (1983). Prior to 1976, § 262(b) provided that a stockholder would receive payment for "the value of his stock *on the effective date of the merger or consolidation*," but the 1976 amendments deleted any reference in subsection (b) to the date-specific limitation. *See* Appellants' Opening Brief at 25, Cede & Co. v. Technicolor, Inc., 542 A.2d 1182 (Del. 1988) (Nos. 18,1987 & 19,1987) (citing 60 Del. Laws ch. 371, § 4 (1976) (emphasis added).

123. *Cede & Co.*, Nos. 7129 & 8358, slip op. at 18, *reprinted in* 13 DEL. J. CORP. L. at 238.

124. *Id.* The issue of liability presents a special problem in the context of an expanded appraisal action since the defendant in the appraisal action is Technicolor, and the defendants in the fraud action include other parties as well. DEL. CODE ANN. tit. 8, § 262(i) (1983) directs that payment of the fair value of the shares be made by the surviving or resulting corporation and does not provide for damages to be assessed against other parties. A consolidation of the two claims in a single trial would eliminate this problem.

125. Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983), *rev'g*, 426 A.2d 1333 (Del. Ch. 1981).

126. *Cede & Co.*, Nos. 7129 & 8358, slip op. at 14, *reprinted in* 13 DEL. J. CORP. L. at 236.

127. *Id.*, slip op. at 14-15, *reprinted in* 13 DEL. J. CORP. L. at 236. It would not appear that reaffirmation of the exclusivity of the appraisal remedy in disputes over fair price represented an important modification in the law as the chancellor suggested. *See supra* note 55 and accompanying text (discussing exclusivity of the appraisal remedy). Rather, it is suggested here that the application of the entire fairness standard to an appraisal action and the proviso that fair value might include rescissory damages that represented significant departures from earlier decisions.

128. *Cede & Co.*, Nos. 7129 & 8358, slip op. at 14, *reprinted in* 13 DEL. J. CORP. L. at 236.

a specific problem."[129] Since *Weinberger* was an "entire fairness" case, not an appraisal action, the court reasoned that allowing rescissory damages to be proven required no expansion of the basic appraisal action.[130] While the court acknowledged that *Weinberger* had preserved the continuing validity of a shareholder's equitable rights in cases of breach of fiduciary duty, it interpreted that to apply to the exclusivity of the appraisal remedy in cases of fair value, not to its expansion to encompass fair dealing.[131] Citing *Rabkin v. Philip A. Hunt Chemical Corp.*,[132] the court said that in such cases appraisal is not necessarily a stockholder's *sole* remedy and an equitable claim should be entertained.[133] This holding, the court asserted, is more consistent with the concept of election of remedies than with consolidation of remedies.[134]

In answering the final question, "When must the election be made?" the court applied a balancing test, weighing the interests of the shareholder and the defendants, while taking into consideration those of the public in the efficient administration of justice.[135] The court concluded rather summarily that requiring election at the time a plaintiff announces himself ready for trial would afford the plaintiff an opportunity to develop a record on all potential issues and at the

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129. *Id.*, slip op. at 20, *reprinted in* 13 DEL. J. CORP. L. at 239. The chancellor's use of the word "narrowed" is perplexing since the statutory language and the legislative history would suggest that far from narrowing the remedy, the legislature has sought to follow the courts' lead in expanding the valuation procedure to include consideration of "all relevant factors." *See supra* notes 35-36 and accompanying text (discussing legislative history and statutory language).

130. *Cede & Co.*, Nos. 7129 & 8358, slip op. at 19-20, *reprinted in* 13 DEL. J. CORP. L. at 238-39. Although *Weinberger* was an entire fairness case, the remedy developed for the plaintiff was discussed throughout the opinion in the context of the statutory remedy which would otherwise have been available to plaintiff under § 262. *See Weinberger*, 457 A.2d at 713-14.

131. *Cede & Co.*, Nos. 7129 & 8358, slip op. at 15, *reprinted in* 13 DEL. J. CORP. L. at 236. The court said that "where a breach of fiduciary duty is alleged and proven, a shareholder has a right of redress, in equity, *distinct* from the right to the fair value of his shares at the time of the merger—*the core right protected by [s]ection 262.*" *Id.* (emphasis added).

132. 498 A.2d 1099 (Del. 1985), *rev'g*, 480 A.2d 655 (Del. Ch. 1984).

133. *Cede & Co.*, Nos. 7129 & 8358, slip op. at 15-16, *reprinted in* 13 DEL. J. CORP. L. at 236-37. The chancellor correctly noted that *Rabkin* did not address the question presented in the case at bar, namely, "whether a claim of procedural unfairness, which if well-founded would give rise to an equitable right of rescission or rescissionary damages, *may* be litigated within the contours of an appraisal action." *Id.*, slip op. at 22 n.3, *reprinted in* 13 DEL. J. CORP. L. at 240.

134. *Id.*, slip op. at 22, *reprinted in* 13 DEL. J. CORP. L. at 240.

135. *Id.*, slip op. at 20-21, *reprinted in* 13 DEL. J. CORP. L. at 239.

same time permit defendants to request additional time to prepare for trial, if needed, at a pretrial conference.[136]

The chancellor declined to comment on two post-*Weinberger* chancery court opinions,[137] which appeared to support an expansion of the appraisal proceeding to include issues of fair dealing, on the basis that they were decided before the supreme court decision in *Rabkin*,[138] with its interpretation of the *Weinberger* "entire fairness" standard.[139]

IV. *CEDE & CO.*: THE DELAWARE SUPREME COURT

The supreme court began its analysis by noting the "disparate" nature of the appraisal remedy and an action for rescissory damages.[140] In an appraisal action, according to the court, the only litigable issue is a determination of the fair value of petitioners' shares on the date of the merger and the only defendant is the surviving corporation, while in a fraud action involving issues of entire fairness, the court may provide an expansive remedy that includes damages against the alleged wrongdoers.[141]

With this distinction in mind, the court believed a ruling that Cinerama's election of the appraisal remedy foreclosed it from asserting a subsequently discovered claim of fraud would violate the teachings of *Weinberger* and *Rabkin*.[142] A shareholder in Cinerama's position is not akin to one pursuing a derivative action on behalf of the corporation, but rather to a shareholder who accepts a cash-out offer in ignorance of any breach of fiduciary duty, and like the latter, he should have the right to seek redress for the breach.[143]

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136. *Id.*, slip op. at 21, *reprinted in* 13 DEL. J. CORP. L. at 239. The chancellor's holding is conclusory in nature, citing no authority in support thereof.

137. Stepak v. Scharffenberger, No. 6530 (Del. Ch. Aug. 9, 1985), *reprinted in* 11 DEL. J. CORP. L. 711 (1986), *aff'd*, No. 298, 1985 (Del. Jan. 30, 1986); Shapiro v. Pabst Brewing Co., No. 7339 (Del. Ch. July 30, 1985), *reprinted in* 11 DEL. J. CORP. L. 704 (1986).

138. Rabkin v. Philip A. Hunt Chem. Corp., 498 A.2d 1099 (Del. 1985), *rev'g*, 480 A.2d 655 (Del. Ch. 1984).

139. *Cede & Co.*, Nos. 7129 & 8358, slip op. at 21-22, *reprinted in* 13 DEL. J. CORP. L. at 239-40.

140. *Cede & Co.*, 542 A.2d at 1186. The court recognized that the two remedies serve different purposes and "are designed to provide different, . . . not interchangeable, remedies." *Id.* (citing Rabkin v. Philip A. Hunt Chem. Corp., 498 A.2d 1099 (Del. 1985); Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983)).

141. *Id.* at 1187.

142. *Id.* at 1188.

143. *See id.*

Furthermore, the court noted, policy considerations militate in favor of permitting the later-discovered fraud claim, since discovery during an appraisal proceeding is likely to be the only method of uncovering the information necessary to pursue a fraud claim.[144] Thus, the court concluded that "to bar those seeking appraisal from asserting a later-discovered fraud claim may effectively immunize a controlling shareholder from answering to a fraud claim."[145] Finally, the court said, considerations of equity required that Cinerama be allowed to plead alternative causes of action since success in one claim would preclude relief in the other.[146] Thus, the supreme court affirmed the court of chancery's denial of defendant's motion to dismiss Cinerama's fraud action.[147]

The court next considered whether Cinerama could assert its fraud claim within the confines of the appraisal proceeding and determined that this would not only impermissibly broaden the legislative remedy, it would also fail to bring the parties necessary for a damage award in the event of fraud before the court.[148] Furthermore, a cashed-out shareholder who later sought to bring an entire fairness claim would be litigating claims identical to those raised in the enlarged appraisal action, creating the risk of inconsistent judgments and raising issues of collateral estoppel.[149]

Turning to the final issue, the court held that the doctrine of election of remedies had no application to this case because the remedies sought "are for the enforcement of different and distinct rights or the redress of different and distinct wrongs."[150]

In holding that Cinerama could proceed simultaneously with its statutory and equitable claims for relief, the court appeared to be strongly influenced by the fact that consolidation was the only way to put Cinerama in the position it would arguably have been in had the defendants disclosed all material information to the minority shareholders at the time of the merger.[151] If Cinerama had known then what it arguably discovered through its appraisal action, it

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144. *Id.* at 1188-89.
145. *Id.* at 1189.
146. *Id.*
147. *Id.*
148. *Id.* The court noted that in an appraisal action, there is no inquiry into claims of wrongdoing with respect to the merger. In a fraud action, however, such an inquiry is made and the alleged wrongdoers are necessary party defendants. *Id.*
149. *Id.* at 1189-90.
150. *Id.* at 1191 (citing 25 Am. Jur. 2d *Election of Remedies* § 10, at 653 (1966)).
151. *See id.*

would have sued to enjoin the merger and, if unsuccessful, would still have had the option of pursuing an appraisal action, the court said.[152] In addition, the consolidated action appeared to offer convenience and economy in the administration of both actions.[153] The court acknowledged the possibility that the option of consolidation could lead dissenting shareholders to pursue appraisal in the hope of uncovering evidence of fraud, but felt that the chancery court's ability to assess the costs of litigation against a party who brings an unmeritorious suit would discourage such litigation.[154]

V. EVALUATION

What *Weinberger* professed to do—expand the utility of the appraisal remedy—*Cede & Co.* in fact has done. No longer will minority shareholders be faced with the Hobson's choice between electing to pursue their appraisal rights and bringing a claim for breach of fiduciary duty. The key element, of course, is discovery. As the Delaware Supreme Court noted, "With the majority of the minority shareholders tendering their shares, only shareholders pursuing discovery during an appraisal proceeding are likely to acquire the relevant information needed to pursue a fraud action if such information exists."[155]

The appraisal statute itself provides for discovery.[156] In light of this statutory mandate to "take into account all relevant factors" when determining fair value,[157] the pertinent question becomes the extent to which all relevant factors are discoverable. Chancery Rule 26(b)(1) provides that any matter, not privileged, which is relevant to the subject matter in the pending action is discoverable whether or not it will be admissible at trial, provided that it is "reasonably

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152. *Id.*

153. *Id.* at 1192.

154. *Id.*

155. *Id.* at 1189. The importance of discovery was noted in an earlier opinion in this controversy where the court of chancery said that post-merger discovery would, no doubt, become an increasingly significant problem in light of the emphasis placed upon the appraisal remedy by *Weinberger*. *Cede & Co.*, No. 7129, slip op. at 2-3 (citation omitted), *reprinted in* 10 DEL. J. CORP. L. at 161.

156. Section 262(h) states: "Upon application by the surviving or resulting corporation or by any stockholder entitled to participate in the appraisal proceeding, the Court may, in its discretion, permit discovery or other pretrial proceedings . . . ." DEL. CODE ANN. tit. 8, § 262 (1983).

157. *Id.*

calculated'' to lead to the discovery of admissible evidence.[158] Since the appraisal statute only excludes speculative elements of value arising from the expectation or accomplishment of the merger from what the court of chancery may consider in determining fair value,[159] practically anything else is discoverable if it is reasonably calculated to lead to admissible evidence as to value as of the date of the merger.[160]

Accordingly, in the case of a leveraged buyout, the court of chancery has held that defendants should not be permitted to use the discovery rules ''to hide behind the bar of the date of the merger'' to prevent minority shareholders, who have the burden of proof on valuation, from discovering elements of future value which were in the picture from the beginning.[161] As the supreme court noted in *Cede & Co.*, ''the majority may have insight into their company's future based primarily on bits and pieces of *nonmaterial* information that have value as a totality.''[162] Such information must be made available to the appraisal petitioner, the court said, in light of the ''acute conflict of interest and the potential for investor harm that is inherent in freezeout transactions.''[163]

The court of chancery, recognizing the potential for abuse in permitting unlimited discovery, has stated that ''as a general rule corporate management should not be required to suffer a costly and disruptive fishing expedition by an appraisal plaintiff.''[164] Furthermore, plaintiffs should not be permitted to use discovery for the purpose of attempting to discover a new cause of action.[165] This,

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158. DEL. CH. CT. R. 26(b)(1) (1974).

159. DEL. CODE ANN. tit. 8, § 262(h) (1983).

160. *See* DEL. CH. CT. R. 26(b)(1) (1974). *See also* Ross v. Proco Management, Inc., No. 6146, slip op. at 6 (Del. Ch. May 23, 1983) (criterion for determining scope of discovery in appraisal action is ''whether the discovery sought is reasonably calculated to lead to admissable evidence as to the value as to the date of the merger'').

161. *Cede & Co.*, No. 7129, slip op. at 14, *reprinted in* 10 DEL. J. CORP. L. at 167. *See also* Garbarino v. Albercan Oil Corp., 109 A.2d 824, 827 (Del. Ch. 1954) (''When this type of value determination is involved, it is unrealistic to shut out the light shed by evidence of value coming from reasonably proximate periods.'').

162. 542 A.2d at 1187 n.8 (citation omitted).

163. *Id.* (quoting R. CLARK, CORPORATE LAW 507, 508 (1986)).

164. *Cede & Co.*, No. 7129, slip op. at 12, *reprinted in* 10 DEL. J. CORP. L. at 166.

165. Dann v. Chrysler Corp., 166 A.2d 431, 433 (Del. Ch. 1960). *See also Garbarino*, 109 A.2d at 828 (a corporation is entitled to prevent unrestricted discovery, even by its stockholders who are in search of ''something'').

however, is precisely what plaintiffs will attempt to do, particularly in light of the supreme court's recognition that discovery during an appraisal proceeding is probably the only way to uncover the evidence necessary to pursue a fraud action.[166] The application of the discovery rules is within the exercise of the court's sound discretion,[167] and if a number of recent chancery court decisions are any indication, the court will exercise that discretion in favor of the minority shareholder based on "what is fair and reasonable under the special circumstances of the case."[168]

VI. CONCLUSION

The Delaware Supreme Court's decision in *Cede & Co.* is likely to have a substantial impact on future cash-out mergers. Appraisal actions will be used more commonly as a means to uncover breach of duty and fraud. Discovery will be the critical issue and that is where future contests will occur. There is a powerful incentive for management to deal fairly with its minority shareholders and to disclose all information that a reasonable shareholder would consider important in deciding whether to sell or retain his stock as *Weinberger* dictates. The end result is a more equitable balancing of the interests of minority and majority shareholders.

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166. *Cede & Co.*, 542 A.2d at 1189.

167. *Dann*, 166 A.2d at 432.

168. *Ross*, No. 6146, slip op. at 5 (quoting *In re Olivetti Underwood Corp.*, 246 A.2d at 806). *See also* Kaye v. Pantone, Inc., No. 5466, slip op. at 5-7 (Del. Ch. Oct. 6, 1981) (granting, in part, plaintiff's motion to compel production of defendant corporation's documents relating to merger in question, including financial records dating back five years, post-merger documents, and documents relating to all executed and proposed licenses, leases, and contracts).