THE EROSION OF THE LAW OF CONTROLLING SHAREHOLDERS

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I. INTRODUCTION

The two traditional legal standards of review of corporate transactions are bipolar.[1] At one end of the spectrum is the business judgment rule. As that standard presumes that directors have made decisions that comport with their fiduciary duties, plaintiffs are required to rebut this presumption.[2] The

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[1]As the Delaware Supreme Court noted, "It is often of critical importance whether a particular decision is one to which the business judgment rule applies or the entire fairness rule applies. It is sometimes thought that the decision whether to apply the business judgment rule or the entire fairness test can be outcome-determinative." Nixon v. Blackwell, 626 A.2d 1366, 1376 (Del. 1993); *see also* Mills Acquisition Co. v. Macmillan, Inc. 559 A.2d 1261, 1279 (Del. 1988) (stating that "[b]ecause the effect of the proper invocation of the business judgment rule is so powerful and the standard of entire fairness so exacting, the determination of the appropriate standard of judicial review frequently is determinative of the outcome of derivative litigation" (citing AC Acquisitions v. Anderson, Clayton & Co., 519 A.2d 103, 111 (Del. Ch. 1986)); *In re* Walt Disney Co. Derivative Litig., No. 15,452, 1998 Del. Ch. LEXIS 186, at *57 (Del. Ch. Oct. 7, 1998) (stating entire fairness standard of review is exacting, but not outcome determinative).

[2]*See In re* MAXXAM, Inc., 659 A.2d 760, 771 (Del. Ch. 1995) (stating that "[i]f the . . . transactions were reviewed under the business judgment standard, the defendants' burden would not be onerous, because under that standard, absent a demonstrated breach of the duty of care or loyalty, the transactions would be upheld if they could be attributed to any rational business purpose"); Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993) (describing the business judgment rule as a "powerful presumption" in favor of directors); *see generally* R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS §§ 4.30-.32 (3d ed. 1998) (describing courts' application of the business judgment rule); DENNIS J. BLOCK ET AL., THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS 11-19 (4th ed. 1993) [hereinafter BLOCK ET AL., THE BUSINESS JUDGMENT RULE] (describing the business judgment rules presumption and effect); DAVID A. DREXLER ET AL., DELAWARE CORPORATION LAW AND PRACTICE § 15.03-.04 (1996) (discussing the business judgment rule and presumption); Dennis J. Block et al., *The Duty of Loyalty and the Evolution of the Scope of Judicial Review*, 59 BROOK. L. REV. 65, 68-70 (1993) [hereinafter Block et al., *The Duty of Loyalty*](describing the business judgment rule and fairness standard); B. Ellen Taylor, *New and Unjustified Restrictions on Delaware Directors' Authority*, 21 DEL. J. CORP. L. 837, 887-88 (1996) (describing the business judgment rule and standard of scrutiny).

fairness standard of review is at the other end of the spectrum. Because the fairness standard requires defendants to prove innumerable considerations that are both subjective and amorphous, defendants view the entire fairness standard as highly problematic.[3]

Over the last thirty years, courts have sometimes found that neither of these divergent standards was well suited to monitor the given fact pattern. Thus, for example, the Delaware Supreme Court created both the "enhanced business judgment rule"[4] to monitor directors' defensive actions in a hostile takeover, as well as the "Zapata two-step" to review whether a corporation could wrest control over a derivative suit from a shareholder who had made

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[3]As described in *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983), fairness involves an all-encompassing analysis including:

> when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained, . . . [as well as] the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock.

Id. at 711. *See also* Nixon v. Blackwell, 626 A.2d 1366, 1378 (Del. 1993) (stating that "where the court is scrutinizing the fairness of a self-interested corporate transaction . . . the reasonableness of the business judgment of the conflicted directors' decision must be examined searchingly"); Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1279 (Del. 1988) (stating that under entire fairness review, "the challenged transaction must withstand rigorous judicial scrutiny"); Kahn v. Tremont Corp., No. 12,339, 1996 Del. Ch. LEXIS 40, at *27 (Del. Ch. Mar. 21, 1996), *reprinted in* 21 DEL. J. CORP. L. 1161, 1182 (1996) ("The concept of fairness is of course not a technical concept. No litmus paper can be found or geiger-counter invented that will make determinations of fairness objective."), *rev'd on other grounds*, 694 A.2d 422 (Del. 1997); Block et al., *The Duty of Loyalty*, *supra* note 2, at 68 (comparing fairness standard with business judgment rule); MICHAEL P. DOOLEY, FUNDAMENTALS OF CORPORATION LAW 610 (1995) (pointing out the "extremely vague and open-ended nature of the fairness standard"); Lawrence E. Mitchell, *Fairness and Trust in Corporate Law*, 43 DUKE L.J. 425, 428 & n.13 (1993) (stating that "[a]lthough fairness defines the concept of the corporate fiduciary, it is itself one of the great unexplained mysteries of corporate law" and describing absence of any explanation in cases or commentary on the meaning of fairness). Recognizing the amorphous aspect of this test, courts have avoided using it in some contexts. *See* Mary Siegel, *Tender Offer Defense Tactics: A Proposal for Reform*, 36 HASTINGS L.J. 377, 394-96 (1985) (discussing that courts have avoided using fairness to evaluate tender offer defensive tactics).

[4]The "enhanced business judgment rule" responds to the risk of directors' acting in their own self-interest in resisting a hostile takeover by requiring directors to prove that they acted in good faith after reasonable investigation and responded proportionately to the threat. *See* Unitrin, Inc. v. American Gen. Corp., 651 A.2d 1361, 1373-74 (Del. 1995) (setting forth the business judgment rule); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) (satisfying the burden requires a showing of "good faith and reasonable investigation"). In *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261 (Del. 1988), the Delaware Supreme Court reiterated *Unocal*'s enhanced business judgment rule and applied it in the context of a corporate action involving a management-sponsored leverage buyout. *See id.* at 1287.

a sufficient showing that the requirement for making demand on the board should be excused as futile.[5]

Similarly, in *Sinclair Oil Corp. v. Levien*,[6] in the context of parent-subsidiary[7] transactions, the Delaware Supreme Court initially questioned the correctness of both plaintiff's demand for a fairness review and defendant's demand for the business judgment rule.[8] The court instead created the "advantage/disadvantage" test as a threshold test to be applied in parent-subsidiary transactions to determine whether the ultimate standard of review should be fairness or business judgment.[9]

The court in *Sinclair* held that if the parent "receives something from the subsidiary to the exclusion of, and detriment to the minority stockholders of the subsidiary,"[10] then the parent will be deemed to have been self-dealing and will be required to prove the fairness of the transaction.[11] On the other hand, if the parent does not get an advantage to the exclusion and detriment of the minority stockholders of the subsidiary, the parent will not be deemed to be self-dealing, and the business judgment rule will apply.[12] The court's logic in *Sinclair* was that neither the fiduciary duty that the parent clearly owes to its subsidiary, nor the fact that the parent is on both sides of a transaction with its subsidiary, is enough to dislodge the business judgment rule. Therefore, before the court would require the defendant to prove

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[5]*See* Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981). In evaluating whether to terminate a derivative lawsuit at the request of a special litigation committee once a shareholder has proven that demand is excused as futile, Delaware courts will first inquire into the "independence and good faith" of the litigation committee and consider whether there is a reasonable basis for its conclusion. *Id.* at 788. Even if the court is satisfied with the committee's independence and the reasonableness of its report, the court may proceed to a second step where it has the option to apply its own business judgment to decide whether to grant the committee's motion to dismiss. *Id.* at 788-89.

[6]280 A.2d 717 (Del. 1971).

[7]A parent corporation is a company that owns more than 50% of the voting shares of another company. A subsidiary corporation is a company that has more than 50% of its voting shares owned by another corporation. *See* BLACK'S LAW DICTIONARY 1428 (6th ed. 1990); *see also* PHILLIP I. BLUMBERG, THE LAW OF CORPORATE GROUPS § 2.01, at 27-28 (1983) (describing the purposes that a subsidiary serves).

[8]*Sinclair*, 280 A.2d at 720.

[9]*Id.* For an earlier example of the "advantage/disadvantage" language, see *Case v. New York Cent. R.R.*, 204 N.E. 643, 646-47 (N.Y. 1965).

[10]*Sinclair*, 280 A.2d at 720.

[11]*See id.*

[12]*See id. See also Case*, 204 N.E.2d at 646-47 (holding that because parent's gain had not come at the expense of the minority shareholders of the subsidiary, the parent's allocation of tax savings realized by consolidating the subsidiary's losses was to be judged by the business judgment rule).

fairness, self-dealing would have to be shown through the advantage/ disadvantage test.[13]

While the court did not give its reasons for developing a threshold test before selecting one of the bipolar tests,[14] one suspects that the court's reasoning was premised on a combination of two factors: first, the high degree of deference accorded under the business judgment rule seems disturbingly insufficient in light of the control any parent exerts over its subsidiary through stock ownership and the usual overlap in directors;[15] and second, recognition that many corporations have subsidiaries and transact business with these controlled corporations.[16] As a result, if control were sufficient to invoke the fairness test, courts would be extremely busy reviewing the fairness of a multitude of transactions. Many of these transactions would have the added complication of needing the court to evaluate basic business decisions under the rubric of a fairness review.[17]

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[13]*Sinclair*, 280 A.2d at 720.

[14]The bipolar tests are the business judgment rule and the fairness standard.

[15]*See, e.g.*, Kahn v. Roberts, 679 A.2d 460, 465 (Del. 1996) (stating that "[t]he business judgment rule normally protects all lawful actions of a board of directors, provided they were taken . . . in the absence of conflicts of interest"); Unitrin, Inc. v. American Gen. Corp. 651 A.2d 1361, 1373 (Del. 1995) (instituting two-part test for directors with inherent conflict of interest in takeover situation before applying business judgment rule); Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (reserving protections of business judgment rule for disinterested directors, i.e., those without conflicts of interest); Ryan v. Tad's Enters., Nos. 10,229 & 11,977, 1996 Del. Ch. LEXIS 54, at *17 (Del. Ch. Apr. 24, 1996), *reprinted in* 21 DEL. J. CORP. L. 1235, 1247 (1996) (stating that "[t]he business judgment review standard will not apply where the decision under challenge is made by a board a majority of whom have a material conflict of interest in the transaction").

[16]*See* PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 5.10 cmt. e, at 328-29 (1994) (discussing the high quantity of parent-subsidiary transactions and the proper standard of review under § 5.10(a)(1)); PHILLIP I. BLUMBERG, THE LAW OF CORPORATE GROUPS 27-28 (1983) (noting that many large corporations conduct business with dozens of subsidiaries); *id.* at 464-69 (indicating that a 1976 study of 11,198 subsidiaries of multinational corporations, 72% were 95%-100% owned, 9% were 51%-99% owned, 6% were co-owned (50%-50%), and 9% were 5-49% owned).

[17]The entire fairness standard of review places the burden on the defendant to demonstrate that the minority shareholders were dealt with fairly and received a fair price. *See* Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983). Even though entire fairness has two components, "the test for fairness is not a bifurcated one as between fair dealing and price. All aspects of the issue must be examined as a whole since the question is one of entire fairness." *Id.* In fact, one reason for the development of the business judgment rule is that courts do not want to and are not equipped to analyze business transactions. *See* Beard v. Elster, 160 A.2d 731, 738-39 (Del. 1960) (stating that "we are precluded from substituting our uninformed opinion for that of experienced business managers of a corporation who have no personal interest in the outcome, and whose sole interest is the furtherance of the corporate enterprise"); Reading Co. v. Trailer Train Co., No. 7422, 1984 Del. Ch. LEXIS 499, at *13 (Del. Ch. Mar. 15, 1984), *reprinted in* 9 DEL. J. CORP. L. 223, 229 (1984) ("In the context of our corporate business world, courts should be loathe to interfere with the internal management of corporations or to interfere with their business decisions unless statutory or case law indicates they have overstepped their bounds."). *See also* Auerbach v. Bennett, 393 N.E.2d 994, 1000 (N.Y. 1979) (stating that the business judgment rule is partly grounded in "prudent recognition

Thus, the court's creation of a threshold test to identify which of the bipolar tests would be the ultimate standard of review was likely generated by both concerns about the propriety of the business judgment rule in this context, as well as a disinclination to review the fairness of a large number of transactions.[18]

Sinclair's attempt to effectively identify at the threshold those controlling-shareholder transactions that warrant the demanding fairness review, however, has largely been dissipated. Three lines of cases have coalesced to cause this result: one has ignored the *Sinclair* test; a second has diluted it by omitting its "detriment" prong; and a third has applied the test mechanically, without any meaningful evaluation at the threshold.[19] As a result, *Sinclair* currently does little more than relegate pure *pro rata* transactions to the business judgment rule. The undermining of *Sinclair* has relegated the bulk of transactions involving controlling shareholders for review under the entire fairness standard, thereby making it the dominant standard of review in Delaware to monitor these transactions. As this significant shift in the law has occurred *sub rosa*, there has been little appreciation that this shift has occurred, no explanation for what may have motivated the shift, no explicit examination of the implications of this change, and no analysis of whether this change is beneficial. As the article concludes that this undocumented shift has not been entirely beneficial, a critical analysis of the Delaware law of controlling shareholders is desirable.

Part II of this article identifies the factors that either are, or should be, relevant to the choice of monitor. Part III traces the development of the law governing both majority and minority controlling-shareholder transactions to document how, in fact, Delaware courts have analyzed these types of transactions. Part IV assesses whether the law has evolved to the correct point. As the article concludes that the relevant case law has drifted astray, Part IV proposes a methodology for monitoring controlling-shareholder transactions.

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that courts are ill equipped and infrequently called on to evaluate what are and must be essentially business judgments"); BLOCK ET AL., THE BUSINESS JUDGMENT RULE, *supra* note 2, at 5-11 (explaining rationale for business judgment rule); Siegel, *supra* note 3, at 407 (discussing Delaware Supreme Court's encouragement of shareholder vote in *Weinberger v. UOP, Inc.* based, in part, on desire to eliminate the need for judicial evaluation of the fairness of a transaction).

[18]*See* DOOLEY, *supra* note 3, at 610 (1995) (subjecting all parent-subsidiary transactions to judicial review under a fairness standard "would undoubtedly increase the number of transactions subject to challenge because of the extremely vague and open-ended nature of the fairness standard").

[19]*See infra* Part III.

II. THE FACTORS RELEVANT TO THE CHOICE OF MONITOR

A wide variety of fact patterns can present conflicts of interest in corporate law. As a result, in selecting the appropriate monitor, courts assess both the risk and the significance of cheating in the given circumstance.[20] The primary factors that courts consider in making this assessment are the status of the parties and the nature of the transaction.[21] For purposes of this article, the conflicted parties are either interested directors, a minority but controlling shareholder, or a majority shareholder, who may be either an individual or a parent corporation dealing with one or more of its subsidiaries. In addition, transactions can be segmented into three groups: those involving mergers; those involving other organic changes;[22] and those involving more routine business dealings.

A. *The Parties in the Transaction*

The law governing controlling-shareholder transactions is predicated on two competing considerations. On the one hand, shareholders who own a sizable percentage of stock have bought stock solely because they believed the purchase to be in their self-interest. Cognizant of this fact, courts have sanctioned the right of all shareholders to vote in their own interest[23] and

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[20]*See* DOOLEY, *supra* note 3, at 642 ("In conflict of interest situations, the choice between prohibitory and policing rules and among policing rules of varying degrees of rigor should logically depend upon the rulemaker's perception of the risk of cheating involved in the type of transaction in question.").

[21]*See id.* at 582 (stating that courts will "have to take into account the nature of the transaction as well as the status of the parties"); *see also infra* notes 82-84 (discussing utility of the market as an added monitor of certain transactions); RONALD J. GILSON & BERNARD S. BLACK, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 721 (2d ed. 1995) (stating that "it is precisely when market constraints on managerial misbehavior fail that legal constraints play a central role").

[22]Other organic changes include amendments to certificates of incorporation, a sale "of all or substantially all [of a corporation's] assets," and share exchanges. *See* HARRY G. HENN, LAW OF CORPORATIONS 697-98 (2d ed. 1970) (listing as examples extraordinary matters that require shareholder approval).

[23]*See* Thorpe v. CERBCO, Inc., 676 A.2d 436, 442 (Del. 1996) (citing DEL. CODE ANN. tit. 8, § 271 (1996) to affirm controlling shareholder's right to vote based on own self-interest in a transaction requiring shareholder approval to sell substantially all of the corporation's assets); Williams v. Geier, 671 A.2d 1368, 1380-81 (Del. 1996) ("Stockholders (even a controlling stockholder bloc) may properly vote in their own economic interest."); Tanzer v. International Gen. Indus., Inc., 379 A.2d 1121, 1123 (Del. 1977) (discussing majority shareholders' right to vote shares as "fundamental right"); Ringling Bros.-Barnum & Bailey Combined Shows, Inc. v. Ringling, 53 A.2d 441, 447 (Del. 1947) ("Generally speaking, a shareholder may exercise wide liberality of judgment in the matter of voting, and it is not objectionable that his motives may be for personal profit, or determined by whims or caprice, so long as he violates no duty owed his fellow shareholders.") (citing Heil v. Standard G. & E. Co., 151 A. 303 (Del. Ch. 1930)). *See also* North-West Trans. Co. v. Beatty, 12 App. Cas. 589 (P.C. 1887) (stating that shareholder/director was

generally to retain the sole right to any control premium when they sell their stock.[24] On the other hand, courts recognize that these shareholders have significant, if not decisive, voting power; that power could skew decisions disproportionately in their favor because of their ability to elect and remove the board of directors.[25] As a result, Delaware courts have placed controlling shareholders under the fiduciary duty rubric[26] in order to be able to constrain

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permitted to cast decisive vote in shareholder ratification of sale of his property to corporation).

[24]Courts do not interfere with controlling shareholders' selling their control bloc of shares and retaining the premium these shares earn, so long as they do not invoke the corporate machinery in aid of the sale. *See* Clagett v. Hutchinson, 583 F.2d 1259, 1262 (4th Cir. 1978) (finding that seller of control block justified in retaining premium as payment for element of control); McDaniel v. Painter, 418 F.2d 545, 547-48 (10th Cir. 1969) (restating "universally accepted rule" that majority stockholder may sell stock at any price, including one that includes a premium for control); Zetlin v. Hanson Holdings, Inc., 397 N.E.2d 387, 388-89 (N.Y. 1979) (controlling shareholder has no duty to share with other stockholders the premium received for sale of controlling shares); Mendel v. Carroll, 651 A.2d 297, 305 & nn.15-18 (Del. Ch. 1994) ("The law has acknowledged, albeit in a guarded and complex way, the legitimacy of the acceptance by controlling shareholders of a control premium.") (citing Cheff v. Mathes, 199 A.2d 548, 555 (Del. 1964); Hecco Ventures v. Sea-Land Corp., 642 A.2d 792 (Del. Ch. May 19, 1986)). *See also* Problems of Fiduciaries Under the Securities Laws, 20 REAL PROP., PROBATE & TRUST J. 503, 602-12 (1985) (discussing general rule allowing controlling shareholders to retain control premium upon sale of their interest and analyzing the exceptions to that rule).

[25]*See* Kahn v. Lynch Communication Sys., Inc., 638 A.2d 1110, 1116 (Del. 1994) (*Lynch I*) (expressing concern about power exercised by shareholder holding sizeable percentage of stock), *aff'd*, 669 A.2d 79 (Del. 1995); Citron v. E.I. Du Pont de Nemours & Co., 584 A.2d 490, 502 (Del. Ch. 1990) (discussing court's concern that controlling shareholder exercises broad coercive power, whether intended or not). *See also* JAMES D. COX ET AL., CORPORATIONS 251 (1991) (discussing the power of controlling shareholders). The court also stated:

> The basis for the controlling stockholder's fiduciary obligation is the sound policy that, just as directors are bound by certain fiduciary obligations, one who has the potential to control the board's actions should be subject to an obligation as rigorous as those applied to the directors. Quite separate is the belief that control in a corporation, whether publicly or closely held, carries with it the potential that the controlling stockholder may choose to exercise control to reap disproportionate benefits at the expense of the corporation or noncontrolling shareholders such that protection of their interests is desirable. That protection arises by imposing the fiduciary standards on the controlling stockholder exercising the controlling influence. The overall objective of the controlling stockholder's fiduciary obligation is not to bar the controlling stockholder form acting in his own self-interest but to assure that when so acting the interests of the corporation are also served.

Id. (footnote omitted).

[26]The classic definition of a "fiduciary" is one who has a "duty, created by his undertaking, to act primarily for another's benefit in matters connected with such undertaking." BLACK'S LAW DICTIONARY 625 (6th ed. 1990). This includes "[a] person or institution who manages money or property for another...." *Id.* Although controlling shareholders do not fit this definition, since no one buys control to act in the best interest of others, courts have nonetheless brought controlling shareholders under the fiduciary umbrella to allow courts to exercise some oversight. Thus, controlling shareholders, like directors, owe fiduciary duties to their corporations, and to the other shareholders. *See, e.g.*, *In re* Reading Co., 711 F.2d 509, 517 (3d Cir. 1983) (applying Delaware

their ability to self-deal. The determination of whether a minority shareholder is also a controlling shareholder is critical, as the Delaware Supreme Court has held that "a shareholder owes a fiduciary duty only if it owns a majority interest in or exercises control over the business affairs of the corporation."[27]

There is no set percentage of stock that will automatically place a minority shareholder under the fiduciary rubric.[28] The key factor is the ability to dictate the terms of a transaction:

> [A] shareholder who owns less than 50% of a corporation's outstanding stocks does not, without more, become a

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law to impose fiduciary duties on majority or controlling shareholders that dominate board of directors or control corporation); Harriman v. E.I. Du Pont de Nemours & Co., 372 F. Supp. 101, 105-06 (D. Del. 1974) (stating that under Delaware law, fiduciary duties attach to the exercise of control of a corporation); Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1344 (Del. 1987) (holding that Delaware courts impose fiduciary duties on shareholders who own a majority interest in the corporation or exercise control over the corporation), *aff'd*, 535 A.2d 1134 (Del. 1988); Lynch v. Vickers Energy Corp., 383 A.2d 278, 279 (Del. 1977) (affirming lower court's reliance on *Allied Chemical & Dye Corp. v. Steel & Tube Co.*, 120 A. 486 (Del. Ch. 1923), for rule of law that when majority shareholders impose their policies upon other shareholders, the majority acquires same fiduciary duties assumed by directors). *See also* Pepper v. Litton, 308 U.S. 295, 306 (1939) (stating that a dominant or controlling stockholder is a fiduciary); Zahn v. Transamerica Corp., 162 F.2d 36, 42-43 (3d Cir. 1947) (finding "unmistakable" the fiduciary status of a controlling shareholder under federal law and citing decisions of various states for the same proposition).

[27]*Ivanhoe Partners*, 535 A.2d at 1344 (citing Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 958 (Del. 1985); Aronson v. Lewis, 473 A.2d 805, 815 (Del. 1984)). *See also* Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 70 (Del. 1984) (stating that only controlling shareholders are fiduciaries). *But see infra* note 38 (listing cases in which majority shareholder held not to be in control).

[28]Gottesman v. General Motors, Corp., 279 F. Supp. 361, 367-68 (S.D.N.Y. 1967) (Du Pont had power to control GM with 23% of stock, with court noting, "Power to control through the election of directors may exist where a large block of shares, even though a minority, is owned by one group and the remaining shares are widely scattered. This is called practical or working control."); *Lynch I*, 638 A.2d at 1114-15 (shareholder deemed to be in control with 43.3% of stock); *In re* Tri-Star Pictures, Inc., 634 A.2d 319, 321, 329 (Del. 1993) (finding that Coca-Cola exercised control although it owned directly only 36.8% of common stock); Kahn v. Tremont Corp., No. 12,339, 1996 Del. Ch. LEXIS 40, at *22-23 (Del. Ch. Mar. 21, 1996), *reprinted in* 21 DEL. J. CORP. L. 1161, 1169 (1996) (owner of 44% of stock held to be controlling shareholder). Similarly, in the "sale of control" context, courts have deemed minority shareholders to be controlling. *See* Essex Universal Corp. v. Yates, 305 F.2d 572 (2d Cir. 1962) (finding control existed by owning 28.3% of stock); Perlman v. Feldmann, 219 F.2d 173 (2d Cir. 1955) (owner of approximately one-third of outstanding shares has control); Insuranshares Corp. v. Northern Fiscal Corp., 35 F. Supp. 22 (E.D. Pa. 1940) (control found with 27% of ownership); Zetlin v. Hanson Holdings, Inc., 379 N.E.2d 387 (N.Y. 1979) (sale of 44.4% of stock constitutes sale of control). *See also* LARRY E. RIBSTEIN, BUSINESS ASSOCIATIONS § 12.03, at 987, 1001 (2d ed. 1990) (citing study showing that ownership of as little as 5-10% of shares may constitute effective control of corporation). *See generally* JOEL SELIGMAN, CORPORATIONS, CASES AND MATERIALS 1026-29 (1995) (discussing factors that may determine corporate control).

> controlling shareholder of that corporation, with a concomitant fiduciary status. For a dominating relationship to exist in the absence of controlling stock ownership, a plaintiff must allege domination by a minority shareholder through actual control of corporate conduct.[29]

As the presumption is that a minority shareholder is not dominant, it is the plaintiff's burden to prove this domination.[30]

In evaluating the minority shareholder's influence on the disputed transaction, courts have examined the relationship between the minority shareholder and each member of the board or negotiating committee,[31] and have considered whether the minority dictated the terms of the transaction.[32]

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[29]*Citron*, 569 A.2d at 70 (quotations and citations omitted). *See also Ivanhoe Partners*, 535 A.2d at 1344 ("[A] shareholder owes a fiduciary duty only if it owns a majority interest in or exercises control over the business affairs of the corporation."). In *Kahn v. Lynch Communication Sys., Inc.*, 638 A.2d 1110 (Del. 1994) (*Lynch I*), the Delaware Supreme Court found the record supported the chancery court's finding that Alcatel: (1) owned 43.3% of the stock; (2) the independent directors deferred to Alcatel because of its position as a significant stockholder, rather than exercising their own judgment; and (3) Alcatel exercised actual control and dominated the corporation's affairs. *See id.* at 1114-15. The court then concluded, "The Court of Chancery's legal conclusion that Alcatel owed the fiduciary duties of a controlling shareholder . . . followed syllogistically as the logical result of its cogent analysis of the record." *Id.* at 1115. *But see* Williams v. Geier, 671 A.2d 1368 (Del. 1996) (majority shareholder was held not to be in control).

[30]*See* Gilbert v. El Paso Co., 490 A.2d 1050, 1055 (Del. Ch. 1984) (stating that one who owns less than 50% of the stock does not, without plaintiff showing more, become a controlling shareholder); Puma v. Marriott, 283 A.2d 693, 695 (Del. Ch. 1971) (finding that other than pointing out defendant owned 46% of the stock, the plaintiff failed to adduce any evidence showing the defendant dominated the outside directors or dictated the terms of the transaction).

[31]*See Lynch I*, 638 A.2d at 1115 (finding minority control, in part, because of minority's relationship with board); *Tri-Star Pictures*, 634 A.2d at 328-29 (concluding that the minority shareholder had control after focusing, in part, on the fact that all seven directors who voted for the transaction had ties to Coca-Cola, which owned 36.8 % of stock); *In re* Sea-Land Corp. Shareholders Litig., No. 8453, 1988 Del. Ch. LEXIS 65, at *9 (Del. Ch. May 13, 1988), *reprinted in* 14 DEL. J. CORP. L. 377, 384 (1989) (finding significant that there were no allegations that defendant had control over board in deciding that shareholder did not exercise control). *See also Gottesman*, 279 F. Supp. at 367-68 (stating capacity to choose directors may constitute control).

If the transaction involves a truly independent negotiating committee, a court ought not to conclude that a minority is in control. Nevertheless, the possibility of having a minority deemed to be in control despite the existence of an independent negotiating committee was suggested in *Lynch I*. *Lynch I*, 638 A.2d at 1117. Although the Delaware Supreme Court in *Lynch I* held that the negotiating committee used by the defendant corporation was, in fact, not independent, this determination was subsequent to the court's decision upholding the lower court's determination of control. *Compare id.* at 1113-14, *with id.* at 1117. In other words, the presence of a negotiating committee in this instance had no impact on the determination of minority control. The court achieved these inconsistent conclusions because it focused on general control rather than on transactional control. *See id.* at 1114-15.

[32]*See In re* Wheelabrator Techs., Inc. Shareholders Litig., 663 A.2d 1194, 1205 (Del. Ch. 1995) (finding no evidence that 22% shareholder controlled the transaction); Kaplan v. Centex Corp., 284 A.2d 119, 123 (Del. Ch. 1971) (holding that plaintiff's allegations of control were

Such an evaluation indicates that courts determine minority control on a transactional basis, rather than deciding whether a minority is generally in control.[33]

This differentiation is sensible, as there is no justification for requiring the minority to defend a transaction it did not dictate. Furthermore, because shareholders can act in their own self-interest,[34] courts should expect shareholders to assume fiduciary responsibilities only when they exercise power not as shareholders but as managers, negotiating or dictating both sides of a transaction.[35] For example, if a truly independent board or committee negotiated a transaction, the minority's power would be no different from any other shareholder's.[36] In that scenario, the minority would be unable to determine the corporation's destiny.[37] In fact, following the same theory, some cases have suggested that even a majority shareholder

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insufficient because of no proof that a 20% owner dominated or controlled transaction); *Puma*, 283 A.2d at 695 (finding no control with 46% of the stock because minority did not dictate terms of transaction); *In re Sea-Land Corp.*, 1988 Del. Ch. LEXIS 65, at *9 n.4, *reprinted in* 14 DEL. J. CORP. L. at 385 n.4 (finding no control by 39.5% owner, emphasizing that rather than evidence of dictation of terms, there was evidence of negotiations); Zlotnick v. Newell Cos., No. 7246, 1984 Del. Ch. LEXIS 591, at *6 (Del. Ch. July 30, 1984), *reprinted in* 9 DEL. J. CORP. L. 845, 849 (1984) (finding that one-third ownership by itself is not control); Liboff v. Allen, No. 2669, 1975 Del. Ch. LEXIS 255, at *11-12 (Del. Ch. Jan. 14, 1975), *reprinted in* 2 DEL. J. CORP. L. 350, 357 (1977) (holding that the mere potential for minority control does not constitute control). *Cf.* Kahn v. Tremont Corp., 694 A.2d 422, 429-30 (Del. 1997) (*Tremont*) (finding the minority dictated the terms of the transaction as the special committee of directors was neither independent nor informed); Rosenblatt v. Getty Oil Co., 493 A.2d 929, 937 (Del. 1985) (finding that the facts did not show that the majority shareholder dictated the terms of the transaction); *In re* Budget Rent A Car Corp. Shareholders Litig., No. 10,418, 1991 Del. Ch. LEXIS 29 (Del. Ch. Mar. 15, 1991), *reprinted in* 17 DEL. J. CORP. L. 220 (1992) (holding majority shareholder did not dictate transaction because of ratification of transaction by disinterested board of directors).

[33]*But see Lynch I*, 638 A.2d at 1114-15 (affirming the chancery court's conclusion that the defendant was controlling because of its domination of the corporation in previous transactions).

[34]*See supra* note 23 and accompanying text.

[35]*Cf. Gottesman*, 279 F. Supp. at 383-84. The court stated that:

> [t]he New York courts have frequently held that a dominant or majority stockholder does not become a fiduciary for other stockholders merely by reason of his voting power. It is only when he steps out of his role as a stockholder and begins to usurp the functions of director in the management of corporate affairs that such a duty is imposed. . . . [Thus,] more than mere power to control is necessary to incur a fiduciary duty.

Id. This is why the court's reference in *Kahn v. Lynch Communication Sys., Inc.*, 669 A.2d 79 (Del. 1995) (*Lynch II*), citing defendant's veto power as a shareholder as evidence of control, was troubling. *See id.* at 81-82.

[36]Block et al., *The Duty of Loyalty*, *supra* note 2, at 91 (stating that a shareholder must affirmatively dictate the destiny of the corporation in order to have fiduciary obligations).

[37]BLOCK ET AL., THE BUSINESS JUDGMENT RULE, *supra* note 2, at 91. In addition, even if a significant minority shareholder controlled the board, transactions that require shareholder approval would preclude the minority from unilaterally effectuating that transaction.

would not be deemed to be in control if there were a truly independent board.[38]

If, however, the corporation is publicly traded, significant differences between majority and minority-controlled corporations exist.[39] The market cannot effectively monitor certain transactions when there is a majority shareholder. For example, when a minority-controlling shareholder proposes a transaction at an insufficient price, a bidder may commence a tender offer to displace the control formerly exercised by the minority shareholder. Obviously, a similar transaction proposed by a majority shareholder will not spur any competing bids.[40] Thus, minority shareholders in a majority-

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[38]Williams v. Geier, 671 A.2d 1368 (Del. 1996) (finding majority shareholder was not in control); Rosenblatt v. Getty Oil Co., 493 A.2d 929 (Del. 1985) (finding that the facts did not show that the majority shareholder dictated terms of the transaction); *In re* Budget Rent A Car Corp. Shareholders Litig., No. 10,418, 1991 Del. Ch. LEXIS 29 (Del. Ch. Mar. 15, 1991), *reprinted in* 17 DEL. J. CORP. L. 220 (1992) (holding majority shareholder did not dictate transaction because of ratification of transaction by disinterested board of directors). *Cf.* Gottesman v. General Motors Corp., 279 F. Supp. 361 (S.D.N.Y. 1967) (finding 23% ownership and election of several board members do not alone constitute control).

[39]One difference is that courts treat decisions to file a consolidated tax return, which is available to a parent owning at least 80% of the shares of its subsidiary, under the deferential business judgment rule. *See* Meyerson v. El Paso Natural Gas Co., 246 A.2d 789, 794 (Del. Ch. 1967) (applying business judgment rule to evaluate parent's retention of tax savings caused by effect of subsidiary's losses on consolidated tax returns). *See also* I.R.C. § 1563 (1994) (illustrating federal consolidated tax return provision). The courts' deference is primarily due to the fact that there is no marketplace counterpart by which to measure the fairness of these transactions. The courts explicitly reject a monitor that weighs tax allocation agreements between parents and subsidiaries against arm's length bargaining. The reality is that such bargaining would never exist in this context. *See Meyerson*, 246 A.2d at 794 (stating that "it is impossible, as between parent and subsidiary, to set fair standards for allocation agreements"). *Meyerson* (citing *Western*) discussing Western Pac. R.R. v. Western Pac. R.R., 197 F.2d 994 (9th Cir. 1951), and queries, "How could this court or the district court determine 'what fair arm's length bargaining would probably have yielded?'" *Meyerson*, 246 A.2d at 791. *See* Getty Oil Co. v. Skelly Oil Co., 267 A.2d 883, 887 (Del. 1970) ("[N]onaffiliates could not be in the position of the parties here. And just as obviously, independent parties would not willingly negotiate to place themselves in the position of the parties here."); Case v. New York Cent. R.R., 19 A.2d 383, 389 (N.Y. App. Div. 1963) (Stevens, J., dissenting) (noting that the tax allocation agreement "could not be made by disinterested parties," the dissent commented that it would be "extremely difficult, if not impossible, to determine what would be fair" in this context). *See generally* Michael B. Goldberg, Note, *The Fiduciary Duty of Parent to Subsidiary Corporation*, 57 VA. L. REV. 1223, 1227 (1971) (discussing problems with the traditional fairness test).

[40]*See* DOOLEY, *supra* note 3, at 650 (stating that if the purchaser is monopsonist and need not consider competing bids, there is more of a risk of cheating). *See also* Kahn v. Tremont Corp., No. 12,339, 1996 Del. Ch. LEXIS 40, at *21 (Del. Ch. Mar. 21, 1996), *reprinted in* 21 DEL. J. CORP. L. 1161, 1179 (1996) (discussing the effect on a special committee).

> Thus, the prospect of a bargaining process, if it can be given some reality, offers the hope of some real advantage. But the creation of a process that has sufficient similarity to an arm's-length process is difficult. Since the parent has, in effect, its own veto over the subsidiary pursuing alternative transactions, the only real source of bargaining leverage is the ability and willingness of the committee to say no to

controlled corporation cannot get a market solution to the majority's inadequate bid. This difference in the market's efficacy suggests that majority and minority-control transactions do not always merit the same level of judicial review as the market can monitor one subset of these transactions.[41] This difference, however, should not be exaggerated, for a minority shareholder's control of the board[42] effectively limits the challenger to initiating a hostile takeover, a transaction that faces significant hurdles.[43]

Once a court determines that a minority shareholder is a controlling shareholder, the courts have not differentiated between those that control because they are minority shareholders who have dominated the transaction and those who control because they own a majority of stock.[44] The courts have grouped all such shareholders together and imposed fiduciary duties on them,[45] using interchangeably the terms "parent" corporation, "majority," and "controlling" shareholder.[46] The courts either have not recognized or have

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> a transaction that is not both a fair transaction in terms of alternatives that would be available to the subsidiary if there were no controlling party and the best transaction that the parent will offer.

Id. (citing *In re* First Boston Shareholders Litig., No. 10,338 (Del. Ch. Feb. 19, 1991)).

[41]*See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 184 (Del. 1986) (relying on the market to police certain transactions because the market, if fair and otherwise unimpeded, will be better able than the courts to establish fair value).

[42]*See supra* note 31 (minority shareholders deemed in control in part by controlling the board).

[43]*See* Jennifer J. Johnson & Mary Siegel, *Corporate Mergers: Redefining the Role of Target Directors*, 136 U. PA. L. REV. 315, 375-76 (1987) (suggesting Delaware monitoring of defensive tactics invalidates only the most egregious tactics). Many state statutes also have anti-takeover provisions. *See, e.g.*, FLA. STAT. ANN. §§ 607.0901 to .0903 (West 1993 & Supp. 1998) (discussing, *inter alia*, control-share acquisition); IND. CODE ANN. §§ 23-1-42-1 to -11, 23-1-43-1 to -24 (Michie 1995) (defining control shares, control share acquisition, and laws governing control shares); N.Y. BUS. CORP. LAW § 717(b) (McKinney Supp. 1998) (discussing duty of directors); 15 PA. CONS. STAT. ANN. §§ 2535-2538, 2541-2548, 2571-2576, 2581-2583 (West 1995) (discussing various shareholder rights). *See generally* David N. Hecht, Note, *The Little Train that Couldn't: Did the Pennsylvania Anti-Takeover Statute Fail to Protect Conrail from a Hostile Suitor?*, 66 FORDHAM L. REV. 931, 934-43 (1997) (discussing various state anti-takeover statutes). In Delaware, there is a controlled share acquisition provision which makes a hostile offer less attractive to the bidder. *See* DEL. CODE ANN. tit. 8, § 203 (Supp. 1996). In addition, the Delaware case law has given the target directors wide latitude to enact defensive tactics. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954-55 (Del. 1985) (requiring directors to prove only their good faith, reasonable investigation, and proportionate response to a perceived threat).

[44]Block et al., *The Duty of Loyalty*, *supra* note 2, at 91-98.

[45]*See id.* (discussing controlling shareholders' duty of loyalty); J.A.C. Hetherington, *Defining the Scope of Controlling Shareholders' Fiduciary Responsibilities*, 22 WAKE FOREST L. REV. 9, 13 (1987) (discussing limits of controlling shareholder duties).

[46]*See Lynch I*, 638 A.2d at 1115 ("A controlling or dominating shareholder standing on both sides of a transaction, as in a parent-subsidiary context, bears the burden of proving its entire fairness."); Kahn v. Tremont Corp., No. 12,339, 1996 Del. Ch. LEXIS 40, at *22 (Del. Ch. Mar. 21, 1996), *reprinted in* 21 DEL. J. CORP. L. 1161, 1179 (1996) (concluding that defendant's ownership of 44.4% of the stock required the court "to work in the context of transaction between a parent and

not found the distinctions significant between being a majority shareholder and being a dominating minority shareholder.

After a shareholder is deemed to be in control, the court must select a monitor for the disputed transaction. Typically, these monitors have either been *Sinclair*'s advantage/disadvantage test [47] or the entire fairness test.[48] Noteworthy, however, is that the Delaware Supreme Court has held that the methodology of Delaware's conflict-of-interest statute, section 144,[49] is inapplicable to transactions with controlling shareholders.[50] As a result,

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its subsidiary"), *rev'd on other grounds*, 694 A.2d 422 (Del. 1997).

[47]*See supra* text accompanying notes 9-12 & *infra* text accompanying notes 100-01.

[48]*See supra* text accompanying note 3 & *infra* text accompanying note 137.

[49]DEL. CODE ANN. tit. 8, § 144(a) (1996). Section 144 is written in the negative, stating that no interested-director transaction is void or voidable if one of three prongs of the statute is satisfied: disinterested directors approve the interested transaction after disclosure; disinterested shareholders approve the interested transaction after disclosure; or the interested transaction is fair to the corporation. *Id.* The statute, however, does not provide a means to uphold such transactions; satisfaction of any of the statute's three prongs merely makes the transaction not void or voidable and, therefore, subject to applicable case law. Case law interpreting the section has, in turn, held that satisfaction of any of the three prongs makes the business judgment rule operative, with the rule's usual burden on the plaintiff. *See* Oberly v. Kirby, 592 A.2d 445, 466 (Del. 1991) (stating that disinterested director or share approval of a transaction effectively blocks challenge by shareholders to that transaction because the business judgment rule becomes operative); Marciano v. Nakash, 535 A.2d 400, 405 n.3 (Del. 1987) ("[A]pproval by fully-informed disinterested directors under section 144(a)(1), or disinterested stockholders under section 144(a)(2), permits invocation of the business judgment rule and limits judicial review to issues of gift or waste with the burden of proof upon the party attacking the transaction."); Nebenzahl v. Miller, No. 13,206, 1996 Del. Ch. LEXIS 113, at *10-11 (Del. Ch. Aug. 26, 1996), *reprinted in* 22 DEL. J. CORP. L. 779, 790 (1997) (holding that compliance with § 144 (a)(1) and (a)(2) invokes the business judgment rule but does not insulate transaction from claim that transaction is unfair) (citing Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1169 (Del. 1995)). *See generally* BLOCK ET AL., THE BUSINESS JUDGMENT RULE, *supra* note 2, at 129 (stating that "where the interested director transaction falls within the ambit of the governing safe harbor provision [section 144(a)], the transaction will be reviewed by the courts pursuant to business judgment rule criteria").

[50]*See Lynch I*, 638 A.2d at 1116 (stating that entire fairness, not § 144, must be the standard of review in a controlling-shareholder transaction because such shareholders have coercive power); Citron v. E.I. Du Pont de Nemours & Co., 584 A.2d 490, 502 (Del. Ch. 1990) (stating that coercive relationship of a controlling shareholder requires more stringent monitors than needed just for a director conflict-of-interest transaction). *But see infra* note 142 and accompanying text (discussing *Weinberger*'s modeling much of its reasoning on § 144).

This refusal to use this statutory provision is all the more significant because it facially applies to controlling-shareholder transactions: the statute applies to transactions with interested or interlocking directors, DEL. CODE ANN. tit. 8, § 144(a) (1996), and most controlling-shareholder transactions have such directors. *See* Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983) (recognizing the inherent conflict directors face when they hold dual directorships in a parent-subsidiary transaction). *See also* Andrew G.T. Moore, *The "Interested" Director or Officer Transaction*, 4 DEL. J. CORP. L. 674, 674-75 (1979) (discussing conflict faced by directors serving on two corporations having interrelated activities, like parents and their subsidiary corporations). As Professor Dooley wrote, "While those [conflict-of-interest] statutes that include common directorships as a conflict could easily be read to apply, the courts have not done so. Instead, the rules for parent-subsidiary disputes have been developed as a separate category as though the statutes

neither section 144 nor its case law will govern a controlling-shareholder transaction. Therefore, while satisfaction of disinterested director or shareholder approval under section 144 will make the business judgment rule operative,[51] identical approval in a controlling-shareholder transaction will merely shift to the plaintiff the burden of proving unfairness.[52] The

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did not exist." DOOLEY, *supra* note 3, at 610. Thus far, the Model Business Corporation Act and the ALI Principles of Corporate Governance: Analysis and Recommendations (1994) [hereinafter *Principles*] agree with the Delaware Supreme Court that controlling-shareholder transactions should not be monitored under the rubric governing interested-director transactions. REVISED MODEL BUS. CORP. ACT. ANN. § 8.60 commentary at 8-387 (Supp. 1997) (noting that Subchapter F of the Revised Model Business Code has no relevance as to how a court should deal with a claim by a minority shareholder in a subsidiary complaining about a transaction between the subsidiary and its parent corporation); *id.* § 8.61 commentary at 8-404 (explaining that while most parent subsidiary transactions have common directors, the courts have treated such cases under the rubric of a controlling shareholders' duty to deal fairly with the minority and have "deliberately skipped over any analytically available alternative approach predicated on a theory" of a director's conflict of interest).

While most state corporate codes do not regulate transactions between parents and their subsidiaries, Maine is the exception. *See* ME. REV. STAT. ANN. tit. 13A, § 717.3 (West 1964) (maintaining that plaintiff must prove unfairness of any transaction by a corporation with its subsidiary, parent, affiliated corporation or a corporation with interlocking directorates).

[51]*See supra* note 49.

[52]*See* Citron v. E.I. Du Pont de Nemours & Co., 584 A.2d 490, 502 (Del. Ch. 1990). Similarly, in *Kahn v. Tremont Corp.*, 694 A.2d 422, 428 (Del. 1997), the Delaware Supreme Court stated:

> Entire fairness remains applicable even when an independent committee is utilized because the underlying factors which raise the specter of impropriety can never be completely eradicated and still require careful judicial scrutiny. This policy reflects the reality that in a transaction such as the one considered in this appeal, the controlling shareholder will continue to dominate the company regardless of the outcome of the transaction. The risk is thus created that those who pass upon the propriety of the transaction might perceive that disapproval may result in retaliation by the controlling shareholder. Consequently, even when the transaction is negotiated by a special committee of independent directors, "no court could be certain whether the transaction fully approximated what truly independent parties would have achieved in an arm's length negotiation." Cognizant of this fact, we have chosen to apply the entire fairness standard to "interested transactions" in order to ensure that all parties to the transaction have fulfilled their fiduciary duties to the corporation and all its shareholders.

Id. at 428-29 (citations omitted) (quoting *Citron*, 584 A.2d at 502; *Lynch I*, 638 A.2d at 1110). *See also In re* Wheelabrator Techs., Inc. Shareholders Litig., 663 A.2d 1194, 1203-04 (Del. Ch. 1995) (explaining that § 144 is applied to transactions between a corporation and its directors, but not to transactions between a corporation and its controlling shareholder); *In re* Walt Disney Co. Derivative Litig., No. 15,452, 1998 LEXIS 186, at *62-63 (Del. Ch. Oct 7, 1998) (discussing the shift in the burden of persuasion under the entire fairness standard).

Moreover, the Delaware Supreme Court has rejected the argument that coercion of the independent committee conclusively makes the transaction unfair:

> Where other economic forces are at work and more likely produced the decision to sell . . . the specter of coercion may not be deemed material with respect to the transaction as a whole, and will not prevent a finding of entire fairness. In this case, no shareholder was treated differently in the transaction from any other

Delaware Chancery Court explained the reasoning underlying its decision to keep fairness as the standard of review in controlling-shareholder transactions:

> Parent subsidiary mergers, unlike stock options, are proposed by a party that controls, and will continue to control, the corporation, whether or not the minority stockholders vote to approve or reject the transaction. The controlling stockholder relationship has the inherent potential to influence, however subtly, the vote of minority stockholders in a manner that is not likely to occur in a transaction with a noncontrolling party. Even where no coercion is intended, shareholders voting on a parent subsidiary merger might perceive that their disapproval could risk retaliation of some kind by the controlling stockholder. For example, the controlling stockholder might decide to stop dividend payments or to effect a subsequent cash out merger at a less favorable price . . . the potential for that perception, and its possible impact upon a shareholder vote, could never be fully eliminated. Consequently, in a merger between the corporation and its controlling stockholder — even one negotiated by disinterested independent directors — no court could be certain whether the transaction terms fully approximate what truly independent parties would have achieved in an arm's length negotiation. Given that uncertainty, a court might well conclude that even minority shareholders who have ratified a parent-subsidiary merger need procedural protections . . . . One way to provide such protections would be to adhere to the more stringent entire fairness standard of judicial review.[53]

The court's reasons for differentiating controlling-shareholder transactions from interested-director transactions are not compelling. Its concerns about subtle coercion and retaliation require constant power over the corporation through continuous domination; yet, as noted above,[54] in evaluating whether a minority shareholder is in control, most courts look at the specific challenged transaction to see whether this shareholder dominated

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> shareholder nor subjected to a two-tiered or squeeze-out treatment . . . . Clearly there was no coercion exerted which was material to this aspect of the transaction, and thus no finding of *per se* liability is required.

See Lynch II, 669 A.2d 79, 86 (Del. 1995) (citation omitted).

[53] *Citron*, 584 A.2d at 502.

[54] *See supra* notes 31-33 and accompanying text.

the transaction at issue, not whether the minority shareholder has continuous control.[55] The court assumes this continuous control because its reasoning is predicated on majority-controlled corporations, and has not differentiated majority from minority-controlled corporations.[56] Moreover, the court fails to consider that the market may be an effective monitor of some of these transactions; not only will the controlling shareholder's stock lose proportionate value from an irrational, retaliatory transaction but, if the controlling shareholder were also only a minority shareholder, an interested bidder might surface to buy stock at depressed prices.[57] Because the court's reasons for differentiating controlling-shareholder transactions from interested-director transactions are not strong, one suspects that intangible concerns about the perception of unfairness might have been its true motive for differentiating these transactions. By keeping fairness as the standard of review in controlling-shareholder transactions, the court is able to impose its judgment on the transaction.[58] Had it agreed to treat controlling-shareholder transactions the same as it treats interested-director transactions that receive the requisite approval, the business judgment rule would have precluded the court's evaluation of the transaction.[59] As a result, while the law governing controlling-shareholder transactions first developed apart from the conflict-of-interest provision, it has thereafter justified its continued independence from it.

In sum, both majority shareholders and minority shareholders who control a transaction are required to act as fiduciaries.[60] Moreover, the Delaware Supreme Court has made clear that the conflict-of-interest statute and its case law are inapplicable to controlling-shareholder transactions.[61] Thus, when the court chooses the fairness standard to monitor a controlling-shareholder transaction, fairness will remain the standard of review, regardless of which party bears the burden of proof.[62]

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[55]*Supra* note 33.

[56]*See supra* notes 45-46 and accompanying text (discussing courts' grouping together majority and minority-controlling shareholders despite some differences).

[57]*But see* DOOLEY, *supra* note 3 and *infra* note 82 and accompanying text.

[58]An intangible concern about the true efficacy of special litigation committees led the court in *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981), to permit the court to use its own business judgment in deciding if a derivative suit should continue past summary judgment. *See id.* at 789.

[59]Where the business judgment rule is in effect, the court is not at liberty to evaluate the fairness or propriety of the business decision. *See* BLOCK ET AL., THE BUSINESS JUDGMENT RULE, *supra* note 2, at 11-15.

[60]*See generally* Block et al., *The Duty of Loyalty*, *supra* note 2, at 91-98 (discussing controlling shareholders' duty of loyalty).

[61]*See supra* notes 49-50 and accompanying text.

[62]Contrast with § 144. *See supra* note 49.

B. *The Type of Transaction*

As noted above,[63] in addition to the status of the parties to the transaction, the type of transaction is relevant to the degree of judicial scrutiny.[64] For this purpose, three groups of transactions should be distinguished: mergers, other organic changes, and everyday transactions.

Dean Bayless Manning is credited with differentiating "enterprise" from "ownership-claim" issues and for predicting that this differentiation would become relevant to the level of judicial scrutiny.[65] Dean Manning classified operational issues, such as the board's decision to expand or contract the company's operations,[66] as largely, if not entirely, matters of business judgment.[67] These decisions will impact shareholders as investors, in that their investment will decline if enough enterprise decisions turn out poorly.[68] These are, however, the classic risks associated with an investment decision.[69] On the other hand, Dean Manning classified as "ownership-claim" issues those decisions that directly relate to the shareholder's "role as an 'owner,' not 'owner of the corporation' as legal doctrine would have it, but owner of his own reified piece of property, *his* share of stock."[70] Dean Manning's examples of such ownership-claim transactions are stock issuances, redemptions, cashouts, reverse stock splits, and mergers.[71] Most organic changes,[72] as well as tender offers and defense[73] thereto, would also fall within this category, as these transactions raise issues of ownership rights

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[63]*See supra* text accompanying note 21.

[64]DOOLEY, *supra* note 3, at 582.

[65]Bayless Manning, *Reflections and Practical Tips on Life in the Boardroom After* Van Gorkom, 41 BUS. LAW. 1, 5 (1985).

[66]*Id.*

[67]*Id.* at 5-6.

[68]*Id.* at 5.

[69]Manning, *supra* note 65, at 5.

[70]*Id.* at 5-6.

[71]*See id.* at 6.

[72]"Organic" or "fundamental changes" generally consist of mergers, sales of "substantially all" of the corporation's assets, share exchanges (in jurisdictions that recognize such transactions), and certain charter amendments. *See, e.g.*, REVISED MODEL BUS. CORP. ACT §§ 10.03, 11.01-.07, 12.01-.02 (1998) (chapter 10 governs charter amendments, chapter 11 governs mergers and share exchanges, while chapter 12 governs asset sales).

[73]Professor Michael Dooley has further refined the "ownership" category by differentiating those decisions which thwart a hostile takeover, causing the corporation to remain independent, and those decisions in which the board agrees to a sale or change in control. Michael P. Dooley, *Two Models of Corporate Governance*, 47 BUS. LAW. 461, 474-75 (1992). He posits that the latter group of cases invite greater judicial review because the board will irrevocably change the nature of the shareholder's claim. *See id.* at 475.

and the value of stock.[74] Any ownership-claim issue hits "very close to a nerve," as such issues are atypically important and often cause an immediate realization of the value of shares.[75]

When Dean Manning differentiated enterprise from ownership-claim issues, he also predicted that courts would take a hands-off policy for enterprise decisions but would scrutinize carefully ownership-claim issues.[76] That prediction became a reality. Chancellor Allen reasoned that judicial review should be based, in part, on the significance of the transaction, and arrived at the same conclusion as did Dean Manning:

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[74]*See* Manning, *supra* note 65, at 5-6. *See also* Paul L. Regan, *The Unimportance of Being Earnest:* Paramount *Rewrites the Rules for Enhanced Scrutiny in Corporate Takeovers*, 46 HASTINGS L.J. 125, 194 (1994) (stating that where shareholders have "too much at stake," deference will not be given to the board and that such decisions fall within a "special category of transactions"). The Delaware corporate statute reflects the unique significance of such ownership-claim transactions as mergers, asset sales and certain charter amendments (but not defensive tactics) by requiring a shareholder vote for these and only these transactions. *See* DEL. CODE ANN. tit. 8, § 251(c) (1996) (requiring shareholder vote for mergers); *id.* § 271(a) (requiring shareholder vote for sale of assets); *id.* § 242(b)(1) (requiring sharheolder vote for most amendments to certificate). Of these organic changes, the Delaware statute singles out mergers as the sole transaction that will, under certain circumstances, trigger appraisal rights. *See* DEL. CODE ANN. tit. 8, § 262 (1996) (setting forth appraisal rights for some mergers). Thus, the right to vote and, in one instance, to have appraisal rights, flag the significance of the transaction. On the other hand, one could argue that these rights diminish the need for judicial scrutiny, as each right provides some level of protection. Specifically, if the shareholder vote is meaningful, it can serve as a monitor as shareholders can decide whether the transaction is in their own interest. *See* DOOLEY, *supra* note 3, at 602. A meaningful shareholder vote occurs when the disinterested shares have the decisive voting power, such as when the controlling shareholder is only a minority shareholder or when the majority shareholder cedes dispositive voting power to the minority by agreeing to vote its shares as the majority of the minority votes. *See, e.g.*, Weinberger v. UOP, Inc., 457 A.2d 701, 712 (Del. 1983) (discussing the need for informed vote of majority of minority shares). Appraisal rights, by awarding the fair value of stock, also serve as a supplemental monitor by awarding shareholders demanding appraisal the judicially-determined value of stock instead of the transaction price. *See* Mary Siegel, *Back to the Future: Appraisal Rights in the Twenty-First Century*, 32 HARV. J. ON LEGIS. 79, 94-97 (1995) (discussing monitoring function of appraisal rights). As the Delaware Supreme Court requires that conflict-of-interest mergers meet the test of both fair dealing and fair price, however, appraisal rights may not effectively monitor some of these transactions. *See infra* note 137.

[75]*See* Manning, *supra* note 65, at 5-6. Dean Manning explained that in ownership-claim transactions, "the impact on the shareholder is qualitatively different, and psychologically he sees it as different. First, the impact is immediate. More important, those transactions hit him directly in his role as an 'owner' . . . ." *Id.* at 5.

[76]*See id.* at 6. Dean Manning noted that a controversial decision by the Delaware Supreme Court, concluding that directors breached their duty of care in an ownership-claim transaction, indicated the court's sensitivity to the ultimate ownership-claim issue: the price for shares in a cash-out merger. *See id.* (discussing *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985)). *See also* E. Norman Veasey, *Duty of Loyalty: The Criticality of the Counselor's Role*, 45 BUS. LAW. 2065, 2066 n.4 (1990) ("[T]he application of the business judgment rule may be shaped differently depending on whether the issue is an 'ownership' issue (one involving control or the equity interests of stockholders); or an 'enterprise' issue (one involving business strategy or operations).") (citing, *inter alia*, Manning, *supra* note 65).

> The more significant the subject matter of the decision, obviously, the greater will be the need [for the board] to probe and consider alternatives. When the decision is to sell the company, or to engage in a recapitalization that will change control of the firm, the gravity of the transaction places a special burden upon the directors to make sure that they have a basis for an informed view.[77]

In addition to the significance of the transaction, there are two other factors that might be relevant to a court's choice of monitor. One is that "end-game"[78] transactions, such as some mergers or reverse stock splits,[79] trigger added concern. In addition to presenting ownership-claim issues, these transactions also terminate the shareholder's ownership interest.[80] Thus, minority shareholders in such transactions have dual concerns: not only will the value of their investment be decided, but the value will also be pegged in a transaction in which the controlling shareholder has no incentive to temper its self-interest.[81] The second factor is the efficacy of the market.

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[77]*In re* Fort Howard Corp. Shareholders Litig., No. 9991, 1988 Del. Ch. LEXIS 110, at *4-5 (Del. Ch. Aug. 8, 1988), *reprinted in* 14 DEL. J. CORP. L. 699, 704-05 (1989) (analyzing tender offer which was the first step in a two-step, leveraged buyout transaction). Similarly, in a change of control case, one scholar reasoned that the "transaction-significance rationale essentially reflects a policy judgment that the court must ensure reasonableness in all takeovers because of the importance of such transactions to the corporation's owners." Regan, *supra* note 74, at 201 (analyzing *Paramount Communication Inc. v. QVC Network Inc.*, 637 A.2d 34, 42-44 (Del. 1994), which describes sale of control and defensive measures as two of the "rare situations which mandate that a court take a more direct and active role in overseeing the decisions made and actions taken by directors").

[78]*See* DOOLEY, *supra* note 3, at 649 (justifying the more rigorous review of entire fairness when there is a "final period problem"). In *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (1986), the Delaware Supreme Court expressed special concerns during an end-game transaction by imposing on directors the primary duty of obtaining "the best price for the stockholders at a sale of the company." *Id.* at 182.

[79]A reverse stock split mandates that a certain number of shares will be consolidated into one share at a given date. Any fractional shares are typically required to be converted to cash. As a result, this transaction can have the effect of cashing out shareholders. *See, e.g.*, J.L. Schiffman & Co. v. Standard Indus., Inc., No. 11,267, 1993 Del. Ch. LEXIS 143, at *2-4 (Del. Ch. July 15, 1993), *reprinted in* 19 DEL. J. CORP. L. 869, 871-72 (1994); Edick v. Contran Corp., No. 7662, 1986 Del. Ch. LEXIS 384, at *1 (Del. Ch. Mar. 18, 1986), *reprinted in* 12 DEL. J. CORP. L. 244 (1987). *See also* Rutheford B. Campbell, Jr., *Rule 145: Mergers, Acquisitions and Recapitulations Under the Securities Act of 1933*, 56 FORDHAM L. REV. 277, 284 (1987) (describing effect of reverse stock splits).

[80]Campbell, *supra* note 79, at 284-85.

[81]*See* DOOLEY, *supra* note 3, at 602-03, 649 (citing R. DUNCAN LUCE & HOWARD RAIFFA, GAMES AND DECISIONS 98-101 (1957) and quoting Robert E. Scott, *Conflict and Cooperation in Long-Term Contracts*, 75 CALIF. L. REV. 2005, 2033 (1987)). The end-game period problem has also been explained as follows:

> [I]n a situation where parties expect to have repeated transactions, the recognition

If the stock is publicly traded, the controlling shareholder's self-interest can constrain its greed because if the transaction diminishes the value of the stock, the controlling shareholder will suffer proportionately.[82] The market may also establish the fairness of a transaction if other bidders are allowed to compete. There are limits, however, to the market's efficacy; not only will majority-controlled and some large minority-owned transactions thwart competitive bidders,[83] but some parent-subsidiary transactions also will have little counterpart in the market.[84]

Both the type of transaction and the degree of control raise reasons to trigger varying levels of judicial review; the combination of the extremes within each category, however, creates a compelling case regarding which monitor the court ought to choose. For example, a cash-out merger effectuated by a majority shareholder would provide the court with the most reasons to scrutinize a transaction carefully.[85] Closely related are all ownership-claim transactions effectuated by either a majority or controlling-minority shareholder. At the other end of the spectrum, causing little judicial concern, is an enterprise issue proposed by a noncontrolling

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> that a party who cheats in one transaction will be penalized by the other party in subsequent transactions reduces the incentive to cheat. However, when a transaction is the last (or only) in a series — that is, the final period — the incentive to cheat reappears because, by definition, the penalty for doing so has disappeared. In the context of an acquisition nothing stops target management from selling out the shareholders in return for side payments from the acquiring company because target management, by definition, will no longer be subject to the constraints of the product, capital and control markets after the acquisition. Perhaps more importantly, if the remaining professional careers of target management are getting short, the size of the side payment may more than compensate them for any *ex post* penalty imposed by the market for managers. In a structural approach to corporate law, it is precisely when market constraints on managerial misbehavior fail that legal constraints play a central role.

GILSON & BLACK, *supra* note 21, at 720-21.

[82]*See* DOOLEY, *supra* note 3, at 602. Because the majority passes some of its losses onto the minority, however, the market is only a partial restraint. *Id.*

[83]*See supra* text accompanying notes 39-43 (discussing limits of the market monitor).

[84]For cases dealing with transactions that have no market counterpart, see Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. 1971) (dispersal of dividends); Getty Oil Co. v. Skelly Oil Co., 267 A.2d 883 (Del. 1970) (dealing with subsidiary's claim that parent has duty to share federally administered oil allocation because subsidiary lost its allocation due to its being a controlled corporation); Meyerson v. El Paso Naturall Gas Co., 246 A.2d 789 (Del. Ch. 1967) (allocation of tax savings from filing consolidated tax returns); Case v. New York Cent. R.R., 204 N.E.2d 643 (N.Y. 1965) (allocation of tax savings from filing consolidated tax returns). *See also supra* note 39 (discussing cases involving consolidated tax returns). *See generally* Eric J. Gouvin, *Resolving the Subsidiary Director's Dilemma*, 47 HASTINGS L.J. 287, 289-93 (1996) (describing the unique relationship between parents and their subsidiaries that often leads to transactions that are not likely to be the same as market-place transactions); Goldberg, *supra* note 39, at 1226-28 (discussing these cases and their treatment of these transactions).

[85]*See supra* note 3 and accompanying text.

shareholder. In between these extremes are enterprise transactions by majority or controlling shareholders. As is later demonstrated,[86] the courts are most inconsistent in choosing monitors for these transactions.

III. THE MONITORS OF CONTROLLING-SHAREHOLDER TRANSACTIONS

A. *The Law Prior to* Sinclair

Prior to *Sinclair*, the Delaware courts monitored controlling-shareholder transactions with either the business judgment rule or by fairness,[87] with fairness as the monitor most often chosen.[88] In addition, some courts that used a fairness test justified their choice of this monitor not simply because one party was in control of both sides of the transaction, but because of concerns later articulated in *Sinclair* — that the parent was benefiting at the expense of and to the detriment of the minority shareholders.[89] It was in this context that *Sinclair* was decided.

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[86]*See infra* note 165 and accompanying text (stating few cases followed the originally-formulated *Sinclair* test).

[87]*See supra* note 1.

[88]*See, e.g.*, Sterling v. Mayflower Hotel Corp., 93 A.2d 107 (Del. 1952) (applying entire fairness to merger between parent and its subsidiary); Keenan v. Eshleman, 2 A.2d 904 (Del. 1938) (applying entire fairness to nonorganic transaction between parent and its subsidiary); David J. Greene & Co. v. Schenley Indus., Inc., 281 A.2d 30 (Del. Ch. 1971) (applying entire fairness to controlling-shareholder merger); David J. Greene & Co. v. Dunhill Int'l, Inc., 249 A.2d 427 (Del. Ch. 1968) (applying entire fairness to merger between parent and its subsidiary). *See also* Goldberg, *supra* note 39, at 1225 ("[M]ost [pre-*Sinclair*] courts continue to decide parent-subsidiary controversies by employing the traditional fairness tests adopted from the common director and majority-minority shareholder cases.").

Pre-*Sinclair* controlling-shareholder cases that used the business judgment rule include: Getty Oil Co. v. Skelly Oil Co., 267 A.2d 883 (Del. 1970); Pierce v. Wahl, 86 A.2d 757 (Del. 1952) (involving a minority-controlling shareholder who caused corporation to pay employee of another corporation owned by defendant); Meyerson v. El Paso Natural Gas Co., 246 A.2d 789 (Del. Ch. 1967) (retention by parent of tax savings from tax consolidation with subsidiary).

[89]*See Pierce*, 86 A.2d at 759 (involving a director owning 40% of the stock who used the corporation's assets for his own benefit); Keenan v. Eshleman, 2 A.2d 904, 908 (Del. 1938) (in reviewing an enterprise transaction under the fairness standard, court noted that the defendants, being in control of both companies, had improperly enriched themselves at plaintiff's expense). *Cf.* Meyerson v. El Paso Natural Gas Co., 246 A.2d 789, 794 (Del. Ch. 1967) (justifying use of the business judgment rule, in part, by noting that the subsidiary had not suffered any harm from the parent's allocation of tax savings to itself); Case v. New York Cent. R.R., 204 N.E.2d 643, 646 (N.Y. 1965) ("A basic ground for judicial interference with corporate decisions on complaint of minority interests is an advantage obtained by the dominant group to the disadvantage of the corporation or its minority owners.").

B. Sinclair Oil Corp. v. Levien[90]

Plaintiff in *Sinclair* was a minority shareholder of Sinven, one of Sinclair Oil Corporation's subsidiaries.[91] The court of chancery found that Sinclair, the parent corporation, owed Sinven a fiduciary duty[92] and that all members of Sinven's board of directors were not independent of Sinclair as they were officers, directors, or employees of corporations in the Sinclair family.[93] Plaintiff brought a derivative suit for damages sustained by Sinven due to three fact patterns: Sinclair allegedly caused Sinven to pay an excessive amount of dividends that plaintiff attributed to Sinclair's need for cash;[94] Sinclair allegedly denied Sinven any possibility of further development by draining Sinven of its cash through these dividends;[95] and Sinclair allegedly prevented Sinven from pursuing a breach of contract between Sinven and Sinclair's wholly-owned subsidiary, Sinclair International Oil Co.[96]

The primary issue in the case was the appropriate standard of review and the allocation of the burden of proof.[97] Sinclair argued that the business judgment rule was the operative standard.[98] The chancellor, however, agreed with the plaintiff that because Sinclair controlled Sinven, Sinclair owed Sinven a fiduciary duty and was therefore required to satisfy the test of intrinsic fairness.[99] The Delaware Supreme Court reversed in part and held:

> A parent does indeed owe a fiduciary duty to its subsidiary when there are parent-subsidiary dealings. *However, this*

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[90]280 A.2d 717 (Del. 1971).

[91]*Id.* Plaintiff owned approximately 3,000 of Sinven's 120,000 publicly-held shares. *Id.* at 719.

[92]*Id.*

[93]*See id.*

[94]*See Sinclair*, 280 A.2d at 720-21. Under the influence of its parent, the subsidiary corporation over a six-year period had paid $38 million more in dividends than it had earned. *Id.* *See also* COX ET AL., *supra* note 25, at 253 (discussing the subsidiary's payment of dividends and placing the burden of proving the transaction's overall fairness when there is self-dealing).

[95]*See Sinclair*, 280 A.2d at 721-22. The plaintiff argued that the subsidiary's dividend policy was guided exclusively by the parent's need for cash and resulted in the subsidiary company's oil exploration activities contracting at a time that the parent company's exploration activities were dramatically expanding. *Id.*

[96]*See id.* at 722-23.

[97]*Id.* at 720.

[98]Defendant argued that the business judgment rule applied because "the law does not bar interlocking directorates or control of one corporation by another." Levien v. Sinclair Oil Corp., 261 A.2d 911, 915 (Del. Ch. 1969) (citing DEL. CODE ANN. tit. 8, § 144(a)(3) (1953) (current version at DEL. CODE ANN.. tit. 8, § 144(a)(3) (1991 & Supp. 1998)).

[99]*See id.* at 914-16.

> *alone will not evoke the intrinsic fairness standard.* This standard will be applied only when the fiduciary duty is accompanied by self-dealing — the situation when a parent is on both sides of a transaction with its subsidiary. Self-dealing occurs when the parent, by virtue of its domination of the subsidiary, causes the subsidiary to act in such a way that the parent receives something from the subsidiary to the exclusion of, and detriment to, the minority stockholders of the subsidiary.[100]

Thus, if the challenged transaction allots something to the parent from the subsidiary to the exclusion of and to the detriment of the minority shareholders of the subsidiary, the parent will be deemed to be self-dealing, and will have to prove that its actions were intrinsically fair.[101] If, on the other hand, the parent has not so benefited, then the parent will not be deemed to be self-dealing, and the business judgment rule will be operative.[102] The *Sinclair* test thus requires evidence of self-dealing, rather than simply relying on either the parent's majority ownership of the subsidiary's stock or the presence of interlocking directors, as reasons to invoke the fairness test.[103]

Applying this standard to plaintiff's allegations, the court held that the appropriate standard by which the dividend decision should be judged was the business judgment rule because the majority shareholder did not get dividends to the exclusion of the minority; rather, both the parent and the minority shareholders of Sinven received their *pro rata* share of the dividends.[104] Similarly, the court sided with the defendant regarding plaintiff's claim that Sinclair had frustrated Sinven's development, finding that the plaintiff could not identify any corporate opportunities which had

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[100]*Sinclair*, 280 A.2d at 720 (emphasis added).

[101]*Sinclair*'s intrinsic fairness test has become synonymous with *Weinberger*'s entire fairness test. *See* Oberly v. Kirby, 592 A.2d 445, 469 (Del. 1991) ("The standard for intrinsic fairness is the searching test announced in *Weinberger*. The interested directors bear the burden of proving the entire fairness of the transaction in all its aspects, including both the fairness of the price and the fairness of the directors' dealings."); Tanzer v. International Gen. Indus., Inc., 402 A.2d 382, 386 (Del. Ch. 1979) ("The words 'entire fairness' are synonymous with the words 'intrinsic fairness.'"). In addition, fairness in § 144(a)(3) of the Delaware code, also now means entire fairness. DEL. CODE ANN. tit. 8, § 144(a)(3) (1991). *See* Unitrin, Inc. v. American Gen. Corp., 651 A.2d 1361, 1371 n.7 (Del. 1995) (stating that § 144(a)(3) codifies the entire fairness test).

[102]*Sinclair*, 280 A.2d at 720.

[103]*Id.* at 720-21.

[104]*Id.* at 721-22. *See also infra* notes 249-51 and accompanying text (discussing how the *Sinclair* test can effectively monitor dividend decisions).

come to Sinven and which Sinclair usurped and thwarted.[105] Because the court found no advantage to Sinclair to the exclusion of and detriment to Sinven's minority shareholders, Sinclair was not self-dealing; therefore, the business judgment rule was the operative standard.[106] Regarding plaintiff's final allegation that Sinclair caused Sinven not to enforce its contract with Sinclair International, however, the court found that Sinclair was self-dealing,[107] as all the benefits of not enforcing the contract between the two subsidiaries redounded to Sinclair to the exclusion of and detriment to Sinven's minority shareholders.[108] The court thus required Sinclair to prove that its causing Sinven not to enforce the contract was intrinsically fair to the minority shareholders of Sinven, a burden which Sinclair was unable to meet.[109]

Sinclair was a significant development in the law of controlling shareholders because the court refused to require all parent-subsidiary transactions to be judged by the intrinsic fairness test, despite the parent's complete domination of the subsidiary's board of directors.[110] Instead, the court created a threshold issue to judge pursuant to the advantage/disadvantage test whether the parent was self-dealing.[111] Moreover, this threshold test was quite demanding, in that it required the parent's advantage to be obtained both at the expense of, as well as to the exclusion of, the subsidiary's minority shareholders before the transaction would be judged by the intrinsic fairness standard.[112] As a result of the difficulty of this threshold test, courts applying this test often find that the business judgment rule, rather than the intrinsic fairness standard, is appropriate.[113]

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[105]*Sinclair*, 280 A.2d at 722.

[106]*Id.* at 721-22.

[107]*Id.* at 723.

[108]*Id.*

[109]*Sinclair*, 280 A.2d at 723. The plaintiff has the burden of proving self-dealing. *See also* Gabelli & Co. Profit Sharing Plan v. Liggett Group, Inc., 444 A.2d 261, 265 (Del. Ch. 1982) (discussing self-dealing) (citing Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. 1971)).

[110]*Sinclair*, 280 A.2d at 720-21.

[111]*Id.* at 720; *supra* note 9.

[112]*Sinclair*, 280 A.2d at 720.

[113]*See, e.g.*, Gabelli & Co. v. Liggett Group Inc., 479 A.2d 276, 281 (Del. 1984) (concerning declaration of dividends); *In re* Budget Rent A Car Corp. Shareholders Litig., No. 10,418, 1991 Del. Ch. LEXIS 29, at *9-12 (Del. Ch. Mar. 15, 1991), *reprinted in* 17 DEL. J. CORP. L. 220, 225-27 (1992) (finding no special benefit to defendant in cash-out merger); Singer v. Creole Petroleum Corp., 297 A.2d 440, 442 (Del. Ch. 1972) (finding no self-dealing in payment of dividends or in prevention of expansion of production and exploration); Chasin v. Gluck, 282 A.2d 188, 192 (Del. Ch. 1971) (finding no benefit to defendant from failure to pay debt on time). *But see* Summa Corp. v. Trans World Airlines, Inc., 540 A.2d 403, 407 (Del. 1988) (applying entire fairness because parent refused to allow subsidiary to buy its own jets, "delayed the production of jets which were ordered, unjustifiably rejected acceptable aircraft, forced TWA [subsidiary] to enter into leases

The Delaware Supreme Court in *Sinclair* did not explain why, despite the presence of interlocking directors in this parent-subsidiary relationship, it neither utilized nor referenced section 144 of the Delaware statute.[114] Nor did the court explain its reasons for rejecting the chancellor's ruling that the parent's control over the subsidiary was per se sufficient to trigger a fairness review, and for instead creating a threshold test for determining whether the parent was self-dealing prior to requiring the parent to prove that its actions were intrinsically fair. As noted above,[115] while the court did not give its reasons for developing a threshold test before selecting one of the bipolar tests, one suspects that the court's reasoning was premised on concerns in this context about the deference accorded under the business judgment rule as well as the significant demands a fairness review imposes on courts.[116] Thus, having recognized the inapplicability of the business judgment rule, but not inclined to review the fairness of a large number of transactions,[117] the court created a demanding threshold test.

C. *The Early Post-*Sinclair *Cases*

Two patterns of review are evident in the controlling shareholder cases decided immediately after *Sinclair*. First, in applying *Sinclair*, the Delaware courts were willing to do some careful scrutiny and analysis in the threshold test before selecting the ultimate standard of review.[118] For

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for aircraft, and sold airplanes to TWA at a profit" to the benefit of the parent and detriment to the subsidiary); Schreiber v. Bryan, 396 A.2d 512, 519 (Del. Ch. 1978) (applying entire fairness because controlling shareholder poised to gain transaction fee and second subsidiary at expense and to the detriment of subsidiary's loss of corporate opportunity).

[114]*See* discussion of § 144, *supra* notes 49-50 and accompanying text. Subsequent cases have explained why courts have relegated § 144 to interested-director transactions, but have not used § 144 to monitor transactions where the directors are interested because a controlling or majority shareholder exists. *See supra* note 50.

[115]*See supra* notes 15-18 and accompanying text.

[116]*See supra* notes 17-18 and accompanying text.

[117]*See* DOOLEY, *supra* note 3, at 610 (subjecting all parent-subsidiary transactions to judicial review under a fairness standard "would undoubtedly increase the number of transactions subject to challenge because of the extremely vague and open-ended nature of the fairness standard").

[118]Gabelli & Co. v. Liggett Group, Inc., 479 A.2d 276 (Del. 1984) (evaluating whether the nonpayment of dividends prior to a cash out merger was self dealing); Schreiber v. Bryan, 396 A.2d 512 (Del. Ch. 1978) (determining appropriate standard of review when minority claimed parent benefited to subsidiary's detriment through a domination of subsidiary's board, a waste of corporate assets, and the subsidiary's loss of corporate opportunity); Trans World Airlines, Inc. v. Summa Corp., 374 A.2d 5 (Del. Ch. 1977) (appraising whether the parent received a benefit at the expense of the minority shareholders by failing to close lease); Singer v. Creole Petroleum Corp., 297 A.2d 440 (Del. Ch. 1972) (assessing whether *pro rata* dividends can constitute self dealing); Chasin v. Gluck, 282 A.2d 188 (Del. Ch. 1971) (evaluating whether majority shareholder interfered with the management of subsidiary or treated subsidiary differently than other creditors); Tuckman v.

example, in *Gabelli & Co. Profit Sharing Plan v. Liggett Group, Inc.*,[119] the Delaware Chancery Court considered the fairness of the merger price in order to evaluate the merit of plaintiff's claim that the premerger withholding of a dividend constituted an abuse of discretion by the controlling shareholder.[120]

Second, a distinct line of cases, the "ownership-claim" transactions,[121] never mentions the *Sinclair* test;[122] all but one[123] of the ownership-claim transactions, whether involving an individual majority shareholder[124] or a

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Aeronsonic Corp., No. 4094, 1982 Del. Ch. LEXIS 452 (Del. Ch. May 20, 1982) (determining standard of review by evaluating whether and officer and director usurped a corporate opportunity to the detriment of shareholders).

[119]444 A.2d 261 (Del. Ch. Apr. 8, 1982).

[120]*Id.* at 264-65. The *Gabelli* court's careful analysis of plaintiff's dividend claim contrasts sharply with the passive manner in which the *Sinclair* court analyzed plaintiff's dividend claim. *See supra* Part III.B (discussing *Sinclair*).

[121]*See supra* notes 70-75 and accompanying text.

[122]In contrast, the enterprise cases decided immediately after *Sinclair* involving enterprise issues — whether by a majority or by a controlling minority shareholder — followed *Sinclair*. Chasin v. Gluck, 282 A.2d 188 (Del. Ch. 1971) (failure of subsidiary to pay debt to parent who owned 51% of subsidiary). The *Gabelli* case cited in this note is the first of three cases involving these parties. While this case pre-dated *Weinberger*, the subsequent cases, *Gabelli & Co. v. Liggett Group, Inc.*, No. 6225, 1983 Del. Ch. LEXIS 418 (Del. Ch. Mar. 2, 1983), *aff'd*, 479 A.2d 276 (Del. 1984), post-dated *Weinberger*. Therefore, these later cases are discussed *infra* notes 154-57 and accompanying text. *See* Gabelli & Co. Profit Sharing Plan v. Liggett Group, Inc., 444 A.2d 261 (Del. Ch. 1982) (involving failure of parent to pay dividend prior to merger cashing out minority shareholders); Schreiber v. Pennzoil Co., 419 A.2d 952 (Del. Ch. 1980) (controlling minority shareholder charging subsidiary a management fee when its subsidiary invested in second subsidiary); Trans World Airlines, Inc. v. Summa Corp., 374 A.2d 5 (Del. Ch. 1977) (finding parent failed to close negotiations for leases of new planes); Singer v. Creole Petroleum Corp., 297 A.2d 440 (Del. Ch. 1972) (involving minority shareholder who claimed parent that owned 95% of the subsidiary paid inadequate prices for certain assets of subsidiary and paid excessive dividends).

[123]The one exception was *Tuckman v. Aeronsonic Corp.*, No. 4094, 1982 Del. Ch. LEXIS 452, at *20-21 (Del. Ch. May 20, 1982) (evaluating the challenged merger). The court stated that:

> [t]he mere presence of this relationship [*i.e.*, the fiduciary relationship imposed by defendant's role as a dominant and controlling stockholder] does not alone impose upon him [defendant] the burden of showing the intrinsic fairness of the entire transaction. In order to impose this burden on Mr. Frank [defendant], plaintiff must have shown that the fiduciary relationship was accompanied by a showing of self-dealing or some other disabling factor and that as a result of his control and domination over Aerosonic and its predecessors, Mr. Frank usurped something of value to the exclusion of, and detriment to, the other stockholders . . . .

Id. (citing Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. 1971); Schreiber v. Pennzoil Co., 419 A.2d 952 (Del. Ch. 1980)).

[124]*See* Roizen v. Multivest, Inc., No. 6535, 1981 Del. Ch. LEXIS 638, at *1 (Del. Ch. Sept. 25, 1981), *reprinted in* 7 DEL. J. CORP. L. 214, 215 (1982) (involving a plaintiff who sought an injunction to enjoin the consummation of a going-private transaction).

parent corporation,[125] reasoned that simply being on both sides of the transaction warranted review under the entire fairness standard.[126] For example, in *Singer v. Magnavox Co.*,[127] the Delaware Supreme Court stated that it is "established law in this State that the dominant corporation, as a majority stockholder standing on both sides of a merger transaction, has 'the burden of establishing its entire fairness' to the minority stockholders, sufficiently to 'pass the test of careful scrutiny by the courts.'"[128] While stressing the impact mergers have on shareholders,[129] these courts intuitively recognized that the significance of this end-game ownership-claim transaction warranted heightened scrutiny.[130] It was against this background that the Delaware Supreme Court decided *Weinberger v. UOP, Inc.*,[131] the landmark case in the development of the entire fairness doctrine.

D. Weinberger v. UOP, Inc.[132]

Weinberger involved a class action by the former shareholders of UOP, Inc., who challenged a cash-out merger between UOP and its majority owner, The Signal Companies Inc.[133] While *Weinberger* addressed numerous issues,[134] the one most relevant here is how to monitor parent-subsidiary cash-out mergers.[135] The Delaware Supreme Court held that the

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[125]*See* Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977) (concerning a parent-subsidiary merger); Tanzer v. International Gen. Indus., Inc., 379 A.2d 1121 (Del. 1977) (involving a parent-subsidiary merger); Young v. Valhi, Inc., 382 A.2d 1372 (Del. Ch. 1978) (involving a cash-out merger between subsidiary and subsidiary's wholly-owned subsidiary in order to allow merger between subsidiary and controlling shareholder); Societe Holding Ray D'Albion S.A. v. Saunders Leasing Sys., Inc., No. 6648, 1981 Del. Ch. LEXIS 555, at *3 (Del. Ch. Dec. 16, 1981) (regarding a majority-proposed recapitalization plan).

[126]*See supra* notes 124-25.

[127]380 A.2d 969 (Del. 1977).

[128]*See id.* at 976 (citing Sterling v. Mayflower Hotel Corp., 93 A.2d 107, 109-10 (Del. 1952)).

[129]*See id.* at 977 (noting that in cash-out mergers, shareholders have more rights than the mere entitlement to be paid fair value for their stock); Tanzer v. International Gen. Indus., Inc., 379 A.2d 1121, 1124 (Del. 1977) (expressing concern about effect of merger on minority shareholders); Young v. Valhi, Inc., 382 A.2d 1372, 1374 (Del. Ch. 1978) (quoting at length concerns about mergers expressed in *Singer*).

[130]*See* DOOLEY, *supra* note 3, at 649.

[131]457 A.2d 701 (Del. 1983).

[132]*Id.*

[133]*Id.* at 703.

[134]The other issues raised in *Weinberger* include: disclosure of material information, see *id.* at 709; the expansion of criteria for evaluating "fair value" for purposes of appraisal rights, see *id.* at 712-13; and the abolition of the business purpose test as a requirement for conflict-of-interest freezeout mergers, see *id.* at 715.

[135]*Weinberger*, 457 A.2d at 703.

plaintiff must first allege some "specific acts of fraud, misrepresentation, or other . . . misconduct to demonstrate the unfairness of the merger terms";[136] thereafter, the majority would bear the burden of showing by a preponderance of the evidence that the transaction was entirely fair.[137] The court further held that "where corporate action has been approved by an informed vote of a majority of the minority [shares], . . . the burden [of proof would shift] to the plaintiff."[138]

In the evolution of the law governing controlling shareholders, *Weinberger* is surely a landmark case. It elucidated many issues that had plagued earlier cash-out merger cases.[139] But *Weinberger* also obfuscated

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[136]*See id.* In *Weinberger*, the Delaware Supreme Court affirmed the lower court's ruling that "the plaintiff in a suit challenging a cash-out merger must allege specific acts of fraud, misrepresentation, or other items of misconduct to demonstrate the unfairness of the merger terms to the minority." *Id.* This aspect of *Weinberger*, however, has rarely been cited in subsequent cases; instead, most cases proceed on the assumption that the parent's majority ownership of stock and the decision by the interlocking directors in the parent and the subsidiary by themselves place the burden to prove entire fairness on the parent. *See, e.g.*, Kahn v. Lynch Communication Sys., Inc. (*Lynch I*), 638 A.2d 1110, 1115 (Del. 1994) (stating that "[a] controlling or dominating shareholder standing on both sides of a transaction . . . bears the burden of proving its entire fairness"); Rosenblatt v. Getty Oil Co., 493 A.2d 929, 937 (Del. 1985) (considering such issues as timing, initiation, and structure of the transaction, as well as intensity of negotiations). Only three cases state that plaintiffs have any initial burden to make the allegations *Weinberger* identifies. *See* Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 70 (Del. 1989) (approving of *Weinberger* factors); Rabkin v. Philip A. Hunt Chem. Corp., 498 A.2d 1099, 1105 (Del. 1985); Kleinhandler v. Borgia, No. 8334, 1987 Del. Ch. LEXIS 413, at *7 (Del. Ch. Mar. 31, 1987), *reprinted in* 13 DEL. J. CORP. L. 307, 311 (1988). In only one of these cases was this burden determinative of the plaintiff's claims relating to the cash-out phase of the challenged merger because "the plaintiff presented no substantial evidence as to the unfairness of the $66 cash-out merger." *Citron*, 569 A.2d at 70. The absence of this evidence led the court to find that *Weinberger* was inapplicable. *Id.*

[137]*See Weinberger*, 457 A.2d at 703. The court also expanded on entire fairness and concluded that entire fairness encompassed both fair dealing and fair price. *Id.* at 711-15. *See also supra* note 3 (discussing nature of entire fairness analysis).

[138]*Weinberger*, 457 A.2d at 703. As the court found that the minority shareholder vote in the case at hand was not informed, the burden of proving entire fairness remained with the majority shareholder. *Id.* This aspect of *Weinberger*'s holding was unclear, as the court did not specify what a plaintiff would have to prove if there had been an informed approval by a majority of minority shares. This issue was clarified somewhat in *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929 (Del. 1985), which required the plaintiff to prove the transaction was unfair after the parent-subsidiary merger was approved by disinterested shares. *See id.* at 937. It was not until *Kahn v. Lynch Communication Sys., Inc. (Lynch I)*, 638 A.2d 1110 (Del. 1994), that the Delaware Supreme Court explicitly acknowledged the confusion and clarified the issue. *See id.* at 1117 (approval of the transaction by independent directors or a majority of the minority shares "shifts the burden of proof on the issue of fairness from the controlling or dominating shareholder to the challenging shareholder-plaintiff" but does not alter the substantive standard of review of entire fairness).

[139]For example, after *Singer v. Magnavox Co.*, 380 A.2d 969 (Del. 1977), cases and scholars questioned what would constitute a valid business purpose to satisfy *Singer*'s holding. *See Weinberger*, 457 A.2d at 715 (questioning the protection provided by business purpose rule). *See also* Richard M. Buxbaum, *The Internal Division of Powers in Corporate Governance*, 73 CALIF.

the law by its omissions. First, like *Sinclair*,[140] *Weinberger* does not mention Delaware section 144, despite the fact that Signal and UOP had interlocking directors.[141] Unlike *Sinclair*, however, *Weinberger* implicitly models much of its reasoning on section 144: the court in dicta encouraged the majority to get approval by disinterested directors or disinterested shares as an alternative to proving the entire fairness of the transaction.[142] Even more curious is *Weinberger*'s treatment of *Sinclair*. Although both cases involved parent-subsidiary transactions, *Weinberger*'s only reference to *Sinclair* is for the indisputable proposition that interlocking directors in such transactions owe fiduciary duties to both corporations;[143] *Sinclair*'s advantage/disadvantage test is never mentioned or utilized. Moreover, *Weinberger* proceeds on the assumption that the conflict of interest created by the

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L. REV. 1671, 1722 n.214 (1985) (stating that "it is arguable that the literalistic yet exasperated tone of some of the post-1976 chancery opinions sent a strong signal to the Supreme Court concerning the views of the trial bench on the difficulty of operationalizing that 'business purpose' trilogy of Supreme Court cases"). The intensity of that question grew after *Tanzer v. International Gen. Indus., Inc.*, 379 A.2d 1121 (Del. 1977), which held that a purpose helpful only to the majority was nevertheless sufficient. *See id.* at 1124. *Weinberger* resolved this issue by dispensing with the business purpose requirement. *Weinberger*, 457 A.2d at 704; *see generally* Siegel, *supra* note 3, at 401-04 (discussing circumstances leading up to business purpose rule and the termination of the rule in *Weinberger*). Similarly, plaintiffs and scholars had repeatedly faulted the conservative valuation methodology used in appraisal cases. *Weinberger* responded to that criticism by expanding the criteria of valuation of appraisal rights to "a more liberal approach [that] must include proof of value by any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in court, subject only to our interpretation of 8 Del. C. § 262(h)." *Weinberger*, 457 A.2d at 713.

[140]*See supra* note 114 and accompanying text.

[141]Five of UOP's 13 directors were either directors or employees of Signal. *See Weinberger*, 457 A.2d at 704. A sixth director was a senior executive of one of Signal's wholly owned subsidiaries. *Id.* A seventh was a partner at an investment bank that represented Signal. *Id.* at 704-05.

[142]As noted *supra* note 49, § 144 has three prongs that will make a conflict-of-interest transaction not void or voidable: the first requires disclosure and approval by disinterested directors, the second requires disclosure and approval by disinterested shares, and the third requires fairness. *See* DEL. CODE ANN. tit. 8, § 144(a) (1996); *see also supra* note 49 and accompanying text. *Weinberger* tracks prongs two and three of § 144, and in dicta, follows prong one. Specifically, *Weinberger* tracks prong two of § 144 by holding that approval by an informed vote of a majority of the minority shares would shift the burden to the plaintiff. *See Weinberger*, 457 A.2d at 703. *Weinberger* also tracks prong three of § 144 by holding that the parent could effectuate a cash-out merger if it could prove that the transaction was entirely fair to the minority shareholders. *See id.* at 710-15. As discussed *supra* note 52 and accompanying text, approval by disinterested directors or shares in the controlling-shareholder transaction context does not change the standard of review; it only shifts to the plaintiff the burden of proving unfairness. This effect is different from the result in interested-director transactions under § 144 where approval by a majority of disinterested shares invokes the business judgment rule. *See supra* notes 52-53 and accompanying text.

[143]*See Weinberger*, 457 A.2d at 710 (citing the chancery court's decision in *Sinclair* for the following proposition: "There is no dilution of this obligation [to prove entire fairness] where one holds dual or multiple directorships, as in a parent-subsidiary context").

majority's controlling both sides of the transaction itself generates the obligation for the majority shareholder to prove fairness,[144] a proposition advocated by both the plaintiff and the lower court in *Sinclair* and *squarely* rejected in *Sinclair* by the Delaware Supreme Court.[145]

Although the court in *Weinberger* offered no justification for ignoring *Sinclair* and its advantage/disadvantage test, some possibilities are evident. First, if the test were applied to any parent-subsidiary cash-out merger, the parent corporation would be deemed to be receiving an advantage — remaining a shareholder — to the exclusion and to the detriment[146] of the cashed-out minority. Thus, any parent-subsidiary cash-out merger warrants a fairness review under the *Sinclair* test. One can square the two cases, therefore, by reasoning that the court in *Weinberger* recognized that the advantage/disadvantage test in a parent-subsidiary cash-out merger will always require the transaction to be judged by the fairness standard, and *Weinberger* simply began with that conclusion.[147] While this would have been a credible basis for the court to distinguish the two cases, and the rationale would have been enormously helpful to subsequent courts, there is no post-*Weinberger* case that indicates that the court in *Weinberger* was implicitly adopting this logic.[148]

Second, the two cases could have been rationalized and differentiated based on the nature of their transactions. *Sinclair* involved challenges to

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[144]*See id.* ("The requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts.").

[145]*See supra* text accompanying note 100. In rejecting both the plaintiff's argument and the lower court's holding, the Delaware Supreme Court in *Sinclair* stated, "A parent does indeed owe a fiduciary duty to its subsidiary when there are parent-subsidiary dealings. However, this alone will not invoke the intrinsic fairness standard. This standard will be applied only when the fiduciary duty is accompanied by self-dealing . . . ." Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971).

[146]While it is obvious that the right for the majority to remain a shareholder is an advantage not shared by the minority, whether such right is to the minority's detriment is less clear. Presumably, the court would consider the involuntary termination of the minority's status as a shareholder to be to the minority's detriment.

[147]*See Weinberger*, 457 A.2d at 710. *See also infra* Part IV.B (arguing that the court should conduct a meaningful inquiry to determine whether a controlling shareholder has taken a benefit to the detriment and exclusion of the other shareholders before the controlling shareholder is required to prove the fairness of the transaction).

[148]Cases that cite both *Sinclair* and *Weinberger* reason that standing on both sides of the transaction invokes entire fairness (*Weinberger*), but that to stand on both sides of the transaction, one must have met the *Sinclair* advantage/disadvantage test. *See* Summa Corp. v. Trans World Airlines, Inc., 540 A.2d 403, 406-07 (Del. 1988) (citing *Weinberger* and *Sinclair* for the proposition that "standing on both sides of the transaction" means in the parent-subsidiary context that the parent benefits to the exclusion and detriment of the minority shareholders of the subsidiary). These cases are misleading, however, for once a court concludes that the defendant benefited to the detriment and exclusion of the minority, the entire fairness test is triggered under *Sinclair*, thereby making any reference to *Weinberger* superfluous.

three enterprise transactions.[149] In that context, it is understandable that the court would find it both undesirable and unwise to evaluate the fairness of any and all such transactions effectuated by a controlling shareholder.[150] *Weinberger*, on the other hand, involved the most extreme situation: a majority shareholder engaging in an end-game ownership-claim transaction.[151] It is again understandable that the court's instincts would be to scrutinize such a transaction closely to assure its fairness. Indeed, as noted above,[152] all but one of the post-*Sinclair*/pre-*Weinberger* cases had evaluated ownership-claim transactions by the fairness test. But *Weinberger*'s failure to address *Sinclair*'s threshold test left the Delaware courts without a justification for this omission.

E. *The Advantage/Disadvantage Test After* Weinberger[153]

The confusion about the status of *Sinclair* compounded when the Delaware Supreme Court, one year after it decided *Weinberger*, affirmed the chancery court's opinion in *Gabelli & Co. v. Liggett Group Inc.*[154] without citing its recently-decided *Weinberger* opinion.[155] Instead, the court relied entirely on *Sinclair* to grant defendant's motion for summary judgment.[156] The court held that although the majority stockholder controlled the dividend decision, there was no evidence of self-dealing as defined in *Sinclair* that would trigger a fairness review.[157] As the court's use of the advantage/disadvantage test in *Gabelli* indicated that *Weinberger* did not

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[149]*Sinclair*, 280 A.2d at 720-21.

[150]*See supra* text accompanying notes 66-74 (discussing distinction between enterprise and ownership transactions). Moreover, courts do not like doing a fairness inquiry. This is probably why *Weinberger* tried to entice defendants to choose an alternative to proving fairness, namely, securing the approval of a majority of disinterested shares. *See also* Siegel, *supra* note 3, at 406-08 (discussing courts' distaste for fairness inquiry).

[151]*See supra* notes 78-81 and accompanying text (discussing end-game transactions and concerns regarding termination of the shareholder's ownership interest).

[152]*See supra* notes 121-22 and accompanying text (noting that after *Sinclair*, the type of transaction appeared to dictate the standard of review).

[153]Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

[154]479 A.2d 276 (Del. 1984).

[155]The omission of any reference to *Weinberger* is all the more striking given that the lower court opinion in *Gabelli & Co. v. Liggett Group, Inc.*, No. 6225, 1983 Del. Ch. LEXIS 418 (Del. Ch. Mar. 2, 1983), which was decided one month after *Weinberger*, does cite to *Weinberger*. *See id.* at *5-6 (to invoke *Weinberger*'s entire fairness, plaintiff here must allege unfairness of the merger price).

[156]*Gabelli & Co.*, 479 A.2d at 281.

[157]*Id.* The court rejected plaintiff's efforts to find a "detriment" to the minority based on the majority's alleged usurpation of the minority's share of the dividend. *Id.* The court held that plaintiff's allegation was based on the mistaken assumption that plaintiff was entitled to dividends either under the law or facts of this case. *See id.*

overrule *Sinclair*, subsequent courts were left to supply their own rationale for *Weinberger*'s failure to mention the advantage/disadvantage test.

The chancery court in *Citron v. E.I. Du Pont de Nemours & Co.*[158] noted this unaccounted-for discrepancy between *Weinberger* and *Sinclair*:

> The precise circumstances that will trigger the "entire fairness" standard of review have not been consistently articulated in the Delaware cases. Sinclair . . . holds that the plaintiff must demonstrate that the parent corporation stood on both sides of the transaction *and* have dictated its terms . . . . However, *Bershad*, *Rosenblatt* and *Weinberger* indicate that to invoke that exacting review standard, all that is required is that the parent corporation have stood on both sides of the transaction.[159]

The court in *Citron* reasoned, however, that because *Citron*'s fact-pattern was analogous to *Weinberger*'s, and because *Weinberger* post-dated *Sinclair*, *Weinberger* was the controlling precedent.[160] As a result, *Citron*'s parent/subsidiary merger was automatically deemed to be a self-dealing transaction, with the burden on the defendant/parent corporation to prove fairness.[161]

Although the court in *Citron* did not know why *Weinberger* had ignored *Sinclair*, the court in *Citron* had a relatively easy time in selecting a standard of review because its facts mirrored *Weinberger*'s. When cases emerged presenting fact patterns with some but not all of the salient characteristics of the transaction in *Weinberger*, however, courts were unprepared to reason through the process of selecting whether *Weinberger* or *Sinclair* was the correct standard of review. It is, therefore, not surprising that courts applied *Sinclair*'s threshold test unevenly and intermittently.

After *Weinberger*, all but one of the majority-controlling shareholder[162] and all minority-controlling shareholder[163] merger cases

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[158]584 A.2d 490 (Del. Ch. 1990).

[159]*Id.* at 500 n.13 (citations omitted).

[160]*See id.* ("Being the most recent pronouncements of the Supreme Court in the parent-subsidiary merger context, *Weinberger*, *Rosenblatt* and *Bershad* are authoritative").

[161]*See id.* at 500. While this case was reviewed under the standard of entire fairness, the burden was subsequently placed on plaintiffs because a committee of disinterested, independent directors negotiated the transactions which was then approved by the corporation's minority stockholders. *See id.* at 501-02.

[162]*See, e.g.*, Bershad v. Curtiss-Wright Corp., 535 A.2d 840, 845 (Del. 1987) (applying entire fairness to cash-out merger of subsidiary by parent); Rosenblatt v. Getty Oil Co., 493 A.2d 929, 937 (Del. 1985) (applying entire fairness to parent-subsidiary, stock-for-stock merger); Wiegand v. Berry Petroleum Co., No. 9316, 1991 Del. Ch. LEXIS 37, at *20 (Del. Ch. Mar. 27, 1991) (noting that defendant conceded that entire fairness standard applied to this parent-subsidiary,

predictably followed *Weinberger*, as did other cases involving ownership-claim transactions.[164] In cases involving enterprise transactions, however, very few cases followed *Sinclair* faithfully.[165] Instead, courts took one of several approaches to *Sinclair*. One approach was, like *Weinberger*, to ignore *Sinclair*'s test and require entire fairness whenever an enterprise transaction involved a controlling shareholder.[166] For example, in *In re*

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cash-out merger); Citron v. E.I. Du Pont de Nemours & Co., 584 A.2d 490, 502 (Del. Ch. 1990) (concluding that entire fairness applies to parent-subsidiary, stock-for-stock merger even when there has been shareholder ratification); *In re* Trans World Airlines, Inc. Shareholders Litig., No. 9844, 1988 Del. Ch. LEXIS 139, at *22 (Del. Ch. Oct. 21, 1988), *reprinted in* 14 DEL. J. CORP. L. 870, 885 (1989) (applying entire fairness initially to a merger between entities controlled by TWA's majority shareholder); Sealy Mattress Co. v. Sealy, Inc., 532 A.2d 1324, 1333 (Del. Ch. 1987) (applying entire fairness to cash-out merger of subsidiary into wholly-owned subsidiary of parent). *But see* Jedwab v. MGM Grand Hotels, Inc., 509 A.2d 584 (Del. Ch. 1986) (applying *Sinclair* to suit where a majority shareholder dictated approval of a merger corporation into an independent third party).

[163]*See* Kahn v. Lynch Communication Sys., Inc. (*Lynch I*), 638 A.2d 1110, 1115 (Del. 1994) (applying entire fairness to minority-controlling shareholder merger).

[164]*See In re* Tri-Star Pictures, Inc., 634 A.2d 319, 327 (Del. 1993) (applying entire fairness to charter amendment by minority-controlling shareholder); Stroud v. Grace, 606 A.2d 75, 90 (Del. 1992) (applying entire fairness in a challenge to charter amendments, proposed by board of directors, whose members were corporation's majority shareholders); Ryan v. Tad's Enters., Inc., Nos. 10,229 & 11,977, 1996 Del. Ch. LEXIS 54, at *18 (Del. Ch. Apr. 24, 1996), *reprinted in* 21 DEL. J. CORP. L. 1235, 1291 (1996) (applying *Weinberger*'s entire fairness test to an asset sale to a third party in which the majority received material consulting contracts, followed by a cash-out merger where individuals owning a majority of the shares controlled both sides of the transaction).

[165]Gabelli & Co. v. Liggett Group Inc., 479 A.2d 276, 280-81 (Del. 1984) (evaluating at the threshold whether the nonpayment of dividends prior to a cash out merger was self dealing); Schreiber v. Bryan, 396 A.2d 512, 519 (Del. Ch. 1978) (using threshold test to determine whether shareholder was stripped of a corporate opportunity); Trans World Airlines, Inc. v. Summa Corp., 374 A.2d 5, 9 (Del. Ch. 1977) (appraising through threshold test whether parent received a benefit at the expense of minority shareholder by failing to close lease); Singer v. Creole Petroleum Corp., 297 A.2d 440, 442 (Del. Ch. 1972) (utilizing advantage/disadvantage test at threshold to determine whether *pro rata* dividends can constitute self dealing); Chasin v. Gluck, 282 A.2d 188, 192-93 (Del. Ch. 1971) (using threshold test to determine whether majority shareholder interfered with the management of subsidiary or treated subsidiary differently than other creditors); Tuckman v. Aeronsonic Corp., No. 4094, 1982 Del. Ch. LEXIS 452, at *20-21 (Del. Ch. May 20, 1982) (determining standard of review at threshold by evaluating whether director benefited to the detriment of shareholders from usurpation of corporate opportunity); *In re* Budget Rent A Car Corp. Shareholders Litig., No. 10,418, 1991 Del. Ch. LEXIS 29, at *9-10 (Del. Ch. Mar. 15, 1991), *reprinted in* 17 DEL. J. CORP. L. 220, 225-26 (1992) (using threshold test to evaluate whether majority benefited at minority's expense in a cash out merger).

[166]Kahn v. Tremont Corp., 694 A.2d 422, 428 (Del. 1997) (finding entire fairness to be the appropriate standard of review without advantage/disadvantage threshold being applied); *In re* MAXXAM, Inc. 659 A.2d 760, 771 (Del. Ch. 1995) (requiring entire fairness standard of review without evaluating at threshold whether there was a benefit to the majority at the expense of the minority).

MAXXAM, Inc.,[167] the chancery court chose to review two majority-controlled enterprise transactions[168] by entire fairness, and made that choice without any mention of *Sinclair*. The court simply repeated the now-familiar tautology: if a controlling shareholder stands on both sides of a transaction, that transaction requires the entire fairness standard of review.[169] Interestingly, had the court utilized the *Sinclair* test, the court would have found that both transactions benefited the majority to the detriment and exclusion of the minority, thereby meriting an entire fairness review.[170]

A second line of cases utilized *Sinclair* as a basis for evaluating the fair dealing prong of entire fairness, rather than as a threshold strainer as it had been designed.[171] For example, in *Summa v. Trans World Airlines,*

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[167]This case went to the Delaware Chancery Court twice: the first time, was on a motion to approve a proposed settlement of a derivative suit, a motion which the chancery court rejected. *In re* MAXXAM, Inc., 659 A.2d 760, 776-77 (Del. Ch. 1995). The second was the court's opinion after the trial. *In re* MAXXAM, Inc., Nos. 12,111 & 12,353, 1997 Del. Ch. LEXIS 51 (Del. Ch. Apr. 4, 1997), *reprinted in* 23 DEL. J. CORP. L. 277 (1998).

[168]The first enterprise transaction took place in 1987 when MAXXAM's board approved two loans to its parent, Federated Development Co., to assist with a land development project called "Mirada." *See In re MAXXAM, Inc.*, 1997 Del. Ch. LEXIS 51, at *9-12, *reprinted in* 23 DEL. J. CORP. L. at 292-93. The second transaction was the 1991 Exchange Agreement between MAXXAM and Federated by which MAXXAM purchased Mirada from Federated by forgiving the 1987 loans and offering other consideration. *See id.* at *16-25, *reprinted in* 23 DEL. J. CORP. L. at 300.

[169]The court noted that the burden of proving the unfairness of the transaction would shift to the plaintiff if a truly independent, disinterested, and informed special committee were to negotiate the transaction, but entire fairness would remain the standard. *See id.* at *40, *reprinted in* 23 DEL. J. CORP. L. at 317. The court, however, found the alleged independent negotiating committee was ineffective because the actual negotiations failed to support a finding of arm's-length bargaining and the approval by MAXXAM's board consisted of simply approving the loans on the terms outlined. *See id.* at *43, *reprinted in* 23 DEL. J. CORP. L. at 330. Moreover, regarding the exchange, the court again concluded that the special committee of MAXXAM's board was defective because the committee members were not independent, not fully informed, and did not bargain effectively. *See id.* at *43-90, *reprinted in* 23 DEL. J. CORP. L. at 330-31.

[170]Once the court chose the fairness review, it had to consider, among other factors, whether the majority shareholder had dealt fairly with minority shareholders. In evaluating whether the parent, Federated, dealt fairly with its subsidiary, the court found that Federated made material misstatements and omissions that impacted the expert's appraisal. The court did not cite to *Sinclair* but used *Sinclair* language in finding that "[t]he result was to advantage Federated [the defendant] unfairly at the expense of MAXXAM's minority shareholders." *Id.* at *84, *reprinted in* 23 DEL. J. CORP. L. at 327.

[171]*See, e.g.*, Kahn v. Tremont Corp., 694 A.2d 422, 428 (Del. 1997); Summa Corp. v. Trans World Airlines, Inc., 540 A.2d 403, 406 (Del. 1988). *Kahn v. Lynch Communication Sys. (Lynch II)*, 669 A.2d 79 (Del. 1995), reasoned that "in addressing the fair dealing component of the transaction . . . mere initiation by the acquirer is not reprehensible so long as the controlling shareholder does not gain a financial advantage at the expense of the minority." *Id.* at 85. Similarly, in *Wiegand v. Berry Petroleum Co.*, No. 9316, 1991 Del. Ch. LEXIS 37 (Del. Ch. Mar. 27, 1991), the defendant conceded that because it owned 80.6% of the corporation, stood on both sides of the merger, and fixed its terms, the entire fairness standard of review governed. *See id.* at *20. The plaintiff contended, *inter alia*, that the defendant unfairly timed the merger so that certain values

Inc.,[172] the court found that Toolco had acted to its benefit at the expense of the minority shareholders.[173] Instead of using this analysis to conclude that

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were not recognized for purposes of determining the merger exchange ratio. *Id.* at *22. The court reasoned that:

> If such improper timing is found to have occurred and benefitted the fiduciary (Berry) at the expense of the minority shareholders, that circumstance may establish unfair dealing.... The evidence clearly establishes a fact dispute as to whether Berry purposefully postponed its joint venture negotiations... until after the merger, with resulting benefit to Berry and commensurate detriment to the Norris minority.

Id. at *22.

While not citing to *Sinclair*, other cases have used advantage/disadvantage language in discussing timing as one aspect of fair dealing. *See Tremont*, 694 A.2d at 431 (stating that "[w]hile Valhi obtained a significant financial advantage in the timing of the purchase, it did not do so at the expense of Tremont"); *In re* MAXXAM, Inc., Nos. 12,111 & 12,353, 1997 Del. Ch. LEXIS 51, at *43-46 (Del. Ch. Apr. 4, 1997), *reprinted in* 23 DEL. J. CORP. L. 277, 330-31 (1998) (concluding that defendant's initiation of transaction benefited defendant and injured plaintiff); Rovner v. Health-Chem Corp., No. 15,007, 1996 Del. Ch. LEXIS 83, at *27 (Del. Ch. July 3, 1996), *reprinted in* 22 DEL. J. CORP. L. 830, 846 (1997) (discussing plaintiff's argument that the timing of Rights Offering benefited controlling shareholder to detriment of minority); Van de Walle v. Unimation, Inc., No. 7046, 1991 Del. Ch. LEXIS 27, at *32 (Del. Ch. Mar. 6, 1991), *reprinted in* 17 DEL. J. CORP. L. 390, 408 (1992) (involving the plaintiff claiming that "merger was timed and initiated for Condec's sole benefit, thereby forcing the minority stock-holders to liquidate their investment in Unimation under maximally disadvantageous conditions"); Sealy Mattress Co. v. Sealy, Inc., 532 A.2d 1324, 1336 (Del. Ch. 1987) (discussing timing aspect of fair dealing, court stated that "the corporate defendants timed the merger to occur at a time when valuation of Sealy was difficult, if not impossible... and took other steps as well, to manipulate Sealy's values for their benefit and to the plaintiffs' detriment"). *Cf.* Smith v. SPNV Holdings, Inc., No. 8395, 1989 Del. Ch. LEXIS 46, at *7 (Del. Ch. Apr. 26, 1989) (relying on *Jedwab* in discussing the timing aspect of fair dealing analysis); Jedwab v. MGM Grand Hotels, Inc., 509 A.2d 584, 599 (Del. Ch. 1986) (discussing timing of merger transaction). The *Jedwab* court stated that:

> [t]he prototype instance in which the timing of a merger would itself likely constitute a breach of a controlling shareholder's duty is 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.

Id.

[172]540 A.2d 403 (Del. 1988). The allegations charged that the majority shareholder delayed ordering planes that the subsidiary needed, "preferring instead to buy the planes and sell or lease them to TWA at a profit." *See id.* at 405. Earlier in the opinion, the court discussed that the Civil Aeronautics Board's approval of the disputed transaction did not immunize the transaction from review for matters, such as breach of fiduciary duty, that were outside the purview of the Civil Aeronautics Board. *Id.* at 406. In explaining why this approval did not immunize the transaction from all potential violations, the court used *Sinclair*'s reasoning without citing to *Sinclair*: "As a whole, Toolco acted for its sole benefit at the expense of its fiduciary duties to TWA's minority shareholders." *Id.*

[173]*Id.* at 407. The *Summa* court noted that:

> Toolco was a 78% shareholder in TWA, and, exerting its control position, Toolco refused to allow TWA to purchase its own jets, delayed the production of jets which were ordered, unjustifiably rejected acceptable aircraft, forced TWA to enter into leases for aircraft, and sold airplanes to TWA at a profit — all to

a fairness test was thus warranted under *Sinclair*, however, the court selected the fairness standard after citing to both *Weinberger* and *Sinclair* and then used the advantage/disadvantage analysis to support its conclusion that Toolco's actions did not comport with basic concepts of fair dealing.[174]

Similarly, *Kahn v. Tremont Corp.*[175] involved an enterprise transaction by a minority-controlling shareholder[176] in which the court used *Sinclair* to analyze fair dealing rather than as a threshold determinant.[177] Tremont's purchase of NL shares from Valhi, Tremont's minority-controlling shareholder, was approved by a purportedly independent committee of Tremont directors.[178] The plaintiff sued Valhi, Tremont, and Tremont's board to rescind the transaction, and for damages, claiming that Valhi had caused Tremont to purchase the NL shares due to reasons that benefited Valhi but not Tremont.[179]

Primarily, *Tremont* focused on the proper standard of review. Plaintiff argued that the defendants had to prove entire fairness under *Weinberger* simply because there was a controlling shareholder on both sides

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> Toolco's benefit, but materially detrimental to the productivity and effectiveness of TWA . . . . Furthermore, Toolco structured the transactions to minimize its exposure to risk at the expense of TWA's profits. Such conduct hardly comports with basic concepts of fair dealing . . . .

Id.

[174]*Id.* The court cited both *Weinberger* and *Sinclair* but did not articulate any conclusion about which was the appropriate monitor. Compounding this confusion was the fact that immediately after citing both cases the court began its fair dealing analysis. The court stated:

> It is well established in Delaware that one who stands on both sides of a transaction has the burden of proving its entire fairness. In the absence of arms length bargaining, clearly the situation here, this obligation inheres in, and invariably arises from the parent-subsidiary relationship. This rule applies when "the parent, by virtue of its domination of the subsidiary, causes the subsidiary to act in such a way that the parent receives something from the subsidiary to the exclusion of, and detriment to the minority stockholders of the subsidiary.

Id. at 406-07 (citations omitted).

[175]694 A.2d 422 (Del. 1997).

[176]Valhi, Inc. owned 44% of Tremont's stock, and 62% of NL Industries' stock. *Id.* at 424-25. Tremont purchased shares of NL Industries from Valhi. *Id.* at 423. Harold Simmons through the Simmons Trusts owned 100% of Contran Corp.; Contran owned 90% of Valhi; Simmons effectively controlled Valhi, Tremont, and NL Industries. *Id.* at 424. Simmons was also chairman of the board of both Valhi and NL, and a member of Tremont's board. *Id.* Other Tremont directors were also officers and directors of Valhi and/or NL Industries. *See id.* (describing ownership of corporations involved in this action).

[177]*Id.* at 428-30.

[178]*Id.* at 428.

[179]Plaintiff claimed that Tremont paid too high of a price for the shares, that the purchase was unfair to Tremont as it was an inappropriate investment, and that the process by which the transaction was effectuated was not fair. *See* Kahn v. Tremont Corp., No. 12,339, 1996 Del. Ch. LEXIS 40, at *3-4 (Del. Ch. Mar. 21, 1996), *reprinted in* 21 DEL. J. CORP. L. 1161, 1169 (1996).

of the transaction.[180] Defendant agreed that it was generally in control of both Tremont and Valhi,[181] but argued that Valhi did not exercise control over this transaction. Defendants contended that because an independent and well-advised committee acted on Tremont's behalf and had simulated arm's-length negotiations, the business judgment rule was warranted.[182] The court agreed that the process in which the special committee engaged "appears in all respects informed, active, and loyal to the interests of Tremont."[183] Nevertheless, unlike prior case law[184] which had found the existence of an independent committee probative of whether the minority controlled the transaction and dictated the resulting standard of review, the court held that an independent board committee would not affect fairness as the standard of review.[185] Instead, Chancellor Allen concluded, however, without any mention of *Sinclair*, that entire fairness was the standard of

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[180]*See id.* at *19-20, *reprinted in* 21 DEL. J. CORP. L. at 1178.

[181]Although Valhi owned only 44% of Tremont, the court erroneously noted that this case "requires one to work in the context of a transaction between a parent and its subsidiary." *See id.* at *22, *reprinted in* 21 DEL. J. CORP. L. at 1179.

[182]*See id.* at *20, *reprinted in* 21 DEL. J. CORP. L. at 1178-79.

[183]*See Kahn*, 1996 Del. Ch. LEXIS 40, at *27, *reprinted in* 21 DEL. J. CORP. L. at 1181. Although the court's ultimate conclusion was that the special committee was effective, the court did express some reservations about the establishment of the committee and its choice of advisors. *See id.* at *25, *reprinted in* 21 DEL. J. CORP. L. at 1180; *see also supra* notes 37-38 and accompanying text (discussing how an independent committee negates the conclusion that a minority shareholder controls a transaction).

[184]The court failed to follow the majority of cases that had tested whether a minority shareholder was in control, by analyzing whether the shareholder controlled the transaction at issue. *See supra* note 32 and accompanying text (discussing that Delaware courts determine minority control on a transactional basis). One significant aspect of that analysis would be, as defendants contended, whether there was an independent negotiating committee that acted on behalf of the corporation. *See supra* notes 37-38 and accompanying text (discussing effect of independent negotiating committee on determination of minority control).

[185]The court's error in categorizing this transaction with a significant minority shareholder as a parent-subsidiary transaction is important, see *supra* note 181, because the reasons the court gave for distrusting the efficacy of an independent negotiating committee in a parent-subsidiary context are not entirely applicable in the minority-controlling shareholder context. Chancellor Allen reasoned:

> Thus, the prospect of a bargaining process [through the independent committee] if it can be given some reality, offers the hope of some real advantage. But the creation of a process that has sufficient similarity to an arm's-length process is difficult. Since the parent has, in effect, its own veto over the subsidiary pursuing alternative transactions, the only real source of bargaining leverage is the ability and willingness of the committee to say no to a transaction that is not both a fair transaction in terms of alternatives that would be available to the subsidiary if there were no controlling party and the best transaction that the parent will offer.

Kahn, 1996 Del. Ch. LEXIS 40, at *21, *reprinted in* 21 DEL. J. CORP. L. at 1179 (citing *In re* First Boston Shareholders Litig., No. 10,338 (Del. Ch. Feb. 19, 1991)). As noted above, see *supra* note 37, a minority does not, by definition, have a veto over alternative transactions. Chancellor Allen, however, assumed that this minority shareholder possessed monopsonist power.

review[186] and used his assessment of the independence of the committee only to shift the burden to the plaintiff to prove that the transaction was unfair.[187] Ultimately, Chancellor Allen decided that the plaintiff failed to demonstrate unfairness.[188]

On appeal, the Delaware Supreme Court, in a 2-1-2 decision, reversed and remanded.[189] The court began its analysis from the proposition that the case involved a transaction by a controlling shareholder.[190] Therefore, the court summarily proffered that all such transactions require defendants to prove the entire fairness of the transaction.[191] Choosing to be governed by

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[186]*Kahn*, No. 12,339, 1996 Del. Ch. LEXIS 40, at *27, *reprinted in* 21 DEL. J. CORP. L. at 1182.

[187]*Id.* at *5, *reprinted in* 21 DEL. J. CORP. L. at 1170.

[188]*See id.* at *5, *reprinted in* 21 DEL. J. CORP. L. at 1170. In coming to this conclusion, the chancellor stated:

> I conclude that plaintiff has failed to show by a preponderance of the evidence that the price of the NL stock was not fair to Tremont. In so concluding I am of the view that the evidence shows that the price was within a range that a reasonable, fully informed buyer might accept. The price was not generous to Tremont; indeed the 7% discount from market on day of contracting is about as small a discount as could be accepted as fair in the circumstances. But generosity is not the standard and there were public shareholders on both sides of the transaction. There were sensible business reasons for the transaction on both sides; the market price was not in my opinion manipulated; and circumstances indicate that the relatively small discount from market was not unfair to the buyer.

Id. at *46-47, *reprinted in* 21 DEL. J. CORP. L. at 1190-91. The court also found that the process was fair. *See id.* at *67-68, *reprinted in* 21 DEL. J. CORP. L. at 1200.

[189]Kahn v. Tremont Corp., 694 A.2d 422, 433 (Del. 1997). Justices Walsh and Holland were in the majority, Judge Quillen concurred, and Justices Berger and Ridgely dissented. Justices Walsh and Holland made findings that led to their conclusion that the special committee was not independent, thereby requiring the defendant to prove entire fairness. *See id.* at 429-30. Judge Quillen wrote a concurring opinion to stress that he agreed with the majority's conclusion that the burden of proving entire fairness should remain with the defendants, but added that he reached his conclusion based on the finding of facts by the chancellor, rather than the findings of the majority. *See id.* at 433. The dissent argued that the chancellor's finding that the special committee was informed, active and loyal to Tremont should be accorded deference, and thus the burden should shift to the plaintiffs as the chancellor had held. *See id.* at 434.

[190]*See id.* at 428. The defendants failed to challenge the conclusion that they were the controlling shareholder of both the buyer and the seller. This failure allowed the court to avoid doing its own analysis of whether the defendant exercised transactional control. Ultimately, because the court determined that the committee was dominated, it could have concluded that control did, in fact, exist. *See id.* at 428-30.

[191]*See id.* at 428. The court noted that the burden of persuasion would shift to the plaintiff if a well-functioning committee of directors existed, an exception which the court found inapplicable to these facts. *See id.* at 429. The Delaware Supreme Court faulted the chancery court's conclusion that the special committee of directors had been independent and informed. *See id.* The Delaware Supreme Court held that the special committee did not operate in an independent or informed manner. *Id.* Specifically, the Delaware Supreme Court found several defects. First, the committee was not independent. *Id.* Even though the members had no personal interest in the transaction, they had significant prior business relationships with Valhi's controlling shareholder. *Id.* at 429-30.

the *Weinberger* merger case law, the Delaware Supreme Court stated that:

> [r]egardless of where the burden lies, when a controlling shareholder stands on both sides of the transaction the conduct of the parties will be viewed under the more exacting standard of entire fairness as opposed to the more deferential business judgment standard. . . . [W]e have chosen to apply the entire fairness standard to "interested transactions" in order to ensure that all parties to the transaction have fulfilled their fiduciary duties to the corporation and all its shareholders.[192]

The court never considered whether this controlling-shareholder enterprise transaction should undergo a *Sinclair* analysis.

After selecting the fairness standard, the court, in its discussion of fair dealing, performed a partial *Sinclair* analysis without mentioning *Sinclair*. The court reasoned that the controlling shareholder's initiation of the transaction was not incompatible with the concept of fair dealing "so long as the controlling shareholder does not gain financial advantage at the expense of the controlled company."[193]

Interstingly, had the courts in *Tremont* and *Summa* applied the *Sinclair* threshold test, they would have concluded that defendants' self-dealing actions warranted the fairness standard of review. Their failure to use *Sinclair* as a threshold determinant may, like *Weinberger,* have been nothing more than their viewing the *Sinclair* test as unnecessary if they found it obvious that the controlling shareholder had received a benefit to the exclusion and detriment of the minority.[194] Ignoring *Sinclair* as a threshold deter, as both the first two lines of case did, however, created confusion as

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Second, the committee's chairman dominated the negotiations, and he was closely connected to Valhi's controlling shareholder. *Id.* at 430. Third, the passiveness of the other committee members made them uninformed about the transaction. *Id.* As the chancery court's view of the committee was its basis for shifting onto the plaintiff the burden of proving unfairness, once the Delaware Supreme Court had a distinctly different view of the committee, it determined that it was the defendants' burden to prove the entire fairness of the transaction. *See id.* On remand, the chancery court declined to enter judgment without permitting additional discovery relevant to the valuation issue. *See* Kahn v. Tremont Corp., No. 12,339, 1997 Del. Ch. LEXIS 150, at *17-18 (Del. Ch. Oct. 27, 1997). Given that all facts are currently unavailable, it is not possible to speculate as to the result had the facts been analyzed through the *Sinclair* test. Had the court used § 144, defendants would still be required to prove fairness under § 144(a)(3) as the court's conclusion that the committee was not independent rendered 144(a)(1) inapplicable, and defendants had not chosen to proceed under (a)(2). *See supra* note 49 (discussing § 144).

[192]*Tremont*, 694 A.2d at 428-29.

[193]*See id.* at 431.

[194]*See supra* notes 131-38 and accompanying text.

to the vitality of the case. Moreover, as discussed in the next section,[195] the *Sinclair* test performs a different function when used to analyze fair dealing instead of being used at the threshold to sift through cases alleging self-dealing in order to determine which ones merit intense scrutiny under the fairness standard.

The third line of cases diluted the *Sinclair* test by omitting its "detriment" prong.[196] For example, *Jedwab v. MGM Grand Hotels, Inc.*[197] involved the merger of a majority-controlled corporation, MGM Grand, into an independent third party, Bally.[198] While the majority shareholder, Kerkorian, did not control both sides of the transaction, he did control both classes of MGM's stock.[199] Plaintiff, a preferred stockholder, claimed that the directors apportioned the merger consideration in order to favor the common shareholders.[200] The court rejected plaintiff's argument that entire fairness applied simply because the fiduciary had an interest that diverged from the minority's.[201] Citing *Sinclair*, Chancellor Allen reasoned that entire fairness applies only if the fiduciary has an interest that conflicts with the minority's interest.[202] Applying this standard, he reasoned that although Kerkorian allocated to himself less cash per common share, he apportioned the opportunity to share in noncash property entirely to himself.[203] Thus, the court concluded that an entire fairness review was warranted.[204]

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[195]*See infra* note 259 and accompanying text.

[196]*See, e.g.*, Nixon v. Blackwell, 626 A.2d 1366 (Del. 1993); Jedwab v. MGM Grand Hotels, Inc., 509 A.2d 584 (Del. Ch. 1986).

[197]509 A.2d 584 (Del. Ch. 1986).

[198]*Id.* at 590.

[199]Kerkorian, individually and through his wholly owned corporation, Tracinda, beneficially owned 69% of MGM's outstanding common stock and 74% of its preferred stock. *Id.* at 591.

[200]*Id.* at 590. Given that Kerkorian owned a larger percentage of preferred stock than of common, plaintiff alleged that Kerkorian's motive in allocating a greater percentage of the consideration to the common stock was to protect himself from possible lawsuits from the common shareholders who had bought stock in response to his announcement of a forthcoming deal and the terms of that deal. *See id.* at 591-92.

[201]*Jedwab*, 509 A.2d at 594-95. Chancellor Allen reasoned:

> Our Supreme Court has made it quite clear that the heightened judicial scrutiny called for by the test of intrinsic or entire fairness is not called forth simply by a demonstration that a controlling shareholder fixes the terms of a transaction and, by exercise of voting power or by domination of the board, compels its effectuation. (The apparent situation presented in this action.) It is in each instance essential to show as well that the fiduciary has an interest with respect to the transaction that conflicts with the interests of minority shareholders.

Id.

[202]*Id.* at 595.

[203]*Id.* Kerkorian kept the right to use the MGM Grand name, as well as certain contingent rights in an ongoing claim for insurance. *Id.*

[204]*Id.* at 595-96.

In its *Sinclair* analysis, however, the court omitted the "detriment" prong and applied only the "exclusion" prong of the advantage/ disadvantage test. By omitting the "detriment" component, the court ignored the fact that although Kerkorian received consideration that was different from that of the other shareholders, his total recovery per share would most likely be less than the amount that the common shareholders received.[205] Therefore, even assuming that Kerkorian's receipt of different consideration constituted a "benefit," that disparate tretment was not to the detriment of the other shareholders. As *Sinclair* requires the benefit to be both to the exclusion and detriment of the other shareholders,[206] a proper application of *Sinclair* would have made the business judgment rule applicable.

Nixon v. Blackwell[207] followed the *Jedwab* pattern of applying a diluted *Sinclair* test to an enterprise transaction that involved minority shareholders.[208] As directors, the minority shareholders[209] caused the corporation to maintain a discriminatory benefits policy that favored defendants, employee stockholders, over plaintiffs, who were nonemployee stockholders.[210] The Delaware Supreme Court agreed with the chancery court that the defendant had to prove entire fairness.[211] The Delaware Supreme Court reversed the chancery court, however, because the supreme court concluded that parity of treatment is not required to establish fairness.[212]

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[205]*See Jedwab*, 509 A.2d at 595.

[206]*See supra* notes 97-103 and accompanying text.

[207]626 A.2d 1366 (Del. 1993).

[208]*Id.* at 1370.

[209]*Id.* All ten directors were shareholders; collectively, they owned 47.5% of the outstanding voting shares of E.C. Barton & Co. *Id.*

[210]*Id.* at 1371. Essentially, two employee benefit plans were challenged by nonemployee stockholders. *Id.* The first was an Employee Stock Ownership Plan that bought Class-B nonvoting stock for eligible employees. *Id.* Upon an employee's termination or retirement, the stock, or its cash value, was distributed to the employee. *Id.* The second benefit was a Key Man Life Insurance Policy that covered certain officers and directors with a death benefit payable to the corporation. *Id.* In connection with this coverage, the board passed a resolution recommending that the proceeds from the insurance be used to repurchase certain stock from the estate of the officers and directors covered by the plan. *Id.* at 1372.

[211]*See Nixon*, 626 A.2d at 1375-76.

[212]*Id.* at 1376-77. The court in *Nixon* explained:

> The trial court in this case, however, appears to have adopted the novel legal principle that Class B stockholders had a right to "liquidity" equal to that which the court found to be available to the defendant. It is well established in our jurisprudence that stockholders need not always be treated equally for all purposes. ...If such corporate practices [like key man insurance programs] were necessarily to require equal treatment for non-employee stockholders, that would be a matter for legislative determination in Delaware. There is no such legislation to that effect.

It is the court's route to a fairness inquiry, rather than its conclusion, that is problematic. As previously discussed, a court selects the fairness standard of review for any of three reasons: one, if the case is proceeding under the Delaware statute's conflict-of-interest provision, section 144(a)(3);[213] two, because of the applicability of *Weinberger*;[214] and three, if the defendant is deemed to be self-dealing under *Sinclair*'s threshold test.[215] As the court references all three of these fairness triggers,[216] it is unclear why entire fairness was chosen as the standard of review.

The choice of route is, however, significant. As the court has previously held that section 144[217] is inapplicable to controlling-shareholder transactions,[218] the court would have to explain why it utilized that section in this case controlling-shareholder case.[219] Second, if the court in *Nixon* took the *Weinberger* route to a fairness monitor, it did so without any analysis of whether the fairness standard should automatically apply when *Nixon*, unlike *Weinberger*, involved only enterprise decisions.[220]

Alternatively, if the court in *Nixon* arrived at a fairness inquiry via *Sinclair*, its *Sinclair* analysis was highly problematic. As in *Jedwab*,[221] at no point does the court either articulate or apply the complete *Sinclair* test; instead, the court in *Nixon* found a benefit to the defendant directors but "no corresponding benefit" to the plaintiffs.[222] Moreover, the court found that

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Id.

[213]*See supra* note 49 (discussing § 144(a) and its application).

[214]*See supra* notes 136-37 (discussing *Weinberger*'s use of fairness monitor).

[215]*See supra* notes 100-01 and accompanying text (discussing *Sinclair*'s threshold test before requiring a fairness review).

[216]*See Nixon*, 626 A.2d at 1375-76 (citing *Sinclair* for threshold test triggering entire fairness review); *id.* (citing *Weinberger* for threshold test triggering entire fairness review); *id.* at 1376 n.6 (citing § 144 for the proposition that application of entire fairness does not always lead to liability of defendant or void the transaction).

[217]It is clear that the transaction could not be "cleansed" under § 144(a)(1) as the defendants constituted the entire board. *See id.* at 1370. The defendants did not attempt to utilize § 144(a)(2) by securing the informed vote of disinterested shares. *See id.* at 1376 (remarking on role of court when there is no informed vote of disinterested shares). *See also* note 45 (discussing § 144).

[218]*See supra* notes 50-52 and accompanying text.

[219]This would have been a difficult conclusion given that the defendants owned 47.5% of the shares and constituted the entire board. *Nixon*, 626 A.2d at 1370.

[220]*Nixon* also differed from *Weinberger* in that *Nixon* was not a parent-subsidiary transaction. In fact, the court in *Nixon* never even analyzed whether the defendants controlled the corporation. Had the court done this analysis, it would have concluded that the defendants controlled the board. *See supra* text accompanying note 209 (describing facts evidencing defendants' control). *See also supra* notes 31-32 and accompanying text (discussing how courts determine who is a controlling shareholder).

[221]*See supra* notes 197-205 and accompanying text.

[222]*See Nixon*, 626 A.2d at 1373-74. Similarly, the court found the defendants benefited "beyond that which benefited other stockholders generally." *Id.* at 1375.

the corporation, as well as the defendants, benefited from the disputed transactions.[223] In other words, had the court done a complete *Sinclair* analysis, it would have reasoned that the defendants benefited to the exclusion of the minority but *not* to their detriment; thereafter, the court would have analyzed defendants' transactions under the business judgment rule because all the components *Sinclair*'s test had not been satisfied. The *Jedwab* and *Nixon* courts, by eliminating one of *Sinclair*'s two prongs, reformulated the *Sinclair* test from one designed to identify self-dealing into one that merely identifies a conflict of interest.[224]

Thus, the court in *Nixon* reached the right result — upholding the disputed transactions — but through the wrong methodology. Section 144(a)(3) should have been inapplicable as this was a controlling-shareholder transaction.[225] *Weinberger* should have been inapplicable because this was only an enterprise transaction. Finally, had the court applied a complete *Sinclair* test, it would have found a fairness test was unnecessary as defendants' benefit was not to the minority's detriment. Under these circumstances, the business judgment rule should have governed.

In sum, the vast majority of cases decided after *Weinberger* ignored the threshold test of *Sinclair*, regardless of whether the case involved a parent-subsidiary relationship or a controlling-shareholder relationship, and regardless of whether the transaction was a merger, another type of ownership issue, or an enterprise issue. Without ever explicitly overruling *Sinclair*, *Weinberger* and its progeny have nevertheless rendered the *Sinclair* advantage/disadvantage test almost obsolete as an effective threshold test. The few post-*Weinberger* cases that applied the *Sinclair* test at the threshold

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[223] *Id.* at 1377. "[T]he creation of ESOPs is a normal corporate practice and is generally thought to benefit the corporation. The same is true generally with respect to key man insurance programs." *Id.*

[224] *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (defining disinterested directors as those who neither (1) "appear on both sides of a transaction" nor (2) "expect to derive any personal financial benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally"). *See also* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 957 (Del. 1985) (applying *Aronson*). *See infra* notes 253-54 and accompanying text (discussing why self-dealing and conflicts of interest are not equivalent). By omitting the detriment requirement, *Nixon* is one of the few cases in which the defendant arguably failed *Sinclair*'s threshold test but is nevertheless able to prove fairness. This result would otherwise seem highly improbable, as it would not be plausible for a self-dealing fiduciary to prove it was entirely fair to benefit to the exclusion and the detriment of the minority. *See infra* notes 257-59 and accompanying text (discussing difficulty of establishing fairness after showing that defendant took to the exclusion and detriment of the minority). *See also supra* notes 202-05 and accompanying text (discussing chancery court's omission of the "detriment" component in *Jedwab*).

[225] *See supra* note 50 (noting inapplicability of § 144 to controlling-shareholder transactions).

all involved enterprise transactions.[226] Very few of that group have been true to the *Sinclair* formulation. Most cases that applied *Sinclair* either diluted the test by eliminating the "detriment" component, or used *Sinclair* reasoning in the fair dealing analysis, but not as a threshold deter.[227] Whether these numerous changes are beneficial or detrimental to Delaware corporate law will be analyzed in Part IV. The law has not accounted for these changes, however, and, one suspects, they were unintentional.

IV. A PROPOSAL FOR MONITORING CONTROLLING-SHAREHOLDER TRANSACTIONS

The above analysis suggests that the current state of the law governing controlling shareholders is problematic. First, the courts have not always focused on how one acquires — or cedes — control. Second, although *Sinclair* created a threshold methodology for deciding whether parent-subsidiary transactions should be monitored by fairness or by business judgment, it indisputably no longer functions as a threshold test for all controlling-shareholder transactions. A large number of transactions — disproportionately involving ownership-claim transactions — have ignored the *Sinclair* test, either because they viewed *Sinclair* as inapplicable or because the challenged transaction so obviously merited a fairness review under the given circumstances that the test was unworthy of citing. When the *Sinclair* test has had some threshold role — disproportionately in enterprise transactions — it has sometimes been diluted by the elimination of its "detriment" prong. Finally, instead of routinely being used as a threshold monitor, *Sinclair* has sometimes been used to evaluate the "fair dealing" prong of entire fairness. In contrast to *Sinclair's* diminished role, *Weinberger*'s entire fairness test has become do — perhaps omnipresent — in this area of the law. This section will, therefore, evaluate the two key issues in this area, namely, (1) what should constitute control and (2) what monitors should govern controlling-shareholder transactions.

A. *What is a Controlling Shareholder?*

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[226]*See* Gabelli & Co. v. Liggett Group Inc., 479 A.2d 276, 281 (Del. 1984) (applying advantage/disadvantage test at threshold and finding no self dealing by parent). *Cf.* Nixon v. Blackwell, 626 A.2d 1366 (Del. 1993) (omitting detriment prong of *Sinclair* test); Jedwab v. MGM Grand Hotels, Inc., 509 A.2d 584, 594-95 (Del. Ch. 1986) (applying *Sinclair* at threshold but omitting disadvantage prong of test); *In re* Budget Rent A Car Corp. Shareholders Litig., No. 10,418, 1991 Del. Ch. LEXIS 29, at *9-10 (Del. Ch. Mar. 15, 1991), *reprinted in* 17 DEL. J. CORP. L. 220, 225-27(1992) (discussing *Sinclair*'s test but ultimately concluding that the challenged ownership transaction was not an interested-director transaction).

[227]*See supra* notes 166, 171, and 196 and accompanying text.

A. *What is a Controlling Shareholder?*

The Delaware case law has articulated two principles that establish when a shareholder will be deemed to be controlling, with concomitant fiduciary duties. First, a shareholder has such a responsibility only if it owns a majority of shares or, despite being a minority shareholder, nevertheless controls the transaction.[228] Plaintiffs have the burden to prove a minority shareholder has transactional control.[229] This is determined by examining the minority's relationship to the board members and the degree of influence the minority exerted over the terms of the transaction.[230] Second, once the shareholder is deemed to be in control, the same judicial monitors apply regardless of whether the shareholder owns a majority or a minority of stock.[231]

This article largely concurs with these Delaware principles. Although there are distinctions between majority and minority control,[232] these differences are not substantial enough to warrant different levels of judicial review. If, in fact, the transaction undergoes a fairness review, the court can calibrate the effect of these distinctions in determining whether the transaction is fair.

Furthermore, the concept of determining minority control on a transactional basis is sound. While the Delaware courts have not always been faithful to this principle,[233] these cases appear to be only sporadic transgressions from otherwise sound principles.

This article posits, however, that both majority and minority shareholders should be deemed to be in control on a transactional basis. As discussed above,[234] given that shareholders can vote in their own self-interest, they should be expected to assume fiduciary responsibilities only when they take control of negotiating and dictating the terms of a

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[228]*See supra* note 27 and accompanying text (only controlling shareholders have fiduciary duties).

[229]*See supra* note 30 and accompanying text (requiring plaintiff to prove the minority shareholder is in control).

[230]*See supra* notes 31-32 and accompanying text (citing numerous cases in support of proposition).

[231]*See supra* notes 45-46 and accompanying text (referencing comment that courts group all controlling shareholders together for purposes of imposing fiduciary duties).

[232]*See supra* notes 39-43 and accompanying text (noting relevant distinctions between majority and minority-controlling shareholders).

[233]Kahn v. Lynch Communication Sys., Inc., 638 A.2d 1110, 1114-15 (Del. 1994) (*Lynch I*) (affirming the chancery court's conclusion that the defendant was controlling because of its domination of the corporation in previous transactions). *See supra* notes 183-86 and accompanying text.

[234]*See supra* notes 23 & 37 and accompanying text.

transaction. Although a majority shareholder normally will be in control, a majority shareholder might well cede control over a particular transaction in order to avoid the burdens that attend to being a controlling shareholder.[235] While the presumption is that a minority shareholder is not in control, however, the presumption should be that a majority shareholder is in control, with the burden on the majority to rebut this presumption.

B. *Is a Threshold Monitor Needed?*

Because the *Sinclair* test is not universally applied, the first query is whether there should be some threshold test for controlling-shareholder transactions before selecting the ultimate standard of review, or whether all such transactions should be reviewed under the entire fairness standard. This is essentially a choice between viewing all such transactions neutrally, with the usual burden on the plaintiff to disturb the presumption of propriety, or viewing such transactions guardedly, by subjecting all of them to a fairness review. As noted above,[236] a fairness review has significant costs in terms of time and predictability. Moreover, a parent corporation that has ongoing business dealings with its partially-owned subsidiary may frequently engage in routine transactions.[237] Thus, the frequency with which these costs could be incurred must be balanced against the perceived benefit: as the fairness test requires the court to closely monitor all aspects of the transaction, controlling shareholders are largely precluded from using their power to enrich themselves unjustifiably.[238]

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[235]*See supra* note 38 (identifying cases wherein the majority had ceded control over the disputed transaction). *See also* Siegel, *supra* note 3, at 407 (positing that the difficulty of proving fairness will likely induce those in control to opt out of this burden by submitting the transaction to a vote of the disinterested shares).

[236]*See supra* note 18. *See also* LARRY E. RIBSTEIN & PETER V. LETSOU, BUSINESS ASSOCIATIONS § 9.07, at 548 (3d ed. 1996) (noting a fairness evaluation of all challenged parent-subsidiary transactions "could increase the governance costs of the parent/partially-owned-subsidiary type of business association to the point where this structure might rarely be feasible"). Ribstein and Letsou noted that "this ownership structure can be useful." *Id.* at 548-49.

[237]*See supra* note 16 (discussing high frequency with which corporations transact business with their subsidiaries).

[238]*See* RIBSTEIN & LETSOU, *supra* note 236, at 549 (discussing parent-subsidiary transactions and duties of majority shareholders).

> Thus, courts considering the application of strict fiduciary duties to the controlling shareholder-subsidiary relationship must be particularly careful to balance the benefits of reducing potential agency costs against the costs of deterring the use of an ownership structure that offers special benefits, particularly in connection with the operation of the market for corporate control.

Id. Professors Ribstein and Letsou also posited that while the *Sinclair* test puts minority shareholders at greater risk of exploitation than would occur under the routine fairness review, minority shareholders receive a benefit that compensates them for this increasing risk. This benefit

Whether this benefit outweighs these costs depends both on one's view of the risks that controlling shareholders will inevitably abuse their power and on the costs if such abuse does occur.[239] *Sinclair*'s underlying premise must be either that such abuse is not inevitable, or that the costs of a routine fairness review outweigh the benefits. We have seen the Delaware case law, at times, suggest that all controlling-shareholder transactions must undergo a fairness review.[240] To the extent those suggestions represent clear holdings, however, the current Delaware law has strayed far from both prior law[241] and from good corporate policy. For example, the ALI Principles of Corporate Governance (*Principles*), for reasons of sheer impracticality, do not require the controlling shareholder to establish the fairness of every parent-subsidiary transaction; rather, the challenger bears the initial burden if the transaction is in the ordinary course of business.[242]

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is that:

> by making it easier for controlling shareholders to engage in transactions that relate to a subsidiary's business, *Sinclair* makes the acquisition of a controlling stake more desirable. This ameliorates the "free rider" problem inherent in dispersed share ownership . . . and encourages monitoring of management both by the market for corporate control, and by large shareholders after they acquire control. Thus, under *Sinclair*, shareholders trade off greater protection from exploitation by controlling shareholders *ex post* for increased monitoring of managers.

Id. at 553.

[239]DOOLEY, *supra* note 3, at 642 ("In conflict of interest situations, the choice between prohibitory and policing rules and among policing rules of varying degrees of rigor should logically depend upon the rulemaker's perception of the risk of cheating involved in the type of transaction in question.").

[240]Explicitly or implicitly, the Delaware courts have suggested this analysis for both ownership transactions, see Weinberger v. UOP, Inc. 457 A.2d 701 (Del. 1983); Citron v. E.I. Du Pont de Nemours & Co. 584 A.2d 490 (Del. Ch. 1990), and for enterprise transactions, see Kahn v. Tremont Corp., 694 A.2d 422 (Del. 1997).

[241]Prior Delaware case law has required that before controlling-shareholder enterprise transactions undergo a fairness review, there must be more than simply standing on both sides of the transaction. *See* discussion of *Sinclair*, *supra* notes 100-09 and accompanying text.

[242]*See* PRINCIPLES, *supra* note 16, § 5.10 cmt. e, at 329:

> It would be impracticable to adopt a legal rule that allowed a minority shareholder in such a subsidiary to simply file a complaint alleging that such transactions had occurred and thereby require the parent to come forward with evidence that the transactions were fair. Accordingly . . . [the *Principles*] provides that in the case of a transaction between a controlling shareholder and the corporation that was in the ordinary course of business, the party who challenges the transaction has the burden of coming forward with evidence that the transaction was unfair, whether or not the transaction was authorized or ratified by disinterested directors or disinterested shareholders. . . . If the complainant satisfie[d] the burden of production, however, the burden of persuasion is on the controlling shareholder; unless, (i) the transaction is authorized in advance by disinterested directors; (ii) the transaction is ratified by disinterested directors and the failure to obtain advance authorization did not adversely affect the interests of the corporation in a significant way; or (iii) the transaction is authorized or ratified by disinterested

The analysis thus far is neither a rejection of *Weinberger* nor an endorsement of the *Sinclair* test; it merely posits that monitoring all controlling-shareholder transactions by entire fairness is overkill. The distinction courts made prior to *Weinberger* and reaffirmed in that case of automatically subjecting controlling-shareholder mergers to a fairness review has merit. Both the gravity of that transaction's effect on minority shareholders and the relative infrequency of these events make the costs of

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shareholders . . . .

Id. (citation omitted). Thus, like *Sinclair*, the *Principles* adopt a neutral view of ordinary controlling-shareholder transactions, and place on the challenger the burden of proving unfairness or waste. *Id.* § 5.10 cmt. e, at 329. The *Principles* do not define what an "ordinary" transaction is; presumably, it is the equivalent of an "enterprise" transaction. *See* discussion *supra* note 65 and accompanying text. The *Principles* deal separately with the controlling stockholder's use of corporate assets, information, and influence, and the controlling stockholder's usurpation of a corporate opportunity. The *Principles* place the burden of proving fairness on the controlling stockholder regarding allegations that the controlling stockholder has usurped a corporate opportunity unless the transaction has received disinterested-director approval, shareholder approval, or ratification. When the controlling stockholder uses corporate assets or information or otherwise exercises influence over the corporation with the effect of obtaining an economic benefit, the *Principles* require either that value be given to the corporation or that any benefit the controlling shareholder obtains is proportionally available to other shareholders similarly situated. *See generally* PRINCIPLES § 5-10 (setting forth rules regarding transactions by a controlling shareholder with the corporation).

In presenting evidence that the transaction was unfair, the *Principles* define "fairness" as a "range of reasonableness" determined by the process followed and the price paid as well as consideration for the best interest of the corporation. *See* PRINCIPLES, *supra* note 16, § 5.02(a)(2)(A) cmt. In addition, fairness may be met in the context of ordinary-course transactions between parents and subsidiaries "by showing that the reasonably related transactions between the parent and the subsidiary, taken as a whole, did not constitute a pattern of overreaching by the parent." *See id.* § 5.10 cmt. e., at 329 It is not clear whether the party challenging the transaction that is able to meet the *Sinclair* standard would satisfy the burden imposed by the *Principles*. While exclusion and detriment would most likely be evidence of unfairness, the vagueness of the *Principles* allows for other factors that may countervail the limited *Sinclair* showing. The *Principles* have followed Delaware in requiring the challenging party to carry its burden before the court will scrutinize the transaction.

The *Principles* provide further protection of the transaction if steps have been taken to "cleanse" it: transactions that have been approved by disinterested shares foreclose a fairness review, leaving the challenger with a cause of action only for waste. In other words, the party challenging the transaction is foreclosed from presenting evidence relating to the unfairness of the transaction because the court will presume fairness if shareholders have approved the transaction. *Id.* § 5.10(a)(2), at 325. *Sinclair*, on the other hand, provides no procedural fairness test that allows a parent to cleanse a transaction with its subsidiary. In fact, disinterested share approval does not affect the *Sinclair* analysis at all because shareholder ratification does not undermine claims of exclusion and detriment. Disinterested shares could still ratify a transaction that excludes and harms them, and for the purposes of *Sinclair*, as long as there is exclusion and detriment, there is self-dealing and, thus, a need for judicial scrutiny under the entire fairness standard. In contrast, if the transaction receives approval from disinterested directors, the *Principles* do not provide a safe harbor; rather, the challenger still has causes of action for unfairness, corporate waste, or proving that the subsequent approval adversely affected the corporation's interest in a significant way. *Id.* § 5.10(b), at 325-26.

a fairness review justified. For these reasons, all controlling-shareholder ownership-claim transactions should undergo a fairness review.

For controlling-shareholder enterprise transactions, however, there should be some threshold test to evaluate which of this much larger group of transactions warrant in-depth scrutiny. Creating a threshold monitor requires identification of the concerns to be addressed. For example, one may be concerned about the controlling shareholder's motive for causing the transaction, or have more concrete concerns about the terms of the transaction. Each, however, is problematic. How can a threshold test quickly evaluate whether the terms of a controlling-shareholder transaction approximate the fair market value of the transaction? Some transactions have an added complication if they have no market equivalent,[243] or are valuable only to the particular majority shareholder. It is even more problematic for a threshold test to ascertain the motive for the transaction, i.e., regardless of whether the terms were fair, was it in the corporation's best interest to enter into this transaction? What is needed then, is a threshold test that quickly and inexpensively identifies that group of enterprise transactions which merit thorough judicial review. It is difficult to establish sensible and workable criteria to make this evaluation, however, because the concerns about controlling-shareholder transactions are both tangible and intangible.

If we posit a spectrum of threshold monitors for controlling-shareholder enterprise cases, simply standing on both sides of the transaction would be at one end of the spectrum, and the *Sinclair* test would be at the other end. *Sinclair* correctly reasoned that if the controlling shareholder is self-dealing, that shareholder should explain why such treatment is nevertheless fair. Two key issues, however, remain unanswered by *Sinclair*: (1) whether the advantage/disadvantage formulation is a good marker of self-dealing; and (2) whether only cases of self-dealing merit a fairness review.

The first open issue questions whether *Sinclair* is an effective threshold test. As applied in *Sinclair*, the advantage/disadvantage test is an ineffective monitor for *pro rata* transactions,[244] such as dividends or

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[243]*See supra* note 39.

[244]In contrast to the dividend claim where the plaintiff can never win if the *Sinclair* test is applied mechanically, a plaintiff always wins if the subsidiary and the parent are in similar lines of business and the plaintiff's claim is that the parent usurped a concrete corporate opportunity. This is because an opportunity that a parent takes for itself that could be offered to its subsidiary is always to the detriment and exclusion of the subsidiary. This is problematic given that parent corporations and their subsidiaries often engage in related businesses, thereby generating competition between the two corporations for new opportunities. RIBSTEIN & LETSOU, *supra* note 236, at 548. The reason that plaintiff lost the corporate opportunity claim in *Sinclair* was that plaintiff could not point to any tangible opportunity. Because the plaintiff will always pass the advantage/disadvantage test if there is a specific opportunity available, the defendant will have to prove the fairness of the

redemptions, as those transactions, in order to be legal, must be done per share. This is why, predictably, plaintiff's dividend claim in *Sinclair* failed to pass its threshold test.[245] Moreover, another defect of the *Sinclair* test is that it is not responsive to a plaintiff's claim in a *pro rata* transaction.[246] For example, by responding in *Sinclair* that the plaintiff received its *pro rata* share of the declared dividend, the court did not address plaintiff's allegation that the parent breached its fiduciary duties by declaring a dividend to meet the parent's need for cash, rather than what was in the best interest of the subsidiary.[247]

On the other hand, one can question whether a minority shareholder can justifiably complain about the majority's motivation if all shares are treated equally. First, if the minority and majority are treated equally, such treatment certainly is in the range of fairness, even if the majority was been motivated by what is in the corporation's best interest. Second, if the majority, regardless of its motive, has the unilateral right to liquidate the corporation[248] — a transaction wherein all shares would be treated equally — how can other *pro rata* actions that are of lesser significance, such as a dividend declaration, be found wanting?

This article suggests that while *pro rata* treatment is highly probative of fairness, *pro rata* treatment ought not to preclude all claims from further review. As a result, what is troubling about *Sinclair* is not the formulation of its test, but rather the mechanistic manner in which the court in *Sinclair* applied the test. As discussed above,[249] the court in *Sinclair* was unresponsive to plaintiff's claim that the dividend decision was motivated by interests that conflicted with the majority's fiduciary duties. The court reasoned only that the minority got its fair share — a claim that the minority had neither raised nor disputed. In contrast, when the minority claimed in *Gabelli* that the majority had withheld dividends for reasons that were inconsistent with its fiduciary duties, the court properly evaluated that claim instead of rotely responding, as it had in *Sinclair*, that all shareholders had

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transaction. This is the same result used by some jurisdictions in evaluating whether a director has improperly seized a corporate opportunity. *See, e.g.*, Durfee v. Durfee & Canning, 80 N.E.2d 522, 529 (Mass. 1948) (determining whether director seized a corporate opportunity based on what is fair in the given set of facts); Miller v. Miller, 222 N.W.2d 71, 81 (Minn. 1974) (demonstrating that, in Minnesota, the determination of whether defendant improperly usurped a corporate opportunity is done by judicial evaluation of what was fair and equitable under the circumstances).

[245]*See supra* notes 119-20 and accompanying text; *see also infra* text accompanying note 250 (discussing *Gabelli*).

[246]*See supra* note 100 and accompanying text.

[247]Sinclair Oil Corp. v. Levien, 280 A.2d 717, 721-22 (Del. 1971).

[248]DEL. CODE ANN. tit. 8, § 275(b) (1991).

[249]*See supra* note 104 and accompanying text.

been treated alike.[250] This willingness to evaluate a plaintiff's claims, rather than dismiss perfunctorily all *pro rata* transactions, provides a more meaningful threshold test.[251]

Requiring a meaningful evaluation at the threshold also ameliorates a second problem with some courts' application of the *Sinclair* test, which is that they have reformulated the *Sinclair* test to require a benefit to the exclusion of others but not to their detriment.[252] The detriment issue is then raised as part of the fair dealing prong of the entire fairness standard of review. The effect of omitting the detriment component at the threshold is that the test becomes whether the shareholders were treated equally; if they were not, then the transaction undergoes a fairness review. Unequal treatment, however, is one form of a conflict of interest, but is not as egregious as self-dealing.[253] These are related but distinct concepts.[254] Indisputably, the reformulated *Sinclair* test, which identifies only a conflict of interest, makes it easier to trigger a fairness review. Thus, if simply standing on both sides of an enterprise transaction should be insufficient to trigger a fairness review, and self-dealing should clearly warrant a fairness review, the question is whether this broad middle category of inequality of treatment should also trigger a fairness review. As described above,[255] *Nixon*

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[250]*See supra* notes 119-20 and accompanying text.

[251]See also *Bennett v. Breuil Petroleum Corp.*, 99 A.2d 236, 240 (Del. Ch. 1953), which reasoned that merely offering plaintiff his *pro rata* share of the newly authorized shares was not dispositive of the case because there were issues that the *pro rata* offering did not address. *Id.* Because the shares were offered for inadequate consideration and "plaintiff has the right not to purchase as well as the right to purchase," other purchases at the inadequate price diluted plaintiff's interest and impaired the value of plaintiff's holdings. *Id.*

[252]*See supra* notes 197-205 and accompanying text (discussing *Jedwab*); 191-211 and accompanying text (discussing *Nixon*).

[253]This is evidenced by the Delaware case law, which repeatedly defines a director conflict as standing on both sides *or* self-dealing. *See, e.g.*, Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) ("From the standpoint of interest, . . . directors can neither appear on both sides of a transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing . . . ."); *In re* Budget Rent A Car Corp. Shareholders Litig., No. 10,418, 1991 Del. Ch. LEXIS 29, at *9-10 (Del. Ch. Mar. 15, 1991), *reprinted in* 17 DEL. J. CORP. L. 220, 225 (1992) (contrasting mere conflicts of interest with self-dealing).

[254]For example, if a majority shareholder causes the corporation to engage in a transaction that benefits the majority to the minority's detriment and exclusion, that shareholder is self-dealing. In contrast, if the majority shareholder causes the corporation to engage in a transaction that benefits the majority's cousin, the majority has a conflict of interest but is not self-dealing, as the majority is not benefiting itself. Similarly, a director who acts to perpetuate herself in office has a conflict of interest but is not self-dealing. *See* Green v. Phillips, No. 14,436, 1996 Del. Ch. LEXIS 76, at *14-15 (Del. Ch. June 19, 1996), *reprinted in* 22 DEL. J. CORP. L. 360, 369 (1997). Indeed, one could have a wide array of transactions that present a conflict of interest, but without the controlling shareholder receiving a benefit to the detriment and exclusion of the minority, that transaction does not involve self-dealing.

[255]*See supra* notes 222-24 and accompanying text.

v. Blackwell presents this exact fact pattern, for the controlling shareholders received a benefit in an enterprise transaction to the exclusion but not to the detriment of the other shareholders. Because of a lack of detriment to the minority shareholders, a proper application of the *Sinclair* test would have merited review under the business judgment rule. The reformulated *Sinclair* test, based solely on inequality of treatment, however, caused a fairness review. In essence, the choice is between looking at the detriment component at the threshold, or making an evaluation of the detriment in the fair dealing analysis. These two choices, however, would not produce the same evaluation, because once the court is in fair dealing, it is allowed to look at any and all factors.[256] The scope of inquiry in the threshold test, therefore, is narrower than an inquiry under the entire fairness standard of review.

This article posits that the detriment analysis should be done in the threshold test in enterprise transactions, so that there is a limited inquiry as to whether the controlling shareholder, which has treated itself differently, has also done so to the detriment of the minority shareholder. Had the court determined at the threshold that the unequal treatment was not to the detriment of the minority in either *Nixon* or *Jedwab*, those transactions would have been subject to the business judgment rule instead of undergoing the all-encompassing fairness review.

It should be noted that, if after a meaningful evaluation at the threshold of both the exclusion and detriment requirements, a court found a controlling shareholder had received such a benefit, a court would be unlikely to find that the transaction was nevertheless fair. Given that a fiduciary is one who undertakes to act in the best interest of another,[257] it would be enormously difficult for the fiduciary to be able to prove it was fair to gain to the exclusion and detriment of the party whose interest the fiduciary was bound to protect. As a result, the advantage/disadvantage test would become highly probative of entire fairness,[258] as the test itself would provide significant evidence that the transaction was unfair.[259] Finally, once

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[256]*See supra* note 3.

[257]*See supra* note 26 (defining "fiduciary").

[258]Because the *Sinclair* test is so demanding, some jurisdictions have chosen not to follow it. *See* COX ET AL., *supra* note 25, at 254. Some courts instead require proportionate sharing of gains among the shareholders. *See, e.g.*, Jones v. H.F. Ahmanson & Co., 460 P.2d 464, 471 (Cal. 1969) ("[Any use] which . . . [majority shareholders] put the corporation or their power to control the corporation must benefit all shareholders proportionately . . . . [T]he burden is on the director or stockholder . . . to prove the good faith of the transaction [and] to show its inherent fairness . . . .").

[259]*See* Summa Corp. v. Trans World Airlines, Inc., 540 A.2d 403, 407 (Del. 1988) (holding that the parent acted unfairly by failing to place orders for its jets in a timely manner and forcing airline to enter into leases, all to the benefit of the majority shareholders but to the detriment of the

a court determines that entire fairness is the appropriate standard of review, the relative sharing — or lack of sharing — of a benefit should be probative of entire fairness. Nevertheless, the *Sinclair* test should be neither the exclusive test of fairness nor a necessary component of fairness given that fairness encompasses a wide range of factors.[260]

The suggested monitor, thus far, is that all controlling shareholder ownership-claim transactions undergo a fairness review simply by virtue of the controlling shareholder being on both sides of the transaction, and that all other claims undergo a meaningful *Sinclair* evaluation of both the exclusion and detriment prongs. The final issue, therefore, is the effect, if any, that disinterested-shareholder or disinterested-director approval should have on any of these transactions. Presumably, because *Weinberger* and its progeny allow such approval to shift the burden to the plaintiff to prove the unfairness of an ownership-claim transaction,[261] the Delaware Supreme Court should allow the same for enterprise transactions. Whether the law should go as far as the *Principles* have in permitting disinterested share approval of an enterprise transaction to eliminate any claim for unfairness, thereby leaving a claim only for waste,[262] is, however, probably more of a

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minority shareholders); Sinclair Oil Corp. v. Levien, 280 A.2d 717,720 (Del. 1971) (after applying advantage/disadvantage to the parent's failure to pursue contract claims on behalf of its partially-owned subsidiary, court found the parent's decision to be unfair). Most of the cases that use the advantage/disadvantage test were on preliminary motions. Once the plaintiff won the preliminary motion by having shown the advantage/disadvantage, the defendants usually settled, presumably because of the difficulty, under these circumstances, of proving that the transaction was nevertheless fair. *See* Smith v. SPNV Holdings, Inc., No. 8395, 1989 Del. Ch. LEXIS 46, at *6-7 (Del. Ch. Apr. 26, 1989) (holding in a motion for summary judgment that elements to invoke entire fairness were present); Schreiber v. Bryan, 396 A.2d 512, 519 (Del. Ch. 1978) (holding in a motion for summary judgment that defendant's transaction benefitted the parent to the detriment and exclusion of the minority shareholders of the subsidiary). *Cf.* Nixon v. Blackwell, 626 A.2d 1366, 1379 (Del. 1993) (demonstrating that only by using part of advantage/disadvantage test was the defendant able to show fairness); Jedwab v. MGM Grand Hotels, Inc., 509 A.2d 584, 595 (Del. Ch. 1986) (demonstrating that only by using a part of advantage/disadvantage test involved the defendant able to show fairness). *But see* Burton v. Exxon Corp., 583 F. Supp. 405 (S.D.N.Y. 1984) (using the *Sinclair* test and then finding that the transaction was fair, but the case was not appropriate for the *Sinclair* test because plaintiff and defendant owned different classes of stock, while *Sinclair* contemplates treating similarly-situated shareholders differently).

[260] *See supra* note 3. *See also* Citron v. E.I. Du Pont de Nemours & Co., 584 A.2d 490, 500 n.13 (Del. Ch. 1990) (stating that the advantage/disadvantage test, when used in the fairness analysis, is only evidence that one element of fairness exists).

[261] *See supra* note 138 and accompanying text.

[262] *See supra* note 242. In contrast to the *Principles*' treatment of "ordinary" transactions, see *id.*, the *Principles* partially follow *Weinberger* for most other transactions. Like *Weinberger*, the *Principles* impose the burden on the controlling shareholder to prove fairness whenever the controlling shareholder is on both sides of this type of transaction. PRINCIPLES, *supra* note 16, § 5.10(a)(1). Like *Weinberger*, fairness is understood to include both process (fair dealing) and price (fair price). *See id.*, § 5.02(a)(2)(A) cmt. In addition, like *Weinberger* and its progeny, see *supra* note 138, the *Principles* shift the burden to the plaintiff to prove unfairness if the transaction

conceptual issue than a real problem, at least with regard to approval by disinterested shares. Consider an enterprise transaction approved by a majority of disinterested shares: the plaintiff would then face the formidable burden of convincing a court to agree with the plaintiff on what is fair and to disregard the shareholder vote. The shareholder vote is presumably an assessment by the plaintiff's peers, after a full and fair disclosure, that they believed the transaction was fair. Under these circumstances, it is difficult to imagine a court disregarding the vote of the group of disinterested shareholders and instead siding with the plaintiff.

Given the concerns that often surround whether approval by disinterested shares or disinterested directors is truly meaningful,[263] however, the Delaware approach of leaving some leeway for judicial review is preferable to insulating the transaction from further review. As a result, this article recommends that approval by disinterested shares or by disinterested directors merely shifts the burden onto the challenger to prove unfairness, rather than insulate the transaction from any possible further review.

V. CONCLUSION

In sum, this article has proposed:

- Different presumptions about whether a person is or is not a controlling shareholder depending on whether that person owns a majority or a minority bloc of shares, but all determinations should be made on a transactional basis. Once a determination of control is made, all such transactions should be monitored alike regardless of whether they involve majority or minority ownership;
- An ownership transaction with a controlling shareholder on both sides warrants a fairness review;

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has been approved by disinterested directors. *Id.* § 5.10(b). The challenging party may also prevail by showing that the transaction constituted corporate waste or, in the case of post-transaction ratification by disinterested directors, that the subsequent approval adversely affected the corporate interest. *Id.* Unlike *Weinberger* and its progeny, however, which do not differentiate between disinterested-director and disinterested-shareholder approval, the *Principles* give greater weight to disinterested-shareholder approval, for a transaction receiving such approval is presumed to be fair. *Id.* § 5.10(a)(2). As with ordinary-course transactions, the challenging party may nevertheless show that the transaction amounts to corporate waste. *Id.* § 5.10(c).

[263] *See* Kahn v. Tremont Corp., 694 A.2d 422, 428 (Del. 1997) (noting that "even when the transaction is negotiated by a special committee of independent directors, 'no court could be certain whether the transaction fully approximated what truly independent parties would have achieved"); Citron v. E.I. Du Pont de Nemours & Co., 584 A.2d 490, 502 (Del. Ch. 1990) (noting that "[t]he controlling stockholder relationship has the inherent potential to influence, however subtly, the vote of minority stockholders"); RIBSTEIN & LETSOU, *supra* note 236, at 548 (stating that transactions between controlling shareholders and their corporations, usually cannot be approved by truly "disinterested" directors).

- A court should do a meaningful threshold inquiry regarding whether a controlling shareholder has taken a benefit to the detriment and exclusion of the other shareholders in an enterprise transaction before the controlling shareholder is required to prove the fairness of the transaction; and
- If fairness is the standard of review, approval of any type of transaction by disinterested shares or disinterested directors should shift the burden to the challenger to prove the unfairness of the transaction.

These four proposals together present a blend of the best of Delaware law's theory about controlling shareholders, to where it has drifted in reality, and the *Principles*. The first proposal — on classifying who is a controlling shareholder — is largely current Delaware law, which has, on occasion, has not been clearly and carefully applied. The second proposal is an articulation of the holdings of those cases preceding and following *Weinberger* that recognized that the significance of ownership-claim transactions warrants careful judicial scrutiny. The third proposal clarifies the most confused and inconsistent part of the Delaware case law, and provides a clear structure for monitoring enterprise transactions. This is where the controlling-shareholder case law emerged in *Sinclair*, but recently went astray in *Jedwab*, *Tremont* and *Nixon*. Finally, the last proposal extends *Weinberger's* dicta about the "cleansing" effect of approval by disinterested shares and disinterested directors. Taken together, these proposals provide an analytical framework to assess these important and complex transactions.