thereby depriving stockholders of another offer; and (4) in evaluating competing bids the defendant board of directors improperly favored a bid based on the time it would take to complete that transaction.

The class actions and a motion for class certification were filed attacking a proposed settlement of the leveraged buy out of defendant company.

The court of chancery, per Vice-Chancellor Berger, rejected the plaintiffs' objections and held that the proposed settlement was fair and reasonable. The motion for class certification was granted because the requirements of Chancery Court Rule 23 were satisfied.

1. Compromise and Settlement ⟹ 2

Delaware law favors the voluntary settlement of contested claims.

2. Compromise and Settlement ⟹ 2

The court must exercise its own business judgment and reach a determination whether the voluntary settlement of contested claims is fair and reasonable.

3. Compromise and Settlement ⟹ 57

It is neither necessary nor appropriate for the court to conduct a full trial on the issues raised in the litigation of whether a voluntary settlement of contested claims is fair and reasonable.

4. Compromise and Settlement ⟹ 2, 6(1)

The court in deciding whether a voluntary settlement of contested claims is fair and reasonable must consider: (1) the nature of the claims asserted; (2) possible defenses; and (3) the legal and factual circumstances of the case.

5. Parties ⟹ 9

In considering a motion for class certification, the court must determine, among other things, whether plaintiffs are adequate representatives of the class. DEL. CH. CT. R. 23(a).

6. Parties 11

One aspect of the "adequacy" test is whether plaintiffs' economic interests conflict with those of other class members.

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David C. McBride, Esquire, of Young, Conaway, Stargatt & Taylor, Wilmington, Delaware, and Marc Wolinsky, Esquire, of Wachtell, Lipton, Rosen & Katz, New York, New York, of counsel, for defendants B-E Holdings, Inc., ECW Acquisition, Inc., and William B. Winter.

R. Franklin Balotti, Esquire, of Richards, Layton & Finger, Wilmington, Delaware, and Sullivan & Cromwell, New York, New York, of counsel, for defendant Broad Street Investment Fund I, L.P.

Brian P. Glancy, Esquire, of Hughes & Sisk, Wilmington, Delaware, and Marshall Patner, Esquire, of Marshall Patner, P.C., Chicago, Illinois, for Burton Rosenfield.

Samuel Wenzer, Pro se.

BERGER, *Vice-Chancellor*

This is the decision on a proposed settlement of two class actions attacking a leveraged buy out of Becor Western, Inc. ("Becor") and a motion for class certification, the approval of which constitutes an integral part of the settlement. The settlement is opposed by Burton Rosenfield ("Rosenfield"), plaintiff in a pending class action attacking the same transaction in the United States

District Court for the Eastern District of Wisconsin (the "federal action"). Rosenfield objects because defendants intend to use the releases they obtain through the settlement and the judgment entered in this Court to seek the termination of the federal action. Another objector, Samuel Wenzer ("Wenzer"), is a member of the class plaintiffs seek to have certified, but is no longer a stockholder of Becor. As a result, if the class is certified and the settlement approved, he will receive no benefit from the increased merger consideration and will lose his right to pursue a damage claim based upon any losses he may have sustained by selling his stock without knowledge of defendants' allegedly wrongful conduct.

The relevant facts may be summarized as follows. Prior to 1986, Becor was in the business of manufacturing surface mining machinery, aerospace systems and components and equipment for petroleum, marine and steel industries. In late 1985, the company's board of directors authorized management to explore the possibility of maximizing stockholder values by the sale of all or part of Becor. In October, 1986, management reported to the board that the most viable method of achieving that result would be the sale of the company in two steps—first the sale of Becor's aerospace operations subsidiary, Western Gear Corporation ("Western Gear"), and then the sale of the remainder of the company's business either to a third party or through a leveraged buy out. Negotiations were then underway with a third party for the sale of Western Gear and the board was advised that BCW Acquisition, Inc. ("BCW"), a newly formed corporation organized by certain members of senior management and other investors, was interested in a leveraged buy out. The Becor board appointed a special committee of outside directors to consider the possible leveraged buy out and related matters. The special committee retained independent counsel and a financial adviser.

On February 16, 1987, after the board and special committee had met on several occasions to review these matters, Becor agreed to sell Western Gear to Lucas Industries, Inc., subject to stockholder approval, and entered into a merger agreement with BCW (now known as B-E Holdings, Inc.). The merger agreement provided that the public stockholders of Becor would receive, for each of their shares, $10.45 in cash (subject to reduction in certain circumstances) and $4.00 in principal amount of a new issue of 12 1/2% senior sinking fund debentures due April 1, 2002. The merger agreement provided that it could not be terminated prior to July 31, 1987 without the consent of the parties and Becor agreed that

it would not solicit or enter into any negotiations with any other entity concerning a possible business combination. This "no shop" provision was expressly subject to a "fiduciary out" clause allowing the Becor board to act if the failure to do so would conflict with the proper discharge of the directors' fiduciary duties.

The complaints were filed on February 18, 1987, the day after the merger agreement was announced. They alleged, generally, that the directors of Becor breached their fiduciary duties because, among other things, the merger price was grossly inadequate, the merger was wrongfully timed to follow a period of temporarily depressed earnings, and the directors did not adequately consider other possible dispositions of Becor's assets or stock. Both complaints sought an injunction restraining the effectuation of the merger.

After the merger agreement had been executed, Becor received an acquisition offer from a third party and expressions of interest from others. On May 6, 1987, the parties to the Delaware actions entered into a memorandum of understanding that included an agreement in principle to settle the litigation. The memorandum provided for certain modifications to the terms of the debentures that were to be a part of the merger consideration and provided a mechanism for an auction of Becor. B-E Holdings agreed to allow the merger agreement to be terminated prior to July 31, 1987 at the request of Becor's board if (1) Becor received a bona fide offer from a competing bidder that was determined to be more advantageous to its stockholders; (2) B-E Holdings failed to propose an alternative transaction that was at least as advantageous as the competitor's bid; and (3) the competitor agreed to honor Becor's agreement to pay Goldman, Sachs & Co. certain fees and to indemnify the investment banking firm against certain liabilities.

A special meeting of Becor's stockholders was held on June 4, 1987 at which time the Western Gear sale was approved and the vote on the original merger agreement was deferred. Between June 4, 1987 and June 25, 1987, Becor received several acquisition offers. In order to facilitate a timely evaluation of those offers and any others that might be forthcoming, the board set July 9, 1987 as the deadline for the submission of any offers. On July 16, 1987, B-E Holdings submitted a revised offer and the board met to consider the four pending offers as well as a recapitalization proposal. After the Becor board reviewed the alternative proposals with its legal and financial advisers, it determined that the new B-E Holdings offer was superior to the others and announced that the new B-E Holdings offer had been accepted in principle. In response

to that announcement, the three other bidders revised their proposals and, notwithstanding the fact that the July 9 deadline had passed, the Becor board considered those revised offers at a meeting on July 27, 1987.

The board determined that the B-E Holdings offer remained the most advantageous and on July 28, 1987 Becor entered into a merger agreement with B-E Holdings and its wholly-owned subsidiary. Pursuant to this new merger agreement, the stockholders of Becor may elect to receive either (1) $17 in cash (subject to proration in the event the holders of more than 57.5% of the outstanding shares elect the cash payment); or (2) a combination of securities consisting of (a) $3 principal amount of 12 1/2% senior notes of B-E Holdings maturing one year after the effective date of the merger; (b) $10 principal amount of 12 1/2% senior debentures of B-E Holdings due September 15, 2002; (c) .2 of 1 share of 12 1/2% Cumulative Exchangeable Preferred Stock of B-E Holdings with a liquidation preference of $25 per share; and (d) .6 of 1 warrant, exercisable between September 15 and November 15, 1992, subject to certain adjustments, to purchase one share of the common stock of B-E Holdings.

After the conclusion of the July 27 board meeting, Lynch Corporation ("Lynch") one of the defeated bidders, orally revised its offer to increase the cash portion of the consideration from $17 to $17.25. Lynch confirmed its revised offer in a letter dated July 28, 1987. Two days later Davis Mining & Manufacturing, Inc. ("Davis"), another defeated bidder, also submitted a revised offer. The new Davis offer increased the cash portion of the consideration to $17.50. By letter dated September 8, 1987, Davis advised the Becor board that its offer of July 30 remained open and that if the Becor board were willing to negotiate with Davis, a transaction that would involve a substantial financial improvement over the July 30 offer could be structured. Becor responded on September 11, 1987 stating that the board understood that all bidders were presenting their best and final offers at the July 27 board meeting and that, having entered into a merger agreement with B-E Holdings on July 28, 1987, the company was not free to negotiate an alternative merger agreement. By letter dated October 13, 1987, Davis again urged the Becor board to consider its offer and its request to negotiate.

On October 24, 1987, the Becor board met and considered both the revised Lynch offer and the revised Davis offer before deciding to recommend the adoption of the B-E Holdings merger

agreement as being fair and in the best interests of the company's stockholders. In reaching its conclusion, with the assistance of financial and legal advisers, the Becor board considered, among other things, the fact that all of the offers included a cash component and a complex package of securities of the post-merger company. Since the company would be highly leveraged after the merger, the board considered the risk associated with the securities packages proposed by each bidder. Thus, although the board recognized that the revised Davis offer (or any other transaction that might be negotiated with Davis) might result in a somewhat higher initial value to stockholders, it determined that the B-E Holdings merger agreement remained the most favorable offer in light of those risks, the delay that would necessarily result from the negotiation and consummation of an alternative transaction and other factors. At a meeting held on December 4, 1987, the stockholders of Becor approved the B-E Holdings merger by the affirmative vote of 97% of the total votes cast, or 67% of the outstanding shares.

On or about August 24, 1987, Rosenfield filed the federal action claiming that the Becor directors breached their fiduciary duties by entering into the merger agreement with B-E Holdings and failing to reopen the bidding after receiving the revised offer from Davis on July 30, 1987. On September 16, 1987, Rosenfield amended his complaint by adding a claim that defendants violated 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") by failing to disclose, among other things, Davis' July 30 bid and its expression of continued interest in September, 1987. On the same day that the amended complaint was filed, Rosenfield sought a preliminary injunction requiring the Becor board to consider all bids presented after July 28, 1987, enjoining consummation of the B-E Holdings merger and requiring defendants to make full disclosure of matters related to the transaction. Rosenfield's motion was denied by Order dated November 5, 1987. On November 12, 1987 Rosenfield again amended his complaint and again moved for a preliminary injunction. The new complaint alleged that the proxy statement disseminated in connection with the B-E Holdings merger was materially misleading, thereby violating Section 14(a) of the Exchange Act. By decision dated November 25, 1987, the federal court again denied Rosenfield's request for injunctive relief. Both decisions were appealed to the United States Court of Appeals for the Seventh Circuit and, on November 27, 1987, Rosenfield moved for an expedited appeal and injunctive relief pending appeal. Both of those motions were denied by Order dated December 3,

1987 after consideration of the parties' memoranda on the motions and Rosenfield's opening brief on appeal. The appellate court stated that the district court had carefully considered Rosenfield's arguments and that it was not likely that the district court's assessment would be reversed.

As noted earlier, Rosenfield objects to the settlement generally on the grounds that it may (and defendants expect that it will) defeat his pending claims in the federal action. In addition, he objects to the B-E Holdings merger on the grounds that: (1) there was no open and free auction of Becor because B-E Holdings was permitted to match or exceed any competitive bid; (2) the special committee of the Becor board did not function independently during the auction in June and July, 1987; (3) the Becor board arbitrarily terminated an active auction on July 27, thereby depriving the stockholders of the benefit of the Davis July 30 offer; and (4) in evaluating the competing bids, the Becor board improperly favored the B-E Holdings bid by discounting the Davis bid based upon the time it would take to complete that transaction.

[1-4] The Court's role in evaluating these objections is well settled. Delaware law favors the voluntary settlement of contested claims. *Polk v. Good*, Del. Supr., 507 A.2d 531 (1986); *Neponsit Inv. Co. v. Abramson*, Del. Supr., 405 A.2d 97 (1979); *Rome v. Archer*, Del. Supr., 197 A.2d 49 (1964). The Court must exercise its own business judgment and reach a determination whether the settlement is fair and reasonable. *Polk v. Good, supra*; *Krinsky v. Helfand*, Del. Supr., 156 A.2d 90 (1959). It is neither necessary nor appropriate for the Court to conduct a full trial on the issues raised in the litigation. Rather, the Court must consider the nature of the claims asserted, possible defenses and the legal and factual circumstances of the case. *Polk v. Good, supra*; *Neponsit Inv. Co. v. Abramson, supra*.

After reviewing the parties' submissions and the record evidence in light of these standards, I conclude that the proposed settlement is fair and reasonable and should be approved. I find it unlikely that Rosenfield would prevail on any of his four specific objections. First, in light of the fact that four different entities engaged in active bidding, I find no basis on which to conclude that B-E Holdings' option to meet or exceed the highest bid interfered with the auction process.

Second, although the special committee did not function separately during the auction process, that fact does not establish or even suggest any wrongdoing. The evidence indicates that the special committee independently considered the original management spon-

sored leveraged buy out proposal. When the auction process got underway, all proposals were considered by the full board[1] without separate review by special committee. However, a majority of the Becor board consists of outside, independent directors. As a result, I do not attach any significance to the fact that the special committee stopped functioning as such when the outside proposals were submitted and evaluated.

I find Rosenfield's argument with respect to the "arbitrary" cutoff of the auction process equally unpersuasive. The auction had been underway for several weeks and the July 30, 1987 deadline was rapidly approaching when the board determined that it would hold a meeting on July 27 and consider all of the bidders' final offers at that time. The bidders were notified of the meeting, invited to attend and told that they must make their highest and best offers at that time. Nothing about these facts casts suspicion on the board's decision to set July 27, 1987 as the final deadline.

Finally, Rosenfield objects to the fact that the board considered the amount of time it would take to consummate any transaction in evaluating the financial terms of each offer. Rosenfield argues that the B-E Holdings offer was favored by this procedure since B-E Holdings had already negotiated and prepared a merger agreement and cleared a proxy statement with respect to the first merger proposal. Thus, the B-E Holdings transaction could be consummated more quickly than any of the others. However, it is clear from the criteria set for evaluating the competing bids that Becor was attempting to determine which bid would provide the greatest financial value for its stockholders. Thus, it does not strike me as inappropriate to consider the amount of time that would be necessary to consummate a transaction in determining the overall value of each bid.

I am also satisfied that the settlement is fair and reasonable notwithstanding the possibility that it will result in the termination of the federal action. Rosenfield's state and federal law claims were considered by the District Court in two motions for a preliminary injunction and those decisions were preliminarily reviewed by the Court of Appeals in denying Rosenfield's motion for an injunction pending appeal. Both courts found, on a preliminary basis, that Rosenfield did not establish a likelihood of success on the merits.

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1. William B. Winter, the only Becor director with an interest in the B-E Holdings merger, did not participate in any of the board's deliberations.

After reviewing the federal court decisions, the November 3, 1987 proxy statement and Rosenfield's opening brief on appeal in the federal action, among other documents, I agree with those preliminary determinations. Thus, I do not find it unfair that the Becor stockholders may be giving to those claims in order to obtain the benefits of the settlement.

The remaining issue relates to the motion for class certification and Wenzer's pro se objection. The class originally proposed by plaintiffs includes all holders of common stock of Becor on any day during the period from February 16, 1987 to November 4, 1987 and their successors or transferees in interest, immediate and remote, except defendants and members of their immediate families. If the proposed class were certified, under the terms of the settlement Wenzer and others like him would be precluded from bringing a claim based upon any damages suffered by the sale of Becor stock without notice that the original merger agreement was under attack and that the company had agreed to open up an auction.

[5-6] In considering a motion for class certification, the Court must determine, among other things, whether plaintiffs are adequate class representatives. Chancery Court Rule 23(a). One aspect of the "adequacy" test is whether plaintiffs' economic interests conflict with those of other class members. *See Schreiber v. Hadson Petroleum Corp. et al.* Del. Ch., Civil Action No. 8513, Hartnett, V. C. (October 29, 1986). In this case, it could be argued that the named plaintiffs, who retained their stock, are obtaining the benefit of the enhanced merger consideration at the expense of the selling stockholders, who will receive no monetary benefit from the settlement but will be forced to release their claims nonetheless.

After the Court expressed concern about the class composition, plaintiffs submitted a letter memorandum arguing, in part, that former stockholders such as Wenzer, in fact, received more for the sale of their stock in the open market than will those class members who receive the merger consideration. This unusual result was caused by the extraordinary decline in market prices on October 19, 1987. Based upon the affidavit of Joel E. Simpson, with the exception of a few days in February and May, 1987, all Becor stockholders who sold their stock during the period from February 17 to May 6, 1987 are in a better position financially than a Becor stockholder participating in the merger. The parties to the Delaware actions have agreed to modify the class to exclude stockholders who held shares on February 16, 1987 and sold their shares during the period from February 17 to February 25, 1987 or on May 5 or 6,

1987 (the only days on which a sale would have resulted in less consideration than that which is offered in the merger)[2].

In light of these newly developed facts and the parties' agreement to limit the class as stated above, I find that the motion for class certification should be granted. Since it now appears that those selling stockholders who are members of the class have not suffered any damages, I find that their interests are not antagonistic to those of the named plaintiffs. There was never any question as to the other requirements for class certification set forth in Chancery Court Rule 23 and I find that all such requirements have been satisfied. Accordingly, the Court will enter an Order and Final Judgment in the form previously submitted by the parties upon modification of that Order to reflect the newly defined class.

SMITH v. SPNV HOLDINGS, INC.

No. 8395

IN RE APPRAISAL OF SHELL OIL CO.

No. 8080 (consolidated)

Court of Chancery of the State of Delaware, New Castle

October 28, 1987

(Revised November 2, 1987)

In January of 1984 defendants announced their intention to effectuate a short-form merger with Shell Oil Co., thereby cashing out the minority shareholders. Following this announcement a consolidated action was brought to enjoin the merger. As a result of the action, a court-approved settlement was reached and ordered on April 22, 1985. Under the order defendants would be free and

2. Rosenfield argues that the Court cannot approve the settlement for the modified class without a new notice setting forth the facts developed by Mr. Simpson. I am not persuaded that a second notice is required. The notice that was sent alerted all class members that the Court might modify the class or the settlement terms without further notice.

clear of all claims to cause the short-form merger. Following a series of appeals by a stockholder committee, including a Rule 60(b) motion, defendants accelerated the effective date of the merger, and proceeded to effectuate it one day after the committee's 60(b) motion was denied.

During the pendency of the consolidated action, Shell continued to declare and pay its regular quarterly dividend. Shell declared a dividend payable to shareholders of record; however, such dividend would not be paid to the minority shareholders if the merger took place prior to June 10, 1985. The effect of this was that Shell did not have to pay approximately $8 million and had use of the minority shareholders' equity in that amount for a quarter of a year without paying any dividend or other consideration. Plaintiffs, therefore, filed a claim asserting that defendants unfairly timed a freeze-out merger to the detriment of the minority shareholders of Shell.

The court of chancery, per Vice-Chancellor Hartnett, dismissed defendants' motion to dismiss for failure to state a claim upon which relief can be granted. Since the challenged transaction was subsequent to the transaction challenged in the former proceedings, the raising of the issue now is not barred by *res judicata*.

1. Pleading ⟹ 34(3), 354(17), 360(4)

On a motion to dismiss, the facts alleged in the complaint are taken to be true, with all inferences construed in favor of plaintiff, and the motion can only be granted where the court finds that under no set of facts would the plaintiff be entitled to recover.

2. Corporations ⟹ 584

Mere technical compliance with legal parameters does not permit inequitable conduct.

3. Corporations ⟹ 193

Unfair dealing by a controlling shareholder is not permitted regardless of the action's legality.

4. Corporations ⟹ 584

The timing of a merger to favor the majority can lead to a cause of action for unfair dealing.

5. Corporations ⟹ 584

A breach of duty would exist if the court found that the minority shareholders showed (1) that the minority was financially injured by the timing, and (2) that the controlling shareholder gained from the timing of the transaction what the majority lost.

6. Judgment ⟹ 951

A plaintiff is not permitted to relitigate his original claim if the same transaction forms the basis for a second action and the claim for relief could have been presented in the prior action.

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Clark W. Furlow, Esquire, of Lassen, Smith, Katzenstein & Furlow, Wilmington, Delaware; H. Lee Godfrey, Esquire, of Susman, Godfrey & McGowan, Houston, Texas, of counsel, for plaintiffs in No. 8080.

Richard L. Sutton, Esquire, Thomas C. Grimm, Esquire, and Lawrence A. Hamermesh, Esquire, of Morris, Nicholas, Arsht & Tunnell, Wilmington, Delaware; and Cravath, Swaine & Moore, New York, New York, of counsel, for defendants.

HARTNETT, *Vice-Chancellor*

Defendants' motion to dismiss plaintiffs' claims for failure to state a claim upon which relief can be granted must be denied. The claims of plaintiffs are based on the assertion that SPNV Holdings, Inc. unfairly timed a freeze-out merger to the detriment of the minority shareholders of Shell Oil Company. Defendants, in response, assert that plaintiffs' claims are barred by the terms of a prior court-approved settlement which compromised claims brought on behalf of the minority stockholders of Shell Oil Company. *Joseph v. Shell Oil Co.*, Del. Ch., C.A. No. 7450-NC Hartnett,

V.C. (April 19, 1985), *aff. sub.nom.*, *Selfe v. Joseph*, Del. Supr., 501 A.2d 409 (1985).

I find that the prior settlement does not bar the present claims and that plaintiffs have sufficiently stated a cause of action so as to preclude defendants' motion to dismiss.

I

The essential facts are not disputed. In January 1984, SPNV Holdings, Inc. ("Holdings"), as part of a tender offer it was making, informed the minority shareholders of Shell Oil Company that if it became the owner of over 90% of Shell Oil's outstanding shares, it would effectuate a short-form merger pursuant to 8 *Del. C.* § 253 thereby cashing out the minority shareholders at a price of $58 per share. As a result of this announcement, six actions were filed seeking to enjoin consummation of the tender offer. These suits were eventually consolidated as *Joseph v. Shell Oil*, C.A. No. 7450-NC and on February 23, 1985, a Stipulation of Settlement and Compromise was entered into. The settlement provided, in part, that Holdings would effectuate a short-form merger promptly following an "Effective Date", which was defined as a date five days after the expiration of thirty-one days after the entry of a final judgment in the settlement, if no appeal was taken, or, if an appeal was taken, five days after resolution of the appeal. If an appeal was taken, the settlement also permitted Holdings to accelerate the Effective Date at any time after expiration of the thirty-one day period.

This Court approved the Settlement on April 19, 1985, (*Joseph v. Shell*, supra) and on April 22, 1985 entered an Order and Final Judgment finding the terms of the Settlement to be fair, adequate, reasonable, and in the best interests of the Class which consisted of all the owners of the minority shares of Shell Oil Company who did not elect to opt-out of the Class and seek an appraisal. The Order and Final Judgment provided, in part, that Holdings "shall be free and clear of all claims to cause the Short Form Merger" of Shell Oil and Holdings.

On May 20, 1985, the Shell Oil Stockholder Committee ("Committee") filed a Rule 60(b) motion, seeking to set aside the Judgment on the grounds that the settlement had been the result of fraud or misrepresentation. On May 21, 1985, Edward Selfe filed a Notice of Appeal of the Settlement Judgment to the Delaware Supreme Court. On May 29, 1985, this Court held a hearing on

the Committee's Rule 60(b) motion and during the hearing a question arose as to whether this Court had jurisdiction to hear the 60(b) motion in light of Selfe's appeal of the case to the Supreme Court. On June 5, 1985, the Committee also appealed the April 22 Final Settlement Judgment and Order.

On June 6, 1985, in response to a request by defendants, the Supreme Court temporarily remanded the case to this Court to enable it to rule on the 60(b) motion. The Office of the Clerk of the Supreme Court is in Dover and the remand was sent to the Register in Chancery in Wilmington. The defendants, however, arranged to pick up a copy of the Remand Order and to have it hand delivered to my Chambers in Dover on June 6, 1985, the same day it was issued, but without indicating to me that any particular action was about to be taken by them. Also, on June 6, 1985, after receiving the hand delivered copy of the Remand, I issued a letter opinion denying the Committee's Rule 60(b) motion. On Friday, June 7, 1985, the following morning, Holdings filed a Notice of Acceleration of the Effective Date of the Settlement with the Register in Chancery and proceeded to effectuate the merger at the close of business on the same day.

During the pendency of the *Joseph v. Shell* litigation, Shell continued to declare and pay its regular quarterly cash dividend of $.50 per share, which was paid both on the majority shares owned by Shell's parent and the minority shares owned by the public. Even after Holdings obtained over 94% of the minority shares on July 31, 1984, Shell continued to declare and pay its regular cash dividend.

On May 31, 1985, Shell declared a $.50 per share dividend payable to shareholders of record on Monday, June 10, 1985. This represented the regular quarterly dividend which Shell had historically declared. The Dividend Declaration, however, stated that the dividend would not be paid to the minority shareholders if the merger of Shell into Holdings took place prior to June 10, 1985. By virtue of the merger being consummated on June 7th, therefore, the dividend of approximately $8,000,000 payable to the public shareholders of Shell became the property of Holdings. The last cash dividend paid to the minority stockholders of Shell was paid in March of 1985. The net result of this manipulation was that Shell Oil Company or its subsidiaries did not have to pay $8 million to the minority stockholders and therefore had the benefit of the use of the minority stockholders' equity for a quarter of a year without paying any dividend or other consideration.

II

[1] "On a motion to dismiss, the facts alleged in the complaint are taken to be true," *Taormina v. Taormina Corp.*, Del. Ch., 78 A.2d 473, 474 (1951), with ". . . all inferences . . . construed in favor of plaintiff . . .," *Jefferson Chemical Co., Inc. v. Mobay Chemical Co.*, Del. Ch., 253 A.2d 512, 516 (1969), and the motion can only be granted ". . . where the court finds that under no set of facts would the plaintiff be entitled to recover.", *McQuail, et al., v. Shell Oil Co., et al.*, Del. Ch., 183 A.2d 581, 583 (1962).

III

In support of their motion to dismiss, the defendants claim the Order and Final Judgment in the *Joseph* action, by its terms, precludes the present plaintiffs from maintaining a claim based on a breach of fiduciary duty. In the alternative, defendants claim that the doctrine of *res judicata* precludes plaintiffs' present claims.

The Order and Final Judgment provides, in part,

> "5. Consolidated Civil Action No. 7450 and Civil Action No. 7699, the complaints therein and all the Settled Claims which were asserted in any of or all the Delaware Actions, including any claims of intervenors, are dismissed with prejudice as to all defendants, *and Holdings, as the holder of more than 90% of the Shares, shall be free and clear of all claims to cause the Short-Form Merger of the Company with Holdings or a subsidiary of Holdings at a merger price of $58 per Share,* except, in accordance with the Stipulation, for any claim for appraisal (exclusive of any claim for any unfair dealing or violation of fiduciary duty) not waived as provided for herein which plaintiffs and members of the Class may have and which may be perfected hereafter for a determination of the fair value of their shares of the Company at the Merger Date." (emphasis added)

[2-3] Defendants argue that this language precludes any judicial inquiry into defendants' actions. Mere technical compliance with legal parameters, however, does not permit inequitable conduct. *Weinberger v. UOP, Inc.*, Del. Supr., 457 A.2d 701 (1983). Unfair dealing by a controlling shareholder is not permitted regardless of the action's legality. *Rabkin v. Philip A. Hunt Chemical Corp.*, Del. Supr., 498 A.2d 1099 (1985); *Schnell v. Chris-Craft Industries*, Del. Supr., 285 A.2d 437 (1971).

[4] Several Delaware cases have held that the timing of a merger to favor the majority can lead to a cause of action for unfair dealing. In *Roland Intern. Corp. v. Najjar*, Del. Supr., 407 A.2d 1032, 1037 (1979) the challenged merger presented "a classic 'going private' transaction, with the majority having complete control over the timing of the 'squeeze play' on the public stockholders". The Delaware Supreme Court stated that "this type of merger calls for the strictest observance of the law of fiduciary duty."

In *Rabkin v. Philip A. Hunt Chemical Corp.*, supra, the defendant, in acquiring majority control of a corporation, agreed to pay $25 net for the minority shares if they were purchased within one year after the acquisition of a majority of the shares. The majority shareholder then waited until shortly after the lapse of one year and purchased the minority shares at a price less than $25 per share. After this Court granted a motion to dismiss, the Delaware Supreme Court reversed and held that the manipulative timing of the cash-out merger after the one year period might constitute unfair dealing and that plaintiffs had stated a cause of action for breach of fiduciary duty, although the agreement between the parties permitted the majority stockholder to purchase shares at any price after one year.

[5] Most recently in *Jedwab v. MGM Grand Hotels, Inc.*, Del. Ch., 509 A.2d 584 (1986), Chancellor Allen addressed the issue of unfair dealing in the timing of a merger by a majority shareholder. In *Jedwab*, a minority shareholder sought to enjoin the merger between the majority shareholder and the corporation. Although not finding the timing to be manipulative, the Court set forth a "prototype instance in which the timing of a merger would itself likely constitute a breach of a controlling shareholder's duty." The Court held that a breach of duty would exist if the Court found that the minority shareholders showed "(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 majority lost."

The present allegations fit the *Jedwab* prototype of a majority shareholder's breach of a fiduciary duty through unfair dealing to the minority shareholders. The retention of corporate dividends equalling approximately $8,000,000 and the failure to compensate the minority for the use of their money financially injured the minority shareholders. The record date for dividends was June 10th, the next business day after the effective date of the merger,

thus indicating that June 7, 1985, the merger date chosen by Holdings, was an "especially poor time to be required to liquidate". *Jedwab*, supra, at 599. Conversely, Holdings gained by being able to retain the $8 million dollar dividend payment. Holdings' claim, therefore, that it had an absolute right to effect the merger at any time is directly contrary to the holdings in *Rabkin* and *Jedwab*.

IV

Defendant also argues that a declaration of a dividend is, as a matter of law, solely the prerogative of a Board of Directors. It strongly relies on *Lewis v. Leaseway Transportation Corp.*, Del. Ch., C.A. No. 8720-NC, Hartnett, V.C. (June 12, 1987). That reliance is misplaced. In *Lewis*, I merely stated that "The declaration of a dividend, of course, is *ordinarily* the sole prerogative of the Board of Directors" (emphasis added). The statement on its face does not state that a Board has untrameled power to declare or not declare a dividend. Cf. *Gabelli & Co., Inc. Profit Sharing Plan v. Liggett Group, Inc.*, Del. Supr., 479 A.2d 276 (1984). In any case, the holding was *obiter dicta* because the issue before the court was not whether a dividend was declared improperly but whether there had been adequate disclosures in a proxy statement.

More importantly, however, the issue of the right to declare a dividend is not relevant to the present claims because the issue is the alleged improper timing of the merger—not the failure to declare a dividend.

V

In further support of its motion to dismiss, the defendants claim that the doctrine of *res judicata* bars the claims now being asserted.

[6] In *Maldonado v. Flynn*, Del. Ch., 417 A.2d 378, 383 (1980), this Court held that a plaintiff is not permitted to relitigate his original claim if the same transaction forms the basis for a second action and the claim for relief could have been presented in the prior action.

The short-form merger under challenge occurred on June 7, 1985, after the April 22, 1985, Final Judgment and Order and the issue before me is whether the timing of the short-form merger constituted unfair dealing by the majority shareholder.

The challenged transaction (the merger) did not take place until one and one-half months after the entry of the prior Final

Judgment and Order approving the Settlement. It therefore could not be the same transaction which was disposed of in the Settlement, nor could a challenge to it have been presented in the prior proceedings.

VI

In summary, the totality of the circumstances surrounding the timing of the Short-Form Merger indicates that a breach of fiduciary duty could have occurred and therefore plaintiffs have stated a cause of action sufficient to defeat defendants' motion to dismiss. Moreover, the challenged transaction was subsequent to the transaction challenged in the former proceedings and the doctrine of *res judicata*, therefore, cannot bar the raising of these issues now. The motion to dismiss of defendants is therefore denied.

IT IS SO ORDERED.

SOLASH v. TELEX CORP.

No. 9518

RICHMAN v. TELEX CORP.

No. 9528

SIMON v. TELEX CORP.

No. 9525

Court of Chancery of the State of Delaware, New Castle

January 19, 1988

Plaintiffs, public shareholders of Telex Corporation, sought a preliminary and permanent injunction against the closing of a tender offer. Plaintiffs allege that the board of directors of Telex breached its fiduciary duty to the shareholders by not bringing the shareholders the highest available price, by relying on the advice of an investment banking firm which had a conflict of interest, and by disseminating materially false or misleading information regarding the offer.

The court of chancery, per Chancellor Allen, held that the business judgment rule applied and found that the defendants had acted in good faith and had not breached their fiduciary duty to the shareholders.

1. Corporations ⟹ 310(1)

The duty of loyalty is transgressed when a corporate fiduciary, whether director, officer, or controlling shareholder, uses his or her corporate office or, in the case of a controlling shareholder, control over corporate machinery, to promote, advance, or effectuate a transaction between the corporation and such person (or an entity in which the fiduciary has a substantial economic interest, directly or indirectly) and that transaction is not substantively fair to the corporation.

2. Corporations ⟹ 310(1), 320(11)

Because businessmen and women are correctly perceived as possessing skills, information, and judgment not possessed by reviewing courts and because there is great social utility in encouraging the allocation of assets and the evaluation and assumption of economic risk by those with such skill and information, courts have long been reluctant to second-guess such decisions when they appear to have been made in good faith.

3. Corporations ⟹ 310(1)

Only if the process is grossly negligent may liability for damage resulting from a good faith decision be found.

4. Corporations ⟹ 310(1)

While the business judgment rule has been called a presumption, the Delaware supreme court has made it clear that, at least where the complaint arguably alleged a conflicting directorial interest, the presumption only arises once the directors have initially established that their decision was made in good faith and upon reasonable investigation.

5. Corporations ⟹ 310(2)

A reasonable investigation is one that is not grossly negligent.

6. Corporations ⟹ 310(2)

To support an inference of bad faith, the decision has to be so grossly off the mark as to amount to "reckless indifference" or a "gross abuse of discretion."

7. Corporations ⟹ 190

A corporate fiduciary, including a controlling shareholder, owes to minority shareholders a state law duty of complete candor when it extends a public offer to purchase stock in the corporation.

8. Corporations ⟹ 307

One who knowingly participates with a fiduciary in a breach of trust renders himself liable to the injured beneficiary.

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Esquire, of O'Sullivan Graev & Karabell, New York, New York, of counsel, for defendant George Partners, Inc.

ALLEN, *Chancellor*

In these related class actions, plaintiffs, who purport to represent the public shareholders of Telex Corporation, a Delaware corporation, seek preliminary and permanent injunctive relief against the closing of a tender offer for 90% of the shares of Telex's common stock. The offer is being made by George Partners, Inc. ("Partners"), a Delaware corporation and a wholly-owned indirect subsidiary of Memorex International N.V., a Netherlands corporation (together "Memorex"). Memorex is not affiliated, through stock ownership or otherwise, with Telex, but its offer has been negotiated with and recommended by Telex's board of directors.

The matter is before the court on an application to preliminarily enjoin the taking down of tendered stock which is presently scheduled to occur no earlier than midnight January 19, 1988. Plaintiffs assert that this relief is justified because the transaction constitutes a breach of fiduciary duty on the part of the Telex directors in which Memorex has knowingly participated. More specifically, plaintiffs claim that the Telex board, in negotiating its endorsement of the Memorex offer, has made no good faith or appropriately deliberative effort to arrange a transaction that would yield to the shareholders the highest available price, has abandoned its duty by knowingly relying upon the investment banking firm of Drexel Burnham Lambert, Inc. which had a clear and palpable conflict of interest, and has permitted or assisted in the dissemination of an offer to purchase by Memorex that is materially false or misleading.

I.

The grant or denial of a motion of this sort calls for the exercise of discretion. The judgment required involves several elements. The strengths and weaknesses of plaintiffs' claim as they appear from a preliminary evaluation of the paper record is, of course, a key aspect under the traditional practice.[1] Irreparable injury that is

1. It is perhaps worthy of note that the recent cases in England have seemed to abandon this element of the test for preliminary injunction. In England it now seems to be the law that the issuance of an interlocutory injunction turns

threatened to plaintiffs if the relief is not granted is, of course, the *sine qua non* of the remedy. The final factor is the balancing of prospective harms. That is, the court must try to evaluate the risk to and the impact upon plaintiff of the irreparable injury with which she is threatened and balance that against the prospect that the defendant or third parties may be wrongfully injured if the relief is improvidently granted. Operations of this kind are obviously not merely technical and certainly not scientific.

In this instance, I conclude that entry of the relief sought threatens greater injury to Telex shareholders than potential benefits. This is not a case, such as *MacAndrews & Forbes v. Revlon, Inc.*, Del.Ch., 501 A.2d 1239 (1985) (bidder for corporation entitled under the circumstances to preliminary injunction of lock-up option benefitting rival suitor), *aff'd* Del.Supr., 506 A.2d 173 (1986) or *AC Acquisitions v. Anderson, Clayton & Co.*, Del.Ch., 519 A.2d 103 (1986) in which the granting of a preliminary injunction, justified on the substantive claims, permitted shareholders to have the benefits of a competing offer. Here, to enjoin completion of the pending tender offer threatens the sole outside opportunity that the shareholders have for a change-in-control transaction at a substantial premium. That prospect was developed after a canvass of some fifty firms failed to uncover any active interest in acquiring the company at prices reflecting a comparable premium to that being offered by Memorex. The sole alternative to the Memorex $61 deal is a recapitalization transaction described below. There is some basis in the record to conclude that Drexel Burnham regards the two transactions as constituting comparable value. But the alternatives are nevertheless quite different (*e.g.*, the Memorex transaction involving $56 in cash and the recapitalization $45 in cash). As our recent cases of *Hecco Ventures v. Sea-Land Corp.*, Del.Ch.,

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largely on the question of irreparable injury and a balancing of the hardships. On the merits, the test for the issuance of a preliminary injunction is satisfied by a determination that the action is not frivolous. This approach is "designed to circumvent the necessity of deciding disputed facts or determining points of law without hearing sufficient argument." *Smith v. Inner London Education Authority* [1978] 1 All E.R. 411, 426. As to the change in approach, *compare J.T. Stratford & Sons, Ltd. v. Lindley* [1965] A.C. 269, 338 *with American Cyanamid Co. v. Ethicon, Ltd.* [1975] A.C. 396; (1975) 38 M.L.R. 672 (A. Gore). This newer English approach, which looks primarily to irreparable injury and balance of the hardships, is reminiscent of my understanding of the test applied by our courts on motions for temporary restraining orders. *See, e.g. U.I.S. v. Walbro*, Del.Ch., Civil Action No. 9323, Allen, C. (October 5, 1987).

Civil Action No. 8486, Jacobs, V.C. (May 19, 1986) and *Freedman v. Restaurant Associates*, Del.Ch., Civil Action No. 9212, Allen, C. (October 16, 1987) indicate (and in this they are only the most recent such cases), it would only be with hesitation and upon a conviction that strong grounds existed for doing so, that a court would act to threaten to deprive shareholders of a transaction that could very well be a preferred one and which a disinterested board has recommended. On the merits of the claims asserted, I have at this time no such conviction.

Accordingly, I will deny the pending application. A more refined statement of the reasoning requiring this result in my own mind must await a description of the Memorex transaction and the history out of which it evolved, including the unsolicited offer of Mr. Asher B. Edelman.

II.

On October 9, 1987 things changed for Telex. On that day Asher Edelman, through a corporation called TLX Acquisitions Corp., commenced an unsolicited tender offer for all of the outstanding shares of the Company at $65 per share cash, subject to several conditions including the arranging of satisfactory financing. At the end of September, Telex stock had been trading at about $60. During the first eight days of October, Telex stock rose steadily, closing on October 8—the day before the announcement of Edelman's offer—at $61. On the day of that announcement, Telex closed at 70-3/8 from which price it gradually receded until the market break on October 19. On the 20th, it closed at 34-1/4.

Telex was not slow in its reaction. It first retained Drexel Burnham Lambert, Inc. ("Drexel"), with whom it had had a continuing investment banking relationship, to advise its board. The full Telex board met on October 16, 1987 at which meeting Drexel expressed the "tentative" view (Hannan Aff. ¶ 7) that Edelman's $65 per share offer was "in all likelihood" inadequate. The directors decided to defer a decision as to what course they would recommend to Telex's shareholders and authorized Drexel to explore possible alternatives to Edelman's offer.

A few days later, on October 19, 1987, the stock market experienced an historic break in prices. Mr. Edelman's "offer" seems to have provided a remarkably skinny cushion for Telex's stock as it fell from a closing price of $62-1/8 on the 16th to a closing price of $34-1/4 on the 20th.

Immediately following Monday's crash, the Telex directors attended a special meeting at which the board adopted an "Interim Safeguard Rights Plan" (the "Rights Plan"). That Plan is said to have been designed to give Telex time to maximize shareholder value by preventing open market purchases of large numbers of shares (*i.e.*, "street sweeps") to take advantage of the depressed nature of the stock market.

Under the 120-day Rights Plan, one right was distributed as a dividend with respect to each Telex share of common stock as of October 20, 1987. When triggered, each right gives the holder the option to buy a Telex share for $2. The Rights would be triggered when an individual or group garnered at least 15% of Telex's shares, unless the shares were acquired either through an agreement with Telex's board for the acquisition of all of Telex's shares, or, in the alternative, through an all-cash tender offer for all outstanding common stock of Telex for no less than $65 per share. Thus, by their terms, the rights did not create an obstacle to the consummation of Edelman's offer, since his all-cash tender offer for all shares had a price of $65 per share.

Having taken immediate action in response to the market crash, the board met again two days later. At that meeting, Drexel reported that in light of the disturbed market conditions, it would be unable to render an opinion whether the $65 price offered by Edelman was adequate or not from a financial point of view. In light of this advice and the unusual market conditions themselves, the board decided it could take no position on Edelman's proposal. Drexel was instructed to continue its exploration of possible alternative types of transactions.

That exploration effort was apparently pursued with diligence. Drexel advised the board that three alternatives to the Edelman transaction appeared feasible: a "white knight" transaction, a management-sponsored leveraged buy-out and a recapitalization. The alternative of doing nothing seemed unavailable; since Edelman's action was seen as putting the company "in play," it was not to be expected that shareholder interests were not going to be fundamentally affected in some way regardless of whether the board acted or not.

Drexel prepared an information book and contacted 50 potential purchasers to explore whether there was sufficient interest to move to a discussion phase with fuller information. Of these, seven firms indicated enough interest to sign a confidentiality and standstill agreement and were furnished with confidential information. Of

these, only two had an interest strong enough to lead to discussions with Telex management. One of these quickly dropped out of consideration. The remaining interested party was Memorex, a company whose lines of business made it a particularly good fit with Telex.

Stephen Jatras, Telex's CEO, and George Bragg, a senior officer of the company, met with Memorex very early on. The first meeting was on October 23, 1987 at which the businesses of the two firms and their strategic fit were broadly discussed. Memorex indicated that if it were interested in Telex, it would be in the firm as an operating entity and not as a "bust-up" proposition. Therefore, it said it would regard the current management and staff as an important part of its acquisition.

Another meeting was held the following week and, at that meeting, Memorex, apparently taking the initiative on the subject, (Jatras Aff. ¶ 9) stated that if it were to acquire Telex, it would put in place a Memorex stock compensation scheme designed to put Telex officers in a position similar to Memorex's current officers with respect to ownership of Memorex's stock. Tax implications of such a program were discussed.

The board met again on November 4. Drexel gave a report on where its canvass of the market for a possible alternative transaction stood. The Edelman offer was to expire on November 5 and had not yet been extended. Mr. Edelman had not announced that he had arranged the financing necessary to close his offer. Based on this fact and continuing uncertainty in the stock market and other factors, the board elected to continue to take no position on Edelman's nominal $66 offer. Given the paucity of "white knight" alternatives, the board on November 4 authorized Drexel to proceed to develop a plan of recapitalization in the event Edelman's offer was not consummated promptly.

On November 5 Edelman announced a four-day extension of his offer. On November 9 he extended it until November 20 and confirmed that he had not yet arranged financing. On November 10, the Company announced that it was preparing documentation to present a recapitalization alternative to the shareholders. The recapitalization transaction would involve (i) a $45 cash dividend, and distribution of (ii) junior subordinated debentures due 2003 with a face amount of $15 together with (iii) a stub share in the resulting, highly-leveraged company. Drexel was of the "view" (which it asserts is different from its presumably, in its own view, more reliable "opinion") that such a package might have a value

to shareholders of between $57 and $61 per old share during the initial distribution period and a value of perhaps $65 or more thereafter. *See* Hannan Aff. ¶ 13. *Compare* Jatras Aff. ¶ 13. This position was given to the board while Edelman's alternative was still at $65 and thus had the effect, and one would be surprised if it were not the principal intended effect, of supplying the board, if need be, with a basis to recommend the recapitalization in preference to the Edelman proposal. The plaintiffs in this suit now rely heavily upon this Drexel view of the value of the recapitalization transaction to argue that the board, in endorsing the Memorex transaction—which offers a blended value of about $61—has closed its eyes to an opportunity to maximize shareholder values represented by the recapitalization transaction. But this will be discussed later.

Apparently responding to the public announcement of the recapitalization option on the 10th of November, Edelman the next day announced he was reviewing all aspects of his conditional offer. On November 20 that offer was extended to the 25th. Also on the 20th and the following day, representatives of Mr. Edelman met with Telex officials at the suggestion of TLX. The subject was the possibility of terminating the Edelman offer. Edelman sought payment of expenses to do so. No agreement was reached.

On November 25 the Edelman offer was revised. It now provided for the purchase of approximately 72% of Telex stock at a price of $55 per share. The new proposal included a "back-end" merger in which the consideration would be junior debentures and common stock designed to have a value of $55. Thus, on a blended basis, the revised proposal offered $39.60 in cash and securities intended to be worth $15.40.

On December 1, Messrs. Jatras and Bragg met again with Memorex and from that time through a meeting on the 5th at which the price was agreed upon, a series of meetings or negotiations were held. During this period, Telex continued to be assisted in the negotiations by Drexel. The role of the Drexel representative is contested, plaintiffs claiming that Drexel negotiated the price and defendants contending that it assisted. It was disclosed that Drexel owned 10% of Memorex, but this palpable conflict of interest was not deemed by Drexel or its employer as disabling.

The transaction that Memorex had in mind had a cash component and a securities component. The ranges of value of the two components was apparently arrived at during discussions between Drexel and Memorex's advisor. Prior to the final December 5

negotiating session, Mr. Jatras was informed that Memorex was considering a range of $54-$56 in cash and $4-$6 in securities. At that final session, agreement was reached on the following transaction.

Memorex would tender for 90% of Telex's shares at $62 per share cash with a follow-up merger in which the non-tendering shares (or shares that by reason of proration were not accepted in the tender offer) would be converted into a new class of redeemable, exchangeable preferred stock that would be so constructed as to have an estimated market value (as of December 12, 1987) on the complex conversion formula used, of $51.65 per old share, if all shares are tendered. Thus, assuming that all shares are tendered, the blended cash component is worth $55.80 (.90 x $62) and the securities component should be worth about $5.16 ($51.65 x 10%) and the total per share value is approximately $60.96. The total cost of the acquisition would be approximately $894,000,000.

On December 6 Memorex submitted to the Telex board a written proposal along the foregoing lines. The Telex board met on December 6 and again on the 11th and 12th. At the meeting on the 6th, the board reviewed the revised Edelman offer in light of a written opinion from Drexel that the revised proposal was inadequate from a financial point of view. The board determined at that time to recommend that the shareholders reject the Edelman offer. Because the inadequate Edelman offer was seen as continuing to reflect a threat to shareholder interests, the board also determined at that time not to redeem the shareholder rights issued pursuant to the Interim Safeguard Rights Plan.

On December 7, Telex publicly announced that Memorex had made a proposal to acquire all of Memorex's shares for a package of $56 in cash and junior preferred stock worth $5 for each share. The market price of Telex stock reacted dramatically. By the close of trading on that day, the price of Telex stock had soared $9.75 per share from the previous close to $51-1/2 per share. (Berman Aff. ¶ 10; de Boisblanc Aff., Vol. 2, Tab 2).

During the period between December 6 and the next board meeting of December 11, documentation for a proposed Memorex transaction was negotiated. In that connection, a stock incentive program for selected continuing officers and employees of Telex was also negotiated.

That program contemplated a payment to officers and employees of Telex who would be retained in Telex following the proposed merger. That payment would be in the form of Memorex

stock, but rights to such stock would "vest" only over time as the officer or employee continued his or her employment. The formula for vesting is that 25% of the allocated Memorex stock vests on April 1, 1988 and the remainder vests, I understand, at the rate of 2.08% per month for each of thirty-six months so that only at the end of a 36-month period is all of the stock vested. One hundred thousand shares of Memorex stock are agreed to be contributed for this purpose and a sum of cash to pay tax bills that will increase as a result of such award. As Memorex stock currently trades at approximately $170 per share, plaintiffs calculate the total value of the cash and securities involved as approximately $25 million. While disagreeing with the pertinence of plaintiffs' calculation, defendants point out that, in any case, the cost to Memorex is very substantially less due to the tax treatment of such payments. In all events, these stock incentive payments are to be made to persons designated by Telex management and include as eligible persons three officers of the company who serve on the company's board of directors.

On December 11 and 12, the Telex board met to consider the various alternatives open to the Company. The board that was in place throughout this period and which acted on the Memorex proposal was comprised of ten members, only three of whom were officers of Telex. At these meetings, Drexel reviewed the situation to date and advised the board that the Edelman proposal was inadequate in its view and that, while there were material differences between the recapitalization proposal and Memorex's proposal, those two proposals were "from the standpoint of value. . .reasonably comparable and that both were fair to shareholders from a financial point of view." (Hannan Aff. ¶ 19). In addition, the board, aware of Drexel's conflicting interest, had retained the firm of Wertheim, Schroder & Co., Incorporated. That firm also delivered a written opinion that the consideration offered in the tender offer-merger transaction was fair to Telex shareholders.

The board recessed on the 11th without acting. Following further deliberations on the 12th, the board unanimously adopted a resolution endorsing the Memorex proposal and recommending that Telex shareholders tender into the offer when made.

On December 14, the Company settled certain pending litigation with Mr. Edelman. As part of that arrangement, Telex paid Edelman $9.47 million as a reimbursement of fees and expenses incurred in his effort to gain control of the Company. The Edelman offer—which, so far as the world could tell, had never succeeded in getting the required financing—was then terminated. Mr. Edel-

man then withdrew, presumably to groves of academe to instruct the young.

The Offer to Purchase was distributed on December 18, 1987. The complaint in this action was filed on December 29, 1987. Following expedited discovery, a motion to preliminarily enjoin the scheduled January 19, 1988 closing was heard on January 14.

III.

While plaintiffs might characterize their theories of liability differently, as I understand their assertions, they involve two basic theories of substantive liability. The first contends that the facts disclose an abandonment of its duty by the outside majority of the Telex board in circumstances in which the company's fate was thereby placed in the hands of an interested minority of the board which was guided and, in important respects (price), controlled by an investment banking firm which itself had an intense conflict of interest. The result of all of this was the recommendation of the Memorex transaction when, so runs the argument, the alternative recapitalization transaction was available, which defendants' own expert at one time indicated had a greater value than that which it now views the Memorex transaction as being worth. The second liability theory proffered relates to the quality of the disclosure in Memorex's Offer to Purchase and is discussed below.

[1] Plaintiffs characterize their "abandonment of responsibility" argument as both a breach of loyalty and of care. The distinction, of course, can be very material in our law. Even accepting plaintiffs' view of the facts, however, they do not in my opinion state a claim for a breach of the duty of loyalty on the part of the dominating outside majority of the board. Without intending to necessarily cover every case,[2] it is possible to say broadly that the duty of loyalty is transgressed when a corporate fiduciary, whether director, officer or controlling shareholder, uses his or her corporate office or, in the case of a controlling shareholder, control over corporate machinery, to promote, advance or effectuate a trans-

2. *See, e.g., AC Acquisitions, supra,* where the entrenchment effect of the challenged transaction and its failure to meet the test of *Unocal Corp. v. Mesa Petroleum Co.*, Del.Supr., 493 A.2d 946 (1985) led to the conclusion that the timing of that transaction constituted a breach of duty, even if determined carefully, and led to the holding that a breach of the duty of loyalty had been made out preliminarily.

action between the corporation and such person (or an entity in which the fiduciary has a substantial economic interest, directly or indirectly) and that transaction is not substantively fair to the corporation. That is, breach of loyalty cases inevitably involve conflicting economic or other interests, even if only in the somewhat diluted form present in every "entrenchment" case.

But the Memorex transaction does not involve allegations of self-dealing of any sort by the majority of the board. Thus, assuming that that majority acted in good faith and in an appropriately deliberative way, its action in approving and recommending the Memorex transaction is entitled to the deference that the law pays to the substantive choices of corporate directors. It is really this question—have the directors exercised good faith and requisite care in proceeding to this point—that the plaintiffs raise on the merits. Where there is no adverse financial or personal interest such as an alleged entrenchment motivation or effect, that question unquestionably implicates not the directors' duty of loyalty, but the duty of care.

What then of the claim of breach of duty of care? For the reasons that follow, I am currently of the view that plaintiffs have not established a reasonable probability of success with respect to this claim.

A.

[2-3] Because businessmen and women are correctly perceived as possessing skills, information and judgment not possessed by reviewing courts and because there is great social utility in encouraging the allocation of assets and the evaluation and assumption of economic risk by those with such skill and information, courts have long been reluctant to second-guess such decisions when they appear to have been made in good faith. Thus, for example, a good faith decision by a disinterested board cannot be the source of director liability even if the process by which the decision was made was arguably negligent. In order to prevent second-guessing on what might be close questions concerning the appropriateness of the process by which a business decision was made, the law has set a high standard. Only if the process is grossly negligent may liability for damage resulting from a good faith decision be found. *See, e.g.*, *Aronson v. Lewis*, Del.Supr., 473 A.2d 805, 812 (1984); *Smith v. Van Gorkom*, Del.Supr., 488 A.2d 858 (1985).

[4] This demanding substantive test is bound-up with the so-called business judgment rule. As made clear in a number of recent

opinions by our Supreme Court, the business judgment rule has both a procedural and a substantive element. While the rule has been called a presumption, the Supreme Court has made it clear that, at least where the complaint arguably alleged a conflicting directorial interest, the presumption only arises once the directors have initially established that their decision was made in good faith and upon reasonable investigation. *See Aronson*, 473 A.2d at 812; *Unocal*, 493 A.2d at 954; *Ivanhoe Partners v. Newmont Mining Corp.*, Del.Supr., ___ A.2d ___ (November 18, 1987) (slip op. at 15).

Whether the business judgment rule is called into play by such a showing or by the disinterested nature of the board's involvement (*see Smith v. Van Gorkom*, Del.Supr., 488 A.2d 858, 872 (1985) (party attacking disinterested board action has burden to show lack of good faith or gross negligence), once applicable, the "presumption" has a powerful substantive effect. There will be no personal liability for a transaction, nor will equitable relief issue, unless the "presumption" is rebutted by plaintiffs. In an interested transaction, plaintiffs may do so by overcoming the defendants' evidence of good faith or of the reasonableness of the process upon which the "presumption" rests; that is, by proving by a preponderance of the admissible evidence that there was no good faith (for example, by proving that the directors in a takeover defense situation were primarily or solely motivated by personal, entrenchment concerns) or that the directors did not perform a reasonable investigation before exercising their judgment.

The question, what constitutes a reasonable investigation in any particular context, is a question the answer to which benefits from, if it does not require, substantive knowledge and expertise. Information is not without costs of various kinds. Whether the benefit of additional information is worth the cost—in terms of delay and in terms of alternative uses of time and money—is always a question that may legitimately be addressed by persons charged with decision-making responsibility. This observation leads to one of the points of connection between the substantive rule of liability (gross negligence) and the procedural/substantive business judgment rule.

[5-6] In preliminarily evaluating whether the party with the burden is likely to meet that burden with respect to the reasonableness of the investigation, it is the gross negligence standard that is applied.[3] Thus, a reasonable investigation is one that is not

3. Where the intermediate form of review established by *Unocal* is required,

grossly negligent. *Smith v. Van Gorkom*, 488 A.2d at 873. The same is true in the case of the good faith requirement. While bad faith may be established in any number of ways, to the extent plaintiffs seek to show bad faith as an inference from conduct that is simply negligent (such as, arguably, reliance upon an investment banker with a material conflict of interest), they must fail. Rather, to support such an inference, the decision has to be so grossly off-the-mark as to amount to "reckless indifference" (*Allaun v. Consolidated Oil Co.*, Del.Ch., 147 A. 257, 261 (1929) or a "gross abuse of discretion" (*Warshaw v. Calhoun*, Del.Supr., 221 A.2d 487, 493 (1966) and *Moskowitz v. Bantrell*, Del.Supr., 190 A.2d 749, 750 (1963)).

With these thoughts in mind, I turn to a discussion of the facts of this case.

B.

A preliminary analysis suggests that plaintiffs have failed now to establish a reasonable probability of overcoming the presumption of sound business judgment and that, as a consequence, they appear reasonably unlikely to prevail at trial. Moreover, even were I to treat this as an interested transaction for some reason, I would not evaluate that likelihood differently at this time.

As to the requirement of good faith, it is pertinent that seven of the ten directors of Telex are outside directors with no interest in Memorex or in employment with Telex after the merger. This factor does not, of course, establish good faith, but it is relevant that no personal motivation of theirs inconsistent with good faith has been advanced. *Polk v. Good*, Del.Supr., 507 A.2d 531 (1986).

Second, the board followed a process that appears in all respects appropriately deliberative. It retained expert advisors and directed them to evaluate the Edelman offer and alternatives to it. It probed the market for control transactions in a way that gave reasonable assurance that all third-party possibilities had been explored. It authorized planning for a recapitalization option. It met frequently to hear reports from management and the specialists retained to assist the board. There were at least 8 board meetings on this

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an additional or at least different element of balance must be satisfied before the benefits of the business judgment rule may be availed. *See Ivanhoe Partners v. Newmont Mining Corp.*, Del.Supr., ____ A.2d ____ (1987) (slip op. at 18, 21-23).

subject over the course of as many weeks and many of them were hours long.

There is simply no real basis in the record created to date to conclude provisionally that the defendants did not act out of good motives or did not proceed in good faith.

As to the second element of the showing necessary to defeat the "presumption" of the business judgment rule—whether the decision attacked was one made after reasonable investigation—I conclude similarly. Surely the board was very active during this crucial period. The only serious charge, in my mind, in this connection is whether the board could reasonably rely upon the word (in negotiating the Memorex deal) and the recommendation of management and Drexel Burnham, given management's prospective financial benefit in a Memorex deal and Drexel's ownership interest in Memorex. Both of these interests were, of course, disclosed to the board. Moreover, the board did retain an independent investment banker who confirmed that, in its opinion, the Memorex transaction was at a fair price.

As to the claimed management interest, the record indicates that the management stock plan was negotiated after the price for the Telex stock was negotiated. This is a technique that moderates conflicting interests. Secondly, the stock plan is apparently designed to put Telex officers in essentially the same position with regard to ownership of Memorex shares as Memorex officers. These are indicia of a fair arrangement. Thirdly, Memorex instigated the program because it had an interest in keeping management talent in place, which is a credible and sensible goal. Memorex had indicated that it would not have paid any portion of those funds to stockholders if they had not paid them (or reserved them) for the stock incentive plan. The Plan with its gradual vesting looks like what it purports to be—an employee compensation scheme. Such a plan is sufficiently conventional, and important to a buyer who intends to operate an acquired company that the independent Telex board cannot be thought to have been credulous or inattentive in relying upon its management for the detailed negotiations of the transaction simply because this issue was also to be addressed. The way in which it was addressed both procedurally and substantively seem to completely justify the board's action—at the very least, one would be hard-pressed on the current record to interpret such reliance as gross negligence.

Reliance upon Drexel Burnham to assist in the negotiation of the Memorex transaction raises a related question of the Telex

board's competency to exercise a judgment protected by the business judgment rule. Since it is factually clear that Drexel Burnham played a significant role in that negotiation, my inability to know now whether (as plaintiffs contend) it negotiated the price or (as defendants assert) it simply assisted management, does not prevent me from preliminarily evaluating this position. It, too, is a question of degree. Reasonable minds might disagree as to whether it was prudent to permit Drexel Burnham to assume important responsibilities in negotiating a transaction in which it had a predominating financial interest opposed to its client's interest.

It would be easy to conclude, on the merits, that it was unwise to be so advised. Nevertheless, several factors might militate against the view that it was irresponsible to permit Drexel to continue its role after serious negotiations commenced with Memorex. First, management of Telex continued to attend to the negotiations and clearly did have an important role. Second, time was short. Edelman's offer, for what it was worth, no doubt had had an impact on the distribution of the company's stock. Consequently, if an alternative deal was to be made available, it surely had to be done quickly. To bring in a new banker to assist price negotiations meaningfully, would involve time. Third, the results of the negotiations could, in all events, be checked against the directors' own views of Telex's value and could be further checked by the retention of an additional investment banker to opine on the fairness of the result of the negotiations. While the second banker's opinion did not go beyond the fairness of the Memorex proposal to value the possible recapitalization alternative, one could call that "negligence" only on the supposition that only businessmen who call themselves investment bankers—and not businessmen who sit on boards of industrial companies—are capable of making rational comparative judgments about stock values of such companies.

While many experienced persons would no doubt be quite uncomfortable relying to any extent upon the advice or assistance of one in Drexel Burnham's position, I am not inclined to think that a decision to do so, in the light of all of the circumstances, may be deemed to constitute negligence (or, *a fortiori*, gross negligence). It is at the very time when decisions are not clear, when reasonable persons might differ as to what wisdom or prudence demands or suggests, that the policy of the law that undergirds the gross negligence standard of director liability becomes most applicable.

* * *

Accordingly, I conclude that the board will likely qualify for the protections of the business judgment rule (*i.e.*, as a substantive rule essentially protecting against liability) and that, therefore, plaintiffs have shown no sufficient reasonable likelihood of success on their claim that the board has breached a duty to the shareholders in negotiating and recommending the Memorex offer in the circumstances to warrant the relief now sought.

IV.

Plaintiffs claim that the disclosures made in the Memorex Offer to Purchase fail to fully and completely disclose material information. Three principal disclosure points are urged. First, it is said that the offer does not disclose the value of the recapitalization option which the board rejected in favor of the Memorex proposal. Second, it is urged that the relationship between Drexel and Memorex—including Drexel's ownership interest—was not fully disclosed. Lastly, it is said that the value of the Memorex stock payment to Telex officers and employees was not fully disclosed.

[7] Our law has emphatically recognized that a corporate fiduciary, including a controlling shareholder, owes to minority shareholders a state law duty of complete candor when it extends a public offer to purchase stock in the corporation. *See, e.g.*, *Lynch v. Vickers Energy Corp.*, Del.Supr., 429 A.2d 497 (1981). However, I am aware of no Delaware case that holds corporate directors accountable for the quality of disclosure in a third party's offer to purchase. The important Delaware cases all involve offers extended by controlling shareholders. *See Weinberger v. UOP, Inc.*, Del.Supr., 457 A.2d 701 (1983); *Lynch v. Vickers*, Del.Supr., 429 A.2d 497 (1981); *Rosenblatt v. Getty Oil Co.*, Del.Supr., 493 A.2d 929 (1985); *Joseph v. Shell Oil Co.*, Del.Ch., 482 A.2d 335 (1984); *Bershad v. Curtis-Wright Corp.*, Del.Supr., No. 184, 1986, Moore, J. (December 30, 1987).[4]

Plaintiffs seek to, in effect, extend the fiduciary responsibilities of the directors to include Memorex and its Offer to Purchase by alleging that Memorex is aiding and abetting the directors in a

4. In *Weinberger v. Rio Grande Industries, Inc.*, Del.Ch., 519 A.2d 116 (1986), this court scrutinized disclosures made by the corporation with respect to a third-party tender offer in a Schedule 14D-9 filing disseminated to shareholders.

breach of duty and by alleging that the Offer to Purchase was "prepared and disseminated by defendants." Complaint ¶ 18. The defendants include George Partners, Inc., Memorex's subsidiary formed to do this transaction, so it is more than a little unclear if this allegation is intended to mean that the director-defendants prepared and disseminated Memorex's offer or not.

[8] In any case, it is well established that one who knowingly participates with a fiduciary in a breach of trust renders himself liable to the injured beneficiary. *See, e.g., Gilbert v. El Paso Co.*, Del.Ch., 490 A.2d 1050 (1984); *Penn Mart Realty Co. v. Becker*, Del.Ch., 298 A.2d 349 (1972). Assuming for present purposes that what is alleged is enough to survive a motion by Memorex to be dismissed,[5] when assessing the probability of ultimate success on a motion of this kind, a court needs more than a bare pleading to support the notion of conspiracy. Here, I see no sufficient record to justify at this time the invocation of this principle. For all that now appears, while this is a friendly merger, it is an arms-length one and there is no sufficient basis to conclude that the director-defendants have a legal or equitable duty to Telex shareholders concerning the quality of disclosure made in Memorex's Offer to Purchase, which, of course, is rather thoroughly regulated by the federal securities laws, in all events.

In the alternative, I have considered each of the arguments concerning disclosure in light of the materiality test laid down by our appellate court. *See Rosenblatt v. Getty Oil Co.*, Del.Supr., 493 A.2d 929 (1985); *Smith v. Van Gorkom*, Del.Supr., 488 A.2d 868, 890 (1985). I conclude that it does not now appear reasonably likely that a reasonable shareholder would view any of the allegedly omitted matters as significantly altering the total mix of information made available to her.

The three points urged do not require extended comment. I believe enough was said to alert shareholders to Drexel's conflict of interest (*see* Offer to Purchase, pp. 9, 10) and that the pertinent fact of the Memorex stock plan for Telex officers- that senior officers on the board would reap a substantial cash-value benefit in the near term and of what amount—was disclosed satisfactorily. (*See* Offer to Purchase, p. 10).

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5. But see *Weinberger v. Rio Grande Industries, Inc.*, Del.Ch., 519 A.2d 116, 131 (1986) granting such a motion of a third-party tender offeror in analogous circumstances.

As to disclosure of theoretical value of the abandoned recapitalization option, I note two things. First, the directors had only some fairly flimsy reportable data, i.e. an expression of view by Drexel that ultimately such a transaction might be worth more than $65 per old share. Second, the fact that the recapitalization, if adopted, "may offer shareholders, in the longer term, greater value per share than the TLX offer" [than at $65 cash] was, in any event, disclosed in a November 5 press release which was sent to each shareholder. Thus, it would appear that repeating that statement one month later would not likely be viewed as significantly altering the total mix of relevant information. *See Seibert v. Sperry Rand Corp.*, 586 F.2d 949, 952 (2d Cir. 1978); *Spielman v. General Host Corp.*, 402 F.Supp. 190, 197 (S.D.N.Y. 1975); *Bertoglio v. Texas International Co.*, 488 F.Supp. 630, 642 (D.Del. 1980).

Accordingly, I conclude that the quality of Memorex's disclosure offers no reasonable prospect for plaintiffs' ultimate success in this litigation.

V.

As indicated above, the balance of harm in this situation in which there is no alternative transaction and issuance of the injunction inescapably involves a risk that the shareholders will lose the opportunity to cash in their investment at a substantial premium requires not only a special conviction about the strength of the legal claim asserted, but also a strong sense that the risks in granting the preliminary relief of an untoward financial result from the stockholders' point of view is small. Repeatedly the plaintiffs' class action bar exhorts the court to bravely risk the consequences in circumstances such as these, asserting that more money to the shareholders, not less, will probably result. At least on facts such as these, a due respect for the interests of the class on whose behalf these exhortations are made, requires, in my judgment, that this invitation be declined.

* * *

For the foregoing reasons, plaintiffs' motion shall be denied. IT IS SO ORDERED.