PRIME COMPUTER, INC. v. ALLEN

No. 9557

Court of Chancery of the State of Delaware, New Castle

January 22, 1988
(revised January 25, 1988)

Plaintiffs, two Delaware corporations who together own 557,300 shares of common stock in defendant Computervision Corporation, brought this action seeking a preliminary injunction against the implementation of defendant corporation's bylaw. The bylaw attempted to allow defendant's stockholders, under particular circumstances, to take stockholder action through consent, without notice, without a meeting and/without a vote pursuant to section 228 of the Delaware General Corporation Law.

The court of chancery, per Chancellor Allen, granted a preliminary injunction as the appropriate remedy against operation of the consent solicitation bylaw. The court found that Delaware law will not permit a bylaw to delay—even for a reasonable period—the activation of stockholder action taken through a tender offeror's consent solicitation in an attempt to afford solicited stockholders an opportunity to reflect upon their decision and, perhaps, change their minds. Upon such a finding, the court concluded that the plaintiffs had established as a matter of law that the bylaw was invalid.

1. Corporations ⟹ 191, 194

Section 228 of the Delaware General Corporation Law creates a right in shareholders to act independently of the directors upon whom they may be dependent to call a meeting. DEL. CODE ANN. tit. 8, § 228 (1983).

2. Corporations ⟹ 191, 194

Under section 228, unless the charter otherwise provides, shareholders may act by written consent, without notice, without a meeting and without a vote. DEL. CODE ANN. tit. 8, § 228 (1983).

3. Corporations ⟹ 191, 194

A board, acting pursuant to authority delegated pursuant to section 109 of the corporation law, is entitled to prevail on the

question of "minimal essential provisions for ministerial review" unless the person attacking the bylaw as excessive persuades the court that the restrictions are more than a reasonable board member could conclude in the circumstances were the minimal requisites for a reliable, prompt determination. DEL. CODE ANN. tit. 8, § 109 (1983).

4. Corporations ⟹ 191, 194

Section 228 creates a stockholder right and acknowledges the power of stockholders, through charter amendment, to restrict that right or to structure its exercise in ways thought to promote corporate interests. DEL. CODE ANN. tit. 8, § 228 (1983).

5. Corporations ⟹ 56

The board may not, consistent with the particular grant of section 228, arrogate to itself through its power to amend the corporation's bylaws, the right to substantially delay implementation of action taken pursuant to that section. DEL. CODE ANN. tit. 8, § 228 (1983).

6. Corporations ⟹ 53, 54

A delay for the purpose of affecting the nature of the section 228 process goes to the heart of the statute and a bylaw that did so would—whether or not it represented one reasonable view of a way to approach corporate governance—be inconsistent with section 228 and invalid under section 109(b). DEL. CODE ANN. tit. 8, § § 228, 109(b) (1983).

7. Corporations ⟹ 53, 54

A bylaw that merely delays effectiveness for a minimum period to assure in a ministerial way that valid action has been taken by shareholders does not attempt either to expand or impede the section 228 process but, rather, to enforce it. DEL. CODE ANN. tit. 8, § 228 (1983).

R. Franklin Balotti, Esquire, Jesse A. Finkelstein, Esquire, Gregory V. Varallo, Esquire, and James C. Strum, Esquire, of Richards, Layton & Finger, Wilmington, Delaware; and John L. Warden, Esquire, David B. Tulchin, Esquire, Norman Feit, Esquire, and Karen A. Popp, Esquire, of Sullivan & Cromwell, New York, New York, of counsel, for plaintiffs.

Steven J. Rothschild, Esquire, Andre G. Bouchard, Esquire, and Jean C. Kissane, Esquire, of Skadden, Arps, Slate, Meagher & Flom, Wilmington, Delaware, Thomas Dougherty, Esquire (Boston office), Peggy L. Kerr, Esquire, and Steven Kronengold, Esquire (New York office), for defendants.

ALLEN, *Chancellor*

The pending motion seeks a preliminary injunction against the effectiveness of a by-law of defendant Computervision, Inc., a Delaware corporation. That by-law purports to establish a process through which, under certain circumstances, stockholders may effectively exercise the power conferred by Section 228 of the Delaware General Corporation Law to take stockholder action through consent, without prior notice, a meeting or a vote. At argument of this motion, plaintiff orally moved for summary judgment contending that the dispositive issue was one of law and no material facts relevant to that issue were contested. It is essentially agreed that the case presents a legal issue.

The by-law in issue is attacked on two bases. First, it is said to be in violation of the plain terms of Section 228 itself and for that reason to be legally void. Second, it is said that even if the by-law were legally valid, the admitted circumstances surrounding its recent adoption show it to be part of an inequitable attempt to defeat a pending tender offer by plaintiff for all of the shares of Computervision. Since it is asserted that that effort is for the sole or primary purposes of protecting the positions of the incumbent board of defendant and for no good business reason, it is concluded that, under established principles of our corporation law, the by-law here under attack may not be implemented. For the reasons that follow, I conclude that under the authority of the Supreme Court's opinion in *Datapoint Corporation v. Plaza Securities, Inc.*, Del. Supr. 496 A.2d 1031 (1985), plaintiff has established as a matter of law the invalidity of the by-law it attacks. Also chiefly on the authority of that case, I conclude that an injunction against im-

plementation of the consent solicitation by-law is the appropriate remedy in the circumstances. These legal conclusions are reached despite my view that the procedure contemplated by the consent solicitation by-law is reasonable in structure and timing and that, if implemented—whether by by-law or charter amendment—it would serve beneficial corporate purposes.

Before explaining the reasoning that leads me to the conclusions reached, I will set forth a summary of the facts out of which the dispute arises.

I.

Prime Computers, Inc., and its wholly-owned subsidiary, Provision Holdings, Inc., are both Delaware corporations. Together, they own 557,300 shares of common stock in Computervision Corporation, which is also a Delaware corporation. Both Prime and Computervision have their principal executive offices in Massachusetts. The individuals named as defendants are all Computervision directors.

On two occasions, Prime made overtures to Computervision to explore the possibility of a combination. On each of the two occasions, Computervision rebuffed Prime. Having rejected Prime's wooing for a second time, Computervision acted in February 1987 to ward off suitors through the adoption of a stock rights plan. As a result of the Computervision board's action, shareholders came to possess certain "purchase rights". Under certain circumstances involving the merger of Computervision or the sale or transfer of over half of its assets or earning power, each holder of a purchase right has the option to exercise his right and receive as much common stock of the acquiror as is worth twice the exercise price of each right.

Each right is redeemable by the board at a price of $0.05 per right under certain circumstances. In certain instances, the rights may only be redeemed if a majority of the "continuing directors"[1]

1. "Continuing Director" is defined as: "(i) any member of the Board, while such person is a member of the Board, who is not an Acquiring Person, or an affiliate or Associate of an Acquiring Person or of any such Affiliate or Associate, and was a member of the Board prior to the date of this Agreement, or (ii) any Person who subsequently becomes a member of the Board, who is not an Acquiring Person, or an Affiliate or Associate of an Acquiring Person, or a representative of an Acquiring Person or of any such Affiliate or Associate, if

agree. The approval of a majority of continuing directors would be required, for example, should any individual or entity (together with affiliates) own 20% of Computervision stock. Additionally, the consent of a majority of continuing directors is necessary to redeem the rights after there has been a change to the majority of the Computervision board as a result of a proxy or consent solicitation.

However, the stock rights do contemplate that a continuing board, which could redeem the rights, would include a board whose members were later appointed through stockholder consent action *but only* if, at the time of such consent, there was outstanding an all cash offer for all of Computervision's stock. In other words, the "poison pill", in this instance, attempted to place in shareholder's hands the question whether an offer for all shares was sufficiently attractive to warrant redemption of the "pill".

On December 28, 1987, Prime (through Provision) began an all-cash tender offer for all of Computervision's outstanding common shares at a price of $13.50 per share. The amount offered was raised to $15.00 on January 13. Unwilling to obligate itself to purchase Computervision on these terms if the "poison pill" rights could be exercised, Prime conditioned its offer on the redemption or neutralization by other means of the purchase rights.

In its offering circular, Prime stated that, it "presently intends to solicit stockholder consents for the removal of [Computervision's] Board of Directors in the event such Board of Directors does not take action to redeem the rights or otherwise make them inapplicable to the offer and the merger in a timely manner". On December 28, 1987, Prime filed materials concerning a proposed consent solicitation with the SEC. A few days later, it filed a schedule 14B with the SEC, disclosing who its contemplated board candidates would be if it undertook a consent solicitation.

Computervision's board met on January 5, 1988. At that meeting, it heard a presentation by counsel regarding consent solicitations. Then, materials concerning proposed by-law amendments regarding consent solicitations were distributed. After being requested to study the materials and having conducted some discussion among themselves, the directors adjourned to reconvene on January 7, 1988.

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such Person's nomination for election or election to the Board is recommended or approved by a majority of the Continuing Directors." (Rights Agreement, Section 1(i), Strum Aff. Ex. A at 4).

At its January 7 meeting, the Computervision board voted to amend the Company's by-laws by adding new sections to Article I, including Sections 12 and 13. Section 12 purports to prevent "any corporate action" from being taken by written consent until "at least twenty (20) days from the date of the commencement of a solicitation. . .of consents". It creates an exemption, however, for any corporate action taken by consent when no more than ten persons have been solicited. Section 13 establishes a procedure for inspecting, counting, and challenging the validity of the consents.

Under Section 13, from the time when the first consent conforming to the requirement of 8 *Del. C.* Section 228(c) is delivered to Computervision, the Corporation's secretary has three business days in which to hire inspectors of elections "for the purpose of performing a ministerial review of the validity of the consents and revocations". (Computervision By-laws, Article I, Section 13, Strum Aff. Ex. E). The inspectors are not allowed to issue their preliminary report unless twenty days have expired since the beginning of the consent solicitation and unless, in addition, the soliciting shareholders have written a request for the preliminary report, stating that they believe that the required number of valid and unrevoked consents have been received pursuant to the by-laws. Moreover, anyone opposing the solicitation must have been given notice of the written request for the preliminary report.

After issuing the preliminary report, the inspectors may not issue a final report until 48 hours have expired, during which time Computervision and the soliciting shareholders may "review the consents and revocations and . . . advise the inspectors and the opposing party in writing as to whether they intend to challenge the preliminary report of the inspectors." If Computervision or the soliciting shareholders give such written notice of an intent to challenge the inspector's preliminary report within 48 hours of its issuance, the inspectors must schedule a "challenge session", which must be recorded by a certified court reporter. After these procedural steps have been complied with, the inspector may issue the final report to the soliciting shareholders and the company.

On January 13, Prime sent a letter and a signed written consent to Computervision to set that date as the record date for purposes of acting by written consent. In response, Computervision's Board has prepared proposed revocations of consents, together with materials urging the shareholders not to sign Prime's consent cards and to execute and mail the board's revocation card (Second Strum Aff. Ex. B).

Prime's offer may close no earlier than January 27. Its consent solicitation continues and the incumbent board is engaged presently in a program design to discourage the joining in the consent action or the giving of revocations.

Prime has also filed an independent action in this court challenging the validity of the stock rights and Computervision has asserted various claims and counterclaims against Prime in other actions here. This case, however, involves a single and relatively straightforward issue, and those other matters will await another day.

II.

Section 228 of our corporation law, originally (in 1967) thought of as a statute of administrative convenience and not of great importance (*see, e.g.*, Folk, *Corporation Law Developments — 1969*, 56 Va. L. Rev. 755, 783 (1970)) has become increasingly important as it has been utilized as a weapon in the takeover wars that have marked the current era. *See, e.g.*, *Pabst Brewing Co. v. Jacobs*, 549 F. Supp. 1068 (D. Del. 1982). This court has had occasion to observe that the use of the consent mechanism to attempt to replace a sitting board may, and frequently does, result in periods of great contention and uncertainty. *See, e.g.*, *Empire of Carolina, Inc. v. Deltona Corp.*, Del. Ch., 501 A.2d 1252 (1985); *Freeman v. Fabiniak*, Del. Ch., Civil Action No. 8035, Hartnett, V.C. (August 15, 1985). While a Section 225 action is available to resolve the question who constitutes the rightful board, a sensible intermediate step is to have an internal corporate process that attempts to promptly and dependably resolve questions relating to the validity of actions purportedly taken through consent. Such a mechanism can be put in place through charter amendment. The question whether and to what extent such a process can be put in place by the board alone through by-law amendment was addressed by our Supreme Court in the leading case of *Datapoint Corporation v. Plaza Securities, Inc.*, Del. Supr., 496 A.2d 1031 (1985). This case involves a further specific answer to that general question. The analysis starts not with *Datapoint*, which is where it concludes, but with the language of the statute.

[1-2] Section 228 provides in pertinent part as follows:

> (a) Unless otherwise provided in the certificate of incorporation, any action required by this chapter to be taken at any annual or special meeting of stockholders of

> a corporation, or any action which may be taken at any annual or special meeting of such stockholders, may be taken without a meeting, without prior notice and without a vote, if a consent or consents in writing, setting forth the action so taken, shall be signed by the holders of outstanding stock having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voted. . .

This statute creates a right in shareholders to act independently of the directors upon whom they may be dependent to call a meeting. Under Section 228, unless the charter otherwise provides, shareholders may act by written consent, without notice, a meeting or a vote.

The Supreme Court in *Datapoint*, while not ruling on the issue, clearly implied that Section 228 is not inconsistent with "a by-law which would impose minimal essential provisions for action taken by shareholder consent." 496 A.2d at 1036. Earlier in its opinion, the court implied that a by-law "designed simply to defer consummation of shareholder action by consent. . .until a ministerial-type review of the sufficiency of the consents has been performed by duly qualified and objective inspections" would be materially different than the by-law treated in that case.

I read *Datapoint* as holding that the question whether a by-law purporting to regulate in some respect the exercise of the Section 228 power is valid turns in each instance upon an evaluation of both the purposes sought to be served by the by-law (in light of the purposes of Section 228) and the timing impact upon the effective exercise of the power to act through written consent.

Before focusing upon the specific issue that this motion most importantly turns upon, I make some preliminary observations.

First, it is notable, I think, that the by-law in question exempts action by consent when ten or fewer shareholders have been solicited. Thus, this by-law could not be used to impede or delay the exercise of direct control by a majority shareholder or small group acting together. *Compare Frantz Manufacturing Co. v. EAC Industries*, Del. Supr., 501 A.2d 401 (1985). Rather, it is addressed to the distinctive characteristics of a *solicitation* of public shareholders. This exemption is, I think, one attribute of a reasonable, carefully-crafted approach to the practical problems that resort to the Section 228 process may raise particularly in a widely held company.

Second, the by-law here in question lacks the most egregious feature of the by-law struck down in *Datapoint*: the litigation hold, which has the effect of permitting the incumbent board to indefinitely postpone effectuation of action taken by shareholders.

[3] *Third*, the provisions of Section 13 which establish a format for the validation of consents and for the administrative determination of the outcome, strike me as not unreasonable. Plaintiff argues that Section 13 involves too many steps and that each step is permitted to take more time than necessity requires. But, clearly the use of Section 228 creates a use for, if not a need for, an agreed-upon corporate mechanism to determine in the first instance what has occurred. Does Section 13 reflect "minimal essential provisions for ministerial review"? Reasonable minds might differ on that question in this instance, but I believe the board, acting pursuant to authority delegated pursuant to Section 109 of the corporation law, while not entitled on a question of this type to the strong presumption of the validity of its action that attaches when a disinterested board acts respecting the business affairs of the corporation (*see Smith v. Van Gorkom*, Del. Supr., 488 A.2d 858 (1985)) is nevertheless entitled to prevail on this question unless the person attacking the by-law as excessive persuades the court that the restrictions are more than a reasonable board member could conclude in the circumstances were the minimal requisites for a reliable, prompt determination. I cannot preliminarily so conclude in this instance. The procedure envisioned by Section 13 is complete but does not appear unduly elaborate. The time periods may prove, in particular cases, a little longer than necessary, but if the process is administered in good faith (as for present purposes I assume it will be) only so much time as is required for each step will be expended.[2]

Fourth, I consider the twenty-day period contemplated by Section 12, which commences with the filing of certain required federal disclosures, as a reasonable period for the solicitation of consents and revocations. That is, if it is legitimate to provide through a by-law for a period in which shareholders who are solicited to join in a consent action may consider the matter, and in which those opposing the matter may communicate counter-arguments, then

2. Such by-laws might better state necessary time limits as "promptly but in all events within *x* hours (or *y* days). . ." to make explicit that at each step the by-law contemplates expeditious action.

twenty days seems incontestably a reasonably short period for that purpose. If common sense requires support for that proposition, I find it in the federal regulations governing tender offer solicitations and in the New York Stock Exchange rules governing consent solicitations by listed firms.[3]

Accordingly, finding the Consent Solicitation By-law reasonable and balanced in all respects, we come to what I see as the principal issue with respect to the merits of plaintiff's contention: is it legally permissible, under Delaware law, *for a by-law* to delay for a reasonable period the effectiveness of stockholder action taken pursuant to a consent solicitation, not to assure ministerially that valid stockholder action has been taken, but, rather to attempt to assure that stockholders are informed of both sides of the question and have an opportunity to maturely consider the decision and, indeed, to change their minds.[4]

As I read the Supreme Court's decision in *Datapoint*, this question is no longer open to debate. The court there stated, after holding that the *length* of the delay occasioned by the by-law there in issue "circumvented" Section 228:

> This delay is not only arbitrary, it is unreasonable. For the underlying intent of the by-law is to provide the incumbent board with time to seek to defeat the shareholder action by management's solicitation of its own proxies or revocations of outstanding shareholder consents. (Emphasis in original.)

Datapoint Corp. v. Plaza Securities Co., 496 A.2d at 1036.

Earlier in its opinion the court stated:

> Section 228 contains no language suggesting that action accomplished. . .through written consent. . .may be lawfully deferred or thwarted on grounds not relating to the legal sufficiency of the consents obtained. 496 A.2d at 1036.

Here the clear intent and effect of Section 12 is to give a reasonable period within which solicited shareholders may consider and re-

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3. *See* New York Stock Exchange Listed Company Manual § 306.00.

4. Since it is clear that such a mechanism may be put in place through charter amendment, this question really is not whether a corporation may have such an arguably salutary procedure in place, but whether the board of directors (to whom the power to amend by-laws is inevitably delegated) may do so without stockholder action. That is, whose prerogative is it?

consider their decision on the question posed by the solicitation. The by-law necessarily delays effectuation of stockholder action to "give time to seek to defeat the shareholder action"—a "ground not relating to the legal sufficiency of the consents obtained."

Defendant here asserts that the twenty-day period called for by Section 12 of its by-law is reasonable in the circumstances (to which I agree) and that it is bad policy to preclude it from adopting this reasonable procedure by by-law (to which I defer to others).

[4-5] With respect to delay for the purpose of permitting the consent process to be more open, deliberate or balanced, etc.—I take it that the Supreme Court has concluded that that is a question to be directed to the legislature. Section 228 creates a stockholder right and acknowledges the power of stockholders, through charter amendment, to restrict that right or to structure its exercise in ways thought to promote corporate interests. The board may propose and recommend an amendment of the charter to that effect, but it may not, consistent with the particular grant of Section 228, arrogate to itself through its power to amend the corporation's by-laws, the right to substantially delay implementation of action taken pursuant to that section.

[6-7] How, then, can the board be empowered to adopt by-laws that have the effect of delaying for a short period the effectiveness of stockholder action taken pursuant to Section 228 during which time ministerial review may occur, as *Datapoint* implies is the case? The answer, I would suppose, is that a delay for the purpose of affecting the nature of the Section 228 process (whether one calls such change a beneficial improvement or an impediment) goes to the heart of the statute and that a by-law that did so would—whether or not it represented one reasonable view of a way to approach corporate governance—be inconsistent with Section 228 and invalid under Section 109(b). A by-law that merely delays effectiveness for a minimum period to assure in a ministerial way that valid action has been taken by shareholders does not attempt either to expand or impede the Section 228 process, but, rather, to enforce it. Such a by-law cannot be said to be inconsistent with the full and free exercise by shareholders of the right created by Section 228. Thus, it cannot be said to be invalid under § 109(b). The distinction between by-laws that expand or contract the purposes sought to be served and those that simply seek to enforce the statutory purpose is, I think, sound and not merely formalistic.

In all events, that it is open to all Delaware corporations to regulate the Section 228 process more completely through charter

amendment should remove, in my view, the sting from a ruling that a by-law of the type here involved—which does seem balanced and reasonable in all respects—may not validly be adopted. Be that as it may, my reading of *Datapoint* compels the conclusion that Section 12 of the Computervision Consent By-law, which imposes a twenty-day period during which the consent solicitation is to stay open, is inconsistent with Section 228 and invalid. Section 13 of that by-law, in concept, strikes me as probably satisfying the test of *Datapoint* for prompt ministerial review. However, as written, it is so interwoven with the provisions of Section 12 that it cannot meaningfully stand alone. Therefore, I conclude that it, too, must fall beneath the same weight.

III.

Prime's claim of irreparable injury is rather unimpressive. Its tender offer is scheduled to close on January 27. It will be recalled that it seeks consents to remove the board so that it may redeem the Computervision stock rights plan so that it may close its tender offer. The tender offer may, of course, be unilaterally extended by Prime and, given the fact that the twenty-day period contemplated by Section 12 of the Consent Solicitation By-law commenced on January 13 or 14, one could reasonably expect that the process envisioned by Section 12 could be completed before the conclusion of the second week of February—a few weeks hence.

Nevertheless, Prime asserts a right, as a shareholder, to the immediate availability of the rights conferred by Section 228. It asserts, quite correctly in my view, that the delay of the exercise of the franchise is itself an injury and that it is an injury not reasonably compensable with damages. That the delay here is rather short is, conceptually, irrelevant in plaintiff's view and, in any case, a short delay may be critical at this stage.

Computervision contends that until 51% of the shares consent that the existence of the by-law confers no injury whatsoever and that, in all events, Prime has it within its power to relieve its present discomfort by extending its offer which would involve no harsh consequence for it.

In *Datapoint* the Supreme Court affirmed the entry of an injunction and again, with that light to guide me, I conclude that a preliminary injunction is appropriately entered on this record. I have concluded that the by-law in question is legally invalid. Its effectuation would materially affect the exercise of a statutory right

and damages could not adequately remedy that injury. That the wrong would be a short duration in the circumstances does not strike me as a consequence of sufficient significance to warrant declining to issue the injunction that would ordinarily follow from these conclusions.

The pending motion presents an issue wholly legal in character. Had the plaintiff timely moved for summary judgment (*see* Chancery Court Rule 56(c) requiring ten days notice of such a motion), I would be inclined to enter final judgment at this time. In all events, for the foregoing reasons, I will enter a preliminary injunction enjoining the operation of defendant's Consent Solicitation By-law pending final determination of this matter. Bond will be $1,000.

Plaintiff will submit a form of order on notice very promptly.

RABKIN v. PHILIP A. HUNT CHEMICAL CORP.

No. 7547

Court of Chancery of the State of Delaware, New Castle

December 17, 1987

Former minority shareholders challenged the cash-out merger of their former corporation with its controlling shareholder. The plaintiffs' amended and supplemented class action complaint included an allegation of negligence against the defendant directors based on their alleged failure to learn of or act on a one year price commitment by the controlling shareholder. Defendant directors moved for reargument after their motion to dismiss was denied.

In the motion for reargument, the directors argued that their alleged neglect could not support a finding of gross negligence and that the complaint did not allege the necessary elements of negligence. In addition, the defendants contended that director neglect claims should be evaluated under the business judgment rule using a standard of gross negligence.

The court, per Vice-Chancellor Berger, denied defendants' motion for reargument and affirmed his original decision, holding that the business judgment rule does not apply to situations in

which directors failed to act due to ignorance; the standard of care in a director neglect claim is based on ordinary negligence—not gross negligence; and the complaint adequately alleged a neglect claim against the defendant directors for their failure to learn of or take action on the price commitment. However, the plaintiffs still bear the burden of proving at trial the causal connection between the directors' negligence and their injury. The causation problem may prove fatal to the plaintiffs' claim after the evidence is developed.

1. Corporations ⟹ 310(1)

The business judgment rule does not apply to a claim where directors allegedly failed to act because they were ignorant of the operative facts.

2. Corporations ⟹ 310(1)

The standard of care in a director "neglect" claim is that which ordinarily careful and prudent men would use in similar circumstances.

3. Corporations ⟹ 310(1), 584

Minority shareholders state a director neglect claim where they allege that the directors failed to learn the terms of a price commitment by the controlling shareholder.

4. Corporations ⟹ 310(1)

Under Delaware law, the business judgment rule operates only in the context of director action. It has no role where directors have abdicated their functions or failed to act. However, a conscious decision by the directors to refrain from acting may be a valid exercise of business judgment and enjoy the protections of the business judgment rule.

5. Corporations ⟹ 310(1)

As a matter of logic and stare decisis, the business judgment rule does not apply to director neglect claims.

6. Corporations ⟹ 310(2)

Under Delaware law, directors are subject to liability for neglect in managing corporate affairs.

7. Corporations ⟹ 310(2)

Consistent with the wide latitude granted to them under the business judgment rule, directors who undertake their decision making responsibility will not be held liable either for a fault in the decision-making process or the decision itself unless they were grossly negligent.

8. Corporations ⟹ 310(2)

When the business judgment rule does not apply as in director neglect claims, ordinary negligence is the appropriate standard of liability.

9. Corporations ⟹ 310(1), 584

Pretrial Procedure ⟹ 622

On a motion to dismiss, a complaint states a claim of director neglect when the directors, in the exercise of ordinary care, should have known about a one year price commitment that directly affected all of the public stockholders.

10. Pretrial Procedure ⟹ 622

On a motion to dismiss, plaintiffs are entitled to the benefit of all reasonable inferences that may be drawn from their well pleaded allegations and the complaint will not be dismissed unless it is clearly without merit, either as a matter of law or fact.

11. Corporations ⟹ 310(1), 584

Pretrial Procedure ⟹ 622

On a motion to dismiss, a complaint states a claim of director neglect if the directors could have prevented the controlling share-

holder from wrongfully manipulating the timing of the merger to avoid the price commitment to minority stockholders.

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R. Franklin Balotti, Esquire, and C. Stephen Bigler, Esquire, of Richards, Layton & Finger, Wilmington, Delaware; and Cravath Swaine & Moore, New York, New York, for defendants Olin Corporation, Olin Acquisition Corporation, Philip A. Hunt Chemical Corporation, John M. Henske, Richard R. Berry, and John W. Johnstone, Jr.

Michael Hanrahan, Esquire, of Prickett, Jones, Elliott, Kristol & Schnee, Wilmington, Delaware; and Shea & Gould, New York, New York, for defendants John R. Bonniwell, Charles J. Lause, Stephen R. Petschek, and George J. Haufler.

Martin P. Tully, Esquire of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for defendants Alfred T. Blomquist and Robert T. Zetena.

BERGER, *Vice-Chancellor*

This is the decision, after briefing and argument, on a motion for reargument filed by Messrs. Bonniwell, Lause, Petschek, Haufler, Blomquist and Zetena (the "Hunt directors"). In its decision of December 4, 1986, this Court held, among other things, that the Consolidated Amended and Supplemented Class Action Complaint (the "Complaint") states a claim against the Hunt directors based upon their alleged failure to learn of a one year price commitment made by defendant Olin Corporation ("Olin") at the time it purchased a majority of the stock of defendant Philip A. Hunt Chemical Corporation ("Hunt"). *See Rabkin v. Philip A. Hunt Chemical Corp.*, Del. Ch., Civil Action No. 7547, Berger, V. C. (December 4, 1986). The Hunt directors argue that their alleged neglect could not support a finding of gross negligence and that the Com-

plaint does not allege the necessary elements of such a claim in any event.

[1-3] In its original decision on this issue, the Court held that (1) the business judgment rule does not apply to a claim, such as this, where directors allegedly failed to act because they were ignorant of the operative facts; (2) the standard of care in a director "neglect" claim is that which "ordinarily careful and prudent men would use in similar circumstances," *Graham v. Allis-Chalmers Mfg. Co.*, Del. Supr., 188 A.2d 125, 130 (1963); and (3) the Complaint adequately alleges a neglect claim against the Hunt directors for their failure to learn the terms of the price commitment and to take action with respect to that commitment prior to its expiration. After consideration of the Hunt directors' motion for reargument, I am not persuaded that those holdings were erroneous and the motion, therefore, must be denied.

[4-5] The first issue is whether the business judgment rule applies to a claim of this sort. In *Aronson v. Lewis*, Del. Supr., 473 A.2d 805, 813 (1984), the Delaware Supreme Court stated:

> [I]t should be noted that the business judgment rule operates only in the context of director action. Technically speaking, it has no role where directors have either abdicated their functions, or absent a conscious decision, failed to act. But it also follows that under applicable principles, a conscious decision to refrain from acting may none the less be a valid exercise of business judgment and enjoy the protections of the rule (footnote omitted).

In a footnote the Court cited three cases in which business judgment concepts had been applied to assess directors' failure to act, but the Court observed that those cases do not actually present issues of business judgment. *Ibid.*, fn. 7. *See, also, Kaplan v. Centex Corporation*, Del. Ch., 284 A.2d 119, 124 (1971) ("Application of the [business judgment] rule of necessity depends upon a showing that informed directors did, in fact, make a business judgment authorizing the transaction under review"). The Hunt directors do not directly question the continuing validity of these decisions and I am satisfied, both as a matter of logic and stare decisis, that the business judgment rule does not apply to the neglect claim.

The question then becomes what standard of care is used to determine liability for director inaction. Both parties agree that liability must be predicated upon a finding of gross negligence. As a result, the Court did not have the benefit of what it assumed

would be plaintiffs' arguments in support of the Court's original ruling and the Court is left in the unenviable position of deciding against both parties.

[6] *Graham v. Allis-Chalmers Mfg. Co.*, *supra* appears to be the most frequently cited authority on the subject of director neglect. In *Allis-Chalmers*, plaintiffs claimed that the defendant directors were liable for their failure to learn of and take steps to prevent violations of the antitrust laws by company employees. The Delaware Supreme Court began its analysis by recognizing the general principle that directors are subject to liability for neglect:

> [D]irectors of a corporation in managing the corporate affairs are bound to use that amount of care which ordinarily careful and prudent men would use in similar circumstances. Their duties are those of control, and whether or not by neglect they have made themselves liable for failure to exercise proper control depends on the circumstances and facts of the particular case.

188 A.2d at 130. After noting that the director defendants could not have known all of the 30,000 company employees and had no grounds on which to suspect that certain of those employees were acting unlawfully, the Court stated:

> In the last analysis, the question of whether a corporate director has become liable for losses to the corporation through neglect of duty is determined by the circumstances. If he has recklessly reposed confidence in an obviously untrustworthy employee, has refused or neglected cavalierly to perform his duty as a director, or has ignored either willfully or through inattention obvious danger signs of employee wrongdoing, the law will cast the burden of liability upon him. This is not the case at bar, however, for as soon as it became evident that there were grounds for suspicion, the Board acted promptly to end it and prevent its recurrence.

Ibid.

Different commentators have relied upon the *Allis-Chalmers* decision in reaching opposite conclusions as to the appropriate standard of care. In an article cited in *Aronson*, S. Samuel Arsht concluded that ordinary negligence is the standard, apparently focusing on the first of the two statements in *Allis-Chalmers* quoted above. Arsht, *Fiduciary Responsibilities of Directors, Officers & Key Employees*, 4 Del.

J. Corp. L. 652, 659 (1979). If one were to focus on the language in the second quotation, where the Court refers to one who "recklessly" reposes confidence in an employee or "cavalierly" neglects his duties, one could conclude that the standard is gross negligence. *See* Veasey & Manning, *Codified Standard - Safe Harbor or Unchartered Reef?*, 35 Bus. Law. 919, 928 (1980). Even more recently commentators and authors remain uncertain on this point. *See* Hanson, *The ALI Corporate Governance Project: Of the Duty of Due Care and the Business Judgment Rule, a Commentary*, 41 Bus. Law. 1237, 1248 (1986) (citing *Lutz v. Boas*, Del. Ch., 171 A.2d 381 (1961) and suggesting that, although the standard of care may be articulated as the ordinarily prudent person standard, the application of that standard to the facts in a given case indicates that "exacerbated neglect" must be found to impose liability); Block, Barton & Rabin, *The Business Judgment Rule*, at 28 (1987) (citing *Allis-Chalmers* for the ordinary prudent man standard but noting that *Smith v. Van Gorkom*, Del. Supr., 488 A.2d 858 (1985) "seemingly [equates] the directors' duty of care with the liability standard of gross negligence."); Balotti & Finkelstein, *The Delaware Law of Corporations and Business Organizations*, § 4.8 (1986) ("gross negligence is probably the law of Delaware in the oversight context as well as the standard of the informed basis/due care test in decision-making").

The Hunt directcrs argue that a claim of director neglect should be reviewed under "business judgment concepts" and that the gross negligence standard should be applied for legal and practical reasons. As a legal matter, they suggest that the directors' failure to focus on "some isolated bit of corporate information" should be no more subject to second guessing by the Court than any of the myriad of business decisions they regularly must make. In other words, according to the Hunt directors, the same deference that is paid to the directors' decisions should be accorded to their judgment of what facts they need to know. As a practical matter, the Hunt directors argue that it would create confusion for directors if they were not held to the same standard in a neglect claim as they are in a claim attacking their business decisions. They suggest that if ordinary negligence were the applicable standard, there would be a new wave of neglect claims filed by disgruntled stockholders. Such stockholders would be unable to find a basis to attack the directors' business decisions and would, instead, base their claim on some fact or occurrence about which the directors were uninformed.

I am not satisfied that the Hunt directors' concerns are well founded. Under an ordinary negligence standard, corporate direc-

tors will face no liability for the failure to focus on an isolated bit of information. An ordinarily prudent person charged with managing a business would not be expected to know, in minute detail, everything that transpires as part of the company's day-to-day operations. If the overlooked fact or transaction were immaterial, there could be no claim based upon director neglect. Moreover, a conscious decision as to the types of information provided to the directors would fall within the protection of the business judgment rule as a general matter. *See Aronson v. Lewis, supra*. Thus, there is no real risk that directors will be inundated with stockholder suits charging neglect.

[7-8] The fact that the Hunt directors' pragmatic concerns appear to be unjustified does not, however, resolve the issue. The question remains whether the standard of care applied to directors who attempt to exercise their business judgment also applies to those who abdicate their managerial responsibility in whole or in part. I think not. As I read *Smith v. Van Gorkom, supra* and the cases cited therein, the gross negligence standard is really a corollary to the business judgment rule. As the Court noted in *Van Gorkom*, "[t]he business judgment rule exists to protect and promote the full and free exercise of the managerial power granted to Delaware directors." *Smith v. Van Gorkom*, 488 A.2d at 872. Consistent with the wide latitude granted to them under the business judgment rule, directors who undertake their decision making responsibility will not be held liable either for a fault in the decision making process or the decision itself unless they were grossly negligent. It does not seem logical to accord the same deference to directors who abdicate their managerial responsibilities. There would be little meaning to the business judgment rule if, in cases not implicating the duty of loyalty, directors were given the same protection from liability whether it applies or not. Accordingly, I conclude that ordinary negligence is the appropriate standard of liability in director neglect claims. I am satisfied that the decisions in *Aronson* and *Allis-Chalmers* support this result and that *Van Gorkom* did not adopt the gross negligence standard in claims such as this one.

[9] The final question is whether the complaint states a claim of director neglect. For purposes of a motion to dismiss, I think it must be conceded that a transaction such as the Olin Acquisition is of major significance to the corporation and its stockholders. Since the price commitment directly affected all of the public stockholders, one could conclude that, in the exercise of ordinary care, the Hunt directors should have known about the one year price

commitment. In short, the price commitment is not "some isolated bit of corporate information."

Nonetheless, the Hunt directors argue that their alleged failure to learn the terms of the Olin Acquisition does not state a claim for relief because (i) they were not in a position to require Olin to act within the one year commitment period, and (ii) the Complaint alleges that Olin had decided to let the price commitment expire before acquiring the publicly held stock. Thus, the Hunt directors argue that there is no causal connection between their failure to learn of the price commitment and the damages suffered.

[10-11] The causation problem raised by the Hunt directors was recognized by the Court in its original decision and may prove fatal to plaintiffs' claim after the evidence is developed. However, on a motion to dismiss, plaintiffs are entitled to the benefit of all reasonable inferences that may be drawn from their well pleaded allegations and the complaint will not be dismissed "unless it is clearly without merit, either as a matter of law or fact." *Rabkin v. Philip A. Hunt Chemical Corp.*, Del. Supr., 498 A.2d 1099, 1104 (1985). It has been recognized that, in a claim such as this, it is extremely difficult to establish causation:

> Analysis of proximate cause is especially difficult in a corporate context where the allegation is that nonfeasance of a director is a proximate cause of damage to a third party. Where a case involves nonfeasance, no one can say "with absolute certainly what would have occurred if the defendant had acted otherwise." [Prosser, *Law of Torts* § 41 at 242]. Nonetheless, where it is reasonable to conclude that the failure to act would produce a particular result and that result has followed, causation may be inferred. *Ibid.*

Francis v. United Jersey Bank, N.J. Supr., 432 A.2d 814, 829 (1981). In that case, like this one, the director charged with neglect was not in a position to halt the wrongful conduct directly. Still, the court concluded that if she had threatened a lawsuit, she would have deterred the wrongdoers. Here, although it is clear from the allegations in the Complaint that the Hunt directors could not have forced Olin to act during the one year price commitment, they could have pressured Olin to do so. The Complaint does allege that the Hunt directors failed to inquire as to Olin's plans with respect to the minority stockholders. Based upon other allegations in the Complaint, one could conclude that, if the Hunt directors

had pursued the matter, they would have learned that Olin decided to acquire the publicly held stock long before the price commitment expired, but that Olin was purposely waiting until the year was over in order to accomplish the merger at a lower price. Assuming, for purposes of this motion, that Olin wrongfully manipulated the timing of the merger to avoid the price commitment, I think it is reasonably inferable from the allegations discussed above that the Hunt directors could have prevented Olin from carrying out its plan if they had been more vigilant.

The Hunt directors' remaining arguments are also unpersuasive. They suggest that the Complaint does not purport to state a neglect claim because it focuses on Olin's allegedly wrongful conduct and because the class plaintiffs seek to represent does not include those who were stockholders during the one year price commitment. While it may be that the neglect claim was an after thought, it is in the Complaint and I know of no authority for the proposition that plaintiffs may only pursue their primary theories of liability. The fact that plaintiffs may not be able to litigate the neglect claim as a class action, likewise, does not warrant dismissal. Plaintiffs allegedly were stockholders during the one year prior to the merger. Thus, they would have standing to maintain this claim individually, even if their class claims are deficient. Finally, the Hunt directors argue that the Supreme Court's description of the claim against Olin is the law of the case and precludes the assertion of the neglect claim. *See Rabkin v. Philip A. Hunt Chemical Corp.*, Del. Supr., 498 A.2d 1099 (1985). I find nothing in the Supreme Court's decision to support this argument.

Based upon the foregoing, the Hunt directors' motion for reargument is denied. IT IS SO ORDERED.

RB ASSOCIATES OF NEW JERSEY, L.P. v. GILLETTE CO.

No. 9711

Court of Chancery of the State of Delaware, New Castle

March 22, 1988

Plaintiff, a registered owner of shares of Gillette Co., seeks the production of a NOBO list from various banks and brokers owning Gillette stock under the authority of section 220 of the Delaware General Corporation Law. The court of chancery, per Chancellor Allen, held that where Gillette has not obtained any NOBO lists itself and has no intention to do so, section 220 does not require that the plaintiff is entitled to information that the corporation itself does not yet have.

1. Corporations ⟹ 181(1)

Delaware law has long recognized and codified a common law right of a record stockholder to have access to a list or ledger of the corporation's stockholders upon demand, for a proper purpose. DEL. CODE ANN. tit. 8, § 220 (1983).

2. Corporations ⟹ 181(2)

All specifically identified information relating to the current identity of shareholders in the hands of the corporation should be made available as well to a shareholder who has an established entitlement to a "list of stockholders" under section 220 of the Delaware General Corporation Law. DEL. CODE ANN. tit. 8, § 220 (1983).

3. Corporations ⟹ 181(2)

The production of a "stock list" must include stock transfer sheets, computer tapes, and lists of beneficial owners of stock registered on the corporation's book by depository firms.

4. Corporations ⟹ 181(2)

Once having established a proper purpose, a stockholder is entitled to the same lists and data relating to stockholders as is

available to the corporation. DEL. CODE ANN. tit. 8, § 220 (1983).

5. Corporations ⟹ 307, 310(1)

Directors of a Delaware corporation have the right and duty to exercise the powers of the corporation and when a board acts or decides not to act with respect to a particular power, the courts will not intervene to second-guess the wisdom, prudence, or advisability of the decision, so long as it appears to have been made advisedly and in good faith. DEL. CODE ANN. tit. 8, § 141(a) (1983).

6. Corporations ⟹ 181(2)

Where a breakdown or list is readily available to the corporation, then such information must be made available to a shareholder as part of the production of a stock list.

7. Corporations ⟹ 181(2)

But where a corporation has not acquired certain lists (NOBO lists) and has no need for them itself, and has no intention to obtain them, directors will not be compelled to obtain them for the benefit of a shareholder.

8. Corporations ⟹ 181(2)

Fairness only requires that relief in a section 220 case should afford to a shareholder the same information regarding the identity of stockholders as the corporation has in its books, records, and other papers, including a NOBO list if a corporation already has such a list.

9. Corporations ⟹ 181(2)

Section 220 does not create a right to require a board to exercise its federal rights under the SEC shareholder communication rules so that plaintiff may have information that the corporation itself does not yet have. DEL. CODE ANN. tit. 8, § 220 (1983).

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Bruce M. Stargatt, Esquire, and Melanie K. Sharp, Esquire, of Young, Conaway, Stargatt & Taylor, Wilmington, Delaware; and Hugh R. Whiting, Esquire, and Richard I. Werder, Jr., Esquire, of Jones, Day, Reavis & Pogue, Cleveland, Ohio, for defendant.

ALLEN, *Chancellor*

A "NOBO" list is a list of beneficial owners of a corporation's stock who do not object to the disclosure of their name and address by the registered owner of the stock (typically, a stock broker or a bank) to the corporation itself for the limited purpose of facilitating direct communication on corporate matters. NOBO lists are a recent creation of federal law.[1] In promulgating the rules requiring brokers, dealers and banks to create such lists upon the request of the issuing corporation, the Securities Exchange Commission considered whether the corporation's shareholders should themselves be granted the power on the same terms as the issuer to require the production of a NOBO list. *See* SEC Release No. 34-22533, 50 Fed. Reg. 204 (1985). That has not, however, been done.

In *Shamrock Associates v. Texas American Energy Corp.*, Del. Ch., 517 A.2d 658 (1986), this court held that a corporation that had procured NOBO lists in connection with the solicitation of proxies for an annual meeting was required to share those lists with a stockholder who had established its right under Section 220 of the Delaware General Corporation Law to inspect "a list of [the corporation's] stockholders."

The present action is also one brought under the authority of Section 220 seeking a stock list. The plaintiff is the registered owner

1. *See* SEC Exchange Act Release No. 21901 (March 28, 1985), CCH Sec. L. Reptr. ¶ 83756, and Release No. 22533 (October 15, 1985), CCH Sec. L. Reptr. ¶ 83930. The Rules creating the NOBO system are contained in SEC Rules 14b-1, 14c-7 and 14a-13, all codified in part 240 of the Code of Federal Regulations.

of shares of Gillette Company and is presently itself contemplating a proxy contest against the incumbent board of defendant. It seeks a list of beneficial owners of Gillette stock who do not object to the disclosure of their identity to the Company, so that it may communicate with them by telephone to solicit their support in the forthcoming contest. The stipulated record indicates that the identity of the beneficial owners of approximately 17% of the Company's common stock would be disclosed on all NOBO lists.

There is here presented none of the issues that frequently arise in stock list cases: no question about the status of the plaintiff or the propriety of the purpose, and no question about the form or delivery of the demand. Indeed, the Company has already delivered to plaintiff, or agreed to deliver, computer tapes, transfer sheets and depository company breakdowns that constitute all of the materials that various opinions of this court have established as constituting a company's stock list for inspection purposes pursuant to Section 220. In this action, plaintiff seeks in addition, the production of NOBO lists from the various banks and brokers owning Gillette stock. The issue thus raised is, however, not decided by *Shamrock Associates*, because, unlike Texas American Energy Corporation, Gillette has not obtained any NOBO lists and, unless ordered by this court to do so, has no intention to obtain such lists.

It claims that it has no need for such lists and that the use of a NOBO list in connection with a proxy fight is inconsistent with federal law. Last year, it did obtain NOBO lists, but did not use them for proxy solicitation purposes, but rather, in connection with admitting shareholders to its annual meeting. Since those lists were then discarded, they are not now in the possession of the Company.

Thus, the case presents a question of first impression in this jurisdiction: whether a Delaware corporation has an obligation to obtain from each of the brokers and banks who are the registered owners of its stock, a so-called NOBO list, for the sole purpose of furnishing such lists to a shareholder who has established a right to inspect the Company's stock list when the corporation itself has not obtained and does not plan on obtaining such lists for its own use. While this question is one of first impression, it does not hang suspended in mid-air. Rather, it sits upon a foundation of statutory and case law, most notably including a short line of cases treating the list of beneficial owners disclosed on the so-called "Cede breakdown," which, in some respects, is analogous to NOBO lists. Thus, a sensible way to approach this problem is first to sketch out this statutory and case law background.

I.

[1] Delaware law has long recognized and codified a common law right of a record stockholder to have access to a list or ledger of the corporation's stockholders upon demand, for a proper purpose. *See State ex rel. Healy v. Superior Oil Corp.*, Del. Super., 13 A.2d 453, 454 (1940). Presently, that right is treated in Section 220 of our corporation statute, which, insofar as relevant to this case, provides as follows:

> (b) Any stockholder . . . shall, upon written demand under oath stating the purpose thereof, have the right during the usual hours for business to inspect for any proper purpose the corporation's stock ledger, a list of its stockholders, and its other books and records, and to make copies or extracts therefrom. A proper purpose shall mean a purpose reasonably related to such person's interest as a stockholder.
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> ***
>
> (c) . . . The Court of Chancery is hereby vested with exclusive jurisdiction to determine whether or not the person seeking inspection is entitled to the inspection sought. . . . The Court may, in its discretion, prescribe any limitations or conditions with reference to the inspection, or award such other or further relief as the Court may deem just and proper.

8 *Del. C.* § 220.

[2-3] The question what constitutes "a list of [a corporation's] stockholders" has received a good deal of judicial attention over recent years. Generally, it may be said that the principle that tends to guide decisions in this area is that all specifically identified information relating to the current identity of shareholders in the hands of the corporation should be made available as well to a shareholder who has established entitlement to a "list of stockholders" under Section 220. Thus, our cases, in requiring the production of a "stock list," have required the production of stock transfer sheets, computer tapes and lists of beneficial owners of stock registered on the corporation's book by depository firms such as Depository Trust Co. (the so-called Cede breakdowns). *See, e.g.*, *Tannetics, Inc. v. A.J. Industries, Inc.*, Del. Ch., C.A. No. 4592,

Marvel, V.C. (Sept. 4, 1974), 2 Del. J. Corp. L. 348 (1974) (computer tapes).

A handful of those cases set forth the legal precedents chiefly relevant here. Stated chronologically, they include *Bear, Stearns & Co. v. Pabst Brewing Company*, Del. Ch., C.A. No. 5456, Brown, V.C. (November 25, 1977); *Giovanini v. Horizon Corporation*, Del. Ch., C.A. No. 5961, Brown, V.C. (September 12, 1979); *Hatleigh Corp. v. Lane Bryant, Inc.*, Del. Ch., 428 A.2d 350 (1981); *Tactron, Inc. v. KDI Corp.*, Del. Ch., No. 7885, Berger, V.C. (January 4, 1985); and *Shamrock Associates v. Texas American Energy Corp.*, Del. Ch., 517 A.2d 658 (1986). Excepting the last of these—*Shamrock Associates*—which, as mentioned above, deals with the question whether a corporation with a NOBO list must produce it as part of its stock list, these cases all deal with the obligation to produce a Cede breakdown. They are instructive because a Cede breakdown is functionally similar in some respect to a NOBO list.

[4] A Cede breakdown (and I use the term in the generic sense it seems to have acquired in our cases to include similar information respecting other stock depository companies such as Kray & Co. and Pacific & Co.), was described by this court in *Giovanini v. Horizon Corporation, supra*, as follows:

> CEDE & Co. is the name utilized by Depository Trust Company to hold shares owned by it. Depository Trust Company is an association of more than 200 brokerage houses and financial institutions which was formed for the purpose of owning shares held in street name for the beneficial interest of customers of the brokerage firms and financial institutions. In other words, the name "CEDE & Co." appearing on the corporate stock ledger is thrice removed from the true beneficial owner. The brokerage house owns the stock for the benefit of its customer, but it holds title through the Depository Trust Company which in turn uses the name CEDE & Co. for this purpose. This is done, as I understand it, for the benefit of those firms participating in the Depository Trust Company so as to simplify their stock transfer transactions on behalf of their customers.

This mechanism of convenience for the brokerage firms, however, prevents the stock ledger from revealing to one examining it just which brokerage firms own shares and the number of shares owned by each. This information, or "breakdown," can be provided

to the corporation at its request. Again, through the wonders of modern computer technology, this can apparently be accomplished in a matter of minutes. Such a breakdown having disclosed the identity of the firms owning stock under the name of "CEDE & Co.", contact can then be made with such firms in order to ascertain the number of beneficial owners on whose behalf they hold stock in street name in order that a proper amount of informational materials may then be forwarded to the brokerage firms for distribution to the beneficial owners.

Slip op. at 2. In *Giovanini*, the court concluded that:

> Since the evidence here shows that such a breakdown is readily available to the corporation for the purpose of making its contact with the shareholders, then I feel that such information should be made available to the plaintiff forthwith so that his list of stockholders for his proper purpose of soliciting their proxies is at least equivalent, in this aspect, with the list available to the corporation for the same purpose.

Slip op. at 4.

Two years later, in *Hatleigh*, *supra*, the court again required that the corporation produce a Cede breakdown. After quoting from *Giovanini*, the court there held:

> A CEDE breakdown showing the names of the brokerage firms and the number of shares they hold is readily available to Lane Bryant and without it there would be no practical way for Hatleigh to learn how many copies of its proposed communication it should send to CEDE & CO. for distribution to the brokerage firms and then to the true owners of Lane Bryant stock.

428 A.2d at 354. The court went on to state a general principle and a limitation:

> Once having established a proper purpose, a stockholder is entitled to the same lists and data relating to stockholders as is available to the corporation. See *Lerman v. Diagnostic Data, Inc.*, Del. Ch., unreported, (C.A. # 6233-NC, Aug. 11, 1980) and *Cargill, Inc. v. Missouri-Portland Cement Co.*, Del. Ch., unreported (C.A. # 4583-NC, Sept. 11, 1974). To hold otherwise would be to give the corporation an unfair advantage in a proxy solicitation

> battle. The best interest of the stockholders requires that they quickly receive all the information generated by the competing interests. Lane Bryant, however, is under no obligation to prepare for Hatleigh lists, data, or computer tapes which are not readily available to it and, of course, Hatleigh must pay any costs involved.

Id. at 354-55.

The next case in the series is the short, 1985 letter opinion by Vice Chancellor Berger in *Tactron, Inc. v. KDI Corporation*, cited above. There, the court, placing emphasis upon the use of the word "available" in *Hatleigh*, held that a corporation could be required to have a Cede breakdown produced as part of a stock list inspection even if the corporation had not already done so. The analysis was brief:

> The demand letter sets forth nine categories of stockholder materials. KDI only takes issue with the production of the materials requested in paragraphs 7-9. Paragraph 7 seeks stockholder breakdowns from central depository systems such as Cede & Co. KDI acknowledges that these stockholder breakdowns are customarily provided. *See, e.g., Goldman v. Aegis Corp.*, Del. Ch., Civil Action No. 8396, Hartnett, V.C. (April 7, 1981). However, KDI contends that it should only be obliged to provide Tactron those breakdowns KDI itself obtains. I disagree. These breakdowns are readily available to KDI and should be made equally available to Tactron, even if KDI does not request the information for itself. *Hatleigh Corp. v. Lane Bryant, Inc.*, Del. Ch., 428 A.2d 350 (1981).

Slip op. at 3.

The final relevant Delaware authority is Vice Chancellor Berger's thoughtful opinion in *Shamrock Associates v. Texas American Energy, supra*. That case, decided shortly after the SEC's stockholder communication regulations went into effect, held that a corporation that had exercised its federal right and had acquired lists of certain (*i.e.*, non-objecting) beneficial owners of its stock from the banks and brokers who owned that stock in street name, was obliged to produce a copy of such lists to a shareholder who had shown itself entitled to inspect the Company's stock list. In so holding, this court rejected an assertion that since Rule 14a-13(b)(2) conferred the right to demand a NOBO list only on the issuer, it would be

inconsistent with federal law, and thus invalid under the supremacy clause of the United States Constitution, to make that list available to shareholders as a matter of state law. It held that, broadly speaking, disclosure would be consistent with, and indeed would foster, the purposes of the Williams Act.[2]

The court also rejected, on the record before it, the claim that a legitimate privacy interest of the persons who had consented to disclosure of their identity to the corporation—but not presumably to a disclosure to other shareholders interested in engaging in communications respecting corporate affairs—would be infringed by disclosure to plaintiffs.

Finally, the court held that it could detect no material difference for these purposes between a Cede breakdown and a NOBO list. Relying upon the language of *Hatleigh* indicating that to withhold the Cede breakdown "would be to give the corporation an unfair advantage . . . [and that] the best interest of stockholders requires that they quickly receive all the information generated by the competing interests" (517 A.2d at 661), the court required the NOBO lists to be produced.

This case now seeks to complete the analogy between a Cede breakdown and a NOBO list by requiring defendant, who neither has NOBO lists nor plans to get any, to order them for the benefit of plaintiff (or perhaps, it should be said, for the benefit of fuller stockholder communication).

II.

This matter has now been presented to the court for final judgment upon a short stipulation of facts and oral argument. The pertinent background facts are few. I have already indicated the approximate percentage of stock that would be expected to be represented on NOBO lists of Gillette's registered owners and the fact that Gillette has not acquired, nor does it intend to acquire, a NOBO list. Additionally, it might be noted that generally all stock brokers have appointed the Independent Election Corporation of America as their agent for purposes of responding to NOBO list requests from issuers and thus, insofar as brokers are concerned,

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2. The courts that have subsequently addressed this question have reached similar conclusions. *See Burlington Industries, Inc. v. C.H. Masland & Sons*, No. 86-3296, ____ F. Supp. ____ (E.D. Pa. June 12, 1986); *Baron v. Strawbridge & Clothier*, No. 86-2474, ____ F. Supp. ____ (E.D. Pa. May 1, 1986).

all non-objecting beneficial owners would be shown on a single list. The same situation does not apparently pertain with respect to banks, who respond to such requests individually. In Gillette's case, there are apparently ten or twelve banks owning its stock and requests to each of those would be necessary. Unlike Cede breakdowns, construction of NOBO lists is not done practically instantaneously; the federal regulations creating the obligation permit ten days for the response to a corporate request to be made.

III.

[5-7] Federal law creates an option for a registered issuer of corporate stock to require the production of lists of certain beneficial owners of its stock. Federal law creates no duty to do so and the question raised by the case is whether state law creates such a duty in the circumstances here presented. It is, of course, axiomatic that the directors of a Delaware corporation have the right and duty to exercise the powers of the corporation, 8 *Del. C.* § 141(a), and when a board acts or decides not to act with respect to a particular power, the courts will not intervene to second-guess the wisdom, prudence or advisability of the decision, so long as it appears to have been made advisedly and in good faith. *Aronson v. Lewis*, Del. Supr., 473 A.2d 805 (1984); *Ivanhoe Partners v. Newmont Mining Corp.*, Del. Supr., ___ A.2d ___, No. 341, Moore, J. (Nov. 18, 1987).

The question what constitutes a "stock list" or what information in the possession of the corporation is to be produced to a shareholder who shows his or her entitlement to inspection of a stock list, is, however, a question of law and not a question of business judgment. Thus, I see a significant difference between cases such as *Hatleigh* and *Shamrock Associates* on the one hand, in which the court construes the meaning of the term "stock list" in the light of the information in the hands of the corporation, and cases such as *Tactron* and this case, which may be viewed as cases in which the court is asked to compel the corporation to take action to change the quantum of information in the hands of the corporation. This difference was, I think, alluded to in *Hatleigh* when the court noted that:

> [The corporation], however, is under no obligation to prepare for Hatleigh lists, data, or computer tapes which are not readily available to it. . .

But, as I view *Tactron*, it too may be viewed as a case in which the corporation had the Cede breakdown. Hence, I do not read it as standing for the proposition that a corporation may be compelled to create new information or cause it to be created in response to a shareholder stock list demand. The reason I say that is the fact that *Tactron* and *Hatleigh* both rely upon *Giovanini* which indicated that "through the wonders of modern computer technology, this [production of a Cede breakdown] can apparently be accomplished in a matter of minutes." *Giovanini*, *supra* at 6. Thus, the Cede breakdown has been viewed as something that can, in effect, be produced instantly. It is, therefore, available to the corporation in a proxy contest immediately when needed, even at the last moment. Accordingly, it can fairly be said that such information is, in a real sense, in the possession of the corporation at all times. As a result, contesting parties cannot be put on substantially the same footing unless a stock list includes depository company breakdowns.

A NOBO list is different in two material respects. First, the evidence demonstrates that such a list takes approximately ten days to produce. It is not immediately available to the issuer. Second, a modern proxy solicitation can hardly be conducted at all without the benefit of a breakdown of the persons for whom a depository company holds its shares. The written proxy materials would all have to be sent to the depository company who would then distribute them to brokers who, in turn, would send them along to beneficial owners. The depository companies are not equipped for this massive forwarding task. Alternatively, search cards could be directed by the issuer to all brokers to find out how many shares they claim to own for others. Without a Cede breakdown, however, an issuer could not tell if responding claims were correct or the proxies valid. Thus, a Cede breakdown is essential to the proxy solicitation process as currently conducted. As a consequence, a registered issuer almost always does have one on hand that is not more than thirty days old.

A NOBO list plays no central role in a proxy contest. While the information it discloses (*i.e.*, the identity of the ultimate owners) may, of course, be of use in telephone solicitations, that information is not necessary for the effective working of the written proxy solicitation process. Once an issuer has acquired that additional information, *Shamrock Associates* establishes that it has an obligation to disclose it to a shareholder as part of the production of a stock list. But where it has not done so, the ideal of equality of access to information concerning identity of shareholders ought not, in

my opinion, go so far as to compel the directors to exercise a judgment to obtain NOBO lists when the corporation itself has no need for them and thus no intention to obtain them.

Only two judicial opinions have been called to my attention in which the question whether a corporation that did not possess a NOBO list should be required to obtain one in order to make it available to plaintiffs. In each, such relief was denied. In an unreported bench ruling, the New Jersey Superior Court rejected, without a statement of reasons, such a request. *See Shamrock Associates v. Matrix Corp.*, N.J. Super., Somerset Co., Diana, J. (December 15, 1987). The Federal District Court for the District of Nevada reached a similar conclusion in *Cenergy Corp. v. Bryson Oil & Gas, P.L.C.*, 662 F. Supp. 1144, 1148 (D. Nev. 1987). In that case, the court applied Nevada corporation law, which, in the absence of controlling Nevada authority, apparently looks to Delaware corporation law opinions for helpful guidance. Thus, there the court cited and discussed *Hatleigh* and *Shamrock Associates v. Texas American Energy Corp.* in recognizing a right to obtain a NOBO list as part of a stock list, but refused to extend *Shamrock* to require the corporation there involved to "acquire specially any shareholder information which it does not already possess in order to then distribute it to [a shareholder]." 662 F. Supp. at 1148.

[8] I do not put a great weight upon these opinions, as, in neither instance was the point here in issue central to the questions there presented. But each does reflect judicial recognition of the fact that a materially different question is presented when one seeks to compel a board to take an action to change the information in the Company's possession, than is presented when a shareholder seeks, for a proper purpose, to share information that the Company does possess. Neither broad concepts of fairness, nor the words of Section 220, in my opinion, require that a corporation be forced, in each instance, to exercise the option created by the applicable SEC Rules at the behest of a shareholder. What fairness does require, and what our opinions repeatedly return to, is the principle that relief in a Section 220 case should afford to a shareholder the same information regarding the identity of stockholders as the corporation has in its books, records and other papers. *See Hatleigh.*

[9] That obligation, of course, includes a NOBO list if a corporation has such a list. In order to enforce this obligation recognized in *Shamrock Associates*, however, and to avoid any possibility of manipulation, it is appropriate in this instance to place Gillette under an order to the effect should it hereafter elect to

obtain a NOBO list in connection with the forthcoming shareholders meeting, it shall notify plaintiff promptly of that fact and shall supply to plaintiff copies of each such list it receives immediately upon Gillette's receipt of it. Beyond that, however, I cannot conclude that Section 220 creates a right to require the Gillette board to exercise its federal rights under the SEC shareholder communication rules so that plaintiff may have information that the corporation itself does not yet have.

Judgment in conformity with the above shall be entered. Defendant may submit a form of order on notice no later than noon, March 24, 1988.

SHINGALA v. BECOR WESTERN, INC.

No. 8858

STEINER v. BECOR WESTERN, INC.

No. 8859

Court of Chancery of the State of Delaware, New Castle

February 3, 1988

Defendant company is in the business of manufacturing equipment for the petroleum, steel, and marine industries. The company's board of directors authorized management to explore the possibility of maximizing stockholder values by selling all or part of the company. The board of directors suggested that the company be sold. Certain members of senior management organized a newly formed corporation and attempted a leveraged buy out of the company. The defendant company entered into a merger agreement with the newly formed corporation and agreed to sell the entire company to a third party, subject to stockholder approval.

Plaintiffs filed suit the day after the merger agreements were announced alleging that the defendant company's directors breached their fiduciary duties because: (1) there was no open and free auction; (2) the special committee of the defendant board of directors did not function independently during the auctions; (3) the defendant board of directors arbitrarily terminated an active auction