THE SALE OF ALL OR SUBSTANTIALLY ALL CORPORATE ASSETS UNDER SECTION 271 OF THE DELAWARE CODE

By Andrew Moore II*

ONE OF THE RELATIVELY unchartered areas of Delaware corporate law centers around the provision of 8 Del. C. § 271, requiring the approval of a majority of the outstanding voting stock of a corporation, whenever it intends to sell, lease or exchange "all or substantially all" of its assets. The focus of this article will be limited to the question of when such stockholder vote is required in the context of § 271. Thus, for present purposes the questions as to how the assets being sold are valued, or the remedies of stockholders and creditors in the event of a violation of § 271, are not considered here.

I. Section 271 and Its Background.

The statute as it is presently enacted provides in pertinent part:

"(a) Every corporation may at any meeting of its board of directors sell, lease, or exchange all or substantially all of its property and assets, including its good will and its corporate franchises, upon such terms and conditions and for such consideration, which may consist in whole or in part of money or other property, including shares of stock in, and/or other securities of, any other corporation or corporations, as its board of directors deems expedient and for the best interest of the corporation, when and as authorized by a resolution adopted by a majority of the outstanding stock of the corporation entitled to vote thereon at a meeting thereof duly called upon at least 20 days notice. The notice of the meeting shall state that such a resolution will be considered." (Emphasis added).

This statute and its predecessors have been a part of the General Corporation Law of the State of Delaware since 1916. It was originally enacted to provide flexibility in the disposition of corporation assets, which the common law restricted, since the sale of all or substantially

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all of a corporation's property could only be achieved by a unanimous vote of the stockholders.¹

However, with the advent of multibusiness corporations, which regularly acquire and dispose of substantial assets and business enterprises, as well as economic considerations which have required major restructurings of corporate entities, certain problems, possible pitfalls, and their avoidance or solution have yet to receive major consideration by the Delaware courts. Particularly, in the area of corporate reorganization or restructuring, as discussed below, there are no decisions of the Delaware courts which specifically touch upon the § 271 issues presented by such corporate activities.

Under § 271, the nature of the transaction, its terms and conditions are solely within the province of the board of directors. This is consistent with the philosophy of the General Corporation Law, that the business and affairs of every corporation shall be managed by or under the direction of a board of directors.² The stockholders have no power to set terms and conditions of any proposed transaction requiring their approval under § 271. Their rights are limited solely to the approval of the transaction contemplated by the board of directors.

The philosophy behind enactment of § 271 is as follows:

"The purpose of the consent statute is to protect the shareholders from fundamental change, or more specifically to protect the shareholder from the destruction of the means to accomplish the purposes or objects for which the corporation was incorporated and actually performs."³

Taken literally, this would seem to preclude the disposition of all assets of the company relating to any specifically identified purpose of the corporation appearing in its Certificate of Incorporation, despite the fact that such assets may only be a major portion of the company's property and not "all or substantially all" of its assets. However, the wording of § 271 and the few court decisions dealing with it, clearly indicate that the corporation is not so restrained. While there are no decisions of the Delaware courts defining the words "all or substantially all" of a company's assets, these terms are not ambiguous and Delaware decisions have tended to establish certain limits and standards under § 271.

There are three major areas of potential difficulty under § 271 which may confront the corporation and its counsel. Each deserves

2. 8 Del. C., § 141.
3. 6A Fletcher, Cyclopedia Corporations, § 2949.2, at 648 (perm. ed., 1968 rev.).
individual consideration, and while in some contexts they are inter-related, it may be helpful to discuss them separately.

A. The outright sale of corporate assets.

While not without its § 271 difficulties, whenever a corporation proposes to sell a major portion of its assets, certain guidelines provided by the Delaware decisions are most helpful. Although no mathematical formula exists to determine "all or substantially all" of a company's assets, it is clear that on either a quantitative or qualitative basis, the sale of 50% or less of a company's property does not fall within the ambit of § 271.4

While there is authority indicating that the sale of 75% of a company's assets may fall within the definition of "all or substantially all" of its property,5 the Supreme Court of Delaware seems to have warned that the Philadelphia National Bank case may not be truly helpful in a § 271 context, since it arose out of a negative covenant in a debenture controlled by Pennsylvania law preventing the sale of "all or substantially all" of the borrower's property. In clearly distinguishing between this contract right arising out of a debenture governed by the law of another state, and the definition of the phrase "all or substantially all" under § 271, Chief Justice Wolcott stated:

"We are of the opinion that this question is not necessarily to be answered by references to the general law concerning the sale of assets by a corporation. The question before us is the narrow one of what particular language of a contract, means, and is to be answered in terms of what the parties were intending to guard against or to insure." (Emphasis added).6

Another important factor in the Philadelphia National Bank case was that the sale in question involved the company's only substantial income producing asset.

While the phrase "all or substantially all" of the company's assets is not subject to mathematical certainty, it clearly appears that the word "or" is conjunctive rather than disjunctive, and the phrase "substantially all" does not create an additional prohibited area of sales outside the purview of the word "all". Instead, it has been suggested that the phrase "substantially all," as it appears in the Model Business Corporation Act, was merely designed "to prevent avoidance of the

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6. Id. 42 Del. Ch. at 111-12, 204 A.2d at 750.
statute by retention of some minimal residue of the original assets." It seems further supported by the following comment of the Supreme Court of Delaware in the *Philadelphia National Bank* case:

"Section 271 requires stockholder approval only for the sale of all of the assets of a Delaware corporation." (Emphasis added).  

It has also been suggested by way of negative implication that a sale of less than all or substantially all of the company's assets is beyond the strictures of § 271. In addition to the foregoing, there are other factors which have emerged through decisions of the Delaware courts, and if applicable to a given situation, they apparently exclude the transaction from the applicability of § 271. Thus, if either of the following propositions can be affirmatively stated, regarding a proposed sale of assets, then stockholders vote does not appear to be required:

(1) The transaction is in the regular course of business of the seller in furtherance of its express corporate objects.

(2) The proposed transaction does not leave the stockholders without owning anything in place of the assets sold.

Taken together, a transaction is only subject to § 271 if all of the following conditions apply:

(1) The sale of assets is quantitatively vital to the operation of the corporation,

(2) Is out of the ordinary, and

(3) Substantially affects the existence and purpose of the corporation.

However, it is clear that shareholder approval is not required of every major sale of assets or restructuring of the corporation, and any "ordinary and regular course of business" test is not intended to limit the directors to customary daily business activities, since every transaction out of normal routine does not necessarily require share-

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8. *Supra*, 204 A.2d at 749.
9. Wingate v. Bercut, 146 F.2d 725 (9th Cir. 1944). See also Folk, *The Delaware General Corporation Law* at 400 n.3 (1972).
11. Finch v. Warrior Cement Corp., 16 Del. Ch. 44, 141 A. 54 (Ch. 1928).
holder approval. In substance, it is only the unusual nature of the transaction, which strikes at the heart of the corporate existence and purpose, which brings it within the purview of § 271.

B. Acquisitions and sales by multibusiness corporations.

With the advent of conglomerates, which have routinely acquired and disposed of independent branches of their corporate business, it appears that this fact has brought them within the ambit of the "regular course of business" test, since the very nature of a conglomerate's operation contemplates such major transactions.

Accordingly, substantial guidance is found in the Gimbel case, and the court has clearly recognized that the acquisition and disposal of major portions of a company's assets over a developing period of years may well have the effect of emasculating § 271, since those transactions are no longer limited or circumscribed by the provisions of § 271. However, in this context the court recognized that shareholders were not without the protection afforded by corporate democracy:

"But it is one thing for a corporation to evolve over a period of years into a multibusiness corporation, the operations of which include the purchase and sale of whole businesses, and another for a single business corporation by a one transaction revolution to sell the entire means of operating its business in exchange for money or a separate business. In the former situation, the processes of corporate democracy customarily have had the opportunity to restrain or otherwise control over a period of years. Thus, there is a chance for some shareholder participation."

C. Restructuring or reorganisation of corporate affairs.

This area is perhaps the one most open to doubt, although the guidelines enunciated in cases falling within the two previous categories seem to provide helpful answers. Because of economic considerations, companies often find it necessary to consolidate units of their operations under a wholly owned subsidiary, and the purposes for such action can range from a need to reduce costs to facilitating the pledge of assets by a single corporate entity. The classic situation arises where A Company decides to transfer a major portion of its income producing assets to a wholly owned subsidiary (B Company). If these comprise 80% of A Company's revenue producing assets, does § 271 become applicable? It is submitted that the answer is no.

14. Id.
15. Id.
16. Id.
17. Id. at 608.
Of course, it is true that the transfer will effectively deprive the A Company stockholders of their right of consent under § 271 if directors of B Corporation later decide to sell all or substantially all of its assets, since stockholder approval by A would be readily available pursuant to 8 Del. C., § 228, permitting written consent of a majority of stockholders in lieu of a meeting.

Notwithstanding the A Company stockholders' loss of consent under § 271, which this type of reorganization involves, it is submitted that the transaction is entirely appropriate and beyond the purview of § 271. While there has been a change in the mode of A Company operations, it is formal rather than substantive, and nothing in the history of § 271 or the Delaware cases indicates that such internal restructuring is within the reach of that statute. A contrary view ignores the realities of modern business needs and the flexibility to meet them which the Delaware corporate law has historically afforded. Assuming the absence of fraud, self-dealing or other improper motives on the part of A Company directors, it cannot be said that the stockholders of A are left owning "nothing in place thereof," or that the transaction substantially affects the existence and purpose of the corporation. While the transaction may be "unusual" as it pertains to A, it clearly does not strike at the heart of the corporate existence and purpose of A. Furthermore, A has not actually effected a transaction which involves the disposition of the "entire means of operating its business."10

In fact, it appears that some years prior to the institution of the Gimbel suit, the Signal Companies had undertaken precisely this form of reorganization, and transferred the assets in question to the subsidiary, whose stock the plaintiff in Gimbel attempted to prevent the defendant from selling.20 Thus, if the parent corporation in the Gimbel case had merely attempted to sell its subsidiary's assets, rather than all of the stock of the subsidiary, it is questionable whether any § 271 claim could have been raised.

While there is authority elsewhere that a corporate reorganization or restructuring, which includes the transfer of substantial assets to a wholly owned subsidiary, is improper,21 it does not appear that either the facts or the law applied in other jurisdictions are consistent with the Delaware decisions discussed above or § 271 itself.

18. Id. at 606.
19. Id. at 606.
20. Id. at 608.
II. Conclusion

The birth of multibusiness corporations or conglomerates has seriously emasculated the provisions of § 271. Their activities have reduced the transfer of substantial assets to the level of ordinary and regular business transactions, even though such transactions may have resulted in the total divestiture of major assets by sale or exchange. In that situation, the stockholders' only remedy is recourse to the displacement of management by corporate democracy. Similarly, the transfer to wholly owned subsidiaries, while clearly divesting stockholders of a § 271 vote, does not involve the loss of corporate objectives and earnings, or otherwise leave the stockholders with nothing in their place. Such transactions, while not yet specifically sanctioned by any decision of the Delaware courts, appear to be soundly supported by the guidelines set forth in other Delaware cases under § 271.