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Volume 29 | Issue 3

Article 13

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1983

## Corporations - Under Delaware Law, Majority Shareholders Have No Duty to Ensure That Minority Shareholders Benefit from a Contractual Corporate Dividend Distribution Policy Where the Latter's Changed Circumstances Preclude Enjoyment of the Benefit

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### Recommended Citation

Gregory F. Lepore, *Corporations - Under Delaware Law, Majority Shareholders Have No Duty to Ensure That Minority Shareholders Benefit from a Contractual Corporate Dividend Distribution Policy Where the Latter's Changed Circumstances Preclude Enjoyment of the Benefit*, 29 Vill. L. Rev. 932 (1983).

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1983-84]

CORPORATIONS—UNDER DELAWARE LAW, MAJORITY SHAREHOLDERS  
HAVE NO DUTY TO ENSURE THAT MINORITY SHAREHOLDERS BENEFIT  
FROM A CONTRACTUAL CORPORATE DIVIDEND DISTRIBUTION POLICY  
WHERE THE LATTER'S CHANGED CIRCUMSTANCES PRECLUDE  
ENJOYMENT OF THE BENEFIT

*In re Reading Co.*, 711 F.2d 509 (1983)

The Reading Company (Reading), owner of an interstate railroad, entered into bankruptcy reorganization in 1971.<sup>1</sup> In April 1976, Reading discontinued its rail operations and conveyed its rail properties to the Consolidated Rail Corporation (Conrail), pursuant to the Regional Rail Reorganization Act of 1973.<sup>2</sup>

One of Reading's assets subject to the control of the trustee in reorganization was a block of Trailer Train Corporation (Trailer Train) stock.<sup>3</sup> Trailer Train was formed in 1955 for the sole purpose of facilitating inter-railroad "piggyback" shipments by establishing a pool of standardized railroad flat cars<sup>4</sup> to be leased at minimum rates to shareholders.<sup>5</sup> Since its

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1. *In re Reading Co.*, 711 F.2d 509, 512 (3d Cir. 1983). Reading's reorganization proceedings were commenced under the Bankruptcy Act of 1898. *Id.* See Bankruptcy Act of 1898, ch. 541, 30 Stat. 544, *repealed by* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 401(a), 92 Stat. 2549, 2682. All subsequent proceedings, including this appeal, were governed by the 1898 Act. 711 F.2d at 512 n.1 (citing Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 403(a), 92 Stat. 2549, 2683).

2. 711 F.2d at 512 (citing 45 U.S.C. §§ 701-797m (1976 & Supp. V 1981)). The Regional Rail Reorganization Act was passed in response to the failure of several major northeastern carriers. See Perritt, *Ask and Ye Shall Receive: The Legislative Response to the Northeast Rail Crisis*, 28 VILL. L. REV. 271, 297-301 (1983). The Act provided that the bankrupt railroads would convey their rail holdings to Conrail, a federally funded corporation, which would operate rail service on the transferred properties. *Id.* at 300.

Reading emerged from bankruptcy reorganization in 1981 but has not reentered the railroad business. 711 F.2d at 512.

3. 711 F.2d at 512-13. Reading acquired 500 shares of Trailer Train stock in 1961, at a book value of \$150,105. *Id.* at 513 (footnote omitted). In so doing, Reading purchased the minimum number of shares which would enable it to lease standardized railroad flat cars under Trailer Train's shareholder pooling agreement. *Id.* For a discussion of Trailer Train's pooling arrangement, see notes 4-5 *infra*.

4. *In re Reading Co.*, 551 F. Supp. 1205, 1207 (E.D. Pa. 1982), *rev'd*, 711 F.2d 509 (3d Cir. 1983). In 1955, the Pennsylvania Railroad Company and others formed Trailer Train and established a pool of 500 standardized railroad cars for hire by shareholder railroads. 711 F.2d at 512. By 1979, Trailer Train's pool had grown to 87,494 piggyback (intermodal), autorack, and special use cars. *Id.* This represented approximately 90% of all of such cars in use in the United States. *Id.* (citation omitted).

5. 711 F.2d at 513. Trailer Train leases cars to railroads across the country under a shareholder pooling agreement which has been approved by the Interstate Commerce Commission. *Id.* (citing American Rail Box Car Co.—Pooling, 347 I.C.C. 862 (1974)). To participate in the plan, a railroad must purchase 500 shares of

incorporation, Trailer Train's policy has been to lease cars to shareholder railroads at the lowest rates necessary to cover expenses, and to invest accumulated earnings in new equipment.<sup>6</sup> Trailer Train does not attempt to maximize profits and has never paid a dividend to its shareholders.<sup>7</sup> The only benefits of stock ownership are access to the large pool of standardized cars and Trailer Train's car hire rates.<sup>8</sup> When Reading purchased its stock

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Trailer Train stock and sign the "Form A Car Contract," which sets forth Trailer Train's rate policy. Railroads owning at least 500 shares have access to Trailer Train cars at Trailer Train's hire rates for use on their own lines or to interchange with other shareholder or nonshareholder railroads. 711 F.2d at 513. For a discussion of Trailer Train's policy as set forth in the Form A Contract, see notes 6 & 9 and accompanying text *infra*.

Reading's 500 shares constituted 2.44% of the outstanding capital stock of Trailer Train. 551 F. Supp. at 1207. The remaining stock is owned by 30 operating railroads, the trustees of Erie Lackawanna Railway Co. (a railroad which entered bankruptcy reorganization prior to Reading), and a diversified freight forwarding company. *Id.* Each shareholder is entitled to nominate one director for each block of 500 shares held; the nominees are elected to the board by all shareholders. *Id.* The district court found that nearly all members of Trailer Train's board of directors are officers of the constituent shareholder railroads. *Id.*

6. 551 F. Supp. at 1210. Trailer Train's rate policy is set forth in Supplement No. 40 of the Form A Car Contract between Trailer Train and its shareholders.

It shall be the policy of Trailer Train to maintain per diem, mileage and other charges at the lowest level required to meet Trailer Train's ordinary and necessary costs and expenses, . . . and to accumulate retained earnings adequate to support continued reasonable enlargement of the number of cars in the pool, to that number found to be needed. It is the intention [of Trailer Train and each of its shareholders] that the total compensation paid to Trailer Train . . . shall be no greater than consistent with the foregoing policy.

*Id.* (quoting Stipulation of Fact No. 34). The finance committee of the board of directors of Trailer Train is responsible for setting up and reviewing the rates to be charged for car hire and for other financial matters. *Id.* As of December 1979, the district court found that of the ten largest users of Trailer Train flatcars, who accounted for 80% of the total use of this equipment, nine had director representatives on the financial committee. *Id.*

7. 711 F.2d at 513.

8. 551 F. Supp. at 1210-11. The district court found that the benefits of Trailer stock ownership are

- (a) For most car types and for most users, rates below ICC rates for the same or similar equipment;
- (b) Access to cars without long-term financial obligation;
- (c) Access to a free-running pool of intermodal cars;
- (d) A pricing policy that encourages broad use of cars;
- (e) Standardization of cars, pooling of information concerning car needs, and efficient volume purchases;
- (f) Equipment obligations carried as debts of Trailer Train and not of the railroad shareholders.

*Id.* From 1956 to 1969, Trailer Train shareholders paid slightly higher rates for the use of Trailer Train cars than they would have paid under the Interstate Commerce Commission (ICC) per diem rate schedule had they chosen to use their own cars on other railroads' lines. *Id.* Due to a change in the ICC per diem rate formula in 1969, the aggregate car hire rates paid by most Trailer Train shareholders since then have been lower than the ICC rates. *Id.* Projections of growth, revenues, and net income

in 1961, it signed a contract setting forth Trailer Train's car rate policy.<sup>9</sup> For fifteen years Reading used Trailer Train's flat cars in its rail operations without challenging the rate policy.<sup>10</sup>

After transferring its rail properties to Conrail in 1976, Reading no longer derived any benefit from its ownership of Trailer Train stock.<sup>11</sup> Further, Reading's trustees were unable to sell the stock to an operating railroad.<sup>12</sup> At that point, Reading's trustees suggested that Trailer Train change its dividend policy, repurchase the stock at book value, or exchange the stock for newly-created debt instruments reflecting Reading's proportionate ownership.<sup>13</sup>

When the board of directors of Trailer Train would not agree to any changes in its policy, Reading's trustees successfully petitioned the reorganization court to order Trailer Train to negotiate a settlement which would

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prepared by management indicated that Trailer Train's rates would remain below prevailing ICC rates through 1988. *Id.*

9. 711 F.2d at 513. Reading signed the Form A Car Contract when it purchased its shares of Trailer Train stock. *Id.* The pertinent portion of the Form A Contract appears in note 6 *supra*. Trailer Train also informed Reading at the time of the purchase that "the car contract requires Trailer Train Company to set per diem and other charges on a basis that will enable the company to meet its expenses and to finance its car acquisitions without, however, yielding excessive profits to Trailer Train Company." 711 F.2d at 513.

10. 711 F.2d at 513. In fact, while in reorganization, Reading joined with the other shareholders to seek ICC approval of the pooling arrangement and Trailer Train's financial policy, which was ultimately granted. *Id.* (citing *American Rail Box Car Co.—Pooling*, 347 I.C.C. 862, 907-08 (1974)).

When Reading terminated its rail operations and transferred its rail properties to Conrail, Reading's trustees successfully requested that its Trailer Train stock not be transferred, "because in their view the stock 'was a valuable asset of the Reading Estate which would eventually produce substantial value for . . . creditors and stockholders.'" *Id.* at 514 (quoting Appendix to Appellant's Brief at 271-72).

11. *Id.* at 513.

12. *Id.* Reading's trustees offered Reading's stock to Trailer Train for repurchase at book value, as required under the Form A Car Contract between Trailer Train and its shareholders, but the corporation declined to repurchase the stock. *Id.* at 514 & n.3 (citation omitted). Reading's trustees also investigated the possibility of selling Reading's shares to the other Trailer Train stockholders, but they found no market. 551 F. Supp. at 1211. The district court found that "because nearly all of the major railroads in the country are already Trailer Train shareholders and because Trailer Train does not pay dividends, no benefit would accrue to an existing shareholder from owning additional shares." *Id.*

13. 711 F.2d at 513. Reading was not the first to suggest a change in Trailer Train's dividend/rate policy. *See* 557 F. Supp. at 1211. Trailer Train's shareholders own from 500 to 1500 shares each, although all shareholders of at least 500 shares enjoy the same right of access to equipment. *Id.* The district court found that there were wide variations between the shareholders' percentage stock ownership and their proportionate use of equipment, and that the ownership/use discrepancy had been the subject of discussions since 1970. *Id.* In 1975-76 the board of Trailer Train appointed a shareholder committee to consider the ownership/use matter in view of the pending transfer of Penn Central, Reading, and Erie Lackawanna rail properties to Conrail. *Id.* In 1978 the finance committee considered restructuring the capital stock to deal with the ownership/user matter. *Id.* However, none of these committees recommended that Trailer Train change its policies. *Id.* at 1212.

enable Reading to derive some benefit from its Trailer Train stock.<sup>14</sup> After a year of unsuccessful negotiations under court order, Reading's trustees amended their petition to request an order compelling Trailer Train either to repurchase the stock or to convert it into interest-bearing debt instruments or dividend-paying preferred stock.<sup>15</sup> In a second amended petition, the trustees contended that Trailer Train's policies constituted a breach of duty to Reading as a minority shareholder.<sup>16</sup>

The district court held that the majority shareholders of Trailer Train had breached their fiduciary duty of fairness by failing to allow Reading to obtain a benefit from its stock ownership comparable to that enjoyed by the shareholders who use the corporation's equipment.<sup>17</sup> The district court ordered Trailer Train to repurchase Reading's stock<sup>18</sup> at current book value.<sup>19</sup>

14. 711 F.2d at 514.

15. *Id.* The trustees' first petition, filed February 1, 1978, alleged that as a result of the Regional Rail Reorganization Act, Reading could no longer profit from its membership in Trailer Train. *Id.* (citation omitted). The petitioners stated that until this "problem" was resolved, they could not file a complete plan for reorganization. *Id.*

Trailer Train moved to dismiss Reading's petition, contending that the reorganization court lacked summary jurisdiction over the issues raised, and that Reading's claim had to be resolved in a plenary proceeding by a court of general jurisdiction. *Id.* The reorganization court held that it had summary jurisdiction, and entered an order compelling negotiations between Trailer Train and Reading. *Id.* (citation omitted). After approximately one year of unsuccessful negotiations, Trailer Train renewed its motion to dismiss the petition for want of jurisdiction, and again the court denied the motion. *Id.* See *In re Reading Co.*, 2 Bankr. 719 (E.D. Pa. 1980).

16. 711 F.2d at 514.

17. *Id.* at 514, 517-18. Reading contended that Trailer Train's "board of directors, acting at the behest of its majority shareholders, had breached a fiduciary duty owed to Reading and other similarly-situated minority shareholders." *Id.* at 517. Reading claimed the board breached that duty by reaffirming Trailer Train's car leasing policy, refusing to pay dividends, and continuing to reinvest earnings in new equipment despite Reading's departure from the railroad business. *Id.* These policies amounted to self-dealing on the part of the majority stockholders, Reading contended, because the operating railroads continued to enjoy the use of the cars to Reading's "exclusion and detriment." *Id.* at 518. Reading claimed that the low car hire rates constituted a "constructive dividend" to the operating railroads, which was denied to Reading and other non-user shareholders. *Id.* For a discussion of the fiduciary duty owed a minority stockholder, see notes 25-35 and accompanying text *infra*. For a discussion of the need to demonstrate self-dealing in an action asserting breach of fiduciary duty, see notes 38-43 and accompanying text *infra*.

The petition requested that the court order Trailer Train to pay dividends on the stock or to pay a share of the savings realized by pool users on account of Trailer Train's low rates. 711 F.2d at 514. In the meantime, Trailer Train had hired outside consultants to study the non-user shareholder issue. *Id.* at 514 n.4. These consultants claimed that Trailer Train had consistently functioned like a co-operative and that stock ownership was never intended to be for investment purposes. *Id.* Therefore, they concluded that the sole benefit of stock ownership should continue to be the use of the railroad cars. *Id.* Trailer Train then offered to purchase Reading's stock for \$1,500,000, but Reading's trustees refused. *Id.* Trailer Train informed the Third Circuit that this offer would remain open regardless of the outcome of the litigation. *Id.*

18. 551 F. Supp. at 1214-18. The district judge stated:

Trailer Train appealed, arguing that the district court lacked summary jurisdiction as a reorganization court to hear Reading's petition, and that neither the directors nor the majority stockholders of Trailer Train had breached any fiduciary duty owed to Reading as a minority shareholder.<sup>20</sup>

On appeal, the United States Court of Appeals for the Third Circuit<sup>21</sup> upheld the district court's exercise of jurisdiction<sup>22</sup> but reversed the lower

While this case presents an unusual variation on the standard situation where a dominant shareholder unilaterally dictates corporate policy for its own benefit and to the detriment of the minority shareholders and possibly the corporation, I am convinced that the combination of Reading's minimal percentage ownership, its inability to derive any benefit from its investment under existing corporate policies, and the complete illiquidity of Trailer Train's stock, brings this action within the ambit of those Delaware cases which have imposed a fiduciary obligation of fairness upon majority shareholders.

*Id.* at 1214. The district court found that the majority shareholders (users of Trailer Train equipment) dominated the board of directors of Trailer Train. *Id.* at 1217. For a discussion of the selection of Trailer Train directors, see note 5 *supra*. The court also found that the majority exercised its control of corporate processes to retain the policies under which equipment use was the sole benefit of stock ownership, thereby benefitting themselves at the expense of nonuser shareholders. 551 F. Supp. at 1217-18. The court stated that where the majority shareholders have control and domination of the corporation and engage in self-dealing, Delaware law subjects their actions to scrutiny under the test of intrinsic fairness. *Id.* at 1215-17 (citations omitted). For a discussion of the intrinsic fairness test and the fiduciary duty of majority shareholders under Delaware law, see notes 34-43 and accompanying text *infra*. The court concluded that the majority shareholders of Trailer Train had breached their fiduciary duty of fairness to the minority by failing to allow minority non-user shareholders to participate *pro rata* in the returns of the enterprise. 551 F. Supp. at 1218 (citing *Southern Pac. Ry. v. Bogert*, 250 U.S. 483, 487-88 (1919)) (further citation omitted). For a discussion of the fiduciary duties of majority shareholders, see notes 34-35 and accompanying text *infra*.

19. 555 F. Supp. 1205. The parties stipulated that the current book value of the stock was \$9,830,707, and the court ordered Trailer Train to pay upon the tender of the stock by Reading. 711 F.2d at 514.

20. 711 F.2d at 514-15.

21. The case was heard by Circuit Judges Hunter and Higginbotham, and Judge John F. Gerry, United States District Judge for the District of New Jersey, sitting by designation. Judge Hunter delivered the opinion of the court.

22. 711 F.2d at 514-17. The district court held that it had jurisdiction to hear Reading's trustees' claim both as a reorganization court and as a federal court sitting in diversity. *Id.* at 515. The Third Circuit agreed with Trailer Train that the district court, sitting as a reorganization court, did not have summary jurisdiction to enforce the obligation which Reading's petition alleged was owed by Trailer Train. *Id.* at 516 (citing *In re Roman*, 23 F.2d 556, 558 (2d Cir. 1928) (interpreting Bankruptcy Act of 1898, ch. 541, § 23(b), 30 Stat. 544, 552)). The Third Circuit noted that while a reorganization court may have summary jurisdiction to determine title to a chose in action, this jurisdiction does not allow a reorganization to enforce that chose in action where the alleged obligation is subject to substantial dispute. 711 F.2d at 515-16. See *Baker v. Gold Seal Liquors, Inc.*, 417 U.S. 467, 471 n.7 (1974) (a chose in action may be "property" of the debtor under the Bankruptcy Act of 1898); *In re Lehigh Valley R.R.*, 458 F.2d 1041, 1043-45 (3d Cir. 1972) (a reorganization court may treat the performance of an executory obligation as property of the debtor only where the obligor does not dispute the obligation or its amount); *In re Penn Central Transp. Co.*, 453 F.2d 520, 523 (3d Cir. 1972) (where a substantial dispute exists, the trustee

court on the merits, *holding* that under Delaware law,<sup>23</sup> majority stockholders have no duty to ensure that a minority shareholder benefit from its stock investment when the latter's changed circumstances render it unable to derive benefit from the corporate dividend distribution policy established by contractual agreement. *In re Reading Co.*, 711 F.2d 509 (3d Cir. 1983).

It is a basic principle of corporate law that the board of directors, vested with the management of the corporation, is required to use its best judgment and independent discretion in determining and executing corporate policy.<sup>24</sup> Directors owe a fiduciary duty of good faith and fair dealing<sup>25</sup> as well as a

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must resort to a plenary action in a court of general jurisdiction to establish that the obligation is an asset subject to the jurisdiction of the reorganization court), *cert. denied*, 408 U.S. 923 (1972). Because Trailer Train raised a substantial objection to its alleged obligation to exchange Reading's stock for other property, the district court did not have jurisdiction as a reorganization court to decide the matter. 711 F.2d at 516.

However, the Third Circuit noted that § 23(a) of the Bankruptcy Act of 1898 allowed district courts to exercise diversity jurisdiction over controversies between trustees and adverse claimants over property claimed for the debtor's estate. *Id.* (citing Bankruptcy Act of 1898, ch. 541, § 23(a), 30 Stat. 544, 552). The Third Circuit found that the requisite elements of diversity jurisdiction were satisfied in that Reading's principal place of business was Pennsylvania, Trailer Train was incorporated in Delaware, and the amount in controversy was greater than \$10,000. 711 F.2d at 516 (citing 28 U.S.C. § 1332 (1982)). The court rejected the argument that the district court's assumption of summary reorganization jurisdiction deprived Trailer Train of its right to a plenary mode of procedure because it found that the district court had given both sides a full hearing and that "[n]o essential characteristic of a plenary proceeding was lacking." 711 F.2d at 517 (quoting *Penn Central*, 453 F.2d at 522) (further citations omitted).

The Bankruptcy Reform Act of 1978 eliminated the summary-plenary distinction. *See* 28 U.S.C. § 1334 (1982); S. REP. NO. 989, 95th Cong., 2d Sess. 18, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5787, 5804. *See* Northern Pipeline Constr. Co. v. Marathon Pipe Line Co., 102 S. Ct. 2858, 2868 (1982) (bankruptcy court may determine debtor's claims against third parties in context of bankruptcy proceedings).

23. 711 F.2d at 517. Because Trailer Train was incorporated in Delaware, the Third Circuit held that the case was governed by Delaware law. *Id.*

24. *See* H. HENN & J. ALEXANDER, LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES 562-64 (3d ed. 1983). The board's functions usually include policy decisions, selection of officers and other executive personnel, fixing of executive compensation, delegation of authority, amendment, adoption and repeal of bylaws, determination and declaration of dividends and other financial matters, and overall supervision. *Id.* at 564. Management is usually vested in the board by statute. *Id.* at 563. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a) (1983). The board has traditionally been required to act in a duly convened meeting, on the theory that "consultation, deliberation, and collective judgment" create the optimal climate for policy decision-making. H. HENN & J. ALEXANDER, *supra*, at 565.

25. H. HENN & J. ALEXANDER, *supra* note 24, at 625.

Cases involving fiduciary duties can traditionally be classified into those involving (a) competing with the corporation, (b) usurpation of corporate opportunity, (c) having some interest which conflicts with the interest of the corporation, (d) insider trading, (e) oppression of minority shareholders, and (f) purchase of sale or control, but such situations do not exhaust the possible corporate applications of fiduciary concepts.

*Id.* at 625.

duty to exercise due care in performing their corporate duties.<sup>26</sup> If the directors observe these duties,<sup>27</sup> they are immune from liability for decisions of the board under the business judgment rule<sup>28</sup> if the decision is attributable

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Delaware has adopted the principle that directors are fiduciaries. See *Lofland v. Cahall*, 13 Del. Ch. 384, 118 A. 1 (Del. 1922) (directors found liable for unauthorized issuance of stock to themselves). As fiduciaries, directors are required to act with "the utmost good faith and fair dealing." *Id.* at 389, 118 A. at 3. There must be "no conflict between duty and self interest" which would violate the director's duty. *Guth v. Loft*, 23 Del. Ch. 255, 270, 5 A.2d 503, 510 (Del. 1939) (diversion of corporate opportunity by director breached his fiduciary duty). See *Arsht, The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93, 115 (1979) ("where a director . . . stands to benefit personally from the decision as a director . . . his or her business judgment is likely to be affected by personal interest"). For other cases applying the principle that directors owe a fiduciary duty to their corporation and its stockholders, see *Bovay v. H.M. Bylesby Co.*, 27 Del. Ch. 381, 38 A.2d 808 (Del. 1944), *Yasik v. Wachtel*, 25 Del. Ch. 247, 17 A.2d 309 (Del. Ch. 1941). For a discussion of the fiduciary duties of directors, see generally 3 W. FLETCHER, *CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* 858 (perm. ed. 1965); Miller, *The Fiduciary Duties of a Corporate Director*, 4 U. BALT. L. REV. 259 (1975) (discussion of duty of directors and situations in which it can arise).

26. H. HENN & J. ALEXANDER, *supra* note 24, at 621. Directors are liable for negligence in acting or failing to act. *Id.* See, e.g., *Hun v. Carey*, 82 N.Y. 65 (1880) (expenditure for new bank building held to be reckless and unreasonable due to financial condition of bank). Once lack of due diligence is established, the business judgment rule defense no longer applies. For a discussion of the business judgment rule, see notes 27-32 and accompanying text *infra*. See, e.g., *Warshaw v. Calhoun*, 43 Del. Ch. 148, 157-58, 221 A.2d 487, 492-93 (Del. 1966) (gross abuse of discretion precludes business judgment rule defense); *Casey v. Woodruff*, 49 N.Y.S.2d 625, 643 (N.Y. Sup. Ct., Spec. Term 1944) (reasonable diligence on the part of directors is required to apply the business judgment rule). See also Note, *The Court's Independent Business Judgment Will Be Applied to a Decision of a Committee of Disinterested Directors to Dismiss a Derivative Suit Alleging a Breach of Fiduciary Duty By a Majority of the Corporation's Directors*, 27 VILL. L. REV. 1308, 1311 (1982).

27. H. HENN & J. ALEXANDER, *supra* note 24, at 612.

28. *Id.* Henn explains the business judgment rule as follows:

Corporate management is vested in the board of directors. If in the course of management, directors arrive at a decision, within the corporation's power (*intra vires*) and their authority for which there is a reasonable basis, and they act in good faith, as the result of their independent discretion and judgment, and uninfluenced by any consideration other than what they honestly believe to be the best interests of the corporation, a court will not interfere with internal management and substitute its judgment for that of the directors to enjoin or set aside the transaction or to surcharge the directors for any resulting loss.

*Id.* at 661 (footnotes omitted).

Delaware courts have adopted the business judgment rule and will not upset management decisions unless there is a strong showing of impropriety in the decision-making process. See *Warshaw v. Calhoun*, 43 Del. Ch. 148, 157, 221 A.2d 487, 492 (Del. 1966) (only a showing of "bad faith" or "gross abuse of discretion" takes a case outside the business judgment rule); *Merchantile Trading Co. v. Rosenbaum Grain Corp.*, 17 Del. Ch. 325, 333-34, 154 A. 457, 461 (Del. Ch. 1931) (courts will not interfere with corporate policy and business management unless "fraud, actual or presumed, or illegal or ultra vires misconduct" is shown).

The rationale behind the business judgment rule is "to encourage qualified persons to serve as directors by protecting them from liability for mere mistakes of judg-



to "any rational business purpose."<sup>29</sup>

One aspect of the directors' fiduciary duty is the obligation to exercise unbiased judgment on behalf of the corporation as a whole, without favoring one group of shareholders over another.<sup>30</sup> Once the plaintiff shows a breach of this duty of impartiality in a decision of the board, the directors are no longer shielded from liability by the business judgment rule.<sup>31</sup>

Preferential treatment by the board of directors may be traceable to a majority shareholder or to a group which has control of the board.<sup>32</sup> While majority shareholders may ordinarily vote their shares and set corporate policy,<sup>33</sup> they owe a fiduciary duty of fairness to the minority.<sup>34</sup> When control-

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ment when they have acted as prudent persons would have in the same situation." Note, *supra* note 26, at 1312 n.16.

For a general discussion of the business judgment rule, see Lewis, *The Business Judgment Rule and Corporate Directors' Liability for Mismanagement*, 22 BAYLOR L. REV. 157 (1978).

29. *Sinclair Oil Co. v. Levien*, 280 A.2d 717, 720 (Del. 1971). See also *Bodell v. General Gas and Elec. Corp.*, 15 Del. Ch. 420, 426, 140 A. 264, 267 (Del. 1927) (honest mistake in setting price of unissued stock not reviewable).

30. *H. HENN & J. ALEXANDER*, *supra* note 24, at 651. Any attempt by a director to favor one corporate group over another breaches the duties owed the corporation by the director. *Id.*

31. See *Arshst*, *supra* note 25, at 116. When an action is brought to challenge the actions of a director, the plaintiff bears the burden of showing that the defendant-director breached his fiduciary duty. See *id.* Once a breach of the duty of loyalty has been shown, the director bears the burden of showing the intrinsic fairness of the transaction. See, e.g., *Singer v. Magnavox Co.*, 380 A.2d 969, 979-80 (Del. 1977) (equity court can scrutinize decision where there is an allegation of a breach of the fiduciary duty owed minority stockholders); *Fliegler v. Lawrence*, 361 A.2d 218 (Del. 1976) (court can scrutinize an interested director transaction, even if ratified by shareholders, to determine its fairness); *Tanzer v. International Gen. Indus.*, 402 A.2d 382, 386 (Del. Ch. 1979) (even where the majority has a bona fide business purpose for its action, it must show "entire fairness" to minority).

32. See, e.g., *Kaplan v. Centex Corp.*, 284 A.2d 119, 123 (Del. Ch. 1971) (a majority shareholder or a dominant group may be able to effect "a direction of corporate conduct in such a way as to comport with the wishes or interests of the corporation (or persons) doing the controlling").

33. *Ringling Bros.-Barnum & Bailey Combined Shows, Inc. v. Ringling*, 29 Del. Ch. 610, 622, 53 A.2d 441, 447 (Del. 1947). In *Ringling Bros.*, the court refused to find that an agreement between two shareholders to act jointly in voting their shares and to submit to arbitration in the event of a disagreement was unfair. *Id.* at 612-20, 53 A.2d at 442-46. In reaching this conclusion, the court stated that "[g]enerally speaking, a shareholder may exercise wide liberality of judgment in the matter of voting, and it is not objectionable that his motives may be for personal profit, or determined by whim, or caprice, so long as he violates no duty owed his fellow shareholders." *Id.* at 622, 53 A.2d at 447 (citing *Heil v. Standard G&E Co.*, 17 Del. Ch. 214, 151 A. 303 (Del. Ch. 1930)). Furthermore, if there is no impropriety, "[a] group of shareholders may . . . vote their respective shares so as to obtain advantages of concerted action." 29 Del. Ch. at 622, 53 A.2d at 447.

34. *Pepper v. Litton*, 308 U.S. 295, 306 (1939) (corporate powers are held in trust); *Allied Chem. & Dye Corp. v. Steel and Tube Co. of Am.*, 14 Del. Ch. 1, 11, 120 A. 486, 491 (Del. Ch. 1923). In *Allied*, the court noted that while the majority could "practically desert the corporate venture by selling out its assets, and thereby . . . deprive their associates of the opportunity to reap gains in the future," this right

ling shareholders use their domination over the corporation<sup>35</sup> to engage in self-dealing, the resulting actions of the board are subject to careful scrutiny by the courts for intrinsic fairness.<sup>36</sup> The "intrinsic fairness test" places the burden on the controlling shareholders to demonstrate the total fairness of their actions to minority shareholders.<sup>37</sup>

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can only "be exercised . . . upon terms and conditions that are fair to the corporation." *Id.*

The duties owed by controlling shareholders have been based on two theories: (1) a direct approach—fiduciary duty is owed because of the position of superiority and influence over the minority's interests held by the majority; (2) an indirect approach—because controlling shareholders dominate the corporation through influence over the board, their duties are analogous to those of the board. H. HENN & J. ALEXANDER, *supra* note 24, at 654.

In a close corporation, shareholders may be held to a stricter standard of loyalty, analogous to those duties owed by partners to one another. *Id.* at 655.

35. See H. HENN & J. ALEXANDER, *supra* note 24, at 654. Domination of the corporation can occur directly through independent shareholder action such as elections, or indirectly through control over the board in a particular decision. *Id.* See *Southern Pac. Ry. v. Bogert*, 250 U.S. 483 (1919) (controlling shareholders owe duty directly to minority where exercising direct action on behalf of themselves); *Zahn v. Transamerica Corp.*, 162 F.2d 36, 46 (3d Cir. 1947) (controlling shareholder had such control over board of corporation that court characterized actions of board in redeeming stock as those of the "puppet" and the actions of the majority shareholder as those of puppeteer).

36. *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 719-20 (Del. 1971). The plaintiff in *Sinclair* complained about the payment of dividends by Sinclair's controlled subsidiary (Sinven), the Sinven board's denial of industrial development, and the failure of Sinven's board to enforce a contract between Sinclair and Sinven. *Id.* at 719. The plaintiff contended that Sinclair was responsible for these actions, because it was a majority shareholder who had dominated Sinven's board. *Id.* Furthermore, the plaintiff contended that such actions benefitted Sinclair to the exclusion of Sinven's minority shareholders. *Id.*

The court in *Sinclair* held that if the parent corporation had received a benefit to exclusion of Sinven's minority shareholders, Sinclair's actions would be subject to scrutiny to determine its fairness. *Id.* at 719-20. However, the court held that Sinclair had not engaged in such self-dealing as to Sinven's payment of dividends because the minority had shared in the benefit of the dividends, and that therefore its actions were protected by the business judgment rule. *Id.* at 721-22. Also, the court found that Sinven had not been denied development by Sinclair. *Id.*

However, as to Sinclair's breach of its contract with Sinven, the court held that the failure of Sinven's board to enforce the contract had amounted to self-dealing by Sinclair, because of Sinclair's domination of Sinven, and that Sinclair was liable because it had failed to demonstrate the intrinsic fairness of its action. *Id.* See also *Warshaw v. Calhoun*, 43 Del. Ch. 148, 157-58, 221 A.2d 487, 492-93 (Del. 1966) (courts will review action only where impropriety shown); *Sterling v. Mayflower Hotel Corp.*, 33 Del. Ch. 293, 298, 93 A.2d 107, 109-10 (Del. 1952) (where directors' action furthers their self-interest, courts will review with careful scrutiny to determine fairness); *Chasin v. Gluck*, 282 A.2d 188, 192 (Del. Ch. 1971) (where self-dealing shown, courts will review decision); E. FOLK, *THE DELAWARE GENERAL CORPORATION LAW 75-77* (1972); H. HENN & J. ALEXANDER, *supra* note 24, at 459; Note, *supra* note 26, at 1311. The personal interest of a director will not void a transaction in Delaware if the interest is disclosed to the board, a board committee or the shareholders; or if the transaction is fair and authorized by the shareholders or the board. See DEL. CODE ANN. tit. 8, § 144 (1982).

37. *Sterling v. Mayflower Hotel Corp.*, 33 Del. Ch. 293, 298, 93 A.2d 107, 109-

In order to invoke the intrinsic fairness test, the Supreme Court of Delaware has held that there must be a showing of self-dealing, or that the majority shareholders used their control to obtain some benefit for themselves to the exclusion and detriment of the minority.<sup>38</sup> In *Schnell v. Chris Craft, Inc.*,<sup>39</sup> the court found self-dealing where the majority advanced the date of the annual shareholders' meeting in order to frustrate a proxy contest.<sup>40</sup> In *Petty v. Penntech Papers, Inc.*,<sup>41</sup> a showing of self-dealing was based on the selective

10 (Del. 1982) (interested party bears burden of showing entire fairness of the transaction). See also *Fliegler v. Lawrence*, 361 A.2d 218 (Del. 1976) (interested directors must show intrinsic fairness); *Tanzer v. International Gen. Indus.*, 402 A.2d 382, 386 (Del. Ch. 1979) (majority must show entire fairness to minority where there is self-dealing).

38. *Sinclair*, 280 A.2d at 720 (parent corporation/majority shareholder held not to have engaged in self-dealing). The court stated: "This standard will be applied only when the fiduciary duty is accompanied by self-dealing. . . . Self-dealing occurs when the parent, by virtue of its domination of the subsidiary, causes the subsidiary to act in such a way that the parent receives something from the subsidiary to the exclusion of, and detriment to, the minority stockholders of the subsidiary." *Id.*

See also *Case v. New York Cent. R.R.*, 15 N.Y.2d 150, 204 N.E.2d 643, 256 N.Y.S.2d 607 (1965) (undue advantage over minority required to invoke intrinsic fairness test). The paradigm example of the application of the intrinsic fairness test to majority shareholder action has been in the context of merger-buyouts. See *Weinberger v. UOP Corp.*, 457 A.2d 701, 710 (Del. 1983) (merger-buyout; majority shareholders owe duty to minority); *Sterling v. Mayflower Hotel Corp.*, 33 Del. Ch. 293, 93 A.2d 107 (Del. 1952) (majority shareholders owe minority shareholders duty of fairness in merger); *David J. Green & Co. v. Dunhill Int'l, Inc.*, 249 A.2d 427 (Del. Ch. 1968) (parent/majority shareholder owes duty to minority shareholders of subsidiary when merging with subsidiary); see also *Condec Corp. v. Lunkenheimer Co.*, 43 Del. Ch. 353, 230 A.2d 769 (Del. 1967) (majority caused issuance of new stock to perpetuate control; duty held to be violated); *Petty v. Penntech Papers, Inc.*, 347 A.2d 140 (Del. Ch. 1975) (majority caused selective redemptions of stock to perpetuate control; held to violate fiduciary duty); *Bennett v. Breuil Petroleum Corp.*, 34 Del. Ch. 6, 99 A.2d 236 (Del. Ch. 1953) (majority shareholder caused increases in authorized shares and reduced par, effectively eliminating preemptive rights of minority shareholders, thereby breaching duty to minority). For a discussion of the general duties of majority shareholders, see *Lynch, A Concern for the Interest of Minority Shareholders Under Modern Corporate Law*, 3 J. CORP. L. 19 (1977) (emphasis on merger situation).

In order to invoke the intrinsic fairness test against a director, the same showing of self-dealing must be made. See notes 25, 28 & 31 and accompanying text *supra*.

39. 285 A.2d 437 (Del. 1971).

40. *Id.* at 439. The court held that management had "attempted to use the corporate machinery and the Delaware Law for the purpose of perpetuating itself in office . . . and . . . for the purpose of obstructing the legitimate efforts of dissident stockholders in the exercise of their rights . . ." *Id.* at 439. Therefore, the court held that the amendment of the bylaws to advance the date of the stockholders' meeting "may not be permitted to stand." *Id.* Cf. *Condec Corp. v. Lukenheimer*, 43 Del. Ch. 353, 230 A.2d 769 (Del. Ch. 1967) (breach of fiduciary duty by directors where authorized but unissued stock was issued for the purpose of preventing plaintiff from obtaining control). *But cf.* *American Hardware Corp. v. Savage Arms Corp.*, 37 Del. Ch. 10, 135 A.2d 725 (Del. Ch.), *aff'd*, 37 Del. Ch. 59, 136 A.2d 690 (Del. 1957) (not unlawful for directors to refuse to adjourn stockholders meeting to prevent proxy contest or for directors to prevent extension of period for proxy contest).

41. 347 A.2d 140 (Del. Ch. 1975).

redemption of preferred stock to perpetuate majority control.<sup>42</sup> The majority shareholders in *Pennitech* were found to have breached their fiduciary duty by unfairly depriving the minority of a benefit which they conferred upon themselves.<sup>43</sup>

Conversely, corporate management is under no duty to change corporate policy to accommodate minority shareholders whose disadvantage is not attributable to self-dealing by the board or the controlling shareholders.<sup>44</sup> In *Getty Oil Co. v. Skelly Oil Co.*,<sup>45</sup> the Supreme Court of Delaware refused to find self-dealing or to invoke the intrinsic fairness test where a third party set the terms of a transaction which had a discriminatory impact on minority shareholders.<sup>46</sup> In such a situation, the court held, the majority's fiduciary duty to the minority does not require "self-sacrifice."<sup>47</sup>

42. *Id.* at 143-44. The plaintiffs in *Petty* held preferred stock (stock entitled to a dividend preference and/or a preference in the distribution of assets upon liquidation) which was redeemable at the option of the corporation. *Id.* at 141. As a class, the preferred stockholders were entitled to elect a majority of the board of directors. *Id.* Two of the preferred shareholders were also members of the board. *Id.* In order to allow the two directors who held shares of the preferred stock to have enough voting power to keep the present board in office indefinitely, the board attempted to exercise the corporation's redemption power over all the preferred stock, except those shares held by the board members. *Id.* This would leave the power to elect a majority of the board in the hands of the present board members who had preferred stock. *Id.* The court held this selective redemption of shares to be self-dealing. *Id.* at 143-44.

43. *Id.* at 143-44. See also *Bennett v. Propp*, 41 Del. Ch. 14, 187 A.2d 405 (Del. 1962) (resolution of board ratifying chairman's unauthorized purchase of outstanding stock in order to perpetuate control unlawful); *Macht v. Merchants Mortgage & Credit Co.*, 22 Del. Ch. 70, 194 A. 23 (Del. 1937) (sale of assets which would vest voting power in preferred stock void without consent of preferred stockholders); *Yasik v. Wachtel*, 25 Del. Ch. 247, 17 A.2d 309 (Del. Ch. 1941) (issuance of shares for purpose of maintaining control is a breach of duty).

44. See *Sinclair Oil v. Levien*, 280 A.2d 717, 720 (Del. 1971) (self-dealing required before intrinsic fairness test applied). For a discussion of *Sinclair*, see notes 36 & 38 *supra*. See also *Getty Oil Co. v. Skelly Oil Co.*, 267 A.2d 883 (Del. 1970) (where third party affects the distribution of benefits among shareholders, no self-dealing is present); *Trans World Airlines v. Summa Corp.*, 374 A.2d 5 (Del. Ch. 1977) (business judgment rule applied where terms set by third party). For a discussion of *Getty* and *TWA*, see notes 45-47 and accompanying text *infra*.

45. 267 A.2d 883 (Del. 1970).

46. *Id.* at 887-88. Getty was the majority shareholder (71%) in Skelly. *Id.* at 884-85. Each company had received a separate oil import allocation under the Mandatory Oil Import Program until the Government discontinued Skelly's allocation because of Getty's control of Skelly. *Id.* at 885. Skelly unsuccessfully attempted to force Getty to share its allocation. *Id.* at 885 (citing *Skelly Oil Co. v. Udall*, 288 F. Supp. 109 (D.D.C. 1968)). Getty brought a declaratory judgment action on the issue of whether it had breached a duty to Skelly. *Id.* at 886. The Delaware Supreme Court found that Getty had not breached any duty to Skelly because the government, rather than Getty, set the terms of the transaction, and therefore there was no self-dealing on Getty's part. *Id.* at 888. Thus, the court would not interfere in the business decision by Getty not to share its allotment with Skelly. *Id.* at 887-88.

47. *Id.* at 888. Cf. *Trans World Airlines v. Summa Corp.*, 374 A.2d 5 (Del. Ch. 1977). In *TWA*, the airline brought suit against its parent corporation, claiming that certain aircraft lease and purchase agreements made by the parent had disadvantaged TWA's minority shareholders, while providing the parent with tax advantages.

Delaware courts view the sale of stock as the creation of a contract between the corporation and the shareholder, with the contract terms set forth in the articles of incorporation, the corporation bylaws, and the incorporation statute.<sup>48</sup> In addition, corporate policies to which the shareholder gives his express or implied consent may be included in the terms of the contract.<sup>49</sup> In *Coleman v. Taub*,<sup>50</sup> the Third Circuit, applying Delaware law, held

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*Id.* at 5-9. The court refused to find self-dealing because of the immunity granted persons whose transactions had been specifically approved by the Civil Aeronautics Board. *Id.* at 10-23 (citing 49 U.S.C. § 1384 (1976)). Since the transactions complained of had been approved by the CAB, the *TWA* court stated that to hold Summa Corp. liable for these transactions "would be . . . to veto conduct specifically authorized by an agency of competent jurisdiction"; further, to find that they were not intrinsically fair "would directly repudiate the [CAB's] determination that they were 'just and reasonable and in the public interest.'" *Id.* at 11-12. In reaching this conclusion, the court favorably cited *Getty*, stating that the business judgment rule is ordinarily applied where a third party, such as a government, sets the terms of the transaction. *Id.* at 9 (citing *Getty Oil Co. v. Skelly Oil Co.*, 267 A.2d 883 (Del. 1970)).

48. *Peters v. United States Mortgage Co.*, 13 Del. Ch. 11, 114 A. 598 (Del. Ch. 1921). The plaintiff in *Peters* was attempting to block a charter change which would eliminate a distribution of a portion of surplus to preferred stockholders and change the surplus distribution to common stockholders from a preferred to a discretionary amount. *Id.* at 13-14, 114 A. at 599-600. The court noted that a corporation enters into a contractual relationship with its shareholders when they purchase stock, and that the relationship is especially applicable to the payment of dividends. *Id.* at 14, 114 A. at 600. The court recognized that the charter (the "contract") could be amended by the proper procedure. *Id.* at 14-22, 114 A. at 600-04. Since this procedure was complied with, the court refused to block the change. *Id.*

For other cases discussing the contractual nature of the corporate/shareholder relationship, see *Weinberg v. Baltimore Brick Co.*, 35 Del. Ch. 144, 114 A.2d 812 (Del. 1955) (control of corporation by preferred shareholders not unfair where agreed to in consideration of preferred shareholders' giving up some of their rights as creditors); *Ellingwood v. Wolf's Head Oil Refining Co.*, 27 Del. Ch. 356, 38 A.2d 743 (Del. 1944) (rights of stockholders are contract rights and must be determined from charter, which is interpreted as contracts are generally); *Shanghai Power Co. v. Delaware Trust Co.*, 316 A.2d 589 (Del. Ch. 1974) (rights of preferred stockholders are contract rights governed by charter provisions, and method of interpretation is that of interpreting written contracts generally). *Cf.* DEL. CODE ANN. tit. 8, § 350 (1982).

49. *Schrieber v. Bryan*, 396 A.2d 512, 519 (Del. Ch. 1978) (terms of contract between shareholder and corporation include corporate policies which were adopted before the shareholder purchased his shares). An important factor in determining the terms of a contract between the corporation and its shareholders as to a corporate policy is whether a shareholder purchased with full knowledge of the policy. *Goodman v. Futrovsky*, 42 Del. Ch. 468, 473-74, 213 A.2d 899, 902-03 (Del. 1965) (purchase from wholesaler who was a large stockholder not unlawful where purchasers of stock were notified of policy in prospectus), *cert. denied*, 383 U.S. 946 (1966). If there is express approval of the corporate policy, this may also be evidence of a binding agreement. *Elster v. American Airlines*, 34 Del. Ch. 94, 97-98, 100 A.2d 219, 221 (Del. Ch. 1953). Receipt of the benefits of a corporate policy is also a factor. *Frank v. Wilson & Co.*, 27 Del. Ch. 292, 304-05, 32 A.2d 277, 282-83 (Del. 1943) (acceptance by preferred stockholder of benefits of recapitalization estops him from objecting to it). Like any contract, these agreements are presumed valid absent fraud, misrepresentation or overreaching. *See Esso Standard Oil v. Cunningham*, 35 Del. Ch. 210, 114 A.2d 380 (Del. Ch. 1963), *aff'd*, 35 Del. Ch. 371, 118 A.2d 611 (Del. 1965) (misrepresentation or overreaching can prevent enforcement of a contract). *See*

that a minority shareholder could bargain away those rights which otherwise would be the basis for a fiduciary duty on the part of the majority.<sup>51</sup>

Absent any contractual provision to the contrary, corporate management has a duty to enable all shareholders to participate *pro rata* in the returns of corporate enterprise.<sup>52</sup> However, it is well-settled that shareholders may agree to have the corporation distribute benefits unequally among its shareholders.<sup>53</sup> In *Wabash Railway v. American Refrigerator Transport Co.*,<sup>54</sup> the

*also* *Eastern States Petroleum Co. v. Universal Oil Prods.*, 29 Del. Ch. 305, 313, 49 A.2d 612, 616 (Del. Ch. 1946) (plaintiff cannot seek approval of contract in part and rescission in part, "as self interest may dictate"); 13 W. FLETCHER, *supra* note 25, § 5737 (rev. perm. ed. 1980) (shareholder contracts with corporation are valid unless contrary to public policy, fraudulent, conflict of interest, or prohibited by statute).

Once there has been valid assent to a corporate policy, the assenting shareholder is estopped to object. *See* 11 W. FLETCHER, *supra* note 25, § 5352 (rev. perm. ed. 1971). *See also* *Allied Supermarkets v. Grocers Dairy Co.*, 391 Mich. 727, 735-37, 29 N.W.2d 55, 58-60 (1982) (shareholder who knew of, bargained for, assented to, and profited from corporate policy cannot successfully argue that it is improper). For a discussion of *Allied*, see notes 56-57 and accompanying text *infra*. *Cf.* DEL. CODE ANN. tit. 8, § 144 (1982) (self-interest by directors will not alone void a transaction where disclosed to and ratified or authorized by shareholders).

50. 638 F.2d 628 (3d Cir. 1981).

51. *Id.* at 636. In *Coleman*, a minority shareholder/ex-employee argued that a freeze-out merger which complied with statutory provisions but terminated his right to corporate participation (i.e. dividends) violated the fiduciary duty owed to him by the majority. *Id.* at 629-31. While recognizing that Delaware courts have held that minority shareholders have, "[a]part from the monetary value that can be placed . . . on corporate stock, . . . additional interests in their shares," the court stated that this "right of participation" may be terminated by the majority "when it serves the corporate good." *Id.* at 634-35 (citing *Singer v. Magnavox Co.*, 380 A.2d 969 (Del. 1977); *Roland Int'l Corp. v. Najjar*, 407 A.2d 1032 (Del. 1979)). The court held that *Coleman* could not argue that the freeze-out was not in the corporate good, as *Coleman's* contract of employment had authorized the corporation to terminate his shareholder status upon the termination of his employment:

*Coleman* bargained for the right to be a shareholder only while he remained an employee . . . . We believe that a minority shareholder may bargain away the "additional interest" in corporate participation which might otherwise be the basis for a fiduciary duty on the part of the majority.

*Id.* at 636-37. For other examples of a shareholder altering a fiduciary duty owed to him by contract, see note 53 and accompanying text *infra*.

52. *Southern Pac. Ry. v. Bogert*, 250 U.S. 483, 492 (1919) (it is a "wrong" for majority not to share "fruits" by distributing them *pro rata* with minority). In *Bogert*, Southern Pacific dominated the board of the Houston and Texas Central Railway Company through indirect ownership of a majority of its stock. *Id.* at 486. Through a reorganization, all of the Houston Company's mortgages were foreclosed and transferred to a new company. *Id.* In this process, Southern Pacific obtained all of the stock and railroad lines of the new Houston Company, while the minority received nothing. *Id.* The United States Supreme Court held that such action was a violation of the duty of the majority to share *pro rata* in participation in corporate activity, and that none of several defenses asserted by the majority was applicable. *Id.* at 488-98.

53. *Wabash Ry. v. American Refrigerator Transit Co.*, 7 F.2d 335 (8th Cir. 1925) (agreement to distribute dividends in form of rebates on purchases from the corporation, in proportion to purchases and not stock ownership, held valid); *Johnson v. United States*, 303 F. Supp. 1, 4 (E.D. Va. 1969) (under Virginia law, shareholders may agree to non-*pro rata* dividend distribution); *Speier v. United States*, 9 F.

Eighth Circuit enforced a shareholder agreement among rail carriers to use corporate assets to operate a refrigerator car company for their joint benefit and to distribute excess profits as rebates in proportion to each shareholder's use of the cars.<sup>55</sup>

Similarly, in *Allied Supermarkets v. Grocers Dairy Co.*,<sup>56</sup> the Michigan Supreme Court held that where the bylaws provided for dividends in the form of rebates on purchases from the corporation, a minority shareholder was not entitled to conventional dividends or stock redemption, even though it was no longer making purchases from the corporation.<sup>57</sup> In an analogous context, the Supreme Court of Delaware has held that a minority shareholder cannot force the partial liquidation of the corporation for its benefit if the corporation is merely acting in the manner for which it was organized, where the corporation's policies were known to the shareholder and were part of the contract with the corporation.<sup>58</sup>

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Supp. 1020, 1023 (Ct. Cl. 1935) (where parties agree, corporation can pay dividends without regard to proportions of ownership); *Little v. Caswell-Doyle-Jones*, 305 So. 2d 842, 844-45 (Fla. App. 1975) (preferential distribution of corporate profits permissible where there is unanimous agreement); *Breslin v. Fries-Breslin Co.*, 70 N.J.L. 274, 58 A. 313 (N.J. App. 1904) (by unanimous consent, shareholders may adopt a non-*pro rata* division of dividends); 14 W. FLETCHER, *supra* note 25, § 5352 (rev. perm. ed. 1971). The articles of incorporation may classify stock as common and preferred. 12 W. FLETCHER, *supra* note 25, § 5443 (rev. perm. ed. 1970). In this event, holders of preferred stock may also be entitled to dividend preference over common stockholders. *See id.* §§ 5443-5451 (rev. perm. ed. 1970) and authorities cited therein.

54. 7 F.2d 335 (8th Cir. 1925).

55. *Id.* at 345-46.

56. 391 Mich. 729, 219 N.W.2d 55 (1974).

57. *Id.* at 736-37, 219 N.W.2d at 59-60. In *Allied*, a supermarket shareholder purchased stock from the dairy cooperative, and was entitled under the corporation's articles to rebates on its purchases of dairy products from the cooperative as its sole dividend. *Id.* at 731-32, 219 N.W.2d at 57-58. Once it ceased to purchase from the cooperative, the supermarket argued that such a dividend distribution scheme was impermissible, and asked for relief in the form of either a distribution of dividends or a forced repurchase of its stock. *Id.* The Michigan Supreme Court held that the dividend distribution scheme was valid because the shareholder had voluntarily and knowingly agreed to it. *Id.* at 736-37, 219 N.W.2d at 59-60. For a discussion of *Allied*, see Herbrecht, *Business Associations*, 22 WAYNE L. REV. 255, 258-59 (1976).

*See also* *Klein v. Greenstein*, 24 N.J. Super. 348, 94 A.2d 497 (1953). In *Klein*, the plaintiff-shareholders complained that they were being disadvantaged because the corporation paid rebates to shareholders who were customers. *Id.* at 350, 94 A.2d at 498. The plaintiffs, who were not customers, sought to share in these payments, claiming that because they were dividends, the plaintiffs were entitled to a proportionate share. *Id.* The court dismissed the action because it did not think the refunds were "dividends," and in so doing noted that "[n]ot every benefit obtained by a stockholder from his corporation is a dividend." *Id.* at 352, 94 A.2d at 499 (citation omitted).

*Cf.* *Buechner v. Farbenfabriken Bayer Aktiengesellschaft*, 38 Del. Ch. 490, 154 A.2d 684 (Del. 1959) (assets of a going corporation belong to the corporation; therefore no individual shareholder may demand partial liquidation).

58. *Berwald v. Mission Dev. Co.*, 40 Del. Ch. 509, 185 A.2d 480 (Del. 1962). In *Berwald*, the Mission Company was a holding company incorporated for the purpose of acquiring and holding substantial amounts of Tidewater Oil Company stock. *Id.* at 510-11, 185 A.2d at 481. When Tidewater began declaring stock dividends in lieu

Against this background, the Third Circuit considered the Reading trustees' claim that Trailer Train's board of directors, acting at the behest of its majority shareholders, breached a fiduciary duty owed to Reading by reaffirming corporate policies under which railroad equipment lease opportunities took the place of cash dividends, in view of the fact that Reading had ceased its railroad operations.<sup>59</sup> The Third Circuit acknowledged that under Delaware law,<sup>60</sup> directors<sup>61</sup> and majority stockholders owe a fiduciary duty to the corporation and to minority shareholders.<sup>62</sup> However, the court explained that the parameters of the fiduciary duty owed depend upon the circumstances of the challenged action or inaction.<sup>63</sup> Under the generally applicable business judgment rule, the Third Circuit noted, Delaware courts will not interfere with rational management decisions.<sup>64</sup> However, the court

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of cash dividends in 1954 in order to conserve cash for improvements, Mission discontinued its payment of dividends. *Id.* at 511, 185 A.2d at 481. The plaintiffs, who had purchased their stock in 1956 and 1959, challenged the defendant's policy of retaining the Tidewater stock dividends. *Id.* at 512-13, 185 A.2d at 482. The court held:

The sole corporate purpose of Mission is and has been to hold Tidewater stock. Any investor in its shares could readily ascertain this fact. Because of this he knows, or should know, that he is buying for growth and not for income.

However the various arguments are put they come to this: Plaintiffs are in effect seeking to wind up the corporation, either wholly or partially, because it is doing exactly what it was lawfully organized to do.

We think the plaintiffs have failed to make a case.

*Id.* at 514-15, 185 A.2d at 483.

Similarly, Third Circuit Chief Judge Seitz (in his previous role as Chancellor) has stated that "a heavy burden is cast on anyone seeking in substance to have the court liquidate [a going corporation]," and that the decision is to be based upon whether the challenged policy existed prior to the minority shareholder's acquisition of stock. *Warsaw v. Calhoun*, 42 Del. Ch. 437, 441, 213 A.2d 539, 541-42 (Del. Ch. 1965), *aff'd*, 43 Del. Ch. 48, 221 A.2d 487 (Del. 1966).

59. 711 F.2d at 517. Reading argued that Trailer Train's reaffirmation of its original car leasing policy, refusal to pay dividends, and continued reinvestment of earnings in new equipment breached a fiduciary duty to minority shareholders in Reading's position who were no longer engaged in rail operations. *Id.*

60. *Id.* The court noted that Delaware law controlled its disposition of Reading's claim, because Trailer Train was incorporated in that state. *Id.* (citing *Thomas v. Roblin Indus.*, 520 F.2d 1393, 1397 (3d Cir. 1975); *RESTATEMENT (SECOND) OF CONFLICTS* §§ 306, 309 (1971)).

61. 711 F.2d at 517 (citing *Guth v. Loft, Inc.*, 23 Del. Ch. 255, 270, 5 A.2d 503, 510 (Del. 1939) (corporate directors stand in a fiduciary relationship to their corporation and its stockholders)). For a discussion of the fiduciary duty of directors, see notes 25-31 and accompanying text *supra*.

62. 711 F.2d at 517 (citing *Singer v. Magnavox Co.*, 380 A.2d 969, 976-77 (Del. 1977) (majority shareholders owe a fiduciary duty to the corporation and to minority shareholders if they combine to dominate the board and control the corporation)) (further citations omitted). For a discussion of the fiduciary duty of majority shareholders, see notes 34-35 and accompanying text *supra*.

63. 711 F.2d at 517 (citing *Gabelli & Co. v. Liggett Group*, 444 A.2d 261, 265 (Del. Ch. 1982) (duty owed by majority depends upon nature of challenged action or inaction)).

64. 711 F.2d at 577 (citing *Sinclair Oil v. Levien*, 280 A.2d 717, 720 (Del. 1971))



continued, where the plaintiff can show that majority shareholders have exercised control over the board of directors to engage in self-dealing, Delaware courts will judge the action of the dominated board under the "intrinsic fairness" test.<sup>65</sup>

The Third Circuit then reviewed the district court's determination that the majority shareholders of Trailer Train had engaged in self-dealing and had maintained corporate policies which did not pass muster under the intrinsic fairness test.<sup>66</sup> The Third Circuit assumed without deciding that a majority shareholder group comprised of operating railroads controlled Trailer Train's board of directors, but the court did not believe Reading had shown that the majority had engaged in self-dealing.<sup>67</sup>

In order for self-dealing to occur, the Third Circuit stated, the majority shareholders must dominate corporate policy in such a way as to enable themselves to receive something from the corporation to the exclusion and detriment of the minority shareholders.<sup>68</sup> Although Reading argued that only the majority benefitted from the use of the equipment, to Reading's exclusion and detriment, the court noted that Reading retained the same right of access to corporate equipment enjoyed by the majority.<sup>69</sup> The Third

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(courts will not interfere with honest business judgment); *Gabelli & Co. v. Liggett Group*, 444 A.2d 261, 265-66 (business judgment rule applied); *E. FOLK*, *supra* note 36, at 75-77. For a discussion of the business judgment rule in the context of Delaware law, see notes 27-31 and accompanying text *supra*.

65. 711 F.2d at 517-18 (citing *Sinclair Oil v. Levien*, 280 A.2d 717, 719-20 (Del. 1971)) (further citations omitted). Under the intrinsic fairness test, the court explained, "those asserting the validity of the corporation's actions have 'the burden of establishing its entire fairness to the minority stockholders, sufficient to "pass the test of careful scrutiny by the courts.'" " 711 F.2d at 518 (quoting *Singer*, 380 A.2d at 976) (further citations omitted). For a discussion of the intrinsic fairness test as developed and interpreted under Delaware law, see notes 34-47 and accompanying text *supra*.

66. 711 F.2d at 518. Finding that the operating railroads of Trailer Train dominated the corporation and used their control to perpetuate policies which benefitted themselves but prevented Reading from getting any return on its stock, the district court had concluded that self-dealing had occurred and that the management decision could not withstand intrinsic fairness scrutiny. *Id.* For a discussion of the district court opinion in *Reading*, see notes 17-19 and accompanying text *supra*.

67. 711 F.2d at 519. Since the requisite element of self-dealing was not established, the Third Circuit reviewed the decision of Trailer Train's board under the business judgment rule, rather than the strict test of intrinsic fairness. *Id.* For a discussion of the intrinsic fairness test and the business judgment rule, see notes 27-47 and accompanying text *supra*.

68. 711 F.2d at 518 (citing *Standard Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971)).

69. 711 F.2d at 518. The Third Circuit quoted the district court's agreement with Reading's argument:

By making use of Trailer Train equipment the sole benefit of stock ownership, the board of directors has effectively permitted the company's user-shareholders to obtain a benefit which is not available to non-users, Reading and Erie Lackawanna.

*Id.* (quoting *In re Reading*, 551 F. Supp. 1205, 1217 (E.D. Pa. 1982)). For a discussion of the district court opinion in *Reading*, see notes 17-19 and accompanying text *supra*. The Third Circuit pointed out that Reading retained the right of access to the pool

Circuit rejected Reading's contention that the majority shareholders' use of the car pool was self-dealing.<sup>70</sup> Reasoning that the use of the cars "is not extended free to all who buy stock" but must be purchased at Trailer Train's rates, the Third Circuit pointed out that while Reading no longer had the benefit of car use, neither did it have the car hire charges as a cost.<sup>71</sup> Unless the benefit of equipment use was disproportionate to its cost, the court continued, "Reading [was not] disadvantaged nor the operating railroads advantaged by [Reading's] inability to use the cars."<sup>72</sup> Therefore, the Third Circuit would not regard the operating railroads' continued use of the corporate car pool as self-dealing.<sup>73</sup>

The Third Circuit then addressed Reading's second allegation of self-dealing: that "the car hire rates, to the extent they were less than the ICC per diem rates, constituted a 'constructive dividend,' " which was denied to the minority non-users.<sup>74</sup> The Third Circuit concluded that Reading could not characterize the dividend distribution scheme as self-dealing, because Reading had specifically agreed to the arrangement at the time it purchased Trailer Train stock.<sup>75</sup> The court recognized that under Delaware law, the fiduciary duty owed to a minority shareholder is subject to change by con-

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cars and the right to a *pro rata* share of the assets on dissolution. 711 F.2d at 518 & n.8. The court also noted that "the rights Reading seeks, *e.g.*, redemption on demand and compulsory dividends, are rights which no shareholder presently possesses." *Id.*

70. 711 F.2d at 518.

71. *Id.* For a discussion of Trailer Train's rate policy, see notes 5-9 and accompanying text *supra*.

72. 711 F.2d at 518 (citation omitted). Only in the event that the car hire rates themselves were a reward of stock ownership, the court explained, would Reading have been disadvantaged by its inability to use the cars. *Id.* (citing *Sinclair Oil v. Levien*, 280 A.2d 717, 723 (Del. 1971)). For a discussion of how Trailer Train's car hire rates compared to the ICC per diem rates, see note 8 *supra*.

73. 711 F.2d at 518.

74. While the Third Circuit did not decide the question of whether the low car hire rates constituted a constructive dividend to the extent that they were lower than the ICC per diem rates, the court noted that the district court had found this theory "less than compelling." *Id.* at 518 n.9. The district court had found that Trailer Train had set its rates to cover its own costs, without reference to the ICC rates. *Id.* Secondly, the district court had said that the low rates were not *pro rata* dividends because "the return which each shareholder obtained was predicated [solely] upon use of the company's equipment and not upon proportionate equity ownership." *Id.* (quoting *In re Reading*, 551 F. Supp. at 1219) (emphasis in original). See also *Klein v. Greenstein*, 24 N.J. Super. 348, 352-53, 94 A.2d 497, 499 (1953) (not all benefits received by shareholders are dividends). Finally, the Third Circuit remarked, "the resemblance to dividends is especially tenuous . . . because Trailer Train's low prices are extended even to non-shareholders in possession of Trailer Train cars." 711 F.2d at 518-19 n.9 (citing *In re Reading*, 557 F. Supp. at 1217 n.5). For a discussion of Trailer Train's rate policies, see notes 5-9 and accompanying text *supra*.

75. 711 F.2d at 519. The Third Circuit noted that Reading agreed to Trailer Train's policies in signing the Form A Car Contract, which "explicitly stated that Trailer Train would charge users of pool cars the lowest possible car hire rates, and would not accumulate surplus earnings or profits from which *pro rata* dividends could be paid." *Id.* (citation omitted).

tractual agreement.<sup>76</sup> While ordinarily dividends must be distributed among shareholders *pro rata* according to their ownership of stock, the court explained that if shareholders unanimously consent to a different scheme, they are bound by their agreement and may be estopped to object to a discriminatory arrangement.<sup>77</sup> Therefore, the Third Circuit stated, "Whether or not the car hire rates are constructive dividends, Reading is receiving exactly the benefits from its Trailer Train stock for which it bargained."<sup>78</sup>

Finally, the Third Circuit stated that Reading's cessation of rail operations did not impose any different or additional fiduciary duty upon the operating shareholders of Trailer Train.<sup>79</sup> The court held that the

76. *Id.* (citing *Coleman v. Taub*, 638 F.2d 628, 629, 636 (3d Cir. 1981) (applying Delaware law) (rights of stockholders may be altered by binding agreements between the stockholders and the corporation); *Weinberg v. Baltimore Brick Co.*, 35 Del. Ch. 225, 241, 114 A.2d 812, 821 (Del. 1955) (control of corporation by preferred shareholders not unfair where so contracted); *Ellingwood v. Wolf's Head Oil Refining Co.*, 27 Del. Ch. 356, 362-63, 38 A.2d 743, 747 (Del. 1944) (rights of stockholders are contract rights which are determined from charter)) (further citation omitted).

77. 711 F.2d at 519 (citing 11 W. FLETCHER, *supra* note 25, § 5352 (rev. perm. ed. 1971)) (further citations omitted). The Third Circuit stated that shareholders may enter a valid and binding agreement to accept distributions in the form of rebates on purchases from the corporation. 711 F.2d at 519 (citing *Wabash Ry. v. American Refrigerator Transit Co.*, 7 F.2d 335, 345-46 (8th Cir. 1925)). Further, the Third Circuit found authority for the proposition that even shareholders who are no longer customers of the corporation are bound by such an agreement. 711 F.2d at 519 (citing *Allied Supermarkets v. Grocers Dairy Co.*, 391 Mich. 729, 735-37, 219 N.W.2d 55, 58-60 (1974)). For a discussion of the effect of shareholders' agreements to alternative dividend distribution schemes, see notes 53-57 and accompanying text *supra*.

78. 711 F.2d at 519. The court stated that Reading could avoid the binding effect of its contract with Trailer Train only by showing that it was obtained by fraud, misrepresentation, or overreaching. *Id.* (citing *Esso Standard Oil Co. v. Cunningham*, 35 Del. Ch. 210, 215, 114 A.2d 380, 383 (Del. Ch. 1953), *aff'd*, 35 Del. Ch. 371, 118 A.2d 611 (Del. 1955)). Even if Reading could make such a showing, it would still have to prove that it did not ratify the agreement by accepting benefits under it. 711 F.2d at 519 (citing *Eastern States Petroleum Co. v. Universal Oil Prods.*, 29 Del. Ch. 305, 313, 49 A.2d 612, 616 (Del. Ch. 1946)) (further citation omitted). The court felt that Reading would be hard-pressed to show that the agreement was fraudulently obtained, since Trailer Train's policies were well-established and Reading was fully aware of them when it purchased its stock. 711 F.2d at 519 (citing *Goodman v. Futrovsky*, 42 Del. Ch. 468, 473-74, 213 A.2d 899, 902-03 (Del. 1965) (purchase from stockholder/wholesaler not unlawful where it was disclosed to prospective stockholders in prospectus), *cert. denied*, 383 U.S. 946 (1966); *Schreiber v. Bryan*, 396 A.2d 512, 519 (Del. Ch. 1978) (awareness of corporate policies before purchase prevents complaint that they are unfair)). Furthermore, the court suggested that because Reading "enjoyed the fruits of those policies for fifteen years without complaint . . . and expressed its approval of those policies both before and after it entered reorganization," it had probably ratified the agreement regardless of how it had been obtained. 711 F.2d at 519 (citing *Frank v. Wilson & Co.*, 27 Del. Ch. 292, 304-05, 32 A.2d 277, 282-83 (Del. 1943); *Elster v. American Airlines*, 34 Del. Ch. 94, 97-98, 100 A.2d 219, 221 (Del. Ch. 1953) (shareholder who votes in favor of a corporate policy cannot later complain that it is unfair)). For a discussion of invalidation of fraudulently-obtained shareholder contracts and ratification, see note 49 *supra*.

79. 711 F.2d at 519-20. Reading argued that since it was permanently deprived

corporation's failure to recognize Reading's changed circumstances did not amount to self-dealing.<sup>80</sup> Noting that the Delaware Supreme Court had held the intrinsic fairness test particularly inapplicable where the terms of a dispute between majority and minority shareholders are set by a third party,<sup>81</sup> the Third Circuit pointed out that Reading's present status was dictated by the federal government.<sup>82</sup> Because "self-sacrifice" is not part of the majority shareholder's fiduciary duty in such cases,<sup>83</sup> the court refused to order the partial liquidation of the corporation "because it is doing exactly what it was lawfully organized to do."<sup>84</sup>

Since Reading could not prove the self-dealing requisite to intrinsic fairness scrutiny, the Third Circuit reviewed Trailer Train's actions under the business judgment rule.<sup>85</sup> The court found that the corporation's reaffirmation of its lease policy, refusal to pay dividends, and continued reinvestment of earnings in new equipment could each be attributed to a rational business purpose.<sup>86</sup> The court concluded that neither the directors nor the majority shareholders had breached their fiduciary duty to Reading.<sup>87</sup>

In examining the decision in *Reading*, it is submitted that the Third Circuit reached an eminently logical conclusion in a rather unique situation, given that under Delaware law the rights of a shareholder are subject to variation by contract.<sup>88</sup> While under normal circumstances Trailer Train

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of the enjoyment of its right of access to the railroad cars by virtue of the conveyance of its rail properties to Conrail, Trailer Train engaged in self-dealing by failing to react to Reading's change of circumstances. *Id.* For a discussion of Reading's conveyance to Conrail under the Regional Rail Reorganization Act, see note 2 and accompanying text *supra*.

80. 711 F.2d at 519-20.

81. *Id.* (citing *Getty Oil Co. v. Skelly Oil Co.*, 267 A.2d 883 (Del. 1970); *Trans World Airlines v. Summa Corp.*, 374 A.2d 5, 9 (Del. Ch. 1977)). For a discussion of *Getty* and *TWA*, see notes 46-47 and accompanying text *supra*. For a general discussion of the intrinsic fairness test, see notes 34-38 and accompanying text *supra*.

82. 711 F.2d at 520. For a discussion of the Regional Rail Reorganization Act, see note 2 and accompanying text *supra*.

83. 711 F.2d at 520 (citing *Getty Oil Co. v. Skelly Oil Co.*, 267 A.2d 883, 888 (Del. 1970)) (further citation omitted).

84. *Id.* (quoting *Berwald v. Mission Dev. Co.*, 40 Del. Ch. 509, 514-15, 185 A.2d 480, 483 (Del. 1962) (plaintiff who wishes to liquidate corporation for acting as lawfully organized to act bears heavy burden)).

85. *Id.* For a general discussion of the intrinsic fairness test and the business judgment rule, see notes 27-38 and accompanying text *supra*.

86. 711 F.2d at 520. The court determined that Trailer Train's car leasing policy, which minimized rates, probably assured a high level of demand for the cars. *Id.* It also determined that the refusal to pay dividends helped maintain the low rates and, finally, that reinvestment of earnings assured that customer demands for equipment could be met. *Id.*

87. *Id.*

88. *See Peters v. United States Mortgage Co.*, 13 Del. Ch. 11, 114 A. 598 (Del. Ch. 1921) (stockholder enters into a contract with corporation when he purchases stock). *See also Weinberg v. Baltimore Brick Co.*, 35 Del. Ch. 225, 114 A.2d 812 (Del. 1955) (contract may alter rights); *Ellingwood v. Wolf's Head Oil Refining Co.*, 27 Del. Ch. 356, 38 A.2d 743 (Del. 1944) (rights of shareholders are contract rights and must be determined from charter, interpreted as any other contract). For a discus-

would have had the duty to allow all shareholders to share *pro rata* in dividends,<sup>89</sup> Reading had agreed to a distribution scheme which allocated dividends in the form of savings on leases from the corporation.<sup>90</sup> This agreement effectively<sup>91</sup> altered the duty owed to Reading by Trailer Train and its majority shareholders.<sup>92</sup>

Reading could not complain that the contract itself was invalid, as there was no evidence of misrepresentation or overreaching.<sup>93</sup> Reading had purchased its stock with full knowledge of Trailer Train's policies and had accepted the benefits of those policies without complaint.<sup>94</sup> It is submitted that it would be manifestly unjust to allow Reading to complain fifteen years later that Trailer Train's policies amounted to a breach of the fiduciary duty owed to it by Trailer Train's directors and majority shareholders.<sup>95</sup>

Furthermore, any harm resulting to Reading arose as a result of its departure from the railroad business and its refusal to dispose of its Trailer

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sion of the contractual nature of shareholder rights under Delaware law, see notes 48-49 and accompanying text *supra*.

The Third Circuit has previously recognized the contractual nature of shareholder rights. *See* *Coleman v. Taub*, 638 F.2d 628 (3d Cir. 1981).

89. *See* *Southern Pac. Ry. v. Bogert*, 250 U.S. 483, 492 (1919). For a discussion of *Bogert*, see note 52 and accompanying text *supra*.

90. For a discussion of the formal agreement entered into by Reading, see notes 6 & 9 and accompanying text *supra*. Even if Reading had not signed the formal contract, it would have been bound by the terms of Trailer Train's policies of which it had notice and by Trailer Train's charter. *See* *Goodman v. Futrovsky*, 42 Del. Ch. 468, 473-74, 213 A.2d 899, 902-03 (Del. 1965), *cert. denied*, 383 U.S. 946 (1966) (knowledge of corporate policy prior to stock purchase alters duty); *Schreiber v. Bryan*, 396 A.2d 572, 519 (Del. Ch. 1978) (contract between shareholder and corporation evidenced by knowledge of corporate policies prior to stock purchase); *Peters v. United States Mortgage Co.*, 13 Del. Ch. 11, 14, 114 A. 598, 600 (Del. Ch. 1921) (contract between shareholders and corporation found in charter). For a discussion of these principles, see notes 48-49 and accompanying text *supra*.

91. *See* *Wabash v. American Refrigerator Transit Co.*, 7 F.2d 335 (8th Cir. 1925) (agreement to distribute dividends, in the form of rebates on purchase from corporation, is valid); *Little v. Caswell-Doyle-Jones*, 305 So. 2d 842, 844-45 (Fla. App. 1975) (unanimous agreement for non-*pro rata* dividend distribution upheld). For a discussion of the propriety of a unanimous agreement to distribute dividends on a non-*pro rata* basis, see notes 53-57 and accompanying text *supra*.

92. *See* *Coleman v. Taub*, 638 F.2d 628 (3d Cir. 1981) (applying Delaware law) (fiduciary duty owed to stockholder may be modified by contract). For a discussion of *Coleman* and other Delaware cases holding that the rights of stockholders are contractual, see notes 48-51 and accompanying text *supra*.

93. *See* *Esso Standard Oil v. Cunningham*, 35 Del. Ch. 210, 114 A.2d 380 (Del. Ch. 1963), *aff'd*, 35 Del. Ch. 371, 118 A.2d 611 (Del. 1965) (misrepresentation or overreaching can invalidate a contract).

94. 711 F.2d at 512, 519.

95. Under Delaware law, knowledge of corporate policy and receipt of its benefits will estop a shareholder from objecting to the policy. *Frank v. Wilson & Co.*, 27 Del. Ch. 292, 304-05, 32 A.2d 277, 282-83 (Del. 1943). It is submitted that another factor supporting estoppel is the equal bargaining power of Reading and Trailer Train. For a discussion of the fiduciary duties of directors and majority stockholders, see notes 25-38 and accompanying text *supra*.

Train stock.<sup>96</sup> Trailer Train undertook its policies of minimization of rates, refusal to pay dividends, and reinvestment of earnings in good faith and in accordance with the contract with its shareholders, including Reading.<sup>97</sup> There was no element of self-dealing on the part of majority shareholders, as Trailer Train was incorporated for the sole purpose of providing a pool of rail cars to its shareholders.<sup>98</sup> Reading agreed to this explicitly by virtue of its purchase of stock with knowledge of these policies.<sup>99</sup> The district court was incorrect in holding that Trailer Train's actions were self-dealing and intrinsically unfair.<sup>100</sup> The district court completely ignored the fact that Reading had agreed to have Trailer Train operate as it did.<sup>101</sup> It is submitted that the district court's failure to consider the contract law issue was questionable; since the court had found as a fact that a contract had been created, at least a consideration of its impact on Reading's rights as a shareholder was required.<sup>102</sup>

The Third Circuit's granting of the relief requested by Reading would have been tantamount to holding that a shareholder can compel the partial liquidation of a corporation even though the corporation is "doing exactly

96. *See* 711 F.2d at 514. Reading did not convey the stock to Conrail when it left the railroad business; its trustees requested that the stock not be transferred because they regarded it as a "valuable asset." *Id.* Furthermore, Reading turned down a \$1,500,000 offer by Trailer Train to repurchase the stock. *Id.* at 514 n.14. Trailer Train agreed to keep the offer open, regardless of the outcome of this litigation. *Id.* It is submitted that Trailer Train's offer, though much less than the stipulated \$9,830,707 book value of the stock, was still generous because there was no market for this unique stock and, at any rate, Trailer Train was not obligated to repurchase it.

97. 711 F.2d at 513. For a discussion of the formal contract entered into by Reading and Trailer Train, see notes 6 & 9 and accompanying text *supra*. Even without this formal contract, Reading would have been bound by these policies, as it purchased its stock with knowledge of them and received the benefits of them. For a discussion of the principle that such express or implied consent to corporate policies gives rise to a contract as between a shareholder and the corporation, see note 49 *supra*.

98. *See* 711 F.2d at 512.

99. 711 F.2d at 513. For a discussion of the implied contract between a shareholder and the corporation, see notes 48-49 and accompanying text *supra*.

100. 551 F. Supp. at 1220. For a discussion of self-dealing and the intrinsic fairness test, see notes 35-43 and accompanying text *supra*.

101. *See* 551 F. Supp. at 1214-20. The district court did not even consider the fact that Delaware law recognizes an implied contract between shareholders and the corporation as to 1) matters in the charter; 2) policies which the shareholder had knowledge of before his stock purchase; and 3) policies that provided benefits which the shareholder accepted. For a discussion of these principles of Delaware law, see notes 48-49 and accompanying text *supra*.

102. It is submitted that even under the intrinsic fairness test, the district court should have found that Trailer Train was completely fair to Reading, because Reading had contractually altered the duty owed to it as a shareholder. *See* *Coleman v. Taub*, 638 F.2d 628 (3d Cir. 1981) (applying Delaware law). For a discussion of *Coleman*, see notes 50-51 and accompanying text *supra*. Thus, even if the Third Circuit had regarded the majority shareholders of Trailer Train as engaging in self-dealing, the contract would still have compelled a ruling in favor of Trailer Train.

what it was lawfully organized to do."<sup>103</sup> A minority shareholder's changed circumstances, over which the corporation had no control, should not give the shareholder any greater rights vis-a-vis the corporation.<sup>104</sup> It is submitted that the Third Circuit properly refused to hold that Reading's changed circumstances warranted the creation of any greater duty on the part of Trailer Train.<sup>105</sup>

It is submitted that while situations precisely analogous to the *Reading* situation may be uncommon, the broader impact of the decision lies in the Third Circuit's clear signal that agreements between minority stockholders and their corporations will be honored. Since valid agreements between stockholders and a corporation need not be based on a formal contract,<sup>106</sup> *Reading* is a warning to shareholders to be aware of the policies of a corporation before investing. The Third Circuit, at least, will not rush to the aid of minority shareholders if a change in circumstances should eliminate the benefits of their stock ownership.<sup>107</sup>

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103. *Berwald v. Mission Co.*, 40 Del. Ch. 509, 512, 185 A.2d 480, 483 (Del. 1962). For a discussion of *Berwald*, see note 58 and accompanying text *supra*.

104. Delaware courts have found the intrinsic fairness test "particularly inapplicable" where the action which disadvantaged the minority shareholders had its basis in action by a party other than the board or the majority shareholders. *Getty Oil Co. v. Skelly Oil Co.*, 267 A.2d 883 (Del. 1970); *Trans World Airlines v. Summa Corp.*, 374 A.2d 5 (Del. Ch. 1977) (decision of board judged under business judgment rule where terms are set by third party).

105. *See Getty*, 267 A.2d at 888. In the words of Supreme Court of Delaware, the majority's fiduciary duty to the minority does not require "self-sacrifice." *Id.*

106. For a discussion of factors which lead to an implied contract between a shareholder and a corporation, see notes 48-49 and accompanying text *supra*.

107. The Third Circuit's decision is consistent with the decisions of the few courts which have had occasion to consider similar questions. *See, e.g., Allied Supermarkets v. Grocers Dairy Co.*, 391 Mich. 769, 219 N.W.2d 55 (1974) (agreement to distribute dividends as rebates on purchases from the corporation binding even on non-customer shareholders); *Klein v. Greenstein*, 24 N.J. Super. 348, 94 A.2d 497 (1953) (rebates on purchases from corporation paid to shareholder/purchasers not unfair to shareholder/non-purchasers.).