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FAIR DEALING COMES OF AGE IN THE REGULATION OF GOING PRIVATE TRANSACTIONS

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INTRODUCTION

The regulation of going private transactions, particularly cash out mergers in which minority shareholders must take cash for their stock,¹ has been the subject of considerable debate over the last several years.² Such transactions are in-

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1. A going private transaction is a transaction designed to eliminate public shareholders from equity participation in the company. It may be accomplished in a variety of ways, such as by merger, sale of assets followed by dissolution, liquidation, or reverse stock split. This article will consider the notion of fair dealing principally in the context of a cash out merger.

A cash out merger is a going private transaction in which a less-than-wholly-owned subsidiary is merged into its parent or a wholly-owned subsidiary of the parent, and the consideration received by the public minority shareholders of the subsidiary consists entirely of cash. The minority shareholders of the subsidiary corporation are "cashed out" or eliminated from equity participation in the surviving corporation. The same transaction can be accomplished by an individual or group of individuals who own a controlling interest in the company rather than by a corporate majority shareholder.

The essence of a freezeout is the displacement of public investors by those who own a controlling block of stock of a corporation, whether individuals or a parent company, for cash or senior securities. The public investors are thus required to give up their equity in the enterprise, while the controllers retain theirs. Freezeouts most commonly take the form of a merger of a corporation into its existing parent or into a shell corporation newly formed for the purpose by those who control the merged entity.

Brudney & Chirelstein, *A Restatement of Corporate Freezeouts*, 87 YALE L.J. 1354, 1357 (1978) [hereinafter cited as *Restatement*].

This article deals only with cash out mergers of publicly held corporations (*i.e.*, corporations subject to the reporting requirements of § 12(g) or § 15(d) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 781, 78o (1982)).

The term "cash out merger" is intended to be nonprejorative; other labels for this kind of transaction are take out merger, freeze out and squeeze out. See *infra* note 12 (discussing proposed classifications for such transactions).

2. See, e.g., Borden, *Going Private—Old Tort, New Tort or No Tort?*, 49 N.Y.U. L. REV. 987 (1974); Brudney & Chirelstein, *Fair Shares in Corporation Mergers and Takeovers*, 88 HARV. L. REV. 297 (1974) [hereinafter cited as *Fair Shares*]; *Restatement*, *supra* note 1; Carney, *Shareholder Coordination Costs, Shark Repellents, and Takeout Mergers: The Case Against Fiduciary Duties*, 1983 AM. B. FOUND. R. J. 341; Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U. L. REV. 913 (1982); Goldman & Wolfe, *In Response to A Restatement of Corporation Freezeouts*, 36 WASH. & LEE L. REV. 683 (1979); Greene, *Corporation Freeze-out Mergers: A proposed Analysis*, 28 STAN. L. REV. 487 (1976); McBride, *Delaware Corporate Law: Judicial Scrutiny of Mergers—The Aftermath of Singer v. The Magnavox Company*, 33 BUS. LAW. 2231 (1978); Robinson, *Elimination of Minority Shareholders*, 6 N.C. L. REV. 515 (1983); Rothschild, *Going Private, Singer, and Rule 13e-3: What are the Standards for Fiduciaries?*, 7 SEC. REG. L.J. 195 (1979); Weiss, *The Law of Take Out Mergers: A Historical Perspective*, 56 N.Y.U. L. REV. 624 (1981); Note, *Singer v. Magnavox and Cash Take-Out Mergers*, 64 VA. L. REV. 1101 (1978); Note, *Singer v. Magnavox Co.: Delaware Imposes Restrictions on Freezeout Mergers*,

herently suspect because a single party stands on both sides of the deal. On the one hand, the majority shareholder, when acquiring the subject company, is the purchaser of the minority's stock. On the other hand, the majority shareholder represents the company being acquired and all of its shareholders in the transaction, either directly or through management that is under the majority's control.³ As a result of its dominance of the subject company and its presence on both sides of the transaction, the majority shareholder often has the ability to establish unilaterally the terms of the transaction. The position of the majority shareholder on both sides of the transaction and its consequent power to dictate the terms of the deal combine to create the likelihood that the majority shareholder will exercise that power to its own advantage and to the corresponding detriment of the minority shareholders.⁴ Such a potential for unfairness to the minority has led some to suggest that going private transactions should be absolutely prohibited,⁵ while others have been content to protect the minority simply by ensuring the availability of appraisal rights.⁶

The Delaware Supreme Court has recently considered how best to regulate going private transactions.⁷ Delaware has generally judged all self dealing transactions, including going private transactions and cash out mergers, against a standard of entire fairness.⁸ As applied to going private transactions, entire fairness originally was interpreted as requiring only that a fair price or exchange ratio

66 CALIF. L. REV. 118 (1978); Comment, *Going Private: An Examination of Going Private Transactions Using the Business Purpose Standard*, 32 Sw. L.J. 641 (1978).

3. [In a going private transaction where management is the purchaser, the problem] is that [m]anagement is acting on both sides of the transaction. In its fiduciary capacity, management is seeking to sell the corporation and, therefore, must have concluded that a sale is in the best interests of the shareholders. In its proprietary capacity, management is seeking to purchase the corporation, and must have concluded that it can do so at a price favorable to it. In short, management is dealing with itself.

Longstreth, *Fairness of Management Buyouts Needs Evaluation*, Legal Times of Washington, Oct. 10, 1983, at 15, col. 3. The transactions discussed by former Securities and Exchange Commissioner Longstreth can be distinguished as involving only one business entity in contrast to other cash out mergers where two viable businesses combine; see *infra* note 12. See also *infra* notes 27-28 and accompanying text (discussing the fiduciary duty of a majority shareholder).

4. The use of control by a majority shareholder to gain an advantage to the corresponding detriment of the minority shareholders constitutes self-dealing. *Sinclair Oil Corp. v. Levien*, 280 A.2d 717 (Del. 1971); *Gabelli & Co. v. Liggett Group, Inc.*, 444 A.2d 261, 265 (Del. Ch. 1982).

See *infra* notes 41-44 and accompanying text; *c.f.* Longstreth, *supra* note 3, at 15, 20.

5. See, e.g., Greene, *supra* note 2, at 495-96, 512-13, who proposed prohibition of going private transactions involving only one corporate business entity; Brudney, *Equal Treatment of Shareholders in Corporate Distributions and Reorganizations*, 71 CALIF. L. REV. 1072, 1091-98, (1983) who urged formal and substantive equal treatment for all shareholders, absent compelling benefits from disparate treatment. See also *Berkowitz v. Power/Mate Corp.* 135 N.J. Super. 36, 49-50, 342 A.2d 566, 574 (N.J. Super. Ch. Div. 1975) (involving a proposed management buyout which the court enjoined); *Gabhart v. Gabhart*, 267 Ind. 370, 388, 370 N.E.2d 345, 356 (1977) (involving a squeeze out in a closely held corporation; the court held that a merger accomplished without a valid corporate purpose should be treated as a dissolution, and governed by the statute regulating voluntary dissolutions). *Cf.* Longstreth, *supra* note 3, at 21, col. 2 (indicating that even procedural safeguards, such as those discussed in this article, are "inadequate to give shareholders full value for their shares.").

6. See, e.g., Berger and Allingham, *A New Light on Cash-Out Mergers: Weinberger Eclipses Singer*, 39 BUS. LAW 1, 10 (1983); *Stauffer v. Standard Brands, Inc.*, 41 Del. Ch. 7, 11, 187 A.2d 78, 80 (1962); *David J. Greene & Co. v. Schenley Indus.*, 281 A.2d 30, 35 (Del. Ch. 1971).

7. Delaware corporation law is influential far beyond the boundaries of the state. The Delaware judiciary has the opportunity to address many issues of first impression in interpreting the law governing Delaware corporations, and its opinions are considered persuasive by courts of other jurisdictions when faced with the same or similar issues.

8. See *infra* notes 30-42 and accompanying text.

be offered to the minority shareholders for their stock.⁹ But in *Weinberger v. UOP, Inc.*,¹⁰ the Delaware Supreme Court held that entire fairness required not only that a fair price be paid to the minority shareholders for their stock, but also that the majority shareholder accord fair treatment to the minority in accomplishing the transaction.¹¹

This article will analyze fair dealing, the procedural aspect of the entire fairness standard, in the context of going private transactions between publicly held parent and subsidiary corporations.¹² In Part I, the theoretical basis of the duty of fair

9. See *infra* note 34 and accompanying text.

10. 457 A.2d 701 (Del. 1983). For a description of the facts in *Weinberger*, see *infra* notes 52-66 and accompanying text. The three *Weinberger* decisions—409 A.2d 1262 (Del. Ch. 1979), 426 A.2d 1333 (Del. Ch. 1981), and 457 A.2d 701 (Del. 1983)—will be referred to as *Weinberger*, *Weinberger II*, and *Weinberger*, respectively.

11. *Weinberger*, 457 A.2d at 711.

12. It is assumed that going private transactions ought to be permitted and that some form of regulation of such transactions is required for the protection of minority shareholders and the preservation of the integrity of the securities markets. For an interesting discussion of whether such transactions should be permitted and, if so, under what circumstances, see Brudney, *supra* note 15; Carney, *supra* note 2; Greene, *supra* note 2; Easterbrook and Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698 (1982).

Proposals have been made to divide going private transactions into three groups and then regulate them according to the class to which they belong. Under this classification scheme the Type I transaction consists of situations in which the acquiring company's initial investment was by way of tender offer for all of the outstanding shares of the acquired corporation. After the acquiring company gained control, it would eliminate the minority shareholders of the acquired corporation by voting its majority stock interest in favor of a merger of the controlled corporation into the acquiring corporation, in which the minority shareholders would be paid cash or other consideration. Greene, *supra* note 2, at 491-92. In order for a transaction to be classified as a Type I cash out, one commentator proposed that the second step cash out merger must be accomplished within one year of the original acquisition of control. *Id.* at 492 n.18.

[T]he two steps in the acquisition—tender offer plus merger—are integrated and represent a “plan.” . . . Although the tag-end merger appears to be an example of self-dealing by the majority stockholders, it is only superficially of that class. Realistically, the tender-plus-merger procedure is merely a way of bypassing the target company's proxy machinery, which is controlled by the incumbent board, and submitting the acquisition proposal to direct referendum of the stockholders.

Restatement, supra note 1, at 1360 (footnote omitted). *But see* Goldman & Wolfe, *supra* note 2, at 692-94.

A Type II going private transaction differs from a Type I transaction in two principal respects. First, the original investment is accomplished pursuant to a tender offer for less than 100% of the outstanding shares of the acquired company. Second, the subsequent cash out merger is effected more than one year after the tender offer. Greene, *supra* note 2, at 492-93. Greene argued that the likelihood of an unfair price being paid to the cashed out minority shareholders in the second step merger was greater in a Type II transaction than in a Type I transaction, in part because “as the time between steps [of acquisition] increases, valuation becomes more difficult, because the arm's-length price paid in the first step [*i.e.*, the tender offer] has little bearing on the value of X [the acquired corporation] at the time of the merger.” *Id.* at 509. He therefore concluded that a Type II cash out should be subject to stricter regulation than a Type I cash out. *Id.* at 510.

A Type III going private transaction involves only one business, and the majority or controlling shareholders of the corporation simply merge the company into a corporate shell created for the purpose of merging and owned 100% by the controlling shareholders. The minority shareholders of the business corporation are paid cash for their stock, and are eliminated from participation in the surviving company. *Id.* at 495. Greene proposed that Type III transactions be prohibited. *Id.* at 512.

Consistent with Greene's focus on the period of time between the original acquisition of control and the subsequent cash out merger, Rule 13e-3, 17 C.F.R. § 240.13e-3 (1983), which regulates going private transactions involving companies subject to the federal securities laws (*see infra* note 16), excepts from its application going private transactions occurring within one year from the date of a tender offer in which the majority shareholder acquired its controlling interest. *Id.* § 240.13e-3(g)(1). The

dealing will be discussed.¹³ In general, procedural fairness is viewed as a means of obtaining substantive fairness. When the decision-making process in a going private transaction resembles an arm's length bargaining process, the result of the process—the substantive terms of the transaction—may be considered fair on the assumption that it will resemble the result of an arm's length bargaining process.

In Part II, the elements required to fulfill the duty of fair dealing are considered. The *Weinberger* opinion is the starting point for the discussion, since it includes a significant enunciation of the principle of fair dealing,¹⁴ although it is not the first exploration of the elements of procedural fairness in the law of Delaware. From time to time, Delaware courts have considered conduct relating to one or more of the elements of fair dealing as indicative of the presence or absence of self dealing. In addition, other states' statutes and administrative regulations¹⁵ governing going private transactions will be discussed to the extent that they address the notion of procedural fairness.

As a comparison to state law, this article will also consider whether the elements of fair dealing are relevant to the regulation of going private transactions by the Securities and Exchange Commission (SEC or Commission) under Rule 13e-3 of the Securities Exchange Act of 1934 (Exchange Act).¹⁶ This regulation requires

Rule conditions the exception on the existence of the following:

That the consideration offered to unaffiliated security holders in such Rule 13e-3 transaction is at least equal to the highest consideration offered during such tender offer and *provided further*, that:

(i) If such tender offer was made for any or all securities of a class of the issuer.

(A) Such tender offer fully disclosed such person's intention to engage in a Rule 13e-3 transaction, the form and effect of such transaction and, to the extent known, the proposed terms thereof; and

(B) Such Rule 13e-3 transaction is substantially similar to that described in such tender offer; or

(ii) If such tender offer was made for less than all the securities of a class of the issuer:

(A) Such tender offer fully disclosed a plan of merger, a plan of liquidation or a similar binding agreement between such person and the issuer with respect to a Rule 13e-3 transaction; and

(B) Such Rule 13e-3 transaction occurs pursuant to the plan of merger, plan of liquidation or similar binding agreement disclosed in the bidder's tender offer.

Id. See also IND. CODE § 23-2-3.1-8.4 (Supp. 1983) (requiring that a second step cash out merger, accomplished within two years of the original acquisition, offer to the shareholders terms substantially equivalent to those offered in the original acquisition); *infra* text accompanying note 205. This article deals primarily with Type II transactions.

13. See *infra* notes 43-50 and accompanying text.

14. See *infra* note 49 and accompanying text.

15. See, e.g., WISC. ADMIN. CODE § SEC 6.05 (1980); IND. CODE § 23-2-3.1-8.4 (Supp. 1983); CAL. CORP. CODE §§ 1101, 1101.1 (Deering 1979 & Supp. 1984).

16. 17 C.F.R. § 240.13e-3 (1983). The disclosure requirements of the Rule are contained in Schedule 13E-3, *id.* § 240.13e-100.

As a result of the responses received by the SEC in connection with its Notice of Public Fact-Finding Investigation in the Matter of Beneficial Ownership, Takeovers and Acquisitions by Foreign and Domestic Persons, Securities Act Release No. 5526, 5 SEC DOCKET 115 (1974), as amended by Securities Act Release No. 5538, 5 SEC DOCKET 406 (1974), the Commission in 1975 began rule-making proceedings regarding going private transactions involving publicly held corporations, Securities Act Release No. 5567, 6 SEC DOCKET 250 (1975), which eventually led to the adoption of Rule 13e-3. The SEC initially proposed to regulate the substance of going private transactions as well as the disclosure of such deals. Proposed Rules 13E-3A and 13E-3B would have required that any going private trans-

disclosure of certain types of information to the minority shareholders of a controlled corporation about to be taken private. Information is required to be disclosed because the SEC considers it to be significant to the public minority shareholders. And significance in many instances means that the information reveals whether or not the majority shareholder exerted its control over the representatives of the minority shareholders. Therefore, if information is required to be disclosed under Rule 13e-3, the conduct underlying the disclosure may be significant to the procedural fairness of the transaction.¹⁷

Finally, in Part III the question of the continued significance of the notion of fair dealing is addressed. The *Weinberger* court determined that fair dealing is important both as evidence of substantive fairness¹⁸ and for purposes of deciding who bears the burden of proof on the issue of fairness,¹⁹ but the court left open the question of whether procedural fairness must be provided *in addition to* substantive fairness.

The position developed in Part III of the article is that procedural fairness is important both in and of itself and as a means to a desired end. As a means to an end, procedural fairness is the best way to obtain substantive fairness before the transaction is accomplished.²⁰ An *ex ante* determination of fair value is important to both the minority and majority shareholders. Appraisal, therefore, as an *ex post* valuation process, is inadequate as the sole test for substantive fairness. Furthermore, fair dealing defines fair value as between the parties to the trans-

action accomplished pursuant to their terms be substantively fair. *Id.* at 265. Similarly, the 1977 version of proposed Rule 13e-3 also addressed the substantive fairness of a Rule 13e-3 transaction. Securities Act Release No. 5884, 13 SEC DOCKET 839, 851 (1977). But the SEC decided to forego regulation of the substantive fairness of a Rule 13e-3 transaction in 1979, when it adopted the final version of Rule 13e-3. The Commission indicated that it would defer to the states, at least temporarily, on the issue of substantive fairness. Securities Act Release No. 6100, 17 SEC DOCKET 1449, 1450-51 (1979). Current Rule 13e-3 regulates going private transactions only by requiring disclosure of certain types of information. 17 C.F.R. § 240-13e (1983).

If Rule 13e-3 had been in effect when the Signal-UOP merger was proposed, the transaction would have been subject to the Rule. The Rule applies to any purchase of securities in connection with a merger by an affiliate of the issuer, if the transaction would result in a class of securities registered under §§ 12(g) or 15(d) of the Exchange Act, 15 U.S.C. §§ 78l(g), 78o(d) (1982), being held by less than 300 people or in the delisting or cessation of quotation on a national securities exchange or the over-the-counter market. 17 C.F.R. § 240.13e-3(a)(3)(ii) (1983). An affiliate is defined in Rule 13e-3(a)(1) to include a person who controls the issuer, so Signal would have been an affiliate of UOP. Moreover, since UOP's common stock was registered pursuant to § 12(g) of the Exchange Act, UOP would have been a Rule 13e-3(b) issuer and, therefore, subject to the anti-fraud provisions of Rule 13e-3(b)(1) as well as the requirements of subsections (d), (e) and (f). Finally, the Rule would have applied to both Signal and UOP; Signal, as the purchaser of equity securities of its affiliate, and UOP, as the solicitor of proxies in connection with a merger with its affiliate. *See* Securities Exchange Act Release No. 17719, 22 SEC DOCKET 783, 789 (1981).

In *Fisher v. Plessey Co., Ltd.*, 555 F. Supp. 442 (S.D.N.Y. 1983), a case challenging an issuer tender offer subject to Rule 13e-4, 17 C.F.R. § 240.13e-4 (1983), the U.S. District Court for the Southern District of New York found a private right of action for damages under Exchange Act § 13(e), 15 U.S.C. § 78m(e) (1982). Similar reasoning might be applied in a case challenging a Rule 13e-3 transaction. *See* Securities Act Release No. 5884, 13 SEC DOCKET at 857 (1977) (SEC intends for private right of action to be implied for violation of Rule 13e-3).

17. *See* Longstreth, *supra* note 3, at 19 ("As so often is the case, these items of disclosure [in Rule 13e-3] have tended to encourage the use of the practices required to be disclosed. This is no accident. When the commission backed away from a substantive rule of fairness, it sought to achieve the same goal through the detailed disclosures required by Rule 13e-3.')

18. *See infra* notes 208-11 and accompanying text.

19. *See infra* notes 212-13 and accompanying text.

20. *See infra* notes 230-39 and accompanying text.

action. Just as the substantive result of arm's length bargaining carries a presumption of fairness, so the result of fair dealing carries a presumption of fairness. Fair price, as between the majority and minority shareholders, is simply that amount which each side accepts voluntarily and with knowledge of all relevant information. Since fair price is a relative concept rather than a number pulled out of the sky, requiring fair dealing will increase the likelihood that the selected price is inherently fair.

But even where a third party determines, after the fact, that the price paid to minority shareholders was indeed fair, as in an appraisal proceeding, the minority shareholders still should be entitled to fair treatment.²¹ Support for this proposition is gained by analogy to the federal securities laws. Just as a board of directors laboring under a conflict of interest may be an inadequate representative of the corporation for disclosure purposes under Section 10(b) and Rule 10b-5 of the Exchange Act,²² so a board tainted by loyalty to the parent company should be considered incapable of representing the corporation in a transaction with the parent. Under such circumstances, the minority shareholders or their representatives should step into the shoes of the subsidiary corporation for purposes of consenting to a deal with the parent. Furthermore, where the subsidiary's consent to the transaction is obtained without providing fair dealing, the consent should be considered ineffective regardless of the substantive fairness of the deal. Substantive fairness has been held to present no defense to a claim that shareholder approval of a transaction was procured by misrepresentation in violation of Rule 14a-9 of the Exchange Act.²³ It can be presumed that the absence of fair dealing would contribute towards obtaining the approval of the transaction, so such approval should be disregarded.

The right to fair dealing, regardless of fair value, is also supported by policy considerations.²⁴ Such a right, at a minimum, would work as an incentive to the majority shareholder to fulfill its duty of fair dealing regardless of the majority's perception of the fairness of the price paid to the minority. And to the extent that the majority shareholder treats the minority fairly, the chance of substantive fairness resulting from the dealing between the parties will be increased. The article concludes that fair dealing should play a major role in regulating self dealing transactions, and offers some suggestions for how best to use the duty of fair dealing to ensure its effectiveness.

PART I

Fair Dealing and the Entire Fairness Test

The term "fair dealing" was first used by the Delaware courts to describe a part of the fiduciary duty of loyalty owed by a director to their corporation.²⁵ The duty of loyalty prohibits a corporate fiduciary from engaging in a self deal-

21. See *infra* notes 240-61 and accompanying text.

22. 15 U.S.C. § 78j (1982); 17 C.F.R. § 240.10b-5 (1983). See *infra* cases cited in notes 251-60 and accompanying text.

23. *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 381-85 (1970). See *infra* notes 240-50 and accompanying text.

24. See *infra* note 261 and accompanying text.

25. In *Lofland v. Cahall*, 13 Del. Ch. 384, 389, 118 A. 1, 3 (1922), the court first held that the directors of a corporation owed a duty of fair dealing to the stockholders of the company. See also *Keenan v. Eshleman*, 23 Del. Ch. 234, 2 A.2d 904 (1938); *Finch v. Warrior Cement Corp.*, 16 Del. Ch. 44, 141 A. 54 (1928).

ing transaction which results in a benefit to the fiduciary and a corresponding detriment to the corporation. When a director, in his individual capacity, contracts or otherwise deals with his corporation, the duty of loyalty requires that he act with the "utmost good faith and fair dealing" in his relations with the company.²⁶

The duty of fair dealing also has been imposed upon majority shareholders as part of the duty of loyalty owed by them to minority shareholders. A majority shareholder who enters into a transaction with the corporation it controls must "follow a course of fair dealing toward the minority shareholders."²⁷ Fair dealing is required in such cases because the majority shareholder stands on both sides of the transaction. It represents its own interest, on the one hand, and directs the actions of the corporation by virtue of its controlling stock ownership interest, on the other hand.

Until recently, when Delaware courts used the term "fair dealing," they used it literally and without elaboration. The duty of fair dealing meant simply a duty to deal fairly, to treat the corporation or its minority shareholders in a fair manner in the context of a particular contract or transaction. Specifically what was required of the director or majority shareholder to constitute fair treatment was an open question.²⁸

In *Lofland*, the directors of the Lewes Fisheries Company were sued for breaching their fiduciary duties by voting themselves salaries when neither the certificate of incorporation nor the by-laws authorized the payment of salaries to directors. The duty of loyalty, and, as part of it, the duty of fair dealing, was discussed because the directors were "on both sides" of the transaction: they acted as directors on behalf of the corporation in voting to approve the salaries and acted in their own interests as recipients of the compensation. *Lofland*, 13 Del. Ch. at 393, 118 A. at 5.

Before deciding *Lofland*, the Delaware Supreme Court used the term "fair dealing" in *Model Heating Co. v. Magarity*, 25 Del. (2 Boyce) 459, 477, 81 A. 394 (1911), in the sense of general good business practices and commercial honesty. Fair dealing has been similarly used in subsequent cases. See, e.g., *VCA Corp. v. United States*, 77-2 U.S. Tax Cas. (CCH) ¶9554 (Ct. Cl. 1977); *Burriss Foods, Inc. v. Dept. of Community Affairs and Economic Dev.* (Del. Ch. April 2, 1975); *Data Gen. Corp. v. Digital Computer Controls, Inc.* (Del. Ch. November 7, 1975).

26. *Lofland v. Cahall*, 13 Del. Ch. 384, 389, 118 A. 1, 3 (1922). See also *Petty v. Penntech Papers, Inc.*, 347 A.2d 140, 143 (Del. Ch. 1975). The plaintiff, a shareholder of Penntech, sued to enjoin the directors from selectively redeeming shares of Penntech preferred stock for the purpose of perpetuating their control of the corporation. The court discussed the duty of fair dealing owed by the directors, citing *Lofland*, in connection with its finding that it was improper to use corporate funds to perpetuate control regardless of authority for such selective redemption in the statute or charter. *Id.*

27. *Levien v. Sinclair Oil Corp.*, 261 A.2d 911, 921 (Del. Ch. 1969), *modified*, 280 A.2d 717 (Del. 1971). Cf. *St. Louis Union Trust v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶96,151, at 92,203 (8th Cir. 1977) (fiduciary duty of fair dealing was not breached by the enforcement of a call, where enforcement was triggered by an event outside the control of the defendant); *Leibert v. Grinnell Corp.*, 41 Del. Ch. 340, 345, 194 A.2d 846, 849 (1963) (Defendant used a contract with an independent third party as a guide to establishing the terms of a contract with its controlled subsidiary, to avoid "the vices of self-dealing implicit in [its] position as the majority stockholder . . .").

28. See *supra* cases cited in notes 25-27. Of all the cases considered, the opinion of Chancellor Duffy in *Levien v. Sinclair Oil Corp.* 261 A.2d 911, 919 (Del. Ch. 1969) came closest to defining fair dealing. In discussing the fact that the majority shareholder, Sinclair, chose to do business with its subsidiary, the court said: "Sinclair voluntarily took on a fiduciary duty. To meet that obligation it could have installed a truly independent board and had it done so the business judgment test might have been dispositive of most of the case. But Sinclair elected not to do that." *Id.* On appeal, the Delaware Supreme Court reversed the lower court's rejection of the applicability of the business judgment rule. The Supreme Court held that the business judgment rule was the applicable standard unless there was both a fiduciary relationship *and* self-dealing which caused the majority shareholder to

In *Weinberger v. UOP, Inc.*,²⁹ the Delaware Supreme Court imposed a duty of "fair dealing," as it had in the past, upon the majority shareholder in a parent-subsidary transaction. The *Weinberger* court, however, did much more than simply recite that the parent owed a duty of fair dealing to the minority shareholders of the subsidiary. It gave content to the term "fair dealing" by delineating specific acts and practices which it would consider relevant in assessing whether or not the duty of fair dealing had been satisfied. By supplying meaning to the two words, "fair dealing," the *Weinberger* court gave the concept of fairness in dealing new importance.

The court also identified the notion of fair dealing as part of the Delaware standard of entire fairness.³⁰ The entire fairness standard is the legal test used to judge cases in which a breach of the duty of loyalty is charged. This standard requires a director or majority shareholder, when entering into a transaction with the corporation, to bear the burden of proving the transaction's entire fairness to the corporation or its minority shareholders.³¹ In placing the burden of proof on the director or majority shareholder, application of the entire fairness test means that the transaction is presumed to be unfair.³² Unfairness is presumed because

receive a benefit to the detriment of the minority shareholders. *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971).

In discussing the unsettled state of the law when the Supreme Court had granted certiorari in *Green v. Santa Fe Indus.*, 533 F.2d 1283 (2d Cir. 1976), but had not yet issued its opinion, *reversed and remanded*, 430 U.S. 462 (1977), one commentator stated: "it might be possible to defeat a motion for preliminary injunction by emphasizing business purposes, obtaining independent appraisals, having the independent directors of the controlled corporation handle the negotiations, allowing the vote of a majority of the public stockholders to determine the outcome, and perhaps giving a preferred stock or a debenture instead of cash." Silberman, *Minority Stockholder Freezeouts and Going Private Transactions, An Overview* (Panel), 32 Bus. LAW. 1489, 1494 (1977). Interestingly, many of the factors relevant to fair dealing were identified there. See *infra* text accompanying notes 92-96, 110-58, and 208-23. See also Nathan & Shapiro, *Legal Standards of Fairness of Merger Terms under Delaware Law*, 2 DEL. J. CORP. L. 44, 46-47 (1977) and Richards, *Protection of Majority Interests*, 4 DEL. J. CORP. L. 728, 728-33 (1979).

29. 457 A.2d 701 (Del. 1983). The transaction at issue in *Weinberger* was a cash out merger of a less-than-100% subsidiary, UOP, Inc., into its parent, Signal. See *supra* notes 1 and 12.

30. "The concept of fairness has two basic aspects: fair dealing and fair price." *Weinberger*, 457 A.2d at 711.

31. The *Weinberger* court explained the "entire fairness" standard as follows:

When directors of a Delaware corporation are on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain. *Gottlieb v. Heyden Chemical Corp.*, Del. Supr., 91 A.2d 57, 57-58 (1952). The requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts. *Sterling v. Mayflower Hotel Corp.*, Del. Supr., 93 A.2d 107, 110 (1952); *Bastian v. Bourns, Inc.*, Del. Ch., 256 A.2d 680, 681 (1969), *aff'd*, Del. Supr., 278 A.2d 467 (1970); *David J. Greene & Co. v. Dunhill International Inc.*, Del. Ch., 249 A.2d 427, 431 (1968).

Id. at 710.

The standard of "entire fairness" was originally applied to a merger of a subsidiary into a parent corporation in *Sterling v. Mayflower Hotel Corp.*, 33 Del. Ch. 293, 298, 93 A.2d 107, 110 (1952). The merger in *Sterling* was not a cash out; stock of the parent company was the consideration paid to the minority for their shares in the subsidiary. *Id.* at 297, 93 A.2d at 109.

32. The starting position for a court is the result which will be required if the burden of proof is not met. Here, that result is a finding for the plaintiff, so the starting position is to assume that the transaction is unfair. See Epstein, *Pleadings and Presumptions*, 40 U. CHI. L. REV. 556, 559 (1973) (explaining that a presumption that responsibility follows from a certain proposition is rebuttable: "the plaintiff has given a reason why the defendant should be held liable, and thereby invites

the director or majority shareholder has the ability to exert influence in establishing the terms of the transaction due to his position on both sides of the deal and, as a result, he has the power to impose terms which are favorable to him but detrimental to the corporation or its minority shareholders.³³

In cases involving going private transactions, Delaware courts historically required only fair value to satisfy the entire fairness standard.³⁴ That is, the inquiry under the entire fairness test was limited to whether adequate consideration was paid by the parent to the subsidiary's minority shareholders for their stock. If the majority shareholder paid fair value, then the transaction was held to satisfy the standard of entire fairness. Thus, while expressed in broad terms, in practice the test had a quite narrow application, going only to the matter of price.

the defendant to provide a reason why, in this case, the presumption should not be made absolute. The presumption lends structure to the argument, but it does not foreclose its further development."'). Cf. *Wright v. Heizer Corp.*, [1977 Transfer Binder] FED. SEC. L. REP. (CCH) ¶96,101, at 91,966 (7th Cir. Sept. 9, 1977) (discussing the burden of proof and presumption of unfairness in the context of a claimed violation of § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78u (1982), and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1983), thereunder).

33. Cf. *Brudney*, *supra* note 5, at 1078 (dividend distributions should be in the same form to all members of the class to prevent major shareholders from discriminating against the minority).

34. See *Sterling v. Mayflower Hotel Corp.*, 33 Del. Ch. 293, 307-10, 93 A.2d 107, 109-17 (Del. Ch. 1952); *David J. Greene & Co. v. Dunhill Int., Inc.*, 249 A.2d 427, 432-36 (Del. 1968) (suit to enjoin a stock-for-stock merger of A.G. Spalding & Bros., Inc. into its parent, Dunhill International, Inc. The court used the test of entire fairness, relying upon *Sterling*, 249 A.2d at 430. In discussing what must be examined in determining entire fairness, the *Dunhill* court stated:

What is to be considered was stated precisely by Chancellor Seitz in *Sterling*: "I conclude that all relevant value figures of both corporations may be examined and compared in order to arrive at a decision as to the fairness of the plan. Thus, while not determinative, nevertheless, the value of each corporation for various purposes, e. g., going concern value, book value, net asset value, market value, is pertinent to the issue presented." (89 A.2d at p. 867).

Id. at 431. Cf. *Abelow v. Midstates Oil Corp.*, 189 A.2d 675, 677 (Del. 1963) (involving a claim that minority shareholders of a 96% owned subsidiary were unfairly treated when the parent's stockholders exchanged their stock for shares of Tennessee Gas Transmission Company, which thereafter, through the parent, bought all of the assets of the subsidiary. The court judged the transaction against a standard of fairness, but fairness was considered only as to the price paid for the assets of the subsidiary); *Fair Shares*, *supra* note 2, at 318 n.49 ("no specific criteria have been offered for determining the 'intrinsic fairness' of a merger price"); *Restatement*, *supra*, note 1, at 1363 (in discussing *Singer v. Magnavox Co.*, 380 A.2d 969 (Del. 1977), the author noted that the court "added, citing the well-known *Sterling* case, that even if such a [legitimate] business purpose were shown to exist, the merger would still be subject to attack on grounds of 'fairness'—presumably a reference to the adequacy of the price paid to the minority" (footnote omitted) (emphasis supplied)); *Borden*, *supra* note 2, at 1015, 1021.

Another line of cases, of which *Stauffer v. Standard Brands, Inc.*, 41 Del. Ch. 7, 187 A.2d 78 (Del. 1962) is the first, held that minority shareholders who were dissatisfied with the terms of a cash out merger were limited to an appraisal remedy. See also *David J. Greene & Co. v. Schenley Indus., Inc.*, 281 A.2d 30, 34-36 (Del. Ch. 1971) (suit to enjoin merger of Schenley into a wholly-owned subsidiary of its parent, Glen Alden. Each minority share of Schenley was to be exchanged for a combination of cash and Glen Alden debentures. While the plaintiff alleged that several factors other than value bore on the entire fairness of the transaction (e.g., tax consequences of the merger), the court focusing solely on the adequacy of consideration paid for the minority's shares, denied the injunction and restricted the plaintiffs to an appraisal proceeding); *Arsht, Minority Stockholder Freeze-Outs Under Delaware Law*, 32 Bus. LAW. 1495, 1497 (1977):

Where the appraisal remedy is unavailable as a check on the conduct of a majority toward the minority, the Delaware courts have closely scrutinized corporate action, even though that action is superficially in compliance with the requirements of the corpora-

In 1977, the Delaware Supreme Court decided *Singer v. Magnavox Co.*³⁵ and held that entire fairness required more than just fair value. Like *Weinberger*, *Singer* involved a going private transaction in which the parent corporation paid cash for the minority's shares. The court in *Singer* decided that even if the majority shareholder paid a fair price for the publicly held shares, the transaction did not satisfy the entire fairness test unless the parent showed that there was some valid purpose for the cash out merger other than eliminating the minority shareholders from equity participation.³⁶ In attempting to give more substance to the entire fairness test, the *Singer* decision left unanswered a number of interpretive questions.³⁷ Among these questions were whether the relevant business purpose had to serve the subsidiary's interests or whether a purpose serving the interests of the parent would suffice,³⁸ whether a valid purpose was required for a short-form cash out merger accomplished pursuant to section 253 of the Delaware Corporation Law, for which shareholder approval was not required,³⁹ and what specific purposes would be considered adequate.⁴⁰ Before all of these questions could be resolved, the Delaware Supreme Court decided *Weinberger*, in which it again

tion law. In the merger context, on the other hand, the appraisal remedy is available to insure that minority stockholders are not denied the fair value of their stock by the conduct of the majority. . . . [T]he only reason for denying effect to an otherwise technically correct merger is that it operates unfairly with respect to minority shareholders. Such unfairness can only arise if the appraisal proceeding is incapable of arriving at the fair value of a minority shareholder's stock. . . . The Delaware courts, however, have not abandoned faith in the reliability of the appraisal remedy.

Id. at 1499.

The Delaware courts apparently considered the *Sterling* rule, requiring the majority shareholder to prove the entire fairness of the transaction, inapplicable to cash out mergers, because appraisal rights were available to cashed out minority shareholders. See Weiss, *supra* note 2, at 655. Regardless of the forum in which fairness was addressed, the issue was the same in cases challenging both cash out mergers and other, noncash going private transactions. That issue was the fairness of the consideration paid by the majority shareholder to the minority.

35. 380 A.2d 969 (Del. 1977).

36. The reason for this requirement of a valid business purpose for the transaction can be explained by the court's finding that

those who control the corporate machinery owe a fiduciary duty to the minority in the exercise thereof over corporate powers and property, and the use of such power to perpetuate control is a violation of that duty.

By analogy, if not *a fortiori*, use of the corporate power solely to *eliminate* the minority is a violation of that duty.

Id. at 979-80. For a discussion of the history of the business purpose test, see Borden, *supra* note 2, at 987, 995-96 and 1022-23.

37. "The decisions in *Singer*, *Tanzer* and *Roland International* have bred some uncertainty in this Court as well as, I think it fair to say, among members of the corporate bar . . ." *Weinberger II*, 426 A.2d at 1342 (Del. Ch. 1981).

38. *Tanzer v. International Gen. Indus., Inc.*, 379 A.2d 1121 (Del. 1977) established that the purpose served by the merger could be that solely of the parent corporation.

39. In *Roland Int'l Corp. v. Najjar*, 407 A.2d 1032 (Del. 1979), the court held that the business purpose test applied to short-form mergers accomplished under DEL. CODE ANN. tit. 8 § 253 (1983) as well as to long-form mergers such as that involved in *Singer*.

40. The issue of what would constitute a valid business purpose was still the subject of confusion when the Chancery Court decided *Weinberger II*, 426 A.2d 1333 (Del. Ch. 1981). Compare *Young v. Valhi, Inc.*, 382 A.2d 1372, 1377 (Del. Ch. 1978) (two purposes were offered to justify the cash out merger: tax savings, which the court dismissed as capable of being achieved by other means, and avoidance of conflicts of interest, which the court described as "somewhat contrived") with

reinterpreted the entire fairness test and, in the process, abolished the business purpose requirement.⁴¹

In reinterpreting the entire fairness standard, the Delaware Supreme Court retained the notion, developed in *Singer*, that fair value is not the sole determinant of the entire fairness of a going private transaction. While the fairness of the value paid to the minority shareholders is still a significant factor in assessing a transaction's entire fairness,⁴² the court in *Weinberger* also required fairness in the way in which the transaction was effected. *Weinberger* thus integrated the meaning of the duty of loyalty and entire fairness by giving content to the notion of fair dealing. As a result, the concept of fair dealing has new importance arising from its place as part of the standard of entire fairness and its expanded and more detailed definition.

The Theory of Fair Dealing

An agreement reached as a result of arm's length bargaining generally is presumed to be substantively fair. Substantive fairness is presumed first because of the existence of the parties' agreement itself. Each party would agree to the transaction only if it viewed the deal as beneficial to its interest and goals. Conversely, either party could reject the transaction and look elsewhere for a better

Weinberger II, 426 A.2d at 1348-50 (the court accepted the following purposes as sufficient to satisfy the *Singer* test: parent's economic interest in securing an investment for its surplus cash; tax, accounting and insurance savings; savings from the elimination of duplicative reporting to government agencies; and avoidance of conflicts of interests).

See Elfin, *Changing Standards and the Future Course of Freezeout Mergers*, 5 J. CORP. L. 261, 270 (1980) (charging that a legitimate business purpose should "have the potential to increase the economic viability of the business enterprise," and furthermore that such increased efficiency not be otherwise economically obtainable); *Restatement, supra* note 1, at 1367 ("The *Singer* decision strongly implies that a corporate purpose is necessary to sustain the legal validity of going private. To meet that condition, the proponents should be required to show that public stock ownership is actually inconsistent with the company's continued viability, not merely that public ownership entails a cost that can be avoided by eliminating the public's interest. But we are not aware that such a showing has ever been made in a going-private case, and we doubt it ever could be."). See also Borden, *supra* note 2, at 1001; Rothschild, *supra* note 2, at 225.

41. The business purpose test was considered by the *Weinberger* court almost as an afterthought. It was eliminated from Delaware's law governing cash out mergers apparently because of the open issues and criticism that it engendered and because, in view of the standards developed in *Weinberger*, the court did not think it provided minority shareholders with "any additional meaningful protection." *Weinberger*, 457 A.2d at 715.

42. As to the method of determining fair value, the *Weinberger* court rejected the historical judicial position that considered the "Delaware block" approach the only acceptable method of valuing stock. The court labelled the Delaware block method of valuation "clearly outmoded" insofar as it "excludes other generally accepted techniques used in the financial community." *Id.* at 712. The only limitations that the court put on the methods of valuation to be used in the future were that they be "otherwise admissible in court," "generally considered acceptable in the financial community" and consistent with the court's interpretation of the Delaware appraisal statute, DEL. CODE ANN, tit. 8 § 262(h) (1983). *Weinberger*, 457 A.2d at 713.

Furthermore, the court expanded its interpretation of the Delaware appraisal statute to give substance to the mandate that "all relevant factors" [emphasis supplied] be considered in determining fair value. The exclusion from consideration of elements of value arising from the accomplishment or expectation of the transaction was given a very narrow interpretation, so that only "pro forma data and projections of a speculative variety relating to the completion of a merger" must be rejected pursuant to the statute. *Id.* The court remanded the case to the Chancellor for consideration of the issue of fair value in light of these new standards. *Id.* at 715.

deal. Where all of the parties have the ability to reject the transaction, agreement indicates that each party considered the transaction substantively fair.⁴³

Substantive fairness is presumed also because of the procedure which led to the agreement—the arm's length bargaining process. Arm's length bargaining requires that each party be independent of the others; no party can be subject to the control of another in an arm's length bargaining situation.⁴⁴ In the context of a transaction between two corporations, an unacceptable relationship resulting in control might arise from either party owning a substantial amount of stock in the other, dependence upon one another for the success of their businesses, sharing common directors, officers or executive employees, or being controlled by the same person. If there is a control relationship, the controlled party cannot necessarily adequately represent its own interests in negotiating and consenting to the transaction; but if there is complete independence, each party can advocate its own purposes in the negotiations and can voluntarily assent to a proposal or walk away from the deal if its purposes are not met.

Arm's length bargaining does not normally exist in a transaction between a parent corporation and its subsidiary. The parent's ability to control the subsidiary as a result of its stock ownership interest generally is sufficient to negate a finding of an arm's length relationship.⁴⁵ As a result of its stock holdings, the parent can single-handedly approve, on behalf of the subsidiary, any transaction required to be approved by a majority of the subsidiary's shares, even if the transaction is between the parent and subsidiary. The parent, moreover, may use its power as a stockholder to elect the directors of the subsidiary, who would normally represent the subsidiary in its dealings with a third party. The parent's control over the subsidiary, thus, can be extended to the director level, so that persons negotiating the deal on behalf of the parent and subsidiary will all be controlled by the parent. Finally, the subsidiary's ability to agree to or reject a transaction with its parent is restricted as compared to the freedom of choice which is enjoyed by the parties to an arm's length transaction. The subsidiary's fate is ultimately controlled by the parent, and if the subsidiary initially rejects a transaction it cannot look elsewhere for a better deal. The existence of this on-going relationship between the parties may undermine the voluntariness of any agreement by the subsidiary. The choice for the subsidiary may be limited to a choice between assent now or assent later.⁴⁶

As a result of the parent's ability to control the subsidiary in their dealings and the consequent absence of arm's length bargaining between them, it is

43. See *Meyerson v. El Paso Natural Gas Co.*, 246 A.2d 789, 791-92 (Del. Ch. 1967).

44. See e.g. *Weinberger*, 457 A.2d at 709-10 n.7. Treas. Reg. § 1.482-1(d)(3) (1970) defines "arm's length" as "the amount which was charged or would have been charged in independent transactions with unrelated parties under the same or similar circumstances." *Id.*

45. Where the parent owns less than 50% of the subsidiary's stock, the courts distinguish between the right or ability to control and the exercise of such control. If control has not been exercised in such a case, the court will treat the situation as one involving arm's length bargaining. See *infra* notes 113-16 and accompanying text. Where, however, the issue is entire fairness and the parent owns 50% or more of the stock of the subsidiary, the ability or right to control is enough in itself to give rise to a presumption that such control was exercised.

46. See *Bershad v. Curtiss-Wright Corp.*, Civil Action Nos. 5827, 5830 (March 21, 1983). The Vice-Chancellor found that a full and fair reading of the proxy statement disclosing a proposed cash out merger revealed that the fate of the minority stockholders was "tied directly to the whim of Curtiss," the majority stockholder. If the parent owns less than 50% of the stock of the subsidiary, or if control otherwise could be sold to a third party, the subsidiary might be able to solicit bids from outsiders in response to a proposed cash out. *Id.* See also Longstreth, *supra* note 3.

difficult, if not impossible, to assess the substantive fairness of a parent-subsidary transaction. In any parent-subsidary transaction, the parent has the ability to establish unilaterally the terms of the transaction, through its control of the subsidiary at the board level, and the power to speak for the subsidiary in accepting the deal, through its control at both the director and shareholder levels. The power of the parent thus subverts both of the reasons that an agreement reached as a result of arm's length bargaining is presumed to be substantively fair. It negates the existence of a true, voluntary agreement by the subsidiary and it disproves the subsidiary's independence, which is necessary for arm's length negotiations. This relationship between the parent and subsidiary makes it difficult to assess the substantive fairness of any "agreement" reached by the parties without recourse to an objective judge of fairness.

The notion of fair dealing developed by the court in *Weinberger* serves the purpose of establishing some circumstances when the agreement reached by a parent and its subsidiary can be presumed to be substantively fair. In a parent-subsidary transaction, fair dealing is intended to simulate arm's length bargaining; satisfying the duty of fair dealing will result in the parties acting *as though* they were bargaining at arm's length. The product of the process of fair dealing, then, ought to resemble the product of arm's length negotiation.⁴⁷ After *Weinberger*, evidence

47. "It is commonly said by courts and commentators that the fiduciary norm in this situation [of a parent-subsidary merger] is one of arm's-length dealing; a fair price for the minority stock is that which an arm's-length bargainer in a free market would have produced." *Fair Shares*, *supra* note 2, at 309. See also Weiss, *Balancing Interests in Cash-Out Mergers: The Promise of Weinberger v. UOP, Inc.*, 8 Del. J. Corp. L. 1, 46 (1983) ("[B]oth the reasonable expectations of the minority and the fiduciary obligations of the controlling shareholder . . . suggests that the controlling shareholder should be required to pay at least as much for the minority's interest as the minority would realize if the corporation were being sold to a third party in an arm's length transaction.")

A transaction which is not tainted by a controlling relationship between the parties and has been negotiated at arm's length is, when challenged, considered in light of the business judgment rule. Application of the business judgment rule results in the transaction being presumed fair.

The business judgment rule is a presumption that a rational business decision of the officers or directors of a corporation is proper unless there exists facts which remove the decision from the protection of the rule, such as self-dealing, conflict of interest, etc. If the business judgment rule applies the objector must bear the burden of persuasion to show the impropriety of the transaction. *Maldonado v. Flynn*, Del. Ch., 413 A.2d 1251 at 1255 (1980). If an objector to a corporate transaction shows, however, that the transaction involves a parent and a subsidiary with the parent controlling the transaction and fixing the terms (as here), and shows that the parent benefitted from the transaction to the exclusion and detriment of its subsidiary, the test of propriety is not the business judgment rule but is the intrinsic fairness rule, which places the burden of persuasion on the parent corporation to show that the transaction is objectively fair. *Sinclair Oil Corporation v. Levien*, Del. Supr., 280 A.2d 717, 720 (1971).

Schreiber v. Pennzoil Co., 419 A.2d 952, 956-57 (Del. Ch. 1980).

In *Puma v. Marriott*, 283 A.2d 693, 695 (Del. Ch. 1971), the court held that the business judgment rule was the applicable test where there was no showing that the 46% shareholder stood on both sides of the transaction and no showing of fraud. The transaction challenged in *Puma* was the acquisition by Marriott Corp. of all of the outstanding stock of six companies owned by the 46% shareholder of Marriott, in exchange for Marriott common stock. See also *David J. Greene & Co. v. Dunhill Int'l Inc.*, 249 A.2d 427, 430 (Del. Ch. 1968) (involving a stock-for-stock merger of a subsidiary into its parent corporation, where the court, in discussing the standard against which to judge the merger, stated: "In the absence of divided interests, the judgment of the majority stockholders and/or the board of directors, as the case may be, is presumed made in good faith and inspired by a bona fides of purpose.").

Cf. Fidanque v. American Maracaibo Co., 33 Del. Ch. 262, 92 A.2d 311 (1952), which involved a suit to enjoin the acquisition by Maracaibo of all of the outstanding stock of the Case Pomeroy companies in exchange for shares of Maracaibo. One of the ten directors of Maracaibo was the "in-

of fair dealing will go far towards establishing the substantive fairness of the terms of the transaction.⁴⁸

In order to simulate the process of arm's length bargaining, fair dealing must address the reason that there can be no arm's length bargaining: the unacceptable power of control held by the parent over the subsidiary. Fair dealing neutralizes the taint of the parent's ability to control the subsidiary by requiring safeguards against the exercise of such control. To that end, the *Weinberger* court stated that fairness in dealing embraced "questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and stockholders were obtained."⁴⁹ These questions are directed at specific elements in the process by which the agreement was reached—timing, initiation, structure, negotiation, disclosure and approval—where the parent's control can be exercised to the detriment of the subsidiary and its minority shareholders. If the parent corporation adopts certain practices relating to an element of the decision-making process which enables it to exert its influence over the subsidiary, such conduct will indicate the absence of fair dealing. The relationship that exists when the majority shareholder exercises its control over the subsidiary is the antithesis of the relationship between parties bargaining at arm's length. Conversely, if the parent adopts practices to neutralize its control and protect the subsidiary's ability to represent its own interests and those of its minority shareholders in the negotiating and deliberative processes, that conduct will indicate the presence of fairness in dealing.⁵⁰ It will indicate that the parent refrained from exercising its influence over the subsidiary, so that the subsidiary was left free to further its own interests. Therefore, in assessing whether the parent has fulfilled its duty to deal fairly with the subsidiary and its minority

direct owner of a large percentage of the stock of the Case Pomeroy companies," was a member of the Maracaibo board committee charged with investigating potential acquisitions for Maracaibo and proposed to the board of Maracaibo the acquisition of the Case Pomeroy companies. *Id.* at 271, 92 A.2d at 316. The court examined the transaction only to ensure that there was no fraud or overreaching present. It distinguished the case before it from a situation where "a majority of the board of directors are officers of the other company involved. In such a case, if there had been no ratification by the stockholders, the burden would be on those who were asserting the validity of the transaction to prove that the transaction was an arm's length transaction and that the interests of the corporation were fully protected." *Id.* at 273, 92 A.2d at 318 (Citations omitted); *Meyerson v. El Paso Natural Gas Co.*, 246 A.2d 789, 794 (Del. Ch. 1967), where the minority shareholder of an 80%-owned subsidiary sued the parent company, El Paso, for unjust enrichment. The plaintiff argued that the parent's retention of all of the tax savings resulting from filing consolidated tax returns with the subsidiary and offsetting El Paso's income with the subsidiary's losses constituted unjust enrichment. The court was convinced that, since the parent and subsidiary shared common management, there could be no effective bargaining between them in negotiating an allocation agreement and it would be impossible to estimate the terms of any agreement reached by independent parties. Therefore, the court refused to establish a "fair" allocation and concluded that "[t]he question, then, is reduced to one of business judgment with which the court should not interfere absent a showing of 'gross and palpable overreaching.'"

48. *Weinberger*, 457 A.2d at 710 n.7. See Note, *Achieving Fairness in Corporate Cash Mergers: Weinberger v. UOP*, 16 CONN. L. REV. 95, 115-16 (1983).

49. *Weinberger*, 457 A.2d at 711. These elements of fair dealing were apparently first identified in an article by Nathan and Shapiro, *supra* note 28, in which the authors' primary focus was on fair price. The notion of procedural fairness was further developed by Richards, *supra* note 28, at 731-32.

50. A distinction could be made between actions which affirmatively protect the minority shareholders, such as providing for or encouraging their representation in negotiations, and actions which merely prevent the majority shareholder from exerting its influence over the minority. Fair dealing, as here interpreted, requires both active and passive protection. See *infra* text accompanying notes 110-31 (discussion of independent negotiations). See also *infra* text accompanying notes 159-75

shareholders, a court must consider whether the parent's conduct, with respect to each element of the bargaining process, resulted in the parent exercising its control over the subsidiary and its minority shareholders, thus contradicting the aim of fair dealing, or whether the parent refrained from exerting its influence in the transaction, so that the dealings between the parties resembled an arm's length bargaining process.

PART II

If the duty of fair dealing is to play any meaningful part in the regulation of parent-subsidiary transactions, the conduct required to satisfy the duty must be clearly defined. The parties to the transaction must be able to ascertain the standard during the planning stages of their dealings so that they can use it to guide their conduct during the decision-making process. Otherwise, the purpose for imposing the duty of fair dealing will not be accomplished, since a retrospective determination of what went wrong cannot lead to a decision of what the product of the dealing would have been if the correct procedure had been followed.⁵¹

In Part II, the standard of conduct required to fulfill the duty of fair dealing will be developed. The starting point for the discussion are the six elements of the decision-making process identified by the *Weinberger* court. As to these six elements, and any others suggested by outside sources, two questions must be addressed. First, does the element identify some aspect of the decision-making process which might be tainted by the parent's exercise of control over the subsidiary (is the element appropriate to the regulation of procedural fairness)? Second, what conduct is required, after *Weinberger*, to satisfy the duty of fair dealing with respect to each element? In the course of the analysis, it is sometimes helpful to have as a backdrop a specific set of facts, and for that purpose the facts of the *Weinberger* case begin the analysis.

Weinberger v. UOP, Inc.

The relationship between the Signal Companies, Inc. (Signal) and UOP, Inc. (UOP) began in 1975, when Signal acquired a 50.5% stock ownership interest in UOP.⁵² At the next annual shareholders meeting of UOP, Signal filled six of the thirteen positions on UOP's board of directors with Signal officers, Signal employees, and a representative of its investment banking firm.⁵³ When the presi-

(discussion of disclosure requirements). See Note, *A Cash-Out Breakthrough in Delaware Judicial Merger Regulation: Weinberger v. UOP, Inc.*, 37 Sw. L.J. 823, 835 (1983).

51. See *infra* note 235-37 and accompanying text.

52. The acquisition agreement provided that Signal would purchase 1.5 million of the authorized but unissued shares of UOP, at a price of \$21 per share, if Signal was successful in making a cash tender offer for 4.3 million publicly held UOP shares at the same price per share. Immediately before the announcement of the tender offer, which attracted more than the desired number of shares, UOP's stock was trading at just below \$14 per share on the New York Stock Exchange. *Weinberger II*, 426 A.2d at 1336.

53. The persons elected by Signal in 1975 to serve on UOP's board of directors were: Charles S. Arledge, Vice President and Director of Signal; Andrew J. Chitrea, Senior Vice President and Director of Signal; Forrest N. Shumway, President and Chief Executive Officer and Director of Signal; William E. Walkup, Chairman of the Board of Directors and Executive Vice President of Signal; Harry H. Wetzel, President and Chief Executive Officer of the Garrett Corporation, a wholly-owned subsidiary of Signal; Frank J. Pizzitola, General Partner, Lazard Freres & Co., the investment banking firm that represented Signal in the 1975 acquisition of UOP. Appendix to the Brief of the Appellant at A51, *Weinberger* [hereinafter cited as Appellant's Appendix]; *Weinberger*, 457 A.2d at 704-05.

dent and chief executive officer of UOP retired, Signal appointed James Crawford, a long-time employee of one of Signal's wholly-owned subsidiaries, in his place. At the same time, Crawford was elected to the UOP and Signal boards of directors.⁵⁴

During the period from 1975 through the end of 1977, Signal was searching for an investment opportunity in order to utilize its excess cash.⁵⁵ In 1978, after pursuing these efforts without success, Signal's sights returned to UOP, when two Signal officers, both of whom were also directors of UOP, prepared a "feasibility study" regarding the possibility of Signal acquiring, for cash, the balance of UOP's outstanding shares.⁵⁶ This feasibility study was discussed among Signal's senior management personnel, who concluded that UOP presented the best opportunity for a friendly cash investment⁵⁷ and decided to call a meeting of the executive committee of Signal's board of directors to propose the acquisition.

Immediately prior to the executive committee meeting, Signal's chairman of the board, William E. Walkup, and president, Forrest N. Shumway, met with Crawford to broach with him the subject of Signal's proposed acquisition.⁵⁸ Crawford reacted favorably to the proposed price range of \$20 to \$21 per UOP share.⁵⁹ Shortly following this discussion, at the executive committee meeting, Signal's top management was authorized to negotiate an agreement with UOP and instructed to present such an agreement to Signal's board of directors within the week.⁶⁰

Between the date of the executive committee meeting and the appointed time

54. *Weinberger II*, 426 A.2d at 1336; *Weinberger*, 457 A.2d at 705.

55. *Weinberger II*, 426 A.2d at 1335-37; *Weinberger*, 457 A.2d at 705. In 1974, Signal sold one of its wholly-owned subsidiaries for \$420 million in cash. It was this cash which prompted Signal to purchase 50.5% of UOP's common stock in 1975 (\$121.8 million (\$21/share multiplied by 5.8 million shares) was the approximate cost of Signal's 1975 investment in UOP). This same source of cash was also the motivating fund behind the 1978 acquisition of the remaining 49.5% of UOP stock.

56. The feasibility study, prepared by Messrs. Arledge and Chittea, is a twenty-seven page document that briefly sets forth the purposes of the merger, the sequence of events for approving the merger and the financial effects of the acquisition of the remaining 49.5% of UOP on Signal as a whole. Appellant's Appendix, at A1472-A1499. See *infra* notes 163-67 and accompanying text.

Signal's original acquisition of UOP occurred more than one year before the cash out merger. The length of this time period between the purchase of the original controlling block and the going private transaction has been considered important by several commentators for purposes of regulating going private transactions. See *supra* note 12. As a result of the expiration of more than one year between the initial acquisition and the cash out, more than minimal regulation of the cash out would be required by such commentators.

Similarly, Rule 13e-3, 17 C.F.R. § 240.13e-3 (1983), would have applied to the transaction involved in *Weinberger* had the Rule then been in effect. The Rule exempts from its provisions certain cash outs occurring within one year from the original acquisition, but in *Weinberger* more than one year had elapsed. See *supra* note 12. Moreover, even if the cash out in *Weinberger* had followed the original acquisition within the one year time limit, it is unclear whether the exception would have been applicable, since Signal acquired its controlling interest pursuant to a combination of the tender offer and the private purchase from UOP. The Rule requires that the controlling interest have been acquired in a tender offer, which would give weight to the tender offer price.

57. These discussions occurred among Messrs. Walkup, Shumway, Arledge, Chittea (all of whom were directors of both Signal and UOP) and Brewster L. Arms (Signal's internal counsel). *Weinberger*, 457 A.2d at 705.

58. *Id.* Crawford was invited to the Signal executive committee as a "courtesy;" he was not a member of that body.

59. "Crawford said he thought such a price would be 'generous,' and that it was certainly one which should be submitted to UOP's minority shareholders for their ultimate consideration." *Id.*

60. *Id.* at 705-06.

of Signal's board meeting, Crawford discussed the proposed acquisition with each of UOP's non-Signal directors, and from these conversations concluded that Signal would have to pay \$21 per share, rather than \$20, to gain the approval of these directors.⁶¹ During the same period, Crawford also contacted UOP's regular investment banker, Lehman Brothers Kuhn Loeb, Inc. (Lehman Brothers), to request their opinion as to the fairness of the price offered by Signal. Three Lehman Brothers analysts conducted a three day investigation of UOP, including a one day due diligence session at the company's offices, and concluded that a price in the range of \$20 to \$21 per share would be fair to the minority shareholders of UOP.⁶²

Six days after Signal's executive committee meeting, the boards of directors of both Signal and UOP convened. The two meetings were connected by telephone, and all of UOP's non-Signal directors were present in person or by telephone.⁶³ Signal's board was the first to consider the proposed acquisition, and it unanimously approved the agreement. Before putting the proposal to a vote of the UOP board, the Signal-designated UOP directors left the room to permit the non-Signal UOP directors to freely discuss the proposed merger.⁶⁴ When the Signal-designated directors returned to the meeting, a proposal to accept Signal's offer was made and adopted. All of the non-Signal directors, plus Crawford and the Signal investment banking representative, voted in favor of the merger. The other Signal-designated members of the board abstained from voting on the advice of counsel, but indicated in the minutes of the meeting that, had they voted, they would have voted in favor of the transaction.

The agreement adopted by the two boards of directors called for Signal to pay \$21 per UOP share, and required that the merger be approved by a majority of the minority shares of UOP in order to become effective.⁶⁵ At UOP's annual shareholders meeting on May 26, 1978, the proposal received the required shareholder approval by votes cast in person and by proxy, and the merger became effective.⁶⁶

61. *Id.* See *infra* note 69 and accompanying text.

62. *Id.* at 707. See *infra* note 78 and accompanying text.

63. *Id.*

64. *Id.* Walkup and Crawford were the only Signal-designated members of UOP's board present in person at the UOP board meeting. The other Signal-designated UOP directors participated in the UOP meeting by conference telephone. The court made it clear that Walkup and Crawford left the meeting for some time before the UOP directors voted on the proposal. While it is not entirely clear from the court's opinion that the telephone hook-up with the other Signal-designated members of the board was disconnected during that same time period, the implication is that the telephone link was in fact broken.

In considering the merger proposal, the UOP directors had before them the proposed agreements, UOP financial statements for the years 1974-1977, its most recent financial statements, market price information, budget projections for 1978, and the Lehman Brothers fairness opinion. The court found that the non-Signal UOP directors did not have the opportunity to examine the feasibility study. *Id.*

65. The merger agreement also required that the merger be approved by two-thirds of all UOP shares, including the shares owned by Signal. *Id.*

66. Of the 3,208,652 minority shares voted at the meeting (56% of the outsider minority shares), 2,953,812 were voted in favor of the merger and 254,840 were voted against it. *Id.* at 707-08.

After the merger became effective, William Weinberger, a minority shareholder of UOP, promptly filed a class action challenging the merger. Weinberger's initial complaint failed to allege any misrepresentations by the defendants, and was dismissed on a Rule 12(b)(6) motion for failure to state a claim upon which relief can be granted. Del. Code Ann., Rule 12(b)(6) of the Rules of the Court of Chancery (1981). The court found that the approval of the merger by a majority of the UOP minority shareholders rendered *Singer v. Manavox Co.*, 380 A.2d 969 (Del. 1977), and its progeny inapplicable, since Signal

Pressured Decision-Making

Fair dealing requires the majority shareholder to respect the integrity of the subsidiary's decision-making process, and that respect includes refraining from imposing unreasonable time constraints upon that process. Decision-making on behalf of the subsidiary occurs at three levels. The first level is the subsidiary's

did not use its control to effectuate the merger. *Weinberger*, 409 A.2d at 1266. The court required the plaintiff to show some "fraud, misrepresentation, or other conduct attributable to the majority shareholder which would warrant setting aside the affirmative vote of the minority for their own benefit." *Id.* at 1268. The amended complaint alleged misrepresentation and was deemed sufficient to state a claim.

Weinberger alleged that the sole purpose of the transaction was to eliminate the minority shareholders of UOP, contrary to the dictates of the *Singer* business purpose requirement. A second challenge to the merger was that the defendants made various misrepresentations in the proxy statement sent to UOP shareholders and in press releases, and that these misrepresentations negated the effectiveness of the affirmative vote of a majority of the UOP minority shares. Weinberger's third claim was that the directors of UOP breached their fiduciary duties by failing to negotiate a higher price for the cashed out shareholders, giving insufficient consideration to the transaction and neglecting to obtain current appraisals of certain UOP assets. Finally, the plaintiff attacked the \$21 price paid for each UOP share as grossly inadequate. *Weinberger II*, 426 A.2d at 1341.

In response to Weinberger's first ground of attack regarding the purpose of the merger, Signal presented facts indicating that the purpose of the merger was to serve its economic interests by finding a suitable investment for its excess cash. The Chancellor accepted this as sufficient to satisfy the business purpose test. *Id.* at 1349-50. The court also recognized that Signal would benefit from the merger by realizing tax, accounting and insurance savings, and by avoiding both potential conflicts of interest and duplicate governmental agency filings. *Id.* at 1349.

The Chancellor rejected the plaintiff's second claim upon finding that no material misrepresentations had been made. In assessing the misrepresentation claims, the court applied the standard of "complete candor" set forth in *Lynch v. Vickers Energy Corp.*, 383 A.2d 278 (Del. 1977). *Weinberger II*, 426 A.2d at 1350-53. See *infra* notes 159-61 and accompanying text.

As to the third charge, the court was convinced that the directors of UOP had acted reasonably in considering Signal's offer, and therefore had not breached their fiduciary duties to the minority shareholders. *Id.* at 1353. See *infra* notes 71-76, 132-35 and accompanying text.

Finally, with respect to the plaintiff's challenge to the price paid by Signal, the Court applied the "Delaware block" approach to value the stock and concluded that the amount of \$21 per share represented a fair price to the UOP minority shareholders. *Id.* at 1356-62. The "Delaware block" method assigns particular weights to certain elements of value (*e.g.*, assets, market price, earnings) and adds the resulting amounts to determine the value per share.

After a full trial, the Chancellor rejected the plaintiff's claims and rendered judgment for Signal. In granting judgment for the defendants, the Chancellor stated that, in addition to its analysis of each of the separate claims asserted by the plaintiff, he also considered the fact that the cash out merger had been approved by a majority of the UOP minority shares as indicative of the fairness of the merger terms. *Id.* at 1362-63.

Quite simply, while structuring the vote in this fashion (at least in my opinion) does not free the transaction from the so-called scrutiny required of the Court, and while this factor alone does not automatically establish that Signal had discharged its fiduciary duty to the minority as a majority shareholder standing on both sides of the transaction, it does not mean that this factor is removed from further consideration by the Court. Rather, it is simply another element that must be considered as part of the overall picture in evaluating the terms of the merger for entire fairness to the minority.

When this element is added to all the other matters considered herein, I am convinced that it conclusively sways the decision in favor of the defendants.

Id. at 1362.

Initially the Supreme Court affirmed the Chancery Court's judgment, but that opinion was withdrawn when the court reheard the case en banc. For a description of portions of the initial opinion of the Supreme Court, see *Deutsch, Weinburger [sic] v. UOP: Analysis of a Dissent*, 6 CORP. L. REV. 29 (1983).

board of directors. The board must decide initially whether it would serve the best interests of the corporation to accept or reject a transaction proposed by the parent or any outside party. The second level consists of the outside advisors and experts of the subsidiary. These outsiders—financial analysts, lawyers and/or accountants—may be hired by the board to consider the advisability and legality of the proposed transaction; their opinions may provide some basis for the board's decision. Finally, the proposal may be submitted to a vote of the subsidiary's shareholders; the stockholders' decision to accept or reject the transaction is the third level of consideration. Unreasonable time pressures imposed by the parent at any of the three levels of consideration will indicate the absence of fairness in dealing.

In *Weinberger*, Signal was criticized for imposing unreasonable time constraints on both the UOP board of directors and UOP's financial advisor, Lehman Brothers.⁶⁷ The relevant time period in *Weinberger* was the six days between the Signal executive committee meeting and the directors meetings at which the cash out merger was approved.⁶⁸ As soon as UOP's president, Crawford, was informed of the proposed cash out by the Signal executive committee on February 28th, he contacted the non-Signal members of UOP's board to inform them of the proposed merger and the offered price range of \$20 to \$21 per UOP share. All of these directors indicated to Crawford that they would approve a price of \$21 per share, but would not approve a lower price.⁶⁹

On March 6, the UOP board met to consider and vote on Signal's proposal. They had before them the proposed merger agreement, Lehman Brothers' fairness opinion, UOP financial data for the previous four years, its most recent financial statements, information on the market price of its stock, and budget projections for 1978. At the meeting, the directors discussed and approved the proposal.⁷⁰

The *Weinberger* court indicated that the decision-making process of the UOP board of directors had been adversely affected by the brief period of time afforded for its consideration of the transaction.⁷¹ The court did not find, however, that the board had breached its duty of care by approving the transaction, nor did it identify any specific course of action that should have been taken by the board but was not pursued because of lack of time. In other words, the court failed

67. There was no allegation that Signal imposed unreasonable time constraints on the minority shareholders. At the shareholder level, Delaware state law provides some guidance in the notice requirements. See DEL. CODE ANN. tit. 8 § 251(c) (Supp. 1982). Rule 13e-3 provides additional guidance. See 17 C.F.R. § 240.13e-3(f)(i) (1983).

68. Six days after the date when Crawford was informed that Signal proposed to buy the remaining publicly held UOP shares, the boards of directors of UOP and Signal met to vote on the merger. Since it is not clear that Crawford informed all of the non-Signal UOP board members of Signal's proposal on February 28, six days, only four of which were business days, was the *maximum* amount of time that any of these directors had to consider the proposal. *Weinberger*, 457 A.2d at 706.

Arledge, Chitica, Walkup and Shumway were the persons who initiated the idea of Signal investing its cash in the remaining publicly held shares of UOP. Crawford, another Signal-designated member of UOP's board, was first informed of the proposal on February 28th, so he, too, had only six days to consider the transaction. *Id.* at 705. There is no indication of the amount of time for consideration given to the two other Signal-designated UOP directors or to the Signal board.

69. "In a conversation with Walkup, Crawford advised that as a result of his communications with UOP's non-Signal directors, it was his feeling that the price would have to be the top of the proposed range, or \$21 per share, if the approval of UOP's outside directors was to be obtained." *Id.* at 706.

70. *Id.* at 707.

71. *Id.* at 711.

to explain why the time schedule imposed upon the UOP board was unreasonable. Since none of the UOP directors requested additional time to consider Signal's proposal, there was no objective evidence that they objected to Signal's schedule.

Pressured decision-making by boards of directors has been considered important by Delaware courts in other contexts. In *Condec Corp. v. Lunkenheimer Company*,⁷² the speed with which a transaction was negotiated and approved by the board of directors was deemed to indicate that the transaction was entered into for an improper purpose. In addition, in *Gimbel v Signal Companies, Inc.*,⁷³ the court concluded that the brief period of the board's deliberations did not cause its action to be reckless, but nonetheless considered hasty decision-making significant to the extent it produced a grossly inadequate price. In these cases, the time constraints under which the boards of directors labored indicated that something else—purpose or price—was amiss.

In *Weinberger* the court did not explain what, if any, adverse consequences resulted from the short time schedule imposed upon the UOP board's consideration of Signal's proposal. One result of those time pressures was to prevent the UOP board from obtaining the reactions of third parties to Signal's offer. Such a reaction might have taken the form of a competing offer for the UOP minority stock⁷⁴ or an adjustment of the market price of Signal stock.⁷⁵ At a minimum, a reaction in either form would have provided the UOP board with an objective view of the sufficiency of Signal's offer. That information would have been useful to the UOP board in formulating its response to the proposal.

Furthermore, perhaps the brevity of the board's deliberations weighed against a finding of fairness in dealing because the time constraints were established solely by Signal and for no apparent reason.⁷⁶ Signal had been looking for an investment opportunity for its excess cash for over a year before it proposed the cash out merger, and the merger was not submitted to a vote of the UOP shareholders until more than two months after the date of the board meetings. Thus, the time pressures that Signal imposed upon the UOP directors' consideration of the merger

72. 43 Del. Ch. 353, 362, 230 A.2d 769, 775 (1967) (involving a challenge to the actions of the directors of the target company in defense against a tender offer; the board's haste in approving the issuance of 75,000 new shares indicated that the "primary purpose of the issuance of such shares was to prevent control of Lunkenheimer from passing to Condec," which the court deemed to be an improper use of the corporate machinery).

73. 316 A.2d 599, 615 (Del. Ch. 1974) (involving a suit to enjoin the sale of a wholly-owned subsidiary to a third party; "[t]he method does not appear to be so bad on its face as to alter the normal legal principles which control. But hasty method which produces a dollar result which appears perhaps to be shocking is significant.").

74. It is unlikely, however, that a third party would have been interested in purchasing a minority interest in UOP. The possibility of selling control might exist under such circumstances if the minority shares and unissued stock could be offered, *See generally* Longstreth, *supra* note 3.

75. It would have been meaningless to consider the UOP stock price as indicative of public reaction to the deal, since the offer by Signal would have established a ceiling price for UOP stock. There was some period of time, however, when the public could have responded to the proposed transaction by trading in Signal stock; the \$20-21 price range was announced in a press release on March 2, and the directors' meetings to vote on the transaction were held on March 6.

76. *But see* Levine, *The Proposed SEC Going Private Rules*, 32 BUS. LAW. 1509, 1511 (1977), in which the author, then a staff member of the SEC, stated that the SEC's review of filings relating to going private transactions took longer than the usual period for such filings during the time when the going private rules were only proposed. This was the time period when the Signal-UOP merger occurred.

were not equally applied to all levels of the transaction's consideration. In addition, the time schedule was established by Signal alone, without consultation with the UOP board.

The Delaware Supreme Court also criticized Signal for putting unreasonable time pressure on Lehman Brothers, UOP's financial advisor. One of the six non-Signal UOP directors contacted by Crawford on February 28th was James Glanville, a Lehman Brothers partner. Crawford called Glanville not only to inform him of Signal's proposal, to which Glanville reacted favorably, but also to ask him if Lehman Brothers would render an opinion on the fairness of the proposed \$20 to \$21 price range offered by Signal for each UOP share. Crawford chose Lehman Brothers to prepare the fairness opinion because he thought that the nearly twenty year association of that firm and UOP, as well as Glanville's position on the board of UOP, would substantially increase the possibility of obtaining the opinion in five days, of which only three were business days.⁷⁷

Glanville assembled a three person team to work on the UOP fairness opinion. These three analysts reviewed UOP's annual reports and SEC filings for the period of 1973 through 1976, its audited financial statements for 1977, its interim reports to shareholders, and the recent and historical market prices and trading volumes for UOP stock. In addition, two of the Lehman Brothers employees spent one day performing a due diligence investigation by interviewing UOP's president, general counsel, chief financial officer, and other key executives and personnel. The result of this examination was that on March 6, at the board of directors meetings, Lehman Brothers delivered an opinion that the proposed merger price of \$21 per share was fair to the minority shareholders of UOP.⁷⁸

What did *not* occur with respect to the Lehman Brothers fairness opinion during this six day period of time, according to the Delaware Supreme Court, was a *careful* study of the information needed to support an opinion that a price of \$21 per UOP was fair.⁷⁹ The court criticized Lehman Brothers, at least impliedly, for spending only three days on the investigation supporting the opinion,⁸⁰

77. *Weinberger*, 457 A.2d at 706; *Weinberger II*, 426 A.2d at 1353. It is unclear whether the Lehman Brothers team worked only on the three business days or also on the weekend, which would have given them five days to prepare their opinion.

78. *Weinberger*, 457 A.2d at 706-07. In fact, Lehman Brothers was apparently willing to opine to the fairness of the merger at any price within the range of \$20 to \$21 per UOP share. The exact language of Lehman Brothers' opinion is: "our opinion is that the proposed merger is fair and equitable to the stockholders of UOP other than Signal." Appellant's Appendix, at A103.

79. *Weinberger*, 457 A.2d at 712.

80. There was no disclosure of the circumstances surrounding the rather cursory preparation of the Lehman Brothers' fairness opinion. Instead, the impression was given UOP's minority that a careful study had been made, when in fact speed was the hallmark, and Mr. Glanville, Lehman's partner in charge of the matter, and also a UOP director, having spent the weekend in Vermont, brought a draft of the "fairness opinion letter" to the UOP directors meeting on March 6, 1978 with the price left blank. We can only conclude from the record that the rush imposed on Lehman Brothers by Signal's timetable contributed to the difficulties under which this investment banking firm attempted to perform its responsibilities. Yet, none of this was disclosed to UOP's minority.

Id.

The fact that the price per share was left blank in the opinion letter is simply illustrative of an extremely common practice, and should not have been interpreted by the court as indicative of the care, or lack thereof, with which Lehman Brothers prepared its opinion.

but did not explain why three days was an insufficient amount of time to spend on the investigation. Lehman Brothers had been UOP's investment banker for nearly twenty years. It, therefore, should have been familiar with UOP's historical financial information and performance. Preparation of the opinion might have necessitated merely updating certain information and evaluating the results of the investigation.⁸¹ The court did not specify any information or method of analysis which the Lehman Brothers team overlooked, misinterpreted or performed inadequately. Nor did the court hold that \$21 per share was not a fair price for the UOP stock.⁸² It is thus unclear exactly what the court thought Lehman Brothers should have done but did not do in the three days it had to accomplish its investigation which rendered the three day period of time unreasonable.

After *Weinberger*, it is unsettled what fair dealing requires regarding the time afforded for the subsidiary's decision-makers to consider the proposed transaction. Since the *Weinberger* court failed to identify anything that should have been, but was not, accomplished by either the UOP board or Lehman Brothers in order to adequately fulfill their respective obligations, the significance of the short periods of time permitted each of them is an open issue. It might be argued that the time periods involved in *Weinberger* were so brief as to convince the court that no board of directors or investment advisor could satisfactorily work within such constraints, but shorter periods of time have been deemed sufficient for decision-makers in other cases.⁸³ In addition, the *Weinberger* court itself stated that the amount of time, standing alone, is irrelevant to fair dealing,⁸⁴ and it gave no indication of what additional period of time would have sufficed. While a specific number of days could be selected as the minimum period in which the decision-making process for the subsidiary should be accomplished,⁸⁵ such an absolute requirement would not guarantee that the actions necessary to reasonable and informed decision making would be taken.

81. This would be consistent with the recent trend of integrating disclosure requirements under the federal securities laws, so that neither effort nor information need be duplicated. See Securities Act Release No. 6383, 24 SEC DOCKET (CCH) 1262 (announcing the SEC's adoption of new Registration Forms S-2 and S-3, and its amendment of Regulation S-K to facilitate integration of the disclosure of information under the Securities Act and the Exchange Act). See also Securities Act Release No. 6499, SEC DOCKET (CCH) (1983) (announcing the adoption of Rule 415, governing shelf registration of securities, in which the SEC indicated its approval of the practice of continuing due diligence by underwriters).

82. "While we do not suggest a monetary result one way or the other. . . [u]ntil the \$21 price is measured on remand by the valuation standards mandated by Delaware law, there can be no finding at the present stage of these proceedings that the price is fair." *Weinberger*, 457 A.2d at 714.

83. See, e.g., *Gimbel v. Signal Companies*, 316 A.2d 599 (Del. Ch. 1974), in which the time involved for the board's deliberation was only a couple of hours.

84. "For whatever reasons, and they were only Signal's, the entire transaction was presented to and approved by UOP's board within four business days. Standing alone, this is not necessarily indicative of any lack of fairness by a majority shareholder. It was what occurred, or more properly what did not occur, during this brief period that makes the time constraints imposed by Signal relevant to the issue of fairness." *Weinberger*, 457 A.2d at 711.

85. See *Borden*, *supra* note 2, at 1039 (proposing that the majority shareholder be required to give a least 90 days advance notice of the proposed cash out transaction so that "others who might be interested in offering a better price would have an opportunity to make their offers known."); *Longstreth*, *supra* note 3, at 21.

With respect to any tender offer which is subject to the Williams Act, 15 U.S.C. § 78n-78o (1982), the target company is required to send to its shareholders within *ten business days* from the commencement of the tender offer a statement recommending acceptance or rejection of the offer or expressing neutrality or inability to take a position with respect thereto. 17 C.F.R. § 240.14e-2

Instead of focusing attention on the number of days or weeks allocated for consideration of the proposal, an unreasonable time constraint should be defined as one that prevents the decision-maker—the board of directors, expert or minority stockholders—from giving adequate consideration to the proposed transaction. For the board of directors, adequate consideration can be defined in terms of a director's fiduciary duty of care. In making decisions on behalf of the corporation, a director is obligated to use that degree of care that an "ordinarily prudent person in a like position would use under similar circumstances."⁸⁶ If a director would breach his duty of care by succumbing to the time pressures imposed by the majority shareholder, then those time pressures are unreasonable. Similarly, the time schedule imposed upon an expert would be unreasonable if compliance with it would cause the expert to violate its professional duties to the subsidiary. In other words, the expert must be allowed sufficient time to perform the necessary investigation, gather the relevant data and analyze all of the information required to render an opinion. Finally, the minority stockholders should be given enough time to read and digest all of the information provided to them, consider their alternatives and simply reflect, for at least a brief period, on the decision that faces them. The reasonableness of the interval of time allowed to any of the three decision-makers depends not upon the number of days, weeks or months, but rather upon the activity or inactivity that occurs and should occur during that period.⁸⁷

The parties whose activity or inactivity will determine the sufficiency of time afforded them, therefore, should participate in establishing the schedule for their decision-making. In order to fulfill its obligation of fairness in dealing, the majority shareholder should refrain from unilaterally determining the time schedule for the subsidiary's consideration of the transaction. At a minimum, the shareholder should consult with the subsidiary's board of directors and the representatives of the two parties should together establish a time schedule. An even better practice would be for the parent to permit the subsidiary's directors, specifically its independent directors,⁸⁸ to determine unilaterally the timing of their and the shareholders' consideration of the transaction. Then, of course, the independent directors of the subsidiary could, if they deemed it useful, take the time necessary to obtain and even solicit the reactions of outsiders to the parent's offer. As a matter of procedural fairness, however, obtaining the reaction of outsiders need not be a condition to a decision on the parent's proposal.⁸⁹

Similarly, the time schedule for the subsidiary's experts should be established by consensus of the subsidiary and the expert, and not by the parent company. The question of how quickly an expert will render an opinion is generally one

(1983). Furthermore, a tender offer must be held open for at least twenty business days from the date of its commencement, 17 C.F.R. § 240.14e-1(a) (1983), and the shareholders of the target company, to whom the offer is made, are guaranteed the right to withdraw any securities they tender within the fifteen day period following the commencement of the tender offer, 17 C.F.R. § 240.14d-7(a)(1) (1983) and Exchange Act § 14(d)(5), 15 U.S.C. § 78n (1982). These time requirements are designed to protect the shareholders of the target company from being pressed into deciding whether or not to accept the bidder's offer.

86. MODEL BUSINESS CORP. ACT § 35 (1979) (added in 1974).

87. The time which is reasonable for one group may not necessarily be reasonable for the others. See *supra* note 84.

88. See *infra* notes 110-25 and accompanying text.

89. But see Longstreth, *supra* note 3, at 21 (proposing that going private transactions be permitted "only after affording all potential bidders a reasonable opportunity to investigate the company and make alternative bids.").

of the issues negotiated by the expert and the client at the time the expert is retained. Since the subsidiary, not the parent, is the client,⁹⁰ the independent representatives of the subsidiary should negotiate the time schedule, and the time schedule should be one which is not so brief as to cause the subsidiary's representatives to be suspicious of the reliability and integrity of the expert's opinion.

Structure

Another issue identified in *Weinberger* as relevant to fairness in dealing is how the transaction was structured. Unfortunately, the *Weinberger* court did no more than mention that the structure of the transaction was "Signal's doing."⁹¹ The definition of the term "structure" and its relevance to fair dealing, however, is supplied by another Delaware case, *Tanzer v. International General Industries*.⁹²

The *Tanzer* court considered three different aspects of the structure of a transaction as bearing on the entire fairness of the deal. The first aspect of structure discussed by the court was the form of the transaction. The court inquired into whether the form of the transaction—a cash out merger—was required in order to satisfy the parent's purposes for the deal, or whether those purposes could be served by an alternative form of transaction that would not force the minority shareholders to give up their equity interests in the merged entity. This inquiry required the identification of the purpose for the transaction, and the Chancellor found that the principal purpose for the cash out merger in *Tanzer* was to facilitate future long term debt financing by the parent corporation.⁹³ The plaintiffs contended that this purpose could have been satisfied by a stock-for-stock merger, or a sale of the subsidiary's assets for the parent's stock and a simultaneous liquidation of the subsidiary. The plaintiffs would have preferred either of these alternatives to the cash out merger because either would have enabled the minority stockholders to share in the benefits of the merger by making them shareholders of the surviving corporation. The essence of the plaintiff's contention was that if the parent could accomplish its purpose without forcing a cash out of the minority shareholders, then the parent's fiduciary duty to the minority would dictate that it pursue a means less onerous than the cash out to accomplish its purpose.⁹⁴

The Chancellor was not convinced, however, that the alternative forms proposed by the plaintiffs were less onerous than a cash out merger. The court implied that the cashed out minority shareholders could use the cash they received

90. *But see infra* notes 136-48 and accompanying text. It could be argued that the expert alone, should set its time schedule, without interference by or consultation with the minority's representatives. In view of the importance of the timing of such transactions, however, such a proposal would be unrealistic. The expert does have a duty, though, not to agree to a time schedule that would render its work impossible.

91. *Weinberger*, 457 A.2d at 711.

92. 402 A.2d 382 (Del. Ch. 1979). While the *Tanzer* court did recognize that entire fairness might be viewed as consisting of fair value and fair dealing, *id.* at 389, it did not use those concepts in assessing the entire fairness of the transaction before it. Instead, it considered the structure of the transaction simply as bearing on its entire fairness, without regard to what particular aspect of fairness was addressed. *Id.* at 387-89.

93. *Id.* at 389.

94. This analysis is analogous to the least onerous means test used in cases alleging an equal protection challenge under the United States Constitution where the challenged classification is suspect, such as race. *See, e.g., Regents of the Univ. of Cal. v. Bakke*, 438 U.S. 265, 305-06 (1978).

to purchase shares of the parent on the open market and thereby obtain an equity interest in the surviving company while sharing the benefits of the merger. In addition, the court indicated that the plaintiffs' alternatives might have been unfair to the minority shareholders because they would have forced the minority to accept stock in the surviving corporation, an investment which they might not have wanted.⁹⁵ The Chancellor did suggest that future cash out mergers be structured to give the minority shareholders a choice of either cash or stock in the parent corporation as consideration for their shares, and indicated that such a choice might render a cash out merger "more fair" to the subsidiary's public shareholders than a cash-only transaction.⁹⁶

The second structural aspect considered by the *Tanzer* court was whether the transaction was structured so that appraisal rights would be available to the subsidiary's minority shareholders. Delaware law provides that appraisal rights are available only in certain kinds of transactions, one of which is a merger where cash is the only form of consideration.⁹⁷ The Chancellor considered the parent's choice of a structure in which appraisal rights were available as indicative of the entire fairness of the deal.

The court further stated that the unavailability of appraisal rights might have indicated unfairness. In connection with its discussion of the alternative forms of the transaction proposed by the plaintiffs, the court noted that appraisal rights would not have been available if either alternative had been used.⁹⁸ That was an additional reason for the Chancellor's rejection of the plaintiff's argument that the proposed alternatives were less onerous than a cash out merger.

The application of *Tanzer's* analysis to the facts of *Weinberger* yields interesting conclusions. In *Weinberger*, the primary purpose of the cash out merger, as found by the Court of Chancery, was to provide Signal with a satisfactory investment for its excess cash.⁹⁹ While there was no evidence that Signal had considered any alternatives to a cash out merger, its purpose of using up cash

95. Of course a minority shareholder who was unhappy with accepting stock of the parent corporation could simply sell his shares in the stock market.

The court also expressed some concern over problems in valuing the parent corporation's stock after the merger. See *Tanzer*, 402 A.2d at 391. The court separately considered the existence of appraisal rights as one of the eight factors relevant to a finding of fairness. *Id.* at 393.

See also Elfin, *supra* note 40, at 272, suggesting that the cash out price include an amount to compensate the minority shareholders for the "the cost in terms of brokerage fees that must be expended in order to secure a like investment;" *Restatement, supra* note 1, at 1373.

96. Such an offer of stock or cash was made by Hilton Hotels Corporation (Hilton) to the minority shareholders of Mayflower Hotel Corp. (Mayflower) in connection with a stock-for-stock merger of Mayflower into its majority shareholder, Hilton. The cash was offered pursuant to an agreement, separate from the merger agreement, between the two corporations. *Sterling v. Mayflower Hotel Corp.*, 93 A.2d 107, 109 (Del. 1952).

See Borden, *supra* note 2, at 1019 ("[U]nless there are significant immediate corporate cost savings in effecting the transaction for cash rather than for stock, the parent should be compelled to offer its stock in these transactions.") See generally *Restatement, supra* note 1, at 1372, 1374, and sources cited in note 32 therein.

97. 402 A.2d at 393. Appraisal rights are not available under DEL. CODE ANN. tit. 8 § 271 (1983), the sale of assets statute, *Hariton v. Arco Electronics, Inc.*, 40 Del. Ch. 326, 182 A.2d 22 (1962), *aff'd* 41 Del. Ch. 74, 188 A.2d 123 (1963), nor where the merger involves the exchange of stock listed on a national securities exchange for the same, DEL. CODE ANN. tit. 8 § 262(b)(1) (1983).

98. 402 A.2d at 390-91.

99. *Weinberger II*, 426 A.2d at 1348-9. See *supra* note 55. The Delaware Supreme Court was not required to consider the lower court's finding regarding Signal's purpose in effecting the transaction in view of its elimination of the business purpose test.

could have been satisfied only by an alternative investment, not by an alternative form of transaction with UOP. Any transaction which would have permitted the minority shareholders to maintain an equity interest in the surviving business would have required Signal to offer its stock instead of cash, and therefore would not have satisfied Signal's goal of using up its cash. Even if Signal had offered the UOP minority shareholders a choice of cash or Signal stock, the availability of stock would have rendered the transaction less satisfactory than one in which only cash was offered. So an alternative form of the transaction would not have accomplished Signal's purpose to the same extent as a cash out merger, and the structure chosen by Signal did have the benefit of making appraisal rights available to the minority shareholders.

It is interesting to note how the two structural elements discussed in *Tanzer* are treated under the SEC's Rule 13e-3, which applies to going private transactions involving public corporations. That Rule requires disclosure relating to both the form of the transaction and the availability of appraisal rights. It requires the majority shareholder to describe any "alternative means" which it considered to accomplish its purposes for the transaction and its reasons for rejecting such alternatives.¹⁰⁰ In addition, the parent must disclose the "reason for the structure" of the transaction.¹⁰¹ A proposed version of the Rule contained a statement that offering the minority shareholders an equity interest in the surviving business entity would be indicative of the substantive fairness of the transaction.¹⁰² This is similar to the *Tanzer* court's indication that fairness might be served best by offering a choice of cash or stock. Thus, both the proposed and current versions of Rule 13e-3 support *Tanzer's* identification of these structural elements as important to an assessment of the fairness of the transaction to all shareholders of the subsidiary.

Regardless of the interpretation offered in *Tanzer* and supported by Rule 13e-3, however, one specific holding of the *Weinberger* decision was the abolition of the business purpose test.¹⁰³ As a result, the use of the notion of a business purpose for the transaction, even simply as a starting point to a consideration of the structure of the deal, may be inconsistent with *Weinberger's* holding. Moreover, even if purpose can be considered in order to assess the efficiency and fairness of the deal's structure, a purpose such as that offered by Signal—to use up excess cash—can easily be concocted to justify a cash-only transaction. And after *Weinberger*, Delaware courts may refuse to become entangled in an argu-

100. 17 C.F.R. § 240.13e-100 item 7(b) (1983).

101. 17 C.F.R. § 240.13e-100 item 7(c) (1983). Schedule 13E-3, item 13(a) also requires disclosure of the existence or nonexistence of appraisal rights. The disclosure of the consideration of alternative forms of the transaction and the availability of appraisal rights is considered "particularly important to investors" by the SEC. Securities Act Release No. 6100, *supra* note 16, at 1451-54. As a result of the SEC's judgment as to the special importance of this information, as well as all other information elicited in response to items 7, 8 and 9 of Schedule 13E-3, that material must be set forth in a section, at the front of the Rule 13E-3 Transaction Statement, designated "Special Factors." 17 C.F.R. § 240.13e-3(e)(3)(i) (1983).

102. An earlier draft of Rule 13e-3 included a substantive fairness requirement as well as the disclosure requirement present in the adopted version of the Rule. *See supra* note 16. One factor listed by the SEC as relevant to the substantive fairness of the transaction to the minority shareholders was whether the consideration offered to such minority shareholders would enable them "to maintain an equity interest in the continuing business enterprise." Proposed Rule 13e-3(b)(2)(J), Securities Act Release No. 5884, *supra* note 16, at 860.

103. *See supra* note 41 and accompanying text.

ment over what is the *true* purpose for the transaction. It may, therefore, prove difficult for a minority shareholder to use this idea of structure successfully to contend that the majority shareholder is effecting a cash out without reason.

Even accepting *Tanzer* as providing the correct interpretation of the term "structure" in the context of fair dealing, two questions are left open. First, it is unclear whether the parent *must* offer the minority shareholders an option of stock or cash even if offering stock conflicts with the parent's purpose for the transaction. This question probably ought to be answered in the negative, at least so long as the stated purpose has some basis in fact. Cash-only mergers are specifically authorized by statute in Delaware,¹⁰⁴ and a judicial interpretation of fairness ought not overrule such an express enunciation of legislative intent. Second, the *Tanzer* court did not conclude that the transaction must be structured in the manner least onerous to the minority shareholders if alternative structures are available. In many cases, the least onerous form of transaction will be a cash out merger. But whether there is an obligation to use the least onerous form of transaction was left open by *Tanzer*.

The third aspect of structure discussed by the Chancellor in *Tanzer* involved the allocation of the effects of the transaction between the majority and minority stockholders. The plaintiffs in *Tanzer* argued that it was unfair for the parent to allocate to itself all of the benefits of the cash out merger.¹⁰⁵ In this connection, the court considered the effects or benefits of the merger to be any gains or savings flowing from the transaction in the form of operating economies, tax savings and/or actual or perceived financial benefits resulting from the combination of the two businesses.¹⁰⁶ It concluded that both the existence and value of such benefits were too speculative to determine prior to the consummation of the transaction. Therefore, the court relegated consideration of the effects of the transaction, as a practical matter, to an appraisal proceeding conducted after the accomplishment of the merger. But the court found that it was precluded from including the effects of the merger in its assessment of fair value because the Delaware appraisal statute prohibited consideration of "any element of value arising from the accomplishment or expectation of the merger."¹⁰⁷ It refused to find that the transaction was unfair simply because none of its benefits had been allocated to the minority shareholders, since those benefits of the merger were precluded from consideration in the assessment of fair value.

In *Weinberger*, however, the Delaware Supreme Court reinterpreted the appraisal statute and held that only "speculative elements of value" flowing from the accomplishment of the transaction were excluded from consideration.¹⁰⁸ Other, non-speculative elements of value arising from the accomplishment of the transaction apparently now can be considered in establishing fair price. So, after *Weinberger*, if the value of the effects of the merger are determinable with some

104. DEL. CODE ANN. tit. 8 § 251(b) (Supp. 1982).

105. 402 A.2d at 394.

106. "To put the matter in context, suppose that the merger of a parent and subsidiary is expected to generate an increment in the combined value of the two companies. In effect, the value of the merged entity is seen to exceed the sum of the premerger value of parent (P) and subsidiary (S) taken separately." *Fair Shares*, *supra* note 2, at 308.

107. DEL. CODE ANN. tit. 8 § 262(h) (Supp. 1982); *Tanzer*, 402 A.2d at 394-95.

108. *Weinberger*, 457 A.2d at 713 (emphasis added). See *supra* note 42.

Tanzer also considered whether the merger was financed by the funds of the subsidiary as one factor that would indicate unfairness. 402 A.2d at 393. See *infra* note 109.

certainty, then they are an appropriate factor to consider in appraising the fair value of the minority's shares.¹⁰⁹

This last aspect of the structure of the transaction does not bear on fairness in dealing. It goes only to the substantive fairness of the deal. If the majority shareholder allocates to itself all of the benefits arising as a result of the transaction, it must simply compensate the minority shareholders for their portion of those benefits. It is no reflection on the fairness with which the parent treats the minority that all of such benefits are allocated to one party. This aspect of structure, then, should be considered only as it bears on the substantive fairness of the transaction and not as a part of fair dealing.

Negotiation

A corporation is typically represented by its board of directors in its relations with third parties.¹¹⁰ The board of directors of a controlled subsidiary corporation will often include at least some members who were elected by and are directors of the parent company.¹¹¹ These directors owe a fiduciary duty of loyalty to both corporations. They are viewed generally as unsatisfactory representatives of the subsidiary in a transaction with the parent because of their divided loyalties.¹¹² If the subsidiary is represented by persons independent of the majority shareholder, the taint of unfairness resulting from the majority shareholder being on both sides of the transaction may be lessened or removed. To that end, the subsidiary corporation might appoint a board committee, composed of directors other than those elected by the parent, to act as its representative in dealing with the parent. The purpose of appointing independent negotiators for the subsidiary is, of course, to reform the relationship between the parent and subsidiary into one which resembles as closely as possible that which exists between independent parties bargaining at arm's length.

The use of independent negotiators in *Puma v. Marriott*¹¹³ and *Harriman*

109. Schedule 13E-3, item 7(d) and instructions (2) and (3) to item 7 require disclosure of the effects of the transaction, including the federal tax consequences.

Item 6 of Schedule 13E-3 requires disclosure of the source of the funds to be used in the subject transaction. 17 C.F.R. § 240.13e-100 item 6 (1983). In the 1977 version of proposed Rule 13E-3, two factors included as indicating the fairness or unfairness of the transaction were the anticipated benefits to be received by the controlling shareholder versus those to be accorded to the minority shareholders as a result of the transaction, including a consideration of the extent to which the transaction would be financed by the funds of the controlled corporation (Proposed R. 13E-3(b)(2)(G)) and the tax consequences of the transaction to the minority shareholders (Proposed R. 13E-3(b)(2)(H), Securities Act Release No. 5884, *supra* note 16, at 860. See Borden, *supra* note 2, at 1014 n.130; Silberman, *supra* note 28, at 1493, regarding the use of the corporation's funds to acquire control thereof.

For a suggestion that fair price be an amount net of income tax liability incurred by the minority shareholders as a result of the merger, see Elfin, *supra* note 40, at 272.

See generally Goldman & Wolfe, *supra* note 2, at 697, (arguing that the benefits of the transaction could many times be obtained without using cash as the only form of consideration).

110. "The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation." DEL. CODE ANN. tit. 8 § 141(a) (Supp. 1982). See also MODEL BUSINESS CORP. ACT § 35.

111. This was the case with UOP and Signal. See *supra* note 53 and accompanying text.

112. See generally *Fair Shares*, *supra* note 2, at 315.

113. 283 A.2d 693 (Del. Ch. 1971). *Puma* involved the acquisition by the Marriott Corporation (Marriott or the Company) of all of the outstanding stock of six corporations owned by the Marriott Group which consisted principally of members of the Marriott family. The Marriott Group also own-

*v. E.I. DuPont de Nemours & Co.*¹¹⁴ led those courts to conclude that no control at all was exerted over the subject corporations. *Puma* and *Harriman* each involved a transaction in which the "controlling" shareholder owned less than fifty percent of the shares of the subject company, but owned enough stock to enable it to exercise control if it so desired. In *Puma*, the negotiators were the independent, outside directors of the Marriott Corporation, the controlled company. In *Harriman*, both the "controlling" and "controlled" corporations were represented by "special negotiating committees composed of persons unconnected with the opposing negotiating party."¹¹⁵ In each case, the court decided that the less than fifty percent ownership interest of the "controlling" shareholder was insufficient, alone, to establish that the shareholder dominated and controlled the subject company. Since the companies were represented by negotiators independent of the "controlling" shareholders, the courts were convinced that the defendant-shareholders had not used their ownership interests to exert control over the companies in the specific transactions at issue. The absence of controlling stock ownership interests coupled with a lack of actual domination in the challenged transactions led the courts to conclude that these transactions should be afforded the presumption of regularity applied to transactions between unaffiliated parties negotiated at arm's length.¹¹⁶

The same transaction that was at issue in *Harriman* was also challenged in *Collins v. SEC.*¹¹⁷ The *Collins* court, however, was not particularly impressed by the independence of the negotiators for the subsidiary. The members of the sub-

ed approximately 46% of the stock of Marriott, and four of the owners of the acquired companies were directors of Marriott. It was this interest of the Marriott Group in the acquired companies and the Company that caused the Company's outside directors to desire to sever the relationship between the Company and the acquired companies. In addition, Marriott wanted to list its stock on the New York Stock Exchange, but the Exchange would not permit such a listing unless the relationship between Marriott and the acquired companies was eliminated. *Id.* at 694-95.

114. 411 F. Supp. 133 (D. Del. 1975). *Harriman* involved a proposed merger of E.I. DuPont de Nemours & Company (DuPont) into Christiana Securities Company (Christiana), an investment company registered under the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 to 80b-21 (1982). At the time of the proposed merger, the DuPont family owned, directly or indirectly, 75% of the outstanding common stock of Christiana. Christiana in turn owned 28.3% of DuPont's common stock, which was sufficient to constitute control by Christiana under § 2(a)(9) of the Investment Company Act. In addition, the two corporations shared five directors. *Id.* at 142.

115. *Harriman*, 411 F. Supp. at 142.

116. *Puma*, 283 A.2d at 695-96; *Harriman*, 411 F. Supp. at 152. The district court in *Harriman*, however, ultimately applied the intrinsic fairness test because the case arose under the Investment Company Act. The court considered the Investment Company Act standard of "fair and reasonable and free from overreaching" to be stricter than the standard of entire fairness. Moreover, the Investment Company Act required the court to consider the rights of the shareholders of both companies, rather than just the rights of the subsidiary's stockholders. *Cf.* Polin v. Conductron Corp., 552 F.2d 797, 808-09 (8th Cir. 1977), in which the "parent" corporation, MDC, owned 46% of the stock of ACI, a corporation purchased by Conductron, which was an 80%-owned subsidiary of MDC. In discussing whether the purchase of ACI by Conductron was a parent-subsidiary transaction, the court stated that "[u]nder Delaware law, non-majority stock ownership is not sufficient, by itself, to establish domination and control." And the lower court found that ACI was not in fact controlled by MDC. Nevertheless, the court felt compelled to scrutinize the transaction "with care" because of MDC's substantial ownership interest in both ACI and Conductron. The court did not, however, hold that the intrinsic or entire fairness test was legally required to be applied under the facts before it. *Id.*

See generally Rothschild, *supra* note 2, at 225, (discussing the issue of whether *Singer* applied to less-than-majority shareholders in effecting cash outs).

117. 532 F.2d 584 (8th Cir. 1976), *rev'd on other grounds sub rom*, E.I. du Pont de Nemours & Co. v. Collins, 432 U.S. 46 (1977).

subsidiary's negotiating committee were full-time employees of the subsidiary; "they were selected for the negotiating committee by a Board of Directors presumptively controlled by...[the parent, and] they had their compensation fixed by a six-man Bonus and Salary Committee, three of whom owned stock in [the parent.]"¹¹⁸ The court concluded that the "arm's-length nature of the bargaining would have been strengthened" if the negotiating committees also included non-employee representatives of the unaffiliated shareholders.¹¹⁹

Weinberger stands in stark contrast to the facts of these cases. UOP did not attempt to neutralize the controlling influence of Signal by appointing independent negotiators. Instead, the entire UOP board of directors, over half of which consisted of persons who were directors and/or employees of Signal,¹²⁰ acted as the representative of UOP and its minority shareholders in the transaction with Signal.¹²¹ The court, in criticizing this failure to arrange for independent representation for UOP, stated that the result "could have been entirely different if UOP had appointed an independent negotiating committee of its outside directors to deal with Signal at arm's length."¹²²

What would have been required in *Weinberger* in order to produce this "entirely different" result? *Puma*, *Harriman* and *Collins* provide some indication of who will be considered an independent negotiator. *Harriman* suggests that, in the context of a parent-subsidiary transaction, independence means, at a minimum, that the subsidiary and its minority shareholders be represented by directors who are unaffiliated with the parent company. If these director-negotiators are employees of the subsidiary, however, they may not adequately protect the interests of the minority shareholders because of their desire to satisfy the parent corporation in order to maintain their jobs after the accomplishment of the transaction. Therefore, in addition to independence from the majority shareholder, independence for the subsidiary's negotiators may require that there be no employment relationship between the director-negotiator and the subsidiary, as suggested by the court in *Collins*.

Of the thirteen members of UOP's board at the time the merger was proposed, five directors had no employment relationship with UOP and had not been designated by Signal.¹²³ These non-employee directors might have been appointed to a committee to represent UOP in the negotiations with Signal. But these directors would have been adequate representatives for the minority shareholders only to the extent that they could have and did exercise truly independent judgment. Truly independent judgment means independence both from Signal, without whose

118. 532 F.2d at 598.

119. *Id.*

120. In addition to the persons listed in note 53, *supra*, the seventh Signal-designated UOP director was James Crawford, UOP's president and chairman.

121. *Weinberger*, 457 A.2d at 704-08.

122. *Id.* at 709 n.7.

123. One of these five directors was James Glanville, the Lehman Brothers partner. While the relationship between Lehman Brothers and UOP did not render Glanville an employee of UOP, it is unclear whether a court would consider Glanville independent from UOP in view of the long and close financial relationship between UOP and Lehman Brothers.

Each of these five directors owned some shares of UOP stock. Appellant's Appendix at A49. This stock ownership might have made them better representatives of the minority shareholders, since it would have aligned their interests as stockholders with those of the minority shareholders. Stock ownership in the parent, of course, would cut the other way.

consent they never would be elected,¹²⁴ as well as from the other members of the board with whom they had served and who had appointed them to the negotiating committee.¹²⁵

As a result of these potential ties between the most independent of all the subsidiary's directors and the majority shareholder or its representatives, the use of a committee of directors, while better than nothing, may not be sufficient to reproduce an arm's length bargaining situation. It is perhaps for this reason that Rule 13e-3 impliedly suggests going beyond the appointment of a directorial negotiating committee to the selection of a third party negotiator. In connection with a discussion of the fairness of the transaction, Schedule 13E-3 requires disclosure of whether the transaction was approved by a majority of the subsidiary's non-employee directors and whether these directors retained an "unaffiliated representative" to act solely on behalf of the minority shareholders in negotiating the terms of the deal.¹²⁶ This "unaffiliated representative" would be someone who is neither a director nor related in any way to either of the parties to the transaction.¹²⁷ The use of a third party negotiator, particularly if the parent corporation is also represented by an independent third party, would come even closer to reproducing an arm's length bargaining situation than would the appointment of a board negotiating committee for the subsidiary. Such representa-

124. *Collins* implies that the selection of members of the negotiating committee by a board that is controlled by the parent taints the independence of the committee members. 539 F.2d at 598.

125. In *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981), the court considered whether it should defer to the decision of independent directors who were members of the board's special litigation committee on the issue of whether a derivative suit against other members of the board should be maintained or dismissed. *Id.* at 787. In deciding not to defer entirely to the committee's decision, the court said:

Moreover, notwithstanding our conviction that Delaware law entrusts the corporate power to a properly authorized committee, we must be mindful that directors are passing judgment on fellow directors in the same corporation and *fellow directors, in this instance, who designated them to serve both as directors and committee members.* The question naturally arises whether a "there but for the grace of God go I" empathy might not play a role. And the further question arises whether inquiry as to independence, good faith and reasonable investigation is sufficient safeguard against abuse, perhaps subconscious abuse.

Id. (emphasis added). While the problem of passing judgment on the actions of fellow directors is not present in the context of parent-subsidiary transactions, a similar concern may be raised as to the identity of outlook and opinion shared by co-directors. *See also* A. BORDEN, GOING PRIVATE § 8.03[2] (1982); Longstreth, *supra* note 3, at 20:

Outside directors are invited to serve, not by the shareholders who routinely vote for them, but by management or, in some cases, other outside directors. Often they have some business or personal connection with the corporation or its management.

In any event, the relationship exerts on them a powerful force to be loyal to management. However subtle and implicit this force may be, its existence cannot honestly be denied. In speaking of loyalty, I am not suggesting a kind of wrongdoing, venality, or antisocial behavior. Loyalty is a human quality—one we typically applaud. Here it is simply a force to be noted.

126. 17 C.F.R. § 240.13e-100 item 8(d) and (e) (1983). The exclusion of employee-directors of the issuer ought also to exclude directors who are employees or directors of the affiliate-parent corporation. The 1977 version of proposed Rule 13e-3 included as considerations possibly bearing upon the substantive fairness of the transaction whether the disinterested directors approved the transaction and whether an independent representative of the minority shareholders was retained to negotiate the deal on behalf of the minority. Securities Act Release No. 5884, *supra* note 16, at 860.

127. 17 C.F.R. § 240.13e-100 item 8(d) (1983).

tion would eliminate any hint of interdependence or influence among the directors of both corporations which might arise from their association through service.¹²⁸

The Delaware Supreme Court has never established a requirement that, in a parent-subsidary transaction, the subsidiary be represented by negotiators who are independent from the parent nor did it announce such a requirement in *Weinberger*.¹²⁹ What the court said in *Weinberger*, however, is equally significant as the creation of such a general rule. The court stated that the appointment of independent negotiators to represent the subsidiary would indicate at least an attempt to reproduce a situation in which arm's length bargaining occurred¹³⁰ and fair dealing is indicated by a showing that the transaction resulted from a process in which each party acted as though the bargaining was at arm's length.¹³¹ After

128. DEL. CODE ANN. tit. 8 § 141(c) (1983), prohibits the board of directors from delegating to a committee of the board "the power or authority in reference . . . [to] adopting an agreement of merger." Since the statute prohibits delegation of such authority to a committee of directors, it would also prohibit such delegation to a non-director third party. The proposed agreement, then, must be submitted to the entire board of the subsidiary for approval or disapproval. However, even under the statute, it would be sufficient if only the independent board members voted, as members of the board and not as members of a committee, while the affiliated members of the board excused themselves.

In *Weinberger*, the Signal-designated members of the UOP board did not vote on the proposed cash out merger. They were, however, present at the UOP board meeting when the merger was approved, and the court criticized the method by which approval of the UOP board was obtained simply because of the participation in deliberations by the Signal-designated directors. 457 A.2d at 709. This criticism of such participation is contrary to at least the spirit of DEL. CODE ANN. tit. 8 § 144 (1974), which governs approval of transactions in which directors are interested. Section 144 provides that:

(a) No contract or transaction between a corporation and . . . any other corporation . . . in which 1 or more of its directors or officers are directors or officers . . . shall be void or voidable solely for this reason, or solely because the director or officer is present at or participates in the meeting of the board or committee thereof which authorizes the contract or transactions, or solely because his or their votes are counted for such purpose,

id., if the contract or transaction is, after full disclosure, approved by the disinterested directors or by the shareholders, or if it is fair to the corporation. *Id.* Of course, § 144 does not regulate transactions that are challenged because of a conflict of interest at the level of a majority shareholder.

129. *But see infra* notes 252-60 and accompanying text.

130. It has become common for an acquisition by a controlling shareholder to be negotiated on behalf of the public shareholders by a committee of independent directors and for the transaction to be subject to approval by a majority of the publicly held shares voting on the transaction. Under the cases which have emphasized negotiation with an independent board of directors an acquisition with these procedural protections would be reviewed by the courts under a standard resembling the "business judgment" rule applicable to an acquisition by an unrelated third party.

Chazen, *Fairness from a Financial Point of View in Acquisitions of Public Companies: Is "Third-Party Sale Value" the Appropriate Standard?* 36 BUS. LAW. 1439, 1440-41 (1981) (footnotes omitted).

131. "Particularly in a parent-subsidary context, a showing that the action taken was as though each of the contending parties had in fact exerted its bargaining power against the other at arm's length is strong evidence that the transaction meets the test of fairness." (citations omitted). *Weinberger*, 457 A.2d at 710 n.7.

"Certainly the judicial valuation proceeding produces a 'fair' price which is at best only a crude approximation of the arm's-length bargain for which it purports to be a proxy." *Fair Shares, supra* note 2, at 318 n.49.

See Restatement, supra note 1, at 1357-58. *Cf. Meyerson v. El Paso Natural Gas Co.*, 246 A.2d 789 (Del. Ch. 1967). *Meyerson* involved a challenge by a minority shareholder of an 80%-owned

Weinberger, the use of independent negotiators to represent the subsidiary, whether committees of directors or third parties, is one of the factors most certain to be considered in assessing fairness in dealing.

In addition to inquiring into who represented UOP in the transaction with Signal, the *Weinberger* court also considered whether any actual bargaining or negotiation occurred between the parent and its subsidiary. The court did not specifically hold that this failure to demand a higher price constituted any breach of duty on the part of the UOP board. The court did, however, characterize the negotiations as "modest at best."¹³² The implication is that the UOP board should have demanded a higher price of Signal, i.e., "negotiated" on the issue of price.¹³³

There is no doubt that UOP's board did not demand that Signal pay more than \$21 for each share of UOP stock. The real question is whether the board *should* have made such a demand. Consider the issue in the context of a merger between two independent corporations. If the board of directors of Company A, after careful consideration, concludes that the initial offer of Company B to pay \$x per A share for the stock of A is a fair and reasonable price for the stock, must the A board then demand that Company B pay more than \$x per A share? Of course not, for such a demand would unnecessarily prolong the merger negotiations, might cause increased legal and investment advisor fees, and could kill the deal entirely. Moreover, if the board of directors of Company B believed that the original offer of \$x per share represented the fair value of A's stock, it might

subsidiary to the parent's retention of all of the tax benefits flowing from the filing of a consolidated tax return. In discussing other cases involving the allocation of tax benefits between parent and subsidiary corporations, the court considered two cases, also involving tax allocations, *Western Pac. Corp. v. Western Pac. R. Co.*, 345 U.S. 247 (1953), and *Case v. New York R.R.*, 232 N.Y.S.2d 702, *rev'd*, 19 A.D.2d 383, 243 N.Y.S.2d 620, *rev'd*, 15 N.Y.2d 150, 256 N.Y.S.2d 607, 204 N.E.2d 643. In *Western Pacific*, Justice Jackson dissented from the Court's action and concluded that the subsidiary was "entitled to what fair arm's-length bargaining would probably have yielded." 345 U.S. at 277. On remand in *Western Pacific*, the Circuit Court reaffirmed its denial of relief to the plaintiff, and responded to Justice Jackson: "how could this court or the district court determine 'what fair arm's-length bargaining would probably have yielded?' Bargaining presupposes negotiations to determine the maximum amount a buyer is willing to pay and the minimum amount a seller is willing to accept. Such activity is a matter of business administration, and is not a judicial function." 206 F.2d 495, 499-500. In *Case*, the dissent of two justices of the Appellate Division was subsequently adopted by the Court of Appeals in reinstating the trial court's denial of relief to the plaintiff minority shareholder. The dissenting justices stated:

Even if this were an arm's length transaction, it would be extremely difficult, if not impossible, to determine what would be fair . . . Traditionally, what is fair is what these two parties would agree on. But actually in such a situation the terms of agreement would depend almost entirely on the bargaining ability and the personal characteristics of the parties. Such factors defy the making of an estimate of the result that would be reached.

19 A.D.2d at 390, 243 N.Y.S.2d at 627. *See also* *Getty Oil v. Skelly Oil*, 267 A.2d 883 (Del. 1970).

132. *Weinberger*, 457 A.2d at 711.

133. This issue was presented to the Chancellor, who rejected the claim on the grounds that there was no absolute obligation on the part of the UOP board to seek a higher price per share than that offered by Signal. Rather, the board's obligation was to act in a reasonable manner in considering Signal's proposal. The Chancellor explained that "if UOP's board, after reviewing the matter [the proposed price range of \$20 to \$21/share], was convinced that the high end of the proposed price range was fair and reasonable to the minority, then its failure to seek still a higher price did not, of itself, constitute a breach of its fiduciary duty owed to its minority shareholders." *Weinberger II*, 426 A.2d at 1354. The Delaware Supreme Court failed to specifically address the Chancellor's conclusion.

constitute a breach of duty to the shareholders of Company B to agree to pay more than \$x per share.¹³⁴

Applying this model to the *Weinberger* case, the question should be whether the UOP board, after careful consideration, concluded that \$21 per share was a fair and reasonable price for the stock. The answer depends in part upon whether the board's consideration of the proposal was deliberate. While the court in *Weinberger* implied that the board's decision-making process was unreasonable due to its brevity, that implication was not supported by factual findings or other explanations.¹³⁵ Furthermore, the combination of the premium offered by Signal over market price and the receipt of the Lehman Brothers fairness opinion provided some support for the UOP directors' conclusion that \$21 per share was a fair price. The analogy to the merger between two independent companies, then, would indicate that UOP had no obligation to negotiate with Signal for a higher price.

But perhaps the court was dissatisfied with the absence of negotiations because the subsidiary was not represented by an independent negotiating team. In such circumstances, the court might presume that the majority shareholder's power of control over the subsidiary was actually exercised to grant it some uncompensated benefit. At the very least, the parent would be tempted to resolve all doubts in its favor, and, since the subsidiary lacked independent representation, there would be no one to challenge the parent's resolution of those doubts or exercise of control. A rule might be established, therefore, to require that, where there are no independent negotiators for the subsidiary, the board of the subsidiary *always* engage in some negotiations with the parents (*i.e.*, demand more money than that initially offered by the parent).

The *Weinberger* court did not establish a requirement of actual negotiation, nor would the concept of fair dealing be furthered significantly by such a requirement. Such a rule would have the benefit of ensuring that the parties engage in only superficial negotiations. It would not, of course, ensure sincere bargaining, and the requirement that a higher price be demanded would not resolve the issues of how much to demand and what amount, if any, to accept. Furthermore, the establishment of such a general rule could have the effect of encouraging the parent initially to place an unreasonably low value on the minority shareholders' stock, in anticipation of later increasing the value in response to the subsidiary's demands. Instead of a rule of apparent negotiation, the concern for adequate protection of the minority's interests should manifest itself through the requirement of independent negotiators for the subsidiary. That, alone, should satisfy the court's concerns in this respect.

134. See *Abelow v. Midstates Oil Corp.*, 189 A.2d 675, (Del. Super Ct. 1963), in which the court, in discussing whether the parent corporation's (Middle) board of directors breached its fiduciary duty to the minority shareholders of the subsidiary (Midstates) when it failed to negotiate for a higher price or more favorable terms in connection with an offer by a third party (Tennessee) to purchase the stock of the parent corporation, said:

After the Middle directors had determined that it was a favorable one they would have been guilty of a breach of duty had they not submitted it to their stockholders. And upon what theory of fiduciary duty were they required to negotiate further with Tennessee for the broadening of the offer to include the Midstates minority? Suppose Tennessee had refused to do so. What could Middle have done about it?

Id. at 678. See generally R. FISHER & B. URY, *GETTING TO YES* (1981).

135. See *supra* text accompanying notes 74-76 and 86-87.

Use of Experts

It is common practice in mergers, particularly parent-subsidary mergers, for the acquired company's representatives to obtain an investment banking firm's opinion regarding the fairness of the proposed transaction.¹³⁶ In cases challenging the actions of majority shareholders, Delaware courts have considered a fairness opinion relevant both to the fairness of the challenged transaction itself and to the reasonableness of the board of directors' action in approving the transaction.¹³⁷ The reliability of the opinion and the degree of influence it carries, however, can be undermined by a lack of independence regarding the investment banking firm that rendered it or the method by which the firm prepared its opinion.

The independence of the investment banking firm retained to prepare a fairness opinion for a parent-subsidary transaction may be questioned on several grounds. First, the existence of a financial relationship between the investment banking firm and the parent company might negate a finding of independence. For example, in *Tanzer v. International General Industries, Inc.*,¹³⁸ an opinion regarding the fairness of the cash out price offered to the subsidiary's minority shareholders was rendered by Dillon, Reed & Co., Inc., an investment banking firm that "had a \$200,000 fee at stake for assisting [the parent] in its long term debt financing program which depended upon the outcome of the merger."¹³⁹ This relationship between the parent and Dillon Reed resulted in Dillon Reed not being considered independent with respect to the minority shareholders of the subsidiary.¹⁴⁰

136. In an acquisition by a controlling shareholder the board of directors customarily obtains an opinion from an investment banking firm that the financial terms are fair to the public shareholders or that the transaction is fair from a financial point of view. . . . An investment banker's opinion on financial fairness may be influential with a court which reviews the fairness of the acquisition and can help establish that the directors had a reasonable basis for a statement under the going private rules that they believed the acquisition was fair to the company's public shareholders.

Chazen, *supra* note 130, at 1442 (footnotes omitted). See also BORDEN, *supra* note 125, at § 8.04.

137. See, e.g., *Tanzer v. Int'l Gen. Indust., Inc.*, 402 A.2d 382, 391 (Del. Ch. 1979) (involving a cash out merger; the court considered an independent recommendation regarding fairness of price as indicating that the price paid to the minority shareholders was "prima facie fair;" the independence of the investment banker in that case, however, was questioned by the court); *Puma v. Marriott*, 283 A.2d 693, 695-96 (Del. Ch. 1971) (independent appraisals significant in finding that the majority shareholder did not dominate both parties to the transaction). See generally *Sterling v. Mayflower Hotel Corp.*, 93 A.2d 107, 109 (Del. 1952); *Harriman v. E.I. Du Pont de Nemours & Co.*, 411 F. Supp. 133, 142 (D. Del. 1975); Chazen, *supra* note 130, at 1442.

Furthermore, section 141(e) of the Delaware Corporation Law, DEL. CODE ANN. tit. 8 § 141(e) (1974), provides that "[a] member of the board of directors of any corporation organized under this chapter . . . shall, in the performance of his duties, be fully protected in relying in good faith upon . . . reports made to the corporation . . . by an appraiser selected with reasonable care by the board of directors." *Id.*

Schedule 13E-3 considers obtaining the fairness opinion or report of an independent firm as bearing upon the reasonableness of the majority shareholder's conclusion that the entire transaction is fair to the cashed out minority shareholders. Schedule 13E-3 item 8(a), (b)(1)(vii), and (d), 17 C.F.R. § 240.13e-100 item 8(a), (b)(1)(vii), (d) (1983). The state of Wisconsin, on the other hand, requires that the fairness opinions of two independent appraisers be obtained in order to establish a presumption that the terms of a going private transaction are fair. The appraisals are only a part of one of three factors necessary to establish the presumption. WISC. ADMIN. CODE § SEC 6.05(1)(a)1 (1980). For a discussion of this rule by the Wisconsin Commissioner of Securities, see Bartell, *Minority Stockholder Freezeouts Under Wisconsin Law* (Panel Discussion), 32 BUS. LAW. 1501 (1977).

138. 402 A.2d 382 (Del. Ch. 1979).

139. *Id.* at 391.

140. *Id.*

In *Weinberger*, the plaintiff argued that the existence of a non-financial relationship between the investment banking firm and the majority shareholder impaired the investment advisor's independence.¹⁴¹ In the Chancery Court, the plaintiff claimed that Lehman Brothers conspired with Signal and the UOP board to deceive UOP's minority shareholders.¹⁴² Lehman Brothers had been UOP's financial advisor in 1975 when Signal acquired its controlling interest in UOP, and it had advised UOP with regard to the terms of that transaction. After the acquisition was completed, several employees of Lehman Brothers prepared a study of the consequences of an acquisition by Signal of the remaining publicly held shares of UOP. This report, apparently requisitioned by Mr. Glanville, concluded that it would be to Signal's benefit to acquire the remaining shares of UOP at a price of \$17 to \$21 per share.¹⁴³ The report was never sent to either Signal or UOP, but was kept in the internal files of Lehman Brothers. It was known to exist, however, by one of the three members of the Lehman Brothers team that prepared the 1978 fairness opinion, who consulted the report during the preparation of the 1978 opinion.¹⁴⁴

The plaintiff claimed that if Lehman Brothers had considered \$21 per UOP share to be a good price for Signal to pay for UOP in 1976, then, in view of UOP's substantially improved financial performance between 1976 and 1978, it would be unreasonable for Lehman Brothers to conclude that the same \$21 per share price was fair compensation to the UOP minority shareholders in 1978. Furthermore, Weinberger argued that the preparation of the 1978 fairness opinion was tainted by the one analyst's knowledge and use of the 1976 report, because the 1976 report was "geared toward that which was a good deal for Signal rather than to a price which was fair to UOP's minority shareholders."¹⁴⁵

The Chancellor was required to decide only whether this evidence supported Weinberger's charge of a conspiracy between Lehman Brothers, Signal and UOP's board of directors. The lack of any knowledge of even the existence of the 1976 report by anyone at Signal or UOP was controlling, and the court concluded that the plaintiff had failed to prove his conspiracy charge.¹⁴⁶

The existence of the 1976 report, however, and the fact that it was requisi-

141. *Weinberger II*, 426 A.2d 1333, 1347.

142. *Id.*

143. That report, designated as Exhibit LB-40 at trial, was entitled "Memorandum to Mr. Forest Shumway—Confidential Draft—Considerations Relating to the Signal Companies' Investment in UOP—Lehman Brothers Incorporated—June 1976." The basic conclusion of LB-40 was that it would be to Signal's advantage to acquire the 49.5 per cent minority interest of UOP at a price of \$17 to \$21 per share.

Id.

144. *Id.* at 1348.

145. *Id.* at 1347.

146. The court added the following comment:

In addition, although Lehman Brothers has been lumped together with Signal and UOP in plaintiff's allegations of breach of fiduciary duty, plaintiff has offered no authority to indicate that an investment banking firm rendering a fairness opinion as to the terms of a merger owes the same fiduciary duty to the minority shareholders as does the majority shareholder who initiated the merger as a direct result of being retained by the management of the controlled subsidiary.

Id. at 1348.

tioned by Glanville, a UOP director in 1976 as well as in 1978,¹⁴⁷ undermine, at least to some degree, the independence of Lehman Brothers from Signal. If in 1976 Lehman Brothers was tempted to vie for Signal's business, the temptation to do so in 1978 was clearly intensified. Lehman Brothers had been UOP's investment banker for nearly twenty years. In order not to lose that business entirely, Lehman Brothers had to look to Signal for a future relationship, and the mere possibility of a future relationship with Signal might have influenced Lehman Brothers' assessment of the fair value of the UOP shares. While the *Weinberger* court was not called upon to decide whether the relationship between Signal and Lehman Brothers impaired the ability of Lehman Brothers to represent UOP, perhaps such a relationship, even though non-financial, should be sufficient to cast doubts in the future upon the independence of an expert in such a position.

Rule 13e-3 sheds an interesting light on the issue. It requires disclosure of any relationship between the parent and the investment banking firm which "is mutually understood to be contemplated."¹⁴⁸ Under the facts of *Weinberger*, no disclosure would have been required unless Signal and Lehman Brothers had agreed that a future business relationship was at least a possibility, and there was no evidence of any such agreement. Rule 13e-3, therefore, supports the conclusion that the mere possibility that Lehman Brothers might court Signal's favor should not be considered sufficient to taint the independence of Lehman Brothers.

Another factor affecting the independence of an investment banking firm in a parent-subsidiary transaction involves the existence of an historical relationship between the firm and the subsidiary. A long-standing relationship with the subsidiary corporation may result in the investment banking firm identifying with the interests of the company as a whole, including those of its majority shareholder. This bond between the investment banking firm and the majority shareholder would be strengthened if, as in *Weinberger*, the lead representative of the investment firm served with the representatives of the majority shareholder on the subsidiary's board of directors. In such circumstances, the ability of the investment banking firm to act solely on behalf of the subsidiary's minority shareholders, whose interests should be considered equivalent to those of the corporation,¹⁴⁹ in assessing the fairness of the price offered for the publicly held stock may be seriously questioned. Rule 13e-3 also identifies a relationship between the investment banking firm and the subsidiary corporation as significant, and it requires disclosure of any such relationship to the minority shareholders.¹⁵⁰

147. Glanville had been a director of UOP since 1971. Appellant's Appendix, at A50.

The Chancellor did consider the independence of Lehman Brothers in connection with the plaintiff's claim that the failure to disclose the lack of independence of Lehman Brothers in the proxy statement was a material omission. The court concluded that there was "no convincing evidence that Lehman Brothers had any commitment to Signal that would have had any bearing on its opinion. . . . There is no evidence of any communications between Signal and Lehman Brothers concerning the merger. As to LB-40, the mysterious document mentioned earlier, the evidence shows that no one at either Signal or UOP was aware of its existence until after the suit was filed. Obviously, there could have been no obligation upon UOP at the time to disclose it as a part of the proxy materials, or to comment on its possible effect as to the independence of Lehman Brothers in giving its opinion." 426 A.2d at 1353.

148. 17 C.F.R. § 240.13e-100 item 9(b)(4) (1983).

149. See *infra* notes 252-60 and accompanying text.

150. With respect to any report, opinion or appraisal . . .

(4) Describe any material relationship between (i) the outside party, its affiliates

To eliminate this possibility of bias, the subsidiary corporation might retain a wholly independent investment banking firm that has no prior relationship with either of the parties to the transaction. For example, in *Harriman v. E.I. Du Pont de Nemours & Co.*,¹⁵¹ a case involving a merger of a partially-owned subsidiary into its parent corporation, each company hired an investment advisor that had no prior relationship with either of the corporate parties to the transaction.¹⁵² In contrast, in *Tanzer* the Chancellor rejected a claim that entire fairness required the minority shareholders to be represented by an independent investment banking firm.¹⁵³ Nor did the Delaware Supreme Court in *Weinberger* establish such a requirement. The court did, however, criticize Lehman Brothers' preparation of the fairness opinion. That criticism might have been partially generated by the choice of the Lehman Brothers firm to do the job.

There are costs as well as benefits associated with retaining an unrelated financial advisor for the minority shareholders. An investment banking firm that represents a company over a long period of time builds up a reservoir of knowledge about the company that cannot easily be duplicated by a new firm. The absence of such an historical familiarity may be reflected in the fee charged by a new, independent firm to prepare a fairness opinion. The new firm will be required to expend time and effort to examine historical financial data about the company with which the company's regular financial advisor is already familiar and, consequently, may be forced to charge substantially more than the company's general advisor. Furthermore, the fees charged by an independent investment firm may include a premium if the firm is hired on a one-time only basis. And in order to ensure that the firm's opinion will not be influenced by its desire for future business from the surviving corporation, its employment may require a prior agreement that no party to the transaction will retain it for some period in the future.

The costs of complete independence, however, must be balanced against its benefits. The principal benefit is to ensure that the interests of the minority shareholders are adequately represented and protected from any domination by the majority shareholder. Independent advisors can determine what would be a fair price from the viewpoint of the minority shareholders by considering such factors as what other alternative investments would be available to the shareholders and the tax consequences of the transaction to the minority. That price can be used as the starting point in negotiations by the independent negotiators to provide maximum protection for the minority.¹⁵⁴ Such representation will minimize the control of the majority shareholder and increase the bargaining power of the minority shareholders.

Even if an independent investment banking firm is retained to advise the con-

and/or unaffiliated representative, and (ii) the issuer or its affiliates, which existed during the past two years or is mutually understood to be contemplated and any compensation received or to be received as a result of such relationship.

17 C.F.R. § 240.13e-100 item 9(b)(4) (1983).

151. 411 F. Supp. 133 (D. Del. 1975).

152. They also jointly hired one firm that had been a financial advisor to each of the corporations. *Id.* at 142-43.

153. "It cannot be said, however, as a matter of law, that this lack of independent representation of the Kliklok minority . . . necessarily caused the minority to not be treated fairly." 402 A.2d at 391.

154. Perhaps the company's regular investment advisor could also be retained, so that the benefit of its experience would not be lost.

trolled corporation, the weight given to the firm's opinion may be affected by the methodology used in formulating the opinion. In *Weinberger*, for example, the \$21 per share figure, which Lehman Brothers concluded was fair, was not independently determined by Lehman Brothers. Rather, the figure was supplied by Signal and UOP. The Chancellor, in discussing the charge that the UOP directors had failed to give reasonable consideration to Signal's proposal, stated that the plaintiff's allegation was supported by the fact that the UOP board "did not seek an independent appraisal of the current value of UOP's shares before acting."¹⁵⁵ The implication of the Chancellor's statement is that different weights should be assigned to an independent appraisal and a fairness opinion which merely puts a stamp of approval on the company's price. In other words, Lehman Brothers' judgment would have been considered much more valuable if Lehman Brothers itself had determined the amount which it considered to represent the fair value of the UOP shares. This implication is supported by Rule 13e-3, which provides that the discussion of a fairness opinion must include disclosure of whether the parent or subsidiary corporation, on the one hand, or the third party expert, on the other hand, determined the amount of consideration to be paid.¹⁵⁶

The court in *Collins v. SEC*¹⁵⁷ added a further refinement to this distinction. There, each of the independent investment bankers was asked to recommend a range of exchange ratios that it deemed to be fair, but they were also each informed of their clients' views as to what the companies thought would constitute a fair exchange ratio. The court considered this type of communication to undermine the integrity of the appraisal process.¹⁵⁸ The experts might have been influenced by the suggestions of their clients, and such influence might have manifested itself in the figure selected by them.

155. *Weinberger II*, 426 A.2d at 1354. Other Delaware cases have focused on a current valuation of certain significant assets of the corporation, such as real estate, as important for the board's full consideration of the fairness of price. *Puma v. Marriott*, 283 A.2d 693 (Del. Ch. 1971); *Gimbel v. Signal*, 316 A.2d 599 (Del. Ch. 1974). In the Chancery Court, *Weinberger* did allege that the UOP board had breached its duty to the minority shareholders by failing to have UOP's real estate and patent assets reappraised. The Chancellor rejected this argument on the grounds that any such reappraisal would not have made any difference to the UOP board. *Weinberger II*, 426 A.2d at 1355. In view of the Supreme Court's revision of Delaware law regarding acceptable methods of valuation, however, perhaps reappraisals of these substantial assets would have been significant to the UOP board.

156. "If such report, opinion or appraisal relates to the fairness of the consideration, state whether the issuer or affiliate determined the amount of consideration to be paid or whether the outside party recommended the amount of consideration to be paid." 17 C.F.R. § 240.13e-100 item 9(b)(5) (1983).

157. 532 F.2d 584 (8th Cir. 1976). This case involved the same transaction at issue in *Harriman v. E.I. DuPont de Nemours & Co.*, 411 F. Supp. 133 (D. Del. 1975), discussed *supra* at text accompanying note 114.

158. The court adopted the following portion of the report of the SEC Division of Investment Management Regulations:

In our view, true independence of financial advisers where fairness is at issue would preclude a situation where the advisers are made aware of their clients' thinking as to proper terms and consciously or not, are likely to tailor their opinions, to some degree, to the results desired. Although it is clear from the Record that all the advisers did considerable and highly competent work, how much more credible their final products would have been had they been permitted to hand them over to their clients without the pressures resulting from the knowledge that the negotiators were striving for a 2.5% discount. Obviously, if that had been the case, the recommended ranges could have been sufficiently disparate to require a re-thinking of the merger terms.

Again, the *Weinberger* court did not address this issue of the method used by an investment advisor to determine a fair price. The purpose of imposing a duty of fair dealing, however, is to keep the deliberative and decision-making process as free as possible of elements of domination or influence by the majority shareholder. To the extent that the method used to establish fair value is one which is free from any involvement by the majority shareholder, it will further the purposes of fairness in dealing and lend support to the value established by the expert.

Disclosure

The standard of disclosure in Delaware for dealings between a majority shareholder and its corporation was most recently enunciated in *Lynch v. Vickers Energy Corp.*¹⁵⁹ *Lynch* held that majority shareholders must satisfy a standard of "complete candor" with respect to the minority shareholders, which requires majority shareholders to "disclose all information in their possession germane to the transaction in issue. And . . . 'germane' . . . means . . . information such as a reasonable shareholder would consider important in deciding whether to sell or retain stock. . . . Completeness, not adequacy, is both the norm and mandate."¹⁶⁰ The purpose of this strict standard of "complete candor" is to pre-

159. 383 A.2d 278 (Del. 1977). *Lynch* involved a tender offer by Vickers, the majority shareholder of TransOcean Oil, Inc., for all of the outstanding shares of TransOcean.

160. *Id.* at 281 (citations omitted); also quoted in *Weinberger*, 457 A.2d at 710.

The question naturally arises as to whether the Delaware standard of disclosure is different from the federal securities law disclosure standard. The Delaware definition of "germane" is identical to the definition of materiality set forth in TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976) with regards to Rule 14a-9, 17 C.F.R. § 240.14a-9 (1983). "An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." Thus, Delaware requires disclosure of all material information. (See Rothschild, *supra* note 2, at 230 n.85.

The emphasis in Delaware on "completeness, not adequacy" suggests that its standard is different from the federal standard. Federal law prohibits the omission of "any material fact necessary to make the statements [already made] therein not false or misleading. . . ." (Rule 14a-9(a), 17 C.F.R. § 240.14a-9 (1983)) or "necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading. . . ." (Rule 10b-5(3), 17 C.F.R. § 240.10b-5 (1983)). Thus, federal law focuses on the *totality* of what is disclosed; Delaware law, on the other hand, seems to focus on the existing information in a vacuum, regardless of its relation to other statements that have been made.

At least in the *Weinberger* case, with respect to the issue of the disclosure of information to the non-Signal UOP directors as opposed to the minority stockholders, the court was dissatisfied with Signal's conduct because Signal had certain information—the feasibility study—that was "germane" to the cash out, but which was not disclosed to the non-Signal UOP directors. The inquiry, thus, was not on disclosure of information necessary to make other statements made not false or misleading; there was no attention given to the relationship between the feasibility study and any other information disclosed. Rather, the obligation imposed by the court was to disclose *all* information "germane to the transaction." This standard seems to be stricter and more inclusive disclosure than that imposed by federal law. See 15 BNA SEC. REG. & L. REP. (BNA) 2104, 2109 (1983) (reporting the comments of Leonard Chazen at the 15th Annual Institute on Securities Regulation: "All of a sudden we seem to be confronted with a Delaware law of disclosure.")

However, shortly after the Supreme Court issued its opinion in *Weinberger*, the Delaware Court of Chancery had a chance to apply the disclosure discussion in *Weinberger* to another cash out merger case, and Vice-Chancellor Longobardi had some interesting comments about the Delaware disclosure standard. In *Bershad v. Curtiss-Wright Corp.*, Civil Action Nos. 5827, 5830 (March 21, 1983), the court addressed the claim of nondisclosure to shareholders, rather than to other directors. The vice-chancellor seemed to emphasize materiality over completeness: "Although it is clear that the letter and spirit of the law call for complete disclosure, disclosure is only required of material facts." (citing

vent majority stockholders "from using special knowledge which they may have to their own advantage and the detriment of the [minority] stockholders."¹⁶¹

The adequacy of disclosure was one of the principal issues involved in the *Weinberger* case.¹⁶² The Delaware Supreme Court applied the standard enunciated in *Lynch* to find that the majority shareholder should have disclosed to the subsidiary's directors and minority shareholders the effects of the transaction on the parent company. The court, in fact, went beyond this by holding that complete disclosure required the parent to inform the subsidiary of the differences in the

Lynch). The court went on to emphasize that the proxy statement should be viewed in its entirety to decide whether it "sufficiently discloses the matter to be voted on," and that the Delaware disclosure standard is consistent with the federal standard. *Id.* The vice-chancellor's focus upon the *sufficiency* of disclosure in the entire proxy statement seems to be a looser interpretation of the "complete candor" standard than that given by the Delaware Supreme Court in *Weinberger*. Perhaps this difference arises from the different circumstances of the two cases—in *Bershad* the disclosure at issue was to stockholders in a proxy statement, in *Weinberger* the disclosure at issue was to other directors.

161. 383 A.2d at 281.

Even a timely and successful challenge to a merger based solely upon the inadequacy of the disclosure of its terms and import may indirectly implicate the fairness question. While a successful challenge may only delay the merger until adequate disclosure is made, it is also possible that a requirement of full disclosure will induce a modification of the transaction which eliminates all reasonable grounds for challenging fairness or will result in a settlement at a somewhat better price for stockholders than was originally proposed in the merger.

Fair Shares, *supra* note 2, at 303 n.15 (citation omitted).

162. "A primary issue mandating reversal is the preparation by two UOP directors, Arledge and Chitrea, of their feasibility study for the exclusive use and benefit of Signal." *Weinberger*, 457 A.2d at 708.

[The disclosure] obligation . . . may offer two kinds of protection to public stockholders against an overreaching parent. First, disclosure of the terms and consequences of the merger exposes insiders to the glare of publicity. The knowledge that any disadvantageous or unequal treatment which they impose on public stockholders will be exposed to the full view of investors may impel the insiders to treat the public stockholders more generously than otherwise. Second, even when the voting power of public shareholders is arithmetically useless, a detailed understanding of the terms and import of the merger may incline a greater number of them to seek appraisal, or even, on grounds of unfairness, to attempt to enjoin the merger or obtain a larger share of its proceeds.

Fair Shares, *supra* note 2, at 301 (footnotes omitted).

The *Weinberger* court defined fair dealing as including "how [the transaction] . . . was . . . disclosed to the directors." 457 A.2d at 711. The court's use of the word "how" raises the possibility that it was concerned with the manner in which information was conveyed to the board, as well as what information was communicated. In *Weinberger*, for example, disclosure of the proposed transaction to the UOP directors was accomplished through a combination of oral and written communication. Signal did not prepare a comprehensive document to disclose the transaction to the UOP directors.

The issue of how information is disclosed has been considered important under the federal securities laws for purposes of Rule 10b-5. Two different aspects of the manner of disclosure might be relevant. First, the form in which the information is disclosed must be such as will convey the information to the intended recipient. Thus disclosure of information in a periodic report to the SEC may not be as effective as a press release to get the information to the marketplace. Second, several courts have held that it is not enough to include information in a disclosure document; the information must be presented in a manner that adequately emphasizes the most important facts. "Buried facts," if material, do not satisfy the standard of full disclosure. See, e.g., *Gould v. American Hawaiian Steamship Co.*, 331 F. Supp. 981 (D. Del. 1971), *aff'd*, 535 F.2d 761 (3d Cir. 1976); *Kohn v. American Metal Climax, Inc.*, 322 F. Supp. 1331 (E.D. Pa. 1971), *aff'd*, 458 F.2d 255 (3d Cir. 1972). Neither of these issues has, however, been considered with respect to disclosure to the board of directors; consideration has been restricted to how information has been disclosed to the shareholders.

effect of the transaction on the parent depending upon various possible terms proposed for the deal. In the past, such disclosure generally has not been required, and it is unclear whether the *Weinberger* court truly intended to expand the Delaware disclosure standard. In order to determine what the court in *Weinberger* held and what is required to be disclosed in future transactions, the details underlying the disclosure issue in *Weinberger* must be examined.

The disclosure problem revolved around Signal's preparation of a feasibility study on the proposed cash out merger. The study was prepared by several persons who served both Signal and UOP, but it was not distributed to the non-Signal members of UOP's board or to its minority shareholders. In the view of the court, the failure to disclose the feasibility study caused the votes of both the directors and stockholders of UOP to be uninformed.

The feasibility study was a sixteen page document that was prepared by Messrs. Arledge and Chitrea, who were directors of both UOP and Signal. It included a brief summary of the acquisition,¹⁶³ a list of eight purposes of the merger,¹⁶⁴ a chronological schedule of events leading up to the merger,¹⁶⁵ a summary of the anticipated terms of a loan to be incurred to finance the cash out, and various tables of financial information.¹⁶⁶ Most of the financial tables illustrated the effects of the acquisition on Signal assuming a purchase price for the UOP stock at varying amounts ranging from \$18 to \$24 per share.¹⁶⁷ The basis of the study was, for the most part, statistical analysis commonly performed by financial analysts, and the bulk of the material contained in it could have been derived from publicly available information.

163. *SUMMARY OF THE PROPOSED ACQUISITION*
CASH MERGER

\$103-137 MILLION (\$18-24 per share) CASH

—BORROWED SHORT-TERM

UOP BECOMES WHOLLY OWNED SUBSIDIARY OF SIGNAL (Appellant's Appendix at A1473).

164. These purposes were reiterated by the court at 457 A.2d at 708.

165.

CASH MERGER—UOP

<u>DATE</u>	<u>SEQUENCE OF EVENTS—fast</u>
3/6/78	SIGNAL BOARD MEETS UOP BOARD MEETS
3/10/78	MERGER AGREEMENT SIGNED
3/15/78	PRELIMINARY PROXY INFORMATION FILED WITH SEC
4/10/78	UOP BOARD MEETS PROXY MATERIAL APPROVED AND MAILED TO UOP SHAREHOLDERS
5/9/78	UOP SHAREHOLDERS MEETING—regularly scheduled

APPROVAL AND CLOSING

Appellant's Appendix at A1476 (The words in lower case are handwritten comments).

166. Signal and/or its subsidiaries planned to negotiate a short term unsecured loan, which would be renegotiated or paid off after the merger. *Id.* at A1484.

167. Other financial tables included in the feasibility study showed (1) a comparison of UOP's 1974 and 1977 stock market prices, the percentage premium of \$21 per share over the market prices, earnings, net worth and dividends (p. A1475); (2) the amount required to cash out the outstanding UOP stock options (pp. A1480-81); and (3) the source of purchase funds depending upon the purchase price, using a range of \$18 to \$24 per UOP share (p. A1483).

The Chancellor found that the feasibility study "indicated that it would be a good investment for Signal to acquire the remaining 49.5 per cent of UOP at any price up to \$24 per share."¹⁶⁸ Although the Chancellor gave no explanation for this conclusion, it appears that he chose the price of \$24 per UOP share as the amount which would be a good investment for Signal because that was the highest dollar amount in the \$18 to \$24 price range used in the feasibility study's financial tables. Of course, the financial tables used every dollar amount between and including \$18 and \$24 per UOP share in assessing the effects of the cash out on Signal, and presumably the range could have been expanded to include both lower and higher per share prices. The Chancellor's selection of the \$24 per share price seems somewhat arbitrary in view of his failure to explain why he chose that price.

The Supreme Court adopted the lower court's finding regarding the \$24 price and added its own explanation for the Chancellor's conclusion. The court explained that any price of up to \$24 per UOP share was a good investment for Signal because the feasibility study showed that "a return on the investment at \$21 would be 15.7% versus 15.5% at \$24 per share. This was a difference of only two-tenths of one percent, while it meant over \$17,000,000 to the minority."¹⁶⁹ If paying an additional \$3 per UOP share would cause Signal to suffer only a negligible 0.2% decrease in the return on investment, then the acquisition of the remaining 49.5% of UOP at \$24 per share would be nearly as beneficial to Signal as at \$21 per share. The court believed that this nearly equivalent benefit to Signal, regardless of whether the UOP shares were purchased for \$21 or \$24, was "germane" to the transaction and that it should have been disclosed to the UOP board as well as to its minority shareholders.¹⁷⁰

When the court's reason for requiring disclosure of the feasibility study is considered in light of the feasibility study itself, two questions are raised: first, what did the 15.5% and 15.7% figures actually represent, and second, what did the court believe they represented? The figures were obtained from two tables in the feasibility study, one of which showed the financial results of the acquisition if Signal paid \$21 per UOP share while the other used the \$24 per share price.¹⁷¹ The 15.5% and 15.7% figures appear on the \$24 per share and \$21 per share tables, respectively, in the line entitled "Return on Equity" and under the column labeled "1978 with 100% UOP: Full Year."¹⁷² The tables do not indicate whether they are intended to convey financial information about UOP or Signal.

The court characterized the 15.5% and 15.7% figures as representing a "return

168. *Weinberger II*, 426 A.2d at 1337.

169. 457 A.2d at 709 (emphasis added).

170. Under such circumstances, paying UOP's minority shareholders \$24 would have had relatively little long-term effect on Signal, and the Chancellor's findings concerning the benefit to Signal, even at a price of \$24, were obviously correct. . . . Certainly, this was a matter of material significance to UOP and its shareholders.

Id. (citation omitted).

171. Identical financial tables using per share purchase prices of \$18, \$19, \$20, \$22 and \$23 were also included in the feasibility study.

172. Each table contained lines for each of the following: sales, net income, earnings per share, return on equity, net income/sales, current ratio, capitalization ratio, total liabilities/equity and book value/share. The columns on each table were entitled: 1978 Profit Plan, 1978 with 100% UOP: Full Year; 1978 with 100% UOP: Eight Months; 1977 Full Year: 100% UOP; 1977 Full Year; 50% UOP.

on the investment.¹⁷³ While this characterization is not entirely free from ambiguity, both the language and context indicate that the court considered these percentage figures to represent the return on the total funds. Signal would invest to acquire the remaining 49.5% of UOP.¹⁷⁴ If the figures did represent the return on Signal's investment in 49.5% of UOP, then it was not unreasonable for the court to characterize the burden on Signal, resulting from a \$3 increase in price, as insubstantial.¹⁷⁵

It is clear, however, that the 15.5% and the 15.7% figures do not represent the return on the total funds Signal would have invested in 49.5% of UOP. Rather, these figures represent the effect that the additional investment at the various alternative purchase prices in 49.5% of UOP would have had on the total return on Signal's equity.¹⁷⁶ In this context, the 0.2% difference was indeed significant to Signal. The 0.2% difference in the return on total equity of Signal is the effect, on Signal, of an increase in the price paid for the additional UOP shares. It represents a "loss" through dilution to all of Signal's existing stockholders as

173. *Weinberger*, 457 A.2d at 709.

174. If the court chose its words carefully, then the use of the term, "return on investment," to describe the two figures shows that the court considered them to represent either: (1) the return on total funds Signal invested in UOP; or (2) the return on total invested funds of Signal as a whole. The manner in which the court used the percentage figures indicates that it believed the percentages illustrated something about Signal's interest in UOP, rather than something about only Signal itself ("a return on *the investment*" (emphasis added)). To obtain the figure representing the return on total funds Signal had invested in UOP, 49.5% of UOP earnings must be divided by the cost of 49.5% of UOP stock.

Since the tables use the term "return on equity" to describe the 15.5% and 15.7% figures, the court might have thought they represented the return on Signal equity invested in UOP. However, because that return is obtained by dividing 49.5% of UOP earnings by the amount of Signal equity invested in 49.5% of UOP, Signal's intent to borrow 100% of the funds needed to purchase the remaining 49.5% of UOP would indicate that the return on Signal equity invested in UOP would be zero.

Even so, it would be surprising if the directors and shareholders could not have derived the figures themselves. The denominator of the fraction (the cost of the 49.5% of UOP stock) could be determined simply by multiplying the number of shares to be acquired (11.5 million shares outstanding minus the 5.8 million shares owned by Signal) by \$21 and \$24. Appellant's Appendix at A23. The numerator of the fraction can be established by multiplying 0.495 by UOP's earnings. While the proxy statement does not indicate Signal's prediction for UOP's 1978 annual earnings, the comparative importance of the \$21 and \$24 purchase prices can be determined by using the 1977 earnings figure which, of course, was disclosed in the Proxy Statement. (The figure used by Signal in the feasibility study as 49.5% of UOP's 1978 full year income was \$14.8 million. See Appellant's Appendix at A1493.) In fact, the percentages yielded are as follows:

\$21 per share purchase price

$$\frac{\$ 15,561,810}{\$119,700,000} = 13\% \text{ [using \$14.8 mil., 12.36\%]}$$

\$24 per share purchase price

$$\frac{\$ 15,561,810}{\$136,800,000} = 11.37\% \text{ [using \$14.8 mil., 10.8\%]}$$

176. The return on total equity of Signal is derived by dividing Signal's earnings (after interest charges) by Signal's total equity. The percentage figures might also represent the return on total invested funds of Signal as a whole. This return would be determined by dividing Signal's earnings (before interest charges) by the sum of Signal's total equity and total debt. It seems more reasonable, however, to assume that the table's designation of "return on equity" was carefully and accurately chosen.

a result of Signal paying an additional \$3 for each UOP share. That is, by paying \$24 per share rather than \$21 per share, Signal would have decreased the return on the total equity invested in it by 0.2%. This information would clearly have been material to Signal's shareholders.

The issue before the court, however, was whether this information was required to be disclosed to the UOP directors and shareholders, not whether it was significant to Signal's stockholders. Assuming the court understood that 15.5% and 15.7% represented the return on total equity of Signal, the issue of whether this information, and therefore the feasibility study, should have been disclosed to the UOP directors and minority shareholders depends in part upon whether information about the effect of the merger *on Signal* was material to a determination of the fair value of the UOP shares. The return on Signal's total equity for 1977, including its 50.5% ownership of UOP, was 12.5%.¹⁷⁷ By acquiring the rest of UOP, this figure would have increased to a minimum of 13.0% for the year 1977.¹⁷⁸ This increase in the return on total equity of Signal, which resulted from Signal's acquisition of the remaining 49.5% of UOP, was one of the beneficial effects of the merger allocated entirely to Signal.¹⁷⁹ The question that remains is whether such information was germane to UOP.

The analysis of this issue is complicated somewhat by the restrictions of the Delaware appraisal statute relating to future value. Prior to *Weinberger*, Delaware courts prohibited the consideration of any element of value resulting from the merger in arriving at the fair value of stock in an appraisal proceeding. Under this standard, it could be argued that since the information could not be considered in appraising the fair value of the shares, it would not be germane to the shareholders. In *Weinberger*, however, the court expanded its interpretation of the factors that could be considered under the appraisal statute in determining the fair value of stock to include certain "elements of future value."¹⁸⁰ Under this expanded interpretation, disclosure of the effects of a cash out merger on the parent might be required because any such benefit received by the parent could be considered in determining the fair value of the minority's shares. By holding that the feasibility study should have been disclosed, the *Weinberger* court established just such a disclosure standard. It required that the benefit to the parent arising from the accomplishment of the transaction be disclosed to the subsidiary.¹⁸¹

The question which remains unanswered is whether the *Weinberger* court intended to require disclosure of the 15.5% and 15.7% figures because of its expanded interpretation of the appraisal statute, or whether the court required disclosure of such information based upon its erroneous belief that the 15.5% and 15.7% figures represented the return on Signal's investment in UOP. Assuming, for the sake of discussion, that the court did in fact intend to require that Signal disclose to the UOP directors and shareholders the effects of the cash out merger *on Signal*, the court thereby created a new standard of disclosure in Delaware. If the court also intended to require disclosure of the difference in

177. Feasibility Study, Appellant's Appendix, at A1478, A1488-92.

178. Assuming a purchase price of \$24 per UOP share. *Id.* at A1492.

179. See *supra* notes 105-09 and accompanying text.

180. 457 A.2d at 713. See *supra* notes 42, 108-09 and accompanying text.

181. By recognizing this benefit to the parent, the court has gone one step towards adopting the recommendations of Brudney and Chirelstein in *Fair Shares*, *supra* note 2, at 319-22, that the gains from the merger be shared by the shareholders of the parent and subsidiary.

the effect of the merger on Signal depending upon each possible purchase price to be paid, it radically expanded the disclosure standard.

The holding that Signal should have disclosed to the UOP directors and shareholders the difference in the effect of the merger on it depending upon various possible stock purchase prices proposed to be paid raises a variety of questions. If this disclosure requirement is to be meaningful, the information must be disclosed at a time when it is still useful, before the stock purchase price has been agreed upon. But disclosure prior to the time the terms of the transaction are well settled is impractical as far as the minority shareholders are concerned. By the time the public shareholders are informed in detail of any significant corporate transaction, all that is left for them to do is approve or disapprove the proposal. The terms have already been established by the directors and are embodied in formal documents. The public shareholders are not given the power to negotiate except by their votes, nor would such a large and diverse group of individuals be capable of yielding that power efficiently.¹⁸² Even if the difference in the effect of the merger on Signal depending upon the purchase price paid had been disclosed to the UOP minority shareholders, that would not have enabled them to demand that Signal pay the \$24 price. At most, such disclosure would have provided additional information for the minority shareholders to consider in deciding whether to approve or reject the proposal.

Application of this expanded disclosure standard at the director level raises far more significant questions. In the context of a going private transaction, the directors, or whoever negotiated the deal on behalf of the subsidiary, would certainly find such information useful in assessing the value of the merger to the parent. But if, in *Weinberger*, Signal should have disclosed the feasibility study to the UOP representatives because it illustrated the effects of alternate proposals on Signal, what else should it have disclosed? Perhaps the question should be phrased in terms of whether any documents, papers or notes prepared by Signal and relating to the cash out merger, as effected or proposed, were *not* required to be disclosed to the UOP representatives. Does the Delaware Supreme Court mean to impose a disclosure standard in situations involving parent-subsidiary transactions which requires a controlling stockholder to share *all* information it has with the representatives of its controlled corporation?

Such a standard is clearly much broader than that of the federal securities laws or prior Delaware law, and it goes beyond simulating an arm's length bargaining situation where the parties presumably do not have identical information. It would, however, serve one very important purpose of fairness in dealing. By requiring that exactly the same information about the transaction be received by the representatives of the parent and subsidiary, any unfair advantage that might otherwise be enjoyed by the majority shareholder as a result of its knowledge and use of confidential material regarding the parent, the subsidiary or both will be eliminated. Furthermore, a requirement of parity of information may lead to the subsidiary's increased confidence in the reliability of the information within its possession. Such a standard would therefore go far towards eliminating any advantage gained as a result of the ability to control,¹⁸³ and perhaps even more

182. See *Fair Shares*, *supra* note 2, at 300.

183. But see *Fair Shares*, *supra* note 2, at 324-25, 315 n.42.

To assume complete independence of the parties implies disparities in information

important it would result in the appearance of equality in bargaining power between the parent and the subsidiary, which in turn might cause the subsidiary's minority shareholders to have more confidence in the integrity of the negotiating and deliberative processes.

It is not at all clear, however, that this standard of absolute and complete disclosure between the parent and subsidiary corporations was what the *Weinberger* court intended to establish. In fact, the court did not clearly state whether the breach of fiduciary duty caused by the failure to disclose the feasibility study was a breach of a duty owed by Signal, as majority shareholder, or by the common Signal-UOP directors. A narrow reading of the *Weinberger* opinion would construe the duty to disclose the feasibility study as part of the duty of loyalty owed to UOP by the common Signal-UOP directors. Several of the Signal-designated members of UOP's board had the benefit of examining the feasibility study. In fact, two of UOP's directors, Arledge and Chitrea, prepared the study. These UOP directors did not, however, share the information in the study with the non-Signal members of the board, nor were they isolated from the board's deliberations on the merger. The Court's conclusion that it was unfair to fail to disclose the feasibility study, therefore, might have been based simply on its finding that the common directors, by keeping information about the benefits of the transaction to Signal from UOP,¹⁸⁴ violated the obligation of unflinching loyalty owed by them to each company.

As a comparison to *Weinberger*, it is interesting to note the Rule 13e-3 requires disclosure of the effects of a going private transaction on the parent corporation, the subsidiary and the minority shareholders. The disclosure must include a discussion of the benefits and detriments of the transaction on all three parties, and these benefits and detriments are to be quantified.¹⁸⁵ While this item

which would pose a problem in valuation proceedings—what information or plans of one company should be deemed to be known to the other? If all the buyer's knowledge and plans are imputed to the seller, the buyer will be deprived of legitimate discovery values. If less than full knowledge is imputed, the question arises as to how much, or what items of knowledge should be imputed.

Id. at 315 n.2.

One interesting question raised by such a broad disclosure standard is whether the parent would be obligated to disclose its upset price to the subsidiary. If so, the preparation by the parent of any written document containing such information would be discouraged.

184. Since the study was prepared by two UOP directors, using UOP information for the exclusive benefit of Signal, and nothing whatever was done to disclose it to the outside UOP directors or the minority shareholders, a question of breach of fiduciary duty arises. This problem occurs because there were common Signal-UOP directors participating, at least to some extent, in the UOP board's decision-making process without full disclosure of the conflicts they faced.

457 A.2d at 709 (footnote omitted). See *supra* note 128.

185. Schedule 13E-3, item 7(d) provides:

Describe the effects of the Rule 13e-3 transaction on the issuer, its affiliates and unaffiliated security holders, including the federal tax consequences.

Instruction: (1) Conclusory statements will not be considered sufficient disclosure in response to Item 7.

(2) The description required by Item 7(d) should include a reasonably detailed discussion of the benefits and detriments of the Rule 13e-3 transaction to the issuer, its affiliates and unaffiliated security holders. The benefits and detriments of the Rule 13e-3 transaction should be quantified to the extent practicable.

might have elicited disclosure of the percentage figure for the return on total equity of Signal using the purchase price agreed upon by the boards of directors of the parent and subsidiary corporations, it would not have required disclosure of the fact that a \$3 difference in the per share purchase price would have yielded a 0.2% difference in the return on Signal's total equity, nor of any other information regarding the proposed prices.

Schedule 13E-3 also requires disclosure of any "report, opinion . . . or appraisal . . . which is materially related to the . . . [going private transaction]."¹⁸⁶ If the feasibility study had been prepared by a third party, it would have been required to be disclosed as a "report . . . relating to the consideration or the fairness of the consideration to be offered" to the minority shareholders.¹⁸⁷ The feasibility study would not, however, fall under this item, which provides for disclosure of such reports only if they have been prepared by someone other than the parent or subsidiary.

The *Weinberger* opinion is ambiguous on the issue of who owed the duty of disclosure and why, and it also leaves open the question of what information the court intended to require to be disclosed and why. The former issue can be most easily resolved, under the narrow interpretation of the opinion, by ensuring that in future parent-subsidiary transactions, the subsidiary is not represented by a group that includes persons who serve both corporations. Such a requirement is entirely consistent with the notion of fair dealing as it relates to the element of negotiation.

Delaware should not, in the interests of fairness in dealing, adopt a broad interpretation of *Weinberger* that would require an absolute sharing of information between the parent and subsidiary. While equality of information might be a laudable and understandable ideal, it is also an unreasonable one. The notion of fair dealing has as its purpose the simulation of an arm's length bargaining situation, which involves at least some notion of adversariness. In contrast, absolute sharing of information would most likely result in the relationship between the parent and subsidiary being characterized by cooperation. While an atmosphere of cooperation may lead to a more efficient bargaining process between truly independent parties, where the parties are not in fact independent, a negotiating process imbued with some degree of adversariness will provide necessary protection against overreaching. Moreover, a complete sharing requirement would be overkill. It would require the parent to disclose information gained because of its ability to control as well as any other relevant information. It is the inclusion of "any other relevant information" in the disclosure standard that makes such a rule unduly burdensome and unreasonable.

A secondary disclosure issue considered by the *Weinberger* court was Signal's failure to disclose to the UOP minority shareholders the "cursory" manner in which Lehman Brothers prepared its fairness opinion. In the opinion letter, a

(3) If this statement is filed by an affiliate of the issuer, the description required by Item 7(d) should include but not be limited to, the effect of the Rule 13e-3 transaction on the affiliate's interest in the net book value and net earnings of the issuer in terms of both dollar amounts and percentages.

17 C.F.R. § 240.13e-100 item 7(d) (1983).

186. 17 C.F.R. § 240.13e-100, item 9(a) (1983).

187. *Id.*

copy of which was distributed to the UOP directors and to the minority shareholders in the proxy statement, Lehman Brothers disclosed the actions it took in preparing its opinion.¹⁸⁸ But the proxy statement did not state that all of Lehman Brothers' activities were accomplished within a period of only three business days.

The problem with requiring disclosure of the time spent on the investigation supporting an investment banking firm's fairness opinion, however, is that, without any standard of comparison, it is a relatively meaningless piece of information. The time spent on the investigation for a fairness opinion ought to vary according to the historical relationship between the company and the expert, the complexity of the company and the sophistication of the expert. At most, disclosure of the number of days or weeks spent on the supporting investigation,¹⁸⁹ when coupled with a description of the activities that were performed as a part of the investigation, would give the shareholders some indication of the case with which the opinion was prepared, and, consequently, the reliability of the opinion.

If the Signal-UOP merger was accomplished today, the amount of time spent by Lehman Brothers in preparing its fairness opinion would not be required to be disclosed pursuant to Rule 13e-3. The Rule does not even require that the opinion itself be disseminated to the minority shareholders,¹⁹⁰ but it does oblige the company to prepare and disclose a summary of the opinion. The summary must "include, but not be limited to, the procedures followed; the findings and recommendations; the bases for and the methods of arriving at such findings and recommendations; instructions received from the issuer or affiliate; and any limitation imposed by the issuer or affiliate on the scope of the investigation."¹⁹¹ While the amount of time spent in preparation of the opinion might be included as part of the discussion of the instructions received by the investment firm, such information is not specifically required to be discussed in the summary and it is not common practice to include it. In a case such as *Weinberger*, however, time was of the essence and it was one of the principal reasons that UOP's Chairman retained the Lehman Brothers firm. Therefore, requiring disclosure of the schedule imposed by Signal might be justified as providing the minority shareholders with a more complete picture of the interests involved in, and the nature of, the deliberative and decision-making processes.

Initiation

The majority shareholder has virtually complete control over *when* to initiate a going private transaction and this control may be used to detrimentally affect the value placed upon the minority's shares in the subsidiary.¹⁹² The time selected

188. The actions taken by Lehman Brothers and listed in the opinion include those referred to in the text accompanying note 78, *supra*, as well as a review of the terms of Signal's 1975 investment in UOP and other cash out mergers of comparable corporations. Appellant's Appendix at A102.

For a discussion of the requirement to disclose the basis upon which the cash out price was established, see Borden, *supra* note 2, at 1029-30.

189. In fact, the disclosure would have to be of the number of days spent by the number of people to be accurate.

190. See Schedule 13E-3, 17 C.F.R. § 240.13e-100 item 9 (1983), and Rule 13E-3(e)(1), 17 C.F.R. § 240.13e(e)(1) (1983). The opinion would, however, be required to be filed as an exhibit to the Schedule pursuant to item 17(b) thereof, 17 C.F.R. § 240.13e-100 item 17(b) (1983).

191. 17 C.F.R. § 240.13e-100 item 9(b)(6) (1983).

192. See *Fair Shares*, *supra* note 2, at 300 ("[T]he timing of the decision to merge may be

for the transaction might be when the economy and the stock market are generally depressed. The market price of the subsidiary's stock then would be low compared to its historical stock prices, but the stock would not be undervalued by the public. On the other hand, the problem might be one of disclosure resulting in undervaluation. The time selected to initiate the transaction might be when the market does not accurately reflect the value of the subsidiary because information favorable to the subsidiary's financial position is known by the majority shareholder but unavailable to the public.

Both of these factors have been considered relevant in assessing the fairness of a majority shareholder's actions. The disclosure aspect of the initiation element was considered in *Polin v. Conductron Corp.*,¹⁹³ where the challenged transaction was a going private merger in which the public shareholders of the subsidiary, Conductron, exchanged their stock for stock of the parent company. The plaintiff claimed that the exchange ratio was grossly inadequate, in part because the parent had waited to initiate the merger until the market price of Conductron stock was artificially low. The artificially depressed market price was caused, according to the plaintiff, by two acts of the parent: its refusal to enforce a legitimate claim on behalf of the subsidiary and its procurement of the delisting of the subsidiary's stock from the American Stock Exchange. The court found that the parent had not caused the delisting or mishandled the subsidiary's claim, which eventually was settled; it therefore concluded that the plaintiff had failed to prove his claim.

Cases like *Polin* can be regulated most efficiently through enforcement of the *Lynch* standard of disclosure. Any information which reflects upon the market value of the subsidiary's stock would clearly be germane to the transaction, and therefore ought to be disclosed. If the information is not ripe for disclosure, the majority shareholder should follow the rule of "disclose or abstain" and delay the transaction until disclosure has been accomplished and the information is accurately reflected in the market price of the minority's shares.¹⁹⁴

Most of the concern regarding the time of the transaction's initiation has involved the depressed market situation rather than a disclosure problem. In *Tanzer*,¹⁹⁵ for example, the plaintiffs argued that the cash out merger was proposed at a time when the subsidiary's stock price was beginning to appreciate, after being depressed by the general market decline in the early 1970's. The Chancellor was unconvinced that it was unfair to execute the transaction at such a time, however, because the market price that was relevant for purposes of com-

based on the parent's anticipation of a substantial increase in the subsidiary's earnings." *Id.* at 305-06); *Arsht*, *supra* note 34, at 1499; *Sommer, Background and Policy Considerations* (Panel), 32 *BUS. LAW* 1513, 1514-15 (1977) ("It seems to me that fairness also has . . . a 'fourth dimension, and that dimension is one of timing. It seems to me that, when management (the insiders) uses corporate assets to take advantage of the cycles in the market for the corporation's stock for their own advantage, this should be put on the scale when weighing to find fairness.'").

193. 552 F.2d 797, 816 (8th Cir. 1977) (applying Delaware law). *See also Harman v. Masoneilan Int'l, Inc.*, 442 A.2d 487 (Del. 1982).

194. *In re Cady, Roberts & Co.*, 40 S.E.C. 907, 912 (1961); *Securities and Exchange Comm'n v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 848 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969). *See Weiss*, *supra* note 2, at 679 n.349; *Restatement*, *supra* note 1, at 1366; *Rothschild*, *supra* note 2, at 198.

For a discussion of the timing of the cash out with respect to the initial affiliation of the parent and subsidiary, see also *supra* note 12.

195. 402 A.2d 382 (Del. Ch. 1979).

parison to the merger price was the market price at the time of, or just prior to, the merger. The Delaware appraisal statute, at the time of the *Tanzer* decision, was interpreted as not permitting consideration of future value, so that the market trend after the merger was irrelevant. The merger price in *Tanzer* included a premium over the market price of the stock on the day preceding the announcement of the merger, and the court considered that premium indicative of substantive fairness.¹⁹⁶

In two cases dealing with "classic" going private transactions, where only one business entity was involved, the courts took more seriously the claim of unfairness resulting from the majority shareholder's selection of a time when the company's stock price was low in comparison to its historical market prices. In *Roland International Corp. v. Najjar*,¹⁹⁷ the court affirmed the denial of a motion to dismiss a complaint which claimed money damages as a result of a cash out merger. In reaching its decision, the court noted that "the majority [had] complete control over the timing of the 'squeeze play' on the public stockholders—a timing conceivably selected to favor the majority only, based upon the status of the market and the elements of an appraisal."¹⁹⁸ This complete control by the majority shareholder convinced the court that the transaction before it should be judged against a standard of "the strictest observance of the law of fiduciary duty."¹⁹⁹ Similarly, in *Berkowitz v. Power/Mate Corp.*,²⁰⁰ the New Jersey Supreme Court, in discussing the fairness of the proposed transaction, noted that the majority shareholders apparently chose "a most opportune time—in relation to Power/Mate's earnings record since it went public—to buy out the minority at an unreasonably low price."²⁰¹ Moreover, just prior to the proposed merger, \$200,000 was paid out to two principal corporate officers as bonuses.²⁰² That payout decreased the company's earnings per share, thereby potentially affecting the stock's market price.²⁰³

The State of Wisconsin has formally addressed the issue of the possible unfairness resulting from the time when a going private transaction is initiated in an administrative securities regulation. The Wisconsin rule adopts a presumption that a going private transaction is fair if certain conditions regarding fair value are met. One of those conditions is that, if the company's most recent sale of stock to the public occurred within ten years before the going private transaction, then the price offered for the stock of the minority shareholders in the going private transaction must be at least equal to the company's most recent public

196. *Id.* at 392-95. As to the amount of the premium in going private transactions generally, see Phalon, *FORBES*, Nov. 7, 1983, at 40, 42.

197. 407 A.2d 1032 (Del. 1979). *Roland* involved a "classic" going private situation, in which only one business enterprise was involved. It would have been categorized as a Type III transaction. See *supra* note 12. Several commentators have recommended prohibition of such transactions.

198. *Id.* at 1037.

199. *Id.* (citations omitted).

200. 135 N.J. Super. 36, 342 A.2d 566 (1975).

201. *Id.* at 48, 342 A.2d at 573. In fact, Power/Mate went public at \$5 per share and proposed to go private at \$2 per share. *Id.* at 39-41, 342 A.2d at 568-69. See *infra* note 204.

202. *Id.* at 48, 342 A.2d at 573 (1975).

203. *Id.* at 48-49, 342 A.2d at 573-74. See also *Schlick v. Penn-Dixie*, 507 F.2d 374 (2d Cir. 1974) (plaintiff claimed that the parent corporation manipulated the market price of the subsidiary's stock and then used the resultant depressed price as the basis of the merger exchange ratio).

See generally Mayerson & Crawford, *Fairness to Minority Shareholders in "Going Private" Transactions: A Growing Concern*, ILL. BAR J. 484, 485 (April 1979); *Fair Shares*, *supra* note 2, at 306.

offering price.²⁰⁴ An Indiana statute prohibits any second step of an acquisition, within two years of the first purchase, unless "substantially equivalent terms" are offered in the second transaction.²⁰⁵ Similarly, Rule 13e-3 excepts from its terms a going private transaction that follows within one year of a tender offer in which the majority shareholder gained control²⁰⁶ so long as the consideration paid to the minority shareholders is at least equal to the highest price offered in the tender offer.

Delaware has not adopted a requirement of equal price regardless of a difference in economic conditions, nor did the *Weinberger* court indicate that such a rule was required for fair dealing. In fact, the court merely identified the initiation of the transaction as one element of fair dealing without explaining the meaning or significance of the term. Schedule 13E-3 provides some guidance on whether this aspect of initiation should be considered relevant to fairness. It requires disclosure of the "the reasons . . . for undertaking such transaction at this time."²⁰⁷ If those reasons include a comparatively low current market price for the subsidiary's stock, then disclosure of that information should provide the subsidiary's representatives and minority shareholders with a basis for assessing the fairness or unfairness of the deal. If they consider the time of the transaction's initiation to cause the fair value of the stock to be unreasonably low, they can exercise their voting power to reject the proposal until a later date. The element of initiation, therefore, is really just one more aspect of the requirement of adequate disclosure. Complete disclosure by the majority shareholder could cure both concerns regarding the time when the transaction is initiated if the minority or its representatives have the ability to respond to such disclosure.

Approval of the Transaction

Delaware law requires a simple majority vote of the stockholders to approve a merger such as that of UOP into Signal.²⁰⁸ A going private transaction, therefore, could be approved by the necessary votes if only the majority shareholder voted, without regard to any voice of the minority shareholders. It is common practice, however, for the majority stockholder to require approval by a majority of the minority shares as a condition to the effectiveness of the merger.

Delaware courts have considered the existence of such a condition evidence of the fairness of the transaction.²⁰⁹ By agreeing to such a condition, the majority shareholder releases some of its controlling power in favor of the minority

204. "The terms of the transactions shall be presumed to be fair if . . . [t]he latest public offering of the securities occurred more than 10 years prior to the transaction, or the compensation is greater than the public offering price." Wis. ADMN. CODE § SEC 6.05 (a)(2) (1980).

205. IND. CODE § 23-2-3.1-8.4 (Supp. 1983).

206. 17 C.F.R. § 240.13e-3(g)(1) (1983). See *supra* note 12; *Fair Shares*, *supra* note 2, at 337. But see Borden, *supra* note 2, at 1006 & n.100 (recommending that the cash out price following a tender offer be below the tender offer price). In response to Borden, see *Restatement*, *supra* note 1, at 1361 n.15.

207. 17 C.F.R. § 240.13e-100 item 7(c).

208. DEL. CODE ANN. tit. 8, § 251(c)(Supp. 1982). See Borden, *supra* note 2, at 1017.

209. The absence of a condition of approval by a majority of the minority shares has been cited as a reason for not placing the burden of proof of unfairness on the minority shareholders, *Tanzer v. Int'l General Indus., Inc.*, 402 A.2d 383, 386 (Del. Ch. 1979); *Harman v. Masonneilan Intern., Inc.*, 442 A.2d 487, 499 (Del. 1982). The presence of such a condition may weigh in favor of a finding of fairness. *Weinberger II*, 426 A.2d 1333, 1362 (Del. Ch. 1981). See BORDEN, *supra* note 125, at § 8.05.

shareholders. In *Tanzer*, the Chancellor stated that the absence of such a condition was good reason for not placing the burden of proving unfairness on the minority shareholders.²¹⁰ The burden of proof rested with the majority shareholder because of its ability to use its power of control to its advantage and to the corresponding detriment of the minority shareholders. Without the condition, the minority has no say whatsoever regarding the transaction. There is no semblance of arm's length bargaining because the majority is the sole meaningful actor in the entire transaction. In contrast, if the merger is subject to the approval of the minority shareholders, then in theory the parent corporation is not using its power of control to force the transaction upon the minority.²¹¹ There is then someone—the minority shareholders—on the other side of the transaction from the majority shareholder.

The court in *Weinberger* recognized this theoretical distinction and gave it practical consequences. It held that if a going private transaction is approved by a majority of the minority shares, and the vote is based upon complete disclosure, then the burden of going forward on the issue of entire fairness shifts to the complaining minority shareholder.²¹² Therefore, such approval removes the

210. 402 A.2d 383, 386 (Del. Ch. 1979).

211. Cf. *Harman v. Masonell Int'l, Inc.*, 442 A.2d 487, 495 (Del. 1982). The complaint alleged proxy misrepresentation "coerced" the stockholders' approval, and the court found this allegation to constitute a charge that the majority shareholder used its power of control to effectuate the transaction. *Id.*

But see Weiss, *supra* note 2, at 676-77 (disagreeing with the view that a vote of minority shareholders should influence the court); Longstreth, *supra* note 3, at 20 (questioning the ability of the minority to accurately assess the fairness of the proposal); *Fair Shares*, *supra* note 2, at 300:

Indeed, even if the merger plan were made effective only when approved by a majority of the public stockholders, as if the latter were a separate class, the barriers to concerted stockholder action in the context of management's exclusive control of the proxy machinery would almost always assure a favorable vote. The atomized nature of the company's stockholdings, together with the easy salability of shares, means that stockholders cannot rely on group action to reject what they see as a mistaken decision to merge, particularly when the decision was made by a parent holding a large block of stock. Moreover, ratification gives dissatisfied stockholders only the limited option of rejecting the merger; they do not generally either initiate the merger discussion or participate in formulating its terms. They are confined to approving or disapproving a transaction, the terms of which are defined by management and can rarely be modified by stockholders during, or after, the bargaining process. Finally, since the timing and context for seeking approval of the merger are also dictated by management which controls, and has unlimited access to, the proxy apparatus, the process of seeking stockholder approval is skewed in favor of a vote for approval.

Id. (footnotes omitted).

Compare Borden, *supra* note 2. In criticizing *Fair Shares*, Borden states that: "One is reminded here of Mr. Churchill's famous dictum: if the choice is to be a determination by an imperfect democratic process or by regulatory fiat, I for one would prefer the former." *Id.* at 1016 n.133.

212. After agreeing with the Chancery Court's determination that the plaintiff bears a burden of pleading "specific acts of fraud, misrepresentation, or other items of misconduct to demonstrate the unfairness of the merger terms to the minority" and is also required to show some reason why "entire fairness" ought to be the standard against which the challenged actions are judged, the Supreme Court addressed the issue of who bears the ultimate burden of proof as to the fairness of the transaction. *Weinberger*, 457 A.2d at 703 (footnote omitted). According to the Chancellor, that burden was on the majority shareholder. The Supreme Court concurred with this as a general rule but carved out one important and potentially all-inclusive exception: where the transaction has been approved by a majority of the minority shares, then the minority shareholder must prove that the transaction was unfair. The court added, as a condition to this exception, the requirement that the majority shareholder demonstrate that the vote of the minority shareholders was based upon full disclosure. Therefore, after *Weinberger*, if there is full disclosure and the merger is approved by a majority

presumption of unfairness which generally attaches to such transactions. Such a shift in the burden of persuasion resulting from an informed vote of the shareholders has been applied in prior Delaware cases, but has never before been applied to a case challenging a fundamental corporate transaction such as a going private merger.²¹³

of the minority shares, then the plaintiff bears the burden of proving that the merger was unfair to the minority shareholders.

Prior to *Weinberger*, once the plaintiff produced evidence of self-dealing, the entire fairness test was applied and the only option open to the defendant was to prove that the transaction was fair. After *Weinberger*, the defendant has two, or perhaps three, responses available. First, the defendant can prove the fairness of the transaction and respond as would have been appropriate before *Weinberger*. Second, the defendant can produce some evidence of fairness by showing that the transaction was approved, after full disclosure, by a "cleansing" vote of the shareholders. This evidence does not conclusively establish the fairness of the transaction, but it results in rebutting the presumption of unfairness. In response, the plaintiff may still show unfairness, even where the transaction has been approved by the minority shareholders after full disclosure. The third option potentially open to the defendant is to show that it has complied with the requirements of fair dealing, and to argue that this also should be regarded as evidence of fairness sufficient to rebut the presumption where approval by the minority shareholders has been obtained. Because evidence of fair dealing establishes full disclosure, the presumption should be considered met. But where approval of the transaction was obtained only at the board level, then even though that can satisfy fair dealing, Delaware has not indicated that it will consider board-level approval sufficient to rebut the presumption of unfairness. See generally Epstein, *supra* note 32 (presenting a system of presumptions regarding the pleading and development of a case).

213. Although the court set forth this exception as if it was a well established rule of law, it was in fact the first time in a case challenging a fundamental corporate transaction, such as a merger, that the Supreme Court held that the affirmative vote of a majority of the minority shares shifts the burden to the plaintiff to prove unfairness. See *Bastian v. Bourns, Inc.*, 256 A.2d 680, 682 (Del. Ch. 1969), *aff'd*, 278 A.2d 467 (Del. 1970) (involving a stock-for-stock merger of affiliated corporations; the court refused to shift the burden of proof even though the transaction was approved by a majority of the minority shares); *Stryker & Brown v. The Bon Ami Co.*, No. 1945 (Del. Ch. March 16, 1964), *reprinted in 2 DEL. J. CORP. L.* 157 (1977) (involving a stock-for-stock parent-subsidary merger; the court refused to put the burden of proof on the minority shareholders even though a majority of the minority shares were voted in favor of the transaction); *David J. Greene & Co. v. Dunhill Int'l, Inc.*, 249 A.2d 427, 432 (Del. Ch. 1968) (involving facts similar to those in *Stryker & Brown*, and following it); *Tanzer v. Int'l Gen. Indus., Inc.*, 402 A.2d 382, 386 (Del. Ch. 1979). *But see Fisher v. United Technologies Corp.*, No. 5847 (Del. Ch. May 12, 1981) *reprinted in 6 DEL. J. CORP. L.* 380 (1981) (involving the second step of a tender offer, a stock-for-stock merger of the target into the bidder, where the court held that shareholder ratification results in the burden of proof being on the plaintiff minority shareholder, citing *Michelson v. Duncan*, 407 A.2d 211 (Del. 1979)).

The court in *Weinberger* cited *Michelson v. Duncan*, 407 A.2d 211 (Del. 1979), as support for the exception. *Michelson* involved a challenge to the directors' modification of a stock option plan of Household Finance Corporation and, as such, involved a claim that the directors were guilty of self-dealing. The directors, however, submitted all of their actions to the shareholders for ratification and, after the plaintiff's suit was brought, the shareholders' vote of approval was obtained. The court held that so long as the corporate act under consideration did not amount to waste or a gift of corporate assets, then a vote of the shareholders based upon full disclosure approving the actions resulted in the plaintiff bearing the burden of proving unfairness. *Accord Gottlieb v. Heyden Chemical Corp.*, 91 A.2d 57, 58-59 (Del. 1952). *But see Fliegler v. Lawrence*, 361 A.2d 218, 221 (Del. 1976) (involving a corporate opportunity claim; the court refused to follow *Gottlieb* because, while a majority of the shares voted approved the transaction, most of the shares that were voted were held by the defendants. "Only about one-third of the 'disinterested' shareholders voted, and we cannot assume that such non-voting shareholders either approved or disapproved."); *Schreiber v. Bryan*, 396 A.2d 512, 519 (Del. Ch. 1978) (involving a claim of corporate opportunity between a parent and subsidiary corporation, where the court disregarded the affirmative vote of a majority of the minority shareholders due to the parent's control over the subsidiary's management and proxy machinery).

While *Michelson* clearly stands for the proposition that, in a typical breach of fiduciary duty case, an informed shareholder vote will result in the burden of proof being placed on the complaining stockholder, the factual context of *Michelson* distinguishes it from *Weinberger*. *Michelson* involved

While *Weinberger* established that minority shareholder approval results in the plaintiff bearing the burden of proving unfairness, it left open the questions of what is sufficient to constitute minority shareholder approval and whether such approval is an independent element of fair dealing aside from its effect on the burden of proof.²¹⁴ As to what constitutes minority shareholder approval, three possibilities exist: the transaction might be conditioned upon approval by a majority of the outstanding minority shares; the transaction might be conditioned upon the approval of a majority of the minority shares voted, with or without specifying a minimum number of minority shares required to be voted; or the transaction might simply be subjected to a vote of all the shareholders without making minority approval a condition for effectiveness, where, in fact, the approval of a majority of the minority shares voted is received. The facts of the *Weinberger* case place it in the second category, but the court there neglected to explain whether the vote would have been effective to shift the burden of persuasion if it had not been obtained pursuant to a condition of the effectiveness of the transaction.

It is interesting to note that the Wisconsin rule governing going private transactions requires both the approval by a majority of the outstanding minority shares and that the vote be obtained pursuant to a condition of the effectiveness of the transaction in order for the vote to support a presumption of the transaction's substantive fairness.²¹⁵ Similarly, Schedule 13E-3 requires disclosure of the existence of a condition of approval by the minority shareholders as part of the discussion of the fairness of the transaction.²¹⁶ The Schedule is ambiguous as to whether the requirement is for a majority of the outstanding minority shares or of the minority shares voted, but the SEC has indicated that the Schedule refers to the latter, less burdensome requirement.²¹⁷

Choosing among these three possibilities raises several questions. On the one hand, the statute requires a simple majority vote to approve a transaction such as that involved in *Weinberger*.²¹⁸ To impose an obligation upon the majority shareholder to relinquish its right to single-handedly approve the transaction runs counter to the statutory rule of a majority vote. On the other hand, if the only consequence of such a condition of minority shareholder approval is to shift the burden of going forward, then the majority shareholder can still accomplish the transaction without consulting the minority so long as it can prove that the deal is fair if it is subsequently challenged. Moreover, if no condition of approval is imposed on the effectiveness of the transaction, there is no incentive for the minority shareholders to vote at all, since the deal will be accomplished with or without their vote.²¹⁹ Therefore, the third alternative of no condition should not be sufficient to relieve the majority shareholder of the burden of proving entire fairness.

a breach of fiduciary duty claim arising out of an ordinary corporate transaction; *Weinberger*, in contrast, involves a fundamental corporate transaction—a merger—for which many of the “rules,” including the necessity for stockholder approval, are different.

214. See *Rosenblatt v. Getty Oil Co.*, Civil Action No. 5278 (Del. Ch. Sept. 19, 1983); Prickett & Hanrahan, *Weinberger v. UOP: Delaware's Effort to Preserve a Level Playing Field for Cash-Out Mergers*, 8 Del. J. Corp. L. 59, 65 (1983).

215. Wisc. ADMIN. CODE § SEC 6.05(1)(a)(3) (1982).

216. 17 C.F.R. § 240.13e-100 item 8(c). In the proposed version of Rule 13e-3, part of the substantive fairness requirement was whether the transaction had been approved by a majority of the minority shares. Proposed Rule 13e-3(b)(2)(A), Securities Act Release No. 5884, *supra* note 16, at 857.

217. Securities Exchange Act Release No. 17719, question 22, *supra* note 16, at 799.

218. DEL. CODE ANN. tit. 8, § 251(c) (1983).

219. *Rosenblatt v. Getty Oil Company*, Civil Action No. 5278 (Del. Ch. Sept. 19, 1983), slip op. at 29.

As between the first two alternatives, requiring approval by a majority of the outstanding minority shares, as opposed to a majority of those shares voted, might result in the imposition of unwarranted burdens of solicitation on the majority shareholder. The majority shareholder may be hard pressed to convince a sufficient number of minority shareholders to vote at all. When any proposal is submitted to a vote of a public corporation's shareholders, there is a substantial tendency towards apathy on the part of the public stockholders. The inability to obtain the affirmative vote of a majority of the outstanding minority shares might result simply from such apathy and the consequent failure of such owners to vote at all, rather than from any negative view of the transaction held by the minority. If that is true, then the view of the minority could be adequately represented by the affirmative vote of a majority of some substantial number of minority shares, though less than a majority of all shares outstanding.²²⁰

More difficult than the burden of proof issue is the question of whether minority approval should be required as a necessary condition to fair dealing. The *Weinberger* court was silent on this question, but its silence might be interpreted as an indication that fair dealing does not require an affirmative vote of the minority. The statute which authorizes cash out mergers provides that the transaction must be approved by a simple majority of the outstanding shares entitled to vote. If, to fulfill its duty of fair dealing, a majority shareholder must submit the proposal to a vote of the minority shareholders and forego effectuating the transaction absent an affirmative vote of a majority of the minority shares, then fair dealing requires the majority shareholder to grant a veto power to the minority. This is in direct conflict with the statutory provision for majority rule and the consequences are infinitely more serious than shifting the burden of proof. Had the *Weinberger* court intended to establish such a contradictory requirement, it presumably would have made its position crystal clear. Instead, the court indicated only that the affirmative vote of a majority of the minority shares might support a finding of fair dealing as well as substantive fairness. The court did not take the next step to find that fair dealing always requires the approval of the minority shareholders even when the other elements of fair dealing are present.

Where the minority shareholders are not represented by persons independent of the majority shareholder at the board level, as was the case in *Weinberger*, fair dealing should require that the transaction be approved by a fully-informed majority of the minority shares.²²¹ Without such a requirement, the minority could be denied any voice in the decision making process; there would be no one at the board or shareholder level to consent to the transaction with the majority shareholder. Consequently, it would be impossible to find that the majority had *not* forced the deal upon the minority by exercising its controlling influence. At the very least, then, fair dealing requires that where the minority shareholders are not provided with adequate representatives at the board level, the minority must be granted an effective veto power over the proposed transaction.

Even if the minority shareholders are represented by independent persons at the board level, the question still remains whether fair dealing *ought* to require

220. In *Weinberger*, only 56% of the outstanding minority shares were voted. When added to the shares controlled by Signal, over 75% of UOP's outstanding shares were voted in favor of the merger. Moreover, the merger did receive the affirmative votes of a majority of the outstanding minority shares. 457 A.2d at 708.

221. See *infra* notes 252-60 and accompanying text.

approval of the transaction by a majority of the minority shares. The statutory sanction of majority rule is premised upon an alignment of the interests of the holders of a majority of the shares with those of the holders of a minority of the shares. The idea is "if it's good enough for the majority, it's good enough for all." In a transaction between the majority shareholder and the corporation, however, the interests of the majority may be significantly different from those of the minority shareholders. Particularly in a cash out merger, where the majority receives value in a different form than the compensation paid to the minority, the majority's consent to the transaction does not bear upon its approval of the deal as it affects the minority. In such a case, that which is good enough for the majority is not even offered to the minority.²²²

From a policy standpoint, however, it is better if the law encourages minority voting without requiring it. The Delaware statute is in direct conflict with any requirement for approval in excess of a majority vote. Furthermore, giving the minority a right to vote on the transaction may not, in fact, be a meaningful addition to their representation at the board level by independent parties. It is improbable that the minority would ever reject a transaction negotiated and approved on its behalf by independent representatives. Not only is it likely that such a transaction would in fact satisfy the interests of the minority shareholders but, in addition, the combination of shareholder apathy and the common failure of shareholders to carefully consider the alternatives offered in voting rights makes it unusual for shareholders to reject any proposal recommended by their representatives. Therefore, no real additional benefit may result from a requirement of minority approval.²²³ Finally, even if fair dealing does not require approval by the minority, it is likely that most parent-subsidary transactions will be conditioned upon such approval simply because of its effect on the burden of proof. Therefore, fair dealing ought to require the affirmative vote of the minority only when they are not represented by independent negotiators at the board level. In other cases, it should not demand that the majority grant a veto power to the minority in order to accomplish a statutorily recognized transaction.

Summary

While *Weinberger* went a long way towards defining fairness in dealing, it did not address the question of whether the identified elements of fair dealing are all equally important or whether some of the elements of fair dealing are more significant than others.²²⁴ The importance of this question is clear in light of future attempts to comply with the duty of fair dealing. So long as the question is unanswered, efforts to comply with the duty may be as unsuccessful as any effort to hit a moving target.

222. Brudney, *supra* note 5, at 1091-102.

223. Weiss, *supra* note 2, at 676-77; Longstreth, *supra* note 3, at 21.

224. A similar question has been considered with respect to § 4(1) of the Securities Act of 1933, 15 U.S.C. § 77d(1) (1982). Generally, six or seven factors are enumerated as being relevant to the availability of a § 4(1) exemption (the number of purchasers and offerees, relationship of offerees to each other and to the issuer, number of units offered, and the size and manner of the offering). It is customary for courts to list all of the factors as relevant to a determination of the availability of the exemption. It has been suggested, however, that at least three of the factors—relationship of offerees to each other, number of units offered and size of the offering—are relatively unimportant. Schneider, *The Statutory Law of Private Placements*, 14 REV. SEC. REG. 869 (1981), reprinted in JENNINGS & MARSH, CASES AND MATERIALS ON SECURITIES REGULATION 250, 251-52 (5th ed. 1982).

The difficulty in determining whether certain elements of fair dealing are more important than others stems from the fact that all of the elements are related. For example, the best way to protect against the risks of the majority's exercise of control associated with the elements of initiation and structure is to require full disclosure and independent representatives for the minority. After full disclosure, the representatives will be able to assess the necessity for the form of the transaction and its impact on the minority shareholders, and then negotiate for a different structure, if necessary. Similarly, the representatives will be able to judge the effects of the timing of the proposal in light of all relevant information regarding the companies and the market. The presence of independent representatives also help to alleviate the concern that the majority shareholder may exert undue time pressures on the subsidiary's decision making process. The independent representatives can protect against such pressures simply because of their independence from the majority. They owe allegiance and a duty of care only to the subsidiary and its minority shareholders. For the same reasons, such representatives are in the best position to ensure that any experts retained on behalf of the subsidiary are free from the influence of the majority shareholder.

As a result of the interrelationship of all the elements fair dealing, it is impossible to formulate a precise mathematical formula of the weight assigned to the various elements. It is possible, however, to identify some of the elements of fair dealing as more important than others. This can be accomplished by considering the elements in light of the purpose of fair dealing. As discussed, fair dealing is intended to neutralize the control of the majority shareholder by recognizing various parts of the process of accomplishing the transaction when that control might be exercised to the detriment of the minority shareholders. Generally, it seeks to protect the minority defensively, by imposing certain obligations, most notably disclosure, on the majority shareholder, as well as offensively, by providing the minority with the ability to protect itself through the presence of independent representatives or the right to veto the transaction.²²⁵

These two elements of fair dealing—disclosure and independent, adequate representation for the minority—are the most important factors for eliminating the taint of the majority shareholder's control. By complying with these two elements, the majority shareholder will be restrained from using its control to the detriment of the minority because it will have to disclose the reasons for and effects of its action. This disclosure will provide the minority and its representatives with all the information necessary to assess the effect of the transaction on both parties, and thereby enable the minority to insist upon equal and fair substantive treatment. Moreover, the independent representatives of the minority will be able to use the information disclosed in an affirmative manner. Full disclosure and independent representation will create an adversary relationship between the minority and the majority and arm the minority to use its position just as effectively as if there was no connection between the parties.

Generally, full disclosure by the majority and independent representation for the minority will lead to compliance with the other elements of fair dealing. Because of the relationship among the elements of fair dealing, these two factors usually will result in protection for the minority against the parent's exercise of

225. See *supra* note 50. For a discussion of the purpose of fair dealing, see *supra* notes 43-50 and accompanying text.

control at the various stages of the bargaining process. Moreover, evidence of fair dealing regarding these consequential elements should indicate compliance with the disclosure and representation requirements.

The aim of the test, however enunciated, is to consider the circumstances as a whole in order to discover whether the transaction was infected by the majority shareholder's influence or whether the dealing between the parent and the subsidiary were conducted as if they were entirely independent of one another. The elements of the duty of fair dealing ought not be used to force a mechanical review, but they may beneficially be employed to add certainty to the court's inquiry and provide guidance to parties trying to comply with the duty of fair dealing.

PART III

One of the fundamental issues raised by the Delaware Supreme Court's decision in *Weinberger* is the continued significance of the requirement of fairness in dealing. That is, is fair dealing relevant only to a determination of fair value (and, is it merely relevant or is it required for a finding of substantive fairness), or must fair dealing be shown even if the price is found to be fair?

The *Weinberger* court did not go very far towards answering these questions. In the last portion of its opinion, where it discussed what constituted fair value, the court indicated that price might be the basic issue in assessing entire fairness. It stated that an appraisal proceeding would be the sole remedy available to future cashed out shareholders in most circumstances.²²⁶ In providing for such a limited remedy, the court expressed its intention to return to the law as it existed prior to *Singer v. Magnavox Co.*,²²⁷ when appraisal was the exclusive financial remedy available to a cashed out shareholder.²²⁸ This statement, alone, indicates that the court did not consider fair dealing a separate compensable right owed to the minority shareholders. The court went on to explain, however, that if the appraisal remedy was inadequate, then the Chancellor still had the power to grant "any form of equitable and monetary relief as may be appropriate" and it identified "cases where fraud, misrepresentation, self-dealing, deliberate waste of corporate assets, or gross and palpable overreaching are involved" as cases where appraisal may be an inadequate remedy.²²⁹ In many cases, if the majority shareholder has breached its duty of fair dealing, there will be fraud, self-dealing and/or misrepresentation. In the hypothetical case where the absence of fair dealing does not amount to fraud or misrepresentation, however, *Weinberger* does not answer whether the minority has a right to anything more than fair price.

Furthermore, *Weinberger's* expression of confidence in the appraisal process could be viewed as negating the significance of fair dealing as a method of determining fair value. The court's emphasis and reliance on appraisal indicates that fair dealing is not the only way to arrive at fair value. If appraisal is available

226. "[A] plaintiff's monetary remedy ordinarily should be confined to the more liberalized appraisal proceeding herein established. . . ." *Weinberger*, 457 A.2d at 714.

227. 380 A.2d 969 (Del. 1977).

228. "Thus, we return to the well established principles of *Stauffer v. Standard Brands, Inc.*, Del. Supr., 187 A.2d 78 (1962) and *David J. Greene & Co. v. Schenley Industries, Inc.*, Del. Ch., 281 A.2d 30 (1971), mandating a stockholder's recourse to the basic remedy of an appraisal." *Weinberger*, 457 A.2d at 715. See also *supra* note 34.

229. *Id.* at 714. Nor did the court indicate that this list was intended to be exclusive.

as an *ex post* check on substantive fairness, perhaps fair dealing is an entirely superfluous notion in the regulation of cash out mergers.

In order to assess the significance of fair dealing as a method for determining substantive fairness, the nature of substantive fairness must be considered. In the context of a parent-subsidiary going private transaction, substantive fairness means fair value. It is the value of an ongoing business to some, but not all, of its owners. Any valuation of an ongoing enterprise involves some degree of uncertainty. Even more uncertainty is characteristic of fair value in the context, because value also may include certain benefits of the transaction to the parent. Such benefits might take the form of operating efficiencies resulting from the actual business combination or tax savings arising from the parent's 100% ownership of the subsidiary. As a result of the difficulty of assigning a dollar value to such benefits and to other characteristics of an ongoing business, the amount constituting fair value is not easily determined with any degree of precision.²³⁰

Several alternative methods exist for establishing fair value prior to the accomplishment of the transaction. One method is to subject the proposed transaction to an *ex ante* review by an objective third party.²³¹ The third party, whether a court or special administrative agency, would be required to assess the fairness of the proposal and perhaps establish alternative terms if the proposal fell short of fair value. Such a procedure obviously would entail costs on society to support the reviewing mechanism. In addition, it might interject significant uncertainties as to the timing of the transaction, which could negatively affect the proponent of the deal. Finally, the parties to the transaction might not have much confidence in the judgment of the court or agency as a result of two factors: the difficulty of determining fair value with precision and the lack of participation in the valuation process by the parties themselves.

Another alternative is to establish a minimum price, such as the most recent public offering price, for fair value.²³² This alternative, of course, has the advantage of certainty. A *minimum* price, however, would not necessarily constitute fair value. And, since this method might not take into consideration any change in circumstances for the corporation, the result could be rather arbitrary.

Fair dealing is a third alternative method of selecting fair value. Instead of relying on an outsider or some objective indicator to determine fair value, fair dealing relies upon the parties to the transaction to make that determination.²³³ It differs from the other two alternatives by its use of an adversary negotiating process. It keeps the parties as the representatives of their own interests and provides them with the power and responsibility for defining fair value themselves, as whatever term, within reason, to which they agree. Fair dealing rests on the assumption that the result of an adversary process is likely to be at least as accurate an assessment of fair value as a third party's judgment. And through participation, direct or indirect, in the process by which fair value is established,

230. See Phalon, *supra* note 196, at 42 (suggesting that "'fair value' is an extremely elastic number. It's generally higher when big investors feel they are being short-changed. And it's lower when a group of odd lotters is up against a management that thinks it holds all the cards"); Brudney, *supra* note 5, at 1085 n.30 & 1095 n.64. See also Weiss, *supra* note 47, at 49 ([T]he courts may be better equipped to pass upon the correctness of the process by which a cash-out merger is arranged than they are to decide if a price is fair." (footnote omitted)).

231. See Greene, *supra* note 2, at 510-11; Brudney, *supra* note 5, at 1098.

232. See, e.g., WISC. ADMIN. CODE § SEC 6.05(1)(a)(2) (1980); IND. CODE § 23-2-3.1-8.4 (Supp. 1983).

233. See *supra* notes 43-50 and accompanying text.

the minority may perceive their interests as more satisfactorily represented than if the entire determination was handed over to an objective party. Fair dealing also avoids any direct cost on society, such as those that would be incurred under the first alternative method, and instead imposes any burden on the parties to the transaction. The costs of compliance with fair dealing ought to be accounted for as any other cost of accomplishing the transaction.

Delaware has elected to rely on fair dealing as the method of determining fair value at the pre-transaction state. *Weinberger* makes it clear, however, that after the accomplishment of the transaction, appraisal is available for assessing fair value. The court's emphasis on appraisal has led some commentators to conclude that fair dealing is superfluous and appraisal is the *only* test for fair value.²³⁴

The availability of appraisal should not be considered equivalent to a pre-transaction process for arriving at fair value. Appraisal comes too late for both the majority and the minority shareholders. Fair dealing offers the majority shareholder some guidance in determining fair value. If the majority shareholder satisfies the requirements of fair dealing, that will be strong evidence that the price agreed upon is fair. If appraisal is the only relevant test of fair value, it leaves the majority shareholder without a means of planning its conduct to comply with the law before the deal is done. The majority can only guess at fair value, and add a premium to the identified base price.²³⁵

Appraisal places the entire burden of testing the fairness of the financial terms of the merger on the minority shareholders. The individual minority shareholders must affirmatively perfect their rights to an appraisal and bear, at least initially, the costs associated with proceeding.²³⁶ Appraisal also imposes a cost of uncertainty on the minority and, indirectly, on all investors. Since appraisal comes *after* the accomplishment of the transaction, the minority will never be sure of whether or not they have been mulcted until after the fact, and even after the fact, an individual minority shareholder will discover the appraised value only if he takes the initiative. For some shareholders, then, the uncertainty may continue. It may also expand into uncertainty of fair treatment in the capital markets generally. It is difficult for an investor to plan against being in the position of a minority shareholder, because takeovers and going private transactions are increasingly common. As a result, it would be hard for the average investor to avoid the risk of being a minority shareholder in a parent-subsidary merger, and the consequent risk of unfair substantive treatment.²³⁷

Appraisal is different from fair dealing in substance, too. Appraisal approaches fair value by delegating the division to an objective third party as judge, as did the first alternative method for an *ex ante* determination.²³⁸ Fair dealing, however, operates on the assumption that the parties to the transaction are in the best position to decide what is fair. It is a less paternalistic method of assessing value than is appraisal. Fair dealing encourages the parties to protect themselves so that an outsider need not interfere, and places the burden of making enforceable bargains on the parties interested in the deal rather than on the courts. It is,

234. Berger and Allingham, *supra* note 6, at 15 SEC. REG. & L. REP. (BNA) 2000-01 (Oct. 28, 1983) (report on 22d Annual Corporate Counsel Institute, comments of A. Gilchrist Sparks III). *But see* Weiss, *supra* note 47, at 54-56.

235. As to the amount of the premium, see Phalon, *supra* note 196, at 42.

236. *But see* DEL. CODE ANN. tit. 8 § 262(j), which provides for an eventual award of attorney's fees in appraisal proceedings.

237. *See* Brudney, *supra* note 5, at 1086.

238. *See supra* note 231 and accompanying text.

therefore, a more efficient method of regulating substantive fairness than is appraisal.

Finally, making appraisal the sole method of determining fair value contravenes the recent trend of the Delaware judiciary to provide more protection for shareholders against potential abuse by management.²³⁹ Appraisal places the entire burden of protecting the minority on the minority, indeed, on individual minority shareholders. Such limited protection stands in stark contrast to Delaware's recent willingness to protect and intervene on behalf of shareholders generally.

Fair dealing, therefore, should have a significant place in the regulation of parent-subsidiary transactions. First, fair dealing is an effective method of ascertaining fair price. Second, the alternative to fair dealing, appraisal, is inadequate as the sole determinative of substantive fairness. Appraisal is available as a backup, for shareholders who are unhappy with the result of the negotiation and deliberative process. Fair dealing, however, should be the initial and primary procedure for defining fair value.

Even though fair dealing defines substantive fairness, that does not mean that fair dealing is a separate right to which minority shareholders are entitled. While in most instances the absence of fair dealing will adversely affect the substantive terms of the deal, such a relationship between procedure and substance may not always exist. Appraisal might validate the price paid to the minority in a transaction where the requirements of fair dealing were not satisfied. *Weinberger* does not answer whether, in such a case, the minority shareholders have been given all that they deserve—*i.e.*, fair price—or have suffered an injury by the lack of fair dealing.

One approach to this problem is suggested by analogy to the issue of causation as it arises under the anti-fraud provisions of the federal securities laws. Assuming that the parent-subsidiary transaction was required to have been approved by the subsidiary's minority shareholders and/or their representatives at the board level,²⁴⁰ it might be asked whether the decision-makers were affected by the absence of fair dealing. In other words, was the approval of the transaction the result of the absence of fair dealing, or would the transaction have been approved even if the requirements of fair dealing had been satisfied? If the substantive terms (*i.e.*, price) of the transaction were fair, then it could be argued that the transaction would have been approved regardless of the existence of fair dealing. The interests of the minority shareholders would be served by any deal which is substantively fair, so those interests would dictate approval. Therefore, the absence of fair dealing could not have caused the approval of the transaction. Since the transaction would have been approved anyway, the absence of fair dealing did not cause any harm to the minority shareholders.

A substantially similar line of reasoning was adopted by the Seventh Circuit Court of Appeals in *Mills v. Electric Auto Lite Co.*²⁴¹ In *Mills*, the plaintiffs, minority shareholders, alleged that they had been induced to approve a proposed merger as a result of material misrepresentations in the proxy statement by which their votes were solicited, in violation of Rule 14a-9 of the Exchange Act.²⁴² The

239. For a discussion of this trend, see Fischel, *supra* note 2.

240. See *infra* notes 251-60 and accompanying text.

241. 403 F.2d 429 (7th Cir. 1968), *vacated*, 396 U.S. 375 (1970).

Court of Appeals affirmed a finding that the proxy statement contained a material misrepresentation.²⁴³ However, the court also held that if respondents were able to show that the transaction would have been approved regardless of the proxy misrepresentation then petitioners would not be entitled to any relief.²⁴⁴

The Supreme Court rejected the reasoning of the Court of Appeals, and found the causation requirement to have been satisfied. The Court disagreed with the lower court's premise that "the shareholders of every corporation are willing to accept any and every fair merger offer put before them."²⁴⁵ It recognized that certain unidentified factors other than the financial value of the offer might influence a shareholder's view of such a fundamental transaction.²⁴⁶ Consequently, the Court disagreed with the proposition that the transaction unquestionably would have received the requisite approval if the proxy statement had made full and accurate disclosure. Instead, it found that the plaintiffs had made out a violation of Rule 14a-9 based upon the misleading proxy statement.²⁴⁷ The substantive fairness or the merger was not a defense to the flaw in the process of obtaining approval of the transaction because the Court could not be sure that the transaction would have been approved had the proxy statement been accurate.²⁴⁸

The Court's analysis in *Mills* provides a useful analogy to the issue of the importance of fair dealing where substantive fairness exists. The premise of the Supreme Court in *Mills* was that substantive fairness does not ensure approval of a transaction. That premise is equally true where the proposed transaction is a cash out merger. The premise is based, at least in part, upon the Court's unwillingness to presume that shareholders or decision-makers are equally motivated by the same factors. While substantive fairness may be sufficient for some, others may be motivated by different considerations, such as the form of their investment or the purpose for the transaction. In *Mills*, the Supreme Court characterized the assumption that any fair transaction would be approved by the shareholders as "pure conjecture."²⁴⁹

If substantive fairness does not guarantee approval, then the manner in which a transaction is presented to the decision-makers may affect their vote. In *Mills*, nondisclosure of the controlling relationship between the majority shareholder and the directors of the subsidiary was enough to negate the effectiveness of the shareholders' approval. Fair dealing includes not only the issue of adequate disclosure, as involved in *Mills*, but also encompasses generally the way in which a transaction is presented to the decision-makers. The absence of fair dealing could induce the shareholders' and/or directors' affirmative vote. Moreover, fair dealing could influence the terms that would be negotiated by the decision-makers,

242. 17 C.F.R. § 240.14a-9 (1983), issued pursuant to § 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n (1982).

243. *Mills*, 403 F.2d at 435.

244. *Id.* at 436.

245. 396 U.S. 375, 382 n.5 (1970).

246. "[I]n view of the many other factors that might lead shareholders to prefer their current position to that of owners of a larger combined enterprise, it is pure conjecture to assume that the fairness of the proposal will always be determinative of their vote." *Id.* at 383 (citation omitted). *Mills* involved a stock-for-stock parent-subsidiary merger.

247. *Id.*

248. *Id.* at 385.

249. See *supra* note 246.

thus reaching beyond the issue of approval. Where fair dealing has not been provided, it would be difficult to show not only whether approval would have been obtained but also what terms would have been negotiated had the requirements of fair dealing been satisfied. Causation should be presumed under such circumstances. The absence of fair dealing should be viewed as having caused the form and approval of the transaction.²⁵⁰

Accepting, then, that a causal relation exists between fair dealing and approval of the transaction, the assumption that approval is required by the minority or their representatives must be examined.²⁵¹ If no such approval is necessary apart from the requirements of fair dealing, then the proposition that fair dealing is important because it is an inducement for approval of the transaction must be rejected. Such a proposition rests upon a circular argument that fair dealing is important because of its affect on the approval process, and the approval process is important because it is an element of fair dealing. If the transaction need not be approved by anyone independent of the majority shareholder, then fair dealing is superfluous to the accomplishment of the transaction.

The Delaware statute authorizing mergers such as that involved in *Weinberger* requires the transaction to be approved by the boards of directors of each of the merging corporations.²⁵² In any parent-subsidary merger accomplished pursuant to section 251 of the Delaware Corporation Law²⁵³ then, the merger must be approved by the board of the subsidiary in order to be effective. In many cases, however, the board of the subsidiary will not be independent of the parent corporation; it is common for at least some members of the subsidiary's board to serve, at the same time, on the board of, or otherwise owe loyalty to, the parent.²⁵⁴ Nowhere does the Delaware statute explicitly require that the board of the subsidiary be independent of the parent in order to approve a parent-subsidary merger. Without such a requirement for approval by independent representatives, however, the statutory command of approval by the board of each merging corporation is meaningless in this context. The parent will consent for itself and for the subsidiary, and the interests of the subsidiary's minority shareholders will be

250. It might be argued that the directors or other board-level representatives should be required to testify as to their reliance on the absence of fair dealing. Unlike the situation in *Mills*, where a shareholder vote was involved, the number of persons required to testify would not render such a requirement impracticable in a case like *Weinberger* where the relevant decision was at the board level. However, it would be just as difficult for the directors to testify as to what they would have done differently if fair dealing had been provided as it is for anyone to show reliance on a failure to disclose. See *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 384-85 (1970). The requirement of materiality in *Mills* can be paralleled by a requirement of a significant departure from fair dealing, involving the element of disclosure or representation. Such a requirement should guarantee that only material departures from the requirements of fair dealing will result in the presumption of causation.

251. See *supra* text accompanying note 240.

252. DEL. CODE ANN. tit. 8 § 251(b) (1983) ("The board of directors of each corporation which desires to merge or consolidate shall adopt a resolution approving an agreement of merger or consolidation.").

A short-form merger, accomplished pursuant to DEL. CODE ANN. tit. 8 § 253 (1983), need not be approved by the board of the subsidiary corporation, and, therefore, presents an entirely different case than that discussed. See *Green v. Sante Fe Indus.*, No. 74 Civ. 3915 (Nov. 22, 1983. S.D.N.Y.) (where the court construed the plaintiff's claim as challenging only the price paid in a short form merger pursuant to DEL. CODE ANN. tit. 8 § 253, it limited the plaintiff to the remedy of appraisal, in reliance on *Weinberger*), *cert. denied*, 434 U.S. 1069 (1978). It is beyond the scope of this article to analyze the necessity for fair dealing in the context of a short-form merger.

253. *Id.* § 251.

254. See *supra* notes 110-12 and accompanying text.

disregarded. Could Delaware intend to render the statutory mandate of approval meaningless? Again, an analogy to the federal securities laws is helpful in resolving this issue.

In actions brought under Section 10(b) and Rule 10b-5 of the Exchange Act,²⁵⁵ courts have recognized that the directors of a corporation are not always adequate representatives of the corporation for disclosure purposes.²⁵⁶ In certain circumstances, disclosure of information to the board of directors will not be considered equivalent to disclosure to the corporation.²⁵⁷ The corporation cannot adequately be represented by its board for disclosure purposes whenever the directors, or some of them, have or represent interests conflicting with those of the corporation.

This idea is based upon the law of agency. A principal (analogous to the corporation) will not be charged with the knowledge of its agent (analogous to the board of directors) whenever the agent acts or represents interests adverse to those of the principal.²⁵⁸ Generally, knowledge is imputed from an agent to the principal because the agent has a duty to disclose relevant information to the principal. If it is obvious that the duty will not be fulfilled because of the agent's dual loyalties, the principal will not be charged with the agent's knowledge. If knowledge of the board would not be imputed to the corporation under agency principles, then, for purposes of the federal securities laws, disclosure to the board should not constitute disclosure to the corporation. It cannot reasonably be presumed that the board will use such information to protect or benefit the corporation. Therefore, disclosure to a different, adequate representative of the corporation is necessary. In such circumstances, the shareholders generally are viewed as the true representatives of the corporation.²⁵⁹ If the board is disqualified, then disclosure must be made to the shareholders in order for such information to be binding on the corporation.

This notion, that disclosure is effective only if made to a suitable representative of the corporation, suggests an answer to the question of whether consent by a board of directors controlled by the other party to the transaction ought to be considered effective for purposes of state law. If the directors would be

255. 15 U.S.C. § 78j (1982); 17 C.F.R. § 240.10b-5 (1983).

256. See *Schoenbaum v. Firstbrook*, 405 F.2d 215 (2d Cir. 1968), *cert. denied*, 395 U.S. 906 (1969); *Goldberg v. Meridor*, 567 F.2d 209 (2d Cir. 1977), *cert. denied*, 434 U.S. 1069 (1978).

257. While it is beyond the scope of this article to analyze the situations in which the board will be an insufficient representative of the corporation for purposes of § 10(b) and Rule 10b-5, at least the easy case may be laid out. In *Goldberg v. Meridor*, 567 F.2d 209 (2d Cir. 1977), *cert. denied*, 434 U.S. 1069 (1978), all of the directors of the subsidiary were apparently under the control of the parent. The parent's control of the subsidiary's directors was sufficient to render the board incapable of representing the corporation for purposes of receiving information on its behalf. In *Jones v. Nat'l Distillers*, [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶97,140 (S.D.N.Y. 1979), two directors of the subsidiary deceived the other directors and the minority shareholders; the court held that was sufficient to allege deception of the stockholders. *Weinberger* is similar to *Jones* in that at least two Signal-UOP directors were aware of *all* relevant information, but the non-Signal UOP directors were uninformed. Moreover, in *Weinberger* a majority of the UOP board was under the control of Signal. See also *Aronson v. Lewis*, No. 203, 1983 (Del. Supr. Ct., March 1, 1984) (Demand on directors excused where a majority of the board is interested in the transaction approved by the board and being challenged. But the fact that a majority of the board was nominated and elected by a majority shareholder does not disqualify such directors from passing upon a transaction to which such majority shareholder is a party.).

258. See RESTATEMENT (SECOND) OF AGENCY § 279 (1957).

259. See *Schoenbaum v. Firstbrook*, 405 F.2d 215, 219-20 (2d Cir. 1968), *cert. denied*, 395 U.S. 906 (1969); *Goldberg v. Meridor*, 567 F.2d 209, 218-20 (2d Cir. 1977), *cert. denied*, 434 U.S. 1069 (1978).

inadequate representatives of the corporation for disclosure purposes in a case such as *Weinberger*, then the minority shareholders would be the appropriate representatives of the corporation for such purposes.²⁶⁰ Disclosure to such shareholders would be required in order to bind the company. Similarly, if the board is incapable of adequately representing the corporation because it is controlled by the other party to the transaction, the consent of the board should not be binding on the corporation. In that case, the corporation should be viewed as equivalent to the minority shareholders, and the requisite consent should be that of such shareholders or *their* representatives. Therefore, state law should be interpreted as requiring consent by a truly representative body, whether or not that constitutes the board of directors. Effective, meaningful consent by the subsidiary should be required. The parent's consent on behalf of the subsidiary, exercised through the subsidiary board of directors, must be considered insufficient to bind the subsidiary in a transaction with the parent.

The analogy to the federal securities laws thus supports the proposition that fair dealing is important in addition to fair price. A parent-subsidiary merger such as that involved in *Weinberger* must be approved by representatives of the subsidiary who are independent of the parent, and the decision of those independent representatives may be affected by the presence or absence of fair dealing. It is, therefore, incumbent upon the parent to satisfy the requirements of fair dealing regardless of the ultimate determination as to the fairness of the price that was actually paid to the minority. Otherwise, the absence of fair dealing will negate the effectiveness of the statutorily required approval of the deal by the subsidiary.

This conclusion is supported by policy considerations, as well. The same factors rendering appraisal inadequate as the sole method of determining fair value—the cost of uncertainty resulting from an *ex post* test, the lack of guidance provided to the majority shareholder, and the burden imposed on the minority shareholders and the courts as a result of such a paternalistic approach²⁶¹—also support a general requirement of fair dealing in addition to fair value. If there is no duty of fair dealing, few majority shareholders will comply with its requirements. Instead, majority shareholders will be apt to estimate fair price, add some premium to that figure, and push the deal through by virtue of their control. Such action may alienate minority shareholders and might conceivably result in the majority shareholder paying substantially more than is required. A requirement of fair dealing would not only further the chances that fair value would, in fact, be paid, but would also eliminate some of the guesswork attached to the determination of that price. The goal of substantive fairness, therefore, justifies the imposition of a requirement of fair dealing as a code of conduct designed to produce the desired result.

Accepting that fair dealing is required in addition to fair price, the inquiry turns to what the form of relief should be where fair dealing was not provided but fair price was paid. If fair value has been paid, has the minority shareholder suffered actual damages from the denial of fair dealing, or, is such a shareholder entitled at best to only nominal damages?

Again, the resolution of similar problems in other areas of the law provides useful analogies. In *Mills v. Electric Auto-Lite Co.*,²⁶² the Supreme Court ad-

260. See *supra* notes 256-59 and accompanying text.

261. See *supra* notes 234-39 and accompanying text.

262. 396 U.S. 375 (1970).

dressed the issue of damages after concluding that the misrepresentation in the proxy statement had resulted in the approval of the transaction.²⁶³ The most obvious form of relief appropriate in *Mills* would have been rescission, since the merger was approved as a result of a violation of Rule 14a-9. There, however, as in most similar cases, rescission is simply not feasible. The time between the accomplishment of the transaction and the court's provision of a remedy would make it nearly impossible to fairly unscramble the combined businesses. Moreover, rescission will not always serve the best interests of the subsidiary corporation, much less those of the combined enterprise.²⁶⁴

Aside from equitable relief, monetary damages might be appropriate to redress the absence of fair dealing. While payment of fair value shows that the shareholders are not entitled to anything more for their stock, perhaps they are entitled to monetary damages simply because of the absence of fair dealing. The Court in *Mills* addressed an analogous issue when it considered whether monetary relief would be appropriate where the misrepresentation did not relate to the substantive terms of the transaction. The Court of Appeals had concluded that the merger was fair to the plaintiffs, but the Supreme Court found that the proxy statement violated Rule 14a-9. The Court declined to hold that the misrepresentation, alone, gave rise to damages without proof of actual injury to the plaintiffs. It held that damages should not be presumed under such circumstances, but should be awarded "only to the extent that they can be shown."²⁶⁵ On appeal after remand from the Supreme Court, the Seventh Circuit Court of Appeals considered the issue of damages in light of the pre-merger market price of the subsidiary's stock and the plaintiff's share of the synergistic savings resulting from the merger.²⁶⁶ The court found that the Auto-Lite shareholders did, in fact, receive their proportionate share of the synergism produced by the merger. The consideration of the synergistic effect of the merger is consistent with the Supreme Court's mandate that damages must be shown, to be recoverable.

It could be argued that damages should be awarded based upon the presumed effect on a shareholder of a denial of procedural fairness. Procedural unfairness might result in a shareholder feeling, or at least suspecting, that he has been mulcted. It could be argued that this feeling or uncertainty might give rise to mental and emotional distress on the part of the shareholder. Such distress, could be presumed whenever fair dealing has not been provided. Proof of actual damages, then, might not be required under such circumstances.

A similar argument was addressed by the Supreme Court in connection with an action brought under 42 U.S.C. § 1983²⁶⁷ for a violation of procedural due pro-

263. *Id.* at 386-97.

264. *See id.* at 386-88.

265. *Id.* at 389.

266. 552 F.2d 1239, 1248-49 (7th Cir. 1977). The synergistic effect of a merger was first identified as an element for consideration in establishing a fair price for the shareholders by Brudney and Chirelstein in *Fair Shares*, *supra* note 2.

267. Every person who, under color of any statute, ordinance, regulation, custom or usage, of any State or Territory, subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress.

42 U.S.C. § 1983 (1976).

cess. In *Carey v. Piphus*,²⁶⁸ the plaintiffs' rights to procedural due process had been violated, resulting in their temporary dismissal from school. The plaintiffs failed to offer any proof as to the nature and extent of their damages. Instead, they asked the Court to presume damages based upon the mental and emotional distress resulting from the denial of their Constitutional rights.²⁶⁹ They did not, however, prove actual mental and emotional distress. The Court rejected the notion that the denial of due process automatically results in mental and emotional distress.²⁷⁰ Not every violation of procedural due process gives rise to a compensable injury. The Court held that actual injury must be proven to support an award of compensatory damages; damages will not be presumed on the basis of an implied injury.²⁷¹

These cases suggest an answer to the question of what form of relief ought to be available where fair price was paid but the requirements of fair dealing were not satisfied. The natural form of relief under such circumstances, as indicated in *Mills*, is rescission. Practically, however, rescission is rarely available as a viable alternative to damages. The combination resulting from the challenged transaction usually has been long established, so that it would not serve the interests of the corporate parties nor those of the shareholders to attempt to undo the deal.

If rescission is the natural remedy, but practically unavailable, then injunctive relief might be the next best thing. If the shareholders can detect a violation of the duty of fair dealing before the accomplishment of the transaction, injunctive relief ought to be granted to prevent the tainted consent from being given. At that point, the relationship between the parties can be adjusted to comply with the primary requirements of disclosure and representation, so that a meaningful decision can be made. While the court in *Weinberger* indicated its intention to return to the days before *Singer*, when injunctive relief was generally unavailable, it left open the right to equitable relief where the circumstances so demanded.²⁷² Where a significant departure from the requirements of fair dealing is detected, and such departure would negate the effectiveness of the subsidiary's approval of the transaction, injunctive relief ought to be available.

If the transaction has been accomplished and rescission is impractical, *Mills* and *Carey* suggest that compensatory damages should not be awarded solely as a result of the denial of fair dealing. But if that means there is no remedy awarded where fair dealing was not been provided, then the right to fair dealing has no teeth. Not only would there be no incentive on the part of minority shareholders to enforce their rights, but there also would be no reason for the majority shareholder to comply with the requirements of fair dealing. The costs of complying with the requirements of fair dealing would outweigh the costs of non-compliance. As a result, if no remedy is provided, there will be, in effect, an

268. 435 U.S. 247 (1978).

269. *Id.* at 261.

270. *Id.* at 263.

271. *Id.* at 264. This conclusion can be supported on the additional ground that the law should not base recovery upon fictitious injuries. In many cases, the denial of procedural due process will not actually cause emotional distress. In fact, the victim may be unaware of the violation of his Constitutional rights. See generally NAHMOD, CIVIL RIGHTS & CIVIL LIBERTIES LITIGATION § 4.02 (1979).

272. 457 A.2d at 714.

incentive for the majority shareholder *not* to deal fairly with the minority. That is exactly what the law should avoid. Even if it is not ultimately required, at the very least, fair dealing should be encouraged and rewarded, not penalized.²⁷³

Furthermore, if fair dealing produces a fair price more often than the absence of fair dealing, the failure to provide a remedy for the denial of fair dealing may, over time, generally reduce the number of transactions in which the price paid is fair. If the persons responsible for planning parent-subsidiary transactions know that if they pay fair value, determined without regard to fair dealing, they will not be liable for damages, then such persons will be less likely to comply with the requirements of fair dealing. The cost of being wrong as to price would be the same whether or not fair dealing was provided, but providing fair dealing would not be free. Therefore, fewer transactions would be conducted in compliance with the requirements of fair dealing, resulting in fewer transactions in which fair value will be paid. The absence of any remedy for fair dealing, then, will result generally in fewer transactions being accomplished where fair price is paid.

To avoid these consequences, some remedy ought to be provided for the denial of fair dealing, regardless of fair price. Several alternatives exist. Nominal damages might be awarded, but they usually constitute such a modest amount that the parties would react just as if no remedy was available. Perhaps a new measure of nominal damages could be developed, to provide for an award that is "not so low as to trivialize the right that was violated."²⁷⁴ Alternatively, an attempt could be made to value the deprivation of fair dealing. A shareholder's uncertainty, where fair dealing was not provided, as to whether or not he was mulcted might be valued as the amount that such a shareholder would charge for the uncertainty—the risk of substantive unfairness.²⁷⁵ Another possibility would be to devise a new exception to the general rule against awarding attorney's fees.²⁷⁶ If nominal damages and attorney's fees could be awarded to a shareholder who successfully proved a violation of the duty of fair dealing, at least the right to fair dealing could be enforced without suffering a burden. Further, enforcement would set an example for future transactions, and thereby encourage others to comply with the requirements of fair dealing. Regardless of the remedy chosen, neither punishment nor overcompensation are required. The remedy should simply result in furthering compliance with fair dealing.

273. See 15 SEC. REG. & L. REP. 2104, 2109 (1983) (reporting the comments of Leonard Chazen at the 15th Annual Institute on Securities Regulation). *But see* Berger and Allingham, *supra* note 6, at 23-24.

274. Barnett, *Resolving the Dilemma of the Exclusionary Rule: An Application of Restitutive Principles of Justice*, 32 EMORY L.J. 937, 980 (1983).

275. See Fuller & Perdue, *The Reliance Interest in Contract Damages: I*, 46 YALE L.J. 52, 60 (1936).

276. The general American rule is that attorney's fees should not be awarded absent specific statutory provision. One exception to this rule, available in *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 392-97 (1970), is where the lawsuit will benefit all shareholders of a class. In such a case, a court might award attorney's fees against the corporation in which such shareholders own stock. This exception is commonly referred to as the "common fund" exception. But in a cash out situation, the plaintiff-shareholders are not owners of the surviving corporation, so the common fund rationale does not justify assessing fees against the surviving entity. As to the private attorney general exception to the American rule, which has not been used in Delaware, see generally *Alyeska Pipeline Service Co. v. Wilderness Society*, 421 U.S. 240 (1975).

CONCLUSION

In the future, the boundaries of the notion of fair dealing must be developed. *Weinberger* established only the skeleton of the elements and the most exacting interpretation of them, but future cases will require courts to decide the outer limits of what is meant by fair dealing. In doing so, the Delaware courts must take care to strike a balance between the interests of the majority and the minority shareholders. The minority should be protected from the controlling influence of the parent, and that protection can be provided by enforcing the duty of fair dealing. The majority shareholder, however, must be provided with some way of effectuating statutorily authorized corporate transactions. The law ought to be clear and certain enough to permit corporations to plan such transactions to comply with its requirements, and those requirements should not be so exacting as to force the majority shareholder to sacrifice its own interests in order to be sure that the deal complies with the law. The concept of fair dealing can be used to strike such a balance if it is developed and applied in a thoughtful and consistent manner.