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Megasubsidiaries and Asset Sales under Section 271: Which Shareholders Must Approve Subsidiary Asset Sales

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NOTE

MEGASUBSIDIARIES AND ASSET SALES UNDER SECTION 271: WHICH SHAREHOLDERS MUST APPROVE SUBSIDIARY ASSET SALES

*Yaman Shukairy**

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INTRODUCTION

Corporate law statutes determine the nature of the relationship between shareholders, the principal owners of the corporation, and the board of directors, those who run and operate the corporation.[1] Under the Delaware

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1. *See* Melvin Aron Eisenberg, *Megasubsidiaries: The Effect of Corporate Structure on Corporate Control*, 84 HARV. L. REV. 1577, 1588 (1971) ("A major function of the corporate statutes is to allocate powers between shareholders and management.").

General Corporation Law ("DGCL"),[2] many of the powers are delegated to the board of directors. More specifically, under section 141, "the business and affairs of every corporation . . . [are] *managed by or under the direction of a board of directors* . . . ."[3] The Delaware courts have interpreted this provision by deferring to decisions by directors and their designated management under the business judgment rule, which presumes that in making a business decision, the directors acted on an informed basis with a good faith, an honest belief that the action taken was in the best interests of the company.[4] As many have noted, "[t]he effect of this presumption when applied by a court is that the court will not substitute its judgment for that of the board, unless it is shown by a preponderance of the evidence that the directors' decision involved a breach of fiduciary duty."[5]

Despite the enormous delegation of power from shareholders to directors, shareholders still retain certain essential powers such as the right to vote on mergers[6] and to elect directors.[7] Among these is the right to vote on the sale of all or substantially all of the assets of the corporation. Section 271 of the DGCL provides that:

> Every corporation may at any meeting of its board of directors or governing body sell, lease or exchange *all or substantially all of its property and assets* . . . as its board of directors or governing body deems expedient and for the best interests of the corporation, when and as authorized by a resolution *adopted by the holders of a majority of the outstanding stock of the corporation entitled to vote* . . . .[8]

In *Gimbel v. The Signal Cos.*, Chancellor Quillen, writing for the Delaware Court of Chancery, articulated the now often-cited *Gimbel* test, which considers both the quantitative and qualitative nature of the proposed asset sale in determining whether an asset sale constituted substantially all of the assets of a corporation.[9] Chancellor Quillen explained that "[i]f the sale is of assets *quantitatively vital* to the operation of the corporation and is *out of the ordinary and substantially affects the existence and purpose of the corporation*, then it is beyond the power of the Board of Directors."[10]

2. For the remainder of this Note, I will abbreviate Delaware General Corporation Law as DGCL.

3. DEL. CODE ANN. tit. 8, § 141(a) (2006) (emphasis added).

4. Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) ("The business judgment rule is the offspring of the fundamental principle, codified in 8 Del.C. § 141(a), that the business and affairs of a Delaware corporation are managed by or under its board of directors.").

5. RODMAN WARD, JR. ET AL., FOLK ON THE DELAWARE GENERAL CORPORATION LAW § 141.2.2.1, at GCL-IV-34 (4th ed. 1999 & Supp. 2006).

6. Tit. 8, § 251(c).

7. *Id.* § 211.1.

8. *Id.* § 271(a) (emphasis added).

9. 316 A.2d 599 (Del. Ch. 1974).

10. *Id.* at 606 (emphasis added).

Because the *Gimbel* test is not a mathematical, bright-line test, many of the issues litigated under section 271 relate to whether a proposed sale of assets unilaterally undertaken by the board is a sale of "substantially all of the assets" of the corporation and therefore requires a shareholder vote.[11] Delaware courts have repeatedly dealt with this issue on a case-by-case basis.[12] There is, however, one technical issue the Delaware courts have yet to completely resolve: whether a sale of substantially all of the assets of a subsidiary which constitutes substantially all of the assets of the parent implicates a parent shareholder vote. Such an issue would arise if a parent corporation decided to sell its assets, which were placed within a subsidiary. The proposed assets to be sold, for the purposes of this Note, represent substantially all of the assets of the *parent* corporation. If the sale is conducted at the subsidiary level, does the sale only require a shareholder vote by the parent corporation, the record holder of the subsidiary's shares, or also a vote by the shareholders of the parent corporation who ultimately are the beneficiaries of the parent corporation?[13] Put another way, does a section 271 transaction effectuated at the subsidiary level require a shareholder vote by the shareholders of the parent corporation or only the shareholders of the subsidiary?

Until recently, the Delaware courts had summarily concluded that the only vote required was the vote of "the record holder of all of the shares," obviating the need to attain shareholder approval from shareholders of a parent corporation.[14] In *J.P. Griffin Holding Corp. v. Mediatrics, Inc.*, the Delaware Court of Chancery concluded that because the defendant corporation was the record holder of all of the shares of its subsidiary and voted all of its shares in favor of the proposed sale, the requirements of section 271 were met.[15] By implication, the court refused to construe section 271 to require shareholders of the parent corporation vote on the proposed asset sale. In the court's view, the section 271 subsidiary asset sale did not require shareholder approval by the shareholders of the parent corporation. A later case, *Leslie v. Telephonics Office Technologies, Inc.*, avoided deciding a similar issue but noted that "more often than not, Delaware courts have upheld the legal significance of corporate form, in a corporate-subsidiary complex . . . ."[16]

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11. *See, e.g.*, Oberly v. Kirby, 592 A.2d 445, 464 (Del. 1991); Hollinger Inc. v. Hollinger Int'l, Inc., 858 A.2d 342 (Del. Ch. 2004); Katz v. Bregman, 431 A.2d 1274 (Del. Ch. 1981); *Gimbel*, 316 A.2d 599 (Del. Ch. 1974).

12. *See generally* WARD ET AL., *supra* note 5, § 271.3.

13. Throughout this Note, I will refer to this hypothetical transaction as a "§ 271 subsidiary asset sale." In addition, I will refer to similar transactions that involved non-Delaware corporations as "subsidiary asset sale" transactions.

14. J.P. Griffin Holding Corp. v. Mediatrics, Inc., No. 4056, 1973 Del. Ch. LEXIS 153, at *5 (Jan. 30, 1973).

15. *Id.*

16. No. 13045, 1993 Del. Ch. LEXIS 272, at *26–27 (Dec. 30, 1993). The *Leslie* court did note, however, the possibility that a vote by shareholders of the parent would be required if the court

A more recent case, however, cast doubt on this technical statutory interpretation by the Delaware courts. In *Hollinger Inc. v. Hollinger International, Inc.*, Vice Chancellor Strine viewed the defendant corporation's argument that the section 271 subsidiary asset sale did not implicate a vote by its shareholders with a healthy amount of skepticism.[17] He cautioned against a strict, technical statutory construction of section 271, because of the widespread phenomenon of public companies indirectly holding all of their operating assets through subsidiaries.[18] Vice Chancellor Strine worried that such a reading of section 271 "would, as a practical matter, render [section] 271 an illusory check on unilateral board power at most public companies."[19] Ultimately, he decided to leave the section 271 subsidiary asset sale issue unresolved,[20] but his brief discussion raises concerns and leaves open the possibility that a court could enjoin a section 271 subsidiary asset sale without approval from shareholders at the parent level.

On its face, this section 271 subsidiary asset sale issue may seem a narrow, technical issue, but its relevance is becoming increasingly important. As noted by Professor Melvin Eisenberg, "a significant portion of the country's business assets is now held, not only by corporations, but by massive subsidiary corporations—megasubsidiaries. As a result, ultimate ownership of business assets is often not only once but twice or more removed from the assets themselves."[21] The growing and widespread practice of corporations placing their assets under subsidiaries supports the need for resolution of the section 271 subsidiary asset sale issue discussed in the hypothetical above. Without certainty on what votes are required to authorize such transactions, certain corporations are less likely to pursue asset sales through their subsidiaries—despite their potentially beneficial, value-creating nature—and instead sell through the parent. Moreover, when corporations do choose to effectuate asset sales through their subsidiaries, litigation is likely to arise between parent shareholders and the parent corporation. These potential adverse effects could create significant costs that ultimately harm shareholders of corporations in Delaware. As such, determination of which shareholders are entitled to a vote to authorize a sale of substantially all of the parent corporation's assets held under a subsidiary is critical. This Note aims to address and resolve this issue.

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concluded that the subsidiary functioned merely as the "instrumentality" of the parent in effecting the asset transaction. *Id.* at *24–25.

17. 858 A.2d 342, 348 (Del. Ch. 2004).

18. *Id.*

19. *Id.*

20. *Id.* (explaining that because "the policy implications of ruling on [defendant corporation]'s technical defense are important, prudence counsels in favor of deferring a necessarily hasty decision on the interesting question presented.").

21. Eisenberg, *supra* note 1, at 1577. Eisenberg argues that this phenomenon of megasubsidiaries threatens shareholder voting rights and as a result, "the right to vote the subsidiary's stock in these transactions either inheres in the parent and is exercisable by the body of the parent's shareholder, or passes through the parent directly to the parent's shareholders." *Id.* at 1588–89. Additionally, with the advent and use of triangular merger structures, assets are more frequently placed at the subsidiary level. *See infra* Section II.B for a discussion of triangular mergers.

This Note argues that a parent shareholder vote is not implicated under section 271 when a parent corporation effectuates a sale of substantially all of its assets held under a subsidiary. Part I examines a number of different corporate law legal regimes, including Delaware's, and concludes that without clear legislative direction, a parent shareholder vote in the context of the hypothetical transaction is not necessary and contrary to a number of principles integral to corporate law and its application. Part II then specifically addresses the non-statutory interpretation aspects of Delaware corporate law as they relate to this issue. Section II.A reviews the separate corporate existence doctrine and its applicability to this particular issue. The doctrine strongly supports the conclusion that a shareholder vote at the parent level is unnecessary. Section II.B considers other form-over-substance transactions, such as triangular mergers and de facto mergers, which Delaware courts have condoned despite their indirect, adverse effects on shareholder rights. Finally, Section II.C engages in a brief fiduciary duty analysis establishing that the fiduciary duties owed by directors to shareholders provide adequate protection to shareholders in the context of a section 271 subsidiary asset sale. Section II.C then concludes that a section 271 transaction effectuated by a subsidiary and voted on by the parent corporation and not the parent's shareholders is entitled to the presumptive protection of the business judgment rule.

I. Examining Different Corporate Law Regimes and Their Approaches to Subsidiary Asset Sales

In considering the section 271 subsidiary asset sale issue, Part I provides an overview of a number of significant state corporate law regimes and how their legislatures and courts have resolved this particular issue. In the context of this brief analysis, the states that do require a parent shareholder vote to authorize the sale of substantially all of the parent corporation's assets held under its subsidiary have done so by following explicit legislative language provided in the relevant statute. Without clear legislative direction, courts, such as New York's, have shown reluctance in requiring a parent shareholder vote.

The discussion in Part I demonstrates an overall consistency between different corporation law regimes, with courts using strict statutory interpretation, focusing on statutory language and plainly interpreting the language. This approach of strict statutory interpretation promotes definiteness and certainty in the law, which invariably enables corporations to better plan based on statutory language. Delaware is no exception to this approach. In fact, as discussed below, the Delaware courts have clung to the notions of certainty when interpreting the DGCL. This Part provides support for why strict statutory interpretation, the general interpretative approach, should also apply to the section 271 context.

Section I.A analyzes the canons of interpretation used by Delaware courts and finds that when a statute's meaning is simple and clear, it should be interpreted as such. Thereafter, Section I.B examines New York corporate

law, which similar to Delaware corporate law, does not provide for explicit directives on the subsidiary asset sale issue. Section I.C then considers other corporate law regimes that require a shareholder vote at the parent level because the respective legislatures have drafted explicit statutory language requiring such a vote. Considering these differing approaches, Part I concludes that without explicit direction from its legislature, Delaware courts must not, through interpretation, create a second requirement of voting at the parent shareholder level.

A. *A Literal and Technical Approach to Statutory Interpretation*

The forthcoming analysis in this Section reveals two dominant principles of statutory interpretation in Delaware. First and foremost, the Delaware Supreme Court has repeatedly provided that if statutory language is plain and simple, it should be interpreted as such. Second, if the language invites interpretation from a court, the court should interpret the statute with the objective of effectuating legislative intent. This can be done by considering both legislative history and preliminary statements made by the Delaware Legislature.

The plain meaning of the words of section 271 of the DGCL should prevail and not require a parent shareholder vote. The pertinent words relating to this issue of section 271 subsidiary asset sales are "when and as authorized by a resolution adopted by *the holders of a majority of the outstanding stock of the corporation entitled to vote thereon*."[22] The phrase "the holders of a majority of the outstanding stock" could mean the actual holder of the subsidiary's stock, the parent corporation, or the ultimate beneficiaries, the shareholders of the parent corporation. Answering this question ultimately depends on the approach of statutory interpretation taken by a court. By canons of interpretation used by Delaware courts, the words of a statute should be followed when a statute's meaning is simple and clear.

The Delaware courts' general approach to statutory interpretation is to accord statutory language its plain meaning, if possible.[23] In the context of interpreting the Medical Malpractice Act under Delaware, the Supreme Court of Delaware in *Sostre v. Swift* emphasized that "[i]t is well settled that '[s]tatutory language, where possible, should be accorded its plain meaning.' Moreover, when a statute is clear and unambiguous there is no need for statutory interpretation."[24] Hence, if a statute's language is unequivocal, a court should interpret the statute according to its plain and simple meaning. This approach essentially ensures the enactment and implementation of legislative directives provided in the statutory provisions.

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22. DEL. CODE ANN. tit. 8, § 271(a) (2006) (emphasis added).

23. Sostre v. Swift, 603 A.2d 809, 813 (Del. 1992).

24. *Id.* (citations omitted). Although the case did not implicate corporate law, a Court of Chancery court cited *Sostre* to support the conclusion that "[w]hen the language of the statute is clear and unambiguous there is no need for statutory interpretation." *In re* Home Shopping Network, Inc. S'holders Litig., No. 12956, 1993 Del. Ch. LEXIS 80, at *35–36 (May 19, 1993).

Sostre is not an outlier case and is consistent, in fact, with the Supreme Court of Delaware's repeated insistence on the importance of interpreting statutory language, where possible, to accord the language its plain meaning. For example, in *State of Delaware v. Lillard*, the Court dealt with an employment related issue. It explained, like the *Sostre* court, that "[s]tatutory language, where possible, should be accorded its plain meaning."[25] The Court also noted that when a Delaware court is forced to interpret a statute, it should interpret the relevant statute "so as to give effect to the intent of the legislature."[26] This approach implies that when the legislative intent is not patently obvious because of the plain nature and simplicity of the statutory language, a court should strive to incorporate the legislative intent behind a provision. Courts can determine this intent by examining legislative history and preliminary statements made by the legislature.[27]

Similarly, in *Silverbrook Cemetery Co. v. Department of Finance of New Castle County*, the Court refused to infuse statutory interpretation or construction. The Court held that "[b]ecause [section] 105 [the relevant provision] is clear and unambiguous, there is no room for statutory interpretation or construction."[28] Further, the Court chided the lower court by explaining that it "erred by engaging in an interpretation of [section] 105" when such an exercise of interpretation was unnecessary and contravened the legislative intent demonstrated in the clarity of the provision's language.[29] Synthesizing this body of case law reveals two dominant principles of statutory interpretation in Delaware. First, if statutory language is plain and simple, the Delaware Supreme Court will interpret it such. Second, if the language requires interpretation, the court should interpret the statute with the objective of effectuating legislative intent, considering both legislative history and preliminary statements made by the Delaware Legislature.

The mandate of interpreting statutes in a simple and literal fashion when the statutory language is plain and clear is heightened in the context of interpreting corporate law.[30] In *Speiser v. Baker*, Chancellor Allen explained this edict: "[t]he utility of a *literal approach* to statutory construction is particularly apparent in the *interpretation of the requirements of our corporation law* [Delaware General Corporation Law]—where both the statute itself and most transactions governed by it are carefully planned and

25. 531 A.2d 613, 617 (Del. 1987).

26. *Id.* In directing Delaware courts to consider the intent of the legislature in interpreting a statute, the Court noted that "[l]egislative history and preliminary statements, such as the preamble, can often aid in statutory construction." *Id.*

27. *Id.*

28. Silverbrook Cemetery Co. v. Dep't of Fin., 449 A.2d 241, 242 (Del. 1982).

29. *See id.*

30. *See* Stephen J. Massey, *Chancellor Allen's Jurisprudence and the Theory of Corporate Law*, 17 DEL. J. CORP. L. 683, 708–09 (1992) (discussing Chancellor Allen's approach to interpreting Delaware corporate law). The author notes that Chancellor Allen has expressed "his belief that the purpose of modern state corporation law statutes—i.e., 'the facilitation of corporation formation and operation'—is best served by a literal interpretation of the terms of such statutes." *Id.* at 708.

result from a thoughtful and highly rational process."[31] Corporations (through their board of directors and advisors) take great efforts to structure their transactions in accordance with the relevant law, hoping to reduce the likelihood of future disputes and litigation. They look to corporate law for guidance. Therefore, when statutory language appears to be clear and plain, corporations will act accordingly. A court conjuring up an unreasonable and non-literal interpretation will disrupt the planning of corporations,[32] thus raising transaction costs. Ultimately, these higher transaction costs are transferred to shareholders.

Chancellor Allen's loyalty to literal interpretation is not without compelling rationale. As he notes, a court should interpret statutory language with "a sensitivity to the importance of the predictability of that law. That sensitivity causes [Delaware] law, in that setting, to reflect an enhanced respect for the literal statutory language."[33] An "enhanced respect" for literal interpretation better promotes predictability and certainty, which allows for corporations to better plan and act.[34] Having established this framework, Chancellor Allen explained what a literal interpretation entails. He stated that a court, when considering the meaning of plain and simple statutory language, should accord the language its "usual and customary meaning to persons familiar with this particular body of law."[35] Hence, the words "entitled to vote," which were at issue in the case, should mean what those familiar with the DGCL expect them to mean.[36]

In supporting Chancellor Allen's approach, Professor Stephen Massey argues that two features of corporate law and practice require literal interpretation by the courts.[37] First, as discussed above, corporate transactions are most often the result of careful, thoughtful planning by sophisticated parties.[38] Therefore, if the parties intended to avoid the literal statutory meanings, they would contract accordingly. Second, "if the knowledgeable and experienced drafters of the [DGCL] had intended [a provision] to be construed in some way other than the literal [meaning], they would have used language that explicitly accomplished that objective."[39] Hence, the pri-

31. 525 A.2d 1001, 1008 (Del. Ch. 1987) (emphasis added).

32. Massey, *supra* note 30, at 708 (quoting William T. Allen, *Competing Conceptions of the Corporation in American Law*, Address at Rocco J. Tresolini Lecture in Law, Lehigh University 2 (Oct. 29, 1990) (noting that corporation law's purpose is "the facilitation of corporation formation and *operation*" (emphasis added))).

33. *Speiser*, 525 A.2d at 1008.

34. *See id.*

35. *Id.*

36. *See id.* In this particular case, Chancellor Allen ultimately rejected the literal argument posited by the plaintiff. He noted that a related phrase to "entitled to vote" implicated in § 160 of the DGCL was not "a technically precise term whose literal meaning is clear," thus "requir[ing] interpretation." *Id.*

37. Massey, *supra* note 30, at 709.

38. *Id.*

39. *Id.*

mary onus of providing corporate law directives on statutory interpretation matters is on the Delaware Legislature, rather than the courts. In addition, literal interpretation placates corporate law's need for certainty, which helps to drive the objective of predictability in the law.[40]

The approach of literal interpretation applies to much of Delaware's corporate law. For example, as demonstrated in a later opinion by Chancellor Chandler, literal interpretation extends to section 203. The statutory matter at issue was whether a partial tender offer is a "business combination," thus implicating section 203.[41] Prior to delving into what a "business combination" entailed, the Chancellor stated that "[o]f *greatest importance* in statutory interpretation is the plain language of the statute itself. When the language of the statute is clear and unambiguous there is no need for statutory interpretation."[42] Because the definition of "business combination" under section 203(c) did not include partial tender offers, Chancellor Chandler ultimately concluded that a partial tender offer did not fall under the scope of "business combination."[43]

The Court of Chancery of Delaware has generally evoked the principles of literal statutory interpretation to an even greater extent than the Supreme Court of Delaware. In the context of a section 271 subsidiary asset sale transaction, the critical question is who are "the holders of a majority of the outstanding stock of the corporation entitled to vote thereon?"[44] The language, on its face, is plain and clear. The corporation that is selling its assets is the appropriate, constituent corporation. It is the entity that has engaged in the transaction and must seek approval from its shareholders. A logical extension of this determination is that the shareholders of the selling corporation are the "holders" under section 271.[45] Approval by the majority of the shareholders of the parent corporation is not needed, because their corporation, the parent corporation, has not engaged in an asset sale and they are not the record holders of shares in the subsidiary corporation.[46] Thus, a literal interpretation leads a rational reader of section 271 to conclude that a section 271 subsidiary asset sale transaction does not implicate a shareholder vote at the parent level. Concluding otherwise would reject the

40. *Id.* Also, see *infra* Section I.C and accompanying footnotes for a discussion on the importance of certainty in corporate law, and more specifically Delaware corporate law.

41. *In re* Home Shopping Network, Inc. S'holders Litig., No. 12956, 1993 Del. Ch. LEXIS 80 (May 19, 1993).

42. *Id.* at *35 (emphasis added).

43. *Id.* at *36–38. The Chancellor engaged in a lengthy discussion and considered legislative history because parts of § 203 were not clear and unambiguous on their face. *Id.* at *40.

44. DEL. CODE ANN. tit. 8, § 271(a) (2006).

45. *See id.* As discussed above in the Introduction, in *J.P. Griffin Holding Corp. v. Mediatrics, Inc.*, the Court of Chancery held that the only vote required was the vote of "the record holder of all of the shares" of the selling subsidiary corporation. No. 4056, 1973 Del. Ch. LEXIS 153, at *5 (Jan. 30, 1973). Because the defendant corporation was the record holder of all of the shares of its subsidiary and voted all of its shares in favor of the proposed sale, the requirements of § 271 were met. *Id.*

46. Rather, the parent corporation is the record holder of the subsidiary's shares.

"enhanced respect" for literal interpretation that Chancellor Allen encouraged, which would reduce the significant objectives of predictability and certainty in corporate law.[47]

Even if one assumes that the language of section 271 is unclear, the little available legislative history[48] buttresses the conclusion that a shareholder vote by the shareholders of the parent corporation is not required under section 271. The enactment of section 271 was meant to add additional flexibility in the procedure for a corporation to sell or otherwise dispose of its assets.[49] Prior to this, the common law provided that neither the directors nor shareholders could sell the corporation's assets if a single shareholder objected.[50] Interpreting an additional voting layer, despite the clear and unambiguous language, would undermine the flexibility section 271 was meant to provide. Moreover, a 1969 amendment indicates the Legislature's intent to restrict voting approval to those "entitled to vote thereon."[51] Prior to the amendment, section 271 required a vote by those "having voting power."[52] In many ways, the words "voting power" are broader and less precise than those "entitled to vote." A shareholder of the parent corporation may have voting power, in the sense that its voting may indirectly affect matters at the subsidiary level. Shareholders of the parent, however, are not entitled to vote because they are not holders of the subsidiary's stock. The amendment, though not completely dispositive, indicates that the Delaware Legislature intended to confine the shareholder vote to those "entitled to vote"—those entitled to vote are the holders of the majority of outstanding stock of the selling subsidiary corporation, not the shareholders of the parent corporation.

The exercise of statutory interpretation is often difficult and subject to the manipulation of a court.[53] This shortcoming, however, does not completely undermine the validity of considering how a provision should be interpreted. As discussed above, Delaware, and in particular the Delaware Court of Chancery, prefers a literal statutory interpretation approach that affords the language of a provision, where possible, its plain and simple meaning. Vice Chancellor Strine warned that such an interpretation in the context of megasubsidiary and conglomerate corporations may render sec-

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47. *See* Speiser v. Baker, 525 A.2d 1001, 1008 (Del. Ch. 1987).

48. Unfortunately, legislative history in Delaware is not methodically compiled. Treatises provide some brief legislative history. This Note will consider these scant pieces of information in supporting its conclusions.

49. WARD ET AL., *supra* note 5, § 271.1.

50. *Id.*

51. 2 R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS § 271, at X-2–X-3 (3rd ed. 1998 & Supp. 2006).

52. *Id.* at X-3.

53. Kenneth W. Starr, *Observations About the Use of Legislative History*, 1987 DUKE L.J. 371, 376 ("The most compelling and widely discussed concern about the use of legislative history is its potential for manipulation. It is often said that one generally finds in the legislative history only that for which one is looking.").

tion 271 irrelevant and an illusory check to board power.[54] Although this warning is helpful, the burden of addressing this concern should be placed on the Delaware Legislature. Delaware, as the largest and preeminent corporate law state, has an active legislature that aims to resolve corporate law issues as they arise.[55] Therefore, the legislature, not judges, should amend section 271 to address this concern of disenfranchising shareholders, if necessary. In fact, the legislature has refrained from amending section 271, despite the existence of *J.P. Griffin Holding Corp. v. Mediatrics, Inc.*, in which the court held that the "holders" under section 271 were the parent corporation, which held all of the shares of the subsidiary.[56] In essence, the Delaware Legislature by remaining dormant on this issue may have assented to the holding of the *J.P Griffin* court and deemed the result appropriate. As such, when a court reviews a section 271 subsidiary asset sale, it should require a shareholder vote only by the shareholders of the subsidiary, normally the parent corporation.

B. *Without Explicit Language, Requiring a Vote by Parent Shareholders Is Contrary to Corporate Law Objectives*

New York courts have held that a subsidiary asset sale under New York's corporate law does not require a parent shareholder vote. Although the holdings of other state courts are not binding in Delaware, they often provide some guidance on certain issues that are either of first impression or unresolved. For example, in *J.P. Griffin Holding Corp. v. Mediatrics, Inc.*, the Court of Chancery of Delaware, in concluding that only the record holder of all shares of the subsidiary selling the assets was required to vote, cited a New York state court decision that previously dealt with the subsidiary asset sale issue.[57]

Under New York law, the analogous provision to section 271 is section 909 of the New York Business Corporation Law, which provides that a "sale, lease, exchange or other disposition of all or substantially all of the assets of a corporation . . . shall be authorized . . . [when, among other required procedures] the shareholders shall approve such sale, lease, exchange or other disposition . . . by vote at a meeting of shareholders . . . of two-thirds of all

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54. Hollinger Inc. v. Hollinger Int'l, Inc., 858 A.2d 342, 348 (Del. Ch. 2004). Although the concern is legitimate, it is not novel and is implicated in other areas, as well. As discussed in Section II.B, corporations often effectuate mergers through subsidiaries via a triangular merger structure to obviate the need for shareholder approval of the parent shareholders. *See infra* Section II.B. Despite this effect, the courts have condoned this form of transaction and have refrained from interpreting § 251, the relevant merger statute, in a way to require a vote by the shareholders of the parent corporation, whose subsidiary is merging. *Hollinger*, 858 A.2d at 348.

55. *See* Wells M. Engledow, *Handicapping the Corporate Law Race*, 28 IOWA J. CORP. L. 143, 161 (2002).

56. No. 4056, 1973 Del. Ch. LEXIS 153, at *5 (Jan. 30, 1973).

57. *Id.* (citing Cross Props., Inc. v. Brook Realty Co., 322 N.Y.S.2d 773 (App. Div. 1971) (limiting the vote of shareholders to the record holders of the shares)).

outstanding shares entitled to vote thereon."[58] In *Cross Properties, Inc. v. Brook Realty Co.*, the Supreme Court, Appellate Division, of New York was called upon to interpret this section of the statute in attempting to determine "whether under New York law a sale of all or substantially all the assets of a New York corporation, which is essentially the wholly owned subsidiary of a twice or thrice removed foreign corporation, must be approved by the ultimate beneficial owners, that is, two thirds of the shareholders of the ultimate parent corporation."[59] Similar to Vice Chancellor Strine's recognition of corporations placing their assets under subsidiaries,[60] the New York court noted the trend of "conglomerate corporate enterprises and so-called megasubsidiaries," which undoubtedly results in some dilution of shareholder voting power.[61] This dilution of shareholder power, however, did not compel the court to read into the statutory language of section 909 to require a shareholder vote by the ultimate beneficiary owners, the shareholders of the parent corporation.[62] The court, rather, chose to interpret the word "shareholders" in section 909 under its plain language by concluding that "'shareholders' referred to in paragraph (3) [of section 909] are the 'shareholder[s] of record'" and not the shareholders of the parent corporation of the subsidiary selling the assets.[63] In following this strict interpretation, the court deferred to the New York Legislature and placed the burden on the legislature to make any sort of requirement of a parent shareholder vote explicit.[64]

The *Cross Properties, Inc.* court's choice not to expand the voting requirement of section 909 to include a vote by shareholders of the parent corporation is justified not only on statutory interpretation grounds, as discussed above, but also on the basis of promoting certainty and definiteness in corporate transactions. In defending its holding, the court explained the potential consequences of holding otherwise: "Such a construction would jeopardize the *definiteness required for the orderly transaction of corporate affairs* and would substantially impair the marketability of [the assets] held by corporate subsidiaries by making the necessity for approval a complex

58. N.Y. BUS. CORP. LAW § 909 (McKinney 2003). Unlike § 271 of the DGCL, § 909 requires a two-thirds vote of all outstanding shares. Section 271 only requires an affirmative vote by the majority of all outstanding shares. DEL. CODE ANN. tit. 8, § 271(a) (2006).

59. *Cross Props., Inc.*, 322 N.Y.S.2d at 779.

60. Hollinger Inc. v. Hollinger Int'l., Inc., 858 A.2d 342, 348 (Del. Ch. 2004).

61. 322 N.Y.S.2d at 780 (recognizing "that utilization of pyramiding corporations often results in the dilution or denial of many shareholder prerogatives").

62. *Id.* Interestingly enough, the court explicitly stated in its opinion that the trend of developing corporate conglomerates and holding companies adversely affects shareholder rights and prerogatives. Despite this noted consequence, the court refrained from infusing judicial paternal protection to shareholders.

63. *Id.*

64. *Id.* The court emphasized that megasubsidiaries and alike existed before § 909 was amended by the New York Legislature in 1962. Despite this existence, the Legislature chose not to amend § 909 to require a vote by parent shareholders in a subsidiary asset sale scenario. *Id.* One can construe not amending § 909 as a form of legislative assent. *See id.*

question of fact."[65] In other words, the importance of certainty and definiteness in corporate matters, in this case, trumped the consideration of dilution of shareholder voting power.[66] Had the court interpreted the statute otherwise, the methodology of corporate statutory law interpretation would lose certainty. With lesser certainty on the voting issue, subsidiaries would have greater difficulty in effectuating asset sales.[67] Such difficulty would likely impede certain value-creating sales, which would ultimately hurt shareholders by not maximizing shareholder value.[68]

The policy consideration of promoting definiteness in corporate matters through predictable statutory interpretation has similar applicability under Delaware law. Like the New York statute, section 271's language, if interpreted plainly, does not require a vote by shareholders of a parent corporation. Without explicit direction from the Delaware Legislature, Delaware courts should be reluctant to infuse an additional layer of shareholder voting. Muddying the interpretation of section 271 will reduce the certainty of Delaware corporate law interpretation.[69] With less certainty, corporations and their boards of directors will naturally act overly cautious and spend valuable resources in attempting to transact in an environment of less certainty.[70]

C. *Explicit Statutory Language Allows for a Parent Shareholder Vote While Still Fostering an Environment of Certainty and Definiteness*

Unlike New York law, New Jersey law and the Model Business Corporation Act both provide explicit language that shareholder approval in the context of a subsidiary asset sale constitutes a vote by the shareholders of a

65. *Id.* at 780 (emphasis added).

66. Later in the opinion, the court did note that fiduciary duties may provide shareholders with adequate protections. *Id.* at 781 ("A sale thus known to be opposed by the majority of the shareholders of the parent (although approved by the directors of the subsidiaries) might constitute a breach of fiduciary obligation")). Later in this Note, I discuss how the duties of loyalty and care under Delaware law provide adequate assurances that the parent corporation and its directors will not act against the interests of shareholders in effectuating § 271 subsidiary asset sales. *See infra* Section II.C.

67. *See* Elliott J. Weiss & Lawrence J. White, *Of Econometrics and Indeterminacy: A Study of Investors' Reactions to "Changes" in Corporate Law*, 75 CAL. L. REV. 551, 569 (1987) (stating generally that "the law's certainty and predictability will reduce transaction costs and facilitate consummation of mergers that presumably benefit the corporation and its shareholders").

68. *See id.*

69. See *infra* Section I.C where I anchor the policy considerations of certainty and definiteness in Delaware case law. Because Delaware is the state where many corporations incorporate, the Delaware courts have placed great emphasis on interpreting laws in a method that promotes certainty, which better enables corporations to plan and transact accordingly.

70. One could argue that granting directors discretion over § 271 subsidiary asset sales increases agency costs and may encourage directors to strip the corporation of its assets, which could destroy shareholder value and ultimately result in a higher cost of capital in the public markets. Such an argument, however, fails to consider the fiduciary duties imposed on directors by Delaware law, namely the duty of loyalty and the duty of care. See *infra* Section II.C for a discussion on how these duties provide adequate protection to shareholders.

parent corporation. Section 14A:10-11 of the New Jersey Corporation Act is the sale of assets provision and requires a shareholder vote approving the sale of all or substantially all of a corporation's assets.[71] The statute further states that "[t]he sale, lease, exchange, or other disposition of all, or substantially all, the assets of one or more subsidiaries of a corporation . . . shall be treated as a disposition within the meaning of subsection 14A:10-11(1) if the subsidiary or subsidiaries constitute all, or substantially all, the assets of the corporation."[72] The inclusion of this additional subsection in section 14A:10-11 ensures that if a wholly owned subsidiary comprises all or substantially all of the assets of a parent corporation, the sale by the subsidiary of its assets is treated as a sale by the parent.[73] In essence, the New Jersey statute *explicitly* eliminates the separate corporate existence of a parent's subsidiary in the context of a subsidiary asset sale. In terms of shareholder approval, a sale by a subsidiary of the parent is like a sale by the parent.

The New Jersey approach of viewing a subsidiary asset sale as an asset sale by the parent corporation aligns with the language provided in the Model Business Corporation Act. Section 12.02(h) of the Act states that "[t]he assets of a direct or indirect consolidated subsidiary shall be deemed the assets of the parent corporation for the purposes of this section [section 12, which is the section for disposition of assets]"[74] Again, the approach is to treat the subsidiary and the parent as one entity thus requiring a vote by the shareholders of the parent corporation. This approach ensures that shareholders are entitled to vote on the sale of substantially all of the assets of their corporation, whether placed under a subsidiary or not.

The dangers and concerns of interpreting the statute to provide additional shareholder protections do not exist, because the New Jersey statute and the Model Business Corporation Act are both explicit in their establishment of a vote by shareholders of the parent corporation. This explicit direction maintains certainty and definiteness in interpretation while still requiring a parent shareholder vote.[75]

Despite the fact that the New Jersey/Model Business Corporation Act and New York approaches reach different results, they both ensure certainty and definiteness, which is likely to encourage and facilitate corporate transactions.[76] This certainty will likely reduce the transaction costs of subsidiaries selling their assets, thereby increasing the value gained by subsidiaries in exchange for the assets they sell.

In considering this comparative analysis, section 271 of the DGCL most resembles New York's section 909 in that both statutes do not provide for

71. N.J. STAT. ANN. § 14A:10–11 (West 2003).

72. *Id.*

73. JOHN R. MACKAY II, NEW JERSEY BUSINESS CORPORATIONS AND OTHER BUSINESS ENTITIES § 9-5 (3d. ed. 2005).

74. MODEL BUS. CORP. ACT § 12.02(h) (2002).

75. *See infra* notes 32–34 and accompanying text.

76. *See* Weiss & White, *supra* note 67.

treatment of a subsidiary asset sale as a sale by the parent. Following the New York interpretation ensures that Delaware courts refrain from creating additional voting requirements that are not explicitly provided for in the statutory language. Moreover, interpreting "holders of a majority of the outstanding stock" to mean the record holders of the shares of the selling entity, which in the case of a subsidiary asset sale would be the subsidiary, promotes greater certainty in the Delaware corporate law regime. This enhanced value ultimately inures to the benefit of the shareholders of the parent corporation.[77]

The relevance and influence of policy considerations of "certainty" and "definiteness" under Delaware law are not limited to the discussions and articles of academics.[78] Rather, the Delaware courts have mentioned the importance of such considerations in determining the outcome of cases. For example, in *Stroud v. Grace*, the Supreme Court of Delaware considered the scope of the duty of disclosure by the board of directors in connection with proposed charter amendments.[79] In reviewing the trial court's extension of the duty of disclosure, the court emphasized that "*[i]t is important that there be certainty in the corporation law*."[80] This consideration of certainty drove the court to conclude that the board had no duty to disclose beyond the requirements provided on the face of the relevant statute.[81] Certainty in interpreting the relevant DGCL statute compelled the court to dismiss the plaintiffs' arguments against the defendant board of directors.[82]

Certainty in interpreting corporate law provides more bright-line tests, which creates a more conducive and efficient transactional environment for corporations. Corporations are more likely to transact, and more specifically in this context, sell and buy assets when they know with greater certainty the required approvals that must be attained. Furthermore, with greater certainty, the chances of litigation are substantially reduced, thus saving corporations significant money in litigation costs. The more efficient transactional market and reduced litigation costs all ultimately lead to greater shareholder value.[83]

Establishing that certainty is an important consideration reinforces this Note's central argument that a board of directors authorizing a section 271 subsidiary asset sale need not attain shareholder approval from the

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77. *Id.*

78. For a few examples, see Isaac Ehrlich & Richard A. Posner, *An Economic Analysis of Legal Rulemaking*, 3 J. LEGAL STUD. 257 (1974); Werner Z. Hirsch, *Reducing Law's Uncertainty and Complexity*, 21 UCLA L. REV. 1233 (1974); and Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557 (1992).

79. 606 A.2d 75 (Del. 1992).

80. *Id.* at 87 (emphasis added).

81. *Id.*

82. *Id.*

83. Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 572 (explaining that litigation costs, such as settlement payments, ultimately lead to "destruction of shareholder value").

shareholders of the parent corporation. Section 271's language on its face only requires a vote by the "the holders of a majority of the outstanding stock."[84] Since the shareholders of the parent corporation are not the holders of the stock of the selling corporation, the subsidiary, their vote is not needed. Ruling otherwise would promote uncertainty in legal interpretation, which, as established above, is contrary to the edicts of the Delaware courts. In the event the Delaware legislature deems a vote at the parent shareholder level necessary, amending section 271 to adopt explicit legislative language[85] requiring a vote by shareholders of the parent corporation is the best course of action in that it protects shareholder interests while not sacrificing certainty in the DGCL.

II. Considering Subsidiary Asset Sales under Delaware Law

This Part determines that Delaware's statutory framework doctrinally supports a shareholder vote only by the record shareholders of a subsidiary. Specifically, Section II.A considers the doctrine of separate corporate existence, which generally treats a corporation as a separate legal entity independent of its shareholders, subsidiaries, and other constituencies. Thereafter, Section II.B catalogues a number of form-over-substance transactions that Delaware courts have repeatedly condoned, despite their consequence, whether intended or not, of infringing on shareholder rights. This analysis helps to rebut arguments mandating a parent shareholder vote in the context of a section 271 subsidiary asset sale in order to better protect shareholder rights. Finally, Section II.C engages in a brief fiduciary duty analysis that supports the conclusion that traditional fiduciary duties provide ample protection for shareholders in the context of section 271 subsidiary asset sale transactions.

A. *Upholding the Doctrine of Separate Corporate Existence*

As a general matter under Delaware law, a corporation is treated as an independent legal entity with a separate existence from its shareholders, management, and subsidiaries.[86] Consequently, a parent corporation is separate from its subsidiary corporation, and therefore, parent shareholders do not have voting rights as they relate to actions conducted by the subsidiary. Addressing this issue is critically important, because in essence, disregarding the corporate existence could provide parent shareholders with a claim that a section 271 subsidiary asset sale transaction mandates a vote by shareholders of the parent corporation. Such an argument would ignore the

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84. Del. Code Ann. tit. 8, § 271(a) (2006).

85. Explicit legislative language should be similar to the language adopted by New Jersey, the Model Business Corporation Act, and other states. *See supra* Section I.C.

86. David A. Drexler et al., Delaware Corporation law and Practice § 8.02 (2004) ("Historically, Delaware courts have been meticulous in their recognition of the concept of separate corporate existence; there are only a handful of reported cases in which the 'corporate veil' has been 'pierced.' ").

repeated efforts of Delaware courts to recognize and uphold the separate legal existence of corporations.[87]

Historically, Delaware courts have repeatedly and meticulously recognized the concept of separate corporate existence.[88] For example, in *In re Sunstates Corp. Shareholder Litigation*, the Court of Chancery of Delaware considered the plaintiffs' agency and veil piercing argument.[89] It concluded that "[f]or the purposes of the corporation law, the act of one corporation is not regarded as the act of another merely because the first corporation is a subsidiary of the other, or because the two may be treated as part of a single economic enterprise for some other purpose."[90] The court then limited the disregard of separate existence to circumstances of sham and fraud.[91]

The Supreme Court of Delaware expressed a similar sentiment about the issue.[92] It held that a court may only disregard separate corporate existence "in the interest of justice, when such matters as fraud, contravention of law or contract, public wrong, or where equitable consideration among members of the corporation require[s] it."[93] Importantly, the circumstances meriting disregard did not include the effectuation of a legitimate section 271 subsidiary asset sale. Fraud and public policy are compelling exceptions to respecting the corporate form of entities, but without indication of fraud, courts should continue to preserve the separate existence of corporate entities. Broadening the exceptions to encompass garden-variety asset sales held at the subsidiary level ignores the Delaware courts' overwhelming trend of upholding the separate existence of corporate entities while exaggerating the intended scope of cases like *Leslie*. Moreover, the Delaware courts have demonstrated that "disenfranchisement" of shareholders in the context of a triangular merger is not necessarily a dispositive reason to disregard corporate existence.[94]

Expanding the circumstances that justify the piercing of the corporate veil and disregard of separate corporate entities has significant policy implications. The notion of treating a corporation as an independent legal entity, one separate from its shareholders, officers, and subsidiaries, is critical and corollary to the concept of limited liability.[95] Without separate corporate existence, limited liability and its many benefits are threatened. Among other things, limited liability facilitates the development of and investment

87. *Id.*

88. *Id.*

89. 788 A.2d 530 (Del. Ch. 2001).

90. *Id.* at 534.

91. *Id.*

92. Pauley Petroleum, Inc. v. Cont'l Oil Co., 239 A.2d 629 (Del. 1968).

93. *Id.* at 633.

94. *See infra* Section II.B (discussing triangular mergers).

95. Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036, 1039 (1991).

in public capital markets for stock ownership in companies.[96] Additionally, without separate corporate existence, certain benefits of shareholders, who are also employees of a corporation, may be reduced, because courts and other governmental entities may then view corporations and their shareholders as one.[97] For example, a shareholder-employee's claim for unemployment benefits may be threatened if the corporation was disregarded and the shareholder-employee was considered a self-employed individual.[98] The importance of these policy considerations requires that disregard only occur with clear legislative intent, such as the case in New Jersey.[99] Therefore, a court should cautiously consider disregarding the separate existence of corporate entities, especially when fraud and sham circumstances are absent.

Courts, however, have disregarded the separate existence of a corporation in certain limited circumstances. For example, in *Leslie v. Telephonics Office Technologies, Inc.*, shareholders of the parent corporation argued for disregarding the separate existence of the parent corporation and subsidiary because they alleged the subsidiary was the alter ego of the parent corporation, thereby requiring a vote by parent shareholders.[100] As explained in *Leslie*, Delaware courts have long recognized the:

> independent legal existence of corporate entities. . . . There are certain exceptions to this rule, however. The use of the corporate form to perpetuate a fraud has always constituted such an exception. Furthermore, when courts determine that a corporation is, in substance, the mere alter ago, or

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96. *Id.* at 1040 (explaining that "[w]ithout limited liability, the risk each investor would face in investing in an enterprise would turn in part on the wealth of other investors. Such a system would have search costs and other costs which would likely lead investors to make a few larger investments where risk-assessment information was accessible, and perhaps entail a reduced level of economic activity across the entire economy."). In the article, the author cites to a number of articles that support the conclusion that limited liability is critical to the public capital markets, including Paul Halpern et al., *An Economic Analysis of Limited Liability in Corporation Law*, 30 U. TORONTO L.J. 117 (1980) and Henry G. Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA L. REV. 259 (1967).

97. *See* Thompson, *supra* note 95, at 1041. Professor Thompson cites two specific cases that provide examples of the danger of disregarding separate legal existence. He first cites to *Markarian v. Califano*, 473 F. Supp. 671 (W.D.N.Y. 1979), in which the court held that the Social Security Administration could not pierce the veil of a close corporation to decrease a claimant's eligibility for benefits on the grounds that earnings were to be considered as coming from a sole proprietorship. Thompson, *supra* note 95, at 1041 n.30. By preserving the separate existence, the claimant, who was a shareholder/employee, was able to claim Social Security benefits. Reaching a different result, in *Roccograndi v. Unemployment Comp. Bd. of Review*, 178 A.2d 786 (Pa. Super. Ct. 1962), the court concluded that the holding shareholder/employees were self-employed and, therefore, ineligible for unemployment benefits. Thompson, *supra* note 95, at 1041 n.31. In this case, the decision by the court ultimately punished shareholders. Analyzing these two cases in conjunction helps to establish the risk, from the shareholder perspective, of regularly disregarding the separate existence of corporations, their shareholders, and their subsidiaries.

98. Thompson, *supra* note 95, at 1041.

99. N.J. STAT. ANN. § 14A:10-11 (2003).

100. No. 13045, 1993 Del. Ch. LEXIS 272, at *26-27 (Dec. 30, 1993).

instrumentality of its owners, they will in certain instances, deny legal effect to the otherwise valid creation of a corporate entity.[101]

The *Leslie* court ultimately denied the motion to dismiss the claim to disregard by explaining that the actions of the parent and subsidiary corporations could justify disregarding their separate existence and treating the parent and subsidiary as a single legal entity under the common control of the parent corporation.[102]

Leslie potentially implicates broad issues by opening the door to disregarding the separate legal existence of corporations, specifically between parent and subsidiary corporations. The following considerations help to limit *Leslie* to its facts and reassure the preservation of the independent legal existence doctrine. First, the hesitancy of the court's language is quite apparent. The court inserted a number of critical qualifiers to its statement that an instrumentality claim is a viable exception to the recognition of independent corporate existence. The court first took great effort to explain that "courts have generally recognized the independent legal existence of corporate entities."[103] Furthermore, even in an instance where "a corporation is, in substance, the mere alter ego, or instrumentality of its owners, [courts] will in *certain instances*, deny legal effect . . . ."[104] The court then concluded its discussion on when to disregard the separate corporate existence by emphasizing that "*more often than not*, Delaware courts have upheld the legal significance of corporate form, in a corporate-subsidiary complex."[105] Although one could deem the court's construction of the alter ego/instrumentality exception as potentially expansive, these many limitations and qualifiers help to limit the broad read of the language. Additionally, the court's language as dicta, and not a holding, does not possess the same precedential strength as earlier cases do, which limit the disregard of separate corporate existence to the circumstances of fraud or evasion of a judicial decree.[106]

A second reason to refrain from broadening the implications of *Leslie* is that it involved a potential oppression of minority shareholders and was not a typical instrumentality case. The court noted that plaintiffs alleged that the

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101. *Id.* at *26–27 (citing Walsh v. Hotel Corp. of Am., 231 A.2d 458, 461 (Del. 1953), in which the Delaware Supreme Court refused to "decide the general proposition as to when a Delaware law court may disregard the corporate structure"). Interestingly, the "alter ego/instrumentality" exception is a more recent development and supported mostly by dicta in Delaware. DREXLER ET AL., *supra* note 86.

102. *See Leslie*, 1993 Del. Ch. LEXIS 272 (Dec. 30, 1993).

103. *Id.* at *26.

104. *Id.* (emphasis added).

105. *Id.* at *26–27 (emphasis added).

106. *E.g.*, Pauley Petroleum, Inc. v. Cont'l Oil Co., 231 A.2d 450, 452–53 (Del. Ch. 1967) ("In the absence of fraud, the separate entity of a corporation is to be recognized. This principle has been enunciated by all of the courts of this state." (quoting Shaffer v. Standard Brands Inc., 178 A.2d 311, 316 (Del. Ch. 1962), *aff'd*, 187 A.2d 78 (Del. 1962))). The *Leslie* opinion is also unpublished and therefore does not carry much precedential weight. *Leslie*, 1993 Del. Ch. LEXIS 727, at *1.

defendant shareholders used their control over the parent corporation to control the subsidiary to help "siphon off assets to themselves [the defendant shareholders], at a cost to shareholders."[107] This action, the plaintiffs claimed, led to the distribution of proceeds to the defendant shareholders to the exclusion of minority shareholders.[108] Oppression of minority shareholders is out of the ordinary and compels a restriction on the reading of *Leslie* as it relates to the doctrine of independent corporate existence, primarily because the driving force in *Leslie* was thwarting oppression of minority shareholders and not reshaping the doctrine of independent corporate existence. The facts also are dissimilar to the circumstances of a typical section 271 subsidiary asset sale transaction, where the subsidiary sells its assets but does nothing to siphon off the proceeds.[109] In a customary section 271 subsidiary asset sale, the *Leslie* facts are inapplicable and therefore applying the court's dicta directive would be inappropriate.

In practice, the Delaware courts have chosen to follow the approach of *In re Sunstates Corp. Shareholder Litigation* by limiting the circumstances of corporate veil piercing. An empirical study found that as a practical matter, Delaware courts rarely disregard the separate existence of Delaware corporations and their constituencies by piercing the corporate veil,[110] particularly in the context of a public corporation.[111] This practice, though not inconsistent with the arguments provided in *Leslie*, aligns with the past historical stance that protects the separate existence of corporate entities, unless evidence of fraud and/or sham intentions is evident.[112]

B. *Form-over-Substance Transactions: Two Illustrative Examples*

A possible argument against the central thesis of this Note is that not requiring a shareholder vote by the shareholders of the parent corporation, the ultimate beneficiaries and "true" shareholders, favors form over substance, which allows directors of Delaware corporations to engage in asset sales without shareholder approval. In response to this argument, it is most important to highlight that Delaware law often favors form over substance.[113] This

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107. *Leslie*, 1993 Del. Ch. LEXIS 272, at *27–28.

108. *Id.* at *28.

109. *Leslie* is also distinguishable on the basis that it involved interested directors/shareholders. *Id.* at *27–28. Because of the existence of a conflict of interests, a court would normally ignore the business judgment rule presumption and more diligently scrutinize the decision of the directors to sell the company's assets. In contrast, in a typical disinterested § 271 subsidiary asset sale transaction, a court would review the directors, decision to sell the assets under the business judgment rule presumption. *See infra* Section II.C.

110. Thompson, *supra* note 95, at 1052–53. Furthermore, "a piercing decision is not less but *more likely* when the shareholder behind the veil is an individual rather than another corporation." *Id.* at 1038 (emphasis added). In our context, we are dealing with a corporation, the parent corporation, and not an individual, so piercing is less likely.

111. *Id.* at 1039.

112. *See* Pauley Petroleum Inc. v. Cont'l Oil Co., 239 A.2d 629 (Del. 1968).

113. Discussing whether normatively a form-over-substance approach is best is not within the scope of this Note. Such a discussion requires a separate extensive analysis.

Section dissects two such examples helping to reaffirm that a form-over-substance approach in the section 271 subsidiary asset sale context is not unusual, but rather a norm established by Delaware precedent.

Delaware's form-over-substance bias is most apparent in the context of triangular mergers. Under section 251 of the DGCL, two corporations may merge into one surviving corporation with the approval of shareholders of the two "constituent" corporations.[114] Assuming an ordinary stock-for-stock merger structure, the shareholders of both the acquiring corporation and the target corporation must approve the transaction.[115] A relatively recent structure, called a triangular merger, allows for the acquiring corporation to eliminate the requirement of attaining its shareholder approval. By using a wholly owned subsidiary as the acquiring entity, the "constituent" corporation becomes the subsidiary and not the parent; therefore, the vote to authorize the transaction is required from the shareholders of the subsidiary, which is the parent corporation, and not the shareholders of the parent corporation.[116]

The indirect effect of using a triangular merger structure is that the shareholders of the parent corporation, the ultimate acquirer, "do not have the right to vote on the merger nor are they entitled to appraisal rights"[117] since the parent corporation is not a constituent corporation under section 251(c).[118] Both the structure and effect of triangular mergers are analogous to those of section 271 subsidiary asset sale transactions. Delaware courts have, as indicated below, repeatedly upheld the triangular merger structure, despite the effects it has had on the rights of parent shareholders. One prominent case in which this structure arose and was upheld is *Paramount Communications, Inc. v. Time Inc.*, where the Delaware Supreme Court dealt primarily with the issue of whether the defensive mechanisms adopted by Time to protect its friendly merger with Warner were in accordance with the *Unocal* standard.[119] The Court noted that the reverse triangular merger structure under "Delaware law did *not* require any vote by Time shareholders."[120]

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114. DEL. CODE ANN. tit. 8, § 251(c) (2006). The merger must also involve an increase of at least 20 percent of the surviving corporation's shares to implicate a vote. *Id.*

115. *Id.*

116. SAMUEL C. THOMPSON, JR., BUSINESS PLANNING FOR MERGERS AND ACQUISITIONS 194–95 (2d ed. 2001) (quoting R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS §§ 9.5, 9.7 (1988)).

117. *Id.* Generally, under § 262, dissenting shareholders of a constituent corporation are afforded appraisal rights as a remedy to a merger. Tit. 8, § 262.

118. Tit. 8, § 251(c).

119. 571 A.2d 1140 (Del. 1989).

120. *Id.* at 1146 (emphasis added). Interestingly enough, prior to a hostile bid by Paramount to acquire Time, the board of Time had structured the merger as a stock merger, thus implicating a vote under New York Stock Exchange rules. *See id.* Upon the issuance of the hostile bid, the Time board restructured the transaction as a cash deal to avoid the New York Stock Exchange voting requirement and ensure that shareholders did not possess veto power on the proposed Time-Warner deal through their exercise of voting. *See id.* Despite this, Chancellor Allen held that the Time board did not breach its fiduciary duties. Edward B. Rock, *Saints and Sinners: How Does Delaware Law Work?*, 44 UCLA L. REV. 1009, 1174 n.182 (1997).

In fact, these structures are commonly accepted under Delaware law and there is no mention of oppression of shareholder rights.

Why oppression of shareholder rights would dominate the determination of section 271 subsidiary asset sale and not a triangular merger is difficult to explain or justify. In both structures, the parent corporation effectuates a transaction using a subsidiary, which has the effect of denying the parent shareholders of voting rights (and in the case of a triangular merger, appraisal rights, too). Upholding triangular mergers while disallowing section 271 subsidiary asset sales without approval by parent shareholders is seemingly inconsistent. As Delaware's treatment of triangular mergers illustrates, in the absence of fiduciary duty violations, Delaware upholds the form of a transaction despite the substantive adverse effects on certain shareholders' rights. Therefore, a section 271 subsidiary asset sale should not require shareholder approval at the parent corporation level, absent legislative action to the contrary.

A second example of where the Delaware courts have elevated form over substance, despite the adverse effects on shareholders, is the de facto merger doctrine. In *Hariton v. Arco Electronics, Inc.*, the Supreme Court of Delaware dealt with the issue of whether a proposed section 271 asset sale followed by a mandatory plan of dissolution and distribution was in fact a de facto merger that implicated appraisal rights under section 262.[121] In the case, the defendant corporation agreed to an asset sale under section 271 in exchange for stock in the acquiring corporation.[122] As part of this asset sale, the defendant corporation agreed to call a shareholder meeting to approve a voluntary liquidation and dissolution, whereby the shares of the acquiring corporation would be distributed to the shareholders of the defendant corporation.[123] In effect, the plaintiff argued that this set of transactions, the asset sale and liquidation, accomplished the same result as a merger of the defendant corporation into the acquiring corporation.[124]

Despite the substance of the transaction, the court denied appraisal rights. The court recognized that the "[p]laintiff's contention that this sale has achieved the same result as a merger is *plainly correct*."[125] Most significantly, the structure had the effect of denying dissenting shareholders their appraisal rights.[126] Despite this recognition, the Court held that "the reorganization here accomplished through [section] 271 and a mandatory plan of dissolution and distribution is legal."[127] The Court justified its position by

121. 188 A.2d 123 (Del. 1963).

122. *Id.* at 124.

123. *Id.*

124. *Id.*

125. *Id.* at 125 (emphasis added).

126. There are no appraisal rights for dissenting shareholders in a § 271 transaction. DEL. CODE ANN. tit. 8, § 262 (2006).

127. *Hariton*, 188 A.2d at 125 ("[The holding of the case] is so because the sale-of-assets statute and the merger statute are independent of each other. They are, so to speak, of equal dignity,

explaining that the board of the defendant corporation was free to choose among the different transaction structures available, and so long as the technical requirements of that structure were met, the Court must respect the form.[128]

The consequence of denying shareholders their appraisal rights under this "de facto merger" transaction did not compel the Court to grant shareholders appraisal rights. In fact, the Court concluded by noting that its conclusion "is not an anomalous result in our corporation law."[129] If the form of a transaction is properly followed under Delaware law, the courts will generally avoid disrupting it regardless of the adverse effects on shareholders.

Both the *Hariton* and *Paramount* cases are illustrative examples of how Delaware courts often elevate form over substance. If a board of directors appropriately follows the relevant Delaware form, be it a triangular merger or an asset sale followed by dissolution, a Delaware court is likely uphold the transaction, despite its adverse effects on shareholders. Similarly, a court should uphold a section 271 subsidiary asset sale that is effectuated only by a vote of the shareholders of the subsidiary, the parent corporation, so long as the form requirements are met and there is no violation of fiduciary duties.

C. *Fiduciary Duties: Protection for Shareholders of Parent Corporations Engaging in Subsidiary Asset Sales*

Allowing for a section 271 subsidiary asset sale transaction to proceed without a vote by the shareholders of the parent corporation may seem problematic to many because of its disenfranchising effect on shareholders. Section 271 was meant to protect shareholders from a corporation unilaterally deciding to sell all or substantially all of its assets, thus changing the substance and purpose of the corporation. Although this consideration does not prevail in the section 271 subsidiary asset sale context, fiduciary obligations provide shareholders adequate protection from the actions of the board of directors in this context.

As provided by the Delaware courts, directors owe shareholders fiduciary duties: the duty of loyalty and the duty of care.[130] In *Smith v. Van Gorkom*,[131] the Delaware Supreme Court explained that directors owe shareholders these duties. The duty of care, among other things, includes a duty to be informed, "prior to making a business decision, of all material information reasonably

and the framers of a reorganization plan may resort to either type of corporate mechanics to achieve the desired end. This is not an anomalous result in our corporation law.").

128. *See id.*

129. *Id.*

130. WARD ET AL., *supra* note 5, § 141. The case law discussing fiduciary duties is extensive. This Note only engages in a brief analysis of these duties as they relate to a § 271 subsidiary asset sale transaction.

131. 488 A.2d 858 (Del. 1985).

available to them."[132] A duty of loyalty "embodies not only an affirmative duty to protect the interests of the corporation, but also an obligation to refrain from conduct which would injure the corporation and its stockholders or deprive them of profit or advantage."[133] Generally, the more significant the subject matter of the decision, the greater is the requirement on directors to probe and consider alternatives, in essence, to "perfect" their fiduciary duties.[134]

Fiduciary duties similarly protect shareholders in subsidiary asset sales. In a section 271 subsidiary asset sale transaction, the directors of the parent corporation owe the standard fiduciary duties toward their shareholders. As such, shareholders are protected from decisions based on gross negligence[135] and/or self-dealing.[136] In the ordinary course, a court will apply the business judgment rule presumption that the directors acted honestly and in good faith with respect to the section 271 subsidiary asset sale transaction.[137] The business judgment rule confers upon the directors a relatively broad amount of discretion in selling the assets of the corporation.[138] This discretion, however, will be denied if a court determines that the directors violated any of their fiduciary duties to shareholders.[139] Therefore, a director's grossly and uninformed vote to authorize a subsidiary asset sale would be overturned. Additionally, a court would reverse a subsidiary asset sale that somehow violated the duty of loyalty or, at a minimum, provide shareholders sufficient monetary damages.

Ultimately, the shareholders of a parent corporation engaging in a section 271 subsidiary asset sale are provided adequate protection through the fiduciary duties of care and loyalty. These two fiduciary duties provide baseline protection for shareholders against actions by the board of directors. This protection helps to alleviate any concerns, as noted by Vice Chancellor Strine,[140] that shareholders are at the mercy of directors if the courts allowed

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132. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984). Put another way, "the duty of care requires a director, when making a business decision, to proceed with a 'critical eye' by acting in an informed and deliberate manner respecting the corporate merits of an issue before the board." Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1345 (Del. 1987).

133. *Ivanhoe Partners*, 535 A.2d at 1345. "Most basically, the duty of loyalty proscribes a fiduciary from any means of misappropriation of assets entrusted to his management and supervision." WARD ET AL., *supra* note 5, § 141.2.1.1.

134. *See* WARD ET AL., *supra* note 5, § 141.

135. *Van Gorkom*, 488 A.2d at 873 (providing that "the concept of gross negligence is also the proper standard for determining whether a business judgment reached by a board of directors was an informed one").

136. *Id.* at 872.

137. Gimbel v. Signal Cos., 316 A.2d 599, 609 (Del. Ch. 1974) (providing that "[t]his presumption, an important aspect of what has generally come to be known as the 'business judgment rule,' has been consistently reaffirmed and broadened with respect to the sale of corporate assets over the past several decades," and citing a number of Delaware decisions supporting this conclusion).

138. *Id.*

139. *Id.*

140. *See* Hollinger Inc. v. Hollinger Int'l, Inc., 858 A.2d 342, 348 (Del. Ch. 2004).

section 271 subsidiary asset sales to proceed without a vote by shareholders of the parent corporation. Moreover, holding that a section 271 subsidiary asset sale does not need approval by parent shareholders preserves the structure of Delaware corporate law. As in other contexts, Delaware corporate law defers to the sound business judgment of directors, who are more sophisticated and possess greater expertise than judges; at the same time, the standard fiduciary duties of loyalty and care provide adequate safeguards to protect shareholders in the event directors violate their duties toward shareholders. Therefore, arguments of shareholder oppression in the context of a section 271 subsidiary asset sale are as unconvincing as the argument that shareholders, in a hypothetical situation, should have a remedy against directors for making an informed, good faith business decision to expand operations internationally that ultimately failed.

CONCLUSION

Many academics and commentators will argue that allowing section 271 subsidiary asset sales to proceed without approval by the shareholders of the parent corporation will only contribute to Delaware's continual "race to the bottom."[141] This critique, however, fails to consider the practical implications of creating an additional voting layer at the parent shareholder level. As demonstrated in this Note, Delaware aims to promote predictability and certainty in its law, particularly in the context of its method of interpreting corporate law. This predictability and certainty fosters a more conducive transactional environment that allows corporations to efficiently and effectively transact. Disrupting this environment should only be done as a last resort or explicitly by the Delaware Legislature. Section 271 allows for a corporation to sell all or substantially all of its assets so long as it attains shareholder approval. Logically, a subsidiary selling its assets under section 271 need only attain approval from *its* shareholders, the parent corporation. Holding otherwise threatens the edicts of the Delaware corporate law and disturbs the conducive transactional nature of Delaware corporate law.

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141. *See* Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U. L. REV. 913, 915 (1982) (arguing that recent "decisions, although containing much rhetoric about protection of shareholders, will actually operate to reduce shareholders' welfare" (emphasis omitted)).