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## THE NEW LAW OF SQUEEZE-OUT MERGERS

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## I. INTRODUCTION

In response to the United States Supreme Court's decision in *Santa Fe Industries, Inc. v. Green*,<sup>1</sup> which sharply limited the role of federal securities law in redressing acts of corporate malfeasance, the Delaware Supreme Court, in *Singer v. Magnavox Co.* and its progeny,<sup>2</sup> expanded the protection available to investors in the context of squeeze-out mergers.<sup>3</sup> According to some proponents of corporate accountability, however, the Delaware Supreme Court's decision in *Weinberger v. UOP, Inc.*<sup>4</sup> indicates a return to the "race for the bottom" in state corporate law.<sup>5</sup>

1. 430 U.S. 462 (1977).

2. *Roland Int'l Corp. v. Najjar*, 407 A.2d 1034 (Del. 1979); *Tanzer v. International Gen. Indus., Inc.*, 379 A.2d 1121 (Del. 1977); *Singer v. Magnavox Co.*, 380 A.2d 969 (Del. 1977).

3. Every state's corporation law provides a statutory procedure by which two or more corporations can be combined into a single corporation even though less than all shareholders approve. A squeeze-out merger involves the use of this statutory merger device by the principal owner of the corporation to eliminate the minority shareholders from the corporation. In *Singer*, the Delaware Supreme Court required the majority to act pursuant to a valid business purpose, other than eliminating the minority interests, in effecting a cash-out merger as well as to act with entire fairness to the minority. *Singer v. Magnavox Co.*, 380 A.2d 969, 978-80 (Del. 1977). Delaware thus started a trend toward increased protection of minority rights often at the expense of the majority's desire for flexibility in managing the affairs of the enterprise.

4. 457 A.2d 701 (Del. 1983).

5. The "race for the bottom" refers to various state efforts to attract more corporations to incorporate in their particular state in order to generate franchise tax revenues by providing a minimal framework for businesses to operate free from restrictions or control. The eminent Professor William L. Cary, who also served as Chairman of the Securities and Exchange Commission, viewed state corporation law as a "race for the bottom" in which Delaware had emerged

The court in *Weinberger* eliminated the *Singer* business purpose requirement<sup>6</sup> and elevated the "entire fairness" test to the sole criterion to judge the terms of a squeeze-out<sup>7</sup> merger.<sup>8</sup> The *Weinberger* court

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victorious. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 705 (1974). Another commentator asserted that "[t]he sovereign state of Delaware is in the business of selling its corporation law." Comment, *Law for Sale: A Study of the Delaware Corporation Law of 1967*, 117 U. PA. L. REV. 861, 861-63 (1969).

In *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984), the Delaware Supreme Court strictly construed the demand requirement and formulated a restrictive test for determining futility. *Aronson* thus increases the burden on a shareholder who is attempting to overcome the presumption of board independence. The decision may be viewed as further evidence of Delaware's return to the "race for the bottom." See M. STEINBERG, CORPORATE INTERNAL AFFAIRS: A CORPORATE AND SECURITIES LAW PERSPECTIVE (1983); Ashman, *Delaware Stiffens Rules on Parent Subsidiary Mergers*, 69 A.B.A. J. 966 (July, 1983); Berger & Allingham, *A New Light on Cash-out Mergers: Weinberger Eclipses Singer*, 39 BUS. LAW 1 (1983); Burgman & Cox, *Reappraising the Role of the Shareholders in the Modern Corporation: Weinberger's Procedural Approach to Fairness in Freezeouts*, 1984 WIS. L. REV. 593; Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 705 (1974); Clark, *Delaware Does A 180 Appraisal Remedy Exclusive*, 5 SEC. & FED. CORP. L. REP. (CLARK BOARDMAN) 49 (1983); Hamermesh, *Going-Private Mergers After UOP*, 16 REV. SEC. REG. (S. & P.) 943 (1983); Payson & Inskip, *Weinberger v. UOP, Inc.: Its Practical Significance in the Planning and Defense of Cash-Out Mergers*, 8 DEL. J. CORP. L. 83 (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 (1983); Sardell, *Cash-Out Mergers: Weinberger v. UOP, Inc.*, 7 CORP. L. REV. 72 (1984); Weiss, *The Law of Take Out Mergers: Weinberger v. UOP, Inc. Ushers in Phase Six*, 4 CARDOZO L. REV. 245 (1983); Weiss, *Balancing Interests in Cash-Out Mergers: The Promise of Weinberger v. UOP, Inc.*, 8 DEL. J. CORP. L. 1 (1983); Note, *Achieving Fairness in Corporate Cash Mergers: Weinberger v. UOP*, 16 CONN. L. REV. 95 (1983); Note, *Delaware Redefines "Entire Fairness" Test for Cash-Out Mergers and Suggests More Liberal Appraisal Remedy*, 28 VILL. L. REV. 1049 (1983); Note, *Delaware Supreme Court Extends Fairness Standard of Appraisal of Minority Shareholders' Stock in A Cash-Out Merger and Eliminates the Business Purpose Test*, 5 WHITTIER L. REV. 661 (1983); Herzel & Colling, *The Use of Independent Negotiating Committees in Squeeze-Out Mergers*, 190 N.Y.L.J., Dec. 12, 1983, at 34, col. 4; Borden, *Delaware Court Writes A Fresh Script For New Going Private Performances*, 189 N.Y.L.J., June 6, 1983, at 25, col. 5; Stein & Hayworth, *Merger Case Will Impact on Minority Shareholders*, 189 N.Y.L.J., June 6, 1983, at 25, col. 3; Bernstein, *Something for Everyone In Cash Out Merger*, 189 N.Y.L.J., Mar. 22, 1983, at 1, col. 1.

6. See *Singer v. Magnavox Co.*, 380 A.2d 969, 978-80 (Del. 1977).

7. A cash-out or freeze-out merger, also known as a going private transaction, is a merger in which the controlling persons of a corporation eliminate public or minority shareholders while retaining ownership of the business. Squeeze-outs fall into three distinct categories: (1) two-step mergers (the tender offer and the merger), (2) going private transactions, and (3) mergers of long-held affiliates. See Greene, *Corporate Freeze-Out Mergers: A Proposed Analysis*, 28 STAN. L. REV. 487, 490-94 (1976).

For an in-depth analysis of the going private concept, see A. BORDEN, GOING PRIVATE (1982); A. BROMBERG, SECURITIES LAW § 4.7 (Supp. 1977); F.H. O'NEAL, OPPRESSION OF MINORITY SHAREHOLDERS (1975); Brudney, *A Note on "Going-Private,"* 61 VA. L. REV. 1019 (1975); Keit, *Going Private: Adopting a Corporate Purpose Standard*, 3 SEC. REG. L.J. 33 (1975); Moore, *Going Private: Techniques and Problems of Eliminating the Public Shareholder*, 1 J. CORP. L. 321 (1976); Solomon, *Going Private: Business Practices, Legal Mechanics, Judicial Standards and Proposals for*

expressed a preference for the appraisal remedy<sup>9</sup> for minority shareholders in such mergers except in cases of "fraud, misrepresentation, self-dealing, deliberate waste of corporate assets or gross and palpable overreaching . . . ."<sup>10</sup> The court expanded, however, the determination of "fair value" under the appraisal remedy.<sup>11</sup>

The *Weinberger* decision limited the scope of protection available to minority shareholders under Delaware law. Significantly, in order to obtain relief in most instances, minority stockholders are required to perfect their rights under the cumbersome procedural requirements of the Delaware appraisal statute.<sup>12</sup> Hence, the court's preference for appraisal effectively will limit the ability of minority shareholders to

*Reform*, 25 BUFFALO L. REV. 141 (1975); Vorenberg, *Exclusiveness of the Dissenting Stockholders Appraisal Right*, 77 HARV. L. REV. 1189 (1964); Note, *Federal Regulation of the Going Private Phenomenon*, 6 CUM. L. REV. 141 (1975); Comment, "Going Private"—*The Insiders Fiduciary Duty and Rule 10b-5: Is Fairness Requisite?*, 28 BAYLOR L. REV. 565 (1976); Comment, *SEC Proposed "Going Private" Rule*, 4 DEL. J. CORP. L. 184 (1978); Comment, *Protection of Minority Shareholders: Freeze-Outs Through Merger*, 22 WAYNE L. REV. 1421 (1976).

8. 457 A.2d at 714.

9. See DEL. CODE ANN. tit. 8, § 262 (1983 Replacement Vol. ) (setting forth Delaware appraisal remedy). Although appraisal is available in virtually all states, the Delaware courts have considerable experience with appraisal proceedings and have developed an integrated body of appraisal law. Therefore, in the discussion of the *Weinberger* decision, this Article will primarily address Delaware case law. For a comparison of the Delaware appraisal statute with other state's appraisal statutes, see Banks, *Measuring the Value of Corporate Stock*, 11 CAL. W.L. REV. 1, 32 (1974).

For further commentary on the appraisal process, see, e.g., Ballantine & Sterling, *Upsetting Mergers and Consolidations: Alternative Remedies of Dissenting Shareholders in California*, 27 CALIF. L. REV. 644 (1939); Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297 (1974); Greene, *Freeze-Out Mergers: A Proposed Analysis*, 28 STAN. L. REV. 487 (1976); Hainline, *Dissenting Shareholders-Fair Cash Value*, 28 DET. LAW. 173 (1960); Kerr & Letts, *Appraisal Procedures for Dissenting Delaware Stockholders*, 20 BUS. LAW. 1093 (1965); Latin, *Remedies of Dissenting Stockholders Under Appraisal Statutes*, 45 HARV. L. REV. 233 (1931); Levy, *Rights of Dissenting Shareholders to Appraisal and Payment*, 15 CORNELL L.Q. 420 (1930); Note, *Dissenting Stockholder's Right of Appraisal-Determination of Value*, 28 N.Y.U. L. REV. 1021 (1953). Comment, *Valuation of Dissenter's Stock Under the Appraisal Statutes*, 79 HARV. L. REV. 1453 (1966); Comment, *Dissenting Stockholder's Right to the "Fair Value" of His Stock*, 20 MD. L. REV. 82 (1960); Comment, *Valuation of Dissenting Shareholders' Stock Under an Appraisal Statute*, 23 MO. L. REV. 223 (1958).

10. 457 A.2d at 714.

11. *Id.* at 712-14. Under the appraisal remedy, a shareholder who dissents from a merger can compel the surviving corporation to purchase his shares at their fair value. See, e.g., DEL. CODE ANN. tit. 8, § 262(i) (Replacement Vol. 1983) ("The Court shall direct the payment of the fair value of the shares, together with interest, if any, by the surviving or resulting corporation to the shareholders entitled thereto upon the surrender to the corporation of the certificates representing such stock . . . .").

12. DEL. CODE ANN. tit. 8, § 262(d) (Replacement Vol. 1983).

bring suit for breach of fiduciary duty to circumstances in which they can prove fraud or one of the other *Weinberger* exceptions.<sup>13</sup> Because of the severe deficiencies associated with the appraisal statute,<sup>14</sup> the limitation on alternative remedies lessens the protection available to minority shareholders. The *Weinberger* decision also has important implications under federal law. Under the rationale of *Goldberg v. Meridor*<sup>15</sup> and its progeny,<sup>16</sup> the success of a federal suit under section 10(b) of the Securities Exchange Act of 1934 and rule 10b-5<sup>17</sup> promulgated thereunder may well depend on the availability of state court relief.<sup>18</sup>

After canvassing Delaware law prior to *Weinberger*, the Article addresses the implications of this important decision. *Weinberger's* application of the "entire fairness" test as the sole standard to scrutinize squeeze-out mergers raises a number of intriguing issues, which the Article examines. In addition, significant developments in other jurisdictions are discussed where appropriate. Thereafter, the Article analyzes the role of the investment banker in rendering a fairness opinion pursuant to a freeze-out merger,<sup>19</sup> focusing on the fiduciary duties an investment banker may owe to minority shareholders when the banker is appraising the value of the minority's interest. The last section of the Article discusses *Weinberger's* impact on the federal securities laws, and in particular, SEC rules 13e-3 and 10b-5.<sup>20</sup>

## II. PRIOR DELAWARE CASE LAW

In 1977, the Delaware Supreme Court began a new era<sup>21</sup> in state

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13. 457 A.2d at 714.

14. See, e.g., Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 222, 233 (1962) ("the only things certain [in the appraisal process] are the uncertainty, the delay, and the expense").

15. 567 F.2d 209 (2d Cir. 1977), cert. denied, 434 U.S. 1069 (1978); see *infra* notes 272-89 and accompanying text.

16. See *Healey v. Catalyst Recovery, Inc.*, 616 F.2d 641, 638 (3rd Cir. 1980); *Alabama Farm Bureau Mut. Cas. Co. v. Alabama Fidelity Life Ins. Co.*, 606 F.2d 602, 613-14 (5th Cir. 1979), cert. denied, 449 U.S. 820 (1980); *Kidwell ex rel. Penfold v. Meikle*, 597 F.2d 1273 (9th Cir. 1979); *Wright v. Heizer Corp.*, 560 F.2d 236, 250 (7th Cir. 1977), cert. denied, 434 U.S. 1066 (1978).

17. 15 U.S.C. § 78(b) (1982); 17 C.F.R. § 240.10b-5 (1984). See *infra* notes 262-63 for the text of section 10(b) and rule 10b-5.

18. See cases cited *supra* note 16.

19. See *infra* notes 193-250 and accompanying text.

20. See *infra* notes 251-289 and accompanying text.

21. For a discussion of *Singer's* effect on Delaware corporate law, see M. STEINBERG, SECURITIES REGULATION: LIABILITIES & REMEDIES § 8.04 (1984); M. STEINBERG, CORPORATE INTER-

corporation law.<sup>22</sup> Until that time, commentators characterized many states as in a "race for the bottom" in their accommodation of the interests of management over the rights of shareholders.<sup>23</sup> The United States Supreme Court's decision in *Santa Fe Industries, Inc. v. Green*,<sup>24</sup> which demonstrated the likelihood of reduced federal regulation of management malfeasance, influenced states to assume a more activist

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NAL AFFAIRS—A CORPORATE AND SECURITIES LAW PERSPECTIVE 177-81 (1983); Ferrara & Steinberg, *A Reappraisal of Santa Fe: Rule 10b-5 and the New Federalism*, 129 U. PA. L. REV. 263 (1980).

22. *Singer v. Magnavox Co.*, 380 A.2d 969 (Del. 1977). See *Roland Int'l Corp. v. Najjar*, 407 A.2d 1032 (Del. 1979); *Tanzer v. International Gen. Indus. Inc.*, 379 A.2d 1121 (Del. 1977).

Portions of this discussion were derived from other works by the author: M. STEINBERG, CORPORATE INTERNAL AFFAIRS: A CORPORATE AND SECURITIES LAW PERSPECTIVE 177-81 (1983) [hereinafter cited as CORPORATE INTERNAL AFFAIRS]; M. STEINBERG, SECURITIES REGULATION: LIABILITIES AND REMEDIES § 8.04 (1984) [hereinafter cited as SECURITIES REGULATION]; Ferrara & Steinberg, *The Interplay Between State Corporation & Federal Securities Law—Santa Fe*, Singer, Burks, Maldonado, *Their Progeny & Beyond*, 7 DEL. J. CORP. L. 1, 7-11 (1982); Ferrara & Steinberg, *A Reappraisal of Santa Fe: Rule 10b-5 and the New Federalism*, 129 U. PA. L. REV. 263, 277-81 (1980); Gonson & Steinberg, *The S.E.C.'s Administrative and Legislative Programs Aimed at Regulating Corporate Internal Affairs*, in STANDARDS FOR REGULATING CORPORATE INTERNAL AFFAIRS 317, 337-40 (1981); Steinberg, *Fiduciary Duties and Disclosure Obligations in Proxy and Tender Contests for Corporate Control*, 30 EMORY L.J. 168, 198-208, 223-33, 252-54 (1981); Steinberg, *Application of the Business Judgment Rule and Related Judicial Principles—Reflections from a Corporate Accountability Perspective*, 56 NOTRE DAME LAW. 903 (1981); Steinberg, Maldonado *In Delaware: Special Litigation Committees—An Unsafe Haven*, 9 SEC. REG. L.J. 381 (1982); Steinberg, *State Court Decisions After Santa Fe*, 9 SEC. REG. L.J. 85 (1981); Steinberg, *The American Law Institute's Draft Restatement on Corporate Governance: The Business Judgment Rule, Related Principles and Some General Observations*, 37 U. MIAMI L. REV. 295 (1983); Steinberg, *The Use of Special Litigation Committees to Terminate Shareholder Derivative Suits*, 35 U. MIAMI L. REV. 1 (1980).

23. See, e.g., Cary, *supra* note 5, at 705; Folk, *Some Reflections of a Corporation Law Draftsman*, 42 CONN. B.J. 409, 410 (1968); Jennings, *Federalization of Corporation Law: Part Way or All the Way*, 31 BUS. LAW. 991 (1976); Kaplan, *Fiduciary Responsibility in the Management of the Corporation*, 31 BUS. LAW. 883 (1976); Manning, *The Shareholders' Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, g 245 (1962); Schwartz, *Federal Chartering of Corporations: An Introduction*, 61 GEO. L.J. 71 (1972); Comment, *Law For Sale: A Study of the Delaware Corporation Law of 1967*, 117 U. PA. L. REV. 861, 898 (1969).

24. 430 U.S. 462 (1977). The *Santa Fe* court held that, absent "manipulation" or "deception," section 10(b) of the Securities Exchange Act of 1934 and rule 10b-5 promulgated thereunder do not cover breaches of fiduciary duty. In *Santa Fe*, the minority shareholders objected to the terms of a short-form merger that had met the requirements of the applicable state statute. Rather than pursuing their state appraisal remedies, the shareholders claimed that the gross undervaluation of the shares was itself a "fraud" within the meaning of rule 10b-5.

In rejecting this "new fraud" concept, the Court commented that the majority's failure to provide the minority with advance notice of the merger was not a material nondisclosure because "under Delaware law [the plaintiffs] could not have enjoined the merger because an appraisal proceeding [was] their sole remedy in the Delaware courts for any alleged unfairness in the terms of a merger." 430 U.S. at 474 n.14.

role in protecting shareholders' interests.<sup>25</sup> Indeed, in *Singer v. Magnavox Co.*,<sup>26</sup> the Delaware Supreme Court viewed *Santa Fe* as a "confirmation by the Supreme Court of the responsibility of a state to govern the internal affairs of corporate life."<sup>27</sup>

### A. *Singer and Its Progeny*

In *Singer*, minority shareholders, whom the majority had frozen out by a merger, sued for nullification of the merger and compensatory damages. Although the merger satisfied the procedural requirements of the applicable state statute,<sup>28</sup> the plaintiffs alleged that the sole purpose of the merger was to eliminate the minority and that the majority had offered grossly inadequate compensation for the minority's stock.<sup>29</sup> The lower court dismissed the complaint on the ground that appraisal was the exclusive remedy.<sup>30</sup> The Delaware Supreme Court reversed and stated that "a § 251 merger, made for the sole purpose of freezing out minority shareholders, is an abuse of corporate process; and . . . states a cause of action for violation of a fiduciary duty."<sup>31</sup> Moreover, the court stressed that the existence of a valid business purpose would not preclude relief to the minority shareholders:

On the contrary, the fiduciary obligation of the majority to the minority stockholders remains and proof of a purpose, other than such freeze out, without more, will not necessarily discharge it. In such case the court will scrutinize the circumstances for compliance with the *Sterling* rule of "entire fairness" and if it finds a violation thereof, will grant such relief as equity may require.<sup>32</sup>

Under *Singer*, therefore, if a plaintiff alleges that the purpose of the merger was improper, the majority shareholders must prove a proper business purpose. In addition, even if proof of a valid business purpose exists, a court must scrutinize the transaction for its "entire fairness"

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25. For works discussing *Santa Fe* and its progeny, see authorities cited *supra* note 22.

26. 380 A.2d 969 (Del. 1977).

27. *Id.* at 976 n.6.

28. DEL. CODE ANN. tit. 8, § 251 (Replacement Vol. 1983).

29. 380 A.2d at 972.

30. *Singer v. Magnavox Co.*, 367 A.2d 1349 (Del. Ch. 1976).

31. 380 A.2d at 980.

32. *Id.* (emphasis added). The *Singer* court relied on the *Sterling* rule, *Sterling v. Mayflower Hotel Corp.*, 33 Del. Ch. 293, 93 A.2d 107, (Del. 1952), which stated that the majority must "bear the burden of establishing [the transaction's] entire fairness . . . [which must] pass the test of careful scrutiny by the courts." *Id.* at 298, 93 A.2d at 110. See 380 A.2d at 976.

and award appropriate relief if a violation is found.<sup>33</sup>

*Singer* ushered in a new era of Delaware corporate law.<sup>34</sup> Subsequent cases reaffirmed *Singer*<sup>35</sup> and extended its principles to short-form mergers.<sup>36</sup> These cases did not, however, foreclose a merger designed primarily to advance a majority shareholder's interest if the merger had a bona fide purpose and was entirely fair to the minority.<sup>37</sup>

33. For further discussion of *Singer*, see, e.g., M. STEINBERG, CORPORATE INTERNAL AFFAIRS, *supra* note 22, at 177-181; Brudney & Chirelstein, *A Restatement of Corporate Freezeouts*, 87 YALE L.J. 1354 (1978); Elfin, *Changing Standards and the Future Course of Freezeout Mergers*, 5 J. CORP. LAW 261 (1980); Ferrara & Steinberg, *supra* note 21; Rothchild, *Going Private, Singer, and Rule 13e-3: What Are the Standards for Fiduciaries?*, 7 SEC. REG. L.J. 195 (1979); Steinberg, *State Court Decisions After Santa Fe*, 9 SEC. REG. L.J. 85 (1981); Note, *Singer v. Magnavox and Cash Take-Out Mergers*, 64 VA. L. REV. 1101 (1978).

34. Prior to *Santa Fe*, there was some authority that, under relevant state law, the majority could not eliminate the minority shareholders in a cash-out merger transaction, unless the majority could demonstrate a valid business purpose. See, e.g., *Bryan v. Brock & Blevins Co.*, 490 F.2d 563, 571 (5th Cir. 1974), *cert. denied*, 419 U.S. 844 (1974) (interpreting Georgia law); see also *Stauffer v. Standard Brands, Inc.*, 41 Del. Ch. 7, 9-10, 187 A.2d 78, 80 (1962) (appraisal remedy exclusive absent fraud or illegality).

35. From these decisions the courts established that a majority shareholder's fiduciary duty was not satisfied by relegating the minority shareholders to their statutory appraisal remedy. See, e.g., *Tanzer v. International Gen. Indus., Inc.*, 379 A.2d 1121 (Del. 1977); *Young v. Valhi, Inc.*, 382 A.2d 1372 (Del. Ch. 1978); see also *Coleman v. Taub*, 487 F. Supp. 118 (D. Del. 1980), *rev'd*, 638 F.2d 628 (3d Cir. 1981) (applying Delaware law); *Fins v. Pearlman*, 424 A.2d 305, 308 (Del. 1980) (intrinsic fairness of terms of the settlement and not the proper purpose for merger is the standard applied to the settlement of an action challenging the merger); *Bell v. Kirby Lumber Corp.*, 413 A.2d 137 (Del. 1980) (distinguishing entire fairness under appraisal statute from that of entire fairness standard under *Singer*).

In addition, a majority shareholder could not affect a merger solely for the purpose of removing the minority. For example, in *Young v. Valhi, Inc.*, 382 A.2d 1372 (Del. Ch. 1978), the chancery court issued a preliminary injunction barring the merger. The Court held that, despite management's assertion that the merger would result in tax savings and the avoidance of future conflicts of interest, "the basic purpose behind the merger . . . is effectuation of a long standing decision on the part of Contran to eliminate the minority shares of Valhi by whatever means as might be found to be workable." *Id.* at 1378.

Even if the merger was consummated for a proper purpose the minority shareholder was entitled to judicial review of the entire fairness of the transaction. See, e.g., *Tanzer v. International Gen. Indus., Inc.*, 379 A.2d 1121, 1125 (Del. 1977) ("entire fairness" test applies not only to the price offered for the stock but to all aspects of the transaction").

36. *Roland Int'l Corp. v. Najjar*, 407 A.2d 1032, 1033 (Del. 1979). Applying the *Singer* principles, the *Najjar* court reasoned that "the need to recognize and enforce such equitable principles is probably greater when the size of the minority is smaller." *Id.* at 1036. See also *Balotti, The Elimination of the Minority Interest by Mergers Pursuant to Section 251 of the General Corporation Law of Delaware*, 1 DEL. J. CORP. L. 63, 73 (1976) (contending that no substantive difference between mergers under the long-form statute and the short-form statute exists).

37. *Tanzer v. International Gen. Indus., Inc.*, 379 A.2d 1121, 1124-25 (Del. 1977). Thus, the *Tanzer* court held:

As a stockholder, [the parent corporation] need not sacrifice its own interest in dealing

On the other hand, a complaint alleging that a merger was unfair or that its purpose was to eliminate the minority frequently withstood a motion to dismiss.<sup>38</sup> In other cases decided by the Delaware Supreme Court,<sup>39</sup> the court held that the fiduciary obligation owed by a majority shareholder to the minority includes a duty of "complete candor." This duty requires the majority to reveal germane facts and circumstances surrounding the tender offer or shareholder vote.<sup>40</sup> Moreover, if a fiduciary breached one of his duties, the "rescissory" measure of

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with a subsidiary; but that interest must not be suspect as a subterfuge, the real purpose of which is to rid itself of unwanted minority shareholders in the subsidiary. That would be a violation of *Singer* and any subterfuge or effort to escape its mandate must be scrutinized with care and dealt with by the Trial Court. And, of course, in any event, a bona fide purpose notwithstanding, [the parent] must be prepared to show that it has met its duty, imposed by *Singer* and *Sterling* . . . of "entire fairness" to the minority.

*Id.* at 1124 (citation omitted).

One commentator has contended that these Delaware cases suggest that a cash-out merger that served no corporate purpose could nonetheless pass scrutiny if it served a purpose of the fiduciary. Rothschild, *supra* note 33, at 215. Moreover, a number of commentators have asserted that, by permitting the majority's bona fide purpose to satisfy *Singer's* first prong, *Tanzer*, in practical effect, virtually eliminated the business purpose test. See, e.g., Weiss, *The Law of Take-Out Mergers: A Historical Perspective*, 56 N.Y.U. L. REV. 624, 664 (1981).

38. See *Kemp v. Angel*, 381 A.2d 241 (Del. Ch. 1977). In *Kemp*, the chancery court held that if there is a reasonable probability that the minority shareholders might prevail, the case must proceed to trial:

[I]t being only at trial that the court can give the required careful scrutiny to the testimony adduced subject to objection and cross examination as well as to other evidence offered in an orderly fashion and also test the credibility of witnesses before reaching a determination as to whether or not the transaction under attack is in fact entirely fair to minority stockholders. . . .

*Id.* at 245. See *Young v. Valhi, Inc.*, 382 A.2d 1372, 1378 (Del. Ch. 1978). A later case held, however, that under certain limited circumstances, a court may subject a complaint attacking a merger to a motion to dismiss for failure to state a cause of action. *Weinberger v. UOP, Inc.*, 409 A.2d 1262, 1267-68 (Del. Ch. 1979), *vacated*, 457 A.2d 701 (Del. 1983).

39. *Lynch v. Vickers Energy Corp.*, 429 A.2d 497 (Del. 1981) (*Lynch II*); *Lynch v. Vickers Energy Corp.*, 383 A.2d 278 (Del. 1977) (*Lynch I*).

40. *Lynch I*, 383 A.2d at 279. The fiduciary duty owed by the majority requires complete disclosure of all the "germane" facts and circumstances. *Id.* at 282. "Germane" in this context may be defined as information that a reasonable shareholder would consider important in making his investment or voting decision. Cf. *TSC Indus., Inc. v. Northway*, 426 U.S. 438 (1976) (materiality, for purpose of SEC rule 14a-9 disclosure, consists of facts which a shareholder would consider important in determining how to vote). *Accord Nelson v. Gammon*, 647 F.2d 710 (6th Cir. 1981) (considering Kentucky law to the effect that full disclosure of a transaction's terms plus shareholders' retention of rights is sufficient); *Junker v. Crory*, 650 F.2d 1349, 1356 (5th Cir. 1981) (under Louisiana law, corporate officers and directors are obliged "to disclose facts within their knowledge to shareholders and to deal with them in an atmosphere of trust and confidence"). See generally *Bauman, Rule 10b-5 and The Corporation's Affirmative Duty to Disclose*, 65 GEO. L.J. 935 (1979); Note, *Disclosure of Material Inside Information: An Affirmative Corporate Duty?*, 1980 ARIZ. ST. L.J. 935.

damages was proper.<sup>41</sup>

### *B. Reaction of Other States*

A number of other states have addressed the issues raised by the court in *Singer*. For example, the West Virginia Supreme Court apparently has adopted the *Singer* rationale.<sup>42</sup> The Indiana Supreme Court has adopted the first prong of the *Singer* rule, holding that a merger must advance a corporate purpose to withstand attack under Indiana corporate law.<sup>43</sup> The Indiana court declined, however, to review mergers under the "entire fairness" standard. It reasoned that such scrutiny would require inordinate judicial intrusion into a corporation's internal affairs.<sup>44</sup> Without explicitly adopting both of *Singer's* prongs, the Supreme Court of Hawaii asserted that "a merger effected for the sole purpose of freezing out the minority interest is a violation of fiduciary principles. . . ."<sup>45</sup>

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41. *Lynch II*, 429 A.2d at 501. "Rescissory damages" are the monetary equivalent of rescission where actual rescission of the merger has become impractical due to the passage of time. In effect, a rescissory measure of damages awards the equivalent value of the stock at the time of resale, if applicable, or at the time of the judgment, thus allowing the minority shareholder to enjoy the increase in value that the majority shareholder had as a result of acquiring and holding the shares. *Id.* See generally 12A FLETCHER CYCLOPEDIA OF CORPORATIONS § 5598 (1980). *But see* *Weinberger v. UOP, Inc.*, 457 A.2d 701, 704, 714 (Del. 1983) (rejecting the application of the rescissory measure to the extent that it limits a stockholder's monetary relief to a single damage formula).

42. *Masinter v. Webco Co.*, 262 S.E.2d 433 (W. Va. 1980).

43. *Gabhart v. Gabhart*, 267 Ind. 377, 388, 370 N.E.2d 345, 356 (1977).

44. The court explained as follows:

The case before us is similar to the case of *Singer v. Magnavox Co.* . . . In that case, the Supreme Court of Delaware . . . relied upon agency principles of fiduciary duty to hold that a corporate merger is subject to judicial scrutiny concerning its "entire fairness" to minority shareholders. We see no need to go that far in deciding the question before us. Under the Delaware view, it appears that every proposed merger would be subject to having its bona fides determined by judicial review. We do not believe the judiciary should intrude into corporate management to that extent.

*Id.*

45. *Perl v. I.U. Int'l Corp.*, 61 Hawaii 622, 640, 607 P.2d 1036, 1046 (1980). *See also* *Twenty Seven Trust v. Realty Growth Investors*, 533 F. Supp. 1028, 1036 (D. Md. 1982) (Maryland law prohibits majority shareholder's use of control for ulterior purposes adverse to the interest of the corporation and its stockholders); *Jones v. H.F. Ahmanson & Co.*, 1 Cal. 3d 93, 108, 460 P.2d 464, 471, 81 Cal. Rptr. 592, 599 (1969) ("[a]ny use to which [majority shareholders] put the corporation or their power to control the corporation must benefit all shareholders proportionately and must not conflict with the proper conduct of the corporation's business"). As the Hawaii Supreme Court stated: "[A]lthough *Ahmanson* did not involve a merger, it appears clear from the language of the opinion that the California Supreme Court would apply the fiduciary duty of good faith and inherent fairness to such a situation." 61 Hawaii at 604 n.12, 607 P.2d at 1047 n.12.

On the other hand, some states have expressly rejected the *Singer* rationale either by statute or judicial decision. For example, a Minnesota statute provides that corporations may merge "with or without a business purpose"<sup>46</sup> and that the remedy for lack of "entire fairness" is appraisal.<sup>47</sup> The Connecticut Supreme Court expressly held that appraisal is a minority shareholder's sole remedy for any alleged unfairness in the terms of a merger.<sup>48</sup> The Pennsylvania Supreme Court, taking a somewhat different course, held that appraisal is the sole *post*-merger remedy for dissenting minority shareholders.<sup>49</sup> The Pennsylvania court, however, recognized the minority's right in the pre-merger period to seek injunctive relief against the consummation of the merger.<sup>50</sup> Hence, although all courts and legislatures have not followed *Singer*, some have recognized that, under certain circumstances, aggrieved minority shareholders may bring an action in state court to enjoin a merger that has not been consummated.<sup>51</sup>

### III. *WEINBERGER V. UOP, INC.*—AN OVERVIEW

In *Weinberger v. UOP, Inc.*,<sup>52</sup> the former minority shareholders of

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46. MINN. STAT. ANN. § 302A.601 (West 1981).

47. General comment (3) of the statute states that "the remedy for lack of 'entire fairness' in the transaction in this act is the appraisal section; by obtaining the fair value of the shares, the dissenting minority shareholder recoups the investment." *Id.*

48. *Yanow v. Teal Industries, Inc.*, 178 Conn. 262, 272, 422 A.2d 311, 318 (1979). See CONN. GEN. STAT. § 33-373(f) (1983). *Accord* *Jones v. Highway Inn, Inc.*, 424 So.2d 944 (Fla. Dist. Ct. App. 1983); *Morris v. Columbia Apts. Corp.*, 323 Ill. App. 292, 55 N.E.2d 401 (1944); *Gordon v. Public Serv. Co.*, 101 N.H. 372, 143 A.2d 428 (1958); *O'Hara v. Pittston Co.*, 186 Va. 325, 42 S.E.2d 269 (1947). However, when the plaintiff alleges fraud or illegality, appraisal clearly should not be the exclusive remedy. See, e.g., *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983); *Pupecki v. James Madison Corp.*, 376 Mass. 212, 382 N.E.2d 1030 (1978).

49. *In re Jones & Laughlin Steel Corp.*, 488 Pa. 524, 531-32, 412 A.2d 1099, 1103 (1980). See PA. CONS. STAT. ANN. tit. 15, § 805 (Purdon 1967); see also Note, *Exclusiveness of the Appraisal Remedy—Legislature Intended that All Actions Be Barred Except for an Appraisal After Consummation of Merger*. *In re Jones & Laughlin Steel Corp.*, 84 DICK L. REV. 543 (1980); Note, *Interplay of Rights of Stockholders Dissenting from Sale of Corporate Assets*, 58 COLUM. L. REV. 251 (1958).

50. 488 Pa. at 532-33, 412 A.2d at 1103-04; see *Dower v. Mosser Indus., Inc.*, 488 F. Supp. 1328, 1341 (E.D. Pa. 1980) (applying Pennsylvania law, the court concluded that the majority had not breached the fiduciary duty they owed to the minority in a merger).

51. Some states arguably limit the dissenting shareholders' rights to an appraisal proceeding to determine fair value. See, e.g., ALA. CODE § 10-2A-163(a) (1975); MINN. STAT. ANN. § 300.16 (West 1969); N.Y. BUS. CORP. CODE § 623(e) (McKinney Supp. 1983-84); WIS. STAT. ANN. § 180.72 (West Supp. 1983-84). For further discussion of state legislation, see Roberts, *The Status of Minority Shareholders' Remedies for Oppression After Santa Fe and Singer and the Question of "Reasonable Investment Expectation" Valuation*, 6 DEL. J. CORP. L. 16, 36-37 (1981).

52. 457 A.2d 701 (Del. 1983). In a pre-trial ruling, the court dismissed the original complaint

UOP brought suit for breach of fiduciary duty arising from a cash-out merger between UOP and UOP's majority owner, the Signal Companies (Signal).<sup>53</sup> The merger plan provided that UOP would merge with Sigco, a wholly owned subsidiary of Signal, and that UOP's minority shareholders would be cashed-out at \$21 per share.<sup>54</sup>

### A. Background

Signal was seeking a suitable investment for a cash surplus created by its 1974 sale of an unrelated subsidiary.<sup>55</sup> Accordingly, Signal's chairman of the board and its president appointed two Signal officers to perform an internal feasibility study concerning the acquisition of the balance of UOP's outstanding shares. These four individuals were directors of UOP and members of the Signal board. The study indicated that UOP would be a good investment for Signal at any price up to \$24 per share.<sup>56</sup> At no time did any person privy to the report share its contents with "non-Signal" UOP directors or UOP minority shareholders.<sup>57</sup> After assessing the internal feasibility study, Signal's executives contacted UOP's president. Without disclosing the feasibility study, they elicited UOP's president's response to an offer for the re-

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for failure to state a cause of action. *Weinberger v. UOP, Inc.*, 409 A.2d 1262 (Del. Ch. 1979). For a discussion of that opinion, see Note, *Delaware Corporation Law: Weinberger v. UOP, Inc.—A Limitation on Singer Fairness Standards?*, 42 U. PITT. L. REV. 915 (1981). Plaintiff's amended complaint alleged specific acts of fraud or misrepresentation in order to meet the requirement that a suit challenging a cash-out merger must allege acts of misconduct demonstrating the unfairness of the merger to the minority. 457 A.2d at 703.

53. *Id.* at 704. In 1974, Signal sold one of its wholly-owned subsidiaries for \$420,000,000 in cash. See *Gimbel v. Signal Companies, Inc.*, 316 A.2d 599, *aff'd*, 316 A.2d 619 (Del. 1974). Signal, due to its cash surplus, then became interested in UOP as a possible investment. Following negotiations, Signal made a successful cash tender offer for 4,300,000 publicly held shares of UOP and purchased 1,500,000 authorized but unissued shares from UOP. Signal purchased both at a price of \$21 per share.

Signal thereby became a 50.5% shareholder of UOP. Of the six directors elected by Signal to UOP's thirteen member board, five were employees or directors of Signal. In 1975, the president and chief executive officer of UOP retired. A former employee and executive vice-president of one of Signal's wholly owned subsidiaries replaced him and assumed positions on the board of directors of both UOP and Signal. 457 A.2d at 705.

54. See *Weinberger v. UOP, Inc.*, 426 A.2d 1333, 1335 (Del. Ch. 1981), *rev'd*, 457 A.2d 701 (Del. 1983).

55. See *Gimbel v. Signal Companies, Inc.*, 316 A.2d 619 (Del. 1974); *supra* note 53.

56. Two Signal officers prepared the feasibility study. Both were directors of UOP as well as Signal and, in addition, Signal's board chairman and its president also served on both boards. 457 A.2d at 705.

57. *Id.* at 708-09.

maintaining UOP shares at a price of \$20 to \$21 per share. The UOP president responded that he believed that the offer was fair.<sup>58</sup>

Signal placed severe time constraints on the response of UOP's management to its offer.<sup>59</sup> Because of these time constraints UOP retained the investment banking firm of Lehman Brothers, which was familiar with UOP's financial position, to render a fairness opinion.<sup>60</sup> After a hurried review, Lehman Brothers concluded that the price of \$21 was fair.<sup>61</sup> The outside directors then approved the merger proposal.<sup>62</sup> Thereafter, a majority of the minority shares actually voting and at least two-thirds of all outstanding shares approved the merger.<sup>63</sup>

The plaintiffs alleged that the UOP majority had breached its fiduciary duty in two respects. According to the plaintiffs, the first breach occurred when the majority caused the merger to go forward solely to remove the minority's interest. Second, the plaintiffs alleged that the majority offered a grossly inadequate price for the minority's interest.<sup>64</sup> The lower court entered judgment for the defendants, concluding that under *Singer* the defendants had met the burden of proving that the merger was for a valid business purpose and that the merger satisfied the entire fairness test.<sup>65</sup> The Delaware Supreme Court reversed the

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58. Although a later press release and proxy statement indicated that the negotiations addressed the price offered, in fact no one negotiated on behalf of UOP for a price higher than \$21 per share. UOP's president concluded that a price at the top of the proposed range (i.e., \$20-\$21) would be suitable. He also expressed concern over UOP employees' job security as well as the stock option incentive programs for key employees. The market price for UOP common stock during this period was \$14.50 per share. *Id.* at 703-06.

59. *Id.* at 706.

60. *Id.* at 705-07.

61. *Id.* at 706. The senior partner from Lehman Brothers filed in the \$21 price per share on the incomplete draft of the "fairness opinion letter" shortly before the directors' meeting. *Id.* at 707.

62. *Id.* at 703. The investment banker was originally a defendant but the plaintiffs subsequently dismissed it. Therefore, the court did not deal with any issues raised by the claims against this defendant. *Id.* at 703, n.3. See *infra* notes 193-250 and accompanying text.

63. At the annual shareholder meeting only 56 percent of the minority shares were actually voted. Therefore, only 51.9% of the total minority shares voted for the merger. When Signal's stock was added to the minority shares voting in favor, a total of 76.2% of UOP's outstanding shares approved the merger. 457 A.2d at 708.

64. *Weinberger v. UOP, Inc.*, 426 A.2d 1333, 1341 (Del. Ch. 1981), *rev'd*, 457 A.2d 701 (Del. 1983).

65. 426 A.2d at 1362-63 (Del. Ch. 1983). The Delaware Chancery Court stated that "*Sterling* is the bedrock on which *Singer*, *Tanzer* and *Roland International* are built." *Id.* at 1344 (citing, *Sterling v. Mayflower Hotel Corp.*, 33 Del. Ch. 293, 93 A.2d 107 (Del. 1952)). The lower court interpreted *Singer* as providing that the majority shareholder's purpose in seeking the merger on a cash-out basis was a specific factor to be considered under the *Sterling* "entire fairness" review,

lower court.<sup>66</sup>

### B. *The Delaware Supreme Court's Decision*

Finding that the terms of the merger failed the entire fairness standard, the Delaware Supreme Court concluded that the majority had breached its fiduciary duty to the minority shareholders.<sup>67</sup> The court reasoned that the merger lacked fairness because "material information necessary to acquaint those shareholders with the bargaining positions of Signal and UOP, was withheld under circumstances amounting to a breach of fiduciary duty."<sup>68</sup>

The court indicated that the pecuniary relief afforded by the appraisal provision<sup>69</sup> ordinarily provides sufficient protection to minority shareholders in a cash-out merger.<sup>70</sup> The court then adopted a "more liberal, less rigid and stylized approach to the valuation process,"<sup>71</sup> and rejected any specific damages formula that purported to limit a shareholder's monetary relief.<sup>72</sup> Finally, the court abolished the business

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and that if the majority's purpose was solely to eliminate the minority, then the majority had breached its fiduciary duty. *Id.* at 1343.

As one commentator recognized: "Left open after *Sterling* was the question whether appraisal was the exclusive remedy in an action challenging a completed interested merger and whether a majority stockholder had an absolute right to use his majority control to bring about a merger for whatever reason he chose, subject only to the duty to pay a fair price." Sparks, *State Regulation of Conflict Transactions*, in STANDARDS FOR REGULATING CORPORATE INTERNAL AFFAIRS 235, 248 (1981).

66. 457 A.2d at 703.

67. *Id.*

68. *Id.* The court relied heavily on the existence and nondisclosure of the Signal feasibility study, which indicated that a price of up to \$24 per share was economically feasible for Signal. Four of UOP's directors, who were also Signal executives, knew of the existence of the study but never revealed it to UOP's board of directors or to the minority shareholders. *Id.* at 712.

69. DEL. CODE ANN. tit. 8, § 262 (Replacement Vol. 1983) provides in pertinent part:

(a) Any stockholder who has complied with subsection (d) and has neither voted in favor of the merger nor consented thereto shall be entitled to an appraisal by the Court of Chancery of the fair value of his shares . . .

(d) Appraisal rights shall be perfected as follows:

(1) . . . each stockholder electing to demand appraisal of his shares shall deliver to the corporation . . . a written demand . . .

(2) . . . within 20 days after the date of mailing of the notice . . .

(h) After determining the stockholders entitled to an appraisal, the Court shall appraise the shares, determining their fair value exclusive of any element of value arising from the accomplishment or expectation of the merger, together with a fair rate of interest, if any, . . . . In determining such fair value, the Court shall take into account all relevant factors. . . .

70. 457 A.2d at 703, 715.

71. *Id.* at 704.

72. *Id.* at 705. The *Weinberger* court overruled *Lynch v. Vickers Energy Corp.*, 429 A.2d 497

purpose requirement of *Singer*, hence relying solely upon the entire fairness test.<sup>73</sup> According to the *Weinberger* court, the fairness test together with the Chancellor's discretion to award necessary relief afforded ample protection to minority shareholders.<sup>74</sup>

*Weinberger* therefore stands for the proposition that appraisal is a minority stockholder's sole remedy in a freeze-out merger, except where fraud, misrepresentation, self-dealing, deliberate waste of corporate assets, or gross and palpable overreaching are present. In those circumstances, the court recognized that the expanded appraisal remedy may not be adequate, leaving the Chancellor free to "fashion any form of equitable and monetary relief as may be appropriate including rescissory damages."<sup>75</sup>

The *Weinberger* decision represents a return by the Delaware courts to the rule that minority shareholders are limited to the monetary fair value of their stock.<sup>76</sup> Although the Delaware high court expanded the financial remedy available under the liberalized appraisal proceeding, it left aggrieved minority shareholders with the choice between agree-

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(Del. 1981) (*Lynch II*) "to the extent that it purports to limit a stockholder's monetary relief to a specific damage formula." 457 A.2d at 705. See 429 A.2d at 507-08 (McNeilly and Quillen, J.J., dissenting).

73. 457 A.2d at 715. The court pointed to the principle developed in *Sterling v. Mayflower Hotel Corp.*, 33 Del. Ch. 293, 297, 93 A.2d 107, 110 (1952), that "where one stands on both sides of a transaction [such as a parent-subsidiary merger], he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts." 457 A.2d at 710. See also *Bastian v. Bourns, Inc.*, 256 A.2d 680, 681 (Del. Ch. 1969), *aff'd*, 278 A.2d 467 (1970); *David J. Greene & Co. v. Dunhill Int'l, Inc.*, 249 A.2d 427, 431 (Del. Ch. 1968).

74. 457 A.2d at 715.

75. *Id.* at 714. See *Cole v. National Cash Credit Assoc.*, 18 Del. Ch. 47, 49, 156 A.2d 183, 184 (Del. Ch. 1931) (providing a basis for the five exceptions created by the *Weinberger* court when courts will not limit minority shareholders to the appraisal remedy). In *Cole*, the Delaware Chancery Court discussed the concepts of actual and constructive fraud in the context of an injunction against a merger. To prove constructive fraud in the alleged undervaluation of shares, the dissenting shareholder must show that the valuation constitutes a conscious abuse of discretion, breach of trust, or mal-administration manifestly causing injury to the dissenting shareholder. Mere inadequacy of price does not equal fraud unless the undervaluation suggests bad faith or reckless indifference to the rights of the minority shareholder. *Id.* at 55, 156 A.2d at 188.

76. See *Manning*, *supra* note 23, at 230 ("the general tendency in the corporate field is to center within management all significant operational control and to relegate the shareholder's claim of 'ownership' to the status of the fungible dollar claim"); *Stauffer v. Standard Brands, Inc.*, 41 Del. Ch. 7, 9-10, 187 A.2d 78, 80 (1962) (appraisal statute generally is sole remedy for recovery of fair value of stock sold pursuant to a merger absent fraud or illegality); *David J. Greene & Co. v. Schenley Indus., Inc.*, 281 A.2d 30, 35 (Del. Ch. 1971) (short form merger statutes constitute constructive notice of elimination of stockholders' property interest in stock).

ing to the price offered or invoking the appraisal remedy.<sup>77</sup> In this regard, however, the procedural requirements and financial costs of the appraisal statute impose a substantial hardship on minority shareholder plaintiffs.<sup>78</sup>

#### IV. FAIR DEALING UNDER *WEINBERGER*

Under *Weinberger*, courts will judge squeeze-out mergers solely under the entire fairness test.<sup>79</sup> This test, developed in *Sterling v. Mayflower Hotel Corporation*,<sup>80</sup> involves two basic aspects: fair dealing and fair price.<sup>81</sup> Fair dealing "embraces 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 the stockholders were obtained."<sup>82</sup> The *Weinberger* court concluded that, because the minority stockholder vote was not informed, the merger failed to satisfy the element of fair dealing.<sup>83</sup>

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77. 457 A.2d at 715.

78. See DEL. CODE ANN. tit. 8, § 262(d) (1 & 2) (1982) (requiring dissenting shareholder to file a written objection containing a formal demand for fair value and setting limited time periods to challenge the price offered). The *Weinberger* court recognized that the procedural requirements of the appraisal statute applied to the expanded appraisal remedy. 457 A.2d at 714 n.8. The court granted plaintiffs a "quasi-appraisal" remedy by allowing them to challenge the element of fair value. In addition, the *Weinberger* court extended the availability of this "quasi-appraisal" remedy to the following lawsuits: (1) any case now pending on appeal to the Delaware Supreme Court; (2) any case now pending in the Court of Chancery that has not yet been appealed but which may be eligible for direct appeal to the supreme court; (3) any case challenging a cash-out merger, the effective date of which is on or before February 1, 1983; and (4) any proposed merger to be presented at a shareholders' meeting, the notification of which notifies the stockholders on or before February 23, 1983. *Id.* at 714-15.

With respect to the financial costs of appraisal, one commentator has opined that "the costs of appraisal are placed improperly on all shareholders, rather than on those who presumably benefit most from the merger—the shareholders of the acquiring corporation." Note, *Achieving Fairness in Corporate Cash Mergers: Weinberger v. UOP*, 16 CONN. L. REV. 95, 117 (1983). See also Recent Development, *Corporations—Mergers—Delaware Redefines "Entire Fairness" Test for Cash-Out Mergers and Suggests More Liberal Appraisal Remedy*, 28 VILL. L. REV. 1049, 1080 n.141 (1983) (procedural structures and limits on attorneys' fees constrain the use of appraisal statutes).

79. 457 A.2d at 712.

80. 33 Del. Ch. 293, 93 A.2d 107 (1952).

81. 457 A.2d at 711.

82. *Id.* See *Tri-Continental Corp. v. Battye*, 31 Del. Ch. 523, 525, 74 A.2d 71, 72 (1950); DEL. CODE ANN. tit. 8, § 262(h) (1982). See generally Moore, *The "Interested" Director or Officer Transaction*, 4 DEL. J. CORP. L. 674, 676 (1979); Nathan & Shapiro, *Legal Standard of Fairness of Merger Terms Under Delaware Law*, 2 DEL. J. CORP. L. 44, 46-47 (1977).

83. 457 A.2d at 703. In reaching this conclusion, the court considered such factors as the duty of candor, the initiation of the merger by the parent company, the time constraints imposed

### A. Presence of Independent Negotiating Committee

The procedure the corporation uses to effect the merger constitutes an important aspect of fair dealing. The *Weinberger* court indicated that in the future a majority stockholder could structure a merger to provide insulation from a rigorous fairness review. In a footnote, the *Weinberger* court asserted that "the result here 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."<sup>84</sup> The existence of such a committee, particularly in the parent-subsidary context, is "strong evidence that the transaction meets the test of fairness."<sup>85</sup>

Thus, to help withstand challenges to mergers on "fair dealing" grounds, the subsidiary corporation should appoint an independent negotiating team composed of disinterested directors<sup>86</sup> to conduct arm's-length negotiations with the parent corporation. The committee should hire outside counsel with no previous affiliation with either corporation or with the investment banking firm responsible for the valuation. The investment banking firm also should not have any previous association with either corporation.<sup>87</sup> The committee, with the assistance of counsel and the investment banker, should scrutinize all material factors that affect the determination of a beneficial price for the minority

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by Signal, the lack of real negotiations, and the nondisclosure of critical information to the minority shareholders. *Id.* at 711-12.

84. *Id.* at 710 n.7.

85. According to the court: "Since fairness in this context can be equated to conduct by a theoretical, wholly independent, board of directors acting upon the matter before them, it is unfortunate that this course apparently was neither considered nor pursued." *Id.*

86. A disinterested director may be defined as one who exercises independent judgment on behalf of the corporation and its shareholders. A showing that a director has a conflict of interest, is under the control of another, or is acting under some other disability should preclude a finding that the director is disinterested. See *Maldonado v. Flynn*, 597 F.2d 789, 793 (2d Cir. 1979); *Falkenberg v. Baldwin*, [1977-78 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,086, at 91,911 (S.D.N.Y. 1977); *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981); M. STEINBERG, CORPORATE INTERNAL AFFAIRS, *supra* note 22, at 190-91; Ferrara & Steinberg, *supra* note 21, at 289-90.

87. *But see supra* note 60. To help ensure that the minority shareholders' interests are paramount in this context, it is important that counsel and the investment banker have no prior ties or substantial contacts with either corporation. By using unaffiliated counsel and investment banking services, the corporation lessens the risk of structural bias. Analogously, the SEC has required a corporation that has violated pertinent reporting and disclosure requirements in connection with a transaction designed to eliminate the minority to appoint a "Special Review Person," who has no prior affiliation with the company and who is acceptable to the Commission, to negotiate on behalf of the interests of the minority shareholders. See, e.g., *In re Spartek Inc.*, [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,961, at 81,407; *In re Woods Corp.*, SEC Securities Exchange Act Release No. 15337, SEC Docket 16-166 (November 16, 1978).

shareholders. This examination should include such elements as prior earnings, asset value, future profitability potential, premium over market price offered in similar transactions, and the value derived by the parent from complete ownership of the subsidiary.<sup>88</sup> Moreover, because the parent as a controlling shareholder owes a fiduciary duty to the subsidiary and its minority shareholders,<sup>89</sup> the parent should be under a duty to disclose all material information in its possession, with the possible exception of an internal feasibility or similar study,<sup>90</sup> that would be relevant to the negotiating team's evaluation. By receiving such information and undertaking an independent assessment, the subsidiary will bargain with the parent in a meaningful manner.

If the subsidiary corporation uses the independent negotiating committee in the manner described above, a court may presume that the merger was fair and decline to conduct an independent fairness review. Under Delaware corporate law, the elements of control and domination or self-dealing must exist in order to invoke the intrinsic fairness test.<sup>91</sup> Therefore, provided that no party stands on both sides of the transaction or that the plaintiff cannot demonstrate a disabling conflict of interest, it may be argued that a court should not subject the merger to an entire fairness review.<sup>92</sup> The appointment of an independent negotiating committee to conduct arm's-length, equal bargaining with the parent corporation allows a court to presume the fairness of the transaction.<sup>93</sup>

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88. *Cf.* Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

89. *See supra* cases cited in notes 30-32 & 35-40.

90. A persuasive argument can be set forth that the majority shareholder, although owing fiduciary duties to the subsidiary and its minority shareholders, has a legitimate interest in furthering its own objectives by paying a bargain price for the subsidiary's outstanding stock. An internal feasibility study helps the parent make this assessment. Disclosure of the study (where the parent does not stand on both sides of the transaction) to the independent negotiating committee will provide reason to believe that the parent will pay *at least* the amount mentioned in the study. The result may well be the termination by parent corporations in undertaking such studies or a lowering of the price that would otherwise be stated in such studies. *Cf.* Tanzer v. International Gen. Indus., Inc., 379 A.2d 1121 (Del. 1977).

91. *Harriman v. E.I. DuPont de Nemours & Co.*, 411 F. Supp. 133, 152 (D. Del. 1975). *See* *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971); *Sterling v. Mayflower Hotel Corp.*, 33 Del. Ch. 293, 315, 93 A.2d 107, 117 (1952); *Puma v. Marriott*, 283 A.2d 693, 696 (Del. Ch. 1971).

92. *See, e.g.,* *Getty Oil Co. v. Skelly Oil Co.*, 267 A.2d 883, 886 (Del. 1970); *Warshaw v. Calhoun*, 221 A.2d 487, 492 (Del. 1966); *Johnston v. Greene*, 35 Del. Ch. 479, 487, 121 A.2d 919, 925 (1956).

93. *See* *Sterling v. Mayflower Hotel Corp.*, 33 Del. Ch. 293, 299, 93 A.2d 107, 110 (1952); *Bastian v. Bourms, Inc.*, 256 A.2d 680, 681 (Del. Ch. 1969), *aff'd*, 256 A.2d 467 (Del. 1970); *David J. Greene & Co. v. Dunhill Int'l Inc.*, 249 A.2d 427, 431 (Del. Ch. 1968).

Authority exists, however, which requires that courts independently scrutinize the decisions of disinterested directors.<sup>94</sup> Although these cases concern the use of special litigation committees to terminate a shareholder's derivative suit, they arguably apply to the use of independent negotiating committees to satisfy the requirement of fairness in a parent-subsidary merger. A court's application of its own "independent business judgment"<sup>95</sup> follows from certain "structural

94. See *Burks v. Lasker*, 441 U.S. 471 (1979); *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981). In *Burks*, the Supreme Court considered the issue of whether a quorum of four statutorily disinterested directors within the meaning of the Investment Company Act could terminate a shareholder's derivative suit brought against fellow directors for violations of the Investment Company and Investment Advisors Acts. The court formulated a two-part test: (1) whether the applicable state law permits the disinterested directors to terminate a shareholder's derivative suit, and (2) whether such a state rule is consistent with the policies underlying the federal securities laws. 441 U.S. at 480, 486. If, however, dismissal is sought in state court, the only inquiry is whether state law authorizes dismissal. See, e.g., *Zapata Corp. v. Maldonado*, 430 A.2d at 789; see also *Auerbach v. Bennett*, 47 N.Y.2d 619, 393 N.E.2d 994, 419 N.Y.S.2d 920 (1979).

A number of federal courts applying *Burks'* first prong have held that dismissal is proper under the applicable state law. See, e.g., *Gaines v. Haughton*, 645 F.2d 761 (9th Cir. 1981), cert. denied, 454 U.S. 1145 (1982) (California law); *Lewis v. Anderson*, 615 F.2d 778 (9th Cir. 1980), cert. denied, 449 U.S. 809 (1980) (California law); *Maldonado v. Flynn*, 603 F.2d 724 (8th Cir. 1979), cert. denied, 444 U.S. 1017 (1980) (Delaware law); *Abbey v. Control Data Corp.*, 603 F.2d 724 (8th Cir. 1979), cert. denied, 444 U.S. 1017 (1980) (Delaware law); *Genzer v. Cunningham*, 498 F. Supp. 682 (E.D. Mich. 1980) (Michigan law); *Siegal v. Merrick*, 84 F.R.D. 106 (S.D.N.Y. 1979) (Delaware law).

Subsequently, two federal courts precluded dismissal under the applicable state law. See *Abella v. Universal Leaf Tobacco Co.*, 495 F. Supp. 713 (E.D. Va. 1980); *Maher v. Zapata Corp.*, 490 F. Supp. 348 (S.D. Tex. 1980) (Delaware law). See also *Joy v. North*, 692 F.2d 880 (2d Cir. 1982) (Connecticut law); *Watts v. Des Moines Register & Tribune*, 525 F. Supp. 1311 (S.D. Iowa 1981) (Iowa law); *Maldonado v. Flynn*, 413 A.2d 1251 (Del. Ch. 1980), rev'd, *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981). See generally M. STEINBERG, CORPORATE INTERNAL AFFAIRS, *supra* note 22, at 133-62; M. STEINBERG, SECURITIES REGULATION, *supra* note 22, § 14.01.

95. The Delaware Supreme Court in *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981), stated that "when stockholders, after making demand and having their suit rejected, attack the board's decision as improper, the board's decision falls under the 'business judgment' rule and will be respected if the requirements of the rule are met." *Id.* at 784 n.10. See, e.g., *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984); *Colonial Sec. Corp. v. Allen*, No. 6778, slip op. (Del. Ch. 18, 1983) (class action suit was derivative on behalf of the corporation and dismissed because plaintiff failed to fulfill the demand requirement or demonstrate the futility of such a demand).

Commentators have distilled the *Zapata* court's holding in demand-refusal cases as follows:

[A] two-step test should be employed in the chancery court's exercise of "independent discretion" in determining whether to grant dismissal. First, with the corporation bearing the burden of proof, the court should inquire into the special litigation committee's independence and good faith and the bases supporting its conclusions. Second, providing that the first step is satisfied, the court should apply "its own independent business judgment" and "should, when appropriate, give special consideration to matters of law and public policy in addition to the corporation's best interests."

M. STEINBERG, CORPORATE INTERNAL AFFAIRS, *supra* note 22, at 150.

bias[es]" and conflicts of interest that are inherent in certain significant decisions made by the board of directors.<sup>96</sup>

Courts should apply this scrutiny to bargaining between a management-appointed negotiating committee and the parent corporation. Although negotiating directors do not pass judgment on fellow directors, as in the special litigation committee context, they are designated to serve both as directors and as committee members by the interested majority directors. In such a situation, inherent structural biases arise.<sup>97</sup> In transactions such as freeze-out mergers, which involve high financial stakes to the majority, a judicial inquiry that ends with a finding that the committee is "disinterested" is not a "sufficient safeguard against abuse, perhaps subconscious abuse."<sup>98</sup> The courts should, therefore, continue to apply their own independent judgment to determinations of whether a merger transaction meets the test of fairness. To encourage the use of such committees, which appear beneficial to minority shareholder interests, the burden of proof generally should shift to the complainants to show that the merger transaction was unfair.<sup>99</sup>

Thus, in evaluating special negotiating committees, the Delaware

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96. "Structural bias" may be defined as "inherent prejudice against [potential shareholder] action resulting from the composition and character of the board of directors." Note, *The Business Judgment Rule in Derivative Suits Against Directors*, 65 CORNELL L. REV. 600, 601 n.14 (1980). Recognizing the problem of structural bias, the Fifth Circuit held that because of conflicts of interest, a corporation's board of directors was incompetent to settle the plaintiff shareholders' derivative claims. *Clark v. Lomas & Nettleton Fin. Corp.*, 625 F.2d 49 (5th Cir. 1980), cert. denied, 450 U.S. 1029 (1981).

For further commentary on this subject, see M. STEINBERG, CORPORATE INTERNAL AFFAIRS, *supra* note 22, at 133-62; M. STEINBERG, SECURITIES REGULATION, *supra* note 22, § 14.01; see also Coffee & Schwartz, *The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform*, 81 COLUM. L. REV. 261 (1981); DeMott, *Defending the Quiet Life: The Role of Special Counsel in Director Terminations of Derivative Suits*, 56 NOTRE DAME LAW. 850, 853-54 (1981); Dent, *The Power of Directors to Terminate Shareholder Litigation: The Death of the Derivative Suit?*, 75 NW. U.L. REV. 96 (1980); Steinberg, *The Use of Special Litigation Committees to Terminate Shareholder Derivative Suits*, 35 U. MIAMI L. REV. 1 (1980); Note, *The Business Judgment Rule in Derivative Suits Against Directors*, 65 CORNELL L. REV. 600 (1980); Brodsky, *Terminating Derivative Suits Under Business Judgment Rule*, N.Y.L.J. p. 1, col. 1 (May 20, 1981).

97. *Zapata Corp. v. Maldonado*, 430 A.2d 779, 787 (Del. 1981).

98. *Id.*

99. This rationale is consistent with the approach adopted in *Weinberger* "where the corporate action has been approved by an informed vote of a majority of the minority shareholders." 457 A.2d at 703, 707-08. See MODEL BUSINESS CORP. ACT § 4 (1979); DEL. CODE ANN. tit. 8, § 144(a)(1) (1982); *Fliegler v. Lawrence*, 361 A.2d 218 (Del. 1976); *Schlensky v. South Parkway Bldg. Corp.*, 19 Ill. 2d 268, 166 N.E.2d 792 (1960); *Remillard Brick Co. v. Remillard-Dandini Co.*, 109 Cal. App. 2d 405, 241 P.2d 66 (1952); see also *infra* notes 104-09 and accompanying text.

courts should adopt a modified version of the two-step test formulated in *Zapata Corp. v. Maldonado*.<sup>100</sup> First, the court should examine the independence of the negotiating committee, its good faith, and the adequacy of the information it possessed. To encourage the use of these independent negotiating committees, the minority should bear the burden of proof regarding the issues of good faith and independence.<sup>101</sup> The court, however, should place the burden on the majority to show fulfillment of its duty of full and fair disclosure. Such an allocation is appropriate because the committee cannot negotiate meaningfully unless it receives all material information within the majority's control that affects price.<sup>102</sup> With respect to the second step, the court, once again with the minority bearing the burden of proof, should independently scrutinize the fairness of the merger.<sup>103</sup>

Hence, because negotiating committees, unlike special litigation committees, are designed to protect the minority's bona fide interests, courts should encourage them. Yet, because of the potential of structural bias, courts should not give the determinations of these committees conclusive effect. The standard proposed above reconciles these competing interests in a compatible framework.

### B. Use of Majority of Minority Vote

The merger between UOP and Signal involved the use of another structural device designed to support the fairness of the merger terms, namely, shareholder approval by a majority of the minority vote.<sup>104</sup> If a subsidiary corporation utilizes this voting structure and fully and

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100. 430 A.2d 779 (Del. 1981). See *supra* note 95.

101. The court should afford the plaintiff adequate, but not vexatious, discovery. See Prickett & Hanrahan, Weinberger v. UOP: *Delaware's Effort to Preserve a Level Playing Field for Cash-Out Mergers*, 8 DEL. J. CORP. L. 59, 73 (1983) ("[t]he only practical way to determine whether there has been full disclosure is to allow the plaintiff reasonable discovery to support his nondisclosure allegations and determine whether or not other germane facts were withheld").

102. See *supra* notes 86-93 and accompanying text. An exception arguably should be made for internal feasibility and similar studies and data compiled by the parent. See *supra* note 90.

103. *Zapata Corp. v. Maldonado*, 430 A.2d 779, 789 (Del. 1981).

104. 457 A.2d at 703, 707-08. The *Weinberger* court had no occasion to resolve the question whether approval by a majority of the minority vote should be based on all outstanding minority shares or only all such shares actually voting. See *id.* at 708. Arguably, the court implied that a majority of all outstanding minority shares is the appropriate standard. "At the meeting only 56%, or 3,208,652, of the minority shares were voted. Of these, 2,953,812, or 51.9% of the total minority, voted for the merger, and 254,840 voted against it." *Id.* See Prickett & Hanrahan, *supra* note 101, at 65-66.

fairly discloses all material facts,<sup>105</sup> the court will shift the burden of proof to the minority to prove the unfairness of the merger.<sup>106</sup> Unless the minority shareholder vote is an informed one, however, such a voting structure will be given no effect.<sup>107</sup>

An informed vote requiring a majority of the minority approval may present the majority with an unnecessary risk. One disadvantage arises if the necessary minority approval is barely obtained<sup>108</sup> and the minority registers a substantial number of dissents. In this event, a court may closely scrutinize the adequacy of disclosure and the fairness of the terms underlying the merger.<sup>109</sup> Although such a voting structure nor-

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105. See *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1981). *Weinberger* reaffirmed that the majority owes the minority a duty of candor. In *Lynch v. Vickers Energy Corp.*, 383 A.2d 278 (Del. 1977) (*Lynch I*), the Delaware Supreme Court stated that, the Chancery Court should examine what information defendants had and . . . measure it against what they gave to the minority stockholders, in a context in which 'complete candor' is required. In other words, the limited function of the Court was to determine whether defendants had disclosed all information in their possession germane to the transaction in issue. And by 'germane' we mean, for present purposes, 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 the mandate under present circumstances.

*Id.* at 281.

A duty of candor prevents insiders from using their special knowledge to their advantage and consequently to the detriment of minority shareholders. See *Speed v. Transamerica Corp.*, 99 F. Supp. 808, 829 (D. Del. 1951); *Talbot v. James*, 259 S.C. 73, 80, 190 S.E.2d 759, 764 (1972). In *Bershad v. Curtiss-Wright Corp.*, No. 5827 (Del. Ch. Mar. 21, 1983), the Delaware Chancery Court indicated that the defendants must bear the burden of showing a complete disclosure of all facts relevant to the transaction. This includes, in the court's view, a showing that the majority of minority vote was an informed one.

106. *Michelson v. Duncan*, 407 A.2d 211, 224 (Del. 1979). See *Gottlieb v. Heyden Chem. Corp.*, 33 Del. Ch. 82, 91 A.2d 57 (1952); *Fidanque v. American Maracaibo Co.*, 33 Del. Ch. 262, 92 A.2d 311 (1952); *Kaufman v. Schoenberg*, 33 Del. Ch. 211, 91 A.2d 786 (1952); see also *infra* note 115.

107. Initially, the plaintiffs must bear the burden of demonstrating a basis for invoking the fairness obligation. 457 A.2d at 703. Moreover, a corporation cannot render a merger totally immune from attack merely by structuring the merger agreement so as to require that a majority of the minority shareholders approve the merger. See *Weinberger v. UOP, Inc.*, 426 A.2d 1333, 1346-47 (Del. Ch. 1981), *rev'd*, 457 A.2d 701 (Del. 1983); *Fisher v. United Technologies Corp.*, 6 DEL. J. CORP. L. 380, 387 (1981) (unreported decision of Delaware Chancery Court); *Cahall v. Lofland*, 114 A. 224 (Del. Ch. 1921). If the minority vote is based on a misleading or incomplete disclosure, shareholder ratification is meaningless. 457 A.2d at 712.

108. See *infra* note 153 and accompanying text. Section 251(c) of title 8 of the Delaware Code mandates that the shareholders approve a subject transaction with a majority of shares entitled to vote and the majority of each class entitled to vote. If the transaction is structured so as to require a majority of all minority shares outstanding and a sufficient number of the minority shares are not voted, the corporation will not obtain the requisite number for approval. See *supra* note 104.

109. See *Berger & Allingham, A New Light on Cash-Out Mergers: Weinberger Eclipses*

mally shifts the burden of proof to the minority, a hotly contested vote, in practical effect, may instead impose upon the majority a heavier burden to establish fairness. Hence, the majority should only use the majority of the minority voting technique when it expects an overwhelming majority of the minority to approve the transaction. In that situation, such a voting structure will provide a presumption that the merger was fair.

### C. *Relation of Procedural Safeguards to Substantive Fairness*

Despite procedural safeguards such as the independent negotiating committee and the super-majority vote, the substantive requirement of fair dealing has uncertain application. These indicia of procedural fair play may not actually serve to promote substantive fairness.<sup>110</sup> Moreover, the *Weinberger* court stated that "in a non-fraudulent transaction, we recognize that price may be the preponderant consideration outweighing other features of the merger."<sup>111</sup> *Weinberger* thus appears to hold that a majority shareholder can freeze out the minority for the sole purpose of eliminating such shareholders if that result is accomplished with full disclosure,<sup>112</sup> procedural safeguards,<sup>113</sup> and without

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*Singer*, 39 BUS. LAW. 1, 13 (1983) (material nondisclosures, e.g., company prospects, merger's purpose, and postmerger plans, could cause shareholder approval of a merger).

110. See *Federal Securities and Corporate Developments*, 15 SEC. REG. & L. REP. (BNA) 1908 (1983) (remarks of former SEC Commissioner Bevis Longstreth). Longstreth feels that the myriad of procedures used "to deflect legal challenges from minority shareholders," in management buyouts, such as investment banker fairness opinions, nonmanagement director approval and unaffiliated shareholder ratification, are "inadequate to give shareholders full value for their shares." *Id.* at 1909; see also *Federal Securities and Corporate Developments*, 16 SEC. REG. & L. REP. (BNA) 641 (1984) (Longstreth calls for reform in leverage buyouts). For Longstreth's comments on fairness opinions by investment bankers and on SEC rule 13e-3, see *infra* notes 252-53 and accompanying text.

111. 457 A.2d at 711. However, the court in *Weinberger* did not overrule *Singer* in its entirety. In addition, the court cited the "entire fairness" standard from *Sterling* quite extensively. *Id.* at 715. See also *Bell v. Kirby Lumber Corp.*, 413 A.2d 137, 150-51 (Del. 1980) (Quillen, J., concurring); Comment, *Bell v. Kirby Lumber Corp.: Ascertaining "Fair Value" Under the Delaware Appraisal Statute*, 31 COLUM. L. REV. 426, 435-36 (1981).

112. See *infra* notes 169-70 and accompanying text. A materially false or misleading disclosure in connection with a merger may constitute deception within the meaning of section 10(b) of the Securities Exchange Act of 1934 (1934 Act) and rule 10b-5. Hence, minority shareholders can, in certain cases, maintain a federal suit in order to recover damages resulting from such a merger. See, e.g., *Goldberg v. Meridor*, 567 F.2d 209 (2d Cir. 1977), *cert. denied*, 434 U.S. 1069 (1978).

113. See Payson & Inskip, *Weinberger v. UOP, Inc.: Its Practical Significance in the Planning and Defense of Cash-Out Mergers*, 8 DEL. J. CORP. L. 83, 90 (1983) ("As a practical matter, the parent's burden of showing the fairness of the transaction will decrease in direct proportion to the number of safeguards employed in structuring the transaction.").

self-dealing or other disabling conflict.<sup>114</sup>

Nonetheless, under *Weinberger* the majority still owes the minority a fiduciary duty. The fiduciary duty of fair dealing forbids the majority from using the corporate machinery solely or primarily to perpetuate its own control.<sup>115</sup> For example, in *Bennett v. Brueil Petrol Corp.*,<sup>116</sup> a dominant shareholder caused the issuance of new shares allegedly to impair the interests of and ultimately force out the minority shareholders. The court denied the defendant's motion for summary judgment, reasoning that a substantial factual dispute existed regarding the legal propriety of the motives of the corporate defendant and its controlling shareholders.<sup>117</sup> Drawing upon such precedent, it may be argued that the minority can challenge a freeze-out merger that is solely or primarily completed to consolidate the majority's control, irrespective of the fairness of the price offered to the minority.<sup>118</sup>

Moreover, the majority cannot manipulate the corporate voting machinery for its own control. Even compliance with the statutory merger formalities<sup>119</sup> does not insulate a merger from judicial review under the

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114. See 457 A.2d at 710-11; *David J. Greene & Co. v. Schenley Indus., Inc.*, 281 A.2d 30, 33 (Del. Ch. 1971).

115. See 457 A.2d at 710 (citing *Guth v. Loft, Inc.*, 23 Del. Ch. 255, 267, 5 A.2d 503, 510 (Del. 1939)). In *Singer*, the court responded to the argument that the right to take is co-extensive with the power to take and that a dissenting shareholder has no legally protected rights in his shares, his certificate or his company beyond a right to be paid fair value when the majority is ready to do this [by stating that] such an argument does not square with the duty stated so eloquently and so forcefully . . . in *Guth v. Loft, Inc.*

380 A.2d at 977-78. See also *Johnson v. Trueblood*, 629 F.2d 287 (3rd Cir. 1980); *Coleman v. Taub*, 487 F. Supp. 118 (D. Del. 1980), *rev'd*, 638 F.2d 628 (3d Cir. 1981); *Cheff v. Mathes*, 41 Del. Ch. 494, 199 A.2d 548 (1965); *Bennett v. Propp*, 41 Del. Ch. 14, 187 A.2d 405 (1962). However, "[w]here the majority shareholder refrains from exercising its powers to control or bring about corporate action (i.e., by conditioning a merger on the approval of a majority of the minority shares), it arguably should not be required to bear the *Sterling-Singer* burden of demonstrating the fairness of the transaction to the minority." *Payson & Inskip*, *supra* note 113, at 91. See also *Prickett & Hanrahan*, *supra* note 101, at 64.

116. 34 Del. Ch. 6, 99 A.2d 236 (Del. Ch. 1953).

117. *Id.* at 12, 99 A.2d at 239.

118. Similarly, in *Condec Corp. v. Lunkenheimer Co.*, 230 A.2d 769 (Del. Ch. 1967), the court stated that "shares may not be issued for an improper purpose such as a takeover of voting control from others." *Id.* at 775. *Condec* involved an action to cancel a stock issue allegedly designed to retain control. The court in *Schnell v. Chris-Craft Indus.*, 285 A.2d 439 (Del. 1971), applied the same rationale as *Bennett* and *Condec* to nullify the advancement of the date of a corporation's annual meeting. The plaintiffs alleged that the purpose of the change was the perpetuation of management's tenure in office.

119. See, e.g., DEL. CODE ANN. tit. 8, § 251 (Replacement Vol. 1983) (long-form merger statute); *id.* § 253 (short-form merger statute).

entire fairness test.<sup>120</sup> Thus, if the majority of a corporation accomplished a merger solely to eliminate the minority, even with full disclosure and a fair price, arguably a court may still find it inherently unfair in certain instances.<sup>121</sup>

There are major difficulties, however, with the thesis that the motivation behind the merger is important after *Weinberger*. In *Tanzer v. International General Industries*,<sup>122</sup> which courts should view in light of *Weinberger*, the court stated that the majority shareholder has a right to vote its shares in its own interest for any motive so long as the purpose underlying the transaction is bona fide. More fundamentally, the criticisms underlying *Singer's* business purpose requirement apply with equal force in this context.<sup>123</sup> The corporation and its controlling shareholders, with the benefit of expert advice rendered by counsel and investment bankers, can readily manufacture an economic justification for a squeeze-out merger. Thus, in practical effect, it can become almost impossible to prove that the majority shareholders acted solely to perpetuate and advance their control.<sup>124</sup> Because of this and other problems with *Singer*,<sup>125</sup> the *Weinberger* court concluded that the busi-

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120. *Sterling v. Mayflower Hotel Corp.*, 33 Del. Ch. 293, 93 A.2d 107, 110 (Del. 1952) (cited with approval in 457 A.2d at 710, 715). See also 380 A.2d at 977 (defendants, absent justification, do not meet their fiduciary duty by relegating minority to appraisal proceedings).

121. Consider, for example, the two-tier merger situation when the bidder makes a tender offer at a certain price to gain a control position in the target corporation, followed by an announced second-step buyout of the remaining minority shares at a lower price. See *infra* notes 155-74 and accompanying text.

122. 379 A.2d 1121, 1123-24 (Del. 1979).

123. See, e.g., Greene, *Corporate Freeze-Out Mergers: A Proposed Analysis*, 28 STAN. L. REV. 487 (1976), Solomon, *Going Private Business Practices, Legal Mechanics, Judicial Standards, and Proposals for Reform*, 25 BUFFALO L. REV. 141 (1975); Terrell & Ranney-Marinelli, *What Constitutes a Valid Purpose for a Merger*, 51 TEMP. L.Q. 852 (1978); Note, *Rule 13e-3 and the Going Private Dilemma: The SEC's Quest for a Substantive Fairness Doctrine*, 58 WASH. U.L.Q. 883 (1980); Note, *Going Private*, 84 YALE L.J. 903 (1975); Comment, *Protection of Minority Shareholders from Freeze-Outs Through Merger*, 22 WAYNE L. REV. 1421 (1976).

124. The corporation and its controlling shareholders can practically always proffer a justification for a merger. See, e.g., *Bryan v. Brock & Blevins Co.*, 490 F.2d 563 (5th Cir. 1974) *cert. denied*, 419 U.S. 844 (1974) (elimination of shareholders who are no longer employees); *Grimes v. Donaldson, Lufkin & Jennette, Inc.*, 392 F. Supp. 1393 (N.D. Fla. 1974), *aff'd*, 521 F.2d 812 (5th Cir. 1975) (elimination of conflicts of interest); *Tanzer v. International Gen. Indus., Inc.*, 379 A.2d 1121 (Del. 1977) (long term trust debt financing); *Tescher v. Chicago Title & Trust Co.*, 59 Ill. 2d 452, 322 N.E.2d 54 (1924), *appeal dismissed*, 422 U.S. 1002 (1975) (operating efficiency); *Matteson v. Ziebarth*, 40 Wash. 2d 286, 242 P.2d 1025 (1952) (en banc) (danger of financial collapse).

125. The lower court decision in *Weinberger*, 426 A.2d at 1342-43, 1348-50, "clearly circumscribed the thrust and effect of *Singer*." 457 A.2d at 715. The Delaware Supreme Court continued: "This has led to the thoroughly sound observation that the business purpose test 'may be . . .

ness purpose test offered shareholders no additional meaningful protection.<sup>126</sup> Therefore, after *Weinberger*, courts will not require the majority to show that a purpose existed other than that of forcing the minority's removal. To hold otherwise would raise the very proof charade that the *Weinberger* court sought to repudiate.<sup>127</sup>

## V. "FAIR VALUE" UNDER THE APPRAISAL STATUTE

After *Weinberger*, the Delaware courts will normally limit minority shareholders to the monetary value of their stock.<sup>128</sup> Therefore, the determination of fair price is crucial. The *Weinberger* standard requires that the court determine fair value by considering all relevant factors, including elements of future value that are susceptible to proof but excluding the speculative effects of the merger.<sup>129</sup> The court de-

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virtually interpreted out of existence, as it was in *Weinberger*." *Id.*, (quoting, Weiss, *supra* note 37, at 671 n.300).

126. 457 A.2d at 715.

127. Thus, the *Weinberger* court's language as well as policy considerations apparently militate against such an approach. This conclusion is supported by a subsequent decision in a diversity case in the Southern District of New York. *Green v. Santa Fe Industries, Inc.*, No. 74 Civ. 3915 (S.D.N.Y. Nov. 27, 1983), *aff'd*, 742 F.2d 1434 (2d Cir.), *cert. denied*, 105 S. Ct. 296 (1984).

The merger between defendant's wholly-owned subsidiary and Kirby Lumber Co. also resulted in a federal securities law claim. *See, e.g.*, *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977); *Bell v. Kirby Lumber Corp.*, 413 A.2d 137 (Del. 1980). In *Green*, the plaintiffs brought a suit against the majority for breach of fiduciary duty. They challenged a section 253 short-form merger under Delaware law on the grounds that the merger advanced no corporate purpose and that the stock was undervalued. The court granted the defendant's motion for summary judgment on the basis of *Weinberger*. Moreover, the court declined to award the plaintiffs the retroactive relief under the quasi-appraisal remedy provided for by the court in *Weinberger*. The court limited this quasi-appraisal remedy to assist only those plaintiffs challenging mergers, which occurred between the 1977 *Singer* decision and the 1983 *Weinberger* decision, who "abjured an appraisal" in reliance on the *Singer* rationale.

Significantly, the court indicated that the purpose behind the short-form merger was to give the parent corporation a method of eliminating the minority. The court noted that to maintain a suit based on a breach of fiduciary duty, the facts must support an allegation of constructive fraud. When the fair value of the shares is significantly greater than the total amount offered, or when the present corporation is depriving the minority shareholders of their rights or otherwise taking advantage of them, then an action for constructive fraud may exist. If subsequent courts adopt such an application of *Weinberger*, the concept of "fair dealing" may offer little substantive protection to minority shareholders in a going private transaction except in the most egregious cases.

128. 457 A.2d at 711.

129. *Id.* at 713. *See also* DEL. CODE ANN. tit. 8, § 262(h) (Replacement Vol. 1983). Compare the approach adopted by the Delaware Supreme Court in *Weinberger* with that of the fairly recent New York appraisal statute. N.Y. BUS. CORP. LAW § 623 (Consol. 1983). Under the New York statute, the appraisal court determines fair value by considering the following factors:

The nature of the transaction giving rise to the shareholder's right to receive payment for shares and its effects on the corporation and its shareholders, the concepts and methods

rived the "all relevant factors" standard from language contained in *Tri-Continental Corp. v. Battye*.<sup>130</sup> Thus, the focus of determining value is on the intrinsic value of the minority's shares as a proportionate interest in a going concern.<sup>131</sup>

Significantly, the *Weinberger* court advocated an approach to valuation that allows "proof of value by any techniques or methods which are generally considered applicable in the financial community."<sup>132</sup> This broad language arguably permits the court to determine fair value

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then customary in the relevant securities and financial markets for determining fair value of shares of a corporation engaging in a similar transaction under comparable circumstances and all other relevant factors.

*Id.* § 623(h)(4). Significantly, the statute eliminates previous statutory language that excluded from the assessment of fair value any appreciation or depreciation arising from the merger. *Id.* Also, in determining fair value, a court may take into account "third-party sale value," namely, "the price the acquired company's shareholders would have received had the company been sold, as a whole, to another unaffiliated purchaser." Comment, *Front-End Loaded Tender Offers: The Application of Federal and State Law to an Innovative Corporate Acquisition Technique*, 131 U. PA. L. REV. 389, 419-20 (1982). For discussion of the California and English frameworks, see Weiss, *supra* note 37, at 682-90.

130. 31 Del. Ch. 523, 74 A.2d 71 (1950).

131. The *Weinberger* court quoted at length from its decision in *Tri-Continental*:

The basic concept of value under the appraisal statute is that the stockholder is entitled to be paid for that which has been taken from him, viz., his proportionate interest in a going concern. By value of the stockholder's proportionate interest in the corporate enterprise is meant the true or intrinsic value of his stock which has been taken by the merger. In determining what figure represents this true or intrinsic value, the appraiser and the courts must take into consideration all factors and elements which reasonably might enter into the fixing of value. Thus, market value, asset value, dividends, earning prospects, the nature of the enterprise and any other facts which were known or which could be ascertained as of the date of merger and which throw any light on future prospects of the merged corporation are not only pertinent to any inquiry as to the value of the dissenting stockholders' interest, but must be considered by the agency fixing the value.

*Id.* at 526, 74 A.2d at 72, quoted in *Weinberger v. UOP, Inc.*, 457 A.2d 701, 713 (Del. 1981). Note that although the court decided *Tri-Continental* in 1950, a Delaware court had not construed the quoted language as such until *Weinberger*. See Weiss, *Balancing Interests in Cash-Out Mergers: The Promise of Weinberger v. UOP, Inc.*, 8 DEL. J. CORP. L. 1, 47 (1983) ("While earlier Delaware decisions have interpreted *Tri-Continental Corp.* as requiring that value be determined by averaging 'market value, asset value, dividends, [and] earnings prospects,' *Weinberger* emphasizes that it is 'future prospects' which 'must be considered.'").

Significantly, the Delaware Supreme Court agreed with the Chancellor's perception "that the approach to valuation [in this breach of fiduciary duty case] was the same as that in an appraisal proceeding." 457 A.2d at 712. See *Weinberger v. UOP, Inc.*, 426 A.2d 1333, 1359-60 (Del. Ch. 1981). For an article discussing the Chancery Court's opinion in *Weinberger*, see Robinson, *Elimination of Minority Stockholders*, 61 N.C.L. REV. 515 (1983).

132. 457 A.2d at 713. See also *Bell v. Kirby Lumber Corp.*, 413 A.2d 137, 151 (Quillen, J., concurring) ("In my judgment, counsel and the courts, through the flexibility implicit in the traditional standard, should encourage the legislatively established valuation process to be open to generally accepted techniques of evaluation used in other areas of business and law.").

by estimating what an independent third party would pay for the shares in an arm's-length transaction.<sup>133</sup> Therefore, it is unclear whether the Delaware Supreme Court still adheres to its decision in *Bell v. Kirby Lumber Corp.*,<sup>134</sup> which applied a going concern standard that does not encompass valuation based on a hypothetical arms-length transaction.<sup>135</sup> In any event, the court in *Weinberger* adopted an expanded appraisal remedy and rejected the traditional "Delaware block" method as the exclusive formula.<sup>136</sup>

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133. See Weiss, *supra* note 131, at 44-49.

134. *Bell v. Kirby Lumber Corp.*, 413 A.2d 137 (Del. 1980). In *Bell*, the minority shareholders contended that an appraisal court should assess value on the basis of the per share value of stock as negotiated in a "hypothetical, third-party arms-length transaction in order to meet *Singer's* standard of entire fairness." *Id.* at 140. The court rejected this argument and applied the traditional "going concern" standard, which is based mainly on earnings, market and asset value. *Id.* at 142-43. Specifically, the *Weinberger* court seemed to follow the concurring opinion by Justice Quillen in *Bell, id.* at 150-51 (Quillen, J., concurring), which stated that "within a statutory appraisal context, the 'entire fairness' and 'careful scrutiny' doctrines are applicable." *Id.* at 150. See 457 A.2d at 712.

135. Compare the New York approach, *supra* note 129, with the *Bell* court's going concern valuation standard. See Weiss, *supra* note 131, at 45-58 (valuation under *Weinberger* requires the majority to pay the minority at least as much as a third-party would pay in an arm's length transaction). For commentary discussing the hypothetical valuation standard, see 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 (1981); Mirvis, *Two-Tier Pricing: Some Appraisal and "Entire Fairness" Valuation Issues*, 38 BUS. LAW. 485 (1983); Weiss, *The Law of Take Out Mergers: Weinberger v. UOP, Inc. Ushers in Phase Six*, 4 CARDOZO L. REV. 245 (1983). See *infra* notes 135-74 and accompanying text. See also *Multitex Corp. v. Dickinson*, 683 F.2d 1325, 1328 (11th Cir. 1982) ("fair value" determined by the price a willing buyer and seller would agree on if both had adequate knowledge of all the facts).

136. 457 A.2d at 712-13. See *Bershad v. Curtiss-Wright*, No. 5827 slip. op. (Del. Ch. Mar. 21, 1983). The Delaware block or weighted average method of valuation, which the *Weinberger* court rejected as the exclusive method of valuation in appraisal proceedings, assigns a particular weight to the elements of value. 457 A.2d at 713. The *Tri-Continental* decision had been subsequently construed "to require that value be determined by averaging 'market value, asset value, dividends [and] earning prospects.'" W. CARY & M. EISENBERG, *CASES & MATERIALS ON CORPORATIONS* 1457 (5th ed. 1980), quoted in Weiss, *supra* note 131, at 252. See *supra* note 133. For a critique of the Delaware block method of valuation, see Brudney, *Efficient Markets and Fair Values in Parent-Subsidiary Mergers*, 4 J. CORP. L. 63 (1978); Schaefer, *The Fallacy of Weighing Asset Value and Earnings Value in the Appraisal of Corporate Stock*, 55 S.C.L. REV. 1331 (1982). See also Francis I. Dupont Co. v. Universal City Studios, Inc., 312 A.2d 344 (Del. Ch. 1973), *aff'd*, 334 A.2d 216 (Del. 1975); David J. Greene & Co. v. Dunhill Int'l, Inc., 249 A.2d 427 (Del. Ch. 1968); Jacques Coe & Co. v. Minneapolis-Moline Co., 31 Del. Ch. 368, 75 A.2d 244 (Del. Ch. 1950); *In re Gen. Realty & Utils. Corp.*, 29 Del. Ch. 480, 52 A.2d 6 (1947); *Chicago Corp. v. Munds*, 172 A. 452 (Del. Ch. 1934). See also *Blasingame v. American Materials, Inc.*, 654 S.W.2d 695 (Tenn. 1983) (Tennessee adopts Delaware block rule construing *Weinberger* narrowly to apply only in cases involving the rights of minority shareholders in cash-out mergers between a corporation in which such shareholders had stock and its majority owner).

### A. Elements of Future Value

In determining fair value, the *Weinberger* court stated that a court should consider elements of future value if known or susceptible of proof as of the date of the merger.<sup>137</sup> According to the court, "all relevant factors" can include, within the court's discretion, rescissory damages if they are susceptible to proof and appropriate.

Generally, a rescissory damages award allows the plaintiff to recover the value of the stock at the time of resale or at the time of judgment<sup>138</sup> and does not limit the plaintiff to the stock's value at the time of the merger.<sup>139</sup> In *Weinberger*, however, the court, overruling its decision in *Lynch II*, held that the Chancellor was not required to award rescissory damages.<sup>140</sup> The Chancellor now has the discretion to apply an out-of-

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137. These other types of future value include future earnings, future dividend policies, and the general future prospects of the company. As construed in *Weinberger*, courts should only exclude future value based on "pro forma data and projections of a speculative variety relating to the completion of a merger." 457 A.2d at 713.

138. In *Lynch v. Vickers Energy Corp.*, 429 A.2d 497 (Del. 1981) (*Lynch II*), the court ordered "damages which are the monetary equivalent to rescission and which will, in effect, equal the increment in value that [the defendant] enjoyed as a result of acquiring and holding the [minority] stock in issue." *Id.* at 501. See 12A W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §§ 5596, 5598 (perm. ed. 1984).

In *Myzel v. Fields*, 386 F.2d 718 (8th Cir. 1967), cert. denied, 390 U.S. 951 (1968), the Eighth Circuit held that if a violation of rule 10b-5 is shown in connection with a sale of securities, section 29(b) of the Securities Exchange Act "declares the sale void." *Id.* at 742. The court of appeals concluded: "If the contract was void as a matter of law, the plaintiff was entitled to restitution of what he sold, or since restoration of the stock was here impossible, an equivalent money judgment." *Id.* See *Mansfield Hardwood Lumber Co. v. Johnson*, 263 F.2d 748 (5th Cir.), cert. denied, 361 U.S. 885 (1959). See also *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11 (1979); *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375 (1970); *Gruenbaum & Steinberg, Section 29(b) of the Securities Exchange Act of 1934: A Viable Remedy Awakened*, 48 GEO. WASH. L. REV. 1 (1979).

139. The *Lynch II* court's determination of the amount of rescissory damages fixed a minimum price or floor value based on "the amount that [the majority shareholder] had authorized to be paid to third parties for open market [pre-merger] purchases of [the company's] stock." *Lynch II*, 429 A.2d at 505. The court reasoned that "given the fiduciary relationship, the arm's length bargaining employed in the purchases should not have resulted in the minority stockholders receiving less than [the majority shareholder] was ready to pay strangers for the same stock." *Id.* This use of a "prior purchase price" valuation rule allowed the plaintiffs in *Lynch II* to recover, when by traditional appraisal standards, the minority shareholders may not have been entitled to damages because the price paid was more than the actual value of a share at the time of the merger. See *Mirvis*, *supra* note 135.

140. 457 A.2d at 714. Therefore, a court should award the minority the increment in value that the majority enjoyed through acquiring and holding the minority shares exclusive of the speculative effects of the merger itself.

Ordinarily, when a plaintiff has two inconsistent remedies available to redress a single right, he must select one of those remedies. Once the plaintiff makes a choice of remedy, the other inconsistent remedy is precluded. For example, when the plaintiff has been induced to act by fraud, the

pocket appraisal measure, which is the difference between the actual value of the stock and the price paid, as well as rescissory damages in appropriate cases.<sup>141</sup> Therefore, the Chancellor may elect to value the stock as of the date of the merger or as of some future date, depending on the circumstances. In practical effect, the *Weinberger* court withdrew the mandatory damages formula, which directly benefited plaintiffs, and substituted a discretionary award that may not provide comparable protection to plaintiffs.

When the procedure utilized to accomplish the merger is suspect, although not fraudulent, courts should choose some future date, such as the time of judgment, as a basis for valuation. This method would result in an award of rescissory damages.<sup>142</sup> Although price may be the

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plaintiff must choose between a suit for damages or one for rescission and restitution. See Hine, *Election of Remedies: A Criticism*, 26 HARV. L. REV. 707 (1913); Patterson, *Improvements in the Law of Restitution*, 4 CORNELL L.Q. 667 (1955); Note, *Election of Remedies: A Delusion?*, 38 COLUM. L. REV. 292 (1938).

141. The majority in *Lynch II* limited the Chancellor solely to a rescissory measure of damages. *Lynch II*, 429 A.2d at 501. But see *Harmon v. Masonellion Int'l, Inc.*, 422 A.2d 487, 500, n.23 (Del. 1982). However, the *Lynch II* court declined to overrule *Poole v. N.V. Deli. Maatschappij*, 224 A.2d 260 (Del. 1966), which applied the out-of-pocket theory in a misrepresentation case and measured the actual value by appraisal standards. The *Lynch II* court merely distinguished between the breach of fiduciary duty case before it and the misrepresentation presented in *Poole*. *Lynch II*, 429 A.2d at 501. See also *Mirvis*, *supra* note 135, at 499 n.73. *Weinberger* overruled *Lynch II* presumably because under *Weinberger's* appraisal approach, a court may award the out-of-pocket measure and/or a rescissory measure of damages. 457 A.2d at 714. The Chancellor may award rescissory damages "if the Chancellor considers them susceptible of proof and a remedy appropriate to all the issues of fairness before him." *Id.* Subsequently, in a divorce case, the Chancellor awarded the husband ownership of the stock in question, but concluded that the wife must be given the "fair value" of her interest as that term is used in *Weinberger*. The court chose to value the stock as of the date of the property division trial as opposed to the date of divorce. It, thereby, awarded the equivalent of rescissory damages to the wife, on the basis of certain equitable factors present. *Walter W.B. v. Elizabeth P.B.*, 462 A.2d 414 (Del. Ch. 1983).

142. Some authorities distinguish between the measure of recovery when the plaintiff seeks to rescind for an innocent misrepresentation and that available for an intentional fraud. When the misrepresentation is deliberate, the plaintiff is allowed to recover the defendant's profits—through the constructive trust theory—even though those profits may exceed any losses suffered by the plaintiff. When the misrepresentation is innocent, however, the plaintiff is entitled to recover the "direct product" of his property. The plaintiff can recover increments such as dividends or interest resulting without independent action by the defendant, but he cannot recover increments derived from the exercise of the defendant's skill, efforts, or opportunities. See RESTATEMENT OF RESTITUTION §§ 151, 202, 205 (1937). But see *Myzel v. Fields*, 386 F.2d 718 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968). In *Myzel*, the defendants argued that a constructive trust was not permissible in cases arising under the Securities Exchange Act. The court apparently rejected that contention, stating that "nondisclosure is the evil proscribed, not the motive that induced it." *Id.* at 747.

“preponderant” factor in nonfraudulent merger transactions,<sup>143</sup> through the award of rescissory damages, the procedural aspect of entire fairness can afford minority shareholders some meaningful protection. Moreover, the *Weinberger* court expressly authorized rescissory damages in cases involving fraud, misrepresentation, self-dealing, deliberate waste of corporate assets, or gross and palpable overreaching.<sup>144</sup> Therefore, in such instances, the Chancellor should allow minority shareholders to recover the “going concern” value of their shares together with any increment in value enjoyed by the majority shareholder exclusive of the speculative effects of the merger.

### B. Availability of Equitable Relief

Consistent with prior Delaware law, the court in *Weinberger* provided that only in highly unusual circumstances will a stockholder successfully obtain a rescission of the merger.<sup>145</sup> Ordinarily, a court should not award injunctive relief when the plaintiff is challenging only the fairness of the cash-out price of a merger.<sup>146</sup> Even if the plaintiff could demonstrate a reasonable probability of success on the merits of a claim of unfair price, the appraisal remedy is normally the exclusive remedy.<sup>147</sup> After *Weinberger*, the plaintiff must prove actual or constructive fraud before a court will issue such an injunction.<sup>148</sup> Hence,

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143. 457 A.2d at 711. See *supra* note 110.

144. 457 A.2d at 714. In delineating these exceptions, the court left open the possibility of a suit for breach of fiduciary duty. See *infra* notes 175-92 and accompanying text.

145. 457 A.2d at 741. At common law, a single shareholder had the right to block a merger. See *Bastian v. Bourns, Inc.*, 256 A.2d 680 n.1 (Del. Ch. 1969), *aff'd*, 278 A.2d 467 (Del. 1970). Under modern law, however, statutes such as DEL. CODE ANN. tit. 8, §§ 251 & 253 (Replacement Vol. 1983) specifically provide for mergers. These statutes generally require only that a majority of the shares entitled to vote approve the merger. See E. FOLK, THE DELAWARE GENERAL CORPORATION LAW 331-32 (1972).

146. The court in *Weinberger* stated that “in a non-fraudulent transaction we recognize that price may be the preponderant consideration outweighing other features of the merger.” 457 A.2d at 711. When there is a gross disparity between the price offered by the majority and fair value, a court should find gross and palpable overreaching, and sufficient grounds for injunctive relief.

147. When the dispute is only over value, the Delaware Supreme Court reasoned that the appraisal remedy adequately protects the shareholders’ interest in obtaining fair value for their shares. 457 A.2d at 715. See *Stauffer v. Standard Brands, Inc.*, 41 Del. Ch. 7, 187 A.2d 78 (Del. 1962); *David J. Greene & Co. v. Schenley Indus., Inc.*, 281 A.2d 30 (Del. Ch. 1971); see also *Berger & Allingham*, *supra* note 109, at 10-11.

148. In *Cole v. National Cash Credit Corp.*, 18 Del. Ch. 47, 156 A. 183 (Del. Ch. 1931), the court formulated the test for obtaining an injunction of a merger. The court required the shareholder to prove actual or constructive fraud in connection with the merger in order to enjoin it. The plaintiff can prove constructive fraud in the alleged undervaluation of the shares, when the

only when the court finds one of the *Weinberger* exceptions to apply will it grant an injunction against a merger.<sup>149</sup>

The *Weinberger* court's holding is consistent with its prior decisions in *Singer*, *Tanzer* and *Najjar* to the extent that it allows a minority shareholder to bring a suit to enjoin the merger if fraud, misrepresentation, self-dealing, or deliberate waste has occurred. Significantly, however, unlike the *Singer* era, when such suits frequently withstood motions to dismiss,<sup>150</sup> after *Weinberger*, the lack of a proper business purpose will not support an injunction against a merger.<sup>151</sup> *Weinberger* thus imposes a higher standard for obtaining injunctive relief against the consummation of a merger.

A court should award an injunction, however, if the majority fails to disclose information that relates to the fairness of the merger price that induced the minority shareholders to forego the election of their ap-

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valuation constitutes a conscious abuse of discretion, or when a breach of trust or maladministration manifestly injures the dissenting shareholder. Mere inadequacy of price does not amount to fraud unless the undervaluation suggests bad faith or reckless indifference to the rights of the minority shareholder. *Id.* at 54, 15 A. at 187-88. *Cole* provided the basis for the *Weinberger* court's listed exceptions and established the proposition that shareholders have the option to accept the terms of the merger or to seek a valuation of the shares in appraisal.

In *David J. Greene & Co. v. Schenley Indus., Inc.*, 281 A.2d 30 (Del. Ch. 1971), the Delaware Chancery Court indicated that it would rarely grant an injunction unless the fair value of the stock was so much greater than the amount offered, the minority shareholders were otherwise deprived of clear rights or so taken advantage of by those charged with a fiduciary duty that the court could imply constructive fraud. Otherwise, the parties are merely disputing value for which appraisal is an adequate remedy. The court further stated that it would not issue a preliminary injunction unless the moving party established a reasonable probability of ultimate success at the final hearing. Finally, the court would not issue an injunction simply because it may not cause any harm pending the final hearing. *Id.* at 33.

149. Therefore, when a court finds fraud or illegality or egregious overreaching, it can award injunctive relief. In addition, cases involving deliberate or ongoing waste of corporate assets present a proper situation for injunctive relief because the surviving corporation may be unable to satisfy appraisal awards. A court may enjoin self-dealing transactions if the parent fails to disclose the benefits it derived from the merger. *See* 457 A.2d at 714. In the post-merger period, injunctions may never be available. *See In re Jones & Laughlin Steel Corp.*, 488 Pa. 524, 412 A.2d 1099 (1980).

150. *See, e.g., Kemp v. Angel*, 381 A.2d 241 (Del. Ch. 1977).

151. *Weinberger* is a partial return to the rationale of pre-*Singer* law in Delaware where courts rarely granted injunctions against the consummation of mergers. *See, e.g., Stauffer v. Standard Brands, Inc.*, 41 Del. Ch. 7, 187 A.2d 78 (Del. 1962); *David J. Greene & Co. v. Schenley Indus., Inc.*, 281 A.2d 30 (Del. Ch. 1971); *David J. Greene & Co. v. Dunhill Int'l*, 249 A.2d 427 (Del. Ch. 1968); *Stryker & Brown v. Bon Ami Co.*, C.A. No. 1945, *reprinted in* 2 DEL. J. CORP. L. 157 (1977) (Del. Ch. Mar. 16, 1964); *Porges v. Vadsco Sales Corp.*, 27 Del. Ch. 127, 32 A.2d 148, 151 (Del. Ch. 1943); *Federal United Corp. v. Havender*, 24 Del. Ch. 318, 11 A.2d 331 (1940); *Cole v. National Cash Credit Ass'n*, 18 Del. Ch. 47, 156 A. 183 (1931).

praisal rights.<sup>152</sup> In addition, a court should make an injunction available to protect minority rights that originate in the terms of the merger agreement. For example, a majority of the minority voting provision requires the approval of this group of shareholders as a condition precedent to the effectiveness of the merger. In that case, the nondisclosure or misstatement of any fact that influenced the shareholders' decision on the merger should satisfy the irreparable injury standard.<sup>153</sup> Thus, the majority's failure to adhere to the disclosure obligations imposed by *Weinberger's* concept of fair dealing may give rise to injunctive relief.<sup>154</sup>

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152. If the failure to deal fairly encourages the shareholders not to perfect their appraisal rights, the shareholders should be able to demonstrate irreparable injury. Such misrepresentations are specifically listed in *Weinberger* as an instance when a court may not consider appraisal an adequate remedy. 457 A.2d at 714. One source contends that the other elements of fair dealing enumerated in *Weinberger, id.* at 711, covering the timing, the initiation, the structure, the negotiations, the disclosure to the directors, and the method of approval of the directors of the transaction are unlikely to "mislead minority shareholders into giving up their appraisal rights, as long as the facts with respect to such matters are fully disclosed." Berger & Allingham, *supra* note 109 at 12. Hence, they argue that *Weinberger* does not impose an obligation on the majority to time, initiate, structure, or negotiate the deal fairly as long as the minority is fully apprised of that information when making a decision to seek or forego appraisal rights. *Id.* at 12-14.

153. Appraisal should be deemed an inadequate remedy in this context. Nondisclosure of any fact that a reasonable shareholder considers material to his decision on how to vote on the merger should lead a court to find that the vote was uninformed and provide a basis for awarding injunctive relief. Arguably, therefore, a voting structure based on majority of minority approval presents unnecessary risks to the majority. It imposes a disclosure obligation broader than the disclosure requirements normally present in a freeze-out merger that often cover the fairness of the price offered. See Berger & Allingham, *supra* note 109, at 13, *supra* note 108 and accompanying text.

154. It is arguable that, unlike *Singer* era injunctions, which tended to be of a more permanent character, injunctive relief granted after *Weinberger* may be temporary in nature and accompanied by an order merely mandating additional disclosure. This approach is premised on the rationale that the lack of a proper business purpose as the basis for injunctive relief in the *Singer* era, in all practicality, brought merger plans to a halt for prolonged periods of time. Because *Weinberger* has eliminated the business purpose test, injunctions will now be largely premised on the lack of adequate disclosure, which can be readily cured by supplemental disclosure and the passage of a sufficient time period to permit shareholders to digest the additional information. Nonetheless, it is possible that in egregious cases courts will conclude that mere supplemental disclosure is insufficient to protect shareholder interests, and order more extensive relief. Cf. *Hanna Mining Co. v. Norcen Energy Resources, Ltd.*, [1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,742 (N.D. Ohio) (extensive relief ordered to remedy violations of section 13(d) of the Exchange Act).

In *Joseph v. Shell Oil Company*, 482 A.2d 335 (Del. Ch. 1984), the court preliminarily enjoined a tender offer for the minority shares of the Shell Oil Corporation because the defendants stood on both sides of the transaction and violated a fiduciary duty to the minority by failing to make adequate disclosure. Initially, the case arose from the decision of the Royal Dutch Petroleum Company to acquire all of the minority shares in its 69.5 percent subsidiary, the Shell Oil Company, in a merger for \$55 cash per share based on the opinion of its investment banker, Morgan Stanley. The Shell board, a majority of which were outside directors, appointed a special commit-

### C. Two-Tier Offers

The typical two-tier control transaction raises some interesting valuation concerns in the appraisal context. In a two-tier control transaction the bidder first makes a partial tender offer to secure a controlling position in the target company. Later, the controlling shareholder, initiates a merger to freeze out the minority at a lower price per share.<sup>155</sup>

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tee made up exclusively of outside directors to evaluate the proposal. The committee rejected the \$55 merger price based on a fairness opinion rendered by Goldman Sachs, another investment banker, that valued the stock at \$80-\$85 per share. Royal Dutch subsequently withdrew its merger proposal and instead commenced a tender offer for Shell at \$58 per share. In order to induce the shareholders to tender their shares, Royal Dutch also announced that it would not propose a tender offer or merger transaction at a price higher than \$58 for at least eighteen months.

The Delaware Chancery Court concluded that the defendants, who stood on both sides of the transaction, owed a fiduciary duty to the minority that it breached by not making adequate disclosures to the minority. The court found such lack of adequate disclosure because Royal Dutch failed to inform Shell's minority shareholders that it declined to supply essential information for Morgan Stanley to arrive at a fair opinion as to value. The chancery court stated: "It defies reason to argue that an oil exploration company such as Shell could be valued without any in-depth inquiry into the estimated value of the probable oil reserves." Royal Dutch also failed to disclose to Shell minority shareholders that members of Shell management made a "going concern" evaluation of the company's stock at \$91 per share. Finally, Royal Dutch violated the duty of fair dealing as set forth in *Weinberger* by not disclosing to Shell minority shareholders that "the initial valuation opinion of Morgan Stanley was arrived at after only eight days of inquiry . . ."

It has been argued that the court's reliance on the nondisclosure aspects of the transaction was misplaced. Before the tender offer's commencement, the conclusion by Shell's special committee that a price of less than \$75 was unfair had been discussed and widely publicized in the SEC Schedule 14D-9 distributed by Shell to all its shareholders. In addition, the Royal Dutch offering circular arguably disclosed the important facts to the shareholders. Moreover, it appears Royal Dutch, as the majority stockholder, did not have substantial access to inside information on Shell. Royal Dutch, the Shell board of directors, and the Shell special committee all had access to the same information and the minority shareholders were well informed as to the differences of opinion on value. See Herzel & Finkelstein, *Fairness, Majority, Minority*, Nat'l L.J., July 16, 1984, at 15-19 col. 3.

The chancery court, however, recognized the fundamental distinction between a freeze-out merger and a tender offer initiated by the majority shareholder. In a tender offer, unlike a freeze-out merger, the shareholder makes his own decision on whether to tender or keep his shares. The court indicated, however, that an exception to the rule that a majority stockholder does not have a fiduciary obligation to offer a fair price in a tender offer exists "when the maker of the tender offer, who has a fiduciary duty to the offeree, structures the offer in such a way as to result in an unfair price being offered and the disclosures are not likely to call the unwary stockholder's attention to the unfairness." On the basis of the material nondisclosures made by Royal Dutch, the court enjoined the tender offer until curative disclosure was made.

155. For a discussion of appraisal and "entire fairness" valuation issues in the two-tier context, see Mirvis, *supra* note 135; Schlagman, *Determining a Fair Price in Two-Step Takeovers of Asset-Rich Firms*, N.Y.L.J. Feb. 1, 1982, at 4, col. 1. Note that under *Weinberger*, the court's approach to valuation generally remains the same whether in the context of an appraisal or a

The first-step tender offer price in this setting reflects a premium that the acquiror will pay to gain control.<sup>156</sup> The price offered in the second step of such a transaction nonetheless should be suspect unless a majority of the disinterested shareholders approve the lower price or economic justifications support the price.<sup>157</sup> Absent these circumstances, a court should classify both steps in a two-tier control transaction as components of a single transaction.<sup>158</sup> Hence, a court should deem the price paid in the tender offer "fair value" unless intervening events justify the second-tier or other appropriate price.

Due to the coercive nature of the forced second step, tender offerors historically have pressed shareholders to tender their shares quickly or risk oversubscription of the initial offer and a subsequent freeze-out at a lower price.<sup>159</sup> In response to this problem, Congress adopted section

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breach of fiduciary duty. 457 A.2d at 712. In either case, the court will apply the fairness test. *Id.* at 715.

156. Courts have recognized that a purchaser is often willing to pay a premium over market price in order to take control of the corporation. *See Gibbons v. Schenley Indus., Inc.*, 339 A.2d 460, 464 (Del. Ch. 1975); *Adams v. R.C. Williams & Co., Inc.*, 39 Del. Ch. 60, 65, 158 A.2d 797, 799 (1960); *Sporborg v. City Specialty Stores, Inc.*, 35 Del. Ch. 560, 565, 123 A.2d 121, 124 (1956); *see also In re Delaware Racing Ass'n*, 42 Del. Ch. 406, 213 A.2d 203, 211 (1965); *Sterling v. Mayflower Hotel Corp.*, 33 Del. Ch. 293, 310, 93 A.2d 107, 116 (1952).

157. Propositions set forth with respect to two-tier offers are not necessarily premised on the "entire fairness" rationale as articulated in *Weinberger* and prior cases. In terms of invoking fiduciary duty principles, courts arguably should distinguish second-step mergers initiated to gain complete ownership shortly after a successful partial tender offer from combinations of long-held business affiliates.

In the latter case there has been a long-term relationship between the two firms, with one managing or controlling the other, and the fiduciary relationship is especially important because it has developed over time; the minority has in fact relied on the majority and maintains an expectation of fairness. Contrarily, the second step of a unitary plan to acquire a target cannot be viewed as a transaction between related parties, and thus no fiduciary duty should be recognized. At the announcement of a two-step tender offer, the bidding corporation is an unrelated outsider—it is in an adversarial relationship to the shareholders of the target corporation. The only duty it owes at this point is to its own shareholders to acquire the target as cheaply as possible. It would be anomalous to hold that at the completion of the first-step tender, and prior to the second-step merger, the acquiring corporation suddenly owes a fiduciary duty to its former adversaries at the expense of its own shareholders.

Comment, *supra* note 129, at 415. *See also* Brudney & Chirelstein, *A Restatement of Corporate Freeze-outs*, 87 YALE L.J. 1354, 1360-61 (1978).

158. *See* Mirvis, *supra* note 135, at 489; Comment, *supra* note 129, at 416.

159. Some commentators contend that the inherently coercive nature of two-tier pricing deprives the target shareholder of the ability "to make an informed, independent judgment on whether [the average of the tiers] is an acceptable overall price for the assets of the firm." Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297, 337 (1974). *See also* Bradley, *Interfirm Tender Offers and the Market for Corporate Control*, 53 J. BUS. 345 (1980); Brudney, *Equal Treatment of Shareholders in Corporate Distributions and Reorganizations*,

14(d)(6) of the Securities Exchange Act<sup>160</sup> and the SEC revised rule 14d-8.<sup>161</sup> These changes in federal law force the offeror to establish a proration pool and to accept on a pro rata basis all shares tendered throughout the duration of the offer.<sup>162</sup> Nevertheless, the minority shareholder remains at a disadvantage in comparison to large institutional investors because the short time periods do not afford an unsophisticated shareholder adequate time either to consider the merits of the offer or to obtain sufficient information upon which to base an informed investment decision.<sup>163</sup> Moreover, courts thus far have rejected

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71 CALIF. L. REV. 1072 (1983); Brudney & Chirelstein, *supra* note 157, at 1440-41, 1471-74; Easterbrook & Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698, 722-28 (1982).

160. Section 14(d)(6) of the Securities Exchange Act provides:

Where any person makes a tender offer, or request or invitation for tenders, for less than all the outstanding equity securities of a class, and where a greater number of securities is deposited pursuant thereto within ten days after copies of the offer or request of invitation are first published or sent or given to security holders than such person is bound or willing to take up and pay for, the securities taken up shall be taken up as nearly as may be pro rata, disregarding fractions, according to the number of securities deposited by each depositor. The provisions of this subsection shall also apply to securities deposited within ten days after notice of an increase in the consideration offered to security holders, as described in paragraph (7), is first published or sent or given to security holders.

15 U.S.C. § 78n(d)(6) (1982).

161. See Exchange Act Release No. 19336, [1982-1983 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 83,306 (1982) [hereinafter Pro Rate Rule]. Rule 14d-8 provides as follows:

Notwithstanding the pro rata provisions of section 14(d)(6) of the Act, if any person makes a tender offer or request or invitation for tenders, for less than all of the outstanding equity securities of a class, and if a greater number of securities are deposited pursuant thereto than such person is bound or willing to take up and pay for, the securities taken up and paid for shall be taken up and paid for as nearly as may be pro rata, disregarding fractions, according to the number of securities deposited by each depositor during the period such offer, request or invitation remains open.

17 C.F.R. § 250.14d-8 (1983). The rule's validity has been questioned. See generally Lederman & Vlahakis, *Pricing and Proration in Tender Offers*, 14 REV. SEC. REG. 813, 815-19 (1981); Note, *Rulemaking Under Section 14(e) of the Exchange Act: The SEC Exceeds Its Reach in Attempting to Pull the Plug on Multiple Proration Pools*, 36 VAND. L. REV. 1313, 1327-30 (1983); Comment, *supra* note 129, at 409-13; Green & Nathan, *The SEC's New Prorating Rule Will Change "Partial" Tender Offers*, Nat'l L.J. Jan. 10, 1983, at 38, col. 1.

162. Under section 14(d)(6) of the Exchange Act, the proration period is ten days from the date of the offer. Whereas, the SEC Proration Rule "effectively extends the proration period for partial tender offers to twenty days. . . . Because Rule 14e-1 provides that a tender offer must remain open for at least twenty days, rule 14d-8's extension of the pro rata period to the life of the tender offer effectively doubles the minimum statutory proration period of ten days that section 14(d)(6) of the Exchange Act established." Note, *supra* note 16, at 1315, 1318. See 17 C.F.R. § 240.14e-1 (1983); see also *Proposed Pro Rata Tender Offer Rule*, Exchange Act Release No. 18761, [1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 83,222, at 85,141 n.2 (May 25, 1982).

163. When the SEC adopted an extended proration period, it recognized the shareholder's need for sufficient time and information to make an investment decision and sought to minimize the confusion created by changing proration periods and multiple proration pools. See *Pro Rata*

shareholder challenges that have attempted to characterize the price paid in a second step forced merger as "manipulative" in violation of section 14(e) of the Williams Act.<sup>164</sup>

A number of states have responded to the problems created by two-tier offers by adopting "equal price" provisions.<sup>165</sup> These provisions generally require that, absent sufficiently disinterested shareholder approval, the bidder must pay the same price in the second-step forced transaction as it paid in the first step.<sup>166</sup> For example, the Pennsylvania "antitakeover" legislation allows forced second-step transactions only if a majority of the disinterested directors or shareholders of the subject corporation approve or if the same price is paid in the second-step transaction as was paid in the first-step tender offer.<sup>167</sup> The Maryland

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Rule, *supra* note 161, at 85,651. Institutional investors such as commercial banks, pension funds, and investment companies are a dominant force on stock exchanges. *See supra* note 159.

164. *See, e.g.*, *Martin Marietta Corp. v. Bendix Corp.*, 549 F. Supp. 623 (D. Md. 1982); *Radol v. Thomas*, 534 F. Supp. 1302 (S.D. Ohio 1982). For other commentary on the Commission's activities under the Williams Act, see Fogelson, Wenig & Friedman, *Changing the Takeover Game: The Securities and Exchange Commission's Proposed Amendments to the Williams Act*, 17 HARV. J. ON LEGIS. 409 (1980); Jupiter, *An Analysis of Efforts to Avoid Williams Act Requirements*, 9 SEC. REG. L.J. 259 (1981); Manges, *SEC Regulation of Issuer and Third-Party Tender Offers*, 8 SEC. REG. L.J. 275 (1981); Thigpen, *Cash Offers, Capital Market Discipline, and the 1968 Legislation Revisited*, 49 TENN. L. REV. 1 (1981); Note, *Expansion of the Williams Act: Tender Offer Regulation for Non-Conventional Purchases*, 11 LOY. U. CHI. L.J. 277 (1980); Note, *Problems in the Regulation of Tender Offers: The Williams Act, State Takeover Statutes, and SEC Rules*, 13 TULSA L.J. 552 (1978); Symposium, *The Federal Scheme of Tender Offer Regulation*, 7 J. CORP. L. 525 (1982).

Note that SEC rule 13e-3, 17 C.F.R. § 240.13e-3 (1984), adopted in Securities Exchange Act Release No. 16075 (1979), normally applies to second-step freeze-out transactions. Generally, rule 13e-3 prohibits fraudulent, deceptive, and manipulative acts or practices in connection with going private transactions. It also prescribes filing, disclosure, and dissemination requirements to prevent such acts or practices. Significantly, the SEC exempts second-step transactions, such as mergers, from the rule if they occur within one year of the first-step tender offer and the tender offeror pays the same price in the "clean-up" transaction as it paid in the tender offer. *See* A. BORDEN, *GOING PRIVATE* (1982); *infra* notes 251-60 and accompanying text.

165. *See* Smith, *Anti-Takeover Measures in 1984 Seen Matching or Exceeding Last Year's Pace*, Wall St. J., March 30, 1984, at 10, col. 2. Anti-takeover statutes present constitutional concerns. *See* *Edgar v. MITE Corp.*, 457 U.S. 624 (1982) (Illinois takeover statute imposed impermissible burden upon interstate commerce); *see also* Bloomenthal, *The New Tender Offer Regimen, State Regulation, and Preemption*, 30 EMORY L.J. 35 (1981); Humphrey, *State Tender Offer Statutes*, 61 N.C.L. REV. 554 (1983); Langevoort, *State Tender Offer Legislation: Interests, Effects, and Political Competency*, 62 CORNELL L. REV. 213 (1977); Sargent, *On the Validity of State Takeover Regulation: State Responses to MITE and Kidwell*, 42 OHIO ST. L.J. 689 (1981).

166. *See, e.g.*, MD. CORPS. & ASS'NS CODE ANN. §§ 3-202, 3-601-03, 8-301(12)-(14) (1982); OHIO REV. CODE ANN. §§ 1701.01, 1701.831 (Page 1978); S. 1144, Act 92 (1983) (amending Pa. Stat. Ann. tit. 15, §§ 408, 409.1, 910 (Purdon)).

167. The Pennsylvania statute reaches fundamental second step transactions, such as mergers or sales of substantially all assets, which frequently follow a hostile tender offer for a bare majority

statute provides that the second-step forced transaction must be at the same price as the first-step tender offer unless a super majority of the shareholders approve the second step.<sup>168</sup>

Although equal price provisions protect minority shareholder interests, these provisions are not without costs. Undoubtedly, they will have a chilling effect on the initiation of adverse corporate takeovers. Equal price provisions increase the cost of such hostile acquisitions because they require the offeror to purchase all the shares at the higher first-step price.<sup>169</sup> The higher cost of purchasing an entire company may lead hostile bidders to conclude that certain offers, which they otherwise might contemplate, are not feasible. Hence, because "equal price" provisions discourage free market activity, they may ultimately harm shareholder interests as a whole and impair market efficiency.<sup>170</sup>

The requirement that tender offerors pay the same price in both steps of a two-tier transaction may thus decrease the frequency of certain beneficial tender offers. Other more meritorious interests, however, outweigh this concern. By enabling an offeror to gain control by means of a partial tender offer at one price, yet subsequently freeze out minority shareholders at a substantially inferior price, this coercive tactic elevates control over equal opportunity for and fair treatment of minority shareholders.<sup>171</sup> Moreover, if a court does not use the tender offer price

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of the target's shares. See Steinberg, *State Law Developments—The Pennsylvania Anti-Takeover Legislation*, 12 SEC. REG. L.J. 184 (1984).

168. MD. CORPS. & ASS'NS CODE ANN. § 3-602 (1982). The Maryland statute specifically provides that eighty percent of the eligible votes must approve any such business combination and that two-thirds of the eligible votes, other than voting stock held by the interested stockholder who is a party to the business combination, must approve the transaction. *Id.* Similarly, the Ohio statute requires approval by a majority of the voting power excluding the votes of any interested shares. OHIO REV. CODE ANN. § 1701.831 (Page 1978). See generally Kreider, *Fortress Without Foundation? Ohio Takeover Act II*, 52 U. CIN. L. REV. 108 (1983); Scriggins & Clarke, *Takeovers and the 1983 Maryland Fair Price Legislation*, 43 MD. L. REV. 266 (1984); Wolff, *The Unconstitutionality of the Arkansas Tender Offer Statute*, 36 ARK. L. REV. 233 (1983).

169. Steinberg, *supra* note 167, at 188.

170. See Carney, *Shareholder Coordination Costs, Shark Repellants, and Takeout Mergers: The Case Against Fiduciary Duties*, 1983 AM. B. FOUND. RESEARCH J. 341; Toms, *Compensating Shareholders Frozen Out in Two-Step Mergers*, 78 COLUM. L. REV. 548 (1978); Easterbrook & Fischel, *supra* note 159, at 423-31.

171. See Brudney, *supra* note 159, at 1118-22. As stated by Professor Brudney:

It has been urged that the costs of a rule of equality in two-step takeover transactions outweigh its gains. The argument is that a rule of equality would increase the cost of, and hence discourage some takeovers. To the extent that the principle of equality encourages holdouts in response to the tender offer, it will make the takeover less likely to succeed and more costly. Two undesirable consequences follow. More productive use of assets by the acquirer is impeded, and the disciplinary effect of the takeover market is

as "fair value" in an appraisal case, many shareholders will bypass the technical, expensive, and cumbersome appraisal proceeding<sup>172</sup> and sell their shares at the price fixed in the second-step merger transaction.

In many states, appraisal remains "a remedy of desperation."<sup>173</sup> Indeed, even large institutional investors acquiesce in two-tier mergers rather than invoke the complex and uncertain appraisal process, as demonstrated by U.S. Steel's second-tier merger transaction with Marathon.<sup>174</sup> Therefore, unless a majority of informed minority shareholders approve the lower second-tier price or outside factors influence the value of the stock between the two steps, the fair value of the shares should remain constant throughout the transaction.

#### VI. EFFECT OF *WEINBERGER* ON STATE BREACH OF FIDUCIARY DUTY SUITS

Plaintiffs who invoke their appraisal remedy are required to fulfill unduly onerous procedures in many states.<sup>175</sup> Because minority share-

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diminished. Moreover, since premiums are always paid on takeovers (in anticipation of more productive use of assets), to discourage takeovers is to make all public investors in potential targets poorer.

The opposing argument is that even if takeovers enhance social utility to some disputed extent, the costs of allowing the acquirer to coerce shareholders into yielding their property are too high. Arguably, the dispersed stockholders are paid less in the takeover than a single knowledgeable seller would be willing to accept. Since dispersed shareholders lack the bargaining capacity of a single owner of a majority of the stock, the bidder's price is likely to be less than the "ideal" market price. To permit the price in the second step merger of a unitary transaction to be lower than the tender price is to further reduce the sellers' price option.

Id. at 1119. See authorities cited *supra* note 159. See also Finkelstein, *Antitakeover Protection Against Two-Tier and Partial Tender Offers: The Validity of Fair Price, Mandatory Bid, and Flip-Over Provisions Under Delaware Law*, 11 SEC. REG. L.J. 291 (1984).

172. See *supra* note 78 and accompanying text; *infra* notes 175, 291-92.

173. Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decision Making*, 57 CALIF. L. REV. 1, 85 (1969).

174. See Comment, *supra* note 129, at 417 n.160, (quoting Garson & Tyson, *Pru Switch on Marathon, Both Now Favor U.S. Steel Merger*, Am. Banker, March 11, 1982, at 10, col. 1.

175. See, e.g., DEL. CODE ANN. tit. 8, § 262 (Replacement Vol. 1983) (shareholder may not have voted for or consented to merger and must make a written demand for payment before the shareholder vote); ILL. STAT. ANN. ch. 32, § 157.70 (Smith-Hurd 1983-84 Supp.) (shareholder must make a written objection before the shareholder's meeting and a written demand within 20 days after the effective date of the merger); see also Garson & Tyson, *supra* note 174 (stating that "after studying Ohio's complex appraisal process," the fourth and sixth largest shareholders of Marathon, Morgan Guaranty Trust and Prudential Insurance Company, elected to acquiesce in the merger of Marathon with U.S. Steel rather than seek appraisal).

Some commentators have advocated lessening the procedural obstacles associated with the appraisal remedy and broadening the coverage of the appraisal statutes. See Latty, *Some Miscellaneous Novelties in the New Corporation Statutes*, 23 LAW & CONTEMP. PROBS. 363, 390 (1958);

holders frequently fail to perfect these procedural requirements and, therefore, lose their right to pursue an appraisal,<sup>176</sup> suits alleging breach of fiduciary duty may be their only option. Indeed, until the courts determine the extent of the *Weinberger* exceptions, the practical effect of the decision may well be an onslaught of breach of fiduciary suits.<sup>177</sup>

In this regard, however, suits for breach of fiduciary duty are more difficult to bring as a result of *Weinberger*. Prior to *Weinberger*, such suits frequently withstood motions to dismiss.<sup>178</sup> After *Weinberger*, however, dissatisfied minority shareholders must allege that the transaction contained specific elements of "fraud, misrepresentation, self-dealing, deliberate waste of corporate assets or gross and palpable overreaching" to survive a motion to dismiss.<sup>179</sup> Unless the court finds one of these exceptions, the minority shareholder cannot challenge the fair-

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Comment, *Minority Rights and the Corporate "Squeeze" and "Freeze"*, 1959 DUKE L.J. 436, 458. The New York appraisal statute appears to be a significant step toward achievement of this objective. N.Y. BUS. CORP. LAW § 623 (McKinney 1982), discussed in Comment, *supra* note 129, at 418-19.

Dean O'Neal argues that states should make appraisal available for any corporate transaction that substantially affects the rights of shareholders in a close corporation by changing the essential nature of the enterprise; for example, a sale of assets. He suggests that the only condition precedent to a shareholder's assertion of his dissenter's rights should be that the notification is in writing, and that he elects to have his shares appraised and purchased. F.H. O'NEAL, *OPPRESSION OF MINORITY SHAREHOLDERS*, 609-10 (1975).

Like New York, some states have lessened the procedural obstacles to the invocation of an appraisal remedy. For example, the North Carolina Business Corporation Act requires the corporation to notify shareholders of their appraisal rights when the corporation asks the shareholders to vote on certain fundamental changes. N.C. GEN. STAT. §§ 55-100(b)(2), 55-108(a), 55-112(c)(2), 55-118(a)(2) (1982). Similarly, in 1974, New Jersey amended its corporation statute to require the corporation to outline to the shareholder the appraisal procedure and imposed upon the corporation an obligation in subsequent communications with shareholders to advise them of deadlines. N.J. REV. STAT. §§ 14A:10-3, 14A:10-11, 14A:11-2 (1976). For more state statute notification procedures, see *infra* note 292.

176. See 457 A.2d at 714 n.8.

177. See Payson & Inskip, *supra* note 113, at 94.

178. See *supra* note 38 and accompanying text.

179. The requirement of specific allegations makes it more important that courts afford plaintiff minority shareholders adequate discovery. See 457 A.2d at 705 ("[t]he plaintiff in a suit challenging a cash-out merger must allege specific acts of fraud, misrepresentation, or other items of misconduct to demonstrate the unfairness of the merger terms to the minority"); Prickett & Hanrahan, *supra* note 101, at 71 ("*Weinberger* shows that even a properly skeptical minority stockholder and his counsel may not be prepared in some cases, without the benefit of discovery, to detail in an original complaint the material facts which the majority stockholder has not disclosed.")

ness of the merger through a suit for breach of fiduciary duty.<sup>180</sup>

Although the *Weinberger* court did not specifically list nondisclosure of a material fact as an exception to the prescribed use of the appraisal remedy, nondisclosure remains a basis for a breach of fiduciary duty suit. Traditionally, a material nondisclosure or a misleading disclosure constituted a breach of fiduciary duty.<sup>181</sup> *Weinberger* supports this argument. There the court held that Signal's failure to disclose the adverse feasibility study to UOP was a breach of the duty of candor that the majority owed the minority.<sup>182</sup>

Traditionally, the fiduciary duty suit made available to the plaintiff a wider range of relief than an appraisal proceeding.<sup>183</sup> The *Weinberger*, court's expansion of the remedies available under the appraisal statute considerably narrows this advantage. After *Weinberger*, the relief available under an appraisal proceeding and a breach of fiduciary duty suit frequently may be identical. In both proceedings, courts will take all relevant factors into account, including where appropriate, the award of rescissory damages.<sup>184</sup> Such an award, however, is within the

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180. In *David J. Greene & Co. v. Schenley Indus., Inc.*, 281 A.2d 30, 33 (Del. Ch. 1971), the Chancery Court indicated that appraisal is an adequate remedy unless the case involved actual or constructive fraud. Usually, the parties are actually disputing value, irrespective of what an action is labeled. *Weinberger* apparently follows this rationale, holding that appraisal is the sole remedy—unless the merger involves fraud, misrepresentation, self-dealing, deliberate waste of corporate assets, or gross and palpable overreaching.

181. Nondisclosure has provided the basis for a state court injunction of the merger and has significant implications on the availability of a section 10(b) suit under the Securities Exchange Act. See *Santa Fe Indus. Inc. v. Green*, 430 U.S. 462, 474 n.14 (1977); *Healey v. Catalyst Recovery of Pa., Inc.*, 616 F.2d 641 (3d Cir. 1980); *Alabama Farm Bureau Mut. Cas. Co. v. American Fidelity Life Ins. Co.*, 606 F.2d 602 (5th Cir. 1979), *cert. denied*, 449 U.S. 820 (1980); *Kidwell ex rel. Penfold v. Meikle*, 597 F.2d 1273 (9th Cir. 1979); *Goldberg v. Meridor*, 567 F.2d 209 (2d Cir. 1977), *cert. denied*, 434 U.S. 1069 (1978); *Wright v. Heizer Corp.*, 560 F.2d 236 (7th Cir. 1977), *cert. denied*, 434 U.S. 1066 (1978).

182. 457 A.2d at 705, 708-09. The court stated that "a primary issue mandating reversal is the preparation by two UOP directors of their feasibility study for the exclusive use and benefit of Signal. This document was of obvious significance to both Signal and UOP." *Id.* at 708. In *SEC v. Senex Corp.*, 399 F. Supp. 497 (E.D. Ky. 1975), independent consulting firms prepared several feasibility reports concerning a bond issue for a municipal project. The promoter withheld the adverse studies from the agencies interested in the project. *Id.* at 504-05. The court found that "the adverse report represented a difference of opinion among experts which should have been disclosed." *Id.* at 505. The nondisclosure of the differing opinions to interested parties constituted conduct "clearly at odds with the spirit of the disclosure requirements." *Id.*

183. See, e.g., Gillerman, *The Corporate Fiduciary Under State Law*, 3 CORP. L. REV. 299 (1980); Kaplan, *supra* note 23; Knauss, *Corporate Governance—A Moving Target*, 79 MICH. L. REV. 478 (1981); Solomon, *supra* note 123.

184. 457 A.2d at 714. See *supra* notes 137-44.

court's discretion and, in practical effect, may be awarded only where one of the *Weinberger* exceptions, i.e., a breach of fiduciary duty, is found.<sup>185</sup> Another important distinction between the appraisal proceeding and the suit for breach of fiduciary duty is that the latter carries with it the possibility of an injunction against the consummation of the merger.<sup>186</sup>

Thus, the state breach of fiduciary duty suit still offers a minority stockholder certain advantages.<sup>187</sup> Most significantly, the shareholder who brings a breach of fiduciary duty suit does not have to comply with the procedural requirements of the appraisal statute. Also, courts are more likely to award rescissory damages in such an action. Moreover, an injunction against the merger's consummation remains a viable remedy in a breach of fiduciary duty suit. Although minority shareholders may wish to use the breach of fiduciary duty suit for these reasons, unless they specifically allege one of the *Weinberger* exceptions, they will be merely challenging the fairness of the price paid.<sup>188</sup> In such a case, appraisal is the sole remedy and courts will relegate the

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185. 457 A.2d at 714. The *Weinberger* court expressly recognized that even the liberalized appraisal remedy may not be adequate in a merger involving conduct encompassed by the exceptions. *Id.*

186. *See supra* note 148.

187. Some commentators, however, maintain that appraisal offers a significant advantage. Shareholders successfully pursuing appraisal will obtain a monetary reward. In a breach of fiduciary duty suit, a court may simply cancel the merger altogether if the majority does not wish to comply with the court-ordered changes in the terms of the merger. Hence, with an appraisal proceeding the shareholders retain the benefit of the improved terms. *See, e.g.,* Comment, *supra* note 111, at 435.

188. In *Bershad v. Curtiss-Wright Corp.*, Civ. 5827 (Del. Ch. Mar. 21, 1983) (available Sept. 7, 1984 on *Lexis*, Del. Corp. Library, Del. Cases File), plaintiffs alleged that a proxy statement was false and misleading in its omission of material facts and that the omission constituted a breach of fiduciary duty. The Delaware Chancery Court found that the proxy statement was neither false nor materially misleading and, therefore, that the minority vote was an informed one. The court stated that "[i]n light of the elimination of the business purpose rule and my finding of complete disclosure, the Plaintiffs are in the precarious position of merely challenging the fairness of the . . . price." *Id.*

The court, however, allowed the minority stockholders who did not vote in favor of the merger and who did not accept any benefit from the merger to challenge the fairness of the price through an appraisal proceeding without perfecting their appraisal rights. The court reasoned that the *Weinberger* court had relaxed the procedural requirements in pending cases that were eligible for direct appeal to the Delaware Supreme Court.

Although the court's decision may tempt minority shareholders to allege a breach of fiduciary duty in order to circumvent the procedural requirements of the appraisal statute, the minority should be cautious. If the minority shareholders cannot support the allegations and, in effect, they are only challenging the price, the courts will relegate plaintiffs to their statutory remedy. Moreover, if such parties fail to perfect their appraisal rights, they may well lose their right to an

minority stockholder to the statutory appraisal proceeding with its procedural prerequisites.<sup>189</sup> Moreover, a court will apply the quasi-appraisal remedy, which grants relief to certain plaintiffs who have not complied with the appraisal statute,<sup>190</sup> only in situations, as in *Weinberger*, where the plaintiff has "abjured an appraisal,"<sup>191</sup> presumably in reliance on the availability of a *Singer*-type breach of fiduciary duty suit.<sup>192</sup>

## VII. THE DUTY OWED TO MINORITY SHAREHOLDERS BY AN INVESTMENT BANKER IN RENDERING A FAIRNESS OPINION

Although the Delaware Supreme Court's opinion did not address the plaintiff's claims against UOP's investment banker,<sup>193</sup> the widespread use of fairness opinions prepared by an investment banker to influence or inform the minority in a tender offer or merger<sup>194</sup> merits attention.

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appraisal. *See Green v. Santa Fe Indus., Inc.*, No. 74 Civ. 3915, slip op. (S.D.N.Y. 1983); *Stauffer v. Standard Brands, Inc.*, 41 Del. Ch. 7, 187 A.2d 78 (1962).

189. Assuming that such a complaint for breach of fiduciary duty survives a motion to dismiss, the settlement value of the action may be greater than that of an appraisal proceeding. Prior to *Weinberger*, the lower courts frequently declined to dismiss a minority shareholder suit if the shareholders sufficiently alleged unfairness or that the only purpose of the merger was to eliminate them. *See Kemp v. Angel*, 381 A.2d 241 (Del. Ch. 1977).

190. 457 A.2d at 714.

191. In *Green v. Santa Fe Indus., Inc.*, No. 74, Civ. 3915, (S.D.N.Y. 1983), *aff'd*, 742 F.2d 1434 (2d Cir), *cert. denied*, 105 S. Ct. 296 (1984) the Southern District of New York refused to allow plaintiffs to challenge the element of fair value when they had made a tactical decision to forego an appraisal. At the time the action was instituted, the Delaware Supreme Court had not yet decided *Singer*. The court submitted that the quasi-appraisal remedy is only available to assist those minority shareholders whose actions arose between the 1977 *Singer* decision and the 1983 *Weinberger* opinion.

192. The quasi-appraisal remedy enumerated in *Weinberger* applies only to the following situations:

- (1) this case; (2) any case now pending on appeal to this Court; (3) any case now pending in the Court of Chancery which has not yet been appealed but which may be eligible for direct appeal to this Court; (4) any case challenging a cash-out merger, the effective date of which is on or before February 1, 1983; and (5) any proposed merger to be presented at a shareholder's meeting, the notification of which is mailed to the stockholders on or before February 23, 1983.

457 A.2d at 714-15.

Therefore, the *Green* court stated that "the policy considerations behind the court's decision to allow certain plaintiffs to continue to seek remedies other than appraisal would not be promoted by a blind application of the court's provision for retroactive relief. Further, plaintiffs would reap a windfall that the Delaware Supreme Court could not have intended." *Green v. Santa Fe Indus., Inc.*, No. 74, Civ. 3915, slip op. at 6 (S.D.N.Y. 1983).

193. The plaintiffs dismissed Lehman Brothers prior to the Delaware Supreme Court's en banc decision. 457 A.2d at 703, n.3.

194. One factor contributing to the widespread use of fairness opinions is SEC rule 13e-3,

Significantly, no judicial authority exists for imposing liability on an investment banker when rendering a fairness opinion based on negligent misrepresentation or fiduciary duty theories.<sup>195</sup> However, the minority shareholder undeniably relies on the opinion of a reputable investment banking firm in deciding whether to approve the terms of a merger, to tender shares to a bidder, or to seek an appraisal of the fair value of the shares.<sup>196</sup>

### A. *Investment Banker's Role in Weinberger*

In *Weinberger*, UOP's president hired Lehman Brothers to prepare a fairness opinion addressing the price the minority should receive for their shares.<sup>197</sup> UOP chose Lehman Brothers because its long-standing business relationship with UOP allowed it to act within the severe time constraints placed on the preparation of the opinion.<sup>198</sup> Initially, a partner of Lehman Brothers, who had been a director and financial advisor to UOP, determined that a price of \$20 to \$21 per share would be fair.<sup>199</sup> Subsequently, a three-man Lehman Brothers team examined the relevant documents and information concerning UOP,<sup>200</sup>

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which contains a number of disclosure requirements for going private transactions. For a further discussion of rule 13e-3, see *supra* note 164; *infra* notes 251-61 and accompanying text.

195. See, e.g., *Weinberger v. UOP, Inc.*, 426 A.2d 1335, 1348 (Del. Ch. 1981); Comment, *The Standard of Care Required of an Investment Banker to Minority Stockholders in a Cashout Merger: Weinberger v. UOP, Inc.*, 8 DEL. J. CORP. LAW 98 (1983).

196. See, e.g., *Denison Mines Ltd. v. Fibreboard Corp.*, 388 F. Supp. 812, 821-22 (D. Del. 1974). See also Comment, *supra* note 195, at 110-11.

197. 426 A.2d at 1338. See also 457 A.2d at 706.

198. See 457 A.2d at 706; 426 A.2d at 1338. In addition, a partner at Lehman Brothers was a long-time director of UOP as well as its financial advisor. The UOP President "felt that [this partner's] familiarity with UOP as a member of its board as well as being a member of Lehman Brothers would also be of assistance in enabling Lehman Brothers to render an opinion within the existing time constraints." *Id.*

199. *Id.* A price of \$20-21 per share represented almost a 50 per cent premium over UOP's market price. *Id.* But see 15 SEC. REG. & L. REP. (BNA) 1908, 1909 (remarks of former SEC Commissioner Bevis Longstreth) (investment bankers place excessive reliance on market price in evaluating the value of the shares).

200. 457 A.2d at 706; 426 A.2d at 1339. The information that the team reviewed included UOP's annual reports and SEC filings for a three-year period, as well as UOP's audited financial statements for the year preceding the buyout, its interim reports to shareholders, and its recent and historical market prices and trading volumes. 457 A.2d at 706. The minority shareholders in *Weinberger* criticized the qualifications of the three man team and the lack of critical analysis of the true worth of the minority shares. They asserted that there was no Lehman opinion except the opinion of the Lehman partner who was a director of UOP. Appellant's Brief at 55, *Weinberger v. UOP, Inc.*, 457 A.2d 201 (Del. 1983).

performed a “due diligence” visit at UOP’s headquarters,<sup>201</sup> and concluded that \$20 or \$21 would be a fair price for the remaining shares of UOP.<sup>202</sup>

On the morning that both UOP’s and Signal’s boards met to consider the proposed merger, the Lehman Brothers partner, as he was flying to the UOP meeting, looked over the materials prepared by the three-man team and the two-page “fairness opinion letter” in which the price had been left blank.<sup>203</sup> At some point “[e]ither during or immediately prior to the directors’ meeting, the two-page ‘fairness opinion letter’ was typed in final form and the price of \$21 per share was inserted.”<sup>204</sup> At the UOP board meeting, Signal’s board chairman presented the UOP directors with financial data including the Lehman Brothers fairness opinion letter and a brief comment on the information that had gone into preparing the letter.<sup>205</sup> The Board approved the merger<sup>206</sup> and advised the shareholders in a subsequent proxy statement that Lehman Brothers had given its opinion that a \$21 price per share was fair to the minority. The letter did not disclose “the hurried method by which this conclusion was reached.”<sup>207</sup>

The plaintiff in *Weinberger* alleged that the preparation of the opinion created a conflict of interest for Lehman Brothers and that Lehman Brothers had conspired with Signal and Signal-controlled management to present the opinion as though Lehman Brothers had given a carefully considered, impartial opinion on the fairness of the merger price.<sup>208</sup> In addition, the plaintiff argued that the failure to disclose the basis of the fairness opinion and the method utilized in its preparation

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201. In the course of the “due diligence” visit, the Lehman team interviewed UOP’s president, its general counsel, its chief financial officer, and other key executives. 457 A.2d at 706.

202. *Id.* at 707. Lehman Brothers had previously advised Signal, the majority shareholder, in its 1975 tender offer for UOP. At that time, Signal acquired a 50.5 per cent interest in UOP. During the course of the contested tender offer, Lehman had drawn up a study of the desirability of acquiring the remaining UOP shares at a price of up to \$21 per share. Plaintiff contended that if \$21 was a fair price in 1975 after a particularly poor year, then \$21 could not possibly be a fair price after two subsequent years of vastly improved performance. 426 A.2d at 1347.

203. 457 A.2d at 707.

204. *Id.*

205. *Id.*

206. The five UOP directors who were also directors of Signal abstained from voting, but indicated that they would have voted in favor of the proposed merger terms. 426 A.2d at 1340.

207. *Id.* at 1341.

208. *Id.* The basis of the conspiracy charge was “that Lehman Brothers was actually working in the interests of Signal rather than UOP’s minority in rendering its fairness opinion,” thereby deceiving the minority shareholders into approving the merger terms. *Id.* at 1347.

violated the majority's duty of complete candor to the minority.<sup>209</sup> Finally, the plaintiffs asserted that when the majority employs an investment banker to render a fairness opinion and thus "to provide assurance to minority stockholders that the offer by the majority is fair," courts should hold the investment banker "to the fiduciary standards of the majority itself."<sup>210</sup> The Delaware Chancery Court entered judgment in favor of Lehman Brothers.<sup>211</sup> The plaintiffs dismissed their complaint against Lehman Brothers prior to the Delaware Supreme Court's en banc decision.<sup>212</sup>

### B. Duties Owed by Investment Bankers

The issue remains whether an investment banker rendering a fairness opinion owes any duty to minority stockholders. In the withdrawn Delaware Supreme Court opinion,<sup>213</sup> the majority found that the only basis for imposing a duty on an investment banker arose from the contractual relationship between the parties.<sup>214</sup> However, the dissent in the withdrawn *Weinberger* opinion declared that an investment banker had a duty to exercise reasonable care.<sup>215</sup> Failure to do so, according to the dissent, should render the investment banker liable under a theory of negligent misrepresentation to the minority shareholders as foreseeable third parties.<sup>216</sup>

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209. 426 A.2d at 1351. See also Appellant's Brief, *supra* note 200, at 53, 55. For a discussion of the requirement of complete candor, see *Lynch v. Vickers Energy Corp.*, 383 A.2d 278 (Del. 1977); *supra* note 40.

210. Appellant's Brief, *supra* note 200, at 50.

211. 426 A.2d at 1398, 1353, 1363.

212. 457 A.2d at 703, n.3.

213. *Weinberger v. UOP, Inc.*, No. 58,1981, (Del. Feb. 9, 1982), *withdrawn*, 457 A.2d 701, 703, n.1.

214. *Id.* See Comment, *supra* note 195, at 105.

215. *Weinberger v. UOP, Inc.*, No. 58,1981, at 7 (Del. Feb. 9, 1982) (Duffy, J., dissenting), *withdrawn*, 457 A.2d at 703, n.1. For an article discussing the Duffy dissent, see Deutsch, *Weinberger v. UOP: Analysis of a Dissent*, 6 CORP. L. REV. 29 (1983).

216. *Id.* The negligent misrepresentation theory is based on section 522 of the Second Restatement of Torts:

(1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

(2) Except as stated in subsection (3), the liability stated in subsection (1) is limited to loss suffered

(a) by the person or one of a limited scope of persons for whose benefit and gui-

The dissent's analysis appears reasonable given the persuasive influence that a fairness opinion may have on the minority.<sup>217</sup> Certainly, investment bankers know that their fairness opinions will be used by the majority to induce the minority stockholders to act.<sup>218</sup> Hence, the minority shareholders constitute a limited class of reasonably foreseeable third parties to whom the investment banker should owe a duty of reasonable care.<sup>219</sup>

An analogy to an accountant's common law liability for negligent representations to third parties supports the concept that an investment banker should owe a duty to the minority.<sup>220</sup> An accountant may be liable for materially negligent representations made in financial statements, audits, or other work papers.<sup>221</sup> Although some courts enforce a

dance he intends to supply the information, or knows that the recipient intends to supply it; and

(b) through reliance upon it in a transaction that he intends the information to influence, or knows that the recipient so intends, or in a substantially similar transaction.

(3) The liability of one who is under a public duty to give the information extends to loss suffered by any of the class of persons for whose benefit the duty is created, in any of the transactions in which it is intended to protect them.

RESTATEMENT (SECOND) OF TORTS § 552 (1976). See *Rusch Factors, Inc. v. Levin*, 284 F. Supp. 85, 91-92 (D.R.I. 1968). See also Comment, *supra* note 195, at 106 n.57.

217. See, e.g., *Denison Mines Ltd. v. Fibreboard Corp.*, 388 F. Supp. 812, 827 (D. Del. 1974); *Weinberger v. UOP, Inc.*, No. 58, 1981, at 7 (Del. Feb. 9, 1982) (Duffy, J., dissenting), *withdrawn*, 457 A.2d at 203, n.7.

218. See *Denison Mines Ltd. v. Fibreboard Corp.*, 388 F. Supp. 812, 821 (D. Del. 1974); see also Comment, *supra* note 195, at 111.

219. See, e.g., *Weinberger v. UOP, Inc.*, No. 58, 1981, at 7 (Del. Feb. 9, 1982) (Duffy, J., dissenting), *withdrawn*, 457 A.2d at 703 n.1; see also W. PROSSER, *LAW OF TORTS* § 107 (4th ed. 1971); Comment, *supra* note 195, at 113.

220. For articles discussing accountants' liabilities at common law, see Fiflis, *Current Problems of Accountant's Responsibilities to Third Parties*, 28 VAND. L. REV. 31, 67-87 (1975); Gruenbaum & Steinberg, *Accountants' Liability and Responsibility: Securities, Criminal and Common Law*, 13 LOY. L.A.L. REV. 247, 308-312 (1980); Hawkins, *Professional Negligence Liability of Public Accounts*, 12 VAND. L. REV. 797 (1959); Kurland, *Accountant's Legal Liability: Ultramares to BarChris*, 25 BUS. LAW. 155 (1969); Marinelli, *The Expanding Scope of Accountants' Liability to Third Parties*, 23 CASE W. RES. L. REV. 113 (1971); Mess, *Accountants and the Common Law: Liability to Third Parties*, 52 NOTRE DAME LAW. 838 (1977); Note, *Accountants' Liabilities for False and Misleading Financial Statements*, 67 COLUM. L. REV. 1437 (1967); Note, *Accountants' Liability for Negligence—A Contemporary Approach for a Modern Profession*, 48 FORDHAM L. REV. 401 (1979). For cases discussing accountants' liability under the federal securities laws, see, e.g., *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976); *Adams v. Standard Knitting Mills, Inc.*, 623 F.2d 422 (6th Cir. 1980), *cert. denied*, 449 U.S. 1607 (1980); *Herzfeld v. Laventhal, Krekstein, Horwath & Horwath*, 540 F.2d 27 (2nd Cir. 1976), *aff'g in part, rev'g in part*, 378 F. Supp. 112 (S.D.N.Y. 1974); *Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643 (S.D.N.Y. 1962).

221. See, e.g., *Hochfelder v. Ernst & Ernst*, 503 F.2d 1100, 1107 (7th Cir. 1974), *rev'd on other grounds*, 425 U.S. 185 (1976); *Rusch Factors, Inc. v. Levin*, 284 F. Supp. 85, 90-93 (D.R.I. 1968);

strict privity requirement,<sup>222</sup> other courts extend the accountant's liability to third parties whose reliance is specifically foreseeable.<sup>223</sup> A court may also find an accountant liable for fraud in certain instances.<sup>224</sup>

The services of both accountants and investment bankers are employed to influence third parties, including minority shareholders, who rely on their representations.<sup>225</sup> Therefore, an investment banker who makes a materially negligent representation in a fairness opinion should be held liable to the minority shareholders for whose benefit the opinion was rendered.<sup>226</sup> Thus, courts normally should hold investment bankers to the standard of reasonable care recognized in the pro-

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Bonhiver v. Graff, 311 Minn. 111, 248 N.W.2d 291 (1976); Ultramares Corp. v. Touche, 255 N.Y. 170, 174 N.E. 441 (1931). An accountant's liability for negligence has been held to cover certified financial statements as well as audits and returns. *See* Seedkem, Inc. v. Safranek, 466 F. Supp. 340 (D. Neb. 1979); Fischer v. Kletz, 266 F. Supp. 180 (S.D.N.Y. 1967); White v. Guarente, 43 N.Y.2d 356, 372 N.E.2d 315 (1977).

222. *See* Ultramares Corp. v. Touche, 255 N.Y. 170, 174 N.E. 442 (1931). The rationale for the privity rule is the fear of creating an unlimited class of potential plaintiffs. *Id.* at 181-85, 174 N.E.2d at 444-48. *See also* Stephens Indus., Inc. v. Haskins & Sells, 438 F.2d 357, 359-60 (10th Cir. 1971); Investors Tax Sheltered Real Estate, Ltd. v. Laventhal, Krekstein, Horwath & Horwath, 370 So. 2d 815, 817 (Fla. Dist. Ct. App. 1979); Investment Corp. of Fla. v. Buchman, 208 So. 2d 291, 293-96 (Fla. Dist. Ct. App. 1968); Western Sur. Co. v. Loy, 3 Kan. App. 2d 310, 312, 594 P.2d 257, 260 (1979).

223. Hochfelder v. Ernst & Ernst, 503 F.2d 1100, 1107 (7th Cir. 1974), *rev'd on other grounds*, 425 U.S. 185 (1976). *See also* Rhode Island Hosp. Trust Nat'l Bank v. Swartz, Bresenoff, Yavner & Jacobs, 455 F.2d 847, 851 (4th Cir. 1972); Rusch Factors, Inc. v. Levin, 284 F. Supp. 85, 90-93 (D.R.I. 1968); Canaveral Capital Corp. v. Bruce, 214 So. 2d 505 (Fla. Dist. Ct. App. 1968); Bonhiver v. Graff, 311 Minn. 111, 128, 248 N.W.2d 291, 301-02 (1976); Aluma Kraft Mfg. Co. v. Elmer Fox & Co., 493 S.W.2d 378, 381-83 (Mo. Ct. App. 1973); White v. Guarente, 43 N.Y.2d 356, 362-63, 372 N.E.2d 315, 319-20 (1977); Milliner v. Elmer Fox & Co., 529 P.2d 806, 808 (Utah 1974); Shatterproof Corp. v. James, 466 S.W.2d 873, 876-80 (Tex. Civ. App. 1971).

In addition, the New Jersey and Wisconsin Supreme Courts have extended an accountant's liability to those persons who foreseeably might rely on the audit. *See* Citizens State Bank v. Timm, Schmidt & Co., S.C., 113 Wis. 2d 376, 335 N.W.2d 361 (1983); H. Rosenblum, Inc. v. Adler, 93 N.J. 324, 461 A.2d 138 (1983).

224. *See, e.g.*, Ultramares Corp. v. Touche, 255 N.Y. 170, 190-91, 174 N.E. 441, 449 (1931) ("negligence or blindness, even when not equivalent to fraud is nonetheless evidence to sustain an inference of fraud. At least this is so if the negligence is gross."); *see also* Fischer v. Kletz, 266 F. Supp. 180 (S.D.N.Y. 1967); Duro Sportswear, Inc. v. Cogen, 131 N.Y.S.2d 20 (N.Y. Sup. Ct. 1954), *aff'd*, 285 A.D. 867, 139 N.Y.S.2d 829 (N.Y. App. Div. 1955); State Street Trust Co. v. Ernst, 278 N.Y. 104, 15 N.E.2d 416 (1938); Gruenbaum & Steinberg, *supra* note 220, at 312-13.

225. *Compare* Fischer v. Kletz, 266 F. Supp. 180, 186 (S.D.N.Y. 1967) (financial data in SEC filings relied on by investors) with Denison Mines, Ltd. v. Fibreboard Corp., 388 F. Supp. 812, 821 (D. Del. 1974) (persuasive impact of investment banker's opinion on stockholders). *See also supra* note 217.

226. *Accord* Weinberger v. UOP, Inc., No. 58,1981, at 7 (Del. Feb. 9, 1982) (Duffy, J., dissenting), *withdrawn*, 457 A.2d at 703 n.1; Comment, *supra* note 195, at 113. *See also* 426 A.2d at 1338.

fession.<sup>227</sup> In light of the *Weinberger* entire fairness standard,<sup>228</sup> the investment banker's fairness opinion, absent exceptional circumstances such as fraudulent concealment of information by insiders, should adequately disclose and fairly present all material information relevant to the per share value of the minority's interest in order to discharge the banker's obligation to exercise reasonable care.<sup>229</sup>

A problem in the application of this theory to fairness opinions lies in the lack of concrete standards in the investment banking community. It appears that, in determining value, the conduct of investment bankers, unlike accountants, is not governed by a set of industry guidelines other than those general factors that the *Weinberger* court laid out.<sup>230</sup> Thus, the weight in a given case assigned to such factors as asset, market, dividend, and earning values is left largely to the discretion of the individual investment banker.<sup>231</sup> Addressing the valuation techniques of two reputable investment bankers in one recent case, the Delaware court referred to the "questionable methodology employed" as well as the "quick and cursory" analysis used before concluding that "both the opinions of Morgan Stanley and of Goldman Sachs leave something to be desired."<sup>232</sup> Moreover, even when investment bankers use the same data for arriving at their opinions, they often express different opinions as to value.<sup>233</sup>

The lack of recognized standards in the investment banking profession provides an additional reason for not permitting the use of such fairness opinions to insulate the transaction from an entire fairness review.<sup>234</sup> In the fair dealing context, procedural safeguards such as the

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227. *Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643 (S.D.N.Y. 1968) (burden of defendant accountant under § 11 of the Securities Act to show due diligence care as a defense).

228. 457 A.2d at 703-04, 715. The fairness review part of *Singer* survived the *Weinberger* decision.

229. *Cf. Herzfeld v. Laventhal, Krekstein, Horwath & Horwath*, 540 F.2d 27 (2d Cir. 1976) (certified financial statement found false and misleading under rule 10b-5; judged by test for the "fairness" of the financial statement taken as a whole). *See generally* Gruenbaum & Steinberg, *supra* note 220, at 258-64.

230. *See* 457 A.2d at 712-13.

231. The nature and trends of the particular industry bring another element into the equation. *Cf. Bell v. Kirby Lumber Corp.*, 413 A.2d 137 (Del. 1980).

232. *Joseph v. Shell Oil Co.*, 482 A.2d 385 (Del. Ch. 1984).

233. *Id. See also Radol v. Thomas*, 584 F. Supp. 1302 (S.D. Ohio 1982); *Richardson v. White, Weld & Co., Inc.*, [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,864 (S.D.N.Y. 1979); *Royal Indus., Inc. v. Monogram Indus., Inc.*, [1976-77 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,863 (C.D. Cal. 1977).

234. Compliance with professional norms may constitute persuasive evidence of due care

special negotiating committee and super majority voting requirements do not guarantee the fairness<sup>235</sup> of a transaction. Similarly, the absence of concrete standards and the ease with which such favorable fairness opinions are obtained<sup>236</sup> dictate that courts should not consider the rendering of such opinions to be an assurance of fairness.

### C. Application to Weinberger

In *Weinberger*, Lehman Brothers arguably failed to satisfy its duty to exercise reasonable care under the circumstances when it rendered the opinion upon which minority shareholders would foreseeably rely.<sup>237</sup> A reasonably complete presentation is not possible when the investment banker flies to the board meeting with a favorable fairness opinion letter in which the "fair" price per share is left blank.<sup>238</sup> Moreover, given the hurried nature of the Lehman Brothers team's conclusions,

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under tort law. See, e.g., *The T.J. Hooper*, 60 F.2d 737 (2d Cir. 1932). However, courts must review the standards utilized in the profession and employ fair presentation principles. Cf. *Hochfelder v. Ernst & Ernst*, 503 F.2d 1100, 1113 (7th Cir. 1974), *rev'd on other grounds*, 425 U.S. 185 (1976) (an accountant's compliance with generally accepted accounting standards (GAAS) is not a bar to recovery unless court finds that GAAS reflects professional practice constituting reasonable prudence); *United States v. Simon*, 425 F.2d 796, 805-06 (2d Cir. 1969), *cert. denied*, 397 U.S. 1006 (1970) (compliance with generally accepted accounting principles is evidence of reasonable care, but remains subject to a fairness review). *But cf.* *SEC v. Arthur Young & Co.*, 590 F.2d 785, 787-89 (9th Cir. 1979) (accountant's compliance with GAAS held to discharge his obligation). See generally Gruenbaum & Steinberg, *supra* note 220, at 258-63; *infra* note 232.

235. See *supra* notes 79-127 and accompanying text.

236. See Weiss, *The Law of Take Out Mergers: Weinberger v. UOP, Inc. Ushers in Phase Six*, 4 CARDOZO L. REV. 245, 255 (1983) ("it often is all too easy for a corporation to find a compliant investment banker prepared to opine, without much study, that a proposed transaction is 'fair and reasonable'"). Cf. *Herzfeld v. Laventhol, Krekstein, Horwath & Horwath*, 540 F.2d 27 (2d Cir. 1976) (rejecting the defense of compliance with GAAS and GAAP, and testing the fairness of the financial statement as a whole). The district court in *Herzfeld* stated:

Compliance with generally accepted accounting principles is not necessarily sufficient for an accountant to discharge his public obligation. Fair presentation is the touchstone for determining the adequacy of disclosure in the financial statements. While adherence to generally accepted accounting principles is a tool to help achieve that end, it is not necessarily a guarantee of fairness.

*Herzfeld v. Laventhol, Krekstein, Horwath & Horwath*, 378 F. Supp. 112, 122 (S.D.N.Y. 1974) (quoting *Sonde, The Responsibility of Professionals Under the Federal Securities Laws—Some Observations*, 68 Nw. U.L. REV. 1, 4 (1973)). See generally Gruenbaum & Steinberg, *supra* note 220, at 263. For a discussion of the duty to disclose, see *infra* notes 237-40 and accompanying text.

237. See 457 A.2d at 703-08.

238. The corporation selected the investment banker, a Lehman Brothers partner, because of his personal familiarity with UOP. Further, the corporation represented him to the Board and shareholders as specially knowledgeable. See Appellant's Brief, *supra* note 200, at 54; *supra* note 198.

compliance with acceptable standards is questionable.<sup>239</sup> Although an investment banker, especially in view of time limitations imposed by a client, cannot always conduct a full review, the banker should fully reveal the extent of his inquiry to those who rely on his findings.<sup>240</sup>

These observations raise the related issue of whether the banker should disclose the basis of the fairness opinion to the minority. The plaintiff in *Weinberger* contended that the failure to disclose the true basis of the opinion violated the requirement of complete candor.<sup>241</sup> In *Denison Mines Ltd. v. Fibreboard Corp.*,<sup>242</sup> a Delaware federal district court held that the "bare reference of the Proxy Statement to an opinion of an independent investment banking firm that the transaction was fair to the company and its stockholders without further reference to the basis for that opinion was misleading."<sup>243</sup> The Delaware Chancery Court in *Weinberger* distinguished the *Denison* case on the grounds that in the case at bar the proxy statement included a copy of the opinion

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239. See *infra* note 244. The plaintiffs in *Weinberger* argued that Lehman Brothers did not actually issue an independent opinion and that the fairness opinion given was entirely that of the Lehman partner who was also a UOP director. Brief of Appellant, *supra* note 200, at 53, 55. Furthermore, plaintiffs contended that Lehman was responsible for the acts of its partner under agency principles. *Id.* at 49. Cf. *In re F.W. Koenecke & Sons, Inc.*, 605 F.2d 310, 312-13 (7th Cir. 1979) (in a case seeking contract damages, court applied traditional agency law to determine accounting firm's liability for the conduct of one of its partners). See generally Gruenbaum & Steinberg, *supra* note 220, at 276-77.

240. Certainly, an investment banker is under no duty to decline an appointment merely because of limited time constraints. However, the banker should exercise reasonable care under the circumstances and fully disclose the limited nature of the review.

241. See *supra* note 214 and accompanying text. When accountants have reason to foresee that third parties will rely on their work, courts may impute a duty to disclose to those third parties. See, e.g., *Spectrum Fin. Cos. v. Marconsult, Inc.*, 608 F.2d 377 (9th Cir. 1979), cert. denied, 446 U.S. 936 (1980); *Zweig v. Hearst Corp.*, 594 F.2d 1261 (9th Cir. 1979); *Wessel v. Buhler*, 437 F.2d 279, 283 (9th Cir. 1971); *Medelsohn v. Capital Underwriters, Inc.*, 490 F. Supp. 1069, 1073 (N.D. Cal. 1979); *Ingenito v. Bermec Corp.*, [1977 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,214, at 92, 487 (S.D.N.Y. Oct. 21, 1977); *In re Equity Funding Corp. of Am. Sec. Litig.*, 416 F. Supp. 161 (C.D. Cal. 1976); *Gold v. DCL, Inc.*, 399 F. Supp. 1123, 1127 (S.D.N.Y. 1973).

242. 388 F. Supp. 812 (D. Del. 1974).

243. *Id.* at 822. See *Berkman v. Rust Craft Greeting Cards, Inc.*, 454 F. Supp. 787, 794 (S.D.N.Y. 1978) (the non-disclosure of an investment banker's conflict of interest was highly relevant in assessing the firm's per share price recommendation). See also *Richardson v. White & Co.*, [1979 Transfer Binders] FED. SEC. L. REP. (CCH) ¶ 96,864 (S.D.N.Y. 1979); *Royal Indus., Inc. v. Monogram Indus., Inc.*, [1976-77 Transfer Binders] FED. SEC. L. REP. (CCH) ¶ 95,863 (C.D. Cal. 1976). For a further discussion of conflicts of interest when the investment banker, acting as a bidder's financial advisor in connection with a tender offer, was the recipient of material, nonpublic information concerning the subject company while acting as its financial advisor, see Steinberg, *Fiduciary Duties and Disclosure Obligations in Proxy and Tender Contests for Corporate Control*, 30 EMORY L.J. 169, 183-84 (1981).

letter and adequately disclosed the basis of that opinion. In so ruling, however, the chancery court ignored the cursory nature of Lehman Brothers' review, which should have been disclosed to UOP shareholders.<sup>244</sup>

#### *D. Propriety of Implying a Fiduciary Duty*

In *Weinberger*, the plaintiff raised the related issue of whether a court should hold an investment banker, who had been retained by the subsidiary corporation to evaluate the fairness of the cash-out price, "to the fiduciary standards of the majority itself."<sup>245</sup> Because the investment banker's knowledge of the relevant facts and its skill in reviewing a merger are superior to the average minority stockholder and because the banker should expect the minority to rely on the fairness opinion, it may be argued that the investment banker owes a fiduciary duty to the minority.<sup>246</sup>

No authority exists, however, to support this proposition.<sup>247</sup> This

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244. See *supra* note 236. In *Weinberger*, the Delaware Supreme Court observed that there was "no disclosure of the circumstances surrounding the rather cursory preparation of the Lehman Brothers' fairness opinion." 457 A.2d at 710. The court implied, however, that this lack of disclosure was solely Signal's obligation. *Id.* This should not be the law. The corporation used the fairness opinion of the investment banker with the banker's consent and with the knowledge that the shareholders would rely upon it. Under these circumstances, the investment banker should be held responsible for the opinion's contents, including any material nondisclosures. Cf. *Dirks v. SEC*, 681 F.2d 824, 835 (D.C. Cir. 1982), *rev'd on other grounds*, 103 S. Ct. 3255 (1983); *Sanders v. John Nuveen & Co.*, 619 F.2d 1222 (7th Cir. 1980), *cert. denied*, 450 U.S. 1005 (1981); *Feit v. Leasco Data Processing Corp.*, 332 F. Supp. 544 (E.D.N.Y. 1971); *Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643 (S.D.N.Y. 1968); *In re The Richmond Corp.*, 41 S.E.C. 398 (1963); *Greene, Determining the Responsibilities of Underwriters Distributing Securities Within an Integrated Disclosure System*, 56 NOTRE DAME LAW. 755 (1981).

245. Appellant's Brief, *supra* note 200, at 50. To find otherwise, "will provide a judicial inducement to investment bankers to give the appearance of working for the minority but actually to further the interests of the majority (who will continue to control the corporation and provide additional investment banking business)." *Id.* See also *Laventhol, Krekstein, Horwath & Horwath v. Tuckman*, 372 A.2d 168 (Del. 1976). One commentator identified the problem of allowing the majority, who owes a fiduciary duty to the minority, to delegate part of that duty to an investment banker when the banker is held to a lower standard of care. The commentator suggests that such a practice serves to create an exception to the *Sterling* rule of strict scrutiny and entire fairness when a party stands on both sides of a transaction. Comment, *supra* note 195, at 110.

246. See *id.* at 118-19. For cases on fiduciary law principles, see *Reynolds v. Wangelin*, 322 Ill. App. 13, 53 N.E.2d 720 (1944); *Koehler v. Haller*, 62 Ind. App. 8, 112 N.E. 527 (1916); *Dawson v. National Life Ins. Co.*, 176 Iowa 362, 157 N.W. 929 (1916); *Williams v. Griffin*, 35 Mich. App. 179, 192 N.W.2d 283 (1971); *McKinley v. Lynch*, 58 W. Va. 44, 51 S.E. 4 (1905).

247. See 426 A.2d at 1348. See also *Walton v. Morgan Stanley & Co.*, 623 F.2d 796 (2d Cir. 1980) (no breach of fiduciary duty by an investment banker who acted upon confidential, non-

lack of authority should not be viewed as determinative. Although it is rare for a long-term relationship to develop between the investment banker and the minority shareholders, the minority places its trust and confidence in the investment banker's opinion and thus has a reasonable expectation of fairness.<sup>248</sup> Moreover, it is beyond dispute that an investment banker ordinarily owes a fiduciary duty to its clients. When an investment banker renders a fairness opinion prepared largely for the benefit of the minority shareholders, and it is foreseeable that the minority will rely upon the opinion,<sup>249</sup> the banker's clientele arguably encompasses the minority shareholders of the client corporation.<sup>250</sup>

In any event, a minority shareholder's foreseeable reliance on the fairness opinion should give rise to a duty of reasonable care by the investment banker. Liability for breach of this duty should be imposed under a theory of negligent misrepresentation to third parties. Courts should require investment bankers to disclose adequately and present fairly all information relevant to the value of the minority interest when rendering a fairness opinion. Moreover, if compelling circumstances mandate that the banker undertake a less than full review, the banker should disclose the actual extent of the review conducted and an explanation of its failure to perform a full review. Courts should hold a banker to this standard of reasonable care in the preparation of the fairness opinion to protect the interests of the minority shareholder adequately.

### VIII. IMPLICATIONS UNDER FEDERAL LAW

The Delaware Supreme Court's decision in *Weinberger* not only affects state corporation law but it also has an indirect impact on certain provisions of the federal securities laws. The following discussion will address the more pertinent issues.

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public information provided by target company in context of previously contemplated tender offer). See generally Steinberg, *supra* note 243, at 181-84.

248. Cf. *Dirks v. SEC*, 103 S. Ct. 3255 (1983) (special relationship creates a duty to disclose or refrain from trading); *Chiarella v. United States*, 445 U.S. 222 (1980) (necessity of special relationship to create fiduciary duty).

249. See 426 A.2d at 1338. UOP "retained the services of the defendant Lehman Brothers for the purpose of rendering an opinion as to the fairness of the price to be paid the minority for their shares". *Id.* Hence, "[t]he majority's purpose in engaging Lehman Brothers was to safeguard the interest of the minority while ensuring that it satisfied its own duty." Comment, *supra* note 195, at 119.

250. See Comment, *supra* note 195, at 117-19.

### A. SEC Rule 13e-3 and Related Issues

In addition to surviving the *Weinberger* entire fairness review under Delaware law, going private transactions must comply with the disclosure requirements of SEC rule 13e-3.<sup>251</sup> Rule 13e-3 requires subject parties to disclose material facts about a going private transaction. The mandated disclosure includes whether the parties reasonably believe that the transaction is fair to shareholders and the factors upon which they base that belief.<sup>252</sup> The rule also obligates subject parties to disclose whether they received an outside opinion on the fairness of the proposed transaction.<sup>253</sup> They must furnish a summary of the opinion and include the basis for and methods employed in reaching the valua-

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251. SEC Sec. Exch. Release No. 34-16,075, 44 Fed. Reg. 46,736 (1979). In general, the rule prohibits "fraudulent, deceptive or manipulative acts or practices in connection with going private transactions and prescribes filing, disclosure, and dissemination requirements as a means reasonably designed to prevent such acts or practices." *Id.* at 46,737. See *supra* note 164. See also SEC Sec. Exch. Act Release No. 34-16,112, 44 Fed. Reg. 49,406 (1979) (Commission adopted rule 13e-4 to govern an issuer's tender offer for its own securities). In general, rule 13e-4 requires that a schedule 13E-4 be filed with the SEC, and establishes disclosure, dissemination, and compliance requirements. Note that an issuer's tender offer, which is regulated by rule 13e-4, is also a going private transaction subject to rule 13e-3; therefore, it must comply with both rules.

For commentary on rule 13e-3, see, e.g., Cohen, *Open Market & Privately Negotiated Purchases of Stock*, INST. ON SEC. REG. 87 (Oct. 10, 1980); Connolly, *New Going Private Rule*, 13 REV. SEC. REG. 975 (1980); Manges, *SEC Regulation of Issuer and Third Party Tender Offers*, 8 SEC. REG. L.J. 275, 278 (1981); Rothschild, *Going Private, Singer, and Rule 13e-3: What Are the Standards for Fiduciaries?*, 7 SEC. REG. L.J. 195, 216-22 (1979); Steinberg, *The Securities and Exchange Commission's Administrative, Enforcement, and Legislative Programs and Policies—Their Influence on Corporate Internal Affairs*, 58 NOTRE DAME LAW. 173, 198-99 (1982); Note, *Regulating Going Private Transactions: SEC Rule 13e-3*, 80 COLUM. L. REV. 782 (1980); Note, *Rule 13e-3 and the Going Private Dilemma: The SEC's Quest for a Substantive Fairness Doctrine*, 58 WASH. U.L.Q. 883 (1980) [hereinafter referred to as *Going Private*].

252. Rule 13e-3, as finally adopted in 1979, also requires the following: (1) a description of both the benefits and detriments of the transaction to the issuer as well as affiliated shareholders; (2) disclosure of any report, opinion, appraisal or negotiation report received from an outside party relative to the going private transaction; (3) disclosure of any plans by the issuer to merge, reorganize, sell assets or employ any other material change after the transaction; (4) disclosure of the source and total amount of funds for the transaction, an estimation of expected expenses, a summary of any loan agreements and arrangements to finance and repay loans. See SEC Schedule 13e-3(H) Items 5, 6, & 9, 17 C.F.R. § 240.13e-100 (1984). Initially, the Commission considered adopting a "fairness" requirement, which would have required any going private transaction to be both substantively and procedurally fair to minority shareholders. See SEC Sec. Exch. Act Release No. 14,185, 42 Fed. Reg. 60,090 (1977). Instead, the SEC requires that the subject parties disclose whether they reasonably believe that the transaction is fair to shareholders and the bases for such belief. Even as adopted a number of commentators contend that the Commission has engaged in substantive regulation under rule 13e-3. See, e.g., Note, *Going Private*, *supra* note 251, at 883-84.

253. The rule also requires management to disclose whether nonaffiliated directors approved

tion. Commentators disagree over whether these rules actually result in going private transactions that are fairer to minority stockholders.<sup>254</sup>

Former SEC Commissioner Longstreth has criticized the widespread use of the easily obtainable favorable investment banker opinions.<sup>255</sup> To prevent abuses in management buyouts, Longstreth suggests that a majority shareholder who wants to buy out public shareholders should first afford independent offerors the opportunity to make alternative bids. The majority, before being permitted to go forward with the

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the transaction and whether the corporate charter requires ratification by a majority of the unaffiliated shareholders. Schedule 13E-3, Item 9 provides:

(a) State whether or not the issuer or affiliate has received any report, opinion (other than an opinion of counsel) or appraisal from an outside party which is materially related to the Rule 13e-3 transaction including, but not limited to, any such report, opinion or appraisal relating to the consideration or the fairness of the consideration to be offered to security holders of the class of securities which is the subject of the Rule 13e-3 transaction or the fairness of such transaction to the issuer or affiliate or to security holders who are not affiliates.

(b) With respect to any report, opinion or appraisal described in Item 9(a) or with respect to any negotiation or report described in Item 8(d) concerning the terms of the Rule 13e-3 transaction:

(1) Identify such outside party and/or unaffiliated representative;

(2) Briefly describe the qualifications of such outside party and/or unaffiliated representative;

(3) Describe the method of selection of such outside party and/or unaffiliated representative;

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

(5) 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.

(6) Furnish a summary concerning such negotiation report, opinion or appraisal which shall include, but not be limited to, the procedures followed; the findings and recommendations; the bases for and 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.

*Instruction.* The information called for by subitem 9(b)(1), (2) and (3) should be given with respect to the firm which provides the report, opinion, or appraisal rather than the employees of such firm who prepared it.

(c) Furnish a statement to the effect that such report, opinion or appraisal shall be made available for inspection and copying at the principal executive offices of the issuer or affiliate during its regular business hours by any interested equity security holder of the issuer or his representative who has been so designated in writing. This statement may also provide that a copy of such report, opinion or appraisal will be transmitted by the issuer or affiliate to any interested equity security holder of the issuer or his representative who has been so designated in writing upon written request and at the expense of the requesting security holder.

254. See articles cited *supra* note 251.

255. See 16 SEC. REG. & L. REP. (BNA) 641 (1984); 15 SEC. REG. & L. REP. (BNA) 1908 (1983). See also *supra* notes 194-98 and accompanying text.

transaction, should then be required to match or top a higher third-party offer.<sup>256</sup> This alternative theoretically presents no risk to management with a controlling interest because the independent third-party offeror has no chance of making a successful tender offer for a majority of the outstanding shares.<sup>257</sup> In practice, however, the controlling shareholder's failure to match the highest price offered may invite lawsuits for breach of fiduciary duty<sup>258</sup> or induce the minority to seek appraisal. In an appraisal proceeding, the price offered by a bona fide offeror would be relevant in determining "fair value."<sup>259</sup>

Under the present framework, moreover, few independent parties would thoroughly evaluate a company without a reasonable chance of successful purchase, except for the investment banker selected by management to render a fairness opinion. Generally, the minority interest cannot afford to hire its own investment banker. Therefore, to help effectuate the intent of the independent evaluation alternative, the outside directors of the subsidiary corporation should retain an investment banker who has no previous contacts with the parent or subsidiary corporation or with either corporation's management. Through the use of the fairness opinion relied on by minority shareholders, an independent investment banker who is free of the usual structural biases<sup>260</sup> will help insure that the going private transaction is fair to the minority. The likelihood of fairness will further increase if the courts hold the investment banker to a standard of reasonable care in the preparation of the opinion. Moreover, when the corporation hires the investment banker specifically to render an opinion for the benefit of the minority, a stronger basis exists for recognizing a fiduciary relationship.<sup>261</sup>

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256. See 15 SEC. REG. & L. REP. (BNA) at 1909-10.

257. If management does not have a controlling interest, however, an independent bidder could successfully initiate its own tender offer. See 15 SEC. REG. & L. REP. (BNA) at 1909 (Stokely-Van Camp's management, after receiving an investment banker's opinion that \$55 per share was "fair and attractive," offered to buy-out all public shareholders; subsequently, Quaker Oats made a successful tender offer at \$77 per share).

258. Such suits apparently would fail under Delaware law because the shareholder would only challenge the sufficiency of the price offered. In that case, appraisal is held to be an adequate remedy. If there is a gross disparity, however, between the price offered by an outside party and the price offered by the controlling shareholder, constructive fraud may be found. See 457 A.2d at 715; *supra* notes 127-44.

259. 457 A.2d at 713.

260. See *supra* note 243 and accompanying text.

261. See *supra* notes 213-47 and accompanying text.

### B. Effect on Rule 10b-5

The Delaware Supreme Court's decision in *Weinberger* may affect the application of section 10(b) of the Securities Exchange Act of 1934<sup>262</sup> and rule 10b-5.<sup>263</sup> Specifically it may affect the recognition of federal disclosure violations that entail breaches of fiduciary duty in connection with corporate mergers.<sup>264</sup>

In *Santa Fe Industries, Inc. v. Green*,<sup>265</sup> the Supreme Court refused to recognize a claim based solely on breach of fiduciary duty as actionable under section 10(b) and rule 10b-5.<sup>266</sup> The *Santa Fe* Court held that "the transaction was neither deceptive nor manipulative and therefore did not violate either [section] 10(b) or Rule 10b-5."<sup>267</sup> In addition, the court indicated that the majority shareholder's failure to give the mi-

262. 15 U.S.C. § 78j(b) (1982). Section 10(b) provides in pertinent part:

Section 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

*Id.*

263. Rule 10b-5 provides as follows:

It shall be unlawful for any person, directly or indirectly, by the use of any means of instrumentality of interstate commerce, or of the mail, or of any facility of any national securities exchange,

(a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1984).

264. See, e.g., *Healey v. Catalyst Recovery, Inc.*, 616 F.2d 641 (3d Cir. 1980); *Goldberg v. Meridor*, 567 F.2d 209 (2d Cir. 1977), cert. denied, 434 U.S. 1069 (1978); *infra* notes 272-73 and accompanying text.

265. 430 U.S. 462 (1977).

266. *Id.* at 471. In *Santa Fe*, minority shareholders objected to the terms of a short-term merger pursuant to Delaware statute. In lieu of pursuing their appraisal remedies, the shareholders commenced an action on behalf of the corporation and other minority shareholders seeking to set aside the merger or to recover the alleged full value of their shares. *Id.* at 466-67.

267. *Id.* at 474. For law review articles discussing *Santa Fe* and its progeny, see, e.g., Block & Schwarzfeld, *Corporate Mismanagement and Breach of Fiduciary Duty After Santa Fe v. Green*, 2 CORP. L. REV. 91 (1979); Campbell, *Santa Fe Industries, Inc. v. Green: An Analysis Two Years Later*, 30 ME. L. REV. 187 (1978); Ferrara & Steinberg, *supra* note 21; Jacobs, *Rule 10b-5 and Self Dealing by Corporate Fiduciaries: An Analysis*, 48 U. CIN. L. REV. 643 (1979); Note, *Suits for*

nority advance notice of the merger did not constitute a material non-disclosure. The Court reasoned that "under Delaware law [the plaintiffs] could not have enjoined the merger because an appraisal proceeding [was] their sole remedy in the Delaware courts for any alleged unfairness in the terms of the merger."<sup>268</sup>

Viewing *Santa Fe* as a "confirmation by the Supreme Court of the responsibility of a state to govern the internal affairs of corporate life,"<sup>269</sup> the Delaware Supreme Court held in *Singer v. Magnavox Co.*<sup>270</sup> that appraisal was not a minority shareholder's sole remedy for alleged unfairness.<sup>271</sup> Concomitantly, a number of federal courts, perceiving that minority shareholders now had an expanded right to seek redress in state courts, recognized a federal right to the information necessary to determine whether the majority had breached its fiduciary duty under state law. According to these courts, as represented by the Second Circuit in *Goldberg v. Meridor*,<sup>272</sup> the failure to provide minority shareholders with such information was a material "deception" within the meaning of section 10(b) and rule 10b-5.<sup>273</sup>

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*Breach of Fiduciary Duty Under Rule 10b-5 After Santa Fe Industries, Inc. v. Green*, 91 HARV. L. REV. 1874 (1978).

268. 430 U.S. at 474 n.14.

269. *Singer v. Magnavox Co.*, 380 A.2d 969, 976 n.6 (Del. 1977).

270. *Id.*

271. *Id.* at 980. See, e.g., *Roland Int'l Corp. v. Najjar*, 407 A.2d 1032 (Del. 1979); *Tanzer v. International Gen. Indus., Inc.*, 379 A.2d 1121 (Del. 1977). See generally *Ferrara & Steinberg*, *supra* note 22, at 78.

272. 567 F.2d 209 (2d Cir. 1977), *cert. denied*, 434 U.S. 1066 (1978). The *Goldberg* rationale is not confined to the merger context. It conceivably extends to any transaction involving a purchase or sale of securities, which, if adequate information had been disclosed, the minority would have been, entitled to seek state court relief to enjoin the contemplated transaction. See *Ferrara & Steinberg*, *supra* note 22, at 286; *Hazen, Corporate Mismanagement in the Federal Securities Act's Anti-Fraud Provisions: A Familiar Path with Some New Detours*, 20 B.C.L. REV. 819 (1979); *Sherard, Federal Judicial and Regulatory Responses to Santa Fe Industries Inc. v. Green*, 35 WASH. & LEE L. REV. 695 (1978); Note, *Goldberg v. Meridor: The Second Circuit's Resurrection of Rule 10b-5 Liability for Breaches of Corporate Fiduciary Duties to Minority Shareholders*, 64 VA. L. REV. 765 (1978); Note, *Securities Regulation Liability for Corporate Mismanagement Under Rule 10b-5 After Santa Fe v. Green*, 27 WAYNE L. REV. 269 (1980).

273. See *supra* note 264. See also *Pellman v. Cinerama, Inc.*, 89 F.R.D. 386 (S.D.N.Y. 1981). This principle is subject to a number of limitations. First, rule 10b-5 claims that are premised on the deception of the corporation in a securities transaction call for a showing that the corporation was "disabled from availing itself of an informed judgment on the part of its board regarding the merits of the transaction." *Superintendent of Ins. of N.Y. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 13 (1971) (quoting with approval *Shell v. Hensley*, 430 F.2d 819, 827 (5th Cir. 1970)). See, e.g., *Biesenbach v. Guenther*, 588 F.2d 400, 402 (3d Cir. 1978); *Lavin v. Data Systems Analysis, Inc.*, 443 F. Supp. 104, 107 (E.D. Pa. 1977), *aff'd*, 578 F.2d 1374 (3d Cir. 1978); *Stedman v. Storer*, 308 F. Supp. 881, 887 (S.D.N.Y. 1969). Second, if disinterested board members who have been

Because in most situations *Weinberger* limits a minority shareholder to the appraisal remedy, the question becomes whether actions predicated on the *Goldberg* rationale remain viable. Although such actions may be less successful in the post-*Weinberger* period, a plaintiff may still bring a *Goldberg*-type action when the complainant satisfies the more onerous *Weinberger* requirements for establishing an entitlement to state injunctive relief.<sup>274</sup> As *Weinberger* made clear, minority shareholders may seek to enjoin the consummation of a merger if they can show that one of the exceptions applies.<sup>275</sup> Hence, although *Weinberger* limits breach of fiduciary duty suits to cases that involve specific types of misconduct, the *Goldberg* rationale remains applicable in those instances.<sup>276</sup>

Certain federal courts in section 10(b) actions, moreover, have downplayed the importance of the omitted information to the state's determination of the availability of an injunction and have instead emphasized the significance of the misleading or omitted information

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fully informed of all material facts vote to approve the transaction, the court will attribute their knowledge to the corporation. In this event, no "deception" occurs within the meaning of rule 10b-5. *Maldonado v. Flynn*, 597 F.2d 789, 795 (2d Cir. 1979). See also *Schoenbaum v. Firstbrook*, 405 F.2d 215, 219-20 (2d Cir. 1968), cert. denied, 395 U.S. 906 (1969); *Pappas v. Moss*, 393 F.2d 865, 869 (3d Cir. 1968); *Ruckle v. Roto Am. Corp.*, 339 F.2d 24, 29 (2d Cir. 1964). Therefore, nondisclosure provides the basis for a claim of corporate deception in a derivative action under rule 10b-5 only if corporate action requires shareholder approval or if the directors are interested or disabled. Third, in most circumstances, management has no duty to disclose its true purpose or to characterize the transaction in pejorative terms. See *Selk v. St. Paul Ammonia Prods., Inc.*, 597 F.2d 635 (8th Cir. 1979) (failure to disclose that purpose of merger was to freeze out minority shareholders not actionable under sections 10(b) and 14(a)); *O'Brien v. Continental Ill. Nat'l Bank & Trust Co.*, 593 F.2d 54, 60 (7th Cir. 1979) (failure to reveal that investment advice was self-serving not actionable under section 10(b)); *Goldberg v. Meridor*, 567 F.2d 209, 218 n.8 (2d Cir. 1977) ("We do not mean to suggest that § 10(b) or Rule 10b-5 requires insiders to characterize the conflict of interest transactions with pejorative nouns or adjectives."); *Gluck v. Agemian*, 495 F. Supp. 1209, 1214 (S.D.N.Y. 1980) ("disclosure of subjective motive is not required under the federal securities laws"); *Bucher v. Shumway*, [1979-80 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,142 (S.D.N.Y. 1979), aff'd, 622 F.2d 572 (2d Cir. 1980), cert. denied, 449 U.S. 841 (1980) (failure to disclose that true purpose of tender offer was to consolidate management's control not actionable under sections 10(b) and 14(e)); *Hundahl v. United Benefit Life Ins. Co.*, 465 F. Supp. 1349, 1364 (N.D. Tex. 1979) (failure to disclose breach of fiduciary duty in scheme to undervalue company not actionable under section 10(b)). See also *Steinberg, The "True Purpose" Cases*, 5 CORP. L. REV. 249 (1982).

274. See *supra* notes 144-54 and accompanying text.

275. See *supra* notes 148-50 and accompanying text. See also *Berger & Allingham, supra* note 109, at 6-8, 4-15.

276. In those circumstances, an injunction of the merger remains a possibility and, therefore, a federal right to the information necessary to determine the basis of such a suit remains viable. See *supra* notes 272-75 and accompanying text.

from the perspective of the investor. For example, in *United States v. Margala*,<sup>277</sup> the Ninth Circuit made clear a section 10(b) claim may be based on grounds other than those that would support a state court action for injunctive relief. Accordingly, a fact is material if a reasonable investor "could respond to the fact's disclosure by protecting himself from possible financial loss."<sup>278</sup>

Despite the foregoing language, a plaintiff's entitlement to federal court relief under the *Goldberg* rationale depends upon the type of showing a court will require the plaintiff to make on the availability of state court injunctive relief. For example, the Second Circuit at a previous point in time merely required the plaintiff to show the bare availability of state court injunctive relief.<sup>279</sup> This standard is too lax. Such an approach frequently allows shareholders who primarily seek to dispute value, which is a traditional state law matter, to bring a federal suit, and thereby circumvent the Supreme Court's decision in *Santa Fe*. Although it may be argued that most *Goldberg* actions primarily involve disputes over value, a distinction exists between purely value disputes and material nondisclosures by the majority that lull minority shareholders into inaction. Such material nondisclosures can induce the minority shareholders to refrain from procuring an injunction against the merger or taking other measures to protect themselves from financial loss. Without a sufficient showing that the minority was lulled into such inaction by the majority's nondisclosures, the state appraisal proceeding, if not unduly cumbersome or expensive to invoke and if capable of determining fair value in a financially realistic manner, provides adequate protection to minority stockholders. Furthermore, traditional notions of federalism relegate corporate internal affairs to the states.<sup>280</sup> In adhering to this policy, the federal courts should not

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277. 662 F.2d 622 (9th Cir. 1981).

278. *Id.* at 626 (citing *SEC v. Blatt*, 583 F.2d 1325, 1331-32 (5th Cir. 1978)). See *Wright v. Heizer Corp.*, 560 F.2d 236, 250 (7th Cir. 1977), *cert. denied*, 434 U.S. 1066 (1978).

279. *But see* *Madison Consultants v. FDIC* [1982-1983 Transfer Binder] *FED. SEC. L. REP.* (CCH) ¶ 99,239 (2nd Cir. 1983) (the Second Circuit has now rejected this standard and has adopted the Seventh and Ninth Circuits' view).

280. See, e.g., *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 478-79 (1977), *cited with approval in Singer*, 380 A.2d at 976, n.6; *Cort v. Ash*, 422 U.S. 66 (1975); *Superintendent of Ins. v. Banker's Life & Casualty Co.*, 404 U.S. 612 (1971). As the Supreme Court stated in *Santa Fe*: "[C]orporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law expressly requires certain responsibilities of directors with respect to shareholders, state law will govern the internal affairs of the corporation." 430 U.S. at 479.

intrude unnecessarily into state court protections absent congressional direction.

The Second, Seventh, and Ninth Circuits currently require plaintiffs who bring a section 10(b), *Goldberg*-type action to prove the success of their state court suit by a fair preponderance of the evidence.<sup>281</sup> By requiring plaintiffs to prove that a state court would have awarded relief, the federal courts condition the existence of a federal right under section 10(b) solely on the applicable state law. The federal interests in uniformity<sup>282</sup> and in full and fair disclosure counsel against the use of this standard. Moreover, this standard may well be impractical to administer because it requires plaintiffs to undertake the burden of a full-blown trial on the state claim.<sup>283</sup> Due to these harsh consequences, this standard provides minority shareholders with inadequate protection under federal law.

The Third and Fifth Circuits embrace a more moderate view. The Third Circuit requires plaintiffs to show a "reasonable probability of ultimate success."<sup>284</sup> This standard conforms to the wording of the Delaware Chancery Court in *David J. Greene & Co. v. Schenley Industries, Inc.*<sup>285</sup> The Fifth Circuit requires plaintiffs to demonstrate a "reasonable basis for state relief."<sup>286</sup> In part, because these standards conform with the actual standards state courts use to determine the

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281. See *Madison Consultants v. FDIC*, [1982-83 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 99,239 (2d Cir. 1981); *Kidwell v. Meikle*, 597 F.2d 1273, 1294 (9th Cir. 1979); *Wright v. Heizer Corp.*, 560 F.2d 236, 250 (7th Cir. 1977), *cert. denied*, 434 U.S. 1066 (1978).

282. See *McClure v. Borne Chemical Co.*, 292 F.2d 824, 829-35 (3d Cir.), *cert. denied*, 368 U.S. 939 (1961); Note, *Suits for Breach of Fiduciary Duty Under Rule 10b-5 After Santa Fe Industries, Inc. v. Green*, 91 HARV. L. REV. 1874, 1891-93 (1978).

283. See *Healey v. Catalyst Recovery*, 616 F.2d 641 (3d Cir. 1980). The Third Circuit disagreed with this standard for two reasons: "First, we believe absolute certainty to be both an impossible goal as well as an impracticable standard for a jury to implement. Second, in most cases the state remedy will be a preliminary injunction, which looks to the likelihood of ultimate success." *Id.* at 647.

284. *Id.*

285. 281 A.2d 30, 35 (Del. Ch. 1971).

286. *Alabama Farm Bureau Mut. Casualty Co., Inc. v. American Fidelity Life Ins. Co.*, 606 F.2d 602 (5th Cir. 1979), *cert. denied*, 449 U.S. 820 (1980). The court stated:

We hold that all that is required to establish 10b-5 liability is a showing that state law remedies were available and that the facts shown make out a prima facie case for relief; it is not necessary to go further and prove that the state action would have been successful . . . [T]he plaintiff must show that there is at least a reasonable basis for state relief, but need not prove that the state suit would in fact have been successful.

*Id.* at 614.

availability of injunctive relief, they represent the preferable view.<sup>287</sup> Moreover, although the existence of a federal right remains dependent on the applicable state law,<sup>288</sup> this standard sufficiently recognizes the federal interest in adequate and fair disclosure. Significantly, however, the standard does not inordinately intrude into areas that are traditionally within the province of state corporate law.<sup>289</sup>

## IX. CONCLUSION

Although *Weinberger* represents a retreat from the Delaware Supreme Court's expansion of minority shareholder protection after *Singer*, it arguably offers a more rational and cohesive framework to the freeze-out merger dilemma. *Singer's* business purpose requirement failed to provide consistent results because the majority often could advance a legitimate purpose for a merger in hindsight and because the inquiry into business purpose itself needlessly diverted the court's attention from the more important issues of fair dealing and fair price.

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287. The Third Circuit's position in *Healey*, and the Fifth Circuit's approach in *Alabama Farm* appear to set a more stringent standard than that required to survive a motion under Federal Rule of Civil Procedure 12(b)(6) to dismiss for failure to state a claim upon which relief can be granted or a motion for summary judgment under Rule 56. Compare the *Healey* and *Alabama Farm* standards with the discussion below of Rules 12(b)(6) and 56.

The Rule 12(b)(6) motion also must be distinguished from a motion for summary judgment under Rule 56, which goes to the merits of the claim and is designed to test whether there is a genuine issue of material fact. The Rule 12(b)(6) motion, as has been mentioned above, only tests whether the claim has been adequately stated in the complaint. Thus, on a motion under Rule 12(b)(6), the court's inquiry essentially is limited to the content of the complaint; summary judgment, on the other hand, involves the use of pleadings, depositions, answers to interrogatories, and affidavits. This distinction between the two provisions is not substantial, however, because Rule 12(b)(6) provides that if "matters outside the pleadings are presented to and not excluded by the court, the motion shall be treated as one for summary judgment. . . ."

5 C. WRIGHT & A. MILLER, FEDERAL PRACTICE AND PROCEDURE § 1356 (1969).

288. See M. STEINBERG, CORPORATE INTERNAL AFFAIRS, *supra* note 22, at 191-94; Ferrara & Steinberg, *supra* note 21, at 292-94; Comment, Goldberg v. Meridor: *The Second Circuit's Resurrection of Rule 10b-5 Liability for Breaches of Corporate Fiduciary Duties to Minority Shareholders*, 64 VA. L. REV. 765, 772-77 (1978).

289. The facts of *Alabama Farm Bureau Mut. Casualty Co., Inc., v. American Fidelity Life Ins. Co.*, 606 F.2d 602 (5th Cir. 1979), support the availability of a federal suit if material nondisclosure is involved. In that case, the corporation repurchased its own stock as part of an alleged plan by the management to perpetuate its own control by artificially raising the market price of its stock and discouraging takeover attempts. Because the defendants had allegedly failed to disclose the inflationary effect of the stock repurchase plan on the market price of the corporation's outstanding shares, the Fifth Circuit found sufficient basis for a derivative suit based on deception under rule 10b-5. The court used the "reasonable basis for state relief" standard to find that the alleged nondisclosure was material.

After *Weinberger*, courts will focus on the fairness of the merger, with price being the most important consideration in a nonfraudulent transaction. The courts should adopt a pragmatic approach and utilize their discretion to fashion remedies to obtain just results.

The *Weinberger* decision is essentially an economic one designed to facilitate mergers. The court appears to create a presumption of fairness if the parties structure the terms of the merger so as to require informed majority of the minority shareholder approval or the use of an independent negotiating committee. When the merger is so structured and the majority has fully and fairly disclosed, the element of fair dealing will frequently be satisfied and, therefore, price becomes the only issue. The result thus signifies a further departure from a vested property rights theory<sup>290</sup> of a stockholder's interest in his shares. Accordingly, the shareholder's rights are relegated to the status of receiving the fair value of his shares, except in limited circumstances.

After limiting the minority shareholder's interest in his shares to their monetary value, the *Weinberger* court liberalized the remedial formula available in an appraisal proceeding. Shareholders are entitled to their proportionate share in a "going concern" and to rescissory damages in certain circumstances. Courts now will value stock by any generally accepted method and exclude only speculative elements of value that relate to the accomplishment of the merger.

Unfortunately, many appraisal statutes impose harsh procedural requirements of which minority shareholders may not be aware.<sup>291</sup> Con-

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290. At common law, certain categories of stockholder rights were "vested" and neither the corporation nor the courts could eliminate or modify these "vested" rights without each shareholder's consent. *See Combes v. Getz*, 285 U.S. 434, 441-42 (1932) ("neither vested property rights nor the obligation of contracts of third persons may be destroyed or impaired" pursuant to the state's reserved power to amend the statute or to authorize a charter amendment); *Keller v. Wilson & Co.*, 21 Del. Ch. 391, 190 A. 115 (1936) (dividend arrears are vested and therefore not alterable through a charter amendment). *But see Coyne v. Park & Tilford Distillers Corp.*, 38 Del. Ch. 514, 522, 154 A.2d 893, 897 (1959) (endorsing a broad view of the state's reserved power to amend the statute); *Federal United Corp. v. Havender*, 24 Del. Ch. 318, 335, 11 A.2d 331, 339 (1940) (although not specifically overruling the vested rights theory, court found that dividend arrears may be modified in the course of a merger); *Davis v. Louisville Gas & Elec. Co.*, 16 Del. Ch. 157, 142 A. 654 (1928). *See generally* E. FOLK, *THE DELAWARE GENERAL CORPORATION LAW 559-60* (1971) ("if corporate action conforms both substantively and procedurally to the requirements of the statute, it is likely that no interests affected by such actions will be demoninated as vested.").

291. "The procedure has grown long and expensive and . . . courts have tended to be increasingly stringent in enforcing the procedural letter of the [appraisal] statutes. Moreover, the only things certain [in the appraisal process] are the uncertainty, the delay and the expense." Manning,

sequently, because courts require shareholders to perfect their rights under the applicable statute to obtain an appraisal, these statutes should require the corporation to provide clear and timely notice to the shareholder of the requirements for invoking the appraisal remedy.<sup>292</sup> Furthermore, legislatures should review the numerous procedural elements and eliminate those that merely serve to burden the minority. Only if the burden of compliance with the appraisal statute is lightened will the new appraisal remedy provide meaningful protection for the minority shareholder.

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*supra* note 23, at 231, 233. Manning believes that although legislatures first viewed appraisal statutes as protecting the civil liberties of the minority, in actual use, the statutes have resulted in "giving greater mobility of action to the majority." *Id.* at 227. The availability of an appraisal remedy frees the majority from the risk of an injunction in certain instances and "relegates the [dissenting] shareholder's claim of 'ownership' to the status of a fungible dollar claim." *Id.* at 228-30. "Among the other drawbacks of appraisal is that all the dissenting stockholders must continue to hold their shares, without receiving the merger consideration, even though they lose their rights as stockholders." Prickett & Hanrahan, *supra* note 101, at 74, n.115. Compare *Keller v. Wilson & Co.*, 21 Del. Ch. 391, 190 A. 115 (1936) (plaintiff did not have an appraisal remedy; court granted injunction) with *Federal United Corp. v. Havender*, 24 Del. Ch. 318, 11 A.2d 331 (1940) (plaintiff failed to acquire an injunction and the court limited him to his appraisal remedy). See also *Hofenstein v. York Ice Mach. Corp.*, 136 F.2d 944 (3d Cir. 1943); *supra* note 74.

292. See, e.g., DEL. CODE ANN. tit. 8, § 262(d)(1) (Replacement Vol. 1983). See also *Raabs v. Villager Indus., Inc.*, 355 A.2d 888 (Del. Ch. 1976) (holding that the corporation must give specific instructions to the shareholders explaining how to file objections and how to make demands for payment). But see CAL. CORP. CODE § 1301(a) (West 1977) (notice by the corporation of appraisal rights only required in case of reorganization); ILL. ANN. STAT. ch. 32, § 157.70 (Smith-Hurd 1983-84 Supp.) (no corporate notice of appraisal remedy required). Under federal law, Schedule 13e-3, item 13(a) requires the following notice:

State whether or not appraisal rights are provided under applicable state law or under the issuer's articles of incorporation or will be voluntarily accorded by the issuer or affiliate to security holders in connection with the Rule 13e-3 transaction and, if so, summarize such appraisal rights. If appraisal rights will not be available, under the applicable state law, to security holders who object to the transaction, briefly outline the rights which may be available to such security holders under such law.