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## Young v. Valhi, Inc. : Extended Protection to Minority Shareholders in Freeze-Out Mergers, 12 J. Marshall J. Prac. & Proc. 683 (1979)

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*YOUNG v. VALHI, INC.*

**EXTENDED PROTECTION TO MINORITY  
SHAREHOLDERS IN FREEZE-  
OUT MERGERS**

A growing number of companies are incorporating within the state of Delaware.<sup>1</sup> This is attributable to the Delaware legislature's commitment to create a "favorable climate" for corporate management.<sup>2</sup> This climate of favorable tax, trust, and

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1. In 1965, 433 of the 1,250 concerns listed on the New York Stock Exchange were Delaware corporations. In 1978, 671 of the 1,610 listed corporations were Delaware concerns. N.Y. Times, Jun. 30, 1978, at D-4, col. 1.

2. In 1975, with the cooperation of the Corporation Department of the Delaware Secretary of State's office, a manual was published to facilitate incorporation within Delaware by laymen. This manual succinctly listed the advantages of the corporate entity and incorporating in Delaware:

1. There is no minimum capital requirement. A corporation can be organized [in Delaware] with zero capital if desired. Many states require that a corporation have at least \$1,000 in capital.

2. One person can hold the offices of President, Treasurer, and Secretary and be all the directors. Many [other] states require at least three officers and/or directors. Therefore, there is no need to bring other persons into a Delaware Corporation if the owner(s) does not desire it.

3. There is an established body of laws relevant to corporations that have been tested in the Delaware courts over the years. In the event of any legal matters that involve Delaware courts there is, therefore, a high degree of predictability in legal proceedings based on past history and experience. This can be meaningful to investors in a corporation. The Court of Chancery in Delaware is the only separate business court system in the United States, and has a long record of pro-management decisions.

4. There is no corporation income tax for corporations that are formed in Delaware but who do not do business in the state.

5. The Franchise Tax on corporations compares favorably with any other state.

6. Shares of stock owned by a person outside the state [of Delaware] are not subject to any Delaware taxes.

7. A person can operate as the owner of a Delaware corporation anonymously if desired.

8. One can form a corporation by mail and never visit the state, even to conduct Annual Meetings. Meetings can be held anywhere, at the option of the directors.

9. The Delaware Corporation Department welcomes new corporations and is organized to process them the same day they are received.

10. Delaware is the friendliest state to corporations. The reason is that the state depends on its Corporation Department as a prime source of revenue. The Corporation Revenue is exceeded only by Income Taxes. The State, therefore, depends on attracting a high volume of corporations. It has, historically, kept its laws and fees relevant to corporations favorable and at a low cost.

corporate law has been created by the enactment of a series of "enabling acts"<sup>3</sup> which allow management to exercise maximum

11. There is no Inheritance Tax on shares of stock held by non-residents [of Delaware]. These shares are taxed only in the state of residence of the owners of the corporation.

12. Director(s) may fix a sales price on any stock that the corporation issues and wishes to sell.

13. Stockholders, directors, and/or committee members may act by unanimous written consent in lieu of formal meetings.

14. Director(s) may determine what part of consideration received for stock is capital.

15. Corporations can pay dividends out of profits as well as surplus.

16. Corporations can hold stock, bonds, or securities of other corporations, real and personal property, within or without the state, without limitations as to amount.

17. Corporations may purchase shares of its [*sic*] own stock and hold, sell and transfer them.

18. Corporations may conduct different kinds of business in combination. If the corporate documents filed with Delaware have the broadest type "purpose clause" as outlined in this report, any business activity of any kind may be conducted. More than one type of business can be conducted by the same corporation without any changes in the documents filed with the state.

19. Corporations have perpetual existence (unless specified in its Certificate of Incorporation).

20. The director(s) has power to make or alter by-laws.

21. Stockholder liability is limited to stock held in the corporation (with exception of taxes and assuming the business is conducted in a legal manner).

22. Only one person acting as the incorporator is required, whereas many states require three.

NICHOLAS, HOW TO FORM YOUR OWN CORPORATION WITHOUT A LAWYER FOR UNDER \$50.00 5-6 (6th ed. 1975).

In 1966, the Vice-Chairman of the Delaware Corporation Law Revision Committee stated:

[while] a liberal corporation law does not necessarily attract business and plants . . . [n]evertheless, the franchise dollar is very important in many states, including Delaware, and when one state hears that a corporation is thinking of transferring to Delaware, for example, but instead has gone to Maryland, the state officials begin thinking of the franchise dollar, and frankly, that is one of the reasons for the formation of this committee—to modernize and liberalize the Delaware Corporation Law.

Address of Richard F. Corroon, Vice-Chairman of the Delaware Corporation Law Revision Commission, speaking at the 1966 Annual Meeting of the Association of American Law Schools, Dec. 29, 1966, *reprinted in* Murdock *Delaware: The Race to the Bottom—Is an End in Sight?*, 9 LOY. CHI. L.J. 643, 644 (1978) [hereinafter cited as Murdock]. "[T]he favorable climate which the state of Delaware had traditionally provided for corporations has been a leading source of revenue for the state . . . The General Assembly . . . declares [this] to be the public policy of the State." Law of Dec. 31, 1963, ch. 218, [1963] 54 DEL. LAWS 724, authorizing the financing of the Delaware Corporation Law Revision Commission of 1967 *reprinted in* Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974) [hereinafter cited as Cary].

3. Cary, *supra* note 2, at 665 (corporate laws enable management to operate with a minimum of interference); Jennings, *Federalization of Cor-*

flexibility in facilitating business transactions.

The legislative hospitality to management has permitted the use of subsidiary corporations.<sup>4</sup> Corporations seeking to expand into new markets acquire sufficient stock of another corporation to obtain a controlling interest therein.<sup>5</sup> The parent then elects its nominees to the board of directors to manage the affairs of the subsidiary. If the parent owns less than all the stock of the subsidiary, there can be conflicts between the interests of the dominating parent corporation and the minority stockholders of the subsidiary.<sup>6</sup> In order to eliminate these conflicts, the Delaware legislature has amended its corporate statutes to allow the majority to "freeze out" the interests of the minority from the corporate enterprise.

While an all-encompassing definition is not possible,<sup>7</sup> a

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*porate Law: Part Way or All the Way*, 31 BUS. LAW. 991 (1976) [hereinafter cited as Jennings] (state statutes emphasize flexibility in facilitating business transactions and providing maximum protection for managerial decisions).

4. The parent-subsidiary corporate relationship may arise from one corporation forming and holding a controlling percentage of the stock of another corporation. The relationship may also result from one corporation buying all, or substantially all, of the shares of a corporation already doing business. See N.D. LATTIN, *LATTIN ON CORPORATIONS* 100 (2d ed. 1971).

5. Financial analysts cite cash-rich companies, low stock prices, and soaring inflation to explain the large increase in corporate mergers.

Many corporations, holding huge amounts of cash and liquid securities, are eager to invest in fast-growing, highly profitable markets. But the uncertain economic outlook has made it cheaper and less risky to buy another firm instead of building new plants or buying new equipment. At the same time, the stock market, in contrast to the previous periods of prosperity, has placed a low value on assets, earnings and growth potential of many companies, making them attractive takeover bargains.

Foreign firms, in particular, consider American corporations unusually good buys. The weak dollar, plus the opportunity to enter the large and relatively stable U.S. market, led foreign buyers to purchase 95 companies in the first half of 1978, a 20 percent increase over foreign acquisitions in the corresponding period [of 1977].

U.S. News & World Report, Oct. 23, 1978, at 44, col. 3.

6. The parent corporation must supply information, under federal and state law, about the subsidiary to the subsidiary's minority stockholders. The cost of compliance with disclosure requirements under the federal securities laws can amount to \$100,000 per year. See Freeman, *Going Private: Corporate Insiders Move to Eliminate Outside Shareholders*, Wall St. J., Oct. 18, 1974, at 1, col. 6. The parent-subsidiary relationship may give rise to questions of conflicts of interest and usurpation of corporate opportunities of the subsidiary by the parent; threats to the parent of litigation by minority stockholders over judgments made by the dominated subsidiary's management with respect to such policy matters as payment of dividends, expansion of the business, or allocation of intercorporate expense. See Greene, *Corporate Freeze-out Mergers: A Proposed Analysis*, 28 STAN. L. REV. 487, 494 (1976) [hereinafter cited as Greene].

7. Freeze-out mergers may be classified as follows: (1) "going private" or "retrieval" freeze-outs where management or controlling shareholders

"freeze-out" may be defined as the displacement of public investors by those who own a controlling block of corporate stock. In exchange for their shares in the corporate enterprise, the minority stockholders receive cash or senior securities.<sup>8</sup> While freeze-outs may be accomplished by a number of indirect means, such as reverse stock splits<sup>9</sup> or the sale of all assets and subsequent corporate dissolution,<sup>10</sup> the amendments to the merger statutes have facilitated direct elimination of the minority stockholders from further participation in the corporate enterprise.<sup>11</sup>

Traditionally, judicial decisions in Delaware exemplified the courts' efforts to adhere to the legislative mandate to create a favorable climate for management.<sup>12</sup> However, in a radical departure from precedent,<sup>13</sup> the Delaware Supreme Court has imposed new restrictions upon freeze-out mergers.<sup>14</sup> The primary restriction is that the majority stockholders owe a fiduciary duty

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have the corporation reacquire its publicly held stock at currently depressed market prices. The retrieved stock often was sold to the public several years earlier by the corporation, in order to raise capital, at considerably higher prices. (2) Two-step or acquisition freeze-outs where an acquiring corporation, having purchased the controlling interests in a target enterprise, completes its acquisition by using the freeze-out mechanism to eliminate the remaining shareholders in the target. (3) Mergers of long-held affiliates where the parent organization, having decided to acquire sole ownership of the subsidiary, eliminates the subsidiary's minority public shareholders through a cash-out merger between the parent and the subsidiary, or between the subsidiary and a shell corporation formed by the parent. Brudney, *A Note on "Going Private"*, 61 VIRGINIA L. REV. 1019 (1975); Greene, *supra* note 6, at 490-96; see Note, *Singer v. Magnavox Co.: Delaware Imposes Restrictions on Freezeout Mergers*, 66 CALIF. L. REV. 118, 118-19 (1978) [hereinafter cited as *Restrictions*].

8. The public investors are forced to give up their interest in the corporation while the control group retains its interest. Brudney and Chirelstein, *A Restatement of Corporate Freezeouts*, 87 YALE L.J. 1354, 1357 (1978) [hereinafter cited as Brudney and Chirelstein]; Greene, *supra* note 6 at 489; Note, *Freezing Out Minority Shareholders*, 74 HARV. L. REV. 1630 (1961).

9. See *Teschner v. Chicago Title and Trust Co.*, 59 Ill. 2d 452, 322 N.E.2d 54 (1974) (amendment of articles of incorporation authorizing reclassification of some 2,233,321 common shares of \$6 $\frac{2}{3}$  par value into 3,722 shares each having par value of \$4,000).

10. See *Willard v. Harrworth Corp.*, 267 A.2d 577 (Del. Supr. 1970) (termination of existence and sale of all assets); *Orzeck v. Englehart*, 41 Del. Ch. 361, 195 A.2d 375 (Del. Supr. 1963) (purchase of all shares of another corporation challenged as *de facto* merger); *Hariton v. Arco Elecs., Inc.*, 41 Del. Ch. 74, 188 A.2d 123 (Del. Supr. 1963), *aff'g*, 40 Del. Ch. 326, 182 A.2d 22 (Del. Ch. 1962) (sale of all assets and subsequent liquidation challenged as *de facto* merger); *Abelow v. Symonds*, 40 Del. Ch. 462, 184 A.2d 173 (Del. Ch. 1962) (involving sale of all assets and subsequent corporate liquidation).

11. See text accompanying note 38 *infra*.

12. See Cary, *supra* note 2, at 670-84 (the trend of the Delaware courts has been a relaxation of fiduciary standards).

13. See text accompanying notes 41-46 *infra*.

14. *Singer v. Magnavox Co.*, 380 A.2d 969 (Del. Supr. 1977).

to their minority counterparts.<sup>15</sup> This duty arises from the majority's domination of the subsidiary's board of directors which approves the terms of the proposed merger. In effect, the parent "stands on both sides of the transaction."<sup>16</sup> Furthermore, a freeze-out merger executed for the sole purpose of eliminating minority stockholders is actionable as a violation of the fiduciary duty.<sup>17</sup> The majority must establish a business purpose behind the merger. Finally, even if the merger is not made for the sole purpose of eliminating the minority stockholders, the majority has not necessarily satisfied its fiduciary duty. Rather, the majority must also establish the "entire fairness" of the terms of the merger.<sup>18</sup>

In its sweeping application of the fiduciary standard, the Delaware Supreme Court left many critical issues unresolved.<sup>19</sup> The court failed to establish criteria to determine which business purposes would and would not justify the elimination of minority stockholders. Nor did it give any suggestion as to what would make the terms of the merger "entirely fair" to the minority stockholders. Further interpretation of these concepts was left to the Court of Chancery, which addressed these issues in the case of *Young v. Valhi, Inc.*<sup>20</sup>

#### FACTS AND PROCEDURAL HISTORY

In July 1975, Contran Corporation (Contran) set out to acquire all shares of Valhi, Inc. (Valhi). Prior to the acquisition, Contran and Valhi were completely unaffiliated entities. Contran, by means of a tender offer,<sup>21</sup> purchased fifty-five percent of

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15. *Id.* at 975-77.

16. *Id.* at 976. Mergers between corporate entities which are tied together by a holding of a majority of one corporation by the other and a common board of directors have been deemed "interested" mergers. See FOLK, THE DELAWARE GENERAL CORPORATION LAW 333 (1972).

17. *Singer v. Magnavox Co.*, 380 A.2d at 980.

18. *Id.*; *Tanzer v. International Gen. Indus., Inc.*, 379 A.2d 1121, 1125 (Del. Supr. 1977).

19. In *Singer* the Delaware Supreme Court initially left unresolved the question of whose business purpose was relevant in a freeze-out merger. 380 A.2d at 980, n.11. But in *Tanzer v. International Gen. Indus., Inc.*, 379 A.2d 1121 (Del. Supr. 1977) the court later resolved this issue by determining that a freeze-out merger to advance a business purpose of the parent corporation, specifically to facilitate long-term debt financing, did not breach the fiduciary duty owed by the parent corporation to its subsidiary. *But see* Murdock, *supra* note 2, at 655 (contending that the parent's change from 81% to 100% interest in the subsidiary was not sufficient to induce an investor to extend long-term debt financing).

20. 382 A.2d 1372 (Del. Ch. 1978).

21. A tender offer is an offer made by a bidder or offeror to purchase the stock of a corporation (the target). See Note, *Defensive Tactics Employed by Incumbent Managements in Contesting Tender Offers*, 21 STAN. L. REV.

the issued and outstanding shares of Valhi.<sup>22</sup> Contran then voted its stock to cause the election of Contran officers and directors to positions as directors of Valhi.<sup>23</sup> Sixteen months after its initial acquisition of control, Contran proposed a merger with Valhi. Valhi's articles of incorporation, however, contained an impediment to accomplishment of the merger. The articles provided that a proposed merger between Valhi and a corporation owning at least five percent of Valhi's stock required the approval of eighty percent of the issued and outstanding stock of Valhi.<sup>24</sup> Following two unsuccessful attempts to procure the requisite eighty percent approval,<sup>25</sup> Contran used its majority holdings to cause the incorporation of VIS Corporation (VIS) as a wholly owned subsidiary of Valhi. VIS was created to enable Contran to use another charter provision of Valhi which permitted the merger of Valhi with a wholly owned subsidiary through a mere majority vote. The terms of the merger provided for the payment of cash to minority stockholders of Valhi and a consequent termination of their future interest in the enterprise.<sup>26</sup>

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1104 (1969) [hereinafter cited as *Defensive Tactics*]. They have become a common method of obtaining control of a publicly held corporation since they are less expensive and less time-consuming than other means of acquisition such as negotiated mergers, gradual market acquisition, or the proxy method. Wilner and Landy, *The Tender Trap: State Takeover Statutes and Their Constitutionality*, 45 *FORDHAM L. REV.* 1 (1976) [hereinafter cited as Wilner and Landy].

22. Contran's tender offer was opposed by the incumbent management of Valhi. Contran's offer of \$20 per share was countered by a \$22 per share offer made by Farnham Corp. (Farnham), a corporation owned by officers and directors of Valhi. After Contran and Farnham had increased their respective offers, Farnham's offer was enjoined by the United States District Court for the Southern District of Texas, Houston Division, in a suit brought by Contran. Plaintiffs' Post-Trial Brief in Support of Their Request for a Preliminary and Permanent Injunction at 4, *Young v. Valhi, Inc.*, 382 A.2d 1372 (Del. Ch. 1978) [hereinafter cited as Plaintiffs' Post-Trial Brief].

23. Two of the five directors of Valhi were officers and/or directors of Contran. Contran was unable to place its nominees in the other three positions because they held staggered terms. See Valhi, Inc. notice of special meeting of stockholders, Sept. 9, 1977, at 42.

24. *Young v. Valhi, Inc.*, 382 A.2d 1372, 1375 (Del. Ch. 1978).

25. The terms of the first proposed merger provided that the minority common shareholders of Valhi would receive, in exchange for their shares, a class of newly created preferred stock, callable at a fixed date. This proposal failed to receive the requisite eighty percent approval. Two months later, an attempt was made to persuade the minority shareholders of Valhi to exchange their common stock for a class of stock similar to that which would have been issued had the original merger proposal been consummated, except that the preferred stock was subject to call at any time. This proposal also failed to receive the necessary shareholder approval. 382 A.2d at 1375. See *Matteson v. Ziebarth*, 40 Wash. 286, 242 P.2d 1025 (1950) (recognizing that the issuance of callable preferred stock in the corporation surviving the merger might result in the ultimate ouster of the recipient of such stock).

26. 382 A.2d at 1376.

Minority stockholders of Valhi challenged the merger on the grounds that (1) the merger was undertaken for the primary purpose of eliminating minority shareholders;<sup>27</sup> (2) the price offered for the minority's shares was not "entirely fair";<sup>28</sup> and (3) the proposed merger was an effort to circumvent the provision in the articles of incorporation requiring eighty percent shareholder approval of a proposed merger.<sup>29</sup>

Defendants contended that consummation of the proposed merger would (1) result in tax savings;<sup>30</sup> and (2) eliminate potential conflicts of interest.<sup>31</sup> Furthermore, defendants pointed out that the proposed price was the result of extensive research by an independent investment banking house and that Valhi's totally independent director<sup>32</sup> found the proposed merger to be

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27. Plaintiffs' Post-Trial Brief, *supra* note 22, at 84-95 (pointing out that tax benefits from the merger were speculative and did not require 100% ownership of Valhi. As to potential conflicts of interest, plaintiffs noted that Contran had voluntarily placed itself in the position of majority and by the merger would avoid its responsibilities, and that conflicts of interest had not materialized since Contran acquired control of Valhi).

28. In determining the value of a dissenting stockholder's shares, courts have looked to such factors as the corporation's average earnings, market value of the stock, and corporate asset value. Each factor is weighted or given a "multiplier" depending upon the corporation's historical earnings, stability, and future prospects at the date of the merger. *Universal City Studios, Inc. v. Francis I. duPont & Co.*, 334 A.2d 216, 218-19 (Del. Supr. 1975). Since Valhi, from its incorporation, had failed to report any earnings and had no foreseeable expectation of reporting earnings, 382 A.2d at 1373, this factor was given little weight. Plaintiffs' Post-Trial Brief, *supra* note 22, at 60 (earnings should be given a weight of 10%). Plaintiffs contended that Valhi's net asset value should be given the most weight since the corporation was engaged in asset acquisition as well as selling off unprofitable ventures. 382 A.2d at 1378; Plaintiffs' Post-Trial Brief, *supra* note 22, at 52. Defendants argued that the public trading in Valhi's shares made market price the most reliable factor in determining the value of plaintiffs' shares. Post-Trial Brief for Defendants at 26, *Young v. Valhi, Inc.*, 382 A.2d 1372 (Del. Ch. 1978). The court stated that "due to Valhi's acquisition and disposal of assets, the 'usual tests' of earnings and market value were not applicable." 382 A.2d at 1373. The court concluded, however, that it was unnecessary to pass on the overall fairness of the price offered the minority stockholders for their stock. 382 A.2d at 1378.

29. Plaintiffs' Post-Trial Brief, *supra* note 22, at 96 (defendants admitted circumvention of the Valhi charter 80% stockholder vote requirement violates their fiduciary obligations under Delaware law).

30. Post-Trial Brief for Defendants at 4, *Young v. Valhi, Inc.*, 382 A.2d 1372 (Del. Ch. 1978) (consummation of the merger prior to Jan. 30, 1978, will give Valhi hard cash benefits for the 1978 tax year); 382 A.2d at 1376-77 (filing of consolidated tax return would affect Valhi's recent gains against Valhi's continuing losses).

31. Post-Trial Brief for Defendants at 6-11, *Young v. Valhi, Inc.*, 382 A.2d 1372 (Del. Ch. 1978) (conflicts of interest arose regarding allocation of land development opportunities and other acquisition opportunities); 382 A.2d at 1376 (claiming that potential conflicts would arise relating to flow of corporate funds, allocation of costs attributable to facilities and personnel, and the interchange of management personnel).

32. *But see* Murdock, *supra* note 2, at 662. (studies have indicated that



fair to the minority.

#### THE OPINION OF THE COURT OF CHANCERY

Following final hearing, the court proposed to determine whether the merger of Valhi into Contran was "entirely fair" to the minority stockholders of Valhi.<sup>33</sup> Specifically, the court focused on whether the circumvention of the eighty percent voting requirement was fair. The court ostensibly relied on the guidelines established by the Delaware Supreme Court in *Singer v. Magnavox Co.*<sup>34</sup> and *Tanzer v. International General Industries, Inc.*<sup>35</sup> An analysis of Delaware corporate law, however, reveals that the *Young* decision can, perhaps, best be explained by a change in policy of the Delaware courts in order to give broad protection to minority stockholders involved in a freeze-out merger.<sup>36</sup>

#### BACKGROUND

##### *Legislative Policy Favoring Mergers*

The Delaware legislature has committed itself to a policy of creating a favorable climate for corporate management.<sup>37</sup> This policy has been manifested in two ways. First, the Delaware merger statutes have been amended to facilitate management's ability to eliminate minority stockholders by payment of cash instead of issuing stock. Initially the merger statute had provided that stockholders of corporations entering into a merger receive stock of the surviving corporation in exchange for their stock.<sup>38</sup>

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"independent" directors on the board owe their presence to the willingness of the interested majority to slate them).

33. 382 A.2d at 1373.

34. *Id.* at 1375-76.

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

36. 379 A.2d 1121 (Del. Supr. 1977).

37. *See* note 2 *supra*.

38. The present merger statute, DEL. CODE tit. 8, § 251 (Cum. Supp. 1977), was originally enacted in 1899 as part of Delaware's first general corporation law. 21 DEL. LAWS, ch. 273, § 54 (1898-1899). Its terms provided that the shareholder receive shares of the surviving corporation. The enactment of this statute abrogated the common law right of a stockholder to veto a proposed merger. At common law, a single stockholder could prevent a merger. *Reynolds Metal Co. v. Colonial Realty Corp.*, 41 Del. Ch. 183, 190 A.2d 752 (Del. Supr. 1963) (dictum); *Chicago Corp. v. Munds*, 20 Del. Ch. 142, 172 A. 452, 455 (Del. Ch. 1934); Greene, *supra* note 6, at 487 n.1; McBride, *Delaware Corporate Law: Judicial Scrutiny of Mergers—The Aftermath of Singer v. The Magnavox Co.*, 33 BUS. LAW. 2231, 2233 (1978) [hereinafter cited as McBride]; Note, *Freezing Out Minority Shareholders*, 74 HARV. L. REV. 1630 (1961). The inarticulated premise of this common law rule had been that a stockholder had a vested right not only to continued participa-

Second, the legislature enacted the statutory appraisal remedy.<sup>39</sup> Under the provisions of the appraisal statute, stockholders who dissented from the merger could do no more than compel the corporation to purchase their shares for fair value. Where the parties could not agree on the fair value of the dissenter's shares, an independent body would be appointed to make an appraisal of the value of the stockholders shares.<sup>40</sup>

#### *Development of the Business Purpose Rule Regarding Freeze-Out Mergers*

From an early date, judicial decisions in Delaware were characterized by an adherence on the part of the courts to the legislative policy of creating a "favorable climate" for management. The courts were impressed by the fact that the laws of the state had provided a mechanism by which two corporations could merge, and declared that mergers were "encouraged and favored."<sup>41</sup> The statutory appraisal remedy was seen as adequate compensation for the loss of the minority stockholder's common law right to veto the merger. Appraisal was seen as a means for dissenting stockholders to retire voluntarily from the enterprise and receive the full monetary value of their shares rather than be forced to continue in a new or changed enter-

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tion in the corporate enterprise, but to retain his interest in the very entity from which he had originally acquired his shares. McBride, *supra* at 2234. The effect of the 1899 statute was to retain the stockholder's vested right to continued participation in the enterprise, but to drop the requirement that it must continue to be the same entity. In 1937 the legislature enacted DEL. CODE tit. 8, § 253 (Cum. Supp. 1977) or "short-form" merger. 41 DEL. LAWS, ch. 131, § 2 (1937). The short-form merger originally only authorized a parent corporation to absorb a wholly-owned subsidiary. Since a vote by the subsidiary's only stockholder would be an empty ritual, a stockholder election, normally required in merger situations, was deemed unnecessary. See A. FREY, J. CHOPER, N. LEECH, C.R. MORRIS, CASES AND MATERIALS ON CORPORATIONS 1199-1200 (2d ed. 1977) [hereinafter cited as FREY AND CHOPER]. In 1957, § 253 was amended, 51 DEL. LAWS, ch. 121, § 6 (1957), to permit a short-form merger between a parent and its merely 90% owner subsidiary. More importantly, the amendment also permitted the subsidiary's minority shareholders to receive "securities, cash[,] or other consideration," rather than shares of the surviving corporation. In 1967, § 251 was amended to allow cash as well as stock or other securities. 56 DEL. LAWS, ch. 50 (1967). Thus, a mere majority could technically eliminate the minority stockholders by exchanging cash for the minority's shares.

39. DEL. CODE tit. 8, § 262 (Cum. Supp. 1977).

40. Note, *Freezing Out Minority Shareholders*, 74 HARV. L. REV. 1630, 1635 (1961).

41. Federal United Corp. v. Havender, 24 Del. Ch. 318, 11 A.2d 331 (Del. Supr. 1940); David J. Greene & Co. v. Schenley Indus., Inc., 281 A.2d 30 (Del. Ch. 1971); Bastian v. Bourns, Inc., 256 A.2d 680 (Del. Ch. 1969), *aff'd*, 278 A.2d 467 (Del. Supr. 1970); Bruce v. E.L. Bruce Co., 40 Del. Ch. 80, 174 A.2d 29 (Del. Ch. 1961); Salt Dome Oil Corp. v. Schenck, 28 Del. Ch. 433, 41 A.2d 583 (Del. Ch. 1945); MacFarlane v. North Am. Cement Corp., 16 Del. Ch. 172, 157 A. 396 (Del. Ch. 1928).

prise.<sup>42</sup>

Later, when the legislature amended the merger statutes to permit the majority to freeze out the minority involuntarily, the courts showed a reluctance to interfere with such freeze-out mergers.<sup>43</sup> The judiciary noted that the merger statutes provided the majority stockholders a means of eliminating the minority,<sup>44</sup> but refused to inquire into the motivation behind the proposed merger to determine the merger's validity.<sup>45</sup> Rather, the courts superficially inquired as to whether the corporation had technically complied with the provisions of the merger statutes. Little concern was shown by the courts for minority stockholders involved in a freeze-out merger.<sup>46</sup> This led to growing

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42. *Hariton v. Arco Elecs.*, 41 Del. Ch. 74, 188 A.2d 123 (Del. Supr. 1963), *affg.*, 40 Del. Ch. 326, 182 A.2d 22 (Del. Ch. 1962); *Reynolds Metal Co. v. Colonial Realty Corp.*, 41 Del. Ch. 183, 190 A.2d 752, 755 (Del. Supr. 1963); *Francis I. duPont & Co. v. Universal City Studios, Inc.*, 343 A.2d 629, 634 (Del. Ch. 1975); *Chicago Corp. v. Munds*, 20 Del. Ch. 142, 172 A. 452 (Del. Ch. 1934). *See generally Vorenberg, Exclusiveness of the Dissenting Stockholder's Appraisal Right*, 77 HARV. L. REV. 1189, 1194-95 (1964) [hereinafter cited as Vorenberg].

43. *See Bastian v. Bourns, Inc.*, 256 A.2d 680, 684 (Del. Ch. 1969), *affd.*, 256 A.2d 680 (Del. Supr. 1970):

[Minority] stockholders who wish to withdraw from the consolidated enterprise here envisioned should do so without disrupting an intercorporate transaction which is encouraged and favored by the laws of Delaware . . . . Recent amendments to the Delaware Corporation Law reflect the continuing legislative approval of such policy.

44. *See Stauffer v. Standard Brands, Inc.*, 41 Del. Ch. 7, 10-11, 187 A.2d 78, 80 (Del. Supr. 1962):

[T]he very purpose of the [merger] statute [permitting the payment of cash in exchange for shares] is to provide the parent corporation with a means of eliminating the minority shareholder's interest in the enterprise. Thereafter the stockholder only has a money claim. This power of the parent corporation to eliminate the minority is a complete answer to plaintiff's charge of breach of trust.

45. "The reasons for a merger or the business necessity behind it are not matters for judicial determination." *MacCrone v. American Capital Corp.*, 51 F. Supp. 462, 462 (D. Del. 1943); *Bruce v. E.L. Bruce Co.*, 40 Del. Ch. 80, 174 A.2d 29 (Del. Ch. 1961); *Kessler, Elimination of Minority Interests by Cash Merger: Two Recent Cases*, 30 BUS. LAW. 699, 705 n.22 (1975).

46. Under the theory that a share of stock is a contract between the stockholder, corporation, and the state, all the provisions of the Delaware General Corporation Law are by implication written into every corporate charter. The stockholder takes his shares with constructive notice that his interest is defeasible. *See Singer v. Magnavox Co.*, 380 A.2d 969, 978 (Del. Supr. 1977); *Federal United Corp. v. Havender*, 24 Del. Ch. 318, 333, 11 A.2d 331, 342 (Del. Supr. 1940), *rev'g.*, 23 Del. Ch. 104, 2 A.2d 143 (Del. Ch. 1938); *Weinberg v. Baltimore Brick Co.*, 35 Del. Ch. 225, 229, 114 A.2d 812, 814 (Del. Supr. 1955); *David J. Greene & Co. v. Schenley Indus., Inc.*, 281 A.2d 30 (Del. Ch. 1971). *Accord*, *Teschner v. Chicago Title & Trust Co.*, 59 Ill. 2d 452, 322 N.E.2d 54 (1974) (corporation's articles of incorporation include Illinois Business Corporation Act). *But see B. & H. Warehouse, Inc. v. Atlas Van Lines, Inc.*, 490 F.2d 818 (5th Cir. 1974) (overly broad charter provision failed to give notice to stockholders of future charter changes). In *Coyne v. Park & Tilford Distillers Corp.*, 37 Del. Ch. 558, 146 A.2d 785 (Del. Ch. 1958), *affd.*, 38

criticism of the state's unwillingness to protect the interests of minority shareholders.<sup>47</sup> The failure of state courts to protect minority interests became more acute when the United States Supreme Court refused to expand the anti-fraud provision of the Securities Exchange Act to provide federal regulation of freeze-out mergers.<sup>48</sup>

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Del. Ch. 514, 154 A.2d 893 (Del. Supr. 1959), minority stockholders sought to enjoy merger between parent corporation and its 95% owned subsidiary. Plaintiffs argued that they had a constitutional right, in the form of a vested property right, not to have their stock confiscated by the 1957 amendment of DEL. CODE tit. 8, § 253 (providing for the payment of cash in exchange of stock) when they had acquired their stock prior to the amendment. The court rejected this argument on the grounds that their investment was not wiped out, but converted. 37 Del. Ch. at 564-65, 146 A.2d at 788-89.

Although the Delaware Supreme Court in *Singer v. Magnavox Co.*, 380 A.2d 969 (Del. Supr. 1977) stated that Delaware courts had long imposed high standards in governing the internal affairs of Delaware corporations, *id.* at 976-77, the cases cited by the court were primarily concerned with the fiduciary duty owed by the directors to the corporation. See *Kaplan v. Fenton*, 278 A.2d 834 (Del. Supr. 1971) (director alleged to have usurped corporate opportunity); *Dolese Bros. Co. v. Brown*, 39 Del. Ch. 1, 157 A.2d 784 (Del. Supr. 1960) (president appropriated corporate business using corporate funds); *Guth v. Loft, Inc.*, 23 Del. Ch. 255, 5 A.2d 503 (Del. Supr. 1939) (officer and director usurped corporate opportunity); *Craig v. Graphic Arts Studio, Inc.*, 39 Del. Ch. 477, 166 A.2d 444 (Del. Ch. 1960) (director wrongfully competed with his corporation); *Brophy v. Cities Service Co.*, 31 Del. Ch. 241, 70 A.2d 5 (Del. Ch. 1949) (derivative suit against corporate employee for use of confidential information).

47. See Jennings, *supra* note 3, at 998 (contending that the state substantive law of fiduciary obligations has fallen into disuse); Note, *The Second Circuit Adopts a Business Purpose Test for Going Private: Marshall v. AFW Fabric Corp. and Green v. Sante Fe Industries, Inc.*, 64 CALIF. L. REV. 1184, 1197-99 (1976) (pointing out that the inability of states to regulate corporations was due to the ability of corporations to incorporate outside states having unfavorable statutes and to the competition among states to attract corporations).

The dissenters' statutory appraisal remedy drew the most criticism. Appraisal was deemed "technical . . . expensive . . . uncertain in result; and, in the case of a publicly held corporation, . . . unlikely to produce a better result than could have been obtained on the market . . . in short, a remedy of desperation. . . ." Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking*, 57 CALIF. L. REV. 1, 85 (1969). See *Matteson v. Ziebarth*, 40 Wash. 2d 286, 242 P.2d 1025 (1952) (minority shareholder who failed to comply with procedural requirements of dissenter's appraisal right is not only precluded from seeking such appraisal but is also barred from raising alternative questions of unfairness and breach of fiduciary duty); Brudney and Chirelstein, *Fairshares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297, 304 (1974) [hereinafter cited as *Fairshares*]; Vorenberg, *supra* note 42, at 1202-03; *Restrictions*, *supra* note 7, at 123-24.

48. In *Sante Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977), the Court refused to extend the reach and coverage of § 10 of the Securities Exchange Act, 15 U.S.C. § 78j (1970), and Securities Exchange Commission Rule 10b-5, 17 CFR § 240.10b-5 (1977), to impose upon majority shareholders the requirement of establishing a valid business purpose for a "freeze-out" merger. In the absence of nondisclosure, misrepresentation, or manipulation by the majority, no federal relief would be granted to minority share-

Due at least in part to the withdrawal of the federal forum, the Delaware Supreme Court was persuaded to recognize its responsibility to minority stockholders.<sup>49</sup> In *Singer v. Magnavox Co.*,<sup>50</sup> the Delaware Supreme Court apparently overruled its precedent<sup>51</sup> by imposing a fiduciary duty upon a parent corporation freezing out stockholders of the subsidiary by a merger.<sup>52</sup> This duty arose from the fact that at the time of the merger the parent controlled the boards of directors of both corporations entering into the merger. In effect the parent stood on both sides of the transaction.<sup>53</sup> Furthermore, *Singer* imposed upon majority stockholders the duty of establishing the existence of a valid business purpose to justify eliminating the minority.<sup>54</sup> Failure to establish a valid business purpose constituted an abuse of corporate process and a breach of the majority's fiduciary duty.<sup>55</sup>

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holders displaced in a Delaware "short-form" merger. The Court stated that absent a clear congressional intent, it was reluctant to federalize substantial portions of corporate law dealing with transactions in securities, particularly when established state policies would be overridden. 430 U.S. at 479. This decision may be viewed as part of the tendency of the Burger Court to limit access to the federal courts. See generally Casenote, *Aldinger v. Howard: At the Crossroads of Pendant Party Jurisdiction and Section 1983 Limits on Suable "Persons"*, 11 J. MAR. J. 231 (1977). For a discussion of federal court of appeals decisions applying rule 10b-5 to freeze-out mergers prior to the *Sante Fe* decision see Greene, *supra* note 6, at 497 n.37.

49. *Singer v. Magnavox Co.*, 380 A.2d 969, 976 n. 6 (Del. Supr. 1977) (stating that the decision of the United States Supreme Court in *Sante Fe Indus., Inc., v. Green*, 430 U.S. 462 (1977), was a "current confirmation by the Supreme Court of the responsibility of a state to govern the internal affairs of corporate life").

50. 380 A.2d 969. North American Phillips Corp. sought to acquire all shares of Magnavox Co. by means of a tender offer. By giving employment contracts and stock options to key Magnavox personnel, North American quelled the opposition of Magnavox's management. 84% of the public stockholders of Magnavox tendered their shares. *Id.* at 971. Thereafter, with its majority holdings, North American organized another Delaware corporation and proceeded to merge it with Magnavox. The minority stockholders of Magnavox, who had received cash for their shares and were eliminated from the enterprise, sought to rescind the merger. *Id.* at 972.

51. 380 A.2d 969 (Del. Supr. 1977). The *Singer* court distinguished previous case law as not involving "a merger in which the minority was totally expelled via a straight 'cash for stock' conversion in which the only purpose of the merger was to eliminate the minority." *Id.* at 978. However, to the extent that previous decisions were inconsistent with the court's holding, they were deemed overruled. *Id.* at 979.

52. *Id.* at 975-80.

53. *Id.* at 976.

54. *Id.* at 975 (stating that although the merger was not fraudulent because it was made without any ascertainable corporate business purpose, defendants' actions constituted a claim upon which relief could be granted based upon application of the law governing corporate fiduciaries).

55. *Id.* at 980 (the court limited itself to the holding that a merger under DEL. CODE tit. 8, § 251 (Cum. Supp. 1977) for the sole purpose of freezing out the minority stated a cause of action for breach of the fiduciary duty).

### The Two-Tier Test

In *Singer*, and a few weeks later in *Tanzer v. International General Industries, Inc.*,<sup>56</sup> the Delaware Supreme Court formulated a two-level standard which majority stockholders must meet in a freeze-out merger. First, the majority must establish a business purpose for the proposed merger in order to justify eliminating the minority stockholders. Second, even where the majority was able to establish a valid<sup>57</sup> or bona fide<sup>58</sup> business purpose, the majority was not relieved of its fiduciary duty. Rather, the majority had the burden of establishing the "entire fairness" of the terms of the merger.<sup>59</sup> The court, however, gave little indication as to what would make the merger "entirely fair."

### The Test of "Entire Fairness"

The "entire fairness" doctrine is not a new concept in Delaware corporate law.<sup>60</sup> The problem facing the Court of Chancery in *Young* lay in the fact that the Delaware Supreme Court had mandated a broader scope of inquiry into corporate mergers without enumerating what the new standards of "fairness" were to be.

### Restatement of the Test of "Entire Fairness"

Historically, when a proposed merger was challenged as being "unfair" to minority stockholders, the issue facing the court was whether the minority stockholder would receive substantially the equivalent *value* of the stock which was held prior to the merger.<sup>61</sup> In determining the "fairness" of the merger, the

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56. 379 A.2d 1121 (Del. Supr. 1977).

57. 380 A.2d at 980.

58. 379 A.2d at 1124. See *Murdock*, *supra* note 2, at 655 (contending that under the test enunciated in *Tanzer*, a plausible business purpose could be manufactured by the parent corporation to justify almost any action).

59. 380 A.2d at 980 (stating that the fiduciary duty of the majority is not discharged merely because the sole purpose of the merger is not to freeze out the minority); 379 A.2d at 1125 (upon finding a bona fide purpose for the freeze-out, minority stockholders are entitled to a fairness hearing).

60. See note 61 *infra*.

61. See, e.g., *Stauffer v. Standard Brands, Inc.*, 41 Del. Ch. 7, 10-11, 187 A.2d 78, 80 (Del. Supr. 1962) (plaintiff claims that cash offered is so grossly inadequate as to constitute constructive fraud); *David J. Greene & Co. v. Schenley Indus., Inc.*, 281 A.2d 30, 33 (Del. Ch. 1971) (parties are in dispute merely as to value for which an appraisal should be adequate); *Bastian v. Bourns, Inc.*, 256 A.2d 680, 681 (Del. Ch. 1969), *aff'd*, 278 A.2d 467 (Del. Supr. 1970) (where plaintiffs only attacked the proposed rate of exchange); *David J. Greene & Co. v. Dunhill Int'l, Inc.*, 249 A.2d 427, 429 (Del. Ch. 1968) (where plaintiffs attacked the exchange ratio as grossly unfair and inequitable); *Bruce v. E.L. Bruce Co.*, 40 Del. Ch. 80, 174 A.2d 29 (Del. Ch. 1961) (where

Delaware courts had focused upon such factors as past earnings and market value of the shares of the corporations entering the merger.<sup>62</sup> The problem with restricting the question of fairness to the value the minority stockholder will receive in exchange for his shares is the inability of the minority stockholder to determine the true value of the subsidiary. Such valuation is customarily based upon information released to the public at the time of the merger. The inequity arises when the parent withholds or conceals information, concerning the subsidiary's future earnings or asset value, which would demonstrate that the subsidiary is worth more than its past record suggests.<sup>63</sup>

A departure from focusing the fairness doctrine only upon the value of the minority's shares took place in *Singer*. In this case, the Delaware Supreme Court rejected defendant's contention that the majority had met its fiduciary obligation by offering the minority the fair value of their shares.<sup>64</sup> Furthermore, in *Tanzer*, the Delaware Supreme Court deemed the lower court's discussion of fairness, only in terms of the price offered the minority, too restrictive. Rather, the supreme court ordered the lower court to inquire into the entire fairness of *all* aspects of the transaction.<sup>65</sup>

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main thrust of plaintiff's complaint was that exchange ratio grossly undervalued corporation's stock).

62. *David J. Greene & Co. v. Dunhill Int'l, Inc.*, 249 A.2d 427, 431 (Del. Ch. 1968).

63. *See Berkowitz v. Power/Mate Corp.*, 135 N.J. Supr. 36, 342 A.2d 566 (Ch. 1975) (declaration of large bonuses to directors prior to decision to merge may have driven earnings down); *Fairshares*, *supra* note 47, at 305-06 (stating that the timing of the decision to merge may be based on parent's anticipation, as a result of information known solely to the parent, of substantial improvement of subsidiary's earning or net assets).

64. 380 A.2d 969, 977-78 (Del. Supr. 1977). In rejecting defendant's argument, the court stated:

At the core of defendant's contention is the premise that a shareholder's right is exclusively in the *value* of his investment, not its *form*. And, they argue, the right is protected by a[n] . . . appraisal [proceeding] which, by definition, results in fair value for the shares. This argument assumes that the right [of the majority] to take is coextensive with the power [of the majority] to take and that a dissenting stockholder has no legally protected right in his shares, his certificate[,] or his company beyond a right to be paid fair value when the majority is ready to do this. *Id.* (emphasis by the court).

*But see Manning, The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 *YALE L.J.* 223, 261 (1962) (contending that the modern stockholder considers himself an investor, rather than an owner; he hires his capital to management for them to determine how to manage his investment).

65. *Tanzer v. International Gen. Indus., Inc.*, 379 A.2d 1121, 1125 (Del. Supr. 1977). *See Kemp v. Angel*, 381 A.2d 241 (Del. Ch. 1977) (stating that fairness, according to *Tanzer*, is determined by more than price).

### *The Eighty Percent Voting Requirement*

The *Young* court focused its inquiry as to fairness upon the circumvention of the eighty percent voting requirement.<sup>66</sup> In doing so the court must have considered the objective of including such a charter provision in Valhi's articles of incorporation.

When a tender offer is made to acquire control of a "target" corporation, the tender offeror may face a number of obstacles. In addition to complying with the Delaware statute which regulates tender offers,<sup>67</sup> the tender offeror often faces fierce resist-

66. *Young v. Valhi, Inc.*, 382 A.2d 1372, 1378-79 (Del. Ch. 1978).

67. In 1975 the Delaware legislature enacted DEL. CODE tit. 8, § 203 (Cum. Supp. 1976) to regulate tender offers. The provisions of the statute require that any corporation seeking to acquire stock from a "target" corporation must (1) give advance notice of its intention to the target; and (2) wait at least twenty days before it is allowed to actually purchase stock. However, an offer made by a target corporation for its own stock is exempted from the provisions of the statute. The Delaware courts have interpreted this statute as protecting stockholders of the target corporation from abuse in a tender offer. In *Royal Indus., Inc. v. Monogram Indus., Inc.*, 366 A.2d 839, 839-40 (Del. Ch. 1976), *rev'd on other grounds*, 372 A.2d 171 (Del. Supr. 1976) the court stated:

Prior to May 1, 1976, the effective date of 8 Del. C., § 203, there was no statutory impediment in the Delaware Corporation Law to the free right of an individual, or of a corporation or other entity, to solicit tenders of stock of another corporation and to offer to buy some or all of the stock so tendered . . . . [M]any solicitations have been made . . . on extremely short notice, making it difficult, . . . for the target corporations properly to advise their stockholders or for such stockholders to decide independently whether or not to [accept the offer], being in many instances faced with a Hobson's choice of either selling out under undue pressure or becoming a member of a small minority stockholders' group. In some instances the target corporation . . . has acquiesced in such take-overs with the result that the stockholders . . . have . . . been victimized by both the offeror and their own corporation. The abuses inherent in such uncontrolled free enterprise led to the enactment of 8 Del. C., § 203, which, in essence, requires an offering corporation or person to give notice of its or his intent to solicit tenders of stock to the target corporation at least twenty days before such offer is to open and to keep such offer open for a minimum of twenty days.

*See American Medicorp, Inc. v. Humana, Inc.*, 381 A.2d 571, 572 (Del. Ch. 1977) (stating that the purpose of the tender offer statute is not to give advantage to the target corporation but to allow the target to give information to its stockholders to enable them to make an informed decision). The "inherent abuses" of a tender offer, referred to in *Royal Indus., Inc. v. Monogram Indus., Inc.*, 366 A.2d at 839-40, include the following: (1) the shares not tendered will tend to decrease in liquidity; (2) if public distribution is reduced below a certain level, the corporation is delisted; (3) a decrease in the amount of public information concerning the offeror due to termination of corporation's registration under § 12 of Securities Exchange Act of 1934.

A tender offer for all, or substantially all, of a company's outstanding stock . . . may well induce a reaction by the offeree based more on panic than on measured evaluation of the merits of the offer. Who, after all, wants to be among the last holders of an illiquid security, and that in a market not even informed by the periodic reporting required of the federal securities laws and regulations?



ance from the target's incumbent management. Such resistance arises from the target management's fear that it will lose its position should the tender offeror acquire control of the target.<sup>68</sup> In response to the growing number of corporate take-overs by tender offers,<sup>69</sup> management has devised a number of "defen-

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Borden, *Going Private—Old Tort, New Tort or No Tort?*, 49 N.Y.U. L. REV. 987, 1004 (1974).

The real object of the tender offer statute, however, may be to protect the management of the target corporation. The notice and delay provisions prevent management from being caught off-guard by a tender offer. The provision which exempts offers made by the corporation from the provisions of the statute allows management to purchase its own corporation's stock without delay in order to ward off a tender offer. See ARANOW & EINHORN, *TENDER OFFERS FOR CORPORATION CONTROL* 172 (1973) [hereinafter cited as ARANOW & EINHORN] "Thinly disguised as legislation for the protection of investors, these statutes cannot in any practical sense be viewed as anything more than attempts to protect incumbent management and local industry." The authors contend that this conclusion is made "patently obvious" where the statute provides an exemption from regulation for offers by third parties that are approved by the board of directors of the target corporation. Indeed, the constitutionality of such statutes has come into question. See Wilner & Landy, *supra* note 21, at 22-23 (contending that while the effect of an individual state statute upon the progress of a tender offer may itself be minimal, there are many such state statutes, and several of them may apply to any one tender offer because the bases for jurisdiction are usually broad and overlapping; hence their cumulative effect places an undue burden on interstate commerce in violation of the commerce clause, U.S. CONST. art. I, § 8, cl. 3). In *Great W. United Corp. v. Kidwell*, 577 F. 2d 1256 (5th Cir. 1978), *rev'd on other grounds sub. nom.*, *Leroy v. Great W. United Corp.*, 99 S. Ct. 2710 (1979) the Fifth Circuit Court of Appeals held that the Idaho statute regulating tender offers, IDAHO CODE §§ 30-1501-13 (Cum. Supp. 1977), which is similar in its provisions to the Delaware, DEL. CODE tit. 8, § 203 (Cum. Supp. 1976), and Illinois, Act of Sept. 8, 1977, P.A. 8-556, § 2.23, ILL. REV. STAT. ch. 121½, § 137.2-23 (1977), statutes, placed an undue burden on interstate commerce and was preempted by the Williams Act Amendments to the Securities Exchange Act of 1934, 15 U.S.C. §§ 78m(b)-(e), 78n(d)-(f) (1970). The Supreme Court, however, refrained from reaching the merits of the case. The Court reversed the Court of Appeals' determination that venue was proper in Texas to enjoin Idaho officials from enforcing provisions of the Idaho Take-Over Act.

In *Uarco, Inc. v. Daylin, Inc.*, No. 78 C 4246 (N.D. Ill., filed Oct. 30, 1978), the district court issued a preliminary injunction enjoining the Illinois Secretary of State from enforcing provisions of the Illinois Business Take-Over Act. In *Mite Corp. v. Dixon*, No. 79 C 200 (N.D. Ill., Judgment Order of Feb. 9, 1979), the district court permanently enjoined the Illinois Secretary of State from enforcing the Illinois Take-Over Act; the court holding that the Illinois Act violated the Commerce Clause and was preempted by the Williams Act provisions of the Security Exchange Act of 1934. These decisions, however, may ultimately be reversed on the basis of an extension of the holding in *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1 (1977) (holding that a tender offeror has no standing to bring a suit, at least for damages, under the Williams Act).

68. See *Defensive Tactics*, *supra* note 21, at 1105 (stating that "management's jobs or independent control of the enterprise may ride on the outcome of a tender offer").

69. See *Elgin Nat'l Indus., Inc. v. Chemetron Corp.*, 299 F. Supp. 367, 370 (D. Del. 1969).

The Board of Directors is concerned with the current trend of

sive tactics" to thwart the tender offeror's attempts. These include seeking a temporary restraining order and preliminary injunction,<sup>70</sup> refusal to supply its stockholders list to the tender offeror,<sup>71</sup> initiating publicity adverse to the tender offeror,<sup>72</sup> and amending the corporate charter to require approval by a significantly larger percentage than a majority of the target corporation's stock in order to effect a merger with a corporation owning more than five to ten percent of the target's stock.<sup>73</sup>

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tender and exchange offers which result in take-overs of public companies. The reason for the Amendment is to discourage persons from attempting to take over the company. . . . The general effect of the Amendment is to make it difficult for a potential acquirer to obtain control of the Board of Directors since it will require two years to remove a majority and three years to remove the entire Board of Directors. In addition the required vote of stockholders to approve a sale of assets is increased to two-thirds, the same voting requirements as provided by statute in the case of a merger.

70. Troubh, *Purchased affection: a primer on cash tender offers*, 54 HARV. BUS. REV. 79, 88 (Jul.-Aug. 1976) [hereinafter cited as Troubh] (stating that a well prepared target corporation will have a petition for a temporary restraining order and preliminary injunction ready before the tender offer is announced). See *Barber-Greene Co. v. Walco Nat'l Corp.*, 428 F. Supp. 567 (D. Del. 1977) (where target corporation delayed tender offer for 90 days); *Royal Indus., Inc. v. Monogram Indus., Inc.*, 372 A.2d 171 (Del. Supr. 1976), *rev'g*, 366 A.2d 839 (Del. Ch. 1976) (filing temporary restraining order caused delay of one month); *American Medicorp, Inc. v. Humana, Inc.*, 381 A.2d 571 (Del. Ch. 1977) (delay of 2 weeks).

71. Troubh, *supra* note 70, at 88 (tender offeror needs stockholder's list to determine the demography of investors in the target corporation).

72. *Id.* (stating that management of the target will attempt to coerce its stockholders into not selling their shares by asserting that the price offered for their shares is too low). See *Singer v. Magnavox Co.*, 380 A.2d 969, 971 (Del. Supr. 1977) (where the board of directors of the target corporation initially voted to oppose the tender offer. A letter was sent to the stockholders of the target notifying them of the board's decision and stating that the "[c]ompany was shocked at the inadequacy of the offer of \$8 per share in relationship to a book value in excess of \$11.00").

73. ARANOW & EINHORN, *supra* note 67, at 260 (one form of discriminatory voting arrangement requires 80% approval to effect a merger with a corporation owning 10% of the target's stock); Mullaney, *Guarding Against Takeovers—Defensive Charter Provisions*, 25 BUS. LAW. 1441, 1442-43 (1970) (stating that the requirements of 80% approval to consummate a merger with corporation owning 10% of target's stock is becoming an increasingly popular defensive charter provision); Troubh, *supra* note 70, at 88-9 (the corporation making the tender offer must make sure there are no impediments to gaining control such as an 80% vote requirement); *Defensive Tactics*, *supra* note 21, at 1109-10 (safeguards for incumbent management's control position may be included in the corporate charter or by-laws).

Events following the *Young* case illustrate the use of such an 80% voting requirement. Contran, through its subsidiary Valhi, Inc., purchased 18% of the outstanding stock of PSA, Inc. Such conduct by Valhi "set the alarms ringing in the halls of PSA."

PSA directors met and decided to immediately take some actions that had been discussed off and on for several years, Mr. Shimp [president of PSA] said. "In a deregulated atmosphere we could certainly be a take over target," he added. "The Valhi purchases prompted us to make our move now."

*Decision of the Court of Chancery*

The *Young* court concluded that the proposed merger was unfair to the minority stockholders. The court relied solely upon the plaintiff's contention that the proposed merger would circumvent the charter provision requiring eighty percent approval of the merger. The court concluded that it was unnecessary to pass on the overall fairness of the price per share offered to the minority. Rather, the court held that the entire merger was unfair because Contran had sought to evade a charter provision which had been placed in Valhi's articles of incorporation to protect Valhi's minority stockholders. The court concluded that, in seeking to evade this provision through merger with the wholly owned subsidiary VIS, and also in seeking to eliminate the minority stockholders, Contran had manipulated corporate machinery to accomplish an inequitable result.<sup>74</sup> The court entered a preliminary injunction against the consummation of the merger.<sup>75</sup>

Having reached this decision, the *Young* court discussed

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PSA directors adopted, and have asked shareholders to approve at a special meeting November 20, a series of amendments to the company's incorporation certificate that "are designed to discourage unilateral attempts by outsiders to gain control" of PSA, the proxy material states.

Under the management proposal, PSA's nine directors would be elected in three classes having staggered terms of three years each, making it more difficult to gain control of the board. The present provision for cumulative voting for directors, which the proxy notes would currently allow Valhi to get at least one seat on the board, would be abolished. Under cumulative voting, each share has a number of votes equal to the total number of directors to be elected. Also, *the affirmative vote of at least 80% of the shares outstanding of PSA would be needed to approve any "business combination" with any entity owning 20% or more of PSA shares.*

Sansweet, *An 18% Stake in Pacific Southwest Air's Parent Is Bought by Contran Corp. Unit*, Wall St. J., Oct. 27, 1978, at 17, col. 1 (emphasis supplied).

Valhi challenged the proposed amendments as improper by filing lawsuits in a San Diego federal court and the Delaware chancery court. Valhi further contended that PSA had violated federal securities law. Wall St. J., Nov. 3, 1978, at 33, col. 1. Valhi also solicited proxies, in opposition to the management of PSA, to halt approval by PSA of the amendments. Wall St. J., Nov. 8, 1978, at 14, col. 3. Valhi, however, was narrowly defeated in a bitter six-week proxy fight. Wall St. J., Feb. 22, 1979, at 10, col. 3. PSA acquired an option from Valhi to buy back its stock and suspend all litigation between PSA and Valhi. The adoption of the anti-takeover amendments by PSA, especially the requirement of an 80% vote in favor of any merger involving the holder of 20% or more of PSA's stock, was cited as a crucial factor in rebuffing the takeover bid. Harris, *PSA Passage of Porcupine Amendment Is Cited for Valhi's Moves to Sell Holding*, Wall St. J., Feb. 23, 1979, at 7, col. 1.

74. *Young v. Valhi, Inc.*, 382 A.2d 1372, 1378-79 (Del. Ch. 1978).

75. *Id.* at 1379.

the two business purposes which the defendants had offered to justify eliminating the minority. First, as to defendant's proffered purpose of tax savings, the court ruled that while the merger would have resulted in savings, the goal of eligibility for a consolidated tax return could have been reached by alternative means.<sup>76</sup> Second, as to the possibility of future conflicts of interest between parent and subsidiary, the court stated that in light of the intercorporate dealings which had taken place since Contran had acquired control, the possibility of such conflicts seemed "somewhat contrived."<sup>77</sup> The court concluded that the basic purpose behind the merger was the accomplishment of a long-standing decision on the part of Contran to eliminate the minority stockholders of Valhi.

#### ANALYSIS

The decision in *Young* relies on a number of tenuous assumptions in its application of the "entire fairness" doctrine and business purpose test. The decision's shortcomings may be explained, in part, by the lack of well-established criteria for the Chancery Court to follow in its application of these tests.<sup>78</sup> Yet, the decision may best be explained as a change in policy by the Delaware courts towards greater protection for the interests of minority stockholders.<sup>79</sup> The decision, particularly in the court's application of the business purpose test, exemplifies that this new policy may be an over-reaction to the unfairness of the past policy of exclusively favoring management.

#### *Application of the "Entire Fairness" Test*

The *Young* court's inquiry into the "entire fairness" of the proposed merger before determining the validity of defendant's proffered business purposes constitutes an apparent shift in focus away from the "two tier" standard established by the Delaware Supreme Court. As previously noted,<sup>80</sup> the supreme

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76. *Id.* at 1377.

77. *Id.* The court, however, did not conclude that elimination of such conflicts could never justify a freeze out merger, and indeed, under the proper circumstances, the elimination of such conflicts would constitute sufficient justification for eliminating minority stockholders. McBride, *supra* note 38, at 2244.

78. "While it is clear that the test is two-pronged and the defendants must show both a valid business purpose and the entire fairness of the transaction, the criteria necessary to satisfy either standard are vague." Note, *Delaware Reverses Its Trend in Going-Private Transactions: The Forgotten Majority*, 11 LOY. L.A. L. REV. 567, 593-94 (1978) [hereinafter cited as *Forgotten Majority*].

79. See note 104 *infra*.

80. See text accompanying notes 50-59 *supra*.

court's guidelines first required an evaluation of the validity of the defendant's proffered business purpose. If a valid or bona fide business purpose was found, then, according to the supreme court's test, the court was required to inquire into the "entire fairness" of the terms of the merger. Since both tests are based on the fiduciary obligation which the parent corporation owes the minority stockholders of the subsidiary,<sup>81</sup> reversing the order of these tests may not be fatal to the court's decision. The decision falters, however, in the assumptions the court made in its application of the "entire fairness" test.

The *Young* court assumed that the eighty percent voting requirement was placed in Valhi's articles of incorporation for the benefit of the minority stockholders.<sup>82</sup> As previously noted,<sup>83</sup> the purpose of such a voting requirement is to protect the positions of incumbent management. The Chancery Court's decision produces a somewhat anomalous result. Under the guise of protecting minority stockholders, the court by implication gives judicial approval to a device which compromises basic principles of corporate democracy.<sup>84</sup> Such a provision may prevent a majority of stockholders from receiving a tender offer aimed at a subsequent merger which is resisted by incumbent management who control only a minority of the voting shares.<sup>85</sup>

The *Young* court further assumed that Contran's circumvention of the eighty percent voting requirement was not sanctioned under Delaware law. This assumption is squarely in conflict with the doctrine, which has been applied by the Delaware courts, that the various provisions of the Delaware corporation law are deemed to have "independent legal significance"

81. See text accompanying notes 52-55 *supra*.

82. *Accord, Forgotten Majority, supra* note 78, at 596.

This conclusion, however, ignores the fact that anti-takeover provisions are not enacted to protect minority shareholders but rather to protect incumbent management from the possibility that the acquiring corporation might no longer desire their services. Moreover, the prospect of unemployment for the incumbent management was extremely high here since prior to Contran's acquiring control of Valhi at least an eleven million dollar loss was attributable to mismanagement. Thus, the future effect of the court's holding will be to grant extraordinary protection to the inefficient management of target corporations and to deter the socially desirable acquisition of "sick" corporations by economically sound corporations.

83. See text accompanying note 73 *supra*.

84. See ARANOW & EINHORN, *supra* note 67, at 259 (such discriminatory voting provisions "transform the will of the majority into what may best be described as the tyranny of the minority").

85. *But cf. Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437, 439 (Del. Supr. 1971) (management's use of corporate machinery, in this instance the power to determine the date of the annual stockholders meeting, to perpetuate itself in office, runs contrary to established principles of corporate democracy).

and are of "equal dignity."<sup>86</sup> Under this doctrine, the validity of action taken under one section of the Delaware General Corporation Law is not dependent upon, nor tested by, the requirements of another unrelated section. A result prohibited by one section of the Delaware statutes is entirely permissible if it can be accomplished under the mechanism of another section, despite the fact that the provisions of the former are "rendered nugatory" by compliance with the latter.<sup>87</sup> If an analogy is made between the charter provisions which govern a corporation and the laws which govern a state,<sup>88</sup> then Contran should have been permitted to evade the eighty percent voting requirement by the charter provision permitting the formation of the wholly owned subsidiary VIS despite the result of rendering the eighty percent requirement nugatory. Thus, in light of the *Young* decision, whether the "equal dignity" doctrine is still a viable concept in Delaware corporate law is questionable, and must eventually be resolved by the Delaware Supreme Court.

#### *Application of the Business Purpose Test*

While the *Young* court's discussion of the business purposes advanced by Contran may be interpreted as dictum,<sup>89</sup> it may also be seen as an attempt by the Court of Chancery to ascertain which business purposes proffered in a freeze-out merger are valid in light of the *Singer* and *Tanzer* decisions.<sup>90</sup> The court's application of the business purpose test has its

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86. Willard v. Harrworth Corp., 267 A.2d 577, 579 (Del. Supr. 1970); Orzeck v. Englehart, 41 Del. Ch. 361, 195 A.2d 375 (Del. Supr. 1963); Hariton v. Arco Elecs., 41 Del. Ch. 74, 188 A.2d 123 (Del. Supr. 1963); Brown v. Wolf, No. 4972 (Del. Ch., decided Jan. 15, 1976) (corporation paid dividend which was illegal under the dividend statute but permissible as redemption and retirement of preferred stock). *Contra*, Applestein v. United Board & Carton Corp., 60 N.J. Super. 33, 159 A.2d 146 (Ch. 1960), *aff'd*, 33 N.J. 72, 161 A.2d 474 (1960); Farris v. Glen Alden Corp., 393 Pa. 427, 143 A.2d 25 (1958); Rath v. Rath Packing Co., 257 Iowa 1277, 136 N.W. 2d 410 (1956).

87. Hariton v. Arco Elecs., 41 Del. Ch. at 76, 188 A.2d at 125.

Plaintiff's contention that this sale has achieved the same result as a merger is plainly correct . . . [T]his result is made possible by the overlapping scope of the merger provision [and the sale-of-substantially-all-assets provision] . . . The reorganization here . . . is legal. This is so because the sale-of-assets statute and the merger statute are independent of each other. They are, so to speak, of equal dignity, and the framers of a reorganization may resort to either type of corporate mechanics to achieve the desired end.

88. "The rules which govern the interpretation of statutes and contracts apply to the interpretation of corporate charters." Sundlun v. Executive Jet Aviation, Inc., 273 A.2d 282, 285 (Del. Ch. 1970).

89. McBride, *supra* note 38, at 2243-44 n.56.

90. *Id.* at 2245 ("Only in [*Young*] has a Delaware Court begun the concrete search for specific purposes which will justify the elimination of minority shareholders . . .").

shortcomings which may be explained, in part, by the vagueness of the rule itself.<sup>91</sup> The major problems of the *Young* and *Singer* decisions is their assumption that all freeze-out mergers are alike.

### *Application of Precedent*

The *Young* court, ostensibly relying on *Singer*, was satisfied that the merger should be enjoined merely because the *basic* purpose of the merger was the elimination of minority stockholders.<sup>92</sup> The *Singer* decision, however, was limited to the situation where the *sole* purpose of the merger was the elimination of the minority.<sup>93</sup> This apparent discrepancy may be reconciled by a review of the procedural histories of each case. In *Singer*, defendants had in effect conceded that the merger was accomplished solely to rid the parent corporation of the minority stockholders of the subsidiary<sup>94</sup> for the purposes of their motion to dismiss plaintiff's complaint on the grounds that it failed to state a claim upon which relief could be granted.<sup>95</sup> Thus the *Singer* court did not have before it the issue of the acceptability of any particular business purpose. In *Young*, on the other hand, defendants asserted the business purposes of tax savings and elimination of conflicts of interest.<sup>96</sup> Thus the *Young* court's application of the "basic purpose" rule does not appear to be inconsistent with the *Singer* decision.

The *Young* court indicated that a proffered business purpose would not be valid if the minority could establish an alternative means of reaching the same goal which did not require their elimination.<sup>97</sup> The Massachusetts Supreme Judicial Court recently used the same line of reasoning in *Wilkes v. Springside Nursing, Inc.*<sup>98</sup> By applying the doctrine of "least restrictive alternative,"<sup>99</sup> the Massachusetts court allowed the minority to demonstrate that an equally acceptable alternative, less detri-

91. See *Tanzer v. International Gen. Indus., Inc.*, 379 A.2d 1121, 1123 (Del. Supr. 1977) ("The parties, following the language of some of the cases, have analyzed the problem in terms of business purpose . . . , but it seems to us that that is not helpful because, at best, the phrase is ambiguous . . . .").

92. 382 A.2d at 1378.

93. *Singer v. Magnavox Co.*, 380 A.2d 969, 980 (Del. Supr. 1977).

94. *Singer v. Magnavox Co.*, 367 A.2d 1349, 1353 (Del. Ch. 1976), *rev'd in part, aff'd in part*, 380 A.2d 969 (Del. Supr. 1977). The Delaware Supreme Court affirmed the holding of the lower court that the Delaware Securities Act was not applicable to the transaction due to lack of jurisdiction. 380 A.2d at 980-82.

95. 367 A.2d at 1351.

96. 382 A.2d at 1377.

97. McBride, *supra* note 38, at 2244.

98. 370 Mass. 842, 353 N.E.2d 657 (1976).

99. Murdock, *supra* note 2, at 656.

mental to the minority's interest, was available to the controlling stockholders.<sup>100</sup> The *Wilkes* case, however, involved majority stockholders of a closely-held corporation severing the sole minority shareholder from the corporate payroll and refusing to elect him as a salaried officer and director. Despite this apparent discrepancy, both situations involve the involuntary ouster of the minority shareholders by the majority.<sup>101</sup> Thus, the use of

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100. The court stated:

When an asserted business purpose for their action is advanced by the majority . . . , we think it is open to minority stockholders to demonstrate that the same legitimate objective could have been achieved through an alternative course of action less harmful to the minority's interest. . . . If called on to settle a dispute, our courts must weigh the legitimate business purpose, if any, against the practicability of a less harmful alternative.

370 Mass. at 851-52, 353 N.E.2d at 663.

101. While there is no set definition of a close corporation, there is general agreement as to its attributes. Its stockholders are few in number, and ordinarily are active in the business. Its shares are not publicly traded and usually are not traded at all. Thus, there is no market for the shares of a close corporation, which presents difficulties for the stockholder who wishes to leave the enterprise. Its scope of operations is usually limited and the amount of capital invested, as compared with a publicly held corporation, is relatively small. FREY AND CHOPER, *supra* note 38, at 519.

The court in *Wilkes* noted the precarious situation of the minority shareholder of a closely-held corporation:

In [*Donahue v. Rodd Electrotpe Co. of New England, Inc.*, 367 Mass. 578, 328 N.E.2d 505 (1975)] we recognized that one peculiar aspect of close corporations was the opportunity afforded to majority stockholders to oppress, disadvantage or "freeze out" minority stockholders. In *Donahue* itself, for example, the majority refused the minority an equal opportunity to sell a ratable number of shares to the corporation at the same price available to the majority. The net result of this refusal, we said, was that the minority could be forced to "sell out at less than fair value," . . . since there is by definition no ready market for minority stock in a close corporation.

"Freeze outs," however, may be accomplished by the use of other devices. One such device which has proved to be particularly effective in accomplishing the purpose of the majority is to deprive minority stockholders of corporate offices and of employment with the corporation. . . . This "freeze-out" technique has been successful because courts fairly consistently have been disinclined to interfere in those facets of internal corporate operations, such as the selection and retention or dismissal of officers, directors and employees, which essentially involve management decisions subject to the principle of majority control. . . . As one authoritative source has said, "[M]any courts apparently feel that there is a legitimate sphere in which the controlling [directors or] shareholders can act in their own interest even if the minority suffers." . . .

The denial of employment to the minority at the hands of the majority is especially pernicious in some instances. A guaranty of employment with the corporation may have been one of the "basic reason[s] why a minority owner has invested capital in the firm." . . . The minority stockholder typically depends on his salary as the principal return on his investment, since the "earnings of a close corporation . . . are distributed in major part in salaries, bonuses and retirement benefits." . . . Other noneconomic interests of the minority stockholder are like-



this line of reasoning by the *Young* court does not appear to be fatal to the court's decision.<sup>102</sup>

Although the *Singer* court was properly focusing only on the facts before it, namely a merger with a dummy corporation set up solely to eliminate minority shareholders, the court's analysis never reached the question of whether the validity of all freeze-out mergers rest on the majority stockholders' establishment of a business purpose.<sup>103</sup> The court did not distinguish between the legitimacy of forced displacements of public stockholders, which are incidental to mergers between functioning enterprises, and displacements which result solely from compelled internal rearrangements of a single business controlled by a few individuals retrieving the outstanding publicly held shares. The former are referred to as "two-step" mergers; the latter are referred to as "going-private." The going-private freeze-out differs from the two-step freeze-out in that a combination of two operating corporate entities is not involved. In going private, controlling stockholders who are responsible for management of the corporation seek to terminate public ownership in the enterprise. In such circumstances, the fiduciary duty of the majority stockholders is unquestionable and a valid business purpose should be required by the majority before eliminating the minority's interest in the enterprise.<sup>104</sup>

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wise injuriously affected by barring him from corporate office. . . . Such action severely restricts his participation in the management of the enterprise, and he is relegated to enjoying those benefits incident to his status as a stockholder. . . . In sum, by terminating a minority stockholder's employment or by severing him from a position as an officer or director, the majority effectively frustrate[s] the minority stockholder's purposes in entering on [sic] the corporate venture and also deny him an equal return on his investment.

370 Mass. at 849-50, 353 N.E.2d at 662-63.

102. See McBride, *supra* note 38, at 2242 ("It might well be questionable whether the purpose is bona fide, at least as regards the fiduciary obligation of a majority shareholder to the minority shareholder, when the proffered purpose does not require the elimination of minority shareholders in order to come to fruition"); Murdock, *supra* note 2, at 656 (stating, without elaboration, that "[t]his innovative theory has much to recommend it").

103. See Brudney and Chirelstein, *supra* note 8, at 1356 (contending that a potential error of the *Singer* decision is a failure to perceive the contextual distinctions among freeze-out mergers).

104. The *Singer* court was not faced with a going-private merger. The lower court expressly recognized this when it stated:

In each of these cases [relied upon by plaintiffs] it was charged that a private corporation had gone public, sold stock and received needed capital thereby. The original stockholders retained controlling interest. Later, after some degree of prosperity, but at a time when depressed market conditions caused the stock to be worth considerably less than the price for which it originally sold, the majority, through the formation of a shell corporation, caused or attempted to cause the corporation to be merged with the majority's wholly owned "shell," with the minor-

In *Young*, the court by implication recognized that it was not dealing with a going-private merger. The court noted that Contran's actions were the effectuation of a long-standing plan to eliminate the minority stockholders.<sup>105</sup> Yet, the court failed to make any distinction between the going-private merger and the two-step merger. The court focused on the merger itself, instead of the circumstances which eventually led to the merger.

### CONCLUSION

The *Young* decision represents the implementation by the Court of Chancery of the new policy of the Delaware Supreme Court affording broad protection to the interests of minority stockholders. This represents a welcome change—from judicial reluctance to interfere with corporate activities—to a posture of broad review of freeze-out mergers so as to protect minority shareholders' interests. It is evident that any sign of manipulation by the majority will be looked upon with disfavor by the Delaware courts. In this light, and given the fact that the Delaware Supreme Court has expressly rejected the concept that

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ity shareholders being paid off and eliminated for a cash price substantially less than the cost of their initial investment . . . . Admittedly there seems something fundamentally inequitable about such a stark progression of events and perhaps a use of the Delaware statute should not be permitted which would allow those with controlling interests who originally sought public participation to later kick out public investors for the sole reason that they have outlived their utility to those in control and are made easy pickings by existing market conditions. *However . . . according to the complaint, such a situation does not exist here .*

367 A.2d 1349, 1358 (Del. Ch. 1976) (emphasis added). The supreme court could have limited its decision to the apparent breach of fiduciary duty by the officers and directors of the target corporation. After initially opposing the tender offer, the management of the target compromised its position and received employment contracts and stock options in exchange. See Brudney and Chirelstein, *supra* note 8, at 1364-65 (the compromise between the managements of the tender offeror and the target corporation raised the issue of "whether the transaction was truly arm's length, or whether the [target corporation's] management had in fact received a personal consideration for its change of position"). Instead, the Delaware Supreme Court took this opportunity to reject the legislative policy favoring management and grant extensive protection to minority stockholders involved in a freeze-out merger. See Brudney and Chirelstein, *supra* note 8, at 1365 ("[T]he new . . . enforcement of fiduciary obligation in *Singer* is a welcome development in the jurisprudence of this vital jurisdiction"); Murdock, *supra* note 2, at 643 (stating that the *Singer* and *Tanzer* decisions "may well represent a reversal in the development of the permissive, management-oriented body of corporate law which had come to be characteristic of Delaware. . . ."); *Restrictions*, *supra* note 7, at 118 (stating that the Delaware Supreme Court has "upset a longstanding trend in the Delaware law of corporate mergers and embarked on a new course of protection for minority shareholders involved in freezeout mergers").

105. 382 A.2d at 1375.

technical compliance with applicable statutory provisions will insulate the transaction from judicial review,<sup>106</sup> it seems unlikely that the "equal dignity" of statutes doctrine will continue to have any validity in Delaware corporate law. By its very definition, the doctrine manipulates one corporate statute to render another nugatory. This trend suggests that minority stockholders of Delaware corporations may expect greater protection in other corporate areas besides freeze-outs.<sup>107</sup>

The *Young* decision also exemplifies the problem encountered with such a sweeping reform movement. Ironically, in its attempt to protect minority stockholders, the *Young* court has given tacit approval to a mechanism designed to protect the positions of incumbent management. In the future, the Delaware courts will, hopefully, give more consideration to the future impact of their decisions rather than merely considering their immediate result. Furthermore, in an attempt to rectify past abuses stemming from adherence to the legislative mandate to create a "favorable climate" for management and eliminate the inequities of the going-private merger, the Delaware courts have classified all freeze-out mergers together. Judicial scrutiny has demanded that the two-step or integrated take-over meet the same criteria as the going private freeze-out. This fails to recognize the important contextual distinctions among freeze-outs and the different criteria which are appropriate for each.

As previously noted, the Delaware courts have introduced a radically different policy to corporate law. Delaware courts once favored management and the majority stockholder to the exclusion of the minority. Now, the courts are favoring minority stockholders and any suspect action by management is highly susceptible to challenge. While this litigation may be necessary in order to effectuate such radical change, eventually one hopes to see a balance struck between the needs of both management, representing the majority, and minority stockholders.

*David A. Schlanger*

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106. *Singer v. Magnavox Co.*, 380 A.2d at 975.

107. See *In re Arthur Treacher's Fish & Chips of Ft. Lauderdale, Inc.*, 386 A.2d 1162, 1166-67 (Del. Ch. 1978) (imposing the fiduciary obligation of *Singer* upon dissolution of joint venture).