

AN “EASILY SIDE-STEPPED” AND “LARGELY HORTATORY” GESTURE?: EXAMINING THE 2005 AMENDMENT TO SECTION 271 OF THE DGCL

INTRODUCTION

Section 271 of the Delaware General Corporation Law (“DGCL”) grants stockholders final approval on transactions that will sell all or substantially all of a corporation’s assets via a vote. In 2004, the Delaware Court of Chancery, in *Hollinger Inc. v. Hollinger International, Inc.*,¹ addressed in dicta whether the stockholders possessed the right to vote on a transaction that sold all or substantially all of the assets of a subsidiary of the corporation.² In 2005, Delaware amended section 271 of the DGCL to address the interpretive issues brought to light by *Hollinger*. This Comment examines the nature of the 2005 amendment and argues against an expansive reading of the amendment that would stretch its implications beyond the scope of section 271 into other sections of the DGCL. Such an expansive reading would be contrary to both Delaware jurisprudence and the Delaware corporate model;³ additionally, an expansive reading is unnecessary because Delaware’s existing standards of review provide adequate stockholder protections.

Corporate law statutes are state laws that serve as default rules governing the relationship between two primary corporate players: the board of directors and the principal owners of the corporation—the stockholders.⁴ For better or worse,⁵ the DGCL is the basis of the preeminent body of law regulating corporate governance in America.⁶ In conjunction with the corporate jurisprudence shaped by the Delaware Supreme Court and the Delaware Court

¹ 858 A.2d 342 (Del. Ch. 2004).

² See *infra* Part I.

³ See *infra* Part III.

⁴ See Melvin Aron Eisenberg, *Megasubsidiaries: The Effect of Corporate Structure on Corporate Control*, 84 HARV. L. REV. 1577, 1587 (1971).

⁵ See generally William J. Carney & George B. Shepherd, *The Mystery of Delaware Law’s Continued Success*, 2009 U. ILL. L. REV. 1 (arguing that Delaware corporate law does not possess superior traits because the high uncertainty leads to excessive and costly litigation).

⁶ See, e.g., Bradley R. Aronstam et al., *Delaware’s Going-Private Dilemma: Fostering Protections for Minority Shareholders in the Wake of Siliconix and Unocal Exploration*, 58 BUS. LAW. 519, 519 n.1 (2003) (stating that Delaware corporate law “has become the nation’s preeminent source of corporate law”).

of Chancery,⁷ the DGCL governs the relationship between the board and stockholders for more than 615,000 business entities.⁸ Among these entities are nearly 60% of the companies on the Fortune 500 and the New York Stock Exchange.⁹

The DGCL charges the board of directors with the primary responsibility of running the business affairs of the corporation.¹⁰ While the board of directors is empowered with broad discretion over the management of the business, stockholders still possess important powers, such as the right to elect directors, the right to vote on mergers, the right of appraisal, and the right to vote on the sale of all or substantially all of the assets of the corporation.¹¹ The last of these rights is codified in section 271 of the DGCL.¹²

At its core, section 271 is a measure enacted to protect the interests of shareholders.¹³ The need for such protections arose in the nineteenth century, when legal thinkers viewed the merging of two independent corporations with deep suspicion.¹⁴ The jurisprudence of the early nineteenth century did not view the sale of all of a corporation's assets as a special or unique transaction requiring additional stockholder protections.¹⁵ Over time, however, the sale of all of a corporation's assets began to be viewed differently from a pure economic operation, and these transactions "took on some color of being fundamental"¹⁶ as courts began viewing sales of all assets as a fundamental

⁷ Jill E. Fisch, *The Peculiar Role of Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1064 (2000) (arguing that Delaware is unusual in corporate law for its heavy reliance on judge-made law).

⁸ Hon. E. Norman Veasey & Christine T. Di Guglielmo, *What Happened in Delaware Corporate Law and Governance from 1992–2004?*, 153 U. PA. L. REV. 1399, 1403 (2005).

⁹ *Id.*

¹⁰ DEL. CODE ANN. tit. 8, § 141(a) (2007).

¹¹ *Id.* §§ 211, 251, 262, 271.

¹² *Id.* § 271.

¹³ Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 228 (1962) ("[S]pecial statutory provisions on sales of all assets [are viewed] as protections to shareholders, designed to temper management's centralized control of so important a transaction.").

¹⁴ *Id.* at 246–48 (describing the nineteenth-century legal mind to view mergers as "terminating" a corporate life—a "legal trauma"). The nineteenth-century legal mind viewed the stockholders' contract with the corporation as something sacred. William J. Carney, *Fundamental Corporate Changes, Minority Shareholders, and Business Purposes*, 1980 AM. B. FOUND. RES. J. 69, 69.

¹⁵ Manning, *supra* note 13, at 254 ("The law of the nineteenth century was ambivalent about corporate sales of all assets."). *But see* Carney, *supra* note 14, at 85–97 (arguing that such a sale required unanimous stockholder consent).

¹⁶ Manning, *supra* note 13, at 254 (citations omitted).

change requiring stockholder consent, much like a merger.¹⁷ This development occurred because an asset sale could be structured to bring about identical economic results as a merger.¹⁸ Consequently, the provisions of section 271 were necessary to maintain consistency in the law and to protect substantive stockholder rights from being infringed upon by lawyers structuring mergers as asset sales.¹⁹

While mergers or sales of corporate assets are no longer viewed as the equivalent of legal “murder,”²⁰ stockholders still possess voting rights to protect them from transactions such as mergers and asset sales.²¹ Since the inception of these corporate protections, corporate law has become increasingly complex and technical.²² Section 271 was recently amended in 2005 to address what may, to casual observers, appear to be a minor and technical issue: the nature of the protections afforded to stockholders when a corporation undertakes a subsidiary asset sale.²³ This seemingly narrow issue is extremely important, however, because most public companies no longer directly hold their valuable operating assets.²⁴ Indeed, ultimate ownership of business assets is usually two or more times removed from the parent corporation.²⁵

Corporations place their assets in subsidiaries for a variety of perfectly legitimate business reasons, such as a desire to limit liabilities to third parties for certain business operations or to minimize tax liabilities.²⁶ The ever-increasing complexity of corporate structures has a profound impact on the

¹⁷ See Carney, *supra* note 14, at 85–97 (discussing the history of the court’s treatment of sales of all assets).

¹⁸ Manning, *supra* note 13, at 256; see also Carney, *supra* note 14, at 70 (noting that under the nineteenth century’s contract view of corporate law, each stockholder had a fundamental right in contract law “to prevent alteration of the business in which he or she invested”).

¹⁹ Manning, *supra* note 13, at 256–57.

²⁰ *Id.* at 244–45 (discussing the modern view of the corporation as a type of “social organism” and contrasting this view with the nineteenth century vision of the corporation as an entity “virtually alive” that could both “‘come into existence’ and ‘die’”).

²¹ The change in perception also relates to the changing view of the corporate charter, from one of a contract enforceable by each stockholder to one of a contract with a majority of stockholders (or at least subject to change by voting rules chosen by the stockholders). See Carney, *supra* note 14, at 71.

²² *Id.*

²³ H.R. 150, 143rd Gen. Assem., Reg. Sess. (Del. 2005).

²⁴ *Hollinger Inc. v. Hollinger Int’l, Inc.*, 858 A.2d 342, 374 (Del. Ch. 2004) (“[I]t is more unusual than typical for public companies to directly hold their valuable operating assets.”).

²⁵ See Eisenberg, *supra* note 4, at 1577 (asserting that subsidiary corporations own a large proportion of American business assets).

²⁶ *Hollinger*, 858 A.2d at 374.

efficacy of stockholder protection provisions such as section 271.²⁷ Legally, the right to vote on the subsidiary's stock inheres in the parent. Consequently, the board of directors of the parent could complete transactions, such as mergers of subsidiaries, without triggering a vote by the parent corporation's stockholders, which would be required by the DGCL if the assets were held directly by the parent.²⁸

The importance of this issue is underscored by the following hypothetical: Suppose that there are two publicly held American corporations specializing in the production of high-end toys.²⁹ These two companies, DreamTown Toys, Inc. (DreamTown) and White-Picket Fence Toy Co. (WPF), share a similar corporate background and history. They also each control large percentages of the high-end toy market. The two companies, mindful of an upcoming election and a possible change in antitrust enforcement, are eager to merge as quickly as possible. Furthermore, the companies want to merge at the lowest possible cost and to avoid unnecessary stockholder votes.

Prior to the 2005 amendment to section 271, their goals arguably could have been achieved by dropping the assets of DreamTown into a subsidiary and then selling those assets to WPF.³⁰ This Comment argues that although the 2005 amendment clearly requires a vote on this transaction, neither the amendment nor the case law prevents DreamTown and WPF from completing an economically similar transaction that avoids section 271's stockholder voting requirement. Section 271, in its current form, leaves the directors another means to the same end.

To accomplish this, DreamTown could create a subsidiary and, without stockholder approval, transfer all of its assets into the wholly owned subsidiary, receiving as consideration 100 shares in the new subsidiary. DreamTown could subsequently complete the transaction without triggering a stockholder vote as follows: WPF could merge DreamTown's subsidiary with

²⁷ Eisenberg, *supra* note 4, at 1577.

²⁸ See *infra* Part II.A (discussing the protection of corporate form and the corporate veil-piercing doctrine).

²⁹ This hypothetical is drawn from a number of sources. See Leo E. Strine, Jr., *Categorical Confusion: Deal Protection Measures in Stock-for-Stock Merger Agreements*, 56 BUS. LAW. 919, 920–21 (2001) [hereinafter Strine, *Categorical Confusion*]; Leo E. Strine, Jr., *The Social Responsibility of Boards of Directors and Stockholders in Change of Control Transactions: Is There Any "There" There?*, 75 S. CAL. L. REV. 1169, 1177–83 (2002); Mark A. Morton & Michael R. Reilly, *Clarity or Confusion: The 2005 Amendments to Section 271 of the Delaware General Corporation Law*, DEAL POINTS (A.B.A./Section of Bus. Law, Comm. on Negotiated Acquisitions, Chi., Ill.), Fall 2005, at 11–12.

³⁰ See *infra* Part I.

either WPF itself or a subsidiary of WPF (the “Cash-Out Merger”).³¹ If WPF were to offer DreamTown cash for its 100 shares in the subsidiary as consideration for the merger, the net effect of the merger would be identical to an asset sale under section 271.³² Despite the similar economic result, under Delaware jurisprudence the transaction would likely be governed by section 251, not by section 271.³³ Thus, despite the statutory precautions meant to protect the stockholders, the merger would bring about the same economic result without triggering any of section 271’s protective measures.³⁴

By focusing on the Cash-Out Merger, this Comment argues that the protections provided by section 271 may still be easily side-stepped, despite the 2005 amendment to the statute. Furthermore, despite assertions to the contrary,³⁵ this result is not only consistent with the Delaware corporate model,³⁶ but also creates the best result for stockholders.³⁷ This Comment argues that the Cash-Out Merger designed to evade the voting requirement of section 271 should not be found illegal or inequitable per se, but should be subject to the “*Revlon* standard” of review,³⁸ which is in itself a formidable shareholder protection.

Part I examines the 2005 amendment to section 271 of the DGCL and *Hollinger Inc. v. Hollinger International, Inc.*, the case that precipitated the amendment. Part II explains the principles of Delaware law that enable a board of directors to avoid the voting requirement of section 271. Part III discusses the “Delaware corporate model,” which results in a certain degree of uncertainty in predicting whether a Delaware court would allow a board of directors to evade the voting requirement of section 271. Part IV explores the various standards of review that may be applicable to the foregoing hypothetical transaction and endorses the *Revlon* standard. Part V then argues that this approach is consistent with Delaware jurisprudence.

³¹ Either with WPF itself or, more likely, with a subsidiary of WPF.

³² The economic results are extremely similar in this case, as the relatively new subsidiary would presumably have few liabilities.

³³ DEL. CODE ANN. tit. 8, § 251 (2007); *see also* discussion *infra* Part II.B.

³⁴ *See infra* Parts II–IV.

³⁵ *See infra* text accompanying notes 64–66.

³⁶ *See* discussion *infra* Parts II–III.

³⁷ *See* discussion *infra* Parts IV–V.

³⁸ *See Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

I. *HOLLINGER* AND THE 2005 AMENDMENT TO SECTION 271

Given the DGCL's status in the world of corporate transactions, any revisions to it are of great interest to corporate practitioners.³⁹ A clear, precise statute provides transactional attorneys with clear guidelines within which they may confidently structure deals in the best interests of their clients.⁴⁰ Conversely, imprecise draftsmanship leaves practitioners on much less certain ground.

One of the benefits of incorporating in Delaware is the general ease and relative promptness with which Delaware may change the DGCL when an issue of interpretation becomes critical.⁴¹ While Delaware's constitution sets a high bar for amending the DGCL,⁴² the economic (and thus political) importance to Delaware of maintaining its leadership in the area of corporate law creates a major incentive for state politicians to act when clarity or reform is needed.⁴³ Consequently, the state legislature is quick to update or modify laws as necessary to supplement the traditional common law basis of Delaware corporate law.⁴⁴ The problem, of course, is that even a well-drafted change to the DGCL can often leave issues unresolved.

One such example of this drafter's dilemma is the recent amendment of section 271 of the DGCL.⁴⁵ To address an interpretive issue brought to the

³⁹ See Veasey & Di Guglielmo, *supra* note 8, at 1403.

⁴⁰ *Hollinger Inc. v. Hollinger Int'l, Inc.*, 858 A.2d 342, 374 (Del. Ch. 2004) (“[T]he virtues that accompany all bright-line tests . . . [are] that they provide clear guidance to transactional planners and limit litigation.”).

⁴¹ John J. Paschetto, *Statutory Clarification Regarding Sales of All or Substantially All Assets of a Delaware Corporation* (2005) (unpublished manuscript, on file with author).

⁴² Compare DEL. CONST. art. IX, § 1 (requiring a two-thirds majority in the House of the General Assembly to approve changes to the general incorporation law), with N.Y. CONST. art. X, § 1 (containing no language referring to a two-thirds majority to amend general incorporation law).

⁴³ See Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face*, 30 DEL. J. CORP. L. 673, 679–80 (2005) [hereinafter Strine, *The Delaware Way*] (“But for us, a small state, it is vital that we remain the leader in corporation law. That leadership produces thousands of Delaware jobs and nearly a quarter of our state’s budget revenues.”); see also E. Norman Veasey, *Musings From The Center of the Corporate Universe*, 7 DEL. L. REV. 163, 165 (2004) (noting that Delaware’s preeminence in corporate law “has greatly benefited Delaware’s revenues along with the ‘ripple effect’—Bankruptcy Court, intellectual property, hotels, services, personal income tax on lawyers, etc.”).

⁴⁴ See Marcel Kahan & Edward B. Rock, *Our Corporate Federalism and the Shape of Corporate Law* (N.Y.U. Law Sch., Working Paper No. 04–020, 2004), available at <http://ssrn.com/abstract=564685> (noting that Delaware corporate law relies on judge-made law).

⁴⁵ See Morton & Reilly, *supra* note 29, at 2–13 (discussing a number of issues left unresolved by the 2005 amendments, including the issue addressed in this Comment).

fore in *Hollinger Inc. v. Hollinger International, Inc.*,⁴⁶ in 2005 the Delaware legislature amended section 271 to clarify that a sale of all the assets of a wholly owned and controlled subsidiary will trigger the vote of the parent corporation's stockholders when the subsidiary's assets represent substantially all of the assets of the parent corporation on a consolidated basis.⁴⁷

Prior to the 2005 amendments, section 271 of the DGCL provided that a board of directors or a governing body "may . . . sell, lease, or exchange all or substantially all of its property and assets . . . as authorized by a resolution adopted by the holders of a majority of the outstanding stock of the corporation entitled to vote thereon."⁴⁸ The pre-2005 version of the statute did not speak to whether section 271's stockholder vote requirement would be triggered by a sale of substantially all of a subsidiary corporation's assets.⁴⁹ Additionally, the pre-2005 version did not address how the law would treat a sale, lease, or exchange of substantially all of a wholly owned and controlled subsidiary corporation's assets when the subsidiary's assets represented substantially all of the consolidated enterprise's assets.⁵⁰

The lack of guidance in the statute as to the treatment of subsidiary asset sales led to differing beliefs among practitioners on whether the sale of the subsidiary's assets would trigger the vote.⁵¹ Many practitioners believed that a sale, lease, or exchange of substantially all of a subsidiary's assets would not trigger a vote, even in the extreme event where those assets represent substantially all of the consolidated enterprise's holdings.⁵² This interpretation was supported not only by a literal reading of the statute,⁵³ but also, seemingly,

⁴⁶ 858 A.2d 342 (Del. Ch. 2004).

⁴⁷ See Paschetto, *supra* note 41, at 3; see also Morton & Reilly, *supra* note 29, at 3.

⁴⁸ DEL. CODE ANN. tit. 8, § 271 (2004).

⁴⁹ *Id.*

⁵⁰ *Id.*

⁵¹ See Paschetto, *supra* note 41, at 1. Practitioners were divided over this issue because the courts had not yet had an opportunity to address it.

⁵² See Mark A. Morton & Michael K. Reilly, *Stockholder Voting and Subsidiary Asset Sales After Hollinger*, DEAL POINTS (A.B.A./Section of Bus. Law, Comm. on Negotiated Acquisitions, Chi., Ill.), Fall 2004, at 3 ("Prior to *Hollinger*, many Delaware practitioners believed that a vote of the stockholders of a parent corporation was not required to approve a sale of assets by a subsidiary, even if the assets constituted all or substantially all of the assets of the parent corporation on a consolidated basis."). The prevailing viewpoint was that if a parent corporation sold its shares in a subsidiary that held substantially all of the consolidated enterprise's assets, section 271 would be implicated because the parent corporation was selling its assets. See Paschetto, *supra* note 41, at 1.

⁵³ Morton & Reilly, *supra* note 52, at 3.

by case law.⁵⁴ Dissenting practitioners held the view that the courts would not read the statute so technically as to render it practically meaningless.

The *Hollinger* decision considerably undermined the technical interpretation of section 271.⁵⁵ In *Hollinger*, a stockholder sued to enjoin the sale of substantially all the assets of a subsidiary of the corporation in which the stockholder–plaintiff held a majority of the voting power.⁵⁶ The stockholder–plaintiff’s argument for an injunction rested on three different grounds.⁵⁷ Among these was the theory that an injunction should be issued under section 271: “[I]t is clear that a sale of the [subsidiary] satisfies the quantitative and qualitative test used to determine whether an asset sale involves substantially all of a corporation’s assets.”⁵⁸ The plaintiffs argued that the sale of the subsidiary would deprive the entire enterprise of substantially all of its value.⁵⁹

The Court of Chancery declined to take this opportunity to pass judgment on whether the plaintiff’s claim under section 271 had any merit;⁶⁰ however, in dicta, the court raised serious misgivings about a technical and strict interpretation of section 271.⁶¹ Although the court recognized both the benefits of a strict interpretation to corporate practitioners⁶² and the consistency such an interpretation would have with Delaware’s director-centered jurisprudence,⁶³ the court nonetheless seemed to place greater emphasis on the considerations weighing against such an interpretation.

⁵⁴ *Id.* at 3–4.

⁵⁵ *Id.* at 10.

⁵⁶ *Hollinger Inc. v. Hollinger Int’l, Inc.*, 858 A.2d 342, 346 (Del. Ch. 2004).

⁵⁷ *Id.* The plaintiff also argued that an injunction should be issued because the transaction “inequitably denuded” the plaintiff’s rights as the controlling stockholder. *Id.* The plaintiff argued in the alternative that an equitable right to vote existed because the board rushed to sell the subsidiary in a manner that inhibited the plaintiff–stockholder from wielding the full power that comes with being a controlling stockholder. *Id.*

⁵⁸ *Id.* The “quantitative and qualitative test” language refers to the so-called *Gimbel* test, in which the Court of Chancery established the principle that if the sale of assets is “quantitatively vital to the operation of the corporation and is out of the ordinary and substantially affects the existence and purpose of the corporation,” then section 271 is implicated. *Gimbel v. Signal Cos., Inc.*, 316 A.2d 599, 606 (Del. Ch. 1974).

⁵⁹ *Hollinger*, 858 A.2d at 346.

⁶⁰ *Id.* at 348. Instead, Vice Chancellor Strine held that although the sale was of a major asset, the subsidiary would still “retain considerable assets that are capable of generating a substantial cash flow.” *Id.* at 348–49. Thus, section 271 was not implicated. *Id.* at 349.

⁶¹ *Id.* at 374.

⁶² *Id.* The benefits included clear guidance to transactional planners and limitation of litigation on the issue. *Id.*

⁶³ *Id.* (“That approach also adheres to the director-centered nature of our law, which leaves directors with wide managerial freedom subject to the strictures of equity It is through this centralized management that stockholder wealth is largely created, or so the thinking goes.”).

The fear that a strict interpretation would render section 271 a “largely hortatory” gesture that would be “easily side-stepped” was among the considerations favoring a less literal approach.⁶⁴ Applying the strict interpretation would leave section 271 as “an illusory check on unilateral board power.”⁶⁵ The court stated that this result would be untenable in an era when the majority of public companies hold most of their assets in subsidiaries.⁶⁶

The court’s decision in *Hollinger* seemed to further complicate the section 271 analysis. The decision also left many practitioners on uneasy ground when advising clients on the scope and reach of section 271.⁶⁷ To resolve the uncertainty among corporate practitioners in the wake of *Hollinger*, the legislature amended section 271 in 2005.⁶⁸ The Delaware legislature amended subsection (c), providing that for the purposes of section 271, “the property and assets of the corporation include the property and assets of any subsidiary of the corporation.”⁶⁹ The amended subsection (c) goes on to define a subsidiary as “any entity wholly-owned and controlled, directly or indirectly, by the corporation.”⁷⁰ Importantly, the Delaware legislature also added the provision that “[n]otwithstanding subsection (a) of this section, except to the extent the certificate of incorporation otherwise provides, no resolution by stockholders or members shall be required for a sale, lease or exchange of property and assets of the corporation to a subsidiary.”⁷¹

Read in its entirety, the post-2005 version of section 271 supports the holding and dicta of *Hollinger*.⁷² The language added to section 271 makes clear the legislature’s intention that for the purposes of section 271, courts should “pierce the corporate veil”⁷³ and pass the vote through the parent

⁶⁴ *Id.*

⁶⁵ *Id.* at 348.

⁶⁶ *Id.* at 374.

⁶⁷ See Morton & Reilly, *supra* note 52, at 17 (“The Court’s decision in *Hollinger* has complicated the analysis as to whether a stockholder vote of a parent corporation is required in connection with the sale of assets by its subsidiary when the assets to be sold constitute all or substantially all of the assets of the parent corporation on a consolidated basis.”).

⁶⁸ H.R. 150, 143rd Gen. Assem., Reg. Sess. (Del. 2005).

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² R. Franklin Balotti, *Recent Developments in Delaware Corporation Law* (ALI-ABA Course of Study, Dec. 1–2, 2005), WL SL046 ALI-ABA 271, 355.

⁷³ See *infra* Part III.A.

corporation to its stockholders if the subsidiary's assets represent all or substantially all of the consolidated enterprise's assets.⁷⁴

Interestingly, the amendment clarified the board's ability to move assets within the corporate family without a vote, by stipulating that "no stockholder vote is required for a sale, lease, or exchange of assets to or with a direct or indirect wholly owned and controlled subsidiary."⁷⁵ Thus, the 2005 amendment made clear that a stockholder vote is not required to "drop down" all or substantially all of a parent corporation's assets into a subsidiary.⁷⁶ It did not, however, address whether a parent corporation can structure a transaction to avoid triggering a section 271 vote.⁷⁷

The 2005 amendment actually supports one step of the Cash-Out Merger discussed in this Comment because the amendment makes clear that DreamTown could drop all its assets into a subsidiary without any stockholder approval. Yet, the 2005 amendment does not address how the courts should ultimately decide to treat the Cash-Out Merger, which is designed to evade section 271's voting requirement. Delaware jurisprudence suggests that courts would treat the Cash-Out Merger, which would bring about the same economic results as a sale under section 271, differently from a straightforward asset sale.

II. THE PROTECTION OF CORPORATE FORM AND THE DOCTRINE OF INDEPENDENT LEGAL SIGNIFICANCE

Delaware jurisprudence has a long history of respecting the dignity of the corporate form in the context of the parent–subsidiary relationship. This Part analyzes the history of both this doctrine and the doctrine of independent legal significance, which allows a board of directors to choose alternate means to the same end. Taken together, these two doctrines provide the basis for limiting the implications of the 2005 amendment to section 271.

A. *The Protection of the Corporate Form*

Delaware courts have traditionally respected the integrity of the parent–subsidiary relationship by viewing the two corporations as separate and distinct

⁷⁴ See *infra* Part III.A; see also Paschetto, *supra* note 41, at 3.

⁷⁵ Balotti, *supra* note 72, at 355.

⁷⁶ See Morton & Reilly, *supra* note 29, at 8.

⁷⁷ *Id.* at 11–12.

legal entities. Without this treatment of the parent–subsidiary relationship,⁷⁸ the court’s decision when reviewing the Cash-Out Merger would be simple to predict: the court would simply hold that the parent and the subsidiary are the same enterprise, and consequently, the parent corporation’s stockholders are also the stockholders of the subsidiary.⁷⁹ Thus, in the Cash-Out Merger, the vote would rest not with the parent corporation but with the parent corporation’s stockholders.⁸⁰

As the law stands, Delaware courts are reluctant to overlook the formal corporate form to pierce the corporate veil. An empirical study on the matter found that Delaware courts rarely pierce the corporate veil of publicly traded corporations.⁸¹ This is not to say that Delaware courts never do so, just that they pierce the veil in only the most limited of circumstances⁸²: “in the interest of justice, when such matters as fraud, contravention of law or contract, public wrong, or where equitable considerations among members of the corporation require it, are involved.”⁸³ Delaware law also recognizes that the veil-piercing is ill-suited for sorting out liability in the context of modern, sophisticated corporate groups with multiple corporate tiers.⁸⁴

Delaware and other courts generally decline to pierce the corporate veil when the proper corporate formalities are followed.⁸⁵ Even when choosing to pierce the corporate veil, Delaware courts have made it clear that Delaware law consistently upholds the veil in the context of the parent–subsidiary

⁷⁸ The doctrine is important for a number of other reasons. For example, without it corporations would not be able to shelter liability for their more dangerous operations from the core of the business, thus greatly increasing the cost of doing business. *See generally* Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036 (1991).

⁷⁹ *See* Eisenberg, *supra* note 4, at 1588.

⁸⁰ *Id.*

⁸¹ *See* Thompson, *supra* note 78, at 1039.

⁸² *See id.* at 1052–53.

⁸³ *Pauley Petroleum Inc. v. Cont’l Oil Co.*, 239 A.2d 629, 633 (Del. 1968). While Delaware courts will utilize the “alter ego” theory to pierce the corporate veil when a corporation is functioning as a façade for the dominant stockholder, Delaware law still requires a showing of fraud. *See, e.g.*, *Wallace ex rel. Cencom Cable Income Partners II, Inc., L.P. v. Wood*, 752 A.2d 1175, 1184 (Del. Ch. 1999) (“Effectively, the corporation must be a sham and exist for no other purpose than as a vehicle for fraud.”).

⁸⁴ *Allied Capital Corp. v. GC-Sun Holdings, L.P.*, 910 A.2d 1020, 1043 (Del. Ch. 2006). The court in *Allied Capital* noted that the doctrine “originally developed in the context of finding individual (human) shareholders liable for corporate debts,” and is not very useful in analyzing the parent and subsidiary relationship. *Id.*

⁸⁵ Stephen M. Bainbridge, *Abolishing Veil Piercing*, 26 J. CORP. L. 479, 513 (2001).

relationship.⁸⁶ Given this well-established doctrine, it is very unlikely that a Delaware court, in the context of our hypothetical, would choose to pierce the corporate veil by holding that the vote passes down to the stockholders of the parent corporation.

Without a piercing of the parent–subsidiary corporate form, DreamTown’s stockholders would have no say in the Cash-Out Merger because the vote rests with the legal stockholder, DreamTown. The significance of the 2005 amendment to section 271 is that the statute clarifies that in the case of asset sales, the court is to pierce the corporate veil by passing the vote to the stockholders if the subsidiary’s assets represent all or substantially all of the consolidated enterprise’s assets.⁸⁷ In other words, the legislature has expressly overridden Delaware common law’s long-standing precedent supporting the individual corporate identities of subsidiaries and parents in the specific context of asset sales.

Whether the courts will uphold the Cash-Out Merger in our hypothetical is a question of statutory interpretation and depends on the impact, if any, the amendment will have on the doctrine of independent legal significance. Arguably, the amendment expresses a legislative purpose to bolster section 271 and prevent it from being easily side-stepped.⁸⁸ This Comment, however, argues that the legislature’s decision not to amend the merger statute by placing a similar provision in section 251 regarding the parent–subsidiary relationship dictates that, in the context of the Cash-Out Merger, the corporate veil should not be pierced, and the deal should be allowed to go forward without triggering a parent–stockholder vote. This position is supported by Delaware’s long adherence to the doctrine of independent legal significance.⁸⁹

B. Doctrine of Independent Legal Significance

As discussed earlier, Delaware corporate law governs the internal affairs of Delaware corporations.⁹⁰ The DGCL “is a specialized form of contract law

⁸⁶ *Leslie v. Telephonics Office Techs., Inc.*, No. 13045, 1993 WL 547188, at *8–9 (Del. Ch. Dec. 30, 1993) (noting that Delaware courts typically “have upheld the legal significance of corporate form, [especially] in a corporate–subsidiary complex”).

⁸⁷ DEL. CODE ANN. tit. 8, § 271 (2007).

⁸⁸ This argument is supported by the quick turn-around time (ten months) between when the Court of Chancery raised concerns in *Hollinger* about the statute’s ability, in its form prior to the 2005 amendment, to prevent such transactions and when the Delaware legislature amended the statute to address the concerns raised by the court in *Hollinger*.

⁸⁹ See *infra* Part II.B.

⁹⁰ Strine, *The Delaware Way*, *supra* note 43, at 674.

that governs the relationship between corporate managers . . . and the stockholders.”⁹¹ The DGCL is the set of default rules governing the stockholder–director relationship, with very few mandatory terms.⁹²

Delaware Supreme Court Chief Justice Myron T. Steele suggests thinking about the DGCL as a menu to provide corporate directors with the flexibility to choose from a number of “reasonable alternatives that can be tailored to companies’ business sectors, markets, and corporate culture.”⁹³ Such a view treats any “statutory vacuum as a purposeful decision to leave room for stockholder choice—as a form of ‘sacred space’ that directors can invade only for carefully limited purposes.”⁹⁴ This view is reflected in Delaware’s doctrine of independent legal significance, which allows directors to “choose among the various methods for accomplishing a business transaction.”⁹⁵

As the Delaware Supreme Court explained in *Orzeck v. Englehart*,⁹⁶ the doctrine recognizes “that action[s] taken in accordance with different sections of [the DGCL] are acts of independent legal significance even though the end result may be the same under different sections.”⁹⁷ Thus, “actions taken under one section” of the DGCL may lead to the same result as an “action taken under another section,” but the legality of one action may not necessarily be “tested by the requirements of the second section.”⁹⁸ The doctrine of independent legal significance allows directors of Delaware corporations “to pursue certain ends by more than one means, thereby enabling them to . . . implement a transaction through a technique that does not require a stockholder vote, while eschewing another statutory method that would have given the stockholders a say.”⁹⁹

⁹¹ *Id.*

⁹² Sean J. Griffith & Myron T. Steele, *On Corporate Law Federalism: Threatening the Thaumatrope*, 61 BUS. LAW. 1, 9 (2005).

⁹³ *Id.*

⁹⁴ William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *The Great Takeover Debate: A Meditation on Bridging the Conceptual Divide*, 69 U. CHI. L. REV. 1067, 1078 (2002).

⁹⁵ Leo E. Strine, Jr., *If Corporate Action Is Lawful, Presumably There Are Circumstances in Which It Is Equitable to Take That Action: The Implicit Corollary to the Rule of Schnell v. Chris-Craft*, 60 BUS. LAW. 877, 879 n.10 (2005) [hereinafter Strine, *If Corporate Action Is Lawful*].

⁹⁶ 195 A.2d 375 (Del. 1963).

⁹⁷ *Id.* at 377.

⁹⁸ *Id.*

⁹⁹ See Strine, *If Corporate Action Is Lawful*, *supra* note 95, at 879. The result of this doctrine’s application in *Orzeck* was that the merger statutes were not implicated when a corporation purchased the shares of seven other independent organizations because the purchase of another’s stock did not effectuate a merger of corporate identities. *Orzeck*, 195 A.2d at 377.

The doctrine of independent legal significance, which has a long history in Delaware jurisprudence,¹⁰⁰ arose in *Hariton v. Arco Electronics, Inc.*, when Delaware rejected the “de facto merger” doctrine.¹⁰¹ This rejection came at a time when many legislatures and courts were moving toward treating “apparent sales of assets,” where a corporation sells all its assets to another corporation for stock and subsequently dissolved, as “mergers.”¹⁰² Under the de facto merger doctrine, formulated by the Pennsylvania Supreme Court in *Farris v. Glen Alden Corp.*,¹⁰³ the legality of a transaction is to be determined by referring “not only to all the provisions of the agreement, but also to the consequences of the transaction and to the purposes of the provisions of the corporation law said to be applicable.”¹⁰⁴ Under this view, if a transaction consummated by a sales contract effects the same result as a statutory merger, the protections afforded stockholders under the statutory merger provision must be granted to stockholders in a sale context.¹⁰⁵

In *Hariton*, the Delaware Court of Chancery rejected the de facto merger doctrine. Loral Electronics Corporation, a New York corporation, agreed to buy all the assets and assume all the debts and liabilities of Arco, a Delaware corporation.¹⁰⁶ In return, Loral would issue 283,000 shares of common stock to Arco.¹⁰⁷ The agreement provided that, upon the closing of the sale, Arco would dissolve and distribute on a pro rata basis all of its shares of Loral.¹⁰⁸ After the completion of the transaction, Arco was not to engage in any business except as necessary to liquidate any remaining assets and dissolve the corporation.¹⁰⁹ The result of the transaction was identical to the results of a merger, but because the transaction was structured as a sale of assets, the stockholders of Arco had no right to appeal to the courts for an appraisal.¹¹⁰ The court held that Delaware law allowed this result because of “the overlapping scope of the merger statute and the statute authorizing the sale of all the corporate assets.”¹¹¹ The court noted that the transaction was not a “de

¹⁰⁰ The doctrine has existed since at least 1963. See text accompanying *infra* notes 101–14.

¹⁰¹ 182 A.2d 22, 23 (Del. Ch. 1962), *aff'd*, 188 A.2d 123 (Del. 1963).

¹⁰² Manning, *supra* note 13, at 257.

¹⁰³ 143 A.2d 25 (Pa. 1958).

¹⁰⁴ *Id.* at 28.

¹⁰⁵ *Id.* at 31.

¹⁰⁶ *Hariton*, 182 A.2d at 23.

¹⁰⁷ *Id.*

¹⁰⁸ *Id.*

¹⁰⁹ *Id.* at 23–24.

¹¹⁰ *Id.* at 27.

¹¹¹ *Id.* at 24.

facto merger, either in the sense that there was a failure to comply with one or more of the requirements of section 271 of the Delaware Corporation Law, or that the result accomplished was in effect a merger entitling plaintiff to a right of appraisal.”¹¹²

In its affirmation of the Court of Chancery’s decision, the Delaware Supreme Court held that the transaction was legal under section 271 because the “sale-of-assets statute and the merger statute are independent of each other.”¹¹³ The court stated that the two statutes were “of equal dignity,” and the structure of the DGCL was such that a director could “resort to either type of corporate mechanics to achieve the desired end.”¹¹⁴

This formulation of the doctrine of independent legal significance has played a role in many of Delaware’s landmark decisions, including the famous *Paramount Communications, Inc. v. Time Inc.*¹¹⁵ case. There, the original transaction between Time and Warner was structured so that the approval of Time’s stockholders by a vote was necessary to consummate the merger.¹¹⁶ The Court of Chancery viewed the issue as follows: “Did Time’s board, having developed a strategic plan of global expansion to be launched through a business combination with Warner, come under a fiduciary duty to jettison its plan and put the corporation’s future into the hands of its shareholders?”¹¹⁷ After receiving an offer from Paramount, “the Time board restructured the transaction to eliminate the need for a stockholder vote.”¹¹⁸ The Court of Chancery upheld this board action under the standard developed in *Unocal Corp. v. Mesa Petroleum Co.*,¹¹⁹ which is used by the courts when reviewing a defensive response to a hostile offer.¹²⁰ It found that Time was not acting out of self-interest, “was fully informed, and believed in good faith that it was taking the best approach for the stockholders.”¹²¹

¹¹² *Id.* at 27.

¹¹³ *Hariton v. Arco Electronics, Inc.*, 188 A.2d 123, 125 (Del. 1963).

¹¹⁴ *Id.*

¹¹⁵ 571 A.2d 1140 (Del. 1989).

¹¹⁶ Strine, *Categorical Confusion*, *supra* note 29, at 932 n.38.

¹¹⁷ *Time*, 571 A.2d at 1149–50.

¹¹⁸ Strine, *Categorical Confusion*, *supra* note 29, at 932 n.38.

¹¹⁹ 493 A.2d 946 (Del. 1985).

¹²⁰ *Time*, 571 A.2d at 1150. The court rejected the plaintiff’s argument that the merger triggered *Revlon* duties because the court found that Time’s negotiations with Warner did not make “the dissolution or break-up of the corporate entity inevitable.” *Id.*

¹²¹ Strine, *Categorical Confusion*, *supra* note 29, at 933 n.38. The Supreme Court of Delaware upheld the board’s actions, including its decision to restructure the deal to eliminate the need for the vote, because it was

In the Cash-Out Merger hypothetical, the doctrine of independent legal significance suggests that the merger would be allowed to go forward without a stockholder vote. The board could have chosen to sell the subsidiary's assets, triggering a vote under section 271. Instead, the board chose to effectuate the transaction under section 251, which does not require a vote by DreamTown's stockholders. The analysis, however, is not complete. Whether the Delaware courts would allow this transaction requires a deeper look at the Delaware corporate model.

III. THE DELAWARE CORPORATE MODEL

A. *The Tension Between Law and Equity*

There is a tension in corporate jurisprudence, much commented on, between the principles of law and equity.¹²² This tension is particularly noticeable in Delaware corporate law due to the role of the Court of Chancery, a court of equity, in shaping Delaware's corporate jurisprudence.¹²³ The role of equity in Delaware's corporate jurisprudence has ebbed and flowed throughout history,¹²⁴ always making its exact place somewhat difficult to pin down. Delaware Supreme Court Justice Jack Jacobs has surmised, however, that the interplay between law and equity is as follows: "acts that comply with the corporate statute are subject to invalidation on equitable grounds, but equitable principles may not be used to salvage a corporate act that violates the corporate statute."¹²⁵

Historically, the approach in Delaware, as well as in many other states, was to interpret corporate statutes literally; if a transaction did not violate a corporate statute or a corporation's bylaws and was not fraudulent, it was

"not a breach of faith for directors to determine that the present stock market price of shares is not representative of the true value." *Time*, 571 A.2d at 1150 n.12.

¹²² See, e.g., Jack B. Jacobs, *The Uneasy Truce Between Law and Equity in Modern Business Enterprise Jurisprudence*, 8 DEL. L. REV. 1, 1–14 (2005) (describing the transformation in business enterprise law from a model of law to one of equity over a 35-year period).

¹²³ Kurt M. Heyman & Christal Lint, *Recent Developments in Corporate Law: Recent Supreme Court Reversals and the Role of Equity in Corporate Jurisprudence*, 6 DEL. L. REV. 451, 462 (2003) ("The Court of Chancery's 'powers are complete to fashion any form of equitable and monetary relief as may be appropriate.'" (quoting *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 817 A.2d 160, 176 (Del. 2002))).

¹²⁴ See Jacobs, *supra* note 122, at 1–14 (describing the period prior to the 1980s as an era when American corporate law fell on the "law" side and the 1980s as a decade when "equity" gained more favor).

¹²⁵ *Id.* at 15 (cryptically noting that "[w]hether that view is correct only time will tell").

upheld.¹²⁶ This was the general trend until the 1970s.¹²⁷ In 1971, however, the Delaware Supreme Court decided *Schnell v. Chris-Craft Industries, Inc.*,¹²⁸ which gave rise to the basic equitable dynamic inherent in Delaware's corporate jurisprudence today.¹²⁹

In *Schnell*, the Delaware Supreme Court struck down a transaction that conformed to the corporate statute.¹³⁰ The management of the corporation utilized a DGCL provision allowing the alteration of corporate bylaws to limit the time available for the plaintiffs to fight a proxy battle.¹³¹ The court concluded “that management has attempted to utilize the corporate machinery and the Delaware Law for the purpose of perpetuating itself in office.”¹³² Calling such motives inequitable and “contrary to established principles of corporate democracy,”¹³³ the court struck down the transaction and set forth the monumental and oft-cited *Schnell* doctrine: “Management contends that it has complied strictly with the provisions of the new Delaware Corporation Law in changing the by-law date. The answer to that contention, of course, is that *inequitable action does not become permissible simply because it is legally possible.*”¹³⁴ With *Schnell*, the Delaware judiciary crystallized its power to prohibit otherwise legal director behavior that exploited the law to achieve inequitable results.¹³⁵

Schnell struck down a legal action by management because the action clearly violated a basic fiduciary principle—management cannot act out of self-interest to the detriment of stockholders. Over time, the Delaware courts have developed various standards of review for examining whether the actions of the board of directors were consistent with its fiduciary duties.¹³⁶

¹²⁶ *Id.* at 3.

¹²⁷ *Id.*

¹²⁸ 285 A.2d 437 (Del. 1971).

¹²⁹ Strine, *If Corporate Action Is Lawful*, *supra* note 95, at 881 (“Nearly thirty-five years ago, the Delaware Supreme Court emphatically rejected the proposition that compliance with the DGCL was all that was required of directors to satisfy their obligations to the corporation and its stockholders.”).

¹³⁰ *See supra* note 129 and accompanying text.

¹³¹ *Schnell*, 285 A.2d at 439.

¹³² *Id.*

¹³³ *Id.*

¹³⁴ *Id.* (emphasis added).

¹³⁵ Strine, *If Corporate Action Is Lawful*, *supra* note 95, at 882.

¹³⁶ *See discussion infra* Part IV.

B. Delaware's Jurisprudence: Narrow Precedents and a Relative Degree of Indeterminacy

In the post-*Schnell* world, Delaware corporate law has grown “to rely on fact-intensive, standard-based tests.”¹³⁷ Commentators have argued, correctly, that the liberal application of equitable principles has made Delaware corporate litigation intensive.¹³⁸ Pro-Delaware commentators, often themselves Delaware practitioners and judges, take pride in the flexibility of Delaware’s corporate jurisprudence.¹³⁹ Less enthusiastic commentators, often non-Delawareans, characterize Delaware jurisprudence as indeterminate and unclear due to the influence of local political and economic considerations.¹⁴⁰ In any event, there can be no doubt that Delaware’s corporate jurisprudence is “highly context-specific” and thus, constantly changing, evolving, and at times, frustratingly unclear.¹⁴¹

This last characteristic is, in the end, perhaps the most difficult aspect of Delaware jurisprudence for practitioners. Due to the open-ended nature of the standards, Delaware’s judicial precedents tend to be narrowly construed.¹⁴² It can be very difficult to determine from precedent when a challenged transaction will be allowed to go forward and when the court will block the transaction. One of the best examples of this difficulty arising in the post-*Schnell* era is predicting when the Delaware courts will utilize the *Schnell*

¹³⁷ Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205, 1236 (2001) (defining “fact-intensive” to mean that “a wide array of factual circumstances is relevant to the resolution of a legal dispute” and “standard-based” to mean that “the relation between a certain set of facts and the outcome of a legal dispute is determined ex post rather than ex ante”).

¹³⁸ See, e.g., *id.* at 1233.

¹³⁹ See, e.g., Griffith & Steele, *supra* note 92, at 1–23. In this article, the Chief Justice of the Delaware Supreme Court, Myron T. Steele, argues that the “shifting between hard-edged rules and fuzzy standards and between strong and weak interpretations of fiduciary constraints” is one of the greatest advantages of Delaware corporate law. *Id.* at 1. The article compares Delaware law to a “thaumatrope,” a popular early nineteenth-century device “that generates an optical illusion through the spinning of a disc with a different image on each side When the viewer spins the thaumatrope, these images blend together to produce what appears to be a composite whole” *Id.* at 2.

¹⁴⁰ See, e.g., Douglas M. Branson, *Indeterminacy: The Final Ingredient in an Interest Group Analysis of Corporate Law*, 43 VAND. L. REV. 85, 88 (1990) (noting the “revolving door movement between the Delaware judiciary and the Delaware corporate law firms,” and arguing that Delaware law benefits from such indeterminacy); see also Kahan & Kamar, *supra* note 137, at 1245–49 (arguing that this indeterminacy encourages litigation that benefits “Delaware’s influential corporate bar”). *But see* Strine, *The Delaware Way*, *supra* note 43, at 679–80 (arguing that, for other states, “the integrity of their corporation law is of far less moment than the fate of a particular corporation,” and citing the situation that arose in North Carolina a few years ago, when the state legislature changed the law to help protect Wachovia Bank from a hostile takeover).

¹⁴¹ See Griffith & Steele, *supra* note 92, at 22.

¹⁴² See, e.g., Kahan & Kamar, *supra* note 137, at 1233.

doctrine and when they will apply the doctrine of independent legal significance.¹⁴³ That choice depends on when the courts decide to utilize their equitable powers.¹⁴⁴

Unfortunately, a survey of the case law provides no great insight into the conflict between equity and law in Delaware corporate jurisprudence.¹⁴⁵ For example, just recently, the Delaware Chancery Court's decision in *Louisiana Municipal Police Employees Retirement Systems v. Crawford*¹⁴⁶ (*LAMPERS*) caught many corporate attorneys by surprise.¹⁴⁷ In *LAMPERS*, the court held that a special dividend paid to one party in a supposed stock-for-stock merger was part of the merger consideration, and thus the stockholders had a right to appraisal.¹⁴⁸ In doing so, the court seemingly used its equitable powers to embrace the "step transaction doctrine"—a tax doctrine that treats the steps of formally separate but related transactions as a single transaction when all the steps are "substantially linked"—over the doctrine of independent legal significance.¹⁴⁹

The *LAMPERS* case perhaps casts doubt on the Cash-Out Merger because it suggests that the court would treat the drop down of assets and the subsequent merger as one transaction, giving the parent company's stockholders a right to vote. Such a reading, however, would be a misapplication of *LAMPERS* because that case was not really about the doctrine of independent legal significance—a legal theory—but rather whether the dividend payment and stock merger were independent—an equitable review.¹⁵⁰ In fact, the court found that they were not independent transactions because the dividend payment only made sense if seen as part of the merger

¹⁴³ This doctrine also goes by the name "the equal dignity rule" and has been criticized for placing form over substance. See Branson, *supra* note 140, at 94.

¹⁴⁴ See Strine, *If Corporate Action Is Lawful*, *supra* note 95, at 879–80 (discussing in broad terms the court's equitable role in protecting stockholders under a system that grants broad authority to corporate directors).

¹⁴⁵ Leo E. Strine, Jr., *Delaware's Corporate-Law System: Is Corporate America Buying an Exquisite Jewel or a Diamond in the Rough? A Response to Kahan & Kamar's Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1257, 1265 (2001) ("I begin by conceding at the outset that in many ways Delaware corporation law is less than optimally clear.").

¹⁴⁶ 918 A.2d 1172 (Del. Ch. 2007).

¹⁴⁷ C. Stephen Bigler & Blake Rohrbacher, *Form over Substance? The Past, Present, and Future of the Doctrine of Independent Legal Significance*, 63 BUS. LAW. 1, 3 (2007).

¹⁴⁸ *LAMPERS*, 918 A.2d at 1191–92.

¹⁴⁹ Bigler & Rohrbacher, *supra* note 147, at 12.

¹⁵⁰ *Id.* at 18.

transaction.¹⁵¹ Consequently, *LAMPERS* should be read as clarifying the doctrine of independent legal significance by reinforcing that the doctrine really only applies where “a statutory alternative exists that would permit the result reached.”¹⁵²

The Cash-Out Merger is permissible as a matter of law because it represents a choice by the board to utilize section 251, rather than section 271, to bring about the desired economic result. The analysis is not complete, however, because the Delaware corporate model uses both legal and equitable principles in reviewing corporate actions. Whether the Delaware courts would find the Cash-Out Merger to be equitable depends on the facts of the case and which standard of review the court would use to determine whether the board of directors acted within the scope of its authority.¹⁵³ Ultimately, each case in Delaware must be analyzed on its own terms. Under the Delaware model, the ability of DreamTown and WPF to complete the Cash-Out Merger turns upon the applicable standard of review.

IV. THE APPLICABLE STANDARD OF REVIEW FOR THE CASH-OUT MERGER

The Delaware courts utilize various standards of review for board actions. As discussed before, the DGCL grants the board of directors broad power and discretion in the management of the corporation.¹⁵⁴ Related to this statutory delegation of authority to the board, the business judgment rule requires courts to defer to the judgment of the board.¹⁵⁵ To satisfy the test under the business judgment rule, directors should not act out of self-interest, on an uninformed basis, in bad faith, or in a manner contrary to the best interests of the

¹⁵¹ *Id.* Arguably, this case strengthens the argument for the Cash-Out Merger because implicit in the court’s decision in *LAMPERS* is the notion that transactions are independent if the transaction makes sense standing alone and there typically are independent reasons for such business restructurings.

¹⁵² *Id.* at 23.

¹⁵³ For example, in a hostile takeover defense case, the *Unocal* standard applies to the board’s conduct. *Unocal v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985) (“The standard of proof . . . is designed to ensure that a defense measure to thwart or impede a takeover is indeed motivated by a good faith concern for the welfare of the corporation and its stockholders, which in all circumstances must be free of any fraud or misconduct.”). Moreover, under *Unocal* the board’s actions must be a reasonable response to the threat posed. *Id.* If a board intentionally interferes with the stockholder’s voting rights, however, the *Blasius* standard may apply. See *infra* Part IV.B.

¹⁵⁴ See *supra* notes 10–12 and accompanying text.

¹⁵⁵ *Growthow v. Perot*, 539 A.2d 180 (Del. 1988), *overruled in part on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

corporation.¹⁵⁶ If this test is satisfied, the court will not question the board's decision.¹⁵⁷

Not all board decisions, however, are reviewed under the standard business judgment rule formulation.¹⁵⁸ For example, a board's decision to exercise corporate powers to fend off a takeover bid is subject to heightened scrutiny.¹⁵⁹ Not only must the board's exercise of power in such situations be consistent with its fiduciary duty to act in the best interests of the stockholders, but the board must also demonstrate that the hostile bid created a threat to the company and that the board's response was reasonable and proportionate to the threat.¹⁶⁰

This Part analyzes the various standards that may apply to the DreamTown board and concludes that *Revlon* duties would be implicated by the Cash-Out Merger. It also argues that the *Revlon* standard adequately protects stockholder interests while providing directors with the traditional degree of flexibility that the Delaware corporate model allows.

A. *The Blasius Standard and the Hauf Decision*

Ostensibly, board actions that interfere with the stockholders' right to vote are reviewed under the standard set forth in *Blasius Industries, Inc., v. Atlas Corp.*¹⁶¹ The board in *Blasius* decided to increase its size by two members to preclude the holders of a majority of the corporation's shares from placing a majority of new directors on the board through consent solicitation.¹⁶² The court noted that the board's primary motivation was "to prevent or delay the shareholders from possibly placing a majority of new members on the board."¹⁶³

¹⁵⁶ *Id.*

¹⁵⁷ *See id.*

¹⁵⁸ *See, e.g., Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 658 (Del. Ch. 1988); *see also supra* text accompanying note 153 (discussing the *Unocal* and *Blasius* standards).

¹⁵⁹ *See supra* note 153 and accompanying text.

¹⁶⁰ *Unocal v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985).

¹⁶¹ *Blasius*, 564 A.2d at 661 ("When election machinery appears, at least facially, to have been manipulated those in charge of the election have the burden of persuasion to justify the action.").

¹⁶² *Id.* at 655.

¹⁶³ *Id.*

In defending its actions, the board invoked the “formidable protections of the business judgment rule.”¹⁶⁴ The court in *Blasius* rejected the board’s arguments, however, concluding that even if the board had acted out of good faith, it acted outside the scope of its authority.¹⁶⁵ The court reasoned that the board’s actions called into question whether the principal (stockholder) or agent (board) should have authority with respect to internal corporate governance.¹⁶⁶ Any board action undertaken with the intent to interfere with the stockholders’ right to vote creates a major conflict between the board and the stockholder majority.¹⁶⁷ The conflict raises legal and equitable questions that the court may not leave for the agent to decide, even if the agent were to do so in accordance with fiduciary duties.¹⁶⁸ Although the court, in equity, declined to adopt a per se rule invalidating board actions taken with the principal purpose of interfering with the stockholder franchise,¹⁶⁹ it created an exacting standard, requiring the board to put forth a compelling justification for the interference.¹⁷⁰

Although the Cash-Out Merger described in this Comment is designed to evade a stockholder vote under section 271, it is extremely unlikely that Delaware courts would review the transactions under the *Blasius* standard. In cases since *Blasius* where the Delaware Court of Chancery could have chosen to apply the exacting *Blasius* standard, the Court of Chancery has declined to do so, seemingly in an effort to limit the application and importance of the doctrine.¹⁷¹ One distinguished practitioner in Delaware noted that where a

¹⁶⁴ *Id.* at 657. The business judgment rule requires a presumption “that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in honest belief that the action taken was in the best interests of the company.” *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. Ch. 1984). To defeat this presumption, a plaintiff must show that the board failed to meet its fiduciary duties; the board’s decisions “will not be disturbed (by the court) if they can be attributed to any rational business purpose.” *Sinclair Oil Corp. v. Levine*, 280 A.2d 717, 720 (Del. 1971).

¹⁶⁵ *Blasius*, 564 A.2d at 658.

¹⁶⁶ *Id.* at 659–60.

¹⁶⁷ *Id.* at 660.

¹⁶⁸ *Id.*

¹⁶⁹ *Id.* at 662.

¹⁷⁰ *Id.* at 661.

¹⁷¹ Cadwalader, Wickersham & Taft, LLP, *Recent Developments in Judicial Review of Interference with Stockholder Franchise*: *Chesapeake Corp. v. Shore*, <http://library.findlaw.com/2000/May/1/129400.html> (last visited Feb. 13, 2009) (noting that subsequent decisions referred to the *Blasius* standard as “unwieldy and redundant”); see also *Chesapeake Corp. v. Shore*, 771 A.2d 293, 323–24 (Del. Ch. 2000) (“[I]t may be optimal simply for Delaware courts to infuse our *Unocal* analyses with the spirit animating *Blasius* and not hesitate to use our remedial powers where an inequitable distortion of corporate democracy has occurred. . . . For purposes of this case, however, I must apply the law as it exists. That means that *Unocal* must be applied to the Supermajority Bylaw because of its defensive origin.”).

business transaction is challenged, *Blasius* typically does not apply.¹⁷² The principal reason is that business transactions typically have “some professed purpose other than impeding the shareholder franchise, while decisions involving the electoral process or the appointment of directors do not.”¹⁷³

This particular view is supported by the Court of Chancery’s decision in *Esopus Creek Value LP v. Hauf*.¹⁷⁴ The court in *Hauf* declined to apply *Blasius* where the board had designed a business transaction for the sole purpose of avoiding a stockholder vote.¹⁷⁵ There, the board of a Delaware corporation tried to sell all or substantially all of its assets without the approval of the corporation’s common stockholders by carrying out the sale in bankruptcy.¹⁷⁶ The board thought that a sale in bankruptcy was the best course because, under federal regulations, a delinquent filing of required documents to the SEC prohibited the corporation from calling a meeting of stockholders to vote on the proposed transaction.¹⁷⁷ To circumvent this roadblock, the board adopted planned to file for bankruptcy before signing the asset sale agreement and to win the approval of the sale in bankruptcy court.¹⁷⁸

The Court of Chancery directly addressed whether the board’s decision to pursue the asset sale in bankruptcy triggered “compelling justification” review under *Blasius*,¹⁷⁹ holding that *Blasius* was not triggered.¹⁸⁰ The court noted its own different duties to protect the stockholder vote in situations where the board action relates directly to the election of directors¹⁸¹ versus other

¹⁷² David McBride & Danielle Gibbs, *Interference with Voting Rights: The Metaphysics of Blasius Industries v. Atlas Corp.*, 26 DEL. J. CORP. L. 927, 938 (2001).

¹⁷³ *Id.* at 939.

¹⁷⁴ 913 A.2d 593 (Del. Ch. 2006). It should be noted that the Court of Chancery has discussed the limits of the *Blasius* standard in dicta in at least two other cases. See *In re MONY Group, Inc. S’holder Litig.*, 853 A.2d 661, 675 n.51 (Del. Ch. 2004) (“*Blasius* is not easily or readily applied outside the context of matters touching on directorial control, as its demanding standard could unduly limit the legitimate exercise of directorial power and discretion in other contexts.”); *State of Wis. Inv. Bd. v. Peerless Sys. Corp.*, No. CIV.A. 16637, 2000 WL 1805376, at *8–9 (Del. Ch. Dec. 4, 2000) (“At least one other decision holds that in takeover defense cases *Unocal* is adequate to protect stockholders.”).

¹⁷⁵ *Hauf*, 913 A.2d at 603.

¹⁷⁶ *Id.* at 596. The corporation, Metromedia International Group, Inc., owned a 100% stake in Metromedia International Telecommunications, Inc., which in turn held a 50.1% equity interest in Magticom, the Republic of Georgia’s leading mobile telephone provider. *Id.* at 597. The proposed sale in this case was the sale of Magticom. *Id.*

¹⁷⁷ *Id.* at 596.

¹⁷⁸ *Id.*

¹⁷⁹ *Id.* at 602.

¹⁸⁰ *Id.* at 603.

¹⁸¹ *Id.* at 602 (“The duty of the courts to protect the shareholder vote is at its highest when the board action relates to the election of directors . . .”).

situations where the stockholder vote is implicated.¹⁸² The court stated that in the latter of these situations, such as when section 271 applies, the courts should apply “the exacting *Blasius* standard sparingly,” such as when the board is violating fiduciary duties to “thwart what appears to be the will of a majority of the stockholders.”¹⁸³ In holding that *Blasius* did not apply, the Court of Chancery reasoned that the board did not structure the transaction to thwart the will of the majority, but did so because of the practical impossibility of complying with section 271 due to the federal regulations barring the board from calling a stockholder meeting.¹⁸⁴

In reviewing the transaction, the court in *Hauf* applied the business judgment rule, ultimately holding the board failed to pass the business judgment test.¹⁸⁵ Citing *Schnell*, the court found the transaction inequitable because the board did not meet the “good faith” standard required of a debtor filing a voluntary petition for relief.¹⁸⁶ At the time of filing, the company was robust and healthy, with virtually no debt, which led the court to conclude that “the board’s conduct . . . inequitably abridged the justified expectations of the common stockholders.”¹⁸⁷

Hauf was, in one respect, a remarkably easy case for the Delaware Court of Chancery because it was obvious that the board’s action was not directed at thwarting the will of the majority of the stockholders.¹⁸⁸ At the time of the decision, about 44% of the parent corporation’s common stockholders openly supported the terms of the sale.¹⁸⁹ Determining whether *Blasius* applies will not always be so easy because the inquiry, consistent with the Delaware model, is very fact-intensive. Indeed, under the hypothetical discussed throughout this Comment, it is impossible to determine what percentage of the parent corporation’s stockholders would approve the sale of the subsidiary. Additionally, the *Blasius* standard is unnecessary when a more appropriate standard can already be found in Delaware jurisprudence.

¹⁸² *Id.* (“In other situations . . . the courts ‘maintain vigilance to ensure that the voting process . . . allows the stockholders a full and fair opportunity to vote.’” (quoting *In re MONY Group, Inc. S’holder Litig.*, 853 A.2d 661, 673 (Del. Ch. 2004))).

¹⁸³ *Id.* (citing *In re MONY*, 853 A.2d at 675).

¹⁸⁴ *Id.* at 603.

¹⁸⁵ *Id.*

¹⁸⁶ *Id.* at 604.

¹⁸⁷ *Id.*

¹⁸⁸ *Id.* at 603 (“The evidence in the record is clear on this point.”).

¹⁸⁹ *Id.*

B. *The Revlon Standard*

In *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,¹⁹⁰ the Delaware Supreme Court established the *Revlon* standard, which lowered the bar for proving that a board has acted in an uninformed manner. *Revlon* dealt with the validity of certain provisions, including a lock-up option and a no-shop provision, which were meant to be defensive measures to thwart the efforts of Pantry Pride, Inc. from acquiring Revlon.¹⁹¹ The court held that these provisions were invalid because the Revlon board breached its duty of care by entering into a contract with such restrictive provisions and ending the active auction for the company.¹⁹²

The Revlon board argued that the measures were adopted to prevent Pantry Pride from breaking up the company, but the board eventually embraced such a breakup.¹⁹³ The Delaware Supreme Court noted that at the moment the Revlon board embraced this reality, “[s]elective dealing to fend off a hostile but determined bidder was no longer a proper objective”; rather, the fiduciary duties of good faith and loyalty required the Revlon board to obtain “the highest price for the benefit of the stockholders.”¹⁹⁴ In doing so, the court stated that while there are situations in which a board may consider other corporate constituencies,¹⁹⁵ any concern for “non-stockholder interests is inappropriate when an auction among active bidders is in progress.”¹⁹⁶

The *Revlon* duty, which boils down to obtaining “the highest value reasonably available,”¹⁹⁷ arises when the sale of the company becomes “inevitable.”¹⁹⁸ Thus, the standard is implicated in at least three circumstances¹⁹⁹: first, when a firm initiates an active bidding process or seeks “to effect a business reorganization involving a clear break-up of the

¹⁹⁰ 506 A.2d 173 (Del. 1986).

¹⁹¹ *Id.* at 175. The Revlon board had entered into the lock-up agreement out of consideration for its note holders and argued that, based on the *Unocal* standard governing defensive measures taken to fend off hostile bids, the board was allowed to consider other corporate constituencies. *Id.* at 182.

¹⁹² *Id.* at 175–76.

¹⁹³ *Id.* at 182.

¹⁹⁴ *Id.*

¹⁹⁵ *Id.* (noting that a board may do this only when “there are rationally related benefits accruing to the stockholders”).

¹⁹⁶ *Id.* (“[T]he object no longer is to protect or maintain the corporate enterprise but to sell it to the highest bidder.”).

¹⁹⁷ William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Function over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, 1321 (2001).

¹⁹⁸ *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1345 (Del. 1987).

¹⁹⁹ *Arnold v. Soc’y for Sav. Bancorp, Inc.*, 650 A.2d 1270, 1290 (Del. 1994).

company”;²⁰⁰ second, “where, in response to a bidder’s offer, a target abandons its long-term strategy and seeks an alternative transaction” to break up the company;²⁰¹ and third, where the transaction results in a “sale or change of control.”²⁰²

The Cash-Out Merger proposed in this Comment falls under *Revlon* because the transaction is meant to effect business reorganization. Additionally, the Cash-Out Merger should be characterized as a change of control because the majority of shares of the subsidiary will shift from one stockholder, DreamTown, to another, WPF. Under *Revlon*, if a stockholder sued to enjoin the transaction, the stockholder would win if the board failed to obtain the highest value reasonably available.

The Delaware Supreme Court’s decision in *McMullin v. Beran*²⁰³ supports the proposition that the Cash-Out Merger will trigger *Revlon* duties. In *McMullin*, the Delaware Supreme Court reversed the Court of Chancery’s dismissal of a minority stockholder’s complaint where the majority stockholder, Atlantic Richfield Company (ARCO), sought buyers and negotiated the sale of the subsidiary, ARCO Chemical Company (Chemical).²⁰⁴ The sale process was triggered when Lyondell Petrochemical Company (Lyondell) placed an unsolicited call to ARCO expressing interest in acquiring Chemical.²⁰⁵ After receiving this call, ARCO employed its financial advisor, Solomon Smith Barney (Solomon), and had Solomon contact various entities to determine their interest in bidding for Chemical.²⁰⁶ After a period of negotiations, Lyondell gave a tender offer to purchase all outstanding shares of Chemical for \$57.75 per share and secured a commitment from ARCO to offer its 80 million shares of Chemical at the same price paid to the minority stockholders.²⁰⁷ This was to be followed by a second-step merger, in which all untendered shares would be cashed out.²⁰⁸ The Chemical board met once and approved the transaction after hearing from ARCO and Solomon about the terms and process of the sale and after hearing from its own financial advisor,

²⁰⁰ *Paramount Commc’ns, Inc. v. Time Inc.*, 571 A.2d 1140, 1150 (Del. 1989).

²⁰¹ *Id.*

²⁰² *Arnold*, 650 A.2d at 1290.

²⁰³ 765 A.2d 910 (Del. 2000).

²⁰⁴ *Id.* at 914–15.

²⁰⁵ *Id.* at 915.

²⁰⁶ *Id.*

²⁰⁷ *Id.* at 916.

²⁰⁸ *Id.*

Merrill Lynch, that the price was financially fair to the minority stockholders.²⁰⁹

The Delaware Supreme Court reversed the dismissal, holding that the subsidiary board had a duty to the minority stockholders to determine that the price would maximize value to the minority stockholders.²¹⁰ The Delaware Supreme Court noted that “when a board is presented with the majority shareholder’s proposal to sell the entire corporation to a third party, the ultimate focus on value maximization is the same as if the board itself had decided to sell the corporation to a third party.”²¹¹ Applying *McMullin* to the Cash-Out Merger suggests that when DreamTown is deciding how to vote its shares in the subsidiary, it will face the same *Revlon* duties to its stockholders as DreamTown’s subsidiary owes to it.

Applying *Revlon* in the context of the Cash-Out Merger is consistent with the Delaware model of deciding cases narrowly. This approach sets an equitable standard under which the courts would review each transaction on a case-by-case basis. Unlike *Blasius*, which is more difficult to apply, *Revlon* is a workable alternative that provides predictability to corporate practitioners. Not only is it relatively easy to determine when *Revlon* will apply, but corporate practitioners are familiar with the standard, allowing practitioners to foresee the difficulties arising from structuring a transaction in the manner proposed in this Comment.

From a policy perspective, *Revlon* is appealing because it maintains stockholder primacy under the property model of corporations, which proposes that the role of the corporation is to maximize wealth for its stockholders.²¹² Under this view, the primary directive of the board is to advance the interests—the profits—of the stockholders.²¹³ Adherents to the property model dismiss the idea that directors should “advance their own social views at the expense of those who have put their capital at risk as shareholders.”²¹⁴ By

²⁰⁹ *Id.*

²¹⁰ *Id.* at 918.

²¹¹ *Id.* at 919. The court noted that while the Chemical board could not realistically “act on an informed basis to secure the best value reasonably available,” it did “have the duty to act on an informed basis to independently ascertain the merger consideration being offered.” *Id.*

²¹² See Allen, Jacobs & Strine, *supra* note 94, at 1075; see also Milton Friedman, *The Social Responsibility of Business Is To Increase Its Profits*, N.Y. TIMES, Sept. 13, 1970 (Magazine), at SM17 (arguing that a corporate executive is responsible only to his or her employers, the stockholders, and that the executive’s primary duty is to make the stockholders money).

²¹³ Allen, Jacobs & Strine, *supra* note 94, at 1075.

²¹⁴ *Id.*

forcing directors to maximize stockholder value in the context of a sale, the *Revlon* standard protects stockholder primacy, but without destroying the Delaware model's general deference to the board of directors, allowing the board to structure transactions as it sees fit.

CONCLUSION

Section 271 of the DGCL was amended in 2005 to ensure that a subsidiary asset sale would trigger a vote by the parent corporation's stockholders if the subsidiary's assets represented all or substantially all of the consolidated enterprise's assets. Delaware could have also amended section 251 to provide a similar provision regarding the merger of a subsidiary, but it did not. It would be inconsistent with Delaware jurisprudence to read section 271's corporate veil-piercing provisions into a transaction carried out under section 251. Furthermore, under Delaware law the stockholders would be adequately protected by the court's power of equitable review. In the context of the Cash-Out Merger, a court would review the transaction under the *Revlon* standard, which ensures that the stockholders of the parent corporation receive maximum value from the sale.

The Cash-Out Merger proposed in this Comment would achieve the same economic result as an asset sale carried out under section 271 without the approval of a stockholder vote. This result reflects Delaware's long-standing deference to director choice, embodied in the doctrine of independent legal significance. While some might argue that allowing the Cash-Out Merger to go forward without a stockholder vote relegates the amended section 271 to an easily side-stepped protection, the reality is that this result is consistent with Delaware corporate law.

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