**I. Agency**

Types of businesses:

* Partnership (closely held)
	+ General partnership
	+ Limited partnership (at least one partner can’t be sued)
* Limited Liability Company/Partnership (owners can’t be sued)
* Closely Held Corporation
* Publicly Held Corporation (dispersed SHs)

**Agency**

Definition: (i) Manifestation of P to A that A will act on P’s behalf and subject to P’s right of control and (ii) manifestation of consent by A

Benefits of agency law:

* Reduces contracting problems w/default roles and facilitates contracts
* Protects against strategic behavior and manipulation of externalities by guaranteeing certain provisions
* Reduces agency costs

Ways to demonstrate agency relationship:

* **Express Actual Authority**—Parties agree by K
* **Implied Actual Authority**—Nature of dealing implies authority (in the eyes of A)
	+ P has de facto control over A (*Cargill*)
	+ A acts on behalf of P (*Cargill*)
	+ Past practice (*Mill Street Church*)
	+ Standard industry practice (*Mill Street Church*)
* **Apparent Authority**—P’s actions would make a reasonable person in 3rd party’s position believe that agency relationship exists (DE + CA require detrimental reliance) (*Lind*) (*Botticello*)
	+ If 3rd party believes it is contracting w/P thru A, but P does not exist or A does not have authority, A is liable.
* **Ratification**—Retroactive creation of agency relationship where (i) A contracts w/3rd party on P’s behalf; (ii) A does not have actual or apparent authority; and (iii) P w/knowledge of K either expressly affirms A’s conduct or acts in a manner manifesting affirmation of the K
	+ P must be aware of K (*Botticello*)
	+ Ratification defeated if 3rd party has withdrawn claim or if inequitable b/c of changed circumstances

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| *Gay Jenson Farms Co. v. Cargill, Inc.* (Minn. 1981)—Farmers sued Cargill (massive grain co.) to recover unpaid debts from Warren (small grain co.), which had become dependent on Cargill. Ct. found Warren was Cargill’s agent, so farmers could collect.* Cargill maintained certain rights of control typical of creditors, but also:
* The level of specificity and daily mgmt gave rise to “de facto control”
* Warren was so indebted to Cargill, all of its profits were Cargill’s (residual claimant)
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| *Mill Street Church of Christ v. Hogan* (Ky. 1990)—Church hired B. Hogan to paint church; B. hired S. Hogan, who injured himself. S. sough workers’ comp. bens. from church, but church argued he was B.’s ee, not theirs. Ct. found S. was church’s ee.* S. had historically employed his brother as agent in church jobs.
* Church never communicated B. did not have this authority, and implied that he did w/statements about another potential ee.
* B. had genuine belief that he had this authority.
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| *Lind v. Schenley Indus.* (3d Cir. 1960)—VP of Sales offered Lind a raise but did not have actual authority to do so. VP did have apparent authority b/c Lind reasonably believed based on VP’s title and certain co. representations that VP had authority to set salaries. |

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| *Botticello v. Stefanovicz* (Conn. 1979)—Husband made rent-to-own K w/tenant after his wife refused to agree to sale. Wife knew about rental but not rent-to-own aspect. Years later tenant sought to invoke right to buy. Wife sought to invalidate K. No apparent authority b/c wife’s silence did not manifest consent for husband to act on her behalf.* Ct., however, required husband pay damages or specific perf., essentially compelling wife to agree to K.
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**Liability in Contract**

A’s Liability to 3rd Party (Rest. 3rd §6.01–.03)

* **Disclosed P**—P is liable on K
* **Undisclosed P (A purporting to act on own behalf)**—A is liable on K
* **Partially disclosed P (A acting on another’s behalf but not declaring whom)**—Both P and A are liable on K (*Atlantic Salmon*)

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| *Atlantic Salmon A/S v. Curran* (Mass. 1992)—Bostonian made a contract w/Norwegian salmon company on behalf of “Boston Seafood,” a co. that was not registered at the time. Created Boston Seafood from Marketing Designs after, and failed to pay K.* Curran is liable for K w/Atlantic Salmon.
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**Agent’s Fiduciary Duties**

* Duty of Care—A must act w/care, competence, and diligence normally exercised by A’s w/similar skills and knowledge.
* Duty of Loyalty—A must act exclusively for P’s benefit in all matters connected w/agency (unless waived) (*Reading*) (*Rash*)

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| *Reading v. Regem* (1948)—Reading (Royal Army Med. Corps. troop) used authority for private profit, implying he acted w/Army’s consent. Army sought to recover profits.* Ct. frames Reading’s actions as a violation of his duties of honesty and good faith.
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| *Rash v. J.V. Intermediate, Ltd.* (10th Cir. 2007)—JVIC hired Rash to manage Tulsa division in 1999. Beginning in 2001, Rash owned and managed 4 businesses w/out disclosing, including 1 that Rash frequently chose to subcontract JVIC work to. Ct. determined Duty of Loyalty includes a duty to disclose, and failing to do so was a breach of Rash’s fiduciary duty.* Additionally, his business ended up competing w/JVIC scaffolding subdivision. Led to usurpation of business opportunity
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| *Meinhard v. Salmon* (N.Y. 1928)—Salmon learned of a building lease opportunity while partnered w/Meinhard. He waited till after partnership expired to cash in. Ct. found that Salmon had a duty to inform Meinhard of the business opportunity.* Remedy is restitution—50% of the value of the lease.
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**II. Corporate Formation, Finance & Limited Liability**

**Valuation**

**Present Value:** PV \* (1 + r)^n = FV so, **PV = FV/(1+r)^n**. Where n represents number of years, PV represents present value, FV represents future value and r represents the discount rate.

**Expected Value**: Weighted average of the value of the investment, weighted by the relative probability of each possible outcome. To calculate, simply add the weighted net present values together.

**Compounding**: **Earlier liquidity on a given investment allows one to compound the interest by reinvesting the return, in addition to the principal**, rather than continuing to reap the same rate of return calculated based on the principal alone.

**Accounting for Risk Premium**: 1) Calculate ERR, 2) calculate and add risk premium (will depend on idiosyncrasies of investor, so will usually be given), 3) discount to present value using **risk-adjusted ERR**, 4) subtract principal and voila, you have your **discounted expected net present value**.

**Corporate Security & Capital Structure**

**Leverage**: Magnifies variance in investment outcomes because higher debt-to-equity ratio leaves fewer equity holders and therefore, profit-sharing among fewer residual claimants, but the increase in debt increases the severity of the bad times because greater liabilities will remain. Leverage confers a risk premium to the equity holders.

**Limited Liability**

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| **Benefits** | **Drawbacks** | **Legal Solutions** |
| Centralized delegated mgmt—no need for SHs to monitor managers; exposure is limited to investment | Overincentivizes risky investment | Regulation: minimum capital reqs; capital maintenance reqs; dividend dist. constraints (not common in US) |
| Greater transferability b/c of lower risk exposure | Voluntary creditors may charge higher interest to account for risky equity incentives | Fiduciary duties to debt (rejected by DE except on eve of and during insolvency creditors become residual claimants) |
| Promotes diversification | Involuntary creditors (e.g. society at large vis-à-vis environmental harms) have no opportunity to bargain ex ante and little opportunity for recovery | Laws: (1) Fraudulent Conveyance; (2) Equitable Subordination; (3) Piercing the Corporate Veil |

**Piercing the Corporate Veil**

**Piercing the Veil**: Creditor can access SH equity funds to collect on firm debts if:

* **Alter Ego**: Pierce the veil if:
	+ (1) Unity of interests & ownership: failure to respect corp. formalities fuses SH + corp. identities, and
	+ (2) Not piercing would “promote injustice or sanction fraud.” (*Pepper Source*)
* **Respondeat Superior**: Pierce the viel if:
	+ (1) SH has control of day-to-day operations (similar to vicarious liability), and
	+ (2) SH manifests abuse of corp. structure (e.g., unjust enrichment)
		- Thin capitalization is not sufficient alone (*Walkovsky*)
* **Instrumentality Rule**: Pierce the veil if:
	+ (1) Total domination of firm; acts entirely in SH interests, not firm interests,
	+ (2) Control used to commit injustice, and
	+ (3) Commission of injustice is proximate cause of injury (*Zaist*)
* **Reverse Pierce**: Where SH has been pierced, P may seek to pierce into another firm owned by SH (*Sea-Land II*)
* **Enterprise Liability**: If a series of firms act as a single enterprise (e.g., thru transactions w/each other w/no expectation of profit/less than arms length), debts may be recoverable from any of the firms, but not from SHs.

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| *Walkovsky v. Carlton* (N.Y. 1966)—Thinly capitalized family of 9 2-car taxi corporations run by Carlton sued in tort by W. Ct. applied respondeat superior test for piercing the veil, finds Carlton exercised control over corps. However, thin capitalization insufficient b/c no evidence Carlton exploited firms for his interest to the exclusion of firm interests. |

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| *Sea-Land Services, Inc. v. Pepper Source* (*Sealand I*) (7th Cir. 1991)—Ct. rejected request to pierce veil for uncompensated tort victims b/c not sufficient injustice and Ps failed to demonstrate that commingling of funds was linked to creditor avoidance. |

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| *Sea-Land II* (7th Cir. 1993)—On remand, Ps found additional evidence of tax fraud, which sufficiently connected commingling of funds w/creditor avoidance, leading to pierce.* Ct. allowed reversed pierce into other corps. owned by D after it was shown he likely hid assets there in anticipation of pierce.
* Arlen notes the reverse pierce of a corp. in which D had a 5% equity holder may have been incorrect, since not a likely place for D to hide equity.
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| *Zaist v. Olson* (Conn. 1967)—Olson controls firm EH; enters sham transaction that only benefits his other firms (1st prong under instrumentality), used control to commit injustice (2nd prong), and sham transaction led to default, harming Zaist (3rd prong). |

**III. Centralized Management & Its Implications**

* **DCGL 102 (Certificate of Incorporation)**: Must include **Corp. name**, **Address**, **Purpose**, **# of shares/Info on Classes+Duration**, **Names+Addresses of Incorporators**
	+ **102(b)(7) (Indemnification)**: Firms can indemnify Dirs. from personal liability for violations of duty of care and settlements under 145 but not violations of duty of loyalty, bad faith, improper personal benefits, or 174 liability. Must be specified in certificate.
* **DCGL 109 (By-Laws)**: SHs have inalienable right to unilaterally amend by-laws; can grant this right to directors in certificate. By-laws cannot conflict w/DCGL
* **DCGL 141 (Board of Directors)**:
	+ **141(a)**: Board of Directors shall manage
		- Cannot delegate all power to a single officer, manager, or SH (*Curtis*)
	+ **141(b)**: Directors hold office until successor elected; default quorum is majority (charter can amend, but not lower than 1/3rd); Bd. decision=majority vote at meeting w/quorum.
	+ **141(c)**: Bd. delegation to committees
	+ **141(d) (Board Classification)**: Creates a staggered Bd. divided into up to three classes of directors, which can differ in number. A majority of SHs can classify the Bd. via cert. of by-laws, but cert. is more reliable against takeovers.
	+ **141(e)**: Safe harbor for directors’ reliance on 3rd party experts. Requires Bd. (i) relies on 3rd party in good faith; (ii) has reasonable belief in 3rd party’s competence and expertise; and (iii) exercised reasonable care on behalf of corp.
	+ **141(k) (Director Removal)**: Directors can be removed w/out cause by majority of SHs unless classified. If Bd. is classified, cause is required.
		- Cannot remove members by downsizing classified Bd. (*Crown Emak*)
* **DCGL 142 (Officers)**: Officers are selected by the Bd. unless there is a contrary by-law.
* **DCGL 211 (Meetings of Stockholders)**:
	+ **211(a)**: Annual meeting must be held (anywhere or as designated in by-laws)
	+ **211(b)**: Directors elected at annual meeting (or by written consent (228) if cert. allows)
	+ **211(c)**: Bd. may call special meetings if cert./by-laws allow (usually 211(d))
* **DCGL 212 (SH Voting Rights)**: One share, one vote. Proxies are allowed by default with max. duration of three years. Irrevocable proxies may be allowed.
	+ **212(a)**: 1 vote per share unless otherwise provided.
* **DCGL 214 (Cumulative Voting)**: Cert. can provide for cumulative voting, allowing minority SHs to prevent unanimous or near unanimous majority control.
	+ Bd. classification can weaken cumulative voting.
* **DCGL 216 (Quorum & Req’d Vote)**: Default SH quorum is majority, but cert. can lower to as little as 1/3rd. Director election is plurality by default, but by-laws can require majority vote. By-law can require a supermajority to amend by-laws or a specific by-law.
* **DCGL 223 (Vacancies & Newly Created Directorships)**: Bd. members can replace vacancies, but inherent power rests w/SHs.
* **DCGL 228 (Consent of SHs in lieu of Meeting)**: SHs may act by written consent on any matter otherwise entitled to act on at a SH meeting, so long as they have # of req’d votes, in writing and signed, and for a proper purpose (e.g. amend by-laws or remove directors/elect replacements, but not to elect successors w/out removing first). Bd. can get rid of 228, but it requires a charter amendment.
* **DCGL 242(b) (Amending the Charter)**: First requires a majority Bd. vote; then majority SH vote.

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| *Manson v. Curtis* (N.Y. 1918)—Corp. by-laws led to “passive Dirs.,” put all power in Manson. Ct. found one-man control violated N.Y. equivalent of 141(a) (“Bd. shall manage”). |

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| *Crown Emak Partners v. Donald A. Kurz et al.* (Del. 2010)—Crown attempted to entrench against TBE (Kurz) attempted takeover by reducing Bd. to 3 Dirs., 2 appointed by Crown, thru by-law amendment. Ct. voided by-law amendment b/c Dirs. cannot be removed w/out cause thru Bd. shrinkage if Bd. is classified, which it was. |

**IV. Fiduciary Duties & Shareholder Litigation**

**Business Judgment Rule (BJR)**: Emanates from DCGL 141(a) (“Bd. shall manage”).

* P challenging Bd. action faces presumption that:
1. Bd. was disinterested
2. Bd. acted w/due care (*Van Gorkom*)
3. Bd. acted w/good faith belief its actions were in firm’s best interest (*Ford*; *Wrigley*)
* P must rebut at least one of these presumptions (*Kamin*)
* The absence of Bd. action is not subject to BJR protection (*Francis*)

**Due Care Standards**:

* BJR
* Enhanced scrutiny (*Revlon*, when selling control)
* Entire fairness (applies to controlling SHs)—most exacting; or damages standard
* *Blasius* (applies to Bd. action w/primary purpose of “thwarting exercise of SH vote”)—Must demonstrate compelling justification.

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| *Kamin v. American Express Co.* (N.Y. 1976)—AmEx ignored a shareholder’s plea to sell shares in order to take advantage of tax loss harvesting (??), instead distributing them as dividends, at some expense to SHs and the corp.* Even a clearly bad business decision gets BJR protection if none of the presumptions are rebutted.
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**Limits on Board Power to Act**

* Ultra vires—Acting beyond one’s legal authority
	+ Bd. cannot decide to violate the law even for profit (*Pyott*)
	+ Most corp. charters state purpose as undertaking any legal activity to make profit.
* Waste—Acting in a way that wastes corp. resources
	+ Corps. have a lot of leeway to give implausible reasons for bad business decisions (e.g. *Wrigley*), but they can’t outright say it is for another purpose (*Ford*).

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| *Dodge v. Ford Motor Co.* (Mich. 1919)—Ford ceased paying special dividends to lower per car cost to massively expand. Dodges challenged this decision. Ford foolishly argued it was for the benefit of society, rather than profit, so Ct. ruled it was waste, ordered corp. pay the special dividend.* Benefit to society is waste.
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| *Shlensky v. Wrigley* (Ill. 1968)—Cubs Bd. refused to install nights, allowing for nighttime games. Terrible business decision, clearly motivated by nostalgia, but corp. claimed it was to protect the neighborhood, indirectly benefiting business. Not waste. |

**Duty of Care: Board Decisions (Role of Committees)**

**Corporate Purpose**: Should directors only look out for SH interests, or should they also consider other stakeholders, including not just themselves and officers but also employees and customers? Ongoing debate.

**Duty of Care**: Two tests:

* Dirs. failed to act where due attention would have prevented harm
	+ Liability standard: good/bad faith (but *Francis*)
	+ *Caremark* test—P must show:
		- (1) Dirs. knew or should have known violations were occurring;
		- (2) Dirs. either (a) didn’t exercise good faith oversight or (b) after learning of crime, did not make good faith effort to remedy (sustained neglect); and
		- (3) Such failure proximately caused the loss
* Dirs. failed to consider all reasonably available material info prior to making a decision
	+ Liability standard: gross negligence
		- If negligence but not gross negligence, duty of care is violated but there is no liability (*Disney*)
		- Bd. can be indemnified from duty of care liability under DGCL 102(b)(7)

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| *Smith v. Van Gorkom* (Del. 1985)—The CEO convinced the Dirs. to agree to a $55/share buyout w/essentially no investigation of alternatives. Ct. found Dirs. were grossly negligent, BJR did not apply, so they were liable.* Led to the creation of § 102(b)(7); which most corps. have added to their certificate.
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| *Cinerama, Inc. v. Technicolor, Inc.* (Del. 1995)—Perlman acquires Tech at double-market price, then profits. SH challenges Bd. approval of acquisition. Ct.: BJR presumption rebutted, but entire fairness standard is met so no damages. No evidence of potential higher price. |

**Duty of Care & Good Faith in Board Decision Making**

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| *Walt Disney Co. Derivative Litigation* (Del. 2006)—Disney gave Eisner massive compensation package; challenged as waste. Ct.: Bd. breached duty of care, but no liability b/c they sought info, hired experts, had multiple meetings, no conflicts of interest, and salaries are a lower level of concern (compared to, e.g., sale of control). |

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| *Morrison v. Berry* (Del. 2018)—Founder of Fresh Market had conflict of interest; attempted to cleanse by recusing, but also Bd. hid docs from SHs. SHs found docs, challenged ongoing sale. Ct.Ch. dismissed under *Corwin* cleansing, but Del. reversed, ruling disclosures cannot make misleading omissions that may affect SH voting. |

* *City of Fort Meyers General Employees Pension Fund v. Haley* (Del. 2020)—Reversed Ct.Ch. + found potential breach of duty of candor where CEO did not disclose offer of better compensation if deal went thru to Bd. + SHs, also aiding + abetting claims survive.

**Director Liability for Inaction, Inadequate Oversight, and Bad Faith**

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| *Francis v. United Jersey Bank* (N.J. 1981)—Sons embezzled; suit brought against Dir. Mom, who was unaware, not attentive. Ct.: ignorance is not a defense to duty of care claims. Rarely applies, but must learn business, object + resign upon learning of illegality. |

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| *In re Caremark Int’l Derivative Litigation* (Del.Ch. 1996)—Co. had limited internal audits to avoid ARPL violations, but still indicted for low-level violations. Suit against Dirs. on duty of care fails, creates the *Caremark* test for legal compliance. |

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| *Stone v. Ritter* (Del. 2006)—Ponzi scheme operated thru bank. Bank had ineffective monitoring system. SHs sued Dirs. on duty of care. Ct.: grossly negligent but not deliberate, so no bad faith. Case dismissed. |

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| *La. Municipal Police Employees’ Retirement System v. Pyott* (Del.Ch. 2012)—Botox co. Allergan pays huge settlement in DOJ suit. Ct. declined to dismiss *Caremark* claim; co. broke the law.* Stands for the premise that corps. cannot decide to violate the law, even for profit.
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| *Marchand II v. Barnhill, Jr.* (Del. 2019)—Bluebell listeria outbreak. Bd. had basic health & safety, but almost no discussion at meetings; no substantive Bd.-level awareness or consideration of potential health problems. Ct.: *Caremark* satisfied; not dismissed. |

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| *In re Clovis Oncology, Inc. Derivative Litigation* (Del.Ch. 2019)—Bd. essentially misled investors about efficacy of drug in development (Roci). Ct. upheld *Caremark* claim b/c Dirs.’ expertise + reliance on “confirmed/unconfirmed response rate” in SH comms. |

**Duty of Loyalty & Corporate Opportunity**

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| *Benihana of Tokyo, Inc. v. Benihana, Inc.* (De. 2006)—Interested Dir. negotiated preferred stock sale to firm he owned. SHs challenged. Ct.: protected by BJR b/c Bd. was aware of Dir.’s interest + transaction was fair/approved by majority of disinterested SHs. |

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| *Fliegler v. Lawrence* (Del. 1976)—Sale approved by SH ratification. Dirs. owned majority of shares, so SH ratification did not provide a shield to challenge of sale’s fairness.* Adds req. that SHs must also be disinterested.
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* **DCGL 144**: Safe harbor: interested Dirs. can be counted toward quorum if:
	+ 144(a)(1): disclosed + approved by disinterested Dirs.
	+ (a)(2): disclosed + approved by SHs
	+ (a)(3): fair when authorized
* **DCGL 122(17)**: Waiver of corporate opportunity constraints on officers, Dirs. + SHs

**Corporate Opportunity**: An opportunity comes to an agent from a 3rd Party, and it is claimed that it is the corporation’s opportunity.

* Traditional test:
	+ Interest: firm has contractual right
	+ Expectancy: firm would get it if agent did not intervene
	+ Necessity: firm needs it vitally (e.g., building firm operates from)
* Modern test (recognizing affirmative obligation to promote firm) factors (*Broz*):
	1. Corp. must be able to exploit opportunity
	2. Opportunity must be w/in line of business (applied broadly, *Personal Touch*)
	3. Corp. must have an interest/expectancy in opportunity
	4. By taking opportunity, agent places themselves in a position inimical to duties
	+ Factors to consider:
		- How agent acquired info (individual or corp. capacity)
		- Whether corp. info used in identifying/exploiting opportunity
		- How far removed from corp.’s core economic activities

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| *Broz v. Cellular Info. Systems, Inc.* (Del. 1996)—Dir. purchased cell license for his own co.; CIS sued, claiming he usurped corp. opportunity. Ct.: Broz not obligated to present opportunity to Bd. b/c (i) CIS had divested from the region; (ii) CIS had covenant forbidding new debts; (iii) acquisition of CIS by interested firm too tenuous.* Created modern 4-factor test
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| *Personal Touch Holding Corp. v. Glaubach, DDS* (Del.Ch. 2019) (Memo. Opinion)—Corp. pres. bought building that corp. had previously tried to purchase. Ct. applied *Broz* test, found Glaubach breached duty of loyalty, awarded $2m damages. |

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| *In re eBay, Inc. Shareholders Litigation* (Del.Ch. 2004)—3 Dirs. offered sweet stock options from Goldman Sachs. SHs sued arguing stock options are corp. opportunity to share w/corp., not individually. Ct. found corp. opportunity b/c (i) securities trading is line of business; (ii) Dirs. got offer b/c of eBay’s business w/GS; (iii) most SHs don’t have access to this opportunity. |

**Liability of Controlling SH**

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| *Sinclair Oil Corp. v. Levien* (Del. 1971)—SH of subsidiary sues controlling SH, Sinclair, for forcing excessive dividends. Ct.: No corp. opportunity where parent did not give oil investment opp. outside Venezuela to sub. Raising dividends is not self-dealing b/c it benefits minority SHs. However, breach that only benefitted Sinclair was self-dealing. |

**Duties of Controlling Shareholders in Sale of Control**

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| *Zetlin v. Hanson Holdings, Inc.* (N.Y. 1979)—Controlling SH sold shares, receiving control premium price not shared w/minority SHs. Minority SH sued, claiming corp. opportunity. Ct.: No corp. opportunity; buyer sought control, so controlling SH was the only party entitled to premium. |

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| *Perlman v. Feldmann* (2d Cir. 1955)—Feldmann sold controlling interest to firm that he knew would exploit corp. opportunity to the detriment of minority SHs. Ct.: controlling SH had duty to firm (and to minority SHs). Sale of control breached duty. |

**Mergers**

* **DCGL 251 (Mergers)** & **271 (Sale, Lease, or Exchange of Assets)**: Bd. adopts resolution, then requires majority vote of SHs. Does not cover purchases.
	+ **251(f)**: No SH vote required for surviving firm post-merger if:
		- Merger does not amend certificate,
		- Each share of stock will be identical post-merger, and
		- Firm issues less than 20% of new shares as part of deal
	+ **251(h)**: No SH vote required if:
		- Tender offer is made for all shares,
		- Enough shares are purchased to have merger voting power,
		- Future controlling SH promises ahead of time to effect merger at the same price as the tender offer, and
		- The merger agreement permits the use of 251(h)
* **DGCL 262**: SH who owned shares thruout merger + who did not vote for merger is entitled to appraisal by the Court of Chancery. (A couple restrictions apply.)

**Duty of Loyalty: Controlling SH Self-Dealing Transactions**

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| *Weinberger v. UOP, Inc.* (Del.Sup. 1983)—Signal sought merger w/sub UOP. Signal had relevant data that was not shared w/UOP’s Dirs. Ct.: Signal + Dirs. on both Bds. breached duties by failing to share info. w/other Dirs. But fair price, so no damages. |

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| *Kahn v. Lynch Commun. Sys.* (Del. 1994)—Alcatel is controlling SH w/43% b/c it leverages threat of hostile takeover + b/c even opposed Bd. members often defer. Ct.: Alcatel dominated acquisition negotiations, but fair price and no prejudice to minority SHs.* Burden is on Alcatel to show entire fairness b/c it dictated merger terms + independent committee did not have arms-length bargaining power.
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**Controlling SH**

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| *Kahn v. Tremont* (Del. 1997)—Stock sold b/n 3 corps. owned by Simmons family w/benefit of sales passing especially to family. Minority SH challenged sale arguing special committee was not independent. Ct.: committee was not independent b/c all 3 members had prior relationships to Simmons family.* Entire fairness burden on controlling SH; but if informed majority of minority SHs (requires ind. committee) approve deal, burden passes to P to prove unfairness.
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| *In re Tesla Motors, Inc. Stockholder Litigation* (Del.Ch. 2018)—Ct. found it reasonable that Musk could be a controlling SH w/just 22% of stock b/c of his ability to dominate Tesla Bd. Reviewed SolarCity (also Musk’s) acquisition under entire fairness. No special committee; several conflicts; and deal would double Tesla’s debt. |

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| *Kahn v. M&F Worldwide* (Del. 2014)—M&F sought merger w/M&F Worldwide. As 43% controlling SH, they established ind. committee + won majority vote of informed minority SHs. Minority SH challenged. M&F’s protections sufficient; dismissed.* Controller buyouts receive BJR if: (i) special committee + majority vote of minority SHs; (ii) committee is independent; (iii) committee can freely select advisors and can say no; (iv) committee meets duty of care in price negotiation; (v) minority vote is informed; and (vi) no coercion.
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| *Olenik v. Lodzinski* (Del. 2019)—Controller buyout met MFW reqs. but too late in the process (8 mos. after negotiations began). Ct.: committee must be established before horse trading begins. |

* *In re HomeFed Corp. Stockholder Litigation* (Del.Ch. 2020)—Controlling SH blew MFW by negotiating around special committee.

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| *In re Delphi Financial* (Del.Ch. 2012)—R controls Delphi w/just 13% of shares b/c his Class B have 10x voting power. On sale Class B become Class A, so R insisted on premium. Minority SHs challenged merger arguing unfair terms. Ct. found likelihood of success but declined to enjoin b/c minority SHs were receiving a premium, availability of damages, lack of alternative offers, and lack of material disclosure violations. |

**Shareholder Suits: Demand & SLCs**

**Shareholder Suits**: The primary SH mechanism for officers’ and directors’ breach of fiduciary duties. Divided into:

* Direct suits—Usually SH class actions, brought on behalf of SHs individually. These require an injury to the individual SH and often arise during mergers.
* Derivative suits—Brought by SHs on behalf of the corp. (but really by plaintiffs’ bar attorneys w/placeholder SHs, as attorneys stand to win the biggest pot). Opportunities for derivative suits are more frequent but have greater obstacles to success, particularly the **demand requirement** and the **special litigation committee** (both judicially constructed).
	+ Distinguishing direct and derivative actions requires determining (i) who suffered the injury and therefore (ii) who is entitled to recovery. Derivative if the corp. stands to recover; direct if SHs. (*Medtronic*—SH tax liability; diluted interest) (*Grimes*—abdication)

**Demand Requirement**: Originating from procedural rule requiring plaintiff demonstrate efforts to obtain desired action from directors (Del.Ch.C. 23.1), a SH’s derivative suit must show either (i) demand on the Bd. was futile or (ii) demand was wrongfully denied.

* **Wrongful Denial**: If a demand is denied (as it always will be), plaintiff must show that the Bd. acted in bad faith or failed to investigate. (*Grimes*)
	+ Plaintiffs are disincentivized from making demands b/c doing so waives the right to allege demand futility.
* **Demand Futility**: Demand is futile if the SH can create a reasonable doubt that (i) the directors are disinterested + independent; or (ii) the challenged transaction is a valid exercise of business judgment.
	+ Even if demand is excused, Bd. retains the right to establish a special litigation committee (SLC).
	+ Tests for determining demand futility:
		- *Rales v. Blasband* (1993) (applies to all situations): P must create reasonable doubt that, at time of complaint, majority of Dirs. can exercise independent/disinterested business judgment in evaluating demand. (burden on P) (*Marchand*; *Sanchez*)
			* Dir. is not automatically disinterested just b/c a D. There must be substantial likelihood of success on merits.
		- *Aronson v. Lewis* (1984) (applies only where Bd. is unchanged, basically a mini-*Rales*): P must create reasonable doubt that majority of Dirs. can exercise independent/disinterested business judgment, or challenged transaction was the product of valid business judgment. (*Seinfeld*)
		- *Facebook* (2020)—Dir. is interested in this case not b/c of ties to CEO but b/c he served as a backchannel to the CEO in discussions of the deal. Confirms *Rales* is the test; *Aronson* is the exception. When considering the Board’s neutrality in reviewing a demand (under BJR), go one-by-one asking if a director:
			* (1) has a material interest in the alleged misconduct;
			* (2) acted to advance self-interest of interested party; or
			* (3) acted in bad faith

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| *In re Medtronic, Inc. Shareholder Litigation* (Minn. 2017)—Medtronic acquired/merged w/Covidien. Med SHs alleged 3 harms: tax liability imposed on Med SHs; Med SHs’ diluted interest in corp.; and wasteful reimbursement to officers and directors.* Capital-gains tax liability imposed solely on Med SHs, and they will recover = direct
* Diluted SH interest in corp. imposed solely on Med SHs, and they will recover = direct
* Excise-tax reimbursement imposed harm on corp., and corp. will recover = derivative
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| *Grimes v. Donald* (Del.Sup. 1996)—Corp. negotiated an outrageous w/out cause golden parachute for Donald. SHs challenged, arguing Bd. abdicated its authority, failed to exercise due care, and committed waste.* Ct. found due care, waste, and excessive compensation claims were all derivative b/c harm was to the corp.
* Ct. found abdication was a direct claim b/c P only sought invalidation of the agreement, not $$ recovery. P argued financial harm Bd. would suffer if it fired Donald w/out cause was a deterrent against exercising its duties if need be. Ct. disagreed, finding it was not an abdication, just a bad deal.
* P’s pre-suit demand in effect conceded that demand was not excused. (citing *Spiegel*)
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| *Hughes v. Hu* (Del.Ch. 2020) (Memo. Opinion)—Woefully incompetent Bd. and officers failed to resolve persistent issues (*Caremark* claim—failure in duty of oversight). SH filed derivative suit and claimed demand was futile.* Majority of Dirs. were defendants, although not a challenge to a specific Bd. action. *Rales* governs, and for both Count I (failure in duty of oversight) and Count II (unjust enrichment), demand is excused.
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| *Marchand II v. Barnhill Jr.* (Del. 2019)—SHs filed derivative suit claiming oversight failure where Bd. did not create a hygiene committee and a *listeria* outbreak followed, tanking stock value. Del.Ch. dismissed demand futility argument b/c one shy of a majority of the Dirs. Del. reverses, finding one more interested Dir.* Dr. Rankin was interested b/c he owed his career to the Kruse family, was closely tied to them. D argument that he had once voted contra to them was not availing.
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| *Del. Cty. Employees Retirement Fund v. Sanchez* (Del. 2015)—Outcome-determinative issue in SH derivative suit was whether Dir. Jackson was disinterested/independent. Jackson had worked for/been friends w/Sanchez (D) for 50 years, donated to his gubernatorial campaign, and owed present and future wealth to Sanchez family.* Personal and business relationships are not distinct and should be considered jointly.
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| *Seinfeld v. Slager* (Del.Ch. 2012)—SH brought derivative suit arguing demand futility b/c of *Aronson* prong 2 (unsound business judgment) on the basis of waste. Ct. states test for waste is an “extreme test,” basically impossible to meet, so dismissed. Merely requires Bd. received “any substantial consideration” and made a good faith effort. |

**Special Litigation Committees**

SLCs can request dismissal, pleading w/burden to demonstrate that there is no genuine issue as to fact and moving party is entitled to dismissal. Ct. must apply the following test:

1. Ct. must inquire into the committee’s independence and good faith;
2. Ct. must assess, in its own business judgment, the merit of the claim and whether it should be dismissed.

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| *Zapata Corp. v. Maldonado* (Del. 1981)—SH brought derivative suit arguing demand futility b/c all Dirs. were named Ds. Bd. subsequently created a 2-member committee of new Dirs. to evaluate, and they dismissed the derivative suit. Ct. assessed when Bd.-created committee has authority to dismiss.* Special committee has authority to file for dismissal, but Ct. must evaluate.
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**V. Shareholder Voting**

**Proxy System**

Especially in smaller firms, large SHs can try to oust incumbent Bds. through proxy fights, in which they solicit small SHs to grant them proxy voting rights by having them sign proxy cards. Proxies are subject to the 1934 Securities Exchange Act.

Proxy solicitation only really makes sense in a proxy contest for control of the Bd., which could lead to reimbursement, and that generally will only be paired with a tender offer.

* **DGCL 112 (Access to Proxy Solicitation Materials)**: Broad discretion to limit access to proxy solicitation materials via by-laws, including requiring min. stock ownership, non-recent acquisition, disclosures, or indemnification for misrepresentations.
* **DGCL 113 (Proxy Expense Reimbursement)**: Broad discretion to compensate SHs for proxy solicitation expenses, but cannot apply retroactively.
	+ Incumbent reimbursement requires:
		- SHs must be informed of insurgent claims, fact of firm hiring proxy solicitors, who is hired, and amount paid;
		- Bd. must approve proxy solicitors;
		- contest must be over legitimate policy question; and (*Levin*)
		- expenses must be reasonable. (*Levin*)
	+ Insurgent reimbursement requires all of the above plus:
		- Insurgents are successful
		- Bd. approves payment
		- Majority of *disinterested* SHs approve payment, curing self-dealing (*Rosenfeld*)
* **DGCL 213 (Record Date)**: Bd.-selected date affixing identities of voters for SH meeting; window of opportunity prevents using record date as takeover defense.
* **Also 211, 212, 216, and 242(b) are relevant**

**Proxy Expense Reimbursement (DGCL 113)**

Reimbursement of Incumbent Dirs.

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| *Levin v. Metro-Goldwyn-Mayer, Inc.* (SDNY 1967)—MGM managers (O’Brien group) spent a relatively small a mount to retain counsel and proxy solicitation services. Insurgent Levin group challenged that this was an unlawful use of corp. resources. Ct. ruled that b/c the issue was genuine differences in business strategy, not personal conflict, and expenses were reasonable. |

Reimbursement of Insurgent Dirs.

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| *Rosenfeld v. Fairchild Engine & Airplane Corp.* (N.Y. 1955)—SH seeks return of money paid from firm treasury to successful insurgents in proxy contest. Dismissed b/c expenses were reasonable and SHs voted to approve by a wide margin.* Ct. rejects waste argument in light of *ex ante* benefits of proxy contests.
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**SH Inspection Rights (DGCL 220)**

* **DGCL 219 (Voter List Access)**: 10-days pre-SH meeting, SHs can access voter list for “any purpose germane to meet.” Too little time to significantly affect proxy contests.
* **DGCL 220 (General Inspection Rights)**: Any SH can, at their own expense, review stock ledger, SH list, or other books & records. Must have credible evidence that a fiduciary duty breach may have occurred (*Seinfeld*), lowest burden of proof in law, and a proper purpose reasonably related to their interest as SH:
	+ Can be to investigate wrongdoing/mismanagement (*Seinfeld*; *Facebook*; *AmerisourceBergen*)
	+ Can be about economic benefit to firm/value of shares (*Crane v. Anaconda*)
	+ Can be to investigate Dir. independence/distinterestedness (*AmerisourceBergen*)
	+ Can be to demonstrate breach for *Aronson* prong 2
	+ Cannot be purely social/moral (*Honeywell*)
	+ Can be after derivative suit dismissed but not if w/prejudice

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| *Crane Co. v. Anaconda Co.* (N.Y. 1976)—Crane purchased 11% of Anaconda on tender offer, then sought Anaconda stock book in order to solicit more tender offer stock purchases, but Anaconda Bd. rejected demand b/c not for a purpose relating to business of Anaconda. Ct. found the purpose was one of general interest to Anaconda SHs.* NY case, but accepted in Del.
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| *State ex rel. Pillsbury v. Honeywell, Inc.* (Minn. 1971)—Honeywell produced frag. bombs. P sought SH ledger and corp. records in order to solicit proxies to force Honeywell cease frag. bomb production. Ct. ruled vehemently that preventing war crimes not a proper purpose. |

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| *In re Facebook, Inc. Section 220 Litigation* (Del.Ch. 2019) (Memo. Opinion)—Cambridge Analytica data breach killed $120b SH wealth in one day. Local 79 General Fund sought books & records under 220 in order to investigate Dirs’ breach of fiduciary duties. Facebook argued the demand failed to implicate Dirs. and, if *Caremark* claim, failed to produce evidence of reporting failures. Ct. determined that public reporting and prior consent decree provided credible basis for Fund’s proper purpose. |

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| *Lebanon Cty. Employees’ Retirement Fund and Teamsters Local 443 Health Services & Insur. Plan v. AmerisourceBergen Corp.* (Del.Ch. ?? 2020)—Opioid distributor subject to class-action litigation. Funds sought records under 220 in order to investigate corp. wrongdoing. * Cts. want 220 demand filed before *Caremark* claim.
* Allegation need not provide evidence of actionable claim; merely of mismanagement or wrongdoing, so 102(b)(7) provides no defense.
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**SH Proposals (Rule 14a-8)**

**Proposals**: SHs can submit proposals to other SHs through the firm. Largely limited to precatory proposals/advisory statements; by-laws on certain corp. governance matters; and procedures for Dir. nomination.

* **SEA Rule 14a-8**: SHs may submit a proposal to other SHs to be mailed by firm’s proxy at firm’s expense if proposer has owned at least $2k in stock for 3 years, $15k for 2 years, or $25k for 1 year (amended Sept. 2020; was 1% or $2k for 1 year). Limited to one proposal per SH, 500 words (or more if firm allows), at least 120 days prior to meeting.
	+ **14a-8(i)**: Bases for exclusion of proposals (Bd. bears burden of proof), proposal:
		- (1) Is not proper for action under state law (*CA v. AFSCME*)
		- (2) Would require illegal action (*CA v. AFSCME*)
		- (3) Is misleading or fraudulent
		- (4) Relates to personal grievance
		- (5) Concerns a “small stakes” matter (*Lovenheim*)
			* Less than 5% of assets; less than 5% of net earnings/gross sales; not otherwise significantly related to firm’s business
		- (6) Is beyond the firm’s power to effectuate.
		- (7) Relates to ordinary business operations (*Wal-Mart*)
			* Step 1: Discern subject matter
			* Step 2: Discern whether subject matter relates to ordinary business
		- (8) Dir. elections – if the proposal:
			* would disqualify a nominee; would remove a sitting Dir.; questions the competence/bus. judgment/character of nominee or Dir.; seeks to exclude a specific person; otherwise could affect upcoming election
			* cannot exclude proposals amending proxy access by-laws
			* *AIG v. AFSCME*—proposals related to a particular election can be excluded but not proposals generally related to elections
		- (9) Directly conflicts w/one of the co.’s own proposals
		- (10) Is rendered moot
		- (11) Substantially duplicates another submitted proposal
		- (12) Was previously submitted and failed to achieve 3% of vote in the past 5 years; 6% if proposed twice; or 10% if proposed three times
		- (13) Relates to specific amounts of cash or stock dividends
	+ **Process**:
		- SH submits proposal to Bd.
		- Bd. finds reason to exclude
		- Bd. informs SH of reason and files with SEC (1) proposal, (2) reason for exclusion, and (3) supporting opinion of counsel
		- SH can respond
		- SEC staff issue (or decline to issue) a “no-action letter”
		- SH can seek an injunction
	+ **14a-11**: SEC rule designed to give short slate authority to SHs (as in *AIG*), but immediately invalidated by SCOTUS in 2011.

**July 2020 SEC Rule Change**: Proxy advisory firms’ voting advice will be considered “solicitation” under federal rules; subject to 14a-9 anti-fraud provisions; and (eff. 2021) such firms will need to take additional steps to disclose conflicts of interest.

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| *Trinity Wall Street v. Wal-Mart Stores, Inc.* (3d Cir. 2015)—Church wants Wal-Mart to cease selling high-capacity firearms, so it submits a proposal to develop standards for Mgmt to use in determining whether to sell products that are a threat to public safety, could damage WM’s reputation, and are considered offensive to family/community values. Ct. finds that the subject matter of the proposal is firearms sales, which is a matter of ordinary business operations, so the proposal is properly excluded under 14-a(8)(i) |

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| *Lovenheim v. Iroquois Brands, Ltd.* (D.D.C. 1985)—Lovenheim wants Iroquois to cease producing foie gras, so he submits a proposal to study foie gras production techniques. Iroquois counters that it is a small stakes matter, and the harm is not economic. Ct. finds that “significantly related” is not limited to economic significance, so proposal is not small stakes or improper. |

* *AFSCME Employees Pension Plan v. AIG* (2d Cir. 2006)—SH proposal to amend by-law to include certain SH-nominated activist candidate on ballot. Earlier SEC rule construing 14a-8(i)(8) “relates to an election” narrowly is preferred, so proposal is not excludable.

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| *CA, Inc. v. AFSCME Employees Pension Plan* (Del. 2008)—AFSCME submitted proposal to add by-law to reimburse nominating expenses if under 50% contested and SH gets at least one Dir.* Not excludable under 14a-8(i)(8), which excludes proposals mandating substantive actions but not procedural actions, and election reimbursement is procedural.
* Excludable under 14a-8(i)(2) b/c it would commit the Bd. to a course of action restricting ability to carry out fiduciary duties. There must be a fiduciary out.
* Fiduciary out—clause allowing Bd. to change course if it is determined to be inconsistent w/fiduciary duties.
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**Federal Law: Anti-Fraud Provisions**

* **SEA Rule 14a-9**: Disallows false/misleading statements (or omissions to correct) in proxy solicitation materials. Implied right of action. Elements:
	+ **Breach**: of cognizable securities law duty
		- If *fact*: objectively false at time made or became false shortly thereafter
		- If *opinion*: objectively false by implication, or subjectively false
			* P must show (a) Bd. didn’t believe what it said, and (b) what it said was false (*Virginia Bankshares*)
	+ **Materiality**: (a) There is a substantial likelihood a reasonable SH would consider fact important in deciding how to vote; (b) must have assumed actual significance in the deliberations of a reasonable (fictitious) SH; (c) and omission would alter total mix of info. (*TSC v. Northway*)
	+ **Mens Rea**: 14a-9 actually requires *negligence*, not *scienter*, as does 10b-5.
	+ **Transaction Causation**: Fraud/misleading statement must be an *essential link* in the transaction.
		- Causation established if transaction could not have proceeded w/out misled SHs (*Mills*)
		- If controlling SH, minority SHs must show they read the proxy, Bd. didn’t believe its statement, and statement was wrong (*Va. Bankshares*)
		- **Note**: no reliance requirement (*Mills*)

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| *Mills v. Electric Auto-Lite Co.* (SCOTUS 1970)—SHs would consider it significant that all Dirs. are nominees of and under control of firm that Auto-Lite is being merged into.* There is no reliance requirement for Rule 10a-9/10b-5 fraud/misleading statement.
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| *Virginia Bankshares, Inc. v. Sandberg* (SCOTUS 1991)—Controlling SH made misleading proxy statement (opinion) regarding merger, which minority SHs then voted for. They could not have stopped the merger, but their votes against it could have shamed the controlling SH.  |

**State Regulation of Voting**

* DGCL 203: Defense against hostile takeovers. Firms can but rarely do opt out.

**Management Defense:**

Lucian Bebchuk—Harvard Law prof. has advocated for SH choice voting rule: once bid is made, Bd. is forced to submit bid to SHs. Bd. can still advocate, but bound to SH vote. Arlen feels this would not actually result in SH choice; SHs would have to accept poison pill.

Marty Lipton (Wachtell Lipton)—Allowing Bd. to defend is an important defense against takeovers. Good for economy; good for SHs. SH choice would take away Bd.’s power to bargain.

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| **Defensive Measures** | Pre Bid | Post Bid |
| Pure Defense | Poison Pill + Classified Bd. | Poison Pill + Scorched Earth |
| Embedded Defense | Change of Control Clause; Structural Defenses | White Knight T/W Acquisition; Spin Offs |

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| *Schnell v. Chris-Craft Indus., Inc.* (Del. 1971)—Proxy contest for firm control. Bd. resists insurgents’ efforts to get SH list. Once insurgents get list, Bd. amends by-laws to move up annual meeting date a month. Ct. enjoins by-law amendment b/c designed to entrench. Rebuts BJR as conflicted transaction, motivated by entrenchment.* Prior Bd. attempts to frustrate insurgents is evidence of entrenchment motivation.
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| *Blasius Indus., Inc. v. Atlas Corp.* (Del.Ch. 1988)—Largest SH (Blasius) proposes restructuring + Bd. objects. Blasius solicits consent to expand Bd. from 7 to 15. Bd. amended by-laws to expand to 9 and filled w/their people.* BJR does not apply to Bd.’s action b/c it is about process, not business.
* If Bd. action interferes w/SH franchise, Bd. has heavy burden of compelling justification.
* Note: this only applies in the context of proxy contests.
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**VI. The Acquisitions Market**

**Defensive Tactics**

* **DGCL § 203** (Anti-Takeover Statute): Firm shall not engage in bus. combination w/interested SH (i.e., at least 15% of shares) w/in 3 yrs of share acquisition.
	+ - Very rarely has any bite. Exception: *Dygex* (not a case we read)
	+ Exceptions:
		- Firm opts out
		- Strike a pre-acquisition deal w/mgmt
		- Make a tender offer contingent on crossing 85%
		- After SH becomes interested, merger approved by Bd. + 2/3ds non-interested SHs
	+ Alternatives:
		- Wait out the 3 yrs
		- Propose an attractive 2nd tier
		- Mount proxy contest to elect a Bd. that will approve the merger
			* Defenses: classified Bd. or deadhand poison pill (invalid in Del.)
* *Unocal* test for assessing defensive measures not protected by BJR (bc inherent entrenchment conflict of interest):
	+ (1) Reasonable threat to corporate policy & effectiveness (coercion; inadequate price; risk of nonconsummation; quality of instruments exchanged; illegality) (easy standard to meet)
		- In *Unocal*, this is a threat to SH ability to get a fair share price.
		- In *Unitrin*, ct. identifies 3 classes of cognizable threats:
			* Opportunity Loss (hostile offer deprives SHs of alternative)
			* Structural Coercion
			* Substantive Coercion (misleadingly low price; not really coercive)
	+ (2) Response is proportional to threat (also easy standard to meet)
		- *Unitrin* bifurcates into 2 prongs:
			* Is the response “draconian”: coercive or preclusive of all deals, not just bad ones? If so, void response. (but *Paramount v. Time*)
			* If not, is the response in the “range of reasonableness”? Wide discretion, and usually yes.
* *Revlon* standard: Sole concern should be maximizing SH value by increasing sale price.
	+ Triggered when:
		- Firm breakup is on the table
		- Sale of firm is on the table (actively seeking bids)
		- Sale of control of firm is on the table (*QVC*)
	+ Duties:
		- Be diligent & vigilant in examining offers
		- Act in good faith
		- Obtain & act w/due care on all available info.
		- Negotiate actively & in good faith w/all bidders
	+ *QVC* framing of *Revlon*: Enhanced scrutiny test: (1) judicial determination of adequacy of decisionmaking process; and (2) judicial examination of reasonableness of Dirs.’ actions.

**Poison Pill**: After *Unocal*, SEC banned discriminatory self-tenders. Instead, corps. developed the “poison pill.” If a raider acquires a % of shares, firm sells its shares at discount to all other SHs, diluting raiders’ ownership and the value of the remaining firm. Bd. can do this unilaterally.

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| *Unocal v. Mesa* (Del. 1985)—Mesa seeks to acquire UNOCAL. Makes coercive two-tiered tender offer (front-end equity & back-end sub. debt). Bd. enacts measure to buy back all stock except Mesa’s as soon as Mesa hits 50%, reversing collective action problem + killing the deal. Mesa argues this breached fiduciary duty by saddling firm w/debt.* Ct. establishes *UNOCAL* standard for assessing defensive actions. Finds threat in SH inability to get fair share price. Finds response to be proportional (treating inflated buy-back price as reflecting control premium, although likely too high).
* SEC later prohibits discriminatory self-tenders, so firms have adopted poison pill.
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* *Unitrin v. Am. Gen. Corp.* (Del. 1995)—Can all-cash all-shares negotiable offer be a threat? Ct. recognizes 3 threats: (1) opportunity loss; (2) structural coercion; and (3) substantive coercion.

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| *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.* (Del. 1985)—Poison pill: when 1 SH reaches 20% (here it’s Pantry Pride), other SHs given note guaranteeing $65 debt security per share. If notes exceed firm value, this essentially distributes firm’s assets to SHs, minus PP. Bd. rejects PP tender offer; PP raises offer, but Bd. rejects and negotiates worse deal w/Forstmann (limiting their own liability). PP sought to enjoin Forstmann deal, arguing Bd. breached its duties by preventing PP from bidding.* Ct. found initial defensive measures were appropriate under *Unocal* test.
* However, once firm’s breakup or sale become inevitable, Bd’s duties shift: singular purpose is to maximize SH value.
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* *Interco* (1988)—Rales Bros. attempt to acquire Interco. Bd. rejects, adopts poison pill. Bd. pursues restructuring plan that benefits SHs. Threat to SHs’ econ. interests but not to firm. Ct.: threat not great enough to justify leaving pill in place. Subsequent cases differ.

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| *Paramount Comms., Inc. v. Time Inc.* (Del. 1989)—Time & Warner nearing merger deal; PC makes tender offer for outstanding Time shares w/conditions. Time Bd. rejects merger b/c it threatens Time’s ability to control its own destiny and b/c inadequate.* SHs raised *Revlon*: Not a *Revlon* claim b/c Time’s sale/breakup was not inevitable.
* PC + SHs raised *Unocal*: (1) Ct. finds threat b/c deal w/PC was investigated & b/c Bd. reasonably determined it was inadequate; (2) deal w/Warner precluding alternative deals was not mgmt coercion of SHs but a reasonable element of a then-ongoing deal.
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| *Paramount Comms. Inc. QVC Network Inc.* (Del. 1994)—PC & Viacom merger negotiations stall when QVC expresses interest in PC. PC rejects QVC, accepts original terms w/Viacom. Merger exempts Viacom from poison pill and adds 3 defensive measures: (1) no-shop provision; (2) $100m termination fee; and (3) stock option agreement for 19.9% of PC stock w/sub. debt + unreasonable Put Feature option. QVC makes big tender offer, but Bd. sticks w/Viacom.* Ct.: B/c public PC SHs will lose majority control (integral that Sumner Redstone will be controlling SH in post-merger firm), *Revlon* triggered.
* Ct.: Original defensive measures not reasonable b/c modest control premium offered.
* Ct. invalidated defensive measures, leading to bidding war that Viacom won.
* **Termination fees**: Compare fee to firm value; preclusive of bidding? pre-negotiations?
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* *Carmody v. Toll Bros.* (Del.Ch. 1998)—“dead hand poison pill” would prevent takeover Bd. from redeeming pill. Ct. rejected “dead hand” pills b/c took power from Dirs. + SHs.
* *Mentor Graphics Corp. v. Quickturn Design* (Del.Ch. 1998)—“no hand pill” invalidated b/c *Unocal* prong 2. Del. Supreme Ct. affirmed but instead b/c ran afoul of 141(a).

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| *Lyondell Chem. Co. v. Ryan* (Del. 2009)—Basel AF makes low offer for Lyondell. Lyondell rejects. Basel keeps raising offer, then starts trying to merge w/someone else. Bd. then tells Basel they’re interested. SHs bring class action alleging breach of duties for allegedly not obtaining best price.* Ct.: Question is not whether *disinterested* Dirs. took every step to obtain best price but whether they utterly failed to attempt to do so.
* Ct. doesn’t just look at info sought by Dirs. but also process.
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| *In re Del Monte Foods Shareholders Litigation* (Del.Ch. 2011)—Barclays, as DM’s fin. advisor, organized merger w/Vestar & KKR w/out disclosing to Bd., suppressing price. Bd. sued for breach of duty; Barclays & KKR sued for aiding & abetting.* Ct.: Bd. may have breached duty; must take “active & direct role” in process.
* Ct.: Barclays was acting in self-interest, could be liable for aiding & abetting breach.
* *Mills v. MacMillan* (Del. 1989)—When Bd. is deceived by interested advisor, it may lose 141(e) (reliance on experts) protection.
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**VII. Federal Securities Fraud (Rules 10b-5, 14e-3 and 1348)**

**Fraud on the Market**

* **SEC Rule 10b-5** (Securities Fraud): Fraud in the context of sale/purchase of securities.
	+ SEC/DOJ Suit Elements:
		- Misstatement/Omission of Fact (must be fact, but can be opinion-based)
		- Materiality (must have financial impact; need not be demonstrably negative)
		- Scienter (knowing/intentional/reckless)
		- In connection w/purchase/sale of securities (lie must affect value)
	+ Private Cause of Action Elements:
		- All of the above, plus:
		- Standing (P must have bought/sold shares during period of lie)
		- Scienter (must additionally plead particularized facts)
			* Good intent does not negate (*Basic*)
		- Transaction Causation
			* *Halliburton* test:
				+ Misrepresentation publicly known
				+ Was material
				+ Stock traded on efficient market
				+ P traded the stock after misrep & before truth came out
			* *Basic* test for rebutting presumption that fraud affected share price:
				+ Shares don’t trade on efficient market, or
				+ Market didn’t believe lie/truth entered market in sufficiently credible way, eliminating lie, or
				+ P didn’t rely on market price
		- Loss Causation
			* Need not be shown at class cert. stage, but transaction causation must be (*Halliburton*)

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| *Basic Inc. v. Levinson* (SCOTUS 1988)—Dirs. spread false rumors to tank deal they didn’t think would be good for SHs. Deal tanked; SHs sued.* Ct.: Good intent does not negate scienter; Basic could have been silent.
* Established “fraud on the market” presumption: b/c market digests all available info into share price, if misrepresentation is publicly known and material, stock was traded in efficient market, and P traded that stock, P is presumed to have relied on the fraud.
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| *Halliburton Co. v. Erica P. John Fund, Inc.* (SCOTUS 2014)—Former SHs sued Halliburton claiming it falsified financial statements and invoking “fraud on the market” theory. “Fraud on the market” presumption invoked at class cert. stage; Halliburton prevented from presenting evidence rebutting presumption. Ct. allowed Halliburton to rebut at class cert. stage but declined to overturn *Basic*. |

**Classic Insider Trading**

* Classic insider trading does not involve fraudulent statements. It is fraud b/c someone was silent when they had a fiduciary duty to share information.
* Rule 10b-5:
	+ Prima facie case if individual trades while “aware” of material nonpublic info.
		- Shifts burden to D, who must show that prior to learning info, they:
			* Had entered binding K to sell at amount/price/date to sell, or
			* Had instructed agent to trade on their account at amount/price/date, or
			* Had prior written plan, adhered to, specifying amount/price/date
* Contemporaneous trader: P must merely demonstrate that they were trading at the same time that D was trading on material nonpublic info.

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| *Chiarella v. US* (SCOTUS 1980)—Print shop owner prints anonymous materials relating to takeover bid. He guesses the takeover firm, buys stock; profits $30k. Caught; agrees to civil consent decree disgorging profits. Criminal charges filed. Chiarella defends that he committed no fraud.* Ct.: Chiarella had no duty to disclose b/c he was not an agent of the firm/had no duty of confidence.
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| *Dirks v. SEC* (SCOTUS 1983)—Tipper-tippee case. Officer Secrist discovers fraud, brings it to Dirks. Dirks’ clients sell. SEC goes after them for insider trading. Secrist had corp. purpose (save firm from fraud). Dirks was not supposed to keep it confidential, so not constructive insider.* Two-part test: Step one: Breach of fiduciary duty + tip was done for personal benefit.
* Step two: Tippee must know of (or be willfully blind to) breach
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| *Salman v. US* (SCOTUS 2016)—Traded on info from brother + brother-in-law’s brother. Primary evidence was family relationship. Ct.: close family relationship is sufficient to sustain a conviction for insider trading.* When tipper provides info to relative/trading partner, can be assumed intended it as equivalent to cash gift, no need to receive something in return
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| *US v. Martoma* (2d Cir. 2017)—SAC Capital traded on info received from two corrupt doctors, no evidence of payment. In light of *Salman*, no need to demonstrate payment b/c gift to trading partner also sufficient. |

**Misappropriation**

* SEC Rule 10b5-2: Duties of trust and confidence in misappropriation:
	+ Agreement to maintain confidentiality, or
	+ History of sharing confidences, or
	+ Receipt of info. from family (but can rebut by showing no history of confidences)
* SEC Rule 14e-3: If an individual is taking steps to make a tender offer, any person (i) who has related info they know is nonpublic (ii) that was acquired from offeror or officer of corp. commits fraud if they trade on that info.
* *Carpenter v. US* (SCOTUS 1987)—WSJ reporter w/prominent stocks column shared his upcoming columns w/trading partners (profiting hundreds of thousands). Guilty of insider trading and wire fraud b/c he owed duty of confidentiality to WSJ (even though WSJ had no interest in the underlying transactions).

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| *US v. O’Hagan* (SCOTUS 1997)—O’Hagan’s law firm hired to oversee Grand Met-Pillsbury merger. O’Hagan learns of merger; buys stock in buyer, reaps big payout to pay off his client theft. Ct.: Misappropriation of confidential info. amounts to fraud under 10b-5. |

* *US v. Chestman* (2d Cir. 1991)—Daughter of officer shared info of merger w/husband, no intention that he would trade on it, told him not to. He did. Ct. found he was not a trusted insider of the family; no expectation of confidentiality.