

# INSIGHTS

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## THE CORPORATE & SECURITIES LAW ADVISOR

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ASPEN PUBLISHERS

Volume 25 Number 3, March 2011

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## IN THE COURTS

### Reviewing the Standards of Review in Delaware

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On January 21, 2011, the Court of Chancery issued *Reis v. Hazelett Strip-Casting Corp.*,<sup>1</sup> a post-trial decision regarding the fairness of a reverse stock split<sup>2</sup> and the resulting injury to the minority stockholders. In *Reis*, Vice Chancellor Laster provided a revealing look into the Court's position on when to apply the three principal standards of review governing Delaware corporate law: (1) business judgment; (2) enhanced scrutiny; and (3) entire fairness. The Court also provided a new justification for applying enhanced scrutiny in "final stage" transactions and imposed liability on non-independent directors under the entire fairness test without an explicit finding of breach of fiduciary duty.

#### Summary of the Opinion

Following a two-day trial, the Court found the following facts. Founded in 1956, Hazelett Strip-Casting Corporation had been owned

by brothers William and Richard Hazelett—William owned 800 shares, and Richard owned 350—until Richard's death in 2002.<sup>3</sup> In his will, Richard bequeathed his 350 shares to 169 different individuals, mostly past and present company employees.<sup>4</sup> Plaintiff Ginette Reis, a co-executor of Richard's will, received two shares.<sup>5</sup>

Hazelett's board had five directors: William, William's son David Hazelett, and three company employees.<sup>6</sup> Determined to keep Hazelett a family-owned company, William and David (through the company) attempted to buy the 350 shares owned by Richard's estate before probate was final for \$1,500 per share.<sup>7</sup> The estate's executors were initially enthusiastic about the cash offer, but they later became concerned that it undervalued the company.<sup>8</sup> William then increased the offer, but the executors did not accept it.<sup>9</sup>

Eventually, Hazelett's board approved a 400-to-1 reverse stock split, with resulting fractional shares being cashed out following a valuation of the company.<sup>10</sup> That ratio ensured that William, post-split, would be the sole beneficial owner of Hazelett stock. William, as majority stockholder, then approved the reverse stock split, and in December 2005, Hazelett's charter was amended to prohibit the issuance of fractional shares.<sup>11</sup> Importantly, the charter amendment did not implement the reverse stock split (even though defendants believed that it had).<sup>12</sup>

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The board retained a valuation firm that, in February 2006, valued Hazelett at \$1,834,443 as of September 30, 2005, making each pre-split share worth \$1,595.17.<sup>13</sup> The board then approved a \$558,309.50 cash payment to Richard's estate for its post-split 350/400 of a Hazelett share.<sup>14</sup> Reis refused the payment and challenged the reverse stock split in the probate court.<sup>15</sup> In January 2008, Hazelett amended its charter again—this time to implement the reverse stock split properly and to rectify the earlier failure to do so. But the board neither sought an updated valuation nor set an updated price for the fractional shares.<sup>16</sup> Shortly thereafter, Reis filed suit in the Court of Chancery.

The Court's legal analysis proceeded in four parts. First, it discussed at length the three standards of review used in Delaware corporate law: the business judgment rule, enhanced scrutiny, and entire fairness.<sup>17</sup> The Court held that reverse stock splits "in which stockholders receive cash in lieu of fractional interests" are final-stage transactions deserving of enhanced scrutiny.<sup>18</sup> But, because the Court found that Hazelett's controlling stockholder (William) was using the reverse stock split to cash out minority stockholders, the transaction was subject to review under the entire fairness standard.<sup>19</sup> Had the split been negotiated by a "duly empowered and properly functioning" independent special committee and conditioned on a "correctly formulated" vote of a majority of the minority shares outstanding, it would have avoided entire fairness review; had only one of those procedural protections been in place, plaintiff would have borne the burden of proving unfairness.<sup>20</sup> This standard of review—in which the use of both procedural protections can completely avoid entire fairness review—is similar to the standards of review recently described in the Court's 2009 *John Q. Hammons* opinion<sup>21</sup> and 2010 *CNX* opinion.<sup>22</sup>

Second, the Court analyzed the applicable valuation standard for "fair value" under Section 155 of the General Corporation Law of the State

of Delaware (DGCL), which deals with fractions of shares.<sup>23</sup> The Delaware Supreme Court had earlier held that Section 155's "fair value" had a meaning independent of the definition of "fair value" in Section 262 (dealing with appraisal).<sup>24</sup> Nevertheless, the *Reis* Court, recognizing that "fair value" in appraisal has been held to be the same as "fair price" in an entire fairness analysis,<sup>25</sup> held that the same analysis would apply to reverse stock splits subject to entire fairness scrutiny.<sup>26</sup>

Third, the Court analyzed the transaction, determining that neither the process nor the price was fair.<sup>27</sup> Fourth, because the Court determined that the proper remedy would be an award of fair value, it proceeded to determine the fair value of Hazelett's shares.<sup>28</sup>

The Court ultimately determined that the fair value of each fractional interest in Hazelett was worth \$3,845 and awarded damages of \$1,268,850 (less the amount that had already been paid plus interest).<sup>29</sup> The Court then—in the absence of an exculpatory charter provision pursuant to Section 102(b)(7) of the DGCL—imposed joint and several liability on all directors for that amount.<sup>30</sup>

### ***Revlon* Enhanced Scrutiny in the Final Stage**

The Court noted that enhanced scrutiny applies in transactions that are "[f]inal stage transactions" for the stockholders.<sup>31</sup> A final-stage transaction—like a cash sale or change of control—is one where the stockholders' ownership in an entity is fundamentally altered.<sup>32</sup> Discussing academic literature, the *Reis* Court noted that, absent enhanced scrutiny, directors of a company in the final stage will be free to indulge their self-interest (or otherwise stray from the stockholders' best interests) because they will no longer face the stockholders' scrutiny at, for example, a subsequent annual election or any subsequent "transaction" (because there will be no subsequent transaction or interaction between

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the parties).<sup>33</sup> To protect stockholders from this potential divergence of interests, *Reis* stated that enhanced scrutiny was proper.

Vice Chancellor Laster has now several times stated his view that all “final stage” transactions are subject to enhanced scrutiny,<sup>34</sup> with *Reis* representing the fullest version of that proposition. While not without surface appeal, that proposition is in some tension with several well-established principles of Delaware law.<sup>35</sup> Specifically, his theory arguably would apply enhanced scrutiny to transactions in which *Revlon* duties have been held not to apply—first, change-of-control transactions where a controller is already in place<sup>36</sup> and, second, stock-for-stock mergers in which the target stockholders will own only a small portion of the combined entity.<sup>37</sup>

The “final stage” theory also appears to represent a new justification for *Revlon* enhanced scrutiny. Traditionally, *Revlon* enhanced scrutiny was prompted by a concern about the target directors’ divided loyalties—about directors preferring one bidder over another for personal reasons that were not in the stockholders’ best interests.<sup>38</sup> For example, in *Revlon* itself, the target management bore “strong personal antipathy to [disfavored bidder] Mr. Perelman” and the “principal benefit [of the favored bid] went to the directors, who avoided personal liability to a class of creditors.”<sup>39</sup> Even the law-review article prominently cited in *Reis* regarding final-stage transactions suggested that the decision in *Revlon* was not motivated by a final-stage concern.<sup>40</sup>

The Delaware Supreme Court’s concern about “favoritism” was manifested in its 1989 creation of *Revlon* enhanced scrutiny in *Macmillan*, holding that—before *Revlon* enhanced scrutiny can apply—plaintiffs must demonstrate that the target board treated one or more bidders on unequal terms.<sup>41</sup> The Delaware Supreme Court reaffirmed this test in its 1994 *QVC* opinion: “The *Macmillan* decision articulates a specific two-part test [*Revlon* enhanced scrutiny] for analyzing board

action where competing bidders are not treated equally. . . . Before this test is invoked, the plaintiff must show, and the trial court must find, that the directors of the target company treated one or more of the respective bidders on unequal terms.”<sup>42</sup> If no favoritism was shown (or if only one bidder emerged), the *Macmillan* test was not met and *Revlon* enhanced scrutiny did not apply.<sup>43</sup>

Since *QVC*, the Delaware courts rarely have mentioned the conditions of the *Macmillan* test. Although the Delaware Supreme Court cases referring to it have not been expressly overruled, the Court of Chancery has applied *Revlon* enhanced scrutiny in situations that might not otherwise pass the *Macmillan* test.<sup>44</sup> Although many Chancery cases still refer to the favoritism concerns animating the old test,<sup>45</sup> practitioners have been (safely) assuming for years that *Macmillan* no longer controls and that all cases involving *Revlon* duties would also involve *Revlon* enhanced scrutiny. Thus, while *Reis*’s “final stage” construct comports with the traditional imposition of *Revlon* duties (to get the best price reasonably available),<sup>46</sup> it offers a new theory justifying the imposition of enhanced scrutiny.

## Personal Liability for Beholden Directors

On the last page of the *Reis* opinion, the Court found that all five directors were “jointly and severally liable for the remedy imposed”—roughly \$1 million in damages.<sup>47</sup> Hazelett’s charter apparently did not contain an exculpatory provision under Section 102(b)(7) of the DGCL,<sup>48</sup> which is uncommon. What was more interesting is that the Court undertook no director-by-director analysis of liability and simply imposed liability on all directors.<sup>49</sup> The Court’s method of imposing liability appears to diverge from typical practice, and practitioners would be well advised to note the concerns this raises.

William was the only director on both sides of the transaction—he was the beneficial owner of

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the only Hazelett shares that would remain outstanding post-split. Therefore, under a traditional liability analysis, only William would have been *per se* liable for the unfair price.<sup>50</sup> That is, under Delaware law, a self-interested fiduciary is liable for an unfair transaction regardless of his or her subjective good faith.<sup>51</sup>

The other four Hazelett directors (even William's son David) were not self-interested; they were only beholden to William.<sup>52</sup> In that context, the Court, after determining that the transaction was unfair, typically would have determined whether each director breached his fiduciary duties.<sup>53</sup> That is, under prior cases, a finding of unfairness would not automatically suffice to impose liability on disinterested (but non-independent) directors.<sup>54</sup> As the Court of Chancery has stated, being beholden to William "is only a fact relevant to the ultimate determination whether [the other four directors] complied with their fiduciary duties, it is not a status crime making them a guarantor of the fairness of the transaction."<sup>55</sup>

The lack of a 102(b)(7) provision would not ordinarily change that analysis. Certainly, in the presence of a 102(b)(7) provision, a director-by-director analysis is crucial because the Court must determine whether the breached fiduciary duty is exculpated.<sup>56</sup> But even without a 102(b)(7) provision, directors must be found to have breached fiduciary duties before liability may be imposed.

Because the Court found them liable, either the Hazelett directors breached their duty of loyalty by failing to act in good faith—which would not be exculpated even if Hazelett had a 102(b)(7) provision<sup>57</sup>—or they breached their duty of care by acting with gross negligence—which is not exculpated without a 102(b)(7) provision.<sup>58</sup> But the Court did not expressly state in its opinion that any of those four directors breached their fiduciary duties (or which fiduciary duty they breached).<sup>59</sup> Perhaps their failure to secure an updated valuation when they rectified their earlier

failure to implement the reverse stock split<sup>60</sup> was a breach of their duty of care.<sup>61</sup> The Court made no specific mention of the four directors' reckless indifference or gross negligence.<sup>62</sup> Further, the Court made no mention of any intentional wrongdoing, scienter, or conscious disregard that would have sufficed for a breach of the four directors' duty of loyalty by failing to act in good faith.<sup>63</sup>

It also could be that *Reis* represents a departure from prior law in that beholden directors may now be held *per se* liable for unfair transactions, just as self-interested directors are. This conclusion necessarily will require further development, but practitioners should be cognizant of this portion of the *Reis* opinion.

## Conclusion

The *Reis* opinion is important in several ways, including in that it highlights Vice Chancellor Laster's move to applying enhanced scrutiny in all final-stage transactions. Finally, *Reis* suggests that non-independent directors may be found *per se* liable for unfair transactions. Even though *Reis*'s direct application is narrow (to cash-out reverse stock splits), the opinion and its statements regarding Delaware's standards of review merit close study by practitioners advising on all final-stage transactions.

## NOTES

1. 2011 WL 303207 (Del. Ch. Jan. 21, 2011, *corrected* Feb. 1, 2011).
2. A reverse stock split is a method by which a corporation, through an amendment to its certificate of incorporation, reduces the number of its outstanding shares (and shares held in treasury) by reclassifying those shares into a number of new shares determined by reference to a specified ratio (e.g., 8 to 1). "[T]o effect a . . . reverse stock split, the corporation must follow the prescribed corporate formalities to amend its certificate of incorporation in such a manner that 'splits' the outstanding shares in accordance with the corporation's intentions." *Blades v. Wisheart*, 2010 WL 4638603, at \*8 (Del. Ch. Nov. 17, 2010). The reverse stock split in *Reis* was not correctly accomplished at first—a December 2005 charter amendment did not actually implement the split. *Reis*, 2011 WL 303207, at \*5. That error was later corrected by a further charter amendment on January 28, 2008. *Id.*

3. *Reis*, 2011 WL 30327, at \*1-2.
4. *Id.* at \*2.
5. *Id.*
6. *Id.* Those five defendants received a total of 20 shares under Richard's will. *Id.*
7. *Id.* at \*3.
8. *Id.*
9. *See id.* at \*4.
10. *Id.* Under the board resolution, fractional shares would be disposed of (or paid in cash) in accordance with Section 155 of the DGCL. *Id.*; *see also* 8 *Del. C.* § 155.
11. *See Reis*, 2011 WL 303207, at \*5.
12. *Id.*; *see supra* note 2.
13. *Reis*, 2011 WL 303207, at \*5.
14. *Id.*
15. *Id.*
16. *Id.* at \*6.
17. *Id.* at \*8-10.
18. *Id.* at \*10. The Court did not expressly provide any exception to that holding. But some reverse stock splits are designed to raise a company's stock price and bring a company in compliance with stock exchange rules. *See, e.g.*, Rite Aid Corp., Form 8-K (Current Report) (Oct. 17, 2008) ("The reverse stock split is intended to increase the per share trading price of the Company's common stock, and make it more attractive to a broader range of institutional investors and enable the Company to regain compliance with the NYSE's price criteria for continued listing. No fractional shares will be issued in connection with the reverse stock split. Shares that would otherwise have resulted in fractional shares from the reverse stock split will be aggregated by the Company's transfer agent and sold in the open market. The proceeds will be allocated pro-rata to the stockholders' respective accounts who are entitled to receive cash in lieu of fractional shares."). Arguably, *Reis* holds that such a reverse stock split would be subject to enhanced scrutiny. Nonetheless, directors should easily be able to meet the standard in that context; the Court suggests that it would be "reasonable for a board to use market value to determine the price paid for fractional interests when there is no controlling stockholder and the stock is widely traded." *Reis*, 2011 WL 303207, at \*10.
19. *Reis*, 2011 WL 303207, at \*10-11.
20. *Id.* at \*10.
21. *In re John Q. Hammons Hotels Inc. S'holder Litig.*, 2009 WL 3165613, at \*12 (Del. Ch. Oct. 2, 2009) ("In this case—which, again, I have determined is not governed by *Lynch*—business judgment would be the applicable standard of review if the transaction were (1) recommended by a disinterested and independent special committee, and (2) approved by stockholders in a non-waivable vote of the majority of all the minority stockholders.").
22. *In re CNX Gas Corp. S'holders Litig.*, 4 A.3d 397, 400 (Del. Ch. 2010); *see also id.* at 412–13 ("Under the *Cox Communications* framework, if a freeze-out merger is both (i) negotiated and approved by a special committee of independent directors and (ii) conditioned on an affirmative vote of a majority of the minority stockholders, then the business judgment standard of review presumptively applies. If the transaction does not incorporate both protective devices, or if a plaintiff can plead particularized facts sufficient to raise a litigable question about the effectiveness of one of the devices, then the transaction is subject to entire fairness review." (citation omitted)).
23. *Reis*, 2011 WL 303207, at \*11-14.
24. *Id.* at \*11; *Applebaum v. Avaya, Inc.*, 812 A.2d 880, 892 (Del. 2002).
25. *Reis*, 2011 WL 303207, at \*11-13.
26. *Id.* at \*14 (noting that the "fair value standard is . . . economically efficient and should be applied consistently to freeze-outs, regardless of form").
27. *Id.* at \*14-17.
28. *Id.* at \*17-27; *see also id.* at \*17 ("This case does not call for a remedy other than an award of fair value. I am convinced that the defendants did not set out to extract value rapaciously from the minority, nor did they freeze out the minority to capture the value of opportunities that the corporation was on the verge of achieving and in which the minority otherwise would have shared.").
29. *Id.* at \*28.
30. *Id.* ("Ordinarily, the existence of a Section 102(b)(7) provision would compel a director-by-director analysis to determine which defendants are personally liable. The defendants have not made a Section 102(b)(7) argument, the full charter is not in the record, and I must assume that Hazelett Strip-Casting lacks a Section 102(b)(7) provision. Accordingly, the defendants are jointly and severally liable for the remedy imposed." (citation omitted)).
31. *Id.* at \*9.
32. *See Lonergan v. EPE Holdings LLC*, 5 A.3d 1008, 1019 (Del. Ch. 2010).
33. *See Reis*, 2011 WL 303207, at \*9.
34. *See, e.g., Steinhardt v. Howard-Anderson*, C.A. No. 5878-VCL, at 4 (Del. Ch. Jan. 24, 2011) (TRANSCRIPT) ("The point is that when enhanced scrutiny applies is when you have a final stage transaction. The reason enhanced scrutiny applies to a change of control is because it's a constructive final stage transaction."); *Reis*, 2011 WL 303207, at \*9; *Scully v. Nighthawk Radiology Holdings, Inc.*, C.A. No. 5890-VCL, at 20 (Del. Ch. Oct. 21, 2010) (TRANSCRIPT) ("I think this is clearly a QVC deal in which enhanced scrutiny is going to apply. I don't know why there was seven pages in the acquiror's brief on the business judgment rule. I mean, this is . . . a reasonableness standard of review. There is no question about the standard of review."); *Lonergan*, 5 A.3d at

1019 (“In a final stage transaction—be it a cash sale, a break-up, or a transaction like a change of control that fundamentally alters ownership rights—there are sufficient dangers to merit employing enhanced scrutiny, which requires that defendant fiduciaries bear the burden of persuasion to show that their motivations were proper and not selfish and that their actions were reasonable in relation to their legitimate objective.” (internal quotation marks omitted)); *In re CNX Gas Corp. S’holders Litig.*, 2010 WL 2705147, at \*11 (Del. Ch. July 5, 2010) (“Arm’s length, two-step transactions generally are end-stage transactions subject to enhanced scrutiny.”).

35. As an initial matter, this theory appears to posit that all directors—even independent directors or directors who have significant equity investments in the company—are susceptible to corrupting influences (or lose their incentive to care) in situations where they will no longer be directly and continually accountable to stockholders. *But cf. Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) (describing the presumptions of the business judgment rule: “in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company”); *Orman v. Cullman*, 794 A.2d 5, 27 n.56 (Del. Ch. 2002) (“A director who is also a shareholder of his corporation is more likely to have interests that are aligned with the other shareholders of that corporation as it is in his best interest, as a shareholder, to negotiate a transaction that will result in the largest return for all shareholders.”); *Loneragan*, 5 A.3d at 1022 (similar); *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1380 (Del. 1985) (“[I]t cannot be presumed that the prestige and perquisites of holding a director’s office or a motive to strengthen collective power prevails over a stockholder-director’s economic interest”).

36. The Delaware courts have previously held that *Revlon* duties are not implicated where a corporation already has a controlling stockholder. *See, e.g., In re John Q. Hammons Hotels Inc. S’holder Litig.*, 2009 WL 3165613, at \*9 (Del. Ch. Oct. 2, 2009) (noting that the minority-stockholder plaintiffs, in challenging a third-party acquisition of a corporation with a controlling stockholder, conceded that the principles articulated in *Revlon* did not govern the board’s conduct in considering the acquisition); *Bershad v. Curtiss-Wright Corp.*, 535 A.2d 840, 845 (Del. 1987) (holding that any attempt to auction the subject company would have been futile because the majority stockholder could have thwarted it). Nevertheless, where a corporation has a controlling stockholder, the board of directors must nonetheless ensure that a proposed transaction is in the corporation’s best interests. *See Mendel v. Carroll*, 651 A.2d 297, 306 (Del. Ch. 1994).

37. Building on the analysis in *Reis*, Vice Chancellor Laster suggested in a recent transcript that such transactions would receive enhanced scrutiny. *See Steinhardt*, C.A. No. 5878-VCL, at 4 (stating that enhanced scrutiny would apply in a stock-for-stock merger in which the target

stockholders would end up with 15 percent of the combined entity because it was, for them, a final-stage transaction); *see also* Bernard Black & Reinier Kraakman, *Delaware’s Takeover Law: The Uncertain Search for Hidden Value*, 96 Nw. U. L. Rev. 521, 545 (2002) (“[W]e believe that minnow-whale stock-for-stock mergers should, and perhaps one day will, trigger *Revlon* duties.”). *But see Arnold v. Soc’y for Sav. Bancorp, Inc.*, 650 A.2d 1270, 1290 (Del. 1994) (holding that such transactions do not trigger *Revlon* duties); Black & Kraakman, *supra*, at 543-45 (describing *Arnold* as involving a minnow-whale stock-for-stock merger).

38. *See, e.g., In re Dollar Thrifty S’holder Litig.*, 2010 WL 3503471, at \*19 (Del. Ch. Sept. 8, 2010) (“The heightened scrutiny that applies in the *Revlon* (and *Unocal*) contexts are, in large measure, rooted in a concern that the board might harbor personal motivations in the sale context that differ from what is best for the corporation and its stockholders. Most traditionally, there is the danger that top corporate managers will resist a sale that might cost them their managerial posts, or prefer a sale to one industry rival rather than another for reasons having more to do with personal ego than with what is best for stockholders.” (footnote omitted)); *cf. Unocal Corp. v. Mesa Petrol. Co.*, 493 A.2d 946, 954 (Del. 1985) (“Because of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders, there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred.”).

39. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 176, 184 (Del. 1986); *see also id.* at 184 (“Thus, when a board ends an intense bidding contest on an insubstantial basis, and where a significant by-product of that action is to protect the directors against a perceived threat of personal liability [i.e., self-interest]. . . , the action cannot withstand the enhanced scrutiny which *Unocal* requires of director conduct.”); *Maric Capital Master Fund, Ltd. v. PLATO Learning, Inc.*, C.A. No. 5402-VCS, at 17 (Del. Ch. May 13, 2010) (TRANSCRIPT) (“Again, we get back to the flavor of *Revlon*, which is really a loyalty-based case; right? . . . There was this hint that Bergerac had a personal antipathy towards Perelman and wanted to sell to anybody but Perelman. You have other cases where there’s some sort of personal reason.”); *Masucci v. Fibernet Telecom Group, Inc.*, C.A. No. 4680-VCS, at 18 (Del. Ch. Nov. 25, 2009) (TRANSCRIPT) (“But I’ll tell you, we’re a long way from the things that inspired the *Revlon* doctrine, you know, which is the actual resistance of a particular bidder because of animus, and the preference for another . . .”).

40. *See* Sean J. Griffith, *Deal Protection Provisions in the Last Period of Play*, 71 Fordham L. Rev. 1899, 1934 (2003) (“By contrast, in *Revlon*, the rationale for applying enhanced scrutiny rather than the business judgment rule was based upon a duty of loyalty analysis and the self-interest of the *Revlon* directors.”).

41. *Mills Acq. Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1288 (Del. 1989) (requiring that, before *Revlon* enhanced scrutiny can apply, “the plaintiff must show, and the trial court must find, that the directors of the target company treated one or more of the respective bidders on unequal terms” and holding that it “is only then that the two-part threshold requirement of *Unocal* is truly invoked”).

42. *Paramount Commc’ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 45 & n.16 (Del. 1994) (internal quotation marks omitted).

43. See, e.g., *Citron v. Fairchild Camera & Instr. Corp.*, 569 A.2d 53, 68-69 (Del. 1989) (“The record also sustains the Chancellor’s findings that Fairchild’s board of directors studiously endeavored to avoid ‘playing favorites,’ consistent not only with *Revlon* but with any ‘enhanced’ duty which, also six years later, was enunciated under *Unocal*. . . . For the reasons stated, we affirm the Court of Chancery’s application of the business judgment rule.” (citation omitted)); *In re Amsted Indus. Inc. Litig.*, 1988 WL 92736, at \*7, \*10 (Del. Ch. Aug. 24, 1988) (applying the business judgment rule in a single-bidder context), *aff’d*, *Barkan v. Amsted Indus., Inc.*, 567 A.2d 1279, 1285 (Del. 1989) (holding that the Court of Chancery did not apply “the wrong standard in evaluating the weight of Barkan’s claims”); *In re J.P. Stevens & Co. S’holders Litig.*, 542 A.2d 770, 779-83 (Del. Ch. 1988) (applying the business judgment rule where the Court was not persuaded that the target board favored one bidder over another); *cf. Smith v. Van Gorkom*, 488 A.2d 858, 872-73 (Del. 1985) (analyzing whether plaintiff had rebutted the business judgment rule in a single-bidder case). *But see In re Holly Farms Corp. S’holders Litig.*, 564 A.2d 342, 348 (Del. Ch. 1989) (“Tyson Foods has borne its *Macmillan* burden of showing that the directors of [defendant] Holly Farms, the target company, treated it on unequal terms *vis a vis* its competitor, ConAgra, in the bidding for control of Holly Farms.” (citing *Macmillan*)); *Norberg v. Young’s Market Co.*, 1989 WL 155462, at \*3 (Del. Ch. Dec. 19, 1989) (“[Plaintiff] contends that the special committee favored the Underwood group’s offer, assuring its eventual success by affording the Underwoods timing and information advantages in the bidding process and by imposing unrealistic requirements upon other bidders or potential bidders. Because the special committee and the board ‘tilted the playing field’ in favor of the Underwoods, argues Norberg, the board failed to adhere to ordinary standards of fairness in the interest of promoting the highest values reasonably attainable for the stockholders’ benefit.” (citing *Macmillan*)).

44. See, e.g., *In re Pennaco Energy, Inc. S’holders Litig.*, 787 A.2d 691, 705 & n.22 (Del. Ch. 2001) (citing *QVC*, but applying *Revlon* enhanced scrutiny in a single-bidder context); *Forgo v. Health Grades, Inc.*, C.A. No. 5716-VCS, at 6 (Del. Ch. Sept. 3, 2010) (TRANSCRIPT) (“Now, admittedly, *Revlon* arose in a kind of quintessentially ‘80s sort of situation where the CEO of a company was resisting it being sold to anyone. But there are also concerns when CEOs have an interest that’s different

than everyone else—even though they’re willing to sell, they have an interest in who the buyer is—and when they are not purely a seller.”).

45. See, e.g., *Police & Fire Ret. Sys. of Detroit v. Bernal*, 2009 WL 1873144, at \*2 (Del. Ch. June 26, 2009) (“Plaintiff has alleged facts that state a colorable claim that the Data Domain board is favoring one bidder over others, thereby deterring bids from third parties that could provide greater value to Data Domain shareholders.”); *In re Topps Co. S’holders Litig.*, 926 A.2d 58, 88 (Del. Ch. 2007) (finding a likelihood that plaintiffs could show a breach of fiduciary duty where the evidence “regrettably suggests that the Topps Incumbent Directors favored Eisner, who they perceived as a friendly suitor who had pledged to retain management and would continue Shorin and his family in an influential role”).

46. See *McMullin v. Beran*, 765 A.2d 910, 918 (Del. 2000) (“Whenever the board is deciding whether to approve a proposed ‘all shares’ tender offer that is to be followed by a cash-out merger, the decision constitutes a final-stage transaction for all shareholders. Consequently, the time frame for the board’s analysis is immediate value maximization for all shareholders.” (footnote omitted)); *Mendel v. Carroll*, 651 A.2d 297, 306 (Del. Ch. 1994) (“[I]f the board were to approve a proposed cash-out merger, it would have to bear in mind that the transaction is a final-stage transaction for the public shareholders. Thus, the time frame for analysis, insofar as those shareholders are concerned, is immediate value maximization.” (emphasis omitted)).

47. 2011 WL 303207, at \*28. The Court actually held “the defendants” liable. *Id.* That phrase presumably includes the defendant corporation, even though corporations themselves typically do not owe fiduciary duties to their stockholders. See, e.g., *In re Dataproducts Corp. S’holders Litig.*, 1991 WL 165301, at \*6 (Del. Ch. Aug. 22, 1991) (“[P]laintiffs concede that a corporation *qua* corporate entity is not a fiduciary of, and thus cannot owe a fiduciary duty to, its shareholders.”); *Ryan v. Lyondell Chem. Co.*, 2008 WL 4174038, at \*1 n.3 (Del. Ch. Aug. 29, 2008) (“Defendants point out that Lyondell, the nominal defendant, did not owe fiduciary duties to the Lyondell stockholders and, accordingly, should have been dismissed. Ryan has not disputed this contention. The Defendants are correct, and the Court’s failure to dismiss Lyondell from this action was an inadvertent oversight. In accordance with Court of Chancery Rule 60(a), an order will be entered granting judgment in favor of Lyondell and dismissing it from this action. For purposes of this letter opinion, the term ‘Defendants’ refers only to the individual defendants, the members of Lyondell’s board.” (citation omitted)).

48. Because no proof was made that Hazelett’s charter contained such an exculpatory provision, the Court assumed that it did not contain one. *Reis*, 2011 WL 303207, at \*28.

49. See *id.* (“Ordinarily, the existence of a Section 102(b)(7) provision would compel a director-by-director analysis to determine which

defendants are personally liable.”); *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 748 (Del. Ch. 2005) (“More recent cases understand that liability determinations must be on a director-by-director basis.”), *aff’d*, 906 A.2d 27 (Del. 2006).

50. See, e.g., *In re Emerging Commc’ns, Inc. S’holders Litig.*, 2004 WL 1305745, at \*38 (Del. Ch. May 3, 2004) (“Prosser, as majority stockholder, breached his duty of loyalty to Greenlight and the plaintiff shareholder class, by eliminating ECM’s minority stockholders for an unfair price in an unfair transaction that afforded the minority no procedural protections. For that breach of duty Prosser is liable to Greenlight and the shareholder class.”).

51. See, e.g., *Venhill Ltd. P’ship v. Hillman*, 2008 WL 2270488, at \*22 (Del. Ch. June 3, 2008) (“As I understand it, only the self-dealing director would be subject to damages liability for the gap between a fair price and the deal price without an inquiry into his subjective state of mind. Why? Because under the traditional operation of the entire fairness standard, the self-dealing director would have breached his duty of loyalty if the transaction was unfair, regardless of whether he acted in subjective good faith. After all, that is the central insight of the entire fairness test, which is that when a fiduciary self-deals he might unfairly advantage himself even if he is subjectively attempting to avoid doing so.” (footnote omitted)); *In re PNB Holding Co. S’holders Litig.*, 2006 WL 2403999, at \*22 n.117 (Del. Ch. Aug. 18, 2006) (“I perceive no basis in this trial record to conclude that the PNB directors intended to deal unfairly with the departing PNB stockholders; that is, that they in bad faith sought to underpay in the Merger. . . . In other words, although I find for structural reasons that the directors owed a duty of fair treatment to the departing minority, and fell short of meeting that duty, I do not find that they fell short out of bad faith.”); cf. *Guttman v. Huang*, 823 A.2d 492, 506 (Del. Ch. 2003) (“There might be situations when a director acts in subjective good faith and is yet not loyal (e.g., if the director is interested in a transaction subject to the entire fairness standard and cannot prove financial fairness), but there is no case in which a director can act in subjective bad faith towards the corporation and act loyally.”).

52. *Reis*, 2011 WL 303207, at \*11, \*17.

53. See *Emerging*, 2004 WL 1305745, at \*38 (“Having concluded that the Privatization was not entirely fair, the Court must next determine the nature of the fiduciary duty violation—whether of care, loyalty, or good faith—that resulted in the unfair transaction.”).

54. See, e.g., *In re Lorol Space & Commc’ns Inc. Consol. Litig.*, 2008 WL 4293781, at \*33 (Del. Ch. Sept. 19, 2008) (“The entire fairness test is one designed to address a transaction’s sustainability, any party other than the interested party, the test is, in itself, not adequate to determine liability for breach of duty. For example, being a non-independent director who approved a conflict transaction found unfair does not make one, without more, liable personally for harm caused. Rather, the

court must examine that director’s behavior in order to assess whether the director breached her fiduciary duties and, if a § 102(b)(7) clause is in effect, acted with the requisite state of mind to have committed a non-exculpated loyalty breach.” (footnote omitted)); *Venhill*, 2008 WL 2270488, at \*23 (“But as to the other directors, even the ones who might be deemed non-independent by status, the presence of the exculpatory charter provision would require an examination of their state of mind, in order to determine whether they breached their duty of loyalty by approving the transaction in bad faith to benefit their relative, rather than in a good faith effort to benefit the corporation. If those directors acted in the good faith belief that they were pursuing the corporation’s best interests—that is, with a loyal state of mind—their failure to procure a fair result does not expose them to liability, because the charter provision immunized them from liability for mere violations of the duty of care. In other words, their status as a relative of the self-dealing director is only a fact relevant to the ultimate determination whether they complied with their fiduciary duties, it is not a status crime making them a guarantor of the fairness of the transaction.” (footnotes omitted)).

55. *Venhill*, 2008 WL 2270488, at \*23.

56. See *Emerging*, 2004 WL 1305745, at \*38.

57. See 8 Del. C. § 102(b)(7)(ii).

58. See *Stone v. Ritter*, 911 A.2d 362, 369-370 (Del. 2006) (discussing “conduct giving rise to a violation of the fiduciary duty of care (i.e., gross negligence)” and that the “requirement to act in good faith is a subsidiary element, i.e., a condition, of the fundamental duty of loyalty” (alteration and internal quotation marks omitted)).

59. The opinion does not explicitly mention either the directors’ duty of care or their duty to act in good faith; it does, however, suggest that there was a “loyalty breach.” *Reis*, 2011 WL 303207, at \*16.

60. See *supra* note 2.

61. Under Section 141(e) of the DGCL, directors are “fully protected in relying in good faith” on reports provided by experts selected with reasonable care. 8 Del. C. § 141(e); see also Thomas A. Uebler, *Reinterpreting Section 141(e) of Delaware’s General Corporation Law: Why Interested Directors Should Be “Fully Protected” in Relying on Expert Advice*, 65 Bus. Law. 1023, 1035 (2010) (“Section 141(e) should provide directors, whether or not they are deemed to be interested, a defense to liability if they reasonably relied in good faith on expert advice but nevertheless produced an unfair transaction, as long as the unfair aspect of the transaction arose from the expert advice.”).

Under Delaware law, a plaintiff would typically have to make certain showings to challenge a director’s reliance on an expert opinion. See *Selectica, Inc. v. Versata Enters., Inc.*, 2010 WL 703062, at \*17 (Del. Ch. Feb. 26, 2010) (“Under § 141(e), where a board has relied on an expert’s advice in making a decision, a due care claim challenging

that decision must establish such facts as would make reliance on the expert opinion unreasonable. [Counterclaim-plaintiff] Trilogy would need to show either that: (a) the Board did not in fact rely on the experts; (b) such reliance was not in good faith; (c) the Board did not reasonably believe that the relevant expert's advice was within that expert's professional competence; (d) the experts were not selected with reasonable care, and the faulty selection was attributable to the directors; (e) the omitted information that the Board allegedly should have considered was so obvious and reasonably available that it was gross negligence for the Board to fail to consider it, regardless of expert advice or lack thereof; or (f) the decision of the Board was so unconscionable as to constitute waste or fraud." (footnote omitted), *aff'd*, 5 A.3d 586 (Del. 2010). Perhaps the Hazelett directors' failure to secure an updated valuation prevented the application of § 141(e); the Court did not discuss the analysis. *See Reis*, 2011 WL 303207, at \*15 ("Technically, the defendants did not set any price. When they actually implemented the reverse split in January 2008, they did not make any effort to determine the 'fair value' of the fractional interest 'as of the time when those entitled to receive such fractions are determined.' They rather left in place the price that SMK concluded in February 2006 was the value of Hazelett Strip-Casting as of September 30, 2005." (citation omitted)).

62. *See In re Lear Corp. S'holder Litig.*, 967 A.2d 640, 652 (Del. Ch. 2008) ("The definition of gross negligence used in our corporate law jurisprudence is extremely stringent."); *Tomczak v. Morton Thiokol, Inc.*, 1990 WL 42607, at \*12 (Del. Ch. Apr. 5, 1990) (stating that "gross

negligence means reckless indifference to or a deliberate disregard of the whole body of stockholders or actions which are without the bounds of reason" (internal quotation marks omitted)); *Solash v. Telex Corp.*, 1988 WL 3587, at \*9 (Del. Ch. Jan. 19, 1988) (stating that, to be grossly negligent, a "decision has to be so grossly off-the-mark as to amount to reckless indifference or a gross abuse of discretion" (citations and internal quotation marks omitted)).

63. *Cf. Blake Rohrbacher, An Unremarkable Case: Good Faith After Lyondell, Corp.* Governance Advisor, July/Aug. 2009, at 17, 18-19 (discussing the requirements for finding a failure to act in good faith).

The *Reis* Court did suggest that, in certain circumstances, a damages award might be granted even if a price is found to be within a range of fairness, if the process was particularly unfair. *See* 2011 WL 303207, at \*16 ("This possibility answers a question that some have posed about what a minority stockholder could be entitled to except a fair price. Depending on the facts and the nature of the loyalty breach, the answer can be a 'fairer' price." (citation omitted)); *cf. William Penn P'ship v. Saliba*,—A.3d —, 2011 WL 440615 (Del. Feb. 9, 2011) (finding no abuse of discretion in the Chancery Court's awarding attorneys' fees and costs for a loyalty breach when the appraised value of the property sold was lower than the sale price and therefore plaintiffs were left without a typical damage award). The *Reis* Court did not find any "[f]actors such as coercion, overreaching, the misuse of confidential information, or secret conflicts" that caused it to award additional damages for the unfair process. 2011 WL 303207, at \*17. Arguably, therefore, it did not find evidence of intentional wrongdoing or scienter.

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