Delaware Improves Its Treatment of Freezeout Mergers: Weinberger v. VOP, Inc.

Geoffrey E. Hobart

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Delaware Improves Its Treatment of Freezeout Mergers: Weinberger v. UOP, Inc.¹ In considering challenges to corporate takeover tactics, state courts have long had difficulty striking a satisfactory balance among the competing interests of a target corporation's management, controlling stockholders and minority shareholders.² While Congress³ and many state governments⁴ have enacted takeover legislation, traditionally the state courts have been left with the difficult task of deciding issues of fiduciary duty and fairness in challenges to corporate takeovers.⁵ State courts have had particular difficulty deciding these issues in cases involving freezeout mergers,⁶ where the acquiring corporation is also the majority shareholder of the target company.⁷ Because the laws of many states, such as Delaware, allow mergers to be effected upon the affirmative vote of a majority of the shareholders of the corporations involved,⁸ freezeout mergers often occur as the second step of a corporate takeover.⁹ After purchasing a majority of the outstanding common

¹ 457 A.2d 701 (Del. 1983).
⁶ For a detailed account of the historical development of judicial treatment of freezeout mergers, see Weiss, supra note 2, at 626-57.
⁸ Delaware General Corporation Law contains two merger provisions. Section 251 is commonly referred to as Delaware's long-form merger statute. Del. Code Ann. tit. 8, § 251 (1983). Section 251 authorizes the consummation of a merger upon the affirmative vote of a simple majority of the shareholders of the acquiring and acquired corporations. Id. § 251(c). Delaware's short-form merger statute simplifies the merger process in situations where the acquiri ng corporation owns 90% or more of the stock of the target company. See id. § 253. Section 253 allows a merger to be effected by the passage of a resolution by the board of directors of the acquiring corporation. Id. § 253(a). Section 253 vests the power to consummate a short-form merger solely with the directors of the acquiring corporation. See id. A merger effected pursuant to section 253 does not have to be approved by a vote of the shareholders of the target company. In fact, when a parent company effects a short-form freezeout merger pursuant to section 253, the parent company is not required to notify the subsidiary's minority shareholders prior to the consummation of the merger. See id.
⁹ See Greene, supra note 7, at 491-94. Commentators have identified three types of freezeout mergers: 1) two-step mergers 2) parent-subsidiary mergers and 3) going-private mergers. See Brud-
stock of the target corporation, the acquiring corporation can achieve sole ownership of the target company by voting its majority interest in the target company in favor of a merger with itself. As a result of this majority vote, the target corporation's minority shareholders are, in effect, forced to sell their shares to the acquiring corporation.

Freezeout mergers differ in several important respects from arm's-length mergers between unaffiliated corporations. Unlike negotiated mergers between unaffiliated corporations, the target company's shareholders are not treated equally. In a typical arm's-length merger acquisition, each shareholder of the target company exchanges his stock for the same proportionate amount of cash or other securities. In a freezeout merger, the majority shareholder continues its investment in the target company's business, while the minority shareholders must either accept the consideration offered by the majority or challenge the adequacy of the merger price in litigation or in an appraisal proceeding. In a freezeout merger, therefore, there is a significant danger that the

ney & Chirelstein, A Restatement of Corporate Freezeouts, 87 YALE L.J. 1354, 1359-76 (1978); Greene, supra note 7, at 491-96. In both two-step mergers and parent-subsidiary mergers, a freezeout merger is part of a corporate takeover. See Greene, supra note 7, at 491-94. A parent-subsidiary merger differs from a two-step merger, however, because in a parent-subsidiary merger the acquiring company first operates the target company as a subsidiary before effecting a freezeout merger to achieve sole ownership of the target. See id. at 492-93. Going-private mergers differ substantially from two-step mergers and parent-subsidiary mergers. In a going-private merger, a company's management, having determined that its shares are undervalued, seeks to eliminate the public stockholders of the company and return the firm to the status of a closely held corporation. Brudney & Chirelstein, supra, at 1365. The insiders typically create a holding company to which they transfer their controlling shares, and then propose a merger of the operating company into the holding company. Id. As a result of the merger, the insiders gain sole ownership of the corporation and the public shareholders generally receive cash in exchange for their shares. Id. Going-private mergers involve problems of fairness that are quite different from the problems created by two-step mergers and parent-subsidiary mergers. See id. at 1365-70. See generally Borden, Going Private - Old Tort, New Tort, or No Tort, 49 N.Y.L. REV. 987 (1974); Note, Going Private, 84 YALE L.J. 903 (1975).

The acquiring company frequently acquires a controlling interest in a corporation through a cash tender offer. See Austin, Tender Offer Update: 1983, 18 MONEY & ACC. 57, 57 (1983). Cash tender offers composed 89% of the total number of tender offers made in 1982. Id.

Generally, the acquiring corporation forms a wholly-owned subsidiary and merges the target company into this newly created shell corporation. See Brudney & Chirelstein, supra note 9, at 1357; Weirs, supra note 2 at 624.

Brudney & Chirelstein maintain that while majority rule is an appropriate means of deciding whether an arm's-length merger should be allowed, majority rule in freezeout mergers does not merit the same deference. See id. at 1357-58. Arm's length mergers are considered presumptively fair because it is thought that the majority vote of the shareholders of each corporation represents the best interests of all the shareholders involved in the transaction. See id. at 1357. Brudney & Chirelstein argue that the majority vote of the shareholders of the target company in an arm's-length merger should be respected because all the target company's shareholders share the common goal of maximizing the returns of their stock and each shareholder will be affected identically by the outcome of the vote. See id. Brudney & Chirelstein argue that majority rule is not the appropriate means of determining whether a freezeout merger should be allowed. See id. at 1358-59. Because a danger exists in freezeout mergers that a self-interested majority stockholder has ruled unfairly, Brudney & Chirelstein conclude that special safeguards are necessary to ensure that the minority shareholders' interests are protected. Id.

Greene, supra note 7, at 490. The dissenter's appraisal remedy is entirely a statutory creation. See, e.g., DEL. CODE ANN. tit. 8, § 262 (1983); N.Y. BUS. CORP. LAW § 623 (McKinney Supp.
target company’s minority shareholders will be treated unfairly, because the acquiring company is acting in its own self-interest in effecting the merger in order to gain sole ownership of the target corporation.\textsuperscript{17} Furthermore, the minority shareholders stand in an inferior position in relation to the majority shareholder because the majority shareholder controls the bargaining process, the flow of information and the valuation of the minority’s stock.\textsuperscript{18} The Delaware courts have had particular difficulty deciding issues of fairness in freezeout merger challenges because the Delaware merger statutes technically allow the consummation of freezeout mergers regardless of any unfairness or breach of fiduciary duty by the majority shareholder.\textsuperscript{19} \textit{Weinberger v. UOP, Inc.} is the Delaware Supreme Court’s most recent attempt to establish an appropriate standard of review for freezeout merger challenges.\textsuperscript{20}

In \textit{Weinberger}, a former shareholder of the Universal Oil Products Company (“UOP”) brought a class action suit in the Delaware Court of Chancery challenging the elimination of UOP’s minority shareholders through a freezeout merger with The Signal Companies.

\textsuperscript{17} See \textit{Brudney & Chirelstein, supra} note 9, at 1358.
\textsuperscript{18} See \textit{Brudney, Efficient Markets and Fair Values in Parent-Subsidiary Mergers}, 4 J. Corp. L. 63, 71 (1978). Brudney states that once a parent company contemplates a merger with a subsidiary, the parent corporation is “not unlikely to” control both the use of accounting conventions and flow of financial information so as to decrease the market price of the subsidiary’s stock below its intrinsic value. \textit{Id.} Brudney argues that for this reason the market price of the subsidiary’s stock should not be an important factor in evaluating the fairness of a merger price. \textit{Id.} at 64.
\textsuperscript{20} \textit{Weinberger v. UOP, Inc.}, 457 A.2d 701 (Del. 1983).
Inc. ("Signal"). The plaintiffs sought to set aside the merger on the grounds that Signal had unfairly used its majority stock ownership position in UOP to freeze out the minority shareholders at an inadequate price. Plaintiffs specifically alleged that Signal had effected the merger for the sole purpose of eliminating the minority shareholders from UOP, that Signal and UOP had misrepresented material facts concerning the bargaining process in the proxy material and certain press releases and that UOP's board of directors had breached their fiduciary duty by not attempting to negotiate a higher merger price with Signal. Signal had acquired a 50.5% interest in UOP in 1975 through a cash tender offer. In 1978, Signal decided to investigate the possibility of acquiring the remainder of UOP's publicly held stock. As part of the investigation, two Signal directors, who were also directors of UOP, prepared a feasibility study for Signal's board of directors. The study concluded that it would be a good investment for Signal to acquire the remaining 49.5% of UOP's shares at any price up to $24 per share.

At a meeting of Signal's executive committee, UOP's chief executive officer, James V. Crawford, who was also a director of Signal, indicated that a Signal proposal to pay $20-$21 per share for UOP's remaining publicly held stock was "generous" and should be submitted to UOP's minority shareholders for their consideration. At this meeting, Signal's executive committee authorized its management to negotiate with UOP for the cash acquisition of UOP's minority shares. Signal's executive committee requested that a proposal be submitted to Signal's board of directors in four business days. During those four days, Crawford spoke with UOP's outside directors by telephone. During that period, Crawford also retained Lehman Brothers Kuhn Loeb, Inc. ("Lehman Brothers"), an investment banking firm, to render a fairness opinion as to the price offered for the minority's stock. After a summary examination of UOP's relevant financial records, Lehman Brothers concluded that a price of $20-$21 per share "would be a fair price for the remaining shares of UOP." The directors of both corporations approved the merger

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22 Id. at 1341.
23 Id.
24 457 A.2d at 704. Signal purchased 1,500,000 of UOP's authorized but unissued common stock at $21 per share. Id. This negotiated purchase was contingent on a successful tender offer for 4,300,000 of UOP's publicly held shares, also at a price of $21 per share. Id. Immediately before the announcement of the tender offer, UOP's common stock had been trading at a fraction under $14 per share. Id. The tender offer was greatly oversubscribed, but Signal limited its purchase to 4,300,000 shares, enough when coupled with its purchase of the unissued shares, to give it a 50.5% ownership interest in UOP. Id.
25 Id. at 705.
26 Id.
27 Id.
28 Id. At this meeting, UOP's president did not try to negotiate a price higher than $21. Id. Apparently, UOP's president was not informed about the results of Signal's feasibility study indicating that Signal was prepared to pay as much as $24 per share for UOP's stock. Id. at 705-06.
29 Id.
30 Id. at 705-06.
31 Id. at 706.
32 Id. Lehman Brothers had previously performed services for UOP and was familiar with UOP's business. Id.
33 Id.
34 Lehman Brothers only spent three days preparing the fairness opinion for UOP due to the time constraints imposed by Signal. Id. at 706-07.
35 Id. at 707.
proposal, but conditioned the consummation of the acquisition on the approval of a majority of UOP's minority shareholders. At UOP's next annual meeting, a majority of UOP's minority shareholders approved the merger with Signal at the price of $21 per share and the merger was subsequently consummated. As a result of the merger, UOP became the wholly-owned subsidiary of Signal.

Not all of UOP's minority shareholders were satisfied with the merger terms, however. On behalf of all of UOP's former shareholders who had not exchanged their shares for the merger price, William B. Weinberger instituted a class action suit in the Delaware Court of Chancery asking for an injunction rescinding the merger. In the event that the court found an injunction to be inappropriate, the plaintiffs requested the court to award damages in an amount the economic equivalent of rescission. The plaintiffs charged that Signal had effected the merger for an improper purpose, that both Signal and UOP were guilty of misrepresentation and that UOP's directors had breached their fiduciary duty by failing to negotiate a higher merger price. The plaintiffs also maintained that Signal had used its majority stock ownership position in UOP to eliminate the minority shareholders at a grossly inadequate price.

After a trial on the merits, the Chancery Court found in favor of the defendants, holding that the merger terms were legally fair to the plaintiffs. In so holding, the court

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36 Id. The directors of both companies met simultaneously. Id. Signal's men on UOP's board of directors participated in various aspects of UOP's board meeting, although they abstained from voting. Id. The minutes of the meeting, however, reveal that each of them stated that if they had voted, they would have voted in favor of the proposed merger. 

37 Id. The merger proposal also required that the minority shares voting in favor of the agreement, when coupled with Signal's 50.5% interest, comprise at least two-thirds of all UOP shares outstanding. 

38 Id. at 708. As of the record date of UOP's annual meeting there were 11,488,302 shares of UOP common stock outstanding. Id. Signal owned 5,688,302 shares. Id. UOP's minority shareholders owned 5,688,302 shares. Id. At the meeting 3,208,652 (56%) of the minority shares voted. Id. Of these 2,953,812 voted in favor of the merger and 254,840 voted against it. Id.

39 Weinberger v. UOP, Inc., 426 A.2d 1333, 1335 (Del. Ch. 1981). UOP was merged into Sigco Incorporated, a shell corporation created by Signal for the purposes of the merger. 

40 Id. The Chancery Court dismissed Weinberger's first complaint, ruling that Weinberger had not alleged sufficient facts demonstrating the unfairness of the challenged merger. Weinberger v. UOP, Inc., 409 A.2d 1262, 1266-68 (Del. Ch. 1979). According to the court, because UOP's minority shareholders had approved the merger, Weinberger had to allege specific acts such as fraud or misrepresentation to state a cause of action for unfairness. Id. Weinberger subsequently filed an amended complaint alleging specific acts of fraud, misrepresentation and misconduct. Weinberger v. UOP, Inc., 426 A.2d 1333, 1340-41 (Del. Ch. 1981).

41 Weinberger v. UOP, Inc., 426 A.2d 1333, 1335 (Del. Ch. 1981). Weinberger argued that a damage award could be in the form of cash or an equivalent amount of Signal stock. 

42 Id. at 1348-56.

43 Id. at 1356-62. The plaintiffs also alleged that Lehman Brothers had conspired with Signal and its controlled UOP board of directors to deceive UOP's minority shareholders into voting to approve the merger terms. Id. at 1347. The plaintiffs contended that Lehman Brothers actually worked in the interests of Signal rather than UOP's minority shareholders in rendering its fairness opinion. Id. The Chancellor held that the plaintiffs had failed to establish such a conspiracy and enter a judgment in favor of Lehman Brothers. Id. at 1348. The plaintiffs did not appeal this aspect of the Chancellor's decision. Weinberger v. UOP, Inc., 457 A.2d 701, 702 (Del. 1983).

44 Subsequent to the completion of the trial, Weinberger also filed a motion seeking to enlarge the class to include all former shareholders of UOP at the time of the merger other than Signal. Weinberger v. UOP, Inc., 426 A.2d 1333, 1335 (Del. Ch. 1981).

45 Id. at 1368. The court reasoned that this result made it unnecessary to consider plaintiffs' motion to enlarge the class. Id.
rejected the plaintiffs' allegations of improper purpose, misrepresentation, breach of fiduciary duty and unfair price. The plaintiffs argued that the merger should be enjoined because Signal had effected the merger for the sole purpose of eliminating UOP's minority shareholders in violation of the business purpose requirement established in Singer v. Magnavox Co. In Singer, the Delaware Supreme Court held that the use of corporate power by a majority shareholder "solely to eliminate the minority" is a violation of its fiduciary duty. The Chancellor ruled that Signal had not breached its duty in this respect because its desire to make a favorable investment with its cash reserves constituted a valid business purpose for effecting the merger. The court rejected plaintiffs' allegations of misrepresentation because it found that both Signal's press releases and UOP's proxy materials were not misleading. The court also found that UOP's board of directors had not breached their fiduciary duty to the plaintiffs because UOP's directors were not required to negotiate a higher merger price for UOP's stock if they believed Signal's original offer to be fair. Finally the court examined the plaintiffs' allegations concerning the fairness of the merger price.

The plaintiffs argued that notwithstanding the Chancellor's findings concerning their claims of improper purpose, misrepresentation and breach of fiduciary duty, they nonetheless were entitled to relief because the merger price of $21 per share was "inadequate and indefensible" on the facts. The plaintiffs offered the testimony of a chartered investment analyst who stated that UOP's stock had a fair value of not less than $26 per share when valued according to the discounted cash flow valuation method and

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\[Id.\] at 1348-62. The Chancellor stated at the beginning of his opinion that due to the numerous contentions made by plaintiff, some matters urged by the plaintiff were not specifically addressed in the opinion. \[Id.\] at 1395. As to those contentions not addressed, however, the Chancellor stated that he nonetheless had considered them. \[Id.\].


\[Id.\] at 380 A.2d 969, 980 (Del. 1977).


\[Id.\] at 1352.

\[Id.\] at 1354, 1356.

\[Id.\] at 1356-62.

\[Id.\] at 1356.

\[Id.\] According to plaintiffs' expert, the discounted cash flow valuation method values a firm's stock according to the cash generating capabilities of a company as a going concern. \[Id.\]. The following are plaintiffs' expert's calculations for 1977:

<table>
<thead>
<tr>
<th>Sources</th>
<th>In Millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income before extraordinary items</td>
<td>$24.3</td>
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<tr>
<td>Depreciation</td>
<td>15.0</td>
</tr>
<tr>
<td>Deferred income taxes</td>
<td>2.3</td>
</tr>
<tr>
<td><strong>Cash flow from operations</strong></td>
<td><strong>$41.6</strong></td>
</tr>
<tr>
<td><strong>Uses</strong></td>
<td></td>
</tr>
<tr>
<td>Additions for plant and equipment</td>
<td>$16.3</td>
</tr>
<tr>
<td>Long-term debt payment (net)</td>
<td>4.5</td>
</tr>
<tr>
<td><strong>Cash requirements</strong></td>
<td><strong>$20.8</strong></td>
</tr>
<tr>
<td><strong>Net free cash from operations</strong></td>
<td><strong>$20.8</strong></td>
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</tbody>
</table>
under a comparative analysis of premiums paid in similar acquisitions. Although the Chancellor received the plaintiffs' evidence, he rejected it indicating that past Delaware practice precluded the use of the discounted cash flow valuation method. Instead, the Chancellor accepted the evidence offered by the defendants who presented expert testimony valuing UOP's shares under the "Delaware block" approach, the valuation approach traditionally approved by Delaware decisions dealing with appraisal proceedings. Under the Delaware block approach, the value of a corporation's stock generally is calculated as a weighted average of the corporation's asset value, market price and earnings per share. The defendants' expert's calculations considered UOP's market value, net asset value and investment value, including UOP's dividend record.

<table>
<thead>
<tr>
<th></th>
<th>7.5%*</th>
<th>8.5%**</th>
</tr>
</thead>
<tbody>
<tr>
<td>Present value of net free cash</td>
<td>$277.3</td>
<td>$244.6</td>
</tr>
<tr>
<td>Excess liquidity</td>
<td>37.0</td>
<td>37.0</td>
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<tr>
<td>Extraordinary items</td>
<td>7.0</td>
<td>7.0</td>
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<tr>
<td>Total discounted cash flow</td>
<td>$321.3</td>
<td>$288.6</td>
</tr>
<tr>
<td>Per share value</td>
<td>$28.09</td>
<td>$25.21</td>
</tr>
</tbody>
</table>

* High side of discount range found in sample of 1977/1978 acquisitions.

Id. at 1357-58. Non-cash expenses such as depreciation and deferred expenses are added back to the income from operations figure in order to derive the cash flow generated from operations. Id. at 1357. Plaintiffs' expert also made similar calculations for 1978 and under UOP's five year business plan for the years 1978-1982. Id. at 1358. Under the 1978 analysis, he found the value of the minority's shares to have been $27.16. Id. Under UOP's five year business plan, plaintiffs' expert testified that the value of UOP's minority interest was either $25.94 or $30.59 per share. Id.

Id. at 1358. Plaintiffs' expert concluded as a result of his comparative analysis of premiums paid in similar acquisitions that a reasonable premium for UOP's publicly held shares would have been between 70 and 80 per cent. Id. at 1357. Applying this to UOP's high of 14% on February 28, 1978, the last trading day before the announcement of the merger negotiations, plaintiffs' expert concluded that under this method of analysis, the fair value of UOP's shares was between $25.65 and $27.30 per share. Id. The defendants' expert testimony concerning acquisition premiums indicated an average market premium of 48% and a median premium of 41% for comparable transactions. Id. at 1362.

Id. at 1359-60. The Chancellor also seemed concerned that the conclusions reached under the discounted cash flow method were somewhat speculative because the valuation could be manipulated by varying the discount rate or varying the estimates necessary to arrive at the net free cash figure itself. See id. at 1359.

Id. at 1361. The Delaware block approach originated in the case of In re General Realty & Utilities Corp., 29 Del. Ch. 480, 496, 500, 52 A.2d 6, 14-15 (Del. Ch. 1947).


The defendants' expert testified that the average high-low market price for the five year period immediately preceding the merger was $13.87. Weinberger v. UOP, Inc., 426 A.2d 1333, 1362 (Del. Ch. 1981).

The defendants' expert calculated the net asset value of UOP to be $20.69 as of the end of the first quarter in 1978, but he argued that this figure should be accorded little weight because Signal was acquiring UOP for its on-going business value. Id.

According to the defendants' expert, the investment value of UOP broke down to be approximately $14.81 per share on a going concern basis and $16.39 per share on a book value basis. Id.

Id. at 1361.
Based on the evidence presented by the defendants, the Chancellor found that there was a reasonable basis for finding the merger price of $21 per share to be a fair price to the minority shareholders of UOP. The Chancellor concluded that when viewed overall, the terms of the merger were legally fair to the plaintiffs. Dissatisfied with the Chancellor's findings, the plaintiffs sought review in the Delaware Supreme Court.

On appeal, the Delaware Supreme Court reversed the Chancellor's decision, specifically eliminating the Singer business purpose requirement from Delaware law. The court examined the Signal-UOP merger under the entire fairness test first articulated in 1952 in the case of *Sterling v. Mayflower Hotel Corp.* In *Sterling*, the Delaware Supreme Court ruled that, because the parent company stood on both sides of the transaction, the parent company had to establish the “entire fairness” of the merger terms to the subsidiary's minority shareholders. In *Weinberger*, the court stated that the concept of entire fairness is composed of two “basic aspects”: fair dealing and fair price. After a review of the facts of the transaction, the court concluded that the Signal-UOP merger did not satisfy “any reasonable concept of fair dealing.” Consequently, the court reversed the Chancellor as to this aspect of his decision. For the purpose of determining fair price under the entire fairness test, and for the purpose of determining fair value in future appraisal proceedings, the *Weinberger* court ruled that Delaware courts are no longer restricted to the exclusive use of the Delaware block, weighted average valuation method. The court held that Delaware courts may now employ any modern valuation technique generally accepted by the financial community in determining the fair value of a corporation’s stock. Although the court found that Signal had not established the entire fairness of the merger terms, the court refused to set aside the merger, finding it “too involved to undo.” The court remanded the case and instructed the Chancellor to decide what, if any, damages to award to the plaintiffs “based upon entire fairness standards, i.e. fair dealing and fair price.”

The *Weinberger* decision represents a significant improvement in Delaware’s treatment of freezeout merger challenges. First, the decision improves the treatment of minority shareholders involved in freezeout mergers. Even though the Singer business purpose requirement represented a possible ground for an injunction, the *Weinberger* court’s elimination of the business purpose test actually improves judicial treatment of minority shareholders involved in freezeout mergers. By directing the attention of the Delaware courts to a review of the twin components of the entire fairness standard, fair dealing and fair price, the *Weinberger* court has made certain that in future cases the
treatment of the minority shareholders will be the sole subject of judicial review. In addition to focusing the Delaware courts' scrutiny of future freezeouts on the treatment of minority shareholders, the Weinberger court also improved the appraisal remedy available to minority shareholders. Although apparently restricting the financial remedy available to minority shareholders to appraisal, the Weinberger court improved the effectiveness of the appraisal remedy by allowing the use of modern valuation techniques in future appraisal proceedings. The use of such techniques in appraisal proceedings will serve to guarantee that former shareholders receive fair value for the shares expropriated from them.

In addition to improving the treatment of minority shareholders, the Weinberger decision also improves the state of Delaware merger law from management's point of view by eliminating the Singer business purpose requirement. No longer will management have to face the uncertainty that a merger will be enjoined because a court found the purpose for the merger to be impermissible. The Weinberger court articulated clear guidelines and procedures that will facilitate the structuring of parent-subsidiary freezeout mergers in the future. By following the procedures suggested by the Weinberger court, management should be able to structure future merger transactions without fear of judicial attack from dissatisfied minority shareholders. Weinberger, therefore, improves the quality of minority shareholder treatment in Delaware and clarifies the expected role of management in structuring parent-subsidiary mergers.

This casenote begins with a discussion of the development of Delaware case law regarding freezeout mergers in order to establish the context in which Weinberger was decided. This historical discussion begins with a description of the important Delaware decisions preceding Singer v. Magnavox Co. This discussion includes a brief description of the United States Supreme Court's decision in Sanle Fe Industries, Inc. v. Green, which immediately preceded the Singer decision and may have influenced the Delaware Supreme Court's decision in that case. This background section concludes with a discussion of Singer and its companion case Tanzer v. International General Industries, Inc., the two cases in which the Delaware Supreme Court announced the business purpose requirement for freezeout mergers. After the background section, this casenote presents a description of the Delaware Supreme Court's opinion in Weinberger. This casenote then analyzes the reasoning and impact of the Weinberger court's decision.

The Weinberger decision represents an improvement in Delaware's treatment of freezeout mergers for two reasons. First, Weinberger's adoption of the entire fairness test as the sole standard of review affords minority shareholders more effective protection against unfair treatment by a majority shareholder than did the Singer business purpose test. Rather than providing minority shareholders with effective protection, the Singer business purpose requirement only served to create confusion among the Delaware courts as to what constituted a valid business purpose for effecting a freezeout merger. Second,
the *Weinberger* decision improves the law from management's point of view by providing management with guidelines for structuring future freezeouts. This casenote will analyze the impact of future use of the procedural guidelines suggested by the *Weinberger* court. While *Weinberger* improves the law of freezeout mergers in Delaware, the Delaware Supreme Court should have gone further in prescribing management procedures. Because the Delaware Supreme Court indicated in *Weinberger* that in the future it would defer to the form of transactions complying with the procedural guidelines it suggested, this casenote submits that the *Weinberger* court should have completely outlined the structural framework these procedures should take by establishing specific negotiating guidelines.

1. The History and Development of Delaware's Treatment of Freezeout Mergers Prior to *Weinberger v. UOP, Inc.*

Historically, minority shareholders have been largely unsuccessful in their attempts to enjoin freezeout mergers entered into under Delaware law. By and large, the Delaware courts have relegated dissatisfied minority shareholders to an independent valuation of their shares in an appraisal proceeding as provided for in Delaware's corporation statutes. Delaware's appraisal statute provides that under certain circumstances, a stockholder of a corporation involved in a merger can petition for an appraisal of the fair value of his shares. If the appraiser finds the fair value of the dissenting shareholder's stock to be higher than the actual merger price, the appraiser will require the corporation to pay cash for the fair value of the stock. Prior to *Singer v. Magnavox Co.*, the Delaware courts generally refused to enjoin freezeout mergers which complied with the technical requirements of the Delaware merger statutes. This policy of judicial *laissez-faire* towards mergers complying with the Delaware merger statutes began in 1940, in the case of *Federal United Corp. v. Havender*.

*Havender* involved a shareholder challenge to the proposed stock for stock merger of the Federal United Corporation ("Federal") with the Bond and Share Company, Federal's wholly-owned subsidiary. The proposed merger would have recapitalized Federal and eliminated the accumulated dividends that had accrued on its preferred stock. Federal's preferred shareholders filed suit in the Court of Chancery seeking an injunction against the payment of dividends on the newly issued stock until all the arrearages on the old stock had been paid. The Chancery Court granted the injunction, finding that al-

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**See infra notes 372-91 and accompanying text.**


**See cases cited supra note 86. For a detailed description of the historical development of the law relevant to freezeout mergers prior to the *Singer* decision see Weiss, *supra* note 2, at 644-57.**

**See Del. Code Ann. tit. 8, § 262 (1983).**

**See id.**

**See Weiss, *supra* note 2, at 644-57.**


**Id. at 322, 11 A.2d at 333.**

**Id.**

24 Del. Ch. 318, 113, 2 A.2d 143, 147 (Del. Ch. 1938).

24 Del. Ch. 96, 109, 6 A.2d 618, 624 (Del. Ch. 1939). The case was heard twice in the Chancery Court. See Havender v. Federal United Corp., 24 Del. Ch. 96, 6
though the transaction was structured as a merger, in substance the transaction was an impermissible recapitalization. 67 On appeal, the Delaware Supreme Court reversed the Chancery Court. 68 According to the Havender court, a single shareholder should not be allowed to block a merger that had met Delaware’s statutory requirements, provided that the merger terms were both fair and equitable. 69 The court stated that the power to merge was “plain, understandable and general,” and “not qualified by limitation or exception.” 70 The court also explained that under Delaware law, minority shareholders take their stock with notice that the corporation in which they own stock may merge with another corporation upon an affirmative vote of the requisite number of stockholders as provided for by Delaware’s merger statutes. 71 The court concluded that if a shareholder is dissatisfied with the terms of a merger, the stockholder should demand and receive the fair value of his shares as provided for by Delaware’s appraisal statute. 101

In 1952, in the case of Sterling v. Mayflower Hotel Corp., 102 the Delaware Supreme Court for the first time allowed minority shareholders to attack a merger on fairness grounds even though on its face, the merger complied with the relevant Delaware statutes. 103 In Sterling, the minority shareholders of the Mayflower Hotel Corporation (“Mayflower”) filed suit in the Chancery Court seeking a preliminary injunction to prevent the proposed stock for stock merger of Mayflower and Mayflower’s parent company, the Hilton Hotels Corporation (“Hilton”). 104 The plaintiffs alleged that the terms of the merger were fraudulent and unfair to Mayflower’s minority shareholders. 105 The Chancery Court found no evidence of fraud and concluded that the terms of the merger were “legally fair” to Mayflower’s minority shareholders. 106 Accordingly, the court refused to issue a preliminary injunction. 107 On appeal, the Delaware Supreme Court affirmed the Chancery Court’s decision. 108 Unlike its previous decision in Havender, however, the Sterling court did not relegate Mayflower’s minority shareholders exclusively...

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A.2d 618 (Del. Ch. 1939); Havender v. Federal United Corp., 23 Del. Ch. 104, 2 A.2d 143 (Del. Ch. 1938). The first time the case was heard, although the Chancellor found generally in favor of the plaintiffs, he stated that he wished to consider further the effects of issuing an injunction before entering a final decree. Havender v. Federal United Corp., 23 Del. Ch. 104, 113-14, 2 A.2d 143, 147 (Del. Ch. 1938). The Chancellor died before he entered a final decree and the case was heard a second time on a motion for reargument by the defendant. Havender v. Federal United Corp., 24 Del. Ch. 96, 99, 6 A.2d 618, 624 (Del. Ch. 1939).


98 Id. at 334, 11 A.2d at 338-39.

99 Id. at 330-31, 11 A.2d at 337.

100 Id. at 333, 11 A.2d at 338.

101 Id. at 334-35, 11 A.2d at 339.

102 33 Del. Ch. 298, 93 A.2d 107 (Del. 1952).

103 Id. at 297-98, 93 A.2d at 109-10.

104 Sterling v. Mayflower Hotel Corp., 33 Del. Ch. 20, 22-23, 89 A.2d 862, 864 (Del. ch. 1952). The merger agreement provided that each share of Mayflower stock would be converted into one share of Hilton stock. Id. at 23, 89 A.2d at 864. At the time of the proposed merger, Hilton owned approximately five-sixths of Mayflower’s outstanding stock. Id.

105 Id. at 22, 89 A.2d at 864.

106 Id. at 35, 89 A.2d at 871.

107 Id.

to the statutory appraisal remedy. Instead, the Sterling court allowed the minority shareholders to challenge the proposed merger, ruling the Hilton had the burden of establishing the "entire fairness" of the transaction because Hilton's directors stood on both sides of the transaction. The court reasoned that this was the appropriate allocation of the burden of proof because Hilton, as the majority shareholder of Mayflower, stood in a fiduciary position in respect to its dealings with Mayflower's minority shareholders. Although the Sterling court allowed the minority shareholders to challenge the merger, the court refused to enjoin the merger because it found that Hilton had established that the terms of the merger were in fact fair to the minority shareholders.

Although the entire fairness requirement announced in Sterling seemed to afford minority shareholders with a means for seeking equitable relief in freezeout merger challenges, subsequent decisions by the Delaware courts did not utilize the Sterling standard as a basis for enjoining unfair mergers. For example, in Stautter v. Standard Brands, Inc., the Delaware Supreme Court did not require the parent company to satisfy the Sterling entire fairness requirement. The Stautter case involved the merger of the Planters Nut and Chocolate Company ("Planters") and Standard Brands, Inc. ("Standard"). Because Standard owned more than 90% of Planters' outstanding stock, Standard's board of directors effected the merger with Planters by adopting an appropriate resolution, as provided for by Delaware's short-form merger statute. The minority shareholders of Planters brought a class action suit in the Court of Chancery seeking to set aside the merger on the grounds that the merger price was so inadequate that it constituted a constructive fraud on Planters' minority shareholders.

On appeal, the Delaware Supreme Court affirmed the Chancery Court's ruling. Because the court found that the "very purpose of the statute [section 253j is to provide the parent corporation with a means of eliminating the minority shareholder's interest in

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109 See id. at 298, 93 A.2d at 110.
110 Id. The defendants apparently conceded that the minority shareholders could attack the merger and did not argue that appraisal should be their exclusive remedy. Id.
111 Id. at 298, 93 A.2d at 109-110. In support of this proposition, the court cited Keenan v. Eshleman, 23 Del. Ch. 234, 2 A.2d 904 (Del. 1938) and Gottlieb v. Heyden Chem. Corp., 33 Del. Ch. 82, 90 A.2d 660 (Del. 1952). Sterling, 33 Del. Ch. at 298, 93 A.2d at 109-10. The Gottlieb case concerned self-dealing on the part of directors involved in a stock option plan. Gottlieb, 3 Del. Ch. at 83-84, 90 A.2d at 661. The Delaware Supreme Court stated that "the burden is upon the directors to prove not only that the transaction was in good faith, but also that its intrinsic fairness will withstand the most searching and objective analysis." Id. at 88, 90 A.2d at 663.
112 Sterling, 33 Del. Ch. at 311, 93 A.2d at 117.
113 41 Del. Ch. 7, 187 A.2d 78 (Del. 1962).
114 See id. at 11, 187 A.2d at 80.
115 Id. at 8, 187 A.2d at 79.
116 Id. at 9, 187 A.2d at 79.
119 Id. at 205, 178 A.2d at 312.
120 Id.
121 Id. at 212, 178 A.2d at 316.
the enterprise," the court held that equitable relief would not be appropriate in the instant case.\textsuperscript{123} In fact, the court stated that it would be "difficult to imagine a case under the short merger statute in which there could be such actual fraud as would entitle a minority to set aside the merger."\textsuperscript{124} The court found that the directors of Planters had not breached any fiduciary obligations owed to the minority shareholders by not attempting to negotiate a higher merger price, because section 253 explicitly authorized unilateral action by Standard's directors by virtue of its 90% ownership interest in Planters.\textsuperscript{125} The court concluded that because the instant case only involved a dispute over the value of the plaintiffs' stock in Planters, the minority shareholders' only remedy was to seek appraisal.\textsuperscript{126} Because the Delaware courts had continually ruled that absent a showing of actual fraud or gross overreaching equitable relief was inappropriate in freezeout merger challenges,\textsuperscript{127} disgruntled minority shareholders began to look to the federal courts for relief.\textsuperscript{128} Although plaintiffs initially met with some success under the federal securities laws under Rule 10b-5,\textsuperscript{129} the Supreme Court in \textit{Sante Fe Industries, Inc. v. Green}\textsuperscript{130} placed severe restrictions on obtaining such relief in the future in federal court.\textsuperscript{131}

The \textit{Sante Fe} case involved the merger of the Kirby Lumber Corporation ("Kirby") and Sante Fe Industries ("Sante Fe").\textsuperscript{132} Sante Fe owned more than 95% of Kirby's stock at the time of the merger.\textsuperscript{133} Pursuant to Delaware's short-form merger statute, Sante Fe's board of directors adopted a resolution approving the merger of the two companies and the merger was subsequently consummated.\textsuperscript{134} Dissatisfied with the merger terms, the former minority shareholders of Kirby brought a class action suit in federal district court.\textsuperscript{135} The plaintiffs alleged that the merger itself, its statutory means of consummation and the merger price constituted a "device, scheme or artifice to defraud" in

\textsuperscript{123} \textit{Id.} at 10-11, 187 A.2d at 80.
\textsuperscript{124} \textit{Id.} at 10, 187 A.2d at 80. The court ruled that because the minority shareholders' only claim involved the adequacy of the merger price, it was not necessary to hold that under no circumstances could a minority shareholder obtain equitable relief for fraud. \textit{Id.} at 11, 187 A.2d at 80.
\textsuperscript{125} \textit{Id.}
\textsuperscript{126} \textit{Id.}
\textsuperscript{127} \textit{See}, e.g., \textit{Coyne v. Park & Tilford Distillers Corp.}, 38 Del. Ch. 514, 522, 154 A.2d 893, 898 (Del. 1959) (merger agreement providing for a cash payment to the minority shareholders was authorized by section 253); \textit{David J. Greene & Co. v. Schenley Indus., Inc.}, 281 A.2d 30, 56 (Del. Ch. 1971) (court of equity should not impede the orderly consummation of a merger absent a showing of fraud or overreaching); \textit{Bruce v. E.L. Bruce Co.}, 40 Del. Ch. 80, 82, 174 A.2d 29, 30 (Del. Ch. 1961) (absent fraud or a showing that the merger terms were so unfair as to shock the conscience of the court minority shareholders would not be allowed to block the merger). In the case of \textit{David J. Greene & Co. v. Dunhill Int'l, Inc.}, 249 A.2d 427, 436 (Del. ch. 1968), however, the Chancery Court did issue a preliminary injunction restraining the consummation of a merger on the grounds that the parent company could not adequately prove the entire fairness of the merger terms. \textit{Id.}
\textsuperscript{128} \textit{See}, e.g., \textit{Green v. Sante Fe Indus., Inc.}, 553 F.2d 1283 (2d Cir. 1976), \textit{rev'd}, 430 U.S. 462 (1977); \textit{Marshel v. AFW Fabric Corp.}, 553 F.2d 1277 (2d Cir. 1976), \textit{vacated}, 429 U.S. 881 (1977).
\textsuperscript{129} \textit{See id.} Rule 10b-5 is found at 17 C.F.R. § 240.10b-5(c) (1983).
\textsuperscript{130} 430 U.S. 462 (1977).
\textsuperscript{131} \textit{Id.} at 465.
\textsuperscript{132} \textit{Id.}
\textsuperscript{133} \textit{Id.}
\textsuperscript{134} \textit{Id.} at 465-66. Pursuant to the merger agreement, Kirby's minority shareholders were paid $150 per share, $50 above the prevailing market price. \textit{Id.} at 466. Kirby's assets, however, were estimated to be worth more than $600 per share. \textit{Id.}
violation of Rule 10b-5. Specifically, the plaintiffs alleged that the means for effecting the Sante Fe-Kirby merger operated as a fraud on Kirby's minority shareholders because the merger was consummated for the benefit of Sante Fe without any legitimate business purpose except to eliminate Kirby's minority shareholders. The plaintiffs also alleged that the low value placed on their shares by Sante Fe was in itself fraud actionable under Rule 10b-5. The district court granted the defendants' motion to dismiss, stating that the reach of Rule 10b-5 did not prevent Delaware from providing majority shareholders with a means of eliminating a minority from the future affairs of a corporation. Absent a showing of misrepresentation or lack of disclosure, the district court ruled that the plaintiffs had failed to state a cause of action under Rule 10b-5. On appeal, the Second Circuit Court of Appeals reversed the district court's ruling. The Circuit Court held that the plaintiffs had stated a cause of action under Rule 10b-5, because, according to the court, Rule 10b-5 encompasses "breaches of fiduciary duty by a majority against minority shareholders without any charge of misrepresentation or lack of disclosure." On writ of certiorari, the Supreme Court reversed the court of appeals.

The Supreme Court held that a transaction had to involve some element of deception or manipulation in order to constitute a violation of Rule 10b-5. The Court found no deception in the matter because Sante Fe had made disclosure to the minority shareholders after the consummation of the merger as provided for in Delaware's short-form merger statute. In addition, the Court found that Sante Fe had not employed any manipulative devices in effecting the merger. The Court concluded, therefore, that plaintiffs' only remedy was to petition for an appraisal of their shares, as provided by Delaware law. The Court reasoned that it would be inappropriate for the federal courts to interpret Rule 10b-5 as outlawing transactions that complied with state law and had been consummated without deception. Significantly, however, the Court stated that,
although there may be a need for federal fiduciary standards to govern mergers, "those standards should not be supplied by judicial extension of section 10(b) and Rule 10b-5 to 'cover the corporate universe.'" Consequently, while it did not approve of Delaware's treatment of freezeout mergers, the Court refused to allow the federal courts to deal with the problems created by freezeout mergers under Rule 10b-5.  

Santa Fe, therefore, decisively threw the matter of freezeout mergers back to the states, setting the stage for the Delaware Supreme Court's landmark decision in Singer v. Magnavox Co.

Singer involved a challenge to the cash merger of Magnavox Company ("Magnavox") and T.M.C. Development Corporation, a wholly-owned subsidiary of the North American Philips Corporation. Philips had acquired 84% of Magnavox through a cash tender offer. Dissatisfied with the terms of the merger, the minority shareholders brought a class action suit in the Delaware Court of Chancery alleging that the merger was fraudulent because its only purpose was to eliminate the minority shareholders of Magnavox at a grossly inadequate price. The Court of Chancery granted the defendants' motion to dismiss, ruling that the merger was not fraudulent merely because it was accomplished for the sole purpose of eliminating Magnavox's minority shareholders.

The Chancery Court stated that, in any event, the plaintiffs' remedy was to seek an appraisal of their shares if they were dissatisfied with the merger price. The plaintiffs appealed this ruling to the state Supreme Court.

The Delaware Supreme Court reversed. The court began its opinion by articulating the obligations owed by a controlling shareholder in the context of a long-form merger. The court explained that the controlling shareholder in a freezeout merger owes a high standard of fiduciary fairness to minority shareholders, which is not always satisfied by full compliance with the Delaware merger statutes. The court stated that despite statutory authorization for the merger and the defendants' compliance with the statute's terms, the transaction was not insulated from review by a court of equity.

According to the Singer court, Delaware courts would not be indifferent to mergers.

\[\text{\footnotesize{\textsuperscript{150}}} \text{Id. at 479-80. In support of this statement, the Court cited Professor Cary's article attacking Delaware's corporate jurisprudence and urging the adoption of new laws incorporating federal fiduciary standards. Id. at 480 n.17 (citing Cary, Federalism and Corporate Law: Reflections Upon Delaware, 83 YALE L.J. 663, 700 (1974)).} \]

\[\text{\footnotesize{\textsuperscript{151}}} \text{See 430 U.S. at 479-80.} \]

\[\text{\footnotesize{\textsuperscript{152}}} \text{380 A.2d 969 (Del. 1977).} \]

\[\text{\footnotesize{\textsuperscript{153}}} \text{Id. at 971.} \]

\[\text{\footnotesize{\textsuperscript{154}}} \text{Id. at 972.} \]

\[\text{\footnotesize{\textsuperscript{155}}} \text{Singer v. Magnavox Co., 367 A.2d 1349, 1358 (Del. Ch. 1976).} \]

\[\text{\footnotesize{\textsuperscript{156}}} \text{Id. at 1362.} \]

\[\text{\footnotesize{\textsuperscript{157}}} \text{Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977).} \]

\[\text{\footnotesize{\textsuperscript{158}}} \text{Id. at 980. Singer was decided shortly after the Supreme Court decided Santa Fe. Santa Fe's suggestion of possible federal corporate legislation, see supra note 149-50 and accompanying text, may have influenced the Singer court's decision to establish a business purpose test for minority shareholder protection. The Singer court stated: "Santa Fe is a current confirmation by the Supreme Court of the responsibility of a state to govern the internal affairs of corporate life." 380 A.2d at 976 n.6.} \]

\[\text{\footnotesize{\textsuperscript{159}}} \text{Id. at 972-73.} \]

\[\text{\footnotesize{\textsuperscript{160}}} \text{Id. at 975.} \]

\[\text{\footnotesize{\textsuperscript{161}}} \text{Id. at 972.} \]

\[\text{\footnotesize{\textsuperscript{162}}} \text{The court held that the merger was assailable because "inequitable action does not become permissible simply because it is legally possible." Id. (quoting Schnell v. Chris-Craft Industries, Inc., 285 A.2d 437, 439 (Del. 1971)).} \]
effected solely for the purpose of eliminating minority shareholders from further equity participation in a corporation, despite earlier case law holding that minority shareholders take their stock with constructive notice that Delaware's merger statutes provide for majority shareholder action in accomplishing mergers. The court then articulated a two pronged test for determining the validity of freezeout mergers. First, the court held that in a parent-subsidiary merger, the majority shareholder must prove a valid business purpose for effecting a merger in order to satisfy Delaware's high fiduciary standards. Second, even if the defendants meet this burden, the court held that the lower courts must also scrutinize all aspects of a merger for compliance with Sterl's mandate of entire fairness.

While the business purpose test announced in Singer clearly marked a shift in Delaware's treatment of freezeout mergers, the court explicitly declined to specify whose business purpose would be relevant in the examination of a merger challenge. More importantly, the court did not articulate any criteria for evaluating what constituted a valid business purpose. The Singer court also failed to elaborate on the concept of entire fairness which was originally developed in Sterl. The Delaware Supreme Court's decision in Tanzer v. International General Industries, Inc. provided partial answers to some of the issues left unresolved by Singer.

One month after the Singer decision was handed down, the Delaware Supreme Court decided the Tanzer case. Tanzer involved a challenge to a proposed long-form merger of the Kliklok Corporation ("Kliklok") and International General Industries ("IGI"). At the time of the proposed merger, IGI owned 81% of Kliklok's outstanding common stock. The Tanzers, owners of Kliklok stock, brought suit in the Court of Chancery seeking a preliminary injunction to prevent the merger on the ground that the sole purpose of the merger was to serve the interests of the majority shareholder. The Chancery Court granted the defendants' motion for summary judgment and the plaintiffs appealed.

On appeal, the Delaware Supreme Court affirmed the Chancery Court's decision, ruling that the Singer business purpose requirement could be satisfied when a merger was effected solely to advance the business purposes of a parent company. The court found

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163 380 A.2d at 979. The Singer court distinguished Havender, Bruce, Stauffer and Schenley as factually different from the instant case. Id. at 978-79. For a discussion of Havender and Stauffer see supra notes 91-101 and 113-36 and accompanying text. The Singer court stated that none of these cases involved straight "cash-for-stock" mergers in which the only purpose for the merger was the elimination of the subsidiary's minority shareholders. 380 A.2d at 987.

164 Id. at 980.

165 Id.

166 Id.

167 Id. n.11.

168 For a discussion of the Sterl test, see supra notes 102-12 and accompanying text.

169 379 A.2d 1121 (Del. 1977).

170 Id. at 1124.

171 Id. at 1122.

172 Id.


174 Id. at 395.


176 Id. at 1124. The court reasoned that IGI, as a stockholder of Kliklok, had a right to "look to its own corporate concerns in determining how to conduct the latter's affairs, including a decision to cause it to merge." Id. The court cited the Ringling rule that a stockholder may vote in his own
that IGI had satisfied the Singer requirement by demonstrating that its merger with Kliklok facilitated its own long-term debt financing. As in Singer, the Tanzer court stated that the establishment of a "bona fide" business purpose would not necessarily discharge the parent company's fiduciary obligations. Employing Singer's two pronged test, the Tanzer court held that even after proving a valid business purpose for effecting the proposed merger, the parent company had to establish that the merger terms were entirely fair to the subsidiary's minority shareholders. Although the Tanzer court affirmed the Chancellor's ruling denying injunctive relief, the court remanded the case because it found that the plaintiffs were still entitled to a "fairness hearing under Singer." While Tanzer answered some of the questions left open by Singer, the decision significantly weakened the potential minority shareholder protection offered by the Singer business purpose test because it upheld a merger effected solely for the business purposes of a parent corporation. Additionally, the Tanzer decision, like Singer, failed to provide the lower courts with any definite guidelines for determining what would constitute a valid business purpose for effecting freezeout mergers in the future. The lower courts were left to decide what constituted a valid business purpose on a case by case basis, and presumably would allow corporations to justify freezeout mergers by advancing purposes no more compelling than the purpose approved in Tanzer. Consequently, because the lower courts were deciding merger challenges on a case by case basis without clear guidelines as to what constituted a valid business purpose, the Chancery Court decisions were often conflicting and somewhat arbitrary. The doctrinal confusion that followed Singer and Tanzer culminated in Weinberger v. UOP, Inc.

self-interest as supporting this conclusion. Id. (citing Ringling Bros. Barnum & Bailey Com. Shows v. Ringling, 29 Del. Ch. 610, 622, 53 A.2d 441, 447 (Del. 1947)).

177 379 A.2d at 1124. The Tanzer court emphasized that while a merger may be effected solely for the business purposes of the parent company, the purpose advanced by the parent company had to be "bona fide" and not a "subterfuge" created to eliminate the minority shareholders. Id. at 1125.

178 Id.

179 Id.

180 See id. at 1124-25.

181 See id. at 1124.

182 See id. at 1124.

183 See Brudney & Chirelstein, supra note 9, at 1371. Brudney & Chirelstein believe that it would be impossible to deny that a commercial goal was wholly lacking in any parent-subsidiary merger. Id. The possibility of economic gain for the parent company always exists because the combined overall value of the enterprises may become greater than the value of the firms as separate entities, prior to the merger. Id. Brudney & Chirelstein maintain that even if these "synergistic gains" are minimal, management still would have other economic justifications for accomplishing a parent-subsidiary merger. Id. A parent-subsidiary merger would reduce the difficulty of establishing fair intercompany dealings in allocating overhead costs, tax benefits and growth opportunities. Id.

184 See Young v. Valhi, Inc., 382 A.2d 1372, 1378 (Del. Ch. 1978). The Chancery Court's decision in Young v. Valhi, Inc., demonstrates the difficulty the lower courts experienced in applying the Singer business purpose test. Id. In Young, the Chancery Court enjoined a parent-subsidiary merger because it found that the "basic purpose" of the merger was to eliminate the minority shareholders of the subsidiary. Id. at 1378. The court rejected the parent company's contentions that the merger would lead to tax savings for the parent company and avoid possible conflicts of interest. Id. at 1377. The court stated that the tax savings could be achieved by other means and that the conflicts were "somewhat contrived." Id. There is little doubt that the merger in Young advanced the economic interests of the parent company and that a "basic purpose" of the parent company in Tanzer was to eliminate the minority shareholders of the subsidiary. The distinctions between the purposes of these two mergers appear to be largely metaphysical.

185 457 A.2d 701 (Del. 1983).
II. The Weinberger Decision

In a unanimous decision, the Delaware Supreme Court ruled that the business purpose requirement announced in Singer was "no longer the law of Delaware." The court ruled that the entire fairness prong of the Singer test was the only appropriate standard of review for shareholder challenges to freezeout mergers. According to the Weinberger court, the concept of entire fairness as first announced in the Sterling case, was comprised of two "basic aspects:" fair dealing and fair price. The Delaware Supreme Court reversed the Chancellor's findings concerning the fair dealing aspects of the case, stating that the Signal-UOP merger did not satisfy "any reasonable concept of fair dealing." The Weinberger court also held that the Delaware courts were no longer restricted exclusively to the use of the Delaware block, weighted average valuation method in determining fair price. The court ruled that the Delaware courts were free to use modern stock valuation techniques for the purpose of determining fair price under the entire fairness test and for the purpose of determining fair value in an appraisal proceeding. Although the Weinberger court reversed the Chancery Court regarding its findings of fair dealing and its strict application of the Delaware block valuation method, the Delaware Supreme Court refused to set aside the "long completed transaction." Instead, the court remanded the case to the Chancery Court for a determination concerning a possible damage award.

The Weinberger court began its review of the Signal-UOP merger by articulating the appropriate allocation of the burden of proof. According to the court, in order to challenge a merger under the Sterling entire fairness standard, minority shareholders must allege specific acts of "fraud, misrepresentation, or other items of misconduct." Once the plaintiff has invoked the Sterling entire fairness obligation, the court stated that the parent company must prove, by a preponderance of the evidence, that the merger terms were entirely fair to the minority shareholders. The court stated, however, that the parent company could shift the burden of proof entirely back to the minority shareholders if it could demonstrate that the terms of the merger were approved by an informed vote of a majority of the minority shareholders. In order to prove that the minority shareholder vote was "informed," the court stated that the parent company had to demonstrate that it completely disclosed all the material facts relevant to the transaction to the minority shareholders.

Turning to a consideration of the facts before it, the Weinberger court found that the vote of UOP's minority shareholders approving the terms of the merger was ineffective, because it was not informed. The court based this finding on the fact that the results of
the feasibility study prepared by two Signal executives who also served on UOP's board of directors, were not disclosed to UOP's minority shareholders. This study indicated that it would be to Signal's advantage to acquire the remainder of UOP's publicly held shares at any price up to $24 per share. Because of this inadequate disclosure, the court ruled that the burden of proof remained Signal's and that in order to prevail, Signal had to prove that the terms of the merger were entirely fair to UOP's minority shareholders. The court then moved to a discussion of whether the transaction in Weinberger was "entirely fair" under the standard developed in Sterling.

According to the Weinberger court, although the concept of entire fairness is comprised of two basic components, fair dealing and fair price, these components should not be considered in isolation in considering the validity of a corporate merger. The court explained that while proof of both fair dealing and fair price would be necessary to satisfy the entire fairness standard, the concept of entire fairness required that a merger also be reviewed in light of the total circumstances surrounding the transaction. The court then discussed the various aspects of a merger transaction that should be examined under each component of the entire fairness standard. The test for fair dealing, the court stated, includes considerations of "when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained." The court, also stated that fair dealing requires "complete candor" in disclosing information to the shareholders and directors of the subsidiary.

Applying this standard to the facts of Weinberger, the court stated that Signal's directors sitting on UOP's board violated this duty of complete candor when they failed to disclose the results of the feasibility study. The Weinberger court found that Signal breached its duty of fair dealing with UOP's minority shareholders in several other instances as well. The court objected to the serious time constraints Signal imposed on UOP's management when the merger proposal was first presented. In addition, the court found that the negotiations that preceded the merger fell far short of the ideal for arm's-length bargaining. The court observed that UOP's president's only attempt at negotiating a higher merger price was to convey to Signal the view of UOP's outside directors that, as to the $20-$21 price range proposed by Signal, the merger price would

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208 Id. at 711. The court stated that the requirement of complete candor is another way of articulating that Signal's directors serving on UOP's board owed UOP and its shareholders an "uncompromising duty of loyalty." Id. at 710.
209 Id. at 711-12. The court also found that the minority shareholders were not informed about the hurried method in which Lehman Brothers prepared the fairness opinion concerning the merger price. Id. at 712.
210 Id. at 710-12.
211 Id. at 711. The court was careful to note, however, that the time constraints, standing alone, would not necessarily be indicative of a lack of fairness by a majority stockholder. Id. See supra notes 30-31 and accompanying text.
212 457 A.2d at 711.
have to be $21 per share. These negotiations were characterized by the court as being "modest at best." The court also objected to the level of participation by the Signal directors sitting on UOP's board at the UOP board meeting concerning the merger proposal. The court found that, although the Signal directors abstained from voting, they actively participated in other aspects of the meeting. Taking all of these factors into consideration, the court found that the circumstances surrounding the Signal-UOP merger did not satisfy "any reasonable concept of fair dealing."

Significantly, the court articulated two methods by which Signal could have established "strong evidence" of fairness in the instant case. First, the court stated that if Signal had engaged in arm's-length negotiations with a committee comprised of UOP's outside directors, the result of the case "could have been entirely different." Second, the court noted that Signal could have achieved the same result if Signal's directors serving on UOP's board had totally abstained from any participation in the transaction. In the absence of an independent negotiating structure or proof of the total abstention of the subsidiary's interested directors in the matter, the court found that Signal was required to prove that it had discharged its fiduciary duty "in light of what is best for both companies." The court concluded that on the facts before it, Signal had not met this obligation.

Turning to the price component of the entire fairness standard, the Weinberger court began its analysis by articulating what it meant by "fair price." The court explained that fair price relates to the economic and financial considerations of the merger. In determining whether a merger price is fair, according to the court, "assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock" must be considered. Moreover, the court held that in determining the value of a corporation's stock, the Delaware courts were no longer restricted to the use of the "Delaware block" weighted average valuation approach, but

213 Id. The court stated that UOP's president, James V. Crawford, never really "talked price with Signal." Id.
214 Id. The court noted that UOP had to alter the original draft of the proxy statement that was to be sent to UOP's minority shareholders. Id. at 708. The proxy statement actually sent to UOP's minority shareholders stated that "the price was determined after discussions between James v. Crawford, a director of Signal and Chief Executive Officer of UOP, and officers of Signal which took place during meetings of February 28, 1978 and in the course of several subsequent telephone conversations." Id. In the original draft of the proxy statement the word "negotiations" had been used rather than "discussions." Id. When the Securities and Exchange Commission began investigating the details of these "negotiations," however, the term was deleted and the word "discussions" was substituted. Id.
215 Id. at 710.
216 Id. at 707.
217 Id. at 712.
218 Id. at 709 n.7.
219 Id. at 710-11.
220 Id. The court stated that Delaware case law had previously established the principle that directors standing on both sides of a transaction are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain. Id. at 710. See Warshaw v. Calhoun, 43 Del. Ch. 148, 156, 221 A.2d 487, 492 (Del. 1966). Gottlieb v. Heyden Chem. Corp., 33 Del. Ch. 177, 178-79, 91 A.2d 57, 57-58 (Del. 1952).
221 457 A.2d at 711.
222 Id.
223 Id. at 711.
224 Id.
instead could also take into account other generally accepted stock valuation techniques. This decision, the court continued, was in keeping with the legislative intent expressed in a then recent amendment to the Delaware corporation law, section 262(h), which provided that "all relevant factors" should be taken into account in valuing the shares of a dissenting shareholder. The court did not examine the fairness of the merger price under the new standards it had announced, deciding that the issue was to be decided by the Chancellor on remand.

After determining that Signal had failed to prove the entire fairness of the transaction, the court turned to a discussion of the appropriate remedy to be applied in the instant case. The court stated that in most instances the financial remedy available to minority shareholders in freezeout merger challenges would be appraisal. In future appraisal proceedings the court noted that minority shareholders would be able to receive the fair value of their stock as determined by modern valuation techniques. The court recognized, however, that such a monetary remedy may not be adequate in certain cases involving "fraud, misrepresentation, self-dealing, deliberate waste of corporate assets or gross and palpable overreaching." The court stated that in these circumstances, "the Chancellor's powers are complete to fashion any form of equitable and monetary relief as may be appropriate, including rescissory damages." Considering the matter before it, the court was careful not to adopt or suggest any particular valuation technique, preferring to leave the selection of valuation techniques to the parties involved in the dispute.

Del. Code Ann. tit. 8, § 262(h) (1983). The court pointed out that the first references to "fair value" appeared in a 1976 amendment to section 262(f). The court also noted that in that 1981 amendment to section 262 the notion of fair value was repeatedly emphasized and the language instructing the courts to "take into account all relevant factors" appeared in section 262(h).

In Weinberger, the plaintiffs had not sought an appraisal under Section 262. The plaintiffs had instead sought rescissory damages of the type considered by the Delaware Supreme Court in Lynch v. Vickers Energy Corp., 429 A.2d 497, 505-06 (Del. 1981). In Lynch, a parent company had acquired the majority interest in a controlled subsidiary through a misleading tender offer solicitation. Id. at 499. The price of oil, the principal asset of the subsidiary, rose rapidly during the period in which fairness of the tender offer solicitation was being litigated. Id. at 501. The Delaware Supreme Court awarded "rescissory damages," which allowed the former minority shareholders to reap the benefits of the increase in oil prices which occurred while the case was being litigated. Id. This result was accomplished by valuing the plaintiffs' stock at the date of the appeal rather than at the date of the merger. Id.

The Weinberger court seemed to indicate that minority shareholders generally would not be entitled to realize windfall profits merely because a majority shareholder had breached some fiduciary duty in connection with the merger. See 457 A.2d at 714. The court left open the possibility that rescissory damages could be awarded in the instant case, however, if the Chancellor, on remand, considered them susceptible of proof and a "remedy appropriate to all the issues of fairness before
that even though Signal had not satisfied the entire fairness test, the merger should not be set aside. The court stated that "this long completed transaction is too involved to undo." Remanding the case to the lower court, the court directed the Chancellor to decide the amount of monetary damages to be awarded, if any, based upon entire fairness standards of fair dealing and fair price.

Finally, the court addressed the Singer business purpose doctrine. The Weinberger court concluded that the business purpose doctrine articulated in Singer should be overruled. The court explained that given the "expanded" appraisal remedy now available to dissenting shareholders through the use of modern valuation techniques and the broad powers of the Chancellor to fashion equitable relief appropriate to the particular circumstances, no "additional meaningful protection" would be afforded to minority shareholders by the application of the Singer business purpose requirement. The Weinberger court observed that in the proceedings below, the Chancellor had "clearly circumscribed the thrust and effect of Singer" by ruling that Signal's desire to make an investment of its cash reserves constituted a valid business purpose for effecting the merger. The Weinberger court admitted that the Chancellor's decision demonstrated that the business purpose doctrine could, in effect, be interpreted out of existence. Consequently, with little else in the way of explanation, the Weinberger court eliminated the Singer business purpose test from Delaware corporation law.

III. The Rationale of Weinberger v. UOP, Inc.

The Weinberger decision represents a significant improvement in Delaware's treatment of freezeout merger challenges. In Weinberger, the Delaware Supreme Court eliminated the Singer business purpose test from Delaware law and established the Sterling entire fairness test as the sole standard of review for freezeout merger challenges. This section of the casenote analyzes the different aspects of the Delaware Supreme Court's decision in Weinberger, beginning with an analysis of the Weinberger court's elimination of the Singer business purpose test. Next, this section of the casenote examines the Weinberger court's decision to establish the Sterling entire fairness test as the sole standard of review for freezeout merger challenges. The two components of the concept of him." Id. Because the Signal-UOP merger was conditioned on approval by a majority of the minority shareholders and approval may not have been secured if Signal had made full disclosure, the Delaware Supreme Court left it to the trial court to decide, on remand, whether the minority interest in UOP should be valued as of a constructive rescission date rather than the date of the merger. Id.

457 A.2d at 714.

Id.

Id.

Id. at 715.

Id.

Id.


457 A.2d at 715.

Id. at 715.

Id. at 710-11.

See infra notes 246-99 and accompanying text.

See infra notes 300-50 and accompanying text.
entire fairness, fair dealing⁴¹ and fair price.⁴² are examined separately in this section of the analysis. This casenote submits that the Weinberger decision improves Delaware merger law by enhancing the quality of minority shareholder protection and by eliminating the uncertainty which surrounded the Singer business purpose test.

A. The Business Purpose Doctrine

The Weinberger court’s decision to overrule the business purpose requirement represents a significant improvement in the Delaware judiciary’s treatment of freezeout merger challenges. The business purpose doctrine originated in 1977 in the case of Singer v. Magnavox Co.⁴³ when the Delaware Supreme Court held that the minority shareholders bringing the merger challenge had stated a cause of action by alleging that the majority shareholder had breached its fiduciary duty by effecting the merger for the sole purpose of eliminating the minority shareholders from the corporation.⁴⁴ By so holding, the Singer court, in effect, required majority shareholders to demonstrate in future merger challenges that the merger in question was effected for business reasons other than the elimination of the minority shareholders from the entity.⁴⁵ In the subsequent case of Tanzer v. International General Industries, Inc., the Delaware Supreme Court limited the scope of the business purpose requirement by holding that the business reasons of a parent company satisfied the business purpose requirement announced in Singer.⁴⁶

It is submitted that the business purpose requirement was an inappropriate standard of review for challenges to freezeout mergers. This section of the casenote first examines the business purpose doctrine as developed by the Delaware Supreme Court in Singer and Tanzer.⁴⁷ Next, this section of the casenote analyzes the effectiveness of the business purpose doctrine in achieving minority shareholder protection in light of the court’s holding in Tanzer.⁴⁸ Finally, this section of the casenote demonstrates that the Weinberger court’s decision to eliminate the Singer business purpose requirement clarifies Delaware merger law and improves the Delaware judiciary’s treatment of minority shareholder interests.⁴⁹

In Singer, the Delaware Supreme Court established a two pronged standard of review comprised of a business purpose requirement and an entire fairness test.⁵⁰ The entire fairness prong of this standard was first established in 1952 in the case of Sterling v. Mayflower Hotel Corp.⁵¹ Subsequent to Sterling, however, the Delaware courts had not consistently required majority shareholders to establish the entire fairness of challenged mergers.⁵² The two pronged standard of review announced by the Singer court marked a

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⁴¹ See infra notes 300-37 and accompanying text.
⁴² See infra notes 338-50 and accompanying text.
⁴³ 380 A.2d 969 (Del. 1977).
⁴⁴ Id. at 980.
⁴⁵ See id.
⁴⁶ 379 A.2d 1121 (Del. 1977).
⁴⁷ Id. at 1124.
⁴⁸ See infra notes 254-83 and accompanying text.
⁴⁹ See infra notes 284-93 and accompanying text.
⁵⁰ See infra notes 294-99 and accompanying text.
⁵¹ 380 A.2d at 980. See supra notes 159-68 and accompanying text.
⁵² 93 Del. Ch. 293, 298, 93 A.2d 107, 110 (Del. 1952).
shift from Delaware's previous treatment of freezeout mergers. Prior to Singer, the Delaware courts had relied almost exclusively on the statutory appraisal remedy for the protection of minority shareholder interests. Before 1977, the Delaware courts had been reluctant to enjoin mergers that complied with the relevant Delaware merger statutes. The Singer court's adoption of a business purpose requirement and its revival of the Sterling entire fairness test provided minority shareholders with the two possible grounds on which to seek an injunction to set aside a freezeout merger. Previously, Delaware courts had held that, absent a showing of fraud or gross overreaching, minority shareholders would be restricted to the statutory appraisal remedy. While the entire fairness prong of the Singer standard of review had roots in prior Delaware law, the business purpose requirement announced by the Singer court plainly seemed to be inconsistent with earlier Delaware merger decisions. Previous Delaware case law had not inquired into the business purposes behind mergers that complied with Delaware's merger statutes.

By establishing the business purpose requirement, the Singer court opened the door to the possibility that equitable relief would be granted in cases where a parent company could not advance sufficient business reasons to justify a decision to merge. In support of its adoption of the business purpose requirement, the Singer court stated that an investor has a legitimate interest in the form, as well as the value, of his investment. This statement appears to be inconsistent with the court's earlier decisions in Federal United Corp., v. Havender and Stauffer v. Standard Brands, Inc., in which the court found that minority shareholders only had the right to receive the cash value of their shares in an appraisal proceeding if they were dissatisfied with the merger terms.

The Singer court applied a narrow reading to the holding in Havender, stating that "Havender stands for the proposition that a merger must be 'fair and equitable in the circumstances of the case' in order to withstand the veto of a dissenting shareholder." The Singer court's characterization of Havender ignored the overall thrust of the opinion which stressed the absence of limits on the majority shareholder's power to merge. The Havender court did not suggest the possibility of equitable relief if a merger was not "fair and equitable," but instead spoke only of the statutory appraisal remedy. In Stauffer, the Delaware Supreme Court ruled that absent a showing of fraud or overreaching, equitable relief would not be appropriate. In its review of the short-form merger in

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257 See cases cited supra note 256. See supra notes 92-126 and accompanying text.
258 See supra notes 92-126 and accompanying text.
259 380 A.2d at 980.
260 See supra note 256.
261 See supra notes 92-126 and accompanying text.
262 380 A.2d at 980.
263 Id. at 977-78.
264 24 Del. Ch. 318, 11 A.2d 331 (Del. 1940).
265 41 Del. Ch. 7, 187 A.2d 78 (Del. 1962).
267 380 A.2d at 979. The court also attempted to distinguish Havender on the ground that cash mergers were not authorized when Havender was decided. Id.
268 See 24 Del. Ch. at 330-31, 11 A.2d at 337.
269 Id. at 334-35, 11 A.2d at 339.
270 41 Del. Ch. at 10, 187 A.2d at 80.
question, the Stauffer court had stated that "the very purpose of the statute [section 253] is to provide the parent corporation with a means of eliminating the minority shareholder's interest in the enterprise."271 The Singer court stated that it did not read the Stauffer decision as approving mergers effected for the sole purpose of freezing out the minority shareholders of a controlled subsidiary.272 Despite the Singer court's efforts to reconcile the business purpose requirement with prior case law, the court's decision to allow minority shareholders to challenge a merger on the ground of improper purpose was inconsistent with previous Delaware case law which relegated minority shareholders exclusively to the statutory appraisal remedy.273

In addition to the difficulties the court experienced explaining the inconsistencies surrounding the business purpose requirement, the Singer court was also unable to establish a clear conceptual foundation for the business purpose test. The Singer court attempted to base the business purpose requirement on the fiduciary obligations previously imposed by Delaware courts on majority shareholders.274 In support of its conclusion that a "$251 merger, made for the sole purpose of freezing out minority shareholders, is an abuse of the corporate process,"275 the Singer court cited a number of decisions that invalidated actions taken by controlling shareholders or corporate officers designed to perpetuate themselves in office.276 The Court reasoned that if the use of corporate power to perpetuate control violated the fiduciary duties owed by majority shareholders, then "[b]y analogy, if not a fortiori, use of corporate power solely to eliminate the minority is a violation of that duty."277 In using this analogy, however, the Singer court failed to take into account the significant factual distinctions between freezeout merger cases and cases involving perpetuation of control by majority shareholders.278

The use of corporate power to perpetuate control is thought to be objectionable because the forces of efficient market allocation of control are frustrated.279 One current theory is that management should not be allowed to block a takeover solely to retain control, because in many instances, takeovers facilitate the replacement of inefficient management.280 When management eliminates a minority interest in a subsidiary corporation in a freezeout merger, however, this transaction has nothing to do with a management tactic to retain control. Indeed, the very fact that the majority shareholder is able to

271 Id. at 10-11, 187 A.2d at 80.
272 380 A.2d at 978-79. The Singer court implicitly acknowledged the conflict between its holding and the Stauffer decision, stating "[a]ny statement in Stauffer inconsistent herewith is held inapplicable to a § 251 merger." Id. at 980.
274 See 380 A.2d at 975-78.
275 Id. at 980.
276 Id. at 979 (citing Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437 (Del. 1971); Condec Corp. v. Lunkenheimer Co., 43 Del. Ch. 353, 250 A.2d 769 (Del. Ch. 1967); Bennett v. Breuil Petroleum Corp., 34 Del. Ch. 6, 99 A.2d 236 (Del. Ch. 1953)).
277 380 A.2d at 980.
278 See id. at 979-80.
280 See Gilson, supra note 279, at 841-42. But see Lipton, Takeover Bids in The Target's Boardroom, 35 BUS. LAW. 101, 106-13 (1979).
effectuate the merger demonstrates that the minority shareholders were not a threat to the majority’s control of the subsidiary. Because the analogy drawn by the Singer court was not parallel, the conceptual basis of the business purpose requirement was suspect in the context of freezeout mergers. Despite the court’s efforts, therefore, the business purpose requirement and the implicit minority shareholder veto power granted by its enactment were inconsistent with prior Delaware merger law.

In addition to the questionable basis of the business purpose requirement, the Singer court did not fully explain what business reasons would satisfy the requirement. Because it was ruling on a motion to dismiss, the court only held that the plaintiffs had stated a cause of action by alleging that the parent company had effected the merger for the sole purpose of eliminating the subsidiary’s minority shareholders. The court’s decision in the subsequent case of Tanzer v. International General Industries, Inc. created substantial uncertainty as to what circumstances would merit equitable relief under the business purpose requirement. In Tanzer, the court allowed the business purpose of a parent company to suffice as justification for accomplishing a merger. Specifically, the court held that the parent company had satisfied the business purpose requirement by demonstrating that the merger with its subsidiary facilitated its own long-term debt financing. In so ruling, the court significantly decreased the probability that the Singer business purpose test could be used successfully to enjoin freezeout mergers. After Tanzer, therefore, it seemed that a parent company would almost certainly be able to justify a merger with a subsidiary by showing it received some financial benefit as a result of the transaction. For example, the business purpose approved in Tanzer, that the merger was accomplished to facilitate the parent company’s long-term debt financing, certainly seemed to be less than compelling. Even though the Singer court apparently devised the business purpose test in order to protect minority shareholder interests in the context of freezeout mergers, the business purpose requirement, as weakened by the court’s holding in Tanzer, did not afford minority shareholders any real protection from unfair treatment by majority shareholders. Although, in theory, the business purpose requirement represented a possible ground on which minority shareholders could win injunctions, plaintiffs were largely unsuccessful in enjoining mergers on improper purpose grounds.

While the overall effect of the Tanzer decision significantly decreased the probability that the business purpose requirement would be used successfully as a grounds for equitable relief, parent companies planning mergers with subsidiaries still had to be

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281 See supra notes 274-78 and accompanying text.
282 See supra notes 92-126 and accompanying text. In Weinberger, the Delaware Supreme Court admitted that “[t]he requirement of a business purpose is new to our law of mergers and was a departure from prior case law.” 457 A.2d at 715.
283 380 A.2d at 980.
284 Tanzer, 379 A.2d at 1124.
285 Id.
286 See Brudney & Chirelstein, supra note 9, at 1371. Brudney & Chirelstein maintain that it would be impossible to deny that a commercial goal was wholly lacking in any parent-subsidiary merger. Id.
287 379 A.2d at 1124.
288 See Weiss, supra note 2, at 657-58.
289 See, e.g., Tanzer, 379 A.2d 1121 (Del. 1977); Weinberger v. UOP, Inc., 426 A.2d 1333 (Del. Ch. 1981); The Chancery Court’s decision in Weinberger illustrates the ineffectiveness of the business purpose requirement as a grounds for equitable relief. 426 A.2d 1333 (Del. Ch. 1981). The Chancellor held that Signal’s desire to make a favorable cash investment was a proper purpose for effecting the Signal-UOP merger. Id. at 1350.
concerned that, in the event of a minority shareholder challenge, their purposes for affecting the merger might be considered improper by a Delaware court. The Tanzer court emphasized that while parent companies had a right to look to their own interests in affecting mergers with subsidiaries, the purposes advanced by the parent company had to be "bona fide" and not suspect as a "subterfuge, the real purpose of which is to rid itself of unwanted minority shareholders in the subsidiary."

In one subsequent merger challenge, the Chancery Court, in the case of Young v. Valhi, Inc., enjoined a parent-subsidiary merger because it found that the "basic purpose" of the merger was to eliminate the subsidiary's minority shareholders. Because the lower courts were left to decide what constituted a "bona fide" purpose for effecting a merger on a case by case basis, a great deal of uncertainty surrounded the business purpose doctrine in the years following Singer and Tanzer.

In addition to the doctrinal confusion created by the Singer business purpose requirement, many commentators criticized the business purpose requirement as being unrelated to the goals of minority shareholder protection. The basis for this view was that Delaware's long-form merger statute technically allows freezeout mergers, regardless of the business reasons for the merger, through its majority vote provision. In Delaware, therefore, absent a showing of fraud or other gross misconduct, it was not reasonable to allow a minority shareholder to block a parent-subsidiary merger, even if the sole purpose of the merger was to eliminate the minority shareholders from further equity participation in the company. Nevertheless, the minority shareholders do have a right to expect fair treatment from the parent company. Minority shareholders have a right to expect that their interests will be adequately represented in the merger negotiations and that they will be paid a fair price for their forced departure from the enterprise. Requiring a showing of a proper business purpose for effecting a merger did nothing to guarantee that minority shareholders who were frozen out of a corporation were treated fairly by the majority shareholder.

The Weinberger court's abandonment of the Singer business purpose requirement represents an improvement in the law governing freezeout mergers in Delaware. The elimination of the business purpose doctrine clarifies Delaware merger law by eliminating the doctrinal confusion created by the conflicting and seemingly arbitrary distinctions drawn by the lower courts between valid and invalid business purposes. Although the lower
courts were mandated by the Tanzer decision to review the purposes offered by a parent company in order to determine whether the purposes were “bona fide,” the lower courts rarely found a parent company’s reasons for effecting a merger to be improper. The practical effect of the business purpose doctrine as applied to parent-subsidiary freezeout mergers, therefore, was that it did not provide minority shareholders any significant protection. Furthermore, when the Delaware courts were examining the business purposes behind a challenged merger, their focus was not directed at the issue that most concerns minority shareholders: the fairness of the merger price. Perhaps the most important consequence of the Weinberger court’s decision to overrule the Singer business purpose requirement is that the treatment received by minority shareholders is now the sole subject of review in freezeout merger challenges. The Weinberger court’s decision to overrule the Singer business purpose test and to establish the Sterling entire fairness standard as the sole standard of review for freezeout merger challenges better guarantees that majority shareholders will receive fair treatment in the future.

B. Entire Fairness

The Delaware Supreme Court in Weinberger reaffirmed the entire fairness prong of the two pronged standard of review announced in Singer. The concept of entire fairness originated in Sterling v. Mayflower Hotel Corp. when the Delaware Supreme Court determined that the parent company, because it stood on both sides of the transaction, had to establish the entire fairness of the merger terms to the subsidiary’s minority shareholders. In Singer, the court held that even if a parent company was successful in establishing that the merger had been effected for a proper purpose, the parent company still had to prove the entire fairness of the transaction. The Singer court, however, did not explain what the concept of entire fairness required, nor did it explain under what circumstances it would be invoked.

The Weinberger court improved the Sterling entire fairness standard by explaining when it would be invoked and how it could be satisfied. The Weinberger court explained that every law suit challenging the fairness of a freezeout merger would not be reviewed under the entire fairness test. According to the court, minority shareholders challenging a merger would have to allege “specific acts of fraud, misrepresentation, or other items of misconduct” in order to challenge a merger under the entire fairness standard. The Weinberger court further improved the entire fairness test by articulating some specific guidelines regarding what would be necessary in order for a freezeout merger to be considered “entirely fair.”

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297 See 379 A.2d at 1124.
298 See, e.g., Weinberger v. UOP, Inc., 426 A.2d 1333 (Del. Ch. 1981). The Chancery Court’s decision in Weinberger is an excellent example of the court’s reluctance to enjoin a merger on improper purpose grounds.
299 See Weinberger, 457 A.2d at 711. The Weinberger court noted that in a non-fraudulent transaction, price is often the “preponderant consideration.”
300 457 A.2d at 710-11.
301 33 Del. Ch. at 298, 93 A.2d at 110.
302 380 A.2d at 980.
303 See supra notes 167-68 and accompanying text.
304 See 457 A.2d at 703.
305 Id.
306 Id. at 709 n.7.
1. Fair Dealing

The Weinberger court stated that the concept of entire fairness was comprised of two "basic aspects," fair dealing and fair price. The court stressed, however, that the concept of entire fairness required that all the elements of a transaction be considered as a whole in determining whether a parent company had sustained its burden of proof. Under the first aspect, the Weinberger court clearly articulated the factors necessary to demonstrate fair dealing in a parent-subsidiary merger. The court stated that once the entire fairness standard had been invoked by a subsidiary's minority shareholders, the parent company had to establish that the manner in which the transaction was timed, initiated, structured, negotiated and disclosed was "entirely fair" to the subsidiary's minority shareholders.

The Weinberger court drew upon the laws of directors' fiduciary obligations as the conceptual foundation for the fair dealing component of the entire fairness test. Citing prior Delaware case law, the court reaffirmed the general duties and obligations of corporate officers acting in dual capacities as directors of two corporations. Prior Delaware case law had clearly established the requirement that when directors of a Delaware corporation stand on both sides of a transaction, they owe the same duty of good management to both corporations. In order to discharge this duty in the context of a parent-subsidiary merger, the Weinberger court announced that dual directors would have to prove that all the elements of the transaction, when considered as a whole, were structured in the best interests of both companies.

The appropriate discharge of this duty of good management in the context of a parent-subsidiary merger would be difficult to achieve in practice given the inherent conflicts of interest that face dual directors. In addition to the difficulties involved in discharging the duty of good management in practice, it would be even more difficult for dual directors to establish that this duty has been discharged in court. The entire fairness standard necessarily requires that courts apply subjective judgment to the facts of a particular case. Because different courts sometimes reach different conclusions based on the same facts and because the duty of good management in parent-subsidiary dealings
is a particularly difficult one to discharge. The Weinberger court sought to provide management with an objective mechanism for establishing the fairness of a parent-subsidiary merger.

The Weinberger court went beyond recapitulating the laws of fiduciary duty by suggesting specific procedures for the discharge of the fiduciary obligations owed by dual directors in the context of a parent-subsidiary merger. The court strongly urged that, in the future, independent negotiating committees composed of subsidiaries' outside directors be appointed to deal with parent companies at arm's-length. The court stated that "in a parent-subsidiary context, a showing that the action taken was as though each of the contending parties had in fact exerted its bargaining power against the other at arm's-length is strong evidence that the transaction meets the test of fairness." In addition, the court stated that a bargaining arrangement involving the total abstention of the interested directors of the subsidiary would achieve the same result. According to the court, absent these suggested bargaining structures, dual directors would be left to discharge their fiduciary duties "in light of what is best for both corporations." A failure to follow the court's suggested guidelines would leave parent companies with the difficult task of proving to the satisfaction of a court that the elements of the transaction were structured in the best interests of both companies.

By advocating an arm's-length bargaining structure, the Weinberger court entrusted much of the responsibility for striking a fair deal with the subsidiary's independent directors. While the Weinberger court stated that it would treat such a bargaining structure as strong evidence of fairness, the opportunity nonetheless exists for substantial abuse of this process. Past experience has demonstrated that independent directors have not always vigorously pursued the interests of minority shareholders in negotiations with a parent company. Directors of controlled subsidiaries often are prone to viewing themselves as serving at the pleasure of the parent company. The actions of UOP's independent directors in the Signal-UOP negotiations evidence this proposition. UOP's independent directors apparently made no effort to press Signal for a price higher than $21 per share. The UOP directors merely acquiesced to the original price range of

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316 See 457 A.2d at 709 n.7.
317 Id.
318 Id.
319 Id. at 710-11.
320 Id.
321 See id. at 709 n.7. Commentators have expressed serious reservations about this reliance on the independent director. See, e.g., Brudney, The Independent Director — Heavenly City or Potemkin Village?, 96 HARV. L. REV. 597, 638-39 (1982); Brudney & Chirelstein, Fair Shares in Corporate Mergers and Takeovers, 88 HARV. L. REV. 297, 298 (1974).
322 457 A.2d at 709 n.7.
324 See Brudney, supra note 321, at 617.
325 See id. at 610-11.
326 457 A.2d at 711.
$20-$21 per share suggested by Signal and then insisted on a price of $21 per share.\textsuperscript{327} Even if UOP's independent directors believed that $21 per share was a fair price, they should have attempted to negotiate a higher price for the minority's stock in order to fulfill their fiduciary obligations to the minority shareholders.\textsuperscript{328} The irony of this particular case is that if the UOP directors had pressed for a higher price, Signal in all likelihood would have agreed because the report prepared as part of the acquisition investigation indicated that it would have been a good investment for Signal to purchase UOP's remaining publicly held shares at any price up to $24 per share.\textsuperscript{329} It seems unlikely that an "independent negotiating committee" of UOP's independent directors would have pressed Signal for a higher price when the group, as a whole, failed to take any action in this direction. Consequently, although the Weinberger court sought to achieve fair dealing in freezeout mergers by establishing a committee of the controlled subsidiary's independent directors, the court's failure to recognize adequately the relationship of such directors to the parent corporation limits the ability of such measures to protect minority shareholder interests.

The Weinberger decision did, however, establish other devices in order to protect minority shareholders from the inequitable treatment that may occur at the hands of docile independent directors. The court, in effect, adopted a totality of the circumstances approach for examining the dealings between a parent company and its subsidiary in a freezeout merger. According to the court, while an independent negotiating structure may be strong evidence of fairness, it is only one part of the fair dealing component of the entire fairness test.\textsuperscript{330} The court stated that once the plaintiff challenging the merger alleges specific instances of misconduct, thus invoking the entire fairness standard, the defendant corporations must prove that the transaction, when considered as a whole, was entirely fair to the subsidiary's minority shareholders.\textsuperscript{331} After Weinberger, it is clear that in order to satisfy this burden, a parent corporation will have to establish, by a preponderance of the evidence, that the timing, initiation, structure, negotiation and disclosure of the transaction were fair to the minority shareholders.\textsuperscript{332} To make the arm's-length bargaining structure it suggested more meaningful and to improve the overall quality of minority shareholder protection, the Weinberger court emphasized the quality of the disclosure of information from parent company to subsidiary.\textsuperscript{333} The Weinberger court articulated strict disclosure requirements to ensure informed decision making by independent directors and minority shareholders in parent-subsidiary dealings.\textsuperscript{334} The court stated that the lower courts are required to measure disclosure in terms of "what the defendants had and to measure it against what they gave to the minority."\textsuperscript{335} According to the court, nothing less than "complete candor" is

\textsuperscript{327} Id. The merger price also happened to be the same as the 1975 tender offer price. \textit{Id.} at 704.

\textsuperscript{328} See 457 A.2d at 711. The Weinberger court did not rule specifically that UOP's directors had a duty to negotiate a higher merger price with Signal. See \textit{id}. The court took note of the absence of negotiations as one factor in its decision that the Signal-UOP merger did not satisfy any reasonable concept of fair dealing. \textit{Id.} at 712.

\textsuperscript{329} \textit{id}. at 705.

\textsuperscript{330} \textit{id}. at 703.

\textsuperscript{331} \textit{id}. at 711.

\textsuperscript{332} \textit{See id.} at 711-12.

\textsuperscript{333} \textit{Id}. at 710.

\textsuperscript{334} 457 A.2d at 710 (citing Lynch v. Vickers Energy Corp., 383 A.2d 278, 281 (Del. 1977)).
required of the parent company. This complete disclosure requirement is of real practical significance to the independent director and the minority shareholder. A subsidiary's independent directors will have greater bargaining leverage if they are negotiating with knowledge of all the information relevant to the transaction. For example, if UOP's independent directors had known that Signal was prepared to pay up to $24 per share for UOP's minority interest, UOP's directors would have been in a position to bargain for a price higher than the $21 per share to which they actually acquiesced.

Complete disclosure is of practical importance to minority shareholders as well. The complete disclosure requirement supplements the minority shareholder protection achieved by the entire fairness standard. In theory, complete disclosure will, in some instances, provide minority shareholders with the information necessary to make allegations of misconduct in order to invoke the entire fairness standard. In situations where no misconduct is apparent, complete disclosure will enable minority shareholders to evaluate the fairness of the merger price for themselves in deciding whether to accept the offered consideration or seek an appraisal.

2. Fair Price

As discussed above, the Weinberger court improved the quality of minority shareholder protection by explaining the fair dealing element of the entire fairness test and by reaffirming strict disclosure requirements for parent companies in the context of freeze-out mergers. In addition to these improvements, the court emphasized that the concept of entire fairness also embraces notions of fair price. The fair price prong of the entire fairness test serves as additional protection for minority shareholders in situations where the fair dealing requirements have been largely satisfied. As a component of the entire fairness test, fair price considerations are only relevant as part of the examination of the total circumstances of a merger after plaintiff has first made the allegations of misconduct necessary to invoke the entire fairness test. When the plaintiff is disputing only the merger price, the Weinberger court held that the plaintiff's sole remedy is statutory appraisal. The court recognized that the merger price in a nonfraudulent transaction is probably "the preponderant consideration outweighing other features of the merger." For the purposes of determining fair price under the entire fairness standard and in order to insure that minority shareholders receive fair value for their shares in an appraisal proceeding, the Weinberger court held that modern valuation techniques could now be used to establish the value of a minority shareholder's stock.

By allowing the use of modern valuation techniques, the court granted minority shareholders greater latitude in proving the fair value of their stock. Prior to Weinberger, the "Delaware block" weighted average approach was the only valuation method allowed to be used by Delaware courts in stock valuation proceedings. The Delaware block

336 See 457 A.2d at 710.
337 See id. at 705, 711.
338 Id. at 711.
339 See id. at 703. The court stated that to invoke the entire fairness obligation, a plaintiff would be required to allege "specific acts of fraud, misrepresentation or other items of misconduct to demonstrate the unfairness of the merger terms to the minority." Id.
340 Id. at 715.
341 Id. at 711.
342 Id. at 712-13.
valuation method was a weighed average of asset value, market price and earnings per share. In *Weinberger*, the Delaware Supreme Court abandoned the exclusive use of the Delaware block method, authorizing the use of contemporary financial market techniques in the resolution of future valuation disputes. In support of this holding, the *Weinberger* court relied heavily on the language of the Delaware appraisal statute, section 262. Section 262 instructs courts to “take into account all relevant factors” in valuing a dissenting shareholder’s stock. According to the court, the factors to be considered in determining fair price include: “assets, market value, earning, future prospects and any other elements that affect the intrinsic or inherent value of a company’s stock.” Among these factors, the *Weinberger* court emphasized that special consideration should be given to a corporation’s “future prospects” in the stock valuation. After identifying the factors to be considered by courts in determining whether the price given to minority shareholders in a freezeout merger was fair, however, the *Weinberger* court did not articulate any workable test for how these factors could be combined into an overall determination of the fairness of the merger price. Instead, the court merely held that courts are required to take “all the relevant factors” into account in determining a shareholder’s proportionate interest in a going concern.

IV. Structuring Freezeout Mergers After *Weinberger*

After *Weinberger*, corporations will be able to structure parent-subsidiary mergers that should, in most instances, be immune from challenges by minority shareholders. The *Weinberger* court took decisive steps toward insulating freezeout mergers from judicial attack by minority shareholders. First, the court clearly articulated procedural guidelines that, if followed will be considered strong evidence of fair dealing. Second, the court was careful to note that section 262 did not mandate a different conclusion. See id. at 713. The court gave a very narrow reading to the language of the section which excludes from consideration elements of value that may arise from the “accomplishment or expectation” of the merger. Id. The court interpreted this language to mean that only the use of pro forma and speculative projections must be excluded from the valuation determination. Id. The court continued by stating that “elements of future value, including the nature of the enterprise, which are known or susceptible of proof as of the date of the merger and not the product of speculation, may be considered.” Id. The court believed that anything less would not be giving full effect to the legislative directive that “all relevant factors” be considered. Id.

See id. at 713. The court did not express approval for any specific valuation technique, see id., apparently preferring to rely on the adversary system to produce the best evidence of fair value.

This type of negotiating structure was becoming more popular with management even prior to the *Weinberger* decision. See Chazen, Fairness From a Financial Point of View in Acquisitions.
the opinion limited minority shareholders’ financial remedy to appraisal.\textsuperscript{353} The \textit{Weinberger} court also established the appropriate allocation of the burden of proof in freezeout merger challenges.\textsuperscript{354} \textit{Weinberger} makes clear that in order for minority shareholders to seek equitable relief under the entire fairness test, they must allege specific acts of fraud, misrepresentation or other items of misconduct.\textsuperscript{355} Once the entire fairness standard has been invoked, the burden of proof rests with the parent company to establish the entire fairness of the merger.\textsuperscript{356} Liability is established if the parent company is unable to meet this burden of proof; it is then left to the court’s discretion to order any form of equitable or monetary relief required by the circumstances.\textsuperscript{357} If minority shareholders are unable to make specific allegations of fraud or other misconduct, the entire fairness test is not invoked and the minority shareholders’ only recourse is to seek an appraisal of their shares as provided for by statute.\textsuperscript{358}

In discussing the allocation of the burden of proof, the \textit{Weinberger} court provided parent companies with a mechanism for shifting the burden of proof back to the minority shareholders after the entire fairness test has been invoked.\textsuperscript{359} In order to shift the burden of proof, the parent company could condition the consummation of the merger on the approval of a majority of the subsidiary’s minority shareholders.\textsuperscript{360} The court stressed, however, that the minority shareholder vote must be an “informed” one.\textsuperscript{361} In order to prove that the vote was informed, the \textit{Weinberger} court ruled that the parent company had to prove that it had disclosed all the material facts relevant to the transaction.\textsuperscript{362} If the parent company is unable to demonstrate that it disclosed all the material facts necessary for a court to consider the vote informed, the \textit{Weinberger} court stated that the burden of proof would then remain the parent company’s.\textsuperscript{363} If the plaintiffs alleged specific acts of misconduct and the parent company demonstrated that a majority of the subsidiary’s minority shareholders had approved the merger in an informed vote, the \textit{Weinberger} court ruled that the burden of proof would then be on the plaintiffs challenging the merger to prove the unfairness of the merger terms to the minority shareholders.\textsuperscript{364} Consequently, if parent companies wished to place the burden of proof on the minority shareholders in subsequent litigation, they could condition the merger on the informed approval of a majority of the subsidiary’s minority shareholders.

If a parent did not want to condition a freezeout merger on a minority shareholder vote, it could take advantage of the independent negotiating structure suggested by the \textit{Weinberger} court.\textsuperscript{365} The court advocated the use of an independent negotiating committee composed of a subsidiary’s outside directors to deal at arm’s-length with the parent

\textsuperscript{353} A2d at 715.
\textsuperscript{354} Id. at 703.
\textsuperscript{355} See id.
\textsuperscript{356} Id.
\textsuperscript{357} Id. at 714.
\textsuperscript{358} Id. at 714-15.
\textsuperscript{359} Id. at 703.
\textsuperscript{360} Id.
\textsuperscript{361} Id.
\textsuperscript{362} Id.
\textsuperscript{363} Id.
\textsuperscript{364} Id.
\textsuperscript{365} See id. at 709 n.7.
company in negotiating the terms of the merger.\footnote{366} The court stated that the use of such a bargaining structure would be "strong evidence" of fairness.\footnote{367} In addition, the \textit{Weinberger} court stated that a showing that the subsidiary's interested directors totally abstained from any participation in the transaction would also be highly probative of the fairness of the deal.\footnote{368} Accordingly, it seems unlikely that parent companies will be willing to structure freezeout mergers in the future without conditioning the merger on minority shareholder approval or employing one of the procedural safeguards suggested by the \textit{Weinberger} court. Once the entire fairness test has been invoked, the parent company must establish the entire fairness of the merger and that it fulfilled its duty of good management to both companies in structuring the deal.\footnote{369} Without making use of these additional protections, parent companies will have a more difficult time meeting this burden of proof, incurring a greater risk that the merger will be set aside.

One potential drawback to the Delaware Supreme Court’s decision in \textit{Weinberger} is that the emphasis the opinion places on compliance with procedural guidelines may cause lower courts to place form over substance in considering challenges to freezeout mergers. Delaware courts should should be alert for situations where the parent company has formally complied with the procedural guidelines set out in \textit{Weinberger}, but has, in fact, subjected the subsidiary’s minority shareholders to substantial unfairness.\footnote{370} By relying on a self-governed artificial arm’s-length bargaining structure, the \textit{Weinberger} court entrusted the subsidiary’s independent directors with the responsibility of fairly representing the interests of the minority shareholders.\footnote{371} Some judicial checks are necessary to guarantee that the actual substance of the parent-subsidiary negotiations truly approximate arm’s-length bargaining.

V. A \textsc{Re}commended \textsc{N}egotiating \textsc{S}tructure \textsc{f}or \textsc{Pa}rent-	extsc{S}ubsidiary \textsc{F}reezeout \textsc{M}ergers

In \textit{Weinberger}, the Delaware Supreme Court stated that in future merger transactions evidence of negotiations between representatives of the parent company and a committee of its subsidiary’s independent directors would be highly indicative of fairness in any subsequent court challenge.\footnote{372} While the court, by stating that such a transaction would be presumptively fair, provided management with strong incentive to use such a negotiating structure, it failed to explore the ramifications of this independent negotiating concept.\footnote{373} For example, the \textit{Weinberger} court did not provide any guidelines as to how the members of the subsidiary’s independent negotiating committee should be selected. Instead, the court merely stated in general terms that the committee should be composed of the subsidiary’s independent directors.\footnote{374} As noted earlier, behind a facade of arm’s-length bargaining, a parent company could dominate merger negotiations by appointing only partisan or indifferent independent directors to the subsidiary’s negotiating team.\footnote{375} The

\begin{footnotes}
\item[366] \textit{Id.}
\item[367] \textit{Id.}
\item[368] \textit{Id. at 710-11.}
\item[369] \textit{Id.}
\item[370] \textit{See} Weiss, \textit{supra} note 323, at 255.
\item[371] \textit{See infra} notes 372-91 and accompanying text.
\item[372] 457 A.2d at 709 n.7.
\item[373] \textit{See id.}
\item[374] \textit{Id.}
\item[375] \textit{See supra} note 321.
\end{footnotes}
Weinberger court should have instructed the lower courts to examine the selection process behind the subsidiary's negotiating committee to make sure that it was free from the parent company's influence before treating the use of such a bargaining structure as strong evidence of fairness. A transaction, therefore, should only be considered presumptively fair in situations where the subsidiary's negotiating committee is truly independent.

A second area in which the Delaware Supreme Court in Weinberger should have taken further steps to protect the interests of minority shareholders is in the determination of a fair price for their stock. Although it is generally recognized that there is no one correct stock valuation method, the Weinberger court could have improved the substance of the arm's-length bargaining structure it suggested by articulating specific negotiating guidelines to be used by the parties in negotiating the price for the minority's stock. Specifically, the independent bargaining structure could provide more effectively for fair treatment of minority shareholders in freezeout merger transactions if the negotiated merger price were required to fall within a specified range. Such a price range is necessary for the protection of minority shareholders because even if the subsidiary's independent directors negotiate the merger price, the final figure is likely to be as low as reasonable pessimism will allow. Commentators have found that a subsidiary's independent directors often view themselves as serving at the pleasure of the parent company. As a result of this perception, total reliance upon independent directors to represent the minority shareholders' interests in merger negotiations with the parent company is misplaced. The Weinberger court, therefore, should have articulated general price guidelines to serve as ceiling and floor benchmarks for future merger negotiations involving an independent negotiating structure.

Specific ceiling and floor figures would provide courts, management and minority shareholders alike with useful guidelines of fairness. Even though, as noted earlier, there is no one generally accepted stock valuation method for determining the proper price for the minority's shares, there has been some agreement among the commentators concerning the valuation formulas of ceiling and floor values of corporate stock. In parent-subsidiary mergers, two valuation methods in particular have been suggested to determine the approximate ceiling and floor values of the subsidiary's stock. At the lower end of the spectrum is the market value of the acquired company's stock. The merger price in a parent-subsidiary merger should never fall below the prevailing market price for the subsidiary's stock, because the minority shareholders should not be forced to accept a price lower than what they could have received if they had sold their stock in the market prior to the merger. The ceiling figure of the recommended price range would be the amount per share that could be realized if the entire company was sold to a third party in an arm's-length transaction. This third party sale value ceiling figure could be

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377 See Brudney & Chirelstein, supra note 321, at 298.
378 See Brudney, supra note 321, at 610-11; Brudney & Chirelstein, supra note 321, at 298.
379 See supra note 376 and accompanying text.
380 See Banks, supra note 376, at 1.
381 See Brudney & Chirelstein, supra note 9, at 1372-73.
382 See id.
383 See Chazen, supra note 352, at 1440; Weiss, supra note 2, at 678-80. Weiss argues that a parent company should be required to pay at least as much for the minority interest in a subsidiary as the minority shareholders could realize if the subsidiary was sold to a third party in an arm's-length transaction. Id.
approximated by analyzing other similar acquisitions or mergers. The representatives of the parent company and its subsidiary should be expected to negotiate the actual merger price within this range of values. Representatives of the subsidiary should press for a premium in excess of the current market price, because it has become customary for the stockholders of a target company to receive a premium above the market price. The representatives of the parent company will be unwilling to pay a premium equal to the ceiling price, however, because the subsidiary's publicly held shares will be worth less to the parent company than they would be to a third party. The subsidiary's publicly held shares are worth less to the parent company because it already owns a controlling interest in the subsidiary. A third party seeking to purchase the entire company would have to pay a higher premium per share because it would be purchasing both the control block owned by the parent company and the minority interest. Because the parent company will, therefore, be unwilling to pay third party sale value for the minority's shares, the subsidiary's negotiating representatives may properly accept a premium lower than third party sale value.

Imposing a lower limit on the price given to minority shareholders in a parent-subsidiary merger would, in effect, set a minimum fair price standard. The parent company should be required to pay the subsidiary's minority shareholders at least enough money, or other valuable consideration, to enable them to reacquire the same proportionate interest in the parent company that they would have possessed had the merger been a straight stock for stock transaction. A direct effect of establishing a minimum floor requirement would be that merger prices falling below this figure would be considered presumptively unfair. A court examining a parent-subsidiary merger under the entire fairness test should consider such a merger price to be highly probative of the unfairness of the entire transaction.

The above suggested price guidelines could be used in courtrooms as well as at bargaining tables. As the starting point in all merger negotiations, both parties would be

In *Weinberger*, the plaintiff attempted to introduce evidence to establish a third party sale value price figure for UOP's stock by offering a comparative analysis of the premiums paid over market in ten other comparable tender offer merger combinations. 457 A.2d at 712.

384 See Chazen, *supra* note 352 at 1440.
385 See id. at 1445.
386 Id. at 1471.
387 Id. at 1447. Chazen believes before an arm's length standard of fairness should be accepted, the parent company should be required to demonstrate that the merger price was within "the range that would have resulted from an arm's length transaction." Id. Chazen argues that there is a range of fairness based on the range of prices a shareholder might obtain if proposals to buy the company were sought from other potential purchasers. Id. at 1439.

388 Brudney & Chirelstein, *supra* note 9, at 1372-73. Brudney & Chirelstein would go further than this minimum requirement, however. They advocate that the minority shareholders should receive a share of the synergistic gains generated by the merger. See Brudney & Chirelstein, *supra* note 321, at 323. This approach was adopted by the Second Circuit Court of Appeals in *Mills v. Electric Auto-Lite Co.*, 552 F.2d 1239, 1248-49 (2d Cir. 1977). Brudney & Chirelstein distinguish between cases where the parent company is closely held as a result of the merger and cases where the parent company remains a public company. Brudney & Chirelstein, *supra* note 9, at 1374. If the parent company is closely held after the merger, Brudney & Chirelstein contend that a merger may be unfair per se, because there is no means for minority shareholders to reacquire an equity interest in the parent corporation. Id. They pointed out that in situations where the parent company is closely held as a result of the merger, there may be no way to determine whether the merger price was fair. Id.
expected to develop their own ceiling and floor price figures. In a subsequent court
challenge to the price given to the minority shareholders under the entire fairness
standard, the court should require a showing that each party actually developed these
price figures and used them in the actual bargaining. In the absence of such a showing,
the court should not accept evidence of an independent negotiating structure as strong
evidence of the fairness of the entire transaction. By requiring that these price guidelines
be followed in all mergers, courts would be able to check for possible abuses of the
Weinberger independent negotiating structure by parent companies.

Established ceiling and floor price guidelines would also be beneficial in situations
where independent negotiating structure were not used by the parties in accomplishing a
merger. In the future, parent companies could be required to disclose these price
guidelines to the subsidiary's directors and minority shareholders. The disclosure of these
standards would be useful to the minority shareholders in assessing whether to approve
the merger terms or dissent and seek an appraisal.369 If a shareholder decided to
challenge such a merger, the court could attempt to simulate arm's-length bargaining
within this range in the context of an adversarial proceeding.370

CONCLUSION

The Weinberger decision clarifies and improves Delaware's treatment of parent-
subsidiary freezeout mergers. Since 1977, Delaware courts had been examining freezeout
mergers under the business purpose requirement announced in Singer v. Magnavox Co.
By overruling the Singer business purpose test, the Weinberger court improved minority
shareholder treatment and facilitated the structuring of future freezeout mergers. Dela-
ware courts now can focus on the merger transaction itself to determine whether the
minority shareholders were treated fairly. Although minority shareholders will be rele-
gated to the appraisal remedy when the only issue in dispute is the adequacy of the
merger price, the Weinberger court improved the appraisal remedy by authorizing the use
of modern valuation techniques in appraisal proceedings in order to ensure that minority
shareholders receive fair value for their stock. Weinberger also recognized the need for
appropriate equitable relief in situations where appraisal was not adequate, but not in
circumstances as broad and ill-defined as those contemplated by the Singer court when it
announced the business purpose requirement. In circumstances where the minority
shareholders make specific allegations of instances of misconduct such as fraud or over-
reaching, the Weinberger court ruled that the parent company would then be required to
prove the entire fairness of the transaction. In instances where the parent company could
not meet this burden, the Weinberger court stated that the Chancellor's powers were
complete to fashion any appropriate form of equitable or monetary relief.

To assist parent corporations in meeting the burdens imposed by the entire fairness
standard, the Weinberger court articulated guidelines. The court recommended the use of
an independent negotiating structure, which when used would be considered by the
courts as strong evidence of fairness. One weakness with the court's decision is the

369 Even if the merger price was presumptively fair, approving the transaction would foreclose a
minority shareholder from seeking an appraisal of his shares. See Del. Code Ann. tit. 8, § 262(a)
(1983).

370 See Chazen, supra note 352, at 1445. Chazen believes that judicial review of freezeout
mergers could be viewed as a substitute for arm's length bargaining on behalf of the public minority
shareholders. Id.
potential for manipulation of this negotiating structure. The Weinberger court could have improved the negotiating structure it suggested by defining specific ceiling and floor price guidelines to be used in the bargaining process. The use of such guidelines would help ensure that the negotiations between parent and subsidiary result in a fair merger price.

Geoffrey E. Hobart