Condensed Outline

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1. Piercing the Corporate Veil and Enterprise Liability
    a. Piercing the Corporate Veil
        i. Definition: Seeking to access shareholder assets to cover the liabilities of the corporation.
        ii. Traditional Test (from *Sea-Land Services*):
            1) Unity of interest and ownership between shareholder and corporate legal personalities is so great that there is no real separation.
            2) Adherence to the fiction of separate corporate existence would sanction a fraud.
            NOTE: The second prong may not be required where:
                a) It's a tort case
                b) If it involves a subsidiary that was a mere alter ego of a parent
                c) If the jurisdiction is friendly to the tort plaintiffs
                d) BUT you could see the sub's use of the parent's name to make money for both as a kind of actual fraud when not accompanied by sufficient assets to cover the sub's liabilities.
        iii. Clark Restatement — The Law of Fraudulent Transfers
            1) Transfers are fraudulent as to present creditors where they are both done without receiving reasonably equivalent consideration and make the debtor insolvent.
            2) Transfers with actual intent to defraud or transfers done by business debtors left with unreasonably small capital are fraudulent as to future creditors as well.
            3) On Clark's theory, corporate activities that look like this will result in veil piercing, not using fraudulent conveyance language to avoid intricacies like tracing.
    b. Enterprise Liability
        i. Definition: Seeking the assets of sister corporations to cover a corporation's liabilities on the theory that the corporations are all part of one actual enterprise.
        ii. Test (hinted at in *Sheffield*): Commingling of funds and assets, holding out by one entity that it is liable for the other's debts, identical equitable ownership, same boards and employees.
2. Direct/Derivative Suits, Demand Futility, and Special Litigation Committees
    a. Direct/Derivative Distinction:
        i. Test — from *Tooley v. Donaldson* (Del. 2004)
            1) Who suffered the alleged harm, the corporation or the suing stockholders individually?
            2) Who would receive the benefit of any recovery or other remedy, the corporation or the stockholders, individually?
        ii. Examples
            1) Direct
                a) False press release that affects the stock price
                b) False proxy statement results in a flawed shareholder vote
                c) Corporate reorganization dilutes shareholder voting rights. *Eisenberg*.
            2) Derivative
                a) A corporation's contract claims
                b) CEO's unfair self-dealing with the corporation
                c) The Board's unfair self-dealing with the corporation
                d) The Board's negligence in assessing CEO self-dealing when ratifying actions
    b. The Demand Requirement for Derivative Suits
        i. Delaware's Demand Excusal Rules — *Grimes*
            1) What Must You Allege?
                a) A majority of the board has a material financial or family interest
                b) A majority of the board is dominated or controlled by the alleged wrongdoer or

by the allegedly interested parties.

c) The underlying decision was not a product of the valid exercise of business judgment.
   i) This prong looks to procedural flaws in the Board's decisionmaking process.
   ii) Very hard to prove, something like gross failure to consider the relevant things.

2) How Must You Allege It?
   a) You must allege it with "the tools at hand" — no discovery, just things like press releases, news accounts, and shareholder inspection rights
   b) You must allege it with "particularized facts" sufficient to create "reasonable doubt" regarding one of the three prongs.

3) Demand Excusal for Allegations About Board Inaction — Rales v. Blasband
   a) You must allege particularized allegations that create a reasonable doubt that the Board could have properly exercised independent judgment.
   b) Thus, the fact that you are suing the whole board does not excuse demand automatically.

ii. New York's Demand Excusal Rules — *Marx v. Akers*

1) What Must You Allege?
   a) Director interest or domination
   b) Failure of business process, especially information gathering
   c) An egregiously bad decision
      i) This prong allows judges to look at the *substance* of the decision, unlike Delaware demand futility law.

2) How Must You Allege It?
   a) With particularlity
   b) (Unclear about discovery prior to alleging demand futility)

iii. Consequences of Demand Made and Refused

1) If demand is made and refused, the Business Judgment Rule protects that refusal.
2) Of course, you can challenge the BJR protection just as you would any BJR protection.

c. Special Litigation Committees — After Demand Is Excused But the Corporation Wants Dismissal

i. Two-Step Inquiry — *Zapata Corp. v. Maldonado* (Del. 1981)

1) Step 1: Was the SLC independent, acting in good faith, and with good process?
   a) The corporation bears the burden of proving these elements.
      i) Test: "Whether an SLC, for any substantial reason, is incapable of being objective and impartial" — Oracle.
         1) Applied stringently in Oracle (Stanford ties)
         2) Applied less strictly by Delaware Supreme in Martha Stewart case (social ties not sufficiently "bias-producing" to void independence)
   b) Plaintiffs may get limited discovery regarding independence, good faith, process
2) Step 2: In its discretion, does the court think the suit should nonetheless proceed?
   a) Rarely used; nod to the expertise of Delaware courts to fish out smelly stuff.
3) Note: New York law seems to follow the same general approach, though it is unclear who bears the burden of proof. *Auerbach v. Bennett* (N.Y. 1979)

ii. If the corporation bears its burden of proof, the BJR protects the decision to dismiss.

3. Suits Against Officers and Directors for Violations of Fiduciary Duties

a. The Business Judgment Rule — *Kamin v. Amex*

i. General Rule: Courts will not inquire into the substantive merits of a Board's decisionmaking unless …

1) Fraud
2) Illegality
3) Self-dealing (by a majority of the Board)
4) Bad Faith
5) Gross nonfeasance

        6) Failures in the process used to make a business decision
    ii. When the BJR is not rebutted by the plaintiff, the plaintiff must prove waste/irrationality.
        1) Waste is found where directors irrationally squander corporate assets. <u>Disney</u>.
        2) "Substantive due care" is <u>mostly</u> foreign to Delaware law. <u>Brehm</u>.
    iii. In the duty of care/duty of loyalty context, when the plaintiff rebuts the BJR the defendant must then prove the <u>entire fairness</u> of the transaction.

b. The Duty of Due Care
    i. Examples of Violations/Non-violations
        1) Gross nonfeasance violates the duty of care. <u>Francis</u> (alcoholic widow case)
        2) Process Failures/Successes in the Merger Context
            a) Failure to gather all material information reasonably available to directors and relevant to their decision violates the duty of care, at least in the merger context. *Van Gorkom*.
            b) *Cinerama*: No violation where CEO consisently sought best price, was very informed, had top advisers, got huge premium, even despite lock-up.
        3) Knowing the order-of-magnitude of a compensation package and relying on compensation experts satisfied the duty of care. <u>In re Disney</u>
        4) Knowing the basics about a candidate and his desirability sufficed to satisfy the duty of care in choosing a President. <u>In re Disney</u>.
    ii. Indemnification for Violations of the Duty of Care — DGCL § 102(b)(7)
        1) Delaware corporations <u>may include</u> in their charters provisions indemnifying their directors and officers for violations of their fiduciary duties except:
            a) No indemnification for breaches of the duty of loyalty
            b) No indemnification for bad faith, intentional misconduct, or knowing illegality
            c) No indemnification for transactions that improperly benefited the director
        2) This provision does not eliminate the duty of care, only certain individual liabilities under the duty of care.
    iii. Reliance on Experts — DGCL § 141(e)
        1) Directors are immune where they rely in good faith upon experts provided:
            a) The director reasonably believes the person is an expert; and
            b) The expert has been chosen with reasonable care by the corporation.
        2) *Brehm v. Eisner*: Reliance on compensation experts protected directors.

c. The Duty of Loyalty (and Good Faith, Apparently)
    i. Self-Interested Transactions
        1) Voidability of Interested-Director Transactions — DGCL § 144(a)(1)
            a) Transactions in which one or more directors have a financial interest are <u>not voidable solely because of that interest where</u>:
                i) An informed committee of independent directors authorize the transaction;
                ii) An informed majority of shareholders authorize the transaction; or
                iii) The transaction is fair to the corporation when authorized, approved, or ratified.
            b) That is, if you can prove approval by informed disinterested directors or informed shareholders, the Business Judgment Rule comes back to protect the transaction.
                i) <u>Fliegler</u>: Shareholder ratification must be by a majority of the outstanding disinterested shareholders.
            c) Examples of Violations/Non-violations
                i) <u>Bayer</u>: No violation in the Celanese ad case because the transaction was entirely fair.
                ii) <u>Benihana</u>: No violation because Abdo's role was sufficiently disclosed and the transaction was approved by the disinterested directors — see DGCL § 144(a)(1)
        2) The Corporate Opportunity Doctrine — *Rose v. CIS* (Del. 1996)

a) Factors: Directors may not take, even at fair price, opportunities which:
   i) The corporation is financially able to take;
   ii) Is in the corporation's line of business;
   iii) Is one in which the corporation has an interest or expectancy; and
   iv) Taking the opportunity will bring the director's interest into conflict with the corporation's,
b) Examples
   i) *CIS* — no violation where cell corp had no desire, ability to take the deal
   ii) *eBay* — violation where eBay could have got the disguised rebates
   iii) *Sinclair* — no proof of oil corp opportunities that were given to the parent

3) Dominant Shareholders
   a) Duties of Controlling Shareholders and Parent/Subs
      i) Controlling shareholders' interested dealings with the corporation are subjected to entire fairness analysis. <u>Pepper v. Litton</u>.
      ii) Parent-sub dealings accompanied by self-dealing — where the parent causes the sub to act such that the parent receives something from the sub to the exclusion of and detriment to the minority sub shareholders — get intrinsic fairness review rather than the BJR. <u>Sinclair</u>.
      iii) You must actually be a controlling shareholder, not just a large shareholder or a very powerful one. <u>Wheelabrator</u>.
   b) Examples
      i) Equal treatment in paying dividends does not trigger fairness. <u>Sinclair</u>.
      ii) But not enforcing a sub's breach of K claim triggers fairness. <u>Sinclair</u>.
      iii) Majority shareholders must inform minority shareholders of material facts where the majority shareholders can force minority shareholders to make a decision about whether to convert their stock or be liquidated. <u>Zahn v. Transamerica Corp.</u>

4) Quick Recap — <u>Wheelabrator</u>'s Summary of the Duty of Loyalty Standards
   a) Arm's Length Transactions
      i) Without shareholder ratification, BJR review nonetheless.
      ii) Informed shareholder ratification cures any problem — plaintiff loses
   b) Interested Director Transactions
      i) Without shareholder ratification, entire fairness
      ii) With ratification, BJR review returns, plaintiff must prove waste.
   c) Controlling Shareholder Arranged Mergers
      i) Without ratification, defendants must prove entire fairness. <u>Weinberger</u>.
      ii) With ratification, plaintiff now must prove unfairness, not waste.
         1) Note distinction: unfairness much easier to prove than waste.

ii. The Obligation of Good Faith
   1) The Basics of Good Faith
      a) Definition of Good Faith — <u>In re Disney</u>
         i) Conduct motivated by actual intent to harm the corporation
         ii) Intentional dereliction of duty, conscious disregard for responsibilities.
      b) Plaintiffs have the duty of proving bad faith to remove the BJR.
      c) Violations of the duty of good faith <u>cannot be exculpated</u> under § 102(b)(7)
   2) Good Faith and <u>Caremark</u> duties to monitor and report
      a) Directors have a duty to create monitoring systems. <u>Caremark</u>/<u>Stone</u>.
      b) But directors are only liable for violations of that duty where:
         i) They "utterly fail" to implement such a system, or
         ii) They "consciously fail" to monitor and oversee the system.
      c) Any reasonably decent reporting system (and usage of one) satisfies <u>Stone</u>.

4. Disclosure and Registration of Securities
   a. The Securities Act of 1933 — Transaction-Based Registration
      i. Definition of a "Security" — Same as in the Securities Exchange Act of 1934, below

ii. Basic Requirements of the Act — § 5's registration rules
    1) Securities may not be "offered" for sale unless registered. 1933 § 5(c).
    2) Securities may not be sold until the Registration Statement is effective. 1933 § 5(a).
    3) Prospectuses must be actually delivered to each buyer. 1933 § 5(b).

iii. The Private Offering Exception
    1) Four Factor Common-Law Like Test — Doran v. Petroleum Mgmt. Corp.
        a) Number of offerees and their relationship to the issuer and each other
            i) The defendant must show all offerees were sophisticated.
            ii) The defendant must show they had access to the same information that a Registration Statement would have provided.
        b) Number of units offered
        c) Size of offering
        d) Manner of offering
    2) Regulation D — Safe Harbors Defining "Private Offerings"
        a) Small Offering / Sophisticated Investor Exceptions
            i) Rule 504 — No registration for offerings < 1 million
            ii) Rule 506 — No registration for < 5 million from sophisticated investors
            iii) Unlimited sales to "accredited investors" like banks and brokers
            iv) Generally can't advertise and must file with the SEC post-offering
        b) Resale-and-Integration
            i) Exemptions must be found for each sale, not just the initial sale.
            ii) Issuers can keep the exemption if they take steps to prevent resale.
            iii) Buyers can resell if they hold for two years and sell few stock. Rule 144.

iv. Civil Liability Under the Securities Act of 1933
    1) 1933 Act § 12(a)(1) — Actions for Violations of § — Doran
        a) Plaintiffs may rescind investments where the offeror:
            i) Failed to register.
            ii) Fails to deliver a statutory prospectus
            iii) Violates the gun-jumping rules
        b) Plaintiffs need only prove offerors were covered by the § 5 requirements
    2) 1933 Act § 11 — MMOs in the Registration Statement — BarChris (bowling alleys)
        a) Standing — Only buyers, but any buyer, may sue.
        b) Possible defendants — issuers, directors, signing executive officers, accountants, and underwriters.
        c) Prima facie case: An MMO in the Registration Statement
        d) Affirmative Defenses
            i) Expertised Portions: The defendant had no reasonable ground to believe, and did not believe, that there were MMOs in the Registration Statement.
            ii) Non-expertised Portions**/Due Diligence:** The defendant had, after reasonable investigation, reasonable grounds to believe, and did believe, the RS was true and contained no MMOs.
        e) Remedy — Difference between price paid and current market value
    3) 1933 Act § 12(a)(2) — MMOs in a prospectus or oral communication
        a) Prima facie case
            i) Sale of a security
                1) Gustafson: § 12(a)(2) does not cover secondary market transactions or private placements, only public offerings.
            ii) Through interstate commerce
            iii) By means of a prospectus or oral communication
            iv) Which prospectus or communication contained MMOs
            v) By a defendant who sold or offered the security
            vi) Which defendant knew or should have known of the MMO
        b) Affirmative Defenses
            i) If the plaintiff pleads defendants' knowledge, the burden of proving

otherwise shifts to the defendant.

b. The Securities Exchange Act of 1934 — Periodic Disclosures
   i. The Basics of the Securities Exchange Act of 1934
      1) Who Has To Register?
         a) § 12(a) — Anyone listed on a national exchange
         b) § 12(g) — 500 or more holders of equity securities, more than 1 million in assets
      2) What Do You Have To Provide?
         a) Form 10 (once)
         b) Form 10-K (annual)
         c) Form 10-Q (quarterly)
         d) Form 8-K (episodic)
   ii. Definition of a "Security" —
      1) 1933 § 2(a)(1) lists a whole bunch of things you'd normally think of as a security, and it has catchalls like "investment contracts" to get at less usual devices.
      2) Modified Howey test for "investment contracts" — Robinson v. Glynn
         a) Is there an investment of money?
         b) Is the investment of money in a common enterprise?
         c) Is the investor unable to exercise meaningful control over the enterprise?
      3) When is something a "stock"?
         a) When issued by a traditional corporation and called "stock," it's stock. Landreth
         b) When issued by another kind of entity, look at its properties under Forman
            i) Are there dividend rights?
            ii) Is the stock a negotiable instrument?
            iii) Can you pledge/hypothecate the item?
            iv) Does it come with voting rights?
            v) Does it have the ability to appreciate in value?
   iii. Civil Liability Under the 1934 Securities Exchange Act
      1) 10B and Rule 10b-5 — MMOs in the Purchase or Sale of Any Security
         a) Standing: You must have actually purchased or sold the security. Blue Chip Stamps.
            i) Purchasing or selling derivative securities counts. Deutschman.
         b) Scienter: There must be recklessness or intent to deceive. Hochfelder.
            i) Due diligence isn't just an affirmative defense, the plaintiff must negate the implications of due diligence in the prima facie case.
            ii) 10b-5 is thus different than 1933 Act § liability for RS MMOs.
         c) Actual deception or manipulation in connection with a securities deal.
            i) Santa Fe Indus.: Breach of fiduciary duty is not enough by itself; there must be some sort of manipulation or deception.
            ii) Non-statement conduct like wash sales, matched orders, and rigged prices could generate 10b liability.
         d) Material Misstatement or Omission — TSC Indus.
            i) Definition: A "substantial likelihood that a reasonable investor would consider it important in deciding" whether to buy or sell
            ii) For speculative events (like mergers), materiality depends on probability x magnitude of the event.
         e) Causation/Reliance and Fraud-on-the-Market Hypothesis — Basic, Inc.
            i) Courts will presume the market price reflected the misinformation and that plaintiffs traded with reliance on that market price.
            ii) Defendants may rebut this presumption by showing:
               1) The market did not believe the misstatements.
               2) The plaintiffs did not rely on the market price for their deals.
            iii) FOM does not apply:
               1) To nonpublic MMOs. West v. Prudential
               2) To closely held corporations with no developed market. Id.

- f) Loss Causation: You must prove the misstatements caused the loss you suffered and that they were not instead caused by other, independent events. Dura.

2) 10B and Rule 10b-5 Liability for Insider Trading
   - a) Standing — Who Can Bring Suit?
     - i) Anyone harmed, such as an outsider who sold to an insider.
     - ii) 1934 Act § 20A(a) — those who bought and sold on the same day
   - b) Elements of an Insider Trading Claim
     - i) The defendant traded in the stock
     - ii) Using material non-public information
       - 1) 10b5-1: Absent trading through a corporate safe harbor program, trading with inside info is presumed to be trading "using" that info.
     - iii) The individual was covered by the insider trading prohibitions
       - 1) Classic Insider — Disclose-or-abstain
       - 2) Tippees — Dirks v. SEC
         - a) Must disclose-or-abstain where:
           1. The insider breached a duty by tipping, and
           2. The tippee knows or should know of that breach.
         - b) Insiders breach duties by tipping only where they will personally benefit from the disclosure.
         - c) **Regulation FD: Any information told to market analysts must also be disclosed to the general public.**
       - 3) Misappropriators — O'Hagan
         - a) Persons who misappropriate confidential information and trade on that information are liable under 10b-5.
         - b) O'Hagan: lawyer traded stock in corporation with which one of his clients was engaged in undisclosed merger talks.
         - c) Rule 10b5-2: Family member tippees must disclose or abstain.
     - iv) Scienter — Defendant must have known info was material and nonpublic
     - v) Reliance — Fraud-on-the-Market Theory
     - vi) Loss Causation
   - c) Remedy: Insiders' profits or losses, less any SEC disgorgement.

3) 14A — Liability for Proxy Statements — See section on proxy fights, below

4) 16B — Short-Swing Profits
   - a) Covered Securities
     - i) Only the securities of 1934 Exchange Act filers.
     - ii) Only applies to "equity securities"; no non-convertible bonds, unlike 10b
   - b) Covered Persons
     - i) Director and Officers
       - 1) Rule 16a-2: Covered if they had that position at either sale or purchase time.
     - ii) Ten Percent Beneficial Owners
       - 1) Must be a 10% owner at both the sale and purchase. Reliance.
       - 2) "At" means "just before":
         - a) Going from 13% to 9.96%, and then from 9.96% to 0% would make you liable only for the first sale. Reliance.
         - b) Going from below 10% to more than 10% cannot make you liable. Foremost-McKesson.
   - c) Remedy
     - i) Disgorgement to the corporation (plus attorney's fees)
     - ii) Disgorgement is determined by the largest possible profit, regardless of the actual order of transactions. No First-In/First-Out Matching.

5. Indemnification of Directors and Officers — DGCL § 145
   - a. Direct Suits — § 145(a)
     - i. Corporations may indemnify Ds and Os from expenses and amounts paid in direct suits if:

            1) The person acted in good faith, and
            2) The person acted in a manner he reasonably believed to be in (or not opposed to) the corporation's best interests, and
            3) The person had no reason to believe his conduct was unlawful.
                a) Merely having to contribute personally is not a bar to indemnification provided that the other statutory requirements are met.
        ii. Corporations _must_ indemnify direct suit D and O defendants where they are "successful on the merits or otherwise." DGCL § 145(c).
            1) _Waltuch_: Where a settlement does not include payment by the D or O, that counts as "success on the merits or otherwise" regardless of whether D or O is absolved.
        iii. Determination of Indemnifiability — § 145(d)
            1) By a majority vote of the directors not involved in the suit.
            2) By a committee of such directors designated by a majority vote of such directors
            3) By _independent legal counsel_ in a _written opinion_.
            4) By the stockholders
    b. Derivative Suits — § 145(a)
        i. Corporations _may_ indemnify Ds and Os in derivative suits if:
            1) The person acted in good faith;
            2) The person acted in a manner he reasonably believed to be in (or not opposed to) the corporation's best interests; and
            3) The person was _not adjudged liable to the corporation_.
                a) If adjudged liable, the Chancery Court has discretion to allow indemnification.
                b) Merely having to contribute personally is not a bar to indemnification provided that the other statutory requirements are met.
        ii. Corporations _must_ indemnify Ds and Os in derivative suits who are "successful on the merits or otherwise." § 145(c).
            1) _Waltuch_: Where a settlement does not include payment by the D or O, that counts as "success on the merits or otherwise" regardless of whether D or O is absolved.
        iii. Determination of Indemnifiability — § 145(d) — See above.
    c. Advancing Expenses — § 145(e) — Corps may advance expenses subject to a promise to repay if the indemnification later turns out to be impermissible.
        i. _Citadel_: If you have a contract for this, you have to pay first and get it back later even if its pretty obvious that indemnification will not be permissible.
    d. Indemnifying to the Full Extent of Delaware Law — § 145(f)
        i. The text says that the other indemnification provisions are not exclusive of other rights.
        ii. Interpretation in _Waltuch_
            1) Corporations may contractually or by charter go to the full limits of § 145.
            2) But they may _not_ contract around its limits on indemnification for things like bad faith.
    e. Other Sources of Indemnification for Directors and Officers
        i. Exculpatory Clauses under § 102(b)(7) — See above
        ii. Director and officer insurance policies — § 145(g)
6. Sarbanes-Oxley and Related Corporate Governance Changes
    a. Changes to the Audit Process
        i. Limit non-audit services provided by auditors to their companies.
        ii. Shift control of auditors from the Board to the Audit Committee
        iii. Mandatory rotation of audit partners and limits on hiring former audit employees
        iv. Require internal controls and § 404 attestations about those controls (expensive)
        v. Disclosure of whether Audit Committee has auditing experts
            1) NYSECG requires that Audit Committee members be financially literate.
    b. Changes to Boards of Directors — Mostly through listing requirements / corporate governance advisors, not SOX
        i. A majority of independent directors on the full Board.
        ii. Only independent directors on Audit, Compensation, and Board Nomination committees
        iii. Must have Audit, Compensation, and Board Nomination Committees

c. Improve Disclosure
   i. Disclosure of critical accounting policies, off-balance sheet arrangements, and so forth.
   ii. SOX 302 requires CEOs and CFOs to certify statements and internal controls.
   iii. Enhanced criminal penalties for disclosure failures
d. Unchanged Territory
   i. Substantive law of self-dealing, compensation, and private benefits.
   ii. Substantive law of Board power and relationship to shareholders
   iii. Substantive law of mergers, acquisitions, and other large transactions

7. Problems of Control
   a. Proxy Fights
      i. Using Corporate Funds To Pay for or Reimburse Proxy-Fight Expenses
         1) Incumbent Board — <u>Levin</u> (S.D.N.Y. 1967)
            a) Corporate funds may be used in fights over <u>policy</u>, <u>not personal control</u>.
            b) Decisions about reimbursement and expenditure protected by the BJR.
         2) Insurgents — <u>Rosenfeld</u> (N.Y. 1955) — Challengers may be reimbursed where:
            a) They are fighting over <u>policy</u>, <u>not personal control</u>.
            b) They are successful.
            c) Their decision to reimburse their expenses is approved by shareholders.
      ii. 1934 Act § 14 — Fraud in the solicitation of proxies for 1934 Act filing corporations
         1) The Basic Regime Under 1934 Act § 14
            14a-1: Definitions — consent for someone to vote for you
            14a-2: Solicitations to which rules apply — broadly defined, anyone soliciting
            14a-3: Info to be furnished — basic info about the transaction
            14a-4: Requirements as to proxy
            14a-5: Presentation of info in proxy statements
            14a-6: Filing requirements
            14a-7: **Mail-or-give-list rule**
            14a-8: **Shareholder proposal rule**
            14a-9: **Antifraud rule**
            14a-12: Solicitations before proxy statement
         2) Rule 14a-9 prohibits fraud in soliciting proxies and has implied right of action. <u>Borak</u>.
         3) Plaintiffs' Prima Facie Case
            a) MMO in the proxy materials
               i) Materiality — <u>TSC Indus.</u> — "A substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote."
               ii) <u>Seinfeld v. Bartz</u>: Not using Black-Scholes to value certain options in compensation is not a material omission from a proxy statement.
            b) Scienter?
               i) Insiders: Negligence might suffice, maybe a little higher standard.
               ii) Outsiders: Probably need to show at least recklessness
            c) Causation — <u>Electric Auto-Lite</u> — Plaintiff must prove only:
               i) There was a material defect in the proxy statement.
               ii) The proxy statement was an "essential link" in the transaction.
                  1) Test: Did the corporation need the shareholders' votes?
         4) Remedy — <u>Electric Auto-Lite</u>
            a) Preliminary injunction or TRO if you are quick enough.
            b) Rescission is possible <u>but highly unlikely</u>.
            c) Damages: Calculated by comparing the transaction with a fair one.
   b. Shareholder Proposals — Rule 14a-8 — Putting Proposals in the Company's Proxy Materials
      i. Who can submit proposals? How often? What format?
         1) Anyone who holds 1% or $2k worth of a corporation's stock.
         2) A shareholder may only submit one proposal per shareholders' meeting.
         3) Proposals must be shorter than 500 words.
      ii. Excluding Shareholder Proposals from Proxy Statements

1) Procedural — If the company can prove:
   a) It told you of a problem and you didn't correct it in 14 days. 14a-8(f)(1)
   b) You didn't hold the requisite amount of securities until the meeting. 14a-8(f)(2)
2) More substantive — If the company (Rule 14a-8(g)) can prove:
   a) Improper Under State Law — 14a-8(i)(1)
      i) Computer Assocs. v. AFSCME (Del.): What can shareholders change?
         1) Decisions about process and procedure may be amended by shareholder votes on bylaws, including provisions for reimbursement of insurgents.
         2) Decisions about substantive business decisions are reserved to the Board under § 141(a)
   b) Violation of Any Law — 14a-8(i)(2)
      i) Computer Assocs.: It would violate Delaware law for a shareholder proposal not to "reserve to directors their full power to exercise their fiduciary duty to decide whether or not it would be inappropriate, in a specific case, to award reimbursement."
      ii) Clark is skeptical about the coherence of this hands-tying argument.
   c) Personal Grievance / Personal Interest — 14a-8(i)(4)
   d) Relevance — 14a-8(i)(5)
      i) Test: If the proposal relates to operations which:
         1) account for less than 5 percent of the company's total assets at the end of its most recent fiscal year, and
         2) for less than 5 percent of its net earning sand gross sales for its most recent fiscal year, and
         3) **is not otherwise significantly related to the company's business**
      ii) Lovenheim: "ethically" or "socially" significant things such as animal-cruelty-related practices may not be excluded for irrelevance.
   e) Management Functions — 14a-8(i)(7)
   f) Relates to Election — 14a-8(i)(8)
      i) Current Rule: "If the proposal relates to a nomination or an election for membership on the company's board of directors or analogous governing body or a procedure for such nomination or election "
      ii) Old Narrow Rule — AFSCME v. AIG — proposals only excluded if about particular elections, but not if about election procedures generally
   g) Substantially Implemented — 14a-8(i)(10)
   h) Duplication — 14a-8(i)(11)

c. Shareholder Inspection Rights
   i. Shareholder list: — Under DGCL § 220, any stockholder with a "proper business purpose" may receive a shareholder list.
      1) "Proper business purpose": Relate to one's investment return, not moral or political goals.
         a) Pillsbury: Concern about land mines in Vietnam not a proper purpose.
         b) Crane Co.: Telling shareholders about a takeover is a proper purpose.
      2) The burden is on the company to prove improper purpose.
      3) The Creation of Previously Non-Existing Lists
         a) Delaware: Shareholders do not have the right to compel corporations to assemble lists of stock in its true, rather than street, name.
         b) New York
            i) Old approach: Corporation must get the NOBO list assembled. Sadler.
            ii) The legislature overturned Sadler, so you need only give the CEDE list.
   ii. Books and records: — Under DGCL § 220, shareholders may access books and records provided that they have a "proper business purpose."
      1) "Proper business purpose" has the same definition as above.
      2) The burden is on the shareholder to prove proper purpose for access to the books.

d. Allocation and Exercise of Shareholder Voting Power
    i. Voting Rights in General
        1) Under DGCL § 151(a), corporations may structure their stocks' voting rights generally as they see fit, giving different classes of stock full, limited, or no voting rights.
        2) Stroh (Ill. 1971) — corporations may create "voting only" stock that allows insulation.
    ii. Control in Close Corporations
        1) Voting Agreements
            a) Delaware
                i) Voting agreements are generally acceptable. Ringling Bros.
                ii) Voting agreements will not fail as "failed" voting trusts. Ringling.
                iii) Specific enforcement will not necessarily be provided. Ringling.
            b) New York
                i) Bus. Corp. L. § 620
                    1) Signed, written shareholder agreements are acceptable
                    2) Restrictions on the Board's management powers are acceptable where:
                        a) They are in the certificate of incorporation
                        b) Unanimously approved by incorporators or shareholders
                        c) Subsequent shareholders give consent
                ii) Old common law approach
                    1) McQuade: Illegal to tie Board's hands in voting for officers.
                    2) Clark: Agreement with fiduciary out is acceptable.
            c) Galler v. Galler (Ill. 1964): Absent harm to non-participating shareholders, creditors, or the general public, voting agreements are specifically enforceable.
            d) Modern Close Corporation Control Agreements — Ramos (Cal. 1992)
                i) Have an explicit buy/sell provision
                ii) Have an explicit dispute resolution mechanism such as forced sale
                iii) Make it specifically enforceable.
        2) Freeze-Outs and Oppression in Close Corporations
            a) Stockholders in close corporations owe one another substantially the same fiduciary duties that partners owe one another. Donahue (Mass. 1975).
                i) These duties are also owned when non-majority shareholders exercise effective veto control over the corporation's acts. Atlantic Props.
            b) Terminating a Minority Shareholder Employee
                i) Wilkes v. Springside Nursing Home (Mass. 1976) — Dominant?
                    1) The defendants must show a legitimate business purpose.
                    2) If they do, the plaintiff must show the purpose could have been achieved in a less intrusive way.
                ii) Glamore Motor: In a contract with an express buy-out, by someone who is not an original founder, the court will not interfere on fiduciary grounds.
                iii) Duff & Phelps: The duty of good faith in buying out a minority shareholder requires disclosure of material information which would be relevant in the minority shareholder's decision to leave.
            c) Freeze-Outs
                i) No entitlement to an implied buy-out provision. Brodie (Mass. 2006)
                ii) Perhaps an entitlement to forced dividends. Brodie.
        3) Judicially Imposed Liquidation or Dissolution
            a) Four Ways To Get Out
                i) Invoke a charter, bylaw, or contractual buyout provision.
                ii) Invoke a statutory dissolution provision
                iii) Invoke a statutory appraisal remedy upon merger or consolidation
                iv) Show that the majority breached a fiduciary duty and tried to freeze out
            b) Statutory Dissolution
                i) Older statutes

1) Dissolution is allowed where there is oppressive or wasteful conduct
2) Coppock: "Oppression" broadly defined, equitable discretion to permit remedies other than dissolution such as a buyout.

ii) Second-wave Statutes
1) Dissolution is allowed where deadlock, waste, or prejudicial conduct
2) Pedro: Court orders forced buyout, damages for breach of fiduciary duties, plus compensation for wrongful termination where the investigating brother is frozen out.
a) Again, buyout allowed rather than dissolution in some cases.

iii) Contemporary statutes
1) Dissolution where reasonably necessary to protect minority shareholders' rights or interests
2) Stuparich (Cal. 2000): Merely exercising majority right to make business decisions does not interfere with shareholders' rights.
3) Haley (Del. Ch. 2004): Buyout provisions aren't automatically exclusive of statutory dissolution, and this status-quo-preserving feud makes it "reasonably impracticable" to go on.

iii. Sale of Control
1) Sale of a control block at a premium is not wrong per se (Zetlin), but only where:
a) The sale is to a looter
b) The sale diverts a corporate opportunity
i) Perlman (2d Cir. 1955): Sale was impermissible where it prevented minority shareholders from benefitting from rationing circumvention plan
c) The sale is fraudulent
d) (Perhaps) The sale involves other misconduct
2) Sale of Control Conditioned on Director Resignations — Essex Universal (2d Cir. 1962)
a) If the purchaser acquires > 50%, he may condition the sale on seriatim directorial resignations.
b) If the purchase acquires < 50%, the sale will be voidable as a naked sale of office if the plaintiff can demonstrate that the purchaser's share is not controlling.
3) Contractual Protections for Minority Shareholders To Share in Premiums
a) Rights-of-First-Refusal: If the majority is going to sell at a certain price, the minority shareholder gets the right to purchase the majority's share at the price.
b) Take-Me-Along Rights: If the minority shareholder doesn't want to exercise first refusal rights, he can require the majority purchase his shares at that price.
c) Note: Jensen-Sundquist — Courts will be skeptical of "form over substance" arguments about these provisions amongst sophisticated parties.

8. Mergers and Acquisitions
a. De Facto Merger and De Facto Non-Merger Doctrine
i. De Facto Merger Doctrine
1) Old Approach:
a) Farris v. Glen Alden (Pa. 1958): If it's really a merger even if in a different form, we're going to make shareholders have the same rights (voting and appraisal) that they would if the transaction were done through ordinary merger methods.
b) Overruled by statute.
2) Delaware Approach: Hariton.
a) No de facto merger doctrine
b) Because different provisions of the DGCL have "equal dignity," the fact that one provision allows something another wouldn't is insufficient reason to try to figure out whether it's "really" a merger.
c) Subtext: Appraisal rights are stupid, and we're going to narrow them.

ii. De Facto Non-Merger Doctrine — Rauch v. RCA Corp. (2d Cir. 1988)
1) Merger agreement cashes out certain shares at $40/share, but the shares contained a provision allowing the corporation to purchase them at $100/share. People are pissed

        2) We aren't going to ask whether this is "really" redemption rather than a merger. Provisions of the DGCL have "independent legal significance."
- b. Types of Mergers and Acquisitions and Their Accompanying Standards of Review
    - i. Substantial Sale of Assets Followed By Liquidation — DGCL 271, 275
        - 1) Approval
            - a) Target board must approve and shareholders must approve sale under § 271
            - b) Target board and shareholders must approve liquidation under § 275
        - 2) Appraisal Rights — Shareholders lack appraisal rights.
    - ii. Merger — DGCL § 251
        - 1) What happens?
            - a) Two corporations decide to merge.
        - 2) Approval
            - a) Both target and acquiring boards must approve, as well as shareholders.
        - 3) Appraisal rights — Both target and acquiring shareholders have appraisal rights.
    - iii. Freeze-Out Merger — DGCL 262, 251
        - 1) What happens?
            - a) Corporation buys controlling share, then causes merger into wholly owned subsidiary, eliminating the minority shareholders and giving them cash.
        - 2) Appraisal rights — dissenting target shareholders get appraisal rights.
        - 3) Standard of Review — <u>Weinberger</u>
            - a) Plaintiff must first allege specific acts of misconduct indicating unfairness.
            - b) The burden then shifts to the defendant to prove entire fairness.
                - i) Fair Dealing
                    - 1) Who started negotiations?
                    - 2) How long were negotiations?
                    - 3) Was there complete candor?
                        - a) <u>Rabkin</u> (Del. 1985):
                - ii) Fair Price
            - c) If the <u>informed</u> majority of minority shareholders approved the merger, or if the subsidiary had an actually independent negotiating committee, the burden shifts to the plaintiff to prove <u>unfairness</u> (not waste, like normal BJR).
                - i) The defendant must prove disclosure or independence of committee.
                - ii) Committee must have "real bargaining power," not be "dictated" to. <u>Kahn v. Lynch Comm. Sys.</u> (Del. 1994)
        - 4) Remedies
            - a) Appraisal is generally the preferred remedy. <u>Weinberger</u>.
            - b) Courts retain equitable powers to order other remedies in rare circumstances.
            - c) Valuation: Anything that I-bankers would use. <u>Weinberger</u>.
        - 5) Other Approaches
            - a) Business Purpose Test — <u>Coggins v. N.E. Patriots</u> (Mass. 1986)
                - i) The Totality of the Circumstances
                    - 1) Was there a business purpose?
                    - 2) Was disclosure to minority shareholders adequate?
                    - 3) Was the transaction at an adequate price?
                - ii) Remedy: Counterfactual value had the merger never taken place.
            - b) Clark thinks it's rare that a corporation won't be able to come up with a purpose
    - iv. Tender Offer + Short Form Merger — DGCL 253
        - 1) What happens?
            - a) Acquiring corporation tenders for > 90% of the target corporation's shares.
            - b) Once acquired, the acquirer completes a statutory short-form merger.
        - 2) Approval — No vote of minority shareholders required — most already tendered!
        - 3) Appraisal — Minority shareholders have appraisal rights
        - 4) Standard of Review
            - a) Entire fairness does not apply absent "actual coercion or disclosure violations"

Siliconix.

b) Entire fairness review not triggered if and only if (Pure Resources):

i) Nonwaivable majority of minority shareholders approve

ii) Controlling shareholder guarantees prompt 253 short form merger

iii) Controlling shareholder makes no "retributive threats"

v. Stock Purchase

1) What happens?

a) The acquiring firm offers its stock to holders of the target's stock at a good deal, then keeps buying until it gains control.

2) Approval — Only individual shareholders, not the target board, need approve.

3) Appraisal rights — Dissenting shareholders cannot get appraisal rights.

4) The Williams Act will require notification that you are going above 5%

5) BJR review unless …

a) Defensive measures

b) *Revlon* best reasonably available deal duties

c) It's really a tender offer + short form or a tender offer + cash out

vi. Tender Offer

1) What happens?

a) The acquirer makes a formal offer for a controlling share of the target's stock.

b) If it wins, it wins.

2) The Williams Act governs the procedures followed in the tender offer. Basics

13(d) —Disclosures by 5 percent owners ("person")

13(e) — Issuer repurchases subject to SEC rules

14(d) —Disclosures required of tender offerors

14(e) —General antifraud rule (R14e-3; cf 10b-5 and 14a-9); "Traffic Rules" and fair treatment of shareholders

14(d)(5): Withdrawal rights (while offer open, R14d-7)

14(d)(6): Pro rata rule (all tenders while offer open, R14d-8)

14(d)(7): Best price rule (all tenders get it, R14d-10)

R14d-10: Offer must be open to all security holders in the class

— Prohibits greenmail to buy off possible raiders as in Unocal.

R14e-1: Minimum offer period (20 business days, 10 more if price raised). Often longer for other reasons.

R14e-5: Bidder cannot buy "outside" tender offer

3) Approval — You don't need target board approval or target shareholder vote (except for in the sense of them tendering you their shares)

4) BJR review unless …

a) Defensive measures

b) *Revlon* best reasonably available deal duties

c) It's really a tender offer + short form or a tender offer + cash out

vii. Proxy Contest — Get Your Director Friends Elected

c. Defensive Measures

i. Types of Defensive Measures

1) Paying greenmail — Cheff v. Mathes upheld the payment of greenmail.

2) Exclusionary Self-Tender

a) Permitted in Unocal.

b) Forbidden now by changes to the SEC's tender offer rules — must offer to all.

3) Poison Pills, or "Shareholder Rights Plans"

4) Asset lock-up

5) Share lock-up

6) Large termination or cancellation fee

ii. Unocal Review of Defensive Measures — The Conditional Business Judgment Rule and the "Range of Reasonableness"

1) Step 0 — Are the measures within the power of the Board?

        2) Step 1 — Is there a reasonable threat to corporate policy and effectiveness?
            a) The directors must prove good faith
            b) The directors must prove reasonable investigation
        3) Step 2 — Is the response proportionate to the threat?
            a) The response must not be "draconian" — "preclusive" or "coercive"
        4) If defendants prove both Steps 1 and Step 2, the BJR protects the defensive measures
            a) Of course, fraud, overreaching, bad faith will negate the BJR.
            b) A primary purpose of entrenching control is <u>not permissible</u> (bad faith)
    iii. Examples of Judicial Review of Defensive Measures
        1) <u>Cheff v. Mathes</u> (early): Greenmail payment okay because of threat to policy
        2) <u>Unocal</u>: A two-tiered front-loaded offer was coercive and inadequate such that there existed a threat, and the Board's defensive measure — an exclusionary self-tender — was one of the ways to prevent that threat by assuring shareholders a better offer.
        3) <u>Revlon</u>: An asset lock-up giving the white knight the power to purchase the crown jewels at a steep discount if another took control and a no-shop clause impermissibly abandoned the Board's duty to getthe best reasonably available price.
        4) <u>Paramount Comm'ns v. Time, Inc.</u> (Del. 1989): A share-exchange option, no-shop provision, and restructuring the deal as a tender offer were proportionate responses to the threats to Time's previously formulated business plan. Paramount could still make a tender offer for Time-Warner.
        5) <u>Omnicare</u> (Del. 2003): Deal protection measures in *friendly* negotiated merger agreements must pass <u>Unocal</u> (even though the Board/shareholders are leaving either way and looking for the best deal). The combination of the § 251(c) provision guaranteeing a shareholder vote, the shareholder voting agreement promising to support the merger — without an effective fiduciary out — are coercive and preclusive defensive measures.
        6) <u>Hilton Hotels</u>: Defensive measures that put the most valuable assets in a new subsidiary with a classified board, a poison pill, and so forth violates <u>Unocal</u> because it is preclusive and <u>interferes with shareholders' voting rights</u>, requiring a <u>compelling justification</u> (under <u>Blasius</u>).
    iv. Merger agreements apparently must have effective fiduciary outs. <u>Omnicare</u>.
        1) Compare <u>Quickturn</u>, invalidating a no-hand poison pill.
d. The Duty To Get the Best Reasonably Available Price — <u>Revlon</u>
    i. What is <u>Revlon</u> scrutiny like?
        1) Courts will enquire seriously about whether the Board took steps in reasonably achieving the goal of getting shareholders the best reasonably available deal.
        2) Key features of this enhanced scrutiny test
            a) Judicial determinations of the adequacy of the decisionmaking process, including the information relied on in that process.
                i) Virtually independent board required
                ii) Good faith negotiation
                iii) Focus on what will be best for shareholders
            b) Judicial determinations of the reasonableness of directors' actions in light of the circumstances then existing.
                i) <u>Lyondell</u>: There is no judicially imposed canonical set of responses one must make in order to satisfy <u>Revlon</u> duties.
    ii. When is <u>Revlon</u> triggered?
        1) <u>Lyondell</u>: "When a corporation embarks on a transaction — on its own or in response to an unsolicited offer — that will result in a change of control," <u>Revlon</u> is triggered.
        2) Examples of Not Triggering
            a) <u>Paramount v. Time-Warner</u> (Del. Ch.): Where no dominant shareholder controls either corporation, <u>Revlon</u> is not triggered because there is no threat to the shareholders' control premium.
            b) <u>Paramount v. Time-Warner</u> (Del. Supr.): Where Paramount wasn't trying to sell

itself, break-up, or abandon its long term strategy, Revlon not triggered. It was just going through with its original plan.

3) Examples of Triggering
    a) Revlon: Bringing in a white knight.
    b) Paramount v. QVC: A transaction which will cause a change in control or a break-up of the corporate entity, as here where Viacom (with a controlling shareholder Redstone) will be purchasing Paramount (unless QVC can sneak in).

iii. What is the Revlon duty? To Get the Best Reasonably Available Deal. Factors
    1) Financing
    2) Seriousness of Bids
    3) Reputation of the Parties

iv. Bad Faith and Revlon:
    1) Did the directors "utterly fail" to attempt to obtain the best price? Lyondell.
    2) Note the distinction between trying to enjoin a merger for violations of Revlon duties of care and trying to make directors personally liable for unexculpable violations of the duty of good faith.

e. State Antitakeover Statutes
    i. Williams Act preemption of state antitakeover statutes
        1) Preempted — Edgar v. MITE Corp. — Had to let management know about a takeover 20 days in advance, had to have an administrative hearing (at an uncertain time) with the Secretary of State deciding the entire fairness of the deal.
        2) Not Preempted — CTS Corp. v. Dynamics Corp. — Acquiring a certain percentage of stock causes you to lose voting rights unless "disinterested" shareholders — neither management nor the hostile bidder — approve (within 50 days)
        3) The purpose of the Williams Act is said to be protecting the independent shareholder from both the management and the acquirer.
    ii. Dormant Commerce Clause review of state antitakeover statutes
        1) Discrimination against interstate commerce
        2) Inconsistent regulations
        3) Balancing — Is the burden on interstate commerce outweighed by state benefits?
    iii. Types of State Antitakeover Provisions
        1) Fair Price Provisions
        2) Control share acquisition statutes — upheld in CTS Corp.
        3) Business Combination Statutes — DGCL § 203
            a) If you are a bidder and want to combine in a freeze-out, you might have to wait for about 3 years.
            b) Ways around the problem
                i) Target board approval (obviously)
                ii) Acquire more than 85% of the corporation's shares
                iii) Run a tender offer, do a proxy fight, get
        4) Non-shareholder constituency statutes
        5) Explicit authorization of discriminatory poison pills