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Challenging Delaware's Desirability as a Haven for Incorporation

Philip S. Garon

Michael A. Stanchfield

John H. Matheson
University of Minnesota Law School, mathe001@umn.edu

CHALLENGING DELAWARE'S DESIRABILITY AS A HAVEN FOR INCORPORATION

Philip S. Garon,† Michael A. Stanchfield,†† and John H. Matheson†††

† Partner, Faegre & Benson LLP, Minneapolis, Minnesota.

†† Partner, Faegre & Benson LLP, Minneapolis, Minnesota.

††† Melvin C. Steen and Corporate Donors Professor of Law, University of Minnesota Law School. Of Counsel, Kaplan, Strangis and Kaplan, P.A., Minneapolis, Minnesota. The authors wish to thank Dave Vander Haar, Ryan Scott, and Ryan Miske for their helpful comments on this Article; and Cate Heaven and Liz Crouse for their valuable research assistance.

I. INTRODUCTION

Whether a "race to the bottom" or a "race to the top,"[1] the competition among many states to encourage businesses to incorporate in their states has wide-ranging consequences for those businesses. Those consequences include the allocation of rights, powers, duties, and liabilities among corporate directors, officers, and shareholders. Despite the tendency to analyze this competition as a multi-state contest,[2] empirical research shows that the "race" is actually a vast number of individual races between just

1. *See* Lucian Bebchuk et al., *Does the Evidence Favor State Competition in Corporate Law?*, 90 CAL. L. REV. 1775, 1777-78 (2002) (summarizing both sides of that debate).

2. *See, e.g.*, Stephen J. Choi & Andrew T. Guzman, *Choice and Federal Intervention in Corporate Law*, 87 VA. L. REV. 961, 961 (2001) ("The choice [of where to incorporate] available to corporations . . . has generated competition among states for incorporations.").

two states at a time: the state in which the would-be corporation's principal office will be located and Delaware.[3]

Attorneys and their clients are regularly faced with the decision of where to incorporate a new business or whether to reincorporate in another state. If the decision involves a Minnesota-based business, one commentator has suggested that the only rational choice for a multi-shareholder corporation is to avoid incorporating in Minnesota,[4] thereby suggesting that Delaware should be the winner by default. The authors believe that is the wrong conclusion.[5]

The analysis in this Article focuses on comparing Delaware corporate law and jurisprudence primarily to one jurisdiction, Minnesota, where the authors reside. The bipartite nature of this comparative focus serves to crystallize significant differences. The utility of the analysis is broader, however. To the extent that the Article concludes that Minnesota provides more favorable or rational corporate treatment than Delaware, this comparison is relevant to corporations based in many other states since a substantial portion of the Minnesota statute is modeled on the Model Business Corporation Act and laws of other states. Moreover, to the extent that the analysis in this Article is critical of Delaware statutory or judicial law standing on its own, the criticism applies in favor of every other state that does not have the particular Delaware statutory provision or judicial decision or construct.

A recent example, however, illustrates the usefulness of an initial analysis comparing only two states, Delaware and Minnesota. On August 1, 2004, the Constitution of the State of Delaware and the Delaware corporate statute were each amended to permit capital stock to be issued to shareholders for virtually any form of consideration, including any tangible or intangible property or any benefit to the corporation.[6] As a result, Delaware corporations may

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3. Lucian Bebchuk & Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 J.L. & ECON. 383, 396-402 (2003).

4. Bryn Vaaler, *Scrap the Minnesota Business Corporation Act!*, 28 WM. MITCHELL L. REV. 1365, 1368-72 (2002).

5. Market data appear to support the authors' conclusion. As of 1999, approximately 75% of the publicly held, non-financial corporations located in Minnesota had chosen Minnesota as their state of incorporation. Bebchuk & Cohen, *supra* note 3, at 395.

6. DEL. CONST. art. IX, § 3 (repealed by 74 Del. Laws ch. 281 (2004)); *see*

now, for the first time, issue stock payable in whole or in part by a promissory note or, most likely, a promise to render future services.[7] The amendment was hailed as an important change to Delaware law designed to increase Delaware corporations' flexibility with respect to stock issuances. Interestingly, however, the new Delaware statutory provision is nearly identical in substance to a statutory provision that has provided flexibility to Minnesota corporations in the key area of stock issuances for over twenty years.[8] That revelation is the genesis of this Article.

The utility and desirability of the Minnesota Business Corporation Act ("MBCA")[9] are subjects of widely divergent opinions. The authors of *Minnesota Corporation Law and Practice*,[10] who are co-authors of this Article, state that the MBCA "continues to be one of the most flexible, state-of-the-art corporation statutes in the nation."[11] A lawyer at one of Minnesota's leading law firms takes a contrary view, alleging that "Minnesota has become a poor choice for incorporation in nearly all cases beyond that of a one-person, one-shareholder incorporated proprietorship. . . . Today . . . the best advice Minnesota lawyers can give their clients, whether their businesses are to be closely or publicly held, is to avoid

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DEL. CODE ANN. tit. 8, § 152 (2001 & Supp. 2004) (setting forth permissible forms of consideration for stock).

7. DEL. CODE ANN. tit. 8, § 152. The Delaware statute previously permitted the use of a promissory note to pay the portion of the purchase price of the stock that did not constitute capital. *Id.* (prior to amendment by 74 Del. Laws ch. 326 (2004)). Unlike the Minnesota statute, section 152 of the Delaware statute does not expressly authorize the issuance of stock for future services, but such consideration probably would be deemed to constitute a statutory "benefit to the corporation."

8. MINN. STAT. § 302A.405, subd. 1(a) (2004).

9. *Id.* ch. 302A. The MBCA was enacted in 1981. MINN. STAT. ANN. § 302A.001 at 181 (West 2004) (Reporter's Notes and Report to the Senate, Preface). Development of the MBCA was spearheaded by an advisory task force formed in May 1979 at the initiative of the Minnesota Senate, the Minnesota Secretary of State, and the Corporation, Banking, and Business Law Section (now the Business Law Section) of the Minnesota State Bar Association. *Id.* A primary objective of the task force was to provide a flexible, comprehensive corporate statute that could be adapted by each corporation through its charter documents and shareholder agreements to accommodate the particular characteristics and needs of the corporation and its shareholders. *Id.* at 184-85 (Background). The statute codifies substantially more corporate law than did its predecessor. *Id.* at 187 (Highlights of the Proposal).

10. 18-19 JOHN H. MATHESON & PHILIP S. GARON, MINNESOTA PRACTICE SERIES: MINNESOTA CORPORATION LAW AND PRACTICE (2d ed. 2004).

11. 18 *id.* § 1.1, at 3.

incorporating in Minnesota."[12]

Such a divergence of views demands a more detailed analysis of the MBCA and its Delaware counterpart and a comparison of Minnesota corporate law to Delaware corporate law.[13] The results of that analysis, as set forth in this Article, are as follows:

(1) The MBCA is preferable to the Delaware corporate statute in several areas of corporate law from the standpoint of key corporate constituencies.[14]

(2) The Delaware corporate statute is preferable in certain other respects to the MBCA from the standpoint of those constituencies.[15]

(3) Several of the statutory differences touted as reasons to incorporate in Delaware simply do not favor Delaware.[16]

(4) Perhaps most importantly, the MBCA codifies substantially more corporate law than does the Delaware statute.[17] The extensive body of corporate case law in Delaware that many find laudable is necessitated by gaps in the Delaware statute. Even though the Delaware case law is extensive, Minnesota's statutory codification creates more certainty than the Delaware case law because of (a) internal ambiguities in many of the Delaware judicial decisions; (b) apparent inconsistencies among certain contemporaneously decided Delaware cases; (c) divergence of certain decisions with the letter of, and apparent policy behind, the Delaware statute; and (d) tendency of the Delaware courts to reverse or ignore precedent and upset expectations.[18]

II. ADVANTAGES OF THE MBCA VERSUS DELAWARE

A. *Incorporation and Annual Fees*

Minnesota charges a fixed incorporation fee of $135, regardless of the corporation's size or the number of its authorized

12. Vaaler, *supra* note 4, at 1368, 1371.
13. *See generally* William F. Archerd & Timothy J. Scallen, *A Comparison of Minnesota and Delaware Business Corporation Statutes*, 14 HAMLINE L. REV. 151 (1990) (reviewing the Minnesota and Delaware corporate statutory differences).
14. *See infra* Part II.
15. *See infra* Part III.
16. *See infra* Part III.
17. *See infra* Part IV.A.
18. *See infra* Part IV.B.

shares,[19] and no annual fees are imposed by the State of Minnesota upon Minnesota corporations.[20] Delaware, in contrast, imposes an initial incorporation fee based upon the monetary value of the corporation's par-value stock.[21] For example, a company with authorized capital stock having an aggregate par value of $10 million would pay an initial incorporation fee of $1,200. If the stock has no par value, Delaware charges a fee based on the number of authorized shares of the corporation.[22]

The more onerous fee for a Delaware corporation is the annual franchise fee, which, subject to possible reduction under an alternative computation, is based upon the number of authorized shares.[23] A corporation with ten million authorized shares, for example, must pay an annual franchise tax of $62,550, or such lower amount calculated under Delaware's alternative formula.[24]

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19. MINN. STAT. § 302A.153 (2004).

20. Although Minnesota Statutes section 302A.821 requires Minnesota corporations to file an annual registration with the secretary of state, no fee is required to be paid with that registration. *Id.* § 302A.821(b), subd. 1; *see also* Minnesota Secretary of State, Domestic Corporation Annual Renewal Form, http://www.sos.state.mn.us/business/pdf/06920908.pdf (last visited Jan. 4, 2006).

21. Delaware's initial incorporation fee on par-value stock is $.02 per $100 of par value up to $2 million of par value, $.01 for each additional $100 of par value up to $20 million of total par value, and $.004 for each additional $100 of par value. DEL. CODE ANN. tit. 8, § 391(a)(1) (2001).

22. The fee for no-par-value stock is $.01 per share up to 20,000 shares, $.005 per share thereafter up to two million shares, and $.004 per share thereafter. *Id.* The minimum incorporation fee, regardless of whether the corporation's stock has par value, is $15.00. *Id.*

23. The annual fee is $35 for 3000 shares or less, $62.50 for up to 5000 shares, $112.50 for up to 10,000 shares, and $62.50 for each additional 10,000 shares or fraction thereof. DEL. CODE ANN. tit. 8, § 503(a) (2001 & Supp. 2004).

24. The Department of State for the State of Delaware provides a Franchise Tax Calculator to assist persons interested in calculating the franchise tax for their companies using either the "Authorized Share Method" described above or the alternative "Assumed Par Value Method" ("APVM"). *See* Delaware Department of State, Division of Corporations, http://www.state.de.us/corp/taxcalc.shtml (last visited Jan. 4, 2006). The APVM, which applies only to a corporation with par-value stock of less than $100 per share, is calculated by dividing the total gross assets of the company by the number of issued shares, multiplying the quotient or, if greater, the par value of the shares, by the number of authorized shares, and imposing the fee at $250 per $1 million or fraction of $1 million of that product. If the product is less than $1 million, the fee is determined on a consolidated basis by taking the quotient of the product divided by $1 million, and then multiplying the result by $250 (subject to the minimum fee of $35). The company's total gross assets are determined by the company's U.S. Form 1120, Schedule L, for the fiscal year ending the calendar year of the report. Using this method, if the company described above with 10 million shares of stock had five million issued shares and

The maximum annual franchise fee is $165,000.[25] The Delaware franchise fees are a significant ongoing financial burden to Delaware corporations. As a result, each corporation must assess whether the benefits of being a Delaware corporation justify such significant additional fees.

B. *Dividends and Stock Repurchases*

The additional Delaware franchise fees certainly are not justified by the differences in the permissibility of dividends and stock repurchases under the laws of the two states. Since its adoption, the MBCA has provided that, unless a Minnesota corporation has outstanding preferred stock, dividends on common stock and repurchases of common stock by the corporation may be made if, after giving effect to the distribution, the corporation can pay its debts as they become due.[26] This provision represented a substantial departure from the statutes of most states, which permitted dividends to be paid only out of net assets of the corporation, subject to certain exceptions and additional limitations.[27]

The Delaware statute permits dividends to be paid only out of a corporation's surplus or from its net profits either for the current year or the preceding year[28] and stock to be repurchased only when

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$1 million in assets (and a per-share par value of $.20 or less), the franchise fee would be $500 instead of $62,550. If the company had $250 million in assets, the franchise tax would be $125,000 if calculated using APVM. Since such amount exceeds the fee calculated using the Authorized Share Method ($62,550), the fee would be calculated using the Authorized Share Method.

25. DEL. CODE ANN. tit. 8, § 503(c).

26. MINN. STAT. § 302A.551, subd. 1 (2004). If a corporation has one or more classes or series of outstanding preferred stock that have preferential rights to distributions, then the corporation may make the distribution with respect to common stock only if (1) all amounts payable to the holders of the preferred stock having a preference for payment of that kind of distribution are paid and (2) the payment of the distribution does not reduce the corporation's remaining net assets below the aggregate preferential amount payable to such holders upon liquidation of the corporation. *Id.* § 302A.551, subd. 4(a).

27. MINN. STAT. ANN. § 302A.551 (West 2004) (Reporter's Notes, 1981, Change From Former Law). For a general discussion of the effect of the Reporter's Notes on the interpretation of MBCA provisions, see 18 MATHESON & GARON, *supra* note 10, § 1.2. A number of other states have since abandoned the "net assets" test for permissible distributions to shareholders. MODEL BUS. CORP. ACT ANN. § 6.40 cmt. nn. 2-5 (2002) (discussing statutory comparison).

28. DEL. CODE ANN. tit. 8, § 170(a) (2001). "Surplus" is defined to be the excess of the net assets over the capital of the corporation. DEL. CODE ANN. tit. 8, §

the repurchase would not impair the corporation's capital.[29] The capital of the shares with par value is the aggregate par value of the issued shares (or such higher amount as the board may have determined).[30]

Statutory restrictions on dividends are generally designed to increase the likelihood that creditors will be paid before shareholders in the event that insufficient funds are available to pay both.[31] Basing these restrictions on net assets or current net profits is artificial because assets may be illiquid and because a company at a particular point in time may have sufficient net assets (or surplus) or current net profits to pay a dividend even though it could not pay its creditors as its debts or other obligations mature. The MBCA's approach, allowing dividends based upon whether the corporation can pay its debts as they become due, accounts for these shortfalls and conforms "with the reality of the world of modern corporate finance."[32] Despite the recognition by the Minnesota legislature in 1981 that surplus tests do not adequately address the public-policy objectives underlying statutes restricting dividends and stock repurchases, the Delaware statute remains unchanged today.

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154 (2001 & Supp. 2004).

29. DEL. CODE ANN. tit. 8, § 160(a) (2001).

30. DEL. CODE ANN. tit. 8, § 154 (2001 & Supp. 2004). The capital of shares without par value is the total consideration paid for those shares, subject to the right of the board to classify as capital a lesser amount of the consideration for shares without par value at the time of the issuance of shares for cash or within sixty days after the issuance of stock for non-cash consideration. *Id.*

31. ROBERT C. CLARK, CORPORATE LAW § 14.3 (1986).

32. The Reporter's Notes to Minnesota Statute § 302A.551 appropriately state:

> The main purpose of this section is to bring the statute into conformity with the reality of the world of modern corporate finance. As the Model Act comment states: It has long been recognized by practitioners and legal scholars that the pervasive statutory structure in which 'par value' and 'stated capital' are basic to the state corporation statutes does not today serve the original purpose of protecting creditors and senior security holders from payments to junior security holders, and may, to the extent security holders are led to believe that it provides some protection, tend to be misleading.

MINN. STAT. ANN. § 302A.551 (West 2004) (Reporter's Notes, 1981, General Comment) (quoting Committee on Corporate Laws, American Bar Association, *Changes in the Model Business Corporation Act—Amendments to Financial Provisions*, 34 BUS. LAW. 1867, 1867 (1979)).

C. *Flexibility for Board Actions*

The flexibility of the MBCA with respect to permissible board actions certainly favors incorporation in Minnesota. A Minnesota corporation may provide in its articles of incorporation that its board of directors can take action by written consent of the same number of directors who could take action at a meeting at which all directors are present (generally a majority of the board) unless the action also requires shareholder approval.[33] The MBCA permits such an action only if the corporation has determined, by so providing in its articles, that such added flexibility is advisable.[34] The Delaware statute, on the other hand, does not provide that flexibility to Delaware corporations.[35] Boards of Delaware corporations cannot take action by less than unanimous written consent of their directors, regardless of whether corporate stakeholders desire to grant that authority.[36]

Additional flexibility also is given under the MBCA to directors who are unable to attend a board meeting. If so provided in the corporation's articles of incorporation or bylaws, absent directors may give advance written consent or opposition to a proposal to be acted on at the meeting (effectively an "absentee ballot").[37] The advance consent or opposition is counted as a vote at the meeting if the proposal at the meeting is substantially the same or has substantially the same effect as the proposal to which the absent director consented or objected.[38] The Delaware statute does not provide this flexibility.

33. MINN. STAT. § 302A.239, subd. 1 (2004).

34. From a policy standpoint, the wisdom of permitting written consent by less than all directors is debatable. Proponents argue that permitting action by less than unanimous written consent provides more flexibility to a board, particularly when action needs to be taken under tight time constraints. Opponents claim that permitting board action by less than unanimous written consent deprives dissenting directors of the opportunity to convince other directors at a board meeting to change their position. The MBCA, however, does not dictate that a board be permitted to take action by less than unanimous written consent. It affords the opportunity to the corporation to decide in its articles of incorporation the wisdom of permitting such actions by less than unanimous consent.

35. DEL. CODE ANN. tit. 8, § 141(f) (2001).

36. *Id.*

37. MINN. STAT. § 302A.233.

38. *Id.* The absentee ballot may not be counted for quorum purposes, however. *Id.*

D. *Short-Form Mergers*

The MBCA also provides more flexibility than the Delaware statute with respect to short-form mergers. State corporate statutes generally include short-form merger provisions, which are designed to avoid the expense and delay associated with requiring shareholders of 90%-or-greater subsidiaries to vote to approve mergers with their parent corporations or, under certain statutes, with other affiliates of the parent corporation.[39] The statutes recognize that the expense and delay is unnecessary in this context because the result of the vote is a foregone conclusion.[40]

The Delaware short-form merger statute is limited in scope, covering mergers between a parent corporation and one or more direct subsidiaries of which at least 90% of the outstanding shares of each class that would be entitled to vote on the merger in the absence of the short-form merger statute are owned by the parent.[41] The merger can be a merger either of one or more of the subsidiaries into the parent or a merger of the parent (or of the parent and one or more of the direct subsidiaries) into one of the direct subsidiaries.[42] The MBCA, in contrast, is more flexible in that it permits mergers of direct *or indirect* subsidiaries with the parent corporation under its short-form merger provisions, so long as at least 90% of each class and series of the subsidiaries that would be entitled to vote on the merger in the absence of the short-form merger statute is directly *or indirectly* owned by the parent corporation.[43] The MBCA also permits use of the short-form merger statute to merge a 90% directly or indirectly owned subsidiary into another similarly owned subsidiary—thereby avoiding a shareholder vote of minority shareholders of those subsidiaries.[44]

39. JAMES D. COX & THOMAS LEE HAZEN, CORPORATIONS § 22.12 (2d ed. 2003).
40. *Id.*
41. DEL. CODE ANN. tit. 8, § 253(a) (2001 & Supp. 2004).
42. *Id.*
43. MINN. STAT. § 302A.621, subd. 1 (2004).
44. *Id.* However, the default rule under the Delaware statute providing that shareholders may take action by less than unanimous written consent, section 228 of the Delaware statute, alleviates to some extent the narrower application of the short-form merger provisions. *See* DEL. CODE. ANN. tit. 8, § 228 (2001).

E. Board Committees

The MBCA also provides substantial flexibility to a board of directors to establish and delegate authority to board committees. Each committee formed may consist of directors and non-directors or solely of non-directors.[45] As noted in the Reporter's Notes to the MBCA, "[t]his provision permits the corporation to make full use of the talents of non-directors with special expertise, or of directors or officers of related or non-related corporations."[46] Moreover, the authority that can be delegated to a committee is not circumscribed by the MBCA—each committee of a Minnesota corporation may have such authority as may be prescribed by the board of directors.[47]

A Delaware board committee, in contrast, must consist solely of directors.[48] Changes to the Delaware statute have eliminated nearly all restrictions on the ability of boards of directors to grant authority to committees.[49] Nevertheless, committees of Delaware corporations cannot be delegated the power of the board to take actions (such as approval of mergers or sales of substantially all assets) that by statute cannot be finally approved without shareholder action or to adopt or amend bylaws that the board has the power to adopt or amend.[50]

F. Statutory Share Exchanges

Even in the area of business combinations, the MBCA offers increased flexibility. Both the MBCA and the Delaware statute authorize merger transactions by which the board of directors and shareholders holding a majority of the outstanding shares can vote to approve a business combination that eliminates all shareholders as shareholders of the merged corporation, regardless of whether the minority shareholders approve the transaction.[51] The MBCA

45. MINN. STAT. § 302A.241, subd. 2.

46. MINN. STAT. ANN. § 302A.241 (West 2004) (Reporter's Notes, 1981, General Comment).

47. MINN. STAT. § 302A.241, subd. 1.

48. DEL. CODE ANN. tit. 8, § 141(c) (2001 & Supp. 2004).

49. *Compare id.* § 141(c)(1), *with id.* § 141(c)(2). The broader statutory authority does not apply to corporations incorporated before July 1, 1996 that have not elected to be governed by the new provisions. *Id.* § 141(c)(1).

50. *Id.* § 141(c)(2).

51. DEL. CODE ANN. tit. 8, §§ 251-252 (2001); MINN. STAT. §§ 302A.601, subd.

also authorizes an alternative type of business combination—the statutory share exchange—whereby the board of directors and shareholders of a Minnesota corporation can approve the exchange by all shareholders (even those who do not approve the exchange) of all of their shares of stock (or all of the shares of a particular class or series) of the acquired corporation for stock of the acquiring corporation or other consideration.[52] The acquired corporation in a statutory share exchange generally becomes a wholly owned subsidiary of the acquiring corporation. The end result is usually the same as in a "reverse triangular" merger.[53]

An acquiring corporation organized in Canada or certain other countries may prefer a statutory share exchange to a merger under the tax or other laws of its jurisdiction of incorporation. While the MBCA facilitates that preference, the Delaware statute does not permit such statutory share exchanges.

In sum, the MBCA offers a backdrop of low taxation and a high degree of flexibility for corporate stakeholders to mold the statutory provisions to their unique needs. An objective analysis of the statute, however, also requires discussion of possible shortcomings of the MBCA—whether real or imagined.

III. POSSIBLE DISADVANTAGES OF THE MBCA VERSUS DELAWARE

Certain aspects of the MBCA, and of state statutes with provisions comparable to those in the MBCA, have occasionally been criticized;[54] those criticisms are discussed in this section. To the extent they are justified, the criticisms should be viewed in the context of the greater flexibility and decreased fees described above that are available to Minnesota corporations. Moreover, an

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1, 302A.615, 302A.651.

52. MINN. STAT. §§ 302A.601, subd. 2, 302A.615.

53. In a reverse triangular merger, the acquiring corporation creates a wholly owned shell subsidiary that merges into the acquired corporation, with the acquired corporation surviving the merger. The plan of merger provides that all shares of the acquired corporation become owned by the acquiring corporation and that former shareholders of the acquired corporation receive cash, shares of the acquiring corporation, or other property from the acquiring corporation. *See generally* 1 LOU R. KLING & EILEEN T. NUGENT, NEGOTIATED ACQUISITIONS OF COMPANIES, SUBSIDIARIES AND DIVISIONS § 1.03[5] (2005) (describing and depicting a reverse triangular merger).

54. *See, e.g.*, Vaaler, *supra* note 4, at 1371. In *Scrap the Minnesota Business Corporation Act!*, Vaaler focuses on several provisions of the MBCA that he alleges make "the MBCA such a bad corporation statute." *Id.*

analysis of each of the allegedly disadvantageous statutory provisions of the MBCA leads the authors to conclude that most are well-crafted provisions that achieve a reasonable balance among director, officer, and shareholder rights and appropriately reflect shareholder expectations, with one notable exception.

A. *Calling Meetings of Shareholders*

Under the MBCA, a special meeting of shareholders may be called by any of the following:[55]

> [t]he chief executive officer; [t]he chief financial officer; [t]wo or more directors; . . . or [a] shareholder or shareholders holding ten percent or more of the voting power of all shares entitled to vote, except that a special meeting for the purpose of considering any action to directly or indirectly facilitate or effect a business combination, including any action to change or otherwise affect the composition of the board of directors for that purpose, must be called by 25 percent or more of the voting power of all shares entitled to vote.[56]

Shareholders of a Delaware corporation are not entitled to demand a special meeting, no matter how significant their ownership stake, unless so authorized by the corporation's certificate of incorporation or bylaws.[57] "Corporations desiring to avoid special meetings called by dissident shareholders prefer the Delaware statute in this regard."[58]

The corporate statutes of most states, however, give shareholders holding a specified percentage of shares the power to call a special meeting. Thirty-two states have a 10% threshold, and most, unlike Minnesota, do not increase the threshold if the action sought is a change in control of the corporation.[59] It is difficult to indict a corporate statute that is substantially identical to a majority of state corporate statutes and provides substantial shareholders and shareholder groups the right to demand a meeting.[60]

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55. MINN. STAT. § 302A.433, subd. 1.
56. *Id.* subd. 1(a)-(c), (e).
57. DEL. CODE ANN. tit. 8, § 211(d) (2001).
58. 18 MATHESON & GARON, *supra* note 10, § 1.5, at 9.
59. MODEL BUS. CORP. ACT ANN. § 7.02 cmt. n.1 (2002) (no increased threshold required).
60. Although Vaaler acknowledges the number of states that permit shareholders to demand a special meeting, he argues that the MBCA's 10%

B. Default Provisions: Cumulative Voting and Preemptive Rights

The authors believe that the indictment of the MBCA's default provisions regarding cumulative voting and preemptive rights is even less sustainable. In *Scrap the Minnesota Business Corporation Act!*,[61] Bryn Vaaler describes Minnesota's default approach to cumulative voting and preemptive rights as "wrong-headed."[62] He reaches that conclusion because, under the MBCA, shareholders of Minnesota corporations have cumulative voting rights and preemptive rights unless the articles of incorporation provide otherwise,[63] whereas shareholders of Delaware corporations do not have such rights unless the certificate of incorporation so provides.[64]

Most attorneys incorporating a Minnesota corporation presumably are familiar with the MBCA and will provide in the articles for the inapplicability of cumulative voting and preemptive rights if that is the desire of the shareholders.[65] Similarly, most attorneys incorporating a Delaware corporation presumably are familiar with the Delaware statute and will provide in the certificate of incorporation for the applicability of cumulative voting and preemptive rights if that is the desire of the shareholders.[66] There may be situations, however, in which an attorney fails to focus on the treatment of cumulative voting or preemptive rights under the applicable statute if the corporate charter is silent and situations in which a corporation is incorporated without a lawyer by persons unaware of the consequences if nothing is stated in the corporate charter.[67]

The "opt-in, opt-out" distinction between the two statutes, as it

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threshold is too low. Vaaler, *supra* note 4, at 1390.

61. Vaaler, *supra* note 4.

62. *Id.* at 1371-72.

63. MINN. STAT. §§ 302A.215, subd. 2 (cumulative voting), 302A.413, subd. 1 (preemptive rights) (2004). The MBCA's default rule of preemptive rights does not apply to securities that are issued for other than money consideration, pursuant to a plan of merger or exchange, under a shareholder-approved benefit plan, upon exercise of stock options or other rights to purchase securities, in a public offering, or in a court-approved plan of reorganization. *Id.* § 302A.413, subd. 4.

64. DEL. CODE ANN. tit. 8, §§ 102(b)(3) (preemptive rights), 214 (cumulative voting) (2001); *see also* 18 MATHESON & GARON, *supra* note 10, § 1.5, at 11-12.

65. 18 MATHESON & GARON, *supra* note 10, § 1.5, at 12.

66. *Id.*

67. *Id.*

pertains to cumulative voting and preemptive rights, would not favor the Delaware statute over the Minnesota statute unless both (1) a substantial number of persons incorporating Minnesota corporations, or who become shareholders of Minnesota corporations, that have not opted out of cumulative voting or preemptive rights are unaware that those provisions apply because there has been no opt-out, and (2) there is a substantially greater likelihood that persons who were not aware of the consequences would have preferred that cumulative voting and preemptive rights not apply than that they do apply.[68] Cumulative voting and preemptive rights are not inherently undesirable statutory provisions.[69] There are presumably a substantial number of shareholders who, even if they are not intimately familiar with the concept of cumulative voting, would expect that a 49% shareholder would have the right to some minority representation on the board of directors and who would be surprised that this is not the default case under Delaware law.[70] A substantial number of minority shareholders may also be surprised to learn that their percentage interests in a closely held corporation could be diluted by the issuance of shares to new shareholders without the original shareholders first having a right to purchase those shares on the same terms unless preemptive rights are expressly provided for in the charter of a Delaware corporation.[71] Which statute is more likely to be a "trap for the unwary"[72] is largely dependent upon what the views of the unwary would be regarding the desirability of cumulative voting and preemptive rights.[73]

C. *Anti-Takeover Provisions*

Anti-takeover provisions in corporate statutes are among the most controversial provisions in those statutes. Proponents believe those statutes are very desirable means of protecting shareholders against certain undesirable takeovers of public corporations, give boards more time to evaluate proposed takeovers and consider

68. *Id.*
69. *Id.*
70. *Id.*
71. *Id.*
72. *See* Vaaler, *supra* note 4, at 1372-77 (describing the MBCA's default provisions in the areas of cumulative voting and preemptive rights).
73. 18 MATHESON & GARON, *supra* note 10, § 1.5, at 12.

alternatives, and increase the negotiating positions of boards to maximize shareholder value in the event of a takeover.[74] Opponents, which include many institutional shareholders and organizations like Institutional Shareholder Services, maintain that those statutes are contrary to good corporate governance, impair the free operation of the market for corporate control, and reduce shareholder value.[75] The authors believe that the anti-takeover statutes in Minnesota, taken as a whole, make incorporation in Minnesota attractive for publicly held corporations and privately held corporations that are likely to become publicly held in the future or that have a large number of shareholders.

Both Minnesota[76] and Delaware[77] have a Business Combination Act. Both statutes provide that a substantial shareholder generally cannot enter into a merger or certain other self-dealing transactions with a publicly held corporation for a period of years after becoming a substantial shareholder unless the corporation pre-approves either the self-dealing transaction or the stock acquisition that results in the shareholder becoming a substantial shareholder.[78] The Minnesota statute is more effective than its Delaware counterpart in furthering the objectives of proponents of statutory anti-takeover protections, namely by

- deterring certain undesirable takeovers in which the shareholders do not receive full value or are not treated equally, particularly if a substantial portion of the takeover price is paid with assets of the acquired corporation or as a result of the collateralization of those assets upon a merger of the company with the substantial shareholder or its affiliates;
- giving the board of directors more time to evaluate the

74. *See* John H. Matheson & Brent A. Olson, *Shareholder Rights and Legislative Wrongs: Toward Balanced Takeover Legislation*, 59 GEO. WASH. L. REV. 1425, 1455 (1991) ("[T]he primary impact state legislation has upon shareholders qua shareholders is the veto power and leverage it affords management in attempting to achieve the highest possible price for the corporation.") (footnote omitted).

75. *See* Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the "Race" Debate and Antitakeover Overreaching*, 150 U. PA. L. REV. 1795, 1830 (2002) ("[V]irtually all academic commentators on both sides of the [race-to-the-bottom vs. race-to-the-top] debate agree that state antitakeover statutes generally reduce shareholder value.") (footnote omitted).

76. MINN. STAT. § 302A.673 (2004).

77. DEL. CODE ANN. tit. 8, § 203 (2001 & Supp. 2004).

78. MINN. STAT. § 302A.673; DEL. CODE ANN. tit. 8, § 203.

transaction and consider possible higher-value alternatives; and

- increasing the negotiating position of the board of directors to maximize the terms and conditions of any takeover.[79]

The ownership threshold under the respective Business Combination Acts for being a substantial shareholder is 10% for a Minnesota corporation compared to 15% for a Delaware corporation.[80] The moratorium period during which mergers or other self-dealing transactions are prohibited is four years for a Minnesota corporation and three years for a Delaware corporation.[81] In addition, the Delaware moratorium, unlike the Minnesota moratorium, can be avoided if the shareholder, immediately after the transaction in which it becomes a substantial shareholder, owns at least 85% of the outstanding voting stock that is not owned by persons who are both directors and officers or certain employee stock plans.[82] The moratorium may also be avoided by a substantial shareholder in Delaware if the transaction in question is approved by both the board of directors and at least two-thirds of the voting stock not owned by the substantial shareholder.[83]

As a result of Minnesota's increased protections, a shareholder holding less than 10% of the stock of a Minnesota corporation is much more likely to seek pre-approval from the corporation before crossing the 10% threshold because: (1) the shareholder will be subject to the moratorium if it crosses the threshold; (2) the moratorium is four years rather than three years; and (3) there are no practical statutory exceptions to the moratorium. A similarly situated shareholder of a Delaware corporation can acquire another 5% of the corporation's voting stock before crossing the statutory threshold. The shareholder can then wage a proxy contest to remove the directors, voting its 14.9% interest. If the shareholder wins, the new board can pre-approve the transaction and avoid the moratorium regardless of whether the old board deemed the merger desirable and without giving the old board the

79. *Compare* MINN. STAT. § 302A.673, *with* DEL. CODE ANN. tit. 8, § 203.
80. MINN. STAT. § 302A.011, subd. 49(a); DEL. CODE ANN. tit. 8, § 203(c)(5).
81. MINN. STAT. § 302A.673, subd. 1(a); DEL. CODE ANN. tit. 8, § 203(a).
82. DEL. CODE ANN. tit. 8, § 203(a)(2).
83. *Id.* § 203(a)(3).

opportunity to negotiate better terms for shareholders generally. Although a shareholder could use the same tactic with respect to a Minnesota corporation, it would need to wage the proxy contest from a 9.9% ownership position rather than a 14.9% ownership position and would be less likely to prevail.[84]

For those who oppose anti-takeover statutes on the theory that they are generally skewed to be pro-management and anti-shareholder, the Minnesota Business Combination Act may be more desirable than its Delaware counterpart in one respect. The pre-approval sufficient to avoid the moratorium under the Minnesota statute must be given by a committee composed solely of one or more disinterested directors who have not been officers or employees of the corporation or a related organization during the preceding five years (or, if there are no such directors, by a committee of three or more disinterested persons who are not directors).[85] The Delaware pre-approval is by the entire board of directors, including the management directors.[86]

While some criticize all anti-takeover statutes as being anti-free market, others attack only one subset of those statutes, control share statutes, as being ineffective and possibly facilitating takeovers.[87] Minnesota has such a statute, frequently referred to as the Control Share Acquisition Act.[88] Twenty-seven states have comparable statutes.[89] Delaware does not.

The Minnesota Control Share Acquisition Act provides that if a publicly held corporation with at least fifty shareholders of record or any other Minnesota corporation with at least 100 shareholders of record has a shareholder with 20% or more of the voting power of the corporation's outstanding shares, that holder can vote only

84. The only downside with respect to a Minnesota corporation would be if a shareholder acquired between 10% and 15% of the stock without pre-approval and later proposed a transaction that was clearly in the best interests of the corporation. That shareholder would be precluded from completing that transaction during the four-year moratorium period if it retains its percentage stock ownership.

85. MINN. STAT. § 302A.673, subd. 1(d)(1)-(2).

86. DEL. CODE ANN. tit. 8, § 203(a)(1).

87. 1 ARTHUR FLEISCHER, JR. & ALEXANDER R. SUSSMAN, TAKEOVER DEFENSE § 4.06[A], at 4-37 (6th ed. 2000 & Supp. 2004) ("[C]ontrol share statutes . . . have not been particularly useful to target companies in defending against hostile bids . . . [and] may be counterproductive.").

88. MINN. STAT. § 302A.671.

89. 1 FLEISCHER & SUSSMAN, *supra* note 87, § 4.01[A], n.152.

20% of the corporation's outstanding voting shares (notwithstanding its stock ownership).[90] There is an exception from the voting limitation if at any time the shareholders of the corporation approve the grant of full voting power by the vote of both a majority of the voting power of the corporation's outstanding shares and a majority of the voting power of the outstanding shares that are not owned by the 20% shareholder or by officers or employee directors of the corporation.[91] However, the meeting of shareholders cannot be held unless the 20% shareholder provides the corporation, for redistribution to all of its shareholders, certain information concerning itself and its plans with respect to the corporation.[92] In addition, the meeting is not required unless, at the time the substantial shareholder delivers the information described above, the substantial shareholder also has definitive agreements in place for all acquisition financing that is not to be provided with its own funds.[93] Even if the shareholder complies with all the conditions necessary to request the meeting, the board has fifty-five days after satisfaction of the conditions to hold the meeting,[94] giving the board more time to evaluate the proposed takeover and consider favorable alternatives to it.

The authors generally agree that the Minnesota Control Share Acquisition Act is relatively ineffective, perhaps even disadvantageous as an anti-takeover protection, because it provides a referendum for the shareholders to vote in favor of the takeover, although the statute does achieve a takeover-preparedness objective of giving the board more time (up to fifty-five days after the substantial shareholder has financing in place and has requested the meeting of shareholders)[95] to evaluate the proposed acquisition. It should be noted, however, that the referendum for the shareholders generally facilitated by control share statutes is less likely under the Minnesota statute than under its counterparts in most states if the shareholder is simply intending to put the corporation "in play" because the substantial shareholder cannot force the referendum unless it has definitive financing in place.

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90. MINN. STAT. § 302A.671. Similar restrictions apply at the $33^{1}/_{3}\%$ and majority ownership thresholds. *Id.*

91. *Id.* subd. 4a.

92. *Id.* subds. 2, 3.

93. *Id.* subd. 4.

94. *Id.* subd. 3.

95. *Id.*

The statute has also been criticized as posing "impediments to routine transactions."[96] The authors have rarely found that to be the case. The statute has exceptions that negate its effect with respect to many of those routine transactions. Stock acquired directly from the corporation is exempt from voting restrictions.[97] Likewise, there is an exception for tender offers and exchange offers for all of a corporation's stock that have been approved by a committee of disinterested directors and result in ownership of more than 50% of the voting stock of the corporation.[98] The "routine transactions" that arguably may be impeded are therefore presumably transactions which the authors submit are not at all routine—the transfer by a shareholder to another shareholder of at least 20% of the voting stock of the corporation, major reorganizations of institutional owners of 20% or greater interests, and certain voting proxies and stock options granted by shareholders in proposed mergers to "lock up" the transaction prior to the shareholder vote.[99]

Concern has also been expressed about the application of the statute to non-public corporations with 100 or more shareholders of record.[100] The authors believe, however, that there are a very limited number of *non-public* Minnesota corporations with 100 or more shareholders of record. Furthermore, even among such companies, takeover attempts occur in situations where protections provided to shareholders of public companies under federal proxy and tender offer rules are, for the most part, unavailable. It is therefore arguable that the Minnesota anti-takeover statutes are more important to non-public, non-closely held corporations than to public corporations.

Moreover, a corporation can opt out of the statute at any time by amending its articles or bylaws. Such an opt-out simply requires

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96. Vaaler, *supra* note 4, at 1397.

97. MINN. STAT. § 302A.011, subd. 38(e) (2004).

98. *Id.* subd. 38(h).

99. Such a "lock-up" is not in the interests of a corporation's shareholders unless the inability to obtain it causes a potential acquirer to refuse to proceed with an otherwise desirable acquisition or to offer a lower takeover premium in order to compensate it for the risk that a third party will outbid it. *See generally* Michael A. Stanchfield, *Voting Lock-ups and Sales of Partially Owned Subsidiaries: Can Shareholders Love a Deal Too Early and Too Much?*, 28 WM. MITCHELL L. REV. 1325, 1358-61 (2002) (discussing the effects of lock-ups).

100. Vaaler, *supra* note 4, at 1396-97.

a shareholder vote.[101] Clients should be advised of the advantages and disadvantages of the statute and consider on an informed basis whether to opt out. Because opting out is not a difficult process, the ability of Minnesota corporations to avail themselves of the Control Share Acquisition Act unless they choose to opt out should not be deemed a substantial disadvantage in light of the advantages resulting from the MBCA and its other anti-takeover provisions.[102]

D. *Shareholder Remedies*

While the authors believe that certain of the purported disadvantages of the MBCA are overstated, one is not—section 302A.751 of the MBCA is a very troubling statute. With respect to certain *closely held* corporations,[103] section 302A.751 may itself be a sufficient reason to incorporate in Delaware, despite the added financial burdens, decreased flexibility, and more limited coverage

101. The vote is generally a vote of a majority of the voting power of the outstanding shares plus a vote of a majority of the voting power of the shares held by persons other than the substantial shareholder or officers or employee directors. MINN. STAT. § 302A.671, subd. 1. However, unless the articles of incorporation provide for a greater number or percentage, the required vote is only a vote of holders of the greater of a majority of the voting power of the shares present and entitled to vote or a majority of the voting power of the minimum number of shares that would constitute a quorum if the amendment is approved by a committee of directors each of whom (1) has not been an officer or employee of the corporation or a related organization during the past five years; (2) is not the substantial shareholder or an affiliate or associate of the substantial shareholder and was not nominated for election by any such shareholder or by its affiliates or associates; and (3) was a director when the substantial shareholder became or proposed to become a 20% (or 33$^1/_3$% or majority) shareholder or was nominated, elected, or recommended for election by a majority of the directors who were directors at the time the substantial shareholder became or proposed to become a 20% (or 33$^1/_3$% or majority) shareholder. *Id.*

102. The other anti-takeover provisions of the MBCA include a so-called "fair price" provision, an "anti-greenmail" provision, and a multiple-constituency statute. *See id.* § 302A.675 (an offeror may not acquire shares of a publicly held corporation within two years after a takeover offer unless the selling shareholder is offered substantially equivalent terms as those in the takeover offer or unless a committee of disinterested directors agrees otherwise before any shares are purchased in the tender offer); § 302A.553, subd. 3; § 302A.251, subd. 5 (discussed in Part IV.A.3 *infra*).

103. The Minnesota legislature enacted section 302A.751 "in recognition that, given the lack of a ready market for their shares, minority shareholders in closely held corporations required enhanced protections." Gunderson v. Alliance of Computer Prof'ls, Inc., 628 N.W.2d 173, 184 (Minn. Ct. App. 2001), *rev. granted* (Minn. July 24, 2001), *appeal dismissed* (Minn. Aug. 17, 2001).

of the Delaware statute.[104]

Section 302A.751 allows a court to "grant any equitable relief it deems just and reasonable in the circumstances" or to "dissolve a corporation and liquidate its assets and business" when it is established that:

(1) the directors are deadlocked, and the shareholders are unable to break the deadlock;
(2) the directors or other controlling persons have acted fraudulently or illegally toward shareholders in their capacity as shareholders or directors, or in the case of a closely held corporation, as officers or employees;
(3) the directors or other controlling persons have acted in a manner unfairly prejudicial toward one or more shareholders in their capacities as shareholders or directors of a corporation that is not a publicly held corporation or as officers or employees of a closely held corporation;
(4) the shareholders are so divided in voting power that for the period including two consecutive regular meetings, they have failed to elect successors to directors;
(5) corporate assets are being misapplied or wasted; or
(6) the duration of the corporation has expired and has not been extended.[105]

Although in theory section 302A.751 applies to all Minnesota corporations, in practice it has rarely, if ever, been applied to publicly held corporations.[106]

Court-determined equitable-relief provisions such as section 302A.751 are not troubling in shareholder actions when directors are deadlocked and the shareholders are unable to break the deadlock, when the shareholders are unable to elect directors, or when waste of corporate assets or fraud is occurring. The Model

104. The Delaware statute includes a subchapter containing special provisions for close corporations. DEL. CODE ANN. tit. 8, subch. XIV (2001). Unlike section 302A.751, however, a Delaware corporation must affirmatively opt-in to the subchapter if its provisions are to apply to the corporation. DEL. CODE ANN. tit. 8, §§ 341-344 (2001). The Delaware Supreme Court has declined to create any special rules to protect minority shareholders in a closely held corporation. Nixon v. Blackwell, 626 A.2d 1366, 1379-81 (Del. 1993).

105. MINN. STAT. § 302A.751, subd. 1 (2004).

106. A recent search of all reported state and federal cases did not reveal any instances of section 302A.751 actions against publicly held corporations.

Business Corporation Act, for example, allows judicial dissolution by shareholder action, but does not expressly permit a court to impose other equitable remedies, in each of those four situations.[107]

The most troubling and distinguishing aspect of section 302A.751 is that equitable relief can be granted to shareholders in any Minnesota *non-public* corporation when it is established that directors or those in control of the corporation have acted in a manner that is "unfairly prejudicial" toward shareholders *in their capacities as shareholders or directors* of the corporation.[108] For a non-public closely held corporation (i.e., thirty-five or less shareholders of record),[109] the statute also authorizes courts to grant relief if the directors or those in control of the corporation have acted in a manner unfairly prejudicial toward shareholders *in their capacities as officers or employees.*[110] No definition of the term "unfairly prejudicial" is given in the statute. The courts have noted that unfairly prejudicial conduct likely includes breaches of fiduciary duty,[111] but that it does not include the failure to fulfill a minority shareholder's "subjective hopes and desires."[112]

Whether practitioners view this basis for equitable relief as undermining basic principles of contract and employment law[113] or as a necessary protection for oppressed minority shareholders with

107. MODEL BUS. CORP. ACT § 14.30 (2005). The significant distinction between the Model Act and section 302A.751 is that the latter includes a provision allowing judicial dissolution or other relief when directors of non-public corporations have acted in a manner unfairly prejudicial toward one or more of their shareholders, while the Model Act contains no such standard. *Compare* MINN. STAT. § 302A.751, subd. 1(b)(3), *with* MODEL BUS. CORP. ACT §14.30. Although the Model Act does not expressly authorize a court to compel the corporation or other shareholders to purchase the plaintiff-shareholder's shares for fair value in lieu of dissolution, it does permit the corporation or the other shareholders to voluntarily elect to do so. MODEL BUS. CORP. ACT § 14.34.

108. MINN. STAT. § 302A.751, subd. 1(b)(3).

109. *Id.* § 302A.011, subd. 6a.

110. *Id.* § 302A.751, subd. 1(b)(3).

111. Berreman v. West Publ'g Co., 615 N.W.2d 362, 373 (Minn. Ct. App. 2000).

112. Gunderson v. Alliance of Computer Prof'ls, Inc., 628 N.W.2d 173, 191 (Minn. Ct. App. 2001), *rev. granted* (Minn. July 24, 2001), *appeal dismissed* (Minn. Aug. 17, 2001) (citing *In re* Kemp & Beatley, Inc., 473 N.E.2d 1173, 1179 (N.Y. 1984)).

113. *See Gunderson*, 628 N.W.2d at 190-92 (holding that, although the plaintiff's rights as an *at-will employee* were fixed by law and that his rights *as a shareholder* were set forth in a buy-sell agreement, his rights *as a shareholder-employee* were not and thus could form the basis of a claim under section 302A.751); *see generally* Vaaler, *supra* note 4, at 1409.

no other way to receive the full value of their investment[114] depends in large part upon whether the attorney is representing or suing the directors or controlling shareholders. From a structural standpoint, however, section 302A.751 burdens closely held corporations and, to a lesser extent, other non-public corporations by encouraging perpetual judicial second-guessing of corporate decisions.[115]

Once the threshold for bringing a shareholder action is met under section 302A.751, the courts have wide judicial discretion to order equitable relief. The statute provides that, in determining whether to order equitable relief, courts should consider the duty shareholders in *closely held corporations* owe one another "to act in an honest, fair, and reasonable manner in the operation of the corporation and the reasonable expectations of all shareholders as they exist at the inception and develop during the course of the shareholders' relationship with the corporation and with each other."[116] One instance of a failure by a director or controlling shareholder to act in an honest, fair, and reasonable manner in the operation of the corporation may be deemed to constitute acting in a manner unfairly prejudicial toward those shareholders—thereby entitling a court to impose equitable relief.[117] Although the authors

114. *See* Joseph W. Anthony & Karlyn Vegoe Boraas, *Betrayed, Belittled . . . But Triumphant Claims of Shareholders in Closely Held Corporations*, 22 WM. MITCHELL L. REV. 1173, 1175-76 (1996).

115. *E.g.*, Pooley v. Mankato Iron & Metal, Inc., 513 N.W.2d 834 (Minn. Ct. App. 1994) (holding that the board's decision to remove an officer/director of the family-owned business after he was convicted for assaulting another director was unfair prejudice triggering a full-value buyout under section 302A.751).

116. MINN. STAT. § 302A.751, subd. 3a (2004). *But see* Advanced Commc'n Design, Inc. v. Follett, 615 N.W.2d 285, 294 (Minn. 2000) (holding that a minority shareholder holding only nonvoting stock in a closely held corporation did not owe fiduciary duties to the corporation, which was controlled by one shareholder who held all of the voting stock and served as the corporation's only director, or to its other shareholders); Wiltse v. Boarder Fin. Servs., Inc., No. A03-852, 2004 WL 771493, at *2 (Minn. Ct. App. Apr. 13, 2004) (holding that buy-out offer to minority shareholder was reasonable and that his expectation of a higher price was unreasonable).

117. *See* MINN. STAT. ANN. § 302A.751 (West 2004) (Reporter's Notes, 1981, Bert Black); Sawyer v. Curt & Co., Inc., Nos. C7-90-2040, C9-90-2040, 1991 WL 65320, at *3 (Minn. Ct. App. Feb. 12, 1991). The *Sawyer* court used the language, "[t]his one incident of unfairly prejudicial conduct is enough to justify the trial court's grant of the motion for a buy-out under MINN. STAT. § 302A.751, subd. 1(b)(2)." *Id.* This excerpt quotes the "unfairly prejudicial" standard in the current section 302A.751, subd. 1(b)(3), but cites to the current fraudulent or illegal standard of section 302A.751, subd. 1(b)(2)). *See id.*

do not believe it to be the intent of the statute, certain Minnesota courts have reached the conclusion that a controlling shareholder *of a closely held corporation* acting contrary to "the reasonable expectations of all shareholders" also is acting in a manner "unfairly prejudicial" toward shareholders, thereby enabling the court to impose equitable relief even if the controlling shareholder did not otherwise act in a manner unfairly prejudicial to the shareholders.[118]

Minnesota courts have utilized the permitted equitable remedies in section 302A.751 to award minority shareholders of closely held corporations broad remedies including buyout and dissolution of the closely held corporation.[119] Minnesota courts have also allowed broad remedies and awards using the "reasonable expectations" standard for minority shareholders. For instance, shareholders who are employees may have a reasonable expectation of continued lifetime employment[120] in addition to the

118. Borrowing language from another part of section 302A.751, Minnesota courts have concluded that unfairly prejudicial conduct under section 302A.751 "is conduct that frustrates the reasonable expectations of shareholders in their capacity as shareholders or directors of a corporation that is not publicly held or as officers or employees of a closely held corporation." Berreman v. West Publ'g Co., 615 N.W.2d 362, 374 (Minn. Ct. App. 2000); *see* Prod. Res. Group, L.L.C. v. VanHercke, No. A03-1584, 2004 WL 1445126, at *3 (Minn. Ct. App. June 29, 2004) (citing *Gunderson,* 628 N.W.2d at 184); *Wiltse,* 2004 WL 771493, at *2; *Sawyer,* 1991 WL 65320, at *2; *see also* Daniel S. Kleinberger, *Why Not Good Faith? The Foibles of Fairness in the Law of Close Corporations,* 16 WM. MITCHELL L. REV. 1143, 1155 (1990) (noting the distinction between the contract-like "reasonable expectations" analysis and the tort-like analysis applied to actions that might be deemed, in the language of the Minnesota statute, unfairly prejudicial).

119. *See, e.g.,* Signal Bank Nat'l Assoc. v. Kemnitz Sand & Gravel, Inc., No. C1-02-274, 2002 WL 31415422, at *4-5 (Minn. Ct. App. Oct. 29, 2002); *Pooley,* 513 N.W.2d at 838.

120. Pedro v. Pedro, 489 N.W.2d 798, 802 (Minn. Ct. App. 1992) (citing Joseph E. Olson, *A Statutory Elixir for the Oppression Malady,* 36 MERCER L. REV. 627, 629 (1985)); *see Sawyer,* 1991 WL 65320, at *2. Although reasonable expectations of employees in a closely held corporation can include continued or lifetime employment, more recent case law indicates there are limits to this "reasonable" expectation. In *Gunderson,* the court held that an expectation of continuing employment is reasonable if continuing employment was part of the shareholder's investment and was known and accepted by other shareholders, properly balanced against the majority or controlling shareholders' need for flexibility in running the business. 628 N.W.2d at 191. In *Production Resource Group, L.L.C. v. Van Hercke,* the court held that a shareholder's expectation of continued employment is not reasonable when the employee-shareholder is terminated for misconduct or incompetence or when violation of the terms of an employment agreement would justify termination for misconduct. 2004 WL 1445126, at *3. Also, in *Regan v.*

right to be bought out at full value in a section 302A.751 action.[121] The obligations imposed on closely held corporations as a result of section 302A.751 combined with the court precedent that it only takes one instance of alleged inequitable treatment to bring a section 302A.751 action creates substantial planning difficulties for practitioners and their closely held clients.

Finally, the courts in section 302A.751 cases have determined that buy-out remedies in favor of minority shareholders should not be subject to minority discounts.[122] Not applying a discount is

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Natural Resources Group, Inc., the court held that shareholder status alone is not sufficient to create a reasonable expectation of continued employment, and that written agreements among shareholders or between shareholders and the corporation should be heavily weighed to determine what are "reasonable expectations" of a shareholder. 345 F. Supp. 2d 1000, 1012-13 (D. Minn. 2004).

121. *Pedro*, 489 N.W.2d at 802-03. This is not to say that Minnesota courts will disregard an explicit agreement between the parties. In *Gunderson*, the shareholders' agreed valuation method resulted in a purchase price lower than the appraised value. 628 N.W.2d at 187. The court stated that Minnesota courts are required to honor shareholder agreements setting the purchase price of shares, unless the court determines that the price is unreasonable under all circumstances. *Id.*

122. *See, e.g.*, *Pooley*, 513 N.W.2d at 838 (citing Spinnaker Software Corp. v. Nicholson, 495 N.W.2d 441, 445 (Minn. Ct. App. 1993); MT Prop., Inc. v. CMC Real Estate Corp., 481 N.W.2d 383, 388 (Minn. Ct. App. 1992)). If a minority discount is not applied, then a 1% shareholder of a corporation worth $100 million, for example, should be entitled to 1% of $100 million without any discount—meaning that the 1% shareholder's shares are as valuable on a per-share basis as a 99% shareholder's shares. This contradicts the generally accepted principle that control of a corporation has value over and above the value of the shares that give that control—a so-called "control premium." *See, e.g.*, Paramount Commc'n Inc. v. QVC Network Inc., 637 A.2d 34, 42-43 (Del. 1994) (describing control premiums). Separate from a minority discount, but also relevant to any discussion regarding the fair value of shares subject to a buy-out remedy, is the issue of whether marketability discounts may be applied in section 302A.751 actions. A marketability discount "'adjusts for a lack of liquidity in one's interest in an entity' and should be distinguished from a minority discount, which adjusts for lack of control of the corporation." Advanced Commc'n Design, Inc. v. Follett, 615 N.W.2d 285, 291 (Minn. 2000) (quoting Balsamides v. Protameen Chem., Inc., 734 A.2d 721, 733 (N.J. 1999)). The Minnesota Supreme Court adopted the A.L.I. standard for court-ordered buyouts pursuant to section 302A.751: Absent extraordinary circumstances, fair value in a court-ordered buy-out means a pro rata share of the value of the corporation as a going concern without discount for lack of marketability. *Id.* at 292-93 (applying the general standard but holding that extraordinary circumstances required the application of a marketability discount because to do otherwise would result in an unfair transfer of wealth from the remaining shareholders to the plaintiff). A Minnesota federal court used the standard in *Advanced Communication Design* to validate a 30% marketability discount, holding that, "[a]pplication of the marketability discount would not

logical in the merger context when shareholders exercising statutory dissenters' rights have been forced out of corporations and all shareholders are receiving the same per-share merger consideration.[123] Unfortunately, these dissenters' rights cases have been used as precedent for minority discount restrictions in section 302A.751 actions despite the differences in context between a shareholder's exercise of statutory dissenters' rights and a court's imposition of a shareholder buyout sought by the shareholder under section 302A.751.[124]

Unlike the other provisions of the MBCA that are designed to promote predictability for those organizing and operating a corporation, section 302A.751 uses undefined concepts and grants of broad discretionary authority for judicial second-guessing. In this regard, section 302A.751 contains many of the negative qualities for which the authors criticize the Delaware corporate statute as a whole.[125]

E. Dissenters' Rights

Vaaler's article, *Scrap the Minnesota Business Corporation Act!*, was written in 2002.[126] At that time, he was critical of Minnesota's then-effective dissenters' rights provisions. His major criticisms fell into the following categories:

- the MBCA at that time did not contain a so-called "market out" exception in the merger context;[127]
- the MBCA affords dissenters' rights in a transaction

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result in an unfair wealth transfer to either party." *Regan*, 345 F. Supp. 2d at 1009 (citing to the buy-out provision in the company's stock purchase agreement stating that the appraiser in a buyout should apply an aggregate discount of 30%).

123. *See* COX & HAZEN, *supra* note 39, § 22.21 (discussing the rationale for the lack of a minority discount in the acquisition context and citing cases).

124. A key distinction between a merger and a court imposed shareholder buyout without a minority discount is that a court-imposed shareholder buyout could be ordered at a time when the corporation may not have liquid assets even to pay a discounted amount and is less likely to have the cash flow to pay a pro-rated portion of the total value of the corporation to the minority shareholder. Moreover, in dissenters' rights cases, the corporation has affirmatively elected to engage in a transaction that would trigger those rights.

125. *See infra* Part IV.B.

126. Vaaler, *supra* note 4.

127. That is, an exception that denies dissenters' rights in situations where the dissenter owns shares that are publicly traded and receives in exchange for those shares in the merger publicly traded shares of another corporation.

involving the sale of assets of a corporation, if the transaction requires shareholder approval under the MBCA;[128]

- the MBCA affords dissenters' rights with respect to an amendment of the articles of incorporation that materially and adversely affects the rights of dissenting shareholders with respect to preferences, voting, cumulative voting, redemption, or preemptive rights;[129]
- in addition to allowing a dissenter to be paid before all claims are resolved, the MBCA assesses costs of a demand and/or court petition against the corporation unless the dissenter's actions in exercising its rights are deemed arbitrary, vexatious and not in good faith, and authorizes a court, if it finds the corporation failed to substantially comply with the dissenters rights procedure under the MBCA, to assess against the corporation such costs of experts and attorneys as the court deems equitable;[130] and
- the MBCA did not allow a corporation to eliminate dissenters' rights for classes or series of shares in its articles of incorporation.[131]

Although several of these criticisms had merit in 2002, recent amendments to the dissenters' rights provisions of the MBCA have corrected many of the disadvantages. Amendments to the MBCA in 2004 created a market-out exception from dissenters' rights similar to that contained in the Delaware statute in the context of a stock-for-stock merger transaction involving publicly traded corporations.[132] The MBCA also now permits a corporation to eliminate dissenters' rights that are otherwise triggered by certain amendments to the articles.[133] It is true that the MBCA authorizes dissenters' rights with respect to a sale or other disposition of substantially all assets.[134] The authors feel, however, that it is more

128. MINN. STAT. § 302A.471, subd. 1(b) (2004).

129. *Id.* subd. 1(a).

130. *Id.* § 302A.473, subd. 8.

131. Vaaler, *supra* note 4.

132. *Compare* MINN. STAT. § 302A.471, subd. 3(c), *with* DEL CODE ANN. tit. 8, § 262(b) (2001).

133. MINN. STAT. § 302A.471, subd. 1(a). An amendment to the articles to eliminate those triggers for dissenters' rights itself entitles shareholders to dissenters' rights. *Id.*

134. *Id.* subd. 1(b). The statute makes an exception for dispositions for cash on terms providing that the net proceeds would be distributed to shareholders pro

difficult to defend the reasons for treating mergers and sales of substantially all assets differently under the Delaware appraisal statute than it is to defend the reasons for treating them the same under the MBCA.

From a procedural aspect, the criticisms of the Minnesota dissenters' rights statute can be justified only if viewed with an eye toward discouraging any exercise of dissenters' rights or delaying payment on the dissenting shares.[135] For instance, under the MBCA, dissenting shareholders receive what the corporation estimates to be the fair value of their shares after the later of the corporate action's effectiveness (e.g., the effective time of a merger) or after the corporation receives a valid demand for payment from the dissenting shareholder.[136] The demand for payment is not made until notice is given to shareholders who have informed the corporation of their intent to dissent and the corporation is not required to give that notice until an unspecified period after the final corporate approval (either by the board or the shareholders, as the case may be) of the action. In a merger situation, shareholders who do not dissent receive the merger consideration shortly after the merger. Why shouldn't dissenting shareholders be entitled to receive, several weeks after the merger, payment of the amount (normally the same per-share merger consideration) the corporation believes to be the fair value of the shares?[137] The authors' only criticism of the procedural aspects of

rata within a year. *Id.*

135. The procedural aspects of Delaware's appraisal statute, including substantial delays in obtaining payment for shares and the absence of an attorneys' fee provision (other than the ability of a shareholder to request that the fees incurred by the shareholder be charged pro rata against all of the shares entitled to appraisal), would seem to discourage the exercise of dissenters' rights in all but the most egregious circumstances. *See* Joseph Evan Calio, *New Appraisals of Old Problems: Reflections on the Delaware Appraisal Proceeding*, 32 AM. BUS. L.J. 1, 63 (1994) (concluding, after a review of Delaware's appraisal statute, that "the effect of liberalizing the appraisal remedy has increased the costs and length of an appraisal while diluting the Chancellor's historical power of being able to shape a remedy as equity dictates").

136. MINN. STAT. § 302A.473, subd. 5(b). With respect to a dissenter who did not become a shareholder until after the public announcement of the corporate action giving rise to dissenters' rights, no such payment need be made until the earlier of the conclusion of the court action or the dissenter's agreement to accept the corporation's estimate of fair value. *Id.*

137. The dissenting shareholder, of course, may not agree to that valuation and retains the opportunity to try to obtain a higher price. *Id.* subd. 6.

the MBCA dissenters' rights provisions is that they do not permit the corporation to recover from a dissenting shareholder any excess paid to the shareholder by the corporation as its estimate of fair value if the court later determines the fair value of the shares is less than the amount the corporation originally paid.[138]

F. Class or Series Voting

When available, class or series voting elevates the position of certain classes or series of shareholders by giving a class or series of otherwise non-voting shareholders or shareholders with an aggregate minority voting interest in the corporation a statutorily mandated veto power over a transaction. As was the case with respect to statutory dissenters' rights under the MBCA in 2002, Vaaler felt the MBCA class- and series-voting rights in 2002 were too extensive.[139]

The list of events under the MBCA provision in effect in 2002 entitled shares to class- or series-voting rights in several more events than the Delaware statute (ten listed events under the MBCA versus three under the Delaware statute).[140] The 2004 amendments to the MBCA reduce that list from ten items to eight, most importantly by the elimination of class- or series-voting rights in the event of a proposed increase or decrease in the aggregate number of authorized shares of that class or series.[141] Comparing the rough numbers (eight items versus three items triggering class- or series-voting rights) is somewhat misleading. One of Delaware's three class-voting events is the increase or decrease in the aggregate number of authorized shares of the class,[142] an item eliminated as a class-voting trigger by the 2004 amendments to the MBCA. The second class vote in Delaware is an increase or decrease in par value of the shares of the class,[143] which is not included in the MBCA because par value is not a meaningful concept under the MBCA.[144] The third "item" in the Delaware list is really a catch-all

138. *Id.* subd. 7.
139. *See* Vaaler, *supra* note 4, at 1381.
140. MINN. STAT. § 302A.137.
141. *See* Vaaler, *supra* note 4, at 1381.
142. DEL. CODE ANN. tit. 8, § 242(b)(2) (2001). This trigger for class voting may be eliminated in a corporation's original certificate of incorporation or by amendment thereto. *Id.*
143. *Id.*
144. MINN. STAT. ANN. § 302A.401 (West 2004) (Reporter's Notes, 1981).

item—any amendment to the certificate of incorporation that would "alter or change the powers, preferences, or special rights of the shares of such class so as to affect them adversely."[145] The remaining items in the MBCA that are missing in Delaware are amendments that would result in an exchange, reclassification, or cancellation of shares of the class or series or of another class or series for that class or series; combine outstanding shares of the class or series into a lesser number of shares of the class or series (i.e., a reverse stock split) in a transaction requiring a shareholder vote unless each other class and series is subject to a similar combination;[146] divide the class into series with differing rights and preferences or authorize the board to do so; create a new class or series with rights and preferences superior to the class or series by amendment to the articles of incorporation rather than through a certificate of designation authorized in the existing articles of incorporation; increase the rights and preferences or the number of authorized shares of a class or series with superior rights; limit or deny existing preemptive rights; or cancel distributions on the class or series that have accrued but have not been declared.[147] Many of those specific items arguably would be included in the Delaware catch-all for amendments to the certificate that would "alter or change the powers, preferences, or special rights of a class or series so as to affect them adversely."[148] Therefore, the class- and series-voting rights under the MBCA are not substantially broader than those under the Delaware statute.

G. *Articles and Bylaw Amendments*

Vaaler apparently believes that shareholders in Minnesota have too much power with respect to amendments of articles of incorporation.[149] He criticizes the MBCA for permitting holders of

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145. DEL. CODE ANN. tit. 8, § 242(b)(2).

146. Generally, however, a reverse stock split by a Minnesota corporation will not require a shareholder vote if the number of authorized shares of the combined class or series is proportionately decreased. *See* MINN. STAT. § 302A.402 (2004).

147. MINN. STAT. § 302A.137.

148. DEL. CODE ANN. tit. 8, § 242(b). This is one of numerous examples of provisions that are vague in the Delaware statute and therefore susceptible to uncertainty and inconsistent judicial interpretation, whereas they are dealt with precisely in the MBCA. *See infra* Part IV.A.

149. *See* Vaaler, *supra* note 4, at 1385-86.

3% or more of the voting power of the shares of a Minnesota corporation to propose amendments to the articles of incorporation even if the board of directors does not approve of the proposed amendment.[150] Under the Delaware statute, the board must approve any proposed amendment to the certificate of incorporation before the amendment can be submitted to shareholders.[151] Whether the balance of shareholder/director rights in this regard is disadvantageous is debatable depending on the interests of the parties to the debate.

Interestingly, the MBCA provides similarly for amendments to the bylaws if proposed by holders of 3% or more of the voting power of the shares of the corporation, whereas the Delaware statute suggests that the shareholders could vote to amend the bylaws even if the amendment is not proposed by either the board or shareholders with at least a minimum percentage stake.[152] In that respect, the Delaware statute shifts more toward the rights of shareholders.[153]

Vaaler is also concerned about the limitations upon the board's ability under the MBCA to unilaterally amend bylaws prescribing procedures for removing directors, filling vacancies in the board, fixing the number of directors (except to increase the number), their classifications, qualifications, or terms of office or fixing a quorum for shareholder meetings.[154] Although he is

150. *See id.* (discussing MINN. STAT. § 302A.135, subd. 2 (2002)).

151. DEL. CODE ANN. tit. 8, § 242(b).

152. *Compare* MINN. STAT. § 302A.181, subd. 3 (2004), *with* DEL. CODE ANN. tit. 8, § 109(a).

153. There is an argument under either statute, however, that amendments to the bylaws (or, in Minnesota, the articles or the bylaws) may not be made by shareholders that restrict the power of the board of directors to manage the corporation. *See* DEL. CODE ANN. tit. 8, § 141(a) (the business and affairs of a corporation shall be managed by or under the direction of the board of directors, except as otherwise provided in the Delaware statute or the corporation's certificate of incorporation); MINN. STAT. §§ 302A.111, subd. 5, 302A.181, subd. 1 (articles and bylaws may not contain provisions that are inconsistent with MINN. STAT. § 302A.201, which provides that, subject to limited exceptions, a corporation's business and affairs must be managed by or under the direction of the board of directors). *But see* Int'l Bhd. of Teamsters Gen. Fund v. Fleming Cos., 975 P.2d 907, 912 (Okla. 1999) (stating that a shareholder-proposed bylaw amendment that would prevent the board from implementing a "poison pill" without shareholder approval is permissible, despite Oklahoma statutory language comparable to that in the Delaware statute).

154. *See* Vaaler, *supra* note 4, at 1391-92 (discussing MINN. STAT. § 302A.181, subd. 2). Two other states similarly provide for certain bylaws that directors may

correct in his assessment that this statute can frustrate attempts to "clean up" bylaw provisions in these areas without going back to the shareholders, the logic of the restrictions on a board of directors' unilateral right to amend such bylaw provisions is difficult to dispute. Allowing directors to extend their own terms of office or change qualifications for directors does not appear to establish appropriate checks and balances in the governance of the corporation. The argument that shareholders can protect themselves through the ability to re-amend the bylaws at the next annual meeting is not sufficient as a practical matter. Shareholders do not tend to have that level of proactivity with respect to bylaw amendments. Indeed, Vaaler has advocated giving directors the right to unilaterally amend bylaw provisions affecting their qualifications and terms because of the difficulty of going back to the shareholders, even if the directors are proponents of the changes.[155]

H. *Indemnification*

The basic difference between the Minnesota and Delaware indemnification statutes is that the Minnesota statute generally provides for mandatory indemnification of directors, officers, committee members, and employees by the corporation and mandatory advances of expenses incurred by directors, officers, committee members, and employees in proceedings against them,[156] whereas the Delaware statute is permissive in these respects.[157] As a corollary to this distinction, the Minnesota statute does not permit indemnification of, or advances to, directors, officers, committee members, or employees unless the statutory conditions to indemnification and advances are satisfied,[158] whereas the Delaware statute on its face states that the statutory provisions are not exclusive.[159]

The MBCA generally provides that a Minnesota corporation must indemnify, among others, a present or former director or officer of the corporation against "judgments, penalties, fines, . . .

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not amend. MODEL BUS. CORP. ACT ANN. § 10.20 (2002) (statutory comparison).

155. Vaaler, *supra* note 4, at 1391-92.

156. MINN. STAT. § 302A.521.

157. DEL. CODE ANN. tit. 8, § 145.

158. MINN. STAT. § 302A.521.

159. DEL. CODE ANN. tit. 8, § 145(f).

settlements, and reasonable expenses, including attorneys' fees and disbursements, incurred by the person" in connection with threatened or pending litigation or administrative, arbitration, or investigative proceedings arising because of the person's acting as a director, officer, committee member, or employee of the corporation, if certain criteria are satisfied.[160] Those criteria in non-criminal cases are that the person:[161]

- has not been indemnified by another organization or employee benefit plan for the same payments;
- has acted in "good faith" (which is defined as "honesty in fact,"[162] without regard to whether the action that is the subject of the proceeding turns out to have been prudent);
- received no improper personal benefit from the conduct that resulted in the proceeding; and
- reasonably believed that the action that led to the pending or threatened proceeding was in the best interests of the corporation.

The determination as to whether the criteria for mandatory indemnification set forth above have been satisfied can be made under the statute only by one of the following four parties:[163]

- The board of directors of the corporation; but the board may not make the determination if 50% or more of the board members are parties to the proceeding.
- A committee of the board composed of two or more directors who are not parties to the proceeding if a quorum of the board consisting of disinterested directors cannot be obtained.
- Special legal counsel, if that counsel has never previously represented the corporation (or any parent, subsidiary, sister corporation or other related organization) or any director, officer, committee member, or employee whose indemnification is at issue.[164]
- The shareholders, provided that the shares held by parties to the proceeding are not entitled to vote on the matter or

160. MINN. STAT. § 302A.521, subd. 2(a).

161. *Id.*

162. *Id.* § 302A.011, subd. 13.

163. *Id.* § 302A.521, subd. 6. An adverse determination can be overturned by a Minnesota court, however. *Id.*

164. *See id.* subd. 19(e) (defining special legal counsel).

to be counted in determining a quorum of shareholders.[165]

The Delaware statute gives the corporation the power, but not the obligation, to indemnify, among others, an existing or former director or officer of a Delaware corporation who satisfies the following criteria in non-criminal cases:[166]

- the person acted in good faith; and
- the person reasonably believed the action to be in, or not opposed to, the best interests of the corporation.

These standards are fairly consistent with those set forth in the MBCA.[167]

The parties who determine whether the Delaware statutory standards for indemnification have been satisfied are fairly comparable to those making the decision for a Minnesota corporation:[168] (1) directors who are not parties, by a majority vote even if less than a quorum; (2) a committee of disinterested directors designated by majority vote of such directors; (3) independent legal counsel if there are no disinterested directors or if a majority of the disinterested directors so directs; or (4) the shareholders.

Although the Minnesota statute arguably is more beneficial to directors and officers because indemnification is mandatory if the statutory standards are satisfied, in practice there is little difference. Delaware corporations generally will provide in their certificates of incorporation, bylaws, or indemnification agreements with directors and officers that the corporation must indemnify its directors and officers to the fullest extent permitted by Delaware law.

The Minnesota statute, however, clearly is beneficial to

165. The MBCA includes procedures for court relief if an adverse determination is made or no determination is made within a stated period. *Id.* subd. 6(a)(5). The Delaware statute, in contrast, is silent regarding the rights of one seeking indemnification in such a situation. This is one of the reasons that Delaware corporations often have indemnification agreements and more detailed charter or bylaw provisions regarding indemnification than Minnesota corporations.

166. DEL. CODE ANN. tit. 8, § 145(a) (2001).

167. From the standpoint of strict logic, it should be easier to satisfy the standard in Delaware that the allegedly actionable behavior was reasonably believed not to be opposed to the best interests of the corporation than the standard in Minnesota that the behavior was reasonably believed to be in the best interests of the corporation.

168. DEL. CODE ANN. tit. 8, § 145(d).

directors and officers with respect to derivative actions. For Minnesota corporations, indemnification for payments in those actions is treated the same as in any other proceeding, except that indemnification amounts paid in any derivative action must be reported to the shareholders of a Minnesota corporation in writing not later than the next meeting of shareholders.[169] The Delaware statute, on the other hand, precludes indemnification of directors and officers for settlement payments and judgments arising out of derivative actions, and permits payment of a director's or officer's expenses in such a derivative action in which the person has been adjudicated to be liable only if a court determines that such person is fairly and reasonably entitled to indemnity for such expenses.[170]

While the Delaware statute is arguably more beneficial to directors and officers because it expressly provides that it is not exclusive of any other indemnification rights,[171] any such indemnification rights would nevertheless be subject to the public policy determinations underlying the statutory limitations.[172] Although indemnification agreements can be used to make permissive indemnification mandatory under the Delaware non-exclusivity provision or to establish indemnification procedures that are not covered at all in the statute, the courts have expressly determined that it cannot be used to avoid the statutory standards for indemnification, such as good faith.[173]

With respect to indemnification itself, there thus do not appear to be significant advantages to being governed by the Minnesota or Delaware statute. With respect to payment or reimbursement by the corporation for expenses of a director or officer before a final determination regarding indemnification, the director or officer clearly is better off being with a Delaware corporation.[174] Under the Delaware statute, such advances may be

169. MINN. STAT. § 302A.521, subds. 1(d), 8.

170. DEL. CODE ANN. tit. 8, § 145(b).

171. *Id.* § 145(f).

172. R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS § 4.26 (3d ed. Supp. 2004).

173. *See, e.g.*, Waltuch v. Conticommodity Servs., Inc., 88 F.3d 87, 90-95 (2d Cir. 1996) (holding that section 145 of the Delaware statute does not confer authority on a corporation to indemnify an officer who did not act in good faith, regardless of section 145(f)); Vonfeldt v. Stifel Fin. Corp., No. Civ.A. 15688, 1999 WL 413393, at *2 (Del. Ch. June 11, 1999) (reiterating the *Waltuch* holding).

174. While the MBCA provides for mandatory payment of such expenses if the statutory standards are satisfied, the Delaware statute provides that a corporation

made before the final disposition of the proceeding upon receipt of an undertaking by or on behalf of the director or officer to repay the amounts advanced if it ultimately is determined that the person has not satisfied the statutory standards for indemnification.[175] Under the MBCA, such advances must be made (not only to officers and directors but also to employees and committee members unless the articles of incorporation or bylaws expressly preclude advances to them), but there are three prerequisites:[176]

- The person receiving the advance must make a written undertaking of the nature required under the Delaware statute to repay all advances if it is ultimately determined that the statutory standards for indemnification have not been satisfied.
- The person receiving the advance must affirm in writing a good faith belief that the statutory standards for such person's indemnification have been satisfied.
- One of the parties entitled to make the final determination as to whether the indemnification criteria have been satisfied must determine that the facts then known to that party would not preclude indemnification under the MBCA.

The last criterion for advances under the MBCA is becoming more difficult to satisfy as a practical matter. The reason is that plaintiffs' attorneys today are more prone to sue all directors, particularly in derivative actions, for actions that do not personally benefit outside directors.[177] This precludes any board or committee members from approving the advances under the MBCA and effectively requires many corporations to select a special legal counsel earlier in the proceeding than seems prudent. Moreover, it frequently is difficult to find a special legal counsel that fulfills the statutory requirement in Minnesota that the counsel must not have ever represented the corporation or a related organization or any director, officer, member of a committee, or employee whose

may provide such advances. Nevertheless, the certificate of incorporation, bylaws, or indemnification agreements of a Delaware corporation generally will negate this disadvantage by providing for advances of expenses to directors and officers to the fullest extent permitted by law.

175. DEL. CODE ANN. tit. 8, § 145(e).

176. MINN. STAT. § 302A.521, subd. 3 (2004).

177. For example, innocent accounting errors resulting in restatements of financial statements.

indemnification is at issue.

On balance, the authors do not believe that the differences in indemnification merit incorporation in Delaware over incorporation in Minnesota or vice versa.

Just as the MBCA has its advantages over the Delaware statute, there are a number of areas in which the Delaware statute is preferable. An objective analysis of the purported advantages of Delaware, however, shows that some are not advantages at all and that others are not as advantageous as many believe.

IV. COMPARATIVE CODIFICATION

The most important and far-reaching difference between the MBCA and other similar state corporate statutes, on the one hand, and their Delaware counterpart, on the other, is the level of codification of corporate law in the statutes. This section discusses the different philosophies regarding the codification of corporate law underlying these corporate statutes, and the various impacts they have on key corporate stakeholders. The MBCA and similar statutes are much more detailed and extensive in scope than the Delaware statute and include more precise definitions of terms used in the statutes. The Delaware philosophy has generally been to create a minimalist statute and leave to the courts the responsibility for filling in the gaps. The authors believe that this comparison of these statutes favors the MBCA and its counterparts in other states over Delaware.

A. *Increased Codification Under the MBCA Versus Delaware*

1. *Standard of Conduct for Directors and Officers*

The different philosophies regarding the level of codification of corporate law of the two states manifests itself in the basic standard of conduct for directors and officers of Minnesota and Delaware corporations. The MBCA expressly sets forth the standard of conduct for directors. It provides that a director shall discharge his or her duties "in good faith, in a manner the director reasonably believes to be in the best interests of the corporation, and with the care an ordinarily prudent person in a like position would exercise under similar circumstances."[178] The statutory standard for officers is identical to that for directors.[179] Delaware has no statutory definition of the standard of conduct of directors or officers, thereby defaulting to the courts to develop the standard.

2. *Statutory Definition of Good Faith*

The concept of good faith is a basic element of the standard of conduct for directors and officers and is central to their protection through statutory indemnification and exculpation. Directors and officers cannot satisfy their fiduciary duties under the MBCA unless they act in good faith.[180] A Minnesota corporation cannot indemnify a director or officer who is determined not to have acted in good faith.[181] Moreover, a Minnesota corporation may, in its articles of incorporation, eliminate a director's personal liability to the corporation and its shareholders for monetary damages for breach of fiduciary duties, but may not eliminate liability *for acts or omissions not in good faith.*[182] "Good faith" is expressly defined in the MBCA as "honesty in fact in the conduct of the act or transaction concerned"[183] such that a director or officer will be deemed to have acted in good faith in taking an action he or she honestly, although perhaps not reasonably, believed was in the corporation's best interests.

In contrast, although the Delaware statute requires good faith for indemnification of officers and directors[184] and for liability of directors for monetary damages in certain circumstances to be eliminated in a corporation's certificate of incorporation,[185] it does not define good faith—leaving that important concept to interpretation by the courts.

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178. MINN. STAT. § 302A.251, subd. 1.

179. *Id.* § 302A.361. Interestingly, the standard of conduct for directors provides that a director who performs those duties is not liable by reason of being or having been a director of the corporation, whereas section 302A.361 contains no comparable provision with respect to officers. The authors presume this is simply an oversight, and it seems clear that officers who satisfy the statutory standard, like directors, would not be liable.

180. *Id.* §§ 302A.251, subd. 1, 302A.361.

181. *Id.* § 302A.521, subd. 2.

182. *Id.* § 302A.251, subd. 4 (emphasis added).

183. *Id.* § 302A.011, subd. 13.

184. DEL. CODE ANN. tit. 8, § 145(a) (2001).

185. *Id.* § 102(b)(7).

3. *Multiple-Constituency Statute*

While both the MBCA and Delaware case law require directors to act in what they believe are the best interests of the corporation, only the MBCA clearly defines which corporate constituencies may be taken into account in making that determination. The MBCA specifically authorizes directors, in considering the best interests of the corporation in discharging their duties, to consider the interests of the corporation's employees, customers, suppliers, and creditors, the economy of the state and nation, community and societal considerations, and the long-term as well as short-term interests of the corporation and its shareholders, including the possibility that these interests may be best served by the continued independence of the corporation.[186] The Delaware statute provides no guidance in this regard.[187]

4. *Asset Transfers*

In addition to codifying directors' and officers' duties and more precisely establishing their protections from liability and monetary obligations, the MBCA much more clearly provides a legal roadmap to directors, officers, and shareholders regarding the permissibility of extraordinary corporate actions such as sales of substantial assets and mergers.[188] The MBCA provides important guidance regarding which dispositions of assets can be effected by a Minnesota corporation without a shareholder vote.[189] It specifically states that no shareholder approval is necessary to transfer assets to a wholly owned subsidiary.[190] The Delaware legislature finally

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186. MINN. STAT. § 302A.251, subd. 5 (2004).

187. Delaware relies upon case law to guide directors' considerations about what is in the best interests of the corporation. The *Revlon* court interpreted some earlier statements in *Unocal* as holding that, except in the context of a sale or break-up of the company, a board may consider non-shareholder constituencies so long as there are rationally related benefits to the shareholders in doing so. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) (citing Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985)); *see infra* Part IV.B.1.c. (discussing the *Revlon* line of cases).

188. MINN. STAT. §§ 302A.661, 302A.601, subd. 1.

189. *Id.* § 302A.661, subds. 1, 2.

190. *Id.* subd. 1. This language is similar to the Model Business Corporation Act. MODEL BUS. CORP. ACT § 12.01(3) (2005) ("No approval of the shareholders of a corporation is required, unless the articles of incorporation otherwise provide: . . . to transfer any or all of the corporation's assets to one or more corporations or other entities all of the shares or interests of which are owned by the

followed suit by adopting a similar provision in 2005,[191] more than ten years after adoption of the Minnesota statute.

The 2004 amendments to the MBCA provided additional guidance in determining whether a particular disposition by a Minnesota corporation of substantial assets to a party, other than a wholly owned subsidiary, is a disposition "of all or substantially all of its property and assets . . . not in the usual and regular course of its business" necessitating a shareholder vote.[192] Those amendments established a safe harbor for transfers that do not trigger the voting requirement. The safe harbor permits dispositions without a shareholder vote if the corporation "retains a significant continuing business activity."[193] A "significant continuing business activity" is one that represents at least (1) 25% of the corporation's consolidated total assets at the end of the most recently completed fiscal year and (2) 25% of either consolidated income from continuing operations before taxes or consolidated revenues from continuing operations for that fiscal year.[194] Delaware corporations are not beneficiaries of such a clear test. Instead, what constitutes "all or substantially all" of a Delaware corporation's assets is again left to the courts to interpret on a case-by-case basis.[195]

5. *Business Purpose for Mergers*

At the time the MBCA was enacted, the Delaware courts were struggling to determine whether a merger that eliminated minority shareholders who did not vote for the merger should be permissible even if there was no valid "business purpose" for the merger.[196] The MBCA expressly eliminated this area of uncertainty by providing that two or more corporations may merge "with or

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corporation.").

191. *See* DEL. CODE ANN. tit. 8, § 271(c) (2001 & Supp. 2005) (amended by 75 Del. Laws ch. 30 (2005)).

192. MINN. STAT. § 302A.661, subd. 2(a).

193. *Id.* subd. 2(b).

194. *Id.*

195. *See* Hollinger Inc. v. Hollinger Int'l, Inc., 858 A.2d 342, 385 (Del. Ch. 2004) ("Although by no means wholly consistent, [section 271] case law has, by and large, refused to find that a disposition involved substantially all of the assets of a corporation when the assets that would remain after the sale were, in themselves, substantial and profitable."). *See infra* Part IV.B.2.

196. *See infra* Part IV.B.1.e.

without a business purpose" upon receiving the requisite board approval and shareholder vote.[197] The Delaware courts flip-flopped, at first requiring a business purpose and then holding that a business purpose is not required for a parent-subsidiary merger.[198]

6. *Revaluation of Surplus for Dividend, Stock-Repurchase Purposes*

Another basic area of corporate law relates to the permissibility of distributions of cash or other property to shareholders in establishing the relative rights of creditors, preferred shareholders, and holders of common stock. Limitations on dividends and stock repurchases based on a corporation's net assets arise under the MBCA only if the corporation has outstanding preferred stock.[199] In that event, the dividend or repurchase is permitted only if all amounts payable to shareholders having a preference for that kind of distribution are made and the payment on the junior stock does not reduce the remaining net assets of the corporation below the aggregate preferential amount payable in the event of liquidation to the holders of preferred stock.[200] The statute specifically provides that the determination of the "net assets" remaining after the distribution can be made "on the basis of financial information prepared in accordance with accounting methods, or a fair valuation, or other methods, reasonable in the circumstances."[201] As stated in the Reporter's Notes, this provision:

> authorizes departures from historical cost accounting and sanctions the utilization of appraisal methods for the purpose of determining the fund available for distributions. . . . In most cases, a fair valuation method on a going concern basis would likely be appropriate, if expectations are that the enterprise will continue as a viable going concern.[202]

For Delaware corporations, the issue of how "net assets" should be valued for purposes of the "surplus" test is much more important than for Minnesota corporations because the existence

197. MINN. STAT. § 302A.601, subd. 1.
198. *See infra* Part IV.B.1.e.
199. MINN. STAT. § 302A.551, subd. 4.
200. *Id.*
201. *Id.*
202. MINN. STAT. ANN. § 302A.551 (West 2004) (Reporter's Notes, 1981, General Comment).

of sufficient "net assets" in excess of "capital" (i.e., surplus) is necessary for a Delaware corporation to declare and pay dividends (except to the extent it has or had net profits for the current or immediately preceding year) or repurchase stock, even if the corporation has no outstanding preferred stock.[203] Nevertheless, there is nothing in the Delaware statute that specifically authorizes the revaluation of assets to their fair market value on a going-concern basis or otherwise, thereby creating some uncertainty as to the flexibility available to the board of directors to determine "net asset" value. Although the Delaware courts have attempted to fill this void,[204] the Delaware legislature could have saved practitioners a substantial amount of anguish in this fundamental area had it followed the approach taken in the MBCA.

7. *Stock Split Without a Shareholder Vote*

Nothing contained in most corporate statutes would preclude a corporation from granting a pro rata stock dividend payable in shares of a corporation's stock to holders of shares of that class of stock, presuming, of course, the corporation has sufficient authorized but unissued shares of that class of stock under its charter to issue the dividend.[205] Unlike other dividends, these involve no transfer of cash or other property constituting corporate assets from the corporation to its shareholders.

A more uncertain issue under the corporate law of most states, including Delaware, is whether a board can *unilaterally* divide outstanding shares of a class of stock into more shares (i.e., a

203. *See* DEL. CODE ANN. tit. 8, § 170 (2001) (providing a dividend may be paid to shareholders out of "either (1) a surplus, as defined and computed in accordance with §§ 154 and 244," or (2) "net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year"); DEL. CODE ANN. tit. 8, § 160(a)(1) (providing that a corporation may not repurchase its own shares if the repurchase would impair the capital of the corporation).

204. *See, e.g.*, Klang v. Smith's Food & Drug Ctrs., Inc., 702 A.2d 150, 154 (Del. 1997) (permitting a board of directors to revalue assets in the stock-repurchase context); Morris v. Standard Gas & Elec. Co., 63 A.2d 577, 585 (Del. Ch. 1949) (holding that boards of directors have some flexibility in revaluing assets to their fair market value for the purpose of determining the validity of dividends).

205. Minnesota Statutes section 302A.405, subdivision 1(b), provides, however, that a dividend of shares of a class or series of stock to holders of another class or series of stock is not permitted unless expressly provided for in the corporation's articles of incorporation or approved by the holders of a majority of the voting power of all shares of the class or series the shares of which would be issued as dividends.

forward stock split) or *unilaterally* combine outstanding shares of a class of stock into fewer shares (i.e., a reverse stock split) on a pro rata basis. In most states, shares with par value cannot be divided into more, or combined into fewer, shares with a greater or lesser par value per share because changing per-share par value necessitates an amendment to the corporate charter, which requires a shareholder vote. This does not necessarily resolve the issue of whether all forward or reverse stock splits require a shareholder vote because the shares being split might not have par value and shares with par value arguably could be split or combined without splitting or combining par value per share.[206]

The MBCA resolves these uncertainties. It not only specifically authorizes the board of directors to issue stock dividends without a shareholder vote,[207] but also permits a board of directors to unilaterally authorize share divisions or combinations without a shareholder vote, subject to certain exceptions.[208] The statute also specifically permits the board, as part of a unilateral stock split, to unilaterally amend the articles of incorporation without a shareholder vote to increase or decrease the number of authorized shares, to increase or decrease par value, and to "make any other change necessary or appropriate to assure that the rights or preferences of the holders of outstanding shares of any class or series will not be adversely affected by the division or combination."[209] Allowing such unilateral board amendments to

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206. For example, a two-for-one stock split arguably could double the number of outstanding shares and the aggregate par value of all outstanding shares without changing par value per share.

207. MINN. STAT. § 302A.402, subd. 3(a) (2004).

208. *Id.* Such unilateral "splitting" cannot be effected if the rights or preferences of the holders of outstanding shares of any class or series will be adversely affected. *Id.* subd. 2(a). An increase or decrease in the relative voting rights of the shares being split or combined arising solely from the increase or decrease in the number of shares outstanding is deemed not to constitute an adverse effect on the outstanding shares of any class or series, however. *Id.* subd. 4. In addition, the MBCA specifically requires shareholder approval for stock splits if the percentage of authorized shares of any class or series remaining unissued after the split will exceed the percentage of authorized shares of that class or series that were unissued before the split (which would be the case in the event of a reverse stock split if the number of authorized shares is not proportionately reduced). *Id.* subd. 2(a). As a result, a corporation with 10,000 authorized shares of which 5000 shares are outstanding could effect a one-for-five reverse stock split without a shareholder vote only if it simultaneously reduces its authorized shares from 10,000 to 2000.

209. *Id.* subd. 3(a).

increase the number of authorized shares permits a board to effect a stock split even if the corporation does not, prior to the unilateral amendment, have sufficient authorized but unissued shares to effect a stock split or to issue a stock dividend.

8. *Broker Non-Votes*

In addition to providing statutory guidance in the areas of director and officer conduct and protection from liability, extraordinary transactions such as mergers and sales of substantial assets, and distributions to shareholders, the MBCA provides precision in determining the requirements for shareholder voting. The MBCA generally permits shareholder action by holders of a "majority of the voting power of the shares present and entitled to vote on that item of business" or such larger proportion or number set forth in the MBCA or the corporation's articles of incorporation.[210] Similarly, in the absence of a provision in the certificate of incorporation or bylaws to the contrary, the affirmative majority vote of the shares of a Delaware corporation present in person or represented by proxy and entitled to vote on the subject matter generally is required for shareholder action.[211]

In Delaware, there is no statutory provision determining whether a so-called "broker non-vote"—a written proxy granting a person the right to vote the shares of a shareholder on certain matters but withholding from the person the power to vote the shareholder's shares on other matters—causes the grantor's shares

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210. MINN. STAT. § 302A.437, subd. 1. The exact statutory requirement is:

> the shareholders shall take action by the affirmative vote of the holders of the greater of (1) a majority of the voting power of the shares present and entitled to vote on that item of business, or (2) a majority of the voting power of the minimum number of the shares entitled to vote that would constitute a quorum for the transaction of business at the meeting, except where [the MBCA] or the articles require a larger proportion or number.

Id. In most contexts, clause (2) of the requirement does not come into play.

211. DEL. CODE ANN. tit. 8, § 216 (2001). Both Minnesota and Delaware provide that directors are elected by a plurality vote. DEL. CODE ANN. tit. 8, § 216; MINN. STAT. § 302A.215, subd. 1. The statutes of both states provide for a higher approval threshold—a majority of the outstanding shares entitled to vote—for certain extraordinary corporate actions. *See, e.g.,* DEL. CODE ANN. tit. 8, § 251(c) (mergers) (2001 & Supp. 2004); MINN. STAT. § 302A.613, subd. 2. *But see* DEL. CODE ANN. tit. 8, § 242(b)(1) (majority of outstanding shares required for such an amendment); MINN. STAT. § 302A.135, subd. 2 (no higher voting threshold for amendment of corporate charter).

to be represented by proxy and entitled to vote on the matters with respect to which the person holding the proxy had no authority to vote.[212] The MBCA, on the other hand, specifically provides that if a proxy is given authority by a shareholder to vote on less than all items of business, the shareholder is considered to be present and entitled to vote by proxy, for purposes of the majority-vote requirement, only with respect to those items of business for which the proxy has authority to vote.[213] Minnesota has therefore clearly provided in its corporate statute that shares subject to a broker non-vote on an item of business are not present and entitled to vote on that item of business (i.e., are not included in the denominator for purposes of determining whether holders of a majority of the voting power of the shares present and entitled to vote has approved that item of business) even though the broker has voted on a discretionary basis on other items of business such as the uncontested election of directors.[214] Once again, Delaware's legislature left that decision to the courts.[215]

9. *Shareholder Action in Lieu of Board of Directors*

In many closely held corporations, including wholly owned subsidiaries, the ability of holders of all the corporation's voting shares to take an action that the state corporate statute reserves to the board of directors remains uncertain. Nothing in the Delaware

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212. *See* DEL. CODE ANN. tit. 8, § 212(c). Section 212(c) does not limit the manner in which a shareholder may authorize another person or persons to act for the shareholder as proxy, and section 216 sets the default quorum standard as the majority of shares entitled to vote, present or in person by proxy, without describing the effect of a proxy that is limited to votes on certain proposals occurring at the meeting. Broker non-votes arise from rules that prohibit broker-dealers holding shares in "street name" from voting on certain "non-routine" proposals absent voting instructions from the beneficial owner. *E.g.*, NYSE Rule 452, http://rules.nyse.com/nysetools/Exchangeviewer.asp?SelectedNode=chp_1_1&manual=/nyse/nyse_rules/nyse-rules/ (last visited Dec. 1, 2005).

213. MINN. STAT. § 302A.449, subd. 8.

214. As a result, a shareholder action of a Minnesota corporation with 1000 outstanding shares of which 400 are voted in favor of the item, 200 are voted against it, and 300 are broker non-votes, will be deemed to have passed if a majority vote of shares present and entitled to vote are needed to approve it.

215. *See* Berlin v. Emerald Partners, 552 A.2d 482, 491-94 (Del. 1989) (reaching a result similar to what the MBCA expressly provides: shares represented by a limited proxy are deemed present for quorum purposes, but are not deemed present and entitled to vote with respect to proposals for which the proxy has no authority to vote).

statute specifically authorizes such a shareholder action.[216] Under the MBCA, however, the holders of all shares entitled to vote for directors may unanimously take any action in lieu of the board of directors.[217] This flexibility is especially useful for wholly owned subsidiaries where it might be impracticable to quickly locate all of the subsidiary's directors (who are often senior executives of the parent corporation) but relatively easy to locate an authorized officer of the parent corporation who can approve the action in lieu of the subsidiary board. In addition, the MBCA specifically authorizes all shareholders and subscribers to enter into written agreements with the corporation concerning the control of any phase of the business and affairs of the corporation, its liquidation and dissolution, and relations among shareholders and subscribers.[218] Such a shareholder control agreement may supersede, to the extent provided in the agreement, the rights of the board to manage the business and affairs of the corporation.[219]

10. Elimination of Fractional Shares

In addition to eliminating minority shareholders through merger, a process which led to a reversal of the Delaware courts' position concerning whether a merger needed to have a business purpose,[220] corporations may desire to eliminate smaller shareholders without their consent through a reverse stock split in which shares of each such shareholder become a single fractional share, which is then cashed out without the shareholder's consent. For instance, if a corporation has numerous shareholders holding less than 100 shares, it could effect a 1-for-100 reverse stock split, cash out each fractional share, and thereby eliminate all shareholders who previously held less than 100 shares. This

216. If the corporation elects in its certificate of incorporation to be a close corporation subject to subchapter XIV of the Delaware statute, however, the corporation may then also provide in its certificate of incorporation that the corporation will be managed by the shareholders rather than by a board of directors. DEL. CODE ANN. tit. 8, § 351.

217. MINN. STAT. § 302A.201, subd. 2.

218. MINN. STAT. § 302A.457. Shareholders of a Delaware corporation electing in its certificate of incorporation to be a close corporation may, by written agreement of a majority of the outstanding shares entitled to vote, restrict the powers of the board of directors in the conduct of the business and affairs of the corporation. DEL. CODE ANN. tit. 8, § 350.

219. MINN. STAT. § 302A.201, subd. 1.

220. *See supra* Part IV.A.5.

process is potentially more disadvantageous to the smaller shareholders than a "freeze-out" merger because no dissenters' rights are available.[221] In most states, including Delaware, the extent to which such a reverse stock split may be used to eliminate shareholders is uncertain.[222] The MBCA codifies the limitations upon freeze-outs of minority shareholders through a reverse stock split, providing a bright-line test for determining the validity of the action. It states that a corporation may not pay money for fractional shares if that action would result in cancellation of more than 20% of the outstanding shares of a class or series.[223]

B. *Precedential (Un)Predictability of Delaware Corporate Law*

As the previous section demonstrates, substantially more corporate legal issues can be resolved within the four corners of the MBCA and similar statutes than within the four corners of the Delaware statute. However, increased codification of a state's corporate laws does not necessarily establish the superiority of those laws. Proponents of the Delaware statute argue that leaving most corporate law matters to the courts rather than codifying them increases the flexibility of the Delaware statute and fosters an evolving corporate law.[224]

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221. *See supra* Part III.E.

222. In *Applebaum v. Avaya, Inc.*, the shareholders authorized the board to effect one of three alternative reverse stock splits (1-for-30, 1-for-40, or 1-for-50) to eliminate shareholders that would own less than one share after the split. 812 A.2d 880, 883 (Del. 2002). The primary purpose was to eliminate millions of very small public shareholders to save very substantial printing and mailing costs. *Id.* at 883. The court upheld the split even though it did not eliminate fractional shares of those who would own more than one share after the reverse stock split. *Id.* at 886-87. It did not resolve the issue, however, of whether the court would have permitted a reverse split that would have eliminated very substantial shareholders in such numbers as would have enabled the corporation to cease being a public corporation. *See id.*

223. MINN. STAT. § 302A.423, subd. 2. As the Reporter's Notes state: "This prohibition protects shareholders against excessive abuse of the power granted by subdivision 1(b) [to cash-out fractional shares] where many or most of the shares are fractional interests due to an unusual ration [sic] of exchange, or where the price of one share is unusually high or where controlling interests have issued only fractional shares." MINN. STAT. ANN. § 302A.423 (West 2004) (Reporter's Notes, 1981, General Comment (c)).

224. *See, e.g.*, Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1064 (2000) (describing "the unique law making function of the Delaware courts" as an explanation for Delaware's success in attracting corporations); E. Norman Veasey & Christine T. Di

The purported increase in flexibility comes at a price: a lack of predictability for corporations attempting to comply with Delaware law. This is particularly the case because of the tendency of the Delaware courts to reverse (or at least significantly alter) course, the frequent unexplained and unacknowledged inconsistencies in court decisions, and ambiguities in certain major decisions.[225] Despite the vast number of corporate law decisions in Delaware, it is notable that many aspects of corporate law that are codified in the MBCA and other state corporate statutes have never been dealt with definitively by the Delaware courts or were clarified many years after practitioners tried to glean the meaning from the Delaware statute.[226] As was stated more than ten years ago in an article regarding then-recent decisions involving fiduciary duties of directors of Delaware corporations:

> [P]redicting developments in Delaware law has always been a somewhat foolish enterprise. Many learned commentators have written careful and lucid analyses predicting the trend of Delaware case law, only to have doctrinal prognostications shattered by the next big case. Predicting the course of Delaware law from prior case law is like watching clouds. They seem, at times, to take on recognizable shapes and forms, even to resemble something familiar. But you know that whatever shapes you think you see can vanish in a puff of wind.[227]

The last decade of Delaware court decisions has not discredited this apt analogy.[228]

Some assert that more extensive case law, such as in Delaware, may create greater predictability and certainty in the law, which

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Guglielmo, *What Happened in Delaware Corporate Law and Governance From 1992-2004? A Retrospective on Some Key Developments*, 153 U. PA. L. REV. 1399, 1412-13 (2005) (praising Delaware's flexible, indeterminate system over more codified models of corporate law).

225. *See* Veasey & DiGuglielmo, *supra* note 224, at 1404.

226. E. Norman Veasey, *An Economic Rationale for Judicial Decisionmaking in Corporate Law*, 53 BUS. LAW. 681, 696-700 (1998). Norman Veasey, the Chief Justice of the Delaware Supreme Court from 1992 to 2004, noted the difficulty of creating a legal system that is both predictable and evolving in stating: "Case law should be reasonably stable, predictable, and dynamic. It is obvious . . . that there is a tension between dynamism and stability in the development of the case law." *Id.* at 688-89.

227. Lawrence A. Cunningham & Charles M. Yablon, *Delaware Fiduciary Law After* QVC *and* Technicolor*: A Unified Standard (and the End of* Revlon *Duties?)*, 49 BUS. LAW. 1593, 1626 (1994).

228. *See infra* Part IV.B.1-3.

may be a very important reason for preferring Delaware as the state for incorporation.[229] While the high number of Delaware corporations plays a role in Delaware's extensive case law, the abundance of case law can also be attributed to the uncertainty of Delaware law, with its limited codification and frequently changing nature, which does not give potential litigants sufficient precedential guidance to resolve their differences without resorting to litigation. Examples of such inconsistencies and unpredictability abound in Delaware case law; the following are specific examples in key areas.

1. *Directors' Fiduciary Duties and Liabilities*

a. *General*

One of the most basic aspects of corporate law is providing guidance regarding a director's fiduciary duties. Because those duties are not spelled out in the Delaware statute, it is necessary to decipher them based on an examination of a number of Delaware cases. This effort is made more difficult because of the uncertain relationship between the duties of a director of a Delaware corporation and the liability of a director who does not satisfy those duties. As three current and former judges of the Delaware Court of Chancery noted in their seminal article in the area, "[t]here exists a close, but not perfect, relationship, between the standard by which [Delaware] courts measure director liability (the 'standard of review') and the standard of behavior that we normatively expect of directors (the 'standard of conduct')."[230]

A review of the case law suggests that the standard of conduct in Delaware may be comparable to the statutory standard of conduct under the MBCA. Under Delaware law, directors

229. Commentators and practitioners frequently equate the amount of case law in Delaware with clear delineation of the law as a result of the quantity of cases. *See, e.g.*, William H. Rehnquist, *The Prominence of the Delaware Court of Chancery in the State-Federal Joint Venture of Providing Justice*, 48 BUS. LAW. 351, 354 (1992) ("Corporate lawyers across the United States have praised the expertise of the [Delaware] Court of Chancery, noting that since the turn of the century, it has handed down thousands of opinions interpreting virtually every provision of Delaware's corporate law statute. No other state court can make such a claim.").

230. William T. Allen et al., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, 1295 (2001).

apparently have the duty to act in good faith, in a manner the directors "honestly" believe to be in the best interests of the corporation, and with due care.[231] If that is the standard, it arguably, at least on its face, would be a lesser standard because the Minnesota statute requires that the directors act in a manner that they reasonably, rather than honestly, believe is in the corporation's best interests.[232] Otherwise, the standards are consistent in that they include a duty of loyalty (i.e., to act in what the directors believe to be the best interests of the corporation), a duty of care, and a "good faith" requirement.

The Delaware courts, however, have expanded on these duties or, perhaps more accurately, divided them into sub-duties to fit certain fact situations. For instance, in the *Caremark* case, the court established a "duty of oversight" within the duty of care, which requires directors "to attempt in good faith to assure that a corporate information and reporting system, which the board

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231. This is actually the standard under the "business judgment rule"—a standard of review, not a standard of conduct. *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (setting forth the elements of the business judgment rule). With regard to the general duties of care and loyalty, the Delaware courts have seemed to use standards of conduct and standards of review interchangeably. *See, e.g., In re* NCS Healthcare, Inc. S'holders Litig., 825 A.2d 240, 257 (Del. Ch. 2002), *rev'd on other grounds sub nom.* Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914 (Del. 2003) ("The applicable *standard of conduct* when deciding whether directors have properly exercised their duty of care is whether they acted with 'gross negligence,' and whether they were adequately informed at the time they made their decision. This is the business judgment *standard of review.*") (emphasis added, footnote omitted).

232. The authors believe, however, that the standards of conduct and liability in Minnesota and Delaware are probably similar. Presumably, the duty of directors in Minnesota and Delaware is to act reasonably but the standard of review (or avoidance of liability) is a lesser standard—that the directors were not grossly negligent or, put another way, that they acted rationally or within a range of reasonableness. Despite Minnesota Statutes section 302A.251, which states that a director performing his or her statutory "duties" is not liable by reason of being or having been a director of the corporation, the authors believe the provision to be a safe harbor and that a director exercising "rational" business judgment would not be liable despite failing to act in what he or she "reasonably" believed to be in the best interests of the corporation as long as the director "honestly" believed his or her conduct was in the corporation's best interests. Janssen v. Best & Flanagan, 662 N.W.2d 876, 882 (Minn. 2003) (citing DENNIS J. BLOCK, ET AL., THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS 18 (5th ed. 1998)) ("The business judgment rule means that as long as the disinterested director(s) made an informed business decision, in good faith, without an abuse of discretion, he or she will not be liable for corporate losses resulting from his or her decision.").

concludes is adequate, exists" that is "reasonably designed to provide to senior management and to the board itself timely, accurate information sufficient to allow management and the board, each within its scope, to reach informed judgments concerning both the corporation's compliance with law and its business performance."[233] In *Revlon* and successor cases in the merger context, discussed in more detail below, the courts established that a board of directors, when approving the sale of the corporation, must act reasonably to obtain the best price it can reasonably obtain in the sale.[234] Moreover, in *Unocal,* the Delaware Supreme Court required that when a board considers defensive tactics in the face of a corporate takeover attempt, it has a duty, before adopting those tactics, to determine that, if the takeover succeeds, a reasonable threat exists to corporate policies and effectiveness: it must then take only actions that are not draconian and are reasonably proportionate responses to the threat.[235]

The standard of conduct for directors of Delaware corporations established through case law generally has not caused major problems for practitioners or directors. The basic standard is similar to that set forth in the MBCA, and the subcategories of duties of oversight and duties in connection with the adoption of defensive takeover tactics have been well established. Courts have consistently followed the seminal cases: *Caremark* and *Unocal.*[236] It is likely that those same subcategories of duties would be presumed by Minnesota attorneys to be imposed in oversight and defensive tactic cases pursuant to the general standard of conduct in the MBCA. The *Revlon* line of cases, on the other hand, shows the fallacy of creating a standard of conduct one case at a time in the context of sales of corporate control.

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233. *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996).

234. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 184 (Del. 1986); *see* discussion *infra* Part IV.B.1.c. *Revlon* suggests that the general duty may be, like Minnesota's, to act in a manner the director reasonably, rather than honestly, believes to be in the best interests of the corporation.

235. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954-55 (Del. 1985). The second prong of the two-prong *Unocal* test was clarified in *Unitrin, Inc. v. American General Corp.*, which held that a defensive measure is "draconian" if it is either "preclusive" or "coercive" and that a non-draconian defensive measure must only fall within a "range of reasonableness" to withstand scrutiny under *Unocal.* 651 A.2d 1361, 1387-89 (Del. 1995).

236. *See Revlon*, 506 A.2d 173; *Unocal*, 493 A.2d 946; *Caremark*, 698 A.2d 959.

The primary problem with the Delaware cases, other than the *Revlon* line of cases, relates not to the standard of conduct for directors but rather to the liability of directors who do not satisfy the standard of conduct. To try to make logical sense of the Delaware law relating to directors' liability, it is necessary to address three separate but interrelated areas: (1) determination of the initial liability of directors who fail to satisfy the Delaware standard of conduct, (2) the exculpation from monetary liability of directors under charter provisions authorized by the Delaware statutes, and (3) indemnification by the corporation with respect to acts of directors for which they are found to have been liable.

b. Van Gorkom *to* Disney—*Directors' Personal Liability*

The three areas referred to above—director liability, exculpation, and indemnification—have gone through a number of changes from 1985 to the present. Their interrelated nature has meant that a change to one area often had potentially unintended consequences in another area.

Until the 1980s, directors were rarely found to be liable for breaching their duty of care, and liability was imposed almost exclusively in situations in which directors were found to have acted in their personal interest, thereby breaching their duty of loyalty.[237] Directors were saved from liability under the so-called "business judgment rule," which is a judicial presumption that the directors acted in good faith, on an informed basis, and in the honest belief that their actions were in the best interests of the corporation.[238] Indeed, it is virtually impossible to find a Delaware case before 1985 in which a director who did not act in self-interest was found to be liable, and practitioners prior to that time generally assumed that directors who were not acting in their self-interest would not be found liable for a breach of the judicially created standard of conduct unless their conduct could not be justified on any rational basis.[239]

Contrary to these widely held beliefs, in the 1985 *Smith v. Van Gorkom* decision—a case so well known that its facts need not be

237. Cunningham & Yablon, *supra* note 227, at 1597.

238. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984). The Delaware courts place the burden on the plaintiffs to rebut the presumptions of the business judgment rule. *Id.*

239. *See* Cunningham & Yablon, *supra* note 227, at 1597.

discussed in detail—the Delaware Supreme Court imposed liability on directors whom it found to have been grossly negligent in approving a merger without an independent valuation of an investment banker, adequate deliberation, or adequate exceptions to the deal-protection provisions in the merger agreement in a situation in which it concluded that the sale process was dominated by the company's chief executive officer.[240] This decision was reached despite the fact that the sale was at a substantial premium to market price and that the directors were all leading businessmen or academics who had a high degree of familiarity with the company.[241] If those directors were in fact grossly negligent, the general view among practitioners was that "gross negligence" was being re-defined by the courts to be more akin to simple "negligence."[242] Without changing the wording of the standard for liability, the courts, to most practitioners and their clients, had changed the actual standard without any warning.[243]

In reaction to widespread concerns about the Delaware Supreme Court's departure in *Van Gorkom* from its previous application of its standard of review of actions of disinterested directors, the Delaware legislature enacted section 102(b)(7) of the Delaware statute.[244] The new legislation allowed a corporation to

240. 488 A.2d 858, 874, 876-77, 880-81 (Del. 1985).

241. *Id.* at 894, 896 (McNeilly, J., dissenting).

242. *See* Roberta Romano, *Corporate Governance in the Aftermath of the Insurance Crisis*, 39 EMORY L.J. 1155, 1160 (1990) ("[M]ost practitioners, like the lower court, would have predicted that the facts in *Van Gorkom* would not constitute gross negligence under Delaware's duty of care standard.").

243. *See* E. Norman Veasey, *Counseling Directors in the New Corporate Culture*, 59 BUS. LAW. 1447, 1447 (2004) ("The watershed year of 1985, featuring *Smith v. VanGorkom* [and other notable cases] was indeed a time when many of the rules of the road did change . . . ."). The change wrought by *Van Gorkom* became even more significant a few years later as a result of the equally surprising decision in *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345 (Del. 1993). In that case the court found that the directors were "grossly negligent" in approving a merger because of a deficient process, thereby losing the benefit of the presumptions under the business judgment rule. *Id.* at 366-67. The consequence of that determination was that the court applied the exacting "entire fairness" standard of review, requiring the directors to prove that the challenged transaction was fair to shareholders as to process and result. *Id.* at 370-72. This blending of the entire fairness standard of review, which had previously been reserved for situations in which directors had a conflict of interest, with the gross-negligence standard for disinterested directors was unique and unanticipated by most Delaware practitioners. Allen et al., *supra* note 230, at 1302.

244. DEL. CODE ANN. tit. 8, § 102(b)(7) (2001).

adopt a charter provision eliminating the liability of its directors for monetary liability to the corporation and its shareholders for all breaches of fiduciary duty other than (1) the duty of loyalty; (2) acts or omissions not in good faith, or which involve intentional misconduct or a knowing violation of law; or (3) any transaction from which the directors derived an improper personal benefit.[245] The urgency the legislature felt to ensure that Delaware corporations could attract and retain qualified directors after *Van Gorkom* is reflected in the enactment of section 102(b)(7), which allows corporations to eliminate directors' monetary liability for breaches of fiduciary duties that are not defined in the Delaware statute.[246]

Prior to the August 2005 post-trial decision of the Delaware Court of Chancery in *The Walt Disney Co. Derivative Litigation*,[247] the Delaware courts clearly broadened directors' exposure to liability in recent decisions, apparently without regard to the legislature's concern about the ability of Delaware corporations to attract and retain directors. For example, in *In re Emerging Communications, Inc. Shareholders Litigation*, the Court of Chancery found certain outside directors, but not others, liable for breaching their fiduciary duties in an acquisition transaction.[248] Although one of the directors, a lawyer, was found liable on duty-of-loyalty grounds because of his professional relationship with the controlling shareholder, liability was also imposed on a professional investment adviser who had no personal financial interest in the transaction itself on the theory that his "specialized financial expertise" put him "in a unique position" to "[know] (or at least having very strong reasons to suspect)" that the transaction price was unfair to the other shareholders of the corporation.[249] The defendant director with that expertise also had received substantial sums professionally from the controlling shareholder,[250] and liability might not have resulted if there was no such relationship. Nevertheless, the fact

245. Section 102(b)(7) also does not eliminate liability under section 174, which holds directors jointly and severally liable for paying unlawful dividends or for an unlawful stock purchase or redemption. DEL. CODE ANN. tit. 8, § 174.

246. *Id.* § 102(b)(7).

247. No. Civ.A. 15452, 2005 WL 2056651 (Del. Ch. Aug. 9, 2005).

248. No. Civ.A. 16415, 2004 WL 1305745 (Del. Ch. May 3, 2004, revised June 4, 2004).

249. *Id.* at *39-40.

250. *Id.* at *34.

that the court focused on the director's unique expertise and did not find other outside directors liable despite their relationships with the controlling shareholder[251] suggested that the Delaware courts were moving even farther away from a true "gross negligence" standard of review for alleged breaches of the duty of care.

The movement of the Delaware courts toward a negligence test for determining a director's liability following *Van Gorkom* was not particularly surprising because it was presaged by *Van Gorkom.* On the other hand, the courts' undercutting of the Delaware exculpation statute designed to protect directors from the *Van Gorkom* decision in the event directors were found to have breached their duty of care was very troubling and demonstrated the problematic interpretation of the statute by the courts.

The exculpation provisions of the Delaware statute were designed to allow corporations to protect directors absolutely from personal monetary liability for breaches of the duty of care, even if the directors were grossly negligent, and to enable directors to obtain dismissal of legal actions against them at a very early stage.[252] The statutory exceptions to the exculpation protection were intended only to ensure that directors acting in their self-interest or in a manner that they themselves believed was not in the best interests of the corporation could not escape liability.[253] The Minnesota statute, which is virtually identical to the Delaware statute, achieves that result even though it also does not protect the director who fails to act in good faith.[254]

251. The court held that the remaining directors were not liable for fiduciary violations aside from breaches of the duty of care. *Id.* at *41. For one director in particular, this holding seems incongruent with the finding against the director with financial expertise. This director had a consulting agreement with the controlling shareholder that represented on average 22.5% of his income for three consecutive years, and the controlling shareholder also had a consulting agreement with the director's son-in-law. *Id.* at *34. All of the directors who were not found personally liable for breaches of fiduciary duties were also paid high compensation for their board positions, and expected to continue as directors of a related entity after the transaction was completed. *Id.* at *35.

252. *See* Malpiede v. Townson, 780 A.2d 1075, 1095 (Del. 2001).

253. *See* R. Franklin Balotti & Mark J. Gentile, *Elimination or Limitation of Director Liability for Delaware Corporations*, 12 DEL. J. CORP. L. 5, 17-18 (1987) ("Absent such 'interest,' however, a director should be able to rely on traditional concepts of the fiduciary duty of care in looking to section 102(b)(7) for protection from monetary damages.").

254. *See* MINN. STAT. § 302A.251, subd. 4 (2004).

Because the Delaware statute requires, but contains no definition of, "good faith,"[255] the Delaware courts needed to formulate a judicial definition. Unfortunately, however, that definition evolved in cases decided prior to the 2005 Chancery Court decision in *Disney* into one that undercut what most directors and practitioners believed was the clear intent of the statute. In the 2003 *Disney* decision, in which the court refused a pre-trial motion to dismiss the claims against the Disney directors for their action and inaction in connection with the employment and severance of Disney's president, Michael Ovitz,[256] the plaintiffs claimed that the directors failed to exercise due care in approving Ovitz's lucrative employment contract, including a generous severance package.[257] The court stated:

> Knowing or deliberate indifference by a director to his or her duty to act faithfully and with appropriate care is conduct, in my opinion, that may not have been taken honestly and in good faith to advance the best interests of the company. Put differently, all of the alleged facts, if true, imply that the defendant directors *knew* that they were making material decisions without adequate information and without adequate deliberation, and that they simply did not care if the decisions caused the corporation and its stockholders to suffer injury or loss. Viewed in this light, plaintiffs' new complaint sufficiently alleges a breach of the directors' obligation to act honestly and in good faith in the corporation's best interests for a Court to conclude, if the facts are true, that the defendant directors' conduct fell outside the protection of the business judgment rule.[258]

Because of this determination, the court refused to dismiss the complaint, despite the fact that the plaintiffs did not question the loyalty of the Disney directors, stating:

> A fair reading of the new complaint, in my opinion, gives rise to a reason to doubt whether the board's actions were taken honestly and in good faith. . . . Since acts or

255. In contrast, the MBCA from the date of its enactment statutorily defined "good faith" as "honesty in fact in the conduct of the act or transaction concerned." *Id.* § 302A.011, subd. 13.

256. *In re* The Walt Disney Co. Derivative Litig., 825 A.2d 275, 291 (Del. Ch. 2003).

257. *Id.* at 278.

258. *Id.* at 289 (emphasis in original).

> omissions not undertaken honestly and in good faith . . . do not fall within the protective ambit of § 102(b)(7), I cannot dismiss the complaint based on the exculpatory Disney charter provision.[259]

It was possible for the court to conclude that under the facts alleged by the *Disney* plaintiffs prior to trial, the directors "knew" they were making material decisions without adequate information and without adequate deliberation.[260] It is questionable, however, how the court could suggest that under those alleged facts the directors "did not care if the decisions caused the corporation and its stockholders to suffer injury or loss."[261] The character of this pre-trial decision suggests that the court was reacting to the Enron, Tyco, Adelphia, and other high-profile corporate abuses that were recently brought to light in the Sarbanes-Oxley era.[262]

What followed from the pre-trial *Disney* decision was one of the longest and most expensive trials in the history of the Court of Chancery.[263] The court's post-trial opinion struggled with the "hazy jurisprudence"[264] regarding what constitutes good faith for purposes of the Delaware statute, determining that it would be easier to define "bad faith" rather than good faith.[265] Continuing the approach it had begun in the pre-trial decision quoted above, the court created a non-exclusive definition of bad faith as "intentional dereliction of duty, [and] a conscious disregard for one's responsibilities."[266] Again, without excluding other possibilities, the court described "[d]eliberate indifference and

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259. *Id.* at 286.

260. *Id.*

261. *Id.* at 289.

262. *See* Veasey, *supra* note 243, at 1453 ("[B]oards should be told that it is arguable . . . that their conduct may be measured not only by the evolving expectations of directors in the context of Delaware common law fiduciary duty, but also it may well be measured against the backdrop of relevant Sarbanes-Oxley SEC Rules.").

263. The trial lasted thirty-seven days, generated over 9000 pages of transcript from twenty-four witnesses, and resulted in a 174-page opinion (with 591 footnotes) by Chancellor Chandler. *In re* Walt Disney Co. Derivative Litig., No. Civ.A. 15452, 2005 WL 2056651, at *1 (Del. Ch. Aug. 9, 2005).

264. *Id.* at *35.

265. *Id.*

266. *Id.* at *36. Leaving the door open for future judicial refinement of the definition, the court noted "[t]o create a definitive and categorical definition of the universe of acts that would constitute bad faith would be difficult, if not impossible." *Id.*

inaction in the face of a duty to act" as "the epitome of faithless conduct."[267]

Although directors in other corporations may take some comfort from the fact that the court ultimately found no liability for any of the directors—even Disney CEO Michael Eisner, whom the court characterized as the "most culpable of the defendants"[268] in a "painfully detailed" story of "conduct that fell significantly short of the best practices of ideal corporate governance"—[269] one cannot be certain of a similar outcome in a future case decided by a different judge or on appeal. Moreover, directors of other corporations should be sure to note that the Disney directors' victory was Pyrrhic—imposing significant reputational and financial costs.

The 2005 *Disney* decision seems to be in some respects consistent, and in other respects inconsistent, with recent Delaware court decisions. Like the 2003 pre-trial decision, it establishes that there can be a lack of good faith in certain egregious circumstances by directors who are indifferent to their duties, even though they do not intentionally act contrary to the best interests of the corporation. On the other hand, the court went to great lengths to distinguish ordinary negligence from actionable gross negligence or bad faith and to establish, based upon its analysis of the facts, that the threshold for a finding of actionable gross negligence or bad faith would be very high—higher than many would have anticipated following the 2003 pre-trial decision.[270]

The plaintiffs in the *Disney* case have appealed the decision. If the Chancery Court's definition of "good faith" survives appeal, it is clear that a director found to have acted in "conscious disregard" of his or her responsibilities without intentionally acting contrary to the best interests of the corporation also would not be entitled to indemnification, which is not permissible unless the director acted in good faith.[271] The director's only protection from personal financial exposure in such a situation would be directors' and officers' liability insurance. The authors believe that the result in the *Disney* decisions could not have been predicted under a plain

267. *Id.*
268. *Id.* at *39.
269. *Id.* at *1.
270. *See id.* at *39-47.
271. DEL. CODE ANN. tit. 8, § 145(a) (2001).

reading of the Delaware exculpation statute or by those with an understanding of the legislative history of the statute. The statute's imprecision gave the courts the opportunity to narrow its application.

c. Revlon *and its Progeny—The Waters Get Murkier*

The *Revlon* decision and the numerous Delaware court decisions that followed, interpreted, and modified it have created a patchwork quilt that continues to present surprises for Delaware corporations and corporate practitioners in the context of sales of corporations. The surprises stem in part from the fact that Delaware, unlike Minnesota,[272] has no statute setting forth whether directors of a Delaware corporation may consider the short-term and the long-term interests of shareholders and the interests of constituencies other than shareholders, when determining whether to sell the corporation or take other corporate actions.

Revlon established that once a board of directors has determined to sell a corporation, it has a court-imposed duty to attempt to get the best price it reasonably can for its shareholders from the sale of the corporation.[273] Obtaining maximum shareholder value in a sale situation does not seem surprising. Indeed, the question arises why that obligation is not simply covered by the general duty to act with due care and in the best interests of the corporation. What *Revlon* appears to have added to those general fiduciary duties, however, is a resolution of the question of which constituencies the board of a Delaware corporation may consider in the sale context. The *Revlon* court categorically established that once the directors have determined to sell the corporation, their duty is to the shareholders only, not to other constituencies, and not even if serving the interests of those other constituencies in the long term would be in the best interests of the corporation's shareholders.[274] The decision has been

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272. *See* MINN. STAT. § 302A.251, subd. 5 (2004).

273. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 184 (Del. 1986).

274. *Id.* Outside of the so-called "*Revlon* zone," the Delaware Supreme Court has stated that a board may consider non-shareholder constituencies so long as there are rationally related benefits to the shareholders in doing so. *Id.* at 182 (citing Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985)); *cf. In re* Toys "R" Us, Inc., S'holder Litig., 877 A.2d 975, 999 n.32 (Del. Ch. 2005) ("In the context of a decision to sell the whole company, the directors could only

interpreted by later Delaware court decisions to hold that the short-term interests, not the long-term interests, of the shareholders are all that may be considered by a board in determining whether to enter into a proposed sale transaction.[275]

The extent to which Minnesota courts would apply a standard comparable to the one in *Revlon* is uncertain.[276] Although the Minnesota courts have not focused on the *Revlon* standard, it is clear that *Revlon* would not remain totally intact given Minnesota's multiple-constituency statute.[277] That statute allows a director, in considering any action, to consider interests of non-shareholder constituencies.[278] While practitioners generally advise boards of Minnesota corporations that they should not approve a sale proposal that is substantially less favorable to shareholders than another alternative even if employees are treated much better under the proposal, the statute presumably would allow boards to approve a transaction that is slightly less favorable to shareholders because it is substantially more favorable to employees, suppliers, creditors, customers, and affected communities than the alternatives. Moreover, the multiple-constituency statute makes it absolutely clear that, unlike the frequent interpretation of *Revlon*, both short-term and long-term interests of shareholders can be considered when making the sale decision.

Minnesota does not have a *Revlon* doctrine, but *Revlon* has not had the precedential value that some would suggest.[279] Indeed,

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consider those constituencies if doing so is rationally related to some benefit to the stockholders, which in that special context must have a relation to price.").

275. *See, e.g.*, Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1150 (Del. 1990) (stating that unless a board of directors is acting under the limited set of circumstances defined in *Revlon*, it is not under any "*per se* duty" to maximize short-term value for its shareholders); *In re* Unitrin, Inc. S'holders Litig., Nos. Civ.A. 13656, 13699, 1994 WL 698483, at *5 (Del. Ch. Oct. 14, 1994), *rev'd on other grounds sub nom.* Unitrin, Inc. v. American Gen. Corp., 651 A.2d 1361 (Del. 1995) (holding that the transfer of a decision regarding a corporation sale to the stockholder-directors was a defensive action best evaluated under *Unocal*, and not a transfer of control requiring the directors to maximize short-term values as defined in *Revlon*). This interpretation has been echoed by commentators. *See, e.g.*, Martin Lipton & Paul K. Rowe, *Pills, Polls and Professors: A Reply to Professor Gilson*, 27 DEL. J. CORP. L. 1, 11 (2002) (explaining that *Revlon's* decision required that directors maximize short-term shareholder values after deciding to sell the company for cash).

276. Vaaler, *supra* note 4, at 1369 n.8.

277. MINN. STAT. § 302A.251, subd. 5.

278. *Id.*

279. *See* Cunningham & Yablon, *supra* note 227, at 1614 (stating that an

Revlon and its progeny may have created more unpredictability and surprises than any other line of Delaware cases.

In the *Time-Warner* case, the Delaware Supreme Court established that in a stock-for-stock merger, *Revlon* is not applicable because the shareholders of the merged company become shareholders of the surviving company.[280] The decision was necessary because *Revlon* had been interpreted to preclude the consideration of long-term shareholder interests, which are highly relevant for board consideration in a stock-for-stock transaction where shareholders of the merged corporation become equity owners of the surviving corporation.

This naturally led to the question of which standard, *Revlon* or *Time-Warner*, applied in part-cash, part-stock transactions, including transactions in which each shareholder received both stock and cash, transactions with a cash-election feature, and transactions in which holders of one class received cash and holders of another class received stock. Although the Delaware courts have decided at least two such cases,[281] no bright line rule has been established with respect to the percentage of cash that subjects a corporation to the *Revlon* standard. The authors submit that Delaware would have been better off without the *Revlon*/non-*Revlon* bifurcation, so that corporations could consider all factors, including the percentage of stock received and its long-term value, in determining whether the transaction was in the best interests of the corporation in the directors' estimation.

The artificial *Revlon*/*Time-Warner* dichotomy created another surprise. The *QVC* case,[282] like *Time-Warner*, involved a straight stock-for-stock transaction. However, following completion of the proposed merger, a single shareholder would have owned a majority of the voting power in the surviving company. The court determined that in that situation, *Revlon* did apply, notwithstanding *Time-Warner*, because the minority shareholders of the surviving

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articulate rationale to determine when a case should be subject to *Revlon* duties is lacking).

280. Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d at 1142.

281. *See In re* Santa Fe Pac. Corp. S'holder Litig., 669 A.2d 59, 71 (Del. 1995) (transaction in which target company shareholders would receive 33% cash and 67% stock deemed not to trigger *Revlon* duties); *In re* Lukens Inc. S'holders Litig., 757 A.2d 720, 732 n.25 (Del. Ch. 1999) (cash consideration in excess of 60% presumed to trigger *Revlon* duties).

282. Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34 (Del. 1994).

company would not in the future have the opportunity to receive a control premium.[283] The "controlling shareholder" exception to the *Time-Warner* exception to the *Revlon* standard could not have been predicted based on the reasoning of the Delaware Supreme Court in *Time-Warner.*[284] It is uncertain whether *Revlon* applies if a single shareholder owns practical voting control of the survivor even though that control is not a majority of the voting power of the corporation.

The ad hoc creation of Delaware law through court decisions, as evidenced by *Revlon* and its progeny, has not created the precedential value that law-abiding boards need in order to conduct themselves in accordance with the law when considering proposed sales of their corporations.

d. Phelps Dodge, ACE Ltd., IXC Communications—*Same Time, Same Issues, Different Results*

The *Revlon* line of cases, particularly after *Time-Warner* and *QVC,* appeared to establish that the board of directors of a Delaware corporation could approve a stock-for-stock merger in which no shareholder would control the merged corporation without being required to get the best price it could reasonably obtain from a sale of the company. Nine years after the *Time-Warner* decision, however, many practitioners were surprised to learn that deal-protection provisions in stock-for-stock merger agreements had to be limited even though the *Revlon* standard did not apply.

In *Phelps Dodge Corp. v. Cyprus Amax Minerals Co.*[285] and *ACE Ltd. v. Capital Re Corp.,*[286] the Delaware Court of Chancery concluded that even in stock-for-stock mergers, boards cannot exercise their business judgment to agree in the merger agreement to refuse to discuss or consider alternative proposals.[287] That appeared to signal that deal protections could not be materially more restrictive in

283. *Id.* at 48.

284. The Delaware Chancery Court in *Time-Warner* had used "control" reasoning similar to that adopted by the Supreme Court in *QVC,* however. Paramount Commc'ns, Inc. v. Time, Inc., Nos. Civ.A. 10866, 10670, 10935, 1989 WL 79880, at *21-23 (Del. Ch. July 14, 1989).

285. Nos. Civ.A. 17398, 17383, 17427, 1999 WL 1054255 (Del. Ch. Sept. 27, 1999).

286. 747 A.2d 95 (Del. Ch. 1999).

287. *Phelps Dodge,* 1999 WL 1054255, at *1-2; *ACE Ltd.,* 747 A.2d at 108-09.

Time-Warner stock-for-stock transactions than in *Revlon* cash transactions. Two days after the *ACE Ltd.* decision, however, the Court of Chancery in *In re IXC Communications, Inc. Shareholders Litigation v. Cincinnati Bell, Inc.*,[288] appeared to take a contrary position concerning restrictions on deal protections in non-*Revlon* situations, perhaps because no third-party proposal had in fact been made in that case.

As these nearly simultaneous, yet seemingly contradictory, holdings indicate, having a substantial body of case law to refer to in the *Revlon* context provides very limited guidance to Delaware corporations, directors, and practitioners.[289]

e. Singer v. Magnavox/Weinberger v. UOP—*Flip Flop*

For the most part, the Delaware courts will attempt to distinguish cases from prior precedent based on what the court believes are meaningful factual differences (*Revlon, Time-Warner, QVC*) or will adopt apparently inconsistent positions (*Phelps Dodge, ACE Ltd., IXC Communications*) without acknowledging the inconsistencies. However, the Delaware courts will occasionally reverse themselves to the surprise of practitioners and corporations alike.

For example, the Delaware courts reversed themselves on the basic issue of whether a business purpose is necessary for a merger. In *Singer v. Magnavox*,[290] the Delaware Supreme Court held that a parent corporation, despite having majority voting power with respect to the shares of its subsidiary, could not merge with the majority-owned subsidiary, thereby freezing-out minority shareholders without their consent, without a proper business

288. Nos. C.A. 17324, 17334, 1999 WL 1009174 (Del. Ch. Oct. 27, 1999).

289. One intriguing theory is that a review of the decision-making process employed by the target company's board of directors was a better predictor of the board's success in litigation in Delaware than any reference to admittedly ambiguous standards of review created by the Delaware courts. *See* Gregory V. Varallo & Srinivas M. Raju, *A Process Based Model for Analyzing Deal Protection Measures*, 55 BUS. LAW. 1609, 1635-36 (2000).

290. 380 A.2d 969, 979 (Del. 1977) ("We hold the law to be that a Delaware Court will not be indifferent to the purpose of a merger when a freeze-out of minority stockholders on a cash-out basis is alleged to be its sole purpose. In such a situation, if it is alleged that the purpose is improper because of the fiduciary obligation owed to the minority, the Court is duty bound to closely examine that allegation even when all of the relevant statutory formalities have been satisfied.").

purpose.[291] Six years later, in *Weinberger v. UOP*,[292] the Delaware Supreme Court unpredictably reversed its position on *Singer* and concluded that no business purpose was required.

2. *Sale of Substantially All Assets*

In deciding cases without judicial precedents, Delaware courts, at times, take positions contrary to the positions predicted by leading Delaware practitioners. These deviations from practitioners' expectations underscore the fact that even with a robust body of case law, Delaware courts have not established precedent on key issues that have been codified by the Minnesota statute. A case in point is the 2004 Delaware decision in *Hollinger Inc. v. Hollinger International, Inc.*[293]

Hollinger involved the issue of whether the sale of substantially all of the assets of a subsidiary of a Delaware corporation constitutes the sale of substantially all of the assets of the parent corporation requiring a vote of the shareholders of the parent under section 271 of the Delaware statute.[294] The whole area of what constitutes a sale of substantially all assets of a Delaware corporation is confusing despite a number of cases in the area, and the issue of whether a sale of assets by a subsidiary is the same as a sale of assets by the parent surprisingly was one of first impression in Delaware.[295]

The court denied the preliminary injunction motion of the controlling shareholder of the parent, who claimed that shareholder approval at the parent level was required. The court denied the motion on the basis that regardless of whether the court

291. The MBCA, as adopted, in reaction to this decision and a Minnesota court decision to the same effect that followed it, *Bird v. Wirtz*, 266 N.W.2d 166 (Minn. 1978), included a provision expressly allowing corporations to merge with or without a business purpose pursuant to a plan of merger approved by the board and a majority vote of the voting power of the outstanding shares. *See* MINN. STAT. ANN. § 302A.601, subd. 1 (West 2004) (Reporter's Notes, 1981) (explaining the rationale for the elimination of the business purpose requirement from the MBCA); *see also supra* Part IV.A.5.

292. 457 A.2d 701, 715 (Del. 1983).

293. 858 A.2d 342 (Del. Ch. 2004).

294. The defendants in the *Hollinger* case argued that section 271 of the Delaware statute does not contemplate ignoring the separate existence of subsidiaries unless the corporate veil between the parent and subsidiary may be pierced. *Id.* at 373.

295. *Id.* at 348.

treated the assets of the subsidiary as assets of the parent corporation, the sale did not constitute a sale of substantially all assets of the parent corporation.[296] However, in *dicta*, the court indicated that it might ignore the technical argument that a sale of assets by a subsidiary was not a sale by the parent at all for purposes of section 271, which, according to one leading Delaware law firm, was "[c]ontrary to the prevailing view among practitioners that section 271 does not trigger a stockholder vote at the parent level when a subsidiary sells all or substantially all of its assets."[297] The court stated:

> When an asset sale by the wholly owned subsidiary is to be consummated by a contract in which the parent entity guarantees the performance of the selling subsidiary that is disposing of all of its assets and in which the parent is liable for any breach of warranty by the subsidiary, the direct act of the parent's board can, without any appreciable stretch, be viewed as selling assets of the parent itself.[298]

This statement by the court likely sent shock waves through the Delaware bar, some members of which had been advising corporations for years that sales of assets by a subsidiary should not be ascribed to the parent under any circumstances under section 271.[299] Likely reacting to the inconsistency between the court's statement and the practitioners' advice, the Delaware legislature finally brought some—but not complete—clarity to the asset-sale area. Effective August 1, 2005, the Delaware corporate statute was amended to provide that shareholders of a corporation need not approve a transfer of the corporation's assets to a wholly owned and controlled subsidiary.[300]

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296. *Id.* at 348-49.

297. Richards, Layton & Finger, P.A., *Recent Delaware Corporate Law Decisions* (Oct. 2004), http://www.rlf.com/articles/10_2004_Corp_Mailing-010530.pdf (last visited Jan. 4, 2006).

298. *Hollinger*, 858 A.2d at 375.

299. While the court did not decide the issue, its discussion suggested that if forced to decide it in the future, it would collapse the subsidiary and the parent for purposes of the section 271 test. One example it gave was of a holding company under which all assets were held by subsidiaries. It noted that under the defendants' theory, if the subsidiaries' assets were all sold and guaranties were provided by the parent, no consent of the parent's shareholders would be needed—a result that the court did not appear ready to accept. *See id.* at 374.

300. DEL. CODE ANN. tit. 8, § 271(c) (2001 & Supp. 2005) (amended by 75 Del. Laws ch. 30 (2005)).

Because a transfer of substantially all of a corporation's assets to a wholly owned subsidiary and then a retransfer by the subsidiary of those assets would arguably avoid a shareholder vote entirely if sales of assets by a subsidiary were not deemed to be sales by the parent, there is a concern that an exemption for transfers to a wholly owned subsidiary of the nature enacted in Minnesota and Delaware not be used as a device to avoid a shareholder vote through a multi-step transaction. The 2005 amendment to the Delaware statute addresses this concern by providing that the property and assets of a corporation and its wholly owned subsidiaries must be considered on a consolidated basis in determining whether a transfer of substantially all assets has occurred—consistent with the *dicta* of the *Hollinger* court and contrary to the previous position of leading Delaware practitioners.[301] The Minnesota statute itself is silent regarding whether assets of a corporation and its subsidiaries would be consolidated—although the Minnesota bar referenced the issue in its recommendation to the legislature, and a court would presumably consolidate in appropriate circumstances. As the authors have previously noted regarding the Minnesota statute:

> Read literally, Section 302A.661 permits a subsidiary to dispose of what constitutes substantially all of the parent's assets on a consolidated basis without a vote of the parent's shareholders. Such assets do not constitute assets of the parent unless the separate corporate entities are disregarded. A court, however, might make a less literal and more equitable determination to require a vote of the parent's shareholders even if the assets being transferred are owned by the subsidiary, particularly if the assets had previously been transferred by the parent corporation to the subsidiary without a shareholder vote.[302]

Until the Delaware legislature brought some clarity to this area in 2005, those Delaware practitioners that had advised clients that a sale of subsidiary assets probably did not necessitate a vote of the parent's shareholders regardless of the magnitude of the sale had, as a corollary to that advice, further advised clients that a transfer of assets to subsidiaries might require a shareholder vote. That latter

301. *Id.* ("For purposes of [section 271] only, the property and assets of the corporation include the property and assets of any [wholly owned and controlled] subsidiary of the corporation.").

302. 18 MATHESON & GARON, *supra* note 10, § 7.19, at 280-81.

advice impeded corporate restructuring by Delaware corporations prior to the 2005 amendment to the Delaware statute, whereas Minnesota corporations have formed subsidiaries and transferred substantial assets to them for years without a shareholder vote and without any fear of violating the MBCA.

Although the Delaware legislature brought some certainty to the parent-subsidiary issues in the asset-sale context, it, unlike the Minnesota legislature,[303] has done nothing to address a more basic but far more confusing area: deciding what constitutes "substantially all" of a corporation's assets for purposes of section 271. In that area, *Hollinger* represents a significant shift from prior court decisions, but still does not provide the kind of guidance that corporations and their advisers need.

In previous court decisions, including the seminal case of *Gimbel v. Signal Co.*,[304] the Delaware courts had applied a very imprecise quantitative/qualitative test to determine what constituted substantially all of the assets. Despite the apparent plain meaning of the words "substantially all," certain Delaware courts appeared to be looking quantitatively at whether the assets sold constituted a majority of the assets or net worth of the corporation or produced a majority of the corporation's revenues or income.[305] Conservative practitioners were concerned that a sale of a majority of a corporation's assets would be deemed to constitute a sale of substantially all assets and thereby necessitate a shareholder vote. The Delaware courts noted, however, that the "test does not lend itself to a strict mathematical standard to be applied in every case . . . ."[306] The qualitative nature of the test utilized by *Gimbel* and several other decisions appeared to be based on whether the assets sold were the assets that had been the

303. Because of the continuing uncertainty of what constituted "substantially all assets" under the MBCA provision, the Minnesota corporate bar recommended, and the legislature in 2004 enacted, the 25% safe harbor discussed below that the court in *Hollinger*, while citing in support of its position, could not ensure is the governing law of Delaware.

304. 316 A.2d 599, 606 (Del. Ch. 1974) ("If the sale is of assets quantitatively vital to the operation of the corporation and is out of the ordinary and substantially affects the existence and purpose of the corporation, then it is beyond the power of the Board of Directors.").

305. *See, e.g.*, Katz v. Bregman, 431 A.2d 1274, 1276 (Del. Ch. 1981) (granting shareholder motion for preliminary injunction preventing the sale of assets by the company that constituted 51% of the corporation's total assets).

306. *Gimbel*, 316 A.2d at 605.

foundation of the business of the corporation (rather than more recently acquired businesses) and substantially affected the existence and purpose of the corporation.[307] The qualitative test obviously introduced significant subjectivity and uncertainty into the equation, which was already imprecise under the quantitative test.

In *Hollinger*, the court found that the business being sold constituted more than 55% of the total consolidated asset value of the corporation's two main businesses on a market-value basis and more than 35% of consolidated assets on a book-value basis and constituted less than 50% of the consolidated revenues and approximately 50% of the consolidated earnings before interest, taxes, depreciation, and amortization (EBITDA—which is effectively a cash flow standard) of the corporation's two main businesses.[308] However, the court, contrary to certain previous decisions, refused to accept an "approximately half" standard on grounds that the legislature never intended such a standard.[309] Interestingly, in that connection the court cited with approval the Model Business Corporation Act's 25% retention standard[310] (which is virtually identical to, and the model for, the provision added to the MBCA in 2004) as support for its position.[311] The court also questioned the wisdom of a qualitative test, suggesting that if the assets are not quantitatively vital, they cannot substantially affect the existence and purpose of the corporation.[312]

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307. *See, e.g.*, *Katz*, 431 A.2d at 1276 ("[T]he proposal . . . to embark on the manufacture of plastic drums represents a radical departure from [the company's] historically successful line of business, namely steel drums.").

308. Hollinger Inc. v. Hollinger Int'l., Inc., 858 A.2d 321, 380 (Del. Ch. 2004).

309. *Id.* at 386.

310. MODEL BUS. CORP. ACT § 12.02 (2005). Under the Model Act's standard, a sale or other disposition of assets requires shareholder approval if, absent certain exceptions, the transaction would leave the corporation without a "significant continuing business activity." *Id.* § 12.02(a). A corporation will be conclusively deemed to have retained a significant continuing business activity if it retains a business that represented at least 25% of the corporation's consolidated (1) total assets as of the most recently completed fiscal year and (2) income from continuing operations before taxes or revenues from continuing operations for that year. *Id.*

311. *Hollinger*, 858 A.2d at 386 n.79.

312. The court was quite straight-forward in admitting the lack of clarity on this subject in previous Delaware cases, noting: "It would be less than candid to fail to acknowledge that the § 271 case law provides less than ideal certainty about the application of the statute to particular circumstances." *Id.* at 378. "Although by no means wholly consistent, that [Delaware] case law has, by and large, refused

The *Hollinger* analysis is certainly better than the prior case law, but it still lacks the certainty of the statutory provisions in the MBCA.

3. Omnicare

While the problems in the area of sales of substantially all assets appear to be with inconsistent and unexpected interpretations of a vague statutory provision, the Delaware courts also have surprised practitioners by interpreting fairly precise statutory provisions in a manner contrary to what the language of, and policy behind, the statutory provisions suggest. The 2003 decision of the Delaware Supreme Court in *Omnicare, Inc. v. NCS Healthcare, Inc.* is the chief offender in this regard.[313]

Omnicare involved the validity of a voting agreement in which holders of a majority of the voting stock agreed in advance to vote to approve a merger. Genesis and Omnicare were competing to purchase NCS, an insolvent publicly traded Delaware corporation.[314] Genesis won the battle and, as part of the Genesis merger agreement, two NCS shareholders who held the majority of the voting power of NCS's stock agreed to vote in favor of the Genesis merger.[315] The merger agreement required that the merger be submitted to a shareholder vote, and that the two NCS shareholders who were parties to the voting agreement agree to vote in favor of the merger agreement, even if the board of directors withdrew its recommendation of the merger.[316]

Everything in the Delaware statute suggested that the court would uphold the validity of the voting agreement and refuse to enjoin the shareholders meeting to vote on the merger. First, a written agreement between two or more shareholders of a Delaware corporation may provide that the shares held by them will be voted as provided in the agreement.[317] Second, the Delaware statute was amended years before to clarify that a merger

to find that a disposition involved substantially all of the assets of a corporation when the assets that would remain after the sale were, in themselves, substantial and profitable." *Id.* at 385.

313. 818 A.2d 914 (Del. 2003).

314. *Id.* at 917-18.

315. *Id.* at 918.

316. *Id.*

317. DEL. CODE ANN. tit. 8, § 218(c) (2001). The Delaware Supreme Court had taken this position even before the statute was enacted. *See* Ringling Bros.-Barnum & Bailey Combined Shows, Inc. v. Ringling, 53A.2d 441 (Del. 1947).

agreement may provide that it must be submitted to shareholders for approval even if a board of directors later determines that the merger is no longer advisable and recommends that the shareholders reject the merger agreement.[318] Third, the Delaware statute allows shareholders to take action by less than unanimous written consent unless otherwise provided in a corporation's certificate of incorporation.[319] Because the Delaware legislature determined that a corporation's shareholders can act by less than unanimous written consent without having a meeting at all, the presumption was that holders of a majority of the voting power of the corporation's outstanding stock could agree in writing in advance of a shareholders' meeting to take binding action at that meeting.

Contrary to expectations, in a sharply divided three-to-two decision, the Delaware Supreme Court enjoined the meeting of shareholders called to approve the merger agreement. The majority's reasoning was that a corporation could not require a shareholders meeting to be held to approve a merger agreement despite a board's withdrawal of its approval of the merger if the majority shareholder vote in favor of the merger agreement was predetermined by a binding voting agreement.[320] This decision leaves practitioners guessing about whether the *Omnicare* decision is likely to be reversed in the future, particularly in view of the split nature of the decision and the adverse reaction to it,[321] and leaves a

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318. DEL. CODE ANN. tit. 8, § 146 (2001 & Supp. 2004) (formerly applicable to merger agreements only and codified at DEL. CODE ANN. tit. 8, § 251(c) (2001)).

319. DEL. CODE ANN. tit. 8, § 228.

320. *Omnicare*, 818 A.2d at 935-36.

321. *See, e.g.*, Orman v. Cullman, No. Civ.A. 18039, 2004 WL 2348395, at *8 n.98 (Del. Ch. Oct. 20, 2004). Chancellor Chandler's comments about the practical effects of *Omnicare*'s post-hoc analysis, "how can a board know, at the time of adopting defensive devices, the terms of a transaction that emerges at a later time? As formulated, the test would appear to result in judicial invalidation of negotiated contractual provisions based on the advantages of hindsight." *Id.* Vice Chancellor Strine has attacked the bright-line approach taken by the *Omnicare* majority. Leo E. Strine, Jr., *If Corporate Action Is Lawful, Presumably There Are Circumstances in Which It Is Equitable to Take That Action: The Implicit Corollary to the Rule of* Schnell v. Chris-Craft, 60 BUS. LAW. 877 (2005). After acknowledging the famous statement in *Schnell v. Chris-Craft Industries, Inc.*, 285 A.2d 437, 439 (Del. 1971), "that inequitable action does not become permissible simply because it is legally possible," he noted that the corollary to that statement is that if the legislature has permitted certain actions, there must be some circumstances in which those actions are permissible—otherwise, why permit them at all? *Id.* at 883. When a court adopts a bright-line equity overlay on legislatively permitted actions,

lingering issue about whether a voting percentage lockup short of a majority (e.g., 45%, 40%, or 35%) would also be invalidated on the theory that it constituted practical control of the corporation.

V. CONCLUSION

The MBCA is a state-of-the-art corporate statute. It and similar statutes of many other states provide substantially more flexibility and certainty than the Delaware statute to corporations and practitioners at substantially less cost. Nevertheless, there are a few provisions in the MBCA, most notably section 302A.751 authorizing courts to grant equitable remedies to shareholders, that, with respect to closely held, multiple-shareholder corporations, may be sufficiently detrimental to justify incorporation in Delaware despite the greater cost and the lack of flexibility and certainty of the Delaware statute. The argument, however, that the extensive case law in Delaware increases predictability regarding Delaware corporate law as compared to the substantially more-extensive codification of the laws of Minnesota and several other states simply does not survive scrutiny. In many core aspects of corporate law, Delaware case law does not provide the clarity or consistency necessary to overcome the imprecision and incompleteness of the Delaware statute and fails to provide precedential predictability.

Strine argues, the court wrongly intrudes into the province of the legislature. *Id.* at 903-05. A similar concern has been expressed by former Chief Justice Veasey. Veasey & Di Guglielmo, *supra* note 224, at 1461 n.256 ("Equitable principles should intrude on lawful activity only when there is a breach of fiduciary duty."). The authors believe that the problem Strine and Veasey identify is not exclusive to the *Omnicare* decision, but rather it is a function of the expansive role generally undertaken by the Delaware courts. Indeed, the problems caused by this kind of equity overlay on express legislative authorization can be found in a number of areas of Delaware corporate law. *See, e.g.*, *supra* Part IV.B.1.e. (discussing the "judicial legislation" that created the "business purpose" test for mergers that was ultimately "repealed" by the courts).